

Future Perspectives of Pacific Alliance – South Korea Partnership

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Introduction

The Pacific Alliance, for short PA, has been considered the most attractive group of countries in Latin America for international investors and countries of other regions. Formed by four of the fastest growing countries in the region: Mexico, Colombia, Peru, and Chile. It is the most outward oriented economic integration group in Latin America. Because of economic attractiveness of PA, South Korea and others want to become associate states of PA. But all of that could change with the emergence of leftist governments in those countries, like the one that happened in Peru recently. This article will look at the probability of that also happening in Chile and Colombia, that face general elections at the end of this and next year and the implications for South Korea in its aim to become a partner of the PA.

Significance of Pacific Alliance in World Economy

The Pacific Alliance is considered the most attractive group of countries in Latin America for international investors and countries of other regions. Its four members concentrates 38% of the GDP, 50% of the total trade, and attracts 45% of all foreign direct investment to the region¹. The main reason why PA is attractive to other countries is that it is formed by countries with open economies and liberal investment environment for foreign companies. Also, these countries have many Free Trade Agreements (FTA) with the main economies in the world (for example all of them, except Mexico, have FTA with South Korea) and increasing economic relationship with Asian countries. That is why several countries, like, South Korea, want to become an associate state of the Pacific Alliance.

The Pacific Alliance was established in April 2011 with the objectives, among others, to move toward the free mobility of goods, services, resources, and people, and to “become a platform of political articulation, economic and commercial integration and projection to the world, with emphasis in the Asia Pacific region”².

The PA countries have a combined population of 225 million persons and an average per capita GDP of USD 18,000. It has achieved a free trade area among them, with the integration of their securities markets, and free mobility of people within the region. All of these make PA attractive to other countries, Already, 59 countries are observant states in the group, and four of them, Australia, Canada, New Zealand, and Singapore

¹ See Pacific Alliance website: “What is the Pacific Alliance?” <https://alianzapacifico.net/en/what-is-the-pacific-alliance/>

² See Pacific Alliance website: “What is the Pacific Alliance?” <https://alianzapacifico.net/en/what-is-the-pacific-alliance/>

are in negotiations to become associate members. Of those four countries, Singapore already started negotiations in July this year (2021) to achieve the Pacific Alliance-Singapore Free Trade Agreement (PASFTA). They plan to sign the agreement at the end of this year. In doing so, Singapore will become the first Associate State of the Pacific Alliance³.

Ongoing Political Changes in Pacific Alliance member countries will not Stop Partnership with Major Economies, including South Korea

But the election of a leftist government in Peru in June this year, that pledged in the election campaign to renegotiate contracts with foreign companies in the extractive sectors, renegotiate Free Trade Agreements, and increase the presence of state in the economy, has raised some doubts about the future attractiveness of the PA. Not only that, Chile at the end of this year and Colombia next year will face general elections to choose a new President, and the probabilities of leftist parties winning the elections is high. Let's see in detail what can happen in these three countries.

Beginning with Peru, in July 28 Pedro Castillo took office in Peru for a period of five years. Castillo, a schoolteacher with no previous experience in public office, was elected in the ticket of the political party "Peru Libre", a leftist party whose main leaders are Marxist-Leninist. In his election campaign he vowed to change the rules of the game in the economy, by increasing the role of the state, putting limits to the foreign investment participation in the economy, and to change the Constitution to make those things possible. He has expressed admiration for Cuba and Venezuela regimes, and this made private investors wary of him. He even said that he will look for to review the free trade agreements Peru has signed.

But, after one month and a half in office it seems perhaps Castillo, at least regarding foreign investment and FTAs, will not apply his radical policies. It seems President Castillo is becoming aware of the importance of foreign trade and investment for the growth of Peru's economy. The country exports of goods have been the main engine of economic growth in the last 30 years since Peru began in 1990 the opening of its economy to foreign trade and investment. That's why exports of goods increased from 7 billion dollars in 2020 to 47 billion dollars in 2019 and this year it could probably record a historical figure of 55 billion dollars⁴. That is possible because of the high prices of copper (30% of Peru value of exports are of copper) and exports of its booming agribusiness sector (like avocado, grapes, etc.). And foreign investment has been the main reason why the production of these goods increased. Most of the mines are foreign owned and foreign investment is also a main player in the agribusiness sector.

³ See the PA website: "Pacific Alliance and Singapore conclude negotiations for the Free Trade Agreement (PASFTA)" <https://alianzapacifico.net/en/pacific-alliance-and-singapore-conclude-negotiations-for-the-free-trade-agreement-pasfta/>

⁴ Gestion newspaper: <https://gestion.pe/economia/exportaciones-este-ano-superaran-niveles-precovid-y-marcaran-record-historico-nndc-noticia/>

One example of this new attitude of Castillo is also his approach to China. This country is the main trade partner of Peru (in the first 7 months of this year China accounted for 35% of Peru exports, and US, the second main destination, accounted for only 12%⁵) and is also the main investor in the last years in the mining sector. He visited the Chinese Embassy on July 15th, even before he was officially declared the winner in the election. And after the elections several Ministers in his government have meet the Chinese Ambassador and executives of Chinese companies, giving them assurance that Peru will continue doing business with them as usual. Chinese investment represents around a quarter of all accumulated foreign investment in Peru. And Chinese companies produce around 25% of copper, 100% of iron ore, and 30% of petroleum of the country⁶.

In the case of Chile, who was the first country in Latin America which began opening its economy from the 1970s to foreign trade and investment in the region, becoming the most open economy (with the most FTAs signed in the region⁷), massive protests in 2019 seems to have produced a shift of attitude. There are three signals for that. First, Chile Congress has not ratified the Comprehensive and Progressive Trans Pacific Partnership, CPTPP, even if in Chile was the host for the signature ceremony of this agreement in 2016. Second, a new Constitution is in process of being written and seems it will put more emphasis in the State participation in the economy. And third, there is a good chance that at the end of this year a candidate from the left will win the Presidential election. Gabriel Boric, a former student leader, won a primary election of the leftwing coalition (defeating a Communist candidate), and is seen as the frontrunner for the coming election, even if still there is much uncertainty⁸.

But Chile, together with Mexico, are two of the most open economies in Latin America, with many FTAs in force and where foreign trade represent a high share of their economies. As can be seen in Table 1 merchandise trade represented 51.7% of GDP for Chile and 75.4% for Mexico, a level near or higher than in Korea for example. Also, it can be seen in the same Table that for Chile, like for Mexico, Colombia, and as said before for Peru, Foreign direct investment plays an important role in their economies, very much higher than in Korea for example. Then, for these reasons is probably that, even if a leftist government like of Gabriel Boric win an election in Chile, it will be from the moderate left, and probably will not change much Chile orientation to an open economy, even if he increases the presence of the state in the economy.

⁵ Ministry of Foreign Trade and Tourism of Peru: Reporte Mensual de Comercio Exterior, Julio 2021 https://cdn.www.gob.pe/uploads/document/file/2152327/RMC_Julio_2021.pdf

⁶ See America Economia, AsiaLink: Maria Osterloh: "Empresas mineras chinas: contribucion al crecimiento economico del Peru" <https://asialink.americaeconomia.com/columna/empresas-mineras-chinas-contribucion-al-crecimiento-economico-del-peru>

⁷ Chile has 30 FTAs in force, compared with 23 for Mexico, 20 for Peru, and 15 for Colombia. See WTO: Participation in Regional trade Agreements, https://www.wto.org/english/tratop_e/region_e/rta_participation_map_e.htm

⁸ Financial Times: "Chiles's social upheaval leaves presidential race wide open" <https://www.ft.com/content/bcd2b8d3-02dc-4bd9-a2f6-78e090924ce9>

Table 1: Economic indicators of PA countries and Korea

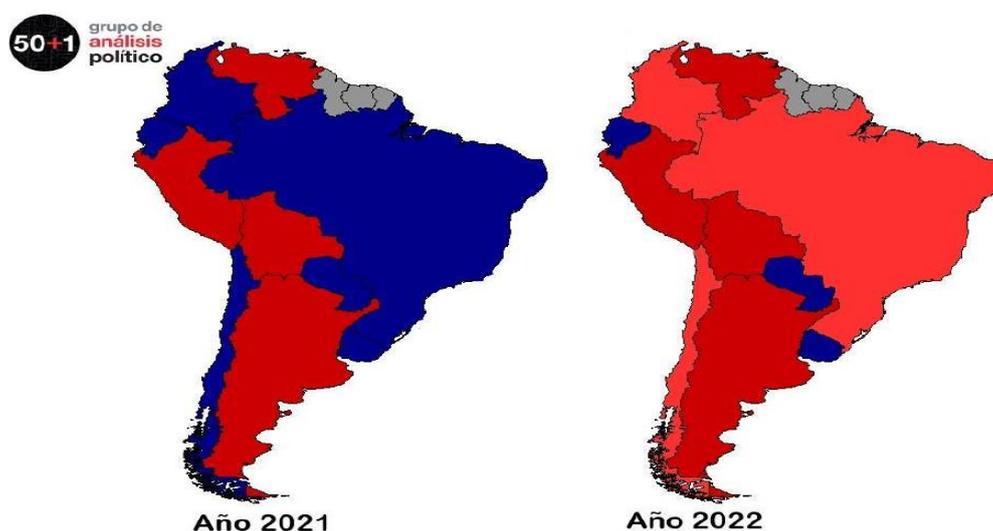
| Country | Exports of goods and services (% of GDP) Year 2020 | Merchandise trade (% of GDP) Year 2020 | Foreign direct investment, net inflows (BoP, current US\$) millions Year 2019 | Foreign direct investment, net inflows (% of GDP) Year 2019 | GDP (current US\$) millions Year 2020 | GDP per capita (current US\$) Year 2020 |
|----------|--|--|---|---|---------------------------------------|---|
| Chile | 31.5 | 51.7 | 12,586 | 4.5 | 252,940 | 13,231 |
| Colombia | 13.7 | 27.5 | 14,313 | 4.4 | 271,346 | 5,332 |
| Mexico | 40.1 | 75.4 | 29,375 | 2.3 | 1,076,163 | 8,346 |
| Peru | 22.3 | 38.9 | 8,891 | 3.9 | 202,014 | 6,126 |
| Korea | 36.9 | 60.1 | 9,634 | 0.6 | 1,630,525 | 31,489 |

Source: The World Bank data, <https://data.worldbank.org/indicator/>

Regarding Colombia, mass protests against the right-wing government in the first months of 2021 also seem to have shift the mood toward the left. A candidate, Gustavo Petro, is seen as standing a good chance to win next May 2022 Presidential election⁹. But he is not from the radical left, so also it seems he will not take a path to move apart the economy from its integration to world markets. Even if in Colombia the share of foreign trade in its economy is not as big as like in Peru, or Chile, or Mexico, it plays an important role, and foreign investment is important in a level comparable to the other PA countries.

So even if by next year there is a chance that many countries in Latin America as seen in Map 1, could have leftist governments (color in red), at least in the Pacific Alliance countries probably the attitude toward foreign trade and investment will not change.

Map 1: More leftist governments in South America in 2022?



Source: Macroconsult: Alianza del Pacifico: Viraje a la izquierda https://sim.macroconsult.pe/wp-content/uploads/2021/07/Reunion-Macroconsult_90721.pdf 9 July 2021

⁹ See Control Risks: “Colombia’s violent protests in 2021 will open door to political transformation” <https://www.controlrisks.com/our-thinking/insights/colombias-violent-protests-in-2021-will-open-door-to-political-transformation>

Future Expectations and Implication

Then, the probability of leftist governments taking control in Chile and Colombia, besides the one already in Peru, and impacting negatively in the attractiveness of the PA for countries like Korea, is not high. Perhaps the example of what is happening in Mexico is a guide. In Mexico there is also a President that is considered by many as leftist, Mr. Manuel Lopez Obrador, who assumed power in 2018. But Mexico policy toward the Pacific Alliance, foreign investment, or the several FTA signed has not changed with him in power.

Besides the reasons seen in Table 1, Mexico for example is also a member of the USMCA, the United State Mexico Canada Agreement, a free trade agreement originally in effect from 1994, but renegotiated in new terms and in effect from 2020. This makes Mexico highly integrated into the economies of its partners in this agreement. For example, more that 65% of foreign trade of Mexico is with Canada and United States (and 80% of Mexico exports go to United States). Besides foreign investment plays a vital role in the development of Mexico economy. So, it is not easy for Mexico government and its business community to change that. Probably the same could happen also in the rest of PA countries, even if leftist governments take power in them.