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Trade: The Undervalued Driver of Regional Integration in Latin America

Many regional organisations in Latin America are currently in crisis. Trade agreements, however, have made progress in the region. Today, 80 per cent of intra-regional trade is already under preferences. In March 2017 several international financial organisations – the World Bank, the International Monetary Fund (IMF), and the Inter-American Development Bank (IDB) – each independently proposed the creation of a Latin American and Caribbean free trade area.

• Although ideological polarisation and the economic crisis led to a stagnation of high-flying regional cooperation projects, regional projects with more pragmatic and issue-specific objectives, such as the Pacific Alliance (PA), are gaining ground.

• In contrast to Trump’s protectionist policies, an overwhelming majority of Latin Americans support free trade with neighbouring countries and regional economic integration.

• Tariffs are no longer the main obstacles to increasing trade in Latin America. The existing network of preferential trade agreements in Latin America provides a platform for the implementation of a regional free trade area.

• The elimination of non-tariff measures, the harmonisation of rules of origin, and the lowering of transport costs by improving the infrastructure and the interoperability of national customs systems can increase intra-regional trade.

• Pragmatic regionalism strives for a harmonisation of rules and standards but does not aspire to create supranational institutions.

Policy Implications
The advances of Latin American economic regionalism have been underrated; they should be more capitalised because the economic strength of a country’s region conditions the success of global integration strategies. Hence, Latin America needs to develop a policy that combines efforts to integrate both at the regional level and globally. The European Union should both support Latin American economic integration and open its markets to competitive Latin American export products.
Latin American Regionalism in Flux

“Regionalisation” refers to transnational social, economic, political, and cultural interactions (including areas such as trade and foreign direct investment) that create a regional space. In contrast, “regionalism” refers to state-led political projects and policies that aim to organise a regional space. Regionalism can be an upshot of growing regionalisation but can also have the objective to advance regionalisation as has typically been the case in Latin America.

Latin America has a long history of regional integration projects – at least three waves since the 1960s. However, all of these regional projects had weak economic bases (e.g. linked to preceding intra-regional trade or regional infrastructure) and normally only managed to secure low levels of compliance in regard to the agreed benchmarks.

These projects very much depended on the will of presidents – or “presidential diplomacy” (Malamud 2005) – and the political constellation at the time. Today (as in the past), regional projects can be interpreted as reactions to perceived external risks and structural changes in the world economy. This can currently be seen in the case of growing US protectionism, which especially affects the North American Free Trade Agreement (NAFTA) and Mexico. At the same time, the economic clout of the Asia-Pacific region constitutes both a push and pull factor for Latin American regionalism, resulting in cross-regional projects.

In the 1990s Latin American regional projects advanced economic integration with the goal of making regional economies more competitive in the world economy. This strand of regional integration projects was labelled “open regionalism.” Mercosur (Mercado Común del Cono Sur), the Andean Community (formerly the Andean Pact), and the Central American Integration System all followed this logic. Later, in the first decade of the twenty-first century, regional projects were less trade based and more politically oriented. Starting with the anti–free trade project ALBA (Alianza Bolivariana para los Pueblos de Nuestra América; 2004) and then with UNASUR (Unión de Naciones Suramericanas; 2008), the first exclusively South American regional organisation, the focus changed to political cooperation in the areas of security, conflict mediation, health, culture, education, science, and infrastructure, inter alia.

Currently, most Latin American regional projects are in crisis or stagnating. These projects were launched at specific junctures by political leaders – such as the Brazilian president Lula or the late Venezuelan president Hugo Chávez – who convinced their colleagues to create new regional organisations (or relaunch existing ones). Latin America has seen the highest number of regional organisations created since 1990. Today, Latin America suffers from a lack of regional leadership. Most presidents are forced to concentrate their energy on surviving in a hostile domestic environment. What is more, ideological conflicts between Latin American governments – for example, in relation to the Venezuelan crisis – have divided the region and made regional cooperation more difficult.

But there are countercurrents which may result in a new regional dynamic capable of facilitating more regionalism and regionalisation. On the one hand, there is a new type of regional organisation – the Pacific Alliance (PA) – which could introduce a different dynamic to Latin American regionalism. The PA embodies a new pragmatic type of regionalism which is based on expanding preexisting bilateral agree-
ments. On the other hand, the advances of Latin American regionalism have been underrated and should be more capitalised. Thus, future regionalism projects should be grounded in more regionalisation in the economic realm. Processes of economic regionalisation might induce new regional projects, not the other way round.

Good Times for Regional Economic Integration

On 23 March 2017 The Economist published an article titled “There has never been a better time for Latin American integration” [1] — a title which, given the economic crisis in many Latin American countries and the stagnation of regional organisations, was quite surprising. In the same month the World Bank, the International Monetary Fund (IMF), and the Inter-American Development Bank (IDB) each independently published a document demanding more economic integration in Latin America. These groups’ respective documents coincide in many points and only manifest some minor variations in terms of their main suggestions.

The World Bank (2017) makes reference to the fact that Latin American and Caribbean countries held, on average, a preferential trade agreement with about four regional partners before 2000. By 2013 the number of agreements had increased to 10. The IDB (2017) similarly emphasises that there are no less than 33 preferential trade agreements between its regional member states and also points to the fact that some 80 per cent of the value of current regional trade in Latin America and the Caribbean is already under preference (excluding agreements that cover less than 80 per cent of products). Moreover, further tariff reductions have been scheduled for the future. Most subregional preferential trade agreements will have reached their full-liberalisation potential by 2020 (Estevadeordal et al. 2016). Based on these advances, the IDB makes the case for the creation of a Latin American and Caribbean free trade area, which would constitute a market of scale for local industries with approximately 7 per cent of global gross domestic product (GDP). The IMF (2017) concurs with the idea of establishing a regional free trade agreement (FTA) that goes beyond liberalising trade tariffs and focuses on lowering non-tariff barriers. And the World Bank (2017) encourages the integration of labour and capital markets in the Americas.

There are signs of further trade liberalisation and economic integration in Latin America. Since 2016 the PA and Mercosur have been negotiating a closer cooperation. Meanwhile, in Central America Guatemala and Honduras launched a customs union at the end of July 2017, which El Salvador and Nicaragua may join later. It is expected that the customs union will cut logistics costs between both countries by 25 per cent and raise the GDP of Guatemala and Honduras by 1 per cent and 1.2 per cent, respectively (Gutiérrez 2017).

Challenges Ahead

One of the challenges for regional economic integration in Latin America and the Caribbean is the relatively low share of intra-regional trade compared to other world regions. Exports are very much concentrated in the commodity sector (as a result of the commodity price boom in the first decade of the twenty-first century). In the
1990s, after the creation of new regional organisations or the revamping of existing ones, there was a significant increase in the share of intra-regional trade. However, after 2000, it dropped again. In most subregional integration schemes it is now well below 20 per cent – the only exception being Central America, where 32.4 per cent of Central American exports remained in the region in 2016 (but only 14.8 per cent of imports came from within the region) (SIECA 2017). Even though Central American intra-regional trade is quite high by Latin American standards, it is still well below intra-regional trade in Europe, Asia, or North America. Latin America needs to diversify and upgrade (in international value chains) its export product basket.

Large Latin American economies dominate intra-regional trade, which is segmented according to the main subregional trade agreements. For Latin American nations, there is no trade hub comparable to China in Asia, while the United States is a more important trade hub than larger Latin American countries. As a result, trade is concentrated outside the region, with the United States, China, and Europe representing the region’s largest markets.

The question is about how to increase intra-regional trade. Moreover, one has to ask whether it makes sense to invest in regional integration instead of focusing on integration into the global economy. The World Bank (2017) disputes the claim that distance no longer matters and that we live in a “flat world.” Instead, it contends that the geographic forces which shape economic performance have increased. Thus, the economic performance of a country in both the long run and the short run is closely correlated with that of its neighbours. As a result, the geographic forces and the economic strength of a region condition the success of a country’s global integration strategies. Hence “it takes a competitive region to make a competitive economy” (World Bank 2017: 15). As a consequence, the World Bank (2017) recommends a strategy that combines efforts to integrate at both the regional level and globally. And the IMF (2017) even argues that trade connections with regional partners might produce larger growth effects than inter-regional trade connections.

As the IMF (2017: 34) argues, Latin America and the Caribbean have not yet fully exploited the opportunities for regional integration. What are the main obstacles? A major criticism of Latin American regional trade agreements has been the delayed implementation of their provisions. Therefore, the implementation, utilisation, and perfecting of existing agreements – the “software” of integration (Estevadeordal et al. 2016) – should be prioritised over negotiating new agreements. There are, however, more challenges.

Tariff barriers are not perceived as important constraints on increasing exports in the region. In 2016 the IMF (2017) conducted a survey of Latin American and Caribbean country authorities on trade policy objectives and strategies and found that non-tariff measures – especially sanitary and phytosanitary standards and technical barriers to trade – were deemed more relevant than tariff barriers with regard to increasing exports in the region; infrastructural deficiencies (see below) and a lack of human capital were also mentioned.

The so-called Balkanisation of regional integration agreements and the multiplication of rules hinder states from reaping the full potential of existing trade agreements. Moreover, the two largest Latin American economies – Brazil and Mexico – are not linked by a preferential trade agreement, nor are Argentina and Mexico. The World Bank (2017) advocates a deepening of economic integration between South America and Central and North America. To some degree, the PA is bridging this
gap by including Mexico and three South American countries. Moreover, two Central American countries (Costa Rica and Panama) are candidates for full membership. At the same time, Mercosur and the PA are striving for a closer cooperation: three Mercosur countries are observer states in the PA, and the PA’s three South American members are associated members of Mercosur. Meanwhile, the Mexican government’s problems with the new US trade policy and the Brazilian economic crisis may be conducive to a closer economic cooperation between Mexico and Brazil.

Regionalisation through Regional Value Chains

The IMF (2017) argues that Latin American countries are undertrading relative to their economic fundamentals. Latin America accounts for 8.2 per cent of global economic activity but only for about 5.1 per cent of global exports of goods and services. Most Latin American economies are characterised by low trade openness (exports and imports as a percentage of GDP). As a result, Latin America’s contribution to global value chains is very limited. The idea behind the open regionalism projects of the 1990s was to create economies of scale and improve the competitiveness of Latin American countries in the world economy. However, with the exception of Mexico (as part of NAFTA), the level of participation of the different Latin American nations through integration schemes in global value chains and global markets for manufactured goods did not really increase. Moreover, only North–South preferential trade agreements (such as the Dominican Republic–Central America Free Trade Agreement [CAFTA-DR] with the US and NAFTA) had a positive effect on extra-bloc exports.

A major obstacle to increased intra-regional trade is the multiple rules of origin regimes that have been adopted in existing preferential trade agreements. Rules of origin are the criteria which determine the nationality of a product (including the admissible percentage of inputs or materials from third countries) for purposes of international trade. The rules of origin determine what products can benefit from bilateral or multilateral tariff preferences. Therefore, international financial organisations propose harmonising the trade rules (especially the rules of origin) between existing subregional trading blocs. Removing these barriers would generate prospects for increased intra-industry trade and the formation of regional value chains. The IDB (2017) argues that extending rules of origin (or the cumulation of origin) between existing trade agreements could potentially double the impact of regional preferential trade agreements on the export of intermediate goods, which could subsequently be used as inputs in the exports of other Latin American countries. It estimates that combining trade agreements and harmonising rules could boost these exports by 9 per cent on average.

Infrastructure: The Hardware of Regional Integration

Transport costs in the region are generally higher than in other regions and developing countries. Latin America lags behind other regions in terms of adequate roads and railways as well as in port and airport efficiency. The IMF (2017) highlights weak connectivity between countries due to geographic factors and low investment in infrastructure as obstacles to increasing trade. Although there are significant topographi-
cal barriers in Latin America, these only partially explain transportation costs in the region. To adequately improve the region’s infrastructure investment of around 5 per cent of regional GDP is necessary; since 1990, however, investment in infrastructure has ranged between 2 per cent and 3 per cent of regional GDP (IDB 2014).

Modernising and expanding infrastructure is both a prerequisite and a tool for major economic regionalisation in Latin America. At the first South American presidential summit (2000), Brazil’s President Fernando H. Cardoso – with the support of Argentina’s President Fernando de la Rua – launched the Initiative for the Integration of Regional Infrastructure in South America (Iniciativa para la Infraestructura Regional Suramericana, IIRSA), which is designed to plan and finance these kinds of projects. Later, the IDB, the Corporación Andina de Fomento (CAF), and the Fondo Financiero para el Desarrollo de la Cuenca del Plata (FONPLATA) joined the initiative by providing credits, while national development banks – especially the Brazilian Development Bank (BNDES) – co-financed such projects.

To a certain degree, the IIRSA was a regionalisation strategy which preceded the foundation of South America’s first regional organisation, UNASUR (formerly the South American Community of Nations). The IIRSA became part of UNASUR and was transformed into the South American Council of Planning (Consejo Suramericano de Planificación, COSIPLAN). In 2016 COSIPLAN’s portfolio included 593 transportation, energy, and communication projects in South America – 22 per cent of which have been concluded and 31 per cent of which are being implemented at a cost of USD 105.336 billion (Beliz and Chelala 2016: 51).

Public Support for Integration and Regionalisation

According to a 2016 INTAL/Latinobarómetro survey (Beliz and Chelala 2016) [2] a high proportion of Latin Americans support political integration (60 per cent) and even more support economic integration (77 per cent). The highest levels of support (> 80 per cent) are found in Paraguay, Uruguay, Venezuela, and Argentina; the lowest support (< 70 per cent), in Guatemala, Brazil, and Mexico. Surprisingly, even in times of growing protectionism and nationalism, a high percentage (69 per cent) of Latin Americans are in favour of free trade with other countries in the region.

Although Latin Americans broadly support regional integration, the concept does not mean the same thing to all people. The 2016 INTAL/Latinobarómetro survey found that regional integration meant free trade to 56 per cent of Latin Americans, political dialogue to 41 per cent, the free movement of people to 34 per cent, the promotion of national and foreign investment to 32 per cent, scientific and academic exchange to 30 per cent, and Latin American political unity vis-à-vis world powers to 21 per cent.

A Lean Institutional Structure

For several decades, the European Union (and its predecessor the European Economic Community) was a role model of regional integration and institution building for Latin America – a region that had been criticised for its lack of supranational institutions. Thus regional organisations like Mercosur and the Andean Commu-
nity, which were created or restructured in the 1990s, still bear a resemblance to the European model.

For example, Mercosur, the Andean Community, and the Central American Integration System all have a parliament which was, at some point, an important element of regional integration projects. The PA, the most recently created regional organisation, instead adopted a watered-down inter-parliamentarian monitoring commission (Comisión Interparlamentaria de Seguimiento de la Alianza del Pacífico), which has quite a fluid composition; nor does it have a dispute settlement mechanism or a court. Moreover, Mercosur and the Andean Community – unlike the PA, CELAC (Comunidad de Estados Latinoamericanos y Caribeños), and ALBA – both have technical secretariats (Closa and Casini 2016), which although not very strong, are still stronger than that of UNASUR.

Even though the lean institutional structure has been perceived as weakness in the past, international financial organisations like the IDB now promote it as the best option for the region. The IDB (2017: 64) is quite forthright on this point: “If anything can be learned from more than a half-century of integration, it is that complex architecture like a customs union with supranational institutions should be avoided. Instead, the objective should be a ‘plain vanilla’ free trade zone, with a focus on goods and services. ... Likewise, the institutional architecture should be inter-governmental rather than supranational in nature, with a commission made up of ministers or senior-level officials overseeing the implementation and operation of the agreement and guiding its future evolution.” From this perspective, the PA might become the new role model for Latin American economic integration.

Cross-Regionalism: The Pacific Alliance

The PA is Latin America’s youngest regional organisation, having been created with the signing of a constitutive treaty by the presidents of Chile, Colombia, Peru, and Mexico in June 2012. As outlined in its various declarations, the primary goal of the PA is to build a zone of deep economic integration and ensure progress towards the free movement of goods, services, capital, and people. A supplementary agreement eliminating tariffs for 92 per cent of mutual trade came into force in May 2016. The remaining 8 per cent of tariffs will be gradually removed (as of mid-2017 around 95 per cent of intra-regional trade had been liberalised). The PA is open to integrating more members; however, full memberships will only be granted to countries that already have an FTA in place with each PA member state – which was the case with regard to the four founding members. This is in contrast to other regional organisations, which were founded with the objective of creating a free trade area (or a customs union). Nevertheless, despite having some innovative elements, the PA also exhibits weaknesses similar to those of other Latin American regional economic integration projects. For example, the percentage of intra-regional trade (exports) amongst countries in the PA has not increased; in fact, it decreased from 3.5 per cent in 2013 to 3.2 per cent in 2015 (Durán and Cracau 2016). But this very low figure is greatly influenced by Mexico, whose main trade partner is the Unites States and which generally has weak trade links with the rest of Latin America. In the cases of Chile, Colombia, and Peru the percentage of exports to the other PA countries ranged from 6 per cent to 8 per cent in 2015 and had increased since 2013.
The PA’s declared objective of the free movement of services and capital might prove more important than growth in the intra-regional trade in goods. Furthermore, the PA may reinforce member countries’ positions in third markets if not necessarily in Latin America. The PA complies with the World Bank’s (2017) recommendation to deepen economic integration between South America and Central and North America. It has been quite successful in its strategy to integrate both at the regional level and globally. The PA now has 52 observer states (40 per cent are from Europe; 17 per cent, from Asia-Pacific) and, in 2017, created a new category for associated members, which reaches out to the Pacific Rim and includes Australia, Canada, New Zealand, and Singapore.

The PA can become a dynamic factor in Latin American economic integration and development by promoting free trade, advancing trade facilitation measures (regulatory issues, border controls, etc.), harmonising and accumulating rules of origin, easing the mobility of people between labour markets, promoting foreign direct investment, integrating financial markets, and increasing economic links to the Asia-Pacific region through regional FTAs. The IDB (2017: 67) recommends that the region head towards a new all-encompassing, region-wide agreement and claims that “To get there, the Pacific Alliance offers what has been, so far, the most successful road map.”

**Conclusion: An Era of Pragmatic Regionalism**

As the second decade of the twenty-first century draws to a close, one should not expect new regional projects in Latin America. It will be difficult enough to keep alive all the existing ones. It is a moment to take stock, to evaluate the advances in and the obstacles to the processes of regional cooperation and integration, and to identify the basis for realistic improvements in the future. It is a moment for pragmatic regionalism and creating linkages to other regions (cross-regionalism). Currently, a strategy based on pragmatic progress seems more promising than a new wave of regional idealism. Moreover, there is a solid material basis for pragmatic advances. More than 80 per cent of intra-regional trade is already under preferences. Thus, most of the adjustment costs after trade liberalisation have already been paid. From this perspective, the existing network of preferential trade agreements provides a very useful platform for expansion and the implementation of a regional free trade area. This can be done step by step and country by country. Not all countries will (or must) participate. It can be promoted by technocrats and does not necessarily need regional leaders (who can nevertheless be helpful). The regional harmonisation of rules of origin can be framed as a technical problem, which may help to reduce political resistance. And in the future, increased economic regionalisation might spur new regionalist projects.

This is a propitious moment for Europe both to support regional integration in Latin America and to promote more trade between the two regions. In the past couple of years many pro-trade governments have come to power in Latin America. Furthermore, the European Union has already signed free trade agreements with all PA member states and all Central American countries; next year, it might also sign an agreement with Mercosur. Finally, enhanced trade relations with Europe might also enable Latin America to counterbalance its growing trade dependency on China and Asia.
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Related GIGA Research

On the one hand, the increasingly polycentric global order is associated with increased opportunities for interaction and more flexibility in terms of partner choice at the regional and international levels. On the other hand, the multiplication and overlapping of institutions engendered by this new order have caused fragmentation and disorder, which could hinder the production of (global) public goods. Against this backdrop, GIGA Research Programme 4’s Research Team 1 (“Power and Global Order”) is seeking to establish what role world regions, as an arena of governance, play in the reconstruction of the global order and how such regions are socially constructed.

Related GIGA Publications

Lenz, Tobias (forthcoming), Frame Diffusion and Institutional Choice in Regional Economic Cooperation, in: International Theory.
Nolte, Detlef, and Nicolás Matías Comini (2016), UNASUR: Regional Pluralism as a Strategic Outcome, in: Contexto Internacional, 38, 2, 545–565.