THE ANDEAN COMMUNITY: A CASE STUDY ON ECONOMIC INTEGRATION
AMONG DEVELOPING COUNTRIES

by

Robben Dashiell Hixson

A Senior Honors Thesis Submitted to the Faculty of
The University of Utah
In Partial Fulfillment of the Requirements for the
Honors Degree of Bachelor of Art

In
International Studies

APPROVED:

______________________________  ________________________________
Howard Lehman, Ph.D.  Johanna Watzinger-Tharpe, Ph.D.
Supervisor  Chair, International Studies

______________________________  ________________________________
Johanna Watzinger-Tharpe, Ph.D.  Martha S. Bradley, Ph.D.
Department Honors Advisor  Dean, Honors
College

May 2011
ABSTRACT

Countries across the globe have formed regional integration schemes for many reasons. Liberalization of trade, greater negotiating power in the world arena, and the acceleration of industrialization are only a few of the many objectives of integration processes. Using the literature in a number of disciplines, this paper first looks at why economic, political and social integration is an attractive goal for the Andean countries: Colombia, Venezuela, Chile, Ecuador, Peru, and Bolivia. This paper analyzes the formation of the Andean Pact and uses it as a basis to determine if economic regional integration is beneficial to developing countries. The closed-economic policies of the individual member countries in the Pact as well as the Pact from 1969 to 1989 resulted in economic stagnation. After 1989, the member states reorganized the Pact into the Andean Community (ANCOM) and abandoned many of their closed-economic policies. This paper looks at the new goals of ANCOM as well as the extent to which they are being realized. Finally, a hypothesis on possible courses of action is brought up. By using the Andean Community as evidence, this paper concludes that developing countries have much to benefit through the use of regional integration.
INTRODUCTION

Supranational organizations have been growing in importance in both international economics and politics over the last half century. Among these organizations are economic integration schemes which have emerged in notable quantities. Integration schemes are agreements among certain countries to work together towards mutually improving their economies. These agreements are usually aimed at liberalizing trade and harmonizing economic policies. Although the most well-known and arguably most successful integration scheme is the European Union, there have been a number of schemes in the world. The most notable unions have been agreements between industrially developed countries, but there have been a number of integration attempts among developing countries that are worth discussing.

Integration schemes between developing countries often have many differences in comparison with those of developed countries. Generally, the main objective of developed countries is reducing inefficiencies in existing domestic industrial structures by allowing an increase in international market competition. This opens up new markets for producers while helping the consumer obtain products more cheaply. Developing countries, on the other hand, usually have little or no industrial base. Since an attempt to improve inefficiencies in a non-existent sector would be redundant, governments of these countries tend to have goals aimed at manipulating rapid industrialization. Rather than work towards regional integration, many developing countries use import substitution or encourage foreign investment to try to close the gap between themselves and the developed world. This paper analyzes a specific area in the world where various strategies have been implemented to bring economic prosperity to the region. Since their
independence, the Andean countries of South America - Colombia, Venezuela, Peru, Ecuador, Bolivia, and Chile - have depended on the exportation of agricultural products and raw materials. There is an apparent lack of industrialization and these economies historically have depended heavily on imported manufactured goods from the U.S. and Europe. As a result, a general fear emerged that unless some action was taken, their standard of living would continue to lag behind that of the developed world.

Starting in 1969, the Andean countries began the integration process and formed the Andean Pact. Economists and political scientists have debated over whether the formation of integration schemes is beneficial to these countries. In one side of the debate realists argue against economic integration. According to realists, any economic gains that can be achieved through participation in economic unions are offset by the potential loss of sovereignty and increase in economic vulnerability. Liberals, on the other hand, support cooperative efforts between countries aimed at economic improvement. This paper takes a more liberal view by focusing on mutual economic and political gains of the Community through integration rather than the loss of national sovereignty.

The Andean Pact of 1969 favored a closed-economic policy in which member countries maintained some individual tariff structures and economic policies. As a result, their economies stagnated in the 1980s and the integration process was halted for a number of years. The reorganization of the Pact in 1989 into the Andean Community effectively changed the closed-economic policy into an open economic policy. The intra-Andean tariffs were torn down and economic policy was coordinated. This paper analyzes the results of the closed-policy in comparison with the results of the open-policy
and determines to what degree economic integration is beneficial to the Andean Countries. Using the Andean Community as a model, this paper will give evidence proving that schemes of integration can be economically and politically beneficial to more than to the developed world only. Regional integration in the developing world can be economically and politically beneficial to the member countries. This paper also hypothesizes that in order for regional integration to succeed the member countries should abandon import substitution and other closed-economic policies, encourage foreign investment, and create a single market.

Chapter One looks at the costs and benefits of free trade areas, common markets, and economic unions in comparison with import substitution. Also, these are looked at in terms of costs and benefits specifically for the Andean Countries. Chapter Two examines the formation of the Andean Pact in 1969 and its strategic policies. Answers are given for why the Pact floundered from 1983 to 1989. Chapter Three analyzes the reorganization of the Pact and the creation of the Andean Community. It outlines the organization's new objectives and policies and explains reasons for its success. The conclusion hypothesizes the future economic and political prospects of the Community and examines the possibilities for further growth and suggestions are made on how best this can be accomplished.
CHAPTER ONE: WHY INTEGRATION?

As the world continues to become increasingly integrated economically, politically, and technologically, politicians and economists debate whether the ultimate effects of integration will be positive or negative. The two camps that take the lead in this argument are realists and liberals. Realism is a theory that focuses on power politics, in which force or threat is the primary method states use to further their interests (Genest, 2004: 42). Realists acknowledge that the nation-state has the responsibility to provide for its own defense and security. Thus, realists tend to be more wary of economic integration than liberals because the interdependence that comes from economic integration gives other states power over the nation-state's prosperity. Because the other state has no responsibility to defend or protect its neighbor state, realists see this sharing of power as hazardous. Realists tend to argue in favor of protectionalism, which is a tactic aimed at closing the economy from the outside world. Unlike realists, liberals point out that states cooperate as much as, if not more than, they compete (Genest, 2004: 124). "States cooperate because it is in their common interest to do so, and prosperity and stability in the international system are the direct result of that cooperation (Genest, 2004: 124). Liberals usually push to open up trade and economic cooperation between countries. Studies have shown that the more open an economy is to trade with the outside world, the better is the growth performance relative to others. For example, a study, Warcziarg and Welsh (2003), of 133 countries between 1950 and 1988 demonstrated that countries that liberalized their trade regimes enjoyed higher annual growths rates after liberalization (International Monetary Fund, 2005: 93). With this in mind, this paper does not argue in favor of one theory over the other overall. This paper does, however, support a liberal
argument for economic integration because there is evidence that suggests economies perform better when they open up and cooperated with the outside world, as this paper will show by analyzing the Andean Community.

Countries often promote economic integration through integration schemes. Economic Integration schemes are agreements between countries to liberalize trade between themselves and harmonize economic policies in order to create a single market. In order to understand the costs and benefits of integration, one must understand the importance the market places in economics. In short, the word market is the place in the commercial world where forces of demand and supply operate and where buyers and sellers interact to trade goods, services, contracts or instruments, for money or barter. For the sake of this paper, two main markets will be looked at: the market on a domestic level and the market on an international level.

The domestic market includes commercial activity within a nation-state. Production, consumption, and intra-national trade all fall under the category of the domestic economy. Governments may choose to manipulate their domestic markets by either encouraging or discouraging the competitive process. Countries that pursue a decentralized competitive system, or a market-oriented policy, will seek to promote competition and the growth of private enterprise. They tend to abolish most regulations domestic agents or foreigners have imposed and are more like to support open-economic policies (Ghellinck, 1988 : 57-58).

Other countries pursue an interventionalist perspective in which industrial policy is seen as a means used by the public authorities to channel industrial activity in the framework of a general economic program towards a number of pre-established
objectives. The means employed to achieve this are many and can be coercive in nature. Systems of quotas, rationing, or imposed prices are ways to influence production and consumption. Subsidies, allowances, or relief from taxation are also used. In more extreme cases the state may also influence economic activity by directly taking on productive activities, whether in collaboration with the private sector or alone (Ghelinck, 1988: 59). The key difference between an interventionalist policy and a market-oriented policy is that while both governments may manipulate the economy, one under a market-oriented structure will do so only to maintain a free market while a government following an interventionalist view will manipulate the economy for reasons other than maintaining a free market. Countries that follow interventionalistic policies tend to close their economies.

The market on the international level is very different from the domestic market. First of all, the factors that impede free trade on an international level are multiplied in comparison to those that impede the domestic market. Costs in transportation, communication, and mobility of people have a detrimental impact on international trade (Morawetz, 1974: 14). On top of the tangible difficulties, foreign trade also is hindered by state intervention. Tariffs, non-tariff barriers, subsidies to domestic producers, and political disputes all generate hindrances on trade. To overcome these obstacles, states have collaborated to create supranational organizations among member countries designed to eliminate or manipulate these factors for the benefit of such member countries. These collaboration attempts are known as economic integration schemes. There are a number of types of integration schemes:
Free Trade Area – An agreement among participating countries in which tariffs and quantitative restrictions are abolished, but each country retains its own tariff against nonmembers. In theory, a free trade area is designed to increase trade between the member countries and give domestic industries the ability to sell their goods to a larger market (Group, 1974: 1).

Customs Union – A free trade area that adopts a common external tariff against nonmember countries. In custom unions, the member countries harmonize their tariff structures against third countries. The main benefit of a customs union is that it prevents foreign companies or countries from infiltrating the free trade zone by exporting goods to the country with the lower tariff rates and then filtering these goods throughout the remaining countries without being subject to their tariff walls. Unions are also used to control importation and protect growing industries (Group, 1974: 1).

Common Market – A customs union in which restrictions on factor movements are abolished. Resources, people, and capital are able to flow easily between member countries in a common market (Group, 1974: 1).

Economic Union – A common market with some degree of harmonization of national economic policies. The Andean Community best fits into this category. There is some degree of harmonization of economic policies in the Community. However, there is still some debate about whether or not the Community meets the qualifications of a common market (Adkisson, 2003: 374).

Total Economic Integration – All monetary, fiscal, and countercyclical policies are unified, which presupposes the establishment of a supranational authority whose
decisions are binding on the member states (Group, 1974: 1). The European Union is an example of near total economic integration.

Each level of economic integration intensifies the amount of interdependence between the member countries. As interdependence grows, policy makers in these countries must first analyze the specific costs and benefits.

Economic Benefits

According to liberals, the economic benefits that can be accrued from forming an integration scheme vary depending on the economic situations of the individual member countries. For example, smaller countries can benefit by having a greater market to export products to without being hindered by tariffs. In the case of the Andean Pact, from 1969 to 1975 Colombia had maintained an increasing trade surplus in intraregional commerce. In 1975 it peaked around $153 million (Fontaine, 1977: 36). Because of the existence of a free trade zone in the Andean Pact, Colombian companies were able to export products to a greater market that otherwise would not have been available to them. In 1973, the population of Colombia was 23.7 million. The total population of the member countries of the Andean Pact was 72.6 million (Fontaine, 1977: 65). By increasing the consumer population by almost 50 million people, companies have a significant growth potential. Both before and during the formation of the Pact, the Andean countries relied primarily on import substitution. Import substitution is a government strategy that calls for replacement of import materials with domestic
materials to encourage local production, stimulate innovation, and increase national self-reliance in critical areas such as technology, manufacturing and food (Grabowski, 2010: 104-116). The main problem of import substitution is that it is less effective in the case of smaller countries. In a small or medium country, producers are hindered because of the limited consumer population in the given country. Having access to a larger market can be equally beneficial for consumers as it is for producers. The larger the market the greater the competition and, theoretically, prices will drop. Consumers can buy goods at lower prices. For this reason, both Bolivia and Peru had agricultural policies that favored the consumer rather than the producer in the early 1970s (Londoño: 1988: 39).

"The wide consensus among economists is that free trade generates aggregate welfare gains through efficient reallocation of resources and production, reduction of prices, and exposure to foreign competition. In aggregate terms, economies that open benefit from doing so." (Cho-Diaz, 2011: 379) This is true in the case of the European Economic Community (now the European Union). "With the removal of [customs, duties, and quotas] the general level of productive efficiency would rise because the inefficient producers would be faced with competition from more efficient outsiders." (Wengel, 1980: 16) To an extent this can be true in the Andean case. "The region's population would allow manufacturers to take advantage of economies of scale ... and competition would prod entrepreneurs into a more efficient use of land, labor, and capital which would also make regionally produced goods more competitive in world markets." (Fontaine, 1977: 12) However, the elimination of industrial inefficiencies would not be a suitable objective. This is due to the fact that there has historically been limited industrial production in these areas (Morawetz, 1974: 4). In fact, the Andean
Economies rely principally on raw material exports, such as mining, agriculture, and petroleum. In 1969 alone, the Andean countries produced 906.7 thousand tons of copper, 185.6 thousand tons of lead, 391.7 thousand tons of zinc, 229.8 million cubic meters of crude oil, 30.1 thousand tons of tin. This accounts for 91% of the continent’s copper output, 88% of tin output, 56% of zinc, 44% of lead, and 80% of oil. Compare that with Brazil, one of the three economic giants of Latin America. Brazil had an output of 4.3 thousand tons of copper, 22.2 thousand tons of lead, negligible amounts of zinc, 1.6 thousand tons of tin, and 10.2 million cubic meters of crude oil (Morawetz, 1974: 2). The Andean countries today still have a strong mining economy. Peru mines 15% of the world’s bismuth, 14.5% of the world’s tin, 14% of the world’s silver, 11% of the world’s zinc, and 7.5% of the world’s gold (ISA April 2011 Country Report, 2011). Colombia is the world’s fourth largest coffee producer and Ecuador is the world’s third largest banana producer (ISA April 2011 Country Report, 2011).

Even though the Andean Countries—Colombia, Peru, Venezuela, Ecuador, and Bolivia—have large reserves of raw materials, heavy industry has lagged far behind that of other countries. In 1970, the Andean manufacturing sector lagged behind even that of Argentina, Brazil, and Mexico individually in metallurgy, machinery, and equipment (Morawetz, 1974: 4). One of the most obvious potential benefits for the Andean countries is the possibility of industrial development. Individual countries often seek to improve their domestic industrial output by pursuing a closed economic policy. A closed economic policy encourages an autarkic system, in which a country becomes more self-sufficient and independent. Through the use of imposing higher tariffs, quotas, or non tariff barriers (NTBs), a state can effectively discourage imports. This creates import
substitution and decreases the supply of the targeted product from foreign producers, thus creating a larger demand for the commodity and thereby encouraging the development of domestic production of the commodity. Before the creation of the Andean Pact, the tariffs of the Andean nations were high. "The unweighted average nominal tariff in Bolivia [was] 54 percent, in Colombia [was] 70 percent, in Peru 90 percent, in Ecuador 106 percent, and in Chile it [was] 172 percent. . . There were even a number of higher tariffs on particular items: Ecuador 291 percent (beverages), Colombia 183 percent (clothing, shoes), Chile 388 percent (beverages) and even tariffs ranging up to 1,008 percent on some chemical products in Chile" (Morawetz, 1974: 31). As a result of a greater acceptance of open-economic trade policies in recent years in Latin America, Andean tariffs have dropped significantly. The average Colombian and Ecuadorian tariff dropped to around 15% by 1995 while Chilean and Venezuelan tariffs dropped to around 12% (International Monetary Fund, 2005).

A closed economic strategy has been a method used by a number of countries to boost domestic production. For example, to allow the young American farmers and manufacturers the ability to compete with the "dumping" strategy of British companies in American ports, Congress placed tariffs on British products. The advantage American producers of 1810 had over Andean producers in 1970 is that American producers enjoyed a larger consumer market. Not only was there a demand for these products in the United States, American farmers sold much of their produce to European consumers. Puyana estimated that in order for there to be a strong enough demand for manufactured products, there must be significant populations with yearly incomes constantly above $1,500 (according to 1980 levels of inflation) (Puyana, 1988: 73). In the cases of
Argentina, Brazil, and Mexico, each had a large enough home market to assure it at least moderate rates of economic growth in the 1960s (Fontaine, 1977: 11). Because of a lack of consumer demand, import substitution failed to encourage rapid industrialization in the Andean countries before the formation of the Pact.

As mentioned above, forming a common market in which tariffs and quotas are eliminated among a group of member countries can create a larger market to sustain a sufficient level of demand for industrial products to ensure industrial growth and can also allow the member countries to maintain protective policies against third countries. The forerunner of the Andean Pact was the Latin American Free Trade Association (LAFTA) created in 1960. It included all the countries that make up Latin America. The main hindrance that LAFTA spawned was the growing concern the smaller member countries had about their inability to compete with the larger countries in the area: Brazil, Argentina, and Mexico (Wengel, 1980: 5). These countries felt that they were not receiving adequate benefits from the Association and were “running the risk of becoming markets for the industrial surplus of the ‘big three’” (Wionczek, 1970: 60). A more exclusive common market was more practical for the Andean countries.

**Economic Costs**

According to a realist perspective, there are two main costs associated with the formation of economic unions. The first of these is the loss of national macroeconomic policy autonomy (Reeve, 1993: 31). In most economic unions, countries must adapt their current economic policy in order to harmonize with the other member countries. “All integration schemes must sooner or later face the question of the degree to which member
countries should harmonize their economic policies” (Morawetz, 1974: 25). In order to avoid disparities in economic growth, those policies concerning tariffs, export subsidies, indirect taxes, exchange rates, planning and macro stabilization, foreign capital, intra-union factor movements, and currency unification must all be coordinated (Morawetz, 1974: 25). Economic integration requires national governments to lend some of their decision-making power to the group of member nations that make up the bloc.

Realists argue against integration because the state’s ability to control its own economy is constrained in this process (Reeve, 1993: 36). “It is difficult if not impossible for a nation to maintain an open economy and, at the same time, pursue policies that significantly vary from the world.” (Bryant, 1987: 93) In the case of a formation of a customs union where a common external tariff is formed to limit trade with third countries while opening up trade between member states, this will happen but only on a regional level.

The stag hunt scenario in Game Theory can be used to describe the risks individual countries take during the integration process. Like this scenario, countries that are involved in customs unions must have faith that the others will not “cheat” and pursue their own national interests at the expense of the union. Ultimately, states are free to make their own decisions even when they group together in economic unions. There is a possibility that a member country will decide to pursue its own economic goals at the expense of the union. An example of this occurred in Chile in 1974 after Pinochet’s military government ousted President Allende. The new regime chose to undergo some major policy changes in order to help reconstruct the economy. “Economic and political leaders were convinced that foreign investment [would have] to play a large part in the
country’s recovery.” (Fontaine, 1977: 21) The new Chilean policy that favored an increase in foreign investment that repudiated much of the Andean Pact’s policy defined in Decision 24 on foreign investment. As much as the initiative proved to be invaluable to Chile’s economy, the consequences it faced in the Pact were severe. In reaction to Chile’s new approach, the other ANCOM members threatened to expel Chile from the Pact and attempted to persuade Pinochet to modify the law. In the end, Chile was forced to withdraw from the Pact.

To prevent cheating, economic unions can intensify the coordination of policies to the point where the union becomes a system of total economic integration in which there is the creation of a supranational authority that can override the authority of the individual member governments to some degree. “Confronted by a tendency to generalize national protectionism which could cause the disintegration of the European Community and in the absence of a political consensus on a coherent and specific European Industrial policy, officials of the Community are led to adopt a policy based on selective, supranationally supervised and negotiated agreements.” (Ghellinck, 1988: 68) However, realists again would argue against supra-nationality because it further restricts the ability of the nation state to govern itself and protect its own interest (Genest, 2004: 44).

There are many external factors that increase risk. While domestic markets are often unpredictable at times, the international market is even more unstable. Economic interdependence increases a state’s vulnerability to other member states (Genest, 2004: 158). Growth in one state can spill over and have positive effects in other states. On the other hand, events such as market crashes, natural disasters, and political upheaval in one
member country in a union will negatively affect the economies of the other members. The U.S. stock market crash of 1987 was an example of how the new integrated markets transmit shocks throughout the world with speed and force (Krugman, 1991: 101). Also, the Greek financial crisis in 2010 showed how one damaged economy in an economic union could threaten the economies of the remainder of the member countries. Even rumors of a threat in another country can have detrimental effects on other member countries due to technological innovations over the past 50 years. “Technology allows information (and panic) to be instantaneously transmitted around the world. Technology also allows massive quantities of funds to move quickly in response to that information.” (Spero, 1988-89: 114; Bryant, 1987: 110)

Economics in South America have historically been subject to the destructive effects of political upheavals and natural disasters over the past century. In its first 146 years of independence Bolivia has undergone 184 changes of government (Morawetz, 1974: 6). Drug cartels, along with FARC rebels have hindered Colombia’s economy and have deterred potential foreign investment opportunities (ISA April 2011 Country Report). Only months after the creation of the Andean Pact in 1969, Peru underwent a military coup that removed Peru from the democratic column and installed in place of it a military dictatorship (Fontaine, 1977: 30). Even after democracy was more or less restored, the country was torn by civil war between the military and the Shining Path rebel group in the 1980s. Ecuador has had a series of coups from 1997 to 2006 and recently the government nationalized many private and U.S.-owned companies. In 2010, rebellious police forces held President Rafael Correa hostage for ten hours in response to dissatisfaction over a new civil service law (Freedom House, 2010). Although Venezuela
has maintained a working democracy from 1960, the most recent regime under President Chavez has denied the country of freedom of press and has placed restrictions on many former basic rights (Freedom House, 2010). Also, the Venezuelan government has nationalized much of the economy and reversed many of its older economic policies ("Venezuela's Oil-dependent Economy: Socialism on the Never-never"). All these external factors prove to be a major road block for the integration process.

Political Benefits

The majority of benefits to be gained from forming an integration scheme are economic in nature but there are a few potential political benefits as well. Some countries use the opportunity to exercise leadership with their neighbors. For example, one of the reasons Venezuela participated in the Andean Pact was the position it had to “exercise leadership in Latin America and the Third World” (Fouts, 1975: 550). In the European Union, Germany has found it now carries a leadership role in Europe and the United States plays a leading role in NAFTA. Leader nations in economic unions have an advantage in negotiating power with other nations in the world. For instance, other countries will take them more seriously when they know they have the power to influence the economic policy of half a dozen other states.

Economic Unions often participate with a single voice in negotiations in the FTAA. In 1998, the Andean Community participated as one voice in FTAA and won 3 out of the 9 chairs of the negotiating groups ("Who Are We?- Andean Community - CAN."). By participating as a single voice, the member countries gain a substantial amount of political leverage in the international arena.
Some of the benefits from an increase in trade between member countries are shown to have positive effects on political relations between those countries. As trade and integration rise between two or more countries, each country has more motivation to help ensure future prosperity in the other countries. Because of the interdependent relationship, prosperity in one country also means prosperity in the other (Genest, 2004: 158). In the case of the Andean Community, one of the most strained relationships in the region is that between Peru and Ecuador. Both countries claim the El Oro region in the Amazon Basin. In 1942 Peru invaded and controlled all of the disputed area. The armed forces of both countries have fought a number of border skirmishes in the El Oro region of the Amazon River Basin, the most recent being in 1995. The countries' commitment to economic integration was one of the leading factors that led prevented the skirmish from escalating into a full-scale war (ISA April 2011 Country Reports).

**Political Costs**

While countries involved in economic unions lose economic autonomy they also lose political autonomy. This is especially true for smaller countries. According to a concern known as symmetry, the economies of weaker countries can easily become so dependent upon those of larger countries in a trading situation that the weaker country loses political power to the more independent country (Genest, 2004: 159). The weaker countries must often align certain policies with those of the other countries. In economic unions, member countries must decide how to harmonize tariff barriers, exchange rate policies, and inflation rate policies in order to match those of other members (Morawetz, 1974: 25). If they fail to do this, they could face repercussions from the other members.
In a system of total economic integration where a supranational entity overrules domestic policy, national governments are limited on how they can regulate and manipulate their economy. Also, an individual government may be pressured by other member countries to change foreign policy towards a third party. In 2005, for example, the Venezuelan government pushed Colombia and other ANCOM members to minimize political negotiations with the United States. President Chavez of Venezuela criticized Colombia for accepting U.S. military aid in fighting drug lords and FARC rebels. He later rebuked the Colombian President for announcing his intent to establish a free trade agreement with the U.S. Colombia was in a difficult position because its two largest trading partners were the U.S., a destination for 39% of Colombian exports, and Venezuela, a destination for 12% of Colombian exports in 2005 (CIA - The World Fact Book). Colombia decided its trade with the U.S. was too valuable to sacrifice, so the government commenced negotiations with Washington. The Venezuelan retaliation was harsh. Venezuela froze trade with Colombia and withdrew from the Andean Community. ("Venezuela and Colombia: Politics versus Trade | The Economist."). From cases similar to the one previously mentioned, it is apparent economics often define politics.

On the surface the creation of economic unions or common markets are purely economic, but there are many hidden political agendas that countries have for forming them. It is interesting to note that the Andean Pact was founded by political leaders, not economic or financial experts. "Frei of Chile, Belaunde of Peru, Lleras of Colombia, and Leoni of Venezuela were civilians and democrats, dedicated to social change by peaceful, orderly means" (Fontaine, 1977: 29). Bolivia and Ecuador at the time would shortly be joined by Peru in being led by military dictators who "insisted on making their own kind
of revolution—radical, authoritarian, anti-American—with a splendid disregard for basic economics' (Fontaine, 1977: 30). Politics and economics are interdependent upon each other. Without a stable political environment, an economic union will flounder. On the other hand, a prosperous economy can help stabilize political turmoil—both domestically and internationally.
CHAPTER 2
SUCCESES AND SETBACKS OF THE ANDEAN PACT

This section is devoted to the assessment of the Andean Pact, which was created in May of 1969. The Pact was formally created in 1969 with the signing of the Cartagena Agreement. The Agreement was signed by the leaders of Peru, Bolivia, Colombia, Ecuador, and Chile. Venezuela joined the Pact four years later (Fontaine, 1977: 13). The Pact remained in force until 1989, when the member countries modified the goals and structure of the Pact to create the Andean Community. The reasons behind the initial successes of the Pact will be analyzed. A theory on why the Pact floundered in the 1980s will be brought up and discussed.

Cartagena Agreement: Institutions and Objectives

The Cartagena Agreement was a reaction to the frustration of the Latin American Free Trade Association (LAFTA). According to the point of view of the smaller and medium economies that would soon form the Andean Pact, mainly the bigger economies of Mexico, Brazil and Argentina benefited from LAFTA (Penaherrera, 1988: 174). The limited free trade area formed in the association was beginning to transform the smaller countries into nothing more than markets for the big three. The countries of Peru, Venezuela, Colombia, Chile, Bolivia, and Ecuador “felt that they were getting few if any benefits from the integration scheme” (Wengel, 1980: 5).

Another problem that frustrated the Association was the fear of these same smaller countries that they did not have enough bargaining power in LAFTA to check the individual ambitions of the “big three”. In 1996, representatives from Chile, Colombia, Venezuela, Ecuador and Peru met in Bogotá and issued the Declaration of Bogotá. In this
meeting, these countries endorsed the creation of a subregional integration scheme within LAFTA (Fontaine, 1977: 13). This led to the creation of the Cartagena Agreement three years later.

Initially, one of the main purposes of the Agreement was to create an entity that could effectively bargain with the larger members of LAFTA (Wengel, 1980: 6). At the time, its combined population of 72.7 million was larger than that of Mexico and Argentina but smaller than that of Brazil and had 25% of the total population of Latin America. It soon became apparent that the subregion would act independently from the Association and its activities would far surpass the expectation of being merely a bargaining chip. The principal reason for the Pact’s formation was to “protect small and medium-sized South American republics from their large neighbors” (Fontaine, 1977: 60). For this reason, it was designed to grow into a strong economic union. There were two ultimate goals for the Pact: to promote rapid industrial and economic development among its members (Fontaine, 1977: 14) and to encourage equal growth among member countries.

In order to promote economic growth, the Pact decided to alter the tariff structure in its countries. Tariffs between themselves would be torn down so the area would effectively become a free trade zone. Tariffs would also be raised up against third parties and eventually a common external tariff would be established. “All the member countries of the Andean Group joined the Pact in the hope that the enlarged market demand would lead both to faster growth in the industrial sector and to the establishing of industries which would have been impossible to contemplate previously, given the size of the individual markets.” (Puyana, 1988: 74)
Harmonization of economic policy between the member states was required to achieve these ambitions. Without harmonization of economic policy, multinational corporations would have a window to exploit the free trade area by slipping in through the country with the lowest tariff barriers. Not only would a free trade zone be established, but the nations would be required to harmonize their tariffs with third countries. Morawetz stated “the greater the differences in pre-union tariff structures, the greater the need for adoption of a common external tariff after trade is freed. If the countries’ prior tariff structures are identical, harmonization is not necessary.” (Morawetz, 1974: 30) The reason for harmonization is to keep foreign imports out of the Pact to encourage domestic import substitution. For instance, if country A and B are both in a free trade zone and country A has high tariffs with third country C while country B has a low tariff with country C, imports from C can still arrive cheaply in A via country B. The signers of the Pact felt that the establishment of a common external tariff was necessary if a common market was to be created (Angarita, 1988: 143).

Another main objective decided upon in the Agreement was to foster balanced economic growth among its members. The terms of the Pact would not allow the appearance of unequal growth where the bigger economies would dominate the weaker economies (Morawetz, 1974: 73). It called for the “more highly developed countries to voluntarily give up part of the industrial growth which would otherwise be concentrated in their area” (Puyana, 1988: 75). By allowing the weaker members of the Pact certain benefits, the Group hoped to accomplish this.

One of the benefits that were granted to the weaker members was the promise of industrial growth in their domestic economies. The Cartagena Agreement outlined a
centralized plan to manipulate production in the weaker countries. In an ideal common market where "only labor and capital costs are taken into account, and assuming that the poorer areas have lower real wages... than their richer neighbors, new industry, and especially new labor intensive industry, should initially tend to locate in the less developed areas of the union." (Morawetz, 1974: 75) An economic process similar to osmosis occurs in which industry leaves the richer countries and settles in the poorer countries and the standards of living among union members are equalized.

A major problem, however, in the Andean Pact was that the benefits of lower wages and capital costs acquired in the poorer countries were often offset by poor infrastructure, a lack of skilled labor necessary for efficient modern industrial production, and poor financial and banking services (Morawetz, 1974: 75). The poor transportation and communication networks of the Andean countries make mobility and integration difficult because of high costs in travel. There were few railroads in the Andes in the 1960s and many of the principal roads were unpaved (Morawetz, 1974: 9).

The drafters of the Cartagena Agreement were aware of these obstacles and prepared to make "the most ambitious attempt at central direction ever attempted by any transnational community" (Fontaine, 1977: 17) previously. Article 1 of the Agreement states:

"The objectives of the present Agreement are to promote the balanced and harmonious development of the member countries, accelerate their growth by means of economic integration, facilitate their participation in the integration scheme established by the Treaty of Montevideo and establish favorable conditions for the conversion of LAFTA to a common market: all this with the purpose of procuring a lasting improvement in the level of living of the people of the subregion." (Morawetz, 1974: 73)
In short, the tools proposed in the Agreement for the fulfillment of the objectives of the Common Market were:

- The harmonization of social and economic policies.
- Joint industrial planning.
- A program of trade liberalization.
- The establishment of a minimum common external tariff to be subsequently replaced by a common external tariff.
- Agricultural development programs.
- The channeling of resources to provide for the necessary investments.
- Physical integration.
- Preferential treatment for Bolivia and Ecuador. (Wengel, 1980: 7)

There were two major innovations that were developed in order to speed up industrial growth in the region because, as Fontaine says in the *Washington Papers*: “the merging of five or six impoverished economies—would not be enough...bolder measures were needed.” (Fontaine, 1977: 14) The first of these innovations was the multilateral control of foreign investment. It was felt among the leaders of the Pact that the presence of foreign investment harmed local capital and increased the power of the foreigner. In June of 1971, the Pact ratified Decision 24, which placed tight controls on future as well as foreign investment (Fontaine, 1977: 15).

The second and “grandest” of the measures was promoting industrialization through sectoral planning (Fontaine, 1977: 14). This type of planning called for agreements to be made among member countries to assign each country exclusive rights to the manufacture of new products within major heavy industries. A system of industrial
distribution was called for to overcome the disparities in transportation costs and poor infrastructures that plagued the weaker member states.

The institutions of the Andean Pact designed to bring about these objectives were as follows:

The Commission—the highest political authority, at least on paper. It was a legislative policy and is responsible for implementing the national interests of the Group. It expresses its will by means of decisions but also is under the obligation to review any proposals made by the Junta. In practice, the Commission proved to have a lesser degree of success than previously anticipated. The lack of supranational authority in the Commission gave the member countries breathing room to disregard many of its decisions. Between 1981 and 1984, when regional forces began to wane in the face of a resurgence of national interests, member states increasingly disregarded the decisions made by the Commission (Adkisson, 2003: 373).

The Junta—the Group’s technical body responsible for defending the common interest of the subregion. It is made up of three members who were appointed by the Commission that have the ability to make autonomous decisions. These decisions are of lesser ranking than those of the Commission, but not withstanding, the Junta has been the most important body in the Pact. The Junta has acted as the executive body of the Pact and although it can make resolutions independent from the Commission, much of its resolutions have been adopted by
the Commission. The majority of the decisions created by the Commission originated in the Junta (Angarita, 1988: 145).

The Andean Court of Justice—the judicial body of the Pact, organized in 1983, responsible for ensuring strict compliance with all commitments of the Agreement. Its judgments were legally binding in the member countries. Unfortunately, the formation of the Court of Justice was created too late to ensure the complete compliance of member countries. By 1983, the member states of the Pact were disillusioned with regional integration and were resorting back to nationalistic interests. The court judges themselves openly recognized that the “Court has suffered from a frustrating inertia, resulting in part from the crisis that the Andean integration process is undergoing” (Angarita, 1988: 147).

The Andean Council—a political advisory body set up to guide the activities of the institutions of the Andean system. It was formed in 1979 and is still a major organization in the Community. The Council is made up of the Ministers of Foreign Affairs of the Andean Nations. The Council drafts foreign policy for the Pact and its focus was driven towards overcoming obstacles of the integration process. The effects of the Council have been mixed. The Council is able to draft foreign policy more effectively because of its awareness of the individual interests of the member states. However, this did not solve the problem of the lack compliance of member states to Andean policy (Angarita 1988: 147).
The Andean Parliament—an advisory body created in 1979 as a result of the growing degree of democratization in the region. It analyzes annual reports and endeavors to improve integration, enhance democracy, and protect human rights. One of the most positive results from this body was the ties it built with the European Parliament. By 1986, seven joint meetings were held between Andean and European Parliaments to discuss democracy and human rights in Latin America (Angarita, 1988: 149). Representatives from the Community, Mercosur, and the European Union have continued to meet since then to discuss further integration (International Monetary Fund, 2010: 92).

The Andean Reserve Fund—set up in 1978—it gives loans, bonds, and accepts deposits to provide greater liquidity in the region and to support the growth of its members. The Consultative Committee, the Advisory Committee for Economic and Social Affairs, the Coordination Councils, and the Andean Development Corporation are all subsidiary bodies designed to facilitate efforts between the Pact, its member governments, and regional enterprises. (Angarita, 1988: 151)

The Andean Pact was not and had never been politically homogeneous. Its policies toward integration varied. In the early 1970s, Colombia and Ecuador favored free enterprise, Chile was moving towards its own brand of socialism, Peru began nationalizing its industries after the military took power in 1969, and Bolivia swung one way to the other with much frequency (Morawetz, 1974: 38). Even the types of government varied and were on nearly opposite ends of the spectrum: Venezuela and Colombia were two of the more liberal democracies in Latin America, Peru had just
undergone a military coup that stripped the country of its democracy, Chile had recently become socialistic and in 1973 would undergo a military coup, and Ecuador and Bolivia were both unstable military-led regimes (Fontaine, 1977: 29-30). Despite these differences, all these countries shared the same vision expressed in the Cartagena Agreement that they needed to work together economically to compete in international economics to improve their domestic economies and standard of living.

Crisis and Fragmentation

This section analyzes the outcome of Andean Pact and its efforts. By analyzing the development of intra-regional trade, the establishment of a common external tariff, and the implementation of the Pact’s sector program, this section discusses how the closed economic tendencies of the Pact’s member states led to the decline of the Pact and economic prosperity as a whole in the region.

The signers of the Cartagena Agreement in 1969 called for a growth of intra-regional trade by increasing trade liberalization. Trade liberalization was an aggressive strategy on paper (Fontaine, 1977: 15) but in reality, the founders of the Cartagena Agreement did not initially anticipate a lot of benefits from greater trade (Wengel, 1980: 2). The Andean countries were not large trading partners in the 1960s because they followed the same economic strategy of exporting raw materials to more industrialized countries like the U.S. and Europe (Wengel, 1980: 3). In 1969, for example, intra-Andean exports only accounted for 5% of total Andean exports (Morawetz, 1974: 5). The gains to be made on an increase in trade were generally small because these products were not heavily taxed anyway.
Some of the major obstacles to the growth of intra-Andean trade have been, as mentioned previously, the poor transportation systems in the Pact. Despite the distances, transportation costs in many cases were higher for trade between member countries than from a member country to the U.S. or Europe (Morawetz, 1974: 14). Suppliers found it more beneficial to sell their goods to foreign buyers than to regional consumers.

The reluctance of member states to lower tariffs proved to be another hindrance to trade. Especially in the case of Bolivia and Ecuador, a concern materialized in the Pact that the stronger economies would use the weaker economies as merely another market and that they would not participate in the growth of the Pact (Fontaine, 1977: 33). To overcome this hesitancy, it was agreed upon that intra-regional tariffs would be cut 10% each year to bring a gradual reduction of tariffs by the end of 1980 (Morawetz, 1974: 6). On top of that, each country was permitted to be exempt from 250 to 600 “items” from this process of liberation until 1985. The richer countries only received 250 exemptions while Bolivia and Ecuador were granted 600 exemptions (Fontaine, 1977: 16).

During the late 1970s as tariffs were gradually coming down there were some positive results in an increase in trade. A relatively important market was established for the intra-regional trading of agricultural products, in a specific case of Colombia becoming the leading buyer of non-coffee exports (Londoño, 1988: 28). Also, there was an increase in intra-regional trade in the 1970s in which intra-Andean trade jumped nearly 20% each year (Fontaine, 1977: 56). In comparison to the average world trade increases of 10% per year, the Andean figures looked impressive (Fontaine, 1977: 56).

Beginning in the early 1980s intra-regional trade dropped in the Andean countries. "The decline in trade lagged with respect to the Central American Common Market and
LAIA as a whole.” (Ocampo, 1988: 123) In fact, an international debt crisis was threatening the majority of the world’s economies (Reeve, 1993: 37). This crisis came into being after the 1978 oil crisis when oil prices again began to rise, causing inflation in Western markets. The Federal Reserve responded by adopting a monetary policy in which interest rates were risen. This led to rapid appreciation of the dollar, which in turn, created an instability in exchange rates and caused many private and public industries to accumulate large amounts of debt (Eskridge, 1985: 35-41).

Many economies responded to the crisis by turning inward and focusing on closing their economies in an attempt to protect them. The effects this had on the Andean Pact were devastating. In 1981, trade dropped by 3.5% in the Pact. Trade dropped another 1.4% drop the following year, and a real collapse came in 1983 with a loss of 49% of trade (Ocampo, 1988: 123). The Junta concluded in 1980 that “The member countries are not convinced that an enlarged market actually exists” (Puyana, 1988: 82). By then, although a free trade zone was in effect, trade was declining.

The establishment of a common external tariff was also one of the main objectives of the Agreement that failed to come into practice fully. The problems associated with the common external tariff were similar to those of the formation of a free trade area in that the member countries had different tariff policies toward third countries and were hesitant to change them (Morawetz, 1974: 38). Bolivia had the lowest amount of tariffs in the Pact because of the country’s dependence on foreign goods while Chile had the highest amount of tariffs (Morawetz, 1974: 33). Chile’s tariff policy changed dramatically after the military coup of 1973, in which the government was prone to lower these tariffs. To help ease the member states into the adoption of the tariff wall, the Pact
initiated a program that called for the creation of a common minimum external tariff by 1975 that would be a 'dry run' before the common external tariff would be established in 1980 (Morawetz, 1974: 65). A common minimum external tariff was an agreement that tariffs could remain above but not below the common minimum (Morawetz, 1974: 31).

The common external tariff never did come into force as planned. Except for Bolivia, the Andean nations already had high tariffs in place (Morawetz, 1974: 31) so there was only moderate interest in setting a common tariff. Since Bolivia was the unquestioned weakest member of the Pact, the rest of the Group tolerated Bolivian deviation from the rules (Penaherrera, 1988: 180-181). Negotiations were stalled and the deadline for the establishment of the tariff was postponed (Wengel, 1980: 56) until the international debt crisis pushed the issue of the common external tariff out of the lime light.

The issue over foreign investment was perhaps the main cause for the near dissolution of the Andean Pact. Decision 24 required the nations of the Pact to (1) exclude future foreign investment from certain basic industries and (2) adopt a fade-out program requiring existing companies to give local (and governmental) investors majority control (51%) of total shares (Fontaine, 1977: 19). Over the period of a few years, foreign companies that operated in the Andean countries were required to gradually sell shares of stock of property in the given country to local buyers until 51% of the total shares was in the hands of local investors.

Tension over this issue began after Pinochet's military government took power in Chile in 1973. Its reversal in foreign investment policy contradicted that of Decision 24. Chile was not the only government to favor foreign investment. Colombia had been an
advocate for foreign investment in the 1960s and 1970s but had chosen to accept
Decision 24 because of their interest in the free market open to them in the Andean Pact
(Wengel, 1980: 9). Bolivia had also willingly accepted the presence of foreign
investment and had already been allowing foreign investment into the country and
directly violating the terms of the Decision (Fontaine, 1977: 21). Because of its weak
economy, Andean governments let Bolivia continue its activities; Chile was not so lucky.
It was called out on encouraging foreign investment and the negotiations and conflicts
that ensued caused for the eventual withdrawal of Chile from the Pact (Penaherrera,
1988: 175).

The last and the most important program that will be discussed is the Andean
sectoral planning. This effort was developed as a way to promote rapid industrialization
in all the member countries (Fontaine, 1977: 16). In theory, once a common market was
established and free trade opened up in the Pact, the increased demand for domestically-
produced manufactured goods would rise and spawn domestic industries. The sectoral
program, or SPIDs (Sectoral Planning of Industrial Development), was an initiative taken
by the Pact to spread out industrial growth throughout the Andean region (Fontaine,
1977: 17). It was distributional in nature in which the six countries of the region would
be assigned the rights to certain industries and has been described as the “most ambitious
attempt at central direction ever attempted by any transnational community” (Fontaine,

The SIDPs focused on four main industries: the light engineering program, the
petrochemical program, the automobile program, and the iron and steel program. Since
the automobile and iron and steel programs were agreed upon later, they never fully
materialized into action. The light engineering and petrochemical programs will only be analyzed in this paper.

The petrochemical program was chosen for a number of reasons to be included in the SIDPs. First of all, petroleum and natural gas are the principle raw materials needed to produce these goods. The Andean nations are exporters of both these materials and have surpluses adequate enough to support the industry (Wengel, 1980: 60). Another reason is that in the 1970s, the petrochemical industry was concentrated in developed countries. This resulted in the exportation of oil from developing countries to developed countries. The developed countries would then produce petrochemicals and sell them back to the developing countries for higher prices (Wengel, 1980: 59). Nevertheless, the demand for petrochemicals in the Andean area was estimated to be around $245 million in the late 1970s. For this reason, the petrochemical industry was very attractive to the developing world. The final reason for the selection of this industry is that it was suited for cooperation schemes because it exhibits significant economies of scale until a certain plant size is reached (Wengel, 1980: 60).

In this program, 56 industries were to be distributed across six countries beginning in 1975. A total of $2.5 billion worth of investment would be required to purchase technology and equipment. The members of the Pact agreed to share the burden of the costs by dividing the costs among themselves (Wengel, 1980: 61). Chile and Colombia eventually gave up their SIDPs claims to be able to maintain low tariffs with a number of third countries, but the rest of the countries actively took part (Puyana, 1988: 80).
The petrochemical program floundered in the late 70s and early 80s. Negotiations had taken far longer than anyone ever anticipated. The program was not even ratified until 1975 and did not start taking effect for another few years (Puyana, 1988: 81). One of the problems the Pact faced was due to the radical (and often opposing) economic policies. Many of the industries mentioned were state-owned industries. Colombia, Peru, and Venezuela already had well-established state-owned petrochemical industries (Fontaine, 1977: 18). Countries were not comfortable with allowing other Latin American states have access to technology without themselves also possessing that technology. “Delays also provided an incentive for member countries to rush into plant construction and thus create faits accomplis, or slipshod industrial development.” (Fontaine, 1977: 17)

Apart from this main obstacle, the Pact encountered a high level of difficulty in evenly promoting economic growth without inequalities. There was no way (at least no way that is not very inexpensive, difficult or bias) to measure the data to determine the costs of the individual countries in accordance with the benefits (Wengel, 1980: 5). In short, the negotiating process took too long because no one could agree on the location or implementation of the industries.

The light engineering program was the most successful of the SIDPs. It required an investment of $450 million and generated 40,000 jobs in a matter of a few years. Its annual value of production is calculated to be $500 million in 1974 and the demand in 1980 was over $800 million (Puyana, 1988: 81). Apart from this, there was a noticeable rise in intra-Andean trade of machine tools and electrical machinery. There is evidence however, that suggests the trade in this sector increased because thirty-three of the
seventy-two units allocated were in production before the signing of the program (Puyana, 1988: 82). Even the $21.4 million dollar investments were allocated to the expansion of existing productions in Colombia and Peru (Puyana, 1988: 82). This gives rise to the question of how much the program actually contributed to the success of this industry.

**Conclusion**

The Andean Pact was put to the test when an economic crisis in the early 1980s hit the international market, forcing many economies to return to autarkic policies. Intra-Andean trade crumbled, the common external tariff and sectoral programs floundered, and member countries repeatedly failed to observe the articles of Agreement after 1980 (Penaherrera, 1988: 175). The countries in the Pact shared the same vision of industrialization, but shared little else in common. Market-oriented economic policy structures were rare in the subregion and each country still believed strongly in closed-economies rooted in nationalism and government interventionalism. Although this was an extraordinary effort that achieved much that had never been done before in South America, the Pact was unlike the European Union in that it failed to open up its member countries’ economies and fully integrate. Although they were experimenting with open market-policies, the member states of the Pact still clung to outdated import-substitution tactics. Another main hindrance came from the interventionalistic nature of the Andean governments. A realist perspective flourished in the Andean countries and the Pact responded by discouraging foreign investment and only reluctantly lowering intra-regional tariffs. The member countries themselves sabotaged the sectoral program out of
mistrust towards one another and regional cooperation became less important national interests.
CHAPTER THREE

THE ANDEAN COMMUNITY—A RENOVATION IN INTEGRATION

In May of 1994, Paul W. Moore and Rebecca K. Hunt said:

“The Andean Community is one of the oldest free trade movements existing today... changes in democratic governance and developments in trade and investment liberalization have prompted renewed interest and action among members.

“The Group has progressed far beyond a free trade agreement, as it begins to implement a customs union similar to the European Union.” (Hunt, Rebecca K. and Moore, Paul W., 1994: 1)

Many states reacted to the international debt crisis by to closing up, establishing protective tariffs, and becoming hesitant to sign economic agreements of free trade with other countries. This decade was a decade of silence for the Andean Community in comparison to the 1970s. In 1983, the Andean Court of Justice entered into effect and there were only other small attempts at renewing the integration process (“Andean Community” : Welcome Page). The Pact, however, did not die out completely.

Beginning in the mid-1980s, a new movement in deregulation was led by Ronald Reagan and Margaret Thatcher (O’Brien, 1992: 18). “Their market-friendly administrations, in addition to pursuing privatization, tax reductions and less interventionist policies, began to remove exchange controls, eliminate regulations on interest rates, dismantle barriers among different types of financial institutions, and open domestic markets to foreigners.” (Spero, 1988-89: 155) Exchange controls in the U.K. were eliminated within days after Thatcher took office as Prime Minister (Crook, 1992: 14). Other deregulation movements soon followed in Canada, France, the Netherlands, Sweden, and West Germany (Reeve, 1993: 17).
The U.S. shift toward deregulation triggered economic policy changes worldwide because of the tremendous size of the U.S. economy. The fast pace of deregulation spawned more multinational corporations, a dramatic increase in trade, and the emergence of a powerful global capital market (Reeve, 1993: 18). The old protectionist practices of import substitution were abandoned as more countries began opening up their markets in the name of competition (Reeve, 1993: 17).

The Andean Pact was affected by the wave of Reaganomics as a new spirit of economic integration influenced the member countries to once again push ahead in the integration process. Beginning in 1987 with the signing to the Quito Protocol, the member states of the Group started toward the process of not only renewing but reorganizing the objectives and tools of the union. Two major changes were to take place. Import substitution and state-regulation industrial development were to be replaced by a focus on free market competition. The Pact also developed a political agenda as it started openly promoting democratization ("Who Are We?- Andean Community -CAN."). Instead of tolerating military coups and dictatorships, the Pact would condemn them.

Democratization in the Community

On June 10, 2000, the Council of the Presidents of the Andean Community signed the “Andean Commitment to Democracy.” The first paragraphs of this document read:

REAFFIRMING the Cartagena Agreement, which states that the Member Countries agree to sign the Subregional Integration Agreement "Founded on principles of equality, justice, peace, solidarity, and democracy";
STRESSING that the Andean Community is a community of democratic nations that have shown a sustained will to promote democratic living and
the constitutional state, both in the Andean Subregion and in Latin America and Caribbean ever since the birth of their integration movement; asserting that the aim of the Andean Community’s political action and of its common foreign policy is to develop, improve, and consolidate democracy and the constitutional state; and ratifying the Presidential Declaration on the Andean Community Commitment to Democracy, signed in Bogota on August 7, 1998 ("Who Are We?- Andean Community -CAN.")

At least on paper, the Andean Pact had always been a promoter of democracy. Upon the signing of the Cartagena Agreement in 1969, it would appear as if the subregion was heading towards a rapid democratization. The only member states controlled by generals or dictators were Bolivia and Ecuador—the two weakest members of the Pact. Within a few years and after two military coups, the political atmosphere reversed in the Pact. The only two democratic states left by 1974 were Colombia and Venezuela. During the 1970s and through much of the 80s, the Pact set democracy aside as a priority and instead focused primarily on economic issues. In the late 1980s, when the Pact began actively promoting democracy, political disputes arose between member countries (Penaherrera, 1988: 175).

These disputes faded and, in 1989, the Presidents of the Andean countries met in the Galapagos to discuss the reorganization of the Pact ("Who Are We?- Andean Community -CAN."). The ‘Strategic Design’ was approved that replaced the close-market system with one of open development. A year later, the Andean Presidents’ Council was created as a formal body of the Pact. The Council comprised only of the Presidents of each member country. Under the Trujillo Protocol signed in 1997, highest authority was given to the Presidents’ Council ("Who Are We?- Andean Community -CAN.").
In fact, the old institutions of the Pact were replaced in this year by the Council of Foreign Ministers, the Andean Community Commission, the General Secretariat, the Latin American Reserve Fund, the Andean Health Organization, the Consultative Council of Indigenous Peoples, the Andean Labor Advisory Council, the Andean Business Advisory Council, the Simón Rodríguez Convention, and the Simón Bolívar Andean University ("Who Are We?- Andean Community -CAN."). The Andean Court of Justice, the Andean Parliament, and the Andean Development Corporation all existed in the Pact in the early 1980s and were kept when the Pact was revamped. These institutions have more political and social implications than their predecessors. These organizations work to strengthen social equality and improvement in the Community. The Andean Health Organization coordinates and supports "the efforts made by member countries, both individually and jointly, for health improvement of their people" ("Who Are We?- Andean Community -CAN.").

The Consultative Council of Indigenous Peoples is made of delegates from the various indigenous groups in the subregion. It expresses its will to the Commission or General Secretariat and works with a number of other organizations to improve relations among indigenous peoples, human rights, education, and overall participation of these groups in the Community ("Who Are We?- Andean Community -CAN.").

The Andean Business Advisory Council is made up of four delegates from the private sector and works to communicate between the Commission and private enterprise. Its main function is to increase participation of the private sector in the Community as the Community becomes integrated into a common market. The Andean Labor Advisory Council is comprised of delegates from organizations in the labor sector. Its function is
to increase participation from this sector in the Community ("Who Are We?- Andean Community -CAN.").

In 1997 the General Secretariat, the executive body of the Community, was created. The General Secretariat took on the function of the Junta in the Cartagena Agreement. It is under the direction of a Secretary General who is elected by the Andean Council of Foreign Ministers. The General Secretary can be a citizen of any one of the member countries and the General Secretary has been filled by a citizen of each of the countries since 1997 ("Who Are We?- Andean Community -CAN.").

Since then, the Community has been taking on an increasing amount of responsibilities of a political organization. In 2000, the members signed the “Andean Community’s Commitment to Democracy”. This document outlined the Andean Community’s vision of democracy. Article One states that “democratic institutions and a constitutional state... are essential to the political cooperation, and the process of economic, social, and culture integration” ("Who Are We?- Andean Community -CAN."). The document goes on to say that if there is a “disruption of the democratic order in any Member Country, the other Andean Community Member Countries shall consult with each other and... with the country involved” ("Who Are We?- Andean Community -CAN."). If the problem is not solved in the country and if these developments work to undermine the integration process, the Member Country will be dealt with in one of the following ways:

a. Suspension of the Member Country’s participation in any of the bodies of the Andean Integration System;

b. Suspension of its participation in the international cooperation projects carried out by the Member Countries;
c. Extension of the suspension to other System bodies, including its disqualification by Andean financial institutions from obtaining access to facilities or loans;

d. Suspension of rights to which it is entitled under the Cartagena Agreement and of the right to coordinate external action in other spheres; and

e. Other measures and actions that are deemed pertinent under International Law. ("Who Are We?- Andean Community -CAN.")

In its relations with third countries, Community members are to follow Article 8 which states, “The Andean Community shall seek to incorporate a democratic clause in the agreements it signs with third parties, in accordance with the criteria set out in this Protocol.” ("Who Are We?- Andean Community -CAN.") In 2002, the Ministers of Foreign Affairs and of Defense approved the Andean Charter for Peace and Security. This charter laid down the principles and commitments for formulating a Community policy on security in the subregion, established a peace zone, regional efforts in the war against terrorism and the limitation of foreign defense spending ("Who Are We?- Andean Community -CAN."). Also, this same year, a committee was formed for disaster prevention and care, a strategy was developed on biodiversity for the tropical Andean countries, and the Andean Charter for the Promotion and Protection of Human Rights was adopted.

Political and social integration occurred in 2003 when the Community announced the Andrés Bello Agreement, designed to strengthen mutual cooperation in matters of common interest related to education, culture, science, and technology. This would lead to the creation of the Andean Identity and the integration of the peoples of subregion countries ("Who Are We?- Andean Community -CAN."). For the first time since Simón Bolívar, political and economic leaders were seriously considering the formation of an “Andean” cultural unity.
These efforts flowered into the creation of new subsidiary institutions in 2004. The Andean Council of Education Ministers and Persons Responsible for Cultural Policy, the Andean Council of Ministers of Social Development, the Andean Community Council of Ministers of the Environment and Sustainable Development and the Andean Advisory Council of Municipal Authorities were created to "promote a culture of integration and strengthening the Andean cultural identity" ("Who Are We? - Andean Community - CAN."). On top of that, a working program was approved for the incorporation of integration subjects into school programs.

There have been a number of obstacles that have hindered democratization. The first major problem was during the 1990s and 2000s, when not all of ANCOM member countries maintained a working democracy. From 1997 to 2006, Ecuador underwent a series of military coups and presidents in exile ("Ecuador": U.S. Department of State). Colombia has been in a state of semi-civil war from the late 1990s to 2002 when drug cartels and FARC rebels battled government troops for territory and power (CIA - The World Fact Book). The most obvious obstacle was the withdrawal of Venezuela from the Community. The motive behind this withdrawal was interventionalist in nature because the move had visibly negative effects on the country's economy. Venezuela withdrew from the Pact in response to Colombia's signing of a free trade agreement with the U.S. ("Venezuela and Colombia: Politics versus Trade | The Economist."). The Venezuela government is not subtle in its political antagonism toward the U.S. and its withdrawal was characterized as an economic weapon used to punish the Community.

In spite of the setbacks the Community has faced in recent years toward political, social, and cultural integration, it has made many advances. The political instability in
Ecuador that was rampant in the 1990s was finally stabilized in 2007 by its new president, Rafael Correa. Upon coming to power, Correa called for the drafting of a new constitution, restored political stability and provided a working democracy that has proven to be sustainable ("Ecuador": U.S. Department of State).

In Colombia, President Uribe’s successful domestic security policies, and pro-market reforms effectively restored peace to most of the country starting in 2002 (CIA – The World Fact Book). Government forces retook most of the lost territory claimed by the FARC and cut down much of the power held by drug cartels.

The situation in Venezuela was a blow to the Community, especially since Venezuela was seen as a possible link to MERCOSUR. The remaining heads of state of the member countries reaffirmed their “vocation for integration and firm intent to strengthen ANCOM” in light of the crisis created by Venezuela ("Who Are We?- Andean Community -CAN."). Within a year of Venezuela’s withdrawal, ANCOM enjoyed the membership of Argentina, Brazil, Paraguay, Uruguay, and Chile in the Group. These countries were accepted as associate members and would enjoy some benefits of being a part of the Community but with no decision-making power.

During the 1990s and 2000s, the majority of the member countries enjoyed having working democracies. Bolivia, as of 1999, was in its second decade of democratic rule and had reached perhaps its highest degree of democratization in the country’s history in spite of a weak judicial structure ("Economy - Bolivia - Tax, Import, Export, Average, Growth, Tariff, Annual, Sector."). Peru is also enjoying democratization. The Shining Path Maoist movement was put down and a greater degree of political stability was restored to the country (CIA – The World Fact Book). Peru is
now ranked by the Freedom House Index as a “free” country. Corruption is not as widespread, legislative and judicial institutions are stronger than in the past, and human rights advocates won a major victory when the government announced the repeal of a law that exemplified the military from being held responsible for human rights abuses (Freedom House, 2010).

One of the principle motives for the leaders of the Andean Community to push for political, social, and cultural integration was their desire to form a common market. For example, the Community describes the purpose of its subsidiary bodies as to achieving attainment of "fuller participation" by this sector "in the construction of an integration process leading to the creation of a common market" ("Who Are We?- Andean Community -CAN."). Full economic integration did not prove to be possible in the case of the Andean Pact because of differing political policies between member countries and a lack of cultural and social harmonization. In the case of the Andean Community, the leaders of the Group are making these initiatives to overcome these trends.

Free Trade and an Expanding Common Market

One of the major changes made in the reorganization of the Andean Pact and the formation of the Andean Community has been its new perspective on trade liberalization. Starting in 1991, the Community adopted its “open skies” policy and called for the elimination of tariffs within the group by 1993 ("Who Are We?- Andean Community -CAN."). Unlike the free trade zone of the 1970s, there would be little room for countries to pick out specific industries that would be exempt from the policy. On top of this, a common external tariff was outlined and due to be in effect by 1995. Foreign investment
would not only be tolerated but also encouraged as a way to bring jobs and industry to the member states ("Who Are We?- Andean Community -CAN.").

Many of the previously mentioned institutions, such as the Andean Business Advisory Council, were aimed toward encouraging privatization and market-oriented policies. The institutions of the Community's predecessor were designed to help member states control their economies through regulation, centralized planning and manipulation of industrial manufacturing. The aim of the institutions of the Community is aimed at encouraging private business to have a voice and take part in the integration process ("Who Are We?- Andean Community -CAN."). In 2000, ANCOM sponsored its 3rd Andean Business Forum in Lima. This Convention saw the participation of representatives from over 1,000 businesses from the private sector ("Who Are We?- Andean Community -CAN.").

Another one of ANCOM’s objectives was to encourage free trade with other countries outside the Community. On November 15, 2004, the Heads of Foreign Ministers of the Andean Community met with the Heads of Foreign Ministers of MERCOSUR and signed the Economic Cooperation Agreement. This agreement marked the creation of the fifth largest trade bloc in the world. Together, ANCOM and MERCOSUR, the bloc has over 350 million consumers, a gross national product of $800 billion and trade of $30 billion ("Mercosur, Ancom Create World’s Fifth Largest Trade Bloc." The World Trade Review). Negotiations over the issue of free trade have occurred between the Community, Chile, the European Union, the United States, and Canada. Free trade agreements have been made with all of these entities (International Monetary Fund, 2005). For example, Peru and Colombia have signed free trade agreements with
the United States (CIA – The World Fact Book). Trade agreements were made between Chile and Venezuela in 1993, Colombia and Chile in 1994, and Chile and Peru in 1998 (International Monetary Fund, 2005: 93). In 1998, ANCOM announced the beginnings of negotiations for an agreement with Panama ("ICTSD • ANCOM Looks Forward to Free Trade With Panama, Mercosur.").

Other efforts to liberalize trade were made by lowering tariffs and non-tariff barriers (NTBs). While tariffs and NTBs were eliminated between the Andean countries, Andean tariff walls were lowered in general toward third countries. The average tariff dispersion in the area declined from 30% in the mid-1980s to 10% by 2001. NTBs were also lowered from an average of 40% in the mid-1980s to around 6% in 2001 (International Monetary Fund, 2005: 92).

Since 1995 progress has been made in the establishment of a common market. In 1995, the four-level common external tariff came into effect. In 2003, the Community officially notified the World Trade Organization that the Community operates as a customs union. The transportation services between the member countries have been liberalized and Ecuador and Colombia began sharing electricity ("Who Are We?- Andean Community -CAN.").

In spite of the progress the Andean Community has made to foster trade, the Community, along with Latin America as a whole continues to lag behind the rest of the world in export goods and services. Even in comparison to other developing economies, the region is slow to accelerate trade. Between 1991 and 2001, for example, Latin American exports as a share of Gross Domestic Product rose from 15% to 21%. This remained low in comparison to Eastern Europe, Africa, and East Asian countries; Eastern
European countries had an average export share of GDP at 42%, African countries were around 35% and East Asian countries were around 32% (International Monetary Fund, 2005: 92).

Experts believe one of the main factors that cause this hindrance is the nature of Latin American export economies. Most Latin American exports are either raw materials or agricultural products. In order to protect domestic agriculture, most industrialize countries use subsidies and NTBs to discourage agricultural imports. Agricultural protectionism in industrialized countries is costly for Latin America. For example, if subsidies in the U.S. were cut by 50% exports from Latin America would increase by 9%. If subsidies were cut by 50% in Europe, Japan, and Canada, exports would increase by 20% in Latin America (International Monetary Fund, 2005: 96).

Conclusion

There have been a number of positive effects of free trade policies bases on privatization and democratization. According to ANCOM, since the signing of the Cartagena Agreement, there has been an 82-fold increase in intra-subregional exports, which rose from $111 million dollars to $9 billion 72 million by 2005. There has been a multiplication by 37 of accrued foreign investment, which climbed from $3.4 billion dollars in 1970 to $127.311 billion by 2005. The growth in manufactured products traded as a percentage among the Andean countries went from 48% in 1970 to 84% by 2005 ("Who Are We?- Andean Community -CAN."). Paul W. Moore and Rebecca K. Hunt of the U.S. Department of Commerce also reported a number of positive figures. They reported that only after one year the formation of the free trade area, trade between
Colombia and Ecuador rose 76%. Trade between Colombia and Venezuela increased 250%, from $1 billion to $2.5 billion. Overall trade between Peru and the rest of the Community rose 29% (Hunt, Rebecca K. and Moore, Paul, W., 1994: 1).

A number of factors explain these outcomes. First of all, a stronger commitment to democracy in the Community led to greater policy harmonization among member countries. An adoption of an open market-oriented policy in the Community freed trade. The encouragement of foreign investment brought more industries and created more jobs for Andeans. The presence of Reaganomics in world economics provided for lower tariffs in third countries, thus allowing Andean businesses to more easily sell their products abroad and also establish industries in Andean countries. Finally, the Community gave the member countries the ability to act as one voice in FTAA negotiations, effectively increasing their bargaining power ("Who Are We?- Andean Community -CAN.").

ANCOM still needs to overcome several obstacles before it can succeed in becoming a major economic force in the world like the European Union or NAFTA. In spite of recent advances in cooperation among member countries to promote stability and democracy, the Freedom House Index still ranks Bolivia, Ecuador, Colombia, and Venezuela as "partly free" (Freedom House Index, 2010). Civil strife, corruption and unstable government institutions in these countries impede economic growth and discourage foreign investment. On top of this, Andean countries need to dedicate more efforts towards improvements in infrastructure. Private enterprises complain about the high levels of congestion and insignificant organization in Andean ports. Delays because of customs administrative policies usually result in a wait of nine days instead of five
compared to most other countries (International Monetary Fund, 2005: 98). With the example of the advances made in the past two decades in the Andean Community, it can be seen that the member states of the Community should continue to pursue open economic policies.
CONCLUSION: FUTURE OR FRAGMENTION?

As shown by the Andean Community, developing countries have much to benefit by forming economic integration schemes and opening their economies. The basic structure of economic integration protects the individual economies against "giant" economies like those of the United States and Europe. Individually, these countries cannot compete with the "giant" economies. Through cooperation, the developed countries pool together and gain political and economic leverage in world affairs. Also, when the member countries of the Community invested in liberal open-economic policies, the overall economies of these countries experienced growth in exports and GDP. Economic progress was also made through combined efforts to promote democracy and political stability in the region. As of 2011, of all the member states of the Community Peru is the most politically stable. Peru is also the country that is growing fastest economically (ISA April 2011 Country Reports). As these same countries resorted to realist closed-economic policies their respective economies suffered because of the lack of trade and foreign investment.

The Andean Community has been one of the most successful integration schemes in history in spite of being located in one of the poorer regions in the world where countries tend to prioritize closed economies over open economies. Continued success will depend on the degree to which the Community is able to harmonize economic and political policy in order to promote further advances in trade and foreign investment. As this happens, other economies will look at the Community as one large market instead of many small markets. Capital, foreign investment, and trade agreements will more likely spill into the region.
The success of the Community also is in the hands of the individual member countries to avoid political turmoil. Any military coup, dictator or civil war can seriously hinder the Community's ability to integrate. The democracy of Bolivia, for example, was seriously threatened in 2008 when armed conflict erupted in Santa Cruz. Because of the high level of integration attained by the Community, severe political turmoil in one member country will negatively affect the other countries as well.

As part of policy harmonization, a renewed effort among the member countries to develop market-oriented economic policies will promote successful integration. The Community, like any integration scheme, needs policy harmonization because the sovereignty of the member states allows them to pursue their own course. However, if all the countries are committed to improving their economies, they are more likely to cooperate to achieve this. For this reason, the process will be helped if the privatization of their respective industries is achieved to the fullest extent possible.

Not only will this improve policy harmonization, it will also help improve their economies. For example, Venezuela's economy suffered after its government implemented the nationalization of the oil industry. Even after oil prices doubled among importer countries, wages for the oil workers in the country have been reportedly falling ("Venezuela's Oil-dependent Economy: Socialism on the Never-never | The Economist."). In the Community, the Ecuadorian government still has possession of many industries, including the oil industry. This is causing a reduced amount of private sector investment that is hurting the economy ("Ecuador." U.S. Department of State).

To an extent, some of the factors are out of ANCOM's control. There is always a risk that another economic crisis will hit the international market. Historically, economic
recessions have driven countries to adopt protectionist economic policies. The individual member countries of ANCOM should not be tempted to return to those policies if the long term success of the Community and of its member states is to be achieved. Cooperation with third countries could be threatened in a recession as well. For this reason, free trade agreements will in the long run benefit ANCOM and its members.

Another key factor is the direct participation of the Presidents in the leadership process. “The direct intervention of Presidents in the leadership of the process within the new model spurred integration and made it possible to attain the main objectives set by the Cartagena Agreement, such as liberalization of trade, adoption of a common external tariff, and the harmonization of foreign trade instruments” (“The Andean Community”: Welcome Page). The continued participation of private enterprise, labor unions, indigenous, and other local organizations will likely raise dedication and commitment to the Community and its goals.

A major concern for the Community is the loss of Venezuela and the toll the loss will have on the Community. Shortly after the withdrawal of Venezuela from the Community, the four remaining member countries expressed their continued commitment to the Community in spite of the loss. Unless one of the countries experience a major regime change, the likelihood that the Community will dissolve is unlikely. The ANCOM countries have felt negative effects because of the loss of Venezuela. In the case of Colombia, Venezuela was especially zealous in tearing down former trade links that had once been liberalized. In order for Venezuela to rejoin the Andean Community, the Venezuelan government will have to return to a market-oriented economic policy.
The Andean Community is a model for developing countries that are small or medium sized. The majority of the member countries set political disputes aside in order to create a stable environment so economic integration could survive. Combined with Mercosur, the Andean Community is the fifth largest free trade zone in the world. It has developed institutions and organizations that not only promote economic growth throughout the region, but also democracy and social justice.
REFERENCES


<http://findarticles.com/p/articles/mi_m1052/is_n5_v115/ai_16042990/>.


"Freedom House: Repeal of Decree Law in Peru A Win for Human Rights."


International Monetary Fund. "Stabilization and Reform in Latin America: a Macroeconomic Perspective on the Experience Since the Early 1990s."


"Who Are We?- Andean Community -CAN." *Comunidad Andina - Andean Community: Organismo De Integración Económica Y Social. Comercio, Relaciones Internacionales, Mercado Común, Normativa, estadisticas, Documentos, Noticias.*

Robben Dashiell Hixson: Honors Student

Birth date: July 22, 1987

Birth place: Salt Lake City, Utah

Address: 2173 Village Point Way
Sandy, UT 84093