Americas QUARTERLY
PUBLISHED BY AMERICAS SOCIETY AND COUNCIL OF THE AMERICAS

ARCHIVE

From issue: **Consulta Previa and Investment** (Spring 2014)

AQ FEATURE

Speaking a Common Language with Latin America: Economics

BY Jose W. Fernandez

Improving relations with the U.S. means deepening already-strong economic ties.

United States-Latin American relations have often suffered from a disconnect.

While we stress security issues, the region's leaders speak of poverty reduction and trade. They resent being seen as afterthoughts to U.S. policies focused elsewhere. As a result, the region is sporadically open to new suitors, such as Spanish investors 15 years ago, or the Chinese today.

Despite their frustration with Washington, Latin American leaders recognize that, as the hemisphere's largest economy and market, the U.S. remains the indispensable partner. The challenge, both for the U.S. and Latin America, is to agree on common economic priorities both sides can pursue jointly, rather than continuing parallel dialogues.

Economic growth, poverty reduction and job creation are common elements on both sides' wish lists.

Politically, the stars are more aligned than ever in recent history for a renewed emphasis on economics in our relations with Latin America. The administration of Mexican President Enrique Peña Nieto has made clear that its priority will be economic reform at home and more integrated North American markets and supply chains. From the beginning of his term, the Mexican president called for elevating our economic diplomacy to the same levels as our security relationship, which led to the first High Level Economic Dialogue (HLED) between Mexico and the U.S. in late September.

In Brazil, President Dilma Rousseff understands that she must jump-start the economy if she is to fulfill the aspirations sparked by her predecessor. Colombia wants to break free from its "drugs and thugs" past with the U.S. and move to a relationship anchored in the newly ratified free trade agreement. Down the Andean spine, with a few notable exceptions, many of Colombia's neighbors have also experienced growth in recent years based on orthodox economics.

There is some truth to the view that Latin America has not been at the center of our foreign policy in recent years. But, rather than a sign of indifference, our pivot to Asia and focus on the Middle East shows that Latin America no longer requires crisis management.

The time has come to reap the economic benefits of our easy coexistence.

In doing so, the U.S. can count on a wide variety of soft-power tools to promote a positive economic agenda: our history, geography, commercial ties, and the increased interconnection of our cultures. In addition, we can capitalize on a growing suspicion in the region that bolstering ties with China may be more of a Faustian bargain than a panacea.

To shift our emphasis in Latin America to economics, we need not pursue grandiose initiatives nor chase after feckless foes. This time, more than a half-century after the Alliance for Progress, small steps will suffice.

But those steps will require that, as former Secretary of State Hillary Clinton underscored when unveiling her vision of "economic statecraft," U.S. diplomats become as conversant with balance sheets as political theory.

In the next few years, our relations should seek to build on our economic common interests and strength in the region. Here's how.

Focus on the Economic Success Stories

Mexico and Brazil are the two largest Latin American economies. Together with Colombia, the fourth largest economy in the region, they are our strongest allies in Latin America. If economics is to be at the center of our relationship with the region, we must begin with them.

As a major regional player that is both pro-market and favorably disposed to the U.S., Mexico can serve as a role model. The Peña Nieto administration has stated that it will concentrate on reforming the economy, which makes sense. While Mexico's export-bound industrial base is well-developed—its exports exceed those of all other Latin American countries combined—the rest of its economy is plagued by red tape and investment barriers. In addition, Peña Nieto is advocating for increased economic integration among the NAFTA partners to make each country's businesses more globally competitive.

All of these topics were discussed by U.S. President Barack Obama at the North American Leaders meeting last February, as well as at the September HLED summit led by Vice President Joe Biden.

Now comes the follow-up.

Given the Mexican president's public and private statements, and his success in pushing historic reforms such as oil and gas liberalization, we should engage with Mexico if it continues to demonstrate a willingness to implement pro-market reforms and upgrade its economic relations with the United States. If Peña Nieto follows through, and the Mexican economy remains on the upswing, the country—and its close partnership with the U.S.—will serve as an example for the rest of the region.

Holding Mexico up as a paradigm for economic reform does not mean neglecting the other major regional power, Brazil.

Brazil's rhetoric can sometimes turn prickly and rankle those who believe that the U.S. should assert leadership at all costs. But the reality is that while Planalto Palace will continue to pursue an assertive regional stance, Brazil recognizes
its limitations.

Indeed, Brazil offers a good case for stressing economics over politics. In 2012, our trade with Brazil increased to $76 billion. America's trade surplus with Brazil is second only to Australia among countries that do not act as transit hubs, such as Hong Kong and the United Arab Emirates; and the number of Brazilians visiting the U.S. make it the fastest growing source of tourists to our country.

Given Brazil's influence, market size and some concerns that it may be moving away from pro-market policies, we must continue to engage our Brazilian counterparts on open investment and regulatory cooperation.

The State Department–led U.S.–Brazil Economic Partnership Dialogue enjoys strong interagency support and a track record of productive engagement on bilateral issues.

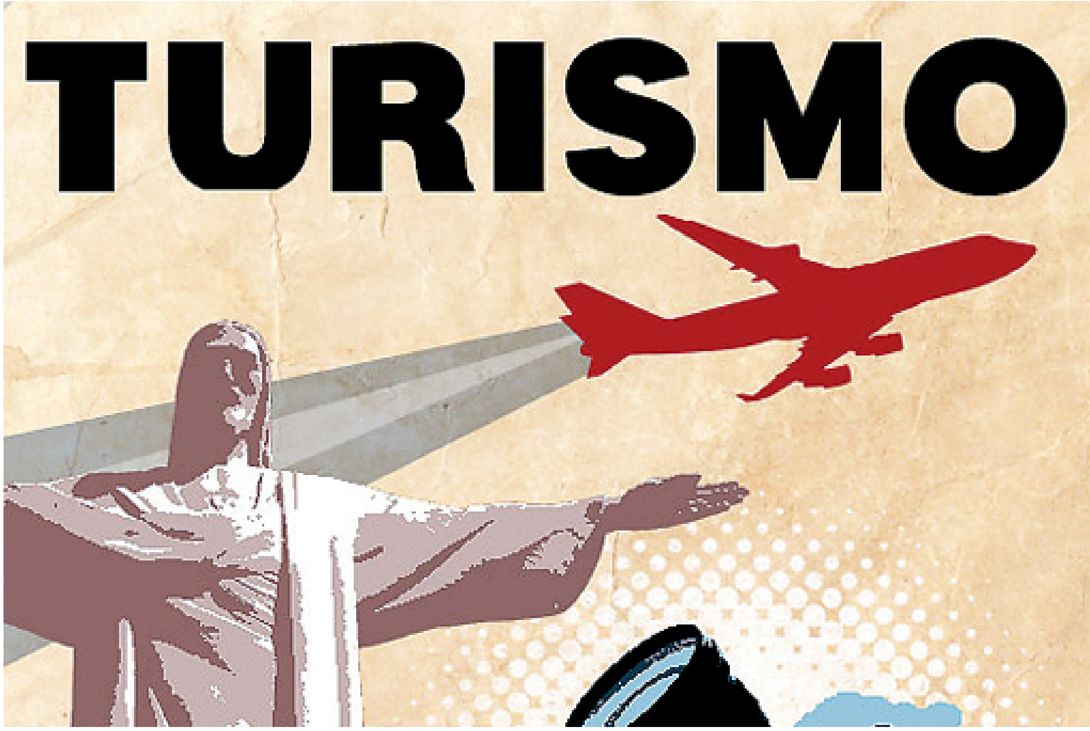

Illustration: Rafael Ricoy

Brazil is also particularly open to cooperation with Washington when it receives equal billing as a co-leader in important areas such as social development, agriculture and fiscal management. For example, Brazil has been a constructive partner in the Domestic Finance for Development (DF4D) program, created by the State Department in 2011 to address looming budgets crises in smaller economies by improving the collection of public revenue, budget transparency and reducing corruption.

Last year, Brazil co-hosted a DF4D workshop that focused on fiscal transparency in El Salvador, Honduras and the Dominican Republic, and it has also agreed to work with Washington to provide technical assistance on tax administration in the region. We have also successfully collaborated with *Empresa Brasileira de Pesquisa Agropecuária* (EMBRAPA) on African agriculture projects that promote biotechnology and better farming techniques consistent with our Feed the Future goals. Washington should continue to include Brazil in trilateral assistance programs and encourage it to take a leadership role in regional development.

Mexico and Brazil, together with Colombia, Peru and Chile, show that good economic policies deliver results. These countries are also our strongest allies in the region, and, with the exception of Brazil, are the founding members of the Alliance of the Pacific, discussed below. We should celebrate their successes, support their focus on social inclusion and small business, and encourage their recent plans to create a policy environment to attract foreign capital, break monopolies and establish transparent regulatory frameworks.

None of these efforts should be heavy lifts for the United States.

Engaging the Middle Class

Between 2000 and 2009, 50 million Latin Americans entered the middle class. Roughly one-third of the population in Latin America is middle class today, no small feat in a continent long scarred by inequality.

For the first time in the region's history, there are as many people in the middle class as there are in moderate poverty. And Latin America's new bourgeois are set to become our natural allies.

Taking advantage of the middle classes' higher purchasing power, we should promote increased tourism from Latin America to the United States. This will not only help our balance of payments, but it will also provide visitors with a first-hand look at our society. We should increase air travel between the U.S. and Latin America via Open Skies Agreements, building on existing civil aviation liberalization agreements with 20 countries in the hemisphere, including Canada, Chile, Peru, Brazil, and Colombia, and explore recent interest from the Peña Nieto administration.

Our tourism destinations should not be limited to Disney World and our national parks. An increased demand for quality education among the new middle class offers the opportunity to promote U.S. universities as a destination for Latin American students, as well as joint programs between U.S. and Latin American schools. Some of the best advocates for America around the world today attended U.S. educational institutions, and Latin America is no exception. As the home of top-flight universities, business schools and Silicon Valley, the U.S. is ideally situated to engage foreign students and policymakers on entrepreneurship and innovation as engines for economic growth and job creation.

Obama's 100,000 Strong program to bring students here from Latin America—with an equal number of Americans going the other way—is a good start, but needs to be scaled up.

To facilitate trade and meet the rising middle classes' appetite for U.S. goods and services, we should also expand the areas of industrial regulatory cooperation. Despite our free trade agreements (FTAs), a hodgepodge of regulatory differences across them inhibits the free flow of U.S. goods and services in the region.

Although there are several ongoing regulatory cooperation dialogues in Latin America, so far the record is mixed. The High-Level Regulatory Cooperation Council between the U.S. and Mexico, led by the U.S. Office of Management and Budget (OMB), has yielded many work plans but only marginally increased our bilateral regulatory coordination.

Cursory engagement with Brazil has offered capacity-building opportunities, but is unlikely to lead to a fully functioning dialogue. But in 2011, we worked with Costa Rica to obtain automatic approval of medical devices certified by the FDA to be sold in Costa Rica, and in the short term, we should build on that experience to bring U.S. medical products into the smaller markets in Latin America.

We should also use the Broader Pacific Dialogue, started last year by the State Department, to discuss the opportunities and challenges presented by the rising Asian economies to encourage regional regulatory and standards work.

Working with the Commerce Department and other U.S. trade and health agencies, Washington also coordinated a regional program last spring to bring several Latin American countries into alignment with U. S. and international health and trade practices on medical devices.

In the long term, however, these patchwork initiatives will not suffice. We will need to harmonize the rules of origin in our Latin America FTAs, which today do not allow for supply chains between, say, Chile and Peru for products to be sold in the United States. If the hemisphere is to become more competitive against Asian manufacturers, regulatory cooperation with our Latin American partners is a must.

Leveraging the Diaspora

Immigrants can act as advocates for U.S. products and investment in their home countries, and are often willing to risk their capital in circumstances that dissuade others. The 53 million-plus Latin American diaspora in the U.S.—a number sure to rise—has not been adequately deployed to support U.S. business.

Hispanics accounted for nearly one-half the U.S. population growth last year. To facilitate investment in small businesses, the State Department has partnered with the U.S. Small Business Administration (SBA) to streamline requests by Latin American governments for technical assistance for their small business support institutions. But this program—right now just a fledgling initiative—should be expanded to enable more Hispanics in the U.S. to act as the vanguard for U.S. business.

Latino immigrants in the U.S. do more than act as bridges to their countries of origin, however. Last year, they sent over $50 billion in remittances back home. Remittances remain one of the largest sources of foreign exchange in the region, in many countries exceeding foreign direct investment (FDI) and development assistance (ODA) combined. In Mexico, Central America and the Caribbean, remittances often account for over 10 percent of GDP.

As the World Bank, the United Nations Conference on Trade and Development (UNCTAD), the Inter-American Development Bank (IDB), and countless development experts have recognized, in an era of fiscal austerity we cannot afford to ignore the potential of remittances.

In 2010, the State Department launched the Building Remittance Investment for Development, Growth and Entrepreneurship (BRIDGE) Initiative. BRIDGE aims to coordinate the capacities of several U.S. government and multilateral partners to use remittance flows for critical infrastructure and development projects.

Partnering with public and private entities that have already successfully implemented several of these projects in emerging markets, the State Department has sought to use BRIDGE to add to the credit enhancement and risk reduction mechanisms available from the U.S. government, thus encouraging banks to direct remittance flows for longer-term, multi-year development projects in infrastructure.

The U.S. should aggressively aim to expand BRIDGE to other Latin American countries with large immigrant populations in the United States. The cost to the U.S. government would be minimal, the returns to the private sector enticing, and the ramifications large in a region of the world that is still starved for long-term capital.

Creating Infrastructure and Increasing Regional Connectivity

Almost every Latin American country has targeted infrastructure as essential for increased economic growth. Brazil and Colombia lead the pack, but Peru and Mexico have also unveiled several billion dollars of water, port, electricity, and road projects.

According to many observers, the rise of the middle class will place more demands on Brazilian infrastructure than the upcoming World Cup and Olympics. Helping Latin American countries with their infrastructure development goals will not only meet the needs of Latin America's new middle class; it will also help create high-paying U.S. jobs. So far, however, U.S. companies have not been up to the task, leaving the field open for their European, Brazilian and Chinese competitors.

Under its Growth Acceleration Program, Brazil will spend approximately $470 billion dollars to develop its energy generation and distribution system, roads, railroads, ports, and airports, as well as stadiums for this year's World Cup and the 2016 Olympics. As Brazil prepares to host these games, we need to leverage our new Aviation Partnership Memorandum of Understanding, signed by former Secretary Clinton and former Foreign Minister Antônio Patriota in 2012, to open opportunities for U.S. firms in the areas of air traffic management, airport infrastructure, equipment and software, and air services technology.

Peña Nieto's inaugural address already announced three new rail projects—one of which, the Transpeninsular Yucatán-Quintana Roo line, is estimated to cost $850 million. This was in line with his campaign promise to increase investment in infrastructure through public-private partnerships. He has also made clear that facilitating cross-border trade will be a central focus in his economic agenda.

The HLED in September of last year built on this promise and focused on improving the infrastructure and border crossings along Mexico's northern border. In the near future, Mexico will need to carry out a comprehensive review of existing roads, bridges and interior infrastructure to reduce traffic bottlenecks and increase the efficiency of border crossings. By virtue of our proximity and historical ties, U.S. companies should have an inside track on many of the projects, since it is unlikely that the Mexican government will be able to fund the projects on its own, and will rely instead on public-private partnerships.

For its part, the government of Colombia has advanced plans to invest roughly $26 billion (about 3.7 percent of GDP) in infrastructure projects over four years. Our new FTA offers a tool for U.S. companies to take advantage of opportunities in Colombia.

And yet, during a 2012 visit to Bogotá, an official in an infrastructure chamber of commerce told me that I was the first U.S. visitor, private or public, who had come to his office in months, while European, Brazilian and Chinese representatives visited him regularly.

We need to help Latin America achieve its infrastructure development objectives, not only because it will increase regional integration and promote opportunities for the U.S. private sector, but also because the involvement of our companies in infrastructure will further our strategic interests. The State Department recently established a region-wide service to publish multilateral development bank projects for our embassies and the U.S. private sector. This should be encouraged, along with engagement on issues that prevent U.S. companies from entering many promising Latin American markets.

Washington is also using other State Department tools, such as the International Visitors Leadership Program and regular calls between U.S. companies and our ambassadors abroad called "Direct Line," to bolster our efforts in Brazil and Colombia. But more will be needed to help U.S. companies benefit from the infrastructure boom.

Improving Fiscal Transparency

Several Caribbean and Central American countries, including the Dominican Republic, Belize and Jamaica, currently face unsustainably high debt levels. Poor tax administration hampers efforts to finance public investment, improvements in security and disaster assistance.

If Petrocaribe dollars dry up under the Nicolás Maduro administration—Caracas has funded over $20 billion to its Petrocaribe partner countries since 2006—today's budget problems will worsen. On the other hand, Brazil's ability to increase its tax intake to 34 percent of GDP enabled former President Luiz Inácio Lula da Silva's administration to lift millions out of poverty.

A key component of this could be the DF4D program mentioned earlier. The premise of the project is that the elites and the new middle classes will not pay taxes, and informality will persist, unless taxpayers are convinced that their funds will not be siphoned off to offshore bank accounts and will instead be used for agreed public purposes. The program currently includes El Salvador and Honduras—whose officials have been extremely receptive—but could be expanded elsewhere in Central America and the Caribbean. As noted earlier, Brazil has been willing to support DF4D in the past and wants to continue its cooperation.

Engaging in a Common Agenda

Recent trade initiatives such as the Trans-Pacific Partnership (TPP) and the Alliance of the Pacific offer unique opportunities to collaborate with like-minded Latin American nations. The addition of Canada and Mexico to the ongoing TPP negotiations rebalanced the geographic and economic scope of the partnership from a predominantly Asian agreement to a broader Pacific compact.

Today, five Western Hemisphere nations (Chile, Peru, Mexico, the U.S., and Canada) are negotiating with seven Asian countries (Australia, Brunei, Japan, Malaysia, New Zealand, Singapore, and Vietnam). The U.S. should work closely with Mexican negotiators to find areas of common interest that will help drive the TPp negotiations toward conclusion. Washington has already engaged with Chilean negotiators to seek alignment, and coordination with Peru has been very productive.

We should also consider Mexico's proposal that any new free trade compact with Europe—currently under discussion between the U.S. and the E.U.—also include our two NAFTA partners. This suggestion would have been unthinkable from a PRI president 12 years ago, and reflects Peña Nieto's conviction that the economic future of the NAFTA partners rests on integrating their supply chains. By working with our Latin American allies on common projects, we will also promote their leadership profile in the region.

The Organisation for Economic Cooperation and Development (OECD) also provides an opportunity to advance pro-market policies throughout Latin America. President Juan Manuel Santos has used Colombia's application for OECD membership to press market-friendly reforms, most recently by signing on to the OECD Investment Codes of Liberalization this past November. The OECD Competition Committee has recommended a number of agreements and standards that Costa Rica could adopt to strengthen domestic economic reform. Peru, which requested membership in November 2012, may also engage with the OECD on economic reforms to further its candidacy.

The OECD has identified Brazil as one of five key partners that would extend global reach and relevance of the organization, although Brazil has been reluctant in this role.The U.S. chose to promote only Colombian accession to the OECD last year, but we should make sure that Costa Rica and Peru are not far behind.

By encouraging the OECD to invite the threecountries to join, as well as other Latin American economies that adhere to free trade principles, we will help cement their recent conversions to market orthodoxy, promote closer trade relations with the U.S., and be seen as standing up for our friends.

At the first Summit of the Americas, the Clinton administration proposed a Free Trade Agreement of the Americas (FTAA). It went nowhere, buried by Brazilian reticence and endless debates over the benefits of free trade. However, the Alliance of the Pacific, a recent Latin-led, bottom-up trade compact, could eventually bring back the dream of an FTAA.

Leaders from Chile, Colombia, Mexico, and Peru (all of whom already have free trade agreements with each other) signed an agreement in 2012 to create the Alliance of the Pacific to deepen economic integration. Among the document's provisions are timetables for reducing customs duties, a common set of rules of origin for goods, and the formation of a joint stock exchange. Costa Rica, Panama, Canada, Australia, New Zealand, Uruguay, Spain, and, most recently, the U.S. are observers along with 22 other countries. The first two have expressed their intent to join as full members.

Without politicizing the Alliance—which has thrived so far by focusing on technical issues and avoiding the ideological fault lines that foiled the FTAA—the U.S. should continue to support the emergence of the Alliance of the Pacific. If it is successful in achieving economic integration and expands its membership, the Alliance could serve as a path for economic modernization across Latin America, and eventually enable these countries to join the Trans-Pacific Partnership and fulfill APEC's vision for a Free Trade Area of the Asia Pacific.

As an immediate benefit, the Alliance of the Pacific represents an opportunity to engage with friends excluded from the OECD, APEC and the TPP.

Focus on the positive

Partnering with our ideological brethren in Latin America to promote an agenda based on free trade, poverty reduction, expansion of the middle class, and the incorporation of the Latin diaspora into our economic toolbox will require a change in our approach to the region that should not prove difficult. It will mean spending less time on irritants that we cannot do much about or that will solve themselves over time. It will also mean directing the dialogue toward a common agenda that propels our allies' leadership and makes good on our offers of partnership.

Doing this will not compel the U.S. to backpedal from its vaunted pivot to Asia; after all, there are no crises in our hemisphere. But it will challenge us to focus the economic dialogue with Latin America away from the distractions caused by the crises outside the hemisphere, and the relatively minor squabbles within it.

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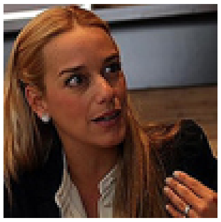

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