New Trade Routes Pacific Alliance

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Pact takes pragmatic approach to integration

The economic initiative has made big strides in two years despite obstacles of geography, politics and infrastructure, writes *John Paul Rathbone*

Alliance members aim to create cross-border economies of scale to help them take full advantage of the Pacific Rim Corbis

So far this year, it has mostly been bad news from Latin America, as it has from many emerging markets. There have been riots and galloping inflation in Venezuela; dwindling foreign reserves and a forced devaluation in Argentina; and another year of slow growth forecast for Brazil.

Yet this does not mean that the "decade of Latin America", announced four years ago, is over. For one, Chile, Colombia, Mexico and Peru this year took a major step by forming a trade pact, called the Pacific Alliance, which through freer trade between members aims to give the region an extended lease of economic life.

Although many might labour over the words "trade agreement", the alliance has been breathlessly described as "inspiring" (by Costa Rica) and "the most exciting thing going on in Latin America at the moment" (by Felipe Larraín, Chile's former finance minister).

One reason for the excitement is size. If it were a single economy, the Pacific Alliance would be among the 10 largest in the world. Together, its members represent 39 per cent of Latin America's $6tn economy and in 2012 almost half of its $144bn of foreign direct investment. As such, it provides an alternative to the region's dominant power, Brazil.

"The alliance is a highly sensitive issue for Brazil, which has been trying to form its own South American group," says Antônio Sampaio of the International Institute for Strategic Studies in London.

There is also its attitude to commerce. The alliance contains some of the region's most business-friendly, best-run and fastest-growing economies – and it is increasingly seen by investment bankers as a driver of cross-border mergers and acquisitions.

But the biggest reason for the hullabaloo is what the alliance aims to achieve. Its central idea is to generate cross-border economies of scale and industrial linkages to help its members take full advantage of the Pacific Rim – the Pacific coastal countries of the Americas and Asia which comprise the fastest-growing region on the planet. Productivity gains will in turn help members to continue growing fast once the commodity boom passes and the easy days of ultra-loose western monetary policy ends.

> Limiting ambitions about the movement of goods, capital and people makes it more likely to achieve them

"At the moment, Peruvian gas is more likely to be exported to Mexico than to Chile. Chile meanwhile buys liquefied natural gas from Trinidad, while Colombia has an energy surplus but no energy interconnection," says Alfredo Moreno, Chile's former foreign minister.

"The Pacific Alliance's approach is to boost trade by cutting intra-regional trade tariffs and not erect new barriers to other countries."

Trade integration, of course, is not a novel Latin American aspiration. As trade within the region is only 29 per cent of the total – compared with 70 per cent in Europe – the potential gains from integration are large. The supply chains that China has with its neighbours, or the US with Mexico, barely exist in South America.

Sadly, South America has a long history of promising trade pacts that fail to reach their potential. One example is Mercosur (Southern Common Market), whose birth in 1991 generated great enthusiasm.

Today, however, the Brazil-dominated group – which includes Argentina, Paraguay, Uruguay and socialist Venezuela – can often more resemble an anti-gringo talking shop than a trade pact.

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Mexican powerhouse strengthens southern ties

Manufacturing Membership may shift geopolitical perceptions of focus chiefly inclined towards US and Canada, writes *Jude Webber*

Auto parts makers in Mexico stand to make large gains from the scrapping of trade barriers Corbis

'Cumulative rules of origin" sounds like one of the drier concepts in international trade law. But for many Mexican manufacturers, it is the key to why the Pacific Alliance makes good business sense.

Take Mexican auto parts manufacturing, a sector dominated by small and medium-sized enterprises for whom scrapping trade barriers has big potential benefits. They will now be able to export parts, say, to Colombia, for inclusion in cars made there that are then exported to Chile – something that would not have been possible under the terms of those two countries' already existing free-trade agreements.

"As a result of this alliance, Mexican car parts exported to Colombia are in effect treated as if they were Colombian. This is a very big advantage," says Eduardo Solis Sánchez, president of the Mexican Automotive Industry Association.

It is hard to put a figure on how big a boost the Pacific Alliance with Chile, Colombia and Peru will prove to manufacturing powerhouse Mexico. It is already the worlds' biggest producer of flatscreen televisions and a major mobile phone and car producer with a fast-growing aerospace industry, and has aggressively flung open its economy, signing more than 40 free-trade agreements worldwide in the past two decades.

But a beaming Enrique Peña Nieto, Mexico's president, in February hailed the Pacific Alliance as "the most innovative integration mechanism Mexico has signed in recent years since the North American Free Trade Agreement" after its leaders agreed to sweep aside tariffs on 92 per cent of goods immediately.

Of the remainder, 7 per cent should be gone in the medium term and the trickiest 1 per cent, many relating to sensitive agricultural goods, should be eliminated within 15 years, says Vanessa Rubio, Mexico's undersecretary for Latin America. "This alliance aims to ensure that Mexican products gain more markets," she says. Mexico's exports to its three Pacific Alliance partners total about $9bn.

"Free trade has been one of the tenets of the modern Mexican economy, and it's through competition and free trade that we will continue to advance," says Ricardo Salinas Pliego, one of Mexico's leading businessmen. His Grupo Salinas operates in banking, media and retail across the region and its strongest Latin American market outside Mexico is Peru.

But Carlos Serrano, chief economist at BBVA Bancomer in Mexico City, says Mexico's long-time focus on North America will not evaporate.

"Nafta [North American Trade Agreement] will continue far and away to be the most important treaty for Mexico – it's Mexico's most important relationship and it will grow more important still," he says, referring to the 20-year-old trade pact with the US and Canada and the prospect that Mexico's historic energy reform will fuel the expansion of industrial sectors exporting to the US.

Nonetheless, Mexico's manufacturing clout complements the more commodities-driven economies of its partners.

"This [the Pacific Alliance] is an additional something that is good to have. Mexico can export more to the Pacific nations and that helps diversify its economy," Mr Serrano adds, recalling how Mexican GDP plunged 6.2 per cent in 2009, far worse than its peers, after the US-led financial crisis.

Mexico and its partners in the alliance are both friends and competitors in some sectors – Colombia also makes cars, and both Chile and Peru also export avocados, for instance – but "the greater good" prevailed after "very intense negotiations" on tariff elimination, Ms Rubio says.

"Strengthening ties with Latin America and opening other markets is a question of global strategy," says Gerardo Gutiérrez Candiani, president of Mexican business lobby, CCE, which noted that Mexico's manufacturing exports were higher than those of the rest of Latin America put together.

"Having a country like Mexico, which is highly competitive in manufacturing, helps balance the weight of Brazil. It's a great, great opportunity," he says.

One lesson from Nafta that could be applied to the Pacific Alliance is the creation of integrated production chains, he adds.

Ms Rubio also sees the alliance boosting opportunities for companies to take part in infrastructure tenders within the bloc.

Industry and trade aside, there is another reason for Mexico's interest in the Pacific Alliance: politics.

The bloc not only offers Latin America's second-biggest economy the chance to boost its international clout by being in the driving seat of an alliance that Mr Peña Nieto calls a "benchmark of global integration".

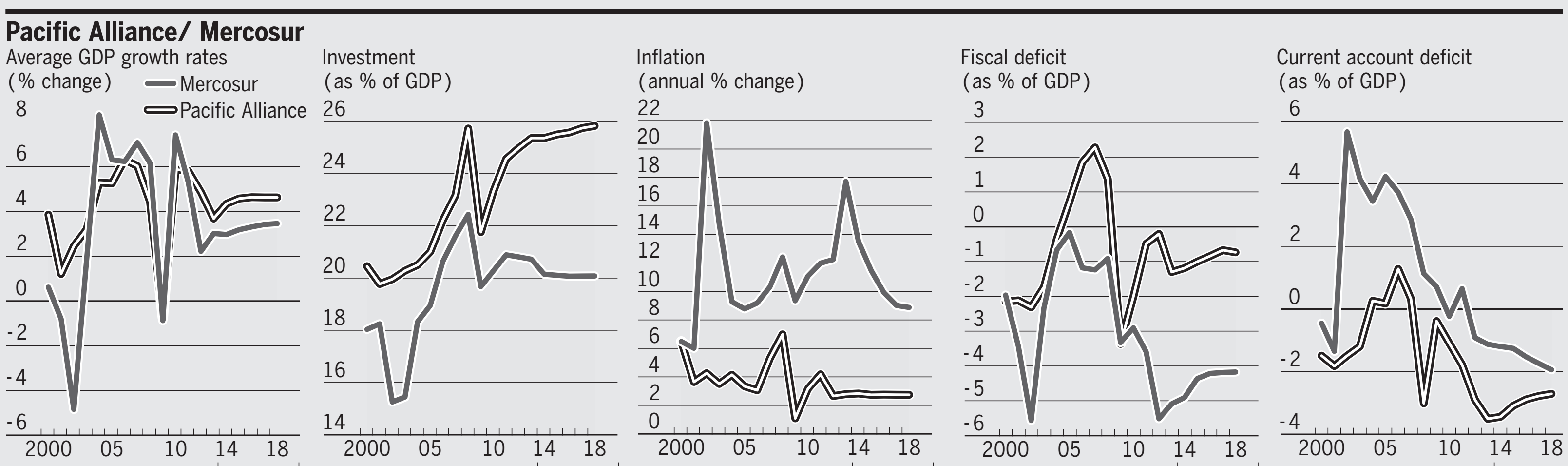
It is also an opportunity to bolster ties with its backyard, which have taken a back seat in the past 20 years, not only through trade but also through education scholarships to study in each other's countries and the elimination of visas.

"This brings Mexico into South America – that's the extent of its importance," says Michael Shifter, president of the Inter-American Dialogue, a Washington think-tank.

"There's a big perception that Mexico has been so focused on the US and North America that it hasn't looked south. It's become a little isolated. Mexico wants to have more diversified relations and be seen as a Latin American country," he says. "This makes geopolitical sense."

> 'Mexico wants to have more diversified relations and be seen as a Latin American country'

The two Latin Americas



Source: IMF

The alliance tends to have less volatile **growth** than Mercosur. As the commodity boom wanes, faster growth is forecast for the alliance.

Alliance countries have higher **investment** and higher growth. Mercosur countries have tended to prioritise consumption.

Inflation tends to be lower in the alliance countries. At the margin, macroeconomic certainty can encourage greater investment.

One reason for lower inflation within the Pacific Alliance is tighter **fiscal discipline** than in Mercosur countries.

A point of vulnerability for the alliance is its larger **current account deficits**, the flipside of larger foreign direct investment inflows.

Politics acts as driving force for Mercosur

Rival coalition

Conflicting priorities hamper group, says *Benedict Mander*

To the east of the Andes, the countries that stretch out towards South America's Atlantic coast – which together form the regional coalition Mercosur – are observing the emergence of the Pacific Alliance, its rival, with unease.

Just as the Pacific Alliance is in the bloom of its youth, some fear that Mercosur – a customs union formed in 1991 that today comprises Brazil, Argentina, Venezuela, Uruguay and Paraguay – may be starting to wither.

The far more ambitious integration project has faltered in recent years thanks to conflicting priorities between its diverse members. Attempts to establish a trade liberalisation agreement with Europe have dragged on for 15 years, most recently running aground because of attempts by Argentina to protect local industry.

Mercosur countries have struggled against serious bouts of instability and are separated by challenging geographical barriers. Brazil, Mercosur's leader, has often gained at the expense of other members, with the inequalities and asymmetries causing smaller countries to complain they are losing out.

Last year Danilo Astori, vice-president of Uruguay, which is Mercosur's least-populated member and enjoys observer status in the Pacific Alliance, said he hoped his country would become a full member of the new bloc "as soon as possible". He criticised the "inaction" of Mercosur.

Many analysts say the Pacific Alliance, which is more focused on promoting freer trade than protecting local industry, is better suited to Uruguay's needs.

But Dante Sica, an economist at abeceb.com, a consultancy in Buenos Aires, insists "the Pacific Alliance is not a threat to Mercosur" and highlights the huge differences between the two.

While the goals of the pro-business Pacific Alliance are largely economic, Mercosur's founders were inspired by the example in Europe and aimed to go further. They intended it also to be a tool to strengthen democracy as its members recovered from dictatorships in the 1980s and hoped it would drive political and cultural integration.

The attitude to freer trade between the two groups is very different: protectionist Mercosur has preferential trade access to less than 7 per cent of global markets. The much more open economies of the Pacific Alliance on average have trade pacts with countries representing almost 75 per cent of the world economy, says abeceb.com.

Therefore, although the combined gross domestic product of Mercosur countries is much greater than that of the Pacific Alliance – $3.1tn compared with $2.2tn – the total trade (exports plus imports) of Pacific Alliance countries amounted to $1.1tn in 2012. This compared with just $653bn in Mercosur, according to abeceb.com.

Although many fear the Pacific Alliance could be yet another nail in the coffin of the idea of a united South America, Matías Spektor, an international affairs specialist at the Getulio Vargas Foundation in Rio de Janeiro, suggests that its success may put pressure on the struggling Mercosur economies to kick-start efforts to seal trade deals not just with the EU, but also the US.

Flagging growth in Brazil, which sees a deal with the EU as key to exploiting its negotiating power with the US, and a looming recession in Argentina may act as an incentive for Mercosur to move ahead in trade negotiations, says Mr Spektor. Venezuela's economic crisis could have a similar effect

"The Pacific Alliance might actually be the spark that brings countries in the region together," he says, adding that "a lot will hinge" on Chile's new president, Michelle Bachelet.

Many had feared the leftleaning Ms Bachelet might turn away from the Pacific Alliance, whose most enthusiastic proponents are on the right, and strengthen ties with closer ideological allies in Brazil and Argentina. Others say she can ill-afford to take risks as Chile's economy decelerates.

In a column in the Spanish newspaper El País, Heraldo Muñoz, Chile's foreign minister, said the new government valued the Pacific Alliance as "an economic integration scheme and a trade platform" although it supported discussions to achieve "a convergence of the Pacific Alliance with Mercosur". If the two blocks fail to converge, and there is success for plans to create the Trans Pacific Partnership, which includes Pacific Alliance countries, the US and various Asian countries, that could pose a "geopolitical problem" for Mercosur, says Daniel Kerner, a Latin America analyst at Eurasia Group, a political risk consultancy.

He believes that "growing disenchantment" and the divergent priorities of Mercosur countries may be its undoing. "We're going to start to see these countries trying to find ways to bypass Mercosur so that they can have different trade agreements," he says.

He explains that Uruguay has long wanted a trade agreement with the US, while Brazil may negotiate a bilateral trade deal with the EU if Argentina continues to cause problems. "For each country, Mercosur will just become less relevant. These agreements never die, they always linger."

Even so, unlike the private-sector-oriented Pacific Alliance, Mercosur is not primarily a trade bloc, says Mr Spektor. In terms of the political integration it has achieved between members, he says, it has been a "tremendous" success. "Is the Mercosur model working? Clearly not. But who said it was really about free trade in the first place?"

> 'The Pacific Alliance might be the spark that brings countries in the region together'

News in Brief

Commodities touch raw nerve

The concentration of mineral resources in alliance countries, especially in Chile and Peru, has led to concerns that the trade bloc could become dependent on commodity exports, given the strong demand in Asia.

Some 80 per cent of copper-rich Chile's exports to Asia in the past decade were metals and ores. They were just a third of Chile's sales to the rest of Latin America, with manufactured goods comprising almost half its regional exports.

Therefore, some say more trade within Latin America, which involves a more diversified and higher value-added basket of goods, would be more beneficial.

If the Pacific Alliance succeeds in strengthening trade within the region and opening opportunities for a wider range of companies, especially small and medium-sized ones, reliance on commodity exports could decrease. That could help to diversify trade with Asia.

Views vary over whether government may need to stimulate specific sectors. Huge distances between the members of the alliance and poor infrastructure linking them pose further problems.

"If the Pacific Alliance develops industries away from commodities that's fine, but it will not be because of decisions from politicians, but because it makes sense," says Jorge Errázuriz, a Chilean banker involved in promoting the alliance.

He argues that state-directed industrial policies have never worked.

Benedict Mander

Mining in copper-rich Chile

Observers weigh their options

The alliance is attracting many "observer nations" with some aspiring to become full members.

Costa Rica is in the pipeline to join and Panama is likely to follow suit after they have signed free trade agreements with members. Guatemala announced last year it would eliminate visa requirements for some member countries.

Ecuador is an observer and, according to some insiders, has expressed its intention to join. Observers Uruguay and Paraguay are also part of the more protectionist Mercosur bloc. "This is a way of signalling that they are prepared to hedge their bets with the freer trade option, should Mercosur falter," explains Barbara Kotschwar of the Peterson Institute for International Economics.

Observer Canada is considered an obvious alliance fit by some but the idea of free movement of people seems to be a spoiler. That could also apply to the US, another observer.

Andres Schipani

Bourse tie-up has way to go

Mexico was one of the founding partners of the Pacific Alliance, but has lagged behind when it comes to joining the stock-exchange tie-up between Colombia, Peru and Chile. This launched in 2011 with high hopes of rivalling Brazil's mighty BM&FBovespa.

Hobbled by the complexity of harmonising regulatory regimes and high operating costs, volume has struggled to take off. But Mexico's plans this year to join the Mercado Integrado Latinoamericano, or Mila, should help. Its combined market capitalisation was $547bn in January with $6.2bn volume.

"Mexico will represent more than half of Mila," says Javier Artigas, country head in Mexico of BTG Pactual, the Brazilian investment bank and a former senior official at Mexico's stock exchange, the BMV. "As money is moving to developed markets, the Latin American bloc may lose some liquidity. So joining together achieves scale and creates more liquidity."

Blue-chip Mexican stocks such as América Móvil, Telmex and Televisa may fly. Chilean investors have shown high demand for Mexican shares. But Mr Artigas says that Mila will "take a while to gain traction".

Carlos Serrano, chief economist at BBVA Bancomer in Mexico sees greater synergies with the US, Mexico's top trading partner. "It's going to take time for Mila to translate into much more activity."

Jude Webber

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Bloc opens doors for businesses in the region

Corporate Positive steps in co-operation are being made, write *Andres Schipani* and *Benedict Mander*

Surrounded by cranes noisily loading and unloading containers at the bustling docks of the port of Buenaventura, Domingo Chinea expresses high hopes for the burgeoning Pacific Alliance trade bloc.

"The Pacific Alliance will open the door to more traffic," says Mr Chinea, head of the body that administers the main Buenaventura port terminal. The port handles more than half of Colombia's maritime cargo.

"There has always been traffic from Mexico, Peru and Chile, but it is growing, especially from Chile," he adds. He points out that, because of the bloc's influence, annual activity at the port has been growing by 12.5 per cent on average, compared with 9.5 per cent growth in earlier times.

Despite being ravaged by violence and poverty, Buenaventura is Colombia's main gateway to the Pacific, receiving manufactured goods from Asia as well as growing cargoes of Chilean wine and goods for its vibrant retail sector. Exports include Colombia's premium grade of coffee bound for Japan and a range of products from the Nutresa group, the country's main food manufacturer.

"Even if we already have operations in the member countries, I believe the Pacific Alliance will generate further benefits not only for companies like ours, but also for consumers and the member countries in general," says Carlos Piedrahita, chief executive of Nutresa.

The conglomerate operates throughout the alliance countries (it expanded into Chile last year when it bought Tresmontes Lucchetti for $758m) and in Asia.

Despite the many advantages that the Pacific Alliance is expected to bring – such as increased investment, and removing barriers to the movement of people and the sharing of resources – in strictly trade terms the benefits may be more limited. This is not only in Latin America but also in Asia, where the alliance is making a special effort to strengthen ties.

Cristian López, corporate export director at Chile's Concha y Toro, Latin America's largest wine producer, says the company has reaped most of the benefits of the trade pacts that Chile signed long ago with countries such as China, Japan and South Korea.

"The Pacific Alliance brings no big pros or cons for the wine sector – the free trade agreements that Chile has signed have already had a positive effect on our business," says Mr López. He nevertheless believes Asia, and in particular China, remains a major growth market, much more so than Latin America and Europe. "Today our challenge is to build the brand and conquer cultural barriers."

Felipe Manterola, who heads the association representing Chile's salmon industry, one of the country's largest export fields, says the sector is more interested in the prospects for the Trans Pacific Partnership. The TPP is a much more ambitious trade accord which includes the US and various Asian countries.

Mr Manterola says the TPP could help reduce trade barriers even further. This would especially be the case with Japan, the destination of about a quarter of Chile's salmon exports.

The Pacific port of Buenaventura handles more than half of Colombia's maritime cargo AFP

Yet the Pacific Alliance is still seen as an important opportunity for well-established companies that do not yet have investments in other member countries.

"The Pacific Alliance will be important for the future of productivity and competitiveness of our companies," says José Alberto Vélez, chief executive of Argos group, Colombia's leading cement maker, which also has big operations in the US, the Caribbean and Central America.

"This is an interesting opportunity for Colombia to keep growing internationally, as well as having a sustainable connection with the countries along the Pacific coast."

One area where much work remains to be done is in financial integration, although there has been progress. Not fully satisfied with the depth of their local markets, fund management groups from Chile and Colombia have set up pension administration companies in neighbouring countries.

> 'It will generate benefits for companies, consumers and member countries'

For example, Sura, one of Colombia's largest financial groups, took over the Dutch group ING's pensions and insurance assets in Mexico, Peru, Colombia and Chile for $3.6bn in 2011. It has spent almost $400m on pension funds in Peru since 2012.

"The Pacific Alliance is an opportunity for pension funds to diversify their investments in four different local markets," says David Bojanini, Sura's chief executive, who sees advantages in the bloc "as long as it provides a more agile and flexible [investment] environment".

Jorge Errázuriz, a prominent Chilean banker involved in promoting the Pacific Alliance, admits that more ambitious plans to integrate the member countries' stock exchanges have so far been disappointing; the Latin American integrated [stock] market (known as Mila from its initials in Spanish), he says, is "not working".

"The integration of financial markets is a big issue," says Mr Errázuriz. "The only way to get there is one step at a time. If you stop, you'll never get to the top."

Pumas capture spirit of times in an era of 'mega' agreements

World trade The gang of four is making waves, writes *Shawn Donnan*

Once upon a time, had four Latin American countries signed a deal to reduce tariffs, lower other trade barriers, integrate their economies and cast a joint and hungry eye over the ocean it would have caused a polite round of applause in global capitals.

But these are very different times.

The move this year by Chile, Colombia, Mexico and Peru to increase their links with each other – with a view to building economic bulk and engaging more efficiently with a rising Asia – is part of a much bigger dance. Those four Latin American countries could end up being a crucial link in the global economy before long.

We are living through the era of the "mega" trade agreement. Fed up with the stalled and 12-year-old Doha Round of negotiations in the World Trade Organisation a growing number of countries eager on moving ahead with trade liberalisation are forging fresh regional and sectoral alliances around the world.

From the Trans-Pacific Partnership, which the US is trying to wrap up with 11 other Pacific Rim countries, to negotiations under way over an even bigger EU-US deal and the Trade in Services Agreement talks taking place in Geneva, big and strategic is the name of the game.

All are being dubbed "21st century" agreements packed with "ambitious" attempts to tackle live issues in the global economy. These range from the rules for cross-border data flows to updating intellectual property, environmental and even labour standards.

The key question for the Pacific Alliance in the years to come will be: just how does it fit in with those pacts?

The signs, so far, that the grouping is at least part of the bigger conversation are good.

Three of the four members of the alliance – Chile, Mexico and Peru – are part of the TPP talks. Moreover, Colombia is mentioned by many trade experts as one of the countries most likely to join in the future. All four have their own bilateral trade agreements with the US and with the EU.

Those important links across the Atlantic and the Pacific oceans mean that many experts believe that one day the Pacific Alliance may formally accede to either, or both, the TPP or the EU-US pacts.

Such a move could be crucial in the years to come. Barbara Kotschwar, a trade and Pacific Alliance expert at the Washington-based Peterson Institute for International Economics, argues that the flurry of mega trade negotiations is likely to result in one of two things.

The first is a revival of multilateral negotiations. The hope of many is that big developing economies like Brazil, China and India will be jolted into action and push harder for the revival of the Doha talks in the WTO, leading to a badly-needed multilateral updating of the rules of global commerce.

> 'Together, the US, EU and Pacific Pumas can set the foundation for an enlarged transatlantic bloc'

The second may be the more likely option. The mega deals would become proxies for a missing multilateral agreement and eventually all be stitched together, creating a behemoth of a trading bloc that benefits only those who are included.

Either way, the Pacific Alliance "view is not to be left behind", says Ms Kotschwar, and "to keep up with what is being crafted in these 21st-century agreements".

Problems are likely. As Samuel George pointed out in a recent report for the Bertelsmann Foundation on what he dubbed the "Pacific Pumas", the members of the Pacific Alliance "do not exactly have compatible export portfolios".

But Mr George also argues that, taken as a bloc, the members of the alliance ought to have a credible voice in global trade.

Their combined trade with the rest of the world of $1.04tn annually accounts, Mr George writes, for half Latin America's total. Were the four countries ever to become one they would supplant Brazil as the globe's fifth most populous country and have a GDP of $2.22tn, enough to make them the world's ninth biggest economy, he adds.

Such heft is alluring to the US and the EU as they contemplate future trading alliances, Mr George says.

"For the US, the Pumas represent a potential partner in the Americas," he writes. "For the EU, the Pumas represent access to high growth, investor-friendly (and Europe-friendly) markets, with a window to East Asia to boot."

"Together, the US, EU and Pacific Pumas can set the foundation for an enlarged transatlantic bloc prepared to negotiate the opportunities and challenges of a Pacific century."

That all depends on one thing: neither the TPP nor the EU-US deals have been completed and still face significant hurdles before they become reality.

But if they ever do, and the world of mega trade agreements continues to develop, the Pacific Alliance is surely in a good place to take advantage.

Barbara Kotschwar of the Peterson Institute for International Economics

Electric interconnection hints at added spark

Energy

Increased power links will foster integration, writes *Lucien Chauvin*

Latin American leaders have long talked of the need for countries to link energy networks to provide the region with a foundation for economic and physical integration.

After decades of declarations and promises, there are still very few interconnected systems. This may now be changing, thanks to the consolidation of the Pacific Alliance, which joins Chile, Colombia, Mexico and Peru, and could soon add Central American members.

Luis Miguel Castilla, Peru's economy minister, says energy interconnection among alliance countries is a logical step "pushing us beyond just trade and financial integration to physical integration. Energy is a critical sector for us to continue to grow."

Peru is, in many ways, at the centre of the potential integration. It possesses vast scope for electricity generation, with the public and private sectors estimating hydroelectric potential at 60,000MW. It has substantial reserves of natural gas.

Alvaro Rios, energy consultant and a former Bolivian energy minister, calculates that Peru's natural gas reserves could top 50tn cubic feet. It is the only country on South America's Pacific coast with a facility for producing and exporting liquefied natural gas (LNG).

A foundation for interconnection already exists on the private side of the equation. Colombia's state-controlled Interconexión Eléctrica, known as ISA, is the principal power transmission company in Peru. It is building a power line down the southern coast to the border with Chile.

Investment in projects under way in Peru has reached more than $700m. ISA will soon be the second largest transmission company in Chile. Chilean companies have invested in Peruvian electricity. Peru LNG, the liquefied natural gas export project operated by US-based Hunt Oil, has a contract to sell nearly 70 per cent of output to Mexico for re-gasification and use in power production.

The governments of Peru and Ecuador announced in November that they would push for the construction of a 500kV electricity transmission line to link the two countries. Ecuador and Colombia are one of the few examples in the region of an integrated system. The line from Peru would effectively link it to Colombia, creating a tri-nation market.

A potentially critical change came in January at the International Court of Justice in The Hague. A ruling on a maritime dispute between Peru and Chile saw Chile keep rich coastal fishing grounds and Peru receive a vast area of ocean up to the 200-mile limit. The verdict ends a dispute that goes back to a late-19th century war between the countries and may pave the way for deeper integration.

Gonzalo Priale, head of Afin, a Peruvian association of private companies operating in public services, says the court's decision and the signing of the alliance's market access treaty in February should facilitate additional integration.

"The obviously sound economic model of the Pacific Alliance countries and the progress already made indicate that we should move to the next level," he says.

> 'We are beginning to see a shift in the matrix, with more excess supply and the ability to ship it'

"Everyone knows that Chile has an energy deficit, so it is eminently reasonable and commercially intelligent for us to export energy to Chile."

The political will may be growing, but infrastructure has to match it. Peru does not have the power plants or transmission lines to export to Chile or other neighbouring countries.

Mr Priale's organisation estimates that Peru needs to invest $32.4bn in electricity generation and transmission by the end of the decade.

Peru's goal, he says, should be adding at least 2,000MW annually to its capacity in the second half of this decade. It would guarantee local demand and mean surplus for export.

Robert Kartheiser, an attorney specialising in energy projects at New York law firm Allen & Overy, says interconnection of power grids sounds good, but will be hard to sell.

"What you find is talk about interconnection, but the first thing politicians will say is that internal demand must be fulfilled. Interconnections, where they exist, don't change market dynamics in one country or another," he adds. "I don't see an explosion of power interconnection projects just yet."

Mr Kartheiser says there is a greater potential for integration based on natural gas.

"We are beginning to see a material shift in the energy matrix with more gas processing plants, excess supply and the ability to ship it via pipelines or vessels.

"There will be significant investment in the gathering, processing and movement of gas, as well as power generation with CCGTs (combined cycle gas turbines)."

On June 30, Peru plans to select the company that will build a gas pipeline from the central jungle to the southern coast. The investment is calculated at $4bn. It could, conceivably, be a potential solution for the unmet energy needs in Chile's mineral-rich, but energy-poor north.

Colombia is working on LNG projects and Mexico's energy reform could unlock huge amounts of resources, including shale gas, which have gone untapped.

Mr Kartheiser says: "The most fascinating development could be uncorking shale gas in the region in the next five to seven years, if regulatory regimes allow.

"We are already seeing excitement among industry players for potential deals."

Partners set sights on more than marketing

Opinion
SAMUEL GEORGE

Like a bubble in asset prices, excitement over the Pacific Alliance can seem inflated and liable to burst.

Depending on whom you talk to, the pact is "the most exciting thing in Latin America" or "the most important alliance you've never heard of".

To the seasoned Latin Americanist, perhaps numbed by the steady diet of short-circuited regional pacts, this excitement can seem disproportionate.

The four members – Chile, Colombia, Mexico and Peru – were already intertwined in a global network of trade deals. Each benefited from bilateral free-trade agreements before forming their group and they all had bilateral agreements with the US, the EU and several East Asian countries.

Moreover, the four original members are not big trading partners of each other. As of 2012, neither Mexico, Chile nor Peru counted an alliance member as a top-five trading partner.

This is hardly surprising. Alliance members do not have complementary exports. Chile will not get far exporting copper to Peru, a major producer.

Poor infrastructure and sheer distance do not portend efficient supply chains. Shipping a container from Bogotá to Barranquilla port is three times the cost of shipping it from Barranquilla to Hong Kong.

Some consider the bloc little more than a publicity stunt. Brazil's foreign minister Antonio Patriota has referred to it as a "marketing success".

This is no bad thing for the alliance. Lost amid headlines from the drug wars and commodity trade publications – and perhaps overshadowed by economic and political vicissitudes in Venezuela and Argentina – is the fact that alliance members have enjoyed strong macroeconomic performance, improved governance and increased global integration.

Alliance inflation has tracked developed-economy inflation since 2005. Reserves are up, while debt and deficit figures are generally within the EU's Maastricht criteria. With improved institutions that have facilitated changes of power, there is reason to believe Chile, Colombia, Mexico and Peru are able to withstand emerging-market turbulence.

These individual advances may be more important than anything that comes out of the alliance. If the bloc can capture global attention and amplify members' voices in trade talks – while perhaps attracting some FDI along the way, then the marketing is – well – a success.

But the true alliance impact may not manifest itself in the real sector. Financial-sector integration may have the greatest impact.

The Mercado Integrado Latinoamericano (Mila), a multilateral effort to integrate the Chilean, Colombian and Peruvian equity markets, is evidence of the group's potential to negotiate barrier-breaking financial agreements.

Alliance members may be growing, but before Mila's founding in 2010, their bourses were largely overlooked. Outside São Paulo and Mexico City, Latin American equity markets lack depth and breadth. Few companies list publicly and transactions are infrequent.

Small and illiquid, these markets can appear one-dimensional: Colombia in energy and financials; Peru in mining; Chile in retail and services. Specialisation may attract boutique investors but is under the radar of the global herd seeking the "next Brazil".

Mila could change this. Even without Mexico, the tie-up's $700bn capitalisation places the bourse second only to Brazil's in market size in South America. With more than 500 companies, Mila offers the largest portfolio in Latin America.

The potential (and expected) integration of the Mexican bourse in 2014 would render a market of global proportions.

Mila is work in progress. The bourses have yet to establish full integration and nettlesome issues such as taxation and currency trading remain unsettled.

Though Mexico has addressed the legal reforms required to join, the Bolsa Mexicana de Valores' projected entry date of early-2014 seems optimistic.

Even so, the initiative has a considerable upside. The momentum of the alliance indicates the regional power accrued by its four members. The bloc is emerging as a magnet for smaller Latin American countries looking for an alternative to, say, the Mercosur model; eight have observer status and Costa Rica is on the verge of membership.

> Pacific Alliance members have enjoyed strong macroeconomic performance

Alliance expansion raises a host of concerns. Initial success can be largely ascribed to the small number of like-minded participants. Faultlines could emerge with the admission of others. Can the alliance safely integrate with Panama, a haven for tax evasion? Can Guatemala and Honduras, embroiled in the war on drugs, agree to waive visa requirements for Mexicans and Colombians?

Despite the challenges, the Pacific Alliance has established itself as an important regional voice. It has reintroduced Mexico into the mix of Latin America's large leaders, provided brawn to Chilean brains and given a voice to Colombia and Peru, as these countries continue to develop internally.

Marketing success? To a degree. But the alliance has the potential to push members towards Asian Tiger-style economies with correspondingly impressive growth.

Samuel George is a project manager with the Bertelsmann Foundation and author of "The Pacific Pumas: An Emerging Model for Emerging Markets".

Founders of trade accord seek closer political ties

Interview Colombia's president tells *Andres Schipani* that the path of partnership reaches beyond commercial arrangements

President Juan Manuel Santos of Colombia AFP

The Casa de Huéspedes Ilustres, Colombia's presidential residence on Cartagena's bay, was abuzz as the evening sun faded over the Caribbean. Waiters busy setting up tables in the elegant garden waved away a scattering of blue parrots as, behind the building, Colombian sailors in pristine white uniforms rehearsed their salutes and drill. They were marching before the flags of Chile, Mexico, and Peru and Colombia itself, the founding members of the Pacific Alliance.

The leaders of the four nations were scheduled to arrive shortly and raise their glasses to the trade agreement at a meeting convened by their host, Colombia's President Juan Manuel Santos.

Earlier that day, during a presidential summit in February, they had agreed to drop more than 90 per cent of tariffs on goods and services in a move to consolidate the alliance, which was officially launched in June 2012.

"I don't think there has been an integration process that has taken decisions as fast as the Pacific Alliance has done," said Mr Santos, dressed in the kind of starched linen guayabera shirt that is suitable for the sultry tropical weather of this part of Colombia.

For him, the process of integration was natural, because the founding members "have a common vision on how to manage our economies, common attitudes regarding foreign investment, the role of the market in the economy and respect for private property."

That vision has helped them reach a combined GDP of more than $2tn – or approximately 40 per cent of Latin America's combined total – earning the Pacific Alliance a place among the world's 10 largest economies.

"We are generating synergies, generating strengths," says Mr Santos, who is a former foreign trade minister. This may suit Colombia well, as the Andean country is also bidding to enter the OECD to stand with Chile and Mexico, who are already members.

"The only one missing will be Peru, and we are encouraging it to join as well," the president adds.

Even if Mr Santos believes the Pacific Alliance to be "a process of integration that implies the easing of [restraints on] trade, investment and movement between member nations and a strengthening of global markets," he also stresses that they are "deepening integration", a process that "goes well beyond free trade".

While the alliance is centred on open markets, it seems founding members are also wanting even closer ties. Their aim resembles that of Europe's Maastricht treaty, which paved the way to closer political integration for EU members, rather than simply forming a trading area.

Colombia's president notes, for example, that they have already established joint embassies and trade delegations in Africa, Asia and the Caucasus. They have standardised university degrees and are allowing greater movement of people between the four nations.

"We plan to go as far as we can," says Mr Santos, pointing to tourism flows between his country and Mexico. They are up 35 per cent since the latter eliminated entry visas.

He says, the members are considering creating a common fund to invest in infrastructure. "We are also studying the possibility of standardising the price of medicines across borders," as a further step towards enhancing the lives of the citizens of the four countries.

> 'Those who want to board the train need to think in ways similar to ours'

Every agreement, however congenial, has its limits. There is no security accord in sight, despite a range of conflicts in three of the signatory states. Mexico and Colombia are, to different extents, badly affected by drug-fuelled violence. Peru is the world's top cocaine producing nation.

At the same time, Chile is in a more fortunate position and has "different security needs from those of Colombia and Mexico".

The president does not discount that a security agreement between the four countries could happen. It would be another step towards further integration, he says: "we are open to any possibility."

A recent visit to Washington by a Colombian defence ministry delegation took with it a "proposal for a meeting" of defence ministers of the four alliance members, plus Costa Rica, which is in the throes of becoming a full member. The US and Canada are observer members of the bloc.

On the domestic security front, Mr Santos has opened peace talks with Marxist rebels that could draw a line under five decades of conflict.

Some analysts, meanwhile, think the consolidation and expansion of the alliance could pit it against the regional coalition of Mercosur. Known by some as the common market of the south, it is led by more protectionist countries such as Argentina and Brazil. "That would be their problem, not ours", says Mr Santos, while emphasising that the alliance is open to new members who aim to contribute to regional wellbeing.

"If Brazil does very well, then Latin America does very well," he points out. "If the Pacific Alliance does very well, Brazil and Latin America do even better. Our attitude is not to exclude or compete with anybody."

Others believe that there could be frictions with the left-oriented Alba (Alianza Bolivariana para los Pueblos de Nuestra América) group of nations, led by Venezuela that includes Ecuador, which has observer status with the Pacific Alliance. "We will welcome those who want to board the train," says President Santos.

"But they need to have a series of visions and ways of thinking similar to ours."

Pact takes a pragmatic approach to developing integration

Continued from Page 1

Although there is always the danger of over-categorisation, its economies tend to be slower growing and suffer higher inflation than the Pacific Alliance.

"If Mercosur represents 21st-century socialism, the Pacific Alliance represents 21st-century capitalism," says Barbara Kotschwar, of the Peterson Institute for International Economics in Washington.

"It takes a pragmatic approach toward development, incorporating elements of social inclusion as well as liberal economic policies," she says.

Such talk does not always go down well in the region. Some critics have called the alliance "only marketing" – no bad thing if the signalling exercise differentiates a country from slower growing and volatile neighbours.

Meanwhile Rafael Correa, president of Ecuador, has called it "more neoliberalism" – a loaded word – while Evo Morales, Bolivian president, has described it as a plot by Washington to divide the region.

The usual Pacific Alliance response is that it is not against anybody. "We are an economic not a political initiative," says Juan Manuel Santos, Colombia's president. Indeed, in many ways the Pacific Alliance is a return to the trade theories of "open regionalism" that prevailed in the 1990s. These led to Mercosur and the now largely defunct Andean Community union and held that opening up to world trade is more advantageous if combined with deeper regional markets.

That return to old economic theory may sound ominous. Indeed the obstacles to the Pacific Alliance succeeding are huge.

Geographically, it is a very long and thin pact that runs 10,000km from toe to tip – with several non-members in between. Talk is easy, while actual implementation is hard. Lack of tax harmonisation, for example, has hampered the vaunted tie-up between the Alliance's stock markets: Mila, their combined bourse, has a daily turnover that is a third of Brazil's Bovespa, despite similar-sized market capitalisations.

National changes of political leadership could also slacken the pace of integration. Michelle Bachelet, Chile's new president, has already said she wants to deepen ties with Argentina and Brazil – although that does not necessarily mean abandoning the Pacific Alliance process.

Lastly, there is the crucial question of developing infrastructure given that poor transport links have long stymied regional integration. Two of the Alliance's biggest ports – Colombia's Buenaventura, and Mexico's Lazaro Cardenas – are also under varying states of emergency due to security problems.

Although the Alliance may yet go the way of other Latin American trade pacts, it has done more in two years than most ever do. Tariffs on 92 per cent of products have been eliminated, the need for visas dropped, which will help pool human capital, and its members have created joint trade missions abroad.

One reason for this progress is that goals are purposely limited. There are no grand plans to establish a common currency or a secretariat – indeed, trade disputes will be settled by the World Trade Organisation.

Nor does the Pacific Alliance have a "judicial identity", so it cannot sign agreements on behalf of members. Limiting ambitions to the free movement of goods, capital and people makes it more likely to achieve them.

All of its countries are also committed to freeing up trade, which they demonstrate by having pre-signed agreements with members. Keeping the alliance "a coalition of the willing" is especially important given the long list of potential applicants, including Canada, Costa Rica, Panama and Uruguay. "It is easy to list the reasons why the Pacific Alliance might amount to nothing,"wrote Moises Naim, at the Carnegie Endowment for International Peace in Washington, recently. "But the list of incentives these countries have to make it succeed are bigger still."

What might be a sign of pooled economic success? Ms Kotschwar suggests "when you can, say, drink 'Pacific-made' pisco sours in Thailand or China, instead of just Peruvian pisco, will be when you can say the alliance has really arrived".