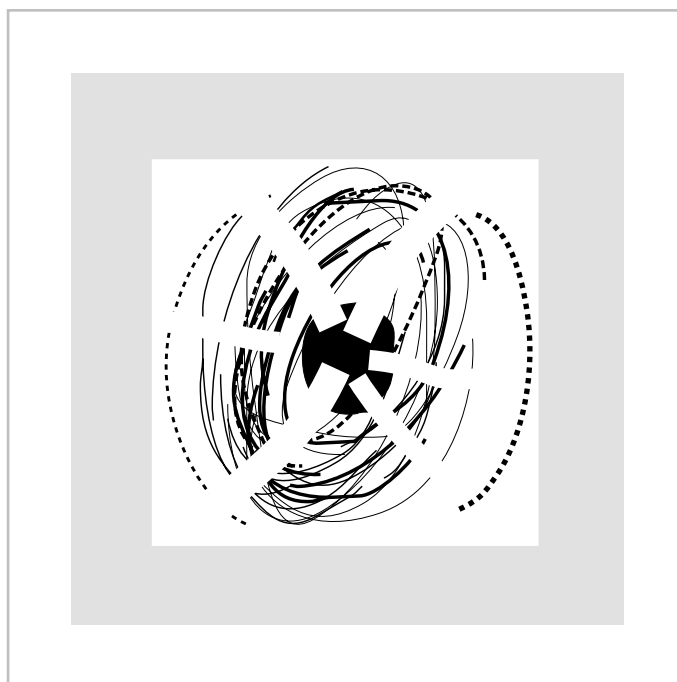


**2004**



# **Latin America and the Caribbean in the World Economy**

**2005 TRENDS**

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**UNITED NATIONS**

**ECLAC**

*Latin America and the Caribbean in the World Economy* is an annual publication prepared by the International Trade and Integration Division of ECLAC in collaboration with its Statistics and Economic Projections Division, the Commission's subregional headquarters in Mexico City and Port of Spain and its offices in Bogotá, Brasilia, Buenos Aires, Montevideo and Washington, D.C. The report was prepared under the supervision of Osvaldo Rosales, Director of the International Trade and Integration Division. Mikio Kuwayama, Officer-in-Charge of the International Trade Unit, served as the technical coordinator.

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The statistical appendix included in the attached CD-ROM was prepared by Jaime Contador with assistance from Andrés Yáñez.

#### **Notes**

The following symbols have been used in the tables in this document:

Three dots (...) indicate that data are not available or are not separately reported.

A dash (–) indicates that the amount is nil or negligible.

A full stop (.) is used to indicate decimals.

The word “dollars” refers to United States dollars, unless otherwise specified.

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United Nations publication

ISBN: 92-1-121443-2

ISSN printed version: 1680-8657      ISSN online version: 1681-0295

LC/G.2283-P

Sales number: E.05.II.G.117

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Printed in Chile

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# Trade and the world economy in 2004 and the outlook for 2005 and 2006

## Contents

	<i>Page</i>
<b>Abstract</b> .....	11
<b>Summary</b> .....	13
<b>Chapter I</b>	
<b>Trade and the world economy in 2004 and the outlook for 2005 and 2006</b> .....	29
<b>A. Introduction</b> .....	29
<b>B. The international economic climate in 2004</b> .....	30
<b>C. Recovery and dynamic growth in the United States</b> .....	33
<b>D. China in the emerging geography of world trade and production</b> .....	34
1. China as an international price maker .....	36
2. China as a new engine of world growth.....	37
3. China's revaluation dilemma.....	39
<b>E. Short-run prospects for the world economy (2005-2006)</b> .....	42
1. The current oil crisis.....	43
2. Risks and uncertainties.....	45
3. Possible adjustment scenarios .....	46
4. Consequences for Latin America and the Caribbean .....	47
<b>Bibliography</b> .....	49
<b>Chapter II</b>	
<b>Negotiations in the multilateral trade system. The World Trade Organization and regional expectations</b> .....	51
<b>A. Latin America and the Caribbean in the multilateral framework</b> .....	51
1. WTO and the legacy of the Uruguay Round.....	52
2. Beginning of a new round of negotiations: the Doha Round .....	54

<b>B. New stage in the Doha Round: topics of negotiation, interests and prospects</b> .....	55
1. The “July package” of 2004: coordinates and achievements .....	56
2. Market access .....	57
3. Further development of trading rules .....	67
4. Cross-cutting and institutional aspects .....	70
<b>C. The new framework and negotiation process</b> .....	73
1. Overview: shifting the Doha agenda? .....	73
2. Coordination among the actors and the role of Latin America and the Caribbean .....	74
<b>Bibliography</b> .....	76

## Chapter III

<b>Regional integration in Latin America and the Caribbean</b> .....	79
<b>A. A critical biennium for regional integration (2004-2005)</b> .....	79
1. Intraregional trade and opening .....	82
<b>B. Regional integration: principal debates and challenges</b> .....	90
1. Strengthening institutions .....	91
2. Harmonizing disciplines .....	91
3. Macroeconomic coordination .....	92
4. Improving infrastructure .....	95
<b>C. Energy integration in South America</b> .....	95
1. The energy ring in South America .....	96
<b>D. Regional integration in Latin America and the Caribbean: principal debates and challenges</b> .....	100
1. MERCOSUR .....	100
2. Andean Community of Nations .....	103
3. North American Free Trade Agreement (NAFTA) .....	104
4. Free Trade Agreement between Central America, the Dominican Republic and the United States (DR-CAFTA): a noteworthy accord .....	104
5. Caribbean Community (CARICOM) .....	108
<b>E. Dispute resolution and incorporation of common regulations</b> .....	111
1. Southern Common Market (MERCOSUR) .....	111
2. Andean Community .....	113
3. Central American Common Market (CACM) .....	116
4. Caribbean Community (CARICOM) .....	116
<b>Bibliography</b> .....	117

## Chapter IV

<b>Concern about a resurgence of protectionism in world markets</b> .....	121
<b>A. Introduction</b> .....	121
<b>B. Implications of the boom in textiles and wearing apparel following the expiration of the Agreement on Textiles and Clothing</b> .....	123
<b>C. Negotiations between the United States and China regarding its currency regime</b> .....	125
<b>D. The sugar and textile industries’ lobbies against ratification of the Free Trade Agreement between the Dominican Republic, Central America and the United States</b> .....	127
<b>E. WTO Appellate Body ruling on the European Union sugar regime</b> .....	131

<b>F. The WTO ruling on the cotton case brought by Brazil</b> .....	133
<b>G. Questioning of the European Union's banana import regime</b> .....	134
<b>H. Offshore outsourcing</b> .....	135
<b>I. The ruling concerning the Byrd amendment</b> .....	138
<b>J. The dispute concerning the cross-border supply of gambling and betting services</b> .....	139
<b>K. Boeing and Airbus: two giants lock horns</b> .....	140
<b>Bibliography</b> .....	142
<b>Chapter V</b>	
<b>Strategic perspectives on the relationship between China and the Latin American and Caribbean region</b> .....	145
<b>A. China in the world economy</b> .....	145
1. Growth of trade between the Latin American and Caribbean region and China .....	152
2. Latin American specialization in Chinese markets .....	154
3. Chinese FDI in Latin America and the Caribbean. ....	157
4. China's new regional integration strategy: a challenge for Latin America and the Caribbean?.....	158
<b>B. Building partnership</b> .....	159
<b>C. China's accession to WTO</b> .....	160
1. Introduction .....	160
2. China's WTO commitments .....	161
3. Improvements made by China after the transitional period: a long way still to go .....	167
4. The concept of market-economy status (mes) and its application .....	168
5. Countries granting market-economy status (mes) to China .....	170
<b>D. Strategic aspects of relations between China and South America</b> .....	171
1. Free-trade agreement with Chile .....	173
2. Investment initiatives in South America .....	174
<b>Bibliography</b> .....	177
<b>Chapter VI</b>	
<b>Trade, security and transport</b> .....	181
<b>A. The Bioterrorism Act</b> .....	181
<b>B. Standards and regulations in the region's main markets</b> .....	184
1. United States .....	184
2. The European Union .....	185
<b>C. Traceability</b> .....	186
<b>D. Transport costs</b> .....	188
1. Trade developments .....	188
<b>E. New transport security standards</b> .....	191
1. A multilateral measure .....	191
2. Voluntary measures .....	192
<b>F. Complementarity between trade facilitation and security</b> .....	195
<b>Bibliography</b> .....	196

## Tables, figures and boxes

Table I.1	Price variations for some commodities.....	36
Table II.1	Participation of Latin American and Caribbean countries in interest groups of the multilateral system.....	53
Table II.2	Basic content of the Doha Round, as determined at the fourth WTO Ministerial Conference, 2001 .....	55
Table II.3	Coordinates of the 2004 “July package” .....	56
Table II.4	Bound and applied tariffs, selected countries .....	64
Table III.1	Latin America and the Caribbean: external relations .....	81
Table III.2	Latin America and the Caribbean: total exports by subregional integration scheme, 1990-2004.....	83
Table III.3	Destinations of exports of principal subregional integration schemes in Latin America and the Caribbean, 2004.....	85
Table III.4	Structure of exports from main subregional integration schemes in Latin America and the Caribbean, 2004 .....	85
Table III.5	Southern Common Market (MERCOSUR): intra-subregional trade market share matrix, 2004 .....	88
Table III.6	Andean Community: intra-subregional trade market share matrix, 2004 .....	88
Table III.7	Central American Common Market (CACM): intra-subregional trade market share matrix, 2004 .....	89
Table III.8	Caribbean Community (CARICOM): intra-subregional trade market share matrix, 2004.....	89
Table III.9	North American Free Trade Agreement (NAFTA): intra-subregional trade market share matrix, 2004 .....	90
Table III.10	Subregional integration schemes: comparison of selected macroeconomic convergence indicators, 2002 and 2004.....	94
Table III.11	Central American Common Market (CACM): principal topics covered in bilateral accords signed by the subregion and comparison with current community regulations .....	107
Table III.12	Central American Common Market (CACM): competition in the intra-subregional market after the signing of DR-CAFTA: possible diversion of intra-subregional trade.....	107
Table III.13	MERCOSUR: incorporation of community regulations into domestic legislation.....	112
Table III.14	MERCOSUR: consultations with the trade commission by requesting country, 2003-2004 .....	113
Table III.15	Andean Community: actions for non-compliance with community regulations.....	114
Table III.16	Andean Community: decisions with statement of grounds, 2000-2004.....	115
Table V.1	China: foreign trade matrix and composition of the deficit/surplus, by technological intensity of goods, 2004.....	148
Table V.2	China: main foreign investment strategies, 2000-2005 .....	149
Table V.3	Foreign direct investment: alliances and cooperation in sectors involved in raw-materials-seeking strategies (selected operations), 2000-2005 .....	151
Table V.4	Asia and the Pacific: share in Latin American and Caribbean trade.....	152
Table V.5	Latin America (13 countries): China's position as a destination market for total exports, around 1990 and 2004 .....	153
Table V.6	China: main products imported from five Latin American countries, 2004.....	155

Table V.7	China: tariff preferences extended in bilateral and plurilateral negotiations, February 2005 .....	158
Table V.8	China's compliance with WTO obligations .....	162
Table V.9	Countries granting mes to China .....	170
Table V.10	Trade relations between China and selected Latin America and Caribbean countries and main results of the state visits made by the chinese president Hu Jintao in the region .....	176
Table VI.1	Maritime freight charges between selected ports .....	189
Table VI.2	Ports included in the container security initiative (CSI).....	194
Figure I.1	World economic indicators .....	31
Figure I.2	Annual flows of dollar assets purchased by central banks, the current account deficit and the real exchange rate in the United States, 1985-2004.....	34
Figure I.3	Trends in exports and imports, by major country categories.....	35
Figure I.4	Trends in current accounts, by region and country.....	40
Figure I.5	Trends in international reserves.....	40
Figure I.6	Oil: trends in supply, demand and real prices.....	44
Figure I.7	Impact of oil prices, measured as a percentage of exports, 2004 .....	48
Figure II.1	Structure of producer support estimate (PSE) per product in selected countries, average 2000-2003.....	59
Figure II.2	Regional trade agreements.....	72
Figure III.1	Latin America and the Caribbean: intraregional trade, 1980-2004 .....	82
Figure III.2	Intraregional trade coefficients in various developing regions and in Latin America and the Caribbean, 1990-1994 and 2000-2004 .....	84
Figure III.3	Latin America and the Caribbean (integration schemes): intra-group trade coefficients, 1980-2004.....	85
Figure III.4	Regional comparison of openness coefficients, 1980-2004 .....	86
Figure III.5	Openness coefficients in different developing regions and Latin America and the Caribbean: 1990-1994 and 2000-2004 .....	87
Figure III.6	Latin America and the Caribbean: openness coefficients of the principal subregional integration schemes, 1980-2004 .....	87
Figure III.7	Latin America and the Caribbean: distribution of total primary energy supply (TPES), 2003.....	98
Figure III.8	MERCOSUR: consultations with the trade commission by type of non-tariff barrier, 1995-2004 .....	112
Figure III.9	Andean Community: opinions with statement of grounds issued by the General secretariat, 2000-2004 .....	115
Figure V.1	China: domestic consumption as a percentage of worldwide consumption of selected products, 1990 and 2004.....	146
Figure V.2	China: trends in the composition of exports, by technological intensity, 1990, 1995 and 2004.....	147
Figure V.3	China: foreign trade mix, by destination and origin, 2004 .....	147
Figure V.4	China's imports from Latin America and the Caribbean .....	153
Figure V.5	China: imports from ASEAN and from Latin America and the Caribbean, 1999 and 2003 .....	154
Figure V.6	Breakdown of China's trade balance with Latin America and the Caribbean, 1995, 2000 and 2003.....	156
Figure VI.1	Latin America (17 countries) and subregions: changes in the incidence of transport costs (January-June of each year).....	190
Figure VI.2	International architecture on trade facilitation.....	195

Box II.1	Principal agriculture reform features contained in the July package.....	60
Box III.1	North American Free Trade Agreement (NAFTA): agenda for prosperity and security.....	105
Box III.2	Free Trade Agreement with the United States (DR-CAFTA): challenge for the CACM integration process and lessons for the Andean Community .....	106
Box III.3	The CARICOM single market and economy (CSME) in the Organization of Eastern Caribbean States (OECS) .....	109
Box V.1	Does China pose a threat to Latin America? .....	157
Box V.2	China and its free trade agreement with ASEAN .....	159
Box V.3	How do the United States and the European Union determine mes?.....	169
Box VI.1	The bioterrorism act: summary of its four provisions .....	182
Box VI.2	Costa Rica: Public-private support for implementation of the bioterrorism act.....	183
Box VI.3	Meat traceability: an example of the steps required .....	187



## Abstract

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The 2004 edition of *Latin America and the Caribbean in the World Economy*, which reviews the past year and looks at trends in 2005, is divided into six chapters.

Chapter I examines recent developments in the world economy, particularly the major changes occurring in the structure of international trade and financial flows and their implications for the Latin American and Caribbean countries.

Chapter II analyses the international negotiations taking place within the framework of the World Trade Organization (WTO). These multilateral negotiations have yet to result in the anticipated convergence, although the participants have shaken off the discouragement that came with the frustrated expectations of Doha and the failure of Cancún, when the original 2005 deadline for the talks' conclusion was pushed back. The chapter gives an account of the negotiations on the main topics under consideration. It also assesses the potential for the success of this process, in which the countries of the region have maintained an increasingly active presence as exemplified by Brazil's leading role in the establishment of the Group of Twenty (G-20).

Chapter III looks at the status of regional integration efforts at this critical juncture, as a number of the region's countries become more actively engaged in North-South negotiations with the United States and the European Union. This situation underscores the need to harmonize the trade agenda's different levels and highlights the classic challenges of subregional integration, i.e., how to go about strengthening the institutional structure for integration, harmonizing disciplines, ensuring macroeconomic coordination and dealing with asymmetries.

Chapter IV discusses protectionist trends in the world economy and especially in developed countries. The analysis covers the pressures being exerted on China's textiles sector, the main agricultural issues and the favourable rulings secured by some developing countries through the Dispute Settlement Body of WTO.

Chapter V considers the strategic aspects of economic and trade relations between China and Latin America and the Caribbean, particularly South America. China has become a major actor in world markets for goods, services and capital and is becoming a valuable strategic ally for the Latin American and Caribbean countries in trade-related matters and negotiations. This chapter reviews the formidable network of trade and investment agreements that has grown up between South America and China, which is engendering expectations of a new type of relationship between the two.

Chapter VI provides a Latin American and Caribbean perspective on the complex links that have developed among trade, security and transport as security measures are tightened in the wake of terrorist attacks in the United States and Europe.



## Summary

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### Introduction

In 2004-2005 the international economy has been influenced by two phenomena that have been taking shape for a number of years now. The first is a new geography of international trade and financial flows, one of whose most salient features is China's greater presence in the world economy and financial system. The second has been the United States economy's strong reactivation in 2004, which has made the global economy's growth pattern more dependent on this country. These two factors, which go a long way towards accounting for the robust expansion of the international economy and trade flows in 2004 and 2005, have both direct and indirect effects on the Latin American and Caribbean economies, given how important the United States and China are to the region as trading partners. The nature of these effects is largely determined by these two economies' particular modalities of growth, as well as the structure of their trade and financial ties. The impact is also shaped, however, by the specific ways in which the region is linked to these two economies and by the profile of its trade and financial relations with the global economy.

The outlook for Latin American and Caribbean trade activity is encouraging, thanks to the dynamic growth of the world economy, and particularly the emergence of China, India and other developing Asian countries as new

global players in the production sector, trade and financial movements. Although there are still factors that provide grounds for a certain degree of pessimism (including the United States' hefty twin deficits, high petroleum

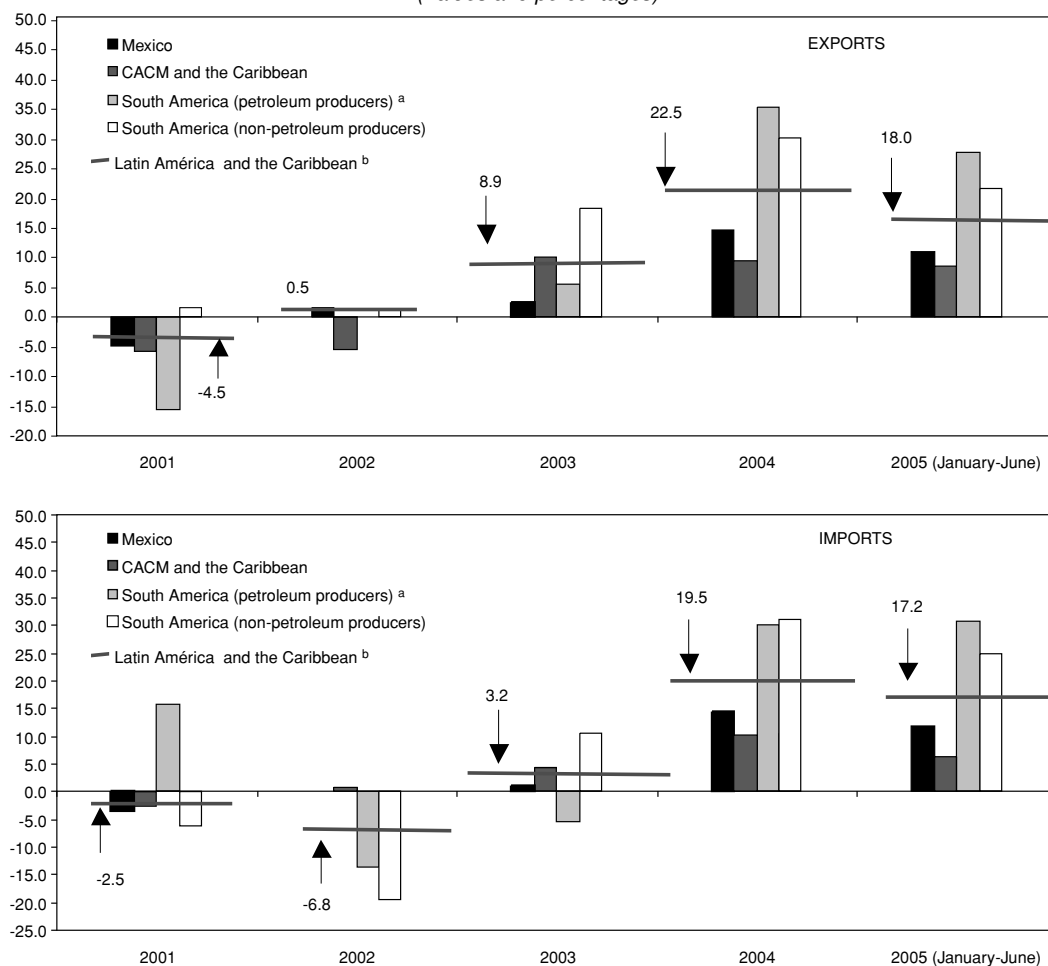
prices, the possibility of interest-rate hikes, an increase in antidumping complaints and in the use of safeguards), on balance, the situation in 2005 remains promising. In the first half of the year, the region's merchandise exports rose by 17%, with the South American countries outpacing Mexico, Central America and the Caribbean in this regard. A similar pattern was seen in imports. If commodity prices continue to climb, the region will see another strong increase in its trade flows, as occurred in 2004 (see figure 1).

The world economy's momentum drove up the growth of merchandise trade in 2004 to a 25-year peak and promises to keep it high in 2005. Within this framework, the trade activity of developing countries has

risen sharply. This is mainly attributable to the expansion of intraregional trade flows that is occurring among the Asian countries as their production linkages with China multiply, thereby spurring on the Asian region's already ample intra-industry trade flows.

Also on the horizon, however, is a marked upswing in the use of protectionist measures such as antidumping actions, safeguards and export quotas. The industrialized countries, especially the United States and the European Union, have increasingly been taking recourse to such measures to shield themselves from developing-country imports, particularly from Asian nations, and protectionism is thus beginning to pose a serious risk to world trade. These potential threats raise a number of

Figure 1  
**LATIN AMERICA AND THE CARIBBEAN: GROWTH RATES OF  
MERCHANDISE EXPORTS AND IMPORTS, 2001-2005**  
(Values and percentages)



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries' statistical offices, customs offices and central banks.

<sup>a</sup> The petroleum-producing countries in South America are: Bolivarian Republic of Venezuela, Colombia and Ecuador. The non-petroleum-producing countries are Argentina, Bolivia, Brazil, Chile, Paraguay, Peru and Uruguay.

<sup>b</sup> 37 countries.

concerns about the Doha Round negotiations and have prompted developing countries to consolidate or broaden their access to industrialized-country markets through the conclusion of bilateral free trade agreements. Recent disputes regarding agricultural products that have been brought before WTO have also called some the developed countries' policies in this regard into question.

The negotiations on market access, standards and other institutional matters taking place in the framework of WTO gained some momentum with the July package, but the overall picture is still rather discouraging. As signalled by the outgoing Director-General of WTO, this raises some urgent questions with regard to the Sixth Ministerial Conference, to be held in December in the Hong Kong Special Administrative Region of China (WTO, 2005). The absence of signals from the main parties to the negotiations on agricultural trade, which is one of the pillars of these talks, inevitably slows progress on the other issues. The failure to make headway on the development dimension, which is a prime motivating factor in the Doha Round, also calls for changes in attitudes and approaches. In particular, progress on market access for agricultural and non-agricultural goods and services continues to hinge on the conclusion of agreements on "modalities". These accords will not be enough to move the talks forward, however, unless rules on antidumping actions, trade facilitation

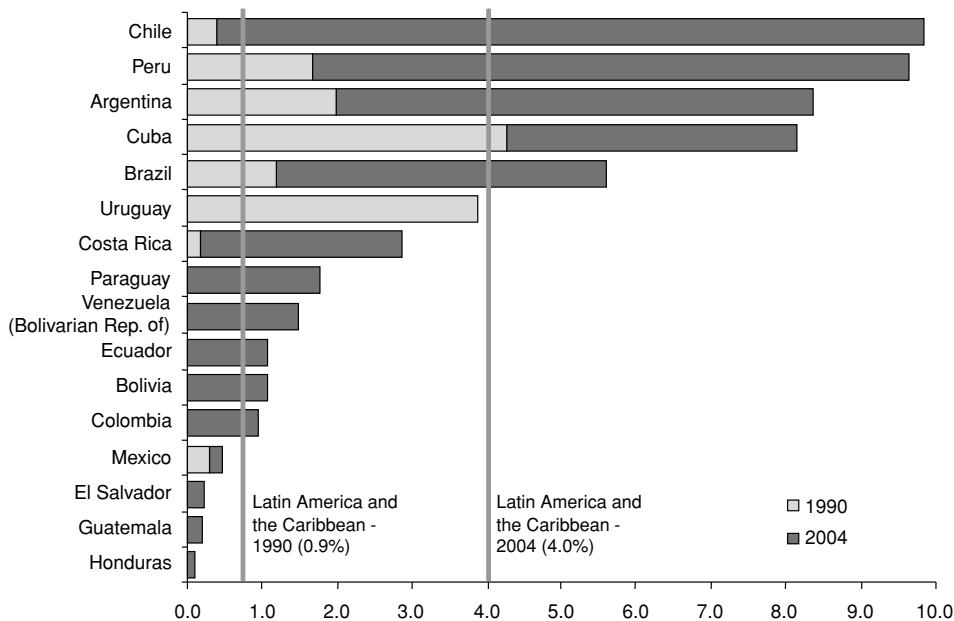
and dispute settlement, among other matters, are also developed and refined.

This is a defining moment for regional integration. The Doha Round has run up against some difficulties, and the countries are concluding an increasing number of intra- and extraregional bilateral trade agreements. This makes it essential to achieve greater coherence among trade policies at the multilateral, hemispheric, subregional, bilateral and unilateral levels. Given the multiple tiers of negotiations, together with the kaleidoscope of decisions involved, a clear internal consensus must be reached on international trade priorities and on means of ensuring consistency among the different public policies.

China's role in Latin American trade has expanded during this decade, and bi-regional trade between the Latin American and Caribbean region and Asia and the Pacific is increasingly shaped by the predominance of China. Japan was the region's biggest customer until recently, but China has now largely displaced it as the leading Asian buyer of Latin American products. The marked concentration of China's trade with Latin America and the Caribbean as a whole is notable for its dynamism (see figure 2) and is gradually diversifying to include a broader range of countries and products.

For the South American countries, China — with its voracious demand for the natural resources that abound in the subregion— represents the world's most

Figure 2  
**LATIN AMERICA AND THE CARIBBEAN: CHINA'S SHARE OF TOTAL EXPORTS, 1990 AND 2004**  
*(Exports to China as a percentage of total exports)*



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the countries.

populous and fastest-growing market. If Chinese demand for commodities and natural resources involving a low or intermediate degree of processing remains high, the South American countries can expect their exports and terms of trade to be reinforced for some time to come. China also offers investments, especially in infrastructure, energy and mining, where these funds could provide supplementary financing for the implementation of major works.

An interesting challenge in this regard is to identify the cases in which Chinese investment would be the most helpful in accelerating the implementation of infrastructure and energy projects. As well as strengthening investment and trade facilitation links with China and the Asia-Pacific region, this would generate externalities for the integration process itself. The region's trade with China suffers from the same constraint that limits all of its international trade activity, namely the high proportion of commodities and semi-processed goods in its export basket. The Latin American and Caribbean region must make every effort to increase the degree of processing of

its natural-resource-based exports and seek new Chinese markets for differentiated, higher value-added products. The current product mix, which is highly dependent on the business cycles of importing countries, does little to stabilize export earnings.

Tariffs have tended to decline in importance as barriers to trade, but new measures such as technical, sanitary and phytosanitary standards and rules on transport and logistical security are now having a growing impact and are starting to have a decisive impact on systemic competitiveness. In addition to low prices, systemic competitiveness is determined by such factors as adequate infrastructure, efficient transport systems, and streamlined customs procedures. Economic agents that are able to meet these new standards are in a position to secure competitive advantages. Steps therefore need to be taken to strengthen the institutions involved in trade logistics, harmonize standards and regulations at the regional and multilateral levels, and improve capacity-building, especially for small and medium-sized exporters.

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## The current status of the global economy and the outlook for the region

The upturn in the global economy that began in the second half of 2003 continued to strengthen during most of 2004, when its growth rate reached a 30-year high. Although this boom took in many of the world's regions, it was most pronounced in developing Asia. This group of countries' performance was strongly influenced by the exceptional performance of a few of its members, such as China (9.5% GDP growth in 2004) and India (7%). Even if Asia is factored out of the calculations, however, the developing regions still posted an impressive 5% growth rate in 2004. What is more, it was probably the first time in the last 30 years that the developing countries entered a growth phase ahead of the developed nations. The buoyancy of the Chinese economy alone accounted for 15% of the global recovery in 2002-2003.

Thanks to the global upturn, in 2004 merchandise trade expanded faster than it had for a quarter of a century, rising at a nominal rate of 21%. This surge reflected sharp increases in the dollar-denominated prices of many products, as well as the large volumes traded. South America's real goods trade picked up especially strongly, outpacing the other world regions. The increases in the prices of petroleum and other commodities and the

upturn in trade in electronics and telecommunications equipment helped the developing countries to achieve a truly extraordinary 31% share of global merchandise trade, which was the largest proportion recorded since 1950. The value of trade in services rose by 16% in 2004, after an even higher increase in 2003. Both these figures reflected a powerful upswing in transport and travel.

Net financial flows to Asian and emerging European economies jumped by 40% in 2004. This was mirrored in Latin America and the Caribbean, whose inward FDI flows climbed by a robust 44% in 2004. At the global level, private capital flows declined as both direct and portfolio investment slipped. The decrease was counterbalanced by official flows, as State authorities in the Asian countries, particularly China, bought United States treasury bonds. This is, in effect, the financial manifestation of a shift in the structure of global demand, with large trade surpluses in the Asian economies helping to finance the United States' current account deficit, which was equivalent to 6.3% of GDP at the end of 2004. Since the upturn in world growth is closely tied to United States consumption levels and, to an extent, investment, the situation calls for increased savings rates on the part of other countries

and the expansion of exports to that market in order to satisfy a demand that is outstripping supply.

The recent revaluation of the yuan must be analysed in the light of these factors. The United States' large external imbalance can only be dealt with by limiting absorption and adjusting relative prices. To achieve the former, the United States must tighten its fiscal and monetary policies to gradually rein in the expansion of expenditure and bring it into line with potential GDP. The latter takes the form of a devaluation of the United States dollar relative to the currencies of economies that are benefiting the most from trade with the United States, namely the Chinese and Asian economies. Given the United States' significance in the world economy, a slowdown there, coupled with a marginal downturn in the developing Asian economies, will have to be accompanied by a higher level of activity in Europe and Japan if the global economy is to avoid a hard landing. These two elements, which are essential in order to dismantle current global financial imbalances, have yet to be factored into growth projections, however.

Most such projections point to a slackening of growth in world output in 2005 and 2006, with rates of between 3.0% and 4.3%. The main factors involved here are: (i) the dampening effect on global demand of higher oil and commodity prices; (ii) exchange-rate adjustments among the main international currencies; (iii) the uncertainty generated by steeper interest-rate hikes; (iv) difficult fiscal situations in many countries, and (v) the threat of global neo-protectionism associated, in particular, with reactions to the increase in Chinese exports.

The current state of the world petroleum market suggests that prices will remain high. According to the conventional calculations, a US\$ 10-per-barrel increase causes world output to fall by half a percentage point

and Latin American output to dip by 0.2 points. In 2004 the price of oil (West Texas Intermediate) averaged US\$ 41.40 per barrel and was projected to reach US\$ 53 by mid-August 2005.

With a tighter fiscal policy and the recent increases in its benchmark interest rate, the United States is expected to post a lower growth rate, of between 3% and 3.6%, in 2005 and a similar rate in 2006. Meanwhile, the European Union is also expected to slow its rate of expansion as a result of more restrictive fiscal policies. The euro zone is projected to grow by only 1.2%-1.6% in 2005 and by 2.0%-2.3% in 2006. In Japan, higher interest rates will curb investment, the fiscal stimulus will weaken and the economy's external surplus will decrease. These factors will hold its growth rate down to around 1% in 2005 and possibly 2% in 2006. Thanks to China's present efforts to cool its economy, economic activity is expected to expand at a rate of between 8.5% and 9.0% in 2005 and by between 8.0% and 9.2% in 2006. Even this somewhat lower growth rate in China will still be high enough to keep GDP growth in the developing countries above the world average, however.

The slower growth rates expected for world output will help to weaken international demand and reduce the volume of international trade, which will expand by only 7.2%-7.4% in 2005, or some two percentage points below the 2004 rate. Global export volumes are expected to be slightly higher in 2006 than in 2005, but the rate of price increases for certain commodities is likely to slacken. Although smaller price rises for commodities, higher petroleum prices and higher interest rates mean that the world economy and trade will be less buoyant in 2005 than in 2004, 2005 will still be a good year for world trade and output, with a dynamic performance being turned in by developing countries, in general, and by Latin America and the Caribbean, in particular.

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## Negotiations in the multilateral trading system: WTO and regional expectations

The negotiating and working agendas established at the Fourth Ministerial Conference of WTO, held in Doha in 2001 (the Doha Round), cover market access issues, the refinement of trade rules and topics that deal explicitly with the concerns of developing countries. However, the debates that arose in the wake of that conference and, in particular, after the following conference, held in Cancún, Mexico, in September

2003, have pushed back the conclusion of this round beyond its original deadline.

The main stumbling blocks to progress in these talks were encountered in the work on agricultural reform and the debates on the development dimension (including special and differential treatment and implementation-related issues). The Fifth Ministerial Conference inherited this climate of discord, which was exacerbated by the

controversy over the so-called “Singapore issues”, which the developing countries have staunchly resisted. The disagreements that had arisen in the aftermath of Cancún were broadly resolved by a decision taken on 1 August 2004, known as the “July package”. Although no new date has been set for the completion of the Doha Round, it is tentatively expected to conclude in 2006. This will depend, however, on the outcome of the forthcoming Sixth Ministerial Conference, to be held in the Hong Kong Special Administrative Region of China in December 2005. The recent meeting of the General Council of WTO, held on 29 July 2005, which was expected to be a landmark event in this process, failed to give any sign of a convergence of the countries’ positions.

Be that as it may, the July package did change the climate of the post-Cancún talks and steered the process in a new direction by determining a number of important matters: (i) the start of negotiations on trade facilitation, which was the only Singapore issue on which consensus was reached; (ii) an agreement to eliminate subsidies on agricultural exports, reduce and discipline subsidy-equivalent measures, secure a substantial reduction in trade-distorting domestic support and incorporate negotiations on cotton; (iii) guidelines for the liberalization of industrial goods based on bound tariffs, without admitting new sub-categories of developing countries but reaffirming the flexibility and corresponding technical assistance required by those countries; and (iv) the establishment of new deadlines for certain tasks, including dispute settlement, development issues and services offers.

It remains very difficult to specify modalities for the three pillars of agricultural reform, since there are major differences in the countries’ underlying structures, be they tariff- or subsidy-based. In addition, exporting countries are not in favour of the proposals that have been tabled for increasing the flexibility and diversification of instruments or for establishing differentiated deadlines for developing countries (which is also an aspect of modality definition), and wish to see a limit on such concessions. Lastly, the possibility of agreeing to a standstill commitment until the round is completed is another key issue. Although some progress has been made this year, a consensus does not yet exist regarding even a preliminary approach to the establishment of modalities in this connection.

Up to July 2005, the work on market access for non-agricultural goods had focused on modalities and technical questions such as conversion to ad valorem equivalents, the treatment of unbound tariffs and sectoral liberalization. Issues of particular concern to developing countries include the proposed degree of tariff binding

and a cap on unbound tariffs. Along with agricultural issues, much of the work has centered on defining a tariff reduction formula and determining what flexibilities are to be extended to developing countries. These are all issues about which developed and developing countries have strongly disagreed. The pace of negotiations on services has picked up in recent months, but progress on the requests-and-offers process and in the discussions on rules and cross-cutting issues has been so slow that he talks on these matters may be reaching a crisis point.

Trade facilitation is an important topic that has been brought into the negotiations on trade rules, but little progress has been made towards specific guidelines on antidumping and subsidies. Deadlines for the Agreement on Trade-Related Aspects on Intellectual Property Rights (TRIPs) have been reviewed, but the proposals made by developing countries regarding the distribution of benefits do not appear to have been taken up. These issues clearly have an impact on competitiveness, and although the developing countries are in need of such regulations, they are reluctant to move forward in these areas because of the costs involved.

With regard to cross-cutting institutional matters, some headway has been achieved on development issues with the incorporation of the cotton initiative, but less progress has been seen in other areas of work in terms of the constraints affecting developing countries (particularly in regard to implementation-related issues, which is one of the areas in which talks are the furthest behind schedule). More specific guidelines or signals are expected in relation to the Dispute Settlement Body, which is not part of the single undertaking, although in fact the system operates very well and could help to carry the negotiations forward (see section 5). The work on regional trade agreements has made headway with the issue of transparency and as its pace picks up further, it may help to spur the talks on other topics.

At Cancún, the configuration of the various groupings and clusters, which included the G-20, attested to the conditions and active participation of the developing countries. After that conference, however, new alliances have formed that cut across the pre-existing ones. One such cluster involves a handful of WTO members, most of which are large economies from the developed and developing worlds, that have differing positions on a given issue. Other group forums are also playing an increasingly important role. These groups, which take the form of “mini-ministerial meetings” and sessions held within the framework of conferences convened by other international bodies, are helping to coordinate different parties’ interests and help to move the negotiating process forward.

In the formation of country groupings based on



common negotiating stances, the Latin American and Caribbean region has come to play an important and, to some extent, leadership role among the developing countries. Structural and policy-based differences exist, however, make it difficult to arrive at a consensus position on all the issues under consideration. Given the countries' differing economic sizes, production and commercial structures, trade policies and development strategies, unified action in all the areas under negotiation is a highly complex undertaking. This hinders efforts to formulate a "regional" proposal for the Doha Round negotiations, on the one hand, and, on the other, encourages the formation of shifting alliances among countries of the region. The challenge here is to build upon those areas where the

countries' views do converge while providing scope for subtly differing stances on the rest without undercutting the cohesiveness of the countries' positions on the main issues, especially agriculture and the development dimension. Under these circumstances, it is all the more important to devise strategies for positioning the countries within the development process. The countries of the region are also increasingly aware of the need to complement trade agreements with domestic policies (forming what has come to be known as the "domestic agenda") in such areas as competitiveness, infrastructure, technological innovation and the modernization of small and medium-sized enterprises (SMEs).

### 2004-2005: a critical biennium for regional integration

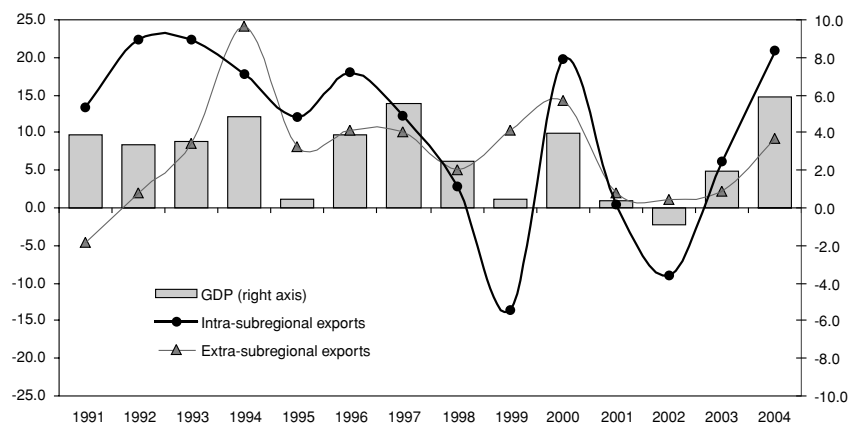
For the second year in a row, 2004 saw a reversal of the downward trend in intraregional trade observed in 2001 and 2002, although the figures still fell short of the record level posted in 1997. Intraregional trade in Latin America and the Caribbean remains low (17%) by comparison with Asia (34%) and the European Union (62%). It is also markedly procyclical (see figure 3).

The low density of trade within subregional integration groups is attributable to various factors, such as slow economic growth, the small size of subregional markets, and the presence of similar export structures that tend to be concentrated in natural resources and that consequently cater primarily to industrialized markets.

Furthermore, the infrastructure for trade within such groups is generally displays greater shortcomings than the infrastructure used for world trade. In addition, trade flows within subregional groups are increasingly made up of manufactures, which are highly sensitive to the business cycle. The growth rate's instability therefore ends up deterring export diversification.

The negotiations between MERCOSUR and the European Union were not completed in 2004 as scheduled and will probably have to wait for the close of the Doha Round in order to rebuild their own political momentum. MERCOSUR has expressed an interest in opening free trade negotiations with the Caribbean Community

Figure 3  
LATIN AMERICA AND THE CARIBBEAN: GDP AND INTRA-SUBREGIONAL AND  
EXTRA-SUBREGIONAL EXPORTS, 1991-2004  
(Annual percentage variation in constant 2000 values)



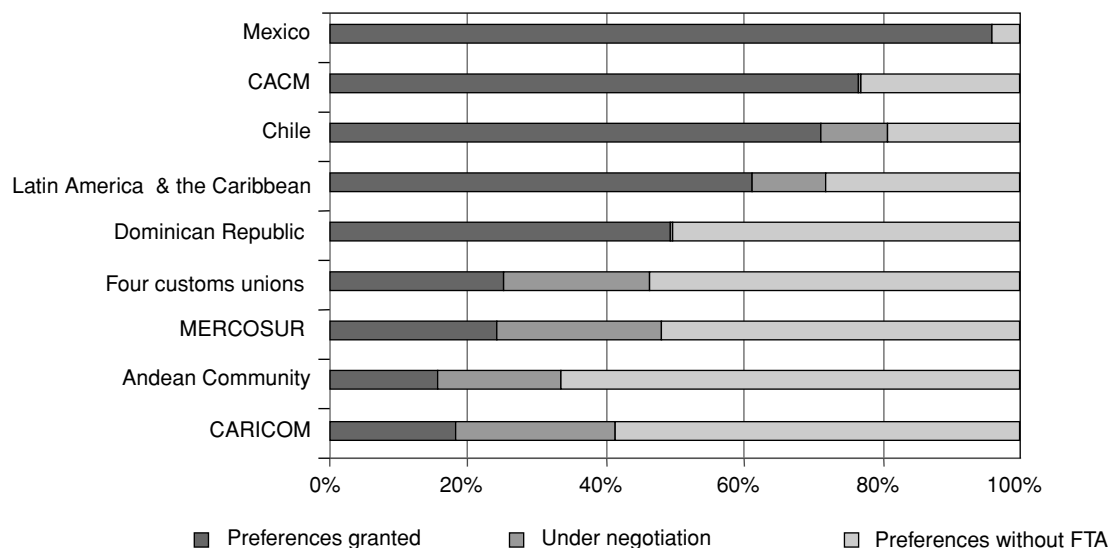
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data.

(CARICOM), Mexico and Morocco in 2005, as well as in reaching partial-scope agreements with India and the Southern African Customs Union (SACU). The Andean Community and MERCOSUR concluded their free trade negotiations and, except in the case of Peru, the resulting agreement has already entered into force. At the beginning of July 2005, the MERCOSUR countries became associate members of the Andean Community, while Chile is expected to follow suit within the next few months. The Andean Community itself is in negotiations with El Salvador, Guatemala and Honduras, and three members of its members (Colombia, Ecuador and Peru) are negotiating a free trade agreement with the United States. CARICOM, meanwhile, is engaging in trade negotiations with Canada and the European Union. There is a crowded agenda for international negotiations, in addition to the region's involvement in the multilateral talks being pursued in the Doha Round. At times, the sheer scale of the agenda can distract the countries' attention from the necessary effort to update subregional integration schemes and make them more efficient, particularly inasmuch as the problems these schemes encounter will not be solved by accumulating extra-community agreements.

Within the existing framework of multi-tiered negotiations, integration mechanisms have shown no signs of remedying some of their traditional failings, such as the weakness of the relevant institutions and

particularly of dispute resolution mechanisms; the failure to enforce community rules once they are adopted; lack of macroeconomic coordination and insufficient attention given to asymmetries within the integration groups. Bilateral South-North agreements (such as the free-trade agreement among the Dominican Republic, Central America and the United States (the expanded CAFTA) which has just been ratified by the Dominican Republic, the agreement between the United States and three countries of the Andean Community (Colombia, Ecuador and Peru) that is now being negotiated, and the efforts being made to arrive at an association agreement between MERCOSUR and the European Union) put added pressure on the region's integration schemes, inasmuch as they include commitments on wider and more far-reaching issues than those addressed by the integration schemes themselves. The dilemma lies in how to preserve the core objectives of integration by rapidly realigning these schemes to prevent them from being overtaken by the course of events or corporate decisions. This is a formidable challenge, as the agenda must now be configured to cope with the asymmetries that are reflected in more demanding commitments with Northern partners and less rigorous ones with subregional groups. These negotiations with the North will result in a notable erosion of intraregional tariff preferences within the four customs unions (see figure 4), and the present situation thus calls for an effort to review and update subregional integration agreements.

Figure 4  
LATIN AMERICA AND THE CARIBBEAN: TARIFF PREFERENCES AS OF JULY 2005  
(Percentages of total exports)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data.

The region's economic actors tend to see trade agreements with industrialized economies as more binding, with more reliable dispute settlement mechanisms and, as a result, greater legal certainty for investment and foreign trade decisions. In addition, trade agreements with the United States or the European Union include potential investment or service commitments that would entail granting most-favoured nation status, and this means that the region's integration schemes have to abide by decisions in which they have taken no part. This spillover opens the door to a rapid reappraisal by the countries of the rules and institutions of their integration efforts while maintaining the idea of an expanded market in which there is free movement of goods and factors, in combination with real progress towards macroeconomic coordination, genuinely binding dispute settlement mechanisms, a proper approach to existing asymmetries, the creation of structural funds to provide evenly distributed benefits and bold initiatives in the energy and infrastructure sectors.

The "energy ring" initiative in the Southern Cone—a bold step that calls for a high level of policy coordination and consistency among the countries involved—is an excellent example worthy of emulation. The creation of this energy ring constitutes a formidable challenge, yet, the priority thus far assigned to this effort by the participating governments and the interest shown in it by foreign investors and multilateral lending institutions provide grounds for cautious optimism regarding this initiative's chances

of success. The scale of the project is such that it could mark a turning point in regional integration by facilitating the adoption of additional measures to reinforce economic and trade complementarity among South American economies.

The importance of the gradual harmonization of the various rules and disciplines employed by subregional integration schemes as a contributing factor in the region's competitiveness has been somewhat underestimated. Efforts should be made to regionalize the rules of origin on a plurilateral basis encompassing all the countries involved. This would provide a powerful boost to intraregional trade and investment decisions. In the same vein, countries that have trade agreements with the United States and with each other could work towards recasting their rules of origin within a plurilateral framework. The regionalization of rules of origin, together with the mutual recognition and harmonization of technical, sanitary and phytosanitary standards, would send a clear signal of commitment to the idea of a unified market. Similar efforts could be made in the area of dispute settlement with a view to establishing a single system encompassing all subregional agreements, together with the economic complementarity and bilateral trade agreements existing among all the countries belonging to any of the subregional schemes (plus Chile and Mexico, which do not belong to any of them). Making progress towards a single dispute settlement mechanism and making its decisions binding would be another strong signal of concrete rather than merely rhetorical commitment to integration.

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## Resurgence of protectionism

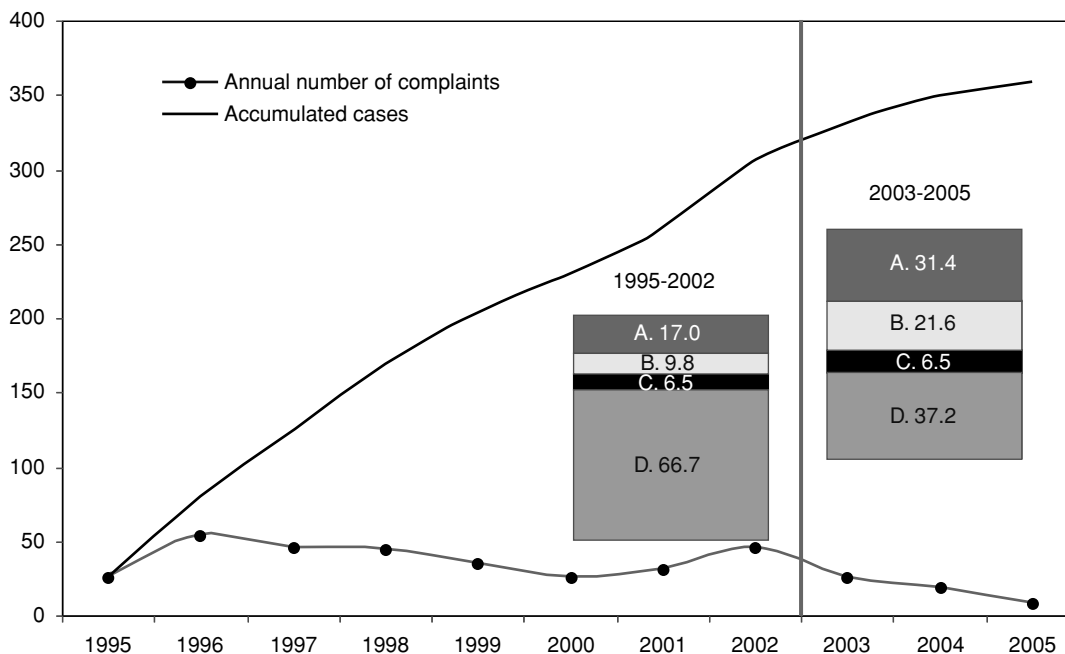
One factor that may curb the growth of the region's export sectors is adoption of protectionist measures by industrialized economies, particularly those of the United States and the European Union. Although the number of cases brought before the WTO Dispute Settlement Body dropped from 38 per year between 1995 and 2002 to a mere 18 in the two and one-half years between January 2003 and June 2005, the proportion of complaints lodged against developed countries in relation to dumping and export subsidies actually increased (see figure 5).

With just a few months to go before the decisive Sixth WTO Ministerial Conference, the debate in the United States over its worsening current account imbalance is being increasingly linked to concern over the rise in Chinese exports to that country's market. Senior authorities within the United States Government and

Congress have deployed a battery of mechanisms to put pressure on the Chinese authorities to revalue the yuan. In simplified terms, the aim of this would be to facilitate the correction of the external imbalance in the United States economy. The tone in the United States Congress has been set by fairly aggressive unilateral proposals which, although none has yet come to fruition, are contributing to considerable uneasiness about trade between China and the United States and about the prospect of the United States playing a leadership role in the Doha Round.

At the end of July 2005, the Central Bank of China responded to strong United States pressure and announced that the system of anchoring the currency to the dollar, in use since 1994, would be replaced by a managed floating exchange-rate system with a 0.3% band around a central rate for the yuan to be set on the basis of a basket made

Figure 5  
**CASES BROUGHT BEFORE THE WTO DISPUTE SETTLEMENT BODY,  
 JANUARY 1995 - MAY 2005**



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of reports from the Dispute Settlement Body (DSB) of the World Trade Organization (WTO).

A = Antidumping; B = Subsidies; C = Sanitary and phytosanitary regulations; and D = Other (which covers issues such as import licences, taxes, agriculture, intellectual property, technical barriers, trade in services, textiles, etc.).

up of its main trading partners' currencies. Although the revaluation of the yuan was initially modest (2.1%), it nonetheless paves the way for international parities to be adjusted to achieve more balanced growth among various parts of the world, particularly if other Asian economies follow suit. Had the yuan and other Asian currencies remained pegged to the dollar, the extent of the resulting devaluation of the United States currency would have brought about revaluations of the euro and Latin American currencies. This would have reduced export buoyancy and growth capacity while increasing the external debt burden as a result of successive rises in international interest rates.

With this major debate providing the backdrop, the end of the Agreement on Textiles and Clothing and the consequent elimination of quotas that impede access to the main markets in question have led to a significant increase in Chinese textile and clothing exports to the United States and the European Union. The production sectors of these countries are now up in arms, and politicians and trade authorities have reacted publicly to the situation. In the first four months of 2005, world exports of Chinese textiles climbed by 18.4%. Although

this was lower than the growth rate recorded in the first four months of 2004, exports to the United States were up by 71% and those to the European Union by 48%. Both trading partners have reacted by initiating protectionist measures in the textile sector, while continuing to insist on the need for a revaluation of the Chinese currency. In response, the Chinese authorities decided to apply fairly hefty tariffs on exports of 74 categories of textile products, although this decision was later revoked as a result of continued pressure to revalue the yuan.

The debates concerning the Central American Free-Trade Agreement (CAFTA) in the United States Congress have highlighted the power of the sugar lobby within that body, and the pressure exerted by that lobby has been reinforced by protectionist voices in the textile sector. This has focused concern on two sectors of major interest to the Central American economies and the Dominican Republic. The voting on the Treaty in both houses of the United States Congress was directly linked to the strength of the protectionist stance taken towards China: following the announcement that the yuan would be revalued at the end of July, some members of Congress stated that they would only vote in favour of CAFTA if Congress adopted

drastic retaliatory measures, including high surcharges on imports from China.

The agricultural sector is both the icon of industrialized economies' protectionism and the focus of recent victories won by developing countries protesting these distortions. One such example is provided by the favourable rulings won by Brazil from multilateral bodies in the cases it has brought against European sugar subsidies and United States cotton subsidies. The judgements delivered by the WTO Dispute Settlement Body on subsidies and domestic support have backed up the developing countries' position on these matters and have upped the stakes of the Doha Round, since certain aspects of these issues could have been addressed in the negotiations had the WTO not already ruled them incompatible with its rules and therefore in need of adjustment.

Given that these are sensitive sectors in the respondent economies, WTO credibility will be called into question

as long as these policies remain unchanged. This reopens the debate on reforming the WTO Dispute Settlement Body itself with a view to guaranteeing the effectiveness of its rulings, since shortcomings in its current procedures allow losing governments to "buy" their way out of the obligation to change a protectionist rule by offering compensation or simply by weathering the retaliatory measures. This often occurs when the case is lost by a developed country that has the economic capacity to offer compensation or neutralize the negative effects of retaliatory measures. The challenge to the credibility and effectiveness of WTO rulings is particularly serious when the parties involved are major players in the world economy and are denouncing practices in breach of multilateral WTO agreements. The most recent example is the Boeing/Airbus dispute, with the world's two largest civil aircraft manufacturers confronting each other in what is set to become the more extensive and complex case ever handled by WTO.

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## China in the new geography of trade and world production

China has come to represent 4% of world GDP and is the sixth largest economy (or the second, measured by purchasing power) in the world. It has thus become a major player in world markets following its accession to WTO and the opening of its economy. From less than 2% of total exports in 2000, China came to account for almost 6.5% in 2004, ranking as the world's third largest exporter. It also ranks third in the world in imports, which expanded by 36% in 2004.

China's exceptional contribution to this global recovery has been in the making for a number of years. Its strong economic growth has had a major impact on the rest of the world, since it has become a large consumer of raw materials, minerals, energy and, to some extent, foodstuffs and industrial products. China is the world's top consumer of coal, tin, zinc, copper and cereals and is one of the leading consumers of fertilizers; iron and steel; bananas; oilseeds and oils; plastics; electronic equipment; optical, photographic and medical equipment; and nuclear reactors and machinery. China accounts for at least 20% of world consumption of 8 out of 16 selected products (see table 1). In addition, it represents much of net world demand for 8 of these products and is one of the three top world consumers of 15 of them. This has brought pressure to bear on international markets and has triggered steep increases in the prices of many of these products. This is

the case of soybeans, nickel and petroleum, whose price increases have outstripped those of manufactured goods, posting a 32% rise in 2004 relative to 2000.

China is now a key trading partner for many of the region's countries, and the Latin American and Caribbean region is China's main supplier of a number of very important mining and food products. Since China's manufacturing exports are less expensive, it has clearly been influential in the decline seen in the prices of steel, zinc, tin, toys, textiles and clothes, and electronics. This has added up to a net improvement in the terms of trade for Latin America, in general, and for South America, in particular.

Latin American exporters are actively competing in Chinese markets with exporters from other regions, and particularly with those from the economies of the Association of South-East Asian Nations (ASEAN). It is therefore in the Latin American and Caribbean countries' interests to strengthen linkages with businesses in Asia, building partnerships and promoting different modalities of cooperation, in order to maintain the buoyancy of their exports of raw materials and semi-processed goods to the Chinese and Asian markets. This will require, in turn, deeper knowledge of those markets.

The region's basket of exports to China has also changed significantly. It now includes a growing

Table 1  
**CHINA: SELECTED PRODUCTS HAVING A STRONG INFLUENCE  
 ON THE WORLD ECONOMY, 2004**  
*(Percentages of world totals)*

Products	Production	Consumption	Imports	Exports	Consumption/ output ratio	Consumption ranking
Coal	41.1	38.6	...	13.7	93.8	1
Iron ore	22.8	36.2	27.6	...	158.6	1
Tin	37.1	27.6	...	13.5	40.4	1
Meat	27.2	27.1	3.1	3.5	99.8	1
Zinc	23.6	25.9	6.8	13.0	56.1	1
Steel	25.8	22.4	2.6	13.5	86.7	1
Aluminium	22.8	21.0	5.6	...	90.5	2
Lead	25.0	19.6	2.6	29.9	77.2	2
Copper	12.9	19.6	25.3	...	157.3	1
Cereals	18.3	18.8	7.1	2.7	102.5	1
Soybeans	8.6	16.8	34.3	0.4	165.6	2
Nickel	7.6	10.6	21.7	3.9	144.4	3
Bananas	9.0	9.7	3.0	0.4	106.0	3
Petroleum	4.3	8.3	7.1	0.8	191.5	2
Sugar	7.4	8.1	2.1	1.0	107.8	2
Natural gas	1.5	1.5	...	...	95.6	14

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Food and Agriculture Organization of the United Nations (FAO), *The State of Agricultural Commodity Markets*, 2004, The Economist Intelligence Unit, *BP Statistical Review of World Energy*, June 2005 [online] <<http://www.bp.com/>>, Heren Energy Ltd., Secretariat of the Organization of Petroleum Exporting Countries (OPEC), United Nations Conference on Trade and Development (UNCTAD), *Commodity Yearbook 2003*; *World Metal Statistics Yearbook*, 2005; *ISSB Monthly World I&S Review* [online] <<http://www.steelonthenet.com/production.html>> and International Iron and Steel Institute, *World Steel in Figures*, 2005.

number of mid-level or high-technology manufactures, which could represent an avenue to the incorporation higher-value-added products in the future. Both China and the Latin American and Caribbean countries would benefit from cooperation to position the region's firms in Chinese value chains. Of course, FDI flows would have to increase substantially in both directions in order for this to happen. One question to be asked regarding trade relations between the two parties is whether China poses a threat to Latin America. The answer to this question is not open and shut, but instead will depend to a great extent on how the two regions cultivate their trade-investment links, as well as the specific policies they adopt to promote joint ventures and partnerships in investment and technology.

As well as contributing to the transparency and predictability of the multilateral system, China's accession to WTO and its commitment to adjust rules and policies have various implications for the region, which can be divided into three categories: (i) access to the Chinese market for the region's exports; (ii) competition between these economies in third markets (particularly

the United States); and (iii) competition from Chinese products in the domestic markets of the region's countries. As a result, certain disciplines and the means or degree of China's compliance with its commitments have taken on greater importance for the region, as has China's stance in the current WTO negotiations, both as a single country and as member of groups with shared proposals and agendas.

It has been three and a half years since China acceded to WTO. Although this is not very long, it is enough to provide grounds for one key observation: China has made considerable progress in implementing its WTO commitments and is continuing to do so. Nevertheless, China's legal regimes continue to form a labyrinth that many countries have difficulty in negotiating. The associated lack of transparency is still one of the main hurdles to the full realization of the potential advantages of China's accession to WTO and to access to fairer competition for its enormous market. Many State firms continue to apply tariff quotas, especially in the agricultural sector, where intellectual property rights are still not fully enforced. China

also continues to deploy sanitary and phytosanitary measures as non-tariff barriers to agricultural goods. The areas giving most cause for concern are copyrights, intellectual property, non-tariff measures and access to services markets.

Importantly, however, an examination of the complaints taken to the Dispute Settlement Body (DSB) indicates that, thus far at least, China is not considered to be in breach of its WTO commitments. On the contrary, China is making use of the DSB to defend itself from trade measures invoked against its products. From the start of 2002 until mid-2005, China has been named as a respondent in four cases and has brought six cases as a complainant. Furthermore, in the interests of resolving trade disputes with China, some countries, including the United States, are forming working groups with the Chinese Government. The European Union has also established a European Commission delegation to work with China and has approved a bilateral cooperation accord as set out in its Regional Strategy Paper for 2002-2006.

Seeking to avert the use of arbitrary procedures and the application of measures corresponding to non-market (transition) economies in future antidumping cases, China is actively lobbying its trading partners in order to secure market-economy status before the 2016 deadline. China is hoping to obtain recognition of that status from the United States, the European Union and Japan. As of July 2005, over 30 countries had granted China market-economy status, including 10 from the region, Argentina, Brazil, and Chile among them. The Chinese authorities have been unflagging in their efforts to win China a reclassification from a transition economy to market-economy status.

China has been engaging in very active diplomacy in a wide variety of forums, including negotiations on bilateral free trade agreements, to ensure recognition of market-economy status. A case in point is the accord recently signed with New Zealand. Australia also granted China market economy status prior to embarking on free trade negotiations and stated that antidumping complaints henceforth will be based on costs incurred in China rather than on third-country costs or prices. In addition, all 10 ASEAN countries granted China market-economy status before the China-ASEAN free trade agreement was signed at the end of 2004, on the understanding that this was an essential requirement for the trade pact's conclusion.

WTO rules allow member countries to approach the issue of market-economy status in a variety of ways. For example, the United States authorities usually reject the price and cost information supplied by China and use information derived from substitute markets. The European Union uses a more hybrid approach for cases involving China and other countries whose economies are classified as being in transition or otherwise not subject to market-economy treatment. Imports from China may thus be considered, in a very limited number of cases, as coming from a market economy, providing that market conditions can be demonstrated to prevail in the industry concerned. In this regard, China's removal from the list of countries having non-market economies should not act as a serious constraint on the use of trade defence mechanisms against sharp increases in imports from China, since WTO instruments will still be available. In any case, continuing to treat China in an apparently discriminatory manner would clearly interfere with bilateral relations rather than contributing to the development of strategic, mutually beneficial ties.

In 2004, Chinese government authorities embarked on a particularly busy itinerary of South American visits. President Hu Jintao conducted State visits to Argentina, Brazil and Chile, as well as Cuba, and Chinese ministers and deputy ministers accompanied high-level business delegations to practically every South American country. During all of these tours, important commitments were made to strengthen economic and trade relations. The Presidents of Argentina, the Bolivarian Republic of Venezuela, Brazil, Colombia, Chile and Peru have also recently paid visits to Beijing, and many more ministerial and business visits have been paid by these and other countries to China in 2004-2005.

These overtures have resulted in almost a hundred public agreements and commitments, which are the outward manifestation of this interesting juncture in economic relations between China and South America and of their mutual interest in moving forward towards a strategic relationship. China has used a variety of formulas —sometimes in combination— to seek closer relations with the Latin American countries: different sorts of trade agreements, direct investment, especially in infrastructure and energy, joint ventures with State enterprises, and special agreements on science and technology. The negotiation of a free trade agreement with Chile opens up a new avenue for establishing more permanent trade and investment links.

## Trade, security and transport

The events of 11 September 2001 in New York and the attacks of 11 March 2004 in Madrid, as well as other incidents of a similar nature, have prompted countries to adopt a series of measures to defend themselves against threats to food security and merchandise transport. The United States, for example, has passed the Bioterrorism Act, which came into effect in mid-December 2003 and is intended to protect the security of the country's food supply.

In order to access these countries' markets, food shipments must comply with new legislation requiring them to provide a full account of the relevant production chain. The life history of a foodstuff is referred to as its "traceability" or "trackability" and provides certain assurances of food security, improves quality management and risk evaluation, boosts consumer confidence and permits the implementation of corrective measures in the event of quality or safety shortfalls. Firms that do not provide proper and timely information to a destination-market country seeking to track a product's entire production chain in the event of any suspicion of tampering may find the product barred from that market, impounded, returned or destroyed. Although these rules have been created in response to a justifiable demand for security, the exporting country faces the challenge of ensuring that they do not turn into market-entry barriers, especially for SMEs that may not have the capacity to meet the new requirements quickly.

The recent cycle of trade expansion has brought with it significant increases in maritime cargo and therefore in the total value of shipments, which began to rise all over the world in 2003. Several factors are implicated in this situation. First, the huge surge in trade between China and the United States has drawn much of the storage capacity in container carriers onto this route, causing a severe shortage of ships on other routes (including Latin American and Caribbean ones) and generating an unprecedented degree of congestion in transport and port systems, especially on the west coast of the United States. In addition, cargo flows are clearly unbalanced. The rise in shipping costs has been further compounded by a steady increase in the price of fuel for cargo vessels. The downturn in shipping rates seen in the second quarter of 2005 may reflect either seasonal factors or the recent slowdown in economic growth in the United States and in growth projections for other OECD countries.

There is an economy-of-scale problem in international transport which translates into an inverse

ratio between the number of shipments and the freight volumes, as described earlier. This limits, particularly, small and medium-sized producers' possibilities of securing long-term transport service contracts at reasonable rates and forces them to pay much more than a firm that ships, say, 50 containers per month. In the case of highly perishable goods, such as fresh berries, the scale of production determines a firm's ability to secure space on cargo flights and thus to engage in direct export operations.

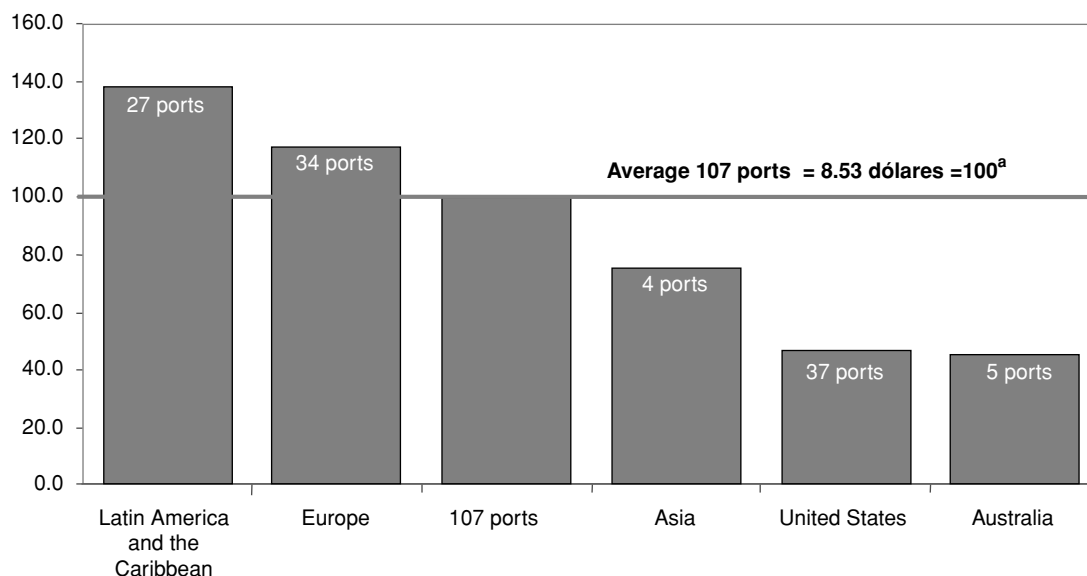
These events, and the repercussions they have on infrastructure and transport security, have not only led to the adoption of more stringent international regulations (International Ship and Port Facility Security Code (ISPS), Bioterrorism Act, traceability, technical standards, sanitary and phytosanitary measures), but have also pushed up the costs of international trade. In mid-2005, a sample of 107 ports worldwide revealed that the average increase in security costs was US\$ 8.53 per container, with a mean incremental cost for the region that is much higher than the average and three times higher than the average in Australia and the United States, even though many countries in the region have not yet invested in electronic scanners to check container contents (see figure 6).

Some security measures adopted in the face of terrorist threats have received the support of the international community, while the legitimacy of others has been questioned in view of their unilateral nature. An ongoing dialogue among all parties concerned is called for, and financing mechanisms for implementing the measures need to be expanded and improved. This would help reduce the high costs of purchasing advanced equipment and technology to enable countries, especially those in Latin America and the Caribbean, to comply with the new security standards. It is also vital to improve the physical infrastructure and to invest in human resources via training programmes. All the parties involved should discuss the new security measures and implement them within a multilateral framework in much the same way as the ISPS has been implemented under the guidance of the International Maritime Organization (IMO), thus ensuring the full participation and support of the international community.

In short, the risks bearing down on the world economy are far from insignificant: a large current account deficit in the United States; stubbornly low growth rates in Japan and the European Union; a



Figure 6  
INTERNATIONAL CHARGES FOR PORT PROTECTION, JUNE 2005



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), "Las medidas de protección portuaria: un año después del código de protección de buques e instalaciones portuarias (PBIP)", *Boletín FAL*, No. 227, July 2005.

<sup>a</sup> Weighted average for trade to December 2004.

rise in oil prices; an unrelenting terrorist threat; and protectionist signals in industrialized economies, chiefly in response to the increase in exports from China and other Asian countries.

The performance of the world economy in 2004-2005 has benefited Latin America and the Caribbean, as it has underpinned high international prices for the region's exports, better terms of trade, low interest rates and, consequently, low inflation and positive fiscal results. Oil prices are a crucial factor for the region as a net exporter. However, a number of small and medium-sized countries in the region are net importers of oil, and prices of around US\$ 60 per barrel therefore translate into high costs for these countries in terms of their fiscal accounts and balance of payments. Net exporters,

meanwhile, face a considerable fiscal challenge as they seek to take advantage of these boom times to save or pay off debts while achieving a more sustainable form of growth.

Increased competition from China and Asia in general should be taken into consideration as a fundamental component of the region's trade, production and technological strategy. The most striking feature of the present global economic cycle is the new geography of the world's economy and its trade flows, which is increasingly centred around Asia and China. Latin American and Caribbean authorities should redouble their efforts to identify and capitalize upon the potential complementarities of greater integration with Asia and with China in particular.



## Chapter I

# Trade and the world economy in 2004 and the outlook for 2005 and 2006

## A. Introduction

Two new developments that have been taking shape in the international economy over the past few years have been particularly significant in 2004-2005. First, a new geography of international trade and financial flows has begun to emerge as China takes on greater economic and financial prominence on the world scene.

The second is a cyclical phenomenon associated with the strong recovery of the United States economy in 2004, which has generated a world economic growth pattern that is more dependent on that country. This situation is so closely connected with the structural change taking place in the world economy that the recovery in the United States can best be understood in the light of this new international financial and production structure. These two developments go a long way towards explaining the exceptional growth of the world economy and trade in 2004.

The change in the international division of labour, with its corresponding dynamic in the areas of trade and finance, has given rise to major imbalances with respect to the accumulation of savings and consumption on a global level, thereby threatening international financial stability. The form that the adjustment of these substantial imbalances in the world economy ultimately takes will be of decisive importance and will, in particular, have

a strong impact on the future growth prospects of Latin America and the Caribbean.

The convergence of these two phenomena will thus have direct and indirect implications for Latin American and Caribbean economies, given the importance of the United States and China in the region's trade. On the one hand, the interaction between these two countries' economies and the specific type of growth they experience, how they establish commercial and financial relations, and the impact on the price of oil will all affect the region. On the other hand, the characteristics of Latin American and Caribbean countries — the composition of their foreign trade, trends in their main import and export markets, and their financing needs and level of external debt — will have their own influence.

This chapter will address some aspects of these structural changes, especially those seen in the geography of trade and finance and the tremendous impact of the current economic boom in the United

States on this process. The current strength of China's economy will then be analysed, along with its role as an international price maker in various sectors and its importance as a new engine of worldwide growth. Next, the difficult issues associated with the world's major currencies will be examined, in particular the debate on the revaluation of the Chinese yuan.

Against that backdrop, the imbalances of the United States economy and possible adjustment scenarios will be reviewed, and their principal implications for the economies of the region will be discussed. The chapter will end with a brief summary of the prospects for growth and trade relations in Latin America and the Caribbean.

## B. The international economic climate in 2004

The recovery of the world economy that began in the second half of 2003 gathered strength throughout most of 2004, bringing overall growth to 4.0% for the year, the highest level achieved in the last three decades.<sup>1</sup> This boom, though relatively widespread, continued to reflect the fact that Asia has experienced a more vigorous recovery than elsewhere. In fact, the developing countries' 6.5% growth rate surpassed the world average, marked the second year in a row of strong growth and was the highest rate to be posted in the last 30 years.<sup>2</sup> The figures for this group of nations are heavily influenced by the exceptional performance of a few countries, such as China (9.5%) and India (7%), but even if these two countries are excluded from the calculations, the other developing regions still managed to attain a growth rate of 5% in 2004. Moreover, this was probably the first time in 30 years that the developing countries entered a growth phase ahead of the developed nations (United Nations, 2005a).

In the industrialized world, growth rates have been more uneven across countries, and the main engine for growth among developed nations and for the world as a whole has been the United States economy, which reported a 4.2% growth rate in 2004, thanks to a robust expansion in the first quarter which outweighed the ensuing slowdown. The most dynamic components of aggregate demand were investment in hardware and software and in housing. Government spending continued its upward trend because of greater defence outlays, though spending was cut in other categories. Long-term interest rates have not echoed the rising trend in the short-term federal funds rate since mid-2004. Real short-term interest rates are still low, however, and is therefore spurring on the money supply. In addition, the long-term rate is moving downward owing to the excess liquidity in the economy, the low level of inflation and expectations of

declining activity due, in part, to the high price of oil.

In 2004, the European Union reported a moderate expansion (2%), which fell short of expectations. Germany's growth was below that average and Italy actually entered a recession, but Spain and France posted higher rates. The main impetus for expansion in this bloc of countries was external demand, although the appreciation of the euro dampened exports and boosted imports beginning in the second half of the year. The Japanese economy grew by 2.6% in 2004, but in the second quarter GDP fell, and the level of activity has been weakening. This situation is attributable to a reduction in private consumption and public investment, given the country's large fiscal deficit and the high level of public-sector indebtedness. The external sector's net positive impact on growth was considerable, thanks to the buoyancy of its exports to China.

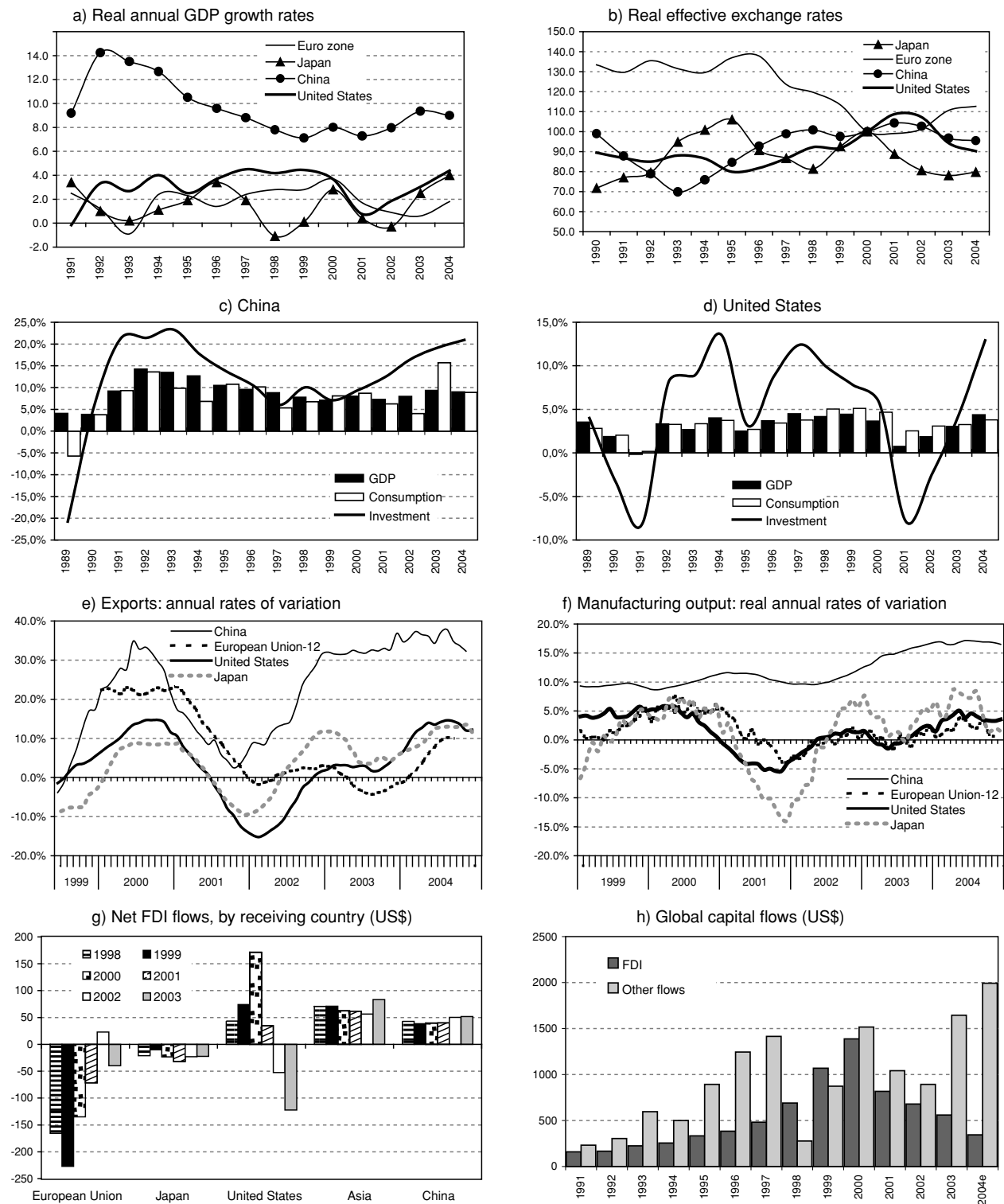
In spite of Chinese officials' attempts to curb what has been considered an excessive expansion, the Chinese economy's growth rate in 2004 (9.5%) was even higher than in 2003 (9.3%). The greatest boost in 2004 came from the notable surge in exports (35%) and fixed investment (26%), which more than offset the decline in private consumption and, during the second half of the year, in manufacturing output as well. The inflation rate slid from 5.5% to 2.4% in the second semester. The step taken to limit demand and contain inflation included the sterilization of the money supply, an increase in banks' reserve ratios, a cutback in real estate loans and a freeze on investment for some products. In addition, interest rates were nudged upward in late October (Ramos and Ryd, 2005).

The United States managed to maintain its share of global GDP (30%), in contrast to the euro zone and Japan, whose shares both shrank somewhat (see figure I.1.a). Consequently, the relative weight of the most advanced

<sup>1</sup> In this chapter, calculations of growth rates are based on market prices and do not take into account purchasing power parity (PPP). Otherwise, world GDP figures would be about 1% higher.

<sup>2</sup> The average annual growth rate for the 1970s, 1980s and 1990s was 5.4%, 3.5% and 3.2%, respectively.

Figure I.1  
**WORLD ECONOMIC INDICATORS**  
*(Percentages and billions of dollars)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the United Nations Conference on Trade and Development (UNCTAD) and International Monetary Fund (IMF).

nations in global GDP declined between 1990-1991 and 2003-2004, while that of developing countries expanded. This is particularly true of China, which doubled its share to 4.2% of global GDP. Latin America and the Caribbean were less dynamic than developing countries as a whole, but they did manage to hold on to their 6% share.<sup>3</sup>

Merchandise trade reached a 25-year high in 2004, jumping by 21% in nominal terms. This robust performance was made possible by sharp increases in the dollar prices of many products and by the large volume of goods traded. In real terms, merchandise trade was up sharply in South America in 2004, surpassing other regions of the world.

Thanks to surging prices for oil and other commodities, especially electronics and telecommunications equipment, developing countries' share in global merchandise trade soared to 31% —the highest level recorded since 1950 (WTO, 2005).<sup>4</sup>

The value of trade in services, on the other hand, was up by just 16% in 2004, following a sharper increase in 2003. This upswing came in response to a steep rise in transport and travel. These trends set the current recovery (2003-2004) apart from the situation in 2001-2002, when merchandise trade rose more slowly than trade in services. The notable expansion in merchandise trade brought to light shortcomings in port and transport facilities, which combined with higher oil prices to drive up the costs of these services. The value of tradable services (three fourths of which is in the hands of industrialized countries) rose to 25% of the value of trade in goods.

In 2004 net private financial flows to developing countries jumped by 34%, although there was a decline at the world level. This development is partly accounted for by the high level of liquidity worldwide and by the low long-term interest rates prevailing in the United States. The bulk of these flows consisted of foreign direct investment (FDI), which had begun to ebb in 2001 but picked up by 3% worldwide in 2004, although this was not enough for it to regain the levels seen between 1998 and 2000.<sup>5</sup> Net flows to Asian and emerging European economies soared in 2004 (40%),<sup>6</sup> but, as a reflection of the international relocation of production facilities, most of these flows went to China (see figures I.1.g and I.1.h).

The region also benefited from larger flows of FDI, which climbed by 44% in 2004 (the first increase since 1999). The region accounts for 22% of all FDI in developing countries, in contrast to the 50% share recorded in the 1970s and 36% in the 1980s. The FDI received by Latin America and the Caribbean in 2004 corresponded to 3% of the region's GDP; this was slightly less than China's share but more than that of Central and Eastern Europe and the rest of Asia (ECLAC, 2005b).

The decrease in flows of private capital in the form of direct or portfolio investments at the global level was offset by official flows in the form of purchases of United States Treasury bonds. This trend is reflected in the steep gain in the "other flows" category in figure I.1.h. The main sources of these official flows are Asian governments (particularly China, Japan, Republic of Korea and Taiwan Province of China), as will be discussed further in a later section. To a great extent, this financial phenomenon is the counterpart of the enhanced competitiveness of Asian exports —China's in particular— on the United States market.

Noteworthy developments on the international scene, in addition to the key role played by the economies of China and other developing countries in the recovery made by global GDP in 2004, included the countercyclical fiscal and monetary measures applied in the United States to deal with the 2001 recession. Thanks to these steps, the recession was shorter and more shallow than previous ones, which in turn kept global GDP growth from declining further.

Given the fact that the recession was so slight, it is remarkable that the economic upturn has been so weak and sluggish in the United States and other developed countries. Part of this situation can be blamed on the lethargic expansion of manufacturing output in industrialized nations (see figure I.1.f).

The slowness of the recovery has been accompanied by persistently high unemployment in developed countries, which has prompted concern about "jobless" growth. This trend is associated with the relocation of production to countries with cheaper labour, particularly China and the emerging nations of Asia, as well as some emerging European countries.

<sup>3</sup> Calculations in constant 2000 dollars, on the basis of IMF, 2004.

<sup>4</sup> For example, in some Asian countries, electronics and telecommunications equipment amounted to over 50% of total exports of goods in 2004, which had a major impact on the expansion of trade flows.

<sup>5</sup> Data from UNCTAD (2005). Reference is made to the recession in the United States, as defined by the National Bureau of Economic Research. Since this country is the main driving force of the world economy, its recession triggered other recessions or severe downturns in most countries of the world. For a discussion of the general concept of recession, see Ryd (2003).

<sup>6</sup> Data calculated on the basis of information from the Institute of International Finance (IIF, 2005).

## C. Recovery and dynamic growth in the United States

The recovery of the United States economy between the first quarter of 2003 and the first quarter of 2004 was a fundamental factor in the expansion of the world economy, especially for China and other Asian countries, as well as the European Union.

The strength of private consumption has been a significant factor in this recovery. In fact, nearly three quarters of the increase in GDP between the onset of the recovery and the third quarter of 2004 corresponds to this sector, while gross fixed investment, which has been slow to pick up speed, has accounted for the other fourth. Two sectors, housing and computer hardware and software, were the main focus of this expansion. The surge in investment, primarily in the housing market, is associated more with durable goods consumption than with the expansion of production. Net exports siphoned off growth, despite the depreciation of the dollar beginning in 2002, and made a negative contribution to GDP, thereby widening the trade and current account deficits.

In contrast to the trends in investment and wages, which have fallen in real terms, the growth rate of earnings began to climb sharply in 2002, although, measured in terms of GDP, they failed to regain the peak level attained in 1997.

Employment has not increased much, while the unemployment rate has remained relatively stagnant. Saving is down, and the level of indebtedness is therefore rising quickly. This is especially the case with household debt, but public-sector and business debt indicators are also high, although businesses have begun to pay off creditors and improve their financial balances. All in all, total debt is approaching 290% of the country's GDP.

This trend can be attributed to a number of fiscal and monetary stimulus measures, such as tax cuts and tax incentives for corporate investment. In addition, the federal funds rate was lowered to 1% in mid-2003. This historically low rate has boosted consumption, especially of durable goods but also of other items as consumers obtain additional liquidity through mortgage refinancing. In short, the real estate market has been a counterbalance to the loss of wealth on the sagging stock market and has bolstered consumption. As a result of these measures, the budget surplus that greeted the current Administration when it took office has turned into a hefty deficit (nearly 5% of GDP), as defence and security spending mount. Nearly one fifth of GDP growth during the recovery can

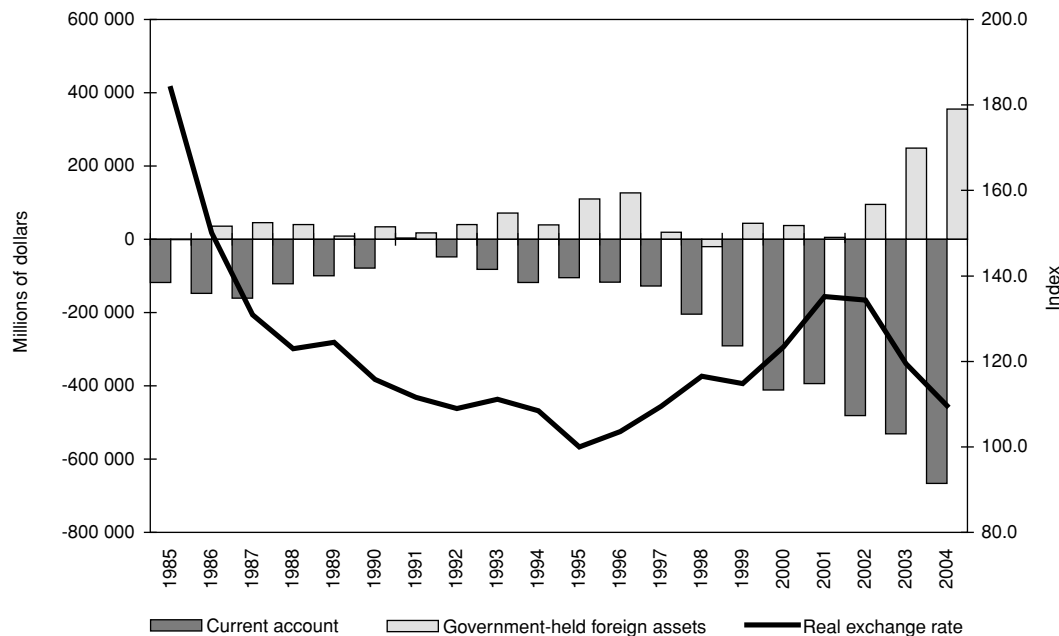
be attributed to higher fiscal spending, much of which has gone to defence. These countercyclical policies are similar to those applied in previous recessions, but in this case have been unusually intensive.

In the second quarter of 2004, the United States economy's growth began to slow, and this trend has carried over into 2005. Monetary policy began to change in July 2004, with eight successive rate hikes bringing interest rates up to 3% by the second quarter of 2005. These adjustments come primarily in response to the Federal Reserve's concerns about the inflationary pressures exerted by oil prices. In fact, inflation has gone from less than 2% in early 2004 to 3.2% at the end of the first quarter of 2005. Excluding energy and food, this indicator rose from 1% to 2.5% during the same period. At the same time, fiscal spending surged, especially in the area of defence, though some of the fiscal stimuli have ceased to be a factor. The investment incentives lasted only through the end of 2004, which explains the smaller contribution of investment to growth in the first quarter of 2005. Gross fixed investment accounts for more of that growth, thanks to a sharp rise in inventories. In addition, the part attributable to consumption has dipped slightly since 2004, but even so, it is responsible for nearly 80% of GDP growth, and over half of that percentage is represented by services.

The external sector also appears to be trending downward; in the first quarter of 2005, exports and imports both grew more slowly than they had in 2004. In any case, imports were more dynamic than exports, so the net contribution to GDP growth attributable to the external sector was even less than it had been in 2004. Thus, the trade and current account deficits continue to widen, despite the real depreciation of the dollar since early 2002. As of May 2005, the value of the currency had fallen nearly 15% below the peak reached in 2002. The current account deficit, which amounted to 6.3% of GDP at the end of 2004, has been financed by an increasing flow of capital from abroad. The composition of this flow has changed, however, with purchases of bonds rising while FDI and equities have fallen sharply from their pre-recession highs. In fact, government bond purchases financed 43.2% of the deficit in 2004 (see figure I.2).

The total stock of government financial assets held by foreigners grew by 38% between 2003 and

Figure I.2  
**ANNUAL FLOWS OF DOLLAR ASSETS PURCHASED BY CENTRAL BANKS, THE CURRENT ACCOUNT DEFICIT AND THE REAL EXCHANGE RATE IN THE UNITED STATES, 1985-2004**



Source: Bureau of Economic Analysis (BEA), United States Department of Commerce and International Monetary Fund.

the end of 2004 to US\$ 1,852 billion. Most of these assets are held by public authorities in Asian countries, particularly China. In fact, this group of countries accounts for nearly 73% of the total, up 3% from the previous year.

China, whose expansion is primarily due to the strong growth of exports and increased investment, especially FDI, has built up a hefty trade surplus with the United States. Although the net total trade balance amounts to just 2% of its GDP, China's trade surplus with the United States accounted for one fourth of the latter's total deficit for 2004 according to official statistics compiled by the United States. Nonetheless, Chinese

Government records indicate that its surplus amounted to only one half of that deficit.

In sum, this recovery of world growth, being closely tied to consumption and, to a certain extent, to United States investment demand, requires saving by other countries and the expansion of exports to that market in order to satisfy a demand that is outstrips supply. In other words, the United States is playing the role of consumer of last resort, and the effect of this compounds the impact of higher defence spending. These factors account for the major imbalances that the country is experiencing, which include the largest current account and budget deficits in its history.

## D. China in the emerging geography of world trade and production

The changes under way in the global financial and production structure, which are associated with the nature of the current recovery and the international division of production, mean that trade will expand much faster

than output, with most of the growth in activity taking place in flows into and out of new centres of production. Thus, the expansion of the volume of world trade was more than twice as high as average annual GDP growth



for the 1990s, and grew even more rapidly in the case of developing nations. In fact, in most countries, though not in the United States, exports, along with the investments that go hand in hand with those flows, appear to be engine of growth. In fact, the volume of world trade was slightly more than 10% greater in 2004 than it had been in 2001, when all the countries were experiencing a slump. The developing countries —and particularly the transition economies and China— actually exceeded that average, with exports and imports rising by about 15% in the transition economies and by 30% in the case of China.

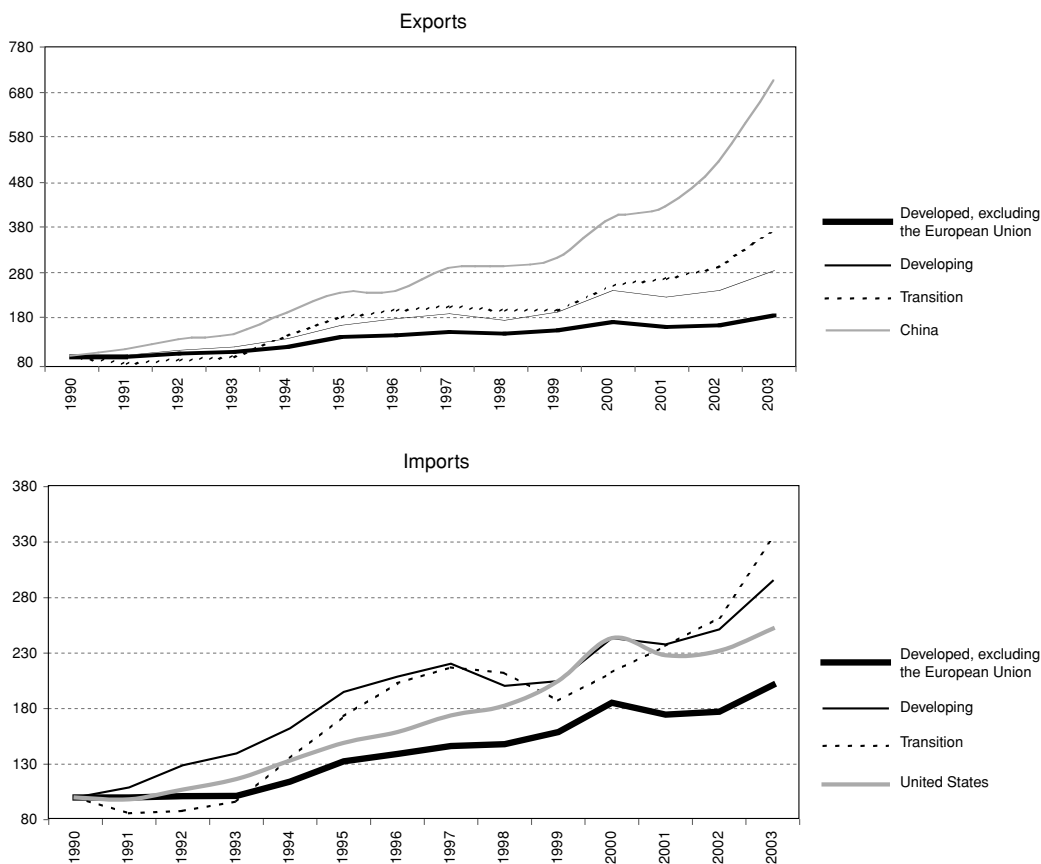
Changes in the relative share of different groups or countries are reflected not only in world GDP but also in trade and in the trade mix. Sharp disparities between regions and countries can be seen, however. As shown in figure I.3, which depicts export trends by major categories of country, it is developing countries and economies in transition that are primarily responsible for the recovery and vitality of exports in the wake of the 2001 crisis. In the developed countries, in contrast,

export growth has stalled and they have therefore failed to regain the rates of expansion they enjoyed before the crisis (see figure I.1.e).

The dynamism of developing countries' trade flows can also be seen in South-South trade relations, as the relative weight of these nations in worldwide exports rose from 9.4% in 1990 to 12.5% in 2002. Most of this expansion can be attributed to the brisk intraregional activity of Asian countries, whose share of world exports doubled during that period (Kuwayama, 2005).

This dynamic expansion reflects the shift in intra-Asian competitive advantages and in production locations as assembly activity in China moves to the forefront. The Asian economies are functionally linked to China's export growth, and behind every Chinese export there may therefore be a great many indirect exports from other Asian economies in the form of parts, components, equipment and services. Indeed, what the world is seeing is an integration of trade arising out of the integration of production chains.

Figure I.3  
TRENDS IN EXPORTS AND IMPORTS, BY MAJOR COUNTRY CATEGORIES  
(Index: 1990 = 100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of statistics from the World Trade Organization (WTO).

## 1. China as an international price maker

The burgeoning Chinese economy, driven by exports and imports, has had major global repercussions. China has become a major consumer of raw materials, minerals, energy, and also, to a certain extent, foodstuffs and manufactures. It is between first and third place worldwide in terms of the consumption of copper, fertilizers, iron and steel, oilseeds and oils, plastics, electronics, and optical, photographic and medical devices, as well as nuclear reactors and machinery. International markets have therefore felt the pressure as the prices of many of these goods have been driven upward. Cases in point include copper, soybeans, nickel and petroleum, whose prices have outpaced those of manufactured goods. These high prices have, however, been partially offset by the depreciation of the dollar against various international currencies, as illustrated in table I.1 with respect to the euro (OECD, 2005).

The growth of China's industrial exports has been concentrated in labour-intensive merchandise requiring large-scale inputs of intermediate goods. The international prices for such products — especially automotive and

electronic goods, textiles and apparel— have plunged. This trend has been fuelled by China's entry into the World Trade Organization (WTO) and, in the case of textiles, by the expiration of the Multifibre Arrangement (MFA) and its attendant restrictions in January 2005. This situation has had a major impact on many Latin American and Caribbean countries that export these goods, especially the maquila industry in Mexico and Central America.

The textile trade provides the best illustration of this development. In the first four months of 2005, Chinese textile exports jumped by 18.4%. Although this increase was lower than the corresponding figure for the same period in 2004, exports to the United States and the European Union climbed by 71% and 48%, respectively. In response, both of these trading partners have introduced protectionist measures in this sector, as well as urging China to revalue its currency. In response, the Chinese authorities decided to impose significant tariffs on exports in 74 categories of textile products, although they later rescinded the decision in the face of persistent pressure to revalue the yuan.<sup>7</sup>

Table I.1  
PRICE VARIATIONS FOR SOME COMMODITIES  
(Percentages)

				Dollars	Euros
	2002	2003	2004	2004/2001	2004/2001
Commodities	1.2	13.8	29.4	49.1	8.5
Soy oil	28.3	21.9	11.2	74.0	27.1
Soy	8.6	24.1	16.1	56.5	14.3
Wheat	16.9	-0.9	6.8	23.7	-9.7
Nickel	13.9	42.2	43.6	132.5	69.8
Iron	-1.0	8.5	17.4	26.0	-7.9
Steel products	1.4	16.4	54.2	81.9	32.9
Copper	-1.2	14.1	61.1	81.6	32.6
Gold	14.4	17.3	12.6	51.0	10.3
Fuels	4.4	22.3	28.8	64.6	20.2
Crude oil	10.8	20.9	25.2	67.7	22.5
Petroleum products	-5.3	23.8	34.8	58.1	15.5
Coal	-16.2	2.9	96.5	69.3	23.7
Natural gas	-15.4	63.9	7.3	48.7	8.6

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

<sup>7</sup> This measure can be considered a goodwill gesture on China's part, since its official position is that both the United States and the European Union delayed the adjustment process for this sector of production, postponing the elimination of most textile quotas beyond the deadline agreed upon in WTO (interview with the official spokesman for the Chinese Government, 26 May 2005, [www.english.mofcom.gov.cn](http://www.english.mofcom.gov.cn)).

Among commodities, steel production is flourishing. China has become the world's leading producer of this product, and in the second half of 2004 it became a net exporter of some steel products, which it sells at prices 30% below the international average. If this trend continues, it will have adverse consequences for several countries in the region, including the Bolivarian Republic of Venezuela, Brazil and Mexico. China's industrialization process is highly energy-intensive, and the country's entry into WTO has exacerbated this situation, since the environmental restrictions instituted by that organization require the substitution of oil for dirtier fuels. In both 2003 and 2004, the annual growth of demand in China was not only the highest in the world, but also quadrupled the rate of increase in global demand for petroleum (IEA, 2005). China accounted for one third of the upsurge in worldwide oil consumption in 2003 and 2004, and its oil imports soared by 70% between 2003 and 2004 (CRS, 2005). In other words, China has become an international price maker both for many manufactured goods and for some commodities.

According to the commodity price index compiled by ECLAC, prices for this group of products climbed by 32% between 2000 and 2004. Some categories were better off than others, however. Such is the case with minerals and metals (48%), oils, flour and oilseeds (45%) and energy

(31%). In contrast, the rise was clearly below average for other products, such as foodstuffs (10%) and forestry and agricultural products (7%). Beverages actually declined in price (-13%).

The World Bank estimates that the rise in commodity prices since 2001, despite the mitigating effect of the dollar's depreciation, has boosted revenues for developing countries by an additional 1.1% of their GDP. This positive effect was primarily felt in oil-exporting countries, to the detriment of importers. Net earnings from increases in other commodity prices were modest or even negative for some countries, since they applied to just a few products (minerals and metals) (World Bank, 2004, chapter I).

Several developing regions and transition economies saw their terms of trade improve, which allowed them to build up large trade, current-account and balance-of-payment surpluses and thus to bolster their net foreign reserves. As a result, several developing countries became major net exporters of capital. This was also the case for Latin America and the Caribbean as a whole, since in 2004 the region recorded a net transfer of capital equivalent to 4% of GDP (ECLAC, 2004). Net oil exporters accounted for most of these transfers, given the steep increase in oil prices seen since 2002.

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## 2. China as a new engine of world growth

China's exceptional role in this cycle of world recovery has been taking shape for several years. In fact, this country enjoyed phenomenal growth between 1980 and 2004, with an average annual rate of 9.5%, albeit with periods of upturns and downturns during that time. For example, during the Asian crisis and the subsequent recession in the United States, the Chinese economy cooled off slightly, with average growth rates of just 7.6% between 1998 and 2002. Beginning in 2003, however, it recovered strongly, expanding by 9.2% in 2003-2004.

One additional characteristic of China's current boom is the large contribution made by its external sector, which has seen net exports regain momentum after being hampered by the Asian crisis prior to 2002. This has stimulated growth and shored up the current account surplus created by capital inflows, which have consisted primarily of FDI and, since 2004, the financial

capital attracted by expectations of a revaluation of the yuan (Ramos and Ryd, 2005).

Thus, China now represents 4% of global GDP and has become the sixth-largest economy in the world (second, if measured by purchasing power parity). As a result, the country accounted for 15% of the international recovery between 2002 and 2003 (United Nations, 2005a). Furthermore, by opening up its economy and being allowed to join WTO, China has also become a key player in world markets, moving from less than 2% of total exports in 2000 to nearly 6.5% in 2004. In this past year, it has boasted a 35% jump in such transactions and now ranks as the world's third-largest exporter, displacing Japan. It also ranks third in imports, with a 36% rise in that category in 2004. China's imports therefore lag somewhat behind its exports, having contributed 16.5% of the world's total import growth in 2002-2003.<sup>8</sup>

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<sup>8</sup> See WTO Statistics, [www.wto.org](http://www.wto.org).

This remarkable export-led trend in China, which, as mentioned earlier, has also been spurred by an intensive investment effort (amounting to more than 40% of GDP), also entails a process of industrialization, urbanization and infrastructure development. It is significant that domestic saving represents such a large share of GDP (42% in 2004) (CRS, 2005). What is more, this country has become a key supplier of manufactured goods to world markets, displacing other Asian economies, as well as several industrialized economies and some developing ones. As noted previously, this situation is directly related to the concentration of FDI.

Indeed, the bulk of FDI went to developed countries in 2000 (80%), with the United States being the primary recipient. By 2003, these flows had shrunk dramatically (60%), with only two thirds of FDI going to this group of nations. FDI received by the United States plunged by 90%. Although flows to developing countries have also declined (albeit by relatively less), China continues to be an increasingly favoured recipient. In 2003, it nearly took the lead in attracting worldwide FDI.<sup>9</sup> Then in 2004, China received US\$ 60.6 billion, and Hong Kong Special Administrative Region of China took in US\$ 33 billion. These two sums combined account for 16% of global FDI, which means that they were bested only by the United States.<sup>10</sup> In fact, this country garnered 20% of total world FDI, having posted a huge upswing as an FDI destination that year. Remarkably, flows to Latin America and the Caribbean are expanding even faster than those to China, but the region's relative share remains small, having edged upward from 7% to 9% between 2003 and 2004 to a total of US\$ 54.4 billion (UNCTAD, 2005).

China's economic opening and expansion has helped strengthen Asia's trade and financial integration. According to the latest available data, nearly 60% of FDI in China comes from its Asian neighbours, with one third of this sum coming from the Hong Kong Special Administrative Region of China, followed by Japan, the Chinese province of Taiwan, Republic of Korea and Singapore. These Asian economies are all among the top 10 sources of FDI in China.<sup>11</sup> The United States comes in third, with one tenth of the total, ahead of Japan in terms of its relative share but behind the Virgin Islands (a tax haven), which accounts for a slightly larger share of FDI than the United States. One innovative feature of the current recovery is China's presence as a foreign investor

in the natural-resource sectors of several developing countries. It has also made investments in the automotive and informatics industries.

China's trade with Asian nations accounted for nearly half its exports and close to two thirds of its imports in 2004. The scale of these trade flows demonstrates the strong production linkages existing between other Asian countries and China. The resulting integration of production in that region is a manifestation of the channelling, as mentioned earlier, of indirect exports through China. Of China's 10 largest export markets, the United States is still in first place (21%), followed by the European Union (18%). Japan was the largest supplier of imports to China (16.8%), followed by the European Union (12%), while the United States, with which China has a hefty surplus, ranked only sixth in that category. Trade with Latin America and the Caribbean, though growing at a clearly above-average pace for China, represented only 4% of total exports and 3% of total imports in 2004. It should be pointed out that China's obviously robust trade with this region is due to the activity of just a few nations, principally Chile, the MERCOSUR countries and Mexico. Brazil ranked tenth as a supplier to China in 2004.

The rise in investment in China has concentrated on a relatively small number of sectors. Examples are the automotive and steel industries, which are already beginning to show signs of overproduction, and, to a lesser extent, cement and aluminium. The expansion of the automotive sector has been fuelled not only by domestic demand, which expanded at an extraordinarily rapid pace in 2003, but also by the fact that major transnational corporations have decided to set up motor vehicle plants in China with a view to supplying the international market. In other words, overproduction, which could generate a high level of investment in this country, could also saturate the domestic market and thereby exert downward pressure on international vehicle prices (Ramos and Ryd, 2005).

The growth trend in China's foreign trade and its balance-of-payments surpluses in 2003 and 2004 translated into a considerable accumulation of foreign reserves. By the end of the first half of 2005, China held US\$ 610 billion in reserves, equivalent to nearly 40% of its GDP, compared to just 10% a decade ago. This amount is also equivalent to one year's worth of imports. The

<sup>9</sup> In fact, China is surpassed only by Luxembourg, and that is because the latter country is a tax haven.

<sup>10</sup> The expanding flow of FDI towards the United States in 2004 is due to the increase in intra-company loans, as American subsidiaries abroad transfer ever-larger sums to their home offices, according to the Bureau of Economic Analysis (2005). Therefore, this movement, facilitated by the depreciation of the dollar, is attributable more to financial considerations than to productive investment.

<sup>11</sup> See Ministry of Commerce of China, [www.mofcom.cn](http://www.mofcom.cn).

reserves have been used primarily to buy United States Treasury bonds in an attempt to keep the currency's dollar parity stable.

First China and then, to a lesser degree, Japan pegged their currencies to the dollar as a means of defending the competitiveness of their exports. These interventions forced other Asian countries to shore up their own currencies, given the financial and commercial integration of this geographic area. The upshot has been trade imbalances and costs incurred by countries with floating currencies, especially in the euro zone, and there has been

concern about the exchange rates of various currencies against the dollar. There has also been speculation on those markets. For this reason, the measures have been heavily criticized, and Chinese authorities have come under mounting pressure to abandon their currency policy. In particular, initiatives have been sponsored in the United States Congress in support of demands by the private sector, European Union authorities and the Group of Seven (G-7), as well as the World Bank and IMF, that not only China but also Japan and the Republic of Korea adopt a more flexible exchange rate.

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### 3. China's revaluation dilemma

The revaluation of the Chinese yuan against the dollar should be viewed in the context of the broader debate about how to resolve financial imbalances in the global economy and, in particular, the United States' huge current account deficit. As with any of such imbalances, the deficit should be tackled with the help of policies designed to absorb liquidity and the adjustment of relative prices. Correction through absorption requires a gradual slowing of spending growth in the United States, which in turn calls for tighter fiscal and monetary policies. Relative price adjustments, meanwhile, will entail the devaluation of the dollar, which, in order to be effective, should also be accompanied by a revaluation of the currencies of countries benefiting the most from trade with the United States (i.e., China and other Asian countries). Because it is the largest economy in the world, a slowdown in the United States and a marginal deceleration of Asian economies ought to be coupled with an upswing in activity in Europe and Japan in order to avoid pushing the world economy into a hard landing.

As mentioned earlier, an enabling feature of this new international division of labour is the fact that, while the United States is the main consumer, China is the supplier par excellence, both of goods and of financing. The fact that the yuan was pegged to the dollar has contributed to this situation. This asymmetrical relationship may be viewed as part of a new monetary system (dubbed "Bretton Woods II"), in which the United States is at the centre and Asian nations form the periphery. The latter, by keeping their currencies fixed against the dollar, are also keeping their own currencies artificially low. This stimulates investment on the periphery and drives exports

towards the centre, resulting in a build-up of the current account deficit in the centre.

The corollary of that deficit is the accumulation of reserves in China and some other Asian nations. These reserves are then converted into credit and channelled to the United States via purchases of United States Treasury bonds. These purchases are partially responsible for the expansion of the global supply of dollars (the money supply in the United States plus reserves in foreign hands), which swelled by 25% in 2004, the largest jump in 30 years. When these dollars return to the United States, they depress bond yields and thus help to hold down interest rates in that country and the rest of the world. Available estimates indicate that Asian bond purchases have driven down yields by between 0.5 and 1.0 percentage points, which means that long-term interest rates will remain relatively low in the United States, with the consequent repercussions for the rest of the world.

This asymmetry has caused major imbalances not only in trade, but also in current accounts, international financial flows and the value of many countries' currencies. As a result, the euro has appreciated sharply, the yen has depreciated and the yuan has appreciated slightly, both relative to the dollar and in real effective terms (see figure I.1.b).<sup>12</sup>

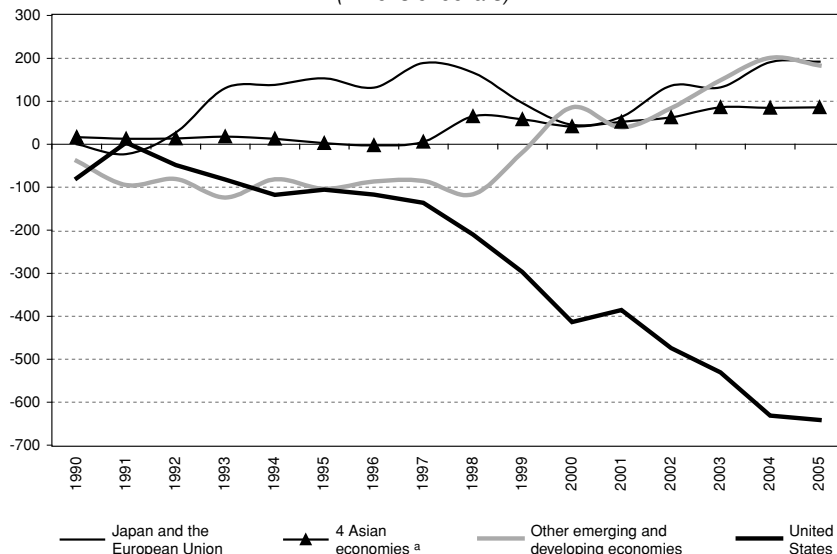
In spite of the depreciation of the dollar, the strength of consumption and investment in the United States have kept the trade and current account deficits high, and this translates into the trends observed in international reserves (see figures I.1.d, I.4 and I.5).

In mid-2005, the United States and the European Union began to step up the pressure on China to revalue

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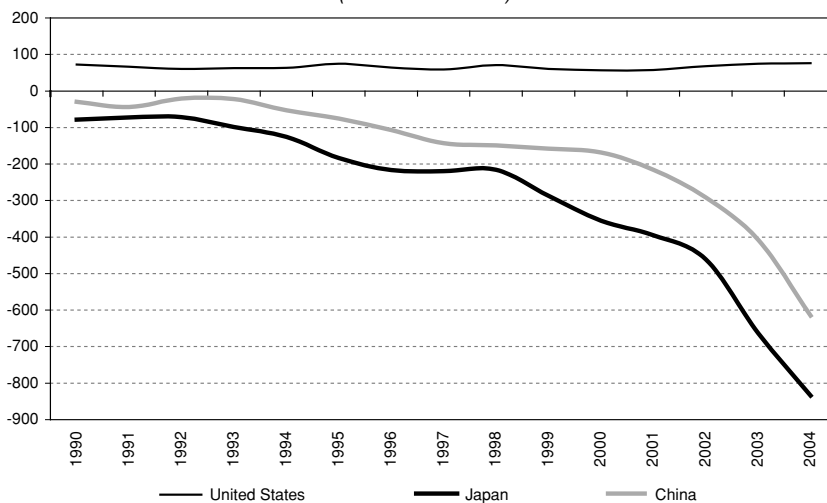
<sup>12</sup> It should be noted that the appreciation of the euro to some degree counteracted the negative impact of higher prices for European imports.

Figure I.4  
**TRENDS IN CURRENT ACCOUNTS, BY REGION AND COUNTRY**  
*(Billions of dollars)*



Source: International Monetary Fund (IMF), *International Financial Statistics* database.  
<sup>a</sup> Hong Kong Special Administrative Region of China, Taiwan Province of China, Republic of Korea and Singapore.

Figure I.5  
**TRENDS IN INTERNATIONAL RESERVES<sup>a</sup>**  
*(Billions of dollars)*



Source: International Monetary Fund (IMF), *International Financial Statistics* database.  
<sup>a</sup> Negative values indicate an increase in reserves.

its currency, which they felt would help correct global imbalances. Two factors come into play here: the actual role that the revaluation will play in correcting such imbalances, and the domestic factors that may have motivated it. In the first case, the United States' current account deficit is the largest in the world economy and stems in part from the continuing gap between the

above-potential growth of the United States and the below-potential growth of Japan and the European Union. The United States is expanding beyond its long-term potential, with an extremely low level of private saving and a hefty public deficit, both financed by funds derived from saving in the rest of the world. Correcting this imbalance will therefore require an integrated package of

policies designed to gradually curb growth in the United States, including tighter fiscal and monetary policies, and a similarly gradual devaluation of the dollar, along with faster growth in Japan and the European Union and a slower pace of growth in China, with the help of a revaluation of the yuan.

It is clear that, given the magnitudes and interactions involved, the emphasis being placed on the revaluation of the yuan is excessive. It is inappropriate for a number of reasons, the first being that China is not responsible for most of the United States trade deficit. In fact, it accounts for only 10% of that deficit, so a 10% revaluation of the yuan would bring the trade-weighted value of the dollar down by just 1%. If the rest of Asia followed China's lead and revalued its currencies, the dollar would decline by a mere 4%. Secondly, there is the fact that the dollar needs to be devalued substantially. The figures cited here fall far short of the required depreciation, since the dollar needs to fall to a level 15% below where it was in mid-2005 in order to bring the external deficit to sustainable levels of between 2% and 3% of GDP. And thirdly, China's exports have a high import content. This means that a revaluation of the Chinese currency would have no more than a limited effect. For example, the value added of Chinese cellular telephones exported to the United States is 15%, so a revaluation of 15% would raise the price of those products in the United States by just 1.5% (*The Economist*, 2005a).

Aside from these concerns, there is a reasonable doubt as to the actual impact of a revaluation on flows between China and the United States. In general, exchange-rate adjustments yield results if the elasticities of the products being traded move in the right direction, assuming a constant level of earnings. In China's case, however, a revaluation would deter foreign investment, thereby dampening the level of economic activity and the growth rate of imports (McKinnon, 2005). In short, while the effect of a revaluation on Chinese exports to the United States would be diminished by the sizeable imported content of the products it sells, its effect on imports would also be uncertain, given the vital role that foreign investment plays in China's growth and the fact that trade between China and the United States, in particular, is dominated by intra-firm commerce, which is less sensitive to price elasticities.

One of many recent studies done on this subject states that a 5% revaluation of the Chinese currency

would reduce the United States current account deficit by a mere 0.03% of GDP by 2007 and that a 20% revaluation would bring it down by just 0.13% by that same year (*Asia Monitor*, 2005). At the international level, an intense debate has arisen as to the wisdom of revaluing the yuan and its implications for the rest of the world.<sup>13</sup>

In late July 2005, the Chinese authorities announced the end of the yuan's 10-year peg to the dollar and the beginning of a transition to a managed float based on a basket of currencies. They indicated that, under this plan (with no word yet on what currencies would be involved or what the weightings would be), the yuan's value against the dollar would be announced on a daily basis. The first day, the yuan climbed by 2.1%, from 8.28 yuan to the dollar to 8.11. After that decision, heading off speculation about an additional revaluation, Chinese officials insisted that any measure affecting the exchange rate must be very gradual and should take into consideration not only the effect on the balance of payments but also its impact on the solidity of the financial system. The announcement of the yuan's revaluation reflects China's sensitivity to the debate going on in the United States and the European Union regarding their respective trade deficits with China and the sustainability of its foreign-exchange policy. It also reveals a fuller understanding of the global role China is beginning to play in defining the world economy's main parameters. And finally, it demonstrates that the Chinese authorities will take a gradual approach to this issue in view of its implications for the management of capital accounts and the soundness of the financial system.

In any event, some analysts oppose the notion that China and other Asian countries should revalue their currencies.<sup>14</sup> They argue that by pegging their currencies to the dollar, these nations have managed to keep their growth rates high, and that China's competitiveness can better be explained by structural factors, particularly the effective division of labour within Asia.<sup>15</sup>

Another study (McKinnon and Schnabl, 2004) also highlights the advantages of the Asian countries' policy of defending the value of their currencies and emphasizes that the reason for setting the exchange rate is not linked to trade relations with the United States. Instead, this policy has more to do with the use of the dollar in international pricing, since only one fifth of Asia's exports go to that country. In this regard, East Asia is a dollarized zone, and even though Japan is the second most important industrialized country in the world

<sup>13</sup> For a more comprehensive review of this debate, see Ramos and Ryd (2005).

<sup>14</sup> For an example of such reasoning, see McKinnon and Schnabl, 2003 and 2004; CEPII, 2003 and 2004; and Dooley, Folkerts-Landau and Garber, 2003.

<sup>15</sup> There are domestic reasons for a moderate revaluation of China's currency, but each should be examined in its own context, without expecting China's currency policy to shoulder the full burden of correcting the imbalances of the world economy.

economy, it uses the dollar more than the yen in trade with its neighbours. For example, half of Japan's exports to Asian countries and three quarters of its imports from them are priced in dollars.

Thus, the revaluation of the yuan, although initially modest, helps to set the stage for an adjustment of international parities that will permit more balanced

growth among the different geographic areas, especially if other Asian currencies follow suit. Indeed, in the absence of such an adjustment in Asian currencies, the necessary devaluation of the dollar would have brought with it revaluations of the euro and of Latin American currencies, which would sap their export strength and their growth capacity.

## E. Short-run prospects for the world economy (2005-2006)<sup>16</sup>

Most projections point towards slower world GDP growth in 2005 and 2006, with rates between 3.0% and 4.3%. In other words, at most, the growth rate would be one percentage point below the rate for 2004.<sup>17</sup> In fact, according to a very recent estimate, projected world growth for 2005 will be down by three tenths of a point, bringing it to 2.9% in 2005 and a similar rate (3.0%) in 2006 (United Nations, 2005b). Several factors underlie these short- and medium-term forecasts. Firstly, global demand is likely to be dampened by the rise in oil and other commodity prices. Secondly, relative shifts in the major currencies' exchange rates will also have an impact. It is assumed, however, that, barring any new geopolitical conflicts, the risks for the world economy may ease, as they did in 2004, when global imbalances and the depreciation of the dollar did not have any major repercussions.

The current imbalances are far from negligible and bear close monitoring, since, depending on the direction they move in, they could hurt the world economy's growth prospects. Also of concern is the uncertainty arising out of the larger hikes in interest rates, the very difficult fiscal situations that many countries are contending with and the structural weaknesses that restrict growth in vital economic areas because they heighten vulnerability to external impacts. To cite just one example, a highly sensitive investment climate exists in many Latin American and Caribbean countries alongside a high rate of foreign borrowing.

In addition, rising oil prices, the terrorist threat and the strong protectionist signals being sent by the major industrialized economies further cloud the medium-term scenario in the world economy.

Aside from the factors mentioned above, world GDP growth projections also take into account the domestic downturn that is likely to occur in some of the larger and more economically influential countries, since a number of these nations were growing at rates quite near their full growth potential in 2004, at the same time that stimulus policies were discontinued in several of them.

The temporary nature of fiscal measures in the United States, along with recent upticks in the prime rate and unprecedented imbalances, all suggest that growth will slacken in that country. This trend has been corroborated by the growth rate recorded for the first quarter of 2005. Moreover, the investment cycle has reached its turning point, higher interest rates will act as a deterrent to investment, and the fiscal stimulus will be weakened. In short, the United States is expected to expand at a lower rate in 2005, probably by between 3% and 3.6%, and this pace will likely be maintained in 2006.

The European Union is also expected to expand more slowly due to tighter fiscal policies and its shrinking external surplus. Thus, it is estimated that the euro zone will record a growth rate of from 1.2% to 1.6% in 2005 and between 2.0% and 2.3% in 2006. As for Japan, it should be noted that steeper interest rates will hinder investment, the fiscal stimulus will be weaker and the foreign surplus will become smaller. Consequently, that country's expansion will be limited and the economy is projected to grow at about 1% in 2005, possibly close to 2% in 2006.

As a result of China's efforts to cool down its economy, it is expected to expand by between 8.5% and 9.0% in 2005 and between 8.0% and 9.2% in 2006. All things considered, even that lower projected growth rate

<sup>16</sup> This section is based on: World Bank, 2004; IMF, 2005; United Nations, 2005b; OECD, 2005b; European Commission, 2005; Johnson, 2005; and Kimbrough, 2005.

<sup>17</sup> As indicated, these rates have been calculated on the basis of market prices.



will enable developing countries to continue to achieve GDP growth above the world average. For the rest of the decade, it is anticipated that two thirds of world consumption will be generated by the United States and the Asia-Pacific region. Thus, developing countries can look forward to growth rates of 3% in 2005 and 6.0% in 2006.

The somewhat slower pace of global GDP growth will help to weaken international demand and therefore reduce the volume of world trade, which will rise at a rate of only 7.2%-7.4% in 2005, according to the main projections. This would be tantamount to a decline of

about two percentage points from 2004. The world volume of exports in 2006 should be slightly higher than in 2005, while commodity prices should rise more slowly than in the past. In sum, although the global economy and international trade will be somewhat less dynamic in 2005 than in 2004, with smaller increases in commodity prices, higher oil prices and escalating interest rates, 2005 will still be a good year for world GDP and trade, and developing countries — particularly those in Latin America and the Caribbean— will post a robust performance.

## 1. The current oil crisis

The oil supply is characterized by high fixed production and transport costs, but also by low variable costs and large economies of scale. This normally leads to major lags between an increase in demand, a rise in prices and the expansion of production capacity. Inversely, once that capacity is generated, a decline in prices does not immediately result in production cuts; on the contrary, oil companies tend to augment production to take advantage of economies of scale. Demand, on the other hand, has a very low price elasticity and a relatively high income elasticity. In other words, demand for oil is closely linked to the level of global economic activity, while production responds slowly to price movements. The result of this combination of factors is a markedly procyclical price trend (Kaufmann, 2000).

The currently high level of oil prices and their impact on the world economy are a cause of increasing concern. Indeed, nearly every recession in the United States economy in the post-war period has been preceded by a rise in oil prices. In fact, it has actually been demonstrated that there is a lag of three quarters between an oil price hike and the beginning of a recession in the United States (Birol and Kaufmann, 2000). By way of illustration, it may be noted that several studies have measured the impact of the price hikes of the 1973-1974 and 1979-1980 crises, and each shows a deterioration in the terms of trade in the member countries of the Organisation for Economic Co-operation and Development (OECD) equivalent to 2% of GDP. In these cases, oil prices climbed by 350% and 130%, respectively. Furthermore, it is estimated that the first of these crises led to a decline in GDP of 4.7% in the United States, 2.5% in Europe and 7% in Japan. According to officials in the United States, the rise in the price of petroleum in 1979 alone was responsible for a drop of 3% in world GDP (IIE, 2000). In practically all the crises mentioned, the price hike coincided with

a world economy that was expanding rapidly, limited oil production capacity and declining investment in petroleum and natural gas prospecting. Nearly all of these factors are present today as well.

Nonetheless, it is estimated that the impact of the current price rises will be smaller than on previous occasions, primarily because the increase in the price of petroleum is comparatively less in real terms. The price went up by 74% between June 2003 and March 2005, which compares favourably with the previous increases of 185% in 1974 and 158% between June 1978 and November 1979 (IMF, 2005). Another reason for the smaller impact is that developed economies are less dependent on oil. Not only have efforts been stepped up to substitute other energy sources, but changes have also taken place in production structures that have reduced energy use and boosted efficiency. For example, in the United States the intensity of oil use per unit of production has been cut in half since the 1970s. Thus, the number of dollars generated for each barrel of petroleum is now a little more than US\$ 1,000 of real GDP. In other developed nations, such as Germany, France, the United Kingdom and Japan, this indicator is more than US\$ 1,600.

The situation is quite different in developing countries, particularly in the Chinese economy. In fact, the rise in income in those nations entails more intensive use of petroleum because of the larger number of motor vehicles and the replacement of other sources of energy such as firewood and coal. As a result, per capita oil consumption has more than doubled since 1970 in Asia. This increase can be explained, first of all, by demand in China, followed by India. These two countries combined accounted for 35% of the rise in global consumption between 1990 and 2003, but they produced only 15% of world GDP during those same years. Moreover, China has become the second-largest consumer of oil in the

world, exceeded only by the United States (IMF, 2005). It should also be emphasized that developing countries make considerably more intensive use of petroleum than industrialized nations. In fact, many of them generate only US\$ 600 of real GDP per barrel of oil; this is especially true of oil importers. In other countries, such as the Russian Federation, Mexico, Indonesia, Thailand and Brazil, the figure is nearly US\$ 850.

In any case, the effects on this group of countries are quite differentiated. The World Bank reports that developing nations that are oil exporters felt an impact on their terms of trade equivalent to 5.6% of GDP, while oil importers in that group reported an impact of -0.3%. For the poorest oil importing countries, it is estimated that the additional burden caused by the rise in oil prices has absorbed 75% of the financing they received from the World Bank for all of their development programmes in 2004. In view of this situation, the wealthier nations will need to increase that financing substantially if the high prices persist.

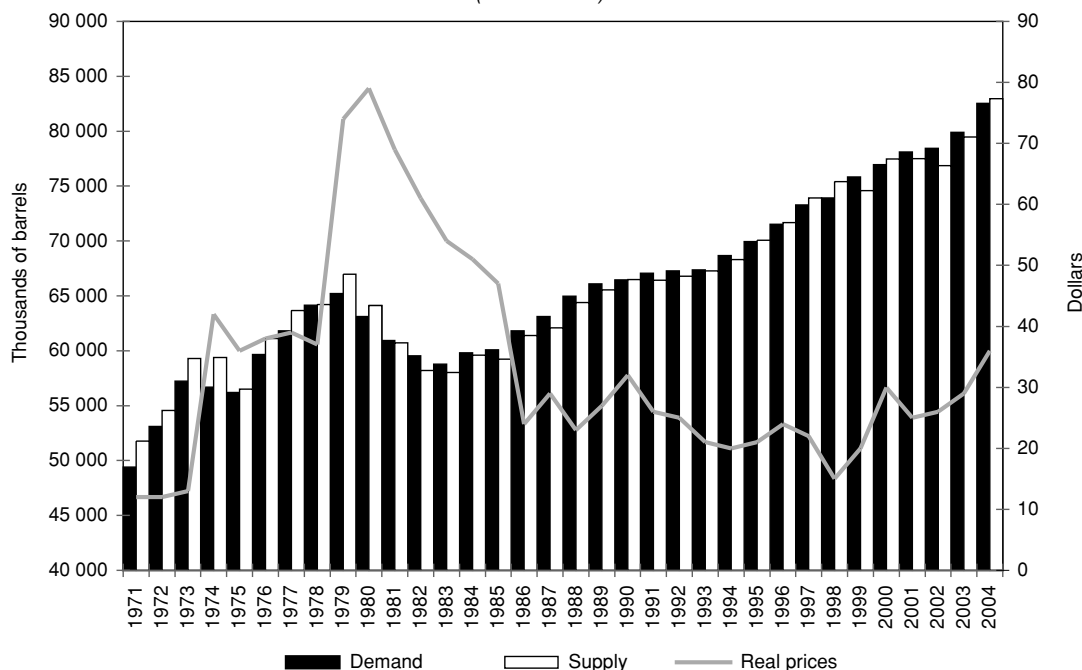
Current conditions on the world oil market suggest that prices will remain high. The International Monetary Fund, for example, bases its growth projections on an average price of US\$ 46.50 per barrel in 2005 and US\$ 43.75 per barrel in 2006, but it indicates that futures contracts place the price slightly above US\$ 50 per barrel in 2005. This level would not endanger world growth, but if the price remains between US\$ 60 and

US\$ 69 per barrel, IMF forecasts for world growth will be reduced by three fourths of a percentage point (*Wall Street Journal*, 2005).

According to conventional calculations, an increase of US\$ 10 in the per-barrel price should result in a half-point reduction in the global GDP growth rate and a 0.2-point reduction in that of Latin America (IEA, 2005). In any event, if oil prices remain high for several years, there will be changes in households' and businesses' consumption patterns that will encourage energy efficiency. In fact, there has been a persistent effort in OECD to make adjustments in energy consumption. Thus, whereas energy imports in the late 1970s amounted to 13% of all commodity imports, by the end of the 1990s that figure was just 4% (*The Economist*, 2005). Moreover, the current cycle of the world economy, unlike that of the 1970s, is characterized by low inflation, an absence of price or wage indexing, and central banks with enhanced credibility and more expertise in controlling inflation. Therefore, today it is less likely that a hike in oil prices will trigger spiralling inflation and interest rates.

However, calculations of real oil prices are not all the same. According to IMF, the price in 2004 (in 2003 dollars) was US\$ 36 per barrel, which compares favourably with previous increases, particularly the maximum price of US\$ 79 per barrel recorded in 1980, also in 2003 dollars (see figure I.6). According to other

Figure I.6  
OIL: TRENDS IN SUPPLY, DEMAND AND REAL PRICES  
(2003 dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Energy Agency (IEA) and the International Monetary Fund (IMF).

sources, the real price in 2004 was close to that seen in 1983, which was still high in comparison with subsequent trends (IEA, 2004). These differences seem to be related to the method used to calculate deflation and the base year chosen.

According to IMF (2005), the more advanced countries will account for only one fourth of the rise in worldwide demand for petroleum in the next 25 years,

and most of the increase will come from developing countries, driven primarily by the expansion of the number of motor vehicles in China and other emerging nations of Asia. In short, by 2030, the demand for oil will have at least doubled in developing countries. This heightened demand is expected to boost the real price of that commodity to a level much greater than the average for the last 20 years.

## 2. Risks and uncertainties

In addition to the risks associated with oil price trends, it is important to note, first of all, the magnitude of the trade and budget deficits in the United States, which have reached increasingly unsustainable levels. For this reason, one possible — though unlikely — scenario is that additional hikes in the benchmark rate will have a greater recessionary impact than has been seen previously in that country, given the high level of average household debt. This would also affect the rest of the world, since such increases would raise the risk premiums in countries with limited resources. The World Bank estimates that a jump of 200 basis points in the interest rate would reduce world growth by half a percentage point per year in the short and medium terms. The problem will become much more serious if the United States does not cut its deficits in the long term, a circumstance that might even lead to a new period of stagflation like the one seen in the 1970s and 1980s (World Bank, 2004, chapter I).

Secondly, there is a risk that the currency composition of international reserves may shift away from the dollar, which could precipitate an uncontrolled depreciation of that currency. Indeed, a change has been observed in Asian banks' preference for dollars. The share of dollars in their international deposits dropped from 81% in September 2001 to 67% in September 2004, according to the Bank for International Settlements (BIS, 2005). If the continuing trend in dollar preferences translates into even higher interest rates, world growth will be eroded further. This would have serious implications for developing countries, which would see their debt service rise and, at the same time, would feel downward pressure on their currencies. Brazil, the Philippines, Indonesia,

Poland and Turkey are among the countries that would suffer this plight.

Thirdly, the downturn in the growth of the Chinese economy may be steeper than predicted, which would have serious implications for global growth and trade in primary goods and certain manufactures, given that nation's current preponderance in the world economy. This possibility would amplify the international repercussions of the problems in the United States economy, given the increasing interdependency of production, trade and finance between the two countries.

Fourthly, there is a looming danger that protectionist measures will be taken in order to rein in imports in industrialized countries, especially the United States and the European Union. The loss of jobs in these countries has sparked a heated debate in which high unemployment levels and domestic products' lack of competitiveness are linked to the relocation of businesses overseas. In addition, the United States and Europe have both exerted pressure on nations that are shoring up their currencies' value against the dollar in an effort to reduce the competitive edge that United States' and European products enjoy in their markets. Europe, above all, has suffered the consequences of the dollar's decline, as the value of the euro has mounted and exports, the most dynamic element in the European economy, have sagged.<sup>18</sup> In view of the escalating current account deficit in the United States, authorities in that country pushed for the revaluation of the yuan. Consequently, protectionist measures have been announced or already applied, with an especially adverse impact on imports from China. The number

<sup>18</sup> The rejection of the European Constitution by France and the Netherlands caused a short-term dip in the exchange rate of the euro, exacerbated by conflicting statements by European leaders. The importance of this effect becomes clear in the calculations of the European Central Bank (ECB), which predict that if a 5% decline in the value of the euro against the currencies of its principal trading partners lasts for 12 months, European growth could gain 0.5 to 0.9 percentage points.

of anti-dumping measures applied by these nations against their Asian counterparts has been on the rise, which reflects this concern and makes protectionism

an important risk factor on the short-term horizon. All of these potential protectionist threats form a cloud of uncertainty over prospects for the Doha Round.

### 3. Possible adjustment scenarios

There is a general consensus that the United States' rising budget and current account deficits are unsustainable and must be reduced immediately, though there is disagreement as to the best ways to accomplish this. To be sure, the longer these adjustments are postponed, the worse the consequences will be, both for that country and for the international economy. Different scenarios can be envisioned depending on what measures are adopted and how the current imbalances play out.

It is conceivable that the current imbalance will persist, or that it will become progressively worse. If so, capital flows into the United States will continue or even intensify to offset the lack of domestic saving. If that occurs, the dollar will stay at practically the same level, while Asian nations will continue their policy of intervening on currency markets. This would put off the necessary adjustment, but the magnitude of the subsequent fall in the dollar's value would increase. The resultant appreciation of the euro would cause more and more problems for European economies, where, as in Japan, growth has been based principally on exports, but at the cost of smaller profit margins. A similar situation would ensue in the Latin American and Caribbean countries, which would be forced to revalue their currencies as the dollar depreciated, thus limiting their exports and their growth.

The Federal Reserve's current policy is designed to ensure that the funds rate has a neutral effect on the economy, that is, neither expansionary nor restrictive. This neutral rate may prove to be between 3.5% and 4%, and may be reached sometime in 2005.

If the imbalances are not corrected and they prompt steeper interest rate hikes in order to attract the capital necessary to finance those deficits while containing inflation, the United States can expect a more significant downturn than usual, considering the high level of household debt and the fact that consumption has been sustained by debt refinancing.

There is also the possibility of a slight decline in consumption in the United States, which might be brought about, for example, by an increase in domestic saving and a slight depreciation of the dollar to make up for the decline in domestic demand. This would

raise the question as to what to do with the surplus that would result from production exceeding consumption in that country in order to shrink the current account deficit. This situation would necessarily force the rest of the world to make an adjustment, resulting in a loss of competitiveness, and everyone would be obliged to absorb the surplus. Both Europe and Japan, in view of their weak domestic demand, would face serious difficulties under these circumstances. In other words, although this scenario would benefit the United States, it would have a mildly recessionary impact on the rest of the world. In any case, a depreciation of the dollar, no matter how large, would not be enough to cut the current account deficit, though it would improve the balance of trade. What would be needed is a change in saving habits or tighter monetary and fiscal policies. It is worth recalling that the cumulative current account deficit for 2004 was twice as high as the deficits recorded in the 1980s, and the dollar has only depreciated by half as much compared to then. Furthermore, a hefty depreciation of the dollar would expose countries with large dollar holdings to negative wealth effects, which would dampen growth and further complicate the absorption problem. In other words, there is reason to believe that the risks of slower growth are greater now than in the second half of the 1980s, when both Europe and Japan were growing faster than they are now.

Finally, we cannot rule out a more drastic adjustment and a steep drop in the dollar if central banks stop counteracting the pressure to revalue their currencies and begin liquidating their dollar reserves. If this were to happen, equities would decrease in value all over the world, international capital movements would ensue, and the dollar would grow extremely weak; in other words, investment and consumption would fall in the United States, undermining that country's role as an engine of international growth. The result would be a more pronounced adjustment in the rest of the world and a widespread recession. All things considered, as of mid-2005 this scenario appears to be very unlikely, however.

The year 2005 will continue to be a good one for global GDP growth and trade. However, if the price of oil climbs too high, the entire world will feel

inflationary pressures. In that case, there would be upward pressure on interest rates, and lending terms would be less promising than in 2004, especially for developing countries. Although there are grounds for a certain optimism regarding short-term prospects, there is no doubt that if the imbalances persist, there is a greater danger of an undesirable turn of events in

the longer term. For this reason, it is necessary for the main actors in the world economy —namely, China, the United States, Japan and the euro area— to adopt coordinated measures to overcome these weaknesses. In addition, protectionist pressures will continue as long as oil prices stay high and the imbalances in world demand are not corrected.

#### 4. Consequences for Latin America and the Caribbean

Latin American and Caribbean exports have shown a marked tendency to increase since the early 1980s, and especially since the 1990s. In the past decade, exports have doubled, although that growth was substantially overshadowed by the tripling of imports. Consequently, towards the end of the last decade the trade balance and the current account began to register ever-larger deficits, amounting to US\$ 13 billion and US\$ 46 billion, respectively. In 2004, however, for the second year in a row GDP growth was accompanied by a current account surplus, thanks mainly to propitious external conditions that favoured a large volume of exports and, above all, improved the terms of trade for the region. This trend is expected to continue throughout 2005, though to a lesser extent.

The region's share of world commodity trade expanded from 7.1% to 9.8% between 1985 and 2000 thanks, in part, to improved production technologies. The reverse is true of low-technology, natural-resource-based manufactures, where its share fell from 5% to 4.6% during the same period (ECLAC, 2002). A significant proportion of these exports are subject to widely fluctuating prices, deteriorating terms of trade and tariff barriers that block access to developed-country markets, especially in the case of agricultural products. Other basic goods, including steel and sheet metal, must, increasingly, contend with non-tariff restrictions such as safeguards, countervailing duties or anti-dumping provisions in those markets (ECLAC, 2003).

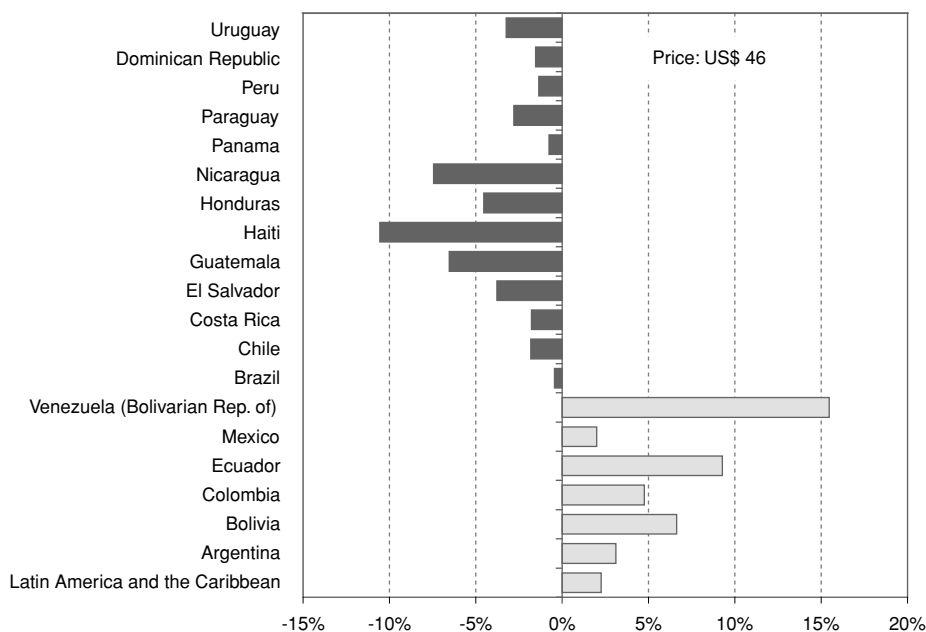
IMF (2005) has noted that developing countries, especially those with hefty current account deficits or limited access to external financing, will be the hardest hit by soaring oil prices, which may translate into a deterioration in their trade balances amounting to between 0.5 and 1 percentage points of GDP. The report makes special mention of the cases of the Dominican Republic, Honduras and Nicaragua. This circumstance is linked to trends in the terms of trade. Indeed, the recent rise in the price of petroleum has favoured net exporters such

as Argentina, the Bolivarian Republic of Venezuela, Colombia, Ecuador and Mexico, while the opposite has happened in Brazil, Chile, Paraguay, Peru and Uruguay. Although the region as a whole saw an improvement of over 5% in its terms of trade in 2004, this increase was 12% for the Bolivarian Republic of Venezuela and Colombia, and most of it was attributable to escalating oil prices. On the other hand, countries such as Brazil, Paraguay and Uruguay suffered losses in this regard ranging from approximately 7 to 9 percentage points (ECLAC, 2004).

In an effort to estimate the impact of changes in oil prices on trade balances in the region for 2005, ECLAC has made calculations using three different price levels for each member State of the Latin American Integration Association (LAIA) (ECLAC, 2005a). The first calculation assumes that the average price that prevailed in the first quarter, US\$ 49 per barrel, holds for the rest of the year. The second one is based on a price of US\$ 40 per barrel, in the light of projections of slower global growth. The last one assumes a price of US\$ 60 for 2005. In the first scenario, the merchandise trade balance would improve by US\$ 13.5 billion for the region as a whole. This improvement would come at a price for several countries, however; Chile, in particular, would see its merchandise trade surplus decline by nearly US\$ 1 billion. In the second case, the merchandise trade balance would improve by just US\$ 3.5 billion, primarily because Mexico would take in less revenue and its trade deficit would increase by nearly US\$ 4 billion. In the third scenario, LAIA would post a surplus of US\$ 28 billion, or 44% more than in 2004, with the Bolivarian Republic of Venezuela accounting for 37% of that upsurge. Chile would suffer the most damage, with its trade balance moving from a surplus to a deficit position 2004 and 2005.

As for the fiscal implications, IMF has estimated (IMF, 1999) that the impact of a 10% hike in the price of petroleum would, thanks to higher public revenues,

Figure I.7  
**IMPACT OF OIL PRICES, MEASURED AS A PERCENTAGE OF EXPORTS, 2004**



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

boost Mexico's GDP by 0.4 points and the Bolivarian Republic of Venezuela's by 1.2 points. Of course, the price of oil not only affects revenues in countries where the State is a major oil producer, but also influences other countries through its effect on tax revenues. Although oil tax revenues have slipped, they are still a significant source of revenues in many nations of the region. In addition, the price of this commodity is reflected, directly or indirectly, in the consumer price index. This impact has been greater in countries that have deregulated prices on the domestic market, including Brazil, Chile, Peru and, to a lesser extent, Mexico. In these cases, rising oil prices have been passed on entirely to consumers (Campodónico, 2001).

The consequences of slower world economic growth for Latin America and the Caribbean will vary depending on how large or small each country's share of international trade is and on the vulnerability of its current account and financial situation. International interest rate hikes will weigh on countries with large debts, while the scarcity of financial resources may hurt investment potential and opportunities for productive development. Nevertheless, as long as the Federal Reserve's policy does not translate into more pronounced or more frequent rate increases and excess liquidity continues to limit the impact on long-term interest rates, debt service costs will remain moderate. The implications of such a policy would

have to be evaluated in light of the debt structure of each country, since the higher the concentration of short-term debt, the greater the repercussions.

In summary, the international economic situation in 2004-2005 has been favourable for the region, since it has included good international prices for exports, improved terms of trade, low interest rates and, consequently, low inflation and positive fiscal outcomes. The recent revaluation of China's currency will allow the depreciation of the dollar to remain moderate, fending off the possibility of a drastic escalation of interest rates in the United States. The gradual reduction of the budget deficit in the United States is moving in the same direction. The price of petroleum is still a critical variable in the region's economic performance. The Latin American and Caribbean region is a net oil exporter, and therefore high prices are good for the region; but several small and medium-sized countries are net importers of oil, and current prices of around US\$ 60 per barrel place a heavy burden on their budgets and balance of payments. Net exporters, for their part, face a considerable fiscal challenge, in that they must find a way of taking advantage of the windfall to bolster savings or to pay down the public sector's debt.

The nations of the region should take China's new stance as a stronger competitive force into consideration. The effect of this increased competition on the part

of China has already become apparent in the textile market, both in the short term (e.g., foreign-exchange policy) and in terms of industrial strategies and long-term trade alliances. This competition may also take on more significance in the case of goods in which China is generating surplus supply, such as those mentioned previously. Even if China's economy slows down a little, its exportable surpluses of these products will probably increase. It is clear that the new geography

of trade, with an increasingly autonomous Asian centre revolving around the Chinese economy, is the most noteworthy feature of this new global business cycle. Within the context of both international negotiations and the design of trade strategies, Latin American and Caribbean authorities will need to redouble their efforts to discover and take advantage of the complementarities that may arise out of greater integration with Asia, in general, and with China, in particular.

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## Chapter II

# Negotiations in the multilateral trade system. The World Trade Organization and regional expectations

## A. Latin America and the Caribbean in the multilateral framework

Since 2001, the member countries of the World Trade Organization (WTO), which currently number 148, have been working on a new multilateral round of trade negotiations which are expected to be concluded by the end of 2006. The current trade system has come a long way since the origins of the General Agreement on Tariffs and Trade (GATT) (1947), including the work done on the Uruguay Round, which has been in force since 1995. The coordinates of the current effort – within the framework of the Doha Round – arise out of an agreement signed in August 2004 that helped breathe life back into the flagging multilateral system. In the initial months of 2005, little progress was made; it was not until the beginning of May, when critical issues in the area of agriculture were resolved, that an optimistic outlook could be justified, though the goals that were set are far from being reached. This task focuses in particular on five fundamental spheres in the negotiating process: modalities in agriculture and access to markets for non-farm products, critical mass of offers to open up service markets, progress on rules and trade facilitation, and adequate treatment of the development aspect (WTO, 2005j).

That process is reviewed in this chapter, beginning with a brief look at the situation leading up to August 2004, the legacy of the Uruguay Round and the orientation of the current Doha Round. The main issues under negotiation are then examined, including their

content, the visions of some key players – including the countries in this region – and the major sticking points. The final section provides an overview of the negotiations and the role of Latin American and Caribbean countries.

## 1. WTO and the legacy of the Uruguay Round

The countries of Latin America and the Caribbean have incorporated trade liberalization as a central theme of their development strategies and are involved in trade negotiations at various levels.<sup>1</sup> For this reason, strengthening multilateral institutions for international trade is a key aspect of these strategies.

With the multilateral system, which operates within the framework established by the Uruguay Round and, since 1995, WTO, the liberalization of goods that was achieved in successive negotiations in GATT was expanded, and the groundwork was laid for beginning a far-reaching reform of two sectors of interest to developing countries – agriculture, and textiles and apparel – that had not previously been fully integrated into the system. That round also resulted in the establishment of liberalization instruments and regulatory frameworks for trade in services, and standards were defined for intellectual property.<sup>2</sup> At the same time, new negotiations were launched in agriculture and services, areas in which the Uruguay Round had just begun the liberalization process. Finally, in that same period some negotiations were concluded for the liberalization of sectors of interest to developed countries, such as the Information Technology Agreement and the corresponding accords on financial services and telecommunications.

Given a number of factors relating to the methodologies, assumptions and scope of available evaluations, the impact of liberalization measures on the volume of agricultural trade can be described as mixed. It is positive, on the one hand, because of the reduction of tariffs, but it is negative with regard to the reduction of subsidies for production and exports.<sup>3</sup> According to Hertel and Martin (2000), the gains in income resulting from liberalization are greater in percentage terms in developing countries, and these gains are primarily due to enhanced efficiency, thanks to the removal of their own protective measures.<sup>4</sup> Something analogous may be occurring with the liberalization of manufactures and increased access to the other main developing-country

markets to which most of their manufactured exports are sold.

The above-mentioned authors estimate that a 40% reduction in tariffs and export subsidies for farm products after the Uruguay Round – in 2005 – has increased global income by nearly US\$ 60 billion per year. This figure rises by another US\$ 10 billion if domestic support is cut by 40% as well. Moreover, with a 40% decrease in tariffs on manufactured goods, the volume of global trade would jump by more than US\$ 380 billion, equivalent to about 5% of projected trade in merchandise and non-factor services in 2005. What is more, the gains almost double if liberalization measures are applied to all kinds of goods, and developing countries would benefit the most, although with an uneven distribution among them. In the case of Latin America and the Caribbean, it is estimated that a 50% cut in tariffs on all goods would boost exports by about 6% (Laird, Cernat and Turrini, 2003).<sup>5</sup>

The Latin American and Caribbean countries began to open up their economies in the late 1980s, when the Uruguay Round was under way, and the implementation of the corresponding agreements complemented and supported the reform efforts being undertaken in these countries. The Uruguay Round therefore did not involve major adjustments, except in areas such as those pertaining to the institutional structure for intellectual property protection and the approach to be taken within the context of the WTO dispute settlement system to policies involving price bands and subsidies that had been adopted by some countries (Lengyel and Ventura, 2003).

By reforming its approach to trade, the region has expanded the role of its external sector in the economy (exports now account for more than 20% of GDP) and has restructured to some extent the areas of specialization for its exports and its target markets.<sup>6</sup> Against that backdrop, the farm and textile sectors have maintained a significant presence, particularly in some countries. The year 2005 marks the end of the implementation period

<sup>1</sup> The countries of Latin America and the Caribbean are classified as developing countries in WTO; only Haiti is in the category of least developed countries.

<sup>2</sup> In the Uruguay Round a broad set of regulations governing trade relations was also devised, disciplining traditional trade policy instruments (anti-dumping, safeguards) and instruments intrinsic to development policies (subsidies, investments). In addition, the transition periods were defined for applying and revising some relevant agreements with respect to the year 2000.

<sup>3</sup> See, in particular, Nogués, 2004; Laird, Cernat and Turrini, 2003; and Whalley, 2000.

<sup>4</sup> The reduction of export subsidies, in contrast, reportedly resulted in deteriorating terms of trade for developing countries that are net food importers (Laird, Cernat and Turrini, 2003).

<sup>5</sup> The figure mentioned for Latin America and the Caribbean contrasts with the figure given for China (7.5%) and South Asia (12%).

<sup>6</sup> All things considered, that export percentage is still one of the lowest in the world, especially in the case of South America.

of the agreements corresponding to the Uruguay Round, the Agreement on Agriculture and the Agreement on Textiles and Clothing.

In the latter sector, a profound change is taking place in the regulatory sphere in these countries, while in the area of agriculture they still face major barriers to entry in the principal markets and distortions in international markets. One reason for this is the level and complexity of tariffs and other border protection mechanisms, such as licenses, quotas and standards; another reason is the level of subsidies that developed countries are providing in this

sector. These distortions also tend to be concentrated in some products that are of special interest to developing countries. Indeed, some analysts believe that the Uruguay Round Agreement on Agriculture “is probably one of the worst” because it lacks transparency and allows the levels of protection to rise (Nogués, 2004, p. 9, see also section B.2.a). Therefore, demands have been made in the negotiations for more liberalization, and caution has been called for regarding the effects on the importing countries of the region. Hence the active participation by these countries in negotiations in the sector (see table II.1). At

Table II.1  
PARTICIPATION OF LATIN AMERICAN AND CARIBBEAN COUNTRIES IN INTEREST GROUPS OF THE MULTILATERAL SYSTEM<sup>a</sup>

GROUP	Created or existing in preparations for Doha, 2001		Created in conjunction with Cancún, 2003, on agriculture <sup>b</sup>			Created in conjunction with other thematic interests current in 2005 <sup>c</sup>			
	Cairns	Common interests	G-20	AU-ACP-LDC	G-33	Friends of Anti-dumping Negotiations	Intellectual Property and Convention on Biological Diversity <sup>d</sup>	Friends of Fish	Colorado
COMPOSITION	17 countries	12 developing countries	20 developing countries	Broad group of developing countries	33 developing countries	18 countries	8 developing countries	9 countries	15 countries
INTEREST	Agriculture liberalization	Developing countries and special and differential treatment	Equitable agricultural liberalization	Balanced agricultural framework	Framework for special products and Special Safeguard Mechanism, agriculture negotiation	Negotiations on anti-dumping	Distribution of benefits of intellectual property	Disciplining fishing subsidies	Negotiations on trade facilitation
Argentina	participant		participant					participant	
Bolivia	participant		participant				participant		
Brazil	participant		participant			participant	participant		
Chile	participant		participant			participant		participant	participant
Colombia	participant					participant	participant		participant
Costa Rica	participant					participant			participant
Cuba		participant	participant		participant				
Ecuador							participant	participant	
El Salvador									
Haiti				participant	participant				
Guatemala	participant		participant						
Honduras		participant			participant				
Mexico			participant			participant			
Nicaragua					participant				
Panama					participant				
Paraguay	participant		participant						participant
Peru					participant		participant	participant	
Dominican Republic		participant		participant	participant		participant		
Uruguay	participant		(participant)						
Venezuela (Bolivarian Rep. of)			participant		participant				
Caribbean countries (of Africa, the Caribbean and the Pacific)				participants (13)	participants (11)				

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information.

<sup>a</sup> This table is not exhaustive because it is difficult to find official information on participation and on the content of proposals by the different groups of countries; it should therefore be used as a reference only.

<sup>b</sup> Changes have been made in the composition of all these groups since Cancún; this table shows the current situation. G-22 is now known as G-20 (see <http://www.g-20.mre.gov.br>). The African Union/African, Caribbean and Pacific States/Least-Developed Countries (AU/ACP/LDC) are made up of 61 members, of which 15 are in this region. This group also opposes the “Singapore issues”. G-33 currently consists of 42 countries, 19 of which are in this region (WTO, 2004d).

<sup>c</sup> In addition to this group, the following groups have made proposals that have been coordinated with the agricultural negotiations: CARICOM – and a subgroup participating in the “Small Developing Island States” – “Central American Group”, MERCOSUR – and in coordination with others, and a “Developing Countries Group”, made up of 15 countries, in which Cuba, the Dominican Republic, El Salvador, Haiti, Honduras and Nicaragua are participating (WTO, 2004d). See also the preceding note.

<sup>d</sup> Although they do not constitute a recognized group, several countries in the region mentioned here have been involved in supporting related proposals (WTO, 2005a).

the same time, the sector has been given special treatment in the countries' trade policies, including preferential treatment in trade agreements within the region; but more progress needs to be made in opening up markets to trading partners, especially other developing countries within the same region.

With the implementation of the Agreement on Textiles and Clothing and the consequent dismantling of the Multifibre Agreement,<sup>7</sup> the textile and apparel sectors became fully incorporated into the GATT multilateral framework of trade in goods. This change is disturbing to countries in the region that produce significant amounts of these goods. Mexico, the Central American nations and the Dominican Republic, in particular, face major challenges in the United States because of competition from China.

One widespread complaint among developing countries is that due attention has not been devoted to asymmetries in countries' levels of development within the multilateral system, given the continuing difficulties they encounter in gaining market access and the distortions created by subsidies in markets of interest, the costs of adjusting their institutions and the narrower range of policies available to foster competitiveness. Moreover, while the expected benefits of the multilateral system may come in the medium and long terms, the adjustments have to be made right away, and the various resources required for the task are limited (see Laird, Fernández de Córdoba and Vanzetti, 2004; Fernández

de Córdoba, Laird and Vanzetti, 2005b; and Fernández and Vanzetti, 2005).

Some of the problems regarding agricultural market access are also present in industrial sectors (tariff peaks and escalation) and especially in the textiles and apparel sector. To improve access, it is not enough just to cut tariffs; an entire series of instruments need to be adjusted as well, including quotas, standards and subsidies (anti-dumping measures).<sup>8</sup> The adjustment costs and changes in the range of policies, on the other hand, arise largely out of the new Uruguay Round disciplines on industrial subsidies, investment, customs valuation and intellectual property.<sup>9</sup> Furthermore, in quantifying the potential value to be gained from the liberalization of services or of trade facilitation, developing countries are somewhat resentful about the efforts they will have to make to adjust their institutions. For the reasons outlined, many developing countries – some in Latin America – have resisted including new issues proposed by the developed countries on the agenda regarding such matters as investment or competition policies. In light of all of this, it can be concluded that a noteworthy feature of the Doha Round is that it raises expectations for more significant concessions by the countries of the North, especially in agriculture, and on sensitive aspects of their policies regarding this sector. For that very reason, such concessions will be all the more difficult to achieve in terms of a balanced result.

## 2. Beginning of a new round of negotiations: the Doha Round

The negotiating and working agenda drawn up at the Fourth WTO Ministerial Conference, held in DOHA in 2001, encompasses market access problems, the refinement of rules and issues arising out of the specific concerns of developing countries. Some of these issues stem from the Uruguay Round agreements, while others have emerged in the course of the application of those agreements or relate to proposed approaches to new conditions and circumstances affecting international trade. As can be seen in table II.2, in the Doha Round there are some matters for which a mandate for negotiations already exists (column 1), while others are to be developed in programmes or working groups

(column 2). The precise content of each of these issues is discussed in the following section.

The negotiating process in the Doha Round was supposed to conclude in 2005, with a midterm review and the adoption of a number of resolutions to take place at the Fifth Ministerial Conference, held in Cancún in September 2003. The progress and conclusion of the negotiations, with the exception of the work on dispute settlement, were to be approached in accordance with the principle of the "single undertaking". However, the debates that followed Doha, particularly at the Fifth Conference, have pushed back the target date, although a draft, the "Derbez text", did emerge from this

<sup>7</sup> That agreement regulated trade in textiles and clothing from the 1970s onward by means of quotas set by importing countries.

<sup>8</sup> Most of these issues are being negotiated, and the corresponding agreements are the ones that have been challenged most often in the WTO dispute settlement system (Davey, 2005).

<sup>9</sup> See Finger and Schuler, 1999; and Finger, 2005. See also Lengyel and Ventura, 2003, with respect to Latin America and the Caribbean.

Table II.2

**BASIC CONTENT OF THE DOHA ROUND, AS DETERMINED AT THE FOURTH WTO MINISTERIAL CONFERENCE, 2001**

Beginning/continuation of negotiations	Work programmes (do not represent negotiation)
<ul style="list-style-type: none"> <li>• Implementation and special and differential treatment</li> <li>• Agriculture</li> <li>• Services</li> <li>• Market access for non-agricultural products</li> <li>• Intellectual property (and its relationship to public health)</li> <li>• WTO rules               <ul style="list-style-type: none"> <li>– anti-dumping measures</li> <li>– subsidies and countervailing measures</li> <li>– regional trade agreements</li> </ul> </li> <li>• Relationship between trade and environment</li> <li>• Dispute settlement</li> </ul>	<ol style="list-style-type: none"> <li>1. Potential negotiation of the “Singapore issues”           <ul style="list-style-type: none"> <li>• Investment</li> <li>• Competition policy</li> <li>• Transparency in procurement</li> <li>• Trade facilitation</li> </ul> </li> <li>2. Continuation of work on aspects of relationship between trade and environment</li> <li>3. Begin work on three matters of interest to developing countries:<sup>a</sup> <ul style="list-style-type: none"> <li>• Small economies</li> <li>• Trade, debt and finance</li> <li>• Trade and technology transfer</li> </ul> </li> </ol>

**Source:** Author’s compilation, based on World Trade Organization (WTO), “Ministerial Declaration” (WT/MIN(01)/DEC/W/1), Doha, Fourth Ministerial Conference, 14 November 2001.

<sup>a</sup> The objectives of these groups are, respectively, to foster fuller integration of the most vulnerable economies into the multilateral system; to contribute to a solution for the debt problem of less developed countries and reinforce consistency among international financial and trade policies; and to increase technology transfer to developing countries. Another goal is to strengthen technical assistance and capacity-building, as well as support for the least developed countries.

conference. The Derbez text has been an important input for subsequent deliberations and reflects the concern expressed by the least developed countries regarding cotton (see WTO, 2003b, and ECLAC, 2004a, chapter V). Among the greatest obstacles to progress since Doha have been the work on agricultural reform, the debate on special and differential treatment, and aspects related to the problems encountered by developing countries in implementing the WTO agreements. In fact, practically none of the deadlines had been met upon arriving in Cancún. The Fifth Conference inherited this climate

of discord, aggravated by the debates on the Singapore issues, which were strongly resisted by developing countries.<sup>10</sup>

After Cancún, the process was characterized by disagreements which were then generally resolved by means of a decision adopted on 1 August 2004. Although no date has been set for the conclusion of this round, 2006 has been tentatively targeted. The results of the next WTO Ministerial Conference, to be held in Hong Kong Special Administrative Region of China in December 2005, will determine whether or not this target can be met.

## B. New stage in the Doha Round: topics of negotiation, interests and prospects

On 1 August 2004, thanks to a package of framework agreements (the “July package”), the WTO General Council managed to move beyond the obstacles and differences that were apparent in the negotiations at Cancún (WTO, 2004a). These difficulties primarily

revolved around four issues: subsidies for agricultural exports, technical issues and matters related to special and differential treatment in access to markets for non-farm products, the Singapore issues and a cotton initiative.<sup>11</sup>

<sup>10</sup> In December 2003 it was agreed to evaluate these issues separately and explore modalities for two of them: trade facilitation and transparency in Government procurement. In this regard, developing countries did not agree to establish a two-track multilateral system, as proposed by the European Union.

<sup>11</sup> The evaluation of December 2003, subsequent to Cancún, made it possible to clear the air and resume negotiations beginning in 2004. The Derbez text was to be a reference, but did not yet have the support of the developing countries. With regard to the process, see the Doha Programme for development in the WTO and the periodic reports of the Institute for Agriculture and Trade Policy (IATP) and the International Centre for Trade and Sustainable Development (ICTSD), among others.

In the months following Cancún, a number of noteworthy initiatives were advanced by developed countries.<sup>12</sup> In January 2004, the United States set out what it views as the principal coordinates and central themes of the negotiating process and the market-access process. In particular, it noted that agriculture is an “essential, catalytic” issue. In November 2003, the European Union had reaffirmed an appeal for greater flexibility, and in May 2004 it advanced some key proposals for agricultural negotiations, such as the elimination of export subsidies. In turn, some groups of developing countries (such as G-20) undertook a coordination effort after the Fifth Conference ended, which also fuelled the process. In short, the work was

intensive, especially with respect to the agricultural negotiations (WTO, 2004b).

In parallel with the work performed within WTO, these negotiations received a considerable boost from many high-level intergovernmental meetings. Most significant were the meetings held in June 2004 in the region (the eleventh session of the United Nations Conference on Trade and Development, in São Paulo, and the meeting of Asia-Pacific Economic Cooperation (APEC) ministers responsible for trade in Pucón, Chile), in addition to the Ministerial Meeting of the Organisation for Economic Co-operation and Development (OECD), which confirms that multilateral work is a gradual consensus-building process.<sup>13</sup>

## 1. The “July package” of 2004: coordinates and achievements

The “July package” outlines a broad framework for continued negotiations and provides impetus for the WTO process. This framework refers to commitments made in the Doha Round and gives some direction to the negotiations on a variety of matters, in some cases with more detailed recommendations and general guidelines. It also reaffirms the commitment to continue negotiating (see table II.3). In addition, the timeline for the work that was established at Doha is extended, with no fixed

ending date, and the next Ministerial Conference is confirmed for 13-18 December 2005 in Hong Kong Special Administrative Region of China.

The July package confirmed that a change had occurred in the climate of the discussions after Cancún, insofar as some important determinations were made: (1) the beginning of negotiations on trade facilitation, the only one of the Singapore issues on which a consensus was reached; (ii) an agreement to eliminate subsidies and

Table II.3  
COORDINATES OF THE 2004 “JULY PACKAGE”

Issues with detailed negotiating guidelines	Guidelines on development	General orientation and commitment to continue negotiating
<ul style="list-style-type: none"> <li>• Agriculture and cotton (annex A)</li> <li>• Market access for non-agricultural products (annex B)</li> <li>• Services (annex C)</li> <li>• Trade facilitation (annex D)</li> </ul>	<ul style="list-style-type: none"> <li>• Principles</li> <li>• Special and differential treatment</li> <li>• Technical assistance</li> <li>• Implementation</li> <li>• Other issues</li> <li>• LDCs</li> </ul>	<ul style="list-style-type: none"> <li>• Rules (including anti-dumping measures, subsidies, countervailing duties and regional trade agreements)</li> <li>• Trade and environment</li> <li>• Intellectual property</li> <li>• Dispute settlement</li> </ul>

**Source:** Author’s compilation, based on World Trade Organization (WTO), “Doha Work Programme. Decision Adopted by the General Council” (WT/L/579), 2 August, 2004.

<sup>12</sup> See Zoellick, 2004, and Letter from Pascal Lamy and Franz Fischler (EU, 2004).

<sup>13</sup> In June 2004, APEC proposed an ambitious and flexible focus to market access in agriculture, with significant reductions in domestic support and the elimination of export subsidies as of a specific date. Regarding market access for non-agricultural products, on the other hand, negotiation on the basis of the Derbez text was encouraged (APEC, 2004a).

equivalent measures for agricultural exports, to ensure a substantial reduction in trade-distorting domestic support, and to incorporate the negotiations on cotton; (iii) guidelines regarding the liberalization of manufactures based on bound tariffs, without admitting new categories in developing countries but confirming the flexibility and the corresponding technical assistance they require; and (iv) the establishment of new time frames for some tasks, such as dispute settlement and offers on services, among others (see the WTO document, 2004c).

Few critical dates are specified in the decision with respect to the agricultural negotiations and

market access for non-agricultural products, and only general guidelines are given for services. Little detail is provided regarding development; the negotiation dates established for implementation tasks and for special and differential treatment are extended, and no more explicit tasks are added for the working groups of interest to developing countries.<sup>14</sup> Nor is there any orientation for groups or work programmes in other areas, such as that of the Singapore issues that will not be negotiated, tasks associated with trade and the environment, and some intellectual property issues.

## 2. Market access

With the resumption of negotiations on agriculture and services in 2000, as provided for in the Uruguay Round, the plan was to accord due attention to developing-country needs and capacity-building. In the case of agriculture, the task also involved the treatment of subsidies granted by developed countries as an important barrier to market access in those countries.<sup>15</sup>

A critical phase in the Doha Round has been the conclusion of an agreement on liberalization “modalities”.<sup>16</sup> Operational targets should be established for the negotiations on these modalities. For the liberalization of trade in goods, this entails a formula for determining tariff reductions, parameters, the implementation base (time of reference), deadlines, flexibility for developing countries, treatment of unbound tariffs and other barriers. It is precisely this series of definitions and the associated technical details that have made progress difficult up to this point, although the underlying problem will continue to be whether the key players have the political will to achieve balanced results for the members of WTO.

### (a) Agriculture: priority issue for countries of the region

#### (i) General conditions and key players

Of the three sectors mentioned, the principal interest of developing countries and countries in the region is agriculture. The Uruguay Round only marked the start the reform process based on the three pillars of market access, domestic support and export competition.<sup>17</sup> In addition to these three pillars, which were reaffirmed at Doha, attention is given to the non-trade concerns related to the sector.

As indicated previously, agriculture faces more distortions than other sectors with respect to the level and complexity of the tariffs and other border barriers – licences, tariff peaks, standards, and quotas – as well as the level of subsidies that developed countries extend to the sector (see FAO, 2005 and Contreras, 2005). In contrast to the situation with regard to manufactures, however, in this sector there are no prohibited subsidies, just a commitment to reduce some of them. The distortions

<sup>14</sup> Small economies; trade, debt and finance, and trade and technology transfer.

<sup>15</sup> The gains derived from the liberalization of trade in agricultural goods would be greater than those arising from the liberalization of non-agricultural goods, but the greatest benefit is achieved when both types of products are broadly liberalized (Laird, Fernández de Córdoba and Vanzetti, 2004).

<sup>16</sup> In Doha, 31 March 2003 had been established as the deadline for agreeing on the new agricultural commitments and initial offers on services. Two years after that deadline, the task has still not been completed.

<sup>17</sup> In WTO, agriculture is considered to include primary and processed goods (basically chapters 1 through 24 of the Harmonized System, without encompassing fishing products but including non-food raw materials of agricultural origin). See WTO, 2003a and ECLAC, 1995 for an overview of the agriculture agreement.

noted tend to be concentrated in some products of special interest to developing countries, such as dairy products, sugar, meat and grains. For this reason, these countries propose to advance on the three pillars of reform, with some specificity regarding greater opportunities for access and flexibility in relation to their development process (WTO, 2004d).

Regarding market access and tariff reductions, in addition to an average tariff that is considerably higher than the average for manufactured goods, there are many instruments for this sector: specific tariffs, seasonal tariffs, tariff peaks, escalation, quotas and others. Although the average tariff applied to the region's products in the principal markets (the United States and the European Union) is relatively low (some with preferential treatment), maximum rates applied by these areas can be as high as 350% (applied by the United States to tobacco) and 52% in the European Union. The average tariff in Asia is higher, and there are tariff peaks in China and Japan for various Latin American and Caribbean products. Moreover, the sector faces other non-tariff barriers, which are being discussed outside the scope of the agricultural agreement. These include anti-dumping measures, licences, standards (and traceability), geographical indications and others.<sup>18</sup>

With respect to subsidies, in the Uruguay Round basically two categories of aid are defined for this sector: export subsidies and production subsidies.<sup>19</sup> The latter represent nearly 90% of spending. Globally, the European Union accounts for approximately two thirds of the two types of aid and for 90% of export subsidies (Jank, Fuchsloch and Kutas, 2004, p. 31, table 1-5).<sup>20</sup> As for domestic support, in 2003 the bloc accounted for 47%, followed by Japan

(17%) and the United States (15%), although in terms of production value the European Free Trade Association (EFTA) comes in first (ECLAC, 2005).<sup>21</sup>

OECD has devised a measure that shows the degree of domestic support for producers in the agricultural sector. Called the producer support estimate (PSE),<sup>22</sup> this indicator accounted for nearly 30% of the value of farm production in 2004, and has declined and changed in structure in most countries (OECD, 2005b). It corresponds basically to the WTO amber box, or the Total Aggregate Measurement of Support (AMS), with a few differences that make it a more precise indicator of domestic support. On average, approximately one third of the specific subsidies go to the category of "other products", and the remainder is distributed more or less equally among grains, milk and meat, as shown in figure II.1.

These products absorb most of the specific aid, and some countries in the region are net exporters of them, even though they must compete with similar products that are heavily subsidized. Several of these products also represent another type of protection in the form of other subsidies, high tariffs, standards and other non-tariff barriers.

Given the high degree of protectionism prevailing in agriculture in the major developed countries, signs of moves towards liberalization and flexibility on their part have a great impact on negotiations in this sector. The United States Trade Representative, Ambassador Robert Zoellick, in a letter written in January 2004, proposed a significant reduction of various barriers, but the elimination of export subsidies by a certain date was considered to be of key importance. The European Union

<sup>18</sup> It should be noted that several disputes over anti-dumping measures, safeguards and technical barriers, among other matters, involve products and instruments in this sector (Davey, 2005).

<sup>19</sup> Production subsidies – domestic support – and export subsidies should be reduced. Among the former, only those that have the greatest impact on trade (amber box) need to be reduced, and disciplines are imposed only on the support that causes the least distortion (blue and green boxes). The amber box is for domestic support measures that are felt to distort production and trade, and it encompasses price supports and subsidies directly tied to the volume of production. The reduction commitments are expressed in terms of a "Total Aggregate Measurement of Support" (AMS). The blue box is an amber box "with conditions" intended to limit distortion, which requires farmers to restrict production. There are no limits on subsidy spending of this type. The green box covers subsidies that are not expected to distort trade, or at worst have a minimal impact on it; the subsidies must be financed with public funds (without charging higher prices to consumers) and should not amount to price supports. The green box tends to encompass programmes that do not focus on specific products, and it includes direct aid to farmers that is "decoupled" from production levels or current prices. It also covers environmental protection and regional development programmes. Green-box subsidies are allowed without limitations, provided that they meet the criteria related to specific policies (WTO, undated). At present, the degree of distortion produced by various instruments is the subject of an intense conceptual debate (see also FAO, 2005).

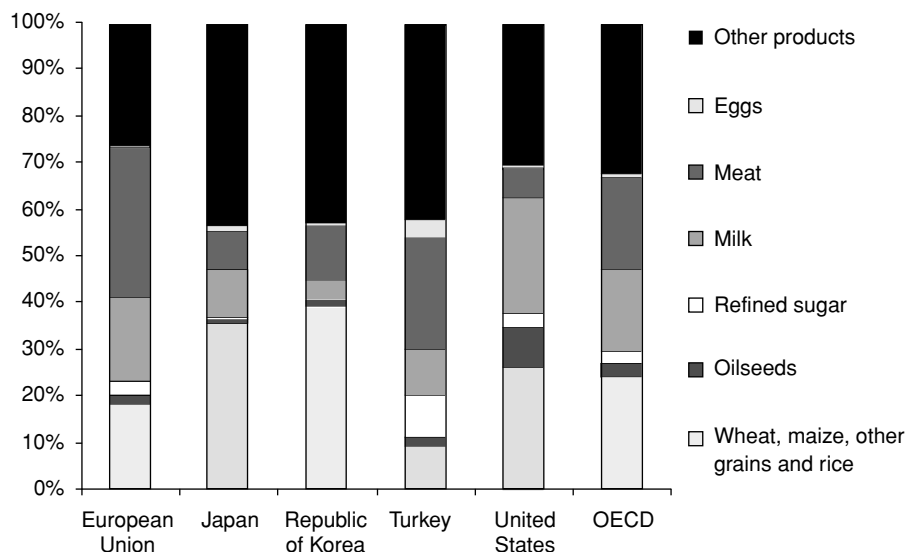
<sup>20</sup> According to notices published in 1998 by WTO. Considering the 1995-1997 average, the products in that bloc with the highest rates of export subsidies, above 100%, were pork, sugar, rice and lard and butter oil (Nogués, 2004, p. 18, table III.4).

<sup>21</sup> Canada and the United States also rank high if spending per farmer is the criterion.

<sup>22</sup> The PSE measures the annual value of gross transfers from consumers and taxpayers to support agricultural and livestock producers. It is divided into two major components: (i) price supports (the more significant form) are calculated on the basis of the difference between domestic prices paid to the producer and international reference prices for the principal agricultural products, which is why this component includes the effect of trade policy; and (ii) budgetary expenditures, including transfers to producers based on production levels and area planted (or number of animals), utilization and restrictions on inputs, total income from the property and others. The PSE does not include other spending in the agricultural sector as a whole (that is, no individual payments to farmers), such as spending on agriculture research or infrastructure.



Figure II.1  
STRUCTURE OF PRODUCER SUPPORT ESTIMATE (PSE) PER PRODUCT IN SELECTED COUNTRIES,  
AVERAGE 2000-2003<sup>a</sup>



Source: Economic Commission for Latin America and the Caribbean (ECLAC), "Panorama de la agricultura de América Latina y el Caribe", Santiago, Chile, 2005, unpublished.

<sup>a</sup> The data for 2003 are estimates.

is the primary user of such subsidies.<sup>23</sup> A note from the European Union in May 2004 sent another important signal, indicating that all export subsidies would be the subject of negotiations based on parallelism with all forms of export competition.<sup>24</sup> The European Union has systematically given special treatment to agriculture, in view of what is referred to as the multifunctionality of the sector. This view is also advocated by other countries in the Group of 10 (G-10), including Japan, the Republic of Korea and other developed countries.

The Cairns Group, which is made up of agricultural exporters, has taken the opposite position. Since the Uruguay Round, it has been an enthusiastic supporter of reform in the sector with a view to merging these disciplines with those applying to manufactured goods. Over the last two years, developing countries in general, and the Group of 20 (G-20) in particular, have been demanded two conditions: (i) greater market access for their products;<sup>25</sup> and (ii) flexibility in the form of different

rates of implementation and levels of commitment from developed and developing countries, while retaining instruments such as agricultural safeguards for the latter only. These groups consider the demand for liberalization in agriculture to be a top priority, but with certain nuances. The Cairns Group, consisting of both developed and developing countries, has staked out stronger positions insofar as it represents agricultural exporters, whereas the G-20, made up of developing countries, includes net agricultural importers, which attenuates its desire for market opening. The active participation of several Latin American and Caribbean countries in this coordination effort reflects the importance of agriculture to the region (see table II.1).<sup>26</sup> The countries of the Caribbean are part of a broad group of developing nations (African Union/African, Caribbean and Pacific States/Least Developed Countries) as well as the Group of 33. The latter, made up of agricultural importers, including China and other countries in the region, is promoting specific instruments

<sup>23</sup> For Zoellick, an ambitious outcome in this sector should precede the negotiations and is the key to their success, with due consideration for the three pillars and, more controversially, non-trade issues.

<sup>24</sup> Parallelism refers to all forms of export subsidies or measures with an equivalent effect, such as credit subsidies for exporters, food aid and the exports of State trading enterprises, areas in which the United States and other developed countries are quite active.

<sup>25</sup> They propose to reduce or eliminate subsidies, apply disciplines to specific products rather than using averages, establish a lower level of progressivity, simplify structures and applied rates, and reduce other barriers.

<sup>26</sup> Agriculture accounts for just over 20% of the region's exports (more than 50% in some economies), and several countries are internationally competitive.

to address the sensitivities of developing countries in the sector.

Two developing countries, Brazil and India, are part of a new partnership in the negotiations, referred to as “the Non-Group 5” (NG-5) or “the Five Interested Parties” (FIP), with the other members being the United States, the European Union and Australia. This group was instrumental in the final stages of the negotiations in reaching the decision that gave rise to the July package.

The high level of tension and expectations in connection with agricultural issues can also be seen in the disputes brought before WTO, inasmuch as several cases regarding the implementation of anti-dumping, safeguard and sanitary and phytosanitary measures, among others, have involved products and instruments in this sector (Davey, 2005). This can be expected to have an impact on negotiations currently under way, and even more so on the results of disputes over sugar and cotton subsidies.<sup>27</sup> With respect to cotton, the G-20 and Cairns Group are likely to strengthen their bargaining positions, pushing disciplines to higher levels of reduction commitments

and bringing in disciplines in the areas of subsidies and domestic support (Abraham, 2005).<sup>28</sup>

#### (ii) The July package and the current debate

The July package of 2004 incorporates diverse viewpoints in a broad guidance framework which is outlined in detail in its annex A. This outline sets forth general and specific criteria for the three pillars of the reform effort. General criteria include: (i) a harmonization element that consists of a tiered formula representing greater reductions in the highest subsidies or tariffs; (ii) reductions in subsidies and tariffs based on “bound” levels; (iii) special and differential treatment provisions that must be incorporated into the modalities in an effective and meaningful manner;<sup>29</sup> (iv) due consideration for non-trade concerns; and (v) the objective of lending greater transparency to the system through notifications and supervision.

Regarding each of the three pillars of agricultural reform — the major features of which are detailed in box II.1 — countless variables remain to be

#### Box II.1

#### PRINCIPAL AGRICULTURE REFORM FEATURES CONTAINED IN THE JULY PACKAGE

##### Market access:

- Single approach to tariff reduction for developed and developing countries, to be applied by means of the tiered formula that differentiates according to tariff bands, with parameters still to be negotiated.
- Fewer liberalization commitments for “sensitive” products, which remain to be defined, with a substantial improvement in market access based on a combination of tariff quota commitments and tariff reductions.
- The possibility for developing countries to define “special” products that are to be subject to less stringent requirements in terms of liberalization, special consideration for tropical products and a Special Safeguard Mechanism.
- Other elements subject to negotiation are tariff simplification, the expansion of quotas for sensitive products and the treatment of preference erosion.

##### Domestic support:

- “Amber box”: a stringent commitment to the overall reduction of aid, reductions in the *de minimis* level and caps for specific products.
- “Blue box”: limits on direct payments, with degrees of freedom; the creation of new possibilities in this box and lesser commitments for developing countries oriented towards areas where the population lives at subsistence levels or in poverty.
- “Green box”: Review of criteria, attention to non-trade concerns, more surveillance and supervision to ensure that trade and production are not distorted (or that distortions are kept to a minimum).

##### Export competition:

- Export subsidies to be eliminated by a credible deadline, in addition to including and disciplining equivalent measures (“parallelism”): export

credits, State trading enterprises and food aid.

- Specificity and transparency in all instruments.

##### Special and differential treatment:

This is integrated into the provisions and modalities through various measures favouring developing countries, including:

- Transition periods and lesser reduction commitments with different coefficients in the various formulas.
- Exemptions from support commitments or from *de minimis* reductions for certain purposes.
- Special market access instruments: “Special” products to meet the needs of food security or rural development, and a Special Safeguard Mechanism.
- Exemptions for least developed countries, attention to the problem of preference erosion and the treatment of cotton, bearing in mind trade and development considerations.

**Source:** Author’s compilation, on the basis of World Trade Organization (WTO), “Doha Work Programme. Decision Adopted by the General Council” (WT/L/579), 2 August 2004.

<sup>27</sup> Documentation on these disputes is available from WTO.

<sup>28</sup> The case filed by Brazil is the first one without a peace clause. It concerns the losses sustained by its producers as a result of the decline in international prices for the product caused by the United States’ support programmes. The panel determined that several instruments in these programmes did not qualify as permitted support (green box) and were not part of the United States’ multilateral commitments. The recommendation, therefore, was to adjust or eliminate these instruments.

<sup>29</sup> Including negotiations on cotton, which must be addressed ambitiously, expeditiously and specifically.

defined.<sup>30</sup> In the discussions that followed the decision, a working procedure was established that would focus on technical aspects, with the understanding that in 2005, the main objective would be to forge an agreement on the modalities. It is essential that this agreement, especially in the area of market access, be achieved at the conference to be held in Hong Kong Special Administrative Region of China in late 2005 so that the round can be concluded the following year.

The conversion of specific tariffs into ad valorem equivalents was one of the most critical technical aspects, since it is necessary in order to negotiate and apply the tariff reduction formula. This matter became a stumbling block towards the end of April 2005 due to differences between exporting and importing countries, as the European Union and the G-10 countries are the primary users of specific tariffs. At the WTO “mini-ministerial” meeting of 4 May 2005, an adjunct to an OECD meeting in Paris, 30 countries reached an agreement on this issue. The NG-5 agreed to it only provisionally, however, and the other WTO member States still have to confirm it.

The technical debates on converting specific tariffs to ad valorem equivalents covered such issues as the method of calculation, data requirements and the calculation verification process (WTO, 2004d and WTO, 2004e; ICTSD, 2005). The aforementioned agreement stipulates that: (i) calculations shall be made based on the unit value, and the specific duty – per unit – shall then be expressed as a percentage of that unit value; (ii) the reference price required for the calculation of the unit value shall be determined by weighting two types of prices (international and import);<sup>31</sup> (iii) the international price shall have a greater weight in the calculation. It should be mentioned that when the conversion is done based on international prices – which are generally lower – the equivalent tariff comes out to a higher percentage, so the reduction should be greater (depending on what band it is located in).<sup>32</sup> The European Union and the G-10 wanted to use import prices, whereas the United States, the Cairns Group and the G-20 favoured international prices, for the reason stated. Under these terms, the agreement was more advantageous for the latter countries; however, there are other related matters, such as the sequence of the calculation, that would suggest a result that balances the competing interests better.

The progressive nature of market access, which is to be achieved with a non-linear formula that guarantees reductions larger than the highest tariffs, is also a complex issue. The developed countries are advocating a mixed market access formula with flexibility for the sensitivities of developing countries, but at the same time they want these countries to open up their own markets to a greater extent. Although the non-linear formula would help reduce escalation and peaks, which is of interest to developing countries, the latter have expressed apprehension about the larger reductions that would come about as a result of their higher tariffs. In the G-20 Ministerial Declaration issued in New Delhi on 19 March 2005, it was reaffirmed that because the formula is the main component of market access, it should be negotiated before addressing flexibility aspects.<sup>33</sup> The declaration also emphasizes that there should be progressivity, proportionality and flexibility, with reference to, respectively, deeper cuts in higher tariffs, less stringent reduction commitments for developing countries and consideration of the sensitive nature of some products, in order to ensure improved market access for all products. Some countries consider that the results of the debate on the formula will be linked to the use of sensitive products, since these would be subject to a smaller tariff reduction.

The developing countries have also called attention to the erosion of preferences that results from the overall lowering of tariffs for countries benefiting from preferential access to certain markets (through the Generalized System of Preferences or other arrangements). In this regard, they propose a comprehensive approach involving increased market access for products that are of vital importance to beneficiary countries, effective use of existing preferences and additional support for dealing with supply constraints, promoting diversification and easing the adjustment.

With the new instrument and product categories incorporated into the agricultural sector, there are many combinations that reflect the flexibility demanded by developing countries, but there are also significant margins for developed countries to provide special treatment. Thus, the real increase in market access for products of interest to developing countries will also depend to a great extent on the agreements that are reached with respect to sensitive products, the quotas used and the way they are administered.

<sup>30</sup> Further complexity arises out of the different viewpoints on issues of interest that have not been agreed upon, such as the sectoral initiatives, the differentiated export tax and geographical indications.

<sup>31</sup> The former are derived from the United Nations Commodity Trade Statistics Database (COMTRADE), with figures carried out to six digits; the import prices are contained in the WTO Integrated Database, with more detailed data.

<sup>32</sup> International prices are different from (national) import prices because of the presence of quotas or preferences.

<sup>33</sup> Uruguay has just joined this group. At this meeting, the G-20 was accompanied by other groups of developing countries. See [http://www.agtradepolicy.org/output/resource/G20\\_delhi\\_declaration.pdf](http://www.agtradepolicy.org/output/resource/G20_delhi_declaration.pdf).

As far as subsidies are concerned, there are several issues for discussion; some cut across the categories of domestic support and export competition, while others are more specific. Among the general questions, one of the developing countries' concerns is that the reduction will be made to bound subsidies that are considered to be much higher than they actually are (known as "water"), so the true effect of the reductions in the principal markets would not be very significant. Furthermore, despite the WTO notification commitments, there is a serious lack of information about these instruments, which makes it difficult to fully understand the situation. Finally, as a result of the recent controversies over certain agricultural products, such as sugar and cotton, the policies of the main users of these instruments, the United States and the European Union, have been called into question. This has sent new signals for the negotiations.

With regard to domestic support, practically all of the instruments are controversial, especially because of the possibility of transferring support between different compartments or "boxes". From the standpoint of developing-country exporters, the most important thing is to guarantee substantial reductions in domestic support by adjusting the point of departure (ideally the levels actually being applied), since the negotiating effort would not make as much sense if it is limited to reducing the "water" in subsidies only. As for the amber box, there is debate about whether the bands should be determined according to the volume of support, which would affect the European Union, Japan and the United States more, or according to the relative impact of the support measures on a country's agricultural sector, which would have a greater effect on the EFTA countries. The developing countries are probably most apprehensive about the blue box, and the support that can be incorporated and the flexibility that would persist are being debated. This category — what some are calling the "new blue box" — is being expanded through the inclusion of support measures that do not require any limitation of production.<sup>34</sup> It is also expected that greater discipline will be introduced into the green box, which covers non-distorting support, to address non-trade concerns and orient it towards the needs of developing countries. This proposal, put forward in March 2005 by the G-20, comes in addition to the need to maintain the *de minimis* levels for these countries, in

light of the practically marginal support granted by these countries to the agricultural sector.

As for export competition — about which clearer signals were sent by the decision taken in August 2004 — there are still some concerns. Although the agreement to eliminate subsidies and equivalent measures is a step forward, there is limited information for negotiation, especially with regard to the latter.<sup>35</sup> The G-20 proposal is to limit the period for eliminating these subsidies to five years, in conjunction with major efforts to discipline the trade-distorting elements of the instruments that do not represent a direct subsidy (credits and others).

In global terms, the difficulty of specifying modalities for the three agricultural reform pillars when major differences exist in the base structure, either for tariffs or for subsidies, is a significant issue. Moreover, the guidelines provided by the July package have expanded the spectrum of instruments that can be used in the sector (taking into account different sensitivities), which complicates their negotiation and makes it difficult to evaluate the real gains that can be made in terms of opening up markets and improving operating conditions for a country's own markets. In addition, there is the fact that flexibility and differential time frames for developing countries (also part of the definition of modalities) are elements that are not welcomed by exporting countries, which are therefore asking that such concessions be curtailed. What is more, the large economies, from which the greatest concessions are expected, have been reluctant to send signals of convergence during the most recent stages of the work. Finally, it is not clear whether the stand-still agreement can be considered another key element during the transition period leading up to the conclusion of the round.

#### **(b) Other sectors under negotiation**

Market access negotiations are very important in the manufacturing and services sectors, as well as the agricultural sector.<sup>36</sup> The liberalization of these sectors, unlike agriculture, has been a priority for developed countries. The debate on manufacturing sectors basically involves border barriers, whereas in the services sector liberalization is closely tied to regulations and other domestic measures.

<sup>34</sup> Although it is not clear that this support is less distorting than the amber box measures, it requires stricter disciplines focused on certain products to prevent distortion and jumping from one box to another, or from one product to another. In addition, capping the support at 5% of production can be quite a high ceiling in the large economies.

<sup>35</sup> This debate is taking place in the context of the restoration of wheat export subsidies in the European Union, although it is within the agreed-upon limits.

<sup>36</sup> See an overview of the agreements for the liberalization of goods and services in the Uruguay Round, GATT 1994 and General Agreement on Trade in Services (GATS) in WTO, 2003a.

## (i) Market access for non-agricultural products

The protection of the manufacturing sector has been a traditional instrument of industrial policy, and the liberalization of this sector is therefore still a concern for developing countries, especially since other policy avenues have been narrowed during the course of the multilateral negotiations. In addition, exports incorporating an increasing content of manufactured goods from these countries are also facing barriers, both in other developing countries (South-South trade) and in developed-country markets in sectors of interest to them because of their labour-intensive nature or the large amount of value added they entail.

The Doha mandate on market access for non-agricultural products addressed the concerns of developing countries, which, except in the case of subsidies, deal with topics similar to those at issue in the case of agriculture:<sup>37</sup> (i) fewer tariff barriers in general, tariff escalation and tariff peaks; (ii) lower non-tariff barriers, some of which are the subject of negotiations in other spheres; (iii) attention to preference erosion; and (iv) policy avenues, flexibility in regard to the commitments of developing countries and assurance that reciprocity need not be total.<sup>38</sup>

Worldwide, manufactures enjoy less protection than agricultural products (see table II.4), but there are major disparities between countries and sectors in terms of the average level of tariffs and the extent to which they are bound, the gap between applied and bound tariffs, peaks and escalation, and others (see Laird, Cernat, Turrini, 2003; Fernández de Córdoba and Vanzetti, 2005).

The negotiation of market access for non-agricultural products was proposed chiefly by developed countries and Asian nations after the preparations for Seattle. In the framework of the Doha Round, the United States asserted that market access for manufactures should aim for the total elimination of tariffs, after which the issue of non-tariff barriers and sectoral negotiations could be tackled (Zoellick, 2004). The United States is a fervent advocate of the latter, and it proposes that negotiations begin once there is a sufficient number of interested countries that have trade in a given sector (the “critical

mass” approach). The European Union, on the other hand, has confirmed its support for the principle that reciprocity should not be total, provided that it is operationalized in accordance with the role played by developing countries in world trade. The developing countries have become increasingly interested in these negotiations, given that manufactured goods represent a growing share of their exports.

Annex B of the July package sets out the guidelines for market access for non-agricultural products and indicates that negotiations have yet to take place to determine the precise modalities.<sup>39</sup> These include a tariff elimination formula, the treatment of unbound tariffs, the sectoral liberalization component and flexibility for developing countries. The guidelines for the sector contain the following elements: (i) a non-linear formula for tariff reduction, applied line by line, without exclusions and on the basis of bound rates;<sup>40</sup> (ii) a sectoral component for the elimination or harmonization of tariffs, oriented towards products of export interest to developing countries; (iii) flexibility for developing countries in the form of longer implementation periods and smaller reductions, but with an increased level of binding commitments; and (iv) the need to address preference erosion or the high degree of dependence on tariff revenues.

In general terms, this mandate leaves a wide range of decisions without clarification, because although the tariff elimination formula will supposedly define the pace of liberalization, the overall result should combine, among other things, sectoral elimination, exceptions for sensitive products, special and differential treatment and the level of bound commitments. Indeed, there is uncertainty about what can be accomplished with the presence of tariff peaks in sectors of interest to developing countries.

Until July 2005, the work focused on modalities and technical matters such as the conversion of tariffs to ad valorem equivalents, the treatment of unbound tariffs and sectoral liberalization. One area of particular concern to developing countries is coverage of the suggested level of bound commitments and limits on the level of unbound tariffs. Both would have a

<sup>37</sup> In WTO this negotiation refers to products not included in agriculture, and therefore includes forestry and fishing products as well.

<sup>38</sup> There are different definitions of non-tariff barriers, but in general they are all measures other than tariffs and trade-distorting policies, which are highly relevant to the negotiations on standards, anti-dumping measures, subsidies and trade facilitation (Fernández de Córdoba and Vanzetti, 2005).

<sup>39</sup> The lack of definitions is a result of the developing countries’ disagreement with the resurgence of the Derbez text in the debate, which prompted the introduction of a paragraph to make annex B of the decision less binding.

<sup>40</sup> It proposes a treatment for unbound tariffs, with parameters to be defined, and possibilities for non-tariff barriers. The decision excludes least developed countries from the formula and from the sectoral initiatives but requires that they increase their level of binding commitments and recommends that the remaining countries give them more free access within a year.

Table II.4  
**BOUND AND APPLIED TARIFFS, SELECTED COUNTRIES**  
*(Percentages)*

Countries	Simple average tariff					
	General		Agricultural		Non-agricultural	
	Bound (1)	Applied (2)	Bound (3)	Applied (4)	Bound (5)	Applied (6)
<b>Latin America</b>						
Argentina	31.9	12.7	32.6	12.0	31.8	12.9
Bolivia	40.0	9.4	40.0	10.0	40.0	9.3
Brazil	31.4	12.4	35.5	10.3	30.8	12.7
Colombia	42.9	12.2	91.9	16.1	35.4	11.6
Chile	25.1	6.0	26.0	6.0	25.0	5.9
Ecuador	21.7	11.9	25.5	14.7	21.1	11.5
Mexico	34.9	18.0	35.1	24.5	34.9	17.1
Paraguay	33.5	10.8	33.2	10.1	33.6	10.9
Peru	30.1	10.2	30.8	13.6	30.0	9.7
Uruguay	31.7	13.3	33.9	12.0	31.3	13.5
Venezuela (Bol. Rep. of)	36.8	12.7	55.7	14.8	33.9	12.4
<b>Caribbean</b>						
Jamaica	49.8	7.2	97.4	15.7	42.5	5.9
Trinidad and Tobago	55.7	7.8	90.2	15.8	50.5	6.6
<b>OCDE</b>						
Canada	5.1	3.9	3.5 <sup>b</sup>	3.0 <sup>b</sup>	5.3	4.0
United States	3.6 <sup>b</sup>	3.7 <sup>b</sup>	... <sup>c</sup>	... <sup>c</sup>	3.2	3.3
Japan	2.9	3.1	6.9 <sup>b</sup>	7.3 <sup>b</sup>	2.3	2.5
European Union	4.1	4.2	... <sup>c</sup>	5.9 <sup>b</sup>	3.9	4.0
<b>Asia</b>						
China	10.0	10.4	15.8	16.2	9.1	9.5
Republic of Korea	15.9	11.2	52.9	41.6	10.1	6.7
India	49.8	29.1	114.5	37.4	34.3	27.9

**Source:** Compiled on the basis of World Trade Organization, *World Trade Report*, 2005, July 2005.

<sup>a</sup> The tariff history of each country corresponds to different years, depending on the availability of information.

<sup>b</sup> The simple averages include between 10% and 40% of tariff headings with at least one specific tariff.

<sup>c</sup> Data unavailable because more than 40% of the tariff headings carried out to six digits have at least one specific tariff.

tendency to reduce the gap between bound and applied tariffs.<sup>41</sup> Developing countries do not share the idea of eliminating low tariffs, as proposed by the developed countries, because they think the protection provided by those tariffs is still important. Some developing countries are also calling for more South-South liberalization in

terms of tariff rates, bound commitments and the gap between bound and applied tariffs in those very countries, given the promising potential for trade between, for example, Asia and Latin America.

The definition of a tariff reduction formula and flexibilities for developing countries, just as in agriculture,

<sup>41</sup> The bound tariff, according to the WTO definition, is a commitment by WTO members not to raise a customs levy above an agreed-upon level. Once a country has bound a duty, it cannot increase it without compensating the countries affected. The problem being debated, which involves primarily developing countries, is how to narrow the wide gap between the bound tariff and the tariff actually applied, with a view to lending greater certainty to market access conditions.

are a major focus of the work, and considerable differences still exist between developed and developing countries.<sup>42</sup> The non-linear formula – the “Swiss” one, in particular, as proposed by developed countries – would involve larger reductions by developing countries because they have a higher tariff level. The debate seems to be aiming for a balance among different parameters of liberalization, such as the level of bound commitments and tariff reduction, implementation periods and exceptions. The developed countries propose differential coefficients for developing and developed countries, but these would mainly pertain to just some of the parameters mentioned. This idea of limited flexibility subject to conditions is not well received among developing countries, which also link progress in these negotiations to developments in the agricultural sector.

The countries of the region have recently suggested various alternatives. One of these proposals, made by Chile, Colombia and Mexico, considers a number of parameters in offering options to developing countries designed to address their sensitivities with a combination of measures that offset flexibilities in one component with a greater commitment in one or more other components. Another proposal, submitted by Argentina, Brazil and India, advances the idea that harmonization does not work among countries with different economic and industrial structures and diverse needs. For this reason, it makes a distinction between the principles of non-total reciprocity, incorporated into the formula with larger coefficients for developing countries, and special and differential treatment, which would provide flexibility in implementation.<sup>43</sup> In addition to these proposals, there is the recent declaration by APEC, issued after the meeting of ministers responsible for trade that was held in the Republic of Korea on 2 and 3 June 2005, which advocates modalities for market access for non-agricultural products “proportional to agriculture”, including the use of the

Swiss formula, with coefficients still to be defined. The value of this declaration is that its members, developed and developing countries alike, represent a significant percentage of world trade and include developing countries that had not previously expressed explicit support for this formula.<sup>44</sup>

Regarding the talks on sector-by-sector liberalization, which have met with some resistance from developing countries, the principal issues revolve around the form of liberalization and the extent to which the commitments in that regard would be mandatory. The proposals tabled thus far have come from developed countries in sectors of interest to them, but some developing countries may also propose export sectors of significance to them, as they have done in the case of agriculture. The frame of reference to date has been the Agreement on Information Technologies of 1997, from which several developing countries have distanced themselves, although it covers nearly 100% of trade.

Recently there has also been some debate among developing countries on proposals concerning the erosion of preferences in market access for non-agricultural products and vulnerability. These proposals have been formulated by small countries in the Caribbean and other regions or by less advanced countries (least developed countries and nations in Africa, the Caribbean and the Pacific).<sup>45</sup> Looking at the effects of these mechanisms on export products of interest to them, other developing countries have recognized the need to consider the interests of the economies that receive preferences, without establishing new categories of countries.<sup>46</sup> A related factor is the effect of liberalization on fiscal revenues and export earnings; this, in turn, has a particularly strong impact on small and open economies, such as those of the Caribbean.<sup>47</sup>

The developing countries taking part in these negotiations have not formed the same sort of organized

<sup>42</sup> The formula expresses the relationship between base or initial tariffs (T0) and the target tariff (T1) by means of a conversion coefficient that will dictate the size of the reduction. In its simplest expression, the linear formula is  $T1 = a \times T0$ , where (1-a) is the amount of reduction.

<sup>43</sup> The elements considered in the proposal advanced by Chile, Colombia and Mexico are the percentage of bound tariffs, a coefficient or extent of tariff reductions measured with a non-linear formula, the exclusion of some products from the formula and the period of implementation. Argentina, Brazil and India, for their part, also incorporate the average level of tariffs present in the countries, consider that special and differential treatment should take the form of implementation periods, reductions lower than those called for in the formula and exclusion for some tariff lines, and propose that the unbound tariff be defined in terms of averages and not line by line (WTO, 2005b and 2005c).

<sup>44</sup> In the declaration, APEC proposes to bind all tariffs and consider them in the tariff elimination formula, as well as adopting the critical mass approach for sectoral initiatives, which would be voluntary.

<sup>45</sup> See WTO, 2005d and 2005e.

<sup>46</sup> The final trade creation and diversion effect resulting from preference erosion and real restrictions on preferences depends on the rules of origin that are required, the supply capacity of beneficiary countries and the conditions imposed by the countries granting the preferences (Laird, Fernández de Córdoba and Venzetti, 2004).

<sup>47</sup> The tariff revenues for many countries in the region amount to between 3% and 10% of fiscal revenues. In Central America and the Caribbean, the percentages are even higher (32% on average, some more than 50%); nevertheless, MERCOSUR has seen greater reductions – from 15% to 51% – according to different hypotheses, without considering other liberalization mechanisms (Fernández de Córdoba, Laird and Vanzetti, 2005b: table 11 and table A.5).

groups as they have in the negotiations on agricultural trade. Now, however, a group made up of large and medium-sized countries — Argentina, Brazil, China, India and South Africa — is emerging which intends to play a proactive role in the negotiations on manufactured products.

(ii) Liberalization of services

Services were gradually but completely incorporated into the multilateral regulatory system after the Uruguay Round, where modes of supply, mechanisms for opening markets and national treatment of the services sector were defined. Because reforms in this sector are still in their initial stages, as in agriculture, negotiations were expected to resume around 2000 in order to carry the liberalization process forward. On the other hand, the principal achievements on tasks undertaken after the Uruguay Round have been in sectors where developed countries have striven to make advances, such as financial services and telecommunications. This contrasts with the meagre progress made on further liberalizing the movement of persons (mode 4), which has been the principal demand of developing countries.

These countries recognize the role of this sector in determining the competitiveness of their economies and are seeking to increase their integration in these markets, garner due consideration for their development status (by building flexibility into the architecture of the agreement and providing scope for national policies) and ensure the autonomy of their liberalization processes. They also clearly understand, however, that this effort must be accompanied by domestic regulation and, judging by the offers made so far, they also stand in need of a great deal of technical assistance.

Doha represents the continuation of the negotiations initiated in January 2000, but the ensuing process and the working environment in the months leading up to Cancún were such that the deadlines for the market access request and offer tasks could not be met.<sup>48</sup> Since not all countries have presented their initial offers, the deadline for presenting revised offers has been extended, and the developed countries believe that the sector has fallen behind in the process. These same countries emphasize the

fundamental contribution this sector makes to growth and development, which is why they are calling for an open attitude towards the interests of developing countries and an awareness of the support they may need for preparing their market access offers and requests. For this reason, even before the July package was announced, there has been a proposal on the table to undertake frank bilateral consultations with members that have not made offers in order to identify the reasons for this and determine their specific technical assistance needs.<sup>49</sup>

The July package reaffirms the guiding principles that came out of Doha, and annex C of the package sets forth general guidelines for the negotiations. Among them, it stated that the revised offers were to be presented by May 2005. It also makes some appeals that bear repeating:<sup>50</sup> (i) the quality of the offers should be improved so that progressive levels of liberalization can be achieved without exclusions; (ii) special attention should be devoted to sectors of interest to developing countries, technical assistance and mode 4 (movement of persons); and (iii) efforts should be made to continue work on domestic regulations and standards. The latter refers to disciplines on safeguards, government procurement and subsidies.

The work thus far has been slow, both in terms of requests and offers and in discussions of cross-cutting themes and rules, and this has signalled a crisis in the process.<sup>51</sup> This demand is primarily made by developed countries, and it was forcefully advocated at a ministerial meeting held in Kenya in early March.<sup>52</sup> Another matter that has been under discussion is mode 4, regarding which some national experiences have been shared. Although there are some offers from developed countries, no commitments have been made — except by the European Union — for further liberalization. According to some developing countries, these offers have been tied to trade commitments in relation to FDI (mode 3), that is, the movement of persons only in the form of transfers within transnational corporations (ICTSD IISD, 2004).

Cross-cutting themes have included the evaluation of trade in services, disciplines for domestic regulation and credit for autonomous liberalization. With contributions from OECD and UNCTAD, the evaluation of trade in

<sup>48</sup> The Latin American perspective on this process is presented in ECLAC, 2003, chapter VII.

<sup>49</sup> Among the technical and political difficulties are the technical aspects of the formulation of requests and offers, the need for national coordination to deal with this process, the overwhelming number of requests, the deterrent effect of missed deadlines and the results of Cancún.

<sup>50</sup> The developing countries felt that date was merely a suggestion (WTO, 2004c).

<sup>51</sup> An evaluation that was presented at the WTO mini-ministerial meeting in Paris in early May 2005, as pointed out by the Director General (WTO, 2005f) in his last report as Chairperson of the Trade Negotiations Committee to the WTO General Council on 29 July 2005 (WTO, 2005j).

<sup>52</sup> As of December 2004 more than 30 members, not counting the least developed countries, had not submitted their offers (WTO, 2004f). In March 2005, only the European Union and Japan had presented their revised offers. As of July 2005, 68 initial offers and 24 revised ones had been submitted.



services has been considered, focusing in particular on obstacles, economic impacts and the relationship with the FDI process. However, there is still the problem of the statistical data needed in order to prepare global evaluations. In addition, although an agreement was forged in 2003 to recognize autonomous liberalization (as a product of unilateral liberalization processes), it does not appear to have had any influence on the offers, and in no case does it represent an automatic right to recognition.

Some developing countries advocate stepping up the work on rules and domestic regulation because these issues should be accompanied by or precede the consideration of market access in order to define the scenario in which liberalization will take place. The discussion of standards

— safeguards, government procurement and subsidies — is relevant because it is related to the policy sphere that is of interest to these countries.

Moreover, developing countries believe that the debate is changing from one of acknowledged flexibility — a characteristic of the General Agreement on Trade in Services, which includes the positive-list approach — to a more demanding, benchmark-based approach which is being endorsed by developed countries (Strickner, 2005). In fact, at the most recent sectoral meetings of WTO and the mini-ministerial meeting of May 2005 (OECD, 2005a), apart from the emphasis on the deadline for submitting revised offers, the participating ministers stressed the need to achieve a critical mass of significant offers.

### 3. Further development of trading rules

Trading rules were one of the areas in which the Doha Round attempted to refine, complement or expand Uruguay Round disciplines in order to provide a more effective framework for trade arising out of liberalization.<sup>53</sup> The rules system is of great interest to developing countries insofar as it can offer more predictable and equitable terms of trade. But it also makes some demands on their institutional capacities and can lead to the erection of less transparent barriers to market access (Short, 2001). Furthermore, it should be taken into account that bilateral or regional agreements are also increasing the commitments being made in this regard. Not only that, but some developing countries have asked to operationalize the consideration of special and differential treatment in the implementation of several of these instruments, which is more difficult in this area than in that of market access, and even more so with respect to anti-dumping measures, as provided for in the agreements.

The July package confirms only in general terms the objective of continuing the work being done in this area, and the negotiations on trade facilitation are added to that. Looking at rules from a broad perspective, the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs Agreement) is also a factor.<sup>54</sup> The goal in all these areas is to make sure that the various instruments do not create unnecessary barriers to trade and that there is due

consideration for the necessary flexibility for developing countries and their development objectives.

#### (a) Anti-dumping, subsidies and countervailing measures

Most of the work of the Negotiating Group on Rules established at Doha in 2001 has concentrated on the anti-dumping mechanism, while subsidies — including those in the fisheries industry — have not yet attained a very high level of specificity.<sup>55</sup> This area has been one of the most complex in terms of dispute settlement, which shows how difficult it has been for countries to adjust to these provisions (Davey, 2005). In this regard, the most recent cases on anti-dumping and on subsidies in key sectors — the Byrd Amendment and Boeing-Airbus — have involved major players.

Developing countries and particularly those in this region have been heavily targeted by anti-dumping measures, especially in respect of commodities. That is why they consider these negotiations very important in ensuring market access. Nevertheless, some of these nations have also been habitual users of this trade defence instrument. Several of them have advanced proposals to provide stricter disciplines to regulate research and implementation in order to prevent the protectionist use of anti-dumping duties. The “Friends of Anti-dumping

<sup>53</sup> This task is complemented by some aspects of the functioning of the rules that were to be revised in the negotiations on implementation.

<sup>54</sup> It should not be forgotten that liberalization of trade in services also has an important rules component.

<sup>55</sup> This group covers the anti-dumping, subsidies and countervailing measures agreements as well as regional agreements.

Negotiations”, a group comprising both developing and developed countries and led by Japan, have been the main promoters of this position and have authored 30% of the proposals.<sup>56</sup> The negotiations in this sphere, proposed since the preparations for the 1999 Ministerial Conference in Seattle, have aroused little interest on the part of the United States, which is more concerned about and willing to negotiate on questions of procedure and transparency. This country has been at the centre of several controversial cases, such as the aforementioned Byrd Amendment (Davey, 2005).

The report and evaluation presented in early 2005 by the group indicates that the negotiating situation has not improved. That, together with the failure to carry out the resolutions on dispute settlement, leaves a large volume of exports at risk (see Davey, 2005). For this reason, the group has issued policy directives that should be considered in the negotiation. These directives are based on six objectives: (i) mitigating the excessive effects of anti-dumping with a view to achieving proportionality; (ii) improving disciplines to prevent the ongoing use of anti-dumping measures; (iii) strengthening procedural guarantees and transparency; (iv) reducing the costs to authorities and stakeholders in the process, especially small exporters; (v) bringing unjustified and unnecessary investigations to a quick conclusion in order to minimize irreparable damage; and (vi) improving substantive regulations governing dumping and damages to improve predictability and minimize transaction costs (WTO, 2005g).

With regard to subsidies (and countervailing measures), which have been the subject of fewer proposals, ideas have been put forward to enhance flexibility and take into account the interest of developing countries in preserving their scope for action in terms of policymaking.<sup>57</sup> Much of the work has focused on fishery subsidies, and the centre of debate has shifted from the need for specific disciplines to the nature and scope of such disciplines. These tasks are being carried out in conjunction with those being performed by WTO in the area of trade and the environment.

In the negotiations on fishery subsidies, there are basically two points of view, represented by the Friends

of Fish group, on the one hand, and by countries such as Japan and the Republic of Korea, on the other hand.<sup>58</sup> The latter nations have gradually accepted the idea of stricter disciplines, but only with a positive list, that is, agreement on strict norms in limited areas. The Friends of Fish countries and the advocates of this item on the agenda propose, in contrast, a “broad approach”, with a negative list for these subsidies, which means that initially all such subsidies are banned, and each exception has to be negotiated (see, for example, WTO, 2004g). Some developing countries —Brazil among them— add the need for special and differential treatment, and others appeal for consideration of the need for sufficient policymaking scope and concern for small-scale fishing activities (ICTSD-IISD, 2004).

### (b) Intellectual property

The Doha negotiating tasks concerning intellectual property refer to geographical indications and the development of some aspects of the relationship between the TRIPs Agreement and public health as set forth in the ad hoc mandate (WTO, 2001c). In addition, there is a broad range of work on the implementation of the agreement and its relationship to the Convention on Biological Diversity, the protection of traditional knowledge and technology transfer. The latter issue is of major interest to developing countries and is being addressed by a new group created specifically for that purpose at Doha.

The perception of developing countries is that the TRIPs Agreement has been one of the most difficult of the Uruguay Round accords to implement (Finger and Schuler, 1999), and many of their demands are concentrated on making it more flexible. One proposal in this regard, which was approved at Doha, has to do with public health. In this connection, Brazil’s participation, along with that of India and other countries, has been most noteworthy. There has been a great deal of debate about the substantive content and legal form of an amendment to TRIPs designed to facilitate access to medicine for countries with insufficient production capacity.<sup>59</sup> The latest recommendation was that this amendment, which

<sup>56</sup> All of the nearly 100 proposals on this issue that had been received as of February 2005 come from this group, the United States and Canada. The group, made up of approximately 20 countries, also includes nations such as the Republic of Korea, Canada and five Latin American countries (see table II.1).

<sup>57</sup> Beginning in 2000, as established in the Uruguay Round, all non-agricultural subsidies became actionable, with the same happening for agricultural subsidies in 2003 as the “peace clause” expired. In Doha an agreement was reached to extend the implementation of certain export subsidies in countries subject to specified criteria.

<sup>58</sup> The Friends of Fish group is made up of about 10 countries, both developed and developing, including the United States and New Zealand, as well as four Latin American nations (see table II.1).

<sup>59</sup> The clause in question is paragraph 6 of the Declaration, according to a decision by the General Council on 30 August 2003 (WTO, 2003c).

had been slated for June 2004, should be completed by the end of March 2005. That target date was not met either, however.

The negotiations on the establishment of a multilateral system of notification and registration of geographical indications for wines and spirits have focused on evaluating the legal effects of registration and participation in the system. Another question being considered is whether the proposals would alter the balance of rights and obligations in TRIPs. In this regard, the developing countries are looking at making registration voluntary, and they are expressing concern about the costs of participating in the multilateral system, as has been the case with other TRIPs instruments. The work on extending the protection of geographical indications to other products, which is of particular importance to the European Union, has been incorporated into the implementation tasks in accordance with the July package (see section B.4). This matter, resisted by developing countries, is also included on a provisional basis in the work on agriculture.

### (c) Trade facilitation

The aim of trade facilitation proposals is to streamline movement, customs procedures and the circulation of goods. This area, along with other regulatory aspects included in the Singapore issues, had been left as a matter for potential negotiation within the Doha mandates. The Singapore issues were proposed by developed countries, (chiefly the European Union), and the preparatory work dates back to 1997, when the ad hoc groups were created by mandate of the conference held in that country (see Izam, 2001). Trade facilitation negotiations have been driven in recent years by the Colorado Group, which proposes clear, binding disciplines in this area.<sup>60</sup> APEC has also played a key role in promoting trade facilitation efforts, has shared relevant experiences and places special emphasis on their importance for the competitiveness of SMEs.

Trade facilitation was the only one of the Singapore issues that developing countries were willing to

incorporate into the negotiations, although they did attempt to exclude it from the single undertaking and from the dispute settlement system. The matter has sparked interest in these countries because they recognize its potential for contributing to their competitiveness,<sup>61</sup> but at the same time they are concerned about the commitments it may entail and the need for resources and technical assistance to implement them.

The July package expresses many of the concerns of developing countries and confirms the Doha guidelines for making sure that negotiations aim at clarifying and improving aspects related to the circulation of goods. This can be seen in annex D of the decision,<sup>62</sup> which recommends that the following articles of the 1994 GATT be examined: V: freedom of transit; VIII: fees and formalities connected with imports and exports; and X: publication and enforcement of trade regulations. The decision indicates that negotiations should establish provisions for effective cooperation among the relevant authorities. It also states that the principle of special and differential treatment should extend beyond the time periods set, that commitments in this area should depend on the countries' capacities and that support from developed countries in the form of technical assistance and capacity building should be provided during the negotiation process, as well as in connection with implementation.<sup>63</sup>

In the initial phases of the work, a trade facilitation negotiating group was established (in October 2004). This group debated the objectives of the agreement, the provisions for special and differential treatment, the role to be played by international organizations, cooperation among customs agencies, the cost of implementation for developing countries, technical cooperation requirements and consideration of landlocked countries, which countries such as Bolivia and Paraguay consider to be a very important matter. As the negotiations have proceeded, the contrast between developed and developing countries' views regarding the binding nature of trade facilitation commitments and the treatment and conditionality of available resources has become ever more apparent.

<sup>60</sup> Comprising about 15 countries, including Japan, the United States, the European Union and four countries in Latin America and the Caribbean (see table II.1).

<sup>61</sup> Estimates of the costs of border procedures range from 2% to 15% of the value of goods traded (OECD, 2003).

<sup>62</sup> A note states that the final format has not yet been determined, but may be non-binding (UNCTAD, 2004b, p. 22).

<sup>63</sup> New approaches to cooperation emerge here, with cooperation being viewed as an integral part of the agreements and one that is linked to countries' development strategies. The Hemispheric Cooperation Programme (HCP) of the Free Trade Area of the Americas (FTAA) serves as a frame of reference in this regard. More limited agreements, such as the Economic Association Agreements of the European Union and Asian countries, also address cooperation in this manner (Aoki, 2004).

## 4. Cross-cutting and institutional aspects

The topics addressed in this section form part of the negotiating agenda of the Doha Round and have a bearing on the range of agreements forged in the framework of WTO. They also reflect longer-term challenges facing the multilateral system, such as the applicability of the most favoured nation principle, the incorporation of the development dimension, and the governance of the system (Sutherland et al, 2004). These topics include the work being done on development, dispute settlement, regional agreements and the environment.

### (a) Development

The incorporation of the development dimension into WTO standards has been a complex proposition, in which the parties have discussed at length the usefulness of instruments provided in the framework of special and differential treatment (such as differentiated deadlines for compliance with commitments), as well as approaches that could provide a more effective response to development needs. Concerns over asymmetries in the development levels of the multilateral system's members led to two negotiation tasks being established at Doha: the implementation of the Uruguay Round agreements and special and differential treatment. With regard to the latter, it was proposed to strengthen the existing provisions in order to make them more precise, effective and operational.<sup>64</sup> With respect to implementation, it was agreed to examine and negotiate on matters relating to a number of the Uruguay Round agreements.<sup>65</sup> The two sets of tasks are complemented with programmes of work on matters of interest to developing countries —small economies; trade, debt and finance; and

technology transfer— and with provisions to strengthen technical assistance, capacity-building and action on least developed countries.

The work on development issues has progressed very little since Cancún, since the agenda has focused instead on agriculture, non-agricultural market access, the Singapore issues and cotton. The July package consolidated the different lines of work on development issues and set out a number of principles and parameters for the process. It was also resolved that no new sub-categories of members would be created, although this issue resurfaced to some extent in the subsequent debates, basically at the prompting of the developed countries.<sup>66</sup> The deadline for the respective bodies to submit their recommendations on special and differential treatment and implementation-related issues was pushed back to July 2005.<sup>67</sup>

### (b) Dispute settlement

The dispute settlement provisions are important for the multilateral trading system because they are used to enforce the member countries' commitments regarding the agreements, thereby making the trading system more secure and predictable. Intensive use has been made of the Dispute Settlement Understanding adopted at the Uruguay Round, which has formed the basis for dispute settlement since WTO was created (with 330 cases and over 350 complainants from 1995 up to May 2005).<sup>68</sup> As part of the Doha agenda, and as confirmed in the July package, member governments agreed to negotiate to improve and clarify the Dispute Settlement Understanding.

<sup>64</sup> These provisions are intended mainly to: increase opportunities for trade, safeguard the interests of developing countries and ensure the flexibility and time horizons allowed to these countries for meeting commitments (see ECLAC, 2004a, chapter V).

<sup>65</sup> By means of a decision adopted at Doha on implementation questions and concerns, almost 40 tasks were established on 12 topics from different agreements, mostly relating to the specific traits of developing countries (WTO, 2001b, ECLAC, 2003, chapter VII).

<sup>66</sup> A group of 22 countries (mainly from the Latin American and Caribbean countries) recently put forward a proposal in the context of the work on small economies, based on an approach that is contrary to the formation of new categories of members. The proponents hope that specific decisions will be taken on their propositions, as well as on the treatment of certain implementation issues and special and differential treatment, at the Sixth Ministerial Conference (WTO, 2005h).

<sup>67</sup> The Committee on Trade and Development has put forward some proposals for expediting the discussions (WTO, 2005i).

<sup>68</sup> Only 25% of these come to be examined by WTO panels, which attests to the importance of the prior steps for arriving at mutually agreed solutions. The Latin American and Caribbean countries have also made intensive use of the system, especially the larger and more diversified exporters (Brazil and Mexico), and have made proposals on the negotiations now underway (see ECLAC, 2003, chapter VIII). Thus far, the region figures in 83 of the 357 complaints, mainly in cases on anti-dumping and subsidies, licences and safeguards, 31 of which have been intraregional.

The Understanding sets out the procedures for a multilateral and orderly approach to dispute settlement. There are four phases to dispute settlement: consultations, the panel process, the appeal and the surveillance of implementation. The Uruguay Round agreements provided for the Understanding to be reviewed by 1999 in order to improve its operation and many proposals have been submitted thus far. These include a review of the stages in order to expedite procedures, consideration of special and differential treatment in the process, the reconfigurations of groups and special panels, the sequencing of procedures when rulings are not complied with and external transparency or public access to proceedings (WTO, 2003b).

The dispute settlement negotiations were the only part of the Doha agenda to be left outside the single undertaking, with a view to arriving at decisions in advance of the rest of the negotiations, originally by May 2003. The negotiations have been delayed over the last two years, however, despite recent cases which have had a large impact on certain products and countries. This has heightened the interest of all the countries, particularly the developing nations, since, in addition to the costs involved in becoming party to a complaint, they have been adversely affected by delays in the implementation of decisions. The system has operated relatively well, but there are problem areas with certain agreements and delays in settling cases and implementing rulings, especially on the part of the developed countries (Davey, 2005).<sup>69</sup> The agreements generating most problems include subsidies, sanitary standards and anti-dumping, with several such disputes arising in the agricultural sector. Another issue is that rulings on disputes over safeguards have sometimes been implemented only at the final stages of the process, which enables them to fulfil their purpose of protectionism before they are eliminated.

Some of the more recent decisions affecting emblematic developed country policies (such as agricultural subsidies on sugar in the European Union and on cotton in the United States) have rekindled interest in negotiating. What is more, Sutherland et al (2004) suggest that dispute settlement has in fact helped to propel certain issues forward, in view of the slowness of the multilateral negotiations and the growing difficulty in reaching decisions by consensus.

### (c) Regional agreements

The compatibility of regional agreements and other types of preferential accords with the multilateral system is governed by a number of WTO provisions, namely article XXIV of GATT, the Enabling Clause and article V of the General Agreement on Trade in Services (WTO, 1995). These rules are intended to ensure that regional agreements promote trade among the contracting parties while minimizing discrimination against third countries. Hence, such agreements must encompass the “essential points” of trade —an idea that is not well defined and therefore open to debate. The multilateral system also promotes the transparent operation of agreements and has established an oversight mechanism (the Committee on Regional Trade Agreements), which has, however, encountered certain difficulties in its work.

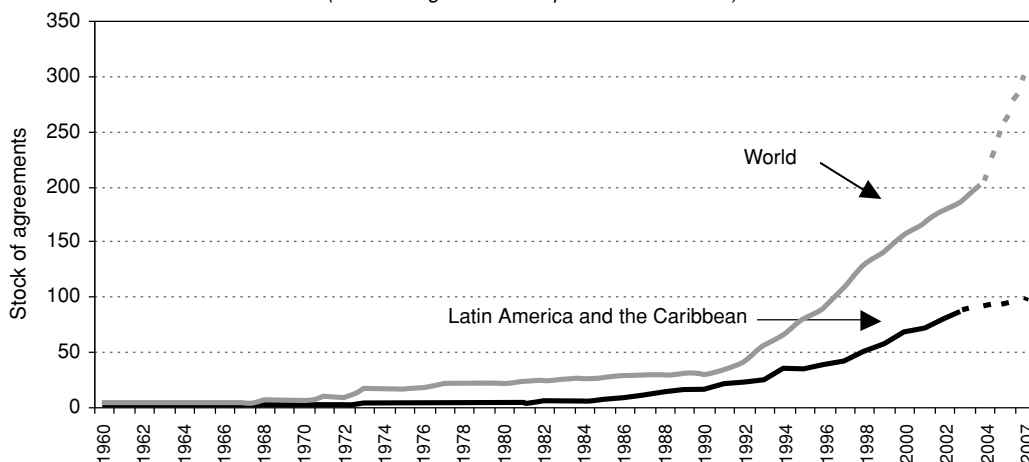
The importance of this topic, given the proliferation of regional agreements in the last few years, is evident from the broad range of recent literature devoted to the subject (see figure II.2).<sup>70</sup> The report prepared for WTO examines the implications of agreements as exceptions to the most-favoured nation principle (Sutherland et al, 2004, chapter II). Similarly to the points made in relation to dispute settlement, regional agreements appear to be a response to institutional difficulties in the multilateral system —such as slow and cumbersome decision-making— which could, ultimately, lead to the fragmentation of the system. For developing countries, the conclusion of regional agreements has often been a way to deal with the asymmetries of the multilateral system and, thus, a means of acting on their development concerns.

The Doha Round encompasses negotiations aimed at clarifying and improving disciplines and procedures applying to regional trade agreements, taking into account the developmental aspects of such agreements. This task was part of the mandate of the Negotiating Group on Rules and was confirmed in the framework of the July package. The process is particularly complex, because of the mounting number of agreements signed or being negotiated and the breadth of the topics involved. The rules incorporated into these agreements, especially in relation to behind-the-border policies, make it more difficult to evaluate the effects on third parties. Particular challenges arise in connection with

<sup>69</sup> Almost 41% of the cases analysed in Davey (2005) had been delayed by over four months; of these, half are still in process. These procedures have lasted 32 months, which is eight months longer than the expected average.

<sup>70</sup> World Bank, 2004; APEC, 2004b; ECLAC, 2004b; UNCTAD, 2004a; Sutherland and others, 2004.

Figure II.2  
**REGIONAL TRADE AGREEMENTS**<sup>a</sup>  
*(Stock of agreements reported and in force)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the World Trade Organization (WTO).

<sup>a</sup> Includes agreements reported under article XXIV of GATT (goods trade), article V of the General Agreement on Trade in Services (GATS) and the Enabling Clause (regional integration among developing countries).

topics such as rules of origin, subsidies, services and anti-dumping rules.

The negotiations take place under a two-pronged approach: procedural and transparency issues and systemic issues or substantive disciplines. Up to this point, many proposals have been submitted on less contentious issues, aimed at increasing transparency, refining reporting requirements and revitalizing the operation of the Regional Trade Agreements Committee.<sup>71</sup> These elements also reflect a greater interest in the surveillance of regional agreements. Systemic issues and the coverage of regional agreements, as well as the developmental dimension, have been addressed only as secondary matters.<sup>72</sup>

#### (d) Trade and the environment

At the end of the Uruguay Round, WTO began formal work on the links between trade and the environment, establishing an ad hoc body known as the Committee on Trade and Environment. This Committee embarked on a wide-ranging debate which was, in some ways, divided along North-South lines. The developing

countries were reluctant to incorporate the issue into the negotiations, since they feared that a protectionist intent underlay the developed countries' proposals (albeit with a variety of priorities) linking the environmental dimension to trade. It was not until Doha that a mandate to negotiate was reached, and this was aimed basically at improving coordination between WTO and the bodies associated with environmental agreements and among their respective rules, as well as the liberalization of environmental goods and services. There was also a commitment to continue working on the environmental dimension of market access and intellectual property, as well as eco-labelling for environmental purposes.

The work on ecological goods and services has moved ahead in a satisfactory manner and has certainly made these concepts more tangible, even though lists of environmental goods are still being reviewed and ways to identify these goods continue to be debated. There is also support for the idea of starting similar negotiations on how environmental goods could be treated in the framework of non-agricultural market access, and on how environmental services would relate to the General Agreement on Trade in Services.

<sup>71</sup> The proposals refer to WTO notification procedures, the capacity of developing countries to meet reporting requirements and the review of south-south agreements, among other issues.

<sup>72</sup> Hence the need to define what is meant by "substantially all the trade" (coverage of the agreement) and deadlines for tariff reduction, and to evaluate the restrictive and discriminatory component of certain policies, such as safeguards, anti-dumping, and so forth.

## C. The new framework and negotiation process

### 1. Overview: shifting the Doha agenda?

As discussed in the first part of this chapter, the Doha Round has raised expectations that the industrialized countries will make certain concessions, particularly in agriculture. This poses certain difficulties for the global negotiation process, although the direction taken by recent trade dispute cases may constitute a reform impetus. The slow progress of the talks can encourage litigation of this sort, although different parties have clearly expressed a preference for negotiations. Although the issues now being negotiated (including subsidies) are core topics, a broader perspective is needed to evaluate the potential outcomes of the process. This is because, first, the issues being negotiated are interdependent (as progress on agriculture is linked to non-agricultural market access, for example) and, second, some general instruments, such as trade contingency measures and other rules, also contribute to market distortions in the agricultural sector.

The July 2004 package confirmed the agenda established at Doha, arriving at conclusions that had been expected in Cancún in 2003. The package made a valuable contribution in the sphere of agriculture, in particular, and it re-established the negotiating climate and process interrupted in Cancún, thus safeguarding the credibility of WTO.

- It gives less guidance on development issues, however. Questions also remain over a number of programmes of work, particularly the Singapore issues that will not be negotiated, and a number of questions of concern for developing countries. A review of the main areas in which the July package is driving the multilateral system forward — market access, rules and other institutional matters — gives a mixed balance that warrants more detailed examination.
- Access to agricultural markets, non-agricultural market access and services: although more coordinates have been set out, these topics hinge basically on agreement on modalities, which requires an intensive amount of highly complex technical work. This was demonstrated

by the conversion of specific to ad valorem tariffs. As well, instruments that have been provided to give both developed and developing countries more flexibility also have the effect of making the negotiations more complex.

- Trade facilitation is a topic that has been brought into the negotiations on trade rules, but little progress has been made towards specific rules on anti-dumping and subsidies. Deadlines for the Agreement on Trade-Related Aspects on Intellectual Property Rights (TRIPs) have been reviewed, but the proposals made by developing countries regarding the distribution of benefits do not appear to have been taken up. These issues clearly have an impact on competitiveness, and although the developing countries are in need of such regulations, they are reluctant to move forward in these areas because of the costs involved (Short, 2001).
- With regard to cross-cutting institutional matters, some headway has been achieved on development issues with the incorporation of the cotton initiative, but less progress has been seen in other areas of work in terms of the constraints affecting developing countries (particularly in regard to implementation-related issues, which is one of the areas in which talks are the furthest behind schedule). More specific guidelines or signals are expected in relation to the Dispute Settlement Body, which is not part of the single undertaking, although in fact the system operates very well and could help to carry the negotiations forward. Although no further guidelines have been reached for the work on regional trade agreements, as the pace of this work picks up further, it may help to spur the talks on other topics.

At the “mini-ministerial” meeting held in Dalian, China on 12 and 13 July 2005, it was clear that sights were set on the General Council meeting to take place at the end of that month, given the absolute need to conclude the talks by the end of 2006.<sup>73</sup> The talks that followed,

<sup>73</sup> This meeting followed those held in Davos (Switzerland) at the end of January, Mombasa (Kenya) in early March, Paris (France) at the start of May (in the framework of the meeting of OECD) and Jeju (Republic of Korea) in June (in the framework of the meeting of APEC). The urgency of the talks was pushed home at all these meetings, especially at the end of April, when the Director-General of WTO weighed the risk of the talks reaching a crisis point.

however, continued to sow doubt over the larger actors' lack of signals on, precisely, the pivotal issue of the negotiating process, namely agriculture, which dictates the pace of progress on other topics. The Trade Negotiations Committee Chairperson's report to the General Council on the eve of its meeting expressly set out a number of urgent points relating to different elements of a road map towards the Ministerial Conference and proposed a checkpoint for review and corrective action no later than mid-October 2005 (WTO, 2005j).

The General Council meeting of 29 July 2005 was expected to make substantial headway and build a solid basis for the run-up to the Sixth Ministerial Conference in Hong Kong Special Administrative Region of China, at which it is hoped to seal agreements on modalities of market access, as a critical landmark in the negotiations.

According to preliminary reports given recently in the press, however, such headway was not made, as was forewarned in the abovementioned report, in which the Chairperson of the Trade Negotiations Committee indicated that what was needed was "not just a change of gear in these negotiations but also a change of attitude and approach" (WTO, 2005j, p.15). Such a shift would increase the possibilities of concluding the Doha Round in 2006. These outcomes will also hinge on further progress being made on certain development issues (special and differential treatment and implementation-related matters) after the summer recess in the northern hemisphere, and on targets and deadlines being met in services and non-agricultural market access, balanced with progress on agriculture, anti-dumping and other rules.

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## 2. Coordination among the actors and the role of Latin America and the Caribbean

The map of actors in the multilateral negotiations has been shifting constantly under the influence of a variety of factors, including the conditions and behaviour of trade itself, the coverage and depth of topics as the system evolves and changes in member countries — which are increasingly developing nations — as well as their perceptions of the outcomes. Around the time of Cancún the configuration of the various groupings tended to reflect the positions of the developing countries, with the G-20 prominent among them.<sup>74</sup> After that conference, however, new alliances have formed that cut across the pre-existing ones. Such clusters involve a handful of WTO members, most of which are large economies from the developed and developing worlds that have differing positions on a given issue (such as agriculture).<sup>75</sup>

This process has also been played out in other forums of discussion and cooperation that have areas in common with WTO. The eleventh United Nations Conference on Trade and Development held in Sao Paulo in June 2004 provided an opportunity to discuss several issues

also dealt with in the framework of WTO and helped to coordinate such groups as the Global System of Trade Preferences (GSTP) and the Non-Group of Five (NG-5) (UNCTAD, 2004b).<sup>76</sup> The members of APEC, for their part, emphasized in their June 2004 statement the need to infuse the multilateral system with a sense of urgency, and define priority lines of action, taking the development dimension into account.<sup>77</sup> This impetus comes as WTO members approach the point at which they will have to decide how to invigorate the negotiations. Thus far in 2005, the forums mentioned have also made important contributions to unfettering the talks and furthering key questions relating to agriculture and non-agricultural market access.

Since world economic growth has been slower and signs of protectionism have appeared in the large economies (as witnessed by a number of recent disputes) conditions have become more complex for the accomplishment of the tasks still outstanding before the Sixth Ministerial Conference. Those conditions also

<sup>74</sup> Up until Doha, the groups revolved around shared thematic interests —the Cairns Group, the Friends of Anti-dumping, the G-10, among others— which appeared to blur the north-south categorization. These groups coexist with new organizations and their role varies in importance according to the context (see table II.1 and GAO, 2005, Appendix IV).

<sup>75</sup> The Non-Group of Five (NG-5) could be described as such a configuration, along with the developing countries which are making proposals on non-agricultural market access.

<sup>76</sup> At UNCTAD XI, the developing countries relaunched the Global System of Trade Preferences in order to deepen their trade, beginning a third round of negotiation in the context of expanding south-south trade.

<sup>77</sup> The influence of APEC comes from having large economies and from the fact that its work has systematically concentrated on issues that are essential to the multilateral debate. The Doha Round was an important working axis for the June 2005 meeting of APEC.



hinge on the leadership and cooperation exercised by such economies, particularly the European Union and the United States, whose main trade authorities have changed since the July package was agreed (GAO, 2005). Since Cancún, in parallel with their activities in the multilateral system, the European Union, Japan and the United States have stepped up their negotiations and agreements with groups or countries from several regions, including Latin America. These negotiations obviously affect the talks at the multilateral level. In addition, the developed countries use such agreements to deepen disciplines that evolve more slowly in the multilateral framework (such as the Singapore issues and intellectual property), and whose contribution to development objectives is not so clear-cut for the developing countries.

The clearest trend within the groups that form around negotiating interests is the growing involvement of the developing countries, which represent more than 100 of the existing 148 members of WTO, and the more intense coordination of their visions and proposals. They played a significant role at Cancún and their proposals were reflected in the outcomes, especially in the course taken by the Singapore issues and the mounting attention given to the system's operation and representation of interests. This stood in contrast to the participation of the developing countries at the Uruguay Round, where they had tended to merely react to the proposals of the developed countries. Clearly, the developing countries, and particularly the Latin American and Caribbean region, have built up negotiating experience in the last decade and their more active role reflects their desire to seize the opportunities that arise while minimizing the adjustment costs involved.

In the formation of country groupings based on common negotiating stances, the Latin American and Caribbean region has come to play an important and, to some extent, leadership role among the developing countries. Structural and policy-based differences exist, however, which make it difficult to arrive at a consensus position on all the issues under consideration. Given the countries' differing economic sizes, production and commercial structures, trade policies and development strategies, unified action in all the areas under negotiation is a highly complex undertaking. This hinders efforts to formulate a "regional" proposal for Doha, on the one hand, and, on the other, encourages the formation of shifting alliances among countries of the region. The

challenge here is to build upon those areas where the countries' views do converge while providing scope for subtly differing stances on the rest without undercutting the cohesiveness of the countries' positions on the main issues, especially agriculture and special and differential treatment.

In this regard, the following lines of action are particularly important in Latin America and the Caribbean: (i) increasing the depth and effectiveness of market openness for their exports (especially of agricultural goods), including significant liberalization of south-south trade; (ii) maintaining policy space for development,<sup>78</sup> making the special and differential treatment envisaged in the Uruguay Round operational and addressing the needs of small and vulnerable economies (preference recipients) without creating new sub-categories of members; (iii) improving such disciplines as anti-dumping, in order to make access to main markets less arbitrary; (iv) moving ahead with the liberalization of services as they apply to the movement of persons (mode 4); and (v) developing institutional and participatory aspects that guarantee transparency and inclusiveness, which are issues raised particularly by the Caribbean countries.

The region's countries have placed their demands on the agenda of a number of different meetings, especially on agriculture, where the region has been very proactive, having made proposals in the framework of the G-20 and the Cairns Group.<sup>79</sup> After the Cancún conference, the Latin American and Caribbean countries became more heavily involved in proposals of a less reactive nature than in the past and dealing with specific topics outside the boundaries of the negotiations on agriculture (for example, non-agricultural market access, the importance of rules and anti-dumping and intellectual property). In addition, the outcomes of recent high-profile disputes, in which these countries have played a major role, are further confirmation of their influence on the evolution of the multilateral system.

Lastly, under these circumstances, it is all the more important to devise strategies for positioning the countries within the development process. In this connection, the countries of the region are increasingly aware of the need to complement trade agreements with domestic policies (forming what has come to be known as the "domestic agenda") in such areas as competitiveness, infrastructure, technological innovation and the modernization of small and medium-sized enterprises (SMEs).

<sup>78</sup> The region played an important role in the debate on TRIPs and public health, for example.

<sup>79</sup> This was clearly appreciated at the mini-ministerial meeting in Kenya. The groups in which those countries participate, particularly the G-20 and the G-33, have also fostered a debate among themselves and with other developing countries—in what has become known as the bottom-up approach—seeking to make the process more inclusive and transparent, as advocated in the G-20's March declaration.

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## Chapter III

# Regional integration in Latin America and the Caribbean

## A. A critical biennium for regional integration (2004-2005)

Regional integration is at a crossroads. The Doha Round is experiencing serious difficulties, and more and more bilateral trade agreements are being negotiated at the same time with partners both inside and outside the region, making it necessary to reinforce consistency among trade policies at different levels: multilateral, hemispheric, subregional, bilateral and unilateral. The multiplicity of levels at which negotiations are taking place and the large number of decisions that must be adopted at those different levels require a clear internal consensus regarding not only the priorities for establishing an international presence, but also the consistency that must be maintained among the various public policies that come into play in the international sphere.

In this multifaceted situation, there is no sign that integration mechanisms have corrected the shortcomings of the past: weakness of forums for dispute resolution; adoption of trade community standards that are not incorporated into national legislation or are not implemented; lack of effective community institutions; absence of macroeconomic coordination and inadequate or non-existent efforts to deal with the asymmetries of the integration scheme. These challenges exist, albeit with different shades and variations, in the Southern Common Market (MERCOSUR), the Andean Community, the Central American Common Market

(CACM) and the Caribbean Community (CARICOM), although greater institutional progress has been made in the latter two.

MERCOSUR-European Union talks could not be completed in 2004 as planned, and apparently the political momentum will not be regained until after the Doha Round. MERCOSUR has expressed interest in launching free trade talks in 2005 with CARICOM, Mexico and Morocco, respectively, as well as partial trade agreements with India and with the Southern African Customs Union (SACU). In addition, free trade negotiations between the Andean Community and MERCOSUR have concluded,

and the agreement is already in effect. In early July 2005, the MERCOSUR countries became associate members of the Andean Community, and Chile should gain that status within the next few months. Talks are also taking place between the Andean Community and El Salvador, Guatemala and Honduras, while three Andean Community Member States (Colombia, Ecuador and Peru) are negotiating a free trade agreement with the United States. Furthermore, CARICOM has launched trade negotiations with Canada and with the European Union, and as indicated, CARICOM expects to begin talks with MERCOSUR. It is clear, then, that there is a broad agenda for international negotiations (see table III.1) that also calls for the region to participate actively in the multilateral scenario of the Doha Round. Such a demanding agenda can sometimes distract attention from the efforts necessary to update and streamline the subregion's own integration schemes, since the problems seen there cannot be overcome by signing on to additional agreements outside the community.

The agreements between the United States and Central America and the Dominican Republic, on the one hand, and between it and Andean Community-3, on the other hand, pose an additional challenge to the respective integration schemes. Indeed, on several important issues, commitments of greater scope and impact than those included in the integration schemes are under consideration for these accords. This is a major opportunity and challenge for these schemes, since the approach to this asymmetry of commitments (more demanding schemes with northern partners and less demanding ones within the subregion) is dictated by the agenda. In general, trade agreements with industrialized economies tend to be viewed as more binding by regional economic players, and their dispute resolution mechanisms are seen as more credible and thus providing greater legal security for decisions on investment and foreign trade.<sup>1</sup> Moreover, in the accords with the United States or the European Union, the commitments countries can make in some aspects of investment or services policy are undertaken within the framework of Most

Favoured Nation (MFN) status, and they therefore pull the integration schemes into decisions in which they did not participate. This “pulling” opens up the possibility for a rapid adjustment of integration regulations to avoid the risk of being overtaken by events.

In a number of areas, this can become quite complex, and a great deal of pragmatism is required to adjust to the new reality, making the appropriate changes in integration regulations and institutions. In this connection, it is important to preserve the central idea of an expanded market with free movement of goods and factors, serious progress towards macroeconomic coordination, effectively binding dispute resolution mechanisms, adequate handling of asymmetries, management of structural funds so as to yield balanced benefits, and bold initiatives in energy and infrastructure. From this perspective, integration processes are still clearly a better option than free trade agreements. It is a matter of persuading the economic and political players to see it this way, and that will not happen without a decisive political impetus, which in turn requires taking risks and fighting domestic interests that advocate protectionism. To be sure, it is even more imperative that this type of internal consensus be built—and leadership is even more critical—in the larger economies of the region. If this does not happen, it will be quite difficult for subregional integration to adapt quickly to current and future challenges.

The “energy ring” initiative in the Southern Cone is a clear example of the path that must be taken, making bold moves that involve a high degree of coordination and consistency among the policies of the Member States. The challenge is considerable, and the priority that Governments have thus far given to the matter, plus the interest shown by foreign investors and multilateral financing organizations, allow some cautious optimism about the initiative's future. If it becomes a reality, given its scope, it will become a turning point for regional integration and will pave the way for new measures to be adopted to reinforce economic and commercial complementarity in South American economies.

<sup>1</sup> Legal security does not mean that there are no disputes, merely that there are institutions in place where they can be litigated. The experience of countries in the region that have made accusations of dumping or safeguards in the United States or the European Union shows that the agreements make available a privileged bilateral forum for addressing such differences, and they allow for successful defences, as seen in the recent case of the Chilean salmon safeguards in the European Union.

Table III.1  
**LATIN AMERICA AND THE CARIBBEAN: EXTERNAL RELATIONS**  
*(as of July 2005)*

	Agreements signed (tariff preferences granted) <sup>a</sup> (% of total exports)	Negotiating free trade or partnership agreement (% of total exports (projected))	Partial trade agreements (Reduced scope)	Other types of agreements
<b>Southern Common Market (MERCOSUR) ACE 18 (1991)</b>	MERCOSUR - Chile (Economic Complementarity Agreement (ACE) 35 - 1996) MERCOSUR - Bolivia (ACE 36 - 1996) MERCOSUR - Peru (ACE 58 - 2003) MERCOSUR - Colombia, Ecuador and Venezuela (Bolivarian Rep. of) (ACE 59 - 2004) Uruguay - Mexico (TLC - 2004)	MERCOSUR - European Union (talks stalled) MERCOSUR - CARICOM <sup>b</sup> Brazil-Morocco <sup>b</sup> Brazil-Egypto <sup>b</sup> MERCOSUR - Mexico <sup>b</sup>	MERCOSUR-India (2004) covers 450 products MERCOSUR - South African Customs Union (SACU) <sup>c</sup> (2004) All countries have partial preference agreements with Cuba in the framework of LAIA	MERCOSUR - European Union Political dialogue and cooperation agreement (PDCA) (1999) MERCOSUR - Egypt Framework Agreement (2004) Brazil - India - South Africa Cooperation Agreement (2004) South American Community of Nations (Political Dialogue Mechanism-2004) MERCOSUR - China (Cooperation Agreements 2004)
<b>Andean Community (CAN) (1969)</b>	Venezuela (Bolivarian Rep. of) CARICOM (1992) Chile - Bolivia (ACE 22 - 1992) Chile - Colombia (ACE 24 - 1992) Bolivia - Mexico (ACE 31 - 1994) Chile - Ecuador (ACE 32 - 1994) Colombia-Venezuela (Bolivarian Rep. of) Mexico (G3) (ACE 34 - 1994) Chile - Peru (ACE 38 - 1998) Peru - MERCOSUR (ACE 58 - 2003) MERCOSUR - Colombia, Ecuador and Venezuela (Bolivarian Rep. of) (ACE 59 - 2004)	CAN <sup>e</sup> - United States (in negotiation) (Only Colombia, Ecuador and Peru) Andean Community- Guatemala, El Salvador and Honduras (Andean Community General Secretariat SGCAN negotiating) Secretariat for Central America Economic Integration (SIECA)	All countries have partial preference agreements with Cuba in the framework of LAIA	Andean Community-European Union PDCA since December 2003 <sup>f</sup> Andean Community - China Political Consultation and Cooperation Mechanism (2000) Andean Community - CACM with Political Dialogue and Cooperation Mechanism South American Community of Nations (Political Dialogue Mechanism-2004)
<b>Central American Common Market (CACM) (1960)</b>	Costa Rica - Mexico (1994) CACM - Dominican Republic (1998) CACM - Chile (1999) Costa Rica - Canada (2001) Costa Rica - Trinidad and Tobago (2002) Costa Rica - CARICOM (2003) Nicaragua - Mexico (1998) Northern Triangle - Mexico (2000) United States (2003 and 2004)	Guatemala, El Salvador and Honduras - CAN (Andean Community General Secretariat (SGCAN) and SIECA negotiating)	...	CARICOM (Cooperation Framework Agreement since 1992) CACM - European Union PDCA since December 2003 <sup>f</sup> CACM - Andean Community with Political Dialogue and Cooperation Mechanism <sup>g</sup>
<b>Caribbean Community (CARICOM) (1973)</b>	CARICOM - Venezuela (Bolivarian Rep. of) (1992) CARICOM - Dominican Republic (2001) Trinidad and Tobago - Costa Rica (2002) CARICOM - Costa Rica (2003)	CARICOM - Canada <sup>g</sup> (negotiating) CARICOM - European Union (negotiations began in July 2004) CARICOM-MERCOSUR <sup>b</sup>	...	Cotonou Agreement (Asia, Caribbean and Pacific European Union) (2005) CARICOM - Association of Caribbean States (ACS) CARICOM - India Cooperation (2003)
<b>4 customs unions</b>	<b>25.0%</b>	<b>21.0%</b>	<b>54.0% (sin preferencias)</b>	

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Maldonado and Durán (2005) and information from integration secretariats of Andean Community, South American Common Market (MERCOSUR), Central American Common Market (CACM) and Caribbean Community (CARICOM).

<sup>a</sup> Includes intraregional preferences.

<sup>b</sup> Negotiations will begin in 2005.

<sup>c</sup> The South African Customs Union (SACU) consists of South Africa, Botswana, Lesotho, Namibia and Swaziland.

<sup>d</sup> An important issue in this partnership is cooperation between the Initiative for the Integration of Regional Infrastructure in South America (IIRSA) and the Puebla-Panama Plan (PPP).

<sup>e</sup> Colombia, Ecuador and Peru.

<sup>f</sup> The European Union confirmed its willingness to begin trade talks in 2006.

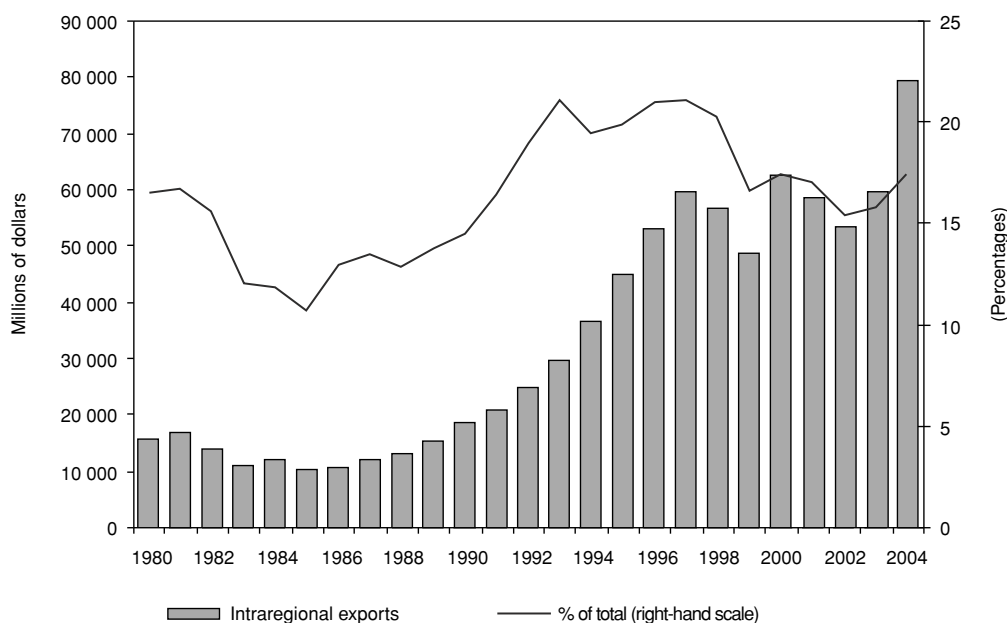
<sup>g</sup> All members of CARICOM (although not Canada) are negotiating sensitive issues: export subsidies, domestic farm supports, textiles and clothing, and the agricultural safeguard.

## 1. Intraregional trade and opening

The downward trend in intraregional trade (defined as the share of combined intraregional exports in the region's total exports), which had begun with the Asian crisis and continued through 2001 and 2002, was reversed in 2004 for the second straight year. Intraregional exports rose at higher rates than total exports, although they

still fell short of the historic record attained in 1997 (see figure III.1 and table III.2). This trend was seen in all subregions, with more vigorous growth seen in the countries of Andean Community and MERCOSUR (58.5% and 36.2%, respectively) than in those of CACM and CARICOM.

Figure III.1  
LATIN AMERICA AND THE CARIBBEAN: INTRAREGIONAL TRADE, 1980-2004<sup>a</sup>  
(Millions of dollars and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data.

<sup>a</sup> Includes intra-group and inter-group exports, in addition to exports from Chile, Mexico, Panama and the Dominican Republic to the remaining countries of the region.

### (a) Intraregional trade still very low

Intraregional trade is still low compared to what is being seen in Asia and the European Union, for example. While in Latin America and the Caribbean (LAC) this figure amounts to 17% of exports, in Asia it is just over a third of them, and it is nearly two-thirds in the European Union. There is a slowly rising trend in Asia, but in our region this trade is lower than it was a decade ago, which shows that intraregional trade has not

managed to become an engine of growth. The CARICOM and CACM figures are much higher than the averages recorded in MERCOSUR and the Andean Community. The latter is the furthest behind in terms of the weight of its intraregional trade, as only 10% of its exports go to the Community market; Peru and the Bolivarian Republic of Venezuela report even lower amounts (see tables III.2 and III.6).



Table III.2  
**LATIN AMERICA AND THE CARIBBEAN: TOTAL EXPORTS AND EXPORTS BY SUBREGIONAL INTEGRATION SCHEME, 1990-2004**  
*(Millions of current dollars and percentages)*

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 <sup>d</sup>
<b>Andean Community</b>															
Total exports (1)	31 751	28 583	28 100	29 683	33 706	39 134	44 375	46 609	38 896	44 603	60 709	53 543	52 177	54 716	74 338
Percentage of annual growth	25.7	-10	-1.7	5.6	13.6	16.1	13.4	5	-16.5	14.7	36.1	-11.8	-2.6	4.9	35.9
Exports to the Andean Community (2)	1 312	1 769	2 118	2 892	3 752	4 812	4 762	5 628	5 504	3 940	5 167	5 656	5 227	4 900	7 766
Percentage of annual growth	26.3	34.8	19.8	36.5	29.7	28.2	-1	18.2	-2.2	-28.4	31.1	9.5	-7.6	-6.2	58.5
Percentage of intra-Community exports (2:1)	4.1	6.2	7.5	9.7	11.1	12.3	10.7	12.1	14.2	8.8	8.5	10.6	10	9	10.4
<b>MERCOSUR</b>															
Total exports (1)	46 403	45 869	50 487	54 328	61 890	70 129	74 407	82 596	80 227	76 305	85 692	89 078	89 500	106 674	134 196
Percentage of annual growth	-0.3	-1.2	10.1	7.6	13.9	13.3	6.1	11	-2.9	-4.9	12.3	4	0.5	19.2	25.8
Exports to MERCOSUR (2)	4 127	5 101	7 190	10 062	12 049	14 199	17 075	20 546	20 322	15 162	17 710	15 298	10 197	12 709	17 311
Percentage of annual growth	7.6	23.6	41	39.9	19.7	17.8	20.3	20.3	-1.1	-25.4	16.8	-13.6	-33.3	24.6	36.2
Percentage of intra-MERCOSUR exports (2:1)	8.9	11.1	14.2	18.5	19.5	20.2	22.9	24.9	25.3	19.9	20.7	17.2	11.4	11.9	12.9
<b>Central American Common Market (CACM)</b>															
Total exports <sup>a</sup> (1)	3 907	4 352	4 610	5 126	5 496	6 777	7 332	9 275	11 077	11 633	11 512	10 185	10 171	11 288	12 100
Percentage of annual growth	9.2	11.4	5.9	11.2	7.2	23.3	8.2	26.5	19.4	5	-1	-11.5	-0.1	11	7.2
Exports to CACM (2)	624	812	1 076	1 138	1 326	1 594	1 388	1 559	1 944	2 010	2 615	2 829	2 871	3 077	3 439
Percentage of annual growth	89	30.1	32.5	5.8	16.5	20.2	-12.9	12.4	24.6	3.4	30.1	8.2	1.5	7.2	11.8
Percentage of intra-CACM exports (2:1)	160	18.7	23.3	22.2	24.1	23.5	18.9	16.8	17.5	17.3	22.7	27.8	28.2	27.3	28.4
<b>Caribbean Community (CARICOM)</b>															
Total exports (1)	4 118	4 034	3 958	3 779	4 471	5 598	5 683	5 861	4 790	5 170	6 358	6 072	5 732	6 466	...
Percentage of annual growth	11.6	-2	-1.9	-4.5	18.3	25.2	1.5	3.1	-18.3	7.9	23	-4.5	-5.6	12.8	...
Exports to CARICOM (2)	509	458	463	536	666	843	875	976	1 031	1 096	1 230	1 384	1 220	1 508	...
Percentage of annual growth	2.9	-10.1	1.1	15.9	24.2	26.5	3.9	11.5	5.7	6.3	12.3	12.4	-11.8	23.6	...
Percentage of intra-CARICOM exports (2:1)	12.4	11.3	11.7	14.2	14.9	15.1	15.4	16.7	21.5	21.2	19.4	22.8	21.3	23.3	...
<b>Latin America and the Caribbean</b>															
Total exports <sup>b</sup> (1)	130 214	126 818	131 731	140 903	187 987	227 922	253 921	283 632	280 065	292 919	359 936	345 484	347 610	376 344	461 021
Percentage of annual growth	19.7	-2.6	3.9	7	33.4	21.2	11.4	11.7	-1.3	4.6	22.7	-3.9	0.6	8.3	22.5
Exports to Latin America and the Caribbean <sup>c</sup> (2)	18 727	20 798	24 931	29 669	36 552	45 180	53 156	59 731	56 644	48 483	62 552	58 607	53 424	59 454	79 575
Percentage of annual growth	8.2	11.0	19.9	19	23.2	23.6	17.7	12.4	-5.2	-14.4	29	-6.3	-8.8	11.3	33.8
Percentage of intraregional exports/Total (2:1)	13.9	16.4	18.9	21.1	19.4	19.8	20.9	21.1	20.2	16.6	17.4	17.0	15.4	15.8	17.3

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from respective regional groupings and from the International Monetary Fund (IMF), *Direction of Trade Statistics*.

<sup>a</sup> Figures do not include maquila industry.

<sup>b</sup> Includes Latin American Integration Association (LAIA), CACM, all countries of CARICOM, Panama, Cuba and the Dominican Republic.

<sup>c</sup> Combines intra-group trade (Andean Community, MERCOSUR, CACM, CARICOM and exports from Chile and Mexico to LAIA) as well as trade between groups, plus the flow of exports from Cuba, Panama and the Dominican Republic to the other countries of the region.

<sup>d</sup> Preliminary figures.

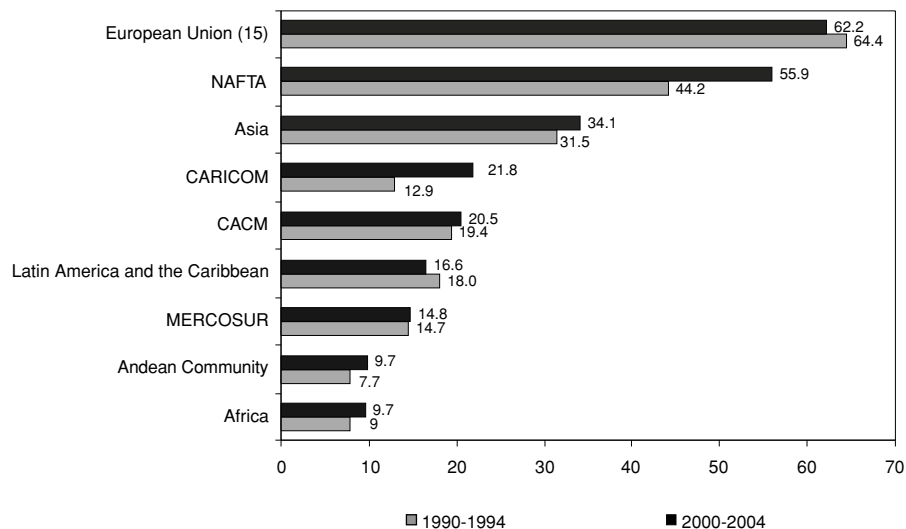
In the past, CACM was always the subregional area engaging in the most trade within its integration scheme. Recently CARICOM has assumed that position, although that is explained primarily by Trinidad and Tobago's trade. If that trade were excluded for purposes of calculation, the subregional trade volume would fall dramatically. Since 2000 intraregional trade has been recovering in CACM, but it is still below the levels reported in the early 1980s and 1990s. In the Andean Community, intra-group trade stayed below 5% of the total in the 1980s, grew steadily to nearly 15% of the total in 1998, and then fell to about 10%. In MERCOSUR, the debt crisis drove the intra-group trade figure down to 5% of the total, and then it gradually rose to 25% in 1998. It fell again to 10% in 2002, and after that year a modest recovery began, but that merely leaves the intra-group trade coefficient at about the same level it had attained 25 years ago (see figures III.2 and III.3). Moreover, both the high percentage of intra-bloc trade in the North American Free Trade Agreement (NAFTA) and the marked vigour seen in the last 10 years are noteworthy.

According to the figures for 2004, the greatest amount of intra-group trade is in CACM and the least

in the Andean Community. Trade with the United States is more significant than intra-group trade in every case, and the same is true with respect to the European Union in every case except CACM. Intra-group trade in MERCOSUR and CARICOM is less than their trade with the United States, the European Union and Asia, respectively (see table III.3).

One prominent feature of this trade is the greater propensity to export manufactured goods within the subregions (see table III.4). This is particularly important in view of the fact that regional integration offers an attractive possibility to expand markets, scales of production, and the growth of higher quality, higher value-added exports, especially of knowledge-intensive goods (Kuwayama and Durán, 2003). These markets can also provide an excellent opportunity to learn and gain experience in trade, as well as a launching pad to reach extraregional markets. Such export diversification, which makes it possible to export goods with a higher value added to the subregions, is especially important for the Andean Community and CARICOM. Given the low coefficients of intraregional trade, however, it is evident that this potential is far from being realized.

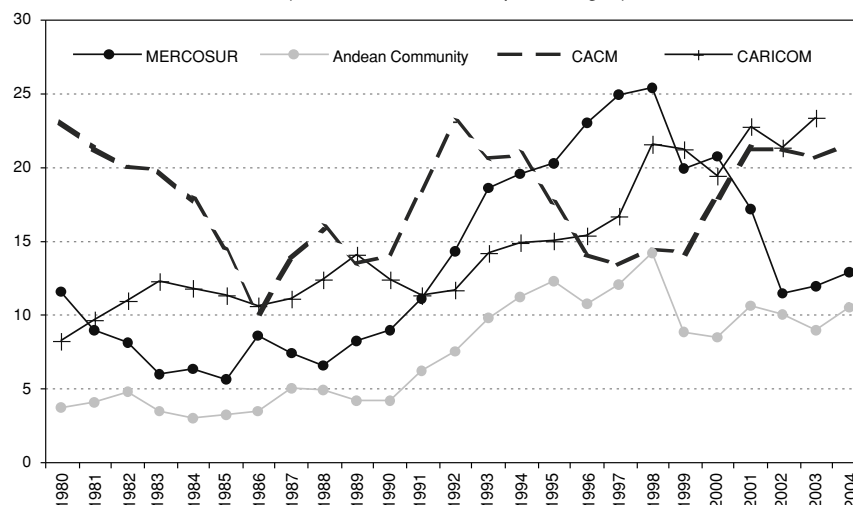
Figure III.2  
INTRAREGIONAL TRADE COEFFICIENTS IN VARIOUS DEVELOPING REGIONS AND IN LATIN AMERICA AND THE CARIBBEAN, 1990-1994 AND 2000-2004<sup>a</sup>  
(Exports of goods as a proportion of GDP, in percentages)



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from General Agreement on Tariffs and Trade (GATT), World Trade Organization (WTO) and official information from subregional groupings in the case of Latin America and the Caribbean. In the case of the Central American Common Market (CACM), the total trade data include maquila and free-zone trade.

<sup>a</sup> Annual average.

Figure III.3  
**LATIN AMERICA AND THE CARIBBEAN (INTEGRATION SCHEMES): INTRA-GROUP TRADE COEFFICIENTS, 1980-2004<sup>a</sup>**  
*(Millions of dollars and percentages)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data.

<sup>a</sup> Intra-group exports as a proportion of total exports.

Table III.3  
**DESTINATION OF EXPORTS OF PRINCIPAL SUBREGIONAL INTEGRATION SCHEMES IN LATIN AMERICA AND THE CARIBBEAN, 2004**  
*(Percentages of total exports)*

	Intra-group	Other LAC countries <sup>a</sup>	United States	European Union	Asia (including Japan)	Other countries
MERCOSUR	12.9	15.4	18.3	23.0	15.7	14.8
Andean Community	10.4	16.8	46.6	11.0	9.6	5.6
Central American Common Market <sup>b</sup>	17.7	8.5	57.8	10.0	2.0	4.0
Caribbean Community <sup>c</sup>	17.1	3.9	51.7	14.5	3.1	9.7
Four Customs Unions <sup>d</sup>	12.7	14.8	32.1	17.7	12.1	10.7

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the countries.

<sup>a</sup> Latin America and the Caribbean.

<sup>b</sup> Totals used to calculate coefficient include maquila and free-zone exports.

<sup>c</sup> Includes information from five countries: Barbados, Guyana, Jamaica, Suriname, and Trinidad and Tobago.

<sup>d</sup> Excluding Chile and Mexico.

Table III.4  
**STRUCTURE OF EXPORTS FROM MAIN SUBREGIONAL INTEGRATION SCHEMES IN LATIN AMERICA AND THE CARIBBEAN, 2004<sup>a</sup>**  
*(Percentages of total exports)*

	Intra-group export coefficient within total exports		Exports (2004/2003) (growth rates: percentages)		Propensity to export manufactured goods <sup>b</sup> (percentages)	
	1998	2004	Intra-subregion	Extra-subregion	Intra-subregion	Extra-subregion
MERCOSUR	25.3	12.9	36.2	25.8	83.8	67.7
Andean Community	14.2	10.4	58.5	35.5	85.7	35.1
Central America Common Market <sup>c</sup>	17.5	28.4	11.8	7.2	84.2	78.3
Caribbean Community	21.5	...	16	1.2	78.4	55.6
<b>Four Customs Unions</b>	<b>21.3</b>	<b>12.9</b>	<b>36.4</b>	<b>31.2</b>	<b>84.1</b>	<b>57.2</b>

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Refers to the coefficient of manufactured goods exports within total exports to different areas.

<sup>c</sup> Does not include exports from the maquila and free zone sector.

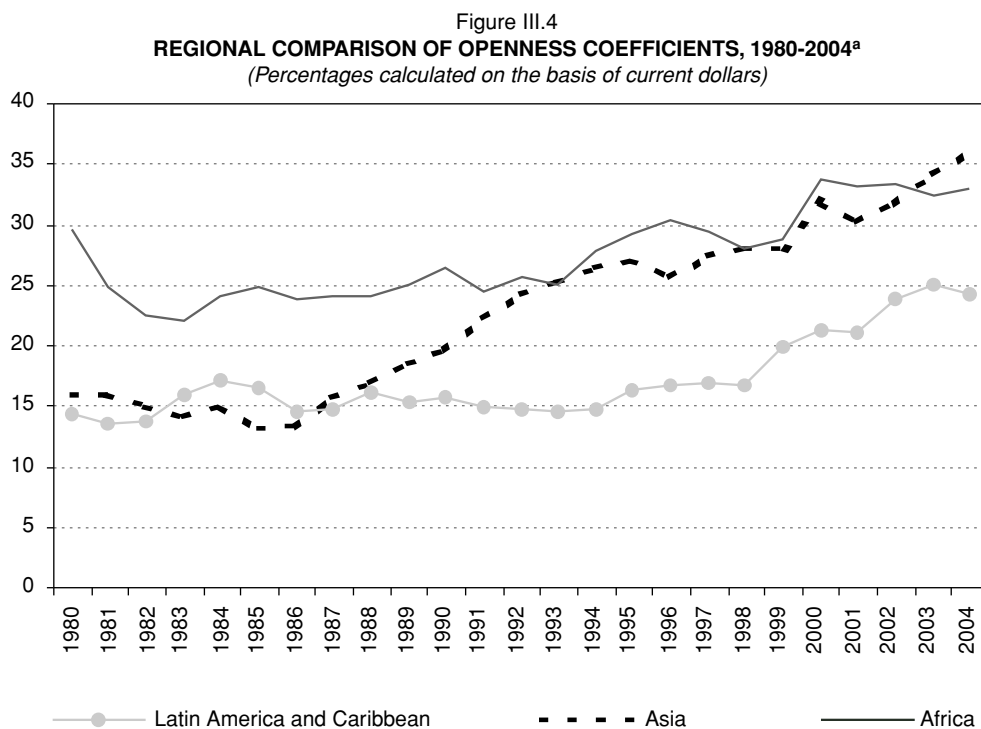
**(b) Economies also less open**

With the exception of a brief period in the mid-1980s, LAC has been and continues to be the least open of the developing regions of the world. For a decade and a half (1980-1995), the openness of the region's economies remained practically stagnant at 15% of GDP. Only in the current decade has the region opened up trade to 20%, and more recently, 25% of GDP. Asia took off in the late 1990s with respect to LAC, from a similar level of openness to the current 35% of GDP, and trade continues to become increasingly open in that region. Africa had been the most open of all the developing regions, but since the middle of this decade Asia has surpassed them all (see figures III.4 and III.5).

Within the region, MERCOSUR is the integration scheme with the lowest openness coefficient, although that indicator has been rising since the late 1990s. The Andean Community is the subregional scheme with the most openness, reporting a level similar to that of CACM. The current openness coefficients of the Andean Community, CARICOM and CACM are less than they were in the early 1980s.

**(c) Intensity of intraregional trade lower in South America**

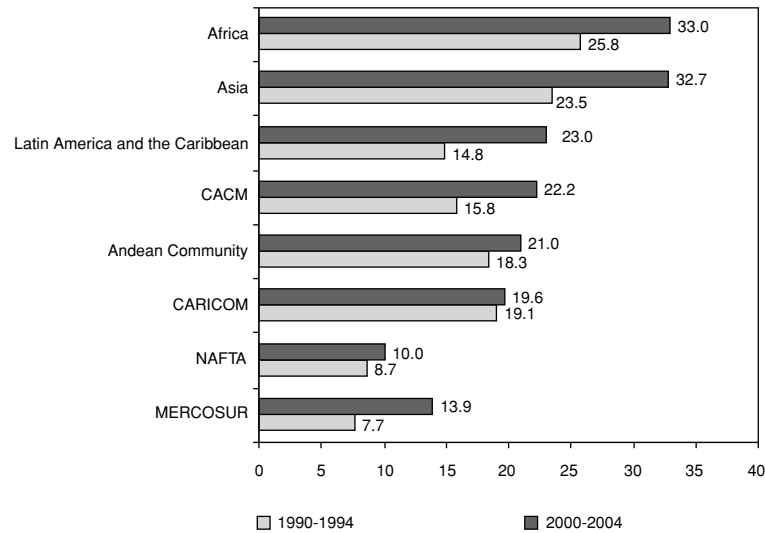
An examination of intraregional trade matrices reveals that CACM has consistently more intensive intra-bloc trade than any other subregional integration scheme, and that El Salvador is more committed than any other country to this trade, with 55% of its exports oriented towards the subregion. Bolivia and Paraguay play the same role in the Andean Community and MERCOSUR, respectively. At first, it seems reasonable to expect relatively smaller economies to be the most oriented towards intra-bloc trade within each integration scheme. That is not so clear, however, since the next five countries with the most trade of this sort after El Salvador are Barbados, Guatemala, Nicaragua, Paraguay and Uruguay, which are not necessarily the smallest economies in the region. If we extend the list to the 10 top economies with these characteristics, we see Argentina and Colombia, which orient nearly 20% of their exports to the subregional scheme, very close to Bolivia's 23%. Nor is the opposite true, as the economies with the least propensity to trade with the subregional market include



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the World Bank, *World Development Indicators* [online].

<sup>a</sup> Exports of goods and services as a share of GDP in each region.

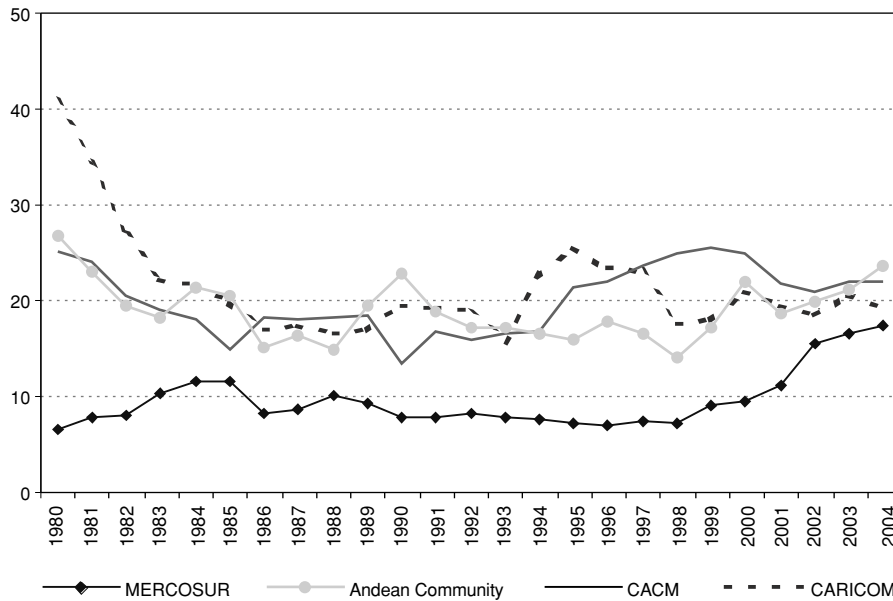
Figure III.5  
**OPENNESS COEFFICIENTS IN DIFFERENT DEVELOPING REGIONS AND LATIN AMERICA AND THE CARIBBEAN: 1990-1994 AND 2000-2004<sup>a</sup>**  
*(Exports as a share of GDP in percentages)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the World Bank, *World Development Indicators* [online] and official information from subregional groupings in the case of Latin America and the Caribbean.

<sup>a</sup> Annual average.

Figure III.6  
**LATIN AMERICA AND THE CARIBBEAN: OPENNESS COEFFICIENTS OF THE PRINCIPAL SUBREGIONAL INTEGRATION SCHEMES, 1980-2004<sup>a</sup>**  
*(Percentages calculated on the basis of current dollars)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data.

<sup>a</sup> Exports of goods and services as a share of GDP in each subregion.

Brazil's, along with those of Jamaica, Peru and the Bolivarian Republic of Venezuela. In other words, the size of the economy should be just one of the variables examined when looking at intra-bloc trade relations.

In any case, these coefficients should be viewed with caution. Indeed, the larger scale of big economies such as Brazil in MERCOSUR, the Bolivarian Republic of Venezuela in the Andean Community, and Trinidad and Tobago in CARICOM, as well as the greater specialization in natural resources of the members of the subregional schemes, make the intraregional trade coefficient lower. In contrast, in other regions such as the European Union, intraregional trade coefficients are higher because of greater homogeneity, economic size, and a greater incidence of intra-industrial trade in patterns of production.

The size effect is most evident in the case of Brazil. The weight of trade within the subregion is slight, as less

than 10% of exports are oriented towards MERCOSUR, but these exports still account for half of the group's exports. At the other extreme are Paraguay and Uruguay, where between one-fourth and one-third of exports are sent to MERCOSUR, and together they represent less than 10% of that bloc's exports (see table III.5).

In the Andean Community, the intra-group trade coefficient within total exports is 10%, after two years of consecutive reductions. The largest increase in this indicator was seen in Colombia, which in turn appears to be the country with the greatest export penetration in the subregion. Indeed, 41% of exports within the Andean Community correspond to Colombia, while that country sends only one-fifth of its total exports to that market. Peru and the Bolivarian Republic of Venezuela are not very dependent on the the Andean Community market, whereas Bolivia sends nearly one-fourth of its exports there (see table III.6).

Table III.5  
**SOUTHERN COMMON MARKET (MERCOSUR): INTRA-SUBREGIONAL  
TRADE MARKET SHARE MATRIX, 2004**  
(Millions of dollars and percentages of total)

2004	Millions of dollars					Percentages					"Intra" coefficient <sup>a</sup>
	Argentina	Brazil	Paraguay	Uruguay	MERCOSUR	Argentina	Brazil	Paraguay	Uruguay	MERCOSUR	
Argentina		5 552	515	703	6 770		32.1	3.0	4.1	39.1	19.9
Brazil	7 373		872	667	8 912	42.6		5.0	3.9	51.5	9.4
Paraguay	106	307		449	863	0.6	1.8		2.6	5.0	32.9
Uruguay	226	487	59		771	1.3	2.8	0.3		4.5	26.5
MERCOSUR	7 705	6 346	1 445	1 819	17 316	44.5	36.6	8.3	10.5	100.0	12.9

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from Secretariat of Foreign Trade, Brazil, National Institute of Statistics and Censuses, Argentina, Central Bank of Paraguay and Central Bank of Uruguay.

<sup>a</sup> The intraregional trade coefficient is defined as the share of all intra-group exports in the group's total exports.

Table III.6  
**ANDEAN COMMUNITY: INTRA-SUBREGIONAL TRADE MARKET SHARE MATRIX, 2004**  
(Millions of dollars and percentages)

2004	Millions of dollars						Percentages						"Intra" coefficient <sup>b</sup>
	Bolivia	Colombia	Ecuador	Peru	Venezuela (Bolivarian Rep. of)	Andean Community	Bolivia	Colombia	Ecuador	Peru	Venezuela (Bolivarian Rep. of)	Andean Community	
Bolivia		118	4	137	219	478		1.5	0.1	1.8	2.8	6.2	23.5
Colombia	57		992	531	1 583	3 163	0.7		12.8	6.8	20.4	40.7	19.3
Ecuador	5	188		578	83	854	0.1	2.4		7.4	1.1	11.0	11.1
Peru	134	266	204		198	802	1.7	3.4	2.6		2.6	10.3	6.5
Venezuela (Bolivarian Rep. of)	4	1 064	514	887		2 469	0.1	13.7	6.6	11.4		31.8	6.3
Andean Community	200	1 636	1 715	2 132	2 083	7 766	2.6	21.1	22.1	27.5	26.8	100.0	10.4

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data of Andean Community.

<sup>a</sup> The intraregional trade coefficient is defined as the share of all intra-group exports in the group's total exports.

The Central American Common Market is important for most of its members. With the exception of Costa Rica, it receives between 20% and 56% of its member countries' exports. This stands in contrast to the Andean Community, for example, where three out of five members send less than 12% of their exports to the subregional market (see table III.7).

In CARICOM, Trinidad and Tobago continues to dominate exports in the subregion (see table III.8), further spurred by the rise in petroleum prices. Setting aside Trinidad and Tobago, it is apparent that intraregional trade has lost importance over the last two decades. Nor are there signs of an upsurge in intraregional trade in services, despite the evident expansion of financial and insurance services in Trinidad.

A number of different factors hinder the expansion of intraregional trade, particularly in the areas of energy and transport. For example, in March 2005 the industrial cost of a kWh was US\$ 0.0001 in Trinidad and Tobago, while on the smaller islands, especially Saint Vincent, the cost was US\$ 0.0036, and accounted for as much as 8% of total sales in the sector. Maritime transport is another major cost. The Trade and Investment Development Corporation (TIDCO) of Trinidad and Tobago estimates that the cost of transporting a 20- to 40-foot container between Trinidad and Barbados is higher than the cost to transport it between Trinidad and London. In short, the weakness of the trade infrastructure makes it difficult to achieve more progress in intra- and extraregional trade,

Table III.7  
**CENTRAL AMERICAN COMMON MARKET (CACM): INTRA-SUBREGIONAL TRADE MARKET SHARE MATRIX, 2004<sup>a</sup>**  
(Millions of dollars and percentages)

2004	Millions of dollars						Percentages						"Intra" coefficient <sup>b</sup>
	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	CACM	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	CACM	
Costa Rica		257	187	168	252	863		7.5	5.4	4.9	7.3	25.1	14.2
El Salvador	100		387	206	129	822	2.9		6.0	3.7	23.9	55.7	
Guatemala	172	543		343	169	1 227	5.0	15.8		10.0	4.9	35.7	41.8
Honduras	30	138	72		39	279	0.9	4.0	2.1		1.1	8.1	22.2
Nicaragua	50	110	31	57		248	1.5	3.2	0.9	1.7		7.2	34.1
<b>CACM</b>	<b>353</b>	<b>1 047</b>	<b>676</b>	<b>773</b>	<b>590</b>	<b>3 440</b>	<b>10.3</b>	<b>30.4</b>	<b>19.7</b>	<b>22.5</b>	<b>17.2</b>	<b>100.0</b>	<b>27.6</b>

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from each country and the Permanent Secretariat of the General Treaty on Central American Economic Integration (SIECA).

<sup>a</sup> Not including exports from the maquila industry and free zones.

<sup>b</sup> The intraregional trade coefficient is defined as the share of all intra-group exports in the group's total exports.

Table III.8  
**CARIBBEAN COMMUNITY (CARICOM): INTRA-SUBREGIONAL TRADE MARKET SHARE MATRIX, 2004**  
(Millions of dollars and percentages)

2004 (January-September) <sup>b</sup>	Millions of dollars						Percentages						"Intra" coefficient <sup>a</sup>
	Barbados	Guyana	Jamaica	Suriname	Trinidad and Tobago	CARICOM (5)	Barbados	Guyana	Jamaica	Suriname	Trinidad and Tobago	CARICOM (5)	
Barbados		6	14	3	28	51		0.8	1.8	0.4	3.6	6.6	48.6
Guyana	10		21	4	10	45	1.3		2.8	0.5	1.3	5.9	17.1
Jamaica	12	3		2	12	29	1.6	0.4		0.3	1.6	3.8	4.8
Suriname	10	8	7		30	55	1.3	1.1	0.9		3.9	7.2	17.1
Trinidad and Tobago													
Tobago	197	84	241	64		585	25.8	10.9	31.4	8.4		76.5	18.8
<b>CARICOM (5)</b>	<b>230</b>	<b>101</b>	<b>283</b>	<b>73</b>	<b>79</b>	<b>765</b>	<b>30.0</b>	<b>13.1</b>	<b>36.9</b>	<b>9.5</b>	<b>10.4</b>	<b>100.0</b>	<b>17.1</b>

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the International Monetary Fund (IMF), *Direction of Trade Statistics* and Bank of Jamaica.

<sup>a</sup> The intraregional trade coefficient is defined as the share of all intra-group exports in the group's total exports.

<sup>b</sup> Preliminary figures.

reinforcing the argument advanced by the economies of the Caribbean that they need special treatment that takes into account these unique characteristics.

Among the countries of the North American Free Trade Agreement (NAFTA), imports to the subregion are especially significant for Canada and Mexico, whose exports are highly concentrated on the United States.

The latter country, in turn, also sends a major share of its exports to Canada and Mexico, which are its main trading partners (see table III.9). The obvious increase in the weight of trade has translated into a mutual interest among the three countries in exploring the possibility of moving towards a single market (see section C in this chapter).

Table III.9  
**NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA): INTRA-SUBREGIONAL  
TRADE MARKET SHARE MATRIX, 2004**  
(Millions of dollars and percentages)

2004	Millions of dollars				Percentages				"Intra" coefficient <sup>a</sup>
	Canada	United States	Mexico	NAFTA	Canada	United States	Mexico	NAFTA	
Canada		269 028	2 261	271 289		37.2	0.3	37.5	85.9
United States	187 713		110 775	298 488	25.9		15.3	41.2	36.6
Mexico	10 359	143 474		153 833	1.4	19.8		21.3	86.7
NAFTA	198 072	412 502	113 036	723 610	274	57	15.6	100.0	55.2

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the International Monetary Fund (IMF), *Direction of Trade Statistics*.

<sup>a</sup> The intraregional trade coefficient is defined as the share of all intra-group exports in the group's total exports.

## B. Regional integration: principal debates and challenges

Previously it was shown that the density of intraregional trade is low in all subregional integration schemes, and that this may be caused by multiple factors, such as infrastructure deficiencies, size of partners' economies with relation to that of the bloc, and heavily commodity-oriented exports (commodities are exported primarily to industrialized economies), as well as other reasons. Among the most decisive factors are probably the weakness of the institutional framework within which integration efforts are taking place, including dispute resolution mechanisms, and the absence of mechanisms for macroeconomic coordination that would help prevent major macroeconomic shocks. When significant crises have occurred, their impact on intra-group flows of trade has not only been devastating, but has also sparked a hysteresis that has been difficult to recover from, as evidenced by the regional trade figures in the wake of the foreign debt crisis and of the Asian crisis, with its subregional correlate, the macroeconomic crises in Brazil and then Argentina.

In this regard, the lack of macroeconomic coordination adds a new element of vulnerability to intraregional trade, making it markedly pro-cyclical. This means not only that trade shrinks when economic activity flags, but also that production becomes more sensitive. The reason for the latter is that these macroeconomic crises, when accompanied by devaluations, can cause drastic changes in competitiveness vis-à-vis partners within the community, and such changes are more significant than the size of the tariffs that have been negotiated or the gains in competitiveness derived from any reasonable increase in productivity. Therefore, these crises activate potential conflicts between partners just when the domestic market is depressed. Sometimes the onslaught of imports from neighbouring countries in the community unleashes protectionist reactions that lead to the adoption of measures for which the community's institutions have no provision (such as safeguards, administrative quotas and a variety of non-tariff barriers related to sanitary, phytosanitary or technical standards) or simply to the



unilateral suspension of the tariff preferences that had been agreed upon. If these cycles are also recurrent, it is foreseeable that integration efforts will lose credibility in the eyes of economic actors, and therefore it will be increasingly difficult to expect major investment initiatives involving integration schemes.

The principal issue to address in subregional integration schemes is legal security for the decisions of exporters, importers and investors. This means that steady progress must be made on incorporating community decisions into domestic legislation and on the enforcement of these determinations. Moreover, from now on only realistic community decisions should be approved, that is, ones that can actually be incorporated into domestic legislation. In addition, dispute resolution mechanisms

must be increasingly binding, which demands a serious political commitment on the part of member countries —Governments and legislatures alike— in order to abide by the rulings of the bodies that mediate trade disputes between community partners.

Thus, macroeconomic coordination and the institutional framework of integration are highly complementary, since advances in each of these areas have a favourable impact on the other, prompting virtuous circles of behaviour among agents that enhance their practical commitment to integration. In contrast, weak institutions and a lack of macroeconomic coordination guarantee that integration will continue to move at a snail's pace, failing to meet the competitiveness and innovation challenges posed by today's world.

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## 1. Strengthening institutions

The region urgently needs to address the shortcomings of its integration institutions. The first priority is to enforce agreements that were signed years ago. This means that customs unions must function as such; that agreed-upon preferences must be honoured; that progress must be made towards drafting common regulations; and fundamentally, that dispute resolution mechanisms must be strengthened. There is no doubt that greater legal security must be provided for all decisions made by economic agents involved in the subregional integration schemes.

Customs unions are not yet fully operating —especially in the cases of MERCOSUR, the Andean Community and CARICOM, and to a lesser extent in CACM— so in practice these are really “imperfect” customs unions. There are still “perforations” in the common external tariff (CET), both within schemes (in

the form of lists of exceptions, special trade regimes including partial or total tariff exemptions, specific duties, and trade defence practices) and outside schemes (through special regimes such as capital goods, or through preferential trade agreements with third countries). All of this makes it very difficult for economic actors to know the real level of protection that is in place. Furthermore, the application of sometimes excessive trade defence practices (safeguards, antidumping and compensatory duties) for exports within the communities poses serious obstacles to free circulation within blocs. Considering the centrality of the issue, this chapter includes a special study on some of them and on the way these trade differences are dealt with in each integration scheme (see section E: Dispute resolution and incorporation of common regulations).

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## 2. Harmonizing disciplines

Once compliance with the agreed-upon regulations has been achieved, the natural next step is to expand the universe of partners committed to compliance. In that regard, one underestimated factor in regional competitiveness is the gradual harmonization of the various rules and disciplines contemplated in the various subregional integration schemes.

It is well known that the multiplicity of rules of origin and their extreme complexity can hinder

the business sector by adding administrative and transaction costs that distort economic decisions. In this connection, an innovative feature in the Free Trade Treaty between the Dominican Republic, Central America and the United States (DR-CAFTA) is the possibility of “accumulating rules of origin” in some textile categories; in other words, inputs that qualify under the rules of origin can come from each of the five signatory States in Central America, from the

Dominican Republic, or from Canada, Mexico or the United States. In our opinion, this is a good idea that should be expanded to as many goods as possible and to the greatest possible number of agreements. Similarly, if MERCOSUR and the Andean Community are already joined by a trade agreement, and each Member State has an agreement with Chile, then a great effort should be made to regionalize the rules of origin, making them multilateral for all of the countries involved; and this would give a considerable boost to intraregional trade and investment decisions. Moreover, the countries in the region that have trade agreements with the United States and that also have agreements among themselves could also move towards making their rules of origin multilateral. Such a move clearly creates more trade and pushes towards the building blocks of liberalization, reinforcing the compatibility of free trade agreements with multilateral regulations.

The regionalization of rules of origin and the mutual recognition of technical, sanitary and phytosanitary regulations would send a strong signal of substantial progress towards the formation of a unified market, not only stimulating domestic investment but also enhancing the attractiveness of the region for foreign investment. It would also create special opportunities for local producers, encourage businesses in the subregions to form associations and, above all, contribute to the development of border areas. These processes would facilitate the learning that businesses must undergo, forging strategic alliances to maintain and reinforce competitiveness.

For example, Central American companies should not be content with just certifying full compliance with the norms and standards required by the market in the United States. They should go further, forming production, trade and technology alliances that will allow them to improve their competitive presence even more on that market, and in Mexico and Canada as well. In that process, it is reasonable to expect that the competitive advantages thus developed will allow them to explore other markets too. Along with this gradual competitive maturation, CACM itself should in turn continue to adjust, modernize and make its new regulations multilateral.

If the principal economic actors believe that one of the main weaknesses of integration schemes is legal uncertainty surrounding the decisions made by exporters, importers and investors, it is likely that, in this regard, the most profitable investment is an investment in credibility. Hence the attraction of efforts to unify dispute resolution systems in all of the subregional schemes as a whole—the Andean Community, MERCOSUR, CACM and CARICOM—and all of the economic complementarity agreements and bilateral trade accords between all the countries that make up any of these schemes plus Chile and Mexico, which belong to none. Moving towards a single dispute resolution system, making it more binding and learning from the best practices of each subregional entity, would send another powerful signal that would jump start the engines of growth as well as strengthening investment and trade.

If the South American Community of Nations were to give priority to these issues—harmonization of rules of origin and of sanitary, phytosanitary and technical regulations, along with the unification of dispute resolution systems—they would fill a critical need and make a substantial contribution to the creation of growth opportunities. If progress were made in developing a regional dispute resolution system, it would be appropriate to reproduce as effectively as possible the regulations and procedures of the World Trade Organization (WTO) in a kind of regional decentralization of that multilateral body. Not only would this eliminate the current duality of dispute resolution (with one serious and binding system, that of the WTO, and another less strict one, the regional body), but it would also allow intraregional trade disputes, which are more numerous, to be resolved within the region itself, saving huge amounts of money and facilitating the formation of a critical mass of professionals with the ability to litigate these cases. This, in turn, would save all the foreign exchange outlays that are now being made to pursue subsequent disputes in the WTO or to defend trade in the United States and the European Union. In that regard, it would certainly make sense to establish close ties with the Latin American Integration Association (LAIA), which some of the highest authorities in the region have already suggested should take the lead in this coordination effort.

### 3. Macroeconomic coordination

It is not difficult to find a few recent examples to illustrate the adverse consequences that a lack of macroeconomic coordination can have for the prospects of integration processes. Brazil's abandonment of its

policy of exchange-rate bands in 1999, the collapse of Argentina's convertibility plan in 2001-2002 and the imposition of exchange controls in the Bolivarian Republic of Venezuela in 2003 are all episodes that

characterized periods of great turbulence in intra-subregional exchanges. Macroeconomic imbalances of this magnitude can fracture subregional commitments, even against the political will of Governments, since they unleash processes that accentuate latent asymmetries in integration or that cause abrupt movements in the flows of trade, aggravating the vulnerability to competition of sectors that may be very sensitive politically.

One of the principal challenges, then, is coordination —and later convergence— in defining and carrying out currency, monetary and fiscal policies. A major convergence of these policies would result in increased flows of trade at the subregional level, reducing volatility and bilateral imbalances and thereby boosting demand and spurring an interest in improving the coordination and consolidation of associated institutions.<sup>2</sup>

The essence of the discussion lies in whether macroeconomic coordination is necessary as a complement to trade integration. The answer is not entirely obvious during the current phases of subregional integration, although in the medium and long terms it is unequivocally in the affirmative. Among the various positions that have been taken are, at one extreme, those promoting close coordination, including convergence in a monetary union with the dollar as the common currency (Lafer, 2000), or convergence on the basis of flotation; and at the other extreme, those claiming that coordination is not necessary because the critical mass of trade does not exist, nor is there any monetary authority or central bank with the reputation necessary to provide leadership in the process.<sup>3</sup> In the middle are those who recognize the difficulties pointed out and propose a “minimum” degree of cooperation in the coordination of macroeconomic policy (Machinea, 2004; Machinea and Rozenwurcel, 2005). The idea is to coordinate both fiscal and monetary policies by strengthening national fiscal, monetary and regulatory institutions. In addition, quantifiable goals are proposed with respect to fiscal balances, inflation, current account deficit, public debt and other indicators, as well as mechanisms to offset the effects of abrupt changes in trade flows due to external disturbances. All of this would be accompanied by a system of incentives (Machinea, 2004; Agosín, 2005) to encourage compliance with the agreed-upon coordination with a view to stimulating demand through coordination.

The closest and most successful experience of this sort can be seen in the European process,

which encompassed nearly 50 years of uninterrupted consolidation. In a recent study, Venables and Winters (2003) suggest that the European Union’s success is based on three pillars:

- a far-reaching microeconomic integration that was built step by step, with reciprocal concessions and weighting of assumed costs;
- a solid set of institutions —the European Commission, the European Court of Justice, the European Central Bank and others— founded on the principle that they are the guardians of the accords; and
- the principle of generalized reciprocity, which made possible the application of redistributive policies (Cohesion Funds) benefiting new members. This third pillar represents an irreplaceable core of pragmatism and political will for advancing the process. That was the basis for the Maastricht criteria in 1992, when the convergence targets for the European Monetary Union were consolidated, covering 12 of the Member States by January 2002. The absence of these three factors in particular, especially the tremendous variability of exchange rates and the great volatility of financial flows, has made true convergence impossible in our integration schemes (with respect to MERCOSUR, see Fanelli, 2004).

The lack of macroeconomic coordination in the region should be understood as the result of the absence of incentives for complementarity and interdependence among the members of a subregional entity and for macroeconomic coordination itself. The two should be viewed as complementary elements, not sequential tasks. Indeed, the European experience is a good illustration of the fact that integration is an iterative process in which the expansion of trade, on the one hand, and the signing of agreements limiting exchange-rate variability, on the other hand, made cooperative solutions possible (IDB, 2002, Machinea, 2003).

Because coordination is of such vital importance for the development of regional integration, it can be argued that “exogenous” incentives, such as the fixed exchange rate system the Europeans inherited from Bretton Woods, are one possibility. Lacking a similar incentive in our region, it is reasonable to postulate that multilateral organizations such as the World Bank and the Inter-American Development Bank (IDB), or subregional

<sup>2</sup> This is not a minor issue, as negative trade balances promote protectionist behaviours in the search for alternative trade defence mechanisms, a less likely scenario in balanced trade environments.

<sup>3</sup> Studies advocating convergence on the basis of flotation include those of Giambiagi, 1999; Lafer, 2000; Eichengreen and Hausmann, 1999; and Lorenzo, Aboal and Badagian, 2004, among others.

entities such as the Andean Development Corporation (ADC) and the Central American Bank for Economic Integration (CABEI) could create positive incentives, collaborating on “coordination” by means of financing packages that boost the potential of subregional accords to expand their influence in various areas such as the application of common standards, similar phytosanitary regulations, a common competition law and others (Machinea, 2003). As a counterpart, countries would voluntarily agree to meet certain macroeconomic and fiscal targets.

At present, the countries of MERCOSUR have achieved convergence with respect to the growth cycle, currency flotation schemes, fiscal results, the application of anti-inflation policies, and a significant reduction of

debt as a percentage of GDP, especially in Brazil and Uruguay (see table III.10). In the Central American Common Market and the Andean Community, the extreme cases of Nicaragua and the Bolivarian Republic of Venezuela have raised the averages.<sup>4</sup> Nevertheless, the most recent figures reflect a noteworthy period in the region’s macroeconomic accounts, with significant progress in controlling inflation and budget deficits. The favourable external cycle in 2004-2005 explains much of this success, but officials have failed to take advantage of the positive circumstances to move forward on macroeconomic coordination schemes that would cushion the impact of future external shocks or prevent the subregions themselves from generating macroeconomic turbulence.

Table III.10  
SUBREGIONAL INTEGRATION SCHEMES: COMPARISON OF SELECTED MACROECONOMIC CONVERGENCE INDICATORS, 2002 AND 2004

Country	Indicator	Inflation		Current-account deficit (% of GDP)		Public deficit (% of GDP)		Public debt (% of GDP)	
		2002	2004	2002	2004	2002	2004	2002	2004
<b>Targets</b>		<b>5% in 2006</b>		...		<b>-3% of GDP</b>		<b>40% in 2010</b>	
<b>Southern Common Market (MERCOSUR)<sup>a</sup></b>		<b>17.8</b>	<b>6.0</b>	<b>0.3</b>	<b>1.9</b>	<b>1.9</b>	<b>-0.7</b>	<b>64.6</b>	<b>56.4</b>
Argentina		41.0	6.1	8.5	2.0	-0.3	1.3	131.5	105.0
Brazil		12.5	7.6	-1.7	1.9	2.6	-1.2	49.4	42.7
Paraguay		14.6	2.8	1.8	0.4	-0.4	0.7	51.2	34.8
Uruguay		25.9	7.6	3.1	-0.8	-4.9	-3.1	85.9	86.5
<b>Targets</b>		<b>10% each country</b>		...		<b>-4% of GDP</b>		<b>50% of GDP</b>	
<b>Andean Community<sup>a</sup></b>		<b>10.9</b>	<b>7.5</b>	<b>1.3</b>	<b>4.1</b>	<b>-3.6</b>	<b>-3.4</b>	<b>45.7</b>	<b>45.3</b>
Bolivia		2.4	4.6	-4.4	2.9	-9.0	-6.1	55.1	58.0
Colombia		7.0	5.5	-1.6	-1.0	-5.0	-5.6	46.3	47.4
Ecuador		9.3	1.9	-5.8	-0.5	-0.8	-1.7	66.8	59.1
Peru		1.5	3.5	-1.9	0.0	-2.1	-1.3	49.3	47.4
Venezuela (Bolivarian Rep. of)		31.2	19.2	8.2	12.6	-3.5	-3.3	36.8	37.4
<b>Target</b>		<b>4% each country</b>		<b>-3.5% of GDP</b>		<b>-2.5% of GDP</b>		<b>50% of GDP</b>	
<b>Central American Common Market (CACM)<sup>a</sup></b>		<b>6.5</b>	<b>8.9</b>	<b>-5.6</b>	<b>-5.3</b>	<b>-2.9</b>	<b>-2.4</b>	<b>51.1</b>	<b>52.6</b>
Costa Rica		9.7	13.1	-5.4	-4.8	-4.3	-3.0	56.0	96.0
El Salvador		2.8	5.3	-2.8	-3.9	-3.1	-1.6	46.0	47.0
Guatemala		6.3	9.2	-5.3	-4.4	-1.0	-2.0	28.0	27.0
Honduras		8.1	9.2	-3.3	-3.7	-5.2	-3.4	67.8	69.0
Nicaragua		4.0	8.9	-19.1	-17.5	-4.1	-3.7	155.0	120.0
<b>3 groups<sup>a</sup></b>		<b>14.7</b>	<b>7.8</b>	<b>0.2</b>	<b>2.0</b>	<b>0.0</b>	<b>-1.6</b>	<b>58.1</b>	<b>53.5</b>

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and Central American Monetary Council.  
<sup>a</sup> Averages weighted by each country’s GDP.

<sup>4</sup> The General Secretariat of the Andean Community in March 2004 prepared a Follow-Up Report that reviews the situation in each Member State. The preliminary results for 2003 and 2004 indicate that the Bolivarian Republic of Venezuela, with an inflation rate of 19.2%, still cannot meet the target of 10%, while Bolivia still has a public deficit higher than the target of 4% of GDP. Its debt level of nearly 80% also exceeds the established threshold (50%).

## 4. Improving infrastructure

The challenge of infrastructure is a constant in any integration effort and in building competitiveness. At present, three initiatives are under way in this area: the Puebla-Panama Plan (PPP) in Central America, the Initiative for the Integration of Regional Infrastructure in South America (IIRSA) in South America, and the “Uniting the Caribbean by Air and Sea” Programme in the countries of the Caribbean (see ECLAC, 2003, 2004 and 2004b).<sup>5,6</sup>

The results, it seems, will take some time to materialize. In the case of IIRSA, 32 priority projects have already been selected, but financing (amounting to US\$ 4.2 billion) is still pending. In the case of PPP,

somewhat more progress has been made, as financing for more than 60% of the required investment of US\$ 4.321 billion has already been assured. In the Caribbean, the work has concentrated on cooperation in training and data gathering programmes with a view to achieving transparency of competition in port operations of shipping companies and transportation in general.

With regard to infrastructure, one innovative development of note — because of the intensity of political support as of the middle of 2005 — is energy integration in the Southern Cone, which will be examined below and will be referred to as an “energy ring”.

## C. Energy integration in South America

Since the twenty-eighth MERCOSUR Summit in Asunción in June 2005, energy integration has emerged as a vitally important link in the transformation of production and the promotion of competitiveness in the subregion. It is also perceived, and with reason, as the principal challenge in regional integration, an opportunity to lay the foundations for a comprehensive integration — following the example of coal and steel in Europe — that will base complementarity on production. This model can also be seen in the Asian integration processes. In the last few years, Argentina, Brazil and Chile have faced energy crises of different magnitudes. The prospect of high growth rates in the next 10 years points to a very strong demand for energy, which will require policies to stimulate investment in this sector.

South American energy integration can provide effective collaboration in that regard. There is a complex dynamic that must incorporate various dimensions: resources (both energy and financial), physical connection and transmission grids, and rules of play expressed in supranational agreements, with harmonized regulatory frameworks, flexible contracts and effective, binding

dispute resolution mechanisms. National policies, in turn, should reinforce the regional vision and the coordination of policies. These are the over-arching themes, but so far the main problems have stemmed not so much from the shortage of resources or the lack of grids as from the difficulty of devising rules and policies that are consistent with stimulating investment and energy interdependence in the region.

The existence of major natural gas reserves, the increasing use of this fuel in the generation of electricity and the rise in worldwide demand for gas have made the development and integration of this market an unavoidable issue both for producers (primarily the Bolivarian Republic of Venezuela, Bolivia, Argentina and Peru) and for consumers (the most important ones being Brazil and Chile). Here is an analysis of recent developments in three energy integration processes in which the four South American countries with the largest reserves are involved:

- Argentina/Chile. Argentina has the third largest proven natural gas reserves in the region, with nearly 21.5

<sup>5</sup> The Puebla-Panama Plan is structured on the basis of eight “Mesoamerican initiatives” (highway integration, energy integration, integration of telecommunications services, trade facilitation and increased competitiveness, human development, sustainable development, prevention and mitigation of natural disasters and tourism), which are intended to promote infrastructure development in Central America.

<sup>6</sup> IIRSA is a multinational initiative involving 12 South American nations that propose to support the development of infrastructure in the region in sectors related to transport, energy and telecommunications (see <http://www.iirsa.org>).

trillion cubic feet (Tcf); and it has the most developed gas industry, with this fuel accounting for 45% of primary energy consumption. Its exports go to neighbouring countries, primarily Chile. In 2004, after abandoning convertibility and experiencing a sharp devaluation, the Government imposed ceilings on energy rates, stimulating a drastic increase in domestic demand which exceeded supply. To balance the market, exports were cut by 50% and gas was imported from Bolivia. The crisis highlighted the domestic transmission grid's inability to cope with significant increases in demand and the consequent need to promote new investments, both in the transmission system and in production. For Chile, the reduction in supply caused difficulties, especially in the northern region. The country's energy strategy, which was heavily dependent on natural gas, therefore had to be redefined. In this case, a domestic policy decision and the resultant failure to adhere to a supranational agreement shone the spotlight on the vulnerability of the integration process, as it became an adjustment variable for solving the problems of one of the Member States. In the absence of major investments in the coming years, Argentina could face severe electricity shortages by the end of the decade, and the supply of gas to Chile will certainly be affected. In Chile, in turn, the problem has been addressed by installing a regasification plant that will allow it to purchase liquefied natural gas in other regions of the world, regasify it at a port in the central part of the country and incorporate it into the central electricity grid. This is a decision of great importance that alters the energy matrix of the industrial apparatus. It would not have been necessary if a "regional energy ring" like the one being proposed had been in place. In that same country, it is estimated that to maintain the growth rate the installed electricity capacity will have to be doubled between 2006 and 2020. As that investment plan materializes, Chile may become a marginal electricity exporter by the beginning of the next decade.

- Bolivarian Republic of Venezuela/Colombia. Even though the Bolivarian Republic of Venezuela has the largest gas reserves in the region (148 Tcf), its gas industry is not well developed. The main use of natural gas is to reinject it into low-pressure oil wells, since the transmission grid is not yet able to connect the eastern (producing) areas with the western (consuming) parts of the country. A US\$ 120 million investment is being contemplated to build a 120-kilometre pipeline between Colombia and the state of Zulia to alleviate part of the gas shortage for the generation of electricity. The assumption is that the Bolivarian Republic of Venezuela will import gas until it can develop its own reserves, and then will be able to reverse the flow of gas and possibly export the fuel to Ecuador and Central America. There is also a proposal to build a multipurpose pipeline that will carry Venezuelan hydrocarbons to the Pacific and eventually to the Chinese market. In the latter case, the option of running the pipeline through Colombia or Panama is being discussed.
- Bolivia/Peru/Mexico. Thanks to major gas reserve discoveries in recent years, Bolivia has become a potential supplier for many markets, in addition to its traditional customers in Argentina and Brazil. The lack of consensus within the country, however, has prevented it from seizing two important opportunities. The first, to export gas to the east coast of the United States through Mexico, was missed because a decision could not be made on which Pacific port the gas would be exported from. The second opportunity, to export gas to Mexico for that country's electricity generation, was forfeited because Bolivia could not agree on a joint strategy with Peru to supplement the exportable supply. The political conflicts that have plagued Bolivia recently and the way they have focused on the gas issue, including the controversy surrounding the selection of the port through which the natural gas would be exported — which could be either Peruvian or Chilean — has practically paralysed any initiative Bolivia might take in this area, making its immense natural gas potential less attractive.

## 1. The energy ring in South America

As this complex scenario unfolds, aggravated by the absence of a hydrocarbons law to regulate productive activity, exports and tax treatment of investors in Bolivia and by Chile's difficulties in obtaining a sure supply of gas from Argentina, there is a renewed interest in consolidating the long-desired integration of the energy

sector. The issue is currently the centrepiece of the debate, after the Governments of Argentina, Brazil, Chile and Uruguay proposed to Peru in June 2005 a plan to build an "energy ring" that would guarantee the supply of gas to their countries through a large regional pipeline stretching approximately 1,750 kilometres.

The gas would come from Camisea, a natural gas field in Peru's Amazon region, 600 kilometres from Lima. Although the reserves were discovered by Shell in 1985, it was not until 1999 that the process actually got under way when the Peruvian Government began accepting international bids for licences to pump, transport and distribute the gas.<sup>7</sup> In 2000, a 40-year licence was let to the consortium led by Pluspetrol Perú Corporation S.A.; distribution and transport were awarded to Transportadora de Gas del Perú S.A. (TGP), a consortium created for the development and operation of that project.<sup>8 9</sup> In 2002, TGP S.A. chose Tractebel to operate the Gas Natural de Lima y Callao (GNLC) gas distribution company, owned by Tractebel. Tractebel will also form a partnership with TGP S.A. for the transportation project.

The cost of the project, which is now estimated at US\$ 2.7 billion and may expand by US\$ 2 billion more in a second stage, has brought in nearly US\$ 1.2 billion in foreign direct investment (FDI), plus financing in the form of loans extended by the Inter-American Development Bank (IDB), the Andean Development Corporation (ADC), the National Bank for Economic and Social Development (BNDES) of Brazil, and some Peruvian banks. In addition to supplying gas to Lima and Callao, the companies plan to export gas to the Pacific coast of Mexico.

The proposal to form an "energy ring" opens up the possibility of exporting gas from Camisea to the south, beginning with the project to build a gas pipeline from Pisco (Peru) through Ilo and Tacna to Tocopilla (Chile), where shipments could amount to 35 million cubic metres a day. This project would make it possible to meet the demand for gas in southern Peru, the power plants of the Norte Grande Interconnected System (SING) and those of the Central Interconnected System (SIC) of Chile, all in an initial stage. Later, with the participation of Bolivia, the provision of gas would expand to Argentina through the NorAndino Gas Pipeline, as a branch to Uruguaiana would be built, and from there to Porto Alegre and Buenos Aires. Thus, the project would meet expected

demand not only in Chile, but also in Argentina, Brazil and Uruguay. The energy ring plan has been the subject of a feasibility study by the Franco-Belgian firm Suez Energy International, and the countries involved have agreed to a second study with IDB. In addition, work is under way to develop a legal framework, which is expected to be completed by the end of 2005 (*El comercio y gestión*, Lima, 7 July 2005). It should cover issues related to investment guarantees, most favoured nation (MFN) status, contingency management and dispute resolution.

The project has been taking shape, to the extent that at the last meeting of MERCOSUR leaders, the Presidents of the four member countries plus Bolivia and the other Andean Community countries reaffirmed their commitment to implementing a project for the creation of the energy ring. The strong political impetus given to the project has encouraged multilateral financing organizations to participate. Indeed, IDB has already announced its support for the initiative, which has an estimated price tag of US\$ 2.5 billion. Some companies, such as Suez-Tractebel, Brazilian Petroleum (Petrobras), Repsol-YPF and Pluspetrol, are already interested. The fact that natural gas accounts for a large share of total energy use and is less onerous than other fuels for the countries of the Southern Cone (see figure III.7) makes the project viable, especially if it is viewed as supplementing other sources of energy, as Chilean President Ricardo Lagos has proposed.<sup>10</sup>

Paraguay and Bolivia have recently begun studying the possibility of jointly building a gas pipeline between Tarija and Vallemiti. The plan, which would have private backing, calls for investments of US\$ 300 million. Paraguayan authorities have received at least three proposals: (i) a Tarija, Chaco-Mariscal, Estigarribia-Vallemiti route that would supply the Brazilian market, specifically the state of Mato Grosso do Sul (this initiative would be backed by Italian investors); (ii) a Tarija-Mariscal, Estigarribia-Asunción route that would supply the areas of Pedro Juan Caballero and Ciudad

<sup>7</sup> In 1998, although a contract had been signed between the Government of Peru and the Shell-Mobil Consortium, guaranteeing the provision of natural gas to the Lima and Callao regions, the companies walked away from the deal because they wanted to export natural gas to Brazil through Bolivian territory and to achieve the vertical integration of the project (pumping, transport and distribution). The companies had planned to invest US\$ 4.5 billion (ECLAC, 1999).

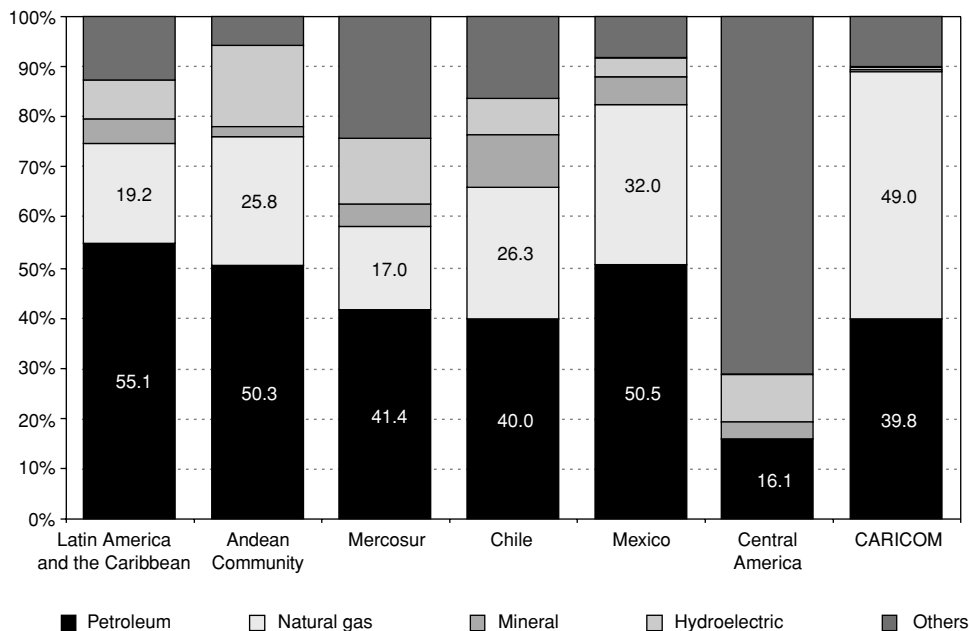
<sup>8</sup> This consortium comprises Hunt Oil Company of Peru LLC, SK Corporation and Tecpetrol del Perú S.A.C. (100% owned by Grupo Techint).

<sup>9</sup> Led by Tecgas N.V. (100% owned by Techint), with the participation of Pluspetrol Resources Corporation, Hunt Oil Company, SK Corporation, Sonatrach Petroleum Corporation B.V.I. and Graña y Montero S.A. (a subsidiary of Halliburton).

<sup>10</sup> There is a dispute regarding the actual level of Camisea's reserves. However, Pluspetrol informed the energy ministers of MERCOSUR and of Chile and Peru that they amount to 57 million cubic metres per day for 20 years. Of that amount, 12 million would go to Peru, 17 million to Mexico and 28 million to the Southern Cone. Furthermore, Repsol and Petrobras are willing to begin prospecting in nearby fields (*Estrategia*, 8 July 2005).

Figure III.7  
**LATIN AMERICA AND THE CARIBBEAN: DISTRIBUTION OF TOTAL PRIMARY ENERGY SUPPLY (TPES), 2003**

(Percentages calculated on the basis of oil-equivalent barrels)<sup>a</sup>



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data and from the Economic- Energetic Information System (SIEE) of Latin American Energy Organization (OLADE), 2004.

<sup>a</sup> Barrels of oil-equivalent (BOE).

del Este, supported by a group of German investors led by Siemens; and (iii) the establishment of a grid to include Bolivia (Tarija), Paraguay (Estigarribia-Balleme), Chile (Iquique) and Brazil (Paranagua), thus linking the Atlantic and the Pacific through an ocean-to-ocean corridor. This third alternative, which is considered the most ambitious and most viable, would enjoy the backing of the multinational *Panamerican Energy*. At present the feasibility study is under way for the first segment joining Tarija and Vallemi (Paraguayan newspaper *ABC*, 28 July 2005).

The global and regional energy prognosis suggests that petroleum will remain the principal source of energy for the next 30 years; that prices will remain high, at least for the rest of this decade; that natural gas is gaining ground in the international energy matrix; and that coal will still be a very important source of energy, although investing in coal will require taking into account increasingly strict environmental criteria, as is now happening in the industrialized economies. A look at energy sources in South America shows that there is an abundant supply of petroleum (the Bolivarian

Republic of Venezuela, Colombia and Ecuador), gas (the Bolivarian Republic of Venezuela, Bolivia, Peru and Argentina), coal (Colombia and Chile) and hydroelectric potential (Brazil, Paraguay, Uruguay, Ecuador, Chile, Colombia and the Bolivarian Republic of Venezuela). In this context, the only explanation for the recent energy crises experienced by several different countries is the absence of mechanisms to stimulate the interconnectivity of energy sources or to provide sufficient legal security for the investments that are needed. That is to say, in the words of Felipe González, what the subregion is really facing is not a shortage of energy but a shortage of energy investment, which is in turn the result of a shortage of institutions that can guarantee the necessary legal security for these to take place.<sup>11</sup> The debate on the “energy ring” that took place at the Asunción Summit will make it possible to address this weakness, and will even open up prospects for the subcontinent to become a key player on the world scene as a supplier not just of oil but also of natural gas.

This is a tremendous challenge, and naturally there are major difficulties that must be dealt with gradually, to

<sup>11</sup> Iberoamerican meeting in Seville, 21-22 April 2005.



the extent that there is a decisive political will to advance in that direction. Consequently, a consensus must be reached on some key principles associated with economic efficiency and the necessary institutional framework. Economic efficiency must rest on a foundation of broad, unified, competitive and transparent markets that allow for timely supplies at the lowest possible cost, with ample coverage, security, and quality of service as well as flexibility in the face of turbulence. For this to happen, it is essential that prices reflect relative scarcity and that public policies clearly differentiate the business function from other functions that may be assigned to companies in this sector. The associated institutions must include regulatory mechanisms that are compatible with market criteria and with non-discriminatory treatment of investors, and that offer legal security and definite stability in the rules of play with respect to prices, investments and taxes. This will enable them to stimulate investments for the replenishment and expansion of capacity and for interconnectivity of different energy sources.

The so-called “energy ring” aims not only to join together all of the efforts that are being made with regard to the use of natural gas, but also to favour the interconnectivity of different energy sources (mainly petroleum, natural gas, coal and hydroelectricity). Promoting energy swaps is a unique technological challenge in the areas of production, law and finance; and another challenge will be to ensure that the “ring” is compatible with national investment efforts. Clearly, the more legal security this subregional initiative can display, the stronger the ties of complementarity between it and national efforts.

Among the many challenges posed by the implementation of the South American “energy ring”, the most noteworthy are the following:

- Ensuring the level of supplies: including Bolivia is key, because Peru’s gas reserves (8.8 Tcf) amounts to less than half of Argentina’s proven reserves (21.5 Tcf) and less than one-third of Bolivia’s (29 Tcf) (Regional Energy Integration Commission, 2005). Fortunately, the respective Bolivian delegations have attended the technical and ministerial meetings that have taken place since the MERCOSUR Summit in Asunción.
- Harmonizing the market and pricing policy structures: the gap in this area is considerable because of the different price formation schemes that exist in each country. Prices can be as much as 11 to 13 times higher in one country than another (Kozulj, 2004). Harmonization will mean that some actors — be they public or private — will see their profit margins shrink, and in general, all will have to get used to a scenario of greater energy efficiency in which price

signals must better reflect the relative scarcity of energy.

- Coordinating dissimilar regulatory frameworks: in this area there is a controversy over which is better, contractual or general regulatory frameworks. The former are more rigid insofar as there are laws, decrees and contracts with provisions governing rates, contractual models, access and dispatch systems, as well as other aspects. General frameworks, in contrast, have little regulation and operators develop their businesses in accordance with contracts negotiated with their customers. A solution to this problem could be the creation of a supranational regulatory body. It is possible that during this initial phase of energy complementarity, a flexible plan will be the most viable option.
- Establishing guarantee mechanisms: considering both the scale and the time span of energy investments, it should be clear that appropriate legal frameworks must be devised to support those investments. In this type of initiative, it is important to note the plurality of parties involved on both the supply and demand sides, hopefully with a web of increasingly cross-linked interests and multinational investments. The presence of IDB and the World Bank can strengthen financial confidence in the initiative, and may require the establishment of some trust funds to protect the network of private contracts underlying the demand for energy.
- Evaluating the presence of external actors: the magnitude of the initiative and the possibility that it will make the subregion a worldwide energy supplier may well interest external investors in the subregion. Given China’s growing interest in investing in energy sources in the subregion (see chapter V), this possibility should also be taken into account in the design of the South American “energy ring”.

In short, the challenge is considerable. After the true level of reserves at Camisea is determined, a legal framework will need to be in place right away to provide regulatory and legal security for investors and purchasers of gas. On this basis, investments in the construction of the pipelines can begin once talks get under way between buyers and sellers of gas and volumes, prices and investment yields are defined. The huge scope of this initiative demands security and appropriate treatment of issues related to taxes, exchange-rate risks and currency transfers, as well as compatibility of technical and economic regulations among all the countries that participate in the project. All of this suggests that we are facing the most serious integration initiative ever to emerge in the subregion. As it takes shape, it will no doubt pave the way for even bolder initiatives.

## D. Regional integration in Latin America and the Caribbean: principal debates and challenges

### 1. MERCOSUR

#### (a) MERCOSUR's political prominence increasing

MERCOSUR has been expanding its role as a means for political synchronization and coordination in South America, among the Member States, with associated countries and with Mexico, which has expressed an interest in associating itself with this subregional integration scheme. The trade agreement between MERCOSUR and the Andean Community and the negotiation of one with the South American Community of Nations are manifestations of this trend.

This upbeat political juncture also coincides with a favourable economic cycle. In this regard, MERCOSUR is seeing the convergence of an expansive economic cycle, a major currency and monetary alignment, positive fiscal balances and less currency and financial volatility. The positive macroeconomic results that Brazil is achieving and the successful renegotiation of Argentina's debt provide further cause for optimism.

Thus, MERCOSUR is in a good position to take advantage of the notable political convergence of the current Presidents of its member countries and their emphasis on strengthening the subregional organization. Another significant asset is the Presidents' high levels of popularity, in particular Brazil's enhanced political prestige and the prominent international role that President Lula has played in events such as the formation of the G-20 and the International Alliance Against Hunger. In short, the international political and economic climate is propitious for bold initiatives for economic integration and cooperation. The recent association with Colombia, Ecuador and the Bolivarian Republic of Venezuela, prior agreements to associate with Peru, Bolivia and Chile, and Mexico's interest in associating with MERCOSUR, all reveal an unprecedented constellation of convergences between MERCOSUR, Chile, the Andean countries and Mexico.

In this new situation, with the addition of Mexico, MERCOSUR will have six associate members and four full members. After Mexico joins, the associate countries' GDPs will be 40% higher than those of full members and will account for 58% of the expanded GDP, while their total exports will be 2.2 times those of the full members. MERCOSUR's growing importance as a political forum

does not, therefore, assure it of corresponding economic and commercial influence. In fact, MERCOSUR's greater political relevance has been accompanied by an unprecedented amount of criticism — at the highest level— of its performance as a customs union.

In addition to considering the high relative profile of associate members, which are by definition outside the customs union, we should also note the diversity of approaches to trade policy. In a few months, the associates may include five countries (Colombia, Chile, Ecuador, Mexico and Peru), and possibly six if Bolivia makes the move, that have signed bilateral accords with the United States. The differences in coverage and scope of the respective agreements — between those with the United States and those with MERCOSUR— pose a particular challenge for the integration mechanisms.

It is obvious that MERCOSUR represents more than customs and trade issues, particularly when its main weaknesses in this area are examined. By the same token, it would be too narrow an interpretation to say that Mexico is moving closer to South America solely on the grounds of trade. There are geopolitical factors that should be examined here, but without a doubt, understanding this rapprochement as something driven by economics or commerce alone would not only be erroneous but would also limit the possibilities of this association. To be sure, a market scenario with a stronger commitment to free trade, with fluidity of investments and legal security for exporters, importers and investors alike, would create the conditions to strengthen the political and economic aspects of Mexico's association with South America. Nonetheless, this scenario does not exist yet, and it should not be taken for granted.

#### (b) MERCOSUR facing a credibility test

This subregional entity is currently facing a test of its credibility and objectives. Its founding protocol, signed in Ouro Preto in 1994, defines it as a customs union, which assumes free trade within the zone, a common external tariff and a common external trade policy. Eleven years later, that objective is far from being attained, and the prospects for the future are complex. There are still too

many tariff exceptions: with respect to both the intra-zone zero tariff and the common external tariff, advances in technical and tariff harmonization have been smaller than expected. Moreover, since the late 1990s new exceptional treatment plans have been introduced —sometimes by consensus, sometimes unilaterally —that undermine these principles (Kosacoff, 2005).

Trade preferences that were negotiated have been undermined by unilateral decisions using measures not always consistent with the standards agreed upon by the Member States. In turn, regulations approved by the members have not been translated into domestic legislation, which widens the gap between trade community standards and public policies actually adopted by the nations within the community, further complicating the future convergence of public policies. Inconsistencies cause delays in strategic decision-making, and eventually hinder domestic consensus-building, thereby creating additional difficulties for convergence in integration processes, which paves the way for future non-compliance with community standards. This is why the definition of differences in MERCOSUR today is so critical for the future of the community.

In 2004 and the first quarter of 2005, trade disputes between Argentina and Brazil at the ministerial level and between the respective business groups made the headlines. Many different sectors of production are involved: Argentina has complained about the damage caused by Brazil's exports of textiles, footwear, televisions, household appliances, batteries, wooden furniture, cotton, yarn, denim and rugs, while Brazil alleges that Argentine products are hurting its chicken, dairy, wheat, rice and sugar industries.

Argentine authorities point to the imbalance in accounts that is suddenly favouring Brazil, claiming that it is due to the failure to honour commitments made under the Asunción Treaty aimed at coordinating macroeconomic policies and establishing integrated investment policies to create intraregional production chains, thereby making MERCOSUR more competitive in other markets. Because these commitments have not resulted in integrated investment policies, Argentine authorities have proposed unilaterally employing provisional compensation mechanisms while waiting for macroeconomic harmonization to take place or for the sectors benefiting from these protective measures to make investments to improve their competitiveness. Among the mechanisms involved are quotas negotiated directly between private parties, safeguards or different types of import licences. In a later discussion, safeguards were rejected and the Brazilian representatives relaxed their stance, expressing a willingness to finance Argentine exports to Brazil as soon as Argentina reinstates the

common external tariff (CET) of 14% for machinery and tools, which limits Argentina's market for these exports.

In early July, Brazil's representatives formally agreed to discuss a competitive adaptation clause in MERCOSUR "similar to safeguards" (*La Nación*, 9 July 2005), although the precise terms have not yet been defined (under what circumstances it would be imposed, what procedures would be followed to implement it, how long it would last, and so on). On the other hand, Brazil insisted that the possibility of a private agreement should be given a chance before turning to this mechanism. In other words, quotas and voluntary export restrictions could be negotiated. One persistent difficulty is that this potential clause is associated with "major macroeconomic alterations", a situation that does not now exist. Therefore, it could not be applied to the numerous controversies currently going on.

Argentina's response is that incentive mechanisms to encourage productive investment should also be discussed to ensure that they do not harm trade. The idea, according to Argentine authorities, is not to eliminate the incentives, but to guarantee equal treatment (*Infobae*, 8 July 2005). Although the precise methodology has not been revealed, the impression is that an attempt would be made to quantify the effect of these incentives on prices, and then to adjust the trade preferences that are granted in order to prevent spurious competition that might result from them.

The debate within MERCOSUR also highlights the weakness of the dispute resolution mechanism, and therefore the absence of complete legal security for investment and foreign trade decisions involving that integration organization. Without legal security or a strong record of honouring commitment deadlines, there is also a disincentive for compliance, and on the contrary, there is an incentive for individual sectors to demand additional exceptions or delays in fulfilling their obligations. In short, the signals are not encouraging for investments in subregional integration. This attitude deters the most entrepreneurial business leaders and leads them to explore other options —including, to be sure, measures aimed at improving the customs union, but also the possibility of creating a free trade zone.

The relatively smaller countries have renewed their complaints that they do not have effective access to the larger markets, which makes it hard for them to attract investments that would come with access to a broader market. There are also allegations of non-compliance with a common investment policy promoting the coordination of production in MERCOSUR and creating competitive advantages for exports to other markets. Another complaint is that larger countries are still subsidizing

investment, making it even more difficult for smaller economies to attract investment. And finally, the failure to make any progress on macroeconomic coordination also costs these economies dearly, as they have absorbed without any compensation the effects of the larger economies' macroeconomic crises. In other words, not only are the size asymmetries among the MERCOSUR partners not being addressed adequately, but they are also being aggravated by the lack of macroeconomic coordination between the larger economies and by the persistence of tax incentives for investment and export promotion in these economies, which distorts relative competitiveness.

Lastly, there are allegations of a failure to meet the timetable of commitments under the Asunción Treaty to undertake trade negotiations for services, investment, public procurement, macroeconomic coordination and integration of production chains.

### (c) MERCOSUR's prospects

One initial conclusion is that the political convergence of the current leaders of Argentina and Brazil, who pledged to strengthen MERCOSUR, has not only failed to achieve results but has also coincided with perhaps the worst juncture for this subregional organization (Candia Vega, 2005). The current crisis is reviving the principal dilemmas facing the entity: (i) the dilemma of customs union versus free trade zone; (ii) the ambiguity between community institutions and inter-Government agreements; (iii) economic asymmetries; and (iv) sectoral asymmetries (Onuki, 2004).

In addition to the well-known difficulties suffered by MERCOSUR, there is a growing gap between the diplomatic importance this body has for Brazil and its importance in the realm of trade (Markwald, 2005). The result is a dynamic inconsistency between the positions of its Member States. On the one hand, the expectations that Brazil would serve as an engine for the growth of exports from Argentina, Paraguay and Uruguay have not been fulfilled, nor have these exports become more diversified. On the other hand, as Brazil becomes more competitive, the subregional area loses its value for the development of Brazil's export sector. However, Brazil needs MERCOSUR as a platform for its international diplomatic efforts, both in the multilateral arena (WTO talks, G-20), and at the hemispheric level (Free Trade Area of the Americas, FTAA); for building leadership among developing countries (relations with China, India, South Africa and the Arab economies), and for its attempt to promote a round of South-South negotiations to promote the Global System of Trade Preferences (SGPC) among developing countries.

As Brazil embarks on this new wave of trade negotiations with partners outside the southern region, it perceives more risks than opportunities, especially the long transition periods that will be required for eliminating tariff barriers; and investment, services and public procurement are not on the agenda (Da Motta Veiga, 2005). Given this attitude, it is wasting an opportunity to set a new standard for tackling such controversial issues in the international arena.

Brazil needs its MERCOSUR partners to stand by its side in achieving its overall objectives, but it is not in a position domestically to meet the demands of its local partners. There is growing uncertainty about MERCOSUR in the Brazilian business sector right now. That uncertainty is based on two elements: (i) the development of trade disputes with Argentina; and (ii) the belief that jointly negotiating the external agenda —for example, in FTAA talks and those with the European Union— would limit Brazil's trade possibilities (CNI, 2004).

For example, the tariff preferences that seven member countries of LAIA (Bolivia, Chile, Colombia, Ecuador, Mexico, Peru and the Bolivarian Republic of Venezuela) have granted to Brazil are eroding as these countries reach trade agreements with partners outside the region. This attrition will be exacerbated if more far-reaching preferences are granted in areas where third countries are more competitive than Brazil. The conclusion of a study examining this issue —how to prevent this deterioration of Brazilian goods' competitiveness— is that Brazil should work on two fronts:

- intensifying the effort to reach agreements in LAIA, expanding preferences and moving towards a free trade zone in South America encompassing “the substance of trade” under Article XXIV of the General Agreement on Tariffs and Trade (GATT);
- resuming FTAA negotiations, to the extent that a balanced agreement can be forged that promotes trade in all directions, adheres to the “single undertaking”, respects the intraregional most favoured nation and substantial trade clauses, and also avoids the effects of trade diversion and the diversity of rules of origin, exemption and exception lists, and dispute resolution mechanisms (Barbosa, 2004). Considering both the number of conditions required of the hemispheric agreement (a reasonable number, incidentally) and the prevailing attitude on free trade in the United States Congress, all indications are that, from Brazil's perspective, the first option is the more viable and the one that can be seen taking shape after the trade pact is signed with the Andean Community.

In Brazil's case, the loss of the subregional market's importance cannot be examined without considering the notable increase in its exports since 2003. In other words, the real limitation on exports to Brazil from its MERCOSUR partners lies in the small economic size of their markets. Some analysts add that even if all intra-zone barriers to trade were removed entirely, it would still be difficult for MERCOSUR's share in Brazilian exports to exceed the record of 17% in the 1997-1998 biennium. Indeed, Brazil would have to increase its imports from MERCOSUR countries to 60% of the market share, which is unlikely (Markwald, 2005). In short, the spectacular increase in Brazilian exports means that MERCOSUR is of declining economic importance to Brazil.

There is a certain consensus that the so-called "deep integration" of MERCOSUR should:

- allow the free circulation of goods within the customs union, guaranteeing compliance with preferential access provisions;
- eliminate distortions in cost-price structures, doing away with subsidized sales prices or investments;
- provide a truly binding dispute resolution mechanism that will operate in the short term;
- work on economies of scale and economies of specialization to stimulate the complementarity of production in MERCOSUR;
- continue making inroads in dealing with size asymmetries, on the basis of the Structural Convergence

Fund approved at the Asunción Summit, striving for a more balanced distribution of the benefits of integration; and

- push decisively for the incorporation of Community provisions in domestic legislation (Machinea, 2004; Kosacoff, 2005; Markwald, 2005; Peña, 2005).

If real progress is made on the aforementioned issues, MERCOSUR will be in a better position to build an expanded, stable market, to contemplate medium- and long-term investments, and to be more competitive in attracting foreign direct investment. All of the above requires clear negotiations between Argentina and Brazil, first to address the issue of the sensitivity of certain products, and secondly to define a *modus operandi* regarding the different approaches to MERCOSUR's strategic options.

This appears to be a complex matter, but it is heartening to realize that none of the principal actors in MERCOSUR has come up with an alternative to the community body (Peña, 2005).

An effectively open regionalism, with a lower CET and a declining trend in tariffs, will make it possible to resist unilateral protectionist temptations, reinforcing the commitment to free trade and also making more room for trade negotiations between MERCOSUR and external partners such as the European Union.

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## 2. Andean Community of Nations

The Andean Community Commission, at a recent meeting in March 2005, adopted a working plan designed to expand the integration of trade, with the following elements:

- allow the free circulation of goods and services, basically by detecting and removing barriers to access; regulating Andean Community safeguards; simplifying and harmonizing customs procedures; harmonizing technical, sanitary and phytosanitary standards; establishing automatic recognition practices; and eliminating measures that have no technical support, along with liberalizing professional services;
- promote a customs union, adopting a CET and agreeing on a farm price stabilization system;
- reinforce the dispute resolution system, incorporating arbitration between private parties and improving the enforcement provisions of rulings;

- establish a joint investment and production development plan, especially with respect to energy and agroindustry, moving towards a system of guarantees for SMEs; and
- foster special support programmes for Bolivia and Ecuador, ensuring that the Andean Community process yields balanced benefits and addresses the most obvious asymmetries.

A special issue for this community organization is the fact that three of its members (Colombia, Ecuador and Peru) are engaged in free trade talks with the United States. These negotiations should conclude by the end of 2005, and all indications are that they will result in commitments that are considerably broader and deeper than those the Member States have with each other. In other words, in the coming years, barring decisive action

to update the Andean Community regulations governing goods, services, investments and trade disciplines, integration may take place on two levels, with the community level being the less intense. Needless to say, if this duality grows, the business climate will gradually turn towards the schemes with more far-reaching provisions and more binding dispute resolution mechanisms. In this regard, these negotiations offer the Andean Community a great opportunity to update its procedures, something

that the annotated working plan calls for. This plan is certainly the minimum necessary to move in the right direction, and the pace will have to quicken if this effort is to keep up with the new commitments.<sup>12</sup>

On 1 January 2005, the the Andean Community-MERCOSUR and Peru-MERCOSUR free trade agreements took effect, immediately freeing up 80% of the trade between the two blocs. The remaining 20%, including sensitive products, will be freed over the next 14 years.

### 3. North American Free Trade Agreement (NAFTA)

At the most recent meeting of NAFTA Heads of State, held in Canada in June 2005, participants expressed an interest in moving from a free trade agreement to a common market, with a view to strengthening North America's competitiveness in a framework that reconciles advances in security and prosperity. The need to deal with border trade facilitation, including customs, transportation, infrastructure and trade security, must be viewed against this backdrop. The list includes some highly complex matters that will be politically difficult to address, such as immigration — in light of attitudes in the United States Congress as the Free Trade Agreement with the Dominican Republic and Central America (DR-CAFTA) goes through the ratification process— and the need to modify some trade policies questioned by the WTO, as well as the controversy over the growing trade deficit with China. Indeed, the gradual convergence of administrative practices and policies among the three NAFTA partners will tend to reduce the discretion that each can exercise in implementing them, eroding the influence of domestic trade policy bodies.

The debate on rising imports from China has also been taking place in Mexico, particularly with regard

to their impact on the textile sector, and more generally in the maquila industry. This concern was expressed in the working groups that reported to the Presidents at the meeting in Canada. They examined ways to stimulate competitiveness throughout the subregion in the face of the threat of Chinese exports, including business and technology alliances to facilitate coordination in the areas of e-commerce, investment and development, and in general, business initiatives that Governments could promote and support as necessary by providing information and other assistance. For Mexico it is a strategic matter, because the advantage of preferential access to the United States market will tend to depreciate gradually over time as the latter country continues its firm policy of bilateral agreements for free trade with countries inside and outside the region. The addition of China's emergence as an increasingly qualified supplier of low- and medium-technology goods on the United States market, with the resultant erosion of the maquila industry's competitive edge, makes it clear why Mexico has made the strategic decision to enhance its competitiveness in the context of expanded markets and the growing prospect of alliances among businesses and with public actors (see box III.1).

### 4. Free Trade Agreement between Central America, the Dominican Republic and the United States (DR-CAFTA): a noteworthy accord

Trade with the United States is the most important for the Central American subregion, and since 2000 it has been governed by the Caribbean Basin-United

States Trade Partnership Act, due to expire in 2008. The negotiations for a free trade agreement began in January 2003 as part of a regional objective of

<sup>12</sup> For example, in the Free Trade Agreement with the United States, the three above-mentioned Andean nations will have to grant national treatment to investments and services from the United States, and will have to do the same in public procurement. Such treatment is clearly superior to that accorded the the Andean Community members in the same areas.

## Box III.1

**NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA): AGENDA FOR PROSPERITY AND SECURITY**

In March 2005, the three Member States of this organization signed an ambitious joint project that goes beyond free trade and is aimed at reinforcing the integration of the three economies. The plan, called the Security and Prosperity Partnership of North America, is based on a series of specific initiatives, some of which are detailed below:

- Promotion of e-commerce. In June 2005, an understanding was signed setting forth common principles for guaranteeing transparency and security in the use of communication and information technologies (CIT) by eliminating barriers to e-commerce in cross-border transactions.
- Liberalization of rules of origin. Thus far, the countries have enhanced the flexibility of several rules of origin for goods such as household appliances, machinery and parts, and precious metals. On 1 May 2006, the list of goods subject to the new rules will expand. The objective of this measure is to facilitate imports of intermediate inputs for the subregion, since the resultant lowering of administrative costs makes the production of tradable goods with subregional content more competitive.
- Sectoral cooperation to improve the region's competitive edge. Based on business development and advances made by the private sector, the Governments established a plan for sectoral initiatives in the

steel and automotive industries. For this purpose, the North American Steel Trade Committee (NASTC) will be strengthened, and a North American Automotive Council will be formed. The competitiveness of both industries is expected to be enhanced, and the world leadership of the subregion's businesses will be maintained.

- Protection of consumer health (bioprotection). In this realm, which includes the exchange of information on cooperative activities in health and food safety, most of the progress has been made between the United States and Canada. These two countries signed a memorandum of understanding, and Mexico is now negotiating a similar instrument.
- Labelling of textiles and apparel. The countries expect to sign an agreement to standardize symbols on the labels of these products in July 2005.
- Temporary entry of professionals. The countries have exchanged procedures that will be applied to modify the professions appendix of the treaty in order to allow an increase in the labour mobility of professionals.
- Plant protection. The countries agreed to harmonize the treatment of bovine spongiform encephalopathy (BSE) in order to safeguard human and animal health in the subregion. By 2007, the countries expect to reduce the redundant testing

and certification requirements in phytosanitary regulations.

- Creation of a sustainable energy economy in North America. Commitment to create the political conditions to promote the sustainable use and supply of energy, as well as joint cooperation in areas such as regulation and energy efficiency; natural gas, including liquefied natural gas; science and technology; oil sands production; nuclear energy; hydrocarbons and energy information, statistics and projections.
- Customs facilitation, infrastructure and trade security. Effort to coordinate these three areas for the purpose of guaranteeing the security of citizens, achieving the full potential of reciprocal exchanges in all modes of transportation (highway, maritime, river and lake, as well as air), and reducing waiting time. A number of complementary measures are applied to this end, including the following: (i) protection of critical infrastructure by means of the coordinated evaluation of vulnerability to permit identification and protection (ports, highways, bridges, airports and others); (ii) development of comparable standards and procedures for the inspection of air passengers, equipment in general and cargo; and (iii) design and implementation of plans to improve the compatibility of security systems governing ports and vessels of all types.

**Source:** NAFTA Secretariat, "Security and Prosperity Partnership of North America", *Report to Leaders*, June 2005.

increasing exports to the United States market and also attracting investment in the subregion. By the middle of December 2003, El Salvador, Guatemala, Honduras and Nicaragua had concluded the negotiation of their free trade agreement with the United States; they were followed by Costa Rica in January 2004. During that time, there were nine rounds of talks in six groups: market access, services and investment, public sector procurement and intellectual property, environment and labour issues, dispute resolution, and institutional matters. The Dominican Republic joined the Treaty in March 2004 (see box III.2).

El Salvador ratified the treaty in December 2004, and Honduras and Guatemala did so in April 2005. At the end of June it was ratified by the United States Congress, despite the controversy over three main issues: the sugar industry, opening up the textile sector and the matter of

labour (that is, the possible loss of jobs in the United States and the labour rights situation in Central America and the Dominican Republic). The United States House of Representatives voted to ratify the treaty by a slim two-vote margin (217 to 215). The Dominican Republic ratified the agreement in September 2005.

It is estimated that, on average, the treaty could boost growth in the subregion by between 0.5% and 1% of GDP and create between 20,000 and 25,000 jobs, as well as starting a downward trend in poverty (SG-SICA and ECLAC, 2004).

In mid-February 2005, the CACM countries and the Dominican Republic signed with the United States several memorandums of understanding and environmental protection agreements, among them the Environmental Cooperation Agreement. They also agreed to establish a Secretariat for Environmental Affairs, which

will help implement the environmental provisions of the treaty signed by the parties (United States Department of Commerce, 2005).

Studies show that advances in customs cooperation among CACM countries have yielded an average gain of at least 0.5% of GDP (Machinea, 2004; ECLAC/SICA, 2004). The treaty with the United States and the Dominican Republic (DR-CAFTA) opens up the possibility of expanding the range of tariff preferences for Central American businesses by about 60% of overall trade, and it could boost subregional GDP by 0.8% to 2.3%, with an increase in total exports of 1.6% to 5.2% (Hinojosa-Ojeda, 2003). Nevertheless, the two principal effects of this type of agreement must be taken into consideration: (i) regulatory consequences and (ii) the possible diversion of intraregional trade due to

competition between subregional products and those coming from the United States.

The commitments made under DR-CAFTA differ in coverage and content from those of CACM (see table III.11), and as a result the latter will be superseded in several key areas, as detailed in box III.2.

In general, North-South bilateral agreements allow access to a broader and more stable market and lead to an increase in worldwide trade flows. In addition, a strong signal is sent to investors and business executives, since the agreements tend to be seen as irreversible processes with a major component of transparency and greater legal security. This results in positive externalities for the design of the signatory country's economic policy (Schiff and Winters, 2004; Rosales, 2005). There may also be incidents of trade diversion within regional integration accords.

#### Box III.2

#### FREE TRADE AGREEMENT WITH THE UNITED STATES (DR-CAFTA): CHALLENGE FOR THE CACM INTEGRATION PROCESS AND LESSONS FOR THE ANDEAN COMMUNITY

The treaty that the countries of the Central American Common Market (CACM) signed with the United States and the tariff preferences they committed to have been supplemented by the agreements signed by those countries between 1995 and 2001, with Mexico in 2001, with the Dominican Republic in 2002, El Salvador and Honduras with Panama in 2002, El Salvador and Costa Rica with Chile in 2002, and Costa Rica with Canada in 2002. In addition, these countries will soon begin negotiating a free trade treaty with MERCOSUR.

It is evident that, given the growing importance of this type of trade pact, most commerce is subject to different, not common, tariff conditions. The true dimension of the preference margins for subregional trade has not yet been evaluated, nor has the effect that such agreements could have on production structures and productivity. Another unknown is how much competitiveness subregional exports have gained when they are also sent to different countries within the same subregion (INTAL, 2004c).

The free trade agreement signed with the United States (which the Dominican Republic also joined) generally maintained the benefits that the subregion already enjoyed and the free

entry of Central American goods into that country. The accord covers nearly 99.7% of industrial goods and takes effect immediately; more than 80% of industrial products made in the United States can be freely imported to Central America, 85% after five years and 100% as of the tenth year. Once the treaty takes effect, 89% of Central America's farm products will be able to enter the United States freely, whereas 50% of the latter's products will enjoy the same conditions in Central America, with the rest being allowed progressively over the next 15 years. Safeguards may be adopted for a period of four years, the duration of the transition to total liberalization. This instrument contains provisions governing trade defence, public contracting, investment, services (including financial), e-commerce, intellectual property, workers' rights, the environment, and dispute resolution (Rodas, 2004).

It is worth noting that, in practice, the commitments undertaken by these countries vis-à-vis the United States are different in magnitude and content from those prevailing in CACM, and therefore the DR-CAFTA regulations will take precedence over CACM standards in some areas: with respect to investment disputes, arbitration under the auspices of the International

Centre for Settlement of Investment Disputes (ICSID) will be required; and cross-border trade in services, financial services and telecommunications will also be governed by DR-CAFTA regulations, except that Costa Rica made selective and gradual commitments in this chapter of the accord and with regard to opening up its insurance industry. The same is true of the chapter on intellectual property, which specifies that second-use patents are not allowed.

In 2005, before DR-CAFTA takes full effect, the countries may adopt a programme to make current CACM standards compatible with those of the new treaty, along with the rest of the bilateral agreements in place in the subregion. In addition to those already mentioned, one particularly sensitive area is rules of origin, which overlap and vary among the different agreements. This could raise transaction costs for exports from the subregion, making them less competitive and even detracting from the possible benefits that might be enjoyed under previous agreements. In any case, if the compatibility effort succeeds, DR-CAFTA will have the effect of enhancing Central American integration.

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Institute for Latin American Integration (INTAL), *Carta mensual*, No. 91, February, 2004; H. Rodas, *El Estado actual y las perspectivas del proceso de integración económica centroamericana, modelo de desarrollo territorial*, Guatemala, 2004 and Central American Integration System and Economic Commission for Latin America and the Caribbean (SICA/ECLAC), *La integración centroamericana: beneficios y costos. Documento síntesis* (LC/MEX/L.603), Mexico City, General Secretariat and ECLAC Subregional Headquarters in Mexico, May 2004.



Table III.11  
**CENTRAL AMERICAN COMMON MARKET (CACM): PRINCIPAL TOPICS COVERED IN BILATERAL ACCORDS SIGNED BY THE SUBREGION AND COMPARISON WITH CURRENT COMMUNITY REGULATIONS**

	Elimination of tariff escalation	Rules of origin	Trade in services	Investment	Technical barrier	Normali- zation	Public procurement	Safeguards antidumping	Competition policy	Intellectual property	Dispute resolution
Central American Common Market (CACM)	✓	...	✓	✓ <sup>a</sup>	...	✓	✓ <sup>b</sup>	✓	✓ <sup>c</sup>	✓	✓
RD-CAFTA <sup>d</sup>	✓	✓	✓	✓	✓	...	✓	✓	...	✓	✓
CACM-Chile	✓	✓	✓	✓ <sup>e</sup>	✓	✓	...	✓	✓	...	✓
CACM-Dominican Republic	✓	✓	✓	✓	✓	...	✓	✓	✓	✓	✓
CACM-Panama	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Costa Rica-Mexico	✓	✓	✓	✓	...	✓	✓	✓	...	✓	✓
Mexico-Nicaragua	✓	✓	✓	✓	✓	✓	✓	✓	...	✓	✓
Mexico-Northern Triangle <sup>f</sup>	✓	✓	✓	✓	...	✓	...	✓	...	...	✓

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from agreements concluded by countries.

<sup>a</sup> With subregional regulations ratified only by Honduras.

<sup>b</sup> With community regulations pending ratification by Honduras.

<sup>c</sup> GATT/WTO international regulations still in force.

<sup>d</sup> Free trade agreement between Central America, the Dominican Republic and the United States.

<sup>e</sup> Includes all investment protection and promotion agreements signed by Chile with the countries of the group.

<sup>f</sup> Comprises El Salvador, Guatemala and Honduras.

Monge, Loria and Gonzáles (2003) determined that NAFTA did not divert intra-subregional trade for Central America, basically because the countries continued to enjoy the unilateral preferences granted under the Caribbean Basin Initiative launched by the United States Government. After DR-CAFTA is signed, the main tangible benefits will be both the consolidation of those preferences, which will become permanent instead of temporary, and the elimination of tariff escalations, which facilitates the diversification of exports. Some recent studies (Hinojosa-Ojeda, 2003; Ángel and Hernández, 2004) evaluating the effects of DR-CAFTA conclude that CACM businesses will face competition from products from the United States that will replace

imports of less competitive products from the subregion (see table III.12). Ángel and Hernández (2004) conclude that opening up to imports from the United States leaves intra-subregional exports, valued at a total of US\$ 1.3678 billion, in a vulnerable situation.

Diversification of trade in CACM would basically affect chemicals, agroindustrial products, the paper industry, food and fertilizer and the plastics industry (Hornbeck, 2003; ECLAC, 2003a and 2003b), which will pose a challenge for non-competitive sectors to restructure their industrial complexes, especially some SMEs. This should be viewed in the context of the expected increase in investment as the market expands and rules become more stable (Cordero, 2005).

Table III.12  
**CENTRAL AMERICAN COMMON MARKET (CACM): COMPETITION IN THE INTRA-SUBREGIONAL MARKET AFTER THE SIGNING OF DR-CAFTA: POSSIBLE DIVERSION OF INTRA-SUBREGIONAL TRADE**  
*(Percentage changes in exports from base year=1997)*

Origin \ Destination									
	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	United States	Mexico	Rest of the world	World <sup>b</sup>
Costa Rica <sup>a</sup>		-0.17	-0.17	2.47	-0.46	0.39	0.49	2.16	1.56
El Salvador <sup>b</sup>	-0.48		0.31	-0.12	0.37	3.62		4.17	3.55
Guatemala <sup>a</sup>	-0.28	-1.67		-0.15	-1.84	2.73	1.71	2.29	5.24
Honduras <sup>a</sup>	1.26	-0.23	-0.26		-0.52	0.44	0.44	3.18	1.72
Nicaragua <sup>b</sup>	-0.76	-0.63	-0.58	-1.14		2.01	6.54	2.36	2.26
Mexico <sup>b</sup>	7.73	-0.71	-0.50	-1.83	0.59	3.61		19.56	7.27
<b>United States<sup>b</sup></b>	<b>7.56</b>	<b>11.28</b>	<b>12.01</b>	<b>2.58</b>	<b>16.53</b>		<b>3.51</b>	<b>-0.14</b>	<b>0.37</b>

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Raúl A. Hinojosa-Ojeda, *Regional Integration Among the Unequal: A CGE Model of US-CAFTA, NAFTA and the Central American Common Market*, Los Angeles, University of California, 2003.

<sup>a</sup> Results of a Computable General Equilibrium (CGE) model that includes static effects.

<sup>b</sup> Results of a CGE model that includes dynamic effects and complete mobility of labour (migration).

The fiscal impact should also be considered. The elimination of tariffs entails a decline in tax revenues, which is expected to be major in Honduras (nearly 5% of revenues), less significant in Costa Rica and Nicaragua (less than 2%) and much smaller

in Guatemala and Nicaragua (under 0.5% of total tax revenues). As for GDP, Honduras will again suffer the greatest losses (between 0.82% and 1.59% of GDP) (Paunovic, 2004; Barreix, Villela and Roca, 2004, respectively).

## 5. Caribbean Community (CARICOM)

The Caribbean Community has stepped up its integration efforts with a view to implementing the CARICOM Single Market and Economy (CSME) by the end of 2005. The main features of the treaty are the free movement of goods and services, capital and labour; the harmonization of laws and regulations affecting trade, including customs procedures; intellectual property, competition policy, taxes, dumping legislation and subsidies.

The 15 member States of the Caribbean Community and the five associate members (Anguila, Bermuda, Cayman Islands, British Virgin Islands, and Turks and Caicos Islands) are not all participating to the same extent in the various aspects of Caribbean integration.<sup>13</sup> For the time being, the Revised Treaty applies to 12 member countries of the Community, of which seven have already incorporated it into their domestic legislation.<sup>14</sup>

One additional complication is the fact that some countries that would join CSME, apart from FTAA, are trying to join other regional integration schemes. For example, Belize has been increasing its participation in coordination mechanisms in Central America, and is also negotiating a free trade agreement with Guatemala. Suriname and Guyana have shown an interest in participating in the South American Community of Nations and have strengthened their ties with Brazil. In any case, the most important integration effort in the Caribbean today is the CARICOM Single Market and Economy, which will initially comprise three countries.

When fully formed, CSME would encompass a market of 6.4 million inhabitants with an estimated GDP of US\$ 39 billion and a labour force of nearly 3 million people. This small regional market includes economies with major asymmetries, four of them with external sales principally of goods. In the case of Trinidad and

Tobago, the sales are of natural gas and petroleum, in that order, along with products of the related petrochemicals industry. Guyana and Suriname export mining products (bauxite and gold) and agricultural goods. The fourth one, Belize, has already expressed a considerable interest in tourism.

The other CSME economies depend more on foreign exchange earnings from services than from goods. At the service-oriented extreme are the economies of Antigua and Barbuda, Barbados and Saint Lucia. In the latter case, as in Saint Vincent and the Grenadines, the growing emphasis on services stems from the erosion of preferential access to the European banana markets.

The regional market is not a major destination for exports of goods or services from CSME countries. The importance of regional integration lies, therefore, in increased productivity and efficiency more than in a significant expansion of exports. This is much more relevant for the small economies of the region (see box III.3).

Despite significant progress in the execution of the CSME protocols, the integration scheme is only that of an imperfect customs union. The final phase of the common external tariff has not yet been implemented uniformly in all countries. There are also still major disparities in the average tariffs (either simple or weighted) that have actually been imposed, primarily due to the magnitude of tariff exemptions for imports. In some cases, especially in the smallest economies, these amount to 5% or 6% of GDP. In addition to exemptions, non-tariff duties are still common, even for products traded within the region. Non-tariff levies include excise taxes, customs surcharges, taxes on foreign currency transactions, environmental fees and special taxes.

<sup>13</sup> Haiti's participation has been suspended since the political change in early 2004, which some members of the organization interpret as the result of unacceptable foreign interference. Bahamas does not want to join the CSME; Montserrat, which has a unique membership status in the Community because it is not an independent nation, requires authorization from the United Kingdom to ratify the Revised Treaty of Chaguaramas, and that is still pending.

<sup>14</sup> Not all 12 countries will implement CSME at the same time. For now, Barbados, Jamaica and Trinidad and Tobago are committed to putting it into effect immediately. The participation of the Organization of Eastern Caribbean States (OECS) will depend on the outcome of negotiations on the CSME development fund for small economies. Belize, Guyana and Suriname are still far from attaining membership.

## Box III.3

**THE CARICOM SINGLE MARKET AND ECONOMY (CSME) IN THE ORGANIZATION OF EASTERN CARIBBEAN STATES (O ECS)**

In the early 1990s, the CARICOM countries agreed to establish the Single Market and Economy (CSME). This objective was reflected in the 2001 amendment of the Treaty of Chaguaramas (1973) that created CARICOM. At the Tenth Special Meeting, held in 2004, the CARICOM Heads of State agreed to put CSME into full operation by 2008.

A higher degree of regional integration, accompanied by the appropriate regulatory framework, would increase the efficiency and productivity of CARICOM economies. Not only does CSME provide an opportunity to reposition the region's production potential and develop its competitiveness, it also presents significant challenges for the smaller Member States of CARICOM.

CARICOM's current integration scheme is an imperfect customs union with some elements of a common market, such as mobility of capital and labour for some categories of skilled workers. The customs union, whose origins date back to the 1970s but was not put into practice by the Member States of CARICOM until 1992, when it was done by consensus, has not succeeded in spurring intraregional trade. In fact, the share of intraregional trade in the total has stagnated or fallen in most countries. In the 1990s, OECS lost half of its share of intraregional

trade and saw its trade deficit with the other countries rise to nearly 7% of GDP by 2003.

The customs union has not contributed to the diversification of trade. Intraregional trade is concentrated at the level of businesses and products. At the country level, it is a regional integration scheme polarized around Trinidad and Tobago, which accounts for more than 50% of total intraregional trade. This is due to structural factors, to the growing significance of visible external restrictions in the loss of market share outside the region, and to the distortions caused by the common external tariff.

It is possible to reverse this trend, however, to the extent that larger-scale development of the incipient trade in services (which is of vital importance to OECS), the current promotion of industrial restructuring, and learning-by-doing processes can all be stimulated.

The Governments of CARICOM countries have placed particular emphasis on intraregional labour mobility, which now includes only six categories of skilled workers. OECS countries can benefit from the entry of skilled workers. Because they also have a large number of unskilled labourers, however, with considerable social and economic ramifications, OECS countries have asked that the labour mobility envisioned in CSME include

that of unskilled labourers so that they can encourage them to move to the larger economies and thus reduce unemployment in the OECS economies.

Capital mobility is a fact in CARICOM. The linkage between financial flows and productive activity is weak, however. Some of the most important commercial banks in the region provide more financing for government debt than for the investment initiatives of the private sector.

One key element for effective participation by smaller countries in CARICOM is the enforcement of chapter VII of the Revised Treaty of Chaguaramas (2001), which defines a special regime for "disadvantaged countries, regions and sectors" and for "the less developed countries of CARICOM". This involves the countries of OECS and Belize.

The lack of precision in the treaty's terminology and area of application is an obstacle to its implementation. For example, there is no distinction between compensatory measures, which are short-term, and structural measures that have a longer timeframe. At the most recent meeting of CARICOM Heads of State (Saint Lucia, 4-6 July 2005), OECS representatives advocated revising some of the chapter's clauses to make it better reflect the reality and the needs of the smallest CARICOM countries.

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), "Efectos e implicaciones del mercado común y economía única de la CARICOM en la Organización de Estados del Caribe Oriental (OECS) y la utilización del Capítulo 7 del Tratado de Chaguaramas" (LC/CAR/L.39), ECLAC Subregional Headquarters for the Caribbean, 16 May 2005.

The Caribbean countries are also facing an external situation characterized by the gradual elimination of preferences and even special and differentiated treatment, as evidenced by the Cotonou Agreement and even paragraph 43 of the Ministerial Declaration of Doha. In fact, the Caribbean countries see CSME as the establishment of a common front to respond jointly to the liberalization of trade in the external context.

The most important issues in intraregional talks are: (i) the Caribbean Court of Justice (CCJ), (ii) the Regional Development Fund and (iii) labour mobility.

The CCJ is a trial court that functions as an international court and is charged with the interpretation

and application of the CARICOM Treaty. Its day-to-day operations are financed by a trust fund equivalent to US\$ 100 million. The estimated cost of financing it is US\$ 5 million per year.<sup>15</sup>

The Development Fund is provided for in chapter VII of the Treaty of Chaguaramas (revised version), and it focuses on disadvantaged countries, sectors and regions.

Chapter VII establishes regulations for alleviating the adverse effects that may arise from the establishment of CSME. They include:

- technical and financial assistance to address economic dislocation arising from the operation of CSME;

<sup>15</sup> The Court will consist of a chief justice and at least nine associate justices. The Regional Judicial and Legal Services Commission will be responsible for appointing the justices of the Court. The chief justice is appointed by a three-quarters majority of the contracting parties. The Court will be headquartered in Trinidad and Tobago.

- special measures to attract investment and industries;
- transitional or temporary arrangements to ameliorate or arrest adverse economic and social impact arising from the operation of CSME;
- measures to assist intraregional industries to become efficient and competitive;
- special measures to help industries achieve structural diversification and infrastructure development;
- assistance to offset disadvantages resulting from the removal of intraregional barriers;
- the establishment of mechanisms to monitor, and assist in the discharge of, obligations assumed under the Treaty of Chaguaramas and other international trade agreements.

The Development Fund (article 158) provides financial and technical assistance for disadvantaged sectors, countries and regions. The CARICOM Council for Finance and Planning (COFAP) is responsible for determining the status, composition and functions of the Development Fund and setting Member States' contributions. To date, the fund has not yet begun its operations and merely consists of a "letter of intent" signed by the CARICOM member countries. In view of the important role this instrument can play in the configuration of CSME, at their penultimate meeting (Port-of-Spain, Trinidad and Tobago, 8-9 November 2004) the CARICOM Heads of State issued a mandate to the Caribbean Development Bank (CDB) to draw up a plan for the operation of the fund.

This task poses major challenges, however. Among them is the absence of a definition of what constitutes a sector or a region. Nor does the Treaty define what is meant by less favoured sector, country or region. Further, it does not set a time period for granting temporary preferences or concessions. More importantly, the chapter envisions only disadvantages that may occur as a consequence of the treaty, but makes no mention of the asymmetry in initial conditions and the hysteresis that may result from that factor. Indeed, initial conditions can determine the final outcome of CSME implementation (ECLAC, 2005). Against this backdrop, it is easy to see why ECLAC (2005) recommends that chapter VII be amended first to make it more relevant for the formation of CSME.

Finally, labour mobility is seen in CSME as a fundamental element in the regional integration process. At present, the CARICOM countries do allow labour

mobility, but only for skilled workers (university graduates, communications specialists, athletes, musicians, artists, administrators, supervisors and other service providers). The decision to grant free mobility only to skilled individuals is an important dividing line between big and small countries. The larger countries — which are not poor, highly indebted countries — such as Trinidad and Tobago and Barbados, are also those with the most skilled workforce in the region. The smaller countries, on the other hand, which in some cases are also those with the highest unemployment rates, have a smaller proportion of skilled labour. That is why the OECS Member States are insisting that labour mobility should include both skilled and unskilled workers.

The countries' authorities have announced that CSME should be functioning fully by 2008, which coincides with the elimination of extra-regional trade preferences. The CARICOM Heads of State have also decided that the improvement of intraregional trade in goods and services and of the customs union should be the first step in forming CSME.

The negotiations between the countries that make up the Caribbean Forum (CARIFORUM) and the European Union with a view to signing an association agreement were launched in April 2004 in Kingston, Jamaica.<sup>16</sup> It has been agreed that the association instrument should facilitate sustainable development, the structural transformation of the Caribbean economies and the regional integration process, including special and differentiated treatment. The basic difference of opinion lies in the number of products to be covered by the agreement. Europe advocates 90% coverage, while the CARIFORUM countries want a much smaller percentage.

Phase II, which is to conclude in September 2005, has two objectives: (i) the definition of the CARIFORUM economic sphere to be governed by the association agreement; and (ii) the identification of the CARIFORUM regional integration priorities that Europe could support. CARICOM has emphasized that its priority is CSME and not integration among CARIFORUM countries (that is, between CARICOM and the Dominican Republic).

CARIFORUM and the European Union are working on an understanding to regulate the functioning of a joint regional preparatory task force, which would undertake a series of technical studies on the state of integration in the Caribbean region. This body links the association agreement talks and development strategies to the provision of financial assistance.<sup>17</sup>

<sup>16</sup> CARIFORUM is made up of Antigua and Barbuda, Bahamas, Barbados, Belize, Cuba, Dominica, the Dominican Republic, Grenada, Guyana, Haiti, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname and Trinidad and Tobago.

<sup>17</sup> The initial programme involves drawing up an inventory of technical studies and policy documents on regional integration processes, and an additional inventory of trade assistance and integration programmes currently in operation in the Caribbean.

Along other lines, in January 2005 the European Union announced that it would apply a new tariff regime for banana imports from producing countries, setting tariffs at 230 euro per metric ton. Some banana exporting countries find this excessively high. In fact, these countries plan to take a unified stand to request a tariff no higher than 75 euro per metric ton. The new regime signals the abandonment of a special quota system and a definite transition towards an import programme based only on tariffs.

CARICOM hopes to conclude talks with Canada for a free trade agreement with the idea of establishing a more permanent form of the preferences granted by CARIBCAN, the trade pact between Canada and CARICOM countries. In the negotiations, which began

in the first half of 2005, the Caribbean Community is trying to attain an asymmetrical treaty. Considering the migratory flow from CARICOM countries to Canada, the accord would also promote the liberalization of services, in accordance with Mode 4 of the General Agreement on Trade in Services (GATS).

Finally, CARICOM is also considering the possibility of negotiating a free trade agreement with the United States, a decision that is certainly not without difficulties and costs. Both the stagnation of FTAA talks and the progress of other bilateral negotiations with the United States are influencing the decision, as is the fact that the latter country (along with Europe) is the primary source of tourism and investment flows in CARICOM.

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## E. Dispute resolution and incorporation of common regulations

Despite major efforts to coordinate the implementation and enforcement of common legislation, there is still a high level of non-compliance with common regulations, most critically in MERCOSUR and the Andean Community. These two groups are making progress on improving their

dispute resolution systems, and if successful, they will have taken a significant step forward. CACM countries have achieved a significant reduction in reciprocal disputes, while the members of CARICOM are attempting to make the Caribbean Court of Justice fully operational.

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### 1. Southern Common Market (MERCOSUR)

The key development during this period was the Olivos Protocol, which came into force after having been signed in 2002. The Common Market Council (CMC) appointed the jurists who will serve on the MERCOSUR Permanent Court of Review (TPR), making it possible for that body to begin its work and putting in place a new dispute resolution system (INTAL, 2004a - No. 96). Later on, the CMC approved Decision 20/04, which establishes the Model Rules of Procedure for the MERCOSUR Ad Hoc Arbitration Tribunal (TAAH) (MERCOSUR Secretariat, 2004b).

A large number of regulations have been issued by the various institutional bodies of MERCOSUR, but only

about 30% have actually been incorporated into domestic legislation in the member countries (see table III.13).<sup>18</sup>

The process of incorporating approved regulations into domestic legal statutes is one of the vital problems facing the scheme today. There are various reasons for it: first, numerous standards have not been defined precisely; and second, the national body charged with incorporating the regulation is not the one that negotiated it, which raises delicate issues of coordination within Governments.

In order to help countries come together and resolve their differences before an actual dispute arises, MERCOSUR created a three-stage system: (i) file a

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<sup>18</sup> This situation could become critical in some sectors, as in the case of decisions regarding the administration of justice, about 80% of which have not yet been incorporated (MERCOSUR Secretariat, 2004).

Table III.13  
**MERCOSUR: INCORPORATION OF COMMUNITY REGULATIONS INTO DOMESTIC LEGISLATION**  
*(From January 2000 to May 2004)*

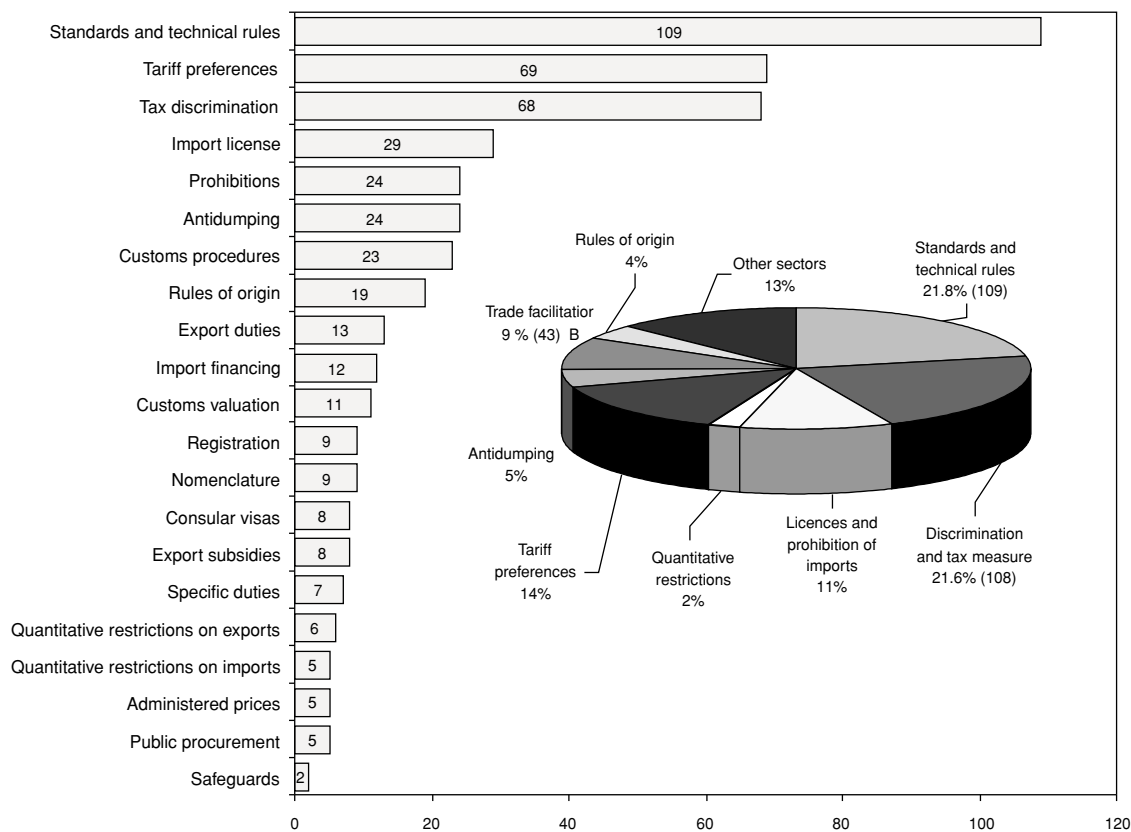
Regulation by body	Totals	Need incorporation	Not incorporated	Percentage of regulations not incorporated
Decisions of the Common Market Council	162	107	64	59.8%
Resolutions of the Common Market Group	277	220	163	74.1%
Directors of the MERCOSUR Trade Commission	46	44	25	56.8%
All MERCOSUR regulations	485	371	252	67.9%

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the MERCOSUR Secretariat.

consultation with the Trade Commission (CCM), (ii) file a complaint with the Common Market Group (GMC) and (iii) take the case to the dispute resolution arbitration system referred to above (Brasilia and Olivos Protocols). Although disputes, in the strictest sense of the term, only arise in the second and third stages, consultations with the CCM are a true reflection of the topics and principal areas

where the most significant differences arise. Between 1995 and 2004 there were 500 consultations (see figure III.8), the main ones being those related to: standards and technical rules (21.8%), discrimination and tax measures (which includes tax discrimination) (21.62%), export duties, financing of imports, export subsidies and specific duties. They are followed by tariff preferences

Figure III.8  
**MERCOSUR: CONSULTATIONS WITH THE TRADE COMMISSION BY TYPE OF NON-TARIFF BARRIER, 1995-2004**  
*(Number of consultations and percentage share)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the MERCOSUR Secretariat, "Primer informe semestral: un foco para el proceso de integración regional" and "LXXV Reunión de la Comisión de Comercio del MERCOSUR. Anexo V Nuevas Consultas" [online] <<http://www.mrree.gub.uy/MERCOSUR/ComisionComercioMERCOSUR/Reunion75/Acta.htm>>.

(14%), licences and prohibition of imports (11%) and items grouped together as measures for trade facilitation (9%), among others (see figure III.8). The sector most severely affected is the food industry (36%), followed by other manufacturing (31%), especially metalworking, chemicals and the textile industry (MERCOSUR Secretariat, 2004b; Maldonado and Durán, 2005).

An analysis of the 32 consultations filed with CCM in the 2003-2004 biennium indicates that: (i) more than half were filed by Argentina and Brazil with respect to their bilateral trade, with Uruguay being the country making the least use of this mechanism; (ii) Brazil has been the subject of the most consultations, especially those filed by Argentina and Paraguay; (iii) the largest number of complaints involves manufactured goods: fertilizers, animal nutrients, tyres, pharmaceuticals, and also soy and lumber in the commodities category (see table III.14).

In the case of Argentina, the number of complaints has grown between 2004 and 2005, especially in the

industrial sectors. The trigger for this upsurge, in the opinion of Argentine authorities, has been Argentina's huge trade deficit with Brazil, as well as the erosion of the competitiveness of many industrial products, particularly household appliances.

The principal conclusion to be drawn from this analysis is that non-tariff barriers predominate, a clear threat to the establishment of a free trade zone. Countries must move towards the harmonization of their rules, especially regulations and standards, and must also limit the application of sectoral exceptions. One allegation made by Argentine producers is that Brazil's mechanisms to boost production and support exporters exacerbate the size asymmetry, making it less likely that other MERCOSUR partners will be able to attract investment for exports to the Brazilian market. They thus complain that an additional distortion remains in place, and so far the group has not taken adequate steps to compensate for it (Delgado, 2004; Bouzas, 2004).

Table III.14  
**MERCOSUR: CONSULTATIONS WITH THE TRADE COMMISSION BY REQUESTING COUNTRY, 2003-2004**  
(Number of consultations by country)

Requiente / Requerido	Argentina	Brazil	Uruguay	Paraguay	Total	Percentages of total
Argentina		9	2		11	34.4
Brazil	4		3	3	10	31.3
Uruguay		3			3	9.4
Paraguay	1	7			8	25.0
Total MERCOSUR	5	19	5	3	32	100.0
Percentages of total	15.6	59.4	15.6	9.4	100	

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the MERCOSUR Secretariat, "Primer informe semestral: un foco para el proceso de integración regional" and "LXXV Reunión de la Comisión de Comercio del MERCOSUR. Anexo V Nuevas Consultas" [online] <<http://www.mrree.gub.uy/MERCOSUR/ComisionComercioMERCOSUR/Reunion75/Acta.htm>>.

## 2. Andean Community

The jurisdictional function in the Andean Community is carried out by the Andean Court of Justice, a collegiate body created by a treaty signed by the members in 1979 and in full operation since January 1984.<sup>19</sup> The actions subject to its jurisdiction are basically the following:

- nullity proceedings against the decisions of the Commission and of the General Secretariat for violating legal standards of the Andean Community;
- actions for failure to comply with obligations under the Community regulatory system. The complaint may be

<sup>19</sup> The process of ratifying the treaty creating the Court was completed four years later, so it took effect in May 1983 and the Court began activities on 2 January 1984. It is headquartered in Quito (Ecuador), and consists of five justices, one for each member State. Their terms are six years, and they can be reappointed just once.

filed by a Member State or by the General Secretariat of the Andean Community (SGCAN), provided the preliminary procedures have been followed<sup>20</sup> under the direction of the General Secretariat, pursuant to the agreement; and

- pre-judicial interpretation, whereby judges of national courts hearing cases to which Andean Community law applies must request an interpretation from the Andean Court of Justice regarding the scope of these regulations.

The Andean Community legal system, unlike its MERCOSUR counterpart, is based on the principle of supranationality, which means that its regulations apply in all member countries and supersede national laws in case of any conflict. Thus, once a standard has been adopted, it is presumed to be immediately incorporated into the laws of every country unless its text expressly stipulates that it must be incorporated into domestic legislation. Nevertheless, in the opinion of the SGCAN, “non-compliance by Member States is still of concern” (SGCAN, 2004). Between 1995 and March 2005, 166 complaints were filed alleging non-compliance, of which 135 (81.3%) had been remedied and 31 (18.7%) remained

unresolved as of mid-March 2005. The countries against which the most complaints are filed are the Bolivarian Republic of Venezuela and Ecuador, and they are also the two countries with the largest number of unresolved cases (13 and 9, respectively) (see table III.15).

Between 2000 and 2004, 279 opinions were issued, of which approximately 25% were on cases filed by the SGCAN on its own initiative.<sup>21 22</sup> Colombia and Peru made the most use of this mechanism, whereas Bolivia filed the smallest number of complaints (see table III.16). After the General Secretariat itself, Colombia, Ecuador and Peru are the countries with the most complaints filed against them.

An analysis of the judgements issued between January and December 2004 reveals that the three countries most likely to use the consultation mechanism were Colombia (18), Peru (13) and Ecuador (10), which together account for 68.3% of all those filed during the period. Ecuador had the most complaints filed against it, with 15% of the total (9 complaints), followed by Colombia with 13% (8 complaints). Peru and the Bolivarian Republic of Venezuela had far fewer, each with 5% (3 complaints). The largest number of complaints were filed against SGCAN, with 58%, equivalent to 35 cases, though 17

Table III.15  
**ANDEAN COMMUNITY: ACTIONS FOR NON-COMPLIANCE WITH COMMUNITY REGULATIONS**  
(1995 - 15 March 2005)

Country	Phase	Phases of procedure in which non-compliance has been remedied			Compliance pending			Total cases
		After ruling and before judicial action	During judicial process	After judgement	Without judgement	With judgement	Total cases of non-compliance	
Bolivia		6	2	1	1	0	1 (10.0%)	10
Colombia		17	7	4	3	2	5 (15.2%)	33
Ecuador		14	8	13	5	4	9 (20.5%)	44
Peru		19	6	8	0	3	3 (8.3%)	36
Venezuela (Bolivarian Republic of)		11	12	7	4	9	13 (30.2%)	43
Subtotal		67	35	33	13	18	31 (18.7%)	166
<b>Total</b>			<b>135 (81.3%)</b>			<b>31 (18.7%)</b>		<b>166</b>

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from General Secretariat of Andean Community, *35 años de integración económica y comercial. Un balance para los países andinos*, May, 2004; “Solución de controversias derivadas de incumplimientos en la Comunidad Andina”, 2004 and “Informe de la Secretaría General sobre cumplimiento de los compromisos y mecanismos de solución de controversias”, 15 March 2005.

<sup>20</sup> According to Decision 425, the SGCAN shall, on its own initiative or at the request of a country, conduct investigations to determine whether a violation took place and shall issue an opinion explaining its reasoning; notice of any representations made shall be given to the member State alleged to be in violation.

<sup>21</sup> As in MERCOSUR, where pre-judicial consultations were reviewed, in the Andean Community opinions issued as a result of that process between 2000 and 2004 were reviewed.

<sup>22</sup> Many of these decisions were prompted by the interests of private parties or businesses in the respective countries.



Table III.16  
**ANDEAN COMMUNITY: DECISIONS WITH STATEMENT OF GROUNDS, 2000-2004**

Claimant / Respondent	Bolivia	Colombia	Ecuador	Peru	Venezuela (Bolivarian Rep. of)	General Secretariat Andean Community	Total
Bolivia		4	0	3	2	2	11
Colombia	0		6	8	8	49	71
Ecuador	0	7		0	1	31	39
Peru	3	8	9		6	43	69
Venezuela (Bolivarian Rep. of)	0	3	2	0		14	19
General Secretariat Andean Community	2	22	16	15	15		70
<b>Total CAN</b>	<b>5</b>	<b>44</b>	<b>33</b>	<b>26</b>	<b>32</b>	<b>139</b>	<b>279</b>

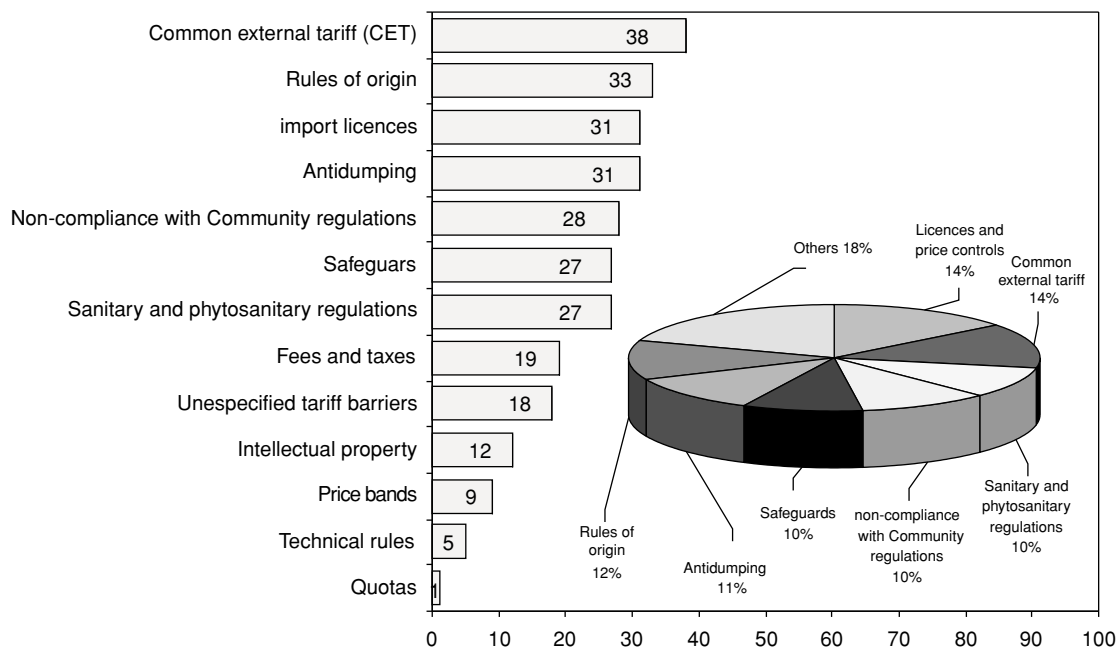
**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from General Secretariat of the Andean Community.

of them were appeals of prior rulings by the General Secretariat and not new complaints. The reasons for the remaining consultations were requests for extensions, for authorization, or for information on the application of certain corrective measures, or measures intended to protect the domestic market of each country.

As for the agreements or regulations alleged to have been violated, during the 2003-2004 biennium safeguards appear to be the most common allegation, with 15 complaints (25% of the total). That category is followed by opinions issued on violations of the common

external tariff (CET), with 11 cases (18%); measures violating Andean Community regulations, with 7 cases (12%); and the use of phytosanitary measures that restrict trade, with 6 complaints (10%). These four types of measures combined account for 65% of all opinions issued by SGCAN in 2004. Looking at a longer period, the main reasons for requests for pre-judicial opinions were the CET (14%), with 38 opinions; licences and price controls (14%), with 39 opinions; and matters related to safeguards, antidumping and rules of origin, with more or less the same number each (see figure III.9).

Figure III.9  
**ANDEAN COMMUNITY: OPINIONS WITH STATEMENT OF GROUNDS ISSUED BY THE GENERAL SECRETARIAT, 2000-2004**  
*(By type of complaint)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from General Secretariat of the Andean Community, 2004.

The economic sectors with the most complaints in 2003-2004 are primarily agriculture (meat, potatoes, fruits, oilseeds, cotton, rice and others), with 30 complaints representing 50% of the total, and manufacturing, with 43.3%, 26 complaints. The measures most often alleged in the area of agroindustrial products (refined oils, canned goods, vegetable fats and oils, and others) are the application of safeguards, phytosanitary

measures, and the non-application or delay of the CET. In the case of manufactured goods (pesticides, brake linings, pharmaceuticals, water purifiers, stoves and extinguishers, footwear and others) the range of allegations is broader, but the most frequent ones are the application of safeguards, violations of rules of origin, delays in the application of the CET and the use of import licences.

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### 3. Central American Common Market (CACM)

In the Central American Common Market, the trend towards fewer violations of free trade standards continues. CACM still maintains some of the restrictions set forth in Annex A of the General Treaty on Central American Economic Integration, which excludes the following products and sets up special systems for them: (i) sugar cane, all countries; (ii) green coffee, all countries; (iii) roasted coffee, Costa Rica and Honduras for all countries; (iv) petroleum derivatives, Honduras

for all countries; (v) ethyl alcohol, Costa Rica with all countries and Honduras with Costa Rica, El Salvador and Nicaragua; and (vi) distilled alcoholic beverages, Honduras with all countries.<sup>23</sup>

In September 2003, there were 17 dispute cases, according to reports from the Central American Economic Integration Secretariat (SIECA) (ECLAC, 2004a), and that figure dwindled rapidly to just one in October 2004. That case is still open.<sup>24</sup>

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### 4. Caribbean Community (CARICOM)

With regard to dispute resolution, the countries are making headway in establishing the Caribbean Court of Justice (CCJ), which will have its headquarters in Port-of-Spain, Trinidad and Tobago.<sup>25</sup> In July 2004, the Heads of Government approved the appointment of the first chief justice, proposed by the Regional Judicial and Legal Services Commission. In October, however, it was decided to postpone the inauguration until the first quarter of 2005. In February 2005, the Caribbean Development Bank was able to transfer US\$ 100,000 to the CCJ Fund.<sup>26</sup> In February 2005, the countries

were notified of the decision by the Privy Council in London invalidating legislative decisions adopted by Jamaica, which prevented that country from depositing the ratification instruments associated with CSME. Consequently, Jamaica's ratification, necessary for the establishment of the Court of Justice, was suspended. The Court of Justice therefore cannot replace the Privy Council, whose functions date back to the colonial period in the Caribbean, when the subjection of these countries' legal systems to that of the mother country was the norm. Barbados and Trinidad and Tobago, expressing their

<sup>23</sup> Under Resolutions 03-2004 and 04-2004 of 28 and 29 June, respectively, the Executive Committee for Economic Integration extended the free trade provisions to the roasted coffee that Honduras exports to El Salvador, Guatemala and Nicaragua.

<sup>24</sup> The remaining dispute, according to a report published by SIECA on 5 January 2005, involves inspection fees charged by Honduran authorities to Costa Rican truckers hauling goods in international transit from Mexico to Costa Rica.

<sup>25</sup> In July 2003, at the twenty-fourth ordinary meeting of the Conference of Heads of Government, the Protocol of Privileges and Immunities of the CCJ and of the Regional Judicial and Legal Services Commission, the protocol for the establishment of the CCJ and the agreement establishing the Financial Fund for the CCJ were signed (SGC, 2004-2005).

<sup>26</sup> The CCJ Fund came into force in January 2004.

solidarity with Jamaica, also postponed the deposit of their ratification instruments while waiting for Jamaica to decide what to do.

After the CCJ is inaugurated, it will have to resolve some conflicts that may arise in connection with tariff barriers. Examples include the general tax levied by Belize; the tax on beer, pasta and carbonated beverages imposed by Saint Kitts and Nevis; as well as the lumber tax adopted by Suriname and the environmental fees set by several countries (SGC, 2005c). Recently, Jamaica applied a waiver of the 25% CET to its rice imports from Guyana and Suriname on the grounds that the two countries are not in compliance. They, in turn, claim they are willing to fulfill their commitments as suppliers, and they complain of pressure exerted on them by Jamaican business owners to lower prices in the short term. This dispute will probably be the first one the CCJ will have to resolve (EIU, 2005).

Trinidad and Tobago has made the most progress in adopting legislation applicable to the common market, as it already has laws governing consumer protection, antidumping regulations and compensatory measures. A draft is being written to implement legislation on harmonized customs models and regulations, while the competition law and the legal systems for the establishment of services and capital remain to be implemented by the countries. In most of the areas requiring legislative harmonization, the first drafts for discussion are still being written (consumer law, antidumping and compensatory measures, banking and insurance legislation, law on companies, intellectual property rights, technical rules and standards, medicine and food labelling, sanitary and phytosanitary measures, subsidies, commercial arbitration and others). In conclusion, little headway has been made, and in practice heterogeneity is the rule (SGC, 2005c).

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## Capítulo IV

# Concern about a resurgence of protectionism in world markets

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### A. Introduction

With the decisive Sixth Ministerial Meeting of the World Trade Organization — to be held in Hong Kong, Special Administrative Region of China, from 13 to 18 December 2005 — just a few months away, the global economy is exhibiting an alarming increase in protectionist leanings, particularly in the most highly industrialized economies. The controversy in the United States concerning that country's deepening current account deficit, for example, is increasingly being tied in with concern about soaring Chinese exports to that market. Senior authorities in the Administration and in Congress have deployed a battery of tactics for putting pressure on China to revalue its currency, since they argue (based on this simplified version of the issue) that this will pave the way for a correction of the present external imbalance in the world's largest economy. Although, as noted in chapter I, the actual figures do not back up this idea, quite drastic unilateral proposals are being put forward in this connection in the United States Congress. These proposals have not been acted upon, but they nonetheless contribute to a certain uneasiness about trade between China and the United States, as well as casting doubt upon the willingness of major political actors in the United States to assume a leadership position in promoting free trade. In so doing they also hamper a process which, while perhaps generating transitional adjustment costs, has the potential to benefit all the parties concerned.

As in the case of textiles, within the context of the Central American Free Trade Agreement (CAFTA-DR), the quarrel about sugar imports was a symbolic test of the Bush Administration's ability to make good on the promise it made to developing countries to liberalize trade in agricultural goods in the Doha Round. If protectionism and special national interests had prevailed and the treaty had not been ratified, it would have been even harder to reach agreement on this point in the WTO negotiations. In fact, the treaty's passage by such a narrow margin raises serious doubts as to the United States Congress' willingness to cut agricultural subsidies or to take other politically difficult steps in future trade agreements, not only within the framework of WTO negotiations but also in connection with bilateral treaties with such countries as Thailand, South Africa, the Andean nations and Panama. The enormous obstacles that the small Central American economies with close ties to the United States — whose total annual exports to the United States market are roughly equal to what China exports to it in a month — had to surmount in order to conclude an agreement with that country provide an idea of just how difficult it may be for other countries of the region to secure free trade agreements (FTAs) that will give them greater access to that market.

The Doha Round negotiations, as well as the trade disputes that have arisen in various areas and the rulings issued in those cases (e.g., the complaint regarding cotton subsidies filed by Brazil and the reform of the European Union's sugar subsidization programme), are forcing industrialized countries to limit their "amber box" subsidies. The path that events are taking within WTO makes it more difficult for countries with high trade barriers in the agricultural sector to maintain production-linked subsidy programmes. In this sense, the Doha agenda represents a unique opportunity to address the protectionism practised by WTO members in sectors of importance to Latin American and Caribbean countries, particularly agriculture (including sugar, cotton and bananas) and textiles and clothing.

With this situation as a backdrop, the expiration of the Agreement on Textiles and Clothing and the consequent elimination of quotas on imports to major markets have been followed by sizeable increases in Chinese exports to the United States and the European Union. In both cases, this sparked wide-ranging protests in production sectors as well as public reactions from political figures and trade authorities. Meanwhile, the debate regarding CAFTA-DR in the United States

Congress has focused attention on the power of the sugar lobby, which has been buttressed by protectionist voices in the textiles industry (i.e., the two subsectors of greatest interest to the economies of Central America and the Dominican Republic).

The agricultural sector is the focal point of protectionism in the industrialized economies, but it is also the arena in which developing countries have won a number of victories over proponents of this sort of trade distortion. Examples include the Dispute Settlement Body's favourable rulings regarding the complaints lodged by Brazil concerning the European Union's sugar subsidies and the United States' subsidization of local cotton producers (WTO, 2002a, 2002b, 2002c and 2003a). These major achievements have implications in a number of areas, above and beyond their impact in terms of employment and growth in developing countries. First of all, the WTO rulings have bolstered the developing countries' arguments concerning agricultural subsidies and domestic supports in developed nations. This raises the ante in the negotiations, since certain aspects of these issues could have been addressed during these talks had the WTO not already ruled them incompatible with its rules and therefore in need of adjustment. Given that these are sensitive sectors in the respondent economies, WTO credibility will be called into question as long as these policies remain unchanged. This reopens the debate on reforming the WTO Dispute Settlement Body (DSB) itself with a view to guaranteeing the effectiveness of its rulings, since shortcomings in its current procedures allow losing governments to "buy" their way out of the obligation to change a protectionist rule by offering compensation or simply by weathering the retaliatory measures. This is especially the case when the loser is a developed country that has the economic capacity to do so (WTO, 2004b).<sup>1</sup>

The inherent challenge to the credibility and effectiveness of WTO rulings is particularly serious when the parties involved are major players in the world economy and are denouncing practices on each other's part that are in breach of multilateral WTO agreements. The United States and the European Union have, for example, been involved in protracted trade disputes concerning hormone-treated beef and steel production (WTO, 1996a, 2002d, 2002e and 2004a). A more recent example is the Boeing/Airbus dispute, with the world's two largest civil aircraft manufacturers confronting each other in what is set to become the most extensive and complex case ever handled by WTO.

<sup>1</sup> For example, the Byrd amendment, the 1916 Anti-Dumping Act and Section 211 of the 1998 Omnibus Appropriations Act have all been found to be incompatible with WTO rules but have yet to be modified by the United States.



In the final analysis, then, protectionist pressures have not eased, nor are they confined to traditional industries such as sugar, cotton and textiles. They are also present in sectors of the “new economy”, such as civil aeronautics and services. An example of the latter is the current debate in the United States about

outsourcing services to India; another is Antigua and Barbuda’s recent victory in the case brought against the United States regarding the application of protectionist measures to games of chance and gambling. These cases will be examined in the following sections.

## B. Implications of the boom in textiles and wearing apparel following the expiration of the Agreement on Textiles and Clothing

Imports of Chinese textile and apparel products into the United States exhibited a striking year-on-year increase of more than 60% in the first half of 2005. Imports of some “sensitive” goods (such as underwear, cotton trousers, and cotton knit shirts) that had previously been governed by the system for setting quotas on a country-by-country basis have trebled or even quadrupled in volume. This is taking place against the backdrop of tense bilateral trade relations at a time when the United States’ trade deficit with China reached a record US\$ 162 billion in 2004, making it the largest trade imbalance ever recorded by the United States with any one trading partner. This upswing in Chinese exports has come at the cost of dwindling shares in United States imports of textiles and clothing for Latin American economies such as those of Mexico and a number of Central American countries. In the first two months of 2005, the United States’ trade deficit with China was continuing to grow much faster than its overall trade deficit.<sup>2</sup>

In light of these tendencies, United States textile and apparel companies have urged the United States Government to re-impose quotas on Chinese imports, alleging that the country has flooded the United States market since the lifting of global quotas on 1 January 2005.<sup>3</sup> On 13 May, the Committee for the Implementation of Textile Agreements (CITA) announced that it would invoke safeguards on a number of categories of apparel under the Agreement on Textiles and Clothing (i.e.,

categories 338/339, 347/348 and 352/652) and would, in addition, impose safeguards on another four categories of imports starting on 26 May (Chinese-origin combed cotton yarn (category 301); men’s and boy’s cotton and man-made fibre shirts (not knit) (category 340/640); man-made fibre knit shirts and blouses (category 638/639); and man-made trousers (647/648)). Upon receipt of this request, on 27 May 2005, China has been obliged to hold its shipments to a level no greater than 7.5% above the preceding year’s. Since no mutually satisfactory solution was reached within the 90-day consultation period, in accordance with the findings of CITA and the terms of China’s WTO accession agreement, the United States was allowed to apply limits on imports of brassieres and specified synthetic fibres from. Strictly speaking, the new United States quotas do not violate the WTO rules, since, earlier on, China accepted the imposition of safeguards through 2008 as one of the conditions set for its entry into WTO in 2001.

European officials also considered some form of trade restriction to stem the flood of Chinese textile and apparel imports into the European Union. Based on import statistics for the first quarter of 2005, the European Commission launched investigations into 10 categories of Chinese textile exports to the European Union. In all of these categories, it was found that import volumes for Chinese textiles had risen above the “alert levels” defined by the Commission.<sup>4</sup> A special task force was

<sup>2</sup> In the first five months of 2005, China’s trade with the United States swelled by 24.6% to US\$ 77.7 billion. Its trade with the European Union jumped by 24.2% to US\$ 81.8 billion, and its trade flows with Japan totalled US\$ 70.2 billion. Chinese garment exports during the same period amounted to US\$ 24.4 billion, up by 17.2% on year (*The Wall Street Journal*, 2005).

<sup>3</sup> There are reportedly about 665,000 textile and apparel manufacturing jobs in the United States, and some quarters fear that those jobs may vanish within a few years. According to the National Council of Textile Organizations, 17,000 jobs were lost in 2005 in the United States following the closure of 11 textile and apparel plants (*The New York Times*, 2005).

<sup>4</sup> Chinese textile exports to the European Union increased by 18% during the first four months of 2005 as compared to the same period of 2004 (*El Mercurio*, 2005).

set up to conduct a full and rapid investigation into the matter. After arduous negotiations, in a bid to defuse a trade row, on 10 June the two sides agreed that between 11 June 2005 and the end of 2007, the growth of Chinese textile exports to the European Union would be limited to an annual increase of from 8% to 12.5% over an agreed base quantity. In 2008, the European Union will apply paragraph 242 of China's WTO Accession Protocol on textiles "with restraint". This provision requires China to limit its exports of these products. In return, the European Union has agreed to halt its investigation into Chinese exports of 10 textile products to the European Union, including cotton cloth, T-shirts, flax yarn, bed sheets, tablecloths and trousers. China's official media has hailed this agreement as an important step forward, stating that the 25-nation bloc's positive approach contrasted sharply with the attitude of the United States and that the European Union will safeguard the Chinese textile industry's interests and provide a stable trading environment for Chinese companies. Other Chinese circles expressed dissatisfaction with the accord, however, and accused the government of giving into foreign pressure. On 5 September, China and the European Union signed a new agreement under which the latter broadened its concessions and was to provide clearance for numerous import shipments from China that had been held up at their ports of entry.

Some of the other countries affected by Chinese textile export surge are to be found in Latin America. Alarmed by a 58% year-on-year increase in Chinese footwear, textiles, cellular phones and furniture in the first quarter of 2005, the Brazilian Government is also considering applying safeguards to protect domestic industries. Of the 11 investigations under way as of May 2005, two involve China. China is also the object of the largest number of antidumping and safeguard measures being applied by Brazil (11 out of the 44 measures in effect as of May 2005) (Ministry of Development, Industry and Commerce, 2005). Imports from China have increased dramatically since the government recognized China as a market economy, a status which increases the difficulty of filing an anti-dumping complaint. Argentina, which, like Brazil, has recognized China as a market economy, has started applying safeguard measures in its textile sector. The Brazilian Government may opt for issuing two different rules, one applying to Chinese textiles and another for all other Chinese products.

The re-imposition of quotas is also contagious: Turkey has decided to impose textile quotas to protect its large domestic industry against an onslaught of Chinese textile and apparel imports. In addition to safeguards, there is increasing interest among manufacturers in pursuing anti-dumping cases. Anti-dumping complaints

are usually a source of greater concern than safeguards, since the latter can be applied only for shorter periods, whereas anti-dumping duties can be maintained for up to five years or more. The procedure involved in lodging an anti-dumping complaint is complex, and in order to file such a case, domestic manufacturers or workers must account for at least 25% of the domestic industry's output.

Thus far, the only countries regarded as having benefited from the elimination of quotas are China and India, and this has been at the expense of middle-income countries, rather than low-income countries such as Bangladesh, Cambodia, the Lao People's Democratic Republic, Mongolia, Nepal, Sri Lanka or Viet Nam. This is partly because many buyers are reluctant to shift too much sourcing to China due to fears that the United States and the European Union might re-impose quotas. Prices of these products are falling, by roughly 12% in the case of apparel imports from China into the United States market and by more than 50% in certain categories (IMF, 2005).

Well aware of the problems that the re-imposition of quotas would cause, China actually went so far as to introduce a tax on its own textile exports at the end of 2004. The tax, seems to have had only a marginal impact, however, and the government has therefore been obliged to consider more drastic restraints, such as the establishment of minimum prices for its exports. In an attempt to ease trade tensions, on 20 May the Chinese authorities announced that they were raising export tariffs on 74 types of textile and apparel products to ¥ 1 (US\$ 0.12) per item of clothing (a threefold increase from the previous level of ¥ 0.3 per unit). These restrictions were not to apply to categories subject to import restrictions abroad, however.

Later, on 30 May, the Chinese Government decided to lift the tariffs on several categories of textile and clothing exports in retaliation against import restrictions imposed by the United States (*Bridges Weekly New Digest*, 2005).

All this could herald a return to the use of "voluntary" export restraints (VERs), whereby, rather than imposing import restrictions, developed countries put pressure on exporting countries to keep their exports in check. VERs were frequently used in the past, until the countries agreed to eliminate them during the final stage of the Uruguay Round. China's decision — after coming under pressure from the European Union and the United States — to levy taxes on its textile exports as a way of avoiding safeguards can be regarded as a variation on such "voluntary" restraints.

A coalition of 15 of the world's poorest developing countries is now lobbying the United States Congress to

pass a new scheme that would give them trade preferences to offset the advantages gained by China and India with the lifting of quotas on textiles and apparel. These countries are at a considerable disadvantage in selling to the United States market, not only vis-à-vis such large exporters as China and India, but also relative to smaller African and Latin American countries that enjoy duty-free access for many garment exports. A number of political hurdles will have to be overcome, however, in order to win passage of the new trade preferences bill, which enjoys some bipartisan support in both houses of Congress, as well as backing from various transnational companies.

China's competitive advantage over Latin America and the Caribbean is one of the reasons why the Bush Administration has tried to level the playing field in order to support the countries' domestic textile and apparel industries. The White House sought to use these measures to gain the industry's support for

CAFTA-DR, which Congress ratified in late July, although by a very thin margin (for a more detailed discussion of this issue, see section C). And in fact, United States textile companies that have moved much of their production to Central America tend to be CAFTA-DR supporters. The ratification of this agreement locked in duty-free access to the United States for this sector, which employs close to 400,000 people (*Financial Times*, 2005a). It has also been seen as sending a clear signal to the world that the United States is willing to make the tough choices needed to advance trade liberalization on a global scale, especially since a failure to win ratification would have undermined the United States' leadership in the Doha Round. If Congress were to refuse to ratify a trade agreement of this sort, other countries engaged in negotiations with the United States might well ask themselves why they should make any concessions whatsoever regarding politically sensitive products.

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## C. Negotiations between the United States and China regarding its currency regime

The implications of the trade dispute between the United States and China concerning textiles and apparel has spilled over into another contentious area: China's currency regime. Some scholars and Congressmen in the United States are of the opinion that it should threaten to levy a hefty surcharge on imports from China. In April, the Senate voted 67 to 33 against killing an amendment that would have attached a provision calling for a 27.5% surcharge to a spending bill.<sup>5</sup> The Democratic Senator from New York, Mr. Schumer, withdrew the amendment, but Senate Republican leaders brought the bill up for a second vote in late July, but it was defeated. The point of this proposal was not to impose duties but rather to persuade China to revalue its currency, the yuan, by 25% or more.

The advocates of a change in China's currency regime argue that today's unsustainable pattern of global trade based on expanding United States deficits and Asian surpluses siphons off jobs and production from the United States and poor countries in Africa and in Latin America and the Caribbean. A higher yuan would allow other Asian countries to revalue their currencies and the United

States to reduce its trade imbalance. To date, by investing the surplus dollars earned from exports in United States Treasury bonds and other dollar-denominated securities, China and other Asian countries are, in effect, recycling the United States' twin deficits. This has held down United States interest rates, encouraged households in that country to borrow and kept Asian currencies from rising. A large-scale revaluation of the yuan and other Asian currencies ought to alter this process, but might also create turbulence in the international financial system. This would also eventually affect the interest rates paid by many Latin America and the Caribbean countries on their foreign debts.

For nearly two years now, the United States Treasury Secretary has been engaging in financial diplomacy in an attempt to convince Chinese leaders that it would be in their own interest to float their exchange rate and thus allow it to respond to global financial markets. The impact of a revaluation of the yuan cannot be predicted with any certainty, however, and it would be unlikely to be enough to bring the United States trade imbalance into a sustainable range.

<sup>5</sup> Mr. Schumer (Democrat Senator from New York) together with Mr. Graham (Republican Senator from South Carolina) stunned administration officials in April by winning bipartisan Senate support for a measure that would threaten China with tariffs up to 27.5% if the Asian country failed to change its currency regime.

As noted in the Report to Congress on International Economic and Exchange Rate Policies, published on 17 May 2005, the Secretary of the Treasury found no major trading partner of the United States met the technical requirements to be considered as manipulating the exchange rate.<sup>6</sup> Secretary John W. Snow also reminded his listeners that the Bush Administration was not calling for an immediate or complete float in fully liberalized capital markets, noting that, given the shallowness of the Chinese banking sector, it did not seem wise for China to undertake a complete float within a context of free capital movements, at this stage.<sup>7</sup> He was also aware that a more flexible currency regime in China, in and of itself, would not solve global imbalances. Nevertheless, in his view, the risks associated with a delay in reforming the currency regime were very substantial, not only for the world economy but also for China itself. An independent monetary policy should allow China to more effectively pursue price stability, stabilize growth and respond to economic shocks.

Although the United States Administration has argued that it is in China's interest to revalue the yuan, the issue poses a difficult problem for it as well. Paul Krugman has contended that low interest rates have been a crucial factor in the United States housing boom and that this boom, in turn, has buoyed consumer spending as homeowners convert their rising house values into cash by refinancing their mortgages (Krugman, 2005). A reversal of China's exchange-rate policy could drive up United States interest rates and perhaps burst the housing bubble, which might well trigger bankruptcies, a downturn in employment in the construction industry and a drop in consumer spending. Krugman has therefore warned that the United States Government is not paying due attention to what effects it might have if China actually does accede to the United States' demands and allows the yuan to rise.

On 21 July, the People's Bank of China announced a 2.1% revaluation, permitting the yuan to move within an adjusted 0.3% band, counting from the close of business on the preceding day, based on a basket of

its main trading partners' currencies. This scale of this revaluation was as had been expected but, at least in theory, this scheme could permit the currency to build up a cumulative increase of as much as 6% per month (if it rose by the maximum amount permitted —0.3%— on each and every working day), which would certainly constitute a significant revaluation. This exchange-rate policy carries forward the administered flotation policy that China has maintained since 1994 and is not expected to have any significant impact in the short run on trade flows between China and its principal markets. Nor is it likely to alter investors' expectations substantially. The possibility does exist, however, that investors may speculate on the yuan and start to invest heavily in China, which might generate inflationary pressures and create asset price bubbles. Meanwhile, this revaluation could benefit Latin America and the Caribbean in the medium term by making the region's products more competitive, not only in the Chinese market but also vis-à-vis Chinese products that they compete with in other markets. As noted in chapter I, if the dollar parity of the yuan and other Asian currencies had remained unchanged, the inevitable devaluation of the dollar would have been reflected in revaluations of the euro and Latin American currencies, thereby dampening the momentum of these countries' export sectors and growth capacity. It would also have added to the external debt burden as international interest rates rose.

In the view of the United States Treasury Department, China has clearly stated that it intends to move towards a market-based, flexible exchange rate and has undertaken the necessary preparations to that end. However, some segments of Congress and the private sector do not share this view and would like to continue pressuring China to apply immediate self-restraints. Some United States officials were reportedly hoping for a revaluation in the range of 10%, but other analysts were projecting that China would widen the yuan-dollar exchange band by a smaller amount, or adopt a trade-weighted currency basket scheme, within a 2%-5% range as a first step towards a freely floating exchange rate.<sup>8</sup>

<sup>6</sup> Under the 1988 Omnibus Trade and Competitiveness Act, the Treasury Secretary is required to analyse "on an annual basis the exchange rate policies of foreign countries, in consultation with the International Monetary Fund, and consider whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade."

<sup>7</sup> According to the United States-China Commission, a move to a flexible exchange rate and a totally open capital account would lead to financial turmoil and could even result in a depreciation of the yuan. This is because China's financial system is quite shallow, and the lifting of all controls on capital movements, thereby providing Chinese residents with the choice of maintaining savings abroad, could result in an exodus of domestic capital. The Commission therefore advocates the idea that, in the short run, China should raise its currency peg substantially and reinstate capital controls. As part of the revaluation, China could use a basket of currencies as a peg for the yuan rather than just the United States dollar (United States-China Economic and Security Review Commission, 2005).

<sup>8</sup> "China told by US to revalue renminbi by 10%" (*Financial Times*, 2005b); "Don't expect a big change in China's exchange-rate policy or much effect on the world economy" (*The Economist*, 2005).

The protectionist tone adopted by the United States manufacturing sector has spread to other industries. With their bonds now being downgraded to “junk” status, General Motors and Ford have stepped up their lobbying efforts in conjunction with other industrial and agricultural associations belonging to the Coalition for a Sound Dollar, which represents over 90% of United States exporters. The Coalition, whose complaints had until recently focused primarily on China, is now broadening its campaign to include Japan and the Republic of Korea as countries that are manipulating their exchange rates.

In these companies’ view, the main cause of their loss of competitiveness is the high cost health care. This constitutes a major problem that Washington has little interest in tackling at present.<sup>9</sup> Most foreign motor vehicle plants in the country are located in Southern states, and a majority of their congressional representatives are Republican. Increased sales of foreign motor vehicles produced in the United States create jobs in these states, making the Republican majority in Congress less sympathetic to job losses in the Midwestern states.

## D. The sugar and textile industries’ lobbies against ratification of the Free Trade Agreement between the Dominican Republic, Central America and the United States

The Bush Administration and the six Latin American Governments concerned hail CAFTA-DR as an unprecedented political and commercial opportunity. The United States Congress, which finally voted in favour of the pact on 27 July 2005, was not entirely convinced of this, however, while organized labour, sugar producers and many textile companies in the United States opposed it, warning that it would harm workers and destroy industries. Workers and industrialists in several CAFTA countries were also concerned about the agreement’s possible adverse effects and tried to slow down its ratification process.

The major advocates of the pact are the United States industries for which it will open up new export opportunities. More than 50 groups from the poultry, dairy, fruit and other industries, together with certain manufacturers and service providers, have supported CAFTA-DR.<sup>10</sup> Their support stems from the fact that, under this agreement, more than 80% of United States manufactures and more than half of its agricultural exports will immediately be granted duty-free entry

to the Central American countries. In addition, the liberalization of the services sector works to the benefit of United States high-technology service providers in areas such as banking, telecommunications, energy, insurance and entertainment. (Office of the United States Trade Representative, 2004).

In addition to these economic factors, there are geographic, social and political reasons for favouring CAFTA-DR. First, Central America shares a border with Mexico, which is already a member of the North American Free Trade Agreement (NAFTA), and CAFTA-DR can thus be seen as a natural extension of that agreement. A second factor is the existence of so many Latin American emigrants living in the United States. Yet another is that this pact is aligned with United States foreign policy towards a region that has suffered from civil conflicts, insurgencies and human rights abuses. Today, this subregion is an important trading partner (the second largest Latin American market for its exports after Mexico), having imported close to US\$ 15 billion of United States products in 2003.<sup>11</sup> This places Central

<sup>9</sup> The “Big Three” make 74% of the motor vehicles manufactured in the United States, employing 400,000 workers at 74 plants in 34 states. Of all the autoparts made in the country, the Big Three purchase close to 80%. These companies provide health insurance benefits for more than 2 million people at an average cost of US\$ 1,275 per vehicle, while foreign producers operating in the United States employ 290,000 workers and spend US\$ 425 per vehicle on health care.

<sup>10</sup> The American Farm Bureau Federation estimates that CAFTA-DR will increase agricultural exports by US\$ 1.5 billion (United States Trade Representative, 2004d).

<sup>11</sup> Reciprocal merchandise trade between the United States and the five CAFTA countries and the Dominican Republic reached US\$ 31.9 billion in 2003, making these countries the thirteenth-largest market for United States products and placing them ahead of Brazil, Singapore and Australia. This means that the Central American market is four times as large as Chile’s, which signed a free trade agreement with the United States in 2003. The five CAFTA nations and the Dominican Republic are thus the second-largest market for United States exports in Latin America, after Mexico (United States Department of Commerce, 2004)

America alongside other large industrialized trading partners of the United States, such as France (US\$ 17 billion) and Italy (US\$ 10.5 billion) (United States Chamber of Commerce). Meanwhile, the Central American subregion is the fifteenth largest buyer of United States imports, with such purchases totalling US\$ 16.8 billion in 2003 (United States Census Bureau, n/d).

One very controversial issue that could have blocked passage of CAFTA-DR by the United States Congress revolved around the sugar industry. This sector put up a great deal of opposition to its ratification, claiming that it would be the clearest loser under the agreement. The pact does, in fact, open up the tightly regulated United States market to imports from the Central American countries and the Dominican Republic. While organized labour and textile manufacturers also opposed the agreement, sugar growers waged by far the strongest battle to defeat it. To this end, they capitalized on the breadth of the industry's political geography, which ranges from cane-producing states such as Louisiana and Florida to sugar-beet producers such as Idaho, Wyoming and Montana. Farmers lobbied their congressional representatives to signal their disapproval of the agreement.

Sugar has long been one of the most sheltered industries in the United States' highly protected agricultural sector. Since the mid-1800s, the United States Government has taken steps to prop up the price of sugar and protect domestic growers, and the existing programme of price supports is practically untouchable. Since the Republican-led Congress began opposing farm supports in the mid-1990s, sugar has been one of the few commodities to survive unscathed. As in the case of textiles and clothing in the context of CAFTA, the dispute over sugar imports is a symbolically important test of the Bush Administration's ability to deliver on a broader promise to developing countries to liberalize agricultural trade as part of the Doha Round. If CAFTA-DR had been defeated in Congress by protectionist voices and special interests, it would have made it difficult for the United States to secure a global accord at WTO.

Although several Republican members of the Senate Finance Committee (the chamber's starting point on trade and a barometer of congressional sentiment) voiced deep concerns about the agreement's implications for the sugar industry, the committee voted in favour of a bill containing

enabling legislation (11 votes in favour, 9 against) on 14 June 2005, with opinions being divided along party lines. The CAFTA-DR countries cleared another hurdle in the United States Congress on the following day when they won a clear majority (25 to 16) in the Ways and Means Committee of the House of Representatives. After the two relevant committees voted in favour of the agreement, the Bush Administration submitted the bill to Congress. The Senate passed it by 54 in favour to 45 against on 30 June (*Inside US Trade*, 2005a). The real battle was waged on the floor of the House of Representatives. The House's passage of the bill by 217 to 215 in the dawn of 25 July surely elicited a sigh of relief from the Bush Administration and other supporters of the agreement. In the end, 25 Republicans broke with their party to vote against the agreement, while a scant 15 of the legislature's 202 Democrats voted for it. The passage of the accord provided a small beacon of hope for advocates of trade liberalization and to some extent helped to counter the idea that protectionist political forces were dominating the United States Congress. Ratification of the agreement by the legislatures of Costa Rica and Nicaragua was still pending at the time of this writing.

During the campaign, the Bush Administration worked unstintingly to retain the treaty's provisions concerning the sugar industry, since their modification would have eroded support in the Central American countries, where many felt that this issue would make or break the agreement. As in the above case, if the amendment aimed at tightening labour-law enforcement that was backed by some congressional representatives had been adopted, the Administration would have had to renegotiate the corresponding chapter of the agreement.<sup>12</sup>

Support for CAFTA-DR came from a variety of sectors, including a number of agribusiness industries, which project that their exports to the CAFTA countries will rise by US\$ 1.5 billion a year once the treaty is fully implemented. In return, however, the Bush Administration agreed to expose United States sugar producers to greater foreign competition. The changes that have been agreed to are modest, however. The agreement will raise import quotas for the CAFTA countries by just 153,140 tons (roughly 1% of United States production) over a 15-year period.<sup>13</sup> In the view of sugar industry officials, those imports will upset the

<sup>12</sup> The panel's top-ranking Democrat, Senator Max Baucus of Montana, faced strong pressure in his state, and two other Republican representatives from that state are opposed to the pact.

<sup>13</sup> Under CAFTA-DR, six countries will obtain a small amount of additional access to the United States sugar market. These countries can now export 311,700 metric tons of sugar each year to the United States under existing tariff-rate quotas. In the first year that CAFTA-DR is in effect, they will be able to export an additional 109,000 metric tons and, by its fifteenth year, the countries may export up to an additional 153,140 metric tons.

balance of the existing price-support programme, which is designed to prop up sugar prices by controlling the amount of sugar put on the market. CAFTA-DR critics say that even a small increase in imports will cut into the production allotments of United States farmers, thus reducing their income.

The United States International Trade Commission (USITC) projects no more than a minimal change in United States sugar prices —between 0.25% and 1.2%— and has noted that even these figures are almost certainly overestimates.<sup>14</sup> Officials have stated that prices should actually not change at all since, under the laws in force and the existing marketing allotment programme, the United States Department of Agriculture (USDA) can simply adjust the amount of sugar that domestic processors are allowed to sell in order to compensate for the small increase in imports. As a result, neither the supply nor the price of sugar should change very much. It should be pointed out that, as an effect of the existing sugar programme, United States sugar prices are from two to three times higher than the world price. Sugar users dislike marketing allotments, but the United States sugar lobby resolutely supports the system.

The sugar lobby, which contributed US\$ 3.2 million to political campaigns in 2004,<sup>15</sup> put strong pressure on Congress to veto CAFTA-DR. These financial contributions helped the sector to see to it that import quotas were maintained over the past three decades, resulting in a 75% reduction in sugar imports. As pointed out earlier, the United States imports only about 10% of the sugar its population consumes, and the price paid by United States consumers is practically twice as much as the international price. With CAFTA-DR, sugar imports will rise by only some 1.2%, while the benefits to this sector in Central America in terms of income for small and medium-sized farmers and increased employment will be significant (Office of the United States Trade Representative, n/d). Healthy competition in the sugar trade should reduce the domestic price in the United States but —welfare gains for consumers notwithstanding— appears to be regarded as a threat by the sugar industry.<sup>16</sup> Continued protectionism in this sector also has significant implications on the domestic front, since industries in the United States that use sugar as an input must face competition in foreign markets for

their final products yet continue paying an extremely high price at home for this important commodity.

USITC has stressed that sugar price supports and marketing allotments are not part of free trade agreements (FTAs). The Administration has reserved domestic farm supports for negotiation in WTO. Under CAFTA-DR, sugar is being treated like any other commodity. USITC has pointed out that none of the provisions contained in CAFTA affects the price-support loan rate for sugar or any other part of the domestic sugar programme. FTAs refer solely to market access, i.e., tariffs, quotas and other non-tariff trade barriers. CAFTA-DR provides for modest increases in United States sugar quotas for the signatory countries, and the exclusion of sugar from the agreement, as was done in the case of the FTA signed by Australia and the United States, would have adversely affected United States interests in the Central American nations, since the elimination of their high trade barriers will open up potential export opportunities for the United States. If the United States had insisted on leaving sugar out of CAFTA-DR, the Central American countries would have responded by excluding corn, beans, pork, poultry, dairy products and other goods that they regard as “sensitive.” Moreover, Congress cannot alter the terms of an executive agreement such as CAFTA-DR. Under Trade Promotion Authority (TPA) procedures, Congress may only ratify or reject trade pacts (since otherwise, the signatory nations would not be approving the same agreement).

The sugar lobby’s efforts were accompanied by similarly intense lobbying by the textile sector, which also pressured Congress to keep it protected from foreign competition. The provisions of the pact on clothing contain restrictive rules of origin that require the use of inputs made in the United States. (CAFTA, n/d) Under these rules, a textile product or clothing item manufactured in Central America or the Dominican Republic must be made out of regional inputs in order to be considered as originating from the region and thus be eligible for preferences on the imported inputs. Accordingly, in order to be eligible for these preferences, clothing exported from Central America or Dominican Republic to the United States must contain textile components made in that country, which tends to raise production prices and cancels out the savings made possible by the lifting of

<sup>14</sup> USITC conducted two different economic analyses on the CAFTA-DR sugar provisions, neither of which took marketing allotments into account. The first study’s findings give a price decline of 0.25%, based on a 2.54% decrease in the industry’s revenues. The second projects an initial price decline of 0.8%, with a 1.2% price decrease after 15 years.

<sup>15</sup> Information provided by the Center for Representative Politics, a research group in Washington, D.C.

<sup>16</sup> The Senate Committee on Agriculture has therefore sought to guarantee that CAFTA will not result in such a price drop (*Inside U.S. Trade*, 2005).

tariffs and quotas. This will lessen the competitiveness of Central American producers, which face strong competition from China and India.

Many Republican members of the House who represent textile-producing districts remained undecided for quite some time or said they would oppose CAFTA-DR. As a result, the Administration found itself debating whether to concentrate its efforts on a compromise with House members from sugar-producing districts or from textile-producing districts. Meanwhile, the United States Government modified some of the CAFTA provisions on pocketing and lining referring to the applicable rules of origin in order to require that, in order to be eligible for duty-free access, any non-visible pocketing and lining of garments must be sourced from the United States or the Central American region (*Inside US Trade*, 2005). The corresponding side agreements have yet to be debated by the six countries in an official forum. In addition, the United States Government has agreed to address some of the specific complaints of its CAFTA-DR partners.<sup>17</sup> However, opponents of the pact have argued that this change is unlikely to be passed into law because the authority to change rules of origin for textiles ultimately rests with Congress, not the Administration. Several members of Congress have linked their support to the approval of a provision would allow the United States to impose countervailing duties on Chinese textile and apparel goods.

From this perspective, although it introduces improved market access provisions, CAFTA-DR is not a totally balanced free trade agreement. Its limitations are concentrated in those sectors that have been protected for years and in which the Central American countries

have strong comparative advantages. The protectionist measures of this sort include the following: (i) the tariff liberalization programme for some products that are “sensitive” to foreign competition; (ii) quotas for certain products; (iii) specific safeguard mechanisms; (iv) local content requirements; and (v) stipulations on a compensation scheme for sugar export, to take the place of broader market access.<sup>18</sup> It should also be mentioned that, in addition to the general safeguard mechanism provided for in the case of sugar exports in chapter 8 of the treaty, there are also to be specific safeguards that could be applied to textiles (Article 3.23, chapter 3) in the event that surges in imports of such products during the transition period.<sup>19</sup> Products whose tariffs are to be reduced gradually include cotton, wool, pillowcases and bed clothing, and cashmere. With respect to sugar, the pact maintains onerous quotas and prohibitive tariffs of more than 100% on imports in excess of the quota. This is one of the highest tariff rates in the United States’ entire tariff schedule. (CAFTA-DR, 2004). According to the United States Trade Representative, the sugar tariff “will not be changed” under CAFTA. This position undoubtedly reflects the political influence of the United States sugar industry (USTR, 2004b). As mentioned earlier, the treaty acquiesces to the use of protectionism, stipulating a “compensation mechanism” in which cash payments are to be made to Central American sugar exporters to make up for the fact that they are not being given free access to the United States market (Article 3.16).<sup>20</sup> This is an inversion of the logic of free trade, because in reality payments are being made in order for the parties to refrain from engaging in trade.

<sup>17</sup> As an example, the Bush Administration has reached an agreement with Nicaragua which will subsequently have to be approved by all members countries of CAFTA-DR. Under this agreement, Nicaragua will be able to use the equivalent of another 300 million square metres of fabric from third countries in garments eligible for duty-free entry to the United States. In return, Nicaragua will agree to use this tariff preference in a way that will minimize any economic damage to United States companies that ship fabric to CAFTA-DR countries for use in making trousers (*Inside US Trade*, 2005a).

<sup>18</sup> The compensation scheme provides cash payments or other forms of trade relief to Central American producers if they cannot ship all the negotiated 109,000 tons of sugar into the United States market.

<sup>19</sup> Article 3.23: Textile Safeguard Measures. “Subject to the following paragraphs, and during the transition period only, if, as a result of the reduction or elimination of a duty provided for in this Agreement, a textile or apparel good of another Party is being imported into the territory of a Party in such increased quantities, in absolute terms or relative to the domestic market for that good, and under such conditions as to cause serious damage, or actual threat thereof, to a domestic industry (...)” [[http://www.ustr.gov/assets/Trade\\_Agreements/Bilateral/CAFTA/CAFTA-DR\\_Final\\_Texts/asset\\_upload\\_file721\\_3920.pdf](http://www.ustr.gov/assets/Trade_Agreements/Bilateral/CAFTA/CAFTA-DR_Final_Texts/asset_upload_file721_3920.pdf)].

<sup>20</sup> Article 3.16: “Sugar compensation Mechanism 1. In any year, the United States may, at its option, apply a mechanism that results in compensation to a Party’s exporters of sugar goods in lieu of according duty-free treatment to some or all of the duty-free quantity of sugar goods (...)”.



## E. WTO Appellate Body ruling on the European Union sugar regime

The decision by the WTO Appellate Body giving the European Union up to 15 months to bring its sugar subsidy regime into compliance with global trade rules constitutes yet another victory for Brazil, after the United States lost a similar appeal over its cotton subsidies.

In this dispute, Australia, Brazil and Thailand challenged two types of European Union sugar exports as being subsidized in ways that contravene the WTO Agreement on Agriculture (WTO, 2002a, 2002b and 2003a). The first claim related to the export of “C-sugar” (over-quota sugar production that must be exported without subsidy). The complaints alleged that these exports benefit from subsidies due to cross-subsidization with revenues from production under A and B quotas and that it is a form of export subsidy resulting from government intervention because excess profits allow European Union sugar producers to subsidize their exports.<sup>21</sup> Under the present system, the total quota amount of 17.4 million tons, allocated among the 25 member States and divided into A quotas (82%) and B quotas (18%), corresponds to the demand on the internal market and to the export of excess-quota sugar with export refunds, respectively. The price guarantee applies only to specific quantities (quotas) of sugar per European Union member States. Sugar produced outside the quota does not receive support and cannot be freely marketed within the European Union. This sugar, declassified and considered as C-sugar, must be exported without refunds being made to the sugar industry or beet producers. The second complaint related to export refunds on 1.6 million tons of sugar, which are equivalent to preferential European Union imports from African, Caribbean and Pacific (ACP) countries and India.

The WTO panel found that the European Union is dumping more than three times the level of subsidized sugar exports that is allowed under WTO rules. (In the

Uruguay Round, the European Union committed to reduce its subsidized sugar exports to a maximum of 1.3 million tons per year. The European Communities’ exports amounted to 4.1 million tons in the 2000/2001 marketing year). The panel also found that in 2004/2005, around 2.1 million tons of what the European Union claims to be unsubsidized sugar (i.e., C-sugar) was effectively cross-subsidized by the Union. They also found that the European Union is contravening its WTO commitments by subsidizing re-exports of an amount equivalent to imports of sugar from the African, Caribbean and Pacific (ACP) countries and India (1.6 million tons). These subsidized exports are not included in the European Union’s reduction commitments and further exceed the European Union’s permitted level of subsidized sugar exports.

The Appellate Body upheld the following findings of the panel: (i) Footnote I to section II, part IV of the European Union Schedule concerning ACP/India-equivalent sugar does not enlarge or otherwise modify the European Communities’ commitment levels as specified in that schedule; and (ii) both the provision of low-priced C-beet to sugar producers and the cross-subsidization involved in the production of C-sugar resulting from the operation of the European Communities’ sugar regime constitute export subsidies subject to the reduction commitments of the WTO Agreement on Agriculture. As a result, the European Communities have been providing export subsidies in excess of the final quantity commitment level of 1,273,500 tons per year.<sup>22</sup> The Appellate Body recommended that the European Communities bring their sugar regime into conformity with their obligations under the WTO Agreement on Agriculture.<sup>23</sup> Following acceptance of the Appellate Body report, which must happen within 30 days after the ruling, the European Union has a “reasonable

<sup>21</sup> Production quotas were set to distribute the production of sugar among the European Union member States and keep total output within certain limits. Thus, these quotas were established at the country level and referred only to the maximum quantity of sugar eligible for price supports (intervention purchases). Member States were free to produce more, but the surplus had to be sold outside the European Union.

<sup>22</sup> The Appellate Body considered that the panel erred in not addressing the claims under the WTO Subsidies Agreement, but the Appellate Body was not in a position to rule on these issues.

<sup>23</sup> In its report, the Appellate Body stated that the production of C-sugar receives a “payment on the export financed by virtue of governmental action”, within the meaning of article 9.1(c) of the Agreement on Agriculture, which regulates export subsidies that are subject to reduction commitments, as in cases where payments relating to exports of an agricultural product are financed by government action.

period of time” to comply with this recommendation. The Appellate Body gave the European Union up to 15 months to do so, instead of the original 90-day deadline called for by Australia, Brazil and Thailand.

The Commission had already committed itself to a reform of the European Union’s sugar market regime, but this WTO decision will undoubtedly put further political pressure on the Commission to do so, as the initial proposals published in the summer of 2004 would not have gone far enough in reducing the European Union’s sugar exports. The European Union expects to see significant job losses in this sector, in what would constitute a continuation of the trend observed in recent years)<sup>24</sup> as a result of the reforms, as well as a decline in its competitiveness, and these projections have been put forward as justification for the postponement of these modifications for a number of years. However, these negative trends are likely to represent short-term consequences and to be offset by long-term benefits. These benefits would include the restructuring of an obsolete sugar system based primarily on unfair trade practices, which would in turn allow the European Union to return to truly sustainable levels of competitiveness, production and employment, rather than relying, as it does now, on a public support regime. This artificial regime is what has maintained the European Union in its place as the world’s largest sugar producer for so many years and as the third largest exporter, after South and Central America (ECLAC, 2000).

The reform will lower internal prices and quotas, reduce exports and export refunds, and do away with intervention, while providing tailored assistance to the ACP sugar-exporting countries affected by the reduction in European Union prices. Any changes that need to be made in the way the European Union sugar market is organized in order to comply with this ruling were to be included in the Commission’s reform proposals, which were to be published on 22 June, and the reform process was scheduled to start in July 2005. In order to give all parties sufficient time to make the necessary adjustments, the Commission has set out a four-year timetable for the implementation of these changes.<sup>25</sup>

The ACP countries,<sup>26</sup> which had participated in the proceedings as third parties, have argued that acceding to the claims of the complainants will have adverse effects on the trade and economic benefits that they enjoy from the exportation of sugar to the European Communities under the Sugar Protocol. In their view, the Appellate Body rulings have systemic implications for the three pillars of the Agreement on Agriculture (market access, domestic support and export subsidies) and have created an element of uncertainty that now needs to be addressed in the Doha Round.

According to figures compiled by the European Communities, there are more than 230,000 farms growing sugar beets in the 15 countries that belonged to the European Union prior to its most recent enlargement (the “EU-15”). A majority of these growers are located in Germany (21%), Italy (20%) and France (14%). There are reportedly 135 processing plants and 6 refineries in these 15 countries, while the Union’s recent enlargement added another 100 sugar processing plants (around 70 in Poland and 30 in the other six new sugar-producing member States). In the 15 pre-enlargement members of the European Union, the number of jobs fell from 37,161 to 20,559 between 1992/1993 and 2001/2002, and a further 15,000 jobs are expected to be lost by 2012 (a reduction of more than 75%). The 25 member States of the newly enlarged Union (the “EU-25”) account for 14% of world sugar output, 13% of world sugar consumption, 12% of world exports of sugar and 5% of total imports of this commodity. The European Union is a key player on world sugar markets, but continues to lag behind Brazil. Brazil occupies a dominant position in exports and does not provide domestic price supports for this product, whose domestic price is higher than world market prices.

In sum, on the one hand, the WTO decision will help to pressure the European Union to undertake trade policy reforms designed to pave the way for more competitive trade in the sugar sector while, on the other, it will put Brazil and other major exporting countries in a position to boost their sugar output, which would presumably cause international prices to decline. This could, in turn, harm

<sup>24</sup> “Over the last decade the sector has shed around 17,000 industry-related jobs. While there were 240 sugar mills in the European Union in 1990, just 135 were left in 2001.” (European Union, 2004).

<sup>25</sup> The main changes that the reform would bring about would be to: (i) reduce the institutional support price from € 632 to € 421 in two steps over a period of three years; (ii) reduce the minimum price for sugar beets from € 43.6 per ton to € 27.4 in two steps over a three-year period; (iii) do away with public intervention, which is to be replaced by a private storage scheme; (iv) reduce the European Union’s production quota by 2.8 million tons (from 17.2 million to 14.6 million tons) over a period of four years; (v) reduce subsidized exports by 2 million tons (from 2.4 million to 0.4 million tons); (vi) grant a decoupled payment to sugar beet farmers as partial (60%) compensation for loss of income; (vii) establish quotas that can be transferred between operators of different member States; and (viii) incorporate a € 250/ton conversion scheme for processing factories leaving the sector.

<sup>26</sup> Barbados, Belize, Côte d’Ivoire, Fiji, Guyana, Jamaica, Kenya, Madagascar, Malawi, Mauritius, Saint Kitts and Nevis, Swaziland, the United Republic of Tanzania, and Trinidad and Tobago filed a joint third-participant submission as the “ACP countries”.

the interests of poorer developing countries, particularly those in Africa and the Caribbean, where sugar exports play a pivotal role in the economy at large.<sup>27</sup> This might

also prompt these countries to apply trade measures aimed at boosting their sugar production, such as subsidies and other kinds of public support.

## F. The WTO ruling on the cotton case brought by Brazil

On 8 September 2004, the WTO panel released its report on the cotton case brought by Brazil. Its findings were then confirmed by the Appellate Body in March 2005 (DSB, 2002c). The panel found that many United States cotton support programmes provide export subsidies that are above the limit permitted under WTO rules. It also ruled that the United States' credit guarantee programmes constitute export subsidies. The report asks the United States to withdraw the prohibited subsidies on a wide range of products, including cotton, soybeans, corn and oilseeds. Because these measures have been found to be in violation of article 3.1b of the Agreement on Subsidies and Countervailing Measures, the United States was called upon to stop subsidizing local producers that make use of United States cotton without delay or, at the latest, within six months of the report's adoption by the WTO Dispute Settlement Body (DSB) or 1 July 2005.

More specifically, the panel ruled that: (i) the "peace clause"<sup>28</sup> does not apply to a number of the measures used by the United States, including domestic support measures and export credit guarantees; (ii) the export credit guarantees for "unscheduled commodities", such as cotton, soybeans and rice, constitute prohibited export subsidies; (iii) some United States domestic support programmes, such as those providing marketing loans (guaranteeing United States farmers a price of US\$ 0.52 per pound of cotton) (WTO, n/d), countercyclical payments (payments to United States farmers to make up the difference between the guaranteed or market price and a "target" price of US\$ 0.72 cents per pound of cotton), market-loss assistance and Step 2 payments<sup>29</sup> were found to have significantly depressed world cotton prices in 1999-2002, thereby causing "serious prejudice"

to Brazil's interests; and (iv) Step 2 payments to cotton exporters constitute prohibited export subsidies and, as such, are not protected by the peace clause, while Step 2 payments to domestic users constitute prohibited import-substitution subsidies, since they were made available only for United States cotton.

The panel sided with the United States on some issues, however. It found, for example that: (i) Brazil had failed to show that United States domestic support programmes had been the cause of an increase in the United States' share in the world market for upland cotton; (ii) other United States domestic support programmes, such as those providing production flexibility contract payments, direct payments and crop insurance payments, did not cause serious prejudice to Brazil's interests, since the complainant did not succeed in showing that these programmes caused significant price suppression; (iii) certain United States export credit guarantees were consistent with United States WTO obligations; (iv) United States domestic support programmes did not threaten to cause serious prejudice to Brazil's interests in 2003-2007 (*Washington Trade Daily*, 2004). The rulings, if upheld on appeal, may put agricultural exporting countries in a position where they can exert more pressure in the Doha trade talks. Since agricultural prices are expected to rise following the dismantlement of these programmes, the effect on Latin American and Caribbean countries will depend on whether they are net exporters or importers.

Although the deadline for withdrawal of the prohibited subsidies was July 2005, immediate changes in the United States cotton programme are very unlikely, as noted by the National Cotton Council of America.<sup>30</sup> In

<sup>27</sup> Central America's share of international sugar exports amounted to 16.8% in 1998-1999, which put it in third place, after South America (28.6%) and Europe (18.8%). In terms of production, in 1998-1999 the Caribbean and Mexico, taken together, were in third place (also behind South America and Europe) (ECLAC, 2000).

<sup>28</sup> The "peace clause" was article 13 of the Agreement on Agriculture, which dealt with "due restraint". This clause shielded countries using subsidies that comply with the agreement from challenges under other WTO agreements. The peace clause expired on 31 December 2003 (WTO, n/d).

<sup>29</sup> The Step 2 programme provides funding to United States companies that export or mill cotton (i.e., process it into fabric or yarn) so that they will buy cotton grown in the United States (Environmental Working Group, n/d).

this case, the parties may agree to a 15-month transition period (ending in June 2006) for adapting to the relevant WTO rules. This is a long-run process which will require coordinated efforts on the part of the United States Trade Representative, the United States Department of Agriculture, other public agencies and the private sector. It is likely that the United States will need more time to comply with the Appellate Body's ruling, since it will have to make changes not only in the cotton sector but throughout the entire agricultural sector. On 20 April 2005, the United States informed the DSB of its intention to comply with the recommendations set forth in its ruling and reported that it had already begun to look into possible ways of doing so. Meanwhile, developing countries await the announcement of the commitments on agricultural subsidies that the United States may make within the framework of the "single-undertaking" approach, which is crucial to the success of the Doha Round.

This cotton case was the first formal challenge made to the massive agricultural subsidies handed out by developed nations to their farmers, which reduce the competitiveness of agricultural exports from developing countries. Other developing-country victories in the international trade arena soon followed. Just a month later, the DSB found other agricultural subsidies —i.e., European subsidies on sugar exports— to be illegal. This case is discussed in the preceding section (WTO, 2002a, 2002b and 2003a). It is no coincidence that the parties ruled against in these two cases were the European Union and United States. These are the economies that apply

the most subsidies, not only in terms of different kinds of mechanisms, but also as measured by the amounts involved, and they are therefore the object of the most complaints in WTO.

These two cases are essential precedents for any other cases brought before the DSB involving agricultural subsidies employed by developed countries. Complaints regarding such subsidies have also tended to increase in number since the expiration of the "peace clause", a mechanism inserted into the Agreement on Agriculture in 1995 that gave countries temporary immunity from legal challenges in such cases. Even under the terms of the peace clause, however, countries enjoyed such immunity only so long as their subsidies did not exceed the levels capped in 1992, whereas those of the European Union and the United States were above those levels.<sup>31</sup> With the expiration of this legal clause, which was used to maintain the bulk of the developed world's subsidies for the past nine years, and given the legal precedents set by the cases concerning subsidies on cotton and sugar exports, developing countries' reactions and protests concerning this unfair trade practice are likely to intensify. Under these circumstances, developed countries have two options: they can either accede to free competition in the international market, or they can create other mechanisms of protection. As non-tariff barriers will tend to increase in order to make up for the reduction of tariffs in recent years, it is more likely that policymakers will redouble their efforts to create new types of agricultural trade barriers.

## G. Questioning of the European Union's banana import regime

Bananas have been one of the most sensitive agricultural products ever since the European Community was founded, and as of 1990 it was the only exception to the rule calling for the free circulation of goods among its member countries. The Council's decision to undertake the common organization of the market in bananas in

1993 was also controversial and gave rise to various trade disputes both before and after the creation of WTO.<sup>32</sup> Given the importance of international trade in this product for the economies of a number of countries, efforts to combat protectionism in this sector prompted a number of complaints to be filed with the DSB. The first

<sup>30</sup> "We do not envision any immediate changes to the U.S. cotton program. It will take some time to evaluate what, if any, changes should be made. Once that determination is made, it will not be a simple process to make a substantive change in U.S. farm policy" (National Cotton Council of America, 2005).

<sup>31</sup> According to the Department of Agriculture, the United States Government paid cotton producers US\$ 1.62 billion in 1992. In 1999 and 2001, however, it breached that cap, paying its cotton farmers US\$ 2.3 billion in 1999 and US\$ 2.06 billion in 2001.

<sup>32</sup> Before 1993, five Latin American countries (the Bolivarian Republic of Venezuela, Colombia, Costa Rica, Guatemala and Nicaragua) had brought a complaint under the rules of the General Agreement on Tariffs and Trade (GATT) concerning the limitations placed on imports of Central American bananas. In that case, the Special Panel found that the preferential treatment accorded to the ACP countries contravened GATT articles I and XI.

of these cases was filed during the first year that WTO was in operation (1995, 1996c, 1997b, 1999).

Measured in terms of the gross value of output, bananas are the fourth-largest food crop in the world, after rice, wheat and maize. Latin America dominates the world banana market, exporting 2.7 million tons to Europe. Approximately 700,000 tons of these bananas come from Ecuador, the world's number one exporter of this product (IUF, 2005). Most Latin American banana exports to Europe are subject to a tariff of € 75 (US\$ 98) per ton if they are within-quota and € 680 (US\$ 880) —an increase of roughly 800%— if they are not.<sup>33</sup> The ACP countries do not pay duty on within-quota exports of bananas.

Preferential treatment for these countries will come to an end on 31 December 2007. In accordance with the WTO ministerial decision of 14 November 2001 on the ACP-EC Partnership Agreement, a new tariff-only regime is to enter into effect for the European Communities on 1 January 2006 (WTO, 2001a). Accordingly, the European Union has proposed that a flat duty of € 230 (US\$ 300) per ton be applied to its imports of Latin American bananas starting on that date. According to the Union, this will help protect banana producers in the Canary Islands and the ACP countries, whose banana exports are duty-free.<sup>34</sup>

From Latin America's standpoint, this tariff would cause it to lose market share and would make it necessary to lay off millions of workers. The largest Latin American producers (the Bolivarian Republic of Venezuela,

Brazil, Colombia, Costa Rica, Ecuador, Guatemala, Honduras and Panama) have requested WTO arbitration in accordance with the provisions of the corresponding ministerial decision. The countries contend that the European proposal is discriminatory and that it violates the Doha Round commitment to ensure that tariffs and other duties do not affect the volumes of Latin American bananas entering European territory or, in the worst of cases, does not change them.<sup>35</sup> According to these Latin American exporting nations, payment of the proposed duty would inevitably carry over into the final price of their bananas, which would thus be far higher than bananas from other areas and consequently would reduce their competitiveness. The WTO arbiters agreed that a tariff of € 230 would prevent Latin American producers from maintaining market access. The European Union then proposed a tariff of € 187 per ton. This proposal met with the displeasure of the Caribbean countries (particularly the Dominican Republic), in which the social and economic effects of low levels of banana exports are quite severe. The European Union has been given a certain period in which to submit a new proposal. If the parties do not reach agreement, WTO will issue a ruling. Although no final decision has yet been taken regarding this instance of European protectionism, the Latin American countries' actions in this case demonstrate their ability to join forces and to work as a bloc in negotiating a fair duty on their exports of a product that constitutes an important source of revenue and employment for them.

## H. Offshore outsourcing

Offshore outsourcing is increasingly perceived as a political issue in the United States, with both the Democrats and the Republicans campaigning to "save American jobs". While offshore outsourcing used to be mainly related to low-skill factory jobs, it is now being used increasingly for non-manufacturing positions in the technology and service industries. As the 2004 presidential election campaign in the United States took place within the context of rather bleak job creation

rates, a great deal of attention was paid to the issue of offshore outsourcing. In fact, ever since the start of the economic recession in 2000, a charged political debate about the effects of offshore outsourcing on the United States economy has prompted numerous studies on the costs and benefits of this business strategy.

Offshore outsourcing is not a new phenomenon, but the decline in transportation costs over the last several years has made it easier for firms to separate production

<sup>33</sup> The WTO Ministerial Decision concerning the ACP-EC Partnership Agreement states: "Noting that the tariff applied to bananas imported in the "A" and "B" quotas shall not exceed 75 €/tonne until the entry into force of the new EC tariff-only regime" (WTO, 2001a).

<sup>34</sup> Paragraph 3, article 36 and annex V of the ACP-EC Partnership Agreement calls for the concession of preferential treatment for exports of products from the ACP countries.

<sup>35</sup> The WTO ministerial decision regarding the ACP-EC Partnership Agreement states: "Noting the assurances from the Parties to the Agreement that any re-binding of the EC tariff on bananas under the relevant GATT Article XXVIII procedures should result in at least maintaining total market access for MFN banana suppliers and their willingness to accept a multilateral control on the implementation of this commitment" (WTO, 2001a).

from consumption. For the last 15 years, China and other Asian countries, Mexico, Brazil and some countries in Eastern Europe have become hubs for the production of television sets, motor vehicles and other manufactures that are then sold on the United States, European and Japanese markets. What sets this wave of outsourcing apart from earlier ones is that previously non-tradable services sectors are now subject to the same forces that drove high-wage blue-collar manufacturing jobs and low-wage, low-skill jobs offshore in the past. (Gnuschke and others, 2004, vol. 62) Improvements in technology that have permitted the standardization of certain types of lower-skill service jobs, the spread of Internet use and the development of inexpensive telecommunication systems have contributed to this trend. Outsourcing is a cost-driven phenomenon that gives companies the ability to work around the clock and access to cheaper labour markets. The main destination of offshore outsourcing in the service sector is India, where well-educated, English-speaking, technically skilled people are willing to work for lower salaries. For example, the average salary range of a computer programmer in India is from US\$ 5,880 to US\$ 11,000, whereas in the United States, programmers earn between US\$ 60,000 and US\$ 80,000. As a result, India is the clear leader, by a wide margin, of the offshore software industry.

While offshore outsourcing allows companies to increase their productivity and their shareholders' profits, it has a direct negative impact on the workers whose jobs are moved overseas, especially in service industries, which are where this practice is most common. According to *The CIA World Factbook*, 72.5% of the United States' US\$ 10 trillion-plus GDP is generated in the services sector, which includes call-centre workers, software developers and other information technology (IT) professionals, many of whose jobs are moving overseas. There is an ongoing debate about how many jobs are lost as a direct consequence of offshore outsourcing, especially in the sectors where this practice is the most common.<sup>36</sup> Clearly, the effects of offshore outsourcing are difficult to determine, since estimates are often based upon inconclusive data and inferences.

Some would argue that it is the "jobless recovery," or slow job growth, combined with economic expansion in the form of increased productivity, that has made offshore outsourcing such an issue. The early 1990s were also marked by a jobless recovery, but however, the associated structural transformation of the economy was what made the boom years of the late 1990s possible (Drezner, 2004). Protecting industries from outsourcing only hurts the domestic economy by retarding the inevitable adjustments that need to be made in order for skilled workers to be competitive. Furthermore, the same changes in production technology that take away jobs by allowing them to be relocated offshore also create new ones. Those who advocate outsourcing, or at least criticize a protectionist response to this phenomenon, argue that the main driving force for growth is technological change, which invariably renders unskilled or low-skilled jobs obsolete and creates opportunities for new jobs and specializations. New products and processes are, in fact, being created that require on-hand maintenance, which cannot be done offshore. Even now, in the midst of the offshore outsourcing debate, 90% of all United States jobs require geographic proximity (Drezner, 2004).

The year 2004 saw a wave of legislative activity in the United States aimed at banning overseas outsourcing of government contracts. Several states, including Colorado, Wisconsin, Indiana and Minnesota, introduced legislation precisely for that purpose. The latest measure of this sort, known as the Thomas-Voinovich amendment, was attached to the US\$ 328 billion Omnibus Appropriations Bill for fiscal 2003 passed by the United States Senate. This measure prohibits private firms from outsourcing federal government contracts overseas.<sup>37</sup>

Democrats also introduced a "Jobs for America Act" in the Senate that would have required corporations to warn their employees and communities before moving jobs overseas. Under this legislation, companies would have had to report on any jobs that they export to other countries (saying how many jobs, where the jobs are going and why), and this information could be used to

<sup>36</sup> The Wharton School of the University of Pennsylvania estimates that 440,000 United States white-collar jobs were lost to outsourcing in 2000-2004. Forrester Research Inc. puts the number of jobs lost at 300,000 and estimates that 3.3 million jobs will be relocated overseas by 2015. International Data Corporation projects that 23% of all white-collar technology jobs will be filled offshore by 2007, up 5% from 2003, and still other reports predict that job losses will rise to 600,000 per year by 2010 (Economy.com, Inc., n/d). Meanwhile, a research paper published by Columbia University in April 2004 estimates that the number of service jobs moving offshore could reach as high as 3.3 million by 2015 (Columbia University, 2004).

<sup>37</sup> The Omnibus Appropriations Bill of 2003 contained a provision (introduced by the Thomas-Voinovich amendment) forbade certain government bodies from outsourcing government work to foreign companies. The new federal rules stipulated that any work outsourced by a federal agency "may not be performed by the contractor at a location outside the United States" unless the same work had been previously performed by federal workers outside the country. The outsourcing restrictions were valid only through fiscal year 2004, which ended on 30 September, and applied to a limited number of federal agencies, including the Department of the Treasury and the Department of Transportation.

bar United States companies from receiving financial aid from the government if they did not protect local jobs to the same extent that they protected jobs they provide outside the United States. This bill, in other words, was intended to punish companies that create jobs outside the United States. The case of Motorola serves to illustrate the scale of the problem that this would have created. Motorola, which is reducing its United States-based workforce to only 56% of its total workforce, receives almost US\$ 500 million in direct loans and loan subsidies from the Export-Import Bank of the United States (*Computer World*, 2004). This bill did not garner enough votes for passage, however. Some of the “Jobs of America Act” critics argued that it would not address the “laundering” of United States jobs through third-party offshore outsourcing contracts, nor would it have any effect on new jobs created outside of the United States by United States-based companies. The failure to pass this bill, despite the public outcry over the loss of information and communication technology (ITC) jobs, clearly demonstrates how much support United States corporations enjoy in Congress.

IT industry lobbies voiced their opposition to the Omnibus Appropriations Bill and observed that it would have little practical impact, since offshore outsourcing was unusual at the federal level anyway. United States IT companies are more worried about the adoption of legislation that would restrict this practice at the state level, where governments facing budget problems tend to be more willing to engage in offshore outsourcing. A number of states are considering other ways of restricting private-sector outsourcing.<sup>38</sup>

Such laws could nevertheless have unexpected negative impacts on United States technology firms if countries decide to retaliate. India’s Minister for Disinvestment, Communications and Information Technology has stated that he views the new United States legislation as protectionist and feels “this would worsen prospects of multilateral negotiations in trade”.

The Indian National Association of Software and Service Companies (NASSCOM) has issued a statement in which it says that, even though the impact of such bills may be minimal, they run counter to the increasing globalization of trade, which benefits all countries, and to the spirit of free trade promoted by WTO (Kumara, n/d).

Despite the public rhetoric of Republicans and Democrats, important sections of both parties are supporters of offshoring, as it increases the profits of major corporations. The United States Chamber of Commerce and many corporate backers of the two major parties, such as IBM, Dell, HP and Sun, oppose such legislation. The Bush Administration, in its annual economic report, praised overseas outsourcing as benefiting the United States economy. It should also be remembered that, despite the loss of many IT jobs in the United States following the technology sector’s 2000 crash, Congress increased the annual allocation of H1-B visas for the temporary importation of skilled foreign workers.

In the midst of these social tensions, the problem has not only been the difficulty involved in coming up with a bill that can address both the interests of national workers seeking to maintain their jobs and the interests of companies in cutting their labour expenses. There are also doubts as to whether any law can reconcile these two major needs satisfactorily. As long as the Legislature does not reach a consensus on this point, there is likely to be an increase in protests on the part of trade unions and in lawsuits based on a federal law (the Trade Adjustment Assistance Programme) that provides aid to workers who have lost their jobs because of the globalization of trade. The debate has also become more heated because this programme does not apply to the services sector, which is the most severely affected by offshore outsourcing.<sup>39</sup> As the United States becomes more and more of a services-based economy, Congress will come under mounting pressure to find a solution acceptable to both sides.

<sup>38</sup> At the individual state level, bills have been passed that make it more difficult to engage in offshore outsourcing. Sixteen states have ratified “right-to-know” statutes that require call centres to disclose their location to clients before conducting any business, thereby potentially damaging companies’ corporate images and public relations strategies if they are outsourcing such services. Most groups that are opposed to offshore outsourcing target health-care and financial-service companies, demanding that the government restrict companies’ transmission of data on their customers to offshore locations. California and Arizona have both passed bills making it illegal for health-care providers to send patients’ records overseas for transcription, and California has also imposed restrictions on the offshore transmission of individuals’ financial data.

<sup>39</sup> This programme was set up in 1962 to provide job training, tuition assistance, health insurance tax credits, job search and relocation reimbursements and extended unemployment benefits to workers who have lost their jobs because of the globalization of trade. It remains limited to manufacturing and agricultural workers, as the government has maintained its position that workers in the software industry are not eligible.

## I. The ruling concerning the Byrd amendment

On 31 August 2004, a WTO ruling was issued which found that eight WTO members were entitled to adopt retaliatory measures against the United States representing a value of up to US\$ 150 million for its failure to comply with its international trade obligations. In January 2003, WTO ruled that the Byrd Amendment was illegal (WTO, 2001a and 2001b) and gave the United States until December 2003 to comply with its ruling; the United States missed this deadline, however. The United States' failure to bring its measure into conformity with WTO rules prompted eight WTO members — Brazil, Canada, Chile, the European Union, India, Japan, Mexico and the Republic of Korea— to request authorization from WTO to impose additional import duties on United States products or to suspend fulfilment of other obligations to the United States. This is when WTO authorized the eight countries to retaliate by imposing up to US\$ 150 million in import duties on United States products.<sup>40</sup>

The Byrd amendment refers to the Continued Dumping and Subsidy Offset Act of 28 October 2000. Under this law, the United States Government distributes the anti-dumping and countervailing duties collected by the Customs Service to the United States companies that brought the corresponding anti-dumping charges against foreign companies (European Union, 2003). This means that United States companies that bring trade remedy cases to United States authorities stand to benefit not only from the imposition of anti-dumping and countervailing duties on competing imports, but also from direct payments from the United States Government when those duties are disbursed. (According to the United States Customs Service, total disbursements made to United States producers under the Byrd amendment amounted to US\$ 231 million in 2001, US\$ 330 million in 2002, US\$ 240 million in 2003 and US\$ 284 million in 2004.) This also means that, by compensating petitioners, the Byrd amendment provides an additional financial

incentive to file anti-dumping and countervailing-duty cases. In other words, by excluding those companies that do not support the petitions from the distribution of compensation, the law encourages them to change their positions simply to maintain their eligibility for such payments.

To qualify for an offset payment under the Byrd amendment, the following conditions must be met: (i) the domestic producer must have supported an application for an anti-dumping or countervailing duty investigation; (ii) there must have been a finding of dumping or subsidization (as well as injury and a causal link); and (iii) the domestic producer must have incurred qualifying expenditure after an anti-dumping duty order or finding, or a countervailing duty order, was issued (Government of Australia, 2002).

In its decision, WTO calculated the level of the additional import duty or other countermeasures based on the amount of offset payments disbursed to United States firms in the latest annual distribution. Specifically, the authorized level of retaliation was based on the trade effects of the most recent payments distributed from anti-dumping or countervailing duties collected on the products originating from each member. The WTO arbitrator ruled that the plaintiff countries could retaliate against the United States with measures equivalent to up to 72% of the annual level of United States anti-dumping and countervailing duties collected on their respective exports and disbursed under the Byrd amendment. These calculations were based on an economic model developed by the WTO arbitrator to measure the trade effect of this law on United States trading partners. Canada, the European Union and Mexico have already begun to apply retaliatory measures, and Japan announced that it would start to levy 15% tariffs on 15 United States products on 1 September (Japan's current level of authorization as established through the arbitration is US\$ 51 million per year).<sup>41</sup>

<sup>40</sup> WTO rules require that, in the event of non-compliance by a member following dispute settlement procedures, complainants seeking to preserve their retaliatory rights must seek retaliation authorization from the Dispute Settlement Body (DSB) under article 22.6 of the Understanding on Rules and Procedures Governing the Settlement of Disputes. Accordingly, on 26 January 2004, the DSB considered the requests for retaliation authorization made by Brazil, Canada, Chile, the European Union, India, Japan, Mexico and the Republic of Korea. On 31 August 2004, the WTO arbitrator ruled that these countries were authorized to retaliate against the United States.

<sup>41</sup> Canada notified the DSB that, as of 1 May 2005, it was suspending the application of concessions and obligations on imports of certain products. During the first year, it plans to levy an additional *ad valorem* duty of 15% on products originating in the United States that are listed in the annex to its notification. This suspension is equivalent to a total value of trade not exceeding the US\$ 11.16 million authorized by the arbitrator. See the document "Canada's Retaliation Notification to the WTO" (International Trade Canada, 2005).



As mentioned earlier, by excluding from compensation those companies or unions not supporting the petitions, opponents maintain that the law encourages companies that might otherwise decline to support petitions to do so simply to maintain eligibility for compensation. Certainly, the possibility of receiving payments for supporting a petition has the potential to bias the process. More requests for anti-dumping measures seem to have been presented by United States producers against foreign competitors (Center for Trade Policy Studies, 2004). Moreover, since the anti-dumping funds that are collected are then distributed among the complainants that have been affected by dumping measures, foreign firms end up subsidizing their United States competitors, to the detriment of their own products' competitiveness (Center for Trade Policy Studies, 2004). This situation is exacerbated by the fact that the United States Congress is firmly opposed to repealing the Byrd amendment and shows no inclination to yield on this point anytime soon.

Though a clear victory for the countries suffering the consequences of the United States' adoption of a protectionist law, this WTO resolution also points up

some of the organization's flaws, such as the doubtful efficacy of its dispute settlement system and the very real consequences of the political influence wielded by some of its members. So far, for example, the retaliatory measures authorized by WTO have failed to achieve their objective. The United States has not amended the law, and exporters in that country appear to be in a position to endure the retaliatory tariffs. While it is within the rights of any WTO member to ignore dispute settlement recommendations and simply put up with retaliatory trade measures if it so chooses, the multilateral system thus appears to be "binding" only for some countries, while others seem to be able to remain out of its reach. Moreover, this case, which adds to a growing list of victories against the United States within the framework of WTO, may help to erode the United States Government's and Congress' support for the organization, to say nothing of the possible consequences for the future of the world trading system. The only certainty is that this state of affairs definitely represents an obstacle for the achievement of the kind of fair and balanced global market that is the subject of such intense debate in the Doha Round.

## J. The dispute concerning the cross-border supply of gambling and betting services

This dispute brought the small twin-island State of Antigua and Barbuda into confrontation with the world's economic giant —the United States— and was the first e-commerce dispute to come before WTO (WTO, 2004c, 2003b). The Appellate Body upheld the panel's earlier decision that found against the United States, rejecting that country's claim that its ban on cross-border Internet gambling and betting does not violate its WTO obligations because the ban was necessary to protect public morals. This dispute is important because it could have a wider impact on the Doha negotiations by imposing a standard approach on countries when making services concessions. More broadly, the ultimate effect of the case could be that the United States (and all WTO members) would no longer be free to rely on their own definitions of what constitutes market opening in certain sectors (*Inside US Trade*, 2004). In its appeal, the United States stated that when it signed the General Agreement on Trade in Services (GATS), it intended for online gambling to be excluded as a form of service in international trade (United States Trade Representative, 2004).

Antigua and Barbuda brought this case against the United States under WTO procedures because it was

refusing to allow firms in Antigua and Barbuda to provide online gambling services to United States customers. The ruling found that the GATS schedule of the United States permitted the cross-border supply of gambling services and that the United States could therefore not deny access. The United States strongly opposed this decision, arguing that it was using a modified classification system that excluded any commitments on gambling services. The report of the WTO interim panel, made public on 10 November 2004, rejected this argument on the grounds that member countries do not have the authority to make such alterations in the classification systems. In January 2005, the United States announced that it would appeal the WTO decision based on the fact that United States law forbids trade in gambling services between states. In addition, the United States argued that gambling falls within the GATS sporting.

On 7 April 2005, the WTO Appellate Body issued its ruling. Although its ruling was mixed, the Appellate Body did uphold the panel's findings regarding two basic issues: (i) that the United States provided for cross-border gambling and betting services in its GATS commitments; and (ii) that the current United States

laws regulating cross-border gambling and betting are not necessary to protect public morals. With respect to the first of these questions, the Appellate Body agreed with the panel's conclusion that the United States market access commitments attached to GATS covering "other recreational services" included gambling services. The Appellate Body also upheld the panel's finding that restrictions under three United States federal laws on various means of supplying gambling services prevented the country from offering services and services suppliers from Antigua and Barbuda treatment "no less favourable" than that set under its GATS commitment schedule. However, the Appellate Body disagreed with the panel's finding that some eight state-level laws were also inconsistent with the GATS commitments of the United States.

The other area of disagreement in the rulings of the panel and the Appellate Body —i.e., the issue of public morals—<sup>42</sup> has to do with the question of whether or not the United States can claim an exception to its GATS obligations on moral grounds when gambling, including Internet gambling, is so prevalent in the country. Another question at issue was the idea that, since it is difficult to prohibit cross-border gambling, the United States and other countries should seek to regulate it instead of prohibiting it. WTO had never ruled on the requirements for use of the public morals exception. Although the United States argued that the panel did not need to consider the question of public morals, it provided sufficient evidence that a ban on cross-border gambling protects public morals and should, therefore, be exempt from WTO obligations. In disagreeing with the finding of the panel, the Appellate Body concluded

that the only inconsistency with the United States defence under the GATS public morals clause stemmed from the fact that the United States had not demonstrated that the prohibition embodied in the measures at issue applied to both foreign and domestic suppliers of remote gambling services. The Appellate Body based its argument on a federal law —the Interstate Horse Racing Act— that appears to permit domestic services providers to supply remote betting services.

The immediate effect of the ruling is that the United States may have to change its gambling and betting laws. Since the Interstate Horse Racing Act permits domestic suppliers to provide remote betting services, the Appellate Body found that there was discrimination against foreign suppliers of gambling services. More importantly, because the Appellate Body found that, by not specifically excluding them, the United States had in fact made a commitment to permit gambling services, all regulations governing gambling activities such as those conducted in casinos, State lotteries, racetracks and slot machines fall under GATS. This means that, in effect, any local regulatory bans or restrictions would be discriminating against foreign suppliers.

The United States announced its intention to bring the laws in question into conformity, but failed to reach an agreement with Antigua and Barbuda regarding what would be a "reasonable period of time" for doing so. Accordingly, Antigua and Barbuda requested that the WTO Dispute Settlement Body set the deadline by arbitration under article 21.3(c) of the Understanding on Rules and Procedures Governing the Settlement of Disputes. The deadline was set at 3 April 2006.

## K. Boeing and Airbus: two giants lock horns

In October 2004, following an exchange of threats, the United States and the European Union both requested WTO consultations, which means, in effect, that they requested arbitration within that multilateral forum of a protracted bilateral disagreement. The dispute stems from the fact that in 2003 Airbus (jointly owned by EADS of France, Germany and Spain and by BAE Systems of

the United Kingdom) overtook Boeing as the world's largest maker of commercial aeroplanes, with Boeing seeing its market share shrink from 73% in 1993 to 48% in 2005.

In its WTO complaint, the United States contended that European subsidization of Airbus (WTO, 2004b) in connection with the launching of new models

<sup>42</sup> The Appellate Body disagreed with the panel's reasoning that the United States had failed the "necessary text" outlined under the public morals defence in the relevant GATS clause and in WTO jurisprudence because it had not entered into consultations with Antigua and Barbuda. In the view of the Appellate Body, "engaging in consultations with Antigua, with a view to arriving at a negotiated settlement... was not an appropriate alternative for the Panel to consider because consultations are by definition a process, the results of which are uncertain and therefore not capable of comparison with the measures at issue in this case".

(“launch aid”) had amounted to US\$ 15 billion over the last decade and violated the Agreement on Subsidies and Countervailing Measures (SCM) of the General Agreement on Tariffs and Trade (GATT).<sup>43</sup> The subsidies were characterized as a broad-ranging system of government assistance that included financing and loans for the design and development of civil aircraft, direct government grants, bank loans on preferential terms, and the assumption and forgiveness of debts (WTO, 2004c).

For its part, the European Union complained to WTO about the United States’ subsidization of Boeing and other producers of civil aircraft in that country, alleging that the tax incentives granted to Boeing had amounted to the equivalent of US\$ 3.2 billion over the last two decades and constituted subsidies in violation of SCM and GATT provisions (WTO, 2004f). It alleged that the assistance provided by the National Aeronautics and Space Administration (NASA), the Department of Commerce and other State agencies, which was supposedly designed to promote technological development and military security, was actually financial aid that allowed the company to lower the price of its aircraft without reducing its profits and therefore to increase its market share while displacing or impeding exports by its competitors, especially Airbus.<sup>44</sup>

Government assistance policies relating to both companies are of long standing, but came to international attention as Boeing began to lose its position as the world’s large commercial aircraft manufacturer, and especially when Airbus began to build its new A350 cargo plane, which would be competing against Boeing’s 787 Dreamliner. The United States maintains that each time Airbus launches a new aircraft, a number of European countries are financing as much as 33% of its development costs. It further contends that, without this government “launch aid”, the firm would have been unable to deploy the range of aircraft it currently has

on the market, which undercuts the competitiveness of Boeing’s new models.

This locking of horns by the two sides casts doubt upon these companies’ ability to compete in the world market without generous government assistance. The other members of WTO are keep a careful eye on this case, which involves huge sums of money and a vast number of jobs. Brazil and Canada, which have set a precedent in this area,<sup>45</sup> are watching it with particular attention. Both the United States and the European Union have requested the establishment of a panel. WTO is thus readying itself to undertake one of the biggest challenges it has yet to face and has sent two commissions to investigate the illegal subsidies that the two economies are allegedly paying to these aircraft producers. Given the complexity of the case and its potential political and economic repercussions, it is expected to be one of the most drawn-out disputes in WTO history. Be this as it may, WTO can be expected to capitalize upon this opportunity to devise more effective sanctions. Whatever the ultimate ruling may be, its efficacy will hinge on its implementation or, failing that, the subsequent retaliatory measures’ effectiveness in deterring these countries from continuing to employ these unfair trade practices. Trade subsidization policies applied by the United States and the European Union have already been ruled against in a number of key sectors (sugar, cotton, steel and others). This has yet to result in the amendment of the policies questioned by WTO, however. The use of retaliatory measures would not appear to be feasible in the cases of Boeing and Airbus, since the sum involved would be so great that they would probably trigger a trade war of unprecedented proportions, which all parties concerned would be keen to avoid. This case thus poses a unique challenge to the effectiveness and credibility of the WTO Dispute Settlement Body.

<sup>43</sup> The Airbus companies to which the case refers are Airbus SAS, its predecessor Airbus GIE and affiliates and related firms, such as parent companies, sister companies and subsidiaries (including Airbus Deutschland GmbH, Airbus España S.L., etc.).

<sup>44</sup> Subsidies granted since 1992 in relation to the development of technology and military security were estimated at US\$ 23 billion. The European Union questioned, among other types of subsidies, those given by NASA for aircraft-related technological research and development, subsidies given by the National Institute of Standards and Technology (Department of Commerce) and tax credits for research and experimentation (WTO, 2004g).

<sup>45</sup> Brazil and Canada accused each other of subsidizing the exports of their respective aircraft makers, EMBRAER and Bombardier, in violation of the SMC (WTO, 1997a and 1996b).

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## Chapter V

# Strategic perspectives on the relationship between China and the Latin American and Caribbean region

## A. China in the world economy

In recent years, China's importance in the world economy has increased exponentially, particularly with regard to production, international trade and foreign direct investment (FDI). In terms of GDP, measured at current prices, China is the world's sixth-largest economy, after the United States, Germany, Japan, the United Kingdom and France. If it continues to grow at rates of over 8%, in two more years it may be the fourth-largest. What is more, if GDP is measured in terms of purchasing power parity (PPP), then China is already the second-largest economy in the world, after the United States.

China's trade statistics indicate that both its exports and imports are growing faster than the world average, while its share of world trade flows swelled from 0.6% in 1977 to nearly 6.5% in 2004. Before the country embarked on free-market economic reforms in 1978, there were 30 countries with a larger share of world trade than it had. Twenty-six years later, China has the third-largest share, with only the United States and Germany ahead of it. Furthermore, this increase has quickened its pace between 2000 and 2004, with China growing nearly 2.7 times faster than the world average and adding approximately US\$ 373 billion to its current exports. The

highly influential role of its market as a buyer of exports from the rest of the world has also helped to spur the growth of world trade.

By 2004, China had become the leading world consumer of copper, tin, zinc, platinum, steel and iron ore; the second-largest buyer of aluminium, petroleum, lead and soya; the third-largest purchaser of nickel; and the fourth-largest of gold. For most of these products, its share of total world consumption is now slightly over 20%, after having more than doubled between 1990 and 2004 (see figure V.1). In the case of some commodities, such as iron ore, gold, petroleum and soya, the force

generated by its surging imports has altered international price trends. The continued expansion of manufactures, which represent 55% of total output, has been the main trigger for this process (NBSC, 2004).

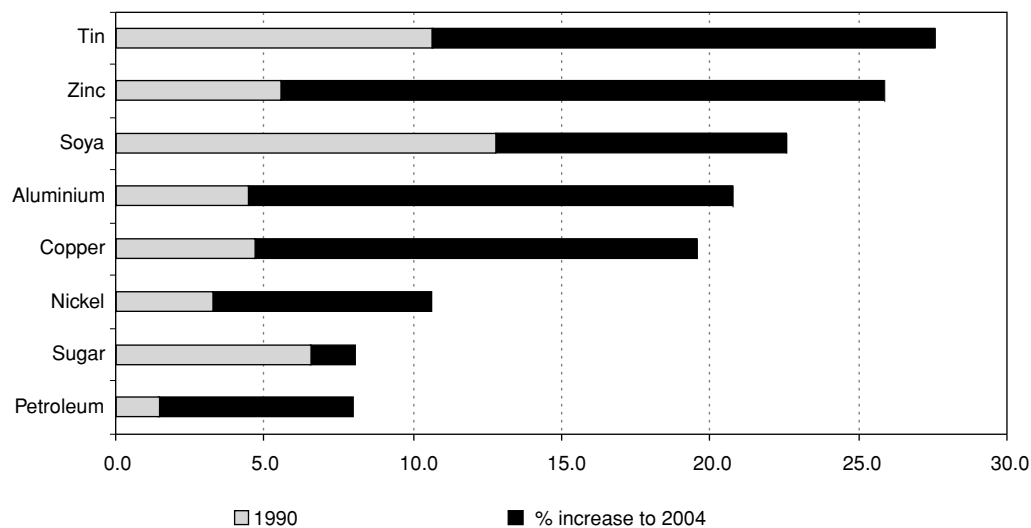
On the other hand, in cases where local production exceeds domestic consumption (e.g., zinc, tin, toys, textiles, clothing and even electronics), the avalanche of Chinese exports is driving down international prices.

Given these circumstances, China has emerged as a key player in the determination of global macroeconomic balances and as a major point of reference in the production strategies of the world's major transnational corporations. At present, 400 of the Fortune 500 companies have set up operations in China. This is not only because of China's attractive market of 1.3 billion consumers. It is also because economic reforms and the Chinese authorities' commitment to turn the country into a market economy are coupled with ambitious medium- and long-term goals designed to transform it into an industrial power by 2010 and a technological power by 2015. As part of their strategy for attracting FDI, the authorities are channelling investments into the sectors that have the strongest impact on economic growth, particularly export industries and ones that add value locally. The

results of this strategy are evidenced by transnational corporations' share in China's total exports, which currently stands at around 50% (UNCTAD, 2005). A particularly noteworthy aspect of this process is that, between 1990 and 2004, high-technology exports grew faster than those of other sectors in the economy, while commodity exports fell steeply (see figure V.2).

China's principal trading partners are its neighbours in Asia and the Pacific, especially Japan and the nations belonging to the Association of Southeast Asian Nations (ASEAN). These countries supply 56% of China's imports and buy 45% of its total exports. Manufactures represent an extremely high percentage (95%) of these trade flows (see figure V.3 and table V.1). China runs a deficit in its trade with these nations (especially the Republic of Korea and Japan) because they are its main suppliers of capital goods and of intermediate inputs for its manufacturing industries. It then exports these products to its other trading partners, especially the United States and the European Union, with which it consistently runs its largest surpluses for trade in low- and high-technology manufactures and, to a lesser extent, for mid-range technologies. The composition of China's trade with other developing countries, primarily of Latin America, Africa and the Middle East, complements these flows, as it is concentrated in commodities and natural-

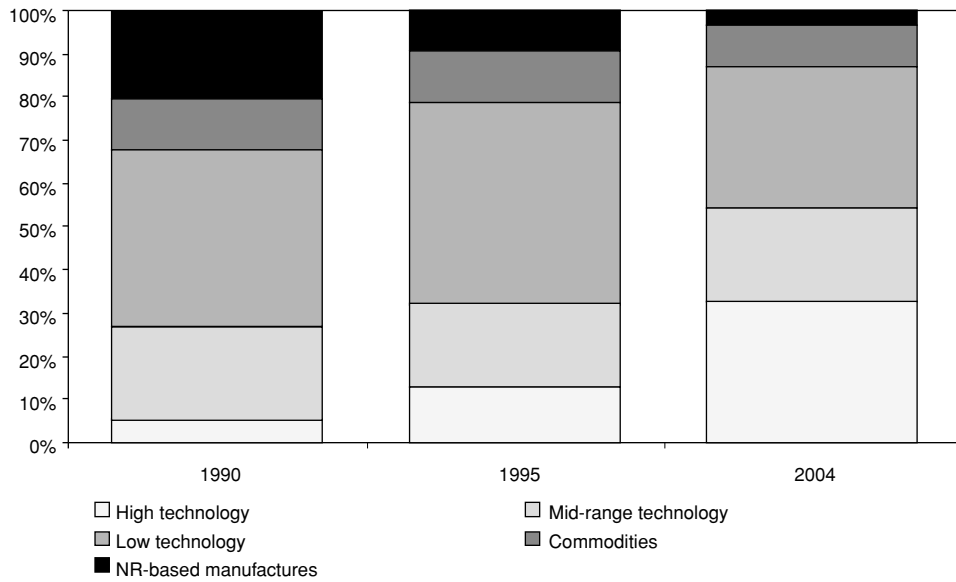
Figure V.1  
**CHINA: DOMESTIC CONSUMPTION AS A PERCENTAGE OF WORLDWIDE CONSUMPTION OF  
 SELECTED PRODUCTS, 1990 AND 2004**  
*(Percentages of world consumption, by product)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bureau of Metal Statistics (WBMS), The Economist Intelligence Unit and United Nations Conference on Trade and Development (UNCTAD).

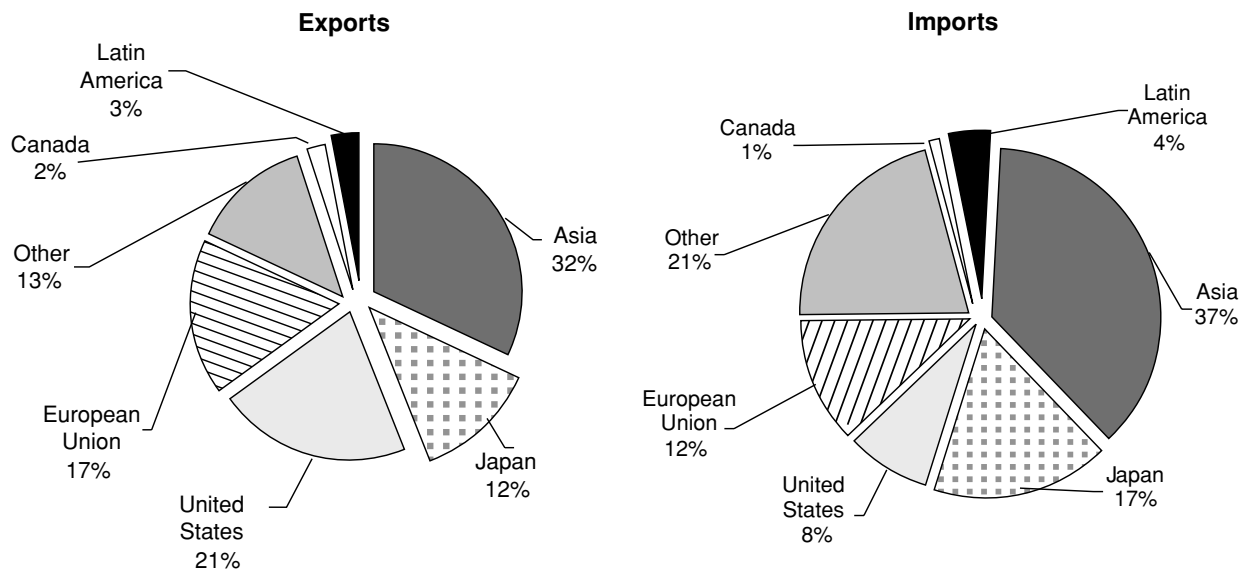


Figure V.2  
**CHINA: TRENDS IN THE COMPOSITION OF EXPORTS, BY TECHNOLOGICAL INTENSITY, 1990, 1995 AND 2004**



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the Commodity Trade Database (COMTRADE).

Figure V.3  
**CHINA: FOREIGN TRADE MIX, BY DESTINATION AND ORIGIN, 2004**



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the Commodity Trade Database (COMTRADE).

Table V.1  
**CHINA: FOREIGN TRADE MATRIX AND COMPOSITION OF THE DEFICIT/SURPLUS,  
 BY TECHNOLOGICAL INTENSITY OF GOODS, 2004**  
*(Millions of dollars at current prices)*

Countries and regions	Trade		Breakdown of trade balance, by technological intensity						
	Total exports	Total imports	Trade balance	Manufactures					
				Commodities	NR-based	Low technology	Mid-range technology	High technology	Other
Asia <sup>a</sup>	262 750	306 067	-43 317	-1 699	-8 648	44 307	-42 226	-35 411	360
Japan	73 509	94 327	-20 818	5 231	502	14 996	-27 084	-14 414	-49
United States	125 149	44 748	80 401	-6 248	82	45 059	13 038	28 371	99
Canada	13 278	3 405	9 873	- 341	- 300	6 400	1 342	2 680	92
European Union	99 929	68 216	31 713	1 073	- 180	23 917	-13 929	20 838	-6
Latin America	17 947	21 667	-3 720	-10 969	-3 404	5 529	3 331	1 793	0
Other	74 272	117 126	-42 854	-42 717	-5 973	21 637	2 259	-17 645	-415
World	593 325	561 229	32 096	-60 901	-18 423	146 849	-36 185	626	130

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the Commodity Trade Database (COMTRADE).

<sup>a</sup> Included Japan.

resource-based manufactures (see table V.1). These developing nations are thus its main suppliers of copper, iron ore, soya, petroleum, fishmeal, sugar and a range of other products, as will be discussed in greater depth in the third section of this chapter. China's trade deficit with Latin America alone jumped from US\$ 6.37 billion to US\$ 10.969 billion between 2003 and 2004.

The strength of the authorities' convictions and their planning have made it possible to capitalize upon the country's comparative advantages at the regional level in order to attract a steady stream of direct investment from the Hong Kong Special Administrative Region (SAR) of China, Taiwan Province of China, Singapore, the Republic of Korea, the United States, the United Kingdom and others. Between 30% and 35% of these investments are channelled through joint ventures established either as new firms or partnership contracts (United States-China Business Council, 2005) or take the form of the reinvestment of Chinese capital that has been re-routed through Hong Kong SAR or other tax havens, such as the Virgin Islands.

In 2004, FDI flows into China amounted to US\$ 60.6 billion, which was equivalent to 26% of the total FDI received by developing countries, 11% of worldwide FDI flows and more than the sum received by the United States (Ministry of Commerce of China, 2005b). Approximately 71% of the country's stock of FDI, which totalled US\$ 570 billion, is composed of investment in manufacturing,<sup>1</sup>

while another 21% is in the services sector (UNCTAD, 2004; Prasad and Wei, 2005).

While China has been a major recipient of FDI over the past two decades, lately it has been investing abroad itself. In fact, among the developing countries, it is now the sixth-largest source of FDI, and the Chinese authorities are trying to encourage the country's firms and citizens to make strategic investments elsewhere in the world. This view of the situation is shared by investment promotion agencies around the world, which see China as a promising source of FDI in 2004-2007. As a matter of fact, some of the developed countries' investment promotion agencies, such as those of Denmark, Sweden and the United Kingdom, already have offices in China, and for more than 10 other countries, China is the biggest foreign investor.<sup>2</sup> A recent UNCTAD study based on a survey of major investment promotion agencies has found that among the five biggest investor countries, in 2003 China passed Japan for the first time ever to claim the fourth-highest ranking, after the United States, the United Kingdom and France.

Success in the creation of export capacity, combined with the expansion of domestic output, the increasing development of manufacturing-related sectors and the country's succession of trade surpluses, enable Chinese firms to make direct investments abroad in strategic sectors, especially technology — and knowledge— based industries. Following in the footsteps of Korean

<sup>1</sup> Investment is particularly strong in electronics and telecommunications hardware.

<sup>2</sup> Japan, the United Kingdom, Singapore, Sweden and other countries have already set up promotional agencies to attract Chinese funds.

companies, Chinese firms are investing via mergers and acquisitions in well-positioned technology-intensive enterprises that possess the necessary know-how and have good reputations backed up by established brand names. They are also making greenfield investments in strategically located research and development (R&D) centres. These factors have permitted some firms to enhance their credibility and penetrate more deeply into new markets.<sup>3</sup> The remarkable expansion achieved by Huawei and ZTE Corporation in the mobile telephone

and telecommunications industry is one example. Others are the partnership between Lenovo Group and IBM, and the merger between TCL Corp., a Chinese producer of television sets, and Thomson, the French DVD maker. Yet another is the partnership formed by Huawei Technologies and Siemens, NEC, Matsushita and Infineon. In these cases, the Chinese firms gain a stronger reputation by association with such widely recognized brands as IBM and as Thomson in Europe and RCA in the United States (see table V.2).

Table V.2  
CHINA: MAIN FOREIGN INVESTMENT STRATEGIES, 2000-2005

Market-seeking investments	Efficiency- and prestige-seeking investments (technologies, R&D, brand names)
<ul style="list-style-type: none"> <li>• Shanghai Haixing Group (Chinese logistics firm) bought Glenoit Corp-Specialty Fabrics of the United States for US\$ 25 million (2002)</li> <li>• Shanghai Electric Group bought Akiyama Machinery Co., Ltd. of Japan (2002)</li> <li>• D'Long International Strategic Investment Group of Xinjiang bought the German Fairchild Dornier 728 jet design software, and had planned to re-launch this aircraft in 2006 (2003). The firm declared bankruptcy before it could pursue this initiative, however.</li> <li>• ZTE Corporation bought the Nepal Telecom mobile telephony network for US\$ 3.9 million (2005)</li> <li>• China Telecom is negotiating the acquisition of a cellular telephony operator in Indonesia (Excelcomindo)</li> <li>• Huawei is forming a strategic alliance with Etisalat, a firm in the United Arab Emirates (2005)</li> <li>• Huawei has won a bid to construct a dense wavelength division multiplexing (DWDM) transmission line in Pakistan. It has also won similar contracts in Bulgaria, Turkey and Romania (2005)</li> <li>• Huawei will expand asynchronous digital subscriber (ADS) networks in Athens, Greece (2005)</li> <li>• China Mobile has signed an agreement with MTV to supply music over cellular telephones</li> <li>• Huawei is considering the possibility of forming strategic alliances with British Telecom and Telefónica España; it has already signed strategic agreements with these companies (2005)</li> <li>• ZTE Corporation is developing a digital network for Nordisk Mobiltelefon AB in Norway (2005)</li> <li>• ZTE Corporation has signed a contract with Telecom Mongolia to supply it with telecommunications equipment (2005)</li> <li>• ZTE Corporation has entered into a partnership with Ericsson to develop an R&amp;D centre in Nanking (2005)</li> <li>• Huawei has concluded an agreement with CoTeCal Cooperativa Telefónica de Calafate Ltda. in Argentina and is now operating as a telephony provider (2005)</li> </ul>	<ul style="list-style-type: none"> <li>• Huawei Technologies and ZTE Corporation have opened R&amp;D centres in Sweden (2003-2004)</li> <li>• Haier, a producer of white goods, has invested in an R&amp;D centre in Germany and in a design centre in Boston, United States (2003-2004)</li> <li>• Guangdong Glanz Group Co. (manufactures) has established an R&amp;D centre in Seattle, United States (2003-2004)</li> <li>• Konka Electronics opened an R&amp;D centre in Silicon Valley in the United States (2003-2004)</li> <li>• Eight Chinese firms have entered into strategic alliances with Danish firms to undertake biotechnological research (starting in 2002)</li> <li>• Lenovo Group Ltd. established an alliance with IBM in order to gain access to that brand name's prestige and to new markets for its products</li> <li>• TCL Corp. bought Schneider Electronics of Germany for US\$ 8 million (2002)</li> <li>• Huayi Group bought Moltech Power System of the United States for US\$ 20 million (2002)</li> <li>• TCL, a Chinese television-set maker, and Thomson, a French DVD operator, have created a joint venture known as TCL-Thomson Electronics. TCL holds 67% of the equity in the venture (2003)</li> <li>• BOE Technology Group bought Hynix Semiconductor, a flat-screen producer in the Republic of Korea, for US\$ 380 million (2002)</li> <li>• BOE Technology bought 26.4% of TPV, a computer monitor producer, for US\$ 135 million (2003)</li> <li>• Huawei Technologies has entered into a joint venture with Siemens, NEC, Matsushita and Infineon (2004)</li> <li>• China Telecom signed an agreement with NEC to build a submarine optical ring in northern Asia (2005)</li> <li>• A Chinese aeronautics company has formed an alliance with Brazil's Embraer to build aircraft (2005)</li> </ul>

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development (UNCTAD), *World Investment Report 2004: The Shift Towards Services*, October, 2004; "China: an emerging FDI outward investor", *E-Brief* [online] <[http://www.unctad.org/sections/dite\\_fdostat/docs/china\\_ebrief\\_en.pdf](http://www.unctad.org/sections/dite_fdostat/docs/china_ebrief_en.pdf)>; *People's Daily Online* (2005) [online] <<http://english.people.com.cn/>>; *China Today. Com* (n/d) <<http://chinatoday.com/>>; *World IT Report* (n/d) [online] <<http://www.worlditreport.com/>> and Telco Flash (2005), "Boletín tecnológico", Jean Amal (ed.).

<sup>3</sup> Some Chinese firms are spending more than 5% (a threshold figure considered to be the international standard for such allocations) of their budgets on R&D (*Hoover's*, 2005).

Another strategy that complements China's policy of opening up its economy to external trade involves investments directed at the placement of local output in new markets, especially in the case of industries (such as machinery and electronics) in which Chinese demand is already covered and excess production capacity exists. Table V.2 lists some of the cases (e.g., Konka Electronics, Skyworth and Changhong Electronic Group, Guandong Media Group) in which these types of investments are being made.

The Chinese authorities are also directing FDI to locations that will guarantee them access to the natural resources and raw materials (such as petroleum, natural gas, iron ore, gold and copper) they need to carry forward their production and development strategy (see table V.3). China's largest petroleum companies — Sinopec, Petrochina and China National Offshore Oil Corporation (CNOOC)— have made investments in approximately 14 countries,<sup>4</sup> and the pace of their investment activity has been picking up in recent years.

CNOOC bid US\$ 18.5 billion to acquire the United States oil company Unocal, thereby besting Chevron's offer (US\$ 16.6 billion) — which the board of directors of Unocal had been on the point of accepting— by a wide margin (*The New York Times*, 2005a and 2005b; Tkacik, 2005). Its chief aim in making the bid was to broaden the range of its hydrocarbon energy sources, since Unocal, which is the United States' ninth-largest company, controls oil reserves and possesses assets in Thailand, Indonesia, Myanmar, Viet Nam and Azerbaijan. The firm also owns 10 platforms in Canada and is engaged in exploration activities in Mexico. The bid sparked opposition in the United States, and some members of Congress called for an enquiry into the impact this would have on the grounds that, since 70% of CNOOC is owned by the Chinese Government, it would thus be an acquisition by the Chinese State, rather than by Chinese businesses.<sup>5</sup> Chevron argued that at least 15% of the CNOOC offer would be subsidized by the Chinese State and asked that the case be referred to the World Trade Organization (WTO) (*Diario el Mundo*, 2005). The issue aroused considerable misgivings, in particular because the acquisition would give China a large share of control over sizeable reserves of natural gas and petroleum in Central Asia and the Caspian Sea (Unocal is currently drilling some 159 billion barrels of petroleum and extracting 1.5 billion cubic feet of natural gas per

day). On 10 August 2005, the board of Unocal decided to accept Chevron's original offer, after CNOOC withdrew its bid. In the coming months, CNOOC is expected to expand or seek partnerships with other petroleum and gas companies that have proven reserves. First, however, China will have to analyse and resolve possible political problems and address the delicate issues inherent in this sector (*Financial Times*, 2005).

In mid-2004, China's Ministry of Commerce and Ministry of Foreign Affairs jointly published a catalogue listing recommended branches of industry in 67 countries and regions for Chinese foreign investors. According to official reports, around 7,000 Chinese firms have already placed investments in over 160 countries and regions. The national authorities' interest in encouraging this outward flow of local capital is supported by the efforts of a number of provincial governments, such as those of Guangdong and Shanghai, which have approved tax incentives to promote the exportation of capital. The impact of these policies has been reinforced by the announcement that low-interest loans will be extended to production enterprises with large-scale foreign investments and that facilities will be created to give priority to imports of these firms' products. The two main recipients of Chinese direct investment are Hong Kong SAR (46.8%) and Macao (13.8%). In the first quarter of 2005, Chinese investment continued to rise, especially in Asia and, within Asia, particularly in Hong Kong SAR, Japan, Taiwan Province of China and Singapore.

The Chinese economy grew by 9.5% in 2004 and will continue to grow rapidly, with the Asian Development Bank (ADB, 2005) projecting its 2005 growth rate at 8.5%. Its high consumption levels will therefore continue to have a tremendous influence on the world economy. What is more, given its progress in opening up its economy to trade as it works to fulfil its commitments as a member of WTO, the country's imports will continue to rise at what are expected to become double-digit rates (ADB projects an import growth rate of about 16%), thus prolonging its positive impact on the prices of commodities such as petroleum, copper, fishmeal, iron ore and soya. This set of conditions is also favourable for Latin America and the Caribbean, and for the South American countries in particular, with which China has a greater degree of production complementarity. This question will be discussed further in the fourth section of this chapter.

<sup>4</sup> Including Indonesia, Kazakhstan, Myanmar, the Sudan and Yemen.

<sup>5</sup> See, inter alia, United States House of Representatives, 2005a and 2005b; *The Wall Street Journal*, 2005.

Table V.3  
**FOREIGN DIRECT INVESTMENT: ALLIANCES AND COOPERATION IN SECTORS INVOLVED IN RAW-MATERIALS-SEEKING STRATEGIES (SELECTED OPERATIONS), 2000-2005**  
*(Millions of dollars)*

Chinese firms	Foreign companies	Type	Sector	Country or region	Stake/ project description	Amount (millions of dollars)
Huaguang Forest Co. Ltd. (2002)	Rayonier Inc.	M&A	Forestry	New Zealand	100%	7.7
China Petroleum & Chemical Corporation (2002)	...	...	Petroleum	Northern Africa	75%	394.0
Petro China Co. Ltd. (2002)	Devon Energy Indonesian Oil	M&A	Petroleum	Indonesia	100%	262.0
Baosteel (2002)	Rio Tinto's Hamersley Iron Unit	Alliance	Iron Gold	Australia	46%	30.0
CNODC and CNPC (2002)	Salyan Oil Ltd.	M&A	Petroleum	Azerbaijan	30%	52.0
China National Offshore Oil Company Ltd (CNOOC) (2002)	Repsol-YPF SA	M&A	Petroleum	Indonesia	100%	585.0
CNOOC (2002)	Tangguh Gas Fields (BP subsidiary)	M&A	Gas	Indonesia	12.5%	275.0
China National Chemical Import and Export Corporation (2002)	Atlantis Subsidiary	M&A	Petroleum-related services	Norway	...	105.0
China Minmetals Nonferrous Metals Co. (2004)	Noranda (Doña Inés de Collahuasi and Loma Bayas)	M&A	Copper	Canada and Chile	...	5 000.0
China International Trust & Investment Corp (CITIC)	Ivanhoe Mines	Alliance	Copper and gold	Mongolia and Myanmar	Joint operation of copper mines	...
China Minmetals Nonferrous Metals Co. (2005)	CODELCO	Alliance	Copper	Chile	Investment and supply agreement	2 000.0
Government of China (2004) (CNOOC)	...	Credit	Petroleum and natural gas	Venezuela (Bolivarian Rep. of)	Exploration and development of natural gas and crude oil reserves	400.0
China Huaneng Power (HP)	BJP Billiton	Alliance	Coal	Australia	Price renegotiation	...
Baoshan Iron and Steel (2004)	Nippon Steel	Alliance	Steel	China	...	...
Baoshan Iron and Steel (2004)	Compañía Vale do Rio Doce	Alliance	Steel	Brazil	New plant construction	1 400.0
China Petroleum Chemical Corp.	Atlantis Holding Norway	M&A	Petroleum	Norway	...	215.0
Yanguang Group (2005)	Vale do Rio Doce / Itochu Corporation	Alliance	Coal	Brazil	New company	...
Jilin Kichkel Industrial Group (2004)	INCO	Alliance	Nickel	China and Australia	Joint venture for mineral exploration	...
Sinopec (2004)	Petrobras	Alliance	Petroleum	Brazil, China and others	Oil drilling in a number of countries	...
Government of China (2004-2006)	...	Loans	Infrastructure	Brazil	Natural gas pipeline and export corridor	...

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC) on the basis of United Nations Conference on Trade and Development (UNCTAD), "China: an emerging FDI outward investor", *E-brief*, 2003; John J. Tkacik Jr., "China & UNOCAL" *Pittsburgh Tribune Review*, 3 July 2005; and *The New York Times*, "China's costly quest for energy control", 27 June 2005.

## 1. Growth of trade between the Latin American and Caribbean region and China

China has been increasing its share in Latin American trade during the course of this decade, and by 2003 it accounted for almost 3% of the region's total exports and 5% of its total imports, thus becoming the Latin American and Caribbean region's largest Asian trading partner (China was the buyer of almost 38% of total exports to Asia and the Pacific and the source of 31%

of imports from that region in 2003). In other words, China's role in the trade flows between these two regions is of growing importance and dynamism. Japan was the region's most important customer until recently, but has now been displaced by China (see table V.4) as the leading Asian buyer of Latin American products.

Table V.4  
**ASIA AND THE PACIFIC: SHARE IN LATIN AMERICAN  
 AND CARIBBEAN TRADE <sup>a</sup>**  
*(Percentages)*

	Latin American and Caribbean exports		Latin American and Caribbean imports	
	1999	2003	1999	2003
Asia and the Pacific	5.8 (100)	7.6 (100)	11.6 (100)	16.6 (100)
China	0.7 (12.7)	2.9 (37.6)	1.9 (16.2)	5.1 (30.6)
Japan	2.4 (41.8)	1.8 (23.2)	4.2 (36.6)	4.4 (26.2)
Republic of Korea	0.7 (12.5)	0.9 (12.1)	2.0 (16.9)	2.2 (13.5)

**Source:** Commodity Trade Database (COMTRADE).

<sup>a</sup> The figures shown in brackets refer to the percentage of total exports to Asia and the Pacific and total imports from that region.

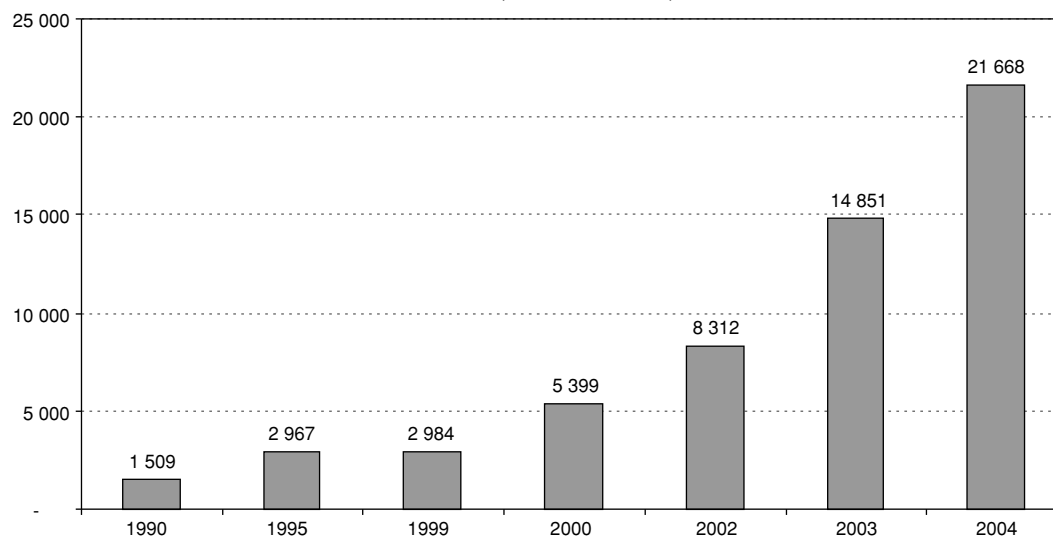
China's imports from Latin America and the Caribbean have expanded at an impressive rate in recent years: between 1990, when they stood at US\$ 1.5 billion, and 1995 they nearly doubled, rising to US\$ 2.966 billion. After a period of flat growth that lasted until 1999, Chinese imports from Latin America and the Caribbean began to soar, jumping to almost US\$ 5.4 billion in 2000 and to US\$ 21.668 billion in 2004 (see figure V.4). This represented an annual growth rate of 42% between 2000 and 2004, which far outstripped the growth rates of China's imports from the world as a whole (26%).

Today China is an extremely important trading partner for many of the region's countries (see table V.5). China absorbs just over 10% of Chile's exports, for example, compared with less than 1% a mere 15 years ago. Other countries, including Argentina, Brazil and Peru, are similarly placed. China is now Brazil's third-largest trading partner, after the United States and Argentina, and vies with Japan for second place in the list

of Chile's trading partners. China's trade with Mexico, the Bolivarian Republic of Venezuela and Costa Rica, though still quite limited, has also increased significantly in recent years.

According to official data from China, the above seven countries (Argentina, the Bolivarian Republic of Venezuela, Brazil, Chile, Costa Rica, Mexico and Peru) supplied almost 95% of the goods and services it imported from Latin America and the Caribbean in 2004. Approximately 40% of those imports came from Brazil (US\$ 8.7 billion), followed by Argentina (with 15%, or US\$ 3.3 billion), Chile (17%, or US\$ 3.7 billion), Mexico (10%, or US\$ 2.1 billion), Peru (7%, or US\$ 1.5 billion), Bolivarian Republic of Venezuela (3%, or US\$ 738 million) and Costa Rica (3%, or US\$ 641 million). Although just a few exporting countries continue to account for the bulk of the region's trade flows with China, the composition of Latin American and Caribbean exports to that country has changed significantly as a larger and larger share of the total comes to be made

Figure V.4  
**CHINA'S IMPORTS FROM LATIN AMERICA AND THE CARIBBEAN**  
*(Millions of dollars)*



Source: Commodity Trade Database (COMTRADE).

Table V.5  
**LATIN AMERICA (13 COUNTRIES): CHINA'S POSITION AS A DESTINATION MARKET FOR TOTAL EXPORTS, AROUND 1990 AND 2004**

Países	Rank among main trading partners		Percentage of total exports	
	1990	2004	1990	2004
Chile	30	3	0.40	10.4
Peru	16	2	1.70	10.2
Cuba	5	4	4.30	8.2
Argentina	14	4	2.00	7.7
Brazil	18	4	1.20	5.6
Uruguay	8	6	3.90	3.8
Paraguay	46	7	0.00	2.7
Costa Rica	32 <sup>a</sup>	10	0.19 <sup>a</sup>	2.6
Bolivia	52 <sup>a</sup>	15	0.00 <sup>a</sup>	1.0
Venezuela (Bolivarian Rep. of)	51	14	0.00	0.8
Colombia	60	21	0.03	0.8
Ecuador	81	19	0.00	0.7
Mexico	27	15	0.30	0.3

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the Commodity Trade Database (COMTRADE); Latin American Integration Association (ALADI); International Monetary Fund (IMF), *Direction of Trade Statistics*, June 2005; and Foreign Trade Corporation of Costa Rica (PROCOMER).

<sup>a</sup> Data for 1991.

up of mid- and high-technology manufactured goods, especially in the cases of exports from Mexico, Costa Rica and Brazil (see figure V.4).<sup>6</sup> A number of Latin American countries are emerging as possible suppliers for

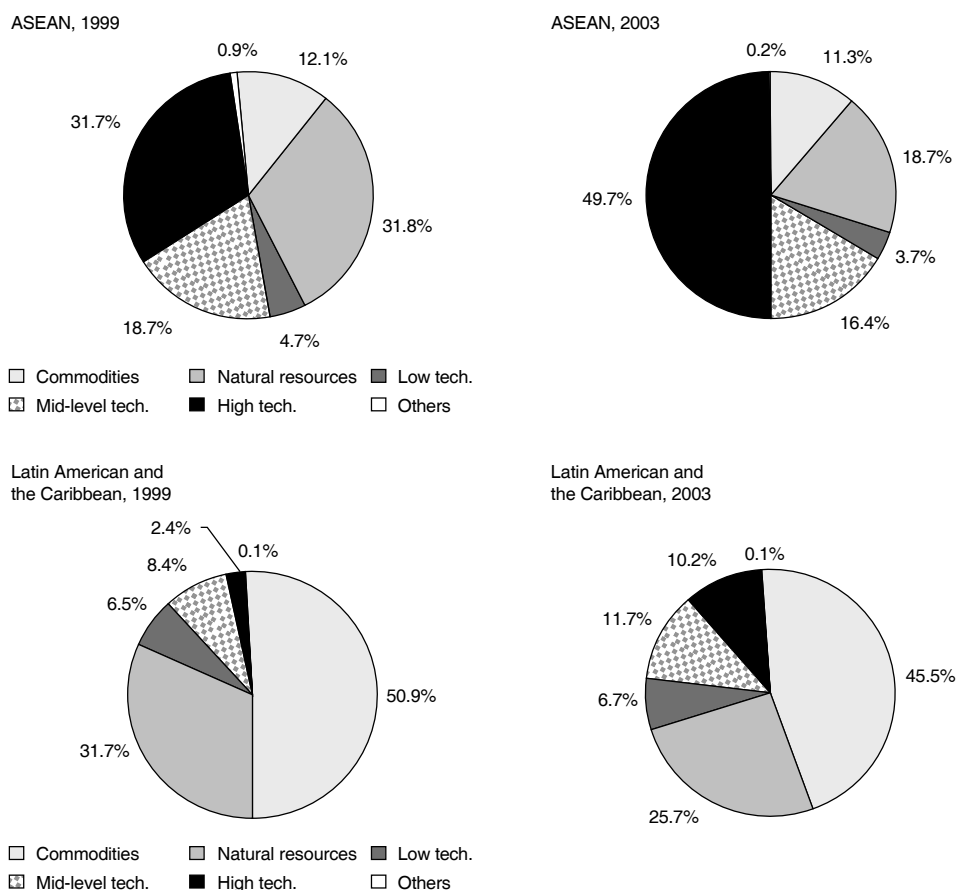
Chinese imports of automotive and spare parts, electrical accessories and electronics. These shifts could open up opportunities for the introduction of higher value-added products into the region's export basket.

## 2. Latin American specialization in Chinese markets

With regard to both commodities and manufactures, the Latin American and Caribbean region differs substantially from the ASEAN countries — the region's most direct

competitors — in terms of its market specialization in China. The ASEAN countries have managed to bring about a dramatic change in their Chinese export basket

Figure V.5  
CHINA: IMPORTS FROM ASEAN AND FROM LATIN AMERICA AND THE CARIBBEAN, 1999 AND 2003



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the Commodity Trade Database (COMTRADE).

<sup>6</sup> Chinese imports of high-technology goods from Latin America and the Caribbean jumped by 485% in 2000 and increased by around 50% to 55% per year thereafter. Imports of mid-range-technology goods have also gathered momentum, expanding by over 120% in 2003 with respect to the 2002 figure. China's 20 main imports from Latin America and the Caribbean include a series of manufactured goods corresponding to the electrical and automotive parts sectors, among others.



since the end of the 1990s (see figure V.5). Today, the high-technology segment represents almost half of ASEAN exports to China, which stands in stark contrast to Latin America, where almost 70% of exports to China are commodities and natural-resource-based manufactures. Even so, there are still 30% of ASEAN exports to China that fall into categories in which the Latin American and Caribbean region enjoys comparative advantages.

The basket of Chinese exports to the Latin American countries is quite different, since it is concentrated in low-technology products, although it does include some mid-range and high-technology goods as well. It is precisely in these sectors (e.g., textiles and clothing, footwear and toys) that Latin American and Caribbean producers perceive a threat from Chinese manufacturers and where trade contingency measures thus tend to be applied (see section 2 of this chapter). Because of their low costs these Chinese industries represents stiff

competition both in the region's local markets and in other major markets such as the United States and the European Union.

Despite some success in penetrating certain manufacturing segments in Chinese markets, commodities and natural-resource-based manufactures continue to drive Chinese-Latin American trade, representing approximately 46% and 30%, respectively, of the region's total exports to China in 2003. Within these sectors, the Latin American and Caribbean region is the foremost supplier of a number of products that are quite important to China. The region provided 65% of the soybean seeds and 74% of the fishmeal imported by China in 2003, for example. China is highly dependent on Latin America for its supply of other goods too, such as sugar, grapes, copper and other minerals and metals (see table V.6). Brazil is one of China's main suppliers of iron ore agglomerates, and Argentina provides 66% of its imports of soybean oil.

Table V.6  
**CHINA: MAIN PRODUCTS IMPORTED FROM FIVE LATIN AMERICAN COUNTRIES, 2004**  
(Percentages of China's total imports from the world)

Main products	Argentina	Brazil	Chile	Cuba	Peru	5 countries (A)	World (B)	% of total C= (A)/(B)
1 Soya (222+4232)	2 555	2 619	0	0	0	5 174	8 528	60.7%
2 Copper (28711+28821+68211_68212)	12	39	2 787	7	505	3 349	8 490	39.4%
3 Iron ( 2815+2816+67251+67461)	25	3 155	168	0	256	3 604	17 474	20.6%
4 Wood and pulp (25171+25172+24831+65121+64162)	53	521	349	0	4	928	4 374	21.2%
5 Fishmeal (08142)	17	0	103	0	502	621	764	81.4%
6 Leather (6114)	103	300	0	0	0	404	2 783	14.5%
7 Machine parts and accessories (7849)	3	101	0	0	0	104	7 305	1.4%
8 Sugar (0611)	0	0	0	111	0	111	225	49.3%
9 Tin (2874)	0	0	0	0	122	122	437	27.9%
10 Zinc (2875)	0	0	8	0	7	15	171	8.6%
11 Propane and butane (34131)	22	4	0	0	0	27	2 397	1.1%
12 Methanol (51211)	0	0	28	0	0	28	348	7.9%
13 Grapes (05751)	0	0	41	0	0	41	67	60.2%
14 Nickel (28721+28722)	0	0	0	45	0	45	128	35.4%
15 Other metal concentrates (28799)	0	0	1	28	0	29	259	11.1%
<b>Sample total</b>	<b>2 790</b>	<b>6 740</b>	<b>3 484</b>	<b>191</b>	<b>1 395</b>	<b>14 601</b>	<b>53 749</b>	<b>27.2%</b>
Otrer products	464	1 933	182	4	128	2 711	507 479	0.5%
<b>Total imports</b>	<b>3 255</b>	<b>8 673</b>	<b>3 667</b>	<b>195</b>	<b>1 523</b>	<b>17 312</b>	<b>561 229</b>	<b>3.1%</b>

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the Commodity Trade Database (COMTRADE).

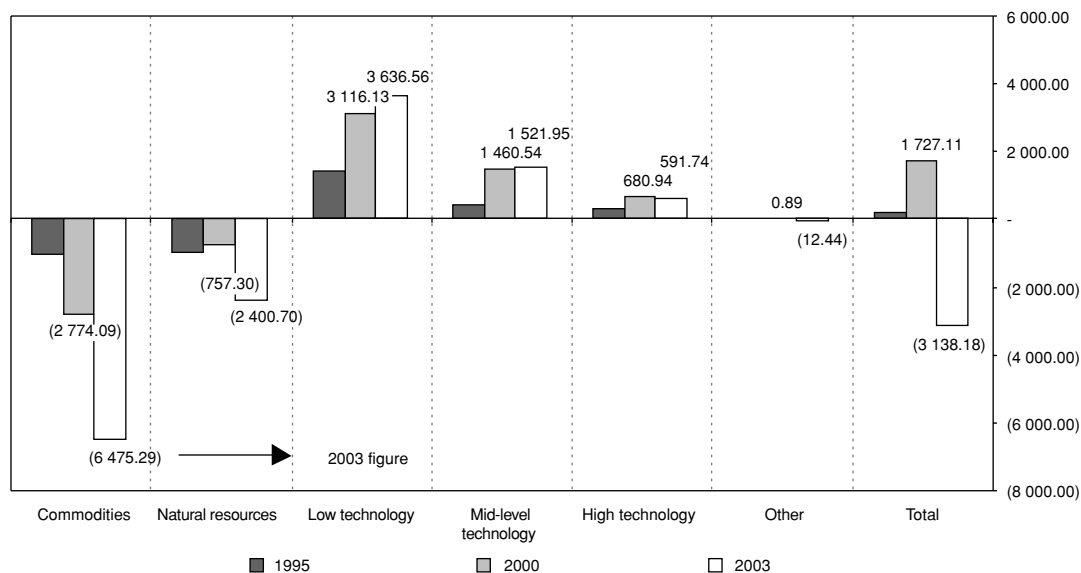
Despite the region's great importance as a supplier of certain agricultural and mining products, Latin American exports face strong competition from other regions. A case in point is the region's exports of soybean seeds, which must compete with exports from China's largest supplier of this product, the United States. This is also true in the case of iron ore, where Australia and India have been China's main suppliers. Thus, the countries of the region are going to have to strengthen their links with the Chinese business community if they are to maintain the momentum of their exports of commodities and semi-manufactured goods and secure new niches in the Chinese market. To do so, they need to forge alliances and promote various types of cooperation within the business community, which will, in turn, entail acquiring a deeper knowledge of Chinese markets.

China's rapidly growing demand for basic inputs, including minerals and foodstuffs, has tipped its trade balance with Latin America and the Caribbean into the red, although this deficit is concentrated in the less processed types of products (see figure V.6). China's exports to Latin America and the Caribbean in other sectors, such as low- or mid-level-technology

goods, yield surpluses, but they are not large enough to offset its mounting deficit in the natural-resource segment.

In short, inter-industry flows predominate in trade between China and Latin America and the Caribbean. China exports manufactured goods, while the Latin American and Caribbean region exports mainly raw materials; this represents a departure from the region's overall pattern, since manufactures are, on the whole, accounting for an increasingly large share of total Latin American exports. The share of total exports to China made up of foodstuffs, minerals and metals has been increasing, which is indicative of the region's comparative advantages and the potential of the Chinese markets. China and the Latin American and Caribbean region should cooperate in positioning Latin American and Caribbean firms in Chinese value chains, which would, of course, require a substantial increase in reciprocal FDI flows. A key question to be answered in terms of the trade relations between these markets is whether or not China poses a threat to Latin America. The answer to this question will largely depend on how trade and investment flows between the two regions evolve (see box V.1).

Figure V.6  
**BREAKDOWN OF CHINA'S TRADE BALANCE WITH LATIN AMERICA AND THE CARIBBEAN, 1995, 2000 AND 2003**  
(Millions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the Commodity Trade Database (COMTRADE).

## Box V.1

**DOES CHINA POSE A THREAT TO LATIN AMERICA?**

The main question with respect to Latin America's relations with China concerns the possible diversion of trade and investment away from the region and towards China. Research has led to conflicting findings on this point.

Lall and Weiss (2004) and Moreira (2004) see China as representing a threat to Latin America's development into an exporter of higher-technology and higher value-added products. Their research suggests that the level of development and the increasing sophistication of the export sector in China and in other South-East Asian countries will eventually crowd out more sophisticated exports from Latin America. Lora (2004) provides a table on checks and balances

between the two and suggests that institutional reforms in both China and Latin America would create a more conducive environment for FDI and private enterprise. López-Córdova (2004) reaches similar conclusions with respect to Mexico and indicates that the main institutional actors (trade unions, industrial employers' associations, political parties and the different branches of government) must strive to implement institutional reforms that will allow them to deal with the challenge posed by China.

With respect to FDI, García-Herrero and Santabábara (2004) and Chantasawat, Fung, Iizaka and Siu (2004) find no evidence of investment substitution or diversion between China and Latin America.

Chantasawat et al. conclude that the key decision-making factor for transnational corporations is that Asia has a production network that Latin America lacks. Investment decisions in Latin America and the Caribbean therefore appear to be based on such factors as market size, economic growth and entry barriers (tariffs), which, though matters of concern for the countries of the region, are not relevant to investments in China. Lastly, Lin (2004) finds that China is a positive factor in terms of both investment and trade, since economic growth creates an even larger market for Asian and Latin American exports alike, thereby acting as an engine of growth for all of these economies.

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC).

**3.****Chinese FDI in Latin America and the Caribbean**

In contrast to its status as a recipient of FDI from the rest of the world, China is just beginning to invest abroad: in 2003, China's outward FDI accounted for only 0.45% of the world's total FDI flows and 0.48% of its FDI stock. Up until the end of 2004, non-financial Chinese companies held a stock of US\$ 33.2 billion abroad, of which US\$ 2.85 billion was invested in 2003, up by 5.5% from 2002. Although it accounts for a relatively small share of the total, China is emerging as one of the main developing-country investors and is more or less on a par, in terms of levels of investment, with the Republic of Korea. Most Chinese FDI has gone to its Asian neighbours.

Nevertheless, Latin America has been an important destination for Chinese investment in recent years. According to official figures from the Ministry of Commerce of the People's Republic of China, almost US\$ 1.04 billion was invested in the region in 2003, which represents 36.5% of the total invested in the rest of the world. As of the end of 2004, China's FDI stock in the region was estimated at almost US\$ 4.62 billion, or 14% of China's outward FDI (*People's Daily Online*, 2004a). This figure compares favourably with that of the Republic of Korea, whose stock of FDI in Latin America and the Caribbean stood at US\$ 4.3 billion

at the end of 2004.<sup>7</sup> As will be discussed further on in this chapter, a surge in Chinese FDI in the region is expected in the next few years, especially in sectors related to energy, mining and food products, as well as infrastructure.

As mentioned earlier, China's trade deficit with the region leans heavily towards commodities and natural-resource-based manufactures. China's strong demand for these products makes it interested in investing in mineral production and in developing the region's transport infrastructure in order to ensure a supply of the products it needs and lower costs.

An UNCTAD report indicates that many national investment promotion agencies ranked China as one of the leading foreign direct investors for 2004-2007.<sup>8</sup> This may be attributed in part to expectations that the Chinese firms that are investing in the region today will attract more investment.

One reason for the low level of Asian (including Chinese) FDI in Latin America and the Caribbean is the lack of intrasectoral businesses complementarity in the East Asian economies owing to their "flying geese" pattern of development, i.e. the sequencing of the industrialization process from one economy to another. Although perhaps over-simplified, this vision of

<sup>7</sup> The Export-Import Bank of Korea.

<sup>8</sup> Statement by Mr. Carlos Fortin (2005).

industrial development in different countries over time does accurately represent the interaction between trade and FDI as a process by which production is shifted across national boundaries, thereby generating complementary

trade flows. Latin American firms need to find ways to position themselves in Asian manufacturing sectors in order to promote reciprocal FDI between China and Latin America and the Caribbean.

#### 4. China's new regional integration strategy: a challenge for Latin America and the Caribbean?

China's sheer size and, more recently, its surging economy have made it an important actor within Asia. As recently as the late 1990s and early years of this century, China's trade policy did not provide for any regional integration schemes or bilateral trade agreements, but its position in this respect had changed radically since then. The country has now achieved a level of development that allows it to open itself up to international competition and integration into the regional and global economy with a view to long-term gains (Wang Jisi, 2004, p. 6). The following table shows the current status of China's negotiations with regard to granting and obtaining tariff preferences in the Asian region and beyond (see table V.7).

The establishment of an Asian free-trade area that includes China, the Republic of Korea and Japan (and perhaps even India) represents a challenge for Latin America because Asian integration has a more intraregional slant, as well as a greater emphasis on intraregional exports in terms of tariff preferences. As discussed previously, commodities and natural resources account for the bulk of China's imports from Latin

America and the Caribbean (although high-technology goods have indeed increased as a proportion of total exports over this period), whereas its imports from ASEAN countries fall mainly into high-technology categories, including ICTs, whose tariffs have come down considerably in the last few years.

The Latin American and Caribbean region could lessen its disadvantage vis-à-vis ASEAN in these segments of the Chinese market if the countries were to sign the WTO Information Technology Agreement (ITA).<sup>9</sup> The disadvantages for the Latin American and Caribbean countries would be heightened most, however, in commodities and natural-resource-based manufactures, where the ASEAN countries enjoy comparative advantages in production and effective tariffs remain high. High tariffs are still applied to oilseed products, leather, paper and paper products and some electronic goods. A reduction in these tariffs under the agreement between China and ASEAN would thus benefit the ASEAN countries at the expense of Latin America and the Caribbean.

Table V.7  
CHINA: TARIFF PREFERENCES EXTENDED IN BILATERAL AND PLURILATERAL NEGOTIATIONS, FEBRUARY 2005

Countries	Asian countries	Rest of the world	Total
China Signed	ASEAN (10) <sup>a</sup> + Bangkok Agreement (6) <sup>b</sup> + India (1) <sup>c</sup> + Pakistan (1) + Thailand (1) <sup>c</sup> + Hong Kong (1) = 18	None	18
China Negotiating	Shanghai Cooperation Organization (SCO) (5) <sup>d</sup> + Australia (1) + Singapore (1) + New Zealand (1) = 8	Gulf Co-operation Council (7) + Chile (1) + Pakistan (1) = 9	17

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>a</sup> The members of ASEAN are Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam.

<sup>b</sup> The Bangkok Agreement countries are Bangladesh, India, the Lao People's Democratic Republic, Philippines, Republic of Korea, Sri Lanka and Thailand.

<sup>c</sup> Not counted in the sum of the total since they are members of ASEAN and/or parties to the Bangkok Agreement.

<sup>d</sup> The Shanghai Cooperation Organization (SCO) is an international inter-governmental organization that was established in Shanghai on 15 June 2001 by six countries: China, the Russian Federation, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan.

<sup>9</sup> As of 13 May 2005, the Information Technology Agreement had 38 participants (covering 63 Members and States or separate customs territories in the process of acceding to WTO) representing approximately 97% of world trade in information technology products. The participants in the region are Costa Rica, El Salvador and Panama. El Salvador has indicated that implementation will begin after the completion of domestic legal procedural requirements, while Panama has not yet submitted the formal documentation (WTO, 2005a).

As part of the commitments set out in the agreement between China and the ASEAN countries, starting in July 2005, tariffs will be lowered by up to 5% on almost 7,000 types of industrial goods by 2015. The tariffs applicable to the six most advanced countries of the group (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand) will be phased out by 2010, while those applied to the other four countries (Cambodia, Lao People's Democratic Republic, Myanmar and Viet Nam) will be eliminated

by 2015. Tariffs on sensitive products (such as rice, cement and motor vehicles) may remain in place until 2018 and those on highly sensitive products will be lowered by a maximum of 50%. This round of tariff reduction was preceded by an "early harvest" scheme for the agricultural sector, which has been in place since the start of 2004 (see box V.2). These measures are expected to increase the ASEAN countries' natural-resource exports to China and their imports of manufactured goods from it.

## Box V.2

**CHINA AND ITS FREE TRADE AGREEMENT WITH ASEAN**

The free trade agreement (FTA) between China and ASEAN was signed in November 2002 in an effort to improve economic cooperation, trade in goods and services, and investment. ASEAN and China recently expanded the scope of the FTA by signing an Agreement on Trade in Goods, which provides for specific tariff savings on traded goods. This agreement entered into effect on 1 July 2005. The tariff preferences will apply to China's imports from ASEAN and vice versa (10% and 15%, respectively). Other provisions include the following:

**The early harvest scheme**

1. Has been in effect since 1 January 2004.
2. Covers selected agricultural products that fall under chapters 1-8 of the Harmonized System.
3. Is not applicable to most manufacturers operating in China.

**Recent expansion to industrial and consumer products**

Tariffs and non-tariff barriers will be reduced on trade in products that fall under chapters 9-97 of the Harmonized System. Firms must qualify in order to take advantage of these new measures.

**Rules of origin**

The aim here is for manufacturing processes in China or ASEAN to account for at least 40% of the value added to the products in question. An analysis of the relevant production chains or business models is required in order to obtain this certification, which gives access to tariff reductions.

**Deadline**

Implementation must be completed by 2010.

**Scope**

In addition to goods, the agreement covers trade in services and investments, albeit to a relatively limited degree.

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC).

## B. Building partnerships

Latin America and the Caribbean have yet to tap into the full potential of China as an export market, and the recent experiences of some countries in the region clearly suggest that there are ample opportunities for increasing the region's natural-resource-based exports. Yet the region's trade with China suffers from the same limitation that affects all its international trade flows, namely the concentration of its exports in commodities and semi-processed goods. The Latin American and Caribbean region must work to increase the degree of processing of its resource-based exports and seek new markets in China for differentiated, higher-value-added goods. The existing product mix, which is highly dependent on the business cycles of importing countries, does nothing to help stabilize import earnings either. An analysis of the strategies used by countries such as Chile or Peru can be

helpful in identifying opportunities for expanding trade with China and reciprocal investment in the future.

Promising opportunities are emerging for expanding interregional trade and reciprocal investment in natural resources. When dealing with these kinds of products it is also important, however, to form strategic partnerships that will increase the value added throughout the production chain and broaden market access. Given the effects of trade liberalization and mounting competition for export markets, government and business leaders need to devise policies and specific measures for the diversification of markets and products that will allow them to take advantage of China's economic growth.

Economic policy-makers in Latin America have tended to overlook the opportunities that natural resources provide for creating linkages, technical innovation and

other externalities. Natural-resource-based activities rival manufacturing in their potential to generate strong gains in productivity, technological spillovers and forward and backward linkages, as the experiences of Australia, Canada, Finland, Sweden and the United States clearly demonstrate. The boom in Chile's extraregional exports has been driven by natural-resource-based products. Latin America can create (and, in fact, is creating) new comparative advantages by means of policies that promote "new endowments" in such areas as human capital, knowledge, solid institutions and sound physical infrastructure.

A great deal of the literature indicates that trade links among Asian economies consist increasingly of intrasectoral trade flows. The Latin American and Caribbean region has also seen a large volume of this type of trade, especially within MERCOSUR. But between the Latin American and Caribbean region and China, intrasectoral trade occurs mainly in products that are of minor significance. Given the divergent models of international specialization in China and in Latin America and the Caribbean, the strong growth of aggregate demand in the Chinese economy offers the region new production

and export opportunities. There are fears, however, that non-Asian countries will be hard put to take full advantage of the potential benefits of China's powerful economic growth because of the highly integrated nature —based mainly on intraregional and intrasectoral trade— of the Asian region's production system.

Generally speaking, the two regions have very different trade and investment patterns and economic integration models. Efforts are needed to ensure a role for the Latin American and Caribbean region in the de facto integration of Asia's production system, in which China plays an increasingly important role. Increased intrasectoral trade between China and Latin America and the Caribbean would give the region new routes into the Chinese market, encourage the incorporation of new technologies and improve worker's skills and corporate management methods, as a follow-on from production activities and the technical assistance that goes with them. Future collaboration with China in connection with FDI would help Latin America and the Caribbean to improve the systemic competitiveness both of individual countries and of the region as a whole.

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## C. China's accession to WTO

### 1. Introduction

The complexity of the negotiations leading up to China's accession to WTO, which took 15 years to conclude, reflects how much work was involved in bringing a developing country into the multilateral trading system at a time when it is making a transition from a planned economy to a market economy. China's entry into WTO points to major changes in trade policy and increased opportunities in the world economy as a whole, and it has certainly fostered predictability and transparency<sup>10</sup> in the country's business dealings. In addition, as a new member of WTO (since 11 December 2001), China has had to adjust its legal system to the new commercial order based on a "free" and competitive market by making fundamental changes in its trade regulations. The accession has also required China to adapt its trade policy

to more than 20 existing multilateral WTO agreements that regulate sensitive issues for this country, such as intellectual property, subsidies, tariffs, services, textiles, agriculture and antidumping. The following section examines China's implementation of measures stemming from its entry into WTO in a number of major economic sectors which are still a cause of concern for its trading partners. It then goes on to explore the challenges that China will face in the future.

Aside from contributing to the transparency and predictability of the multilateral system, China's accession to WTO and its commitments regarding regulatory changes have implications for Latin America and the Caribbean in at least three different areas: access for the region's exports to the Chinese market; competition

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<sup>10</sup> Transparency in trade is one of the main objectives of WTO. In order for China to achieve such transparency, it agreed to publish laws and regulations in official journals on a regular basis, along with relevant information on those statutes. The object of this procedure is to create inquiry points so that companies can obtain information about these laws and regulations and to give them a reasonable amount of time for comment, prior to the statutes' implementation.

between the region and China economy in other markets (especially in the United States); and competition from Chinese products in the Latin American and Caribbean countries' domestic markets. Certain disciplines and the degree or form of China's fulfilment of its commitments thus take on heightened importance for the region, as does China's stance in the current WTO negotiations, whether as an individual country or as part of groups of countries that share particular views and proposals.<sup>11</sup> Stated more broadly, the countries of the region will be watching to see what general direction China's trade policy takes.<sup>12</sup>

Of course, these developments are not equally relevant to all the subregions of Latin America and the Caribbean. In view of the different subregions' trade specializations and market orientations, a distinction

should be drawn between the potential effects for at least two areas, namely South America and Meso-America. South American countries, which are essentially exporters of agricultural and mining products, are primarily interested in matters affecting their access to the Chinese market.<sup>13</sup> The countries of Meso-America, on the other hand, are mainly concerned about Chinese trade policies which, apart from the competitive advantages they may generate in such areas as wages, that influence China's competitiveness in other markets.<sup>14</sup> Brazil shares its South American neighbours' focus on market access, but may also have a stake in policy issues that have a bearing on competition from China in its own domestic market and in other economies. These questions are also important to Mexico, although its main consideration is competition in the United States market.<sup>15</sup>

## 2. China's WTO commitments

Most of the key commitments made by China in connection with its entry into WTO were scheduled to be fully phased in by 11 December 2004 (a brief transitional period was considered necessary for such a complex and huge economy as China's). Thus, from 2005 on, the world expects China to live up to its WTO commitments.<sup>16</sup> Apart from the considerable structural adjustments associated with its rapid integration into the multilateral trading system, China has also been making major changes in its domestic trade policy since its WTO accession. It still has a long way to go, however, before it will have finished shaping its international trading rules (see table V.8). **Tariffs and non-tariff barriers:** China continues to increase access to its markets for all WTO members by

progressively reducing its tariff rates and is on track to have lowered its tariffs on goods from the average 1997 rate of 25% to 7% over a five-year period beginning on 1 January 2002. The average 2001 rate of 16.4% had been lowered to 10.4% by 2004 and to 9.4% as of early 2005. These rates compare favourably with those of some other developing countries, such as Brazil, India and Indonesia, which have rates of over 25% (Wolff, 2005, p. 7). Although nearly all of the reductions for industrial goods were completed by 1 January 2005,<sup>17</sup> reductions for a few industrial products will continue to be phased in until 2010. The country also has signed the Information Technology Agreement (ITA), which calls for the elimination of tariffs on information technology (IT) products.<sup>18</sup>

<sup>11</sup> China and Latin America and the Caribbean have found common ground, in particular, on coordination within G-20, on proposals on agriculture and as part of the group known as "Friends of Anti-Dumping Negotiations".

<sup>12</sup> Industrial policy is a key aspect of this (Wolff, 2005).

<sup>13</sup> Of particular importance in this regard are sanitary measures, administration of agricultural quotas and other non-tariff barriers, which have proven to be greater obstacles than tariffs to market access for exports of fruit or processed foods (ECLAC, 2004, chapter IV). Intensive deployment of antidumping rules and systems of licences and certification are also contentious issues (Wolff, 2005).

<sup>14</sup> The most obvious example of this is the textiles and clothing sector, after the full implementation of the Agreement on Textiles and Clothing, but research has also been conducted into the risks for the electronic products segment (ECLAC, 2004). Local government subsidies and special treatment for FDI could affect the competitiveness of some of these products in domestic and third markets alike (Lora, 2005).

<sup>15</sup> IDB (2004) finds that Mexico will be the most affected by competition from China, since its export profile, like the sectoral distribution of its FDI, is very similar to China's.

<sup>16</sup> The first WTO Trade Policy Review of China is expected in 2006. Meanwhile, China has agreed with WTO to create a special multilateral mechanism, known as the Transitional Review Mechanism, to review its compliance on an annual basis for a period of 10 years following its accession.

<sup>17</sup> See the website of the United States Department of Commerce (Office of China Economic Area, n/d).

<sup>18</sup> The Ministerial Declaration on Trade in Information Technology Products (ITA) was concluded at the Ministerial Conference of WTO held in Singapore in December 1996. Participation in ITA means that a country must have eliminated tariffs and all other duties and charges on specified IT imports from WTO members by 1 January 2000 (developing-country participants have been granted extended periods for some products) (See the website of the WTO).

Table V.8

**CHINA'S COMPLIANCE WITH WTO OBLIGATIONS**

Issue	Successes	Work in progress
Tariffs and quotas	<ul style="list-style-type: none"> <li>On 1 January 2005, China further decreased its average tariff rate to 9.4%, down from 10.4% in 2004 and 16.4% in 2003.</li> <li>China eliminated all of the trade-distorting non-tariff measures specified in its Protocol of Accession, including import quotas and licensing and tendering requirements.</li> </ul>	<ul style="list-style-type: none"> <li>There continue to be claims that the WTO Agreement on Customs Valuation is not being fully enforced.</li> <li>Some tariffs on goods have been eliminated and others have been reduced; most of these reductions were to be implemented by 2004 and in no case are they to be made later than 2010.</li> </ul>
Trading rights and distribution rights	<ul style="list-style-type: none"> <li>China formally implemented its commitments in July 2004, six months ahead of the deadline.</li> <li>A revised foreign trade law was approved in April 2004 to allow domestic firms, joint ventures and foreign entities to automatically enjoy trading rights following proper registration with the Ministry of Commerce.</li> </ul>	<ul style="list-style-type: none"> <li>In the area of distribution, China has yet to fully implement its commitments to eliminate national-treatment and market-access restrictions on foreign enterprises.</li> <li>Licensing is still slow and cumbersome and is not available at all for direct-sale organizations, even though China committed to remove these restrictions by December 2004.</li> <li>The value of trading rights is limited by restricted access to distribution rights.</li> </ul>
Trade-related investment obligations	<ul style="list-style-type: none"> <li>China has passed legislation to eliminate "trade-balancing requirements" for foreign investment, in accordance with the WTO agreement on Trade-Related Investment Measures (TRIMS). These restrictions included export-performance, local-content, foreign-exchange balancing and technology-transfer requirements.</li> </ul>	<ul style="list-style-type: none"> <li>Foreign investors have concerns about the encouragement of technology transfer.</li> <li>There are strict limits on investments in content-based areas of the print media and access to broadcasting licenses. Production of motor vehicles by firms in which foreigners hold a majority stake is confined to special economic zones and to exports.</li> </ul>
Agriculture	<ul style="list-style-type: none"> <li>Reduction of tariffs, improved administration of tariff-rate quotas (TRQs) and limited further use of trade- or production-distorting agricultural subsidies.</li> </ul>	<ul style="list-style-type: none"> <li>There have been some unjustified sanitary and phytosanitary (SPS) restrictions on crops, beef, chicken and related products (SPSs with questionable scientific bases).</li> <li>Uncertainties and onerous restrictions with respect to quarantine processes.</li> <li>Defaults on import contracts when commodity prices have fallen.</li> <li>Some lack of transparency in the administration of TRQs.</li> <li>Unclear timetable for putting an end to export subsidies.</li> </ul>
Services	<ul style="list-style-type: none"> <li>Greater market access to a number of its services industries. China has removed some geographic limitations on the banking and insurance sectors and has streamlined its licensing process.</li> <li>Foreign telecommunications suppliers are permitted to establish joint ventures, without quantitative restrictions, and to provide services in several cities.</li> </ul>	<ul style="list-style-type: none"> <li>The opening up of certain sectors to foreign investment appears to have stalled (mainly in cinemas, publication distribution, communications, Internet and Internet information services).</li> <li>For foreign providers, entry barriers remain in such sectors as insurance, telecommunications and other services due to complex licensing and operating requirements.</li> <li>Within five years of accession (December 2006), foreign financial institutions will be permitted to provide services to all Chinese clients.</li> <li>By December 2006, there will be no geographic restrictions on foreign investment in the telecommunications industry.</li> <li>By December 2006, wholly foreign-owned insurance subsidiaries will be permitted.</li> </ul>



Table V.8 (cont.)

Issue	Successes	Work in progress
Legal framework	<ul style="list-style-type: none"> <li>China reviewed more than 2,500 trade-related laws, regulations and other measures with a view to compliance with its WTO commitments.</li> <li>This review led to the repeal of more than 800 laws and regulations and the passage of 550 new or revised laws or regulations.</li> </ul>	<ul style="list-style-type: none"> <li>Complaints have been lodged by foreign business about a lack of transparency in the formulation of regulations and rule-making by regulatory agencies.</li> <li>China has been slow to translate its laws into one of the official WTO languages.</li> </ul>
National treatment	<ul style="list-style-type: none"> <li>Repeal of the discriminatory VAT rebates policy for Chinese-produced semiconductors.</li> </ul>	<ul style="list-style-type: none"> <li>The authorities had created a series of incentives designed by the provinces to replace the discriminatory VAT rebate system. Monitoring is necessary.</li> </ul>
Subsidies	<ul style="list-style-type: none"> <li>All forms of export subsidies inconsistent with WTO rules were eliminated upon accession.</li> <li>China will limit its subsidies for agricultural production to 8.5% of the value of farm output, which is less than the 10% limit allowed for developing countries under the Agreement on Agriculture.</li> </ul>	<ul style="list-style-type: none"> <li>China must submit a notification of its subsidy programmes to WTO on an annual basis.</li> <li>China must submit subsidies notification as required by article 25 of the SCM Agreement</li> </ul>
Trade remedies	<ul style="list-style-type: none"> <li>China has agreed to the use by its WTO trading partners, for a period of 12 years following its accession, of safeguards against Chinese goods.</li> <li>China has agreed to the use, for a period of 7 years following its accession, of special textile safeguards.</li> <li>China has agreed to the use, for a period of 15 years following its accession, of antidumping measures.</li> <li>Some progress has been made in relation to China's antidumping regime. In July 2004 it issued a revised foreign trade law that clarifies its trade remedy regulations.</li> </ul>	<ul style="list-style-type: none"> <li>Chinese contingency measures in force: <ul style="list-style-type: none"> <li>-Antidumping (June 2004): 56</li> <li>-Countervailing duties (June 2004): 0</li> <li>- Safeguards (October 2004): 0 (China has conducted only one safeguard proceeding since its accession; that proceeding was terminated in 2003.</li> </ul> </li> </ul>
Intellectual property rights (IPR)	<ul style="list-style-type: none"> <li>China has promulgated regulations on trademark, copyright and patent infringement.</li> <li>China has been cooperating with relevant international organizations and has created several departments to protect IPRs.</li> <li>A Market Order Rectification Office has been established to strengthen inter-agency IPR enforcement efforts.</li> <li>Chinese courts have issued findings that may lead to an increase in the use of criminal penalties for IPR violations.</li> </ul>	<ul style="list-style-type: none"> <li>China committed to facilitate increased criminal prosecution of IPR violations and to increase enforcement activities and education campaigns.</li> <li>China committed to improve protection of electronics by ratifying the WIPO Internet treaties as soon as possible and by extending the existing ban on the use of pirated software by the central government and provincial agencies to include local governments.</li> </ul>

**Source:** Alan W. Wolff, *China's Compliance with Its WTO Obligations*, The Center for American and International Law, Plano, Texas, 15 June 2005; United States Trade Representative (USTR), *2005 National Trade Estimate Report on Foreign Trade Barriers, 2005*, and *2004 Report to Congress on China's WTO Compliance*, 11 December 2004.

In addition, despite some initial implementation delays, China has eliminated all of the trade-distorting non-tariff measures specified in its Protocol of Accession, including import quotas and licensing and tendering requirements, in accordance with the scheduled deadline under its WTO accession agreement of 1 January 2004 (USTR, 2004).

**Textiles:** Quotas on textiles were eliminated on 31 December 2004, but a safeguard mechanism will be in place until the end of 2008 to permit WTO members to take action to curb their imports if Chinese textile exports lead to market disruptions (WTO, 2005b).

**Agriculture:** China's principal commitment in this area is to refrain from maintaining or introducing any

export subsidies on agricultural products. It has agreed to limit its subsidies for agricultural production to 8.5% of the value of farm output under article 6.4 of the Agreement on Agriculture and to apply the same limit to subsidies covered by article 6.2 of the Agreement (rural development programmes in developing countries).

China's reduction in tariff bindings has proceeded according to its WTO accession schedule, with average tariff rates on agricultural goods decreasing from 31% in 1997 to 15.6% in 2004 (WTO, 2004a). There are some doubts, however, concerning the sanitary and phytosanitary procedures adopted by China. These sorts of restrictions have recently blocked market access for major crops and other agricultural goods such as beef, chicken and related products. Moreover, concerns have been expressed regarding its elimination of export subsidies in some cases. As discussed elsewhere in this chapter, China's large population, whose food needs are constantly on the rise, represents an enormous potential for trade in agricultural products for many Latin American exporting countries. It is important to bear in mind that agricultural exports from Latin America to China have increased substantially in recent years, climbing from US\$ 495 million in 1999 to US\$ 2.751 billion in 2003.<sup>19</sup>

**Services:** Telecommunications, banking and insurance are sectors in which the liberalization process has made steady progress. Upon China's accession, foreign service providers were permitted to establish joint ventures in the telecommunications sector, without quantitative restrictions and to furnish services in several cities. Foreign investment in joint ventures was initially limited to 25%, but this percentage was then gradually raised to 49% by December 2004. Within five years of accession (December 2006), there are to be no geographic restrictions whatsoever.

In the banking sector, upon accession, foreign financial institutions were permitted to provide services in China, with no restrictions on the nature of their clients, for transactions in foreign currencies. In the case of local-currency operations, as of December 2003 foreign financial institutions were permitted to provide services to Chinese enterprises, and from December 2006 on, will be allowed to furnish services to all Chinese clients. Companies in the insurance sector are treated differently

depending on the business segment concerned. Initially, foreign non-life insurers were allowed to establish a branch or a joint venture with up to 51% foreign ownership, while foreign life insurers were permitted to enter into a joint venture with the partner of their choice subject to a limitation of 50% foreign ownership. Since December 2003, foreign non-life insurers have been allowed to establish wholly-owned subsidiaries. For large-scale commercial risks, reinsurance and international marine, aviation and transport insurance and reinsurance, joint ventures with foreign equity of no more than 50% were permitted upon accession. In December 2004, the percentage were increased to 51%, and in December 2006, wholly foreign-owned subsidiaries will be permitted. On the other hand, China has made less progress in opening up its services sector, and some countries have complained about a lack of transparency and predictability (USTR, 2004).

There are some sectors in which China's licensing and operating requirements continue to be complex and difficult to comply with. Problems of this nature have been encountered by major developed-country services sectors such as the insurance and telecommunications industries.<sup>20</sup> The availability of trading rights also continues to be limited by existing corporate eligibility requirements dealing with minimum registered capital, import levels, export levels and prior experience. Foreign enterprises continue to face some restrictions in terms of their distribution of products in China as well.<sup>21</sup> In the area of distribution, China has yet to fully comply with its commitments to eliminate national-treatment requirements and market-access restrictions on foreign enterprises. For example, licensing is still slow, and it is not available at all for direct-sale enterprises, even though China made a commitment to remove restrictions on these firms by December 2004.<sup>22</sup>

**Subsidies:** China is behind schedule in its fulfilment of transparency requirements under the Subsidies Agreement relating to the notification of its subsidy programmes to WTO on an annual basis. China has yet to submit a subsidy notification as required by article 25 of the Agreement on Subsidies and Countervailing Measures.

**Antidumping:** Since 1995, China has become the primary object of antidumping complaints worldwide.<sup>23</sup>

<sup>19</sup> COMTRADE.

<sup>20</sup> According to the United States Trade Representative, Chinese regulatory authorities continue to impede access for foreign providers of insurance, telecommunications and other services, particularly through the use of excessively high capital requirements (USTR, 2004, p. 6).

<sup>21</sup> See the website of the United States Trade Representative.

<sup>22</sup> While the Ministry of Commerce issued a regulation in 2004 to remove restrictions on joint ventures' ability to provide distribution services in China, the agency's delay in issuing implementing procedures has limited foreign businesses' involvement in domestic distribution in China (Wolff, 2005, p. 8).

<sup>23</sup> About half of all United States antidumping cases have been directed at China (Hufbauer and Wong, 2004, p. 16).

The country has, however, made substantial progress in bringing its antidumping legislation into conformance with the provisions and requirements of the WTO Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (often referred to as the “Antidumping Agreement”). The Ministry of Foreign Trade and Economic Cooperation established many of the rules that now apply to antidumping issues (investigation, disclosure, questionnaires, etc). Today, its successor, the Ministry of Commerce, consolidates these antidumping functions within its Bureau of Fair Trade for Imports and Exports and its Bureau of Industry Injury Investigation). WTO members are still authorized to use a “non-market economy methodology” in antidumping determinations against China until the end of 2016 (WTO, 2001). This issue will be discussed in greater detail in the following section.

Another commitment made by China is to eliminate dual pricing practices as well as differences in treatment accorded to goods produced for sale in China in comparison to those produced for export. This represents a commitment to refrain from dumping, which has been one of the main international points of contention regarding the low prices of Chinese products. Just as one example, as of May 2005, there were 44 antidumping and safeguard measures being applied by Brazil and, of those cases, 11 were against Chinese products.<sup>24</sup> China is the country that is most frequently affected by the application of these sorts of protectionist measures, not only by Brazil but also by other major trading partners such as the United States, the European Union, Canada and others.

**Intellectual property rights:** Intellectual property is one of the most problematic areas for China. In order to comply with the standards set forth in the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (the “TRIPS Agreement”), it has been making an effort to improve the enforcement of intellectual property rights (IPRs). China has introduced changes in its almost non-existent intellectual property legislation and

has mounted educational campaigns to strengthen the protection accorded to intellectual property. It has also revised its patent, trademark and copyright laws to align them with the WTO Intellectual Property Agreement. A Market Order Rectification Office has been established to strengthen inter-agency IPR enforcement efforts, and Chinese courts issued findings that may lead to an increase in the use of criminal penalties for IPR violations. In 2001, around the time when China was admitted into the WTO, it revised its IPR regulations, but as far back as the 1980s, China was acceding to major international conventions and agreements for the protection of IPR and cooperating with relevant international organizations, such as the World Intellectual Property Organization (WIPO), the International Union for the Protection of New Varieties of Plants (UPOV) and the Asia-Pacific Economic Cooperation Forum (APEC).<sup>25</sup> The IPR system in China operates on the basis of a two-way parallel protection mode encompassing both administrative and judicial protection.<sup>26</sup> Several different departments in China are responsible for protecting intellectual property rights.<sup>27</sup>

However, countries such as the United States, where IPR legislation is more complete and complex, are not completely satisfied with Chinese efforts to ensure effective IPR protection, given the fact that counterfeiting and piracy in China continue to harm businesses in other countries (USTR, 2004). China has stated that it will ratify and implement the WIPO Internet treaties as soon as possible. According to the United States Department of Commerce, China’s piracy rate remains one of the highest in the world (over 90%), and piracy costs United States companies over US\$ 1 billion in legitimate business each year (USTR, 2005, p. 16). On average, 20% of all consumer products in the Chinese market are counterfeit. A report from International Data Corporation (IDC) indicates that the countries with the highest rates of software piracy are China and Viet Nam (92%).<sup>28</sup> There are many concerns about China’s implementation of TRIPS

<sup>24</sup> Brazilian Ministry of Development, Industry and Foreign Trade (2005).

<sup>25</sup> Since 1980, when China first acceded to the Convention Establishing the World Intellectual Property Organization, it has acceded to the Paris Convention for the Protection of Industrial Property, Treaty on Intellectual Property in Respect of Integrated Circuits, Madrid Agreement Concerning the International Registration of Marks, Universal Copyright Convention, Convention for the Protection of Producers of Phonograms against Unauthorized Duplication of their Phonograms, Patent Cooperation Treaty, Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks, International Convention for the Protection of New Varieties of Plants, the WTO TRIPS Agreement, and others. See Tianjin Economic-Technological Development Area.

<sup>26</sup> After issuing the “Opinions on Increasing Work Contacts Between Administrative Law Enforcement Organs and Public Security Organs and People’s Procuratorates”, a mechanism involving the coordination of administrative law enforcement and criminal law enforcement was established in order to create a joint authority for dealing with IPR infringements.

<sup>27</sup> The main such bodies are the State Intellectual Property Office, State Administration for Industry and Commerce, General Administration of Press and Publications, State Copyright Bureau, Ministry of Culture, Ministry of Agriculture, State Forestry Administration, Ministry of Public Security, General Administration of Customs, Supreme People’s Court and Supreme People’s Procuratorate.

<sup>28</sup> In Latin American, countries at the top of the software piracy list are said to be Colombia (53%), Puerto Rico (46%) and Brazil (63%) (IDC, 2004).

Agreement obligations as well. The United States Trade Representative's 2005 "Special 301" annual review on the adequacy and effectiveness of IPR protection in 90 countries finds that Chinese criminal enforcement of IPR violations has not yet had a significant deterrent effect on infringers, as China has pursued criminal prosecutions in only a few infringement cases. The review also states that the United States will elevate China onto the Priority Watch List "on the basis of serious concerns about China's compliance with its WTO TRIPS obligations and commitments" (USTR, 2005, p. 15).

**Trade-related investments:** China has made a commitment to eliminate "trade-balancing requirements" (export performance, local content, foreign-exchange balancing and technology transfer) for foreign investment in accordance with the WTO Agreement on Trade-Related Investment Measures (the "TRIMS Agreement"). It has also agreed not to force technology transfer (WTO, 2001). However, various sectors continue to be subject to investment limitations (e.g., the media and the automotive industry)(WTO, 2003). Moreover, there is concern regarding China's continued "encouragement" of technology transfer despite regulations that formally prohibit the practice. This situation was noted by the United States at the 2004 WTO transitional review of China's compliance with the TRIMS Agreement (WTO, 2003).

**Trading rights:** China committed to progressively liberalize the scope of the right to trade in such a manner as to ensure that within three years after accession (December 2004), all enterprises in China would obtain the right to import and export all goods throughout the customs territory of China, with the exception of certain goods specified in the Protocol that are subject to limitations in this respect. China formally implemented its WTO trading rights commitments in July 2004, six months ahead of schedule (USTR, 2004, pp. 12-14).

Considering the extremely restrictive trading system that existed before its accession to WTO (in

most cases, enterprises in which foreign investors held equity were allowed to import only what they needed for manufacturing processes in China and to export only what they produced in China), today China has advanced considerably in the liberalization of trading rights and distribution services. The Ministry of Commerce has issued regulations concerning the proper registration procedures to be completed by foreign trade operators in order to automatically qualify for trading rights.<sup>29</sup> Due to China's implementation of its commitments to liberalize distribution services (including wholesaling services, commission agents' services, retail services and franchising services), companies and individuals can now import goods to China and export goods from it without having to use a middleman.<sup>30</sup> As mentioned earlier, major changes in the telecommunications, banking and insurance sectors are expected in December 2006. There will be no geographic restrictions on telecommunications companies, foreign financial institutions will be permitted to provide services to all Chinese clients and wholly foreign-owned insurers will be permitted to establish subsidiaries.<sup>31</sup>

**Value added tax (VAT):** There have been reports of the discriminatory application of value added taxes in violation of national-treatment obligations (USTR, 2004).

China's fulfilment of its commitment to WTO principles of market access has been questioned by other WTO members, which claim that some of China's policies are discriminatory. China's semiconductor VAT policies are a case in point and serve to illustrate its efforts to promote uniquely Chinese standards for wireless encryption and third generation (3G) wireless telephony.<sup>32</sup> The United States, with support from four other WTO members, had recourse to the WTO dispute settlement mechanism and challenged China, for the first time, claiming that its VAT policies were discriminatory because they favoured Chinese-produced semiconductors over imported semiconductors.

<sup>29</sup> With the issuance of the *Circular Concerning the Rules on the Administration of Import and Export Rights* and the issuance of the *Notice on the Rectification of Import and Export Qualification Standards and Verification Procedures* by the Ministry of Commerce, China has kept pace with the required reductions in the minimum registered capital requirement for Chinese enterprises to obtain trading rights. China's treatment of "foreign-invested enterprises" seeking to operate as trading companies has been set forth in the *Provisional Rules for the Establishment of Chinese-Foreign Equity Joint Venture Foreign Trade Companies*, issued by the Ministry of Foreign Trade and Cooperation in January 2003. Moreover, the National People's Congress of China issued a revised foreign trade law in April 2004 to allow domestic firms, joint ventures and foreign entities to automatically enjoy trading rights following proper registration with the Ministry of Commerce. For further information, see the Ministry of Commerce website (n/d).

<sup>30</sup> Prior to its WTO accession, China generally did not permit foreign enterprises to distribute products in China. In its accession agreement, China committed to eliminate national-treatment and market-access restrictions on foreign enterprises.

<sup>31</sup> See the WTO website.

<sup>32</sup> More recently, a government procurement policy has mandated purchases of Chinese-produced software.

### 3. Improvements made by China after the transitional period: a long way still to go

The three and one-half years that have passed since China joined WTO are not a long enough period to permit a fair judgement concerning the degree of China's compliance with its multilateral obligations. Nevertheless, several observations can be made based on the events that have occurred since the critical transitional period. Perfect compliance is unlikely to be attained by a country that was a closed economy such a short time ago. Yet China has made considerable progress in the implementation of its WTO commitments, and the Ministry of Foreign Trade and Cooperation and its successor, the Ministry of Commerce, as well as other agencies, have worked to address the need for "fair and equitable trade". On the other hand, China's regulatory regimes continue to seem like a labyrinth to many countries, and the lack of transparency is one of the major challenges to be met in realizing the potential benefits of China's WTO accession and in opening this huge market up to fair competition. Many tariff-rate quotas (TRQs) continue to be employed by State-owned trading companies, particularly in agriculture, while enforcement of IPRs is still ineffective in some cases. China continues to use sanitary and phytosanitary measures as non-tariff trade barriers for agricultural commodities (United States-China Business Council, 2004). The areas of principal concern are distribution rights, intellectual property, trading rights, non-tariff measures and service market access. However, it is important to note that China has not been found to have violated any of its obligations under the WTO dispute settlement system and is taking advantage of this mechanism to challenge some of the trade measures used against Chinese products. From the start of 2002 until the middle of 2005, China participated actively in the WTO dispute settlement mechanism: in four cases as a respondent (WTO, 2004c) and in six as a complainant (WTO, 2002a, 2002b, 2002c, 2002d, 2003b y 2004d).

In order to resolve trade disputes, countries such as the United States are setting up working groups with the Chinese Government to solve specific problems that their companies face in exporting to Chinese territory. For example, at the April 2004 meeting of the Joint Commission on Commerce and Trade (JCTT), China agreed to implement its trading rights commitments, to improve IPR protection and to work towards eliminating discriminatory industrial policies and, in general, opening up its market more fully to United States exporters. In return, as concessions to China, the Bush Administration has promised to establish a process to help China qualify for market-economy status under United States trade law. Without this status, China will remain subject to an increasing number of antidumping cases that could result in higher duties on its exports to the United States (USTR, 2004). In addition, the European Union has sent a delegation of the European Commission to China and has set up a bilateral European Union-China cooperation programme as defined in the Country Strategy Paper for 2002-2006.<sup>33</sup> Some Latin American countries, such as Chile and Brazil, have also launched cooperation programmes with China.<sup>34</sup>

From a domestic, short-term perspective, these WTO commitments will probably raise the price of Chinese products which are currently protected by unfair trade restrictions. This is likely to be considered a positive development for the international market as a whole, since it will decrease the price gap between Chinese and other countries' products. As an illustration, it may be noted that China's participation in the world economy has soared since it joined WTO in December 2001. (It is now the third-largest trading nation in the world, behind only the United States and Germany (WTO, 2004b)). China's accession to WTO is also helping it to attract more foreign investors, who now find that they are on an equal footing in terms of certain specific problem areas and feel more

<sup>33</sup> This programme sets out a framework for the European Union's cooperation with China in 2002-2006. It is designed to support the implementation of the European Union's broad policy objectives regarding China, which include China's further integration into the world economy and world trading system; support for China's transition to an open society based on the rule of law and respect for human rights; make better use of European resources by improving coordination between European Union assistance and bilateral spending by member States; and enhance the European Union's profile in China (European Commission, 2002).

<sup>34</sup> See "Comunicado Conjunto de Prensa sobre Seis Coincidencias en la Cooperación Económica y Comercial entre Chile y China" (joint press release on six areas of convergence in economic and commercial cooperation between Chile and China) (DIRECON, 2004) concerning the establishment of a working group by these countries. Brazil and China have also formed a mixed economic and trade commission to help improve their economic relations and have signed a memorandum of understanding to facilitate cooperation in trade and investment.

secure about participating in China's domestic market. As just one example, bilateral trade between China and the United States increased by 84% to roughly US\$ 219 billion in 2004. This statistic is not solely a result of United States imports, either. United States exports of goods to China jumped by 83% as well. By comparison,

United States commodity exports to the rest of the world (excluding China) increased by only 7%.<sup>35</sup> This is one of the positive outcomes of doing business in a more rule-based and therefore more predictable market that allows the business community to compete within a fairer price structure.

#### 4. The concept of market-economy status (mes) and its application

The non-market economy (NME) clause has its origin in subparagraph (b) of article VI.1 of GATT (1994), which allows WTO member countries to recognize that NMEs<sup>36</sup> may need to be treated differently than market economies in antidumping cases. This provision, which dates back to the 1954-1955 GATT review session, originated with the consideration of issues related to the Working Party on the Accession of Poland and has been subsumed under article 2.7 of the current Antidumping Agreement. Under this provision, the WTO Antidumping Agreement allows members to use prices in "surrogate" markets to arrive at what is referred to as the "normal value" of goods or services in an NME. In China's case, the surrogate markets used to arrive at the normal value are often India, Turkey and Mexico (Lyengar, 2004). MES would not only change how antidumping actions against Chinese firms are judged, but would also affect how Chinese authorities position the economy in the world's trading system, as well as assuaging their fears concerning Western protectionism.

WTO does not classify countries according to whether or not they qualify for MES. That task is left to individual countries, and Chinese trade officials therefore have to lobby individual governments. In its WTO Protocol of Accession, however, China agreed that investigating authorities in other WTO members may apply non-market methodologies in antidumping and countervailing duty investigations. It is noteworthy that the applicable provisions of the Protocol are not intended to serve as a *carte blanche* to apply NME methodologies in all cases. Instead, in the antidumping cases, importing countries

are permitted to use alternative methodologies (Stoler, 2004). Recourse to these alternative methodologies, such as the use of surrogate pricing information, is somewhat circumscribed by the fact that Chinese exporters are expected to be given the opportunity in advance to show that market-economy conditions prevail in the industry under investigation. This allows Chinese exporters to put together a case in order to show the investigating authorities that their prices and cost information are not distorted as they would be in an NME. The provisions allowing recourse to non-market methodologies expire in 2016, 15 years after China's accession to WTO.

The language of the Protocol thus allows WTO members to deal with the issue surrounding China's MES on a differentiated basis. For example, United States authorities usually decline to accept information on prices and costs provided in China, preferring instead to use information derived from surrogate markets. In contrast, the European Union applies a hybrid approach in antidumping cases involving China and other countries that might be considered to be NMEs. This makes it possible, in limited cases, to treat Chinese imports as coming from a market economy, if it can be shown that market-economy conditions prevail in limited, industry-specific cases. In such instances, the corresponding investigation can thus be treated as one involving a market economy (see box V.3).<sup>37</sup> Since 1999 the Republic of Korea has taken a similar approach in dealings with China to determine whether market-economy conditions might apply in the case of specific branches of industry (Stoler, 2003; Hufbauer and Wong, 2004). India, which

<sup>35</sup> See the website of the Center for Trade Policy Studies (CTPS) (n/d) [<http://www.freetrade.org/>].

<sup>36</sup> At present, there are 10 NMEs: Albania, Armenia, China, Georgia, Kazakhstan, Kyrgyzstan, the Republic of Moldova, Mongolia, Ukraine, and Viet Nam. The Russian Federation was granted an MES rating in 2000, but Viet Nam's request for MES status has been considered and rejected.

<sup>37</sup> In late 1998, the European Union adapted its trade defence rules to allow individual companies to claim MES if they could prove that their prices and costs were not influenced by the State. Official European Union sources indicate that, out of the 111 individual requests received from 1999 to the end of June 2004, only 28 have been found to be acceptable. See "China-Market economy status in trade defence investigations" (European Commission, 2004). Another source reports that 16 chemical fibre cloth producers have won MES from the European Union, while the requests from 28 firms have been rejected and another 12 are awaiting a decision. See [China.org.cn](http://China.org.cn), 2005.

still considers China to be an NME, has adopted a similar policy, under which the authorities can apply rules normally reserved for investigations directed at a market economy (Stoler, 2003, p. 4). Canada also has applied the sector-by-sector approach. Argentina is reported to have opted to consider China as having “full” MES, thereby giving up the possibility of applying the “selective” approach (probably due to the costs involved

in undertaking investigations in specific sectors) (Tussie y Bianchi, 2004). Thus, several countries are already providing an opportunity for Chinese firms to argue that they operate in a market-economy environment. China and other NMEs are urging the United States and other countries that are currently applying an inflexible, across-the-board approach to take this more flexible route.

#### Box V.3

#### HOW DO THE UNITED STATES AND THE EUROPEAN UNION DETERMINE MES?

Chapter 4 of the United States Tariff Act of 1930, as amended in 1979, stipulates six criteria to determine NME status based on the presence or absence of currency convertibility, wage-rate determination by bargaining between labour and management, joint ventures for foreign investment, government control over means of production, government control over allocation of resources and prices, and “such other factors” as the administering authority may consider appropriate for the review. The only favourable aspect of an NME designation from the perspective of the respondent country is that NMEs are currently not subject to countervailing duties. Out of the six criteria, the two major hurdles are reportedly exchange rate policy and labour standards (Hufbauer y Wong, 2004, p. 17). In evaluating the Russian Federation’s MES designation, United States authorities found that it basically meets all six criteria, although to varying degrees. By contrast, it was found that Viet Nam does not meet the test on most counts. Although Viet Nam has made strides in the area of wage-rate determination, it failed the test in respect of exchange-rate policy and currency convertibility, restrictive policies on foreign investment, continued government involvement in the economy and distortions in the banking sector. In addition, Viet Nam was found to be weak in terms of

the criterion relating to the presence of an independent judiciary (Stoler, 2003, p. 4).

The European Union, unlike the United States, reclassified China as an “economy in transition” in 1998, which permits antidumping allegations to be considered on a case-by-case basis using the following five criteria: government influence on corporate operations, legal certainty in a planned economy, effective corporate regulations (e.g., accounting standards), an effective legal framework for bankruptcy proceedings and property rights protection, and currency convertibility. The European Union has found that China has fulfilled only one of these five requirements, namely the absence of barter trade and the absence of State-induced distortions in the operations of enterprises as a result of privatization processes.

The official Chinese view regarding the issue is obviously quite different. A study commissioned by China’s Ministry of Commerce concluded that, as of the end of 2001, “China is about 69 percent a market economy measured by the internationally accepted standard, exceeding 60% as the threshold of a market economy country”. In a similar vein, a permanent adviser to the China Association of International Trade stated that, “Ninety-eight percent of China’s commodities are priced according to market demand and supply. Enterprises operate

independently, without the control of government”.

NME status allows antidumping investigators to use surrogate-market prices in estimating the prices charged by Chinese exporters. It tends to be easier to prove the existence of dumping when using surrogate prices than under the antidumping rules applying to market economies. Based on the 208 antidumping cases initiated by the United States and the European Union between 1995 and 1998, Messerlin (2004) estimates that the biases of the NME procedure in alleged dumping cases involving Chinese exports have been within a range of 3%-14% for the United States and 20%-24% for the European Union, under a mix of price comparisons and constructed prices. Under the various constructed value methods, the biases can amount to up to 25% for both the United States and the European Union.

The highest dumping margins are associated with NME status (40% in the United States and 46% in the European Union). However, it should be borne in mind that, compared to China’s total exports, the value of the exports that are subject to antidumping investigations is miniscule. Of China’s total exports in 2003 (US\$ 438 billion), the value of the exports involved in antidumping cases initiated by 19 countries represented US\$ 2.2 billion, or just 0.5% of the total (Jing Gu, 2005, p. 20).

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC).

On the other hand, Australia’s experience seems to suggest that there are few additional or special protections associated with a strict application of the NME rules. Contrary to what is generally thought, NME status does not allow trading countries to automatically have recourse to the use of surrogate third-country pricing and cost information. Nor does it guarantee higher dumping margins in antidumping cases involving China. Stoler

(2003, p. 3) points out that even where an investigation involves a country with NME status, there are still a series of steps that are normally required in order to use surrogate third-country information. The use of such information is not mandatory, either. The Australian customs authorities prefer to use the domestic prices charged by other vendors of like goods in China whose prices are not distorted by price controls. Where costs

for raw material inputs are found to be affected by the supply of those materials by Chinese government-owned companies, the customs authorities first attempt to obtain alternative price information for these materials from non-government-owned companies that supply such materials either to the same firm or to other exporters in China. If this option is not available, customs authorities may resort to other “reasonable and appropriate” methods to determine suitable raw material input prices, including, but not limited to, surrogate price information from third countries. Moreover, when surrogate information is actually used in an NME situation, the domestic market of the surrogate country should be “reasonably representative” of the domestic market of the affected

NME, which also requires customs officials to prove that the surrogate market is free of market distortions.

Given the above, removing China from the NME list should not greatly disadvantage the Latin American and Caribbean countries that have already granted MES status to China, since their ability to apply antidumping measures should not be seriously curtailed. These countries can also accommodate their antidumping policies by relying more on a case-by-case approach. On the other hand, it is clear that continuing to treat China as an NME in a seemingly discriminatory manner has been a stumbling block for efforts to improve bilateral trade relations with the rest of the world, including Latin America and the Caribbean.

## 5. Countries granting market-economy status (mes) to China

To prevent the ad hoc and often discriminatory NME methodology from being used in future antidumping cases, China is actively seeking to convince its key trading partners (including the United States, the European Union and Japan) to grant it MES ahead of the 2016 WTO deadline.<sup>38</sup> As of mid-2005, more than 30 countries —including 10 in the Latin American and Caribbean region— have granted MES to China (see table V.9). Chinese authorities are actively seeking a review of its NME status in various forums and, as part of this effort, have sought to conclude a series of bilateral free trade agreements (FTAs) under which it would enjoy MES,

as it now does in the case of New Zealand. In the run-up to the FTA negotiations with China which Australia agreed to undertake after its recognition of China as a market economy, Australia will reportedly begin to pursue antidumping cases based on costs incurred in China rather than using surrogate-country costs or prices. Brazil and Chile have agreed to pursue a fast-track MES study regarding China. The recognition of China’s MES by all the 10 ASEAN members was a crucial element in paving the way for the conclusion of an FTA with these countries in late 2004. In addition, Iceland’s decision to extend MES recognition to China has served as the basis

Table V.9  
COUNTRIES GRANTING MES TO CHINA  
(As of June 2005)

Latin America and the Caribbean	Asia and the Pacific	Africa	Europa
Antigua and Barbuda	ASEAN (10)	Benin	Armenia
Argentina	Australia	Congo	Georgia
Barbados	New Zealand	Djibouti	Iceland
Bolivarian Republic of Venezuela	Pakistan	Nigeria	Kyrgyzstan
Brazil	Samoa	South Africa	Republic of Moldova
Chile		Togo	Russian Federation
Guyana			
Jamaica			
Peru			
Trinidad and Tobago			

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>38</sup> As of June 2004, The EU had 32 definitive antidumping measures in force and 22 ongoing antidumping investigations against China, while the United States had 52 antidumping measures in force (European Commission, 2004).



for a joint feasibility study on a possible FTA between the two countries, whose initiation was announced mid-May 2005.

In order for a flexible, case-by-case mechanism to be effective, Latin American and Caribbean governments should work together with Chinese authorities and companies to ensure proper and authentic documentation of price and cost information. An additional consideration is raised by the fact that investigating individual companies is a costly and time-consuming process, especially for developing-country authorities. The case-by-case approach also places the burden of proof on the Chinese companies named in such allegations, which is yet another reason why bilateral cooperation between the countries of the region and China is so important in this area. The Ministry of Commerce of China has announced its intention to provide support and assistance to Chinese enterprises in the process of acquiring MES, either for their specific industries or in antidumping cases in which they are involved, and has already taken substantive steps in this regard (*People's Daily Online*, 2004b; *China.org.cn*, 2004).

It should be remembered that, under WTO rules, investigating authorities are in all cases required to calculate accurate antidumping margins regardless of the country's status. Maintaining the status of a

country or moving it from one status to another does not affect this obligation, nor does it in any way affect the determination of injury or of a causal link. Regardless of how the margin is arrived at, China has every right to use the WTO dispute settlement mechanism to challenge any dumping margin that it believes is not accurately calculated (Stoler, 2004, p. 3). China has been restructuring and developing the various components of its trade regime, including its own antidumping law and other trade remedies, since 1997. It has initiated 34 antidumping investigations since then, but has been relatively cautious in doing so (Jing Gu., 2005, p. 13). Instead, China has been adopting a pre-emptive diplomatic course of action in an effort to avoid trade disputes. Since 2002, the country has sought to persuade its trading partners to treat it as a market economy rather than retaliating with its own national antidumping measures. China's MES recognition by a large number of Latin American and the Caribbean countries can be analysed within this context. As not only the major developed economies but also many large developing countries have become frequent users of antidumping rules, China could decide to change its approach. The countries of the region should strive to avoid such an outcome by means of mutual cooperation on the NME and related antidumping issues.

## D. Strategic aspects of relations between China and South America

The year 2004 was a particularly busy one, with Chinese authorities visiting South America on several occasions. President Hu Jintao paid State visits to Argentina, Brazil and Chile, and practically all the South American countries received visits from Chinese Ministers or Deputy Ministers accompanied by high-ranking business delegations. During all of these visits, commitments were made to strengthen economic and trade relations. In addition, the Presidents of Argentina, the Bolivarian Republic of Venezuela, Brazil, Chile, Colombia and Peru have visited Beijing, and many more ministerial and business delegations from these and other South American countries have visited China in 2004 and 2005. These visits have resulted in nearly a hundred public commitments and agreements marking a vital step in relations between China and South America and their mutual interest in building a strategic relationship.

China needs to consolidate its relations with Latin America. Its high growth rate and its industrial

retooling of old rural facilities have boosted the country's infrastructure requirements and energy demand and these needs, together with the sharp increase in its demand for foodstuffs, are a powerful reason for strengthening relations with Latin American natural-resource exporters. China also needs to ensure unfettered entry for its exports and to secure recognition as a market economy, which was successfully negotiated by the Chinese President during his visits to the region. China also wishes to pave the way for trade agreements with South America that will ensure preferential access for its products and prevent it from losing competitiveness relative to North American products (as a result of the North American Free Trade Agreement (NAFTA) or bilateral trade agreements) or European goods (in the light of the European Union's free trade negotiations with MERCOSUR and the Andean Community).

China has employed a combination of different approaches in forging closer relationships with

Latin American countries, including various types of trade agreements, direct investments (particularly in infrastructure and energy), joint ventures with State enterprises and special science and technology arrangements. The conclusion of a free trade agreement with Chile paves the way for more permanent trade and investment links. As is to be expected, this strategy of deepening and diversifying economic relations entails a considerable political component. China has grasped the significance of its increasingly influential position in the world economy and, just as the United States and the European Union are seeking to ensure a major economic role for themselves in Asia, China is seeking to establish a presence in Latin America. Although China's efforts to create closer ties are not confined to South America, there are various historical reasons why China's relations with Central America and the Caribbean have sometimes flowed less smoothly, although this is now changing quickly. In early 2005, a high-level meeting took place in the Caribbean between the senior authorities of the Chinese Ministry of Foreign Affairs and their Caribbean counterparts, and China is now a member of the Caribbean Development Bank. Nonetheless, the convergence of China's and Brazil's positions in international forums, the economic potential of a bilateral relationship between those two countries and China's dialogue with Chile in APEC have tended to focus its attention on South America.

For the countries of this subregion, China is the largest and fastest growing world market for the natural resources that abound in this part of the Americas. If China's soaring demand for these raw materials or semi-processed commodities and natural resources continues, South American countries can expect their export growth and terms of trade to be bolstered by Chinese demand for a long time to come. China is also a source of investment, particularly in infrastructure and energy, which supplements the available financing for ventures in these sectors. It is important for the countries to pinpoint the infrastructure and energy projects where this investment can be most effective in shortening the lead times for such undertakings. This type of targeting will not only reinforce trade facilitation and investment links between with China and with Asia and the Pacific, but will also generate positive externalities for the integration process as such.

For Chile, the free-trade agreement with China is a major step forward in its strategy of serving as an investment platform and trade bridge between Latin America and Asia, especially since it already has a free-trade agreement with the Republic of Korea and, in the second quarter of 2005, concluded negotiations for similar agreements with Singapore and New Zealand (which are soon to be joined by Brunei Darussalam).

For China, the agreement with Chile opens the way for mining investments in the world's leading copper producer, with the strategic alliance between China Minmetals Non-ferrous Metals Co. Ltd. and CODELCO constituting a milestone in its efforts to ensure a supply of copper over the long term. In addition, at least in theory, this agreement gives China access to the vast network of trade agreements that Chile has been establishing. This would include preferential access to the MERCOSUR market, although that possibility is still being evaluated, as it would require Chinese investments. The agreement with Chile may also prove to be the first in a series of agreements with other South American countries over the next few years. These agreements could then be converted into multilateral arrangements, much like what has been done with the agreement between China and ASEAN. Apart from endogenous factors, the pace of progress in this respect will depend on how the advances of the Doha Round measure up against the headway being made by the Free Trade Area of the Americas (FTAA) and the European Union's negotiations with MERCOSUR and the Andean Community.

For Brazil, Latin America's largest economy, China (along with India and the Russian Federation) represents a powerful ally in its quest for a multipolar world. Indeed, Brazil and China have been working together in highly interesting and innovative ways in the Doha negotiations as part of G-20, a group that advocates the developing countries' positions on agricultural issues. The G-20 is playing a key role in the negotiations and reflects the unprecedented degree of influence that developing countries have gained in these talks. China and Brazil have fairly similar stances on various items on the multilateral trade agenda, such as investment, intellectual property and services. The two countries are also seeking to promote strategic alliances that will add value to commodities and processed products as well as investments that will encourage technology transfer. Progress in space technology, aeronautics and biotechnology are examples of South-South cooperation in high-technology fields. In the area of trade, Brazil can provide China with a reliable supply of soya and iron ore over the long term, as well as being Latin America's largest market for Chinese manufactures.

The Government of the Bolivarian Republic of Venezuela has also shown a keen interest in concluding trade agreements with China. The world's fifth-largest oil exporter is currently working to diversify its oil sales and foreign investment and to reduce its economic reliance on the United States. Closer ties with China offer an opportunity to do so, while China itself is interested in setting up joint ventures and participating in mining and oil operations all over the world.

Colombia faces a more formidable challenge in this respect than its neighbour. First, Colombia produces many of the intermediate goods that are also being exported by China. Second, the country does not have the oil or mining reserves that the Bolivarian Republic of Venezuela and Ecuador do. Nevertheless, during the Colombian President's visit to Beijing in April 2005, a number of cooperation agreements were signed, and China committed to invest in the textile, infrastructure and hydrocarbons sectors. According to the president of Proexport, an association of Colombian exporters, if Colombia is to compete successfully with China, it will have to decide which activities are strategic priorities, enhance the competitiveness of those sectors, differentiate its products and carry forward the modernization process at all levels. These elements will play a crucial role in building economic complementarities with China, a task that can be much more readily achieved if both countries are involved in the dynamic creation of competitive advantages.

Peru's expectations at the prospect of closer economic relations with China have also been a focus of national debate. In line with joint government declarations and the cooperation agreements signed in early 2005, movement in this direction will start with

increased exports of raw materials, mining products and fruits and vegetables and with the development of tourism. China's interest lies in increasing its investments, especially in the hydrocarbons sector. On this basis, the countries signed agreements aimed at developing tourism in both directions and facilitating the exportation of fresh fruit (especially of grapes to China and apples to Peru). Reciprocal cooperation arrangements were also set up to promote investment in natural resources (including hydrocarbons), infrastructure and tourism.

In November 2004 the President of China visited Argentina with a view to strengthening trade relations and winning support through the provision of fresh funds to boost investment. Earlier on, President Kirchner, along with several governmental ministers and a large business delegation, had visited China. The two countries concluded a series of agreements to facilitate the entry of higher-valued-added soya products, meat and other processed food into China. Argentine exports to China could increase from US\$ 3 billion to an estimated US\$ 10 billion in the next five years. One of these agreements opened up the Chinese market to exports of fresh beef and poultry from Argentina, and under its provisions permits were issued to five meat-packing plants and 11 poultry producers in Argentina (*El Cronista*, 2005).

## 1. Free-trade agreement with Chile

For Chile, a free-trade agreement (FTA) with China would not only be a significant step forward in the implementation of its international strategy, but would also provide huge trade benefits. Estimates prepared by the Economics Department of the Chilean Ministry of Foreign Affairs indicate that an FTA with China would provide a strong incentive for exports to the Chinese market and would have a particularly strong impact on crop, livestock, forestry and fishing products, which could increase by almost 95%. Exports of mining products and of processed food and beverage products would also rise, thanks to the elimination of tariffs and tariff escalation. In addition to liberalizing bilateral trade, an FTA could also increase market transparency by facilitating the correction of trade distortions and providing greater legal certainty for business dealings. Such an agreement would be of paramount importance for Chile, especially since China seems to be on its way to becoming the country's second-largest export market.

Chile's successful negotiations with the United States, the European Union and the Republic of Korea

can be credited for having opened the way for its FTA negotiations with China. These talks fell in line with China's desire to move forward in trade negotiations with its ASEAN neighbours and thus drew the attention of the Chinese authorities, who reasoned that the experience of negotiating with Chile could help them become more sophisticated in their negotiations first with Asian partners and then with the rest of the world. Yet another consideration was the historic ties between Chile and China, which created closer bilateral trade links during the 1990s and have maintained diplomatic relations since 1970. Chile was the first Latin American country to establish diplomatic relations with China, the first to conclude bilateral negotiations on China's entry into WTO and the first to grant China market economy status. All of the above, combined with the close contacts between Ministers and heads of State in the context of APEC, paved the way for President Lagos and President Hu Jintao to announce the opening of FTA negotiations at the APEC meeting held in November 2004.

In the first round of negotiations, held in January 2005, the parties established what issues they would seek to reach agreement upon. These topics include the procedures to be used for negotiating tariffs, market access, rules of origin, customs procedures, technical trade barriers, trade protection measures and dispute settlement. During the second round (April 2005), the parties set up a high-level technical group of senior government representatives from the two countries. In

the third (June 2005), progress was made concerning the procedures to be used in negotiating tariff offers and within the various groups. Talks also began on how future negotiations might approach issues related to trade in services, investment, intellectual property, trade facilitation, scientific and technological cooperation, labour issues, small and medium-sized enterprises (SMEs) and social security, sustainable development and cooperation in the mining sector.

## 2. Investment initiatives in South America

Out of the US\$ 1.8 billion that China invested abroad in 2004 (in areas other than the financial sector), Latin America received almost US\$ 889 million. According to statistics from the Chinese Ministry of Commerce, the mining sector received 55% of total Chinese investment abroad. This should come as no surprise, since China's strategy for ensuring it has supplies of raw materials over the long term entails increasing movements of capital —including those entering Latin America— in sectors such as energy, mining, infrastructure and agriculture.

### (a) Energy

China has doubled its energy imports over the last five years and is now the world's second-largest consumer of energy. It also consumes three times as much energy per dollar of GDP as the world average. Such a high level of consumption relative to a GDP that is growing by leaps and bounds calls for extremely high levels of domestic and foreign investment if bottlenecks in terms of energy and critical inputs are to be prevented from curbing the pace of growth. This is why energy figures so prominently in relations between China and Latin America and why such large investments are being made to ensure a smooth and reliable supply for the future. For instance, China has granted the Bolivarian Republic of Venezuela a loan of US\$ 4 billion for energy projects and is planning to step up economic cooperation to develop the country's vast oil and natural gas reserves. In return, the Bolivarian Republic of Venezuela has committed to begin exporting 600,000 barrels a day of fuel oil and 1.8 metric tonnes of orimulsion (a fuel used to generate electricity). There are, however, logistical problems (the lack of specialized refineries and the absence of a suitable tanker fleet) standing in the way of any major increase in oil exports to the Chinese market.

This is also an obstacle in terms of China's plans to obtain supplies from a number of Latin American countries. From a long-term perspective, however, China is actively involved in plans for future investment in the region's hydrocarbons sector. It is currently negotiating with Colombia concerning investments in the exploration of petroleum deposits (87% of which would be in virgin oilfields). The first stage in the process was a meeting between the Colombia's State-run oil company and China's Petrochem, which resulted in a cooperation agreement. Chinese companies are not only interested in exploration and exploitation of crude, however, but also in the infrastructure required to export it. Significant progress has already been made in bringing Chinese capital into major projects, such as the construction of a pipeline between the Bolivarian Republic of Venezuela and Colombia, which would benefit all three countries. This pipeline, in which Colombian investors are also involved, would run across the north of Colombia to the Pacific, thereby facilitating the export of Venezuelan and Colombian fuel to China.

Chinese specialists are also involved in discussions with technical experts in other South American countries to ensure future supplies. China has entered into negotiations with Argentina to form a strategic alliance with the recently created State enterprise Enarsa for oil and natural gas exploration. In Brazil, headway has been made in negotiations between the Brazilian company Petrobras and the Chinese enterprise Sinopec to set up joint oil drilling ventures throughout the world: first in the seas off the coasts of Brazil and China, and eventually off the coastlines of Africa, the Bolivarian Republic of Venezuela, Colombia and Mexico. Chinese engineers are also studying the production processes, operations and distribution networks of Brazil's ethanol industry.

**(b) Mining**

Steady and growing demand for minerals such as copper, iron and zinc has led the Chinese Government to explore ways of ensuring supplies, either through long-term import agreements, strategic alliances with Latin American mining companies or FDI. Many Chinese mining companies already have direct investments in Peru, Ecuador and the Bolivarian Republic of Venezuela. In Brazil, the Baoshan iron and steel company of Shanghai is building a plant as part of one of the largest Chinese investment projects abroad. In mid-2005, the Yanguang Group of China concluded an agreement with Vale do Rio Doce and Itochu Corporation (Japan) to set up mineral and metallurgical coal production facilities with a view to manufacturing steel in Brazil.

In Chile in 2004, the Chinese company Minmetals Nonferrous Metals paid US\$ 5 billion for the copper deposits of Doña Inés de Collahuasi and Lomas Bayas, previously owned by Noranda of Canada. Although this will supply China with 600,000 tonnes of copper over the next few years, it needs even more. The Chinese company has therefore reached a US\$ 2 billion investment and supply agreement with the Chilean Copper Commission (CODELCO). Initially, Minmetals will invest US\$ 550 million in exchange for a 50% stake in a joint venture with CODELCO. In exchange, the Chinese have a supply contract for 55,000 tonnes of copper for the next 15 years. The agreement gives Minmetals a purchase option on 25% of the Gaby mine, which has an estimated production capacity of 150,000 tonnes of copper cathode.

**(c) Infrastructure**

Although South America can cover part of China's future demand for raw materials, the slow development of the subregion's infrastructure will create a bottleneck, given the volumes involved. Hence China's keen interest in helping to finance a wide variety of infrastructure projects. China plans, for example, to invest in a project aimed at restructuring Argentina's railways in order to reduce transport costs for beef and soya. In Brazil, the Government of China has expressed interest in investing US\$ 5 billion in infrastructure in the short term. In railways alone, US\$ 11 million is to be invested by 2008, with US\$ 7 billion of that figure corresponding to private enterprise and US\$ 4 billion to the public sector. By increasing the number of kilometres of railroad tracks, Brazil can considerably reduce its soya shipping costs

(90% of soya cargo is currently transported by road). China also agreed to provide competitive financing for the construction of the gas pipeline that will supply the north-east of Brazil with natural gas starting in 2006. In addition, the Chinese Government has offered to invest US\$ 2 billion in the northern export corridor (more specifically the Port of Itaqui, where soya and iron are shipped to the United States, Europe and Asia), in the north-south railway and in the Maranhão grain terminal to be built close to Itaqui.

**(d) Science and technology**

In recent years, China has made great strides in R&D and technological innovation. Bilateral cooperation between China and Latin American countries could include instructional programmes and the exchange of experiences in key areas of innovation. The Latin American countries have the capacity to design and make use of such agreements in order to take advantage of technological and investment complementarities. China and Brazil provide a good example of South-South cooperation in such high-technology areas as space technology and aeronautics. The Brazilian aeronautics enterprise Embraer has entered into a joint investment venture with a Chinese partner in the city of Harbin, in north-eastern China. This enterprise, with an annual production capacity of 24 regional aircraft, has already delivered its first series of planes to South China Airlines. China and Brazil have also jointly designed, produced and launched two earth resource satellites (CBER-1 in 1999 and CBER-2 in 2003). The images sent back by these satellites have been used for agriculture, forestry, soil analysis, mineral resource surveys, water conservation, cartography, environmental protection, disaster monitoring and urban planning. The two countries plan to launch three more of these satellites over the next few years.

Thus, for example, technological cooperation can put satellites in orbit that provide data for use in livestock pest control, integrated border control and tracking. Here again, the countries of the region can take advantage of opportunities for strengthening economic complementarity by undertaking creative, forward-looking efforts to identify and promote mutually beneficial prospects. As many of these opportunities will entail improvements in the development of energy resources, infrastructure and trade facilitation, as well as fresh investment, the subregion's integration process will also benefit.

Table V.10  
**TRADE RELATIONS BETWEEN CHINA AND SELECTED LATIN AMERICAN AND CARIBBEAN COUNTRIES AND MAIN RESULTS OF THE STATE VISITS MADE BY THE CHINESE PRESIDENT HU JINTAO IN THE REGION**

	Argentina (2003)	Brazil (2004)	Chile (2004)	Colombia (2003)	Peru (2004)	Cuba (2003)	Bolivarian Republic of Venezuela (2003)
China as destination for exports	4th place	4th place	3rd place	26th place	2nd place	6th place	18th place
China as origin of imports	4th place	4th place	4th place	5th place	3rd place	3rd place	12th place
Main products exported to China	Soya, leather, gas, oil	Soya, iron, car parts, space technology products	Copper, fishmeal, wood pulp, grapes	Iron ore, copper and other alloys	Copper, fishmeal, zinc, tin, etc.	Sugar, nickel, aluminium, metals, vaccines, tourism	Oil, iron and minerals
Exports to China as a percentage of total exports	8%	6.2%	9.1%	0.6%	10%	5%	1%
Products imported from China	Computers, motorbikes, lamps, herbicides	Televisions, electrical and electronic equipment, air conditioning	Footwear, televisions, textiles	Sound equipment, electronic equipment, computers, textiles	Televisions, motorbikes, radios	Legumes, rice, televisions, footwear, electronic products	Transport equipment and machinery
Imports from China as a percentage of total imports	5.0%	4.2%	7.4%	5.0%	7.6%	4.7%	2.1%
Business deals and alliances	Interest in new business investment estimated at US\$ 20 billion <sup>a</sup> in infrastructure, housing, transport, communications and space technology. Discussions on strategic alliance with the State enterprise ENARSA in Argentina. Opening of Chinese market for beef/veal and poultry exports. Permits granted to 5 meat plants and 11 chicken producers.	Possibility of joint binational ventures in sectors such as information technology, steel, agroindustry and trading companies. Received investment worth US\$ 1.3 billion, further investment estimated between US\$ 5 billion and US\$ 7 billion. Association agreement between Petrobras and Sinopec to set up joint oil exploration ventures. Baoshan iron and steel company and Vale do Rio Doce participating in building production plant. The Yanguang company concluded an agreement with Vale and Itochu Corp. of Japan to set up a mineral and metallurgical coal production venture to manufacture steel.	Interest in new business investment. Investment and supply agreement worth US\$ 2 billion concluded by CODELCO and China's Minmetals: contract for 55,000 tonnes of copper over 15 years and purchase option on 25% of Gaby mine.	Cooperation agreement between Colombia and China Petroleum. Participation of Chinese capital in construction of pipeline between the Bolivarian Republic of Venezuela and Colombia, with a view to facilitating exports to China.	Minmetals Corp. purchased property of the Canadian corporation Noranda, owner of the Antamina mining operation (September). Studying possibility of joint investment in textiles and clothing.	Cuban officials acknowledged that 41 Chinese tourist agencies already do business with Cuba. Investment of US\$ 1.8 billion over the next 10 years.	US\$ 4 billion of credit for energy projects, in exchange for Venezuelan commitment to export 600,000 barrels a day of fuel oil and 1.8 metric tonnes of orimulsion.
Recognition of China as a market economy	Yes (16-11-2004)	Yes (17-11-2004)	Yes (18-11-2004) <sup>b</sup>	No	Yes (20-11-2004)	N.A.	Yes. December 2004

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and the Commodity Trade Database (COMTRADE).

<sup>a</sup> The authorities themselves cautiously point out that these figures refer to long-term investments over as much as 10 years.

<sup>b</sup> At the United Nations General Assembly in mid-September 2004, the then Foreign Minister of Chile officially informed his Chinese colleague of the decision to recognize China as a market economy. The official announcement was made during the Chinese President's State visit to Chile in November 2004.

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## Chapter VI

# Trade, security and transport

## A. The Bioterrorism Act

Free trade agreements have been giving the countries better access to markets. While the incidence of tariffs as a trade barrier is declining, the importance of new sanitary, phytosanitary and security measures in transport and logistics is increasing, to the extent that these are becoming a key factor in systemic competitiveness. This competitiveness extends beyond low prices to include appropriate infrastructure, efficient transport systems and fast, simplified customs procedures, among other things. By meeting the new standards, economic agents can secure competitive advantages. This means strengthening the institutions involved with trade logistics, harmonizing different rules and regulations both regionally and multilaterally, and promoting and improving capability building, with particular emphasis on the needs of small and medium-sized exporters.

After the New York attacks of 11 September 2001, health authorities in many countries began to strengthen their public health and security measures. In the United States this led to the drafting of a specific law against acts of terrorism, with a section on foods that laid down new

requirements for the entry of agricultural products into the United States market.<sup>1</sup> On 12 June 2002 the Public Health Security and Bioterrorism Preparedness and Response Act, better known as the Bioterrorism Act, was passed into law with a view to protecting the food system of the

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<sup>1</sup> Other countries have continued to be guided by World Health Organization (WHO) directives.

United States (ProChile, 2003). On 12 December 2003 the new provisions began to apply to the production, distribution and sale of foodstuffs in the country.<sup>2 3</sup>

A variety of measures were taken so that imported foodstuffs could be monitored exhaustively, including the creation of institutions to supervise the security of shipments: the Customs-Trade Partnership against Terrorism (C-TPAT) and the Container Security Initiative (CSI), both of which are dealt with in greater detail in another section. Precautionary measures were increased at every stage of the food chain and supplementary provisions were announced to prevent toxic substances being introduced into the production process. The Act is designed to achieve food security and to meet the need for implementation of production process certification throughout the production chain. The new Act is structured into five titles, divided into subtitles and sections, but title III is the one dealing with the safety and security of the food and drug supply.<sup>4</sup>

The proposed regulations require all domestic and foreign food producers that manufacture, process, pack, distribute, receive or hold food for human or animal consumption in the United States to register with the Food and Drug Administration so that this can identify food exporters, the country of origin, the name and address of the food processing organization and its trademark. A second requirement is to give advance notice to both the FDA and the Customs and Border Protection (CBP) Bureau of the arrival in the United States and

content of each export shipment.<sup>5</sup> The Act also requires foreign facilities to appoint a United States agent who lives or operates a business in the country, and is thus physically present there. As in the case of the European Union, access for food products will be conditional on the provision of full information on the quality of the production processes involved, and this stipulation will cover everything from fruit and vegetable packing plants to agroindustry, including dairy products and meat (Puentes, 2003).

FDA-registered establishments will have to create and maintain records identifying the provenance and destination of foodstuffs (Section 305, Registration of food facilities). Non-compliance with this requirement may result in the loss of the product concerned, if it is perishable, since it will be held at the port of entry pending registration, and this will involve a cost for the producer. These records will enable the FDA to trace products back if there is any threat to the health of United States citizens (Section 306, Maintenance and inspection of records for foods), notify the facilities affected (companies, warehouses or commercialization and distribution centres) and impound foodstuffs if it has good grounds for believing that they are a threat to human or animal health (Section 307, Prior notice of imported food shipments). Box VI.1 gives a summary of the four provisions of the Bioterrorism Act.

This Act, now passed into law by the United States Congress, has been strongly criticized by an important

#### Box VI.1

#### THE BIOTERRORISM ACT: SUMMARY OF ITS FOUR PROVISIONS

- |  |   |  |
|--|---|--|
| <p><b>1) Record-keeping by facilities for traceability purposes:</b> United States and foreign facilities that manufacture, process, pack, distribute, receive or hold foodstuffs for human or animal consumption in the United States must create and maintain records that allow the FDA to track these products in the event that there might be threats to the health of human beings or animals in the country.</p> | <p><b>2) Prior notice of imported food shipments:</b> As of 12 December 2003, the FDA must be given prior notice of each and every food item entering the United States. This notice must be sent no fewer than eight hours and no more than five days before the arrival of the merchandise.</p> <p><b>3) Creation and maintenance of records:</b> Persons manufacturing, processing, packing, distributing, receiving, holding or importing foods</p> | <p>are obliged to create and maintain such records as the FDA deems necessary to identify the previous suppliers and subsequent recipients of these foods.</p> <p><b>4) Administrative detention:</b> The FDA is authorized to order the administrative detention of food items if it has credible evidence or information that these foods present a threat of serious adverse health consequences or death to humans or animals.</p> |
|--|---|--|

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of the Bioterrorism Act.

<sup>2</sup> The provisions will come into force automatically, and by the time they do so the Food and Drug Administration must have registered all installations that manufacture, process, pack or hold food for consumption in the United States, even if the provisions are still at the implementation stage.

<sup>3</sup> Meat and poultry products and eggs are not subject to these rules, since the United States Department of Agriculture (USDA) is wholly and exclusively responsible for regulating them.

<sup>4</sup> The 2002 Bioterrorism Act is divided into: Title I. National preparedness for bioterrorism and other public health emergencies; Title II. Enhancing controls on dangerous biological agents and toxins; Title III. Protecting safety and security of food and drug supply; Title IV. Drinking water security and safety, and Title V. Additional provisions (FDA, 2002).

<sup>5</sup> In the case of food products, the FDA must be given two hours' notice if transportation is by road, four hours if it is by air or railway and eight hours if it is by sea.

sector of the country's economy, the Produce Marketing Association, which operates in the market for fruit, vegetables and other fresh produce. This organization, backed by other distributors and producers, has asked the authorities to make the provisions enacted more flexible, citing as an example the complexity of the monitoring system for perishable produce such as fruit and vegetables (Fundación Grupo Eroski, 2002). In practice, the Bioterrorism Act represents the application of the concept of traceability in food production, processing and trading and lays down the requirement that records be kept of individual products or batches, these records being related unequivocally to the product or commodity. Furthermore, the labelling must trace the movement of the product (by means of a code) from origin to market, or cover a stage in the process that links in to a record containing information on the stages not indicated in the labelling.

These provisions are a response to a new and justified security demand. The challenge is to ensure that they do not become another type of market access barrier. This is a legitimate and understandable concern in the case of small and medium-sized enterprises trying to fathom whether or not they have the capacity to adapt to and quickly comply with the new requirements. If these companies are unable to understand what information they have to provide to the United States authorities so that these can successfully track the product through all the stages of the production chain in cases where adulteration is suspected, they will be debarred from selling the product in that market, or it may be detained, returned or destroyed (Section 303, Administrative detention). In practice, rigid application of the regulations unaccompanied by technical capability-building assistance for SMEs would be detrimental to export diversification and to efforts to increase the presence of such companies in export flows.

In mid-June 2004, a final regulation issued by the FDA set out the procedures for administrative detention of suspect foods, allowing them to be held for up to 30 days (up to four days in the case of perishable products) if there was credible evidence that they might be unsafe for

human or animal consumption (International Information Programs, 2004).<sup>6</sup>

When perishable foodstuffs are detained, the exporter or the exporter's representative must appeal within two calendar days; in the case of non-perishable foods, the time limit is four days.

In its analyses of the economic impact of the Bioterrorism Act, the FDA has acknowledged the existence of a number of costs for companies exporting food to the United States. These include: (i) additional transportation to a secure storage facility; (ii) additional storage; (iii) delays in releasing transport equipment containing detained products; (iv) loss of value of products in the perishable foods category; (v) cost of labelling detained products, and (vi) cost of appealing against administrative detentions. Considering that maritime transportation is more expensive for small exporters, what this legislation does in practice is to place additional costs on the external food sales of SMEs. In the absence of public policies to address these issues, these costs could well neutralize the tariff cuts obtained in the free trade agreements signed with the United States.

To all this must be added the costs to companies exporting food to the United States of engaging an agent in the country, estimated at between US\$ 700 and US\$ 1,000 a year; furthermore, the time required to engage an agent is put at between 5 and 15 hours, if contact is in English over the Internet. In late 2004, the FDA had a total of 131,086 foreign facilities on its books, of which 24,963 were in Latin American and Caribbean countries (Argentina, 1,994; Bolivia, 148; Brazil, 2,643; Colombia, 2,081; Ecuador, 3,136; Jamaica, 386; México, 8,453; Paraguay, 100; Trinidad and Tobago, 200; Peru, 1,225). According to the FDA database, in 2004 there were 330 administrative detentions of food shipments from Colombia, Ecuador and Peru. Box VI.2 describes, by way of example, the public-private partnership created in Costa Rica to facilitate implementation of the Bioterrorism Act.

#### Box VI.2

#### **COSTA RICA: PUBLIC-PRIVATE SUPPORT FOR IMPLEMENTATION OF THE BIOTERRORISM ACT**

To pool the efforts being made to facilitate implementation of the Bioterrorism Act, in 2003 Costa Rica created a mixed public-private national commission involving representatives

from the State Phytosanitary Service, the Costa Rican Chamber of Exporters and agricultural and trade organizations, among many others. Since its establishment the

Commission has provided training courses, exporter registration centres and Internet connection points for companies requiring these services.

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information.

<sup>6</sup> This regulation implements one of the four provisions included in the Bioterrorism Act, and its purpose is to ensure the safety and security of foodstuffs. Another two provisions concern registration of facilities with the FDA and advance notice of the arrival of foodstuffs imported or offered for import into the United States. A planned fourth provision concerns the identification of previous suppliers.

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## B. Standards and regulations in the region's main markets

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### 1. United States

Entering the United States market is a long and costly process, and can take years. Exporters are responsible for meeting all the requirements of the United States Department of Agriculture (USDA). Furthermore, it may happen that, despite the time and money invested, for some products the restrictions prove to be insurmountable.

The Animal and Plant Health Inspection Service (APHIS), an offshoot of the USDA, is in charge of protecting and promoting agricultural health in the United States. The APHIS has regulatory responsibilities for preventing the country's plants and animals from being affected by exotic pests and diseases. Its Import Authorization System (IAS) allows interested parties to apply for import permits for fruit and vegetables, animal products and organisms. The IAS publishes a list summarizing the animal health situation by country and by area from the USDA perspective, including specific diseases of livestock, poultry and other animals (APHIS, 2005).

Phytosanitary barriers affect a large proportion of the fruit coming into the United States market. All such produce is subject to a requirement for specific documentation certified by the APHIS representative in the countries concerned, and is usually submitted to a variety of tests and treatments before being exported. To reduce the risk of potentially harmful pests being introduced in fruit and vegetables, most of these products have to comply with complex sanitary and phytosanitary requirements before they can enter the United States.

The most harmful pest detected in merchandise from Latin America and the Caribbean is the fruit fly, of which there are over 300 varieties, many of them concentrated in the region. The most common varieties are the South American, from Mexico and South America, the West Indian, from the Caribbean, and the Mediterranean, found in Central and South America.

To deal with the issue of quarantine, a Plant Protection and Quarantine (PPQ) unit has been created

inside APHIS and this has divided products entering the United States into three categories: unrestricted, prohibitory and restrictive. Products in the first category are allowed in without being subjected to detailed inspection or quarantine. They include, for example, aloe vera, coconut, garlic bulbs, ginger root, maguey leaf, mushrooms, palm hearts, tamarind and water chestnuts (APHIS, 1986). "Prohibitory" products are those fruits and plants that are not allowed in owing to the possible presence of pests for which the United States has no quarantine treatment. The "restrictive" group of products consists of fruit and vegetables allowed in only after quarantine treatments and post-harvest inspections to ensure that potential threats such as the fruit fly have disappeared.

This fly is known for its ability to adapt to a great variety of climates and fruits. Originally from Africa, it has spread around the globe through trade and travel. The countries where this pest has not appeared have to take preventive measures. In the case of the United States, some products may enter only if they have been duly inspected and have the resultant certification from APHIS-USDA; others require quarantine treatment.

In some situations, quarantine may represent a major barrier to access for the region's exports. To comply with standards and regulations and be able to export, the countries of Latin America and the Caribbean have to pay high costs and pass through a long process. The barrier to exporting may be very considerable if the country has to pay for its products to be inspected in United States quarantine, incur installation and infrastructure costs so that treatment can be carried out in the country of origin, employ APHIS personnel to supervise treatment, obtain the relevant compliance certificates or send products to APHIS-approved entry ports for treatment to be carried out, with all the deterioration of the merchandise this may entail. All this is the result of the procedures and regulations established under the auspices of the USDA, APHIS and PPQ.

## 2. The European Union

### a) Technical standards

European Union regulations lay down the characteristics required of imported products or their production processes, and may include provisions regarding terminology, symbols, labelling or packaging. There are technical standards set by national laws (unharmonized) and others that apply right across the EU (harmonized). The purpose of harmonization is to relieve exporters from having to cope with 15 (or 25, from 2004) different sets of regulations, replacing these with just one. In 2001, harmonization covered 21% of import products (WTO, 2004).

At the EU level, regulations are of two types: the “old” type, which lay down detailed and specific technical requirements, and the “new” type, which confine themselves to essential provisions aimed at achieving health, security and environmental goals. Regulations of the first type apply to vehicles, cosmetics, chemicals, foods and pharmaceuticals; those of the second to a variety of products such as toys, building materials, machinery, pressurized equipment, medical instruments, electrical and electronic equipment, gas appliances, etc.

Under the new approach, regulations have to be based on harmonized European standards<sup>7</sup> of a voluntary nature, or on producer initiatives. Preparation and approval of these standards may take an average of between eight months (European Committee for Standardization (CEN)) and over two years (European Telecommunications Standards Institute (ETSI)).

### b) Sanitary and phytosanitary measures

EU regulations lay down five general principles for the food safety regime: (i) a high level of food security at every stage of the food chain; (ii) risk analysis as a fundamental element of food security policy; (iii) the

full responsibility of those running food businesses for the safety of the products they import, produce, prepare, offer on the market or distribute; (iv) the traceability of products at every stage of the food chain; and (v) the right of citizens to receive clear and accurate information from the public authorities.<sup>8</sup>

A European Food Safety Authority (EFSA) has been created, and the rapid alert system for food and feed has been strengthened.<sup>9</sup> The Commission of the European Union is empowered to apply emergency measures to contain serious risks to human, animal and environmental health. It gives decision makers the option of applying the “precautionary principle” in cases where measures have to be taken to protect health but the scientific information on the risk is inconclusive or incomplete. Furthermore, EU regulations allows risk management measures to be based not just on scientific evaluation, but on other “relevant” factors as well. This provision has aroused some criticism, however, because the “other factors” are not clearly defined.

EFSA provides independent scientific advice to the Commission on all matters directly or indirectly affecting food safety. Although the decisions are made by the Council of the European Union and, in some cases, by the Commission,<sup>10</sup> EFSA pronouncements have a large influence on food safety policymaking and legislation. EFSA is required to work through an Advisory Forum to establish close collaboration and partnerships with representatives of the competent bodies in member States, and thus form an EU-wide scientific network dedicated to food safety so that information is shared effectively.<sup>11</sup>

An EU decision adopted on 4 July 2003 placed special conditions on the import of Brazil nuts in shells originating in or consigned from Brazil (EU, 2003a), unless each consignment was accompanied by a report on the official sampling and analysis results for that consignment, and by a health certificate.<sup>12</sup> On 20 June

<sup>7</sup> Like those established by the European Committee for Standardization (CEN), the European Committee for Electrotechnical Standardization (CENELEC) and the European Telecommunications Standards Institute (ETSI).

<sup>8</sup> Regulation (EC) 178/2002 harmonizes the concepts, principals and procedures to be applied by member States when adopting national food safety standards. Activities in this area span the whole food production chain from zoosanitary and phytosanitary aspects to the labelling of food products, as well as animal protection issues.

<sup>9</sup> This is a Commission system for rapid information sharing among member States in the event of a serious and imminent hazard (third parties are also allowed to participate).

<sup>10</sup> In cases where emergency safety measures are needed.

<sup>11</sup> Should a substantive unresolved disagreement arise on scientific issues between EFSA and the competent body in a member State, a joint document must be drafted to clarify the issues at stake and indicate where the relevant data are uncertain, so that the Council can take a decision.

<sup>12</sup> These measures were adopted after the Food and Veterinary Office (FVO) had carried out an assessment mission in Brazil.

2003, the Commission adopted emergency measures whereby member States were banned from importing hot chilli and hot chilli products (CN code 0904 20 90) (EU, 2003b), except where an analytical report was submitted to show that the product did not contain “Sudan red”.<sup>13</sup>

The EU also extended its ban on selling toys and childcare articles intended to be placed in the mouth by children under 3 and made of soft PVC containing particular phthalates (EU, 1999).

## C. Traceability

Food safety, a constant concern of all consumers in both developed and developing countries, has moved up the external trade agenda as its close functional relationship with security issues has been recognized.

Progress with the application of biotechnology techniques has served to highlight the subject of food safety and quality, turning it into a matter of worldwide interest, and to raise people’s awareness of the potential dangers that the foods they consume might pose.

Some of the health problems that have arisen in recent years, such as the cases of denatured rapeseed oil, spongiform encephalopathy (“mad cow” disease), which affects cattle and has repercussions for human health, dioxin-contaminated foodstuffs, the appearance of genetically modified organisms and uncertainty about the effects of consuming them, and the need to implement certification of production processes, combined subsequently with the repercussions of the terrorist attacks of 11 September 2001, have led governments in the European Union countries, the United States and Japan to demand precise information on the history of the foodstuffs sold in their markets, both nationally and internationally, in order to be able to develop more effective tracking methods enabling them to trace the journey of each foodstuff from the point of origin to the point of sale or the consumer’s table.

To enter these countries’ markets, foods now have to comply with new legislative provisions requiring them to be accompanied by full information on the production chain. This report on the life of a food product is known by the name of traceability or trackability, a method used to structure information and provide guarantees

on food security, improve quality management and risk evaluation, increase consumer confidence and enable corrective measures to be taken promptly when safety and quality failures occur.<sup>14</sup>

The *Codex Alimentarius* defines traceability as “the ability to follow the movement of a food through specified stage(s) of production, processing and distribution” (FAO/WHO, 1999). The United Nations Food and Agriculture Organization (FAO) and the World Health Organization (WHO) have also recognized that this mechanism for tracking and understanding the life cycle of food is a crisis prevention measure for which member countries need to make regulatory provision in the near future.

In other words, traceability is the path used to follow a product from origin to destination (tracking or trace-forward) or vice-versa (tracing or trace-back), taking in all the components that are added over the length of the production chain. The purpose of keeping these records is to be able to identify the critical point or points when a health contingency occurs, and thus localize the emergency, isolate it and resolve it at the exact point of the production chain where it has occurred, without affecting the continuity of other trade flows. The ability to detect the problem quickly will depend on the means used to ensure successful tracking.

Since 1 January 2005, it has been compulsory for full information to be provided on the quality of the production process before food products can be allowed into the European Union. Regulation (EC) 178/2002 of the European Parliament and Council of 28 January 2002 established the general principles and requirements for food legislation, created the European

<sup>13</sup> This measure was ordered after “Sudan red” was discovered in hot chilli products from India being sold in France.

<sup>14</sup> The system of traceability applies to food, feed and food-producing animals; it concerns all operatives in the chain, industry, transport, distribution and retail.



Food Safety Authority and laid down food security procedures.<sup>15 16 17</sup>

The Regulation requires food labels to show the packaging date, use-by date and composition, with clear information certifying the processing it has undergone and its origin (modified or otherwise). This information has to be easily understandable by consumers, but it also has to include precise details of each participant in the production chain, given that all of them have to take their share of responsibility under the traceability system. Again, it represents an additional cost, but by providing prompt and relevant responses when health hazards arise it also translates into a better commercial image for the brand, enabling it to penetrate more profitable market segments. In other words, the extra initial cost may well yield a competitive advantage.

Countries that export agricultural foodstuffs to the European Union, and the EU itself, have seen a recent upsurge in companies offering advice on the design and implementation of traceability systems to comply with

these requirements. They include, by way of example, Food Trace in Europe and Traza Chile in Chile.<sup>18</sup>

By implementing a traceability system, firms add costs that, if transferred to the product, would increase its price and reduce its competitiveness. Recent food security measures have had a negative effect on the agricultural export markets of Latin America and the Caribbean, since their implementation requires technology for translating codes into a language that is more comprehensible to consumers.

If meat is taken as an example, the level of requirements for exporting it is not the same in the United States as in the European Union (see box VI.3). In Europe, regulations are stricter and traceability of origin and movements is required at the individual level (each head), while both anabolics and the use of chicken manure as feed are prohibited. In the United States, traceability is at the herd level, anabolics are accepted and evaluations have to be carried out using the hazard analysis and critical control point (HACCP) system.

#### Box VI.3

#### MEAT TRACEABILITY: AN EXAMPLE OF THE STEPS REQUIRED

##### Traceability of the product

###### *Production information stage:*

1. Individual identification of the animal: date and place of birth, owner, sex and race (e.g., branding).
2. Information on movement of the animal, place of butchering and death.
3. Access to the information for interested parties.

##### Traceability of the production process

###### *A. Processing stage:*

1. Information on date of reception and origin.
2. Rearing and fattening method used until weaning.

3. Feeding and preparation of animals: processing of meat products and derivatives.
4. Slaughtering, packaging and cold storage.
5. Method used to butcher and process the meat: involvement of slaughterhouses and refrigeration and dismembering plants.

###### *B. Distribution stage:*

1. Identification of establishments in national health register of livestock producers.
2. Identification of establishments supplying animals.
3. Obligatory use of brands and marks.

###### *C. Marketing stage:*

1. Date of dispatch.
2. Dispatch time.
3. Name of distributor.
4. Sale and commercialization of meat products and by-products; sale to distributors, retailers and consumers; sale for the production, for example, of cured meat products; transportation within the country; transport and packing for export; supermarkets as key actors.

###### *D. Consumption stage:*

Production, process and distribution information is collected from the perspective of the consumption being tracked.

**Source:** Paola Conca, "Trazabilidad", Santiago, Chile, Dirección de Promoción de Exportaciones (ProChile), October 2004, unpublished; Mariela Bianco and Marta Chiappe, *Estado actual de los sistemas de trazabilidad para bovinos de los países del Cono Sur*, Programa Cooperativo para el Desarrollo Tecnológico Agropecuario del Cono Sur/Inter-American Institute for Cooperation on Agriculture (PROCISUR/IICA), May 2004; Sociedad de Fomento Fabril (SOFOFA), Chilean American Chamber of Commerce (AMCHAM Chile), Corporación de Fomento de la Producción (CORFO) and McKinsey & Company, "Carne bovina: desafíos y potencial exportador", study of the Pro Competitividad programme (PROCOM), Santiago, Chile, 2004.

<sup>15</sup> Official Journal of the European Communities.

<sup>16</sup> Regulation (EC) 178/2002 defines traceability as "the ability to trace and follow a food, feed, food-producing animal or substance intended to be, or expected to be incorporated into a food or feed, through all stages of production, processing and distribution".

<sup>17</sup> Traceability is incorporated into article 18 of Regulation 178/2002.

<sup>18</sup> Traza Chile was set up by Fundación Chile and the National Chamber of Commerce, with the involvement of Oracle and Megasoft Computer Technologies.

## D. Transport costs

### 1. Trade developments

The recent cycle of trade growth is due to the recovery of economic growth in certain developed countries, particularly the United States and Japan, and the continuous expansion of domestic demand in South-East Asia and China. In the last two years, demand in these countries has driven up the prices of the main commodities exported by Latin America and the Caribbean, such as soya, fishmeal, wool, wood pulp, iron ore, copper and oil. For example, changes in soya, coal and iron exports and container cargoes alone led to an estimated rise in maritime shipments to China of at least 167 million tons between 2002 and 2003.

In 2004, goods exports from Latin America rose particularly fast in the mining products segment, with growth of over 40%. Up to September 2004, for example, growth in mining product exports by value exceeded 30% in 10 countries of the region: Brazil, Uruguay, Chile, Bolivia, Ecuador, Peru, Honduras, Nicaragua, Venezuela and the Dominican Republic. Again, exports of manufactured and agricultural goods increased by 21% and 11% during the same period. When the main components of the export rise are broken down, it transpires that some 50% was due to higher prices.

#### a) Higher freight charges

In the maritime shipping industry, a clear distinction can be drawn between three markets that operate in parallel: (i) general cargo ships, most of which transport containers exclusively, while other mixed cargo vessels transport containers plus other unitized cargoes such as pallets; (ii) bulk carriers, which transport bulk dry cargoes (cereals, ore); and (iii) tankers, which carry mainly liquid cargoes, particularly oil and its derivatives.

During 2003 an upturn began in maritime freight charges throughout the world, and prices are still rising. For example, the Baltic Dry Index (BDI) of bulk dry cargo rates rose from 1,800 points in January 2003 to 5,800 points in February 2004. Similarly, the average cost of transporting a container rose from about US\$ 1,100 in 2003 to close to US\$ 1,950 in 2004.

A number of factors have contributed to this. First, there is the explosive growth of trade between China and

the United States, which has attracted a large proportion of container ship hold capacity on to this route and led to a severe shortage of ships on other routes, including those of Latin America and the Caribbean, while generating unprecedented congestion in transport and port systems, chiefly on the west coast of the United States.

Furthermore, this trade is characterized by a large imbalance in cargo flows; in 2002, there was a flow of 7.4 million TEUs (the amount of merchandise that can be carried in a 20-foot container) from Asia to North America, a figure which rose to 10.2 million in 2004, while the flow in the other direction remained practically unchanged at some 3.5 billion TEUs. This imbalance is clearly reflected in freight prices, which stand at a ratio of three to one.

Another determining factor in higher freight charges has been the constant rise in the price of fuel for ships, which went up from US\$ 150 per metric ton of fuel in May 2002 to US\$ 225 in September 2004. Meanwhile, the rising price of steel has increased the cost of building new ships. Ship charter contracts also saw dramatic rate rises of up to 150% between 2002 and 2004.

To take just the period up to end-2003, container freight charges were up by between 18% and 30% in Latin America and by as much as 27% on the main trade routes.

During the first half of 2004, rates for scheduled cargo transported under conditions similar to those obtaining before continued to rise so that, in the case of Latin America, they were 39% higher on average at the beginning of the second quarter than in June 2003, with increases of up to 65% on some routes that are important to the region. Non-scheduled dry cargo rates increased to an even more dramatic and indeed unprecedented degree: from the low point in the price cycle (mid-2002), they had risen as much as sixfold by the peak in early February 2004.

However, shipping rates began to fall sharply in December 2004, and the decline continued throughout the first half of 2005. The BDI fell from a peak of over 6,000 points in the first week of December 2004 to about 4,000 points in early February 2005, then to less than 3,000 points in late May 2005. This decline in rates should be

treated with caution, chiefly because of the influence of seasonal factors, given that between April and July 2004 the index fell by more than 2,500 points. As was noted in chapter I, the recent economic slowdown in the United States and the reduction in growth forecasts for the other countries of the Organisation for Economic Co-operation and Development (OECD) would appear to be behind this decline in shipping costs.

From the perspective of agricultural and agro-industrial exports from Brazil and Mexico to the leading markets, it transpires that for both countries the European Union is the market for which freight costs are highest. At the same time, at least for some agricultural products, the incidence of transport costs between Brazil and Mexico and the other Latin American countries is significant. This could be due to the high costs of transportation between the west and east coasts of Latin America.

#### b) Other variables affecting transport costs

The finding that the European Union is a consistently dearer market to serve is not explained only by its distance from Brazil or Mexico, even though this factor may appear to be more important in determining transport costs than has been concluded on the basis of empirical evidence in the case of United States imports.

A common language with the exporting country, high-quality domestic transport and communications infrastructure, efficient ports and large freight volumes all tend to reduce transport costs. High unit values, on the other hand, push up transport costs by making insurance more expensive.

Imbalances in trade flows have a significant incidence on the freight charges of shipping companies. In 1998, 72% of containers sent from the Caribbean to the United States were empty. Consequently, export freight costs from that subregion (Port of Spain, in Trinidad and Tobago) to the United States (Miami) were considerably lower than the freight costs for imports from the United States: US\$ 750/TEU and US\$ 1,400/TEU, respectively. Within a given region, again, transportation to transshipment ports is significantly cheaper than transportation to ports that are a similar distance away from the exporter, but are not used for transshipment. This is the case, for example, with the port of Kingston in the Caribbean.

Freight charges will also increase when special transportation conditions are required, as the comparison between frozen and fresh foods in table VI.1 shows.

For exports of fresh fruit and vegetables, which are transported for preference by air because they are highly perishable, freight charges have an even higher incidence

Table VI.1  
MARITIME FREIGHT CHARGES BETWEEN SELECTED PORTS<sup>a</sup>  
(Dollar value per 40-foot container)

Port of destination	Miami	New York	Hamburg
Port of origin			
<b>Preserved fish (dry container)</b>			
Brazil (Santos)	2 616	2 662	2 165
Chile (Valparaíso)	2 380	2 380	2 339
Colombia (Buenaventura)	2 815	2 850	1 890
Peru (Callao)	2 855	2 900	2 105
<b>Frozen fish (reefer)</b>			
Brazil (Santos)	4 440	4 475	3 700
Chile (Valparaíso)	4 175	4 455	4 989
Colombia (Buenaventura)	4 465	4 465	4 375
Peru (Callao)	4 560 <sup>b</sup>	4 840	4 380
<b>Preserved asparagus (dry container)</b>			
Brazil (Santos)	1 600	2 285	1 400
Chile (Valparaíso)	1 865	1 925	1 660
Peru (Callao)	1 965	1 975	1 425

**Source:** Comisión para la Promoción de las Exportaciones de Perú (PROMPEX), "Plan Nacional de Desarrollo de las Exportaciones al 2006. Análisis comparativo de competitividad", Lima, 2003.

<sup>a</sup> Freight charges include fuel costs, among others (average rates). 40-foot container = 25 MT.

<sup>b</sup> The port of origin is Paita.

in the final price, something that is illustrated by the evidence on exports of fresh (green) asparagus from Peru (the main exporter, along with Mexico) and Colombia to the United States, the largest import market, and the information on external sales of berries from Chile and tomatoes from Mexico in that market. It should be noted that, because of the unilateral tariff preferences granted by the United States to the Andean countries, asparagus from the latter enters tariff-free.

For exports of fresh blueberries from Chile to the United States, air freight (plus insurance) represents about a third of the FOB price (a quarter of the CIF price) of these berries, whose value per 2 kilogram box averaged US\$ 20 in the wholesale markets of Philadelphia and Los Angeles in the 2000/2001 and 2001/2002 seasons. Fresh blueberries are now exported by sea as well, in containers with a modified and controlled climate. Shipping rates range from US\$ 1.2 to US\$ 1.7 per box.

For fresh tomato exports from Mexico to the United States, total transport costs (to and within the United States) represent 10.9% and 15.3% of the selling price in Los Angeles and Chicago, respectively, while tariffs account for just 2.8% and 2.3%. The total direct and indirect costs of commercializing fresh Sinaloa plum tomatoes account for between 21.3% and 29.9% of the final price in the main United States retail markets.

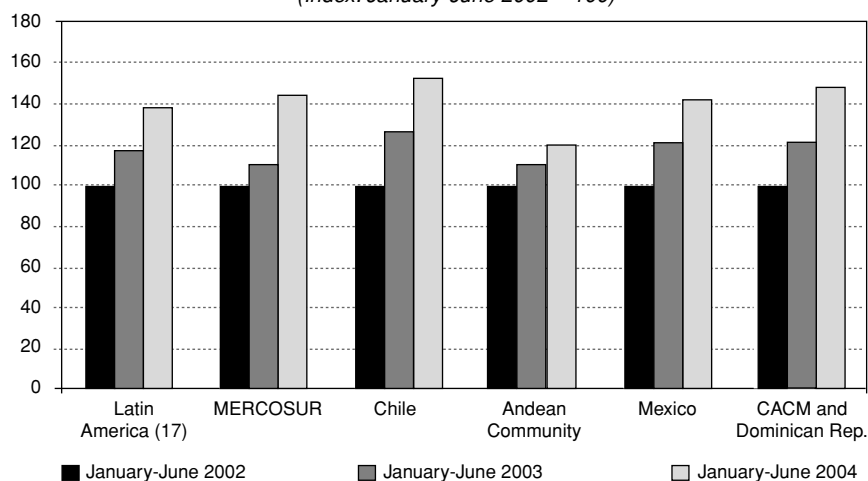
Internal transport costs in Mexico are equally substantial. In the case of fresh Sinaloa tomatoes,

they account for 17.9% of the price in Mexico City (13.8% and 12.3% in Guadalajara and Monterrey, respectively). The radial configuration of Mexico's highway infrastructure, centring on the capital (as is also the case in many other countries of the region) creates a profound spatial segmentation between regions and heightens the advantages of regions in the north owing to their proximity to the border with the United States.

### c) Factors limiting the access of small and medium-sized producers to export markets

Besides the deficiencies of local infrastructure, another factor are the economies of scale that exist in international transportation. These mean that there is an inverse relationship between freight costs and volumes, as described earlier, and this places particular constraints on the access of small and medium-sized producers to export markets. According to the Association of Manufacturing Exporters (ASEXMA) in Chile, small exporters (those sending just one or two containers a month) "may pay up to 50% more than a business sending 50 containers a month". In the case of highly perishable products, such as fresh berries, the scale of production will determine the producer's ability to obtain air transport slots and thus export directly.

Figure VI.1  
LATIN AMERICA (17 COUNTRIES) AND SUBREGIONS: CHANGES IN THE INCIDENCE OF TRANSPORT COSTS<sup>a</sup>  
(JANUARY-JUNE OF EACH YEAR)  
(Index: January-June 2002 = 100)



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the countries concerned, commodity prices and shipping rates (soya, iron ore, oil and merchandise rates).

<sup>a</sup> Index numbers calculated from the ratio of transport costs to total exports.

## E. New transport security standards

The events of 11 September 2001 in New York and the attacks of 11 March 2004 in Madrid, together with other incidents of a similar kind and with similar motivations, have led to the adoption of a number of measures to counteract emerging threats in goods transportation. Some security measures have been supported by the international community, while the legitimacy of others has been questioned because of their unilateral character.

Where security investments in the United States are concerned, studies prepared by the National Academy of Sciences of the United States (2004a and 2004b) argue that much of the antiterrorism equipment used at present is ineffective. The problems detected include the following: (i) monitoring systems in ports and at borders cannot differentiate between the radiation produced by a nuclear bomb and that created by materials such as ceramic tiles or the like; (ii) the new instruments devised to inspect passengers at airports are no more effective than those used formerly; and (iii) the machines used by the postal service inspect only a small percentage of the mail and look for anthrax, but not other biological agents. After spending US\$ 4.5 billion on security equipment, the United States authorities estimate that it might cost

another US\$ 7 billion to bring this up to standard (*The New York Times*, 2005a).

There needs to be a good level of dialogue among all the parties affected, and a way needs to be found of providing more and better financing mechanisms to mitigate the burden and high cost of acquiring cutting-edge equipment and technologies that countries, particularly those of Latin America and the Caribbean, need if they are to be able to comply satisfactorily with the new security standards. There is also a need to modernize physical infrastructure and invest in programmes to train qualified human resources.

Multilateralism reduces the likelihood of measures turning into a new form of protectionism, as may happen when they are imposed unilaterally or bilaterally. In relation to new security measures, some examples of international action coordinated on a multilateral basis might include, first, the implementation of the International Ship and Port Security (ISPS) Code of the International Maritime Organization (IMO) and, second, the recent efforts made by the World Customs Organization (WCO) to provide the international community with a trade facilitation and security framework.

### 1. A multilateral measure

The International Ship and Port Security (ISPS) Code of the International Maritime Organization (IMO) was adopted in London, United Kingdom, in December 2002 by the States parties to the International Convention for the Safety of Life at Sea. It came into force on 1 July 2004 and its application is compulsory for the 148 States that signed that Convention.

Its main purpose is to provide a regulatory framework that facilitates risk evaluation, in order to prevent maritime transport and port infrastructure (ships, facilities, cargo and passengers) being used to commit terrorist attacks. It enables governments to increase their protection measures to deal with the new threats on a coordinated international basis.

Under one of the provisions of the ISPS Code, ships, port installations and shipping companies must

appoint trained protection officers accredited by the shipping authority. In addition, ports and shipping companies are required to have contingency plans, based on evaluations of protection needs, to prevent potential acts of terrorism.

The purpose of these security measures is to minimize risks like the following, among others: attacks (bombings, adulteration of cargo, hold-ups, vandalism, use of ships as weapons, sabotage); armed actions (piracy); terrorism; hijacking; smuggling; stowaways; hostage-taking; illegal trafficking and transportation of weapons, drugs and persons; collateral damage that might be caused by fires, explosions and stowaways. Part A of the ISPS Code is compulsory and it clearly lays down the responsibilities and obligations of the different parties involved with security (member States, shipping

companies, captains and port facilities). Part B of the Code contains a number of recommendations relating to the provisions set out in part A.

As regards the state of implementation of the ISPS Code, information supplied by IMO in early 2005 shows that seven months after it came into force, it had been put into practice by 145 countries, representing some 9,600 port facilities (97% of the total) and 95% of the world shipping fleet. In Latin America and the Caribbean it has been implemented at 718 port facilities, which are certified accordingly. All port facilities in Canada and the United States are reported to have obtained their ISPS Code certification.

While most of the ECLAC member countries in the region have obtained this security certification, however, there are still ports that do not have it. In the case of ports that are certified, meanwhile, the initial efforts made to obtain certification appear to have slackened as the months have gone by, either because no incidents have occurred or for other reasons. The fact is, though, that efforts should be unremitting, so that these ports can reduce yet further their vulnerability to terrorist threats and the risk of losing competitiveness.

Again, some obstacles to implementation of the ISPS Code have been detected. Surveys carried out recently by both ECLAC and the Inter-American Committee on Ports (CIP) of the Organization of American States (OAS) have shown that among the region's foreign trade community there is a degree of ignorance about security measures, the impact and effects of ISPS implementation in terms of costs, and who is to meet these additional costs. Again, although there is great interest in certifying all port facilities, there are constraints such as a lack of financial resources for training security officers and technical assistance auditors in the areas of risk analysis and evaluation, and for purchasing communication and high-technology equipment. This is undoubtedly an area

that can be addressed through hemispheric technical assistance programmes.

The level of investment required to comply with ISPS security standards can be considerable. In Brazil, for example, the Federal Government allocated close to US\$ 40 million to strengthen security at ports and terminals in 2004, and plans to spend a similar amount in 2005. At the individual level, the container terminal of the port of Suape in the state of Pernambuco is reported to have invested about US\$ 600,000, and the port of Itajaí, in Santa Catarina, about US\$ 1.2 million. The container terminal of Paranagua in Paraná has invested a total of US\$ 6 million in its security plans since the concession was awarded six years ago.

The security surcharge applied in a sample of 27 Latin American and Caribbean ports averages US\$ 11.84 per container. This compares unfavourably with the world average of US\$ 8.53 at a sample of 107 ports. The average is US\$ 3.88 in Australia (sample of five ports), US\$ 4 in the United States (sample of 37 ports), US\$ 10.5 in Europe (sample of 34 ports) and US\$ 6.47 in Asia (sample of four ports).

Again, a number of ports are levying a security surcharge that should ideally be spread along the whole export chain, from the point of origin to the final user. Among the increases recorded, mention may be made of the following: at a number of European ports, US\$ 10.8 has to be paid per container; at two port terminals in Port Klang, Malaysia, an additional charge of US\$ 34 is now being levied for the movement of each container selected to pass through a scanner, in compliance with the provisions of the Container Security Initiative (CSI). In the United States, an additional charge of 5% has been set by the Gulf Seaports Marine Terminal Conference (GSMTC), which includes 20 port terminals, while in Mexico a surcharge of US\$ 10 per container is being applied.

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## 2. Voluntary measures

### a) The Container Security Initiative (CSI)

This initiative was started in January 2002 by the United States Customs and Border Protection Bureau, and is voluntary in nature. Its purpose is to improve the security of containers so that the cargo transported in them cannot become an easy terrorist target. It is a multifaceted approach covering everything from the design of containers to the procedures for identifying

those considered to pose a risk and for achieving the capability of monitoring them in United States ports and the major centres of Europe and Asia. To facilitate the detection of potential security threats as rapidly as possible, four main elements are included:

- The use of automated information to identify and select containers that pose a risk;
- Pre-screening of containers identified as posing a risk before they arrive at United States ports;

- The use of detection technologies to quickly pre-screen containers that pose a risk;
- The use of smarter, tamper-evident containers. Unless they are found to have been tampered with, containers identified as posing a risk will be screened at the port of departure instead of the port of arrival, using a combination of large-scale X-ray and gamma-ray devices and global positioning transponders.

To begin with, this programme covered the world's 20 busiest seaports, since these handled almost 70% of containers bound for the United States, but it is now being extended to other ports outside this category, chiefly for precautionary reasons and in the interests of competitiveness. This is the case with the ports of Durban (South Africa), Gothenburg (Sweden) and Klang and Tanjung Pelepas (Malaysia). Table VI.2 shows the state of implementation of the CSI programme, which covered a total of 37 ports in 19 countries as of March 2005.

Argentina recently became the first country in the region to join the CSI programme. On 8 May 2005, the customs services of Argentina and the United States signed a mutual cooperation agreement to improve container control under this Initiative. The investment timetable provides for the purchase of nine X-ray type mobile scanners at an estimated cost of US\$ 5 million apiece. After a tendering process, the first of these is expected to be operational at the port of Buenos Aires towards the end of 2005. These mobile devices can be moved around the country as needs require. Plans have also been made to purchase three fixed X-ray type scanners to be installed at Buenos Aires, Paso de Los Libres and Uspallata within two years. The Argentine customs authorities regard this expenditure as a public investment forming part of a broader port and trade security strategy. They have stated that they do not expect to pass on these costs to economic agents.

The customs services of other countries in the region, including Brazil and Uruguay, have also been holding discussions on this issue with their counterparts in the United States, suggesting that they too should be in a position to join the CSI programme in the near future. At the same time, it transpires that various Latin American and Caribbean exporters sending containers to the port of Miami have expressed concern about the slowness of the container inspection process, which takes from two to six days.

#### **b) The 24-hour rule for arrival at United States ports**

In early December 2002, the United States Customs and Border Protection Bureau implemented the measure

known as the 24-hour rule, whereby all vessels heading to a port in that country have to submit a cargo declaration at least 24 hours before cargo is laden aboard the vessel at the foreign port.

In May 2003, the United States customs services were authorized to levy fines for non-compliance with this rule. Since then, ports have been responsible for sending the first "Do Not Load" message to vessels presenting invalid or incomplete cargo descriptions, and also for informing the National Targeting Center (NTC) so that it can process the "Do Not Load" order. Fines can also be levied for late cargo declarations, for errors in the names and addresses of the cargo consignees and for cargoes that are not unloaded due to non-compliance with this measure. Fines start at US\$ 5,000 and can be increased in the case of repeat infractions.

#### **c) The United States Customs-Trade Partnership Against Terrorism (C-TPAT)**

This is another voluntary cooperation initiative involving the United States Government, importers and the transport chain. It was put into effect in April 2002 and has now been extended to Canada, Mexico and, recently, the other Latin American countries. The purpose of this initiative was basically to widen the security perimeter as much as possible so that United States importers could transport their goods within a system of secure partnerships with transport, storage and manufacturing companies and thereby enhance container security right along the supply chain, from origin to final destination.

As regards the state of implementation of C-TPAT, as of March 2005 over 7,000 companies were participating in this initiative, including the world's three great port terminal operators, Hutchison Port Holdings, PSA Corporation, Ltd. and P&O Ports. A joint pilot project for container transportation between Singapore, Hong Kong Special Administrative Region of China and Seattle/Tacoma in the United States has been put into operation. The innovation lies in the use of a smart electronic sealing system, although the costs of purchasing and operating this are still too high for it to be employed on a mass scale. In the view of a number of SMEs participating in C-TPAT, furthermore, there is a need for further clarification and specification of the security requirements laid down by this initiative. As of May 2005, the chances of the United States authorities conducting physical inspections of incoming containers were one in 306 for C-TPAT members and one in 47 for non-members (*The New York Times*, 2005b).

Besides the issue of compliance with the security measures described above, which concern civil society at every level, be it local, national or international, it

Table VI.2  
**PORTS INCLUDED IN THE CONTAINER SECURITY INITIATIVE (CSI)**  
*Situation as of March 2005 (37 ports in 19 countries)*

Port	Country	Region/continent
Durban	South Africa	Africa
Halifax	Canada	North America
Montreal	Canada	North America
Vancouver	Canada	North America
Dubai	United Arab Emirates	West Asia
Shanghai	China	East Asia
Shenzhen	China	East Asia
Pusan	Republic of Korea	East Asia
Hong Kong	Hong Kong SAR	East Asia
Kobe	Japan	East Asia
Nagoya	Japan	East Asia
Osaka	Japan	East Asia
Tokyo	Japan	East Asia
Yokohama	Japan	East Asia
Port Klang	Malaysia	South-East Asia
Tanjung Pelepas	Malaysia	South-East Asia
Singapore	Singapore	South-East Asia
Laem Chabang	Thailand	South-East Asia
Colombo	Sri Lanka	South Asia
Bremerhaven	Germany	Europe
Hamburg	Germany	Europe
Antwerp	Belgium	Europe
Zeebrugge	Belgium	Europe
Le Havre	France	Europe
Marseilles	France	Europe
Piraeus	Greece	Europe
Genoa	Italy	Europe
Gioia Tauro	Italy	Europe
La Spezia	Italy	Europe
Leghorn	Italy	Europe
Rotterdam	Netherlands	Europe
Felixstowe	United Kingdom	Europe
Liverpool	United Kingdom	Europe
Southampton	United Kingdom	Europe
Thamesport	United Kingdom	Europe
Tilbury	United Kingdom	Europe
Gothenburg	Sweden	Europe

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from United States Customs and Border Protection (CBP) [online] <[http://www.customs.gov/xp/cgov/border\\_security/international\\_activities/csi/ports\\_in\\_csi.xml](http://www.customs.gov/xp/cgov/border_security/international_activities/csi/ports_in_csi.xml)>.



is becoming more and more obvious that businesses and governments which join security initiatives at an early stage will be the best placed to lower their levels of risk and vulnerability to terrorist threats. They will thus be in a position to compete in an ever more demanding environment and avoid the loss of customers or markets.

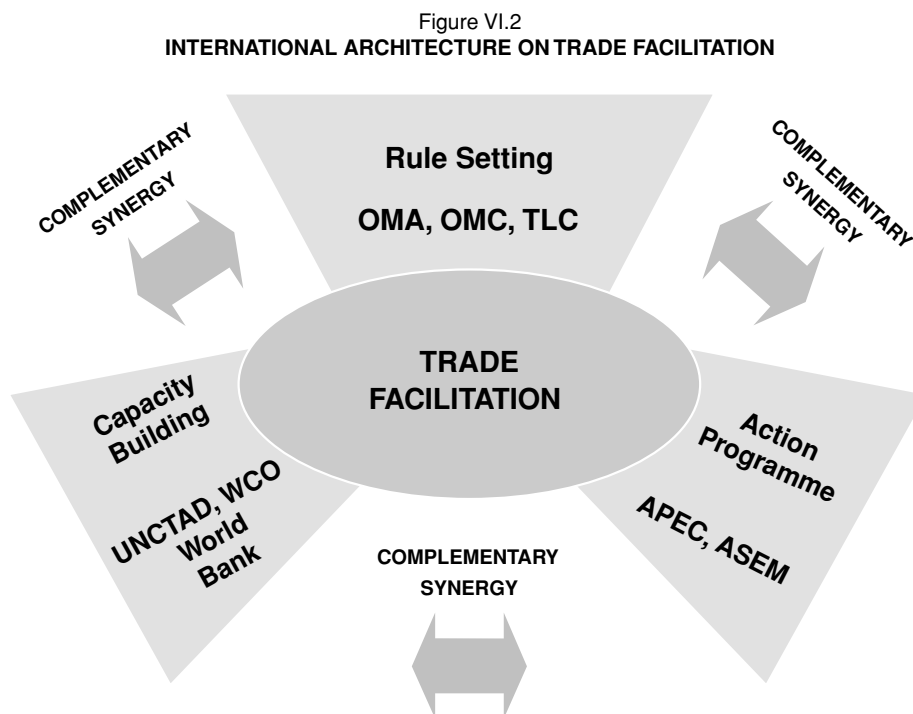
In future, however, it would be advisable for new security measures to be discussed in advance by all interested or affected parties and then implemented at a multilateral level, as happened with the ISPS Code, which was debated at IMO and thus enjoys the participation and full support of the international community.

## F. Complementarity between trade facilitation and security

The concept of trade facilitation refers to any deliberate action, whether unilateral or negotiated, intended to simplify operational procedures and reduce or eliminate transaction costs affecting or hindering international trade and economic movements (ECLAC, 2001). According to the World Trade Organization (WTO), trade facilitation is the simplification and harmonization of international trade procedures, by which are meant the activities, practices and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade.

Security measures can perfectly well be complementary to facilitation measures, since the two are closely related and can both bring major benefits to the international community. Figure VI.2 exemplifies this relationship, with special emphasis on the complementary synergy that exists between standard-setting, programmes of action and capacity building by the different international bodies.

Concerning WTO modalities for negotiations on trade facilitation, progress has been made in this area recently with the Decision of August 2004, which states



Source: World Trade Organization (WTO), "International architecture on trade facilitation, the WTO and international organizations and framework. Council for Trade in Goods" (G/C/W/465), 10 June 2003.

that negotiating procedures are to form annex D of that decision.

The objectives of annex D are to clarify and improve relevant aspects of articles V, VIII and X of the General Agreement on Tariffs and Trade (GATT) concerning: (i) freedom of transit; (ii) fees and formalities connected with importation and exportation; and (iii) publication and administration of trade regulations. The mandate also lays particular emphasis on special and differentiated treatment, and on technical assistance.

The WTO Negotiating Group on Trade Facilitation began operations in November 2004 and its working programme contains a full schedule of meetings for 2005. Representatives of the following institutions are participating as special observers: the World Bank, the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD), the World Customs Organization (WCO) and the United Nations Conference on Trade and Development (UNCTAD). It would be helpful for this group to take account of the related work on trade facilitation being done by the Regional Commissions of the United Nations, particularly the Economic Commission for Europe and the United Nations Centre for Trade Facilitation and Electronic Business (UN/CEFACT), whose work is aimed at simplifying and standardizing documents, applying international codes and designing and implementing one-stop shops for foreign trade, issues that link in directly to articles V, VIII and X of GATT.

Also important is a recent interregional trade facilitation initiative developed jointly by the United Nations Regional Commissions. This is a project to support the Millennium Development Goals, designed with a view to supplementing WTO and UNCTAD efforts in the area of technical cooperation for capacity building, growth and integration with the Doha Development Programme. This project, which will aim to enhance trade facilitation, seeks to: (i) raise awareness and understanding among governments and businesses of trade facilitation and of the role that can be played by information and communication technologies (ICTs); (ii) increase the use of ICTs by micro, small and medium-sized enterprises (MSMEs) in trade facilitation; and (iii) create national capabilities for negotiating on trade facilitation issues.

Among the short-term products or components proposed by ECLAC for this initiative are the following: (i) the launch of an electronic forum (WebBoard) for discussion and information sharing; (ii) the creation of an Internet portal to spread information and knowledge that can help MSMEs enter the supply chain; (iii) the establishment of an interregional network of academic institutions in the public and private sectors to promote the sharing of experience and know-how relating to trade expansion and diversification, among other issues; and (iv) the identification both of ICT weaknesses and of tools for closing the gap that now exists between companies and between countries.

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