The Most Important Alliance You've Never Heard Of

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SUMMARY Four nations in Latin America are developing an initiative that could add new dynamism to the region, redraw its economic map, and boost its connections with the rest of the world—especially Asia.

In Venezuela, students have been killed while protesting against the government of Nicolás Maduro, who is jailing opposition leaders and just closed a television station that dared broadcast the demonstrations. Argentina is irresponsibly racing toward a dangerous economic cliff. The Brazilian economy is in recession and 2014 will mark its fourth consecutive year of subpar growth, as the country reels from its largest capital flight in more than 10 years.

Is a decade of progress in Latin America coming to an end? For some countries, surely. But not necessarily for the entire region. Four nations are developing an initiative that could add new dynamism to Latin America, redraw the economic map of the region, and boost its connections with the rest of the world—especially Asia. It could also offer neighboring countries a pragmatic alternative to the more political groupings dominated by Brazil, Cuba, and Venezuela.

Amid all the bad news in the region, the presidents of Chile, Colombia, Mexico, and Peru met with little fanfare in Cartagena last week to seal an economic pact launched in 2012. They call their project the Pacific Alliance, and it will soon include Costa Rica and possibly several other countries. The four founding members are the most successful economies in Latin America; they boast the region's highest economic-growth rates and lowest inflation rates. Together, they represent 36 percent of the region's economy, 50 percent of its international trade, and 41 percent of all incoming foreign investment. If the Alliance were a country, it would be the world's eighth-largest economy and seventh-largest exporter. Its members lead the lists of the most competitive economies in Latin America and those where it's easiest to do business. Given that trade among the four countries is currently a mere 4 percent of their total trade, the potential to expand trade and investment flows is huge.

Unfortunately, history shows that potential alone is not enough to cement regional agreements. Like all previous attempts at integrating Latin American economies, the Pacific Alliance is animated by the huge gains that would accrue from successfully developing closer economic ties between neighbors. But the potential of Latin American integration initiatives has always been as enormous as the actual results have been meager.

The surprise, however, is that the Pacific Alliance has already yielded more results in its 20 months of existence than similar initiatives that have been around for decades. The four countries have eliminated 92 percent of all import tariffs among them. Chile, Colombia, and Peru have linked their stock markets so that a company listed in one of the exchanges can be traded in the other two. Mexico is expected to follow suit this year, meaning this integrated stock market will rival that of Brazil as the largest in Latin America. The four countries have eliminated the need for business and tourist visas for visiting nationals of bloc members. In a break with tradition, the joint communiqués of Alliance presidents tend to be brief and concrete in terms of goals, timelines, and roadmaps.

In the years ahead, Latin American economies will confront a less favorable global economic climate, creating incentives to find new sources of growth. And the Pacific Alliance may spawn these growth opportunities thanks to larger trade and investment flows. One of the explicit ambitions of the founders, in fact, is to establish the Alliance as the most attractive gateway to Latin America for Asian companies. Meanwhile, in the rest of the region, populism and economic policies long on promises but short on results will become harder to sustain as the windfalls produced by booming commodity prices become less frequent or disappear altogether. Argentina and Venezuela's current economic travails are a case in point. This reality will make the Alliance more appealing to neighboring countries—and, for that matter, countries around the world. A diverse group of 25 nations including Finland, India, and Israel have already applied for observer status in the body.

Still, despite the many reasons for cautious optimism, it is important to keep in mind that these four countries are attempting to achieve something that has eluded the region for over two centuries.

Bolívar's Failed Dream

In the early 19th century, the dream that haunted Simón Bolívar was to integrate the South American provinces whose successful wars of independence from Spain he had led. *El Libertador* was constantly cajoling other leaders and convening international summits to build support for the project, ultimately growing despondent over his failure to make this vision of American unity come true. Here, too, he was a pioneer.

Two hundred years later, Latin American leaders continue to talk, summit, and promise that integrating their countries is a priority. And, like Bolívar, they have little to show for their efforts. For example, despite the boom in international commerce that began in the 1990s, Latin American countries still don't trade much with each other. Only 20 percent of all Latin American exports go to other countries in the region. In contrast, half of all Asian or North American exports are bought by neighboring nations, while in Europe an enormous 70 percent of exports go to other European countries. Brazil exports to China roughly as much as it ships to all of Latin America combined. Mexico's exports to the United States are 10 times larger than what it sells to all the countries south of its border.

Despite the fiery rhetoric about shared values, common interests, and collective goals, in practice Latin American countries have exhibited a stubborn inability to work together. Not only have they failed to substantially deepen their economic ties, but they have rarely been able to develop and defend a common regional stance—on the environment, trade, democracy, or drug trafficking—in their dealings with the rest of the world. Nor have they managed to rely on each other in dealing with internal crises—from coups and stolen elections, to national disasters and battles with drug cartels.

Yet, even as Latin American integration is faltering, the institutions charged with promoting it are booming. The region is burdened by a heavy load of institutional debris accumulated over decades of speeches and summits. The great majority of these multilateral organizations quickly faded into irrelevance, but only a few small ones have been closed or defunded. The remaining intergovernmental zombies have offices, employees, fancy websites—and little to show for it. Even the most promising one, Mercosur, an ambitious economic and political agreement launched in 1991 between Argentina, Brazil, Paraguay, and Uruguay (and which in 2012 admitted Venezuela and suspended Paraguay after its president was impeached) has been a disappointment when measured against its goals and potential. Brazil and Argentina are not just neighbors but the two largest nations in South America. Yet squabbles, economic crises, and differing political and economic agendas have crippled their integration and thwarted the project.

In 2012, for example, trade among Mercosur members was a paltry 15 percent of the countries' combined trade, whereas 20 percent of their total commerce was with Europe and 14 percent with China alone. Increasingly, the lofty economic ambitions that originally inspired Mercosur have been replaced by parochial political maneuvers, ideological posturing, and bitter recriminations among members. Noting that Paraguay may have been expelled from Mercosur to sidestep the country's "opposition to the admission of socialist Venezuela," a 2013 *Financial Times* editorial concluded that "the group has become little more than an anti-gringo talking shop."

An Alliance Borne of Urgency

One reason the Pacific Alliance may succeed is the increasingly urgent need to transcend the chronic failure to link Latin America's economies.

The Alliance would never have become a priority for its four members if Brazil had offered a credible plan to further economic integration with its most trade-oriented Latin American neighbors. Or if Hugo Chávez had been less successful in making free trade a bad word. The late Venezuelan president prioritized political over economic integration, and he was not shy about using his country's oil to scuttle "neoliberal free trade agreements." The United States, meanwhile, was too distracted by emergencies abroad and hobbled by gridlocked politics at home to launch initiatives capable of inspiring Latin American leaders.

All this paved the way for an alliance of four successful Latin American countries ignored by Brazil, threatened by Venezuela's growing regional influence, and unattended by the United States. The allure of Asia's giant economies was also a consideration. If it succeeds, the Alliance will not only boost members' trade and investment with each other but also, more importantly, become an attractive economic partner for Asian nations interested in exploring economic opportunities in Latin America. The members of the Pacific Alliance are taking the need to pivot toward Asia more seriously than the United States is.

Other countries that could have spearheaded Latin America's deeper integration with the rest of the world were either unable to lead such a project, distracted by other demands, or simply not interested. Most notable among these nations is Latin America's giant: Brazil. Paradoxically, its behavior created the conditions for the emergence of an alliance that Brazilian leaders clearly dislike.

The first decade of the 21st century was good to Brazil. Buoyed by booming commodities exports to Asia, easy access to financial markets, and the charismatic leadership of President Luiz Inácio Lula da Silva, the nation experienced a decade of prosperity and social development. Lula resisted pressure from his own party to abandon the orthodox economic policies that had finally tamed Brazil's chronic financial instability, and used the commodities windfall to expand the social programs he had inherited. While Lula and his aides always stressed that building closer ties with neighbors was a priority, in practice it became obvious that Brazil and its president wanted to play in a larger—indeed international—setting.

As the financial crisis hit the United States and Europe in 2008, Lula leveraged his success at home and the fact that Brazil had ably navigated the economic turmoil to become the voice that, on behalf of the rest of the world, berated the bankers and governments responsible for the crash. "This crisis was caused by no black man or woman or by no indigenous person or by no poor person. This crisis was fostered and boosted by irrational behavior of some people that are white, blue-eyed," Lula said in 2009 on the eve of a G-20 meeting where he would be treated as a primus inter pares. The Brazilian president also tried to intervene in the delicate negotiations of the United States and Europe with Iran over its nuclear program, and volunteered to mediate in the conflict between Israelis and Palestinians. His diplomats were actively engaged with other BRIC nations (Russia, India, China, and South Africa) in developing a common platform from which to influence global affairs, while also seeking to expand Brazil's presence in Africa and make the country a permanent member of the UN Security Council. These efforts didn't amount to much, but they did enhance Brazil's reputation as a global player.

While Brazil was soaring, Mexico—its historical rival for leadership in Latin America—was tanking. The U.S. recession reduced demand for Mexican exports, which are dominated by manufactured goods sold to the States. Mexicans working in the U.S. sent back fewer remittances—an important revenue source for the country. In 2009, the outbreak of a new strain of influenza created a panic that, for a time, halted the flow of foreign tourists to Mexico. Upon taking office in 2006, President Felipe Calderón launched an all-out war against the country's powerful drug cartels that sparked massive violence and left at least 60,000 people dead.

Brazil geopolitical ambitions and Mexico's domestic tragedies left the field in Latin America wide open for Hugo Chávez to play. And play he did. He launched the Bolivarian Alliance for the Peoples of Our America (ALBA in Spanish) as an alternative to the FTAA (ALCA), the U.S.-led initiative to create a region-wide free trade zone. Venezuela and Cuba signed ALBA into existence in 2004, and it now includes Bolivia, Ecuador, Nicaragua, and four small Caribbean island nations. In 2008, Chávez, together with the leaders of Brazil and Argentina, promoted the Union of South American Nations (UNASUR), which brought together the members of Mercosur and the Andean Community of Nations (CAN)—and conveniently excluded Mexico, a member of NAFTA, its free trade agreement with the U.S. and Canada. As if these new integration schemes were not enough, in 2011 the Community of Latin American and Caribbean States (CELAC) took shape in Caracas, with Chávez at the helm. It includes all nations in the Western Hemisphere—except the U.S. and Canada. Its founding charter stressed that members sought to "build just, democratic and free societies … with full respect for the democratic values of the region, the rule of law, and human rights." Yet in 2013 CELAC appointed as its president the head of one of the world's oldest dictatorships, Cuba's Raúl Castro. And this year CELAC held a summit in Havana.

Despite all this activity, none of these old and new regional organizations has so far succeeded in fostering a significant and sustainable expansion of economic ties among members. It's precisely this vacuum that the Pacific Alliance is trying to fill.

Leaders of the region's more political and anti-American groupings have not welcomed the Alliance. Bolivia's Evo Morales, for example, bluntly stated that the bloc was a conspiracy hatched in Washington to divide UNASUR. Ecuador's Rafael Correa declared that "more neoliberalism, more free trade, this naive desire for [trade] openness, this forming of markets and not societies, creates consumers not citizens." In Brazil, Lula claimed that the Alliance was trying to bring the much-derided Washington Consensus back to South America, while Antonio Patriota, the former minister of foreign affairs, dismissed the body as just "marketing or a new package for the same existing produce." The presidents of the four Pacific Alliance countries, for their part, insist that the initiative is simply an economic arrangement to promote trade and investment.

The Pacific Alliance's Potential—and Potential Pitfalls

It is too early to know whether the Pacific Alliance will tie the economies of Chile, Colombia, Mexico, and Peru closer together—or become one more regional zombie. If it succeeds, the bloc could attract additional members and emerge as the primary Latin American economic interlocutor for Asia and the

United States. It may even force Brazil to seek economic rapprochement with its neighbors and rethink its actions in the global arena.

Still, significant obstacles lie ahead. Take the issue of protectionism. Yes, Pacific Alliance countries have eliminated tariffs for 92 percent of their trade. But doing away with trade barriers for the remaining 8 percent is proving harder than expected since they touch politically sensitive sectors such as agriculture, textiles, and garments. Protectionist pressure may also keep Mexico out of the Integrated Latin American Market (MILA) with which Chile, Colombia, and Peru are experimenting.

And then there's politics. Chile recently elected a new president and Colombia's presidential elections are coming up in May (Peru's are in 2016). The new presidents may not be as committed to the Pacific Alliance as their predecessors. In Mexico, President Enrique Peña Nieto is spending much of his political capital on a broad set of necessary but controversial economic reforms that may leave him with little muscle to promote the bloc.

But while celebrating the Pacific Alliance is surely premature, dismissing it is also unwarranted. The economies of its four member countries are still growing despite the crisis in emerging markets battering Brazil and Argentina. As economic growth elsewhere in Latin America starts to slow, the need for such a pragmatic and competitive integration scheme will become even more urgent. Soon enough, we'll know whether the Pacific Alliance has joined the junkyard of Latin American integration schemes—or become a force that policymakers and investors alike cannot afford to ignore.

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