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The Emergence of the Pacific Alliance and Implications for Korea

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The Rise of the Pacific Alliance

In June 2012, four Latin American countries on the Pacific coast (Chile, Colombia, Mexico, and Peru) declared the establishment of a new economic integration initiative within the region, and consequently launched the Pacific Alliance. Since then, it has been making rapid progress and is expected to open up new horizons in regional economic integration. Under recent circumstances in which existing regional communities, such as MERCOSUR (Southern Cone Common Market) and ALBA (Bolivarian Alliance for the Peoples of Our America), are faltering, the Pacific Alliance draws increasing attention from the world as it advocates open regionalism.

Of the member countries of the Pacific Alliance, all four have already signed FTAs. The intention of these countries, however, is to deepen existing economic integration through the Pacific Alliance. Narrowing geographical distance by working on the joint project of transportation infrastructure and eliminating cross-border visa requirements to encourage freer movement of human resources are key pillars of their plan.

Their ultimate goal, however, paints a much bigger picture. These countries seek more opportunities in the outer regions, especially in the Asia Pacific, where the four countries share significant economic interests. Given the larger size of the market, they will gain stronger bargaining power toward emerging markets in the Asia Paciffic. Although a higher level of internal integration would require more time to be accomplished, at present, the four countries are simultaneously putting efforts into working on common external affairs.

Table 1. Comparison of macroeconomic indicators in 2013

	Pacific Alliance					Brazil
	Mexico	Colombia	Peru	Chile	4 Countries	
GDP (USD billion)	1,261	378.1	206.5	277.0	2,122.60	2,245.4
GDP Growth (%)	1.3	4.3	5.0	4.1	5.0	2.5
Inward Direct Investment (USD billion)	35.2	16.77	9.1	20.3	81.37	64.0
Export (USD billion)	380.9	58.0	42.1	76.7	557.7	242.2
Import (USD billion)	381.6	55.0	42.2	74.6	553.4	239.6
Dependence on Foreign trade (%)	60.4	29.8	40.8	54.6	52.3	21.4
Unemployment rate (%)	4.9	9.7	6.5	6.0	6.7	5.4
Inflation rate(average, %)	3.8	2.0	2.8	1.9	2.6	6.2

Source: EIU Viewswire; CEPAL(2013a), p. 21, p. 25, p. 26; CEPAL(2013b), p. 19.

Economic Overview of the Pacific Alliance

The size of the Pacific Alliance accounts for about 35% of the Latin American economy, similar to that of Brazil, the 7th largest economy in the world. The total population of the Pacific Alliance is about 290 million and the GDP per capita is approximately USD 10,000. Above all, these four countries have shown robust economic growth rates higher than the Latin American average since 2005. Also, their inflation rates have been relatively low and stable. In fact, these four countries have served as the engine of the recent economic growth in Latin America.

The member countries of the Pacific Alliance are considerably dependent on foreign trade and are very proactive on foreign trade policy. Chile has 22 FTAs (60 participants), Peru has 15 (50 participants), Colombia has 12 (30 participants), and Mexico has 12 (44 participants). The trade volume of these four countries amounts to about USD 1.1 trillion, which is almost 50% of the total trade volume of Latin America.

They also keep a positive stance toward receiving foreign investments. According to Doing Business 2014 published by the World Bank, each of these countries are ranked among 1st to 5th within the Latin American region, which means regulations are simpler and it costs less for foreign firms to do business. In 2013, the inflow of FDI to the Pacific Alliance was USD 81 billion in sum, higher than that of Brazil (USD 64 billion). Their high level of openness is in contrast with Brazil, which focuses more on the domestic economy.

Even though the four countries of the Pacific Alliance are linked through FTAs, the volume of intraregional trade is considerably low. Out of total exports, intraregional exports account for only about 3.7%, based on a 3-year data analysis from 2011 to 2013. The reason for this would be the similarity of their industrial structures and Mexico's high dependence on the U.S. economy.

Table 2. Intraregional trade of the Pacific Alliance in 2011-13 (average)

(Unit: millions (USD))

		Importer				Pacific Alliance	World
		Chile	Colombia	Mexico	Peru		
Exporter	Chile	-	893	1,493	1,904	4,290	78,696
	Colombia	1,983	-	800	1,415	4,199	58,666
	Mexico	2,136	5,320	-	1,528	8,984	366,756
	Peru	1,858	919	464	-	3,241	43,897
Pacific Alliance		5,978	7,132	2,757	4,848	20,714	548,015

Source: IMF eLibrary Data.

Investment relationships among the member countries seem to be insignificant in terms of total value, but the ratios tell another story. Mexico, the biggest investor in the Pacific Alliance, has focused its investments in Colombia and Chile. Colombia has invested more in Andean countries, while Peru is the most favored investment destination for Chile. The sectors in which Chile is investing include finance, retail, and minerals. Also, for Peru, Chile is the most important investment destination. Peru invests 42% of its ODI in the Pacific Alliance members and out of this, 82% goes to Chile.

Prospects of the Pacific Alliance

According to a quantitative analysis on the prospect of the Pacific Alliance based on the macroeconomic indicators of the member countries, the Pacific Alliance shows a positive but somewhat limited prospect. When it comes to various qualitative aspects, however, the future of the Pacific Alliance is quite bright.

From an institutional aspect, the Pacific Alliance avoids institutionalization and bureaucratization. Given that existing regional communities in Latin America focused on institutionalization and failed to produce practical outcomes, the minimal level of institutionalism within the Pacific Alliance is expected to seek pragmatic development as a new model of regional integration. The Pacific Alliance has a high level of sociocultural homogeneity, which means that each country is a natural market to the others.[1] Although the member countries are somewhat spread out, this potential geographical disadvantage has not been an issue, and rather encouraged the member countries to work on transport infrastructure projects to narrow down their distance.

In terms of economic aspects, the member countries of the Pacific Alliance maintain a relatively good business environment and boast high economic freedom among Latin American countries, and this well supports the characteristics of its open regionalism, which pursues Asia-Pacific markets. Nonetheless, the very high percentage of agricultural products in exports may be a potential issue when the Pacific Alliance tries to abolish tariffs completely.

In political terms, the Pacific Alliance member countries have rightist or center-leftist liberal dispositions and a high level of democracy. There is little concern for security within or outside of the Pacific Alliance, and the external hegemon, the United States, is quite in

[1] A natural market refers to countries with geographical proximity, the same language, a common historical and cultural heritage.

favor of this trade bloc. Also, the political will of each member government is very strong, which implies even brighter prospects for the Pacific Alliance.

This study also examined common trends among the four countries' GDP, investment, and trade flow by using the Johansen cointegration test to examine whether the Pacific Alliance has strong economic incentives to be integrated. If the four countries react similarly to external economic shock, this could be considered as the grounds that they satisfy the necessary conditions for successful economic integration (Christodoulakis, Dimelis and Kollintzas, 1995; Fiorito and Kollintzas, 1994). High degrees of synchronization in macroeconomic variables are deemed an important factor for successful economic integration because a unified economic policy could possibly function better due to this common trend (Sato and Zhang 2006).

Participating in economic integration often restricts the formulation of independent economic policies, rather requiring their alignment and harmonization. If the countries have more to gain from economic integration, they have strong incentive to cooperate within the alliance. One important fact is that this common trend test is rather a necessary condition for successful economic integration. Even though countries have strong economic incentives to integrate, political will could also work considerably well in decision-making procedures.

First, using unit root test, stationarity was tested for the three variables. It was found that the three variables in the log level are non-stationary, whereas those in the log first difference of GDP are stationary. The results of the common trends of the four countries′ GDP, trade, and investment using Johansen test are reported in Table 3. Likelihood ratios based on λ_{max} and λ_{trace} test statistics indicated that there is at least one co-integrating vector for trade and investment, respectively. Such results point to co-movements in trade and investment among the four Pacific Alliance members. In terms of GDP, only λ_{max} statistics showed that at least one co-integrating vector exists. Hence, these three macro-economic variables have at least one common trend, and that the four countries crossed the threshold supports the idea, albeit not quite strong, of pursuing economic integration among the four countries.

Table3. Johansen Cointegration test

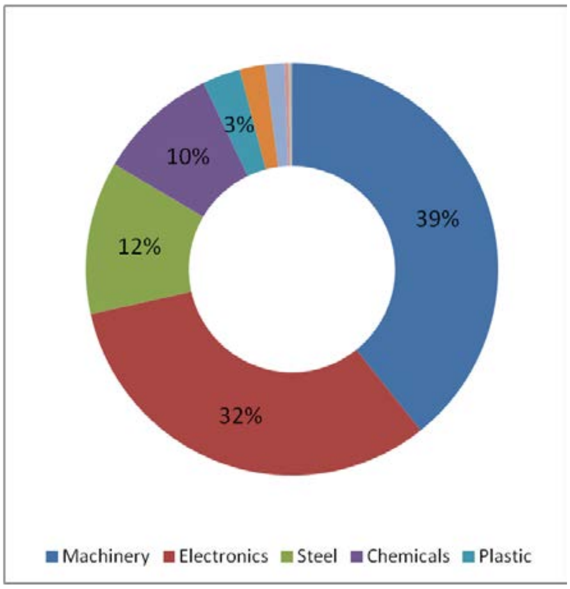
Variables	H_0	λ_{trace}	λ_{max}
RGDP	r≤0	46.723	28.101*
	r≤1	18.621	10.540
	r≤2	8.080	6.382
	r≤3	1.698	1.698
Trade	r≤0	69.539*	39.019*
	r≤1	30.520	21.028
	r≤2	9.491	5.956
	r≤3	3.535	3.535
Investment	r≤0	55.986*	28.904*
	r≤1	27.081	13.462
	r≤2	13.619	9.404
	r≤3	4.214	4.214

Note: * denotes significance at 5%.

Korea–Pacific Alliance Economic Relations

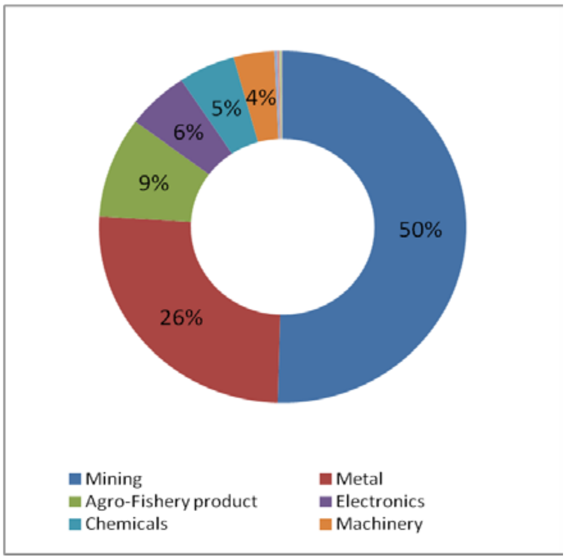
Korea and the Pacific Alliance members have maintained close economic relationships, mainly through trade. Korea’s trade with the Pacific Alliance accounts for more than 40% of its trade with the entire Latin American region. Currently, the three aforementioned countries, excluding Mexico, have FTAs with Korea. Most of Korea's exports to the Pacific Alliance consist of machinery, electronics, steel, chemicals, and plastics. On the contrary, Korea mainly imports minerals from the Pacific Alliance, which account for almost 50% of total imports, followed by steel, agro-fishery products, and electronics.

Figure 1. Korea's exports to the Pacific Alliance



Source: Kita.net.

Figure 2. Korea's imports from the Pacific Alliance



Source: Kita.net.

In terms of investment relationships, Korea has unilateral partnerships with the Pacific Alliance member countries. In 2013, Korea's investment to the Pacific Alliance reached about USD 1.1 billion, and has been increasing constantly since 2009. This accounts for almost 20% of Korea's total investment in Latin America. Mining, manufacturing, and construction are the sectors in which Korean companies express the most interest. In contrast, investment from the four countries into Korea reached only USD 4.6 million between 2009 and 2014 Q1 displaying a fluctuation according to the Ministry of Trade, Industry & Energy of Korea.

Implications for Korea

It may be too early to discuss any concrete cooperation with the Pacific Alliance, given that it currently focuses on deepening internal consolidation. Nonetheless, it is necessary to build the foundation for future cooperation as the Pacific Alliance is beginning serious discussions about cooperation with the Asia-Pacific in the near future. Thus, Korea will have to draw up a medium and long-term view, rather than one in the short term.

To begin with, Korea will have to reduce the gap between the interests of Korea and the Pacific Alliance, and will have to pursue investment initiatives in the Pacific Alliance member countries in areas that encourage FDI, for instance mining, transportation infrastructure, and renewable energy. Through gradual and steady efforts to improve its relationship with the Pacific Alliance, Korea will be able to gain a more favorable position in future activities that require cooperation.

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