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CONTENTS

Social images of technological change, <i>E. Faletto</i> .	7
Attitudes to technical change, <i>C. Filgueira</i> .	17
International competitiveness and specialization, <i>O. Mandeng</i> .	25
Commodity exports and Latin American development, <i>J. M. Benavente</i> .	41
The role of the State in technological progress, <i>R. Mosquera</i> .	61
The polluter must pay, <i>R. Valenzuela</i> .	71
Macroeconomic policy coordination and integration, <i>A. Schwidrowski</i> .	83
Reconciling subregional and hemispheric integration, <i>J. A. Fuentes</i> .	99
The Latin American Labour Market, 1950-1990, <i>R. Infante</i> and <i>E. Klein</i> .	121
The economic and social significance of narcotics, <i>J. Giusti</i> .	137
Ideology and development: Brazil, 1930-1964, <i>R. Bielschowsky</i> .	145
Guidelines for contributors to <i>CEPAL Review</i> .	168
ECLAC publications	169

Reconciling subregional and hemispheric integration

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This article analyses the type of subregional integration efforts which could at the same time help to further the aims of increasing competitiveness, taking advantage of the opportunities created by the Enterprise for the Americas, and progressing towards an open world economy where multilateral rules rather than the use of naked power prevail. In particular, it is argued that subregional integration can, on the one hand, serve as a precedent for possible subsequent non-discriminatory agreements, while on the other hand it can create favourable conditions for growth based on greater efficiency and competitiveness, as well as promoting domestic and foreign investment.

This dual potential of subregional integration is first of all explored with regard to trade liberalization, trade rules, and factor mobility. As well as considering the potential effects of easing the application of tariff and non-tariff barriers, an appraisal is made of the possibility of joint action on matters which have been the subject of multilateral trade negotiations and negotiations between the United States and Canada and Mexico, such as countervailing duties, safeguard clauses, rules on origin, services, and intellectual property. Finally, some institutional requirements of subregional integration processes are identified in the light of the above objectives, and the implications of the process of transition caused by the liberalization due to subregional and hemispheric integration are explored.

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Introduction

After a crisis period in which the absence of general guidelines was compounded by excessive flexibility, the Latin American and Caribbean integration process seems to be entering a new phase combining pragmatism with a clearer sense of direction, stemming primarily from a quest for international competitiveness. In addition, there is an awareness of the need to achieve two seemingly contradictory objectives: building up a world economy where multilateral rules rather than the use of naked power prevail, and taking advantage of the opportunities created by the Enterprise for the Americas. Subregional integration could play an important role in reconciling these dimensions of trade policy by establishing bases for increasing competitiveness, taking advantage of hemispheric integration, and making effective progress towards an open international economy: in other words, it would be a clearly "outward-oriented" form of economic integration.

The aim of this paper is to identify the types of subregional integration actions which are consonant with this approach. The countries subject to this integration are considered to be those already forming part of groups such as MERCOSUR, the Andean Group, the Central American Common Market and CARICOM, but the possibility of alternative groups or the expansion of existing groups is not ruled out. It should be noted that there are big differences between the various groups, reflecting the growing diversity of the countries which make up Latin America and the Caribbean.

To begin with, the outstanding issues that need to be taken into account when seeking to further subregional integration in the light of the above objectives are identified. Hence, a brief analysis of the relations between integration (both subregional and hemispheric) and competitiveness is made, followed by consideration of the links between integration and multilateralism. This brings us to the central part of the paper, which, as already mentioned, consists of the identification of types of subregional action consonant with the quest for competitiveness, the exploitation of the opportunities offered by hemispheric integration, and progress towards an open and non-discriminatory world economy. In view of the broader geographic

scope of hemispheric integration, these are not the only issues that may need to be negotiated when establishing a hemispheric free trade zone, but these areas of common action do seem to cover most of the issues relevant to subregional integration itself. At all events, this paper is designed to

provide an introduction to each issue and to serve as a first approach to the economic criteria on the basis of which an appraisal in greater depth could be carried out for the specific cases of individual countries or groups of countries in Latin America and the Caribbean.

I

Subregional integration and competitiveness

Subregional integration can help to increase competitiveness through its effects on efficiency, the incorporation of technical progress, and investment. The relation between these variables and subregional integration in Latin America and the Caribbean is described briefly below.

1. Efficiency

Thanks to the unilateral liberalization processes carried out in Latin America and the Caribbean since the 1980s, the potential costs of integration have been reduced, particularly as regards the costs that the relatively less developed countries would have to pay by importing goods from their neighbours at higher prices than they would have had to pay if they had bought them from countries which were not members of the integration agreements. Moreover, subregional integration may well permit intra-regional imports to take the place of goods previously produced less efficiently on a domestic basis, which, according to traditional customs union theory, will favour the consumer and free resources that can be used more efficiently to produce goods that can compete on regional or international markets¹. Also in line with the foregoing, it will moreover reduce monopoly rents and the resultant inefficiency of the unproductive agents associated with them.

¹For a discussion of trade creation and diversion at the hemispheric level, see ECLAC, 1990a. According to this theory, prior unilateral trade liberalization would reduce the possibility of diversion of trade, and intra-regional trade liberalization would result in the creation of more trade.

2. Technological externalities and technical progress

The integration and liberalization of markets can expand the effects of innovation by reducing the mean cost of technological research and development, increasing the efficiency and utilization of specialized inputs or support services, and generating technological externalities (Baldwin, 1989; ECLAC, 1990b). Thus, an expanded market would enable greater benefits to be derived from investment in research and development, by taking advantage of economies of scale and reducing the cost/sales price ratio. The standardization of regulations would have a similar effect and, together with the elimination of national barriers to competition in general, would increase the incentive for innovation through more intensive interaction among enterprises and heightened demands on the part of local consumers, as noted by M. Porter in the case of various industrialized countries (Porter, 1990). In addition, integration would create opportunities for taking advantage of economies of scale in other activities, including production and marketing, and these could be particularly important in the case of incipient export industries.

The establishment of an expanded market could also involve costs for the process of development and incorporation of technical progress, due to the geographical restrictions imposed on liberalization, which would affect one group of countries, but not others which are the international source of innovations and of possible technological externalities deriving from the presence of many innovators. Since these effects do not depend solely on the relations between goods markets but also on the closeness, intensity and nature of the inter-

action between the economic agents, however, there would be a possibility of weakening the negative effects of the discriminatory expansion of markets by means of institutional arrangements designed to take greater advantage of the positive effects of geographical and cultural proximity².

3. Investment

In the light of the foregoing, three effects of integration on investment may be identified. Firstly, assuming that investment is determined by its expected yield and the cost of obtaining resources, the greater efficiency resulting from the (net) benefits of more efficient resource allocation would result in increased income which, in turn, would lead

to increased saving and higher levels of investment. Secondly, both domestic and foreign investment would increase as a result of the higher yields deriving from liberalization, deregulation, economies of scale, innovations, externalities, and common standards. Both the former and the latter effects would help to increase or multiply the benefits due to the better (static) resource allocation, while the incorporation of technical progress associated with the investment would mean greater competitiveness. Finally, the expectations created by an expanded market, offering the possibility of bigger total profits, would help to increase both domestic and foreign investment and could give rise to greater bargaining power *vis-à-vis* big foreign firms.

II

Hemispheric integration and competitiveness

In view of the effects that subregional integration has on competitiveness, it may be concluded that hemispheric integration offers possibilities of further increasing or extending such effects, thereby giving rise to the possibility of a mutually favourable relation between the two processes. A brief description is given below of the ways in which hemispheric integration could expand the effects of subregional integration on efficiency, the incorporation of technical progress, and investment, especially by giving access to a secure expanded market.

1. Efficiency

Hemispheric integration's contribution to efficiency will depend to a considerable extent on the degree of trade liberalization previously achieved. If there was already some prior unilateral liberalization, the cost

of obtaining more expensive imports from North America under the terms of a preferential agreement with one or all the members of the North American Free Trade Agreement (NAFTA) will not be so heavy. This would be so in the case of Mexico. Moreover, according to traditional theory, benefits would be obtained from the displacement of inefficient Latin American and Caribbean products by those produced more efficiently in the member countries of NAFTA, especially the United States, since this would amount to the same thing as a unilateral lowering of protection. This may be considered to be the experience of Canada, for example, most of whose imports already came from the United States when free trade was agreed between the two countries. Thus, it may be considered that in Canada the benefits derived from trade liberalization through *imports*, with consequent reallocation of resources, were combined with those resulting from more secure access for Canada's *exports* to the United States market³.

²The externalities which exist at the local level because of close and continuous contact between agents of production can clearly be of the greatest importance, as is shown by the experience of Brazil (technology parks), the United States (Silicon Valley), or Germany (the Ruhr Valley). The encouragement of local externalities can be one of the fundamental bases for integration between border areas or between small neighbouring countries such as those of Central America. With regard to the interaction between agents of production, externalities and institutional arrangements in Latin America and the Caribbean, see especially ECLAC (1990b), pp. 71-73, 110-114 and 164-170.

³G.K. Helleiner makes a comparison of some of the central arguments used in the negotiation of the free trade agreement between the United States and Canada with those put forward in the negotiations between the United States and Mexico, noting how important assured access to the United States market was for both those countries. In contrast, Canada attached greater importance to the benefits deriving from the reduction of Canadian protection (creation of trade), whereas in Mexico the importance of this effect had already been reduced by the prior unilateral liberalization. See Helleiner, 1990.

2. Access to the North American market

The main trading partner of Latin America and the Caribbean in recent years has been the United States, which has accounted for rather more than one-third of the region's total imports and exports, albeit with substantial differences from one country to another (ECLAC, 1990a). The importance of maintaining open access to this market and further liberalizing trade with it is clear when it is noted that although Latin American and Caribbean exports to it have grown faster than those to other parts of the world, and at the end of the 1980s the United States was applying a weighted average tariff of only 2%, that country has been increasing its non-tariff protection measures in some areas (ECLAC, 1990a; Gonçalves and De Castro, 1989)⁴. One of the main benefits of hemispheric integration would be to put a stop to that trend.

At the end of the 1980s, non-tariff barriers were applied to 18.9% of the region's total exports (excluding the Caribbean and Central America), especially to clothing, iron and steel, yarns, fabrics and textiles, oilseeds, nuts, and agricultural raw materials. Argentina, Colombia and Brazil were the countries most seriously affected by these measures. Furthermore, the United States has traditionally been the country which has made most use of voluntary export restraints, countervailing duties and anti-dumping measures (Olechowski, 1987), as well as discriminatory means of exerting pressure such as Section 301. Easing tariff and non-tariff barriers, especially in the case of the United States, could therefore have a decisive effect on exports and domestic and foreign investment in Latin America and the Caribbean, although the problems inherent in an uncertain process of transition or

non-guaranteed access could reduce expectations or even make them negative.

3. Foreign investment and technological externalities

If Latin America and the Caribbean could gain assured access to a market as big as that of the United States, this could warrant particularly favourable expectations, especially because of the possibilities this would open up for attracting foreign investment and giving rise to a far-reaching continent-wide process of industrial reorganization, the implications of which are so vast that in reality they cannot be accurately gauged in advance. In these circumstances, particular importance would also be assumed by institutional arrangements between Latin American, Caribbean and North American agents which could lead to the generation and exploitation of technological externalities, especially with regard to the use of natural resources and skilled human resources.

However, the region should not wait for the establishment of an expanded hemispheric market, although the expectations in this direction would help stimulate new institutional arrangements. A significant item in this respect is that the Andean Group countries, as part of their lines of action vis-à-vis the Enterprise for the Americas, have adopted proposals for Andean-American technological research and development projects with business participation and for promoting the subcontracting of research and development projects by United States organizations to Andean bodies (SELA, 1991a). Such measures would help to stop the "brain drain" sometimes associated with the integration of two regions of different levels of development.

III

Integration and multilateral agreements

GATT's original proposals with regard to customs unions and free trade areas were designed to permit

⁴ At the same time, tariff graduation results in some dispersion around the weighted average tariff of 2%.

these to be compatible with GATT, and according to traditional economic theory, preferential arrangements can increase the well-being both of the participating countries and of nations outside such agreements (Bhagwati, 1990). The relationship be-

tween the various integration processes and the degree of geographical discrimination and its effects will consequently depend on the specific features of the integration processes put into effect. Thus, for example, if the trade liberalization effects outweigh those of geographical discrimination, as posited in the following sections, integration will contribute to the formation of a less discriminatory international economy.

Furthermore, the Uruguay Round negotiations have shown that it is possible for the countries of the Western Hemisphere as a whole to form fruitful alliances on issues involving multilateral trade liberalization, as in the case of agriculture. This raises the possibility of a veritable strategic alliance, with hemispheric-level negotiations which could serve as a precedent for the adoption of non-discriminatory multilateral agreements, though they call for careful analysis in each case.

Thus, the application of safeguard rules in line with the criteria favoured by the United States in the case of the North American Free Trade Area (NAFTA), together with the intention to cover such issues as subsidies, public sector purchases and restrictions due to balance-of-payments problems in the case of the free trade areas which would form part of the Enterprise for the Americas in general,⁵ suggest the possible application at the regional or hemispheric level of the trade measures which were supported by the United States in GATT but on which it has not been possible to reach agreement at the multilateral level, although they could serve as precedents for subsequent agreements at that level.⁶ In addition, these areas could include "special provisions for managing trade and access to natural resources and natural resource-based products" (Frechette, 1991).

The emphasis placed by the United States on liberalizing the trade in services and eliminating

restrictions on foreign investment and the commercial exploitation of intellectual property is also well known. One argument put forward in favour of the negotiation of the free trade agreement between the United States and Canada, for example, was the possibility of making progress in the establishment of rules on those matters which, in view of the slow progress made towards such agreements in GATT, would serve as a precedent for the establishment of multilateral rules in a subsequent stage (Schott, 1989).

In view of the foregoing, there is a possibility that the Western Hemisphere may occupy a kind of spearhead position in multilateral liberalization, which would involve both risks and opportunities. On the one hand, subregional integration would help to lay precedents, as in the case of the agreement between the United States and Canada, which would favour the positions of the Latin American and Caribbean countries at the hemispheric level and would further the possibility that inter-American integration could make an effective contribution to the establishment of a non-discriminatory international economy in which the application of rules rather than the exercise of power prevails. One way of achieving this would be through the use of trade instruments which minimize the negative effects of discrimination while at the same time ensuring the benefits resulting from progress towards situations of greater liberalization.

On the other hand, due account should be taken of the multilateral angle and the possibility of transferring to that level—which is less disadvantageous for the weaker countries—the negotiations on issues such as safeguard clauses or subsidies and countervailing duties, where there are big differences between the less discriminatory position held by Latin America and the Caribbean, on the one hand, and the more discriminatory position of the United States on the other. In this sense, it is of the greatest urgency to make a clear appraisal of the results of the Uruguay Round and the possibility that the multilateral agreements on non-tariff barriers can be applied to trade between the free trade areas existing in the American continent.

⁵Statements by Myles Frechette on 12 June 1991: "The United States considers that the Enterprise for the Americas and the Uruguay Round are mutually complementary" (Frechette, 1991).

⁶From the point of view of Latin America and the Caribbean, as an importing region, another significant precedent could be the free trade agreement between the United States and Israel, which includes more severe provisions regarding the use of protection justified on the grounds of the existence of infant industries or balance-of-payments problems. See Aminoff, 1991.

IV

Subregional action

Although there will naturally be differences in the rate of progress of the various subregional integration schemes, it is reasonable to expect a process of convergence to facilitate the development of competitiveness, take advantage of hemispheric integration, and move towards a non-discriminatory system of trade and investment. Some of the issues which could give rise to convergent or common subregional action to facilitate that process are identified below. They are grouped under the headings of stabilization, trade liberalization, trade rules, factor mobility, institutional arrangements, and the process of transition.

A. The prior stabilization process

A prior condition for promoting a broad integration process in the medium or long term is that there should be a certain minimum degree of macroeconomic stability. There are three reasons for this. Firstly, the existence of big imbalances reflects, at least in part, internal weaknesses with regard to economic policy which must be overcome if the countries are to be able to define their priorities and strategies at the *national* level; once defined, these can form the basis for integration agreements with other countries. Otherwise, these imbalances will lead to failure to fulfil the commitments entered into with other countries and will thus undermine the whole idea of integration. Secondly, financial imbalances can give rise to variations in the real exchange rate and reduce the transparency of the policies applied, thus impeding reciprocal trade and capital flows. They may also heighten the differences which exist between countries by leading to the concentration of foreign investment in the most stable countries.

Finally, it must be borne in mind that the Enterprise for the Americas, as proposed by the United States, includes elements which unilaterally condition the eligibility of the beneficiaries. With regard to debt reduction, in particular, they include some criteria whose implications with regard to stabilization and adjustment (as well as foreign investment) are harsher than the terms of the Paris Club (SELA, 1991b). Although it is not yet clear how the criteria regarding trade liberalization will be established, the prior

achievement of stabilization would avoid conflicts over the interpretation of the conditions connected with this macroeconomic objective.

The foregoing does not mean that joint action before the achievement of stabilization should be completely ruled out, but it does mean that stabilization must be the primary focus of attention and cooperation in the first stage, based on the domestic efforts of each country. An example which may be mentioned in this connection is that of the regional action to promote the stabilization of Peru through the formation of a support group backed up by a number of Latin American countries both with individual financial contributions and with joint contributions made through the Latin American Reserve Fund (FLAR), which took the place of the former Andean Reserve Fund. Similar action could be carried out through comparable mechanisms in other subregions, as in the case of the Central American Monetary Stabilization Fund (FOCEM). It would not be necessary to reach broader macroeconomic cooperation agreements until progress had been made towards a higher degree of subregional or regional economic interdependence (ECLAC, 1991a).

B. Trade liberalization

Past integration agreements in Latin America and the Caribbean were generally centered on trade liberalization through the elimination of tariffs among the members of the integration group, including on occasions agreements for the application of a common tariff against third countries. Although this approach is still used, the current circumstances justify some rethinking of this approach to take account of real trade flows, the existence of non-tariff barriers, and relations with trading partners from outside the continent. These issues are considered below.

1. Expanded competitive markets

Liberalizing trade between individual Latin American and Caribbean countries and the United States or NAFTA in general involves liberalizing intra-regional trade too. Under a hemispheric free trade

agreement, existing intra-Latin American trade which had not yet been liberalized could be replaced by imports from North America that benefited from the agreement. This would mean the diversion of intra-Latin American and Caribbean exports in so far as the free trade agreement with the United States favoured North American products more than those of Latin America and the Caribbean.⁷ Eliminating this diversion would therefore call for the prior liberalization of intra-Latin American and Caribbean trade.

In the absence of such liberalization of intra-regional trade as a whole, the trade diversion in question could be minimized by establishing free trade among the countries with the biggest intra-regional trade: an approach which would tend to coincide with the already existing subregional integration schemes (table 1) and with the views expressed in this respect by the United States Government. It may be noted that trade *within* each subregion is greater than trade *between* the subregions of Latin America and the Caribbean, except in the case of the Andean Group, whose reciprocal trade is less important than its imports from the

MERCOSUR countries (particularly Brazil) (table 1). The operation of subregional or regional payments and monetary cooperation systems (Fuentes and Villanueva, 1989, pp. 197-202) and the elimination of the obstacles standing in the way of trade because of the intra-regional debt,⁸ would also help to avoid discrimination against internal trade in the region on account of foreign exchange restrictions.

It would not just be a question of establishing a form of free trade which would have a single, one-time resource reallocation effect in each subregion, however. It would also be necessary to adopt common technical rules and standards and consumer protection regulations; rules on competition which would reduce the incidence of restrictive trade practices; and regulations, incentives and taxes designed to preserve the environment and promote sustainable use of natural resources. This more demanding internal market, with limited protection against third countries, could form a basis for exporting to the rest of the world, and especially to North America.

2. Non-tariff barriers

Article XXIV of the General Agreement on Tariffs and Trade provides that free trade areas and customs unions compatible with GATT are those which involve the elimination of customs duties or other restrictive trade regulations applicable at least to the bulk of trade in products originating from the territories in question. As well as meaning, in the strict sense, that most or all subregional trade must be freed from the payment of customs duties, this also assumes the elimination of non-tariff barriers.

It would be possible to establish a preferential system of non-tariff barriers, like that used by the European Community for the developing countries which are members of the Lomé agreements, which includes for example the fixing of more favourable quotas for certain agricultural products, tuna fish and textiles, or the more flexible application of rules on origin and safeguard clauses (Stevens, 1986). The management of non-tariff barriers, regardless of whether they are discriminatory or not,

Table 1
GEOGRAPHICAL STRUCTURE
OF IMPORTS, 1989
(Percentages)^a

Destination: Origin:	MERCOSUR	Andean Group	CACM	CARICOM
MERCOSUR	14.1	9.0	2.9	2.8
Andean Group	3.1	6.6	7.3	4.4
Central American Common Market (CACM)	0.0	0.2	9.6	0.6
CARICOM ^b	0.1	0.2	0.2	6.0
Rest of Latin America and the Caribbean	3.7	3.7	8.3	2.0
United States	23.8	39.8	38.2	50.9
Rest of world	54.8	40.5	33.4	33.4
Total	100.0	100.0	100.0	100.0

Source: Calculated on the basis of ECLAC export data.

^aPercentages are weighted.

^bData for CARICOM only cover Jamaica, Trinidad and Tobago and Barbados.

⁷It should be borne in mind, however, that such replacement would give rise to the creation of trade if it took place even though products from both areas had the same treatment.

⁸See the set of articles in INTAL (1991) on the subject of proposals for reducing the intra-regional debt.

however,⁹ is administratively a more complex matter than the management of discriminatory tariffs, and it lends itself to a higher degree of arbitrariness, distortions, and pressure by interest groups. From the moment when subregional markets are set up, up to the culmination in a liberalized hemispheric market, therefore, it would be necessary to agree on the total elimination of non-tariff barriers, even if this were accompanied by some increase in tariffs in order to facilitate this transitional process.

3. Common external tariffs

From the point of view of more efficient resource allocation, a customs union is not necessarily superior to a free trade area (Robson, 1980, pp. 20-30). The existence of a first country with lower tariffs may mean that it can export all or part of its production to a second member country of the free trade area, while supplying all or part of its own needs with imports from the rest of the world. In the second country, there will be a positive resource reallocation effect to the extent that its less efficient production is replaced by the production of the first country, while in the latter country the government will receive greater tax income as a result of the increase in the country's imports from outside the free trade area.

Furthermore, a free trade area would reduce the possibility of making more expensive imports in the country with the lowest tariffs, to the extent that a common external tariff was reflected in higher (average) levels of protection. At the same time, it is probable that a free trade area will give greater flexibility and make it possible to advance more rapidly in subsequent negotiations with the North American Free Trade Area or the United States, particularly if levels of tariff protection are already low.

The absence of a common external tariff, however, will encourage smuggling, and as long as the tariff structures are different and there is a substan-

tial proportion of trade among the member countries of the free trade area, this could give rise to differentiated levels of protection and incentives which would favour inefficient allocation of investments among the countries. Geographical proximity of the countries would increase the possibilities of smuggling, while the importance of a differentiated incentive structure would increase if the structures of production were similar and interdependent. Since both phenomena would tend to be more important among the member countries of existing integration groupings,¹⁰ There would be appear to be more justification for the establishment of a customs union among some of these countries than at the continental level, since the distances and differences are greater and reciprocal trade is on a smaller scale. A common external tariff would also help to strengthen the image of joint negotiation, although a free trade area can also serve as a basis for this type of negotiation. Various groups have already set precise dates for the adoption of agreements on common tariffs as well as on free trade in goods (table 2).

Table 2
SUBREGIONAL INTEGRATION
TARGET DATES

	Common external tariff	Free trade in goods
MERCOSUR	1995	1995
Andean Group	1995	1992
Central American		
Common Market	1993	1992
CARICOM	1991	1991

Source: ECLAC (1991b): *La evolución reciente de los procesos de integración en América Latina y el Caribe* (LC/R.992), Santiago, Chile, 15 April, and data published in the press.

The nearest deadlines are in the case of CARICOM and the Andean Group, although there have been some delays with regard to the common external tariff of CARICOM, on which agreement was due as from 1990. In Central America, it has been agreed to establish a common external tariff with a ceiling of 20% and a minimum of 5% before 31 December 1992.

¹⁰The biggest differences would appear to exist within MERCOSUR, where there is some degree of contrast between the scale and degree of openness of Uruguay and Paraguay on the one hand, and Brazil on the other.

⁹In practice, it may be very difficult to determine when a non-tariff barrier is *not* discriminatory, since there may be different criteria for defining situations of equivalent treatment. In the case of quantitative restrictions, in particular, equivalent treatment may be based on the maintenance of market quotas, global licenses for importers, import permits made available to the first importers who apply for them, or the auctioning of permits or licenses on the free market.

4. Trade with individual member countries of the North American Free Trade Area or of the region

Although the formation of subregional groups might be seen as the only step before integration with the United States, consideration should also be given to the possibility of various combinations, including intermediate or simultaneous stages in this process. These could involve integration among existing subgroups or the integration of subgroups with the North American Free Trade Area, individual Latin American and Caribbean countries, or individual member countries of NAFTA.

Potential examples of the latter approach are the framework agreement jointly negotiated by the member countries of MERCOSUR with the United States, the agreement to set up a free trade area between Mexico and Central America by 1996, and the commitments for the establishment of a free trade area among Mexico, Colombia and Venezuela for 1992. In the case of adjoining countries, the tariff levels of the participating countries take on greater importance, for the reasons already explained earlier.¹¹

The recent integration process based on the establishment of free trade areas shows the desirability of organizing the subregional groupings on a flexible basis in order, in particular, to facilitate the entry of new member countries into the existing groupings. This would also avoid or reduce the costs due to the proliferation of discriminatory arrangements and their administration, since all the countries would have the same sense of direction aimed at furthering trade liberalization and the development of the international competitiveness of the participating countries.

In the case of the countries which are beneficiaries of the Caribbean Basin Initiative, it could also be important to expand the geographical scope of their negotiations to include an agreement with NAFTA. Although they already have some significant access to the United States through the special

preferences they enjoy, the same is not true of the Central American countries' trade with Canada or that of the Central American and Caribbean countries with Mexico. The agreement between Mexico and Central America which is scheduled to come into effect in 1996 could be partially equivalent (although on a broader scale, since it involves a free trade area based on a certain degree of reciprocity) to the preference scheme which Canada already has with the Caribbean.

Negotiations similar to those of Central America with Canada and the Caribbean with Mexico would form a convergent process aimed at establishing a free trade area involving most of the Northern Hemisphere American countries. The small size of these two subregions should facilitate their entry into NAFTA. This access to the expanded North American market would at least partly compensate for the erosion in their preferences with the United States (and also, in the case of the Caribbean, with Canada) caused by the establishment of NAFTA, and it would be an element which should be given emphasis in the negotiations,¹² including those with the United States aimed at obtaining greater security and access for the most important export products of Central America and the Caribbean, such as textiles, leather goods, sugar and meat.

In discussing future relations with NAFTA, it would be desirable to evaluate various access paths which could assume different forms depending on: a) the possibility of reaching agreement with all or some of the members of NAFTA or b) joint or individual action by countries seeking to reach agreement with the NAFTA members. Chile could be an example of individual action whereby, after reaching an initial agreement with Mexico, it would proceed to negotiate an agreement with the United States or with NAFTA as a whole. The Central American countries would appear to be following the same path, but on a collective basis and with a greater time lag. MERCOSUR and CARICOM would appear to be favouring joint negotiations with the United States which could eventually lead to an agreement with NAFTA. The bargaining power, the

¹¹It would be possible, for example, to imagine a hypothetical situation of trade creation in which, *ceteris paribus*, the country or group of countries with higher tariffs (such as the Central American countries, for example) would import products from a member of the customs union with lower tariffs (Mexico), which in turn would supply part of its market through imports from a third country (the United States), without all this trade being affected by the application of rules on origin.

¹²This could be expected to give rise to a triangular negotiating effect: the concessions granted by the United States to Mexico would be linked with the concessions which Mexico would give to the Central American countries, which would thus be compensated for the erosion in their preferences with the United States due to the Mexico-United States agreement.

speed with which agreement is reached, and the costs of the transaction will vary in each case, depending on the path followed, but in all cases the content of a clause permitting access to NAFTA would appear to be of fundamental importance.

5. Trade barriers against third countries

The Enterprise for the Americas may be interpreted as the recognition and desire for consolidation on the part of the United States of the gradual process of economic liberalization, including trade liberalization, which has been carried on in most of the countries of Latin America and the Caribbean.¹³ It may be seen as representing a credit which had hitherto been denied at the multilateral level, despite the pleas of the developing countries in this respect (Inside U.S. Trade, 1991; Whalley (ed.), 1991, pp. 75 and 76).

An important cost of the hemispheric preferential trade liberalization agreement would be the diversion of the flow of imports from outside the region, which would mean importing North American, Latin American and Caribbean goods that would cost more than goods from outside the region, net of tariffs. The greater the margin of preference given to hemispheric products through protection against third countries, the higher the cost of this diversion, which would also depend on the proportion of imports coming from third countries. Reducing this cost would mean lowering tariffs and/or eliminating non-tariff barriers affecting imports from third countries. If this continued to be difficult to achieve at the multilateral level, this would justify negotiations with other blocs, provided these gave due credit for the unilateral liberalization of trade by Latin America and the Caribbean. It would therefore be necessary for the subregions and the individual countries of the region to group themselves together in order to negotiate jointly with other countries or blocs such as Japan and the European Community.

Table 1 gives a broad idea of the relative magnitude of the cost of diverting trade for each integration subgrouping in Latin America and the Caribbean in general. These costs would tend to be

less, *ceteris paribus*, in the Central American and Caribbean countries, where the proportion of imports from outside the region comes to approximately 33% of total imports, but in the MERCOSUR countries this proportion is significantly higher, amounting to some 55% of their total imports. The Andean Group countries, for their part, would be in an intermediate position, with a figure of 41%. This would mean that MERCOSUR, followed by the Andean Group, would be the groups of countries which, in view of the higher potential costs of a discriminatory hemispheric agreement, should have more interest in negotiating reciprocal trade liberalization agreements with other groups of countries.

C. Rules affecting trade

The multilateral trade negotiations carried on in GATT are an illustration of the difficulties encountered in reaching agreement on such issues as subsidies, countervailing duties and safeguard clauses. They also reflect the growing importance being attached to environmental issues. At the same time, the problem of the origin of goods becomes a central issue in the event of the establishment of a free trade area. Together, these issues involve rules which have an increasing effect on trade, so that it is necessary to define the contribution that subregional integration should make to each system of rules. This is dealt with in the following sections.

1. Subsidies, countervailing duties, and antidumping practices

The fact that the United States is the country which most frequently applies countervailing duties to exports receiving subsidies, the absence of any common definition of subsidies within GATT (although there is an international code of conduct on them), the pressure on fiscal resources, and a certain tendency to use the threat of countervailing duties ("harassment") as a protectionist practice, justify the view that it is inadvisable to use direct subsidies to promote exports (Finger and Nogués, 1987). A step forward in this direction would be the elimination of subsidies on Latin American and Caribbean exports to member countries of subregional groupings, as indeed is already the case in

¹³According to Myles Frechette, the Enterprise could not have been conceived without the impressive commitment to economic reform, liberalization and democracy undertaken in recent years by each of the Latin American nations (Frechette, 1991).

such areas as Central America, since this would avoid conflicts between exporters and domestic producers and controversies over incentives in the region (Fuentes and Villanueva, 1989, p. 180).¹⁴

The possibility of suffering the application of countervailing duties would also be reduced if public expenditure were channelled towards indirect subsidies aimed in particular at strengthening human capital, such as training, advisory assistance and technical research and development: areas for regional or subregional action in which significant economies of scale can be achieved and the recent arguments in favour of selective stimuli can be applied.¹⁵ At the same time, it would be necessary to *keep up* the negotiations on subsidies and countervailing duties in GATT, where the advantages of a multilateral environment for the weaker countries are clearly evident. Furthermore, in the negotiations on this issue the confrontation is fundamentally between the United States and the other countries (including the developing countries, Japan and the European Community),¹⁶ in contrast with regional or bilateral negotiations with the United States, where the region's negotiating power might be smaller.

At the same time, it would be necessary to take into account the possibility that the *imports* of Latin American and Caribbean countries might be affected by subsidies and trade practices warranting the application of countervailing duties or antidumping practices. This could be particularly important in the case of agricultural products. Adopting strict legislation in this matter would be in keeping with a position calling for the elimination of subsidies as an export promotion instrument, but it would be necessary to take into account the effects of this position on consumers and the possibility that it would merely amount to yet another instrument of protection. Thus, a

code on antidumping practices or countervailing duties applied jointly, as proposed in the case of MERCOSUR or the Central American Common Market, while having the advantage that it is an instrument against the use of subsidies that distort trade, may also possibly mean higher-priced intra-regional imports.

In general, when implementing agreements on countervailing duties or antidumping practices it would be necessary to compare their costs and benefits in the light of two effects: those resulting from the prevention of subsidized imports and those resulting from the need to pay more for imports. It would have to be borne in mind that in the case of subsidized imports, the distortions resulting from having to pay more for imports might affect only consumption and not production, since exports might be produced more efficiently by a country which does not subsidize them, as in the case of Argentine agricultural products compared with those of Europe. At the same time, it is obvious that it would also be necessary to evaluate the political effect of joint action of this type on the international use of subsidies, especially in the light of the multilateral trade negotiations within GATT.

The application of countervailing duties and antidumping practices makes it necessary to define suitable machinery for settling disputes arising over them. At the subregional level, such machinery would help to reduce the likelihood of unilateral action, and its importance as a precedent at the inter-American level would be increased by the fact that the history and legal background of most of the countries of Latin America and the Caribbean are different from those of the United States and Canada. The subregional action could be aimed at advancing towards the use of the multilateral machinery of GATT in these matters, which would call for an increase in GATT's capacity to impose sanctions, so that it could effectively help to prevent unilateral action by more powerful countries.

2. Safeguard clauses

The United States and other developed countries have generally preferred to impose *bilateral* restrictions on imports instead of applying Article XIX of GATT on safeguard clauses, which, unlike

¹⁴The elimination of subsidies which would tend to give rise to countervailing action at the international level does not rule out the possibility of granting export credits, which could also include subsidized interest rates.

¹⁵I refer to the growing academic literature on strategic trade policy, especially the possible justification of tariffs or subsidies aimed at developing incipient national industries of a strategic nature and policies for altering the distribution of monopoly gains. See, for example, Krugman, 1987.

¹⁶While the United States tends to emphasize the need for discipline with regard to subsidies, the other countries emphasize this need with regard to countervailing duties.

countervailing duties and antidumping practices, must be applied without discrimination and are subject to compensation. Since they are an alternative to other discriminatory measures, the relative reluctance to apply safeguard clauses has its counterpart in the application of various other discriminatory trade barriers, such as voluntary export restrictions, market management arrangements, and sectoral agreements.

Since the United States Government aims to apply safeguard measures in NAFTA which are broadly similar to those applicable to Canada (United States, 1991), the free trade agreement with that country, which provides for a dual means of application of safeguard measures, assumes importance as a precedent. It provides, on the one hand, for the use of Article XIX of GATT, which is not discriminatory, but it excludes its application to Canada when the latter country's exports are not "substantial" or do not make an "important" contribution to the damage done, and on the other hand it provides for bilateral procedures involving restrictions that can be applied for a maximum of three years in cases of "serious" damage. From the point of view of Canada, this limit of three years and the possibility of being excluded from the general application of safeguard measures represent concessions obtained in its negotiations with the United States, but the controversial definition of "damage" remains subject to the interpretation given to the laws of the United States (Kymlicka, 1987).

The application of safeguard rules at the level of NAFTA as a whole could be interpreted as a tendency towards the regional application of this type of restrictions, with the consequent likelihood that the United States will seek to apply them to the free trade areas with the Latin American and Caribbean countries in general. It would be necessary to take account not only of their implications for access to the North American market and the concessions won by Canada in this respect, but also their effects as instruments of protection in Latin America and the Caribbean, while it would also be necessary to consider the possibility of signing prior subregional agreements in keeping with the conditions of the countries making up the area.

The latter action could form part of a gradual process of accumulation of precedents, begun at the subregional level but supplemented with active

negotiations at the multilateral level; at the same time, the application of safeguard measures should be subject to independent and transparent appraisals of the alleged material damage and should be based on the use of temporary restrictions, preferably *ad valorem* tariffs.¹⁷

3. Rules on origin

There is a danger that there may be considerable broadening of the criterion on which the use of rules on origin is normally based: namely, to prevent the diversion of trade due to tariff differences among the countries making up a free trade area. The importance attached to rules on origin by the United States in the free trade area with Mexico is due basically to the possibility that that area could serve as a means for the indirect introduction of goods from Japan and South East Asia, but the degree to which such goods are subjected to processing in Mexico is an important issue for debate.

There are four considerations which should be taken into account here. Firstly, the looser rules on origin are, the smaller will be the amount of diversion of trade resulting from a free trade area, since such rules are equivalent to additional measures discriminating against trade with third countries. At the subregional level, rules on origin which demand high national or subregional content may strengthen the diversionary effects of a high external tariff. Secondly, and as part of the foregoing, rules on origin which are applied very strictly may have a frankly protectionist nature and may serve to restrict the access of exports of a member country of the free trade area to another country. This occurred, for example, in the case of the free trade agreement between the United States and Canada, with regard to textiles and clothing. Thirdly, in the case of rules on origin which implicitly discriminate according to the origin of the capital involved, the determining criterion would seem to be whether or not oligopolistic rents (and wages that incorporate such rents) are obtained, since alternative rules on origin based on the degree of processing or added value could mi-

¹⁷There are also other safeguard mechanisms which are not analysed in this article. The best known of these is probably that which permits the application of restrictions on imports for balance-of-payments reasons, as provided for in Article XVIII-B of GATT (GATT, 1985).

nimize the impact of trade on direct and indirect employment.

Finally, the fact that the weaker economies generally have less capacity to export products with a higher proportion of added value or national inputs would imply that very strict rules discriminate against such countries. This would therefore justify the application of rules on origin which are not excessively strict at the subregional level, and this, as in the case of other issues, could have some importance as a precedent with regard to hemispheric integration.¹⁸

4. *Public sector purchases*

The formal proposals made in the past that public sector purchases should be used to promote integration, especially within ALADI or the Central American Common Market, have not been put into practice. This has been due to the higher cost of imports from countries of the region compared with those from the rest of the world, which are also often available on more favourable financing terms or with direct subsidies: a consideration which has been all the more telling in view of the deterioration in the fiscal situation of the governments concerned. In some infrastructural projects, however, preferential treatment has been given to construction and engineering enterprises of the region, and this shows the possibility of using public sector purchases as an instrument that can serve, through common rules and co-investment agreements, to promote the generation and absorption of technological externalities at the regional or subregional level. There are also some concrete examples of joint purchases of goods, as in the case of purchases of medicines by the social security institutions of the Central American countries, in order to reduce costs.

The costs and benefits associated with subregional or regional action in this field have their counterpart in the multilateral regulations reflected in the GATT code of conduct on public sector purchases, which calls for the extension of "national treatment" to imports of goods (but not services)

¹⁸The possibility of using rules on origin of a cumulative nature, which treat value added in neighbouring countries or in member countries of integration schemes as though it was national value added would, for their part, reduce the likelihood of diversion of intra-Latin American or Caribbean trade within a hemispheric integration scheme.

from GATT members, thereby expanding the access of such exports to new markets. The code only applies to purchases over a certain level made by Government institutions which are explicitly subject to the code as a result of negotiations providing for the exchange of concessions. In the case of the agreements by the United States with Israel and Canada, national treatment is extended to the same institutions, but for a total value of purchases below the threshold level agreed upon in GATT.

At the subregional level, an alternative worth considering could be the signing of agreements with a limited number of institutions in respect of a similarly limited number of products or services, and with lower threshold figures, in sectors where the positive effect of the resulting technological externalities would be greater than the possible negative effect of the costs resulting from the higher-priced imports. At all events, this is an important instrument for promoting selective cooperation relations among Latin American enterprises which are competing with each other and among technological research and development enterprises and bodies. It also involves expediting the exchange of information in order to create possibilities for joint purchases. Subregional integration action in this field and the eventual incorporation of Latin American and Caribbean governmental bodies under the GATT code of conduct would be compatible with these objectives, provided that the subregional action was in keeping with one of the following conditions: that it should cover services, extend preferential treatment to a threshold level lower than that applied at the subregional level, or include different institutions in both agreements. Similar considerations would also be valid at the inter-American level.

5. *Natural resources and the environment*

Joint treatment of the issues of natural resources and the environment is justified not only by their political importance in general, but also by their growing incidence on trade. This has been reflected in the negotiations between Mexico and the United States on specific problems such as tuna-fishing; in the concern of North American ecological groups about the links between investment and trade and the environment; in the reintroduction of the issue in GATT as a result of an initiative by the

EFTA countries; in the danger that arguments in favour of the environment may be used as instruments of protection; and in the very significant potential incidence of environment regulations on trade (Whalley, 1991). In addition, it is necessary to bear in mind the abundance of natural resources in most of Latin America and the importance of the question of the access to their exploitation, which is a central issue in the negotiations between the United States and Canada on the liberalization of restrictions on foreign investment.

Within subregional integration, little has been done in this area, with the possible exception of proposals for border integration aimed at the joint exploitation of the resources of shared regions. The fact that this is a new area gives the region ample scope for taking initiatives, and this opportunity must not be wasted. Regulations and incentives aimed at preserving the environment and promoting the sustainable utilization of natural resources can have two implications. Firstly, the fact that in Latin America and the Caribbean higher relative priority is given to the sustainable exploitation of natural resources (an item relevant to the level of living) than to protection of the environment (which is relevant to the quality of life) is reflected in a market for goods and services for environmental protection which has its own special features and can largely be supplied by the more industrially advanced countries of the region (ECLAC, 1991c, pp. 89-90). The establishment of demanding standards and suitable incentives could facilitate the transformation of the various subregional markets into bases for exporting to the rest of the world. Because of the special features and greater requirements of the region, the equipment and services in question could have a certain competitive advantage which could enable them to fill some niches in the international market. Secondly, in this context the increasingly high social value attached to environmental rules on products, production processes and raw materials could convert them into an instrument for the differentiation of natural resource-based products which could be useful in international markets where there is only sluggish demand (ECLAC, 1991d, p.30).

Furthermore, the use of certain common standards, possibly combined with the application of taxes in the case of exports of non-renewable natural resources in order to reflect their opportunity cost, would tend to be more compatible with a type of trade governed by transparent rules than the use

of various direct controls of national origin. However, environmental policies or regulations involve a very high demand for information, and serious problems of concertation among the countries may be expected when it becomes necessary to tackle specific regulatory aspects, as the experience of the European Community has shown (ECLAC, 1991d, pp. 111-112).

Consequently, an intensive prior process of research, discussion and interaction would be called for among the public and private agents connected with environmental matters in the various countries in order to be able to progress towards the establishment of common rules and incentives at the subregional or regional level. The execution of joint research work and the exchange of information by universities, technological institutes and consultancy enterprises of the various countries could therefore serve as a basis for the adoption of coordinated or joint policies by the subregions concerned. Such initiatives could be strengthened by interaction with entrepreneurs of the region who might wish to participate in them in order to take advantage of the expected dynamic regional market for environmental goods and services, and this would contribute both to the export of such goods and services outside the region and to the export of natural resource-based products which might be used as inputs.

D. Factor mobility

The establishment of a free trade area at the hemispheric level, with the consequent expected liberalization of trade in services and foreign investment, would facilitate the mobilization of "factors"; indeed, strictly speaking one should not speak of a "free trade area" but should rather have in mind something more ambitious such as an "expanded economic space".

Likewise, the fact that trade in services often implies the mobility of factors, including capital, and that direct investment of foreign capital involves the exploitation of technological assets subject to various degrees of legal protection, highlights the close links that exist between services, foreign investment and intellectual property. It may also be expected that the United States will assign particular priority to the achievement of agreements with the Latin American and Caribbean countries in these areas, where the negotiations at

the multilateral and hemispheric level are interdependent.¹⁹ The role of subregional integration in this context is analysed below.

1. *Services and mobility of labour*

In view of the "non-accumulative" nature of most services, their provision involves direct contact between suppliers and users, which may involve the mobility of both these agents and, in the case of the supplier, calls for the mobility not only of capital but also, at least temporarily, of various types of labour.²⁰ This explains the importance of the right of establishment as a fundamental conditioning factor in the trade in services, although this right must also be accompanied by provisions permitting at least a minimum of mobility of skilled labour.

While the United States tends to emphasize the importance of the right of establishment in a restricted sense, minimizing the contribution of labour and stressing rather the contribution made by capital or foreign direct investment, in seeking to promote the integration of services at the subregional or regional level it is necessary to attach importance to the contribution made by labour of varying levels of skills. While recognizing the mass of difficulties and special situations involved in the harmonization of the regulations on services of very different types, it is nevertheless necessary to promote their liberalization (for example, of engineering and construction enterprises) at the regional or subregional level by assigning at least as much priority to the mobility of skilled or semi-skilled labour as to the intra-regional mobility of capital. Even-handed treatment of the mobility of capital and of labour deserves close attention in this context. This would be fully in line with the promotion of the generation and absorption of technological externalities and the establishment of some precedents in the matter of services; furthermore, it would be in keeping with the conditions of the region, and it could help to strengthen the region's bargaining position on these issues.

¹⁹Myles Frechette states that the United States hopes that the success of the Uruguay Round will establish basic international standards for trade in services, protection of intellectual property rights, investment yield requirements and other equally important areas, which would considerably facilitate the negotiation of free trade agreements in the hemisphere (Frechette, 1991).

²⁰As Bhagwati (1987) notes, there are also some accumulative cross-border services, such as data transmission, and others which involve the mobility of the consumers, such as tourism.

Just as in the case of trade in goods, the diversion of trade that could result from more favourable treatment for North American or regional suppliers compared with those from the rest of the world could also be important in the case of services. This would be particularly so in the case of producer services, which are in the nature of an intermediate input²¹ and could therefore affect the competitiveness of exports. Consequently, in the event of the existence of regulations or restrictions on the supply of external services, liberalization of the conditions regarding the right of establishment would also justify some liberalization of the regulations affecting third countries, in order to minimize the costs due to diversion, or else there should be rapid negotiations with such countries in order to obtain some concessions in exchange for such liberalization.

It has also been argued that in view of the relatively limited benefits that the United States would obtain from the free trade agreements in the field of trade proper, its main objectives are likely to be centered on obtaining concessions in the area of services, foreign investment and intellectual property (Helleiner, 1990). These tactics would be in keeping with the position initially maintained by that country with regard to the Uruguay Round: namely, making concessions over goods in exchange for the incorporation into GATT of the issue of services, foreign investment and intellectual property. In view of the foregoing, the need to set up subregional or regional precedents becomes important when the scanty past experience with regard to services in the subregional integration schemes (with the partial exception of CARICOM) (ECLAC, 1988) is contrasted with the gradual process of establishing rules on trade in services promoted by the United States. Thus, the free trade agreement between the United States and Israel includes a "framework treaty" on trade in services, with a commitment to hold negotiations on the rules applicable to services, and the later agreement with Canada covers the major part of trade in services, providing for the right of establishment and national treatment, although the "cultural" industries (radio, television, publishing and recording) are excluded. Some recent initiatives such as the liberalization of air transport in the Andean Group and the

²¹With regard to the relation between some services and competitiveness in Latin America and the Caribbean, see ECLAC, 1990b, pp.137-143.

active position taken by Latin America and the Caribbean in the Uruguay Round on the subject of services, together with their initiatives in this respect,²² provide a solid basis for future understanding on these matters.

2. Intellectual property

It is obvious that the United States Administration assigns great importance to the controversial issue of intellectual property, including in particular the protection of pharmaceutical patents, and it is equally clear that the basic motive behind foreign direct investment is to internalize a number of economic relations in order to ensure the exploitation of that country's technological assets (Helleiner, 1988). Consequently, considerable importance is assumed by the need for policies or regulations that will facilitate a certain amount of dissemination of technology (in such areas as management and marketing, for example), even though they may not concern the central technological asset (such as production technologies or specific processes) of the foreign firm.

Various countries are already in the process of modifying their legislation on intellectual property. In this respect, there is every justification for harmonizing such legislation at the subregional level. This could guarantee the exploitation of the technological assets of firms within certain time limits, thus giving greater security. At the same time, however, it would be desirable to promote the use of technological externalities through the dissemination of information on patents among businessmen and the stimulation of related activities which could include, for example, the proposals on science and technology made by the Andean Group with regard to the Enterprise for the Americas (SELA, 1991a). The Andean Group, whose subregional rules on various aspects of intellectual property are currently under review, could serve—like the European Patents Office—as an example of integration in this field, backed up by a parallel process of negotiation on these issues in the relevant multilateral forum.

3. Foreign investment

Secure access to the North American market, and, in more general terms, the gradual establishment of

a hemispheric market for goods and services, would lead as one of its main effects to the expansion of foreign investment both from inside and outside the region. The experience of the European Community, which has registered a significant increase in foreign investment in mergers, acquisitions and agreements for joint operation with an eye to the 1992 unified market, shows what could happen in an expanded Latin America and Caribbean market (OECD, 1990, p. 8). Its effects are contradictory, however. On the one hand, it makes it possible to take advantage of—and is itself part of—the economies of scale in production, marketing and technological development which imply greater efficiency and competitiveness and are an inherent part of any integration process, but on the other hand, it also implies the possibility of restrictive trade practices which run counter to efficient resource allocation and could prejudice consumers or involve restrictions on exports, among other effects.

It is necessary to draw a distinction, in this context, between the regulation of foreign investment in general and the more specific rules on requirements with regard to national content and exports which are the subject of negotiations promoted by the United States inside and outside GATT. With regard to the first of these, the Enterprise for the Americas provides for resources to stimulate reforms aimed at facilitating foreign and national investment, and this could serve as an opportunity for harmonizing legislation at the subregional level, which, as well as reducing the costs associated with the interpretation of different laws, would give investors greater security by reducing the probability of unilateral changes in a particular country's legislation. The possibility of establishing investment contracts which have a common format could be a step in this direction. This would have to be compatible with legislation to promote the establishment of multinational enterprises of a subregional nature, such as the special regime for CARICOM enterprises.

At the same time, it would be necessary to evaluate the complex relations which exist between trade-related investment measures (TRIMS), which are under negotiation in the Uruguay Round, the restrictive trade practices of transnational corporations, and rules on origin which discriminate according to the nationality of an enterprise's capital.

²²See in particular SELA (1990).

It should be hoped, for example, that the liberalization of (public) export requirements would coincide with the (private) elimination of restrictions on exports (through technology transfer agreements, for example) and with the elimination of rules which (as in the case of the North American agreements on motor vehicles, which lead to the *de facto* exclusion of Japanese and European investments) operate in practice as rules on origin based on the criterion of the national origin of the capital.

E. Institutional arrangements

In view of the existence of technological externalities, it is considered appropriate to refer below to some features of institutional arrangements which could promote the generation and appropriation of such externalities. Some requisites of public integration institutions are also identified in the light of the foregoing.

1. Arrangements for promoting innovation

A distinction must be drawn between two types of institutional action or cooperation which could help to promote the generation and appropriation of technological externalities: arrangements based on sectoral criteria, and those based on criteria of a geographical nature. In the first case, what would be involved would be the promotion of joint action in sectors where countries share the view that priority should be given to the aim of achieving or maintaining levels of technological excellence. This action would represent the points of convergence of areas subject to selective technological policies at the national level, and could take the form of strategic alliances between enterprises and governments, while it could also include cooperation in research and development activities at a pre-competitive level, or cooperation in the areas of technology, production or marketing between enterprises which do compete with each other. The relations between the enterprises could be either vertical (supplier/user) or horizontal (common use of technological, financial, information or marketing services), normally in connection with particular integrated production systems.

Since natural resources and relatively low-cost labour (skilled or not) may be considered as the

fundamental sources of the competitiveness of Latin America and the Caribbean, in principle there would be a good deal of justification for favouring strategic alliances between enterprises, or between enterprises and governments, to promote the generation and assimilation of technological externalities involving these two factors. Potential examples of such arrangements would be the agreements by Brazil and Argentina on biotechnology, the Latin American Association of Capital Goods Producers (ALABIC), and the possible arrangements between entrepreneurs and bodies of various countries for the supply of goods and services relating to the environment.

Secondly, it could be particularly appropriate to seek arrangements designed to take advantage of geographical and cultural proximity, which, when accompanied by similar structures of production and the same or very similar availability of natural resources, would serve to stimulate an intensive and high-quality interaction between the various agents responsible for production and innovation. Arrangements which, in the case of industrialized or large countries, would involve the establishment of *national* systems of innovation, would probably need to be adapted to promote the establishment of *subregional* systems of innovation sharing the same well-defined sense of direction, combined with a high degree of local autonomy. These systems could be made up of various nuclei or conglomerates of enterprises and institutions with national or subregional bases of operation, depending on the scale of the industries, countries or subregions in question. A typical example of a component of a subregional system of innovation would be the University of the West Indies in the Caribbean (ECLAC, 1990b, p. 167).

It should be emphasized that arrangements based on sectoral criteria are a necessary but not of themselves sufficient condition for promoting the development and application of technical progress. Only in the presence of an effectively expanded, secure and liberalized market which stimulates competition and the need to apply innovations could these arrangements become sources of technical progress effectively applied to regional production. Arrangements based on geographical criteria, for their part, would strengthen the effects of sectoral institutional arrangements and a competitive market but would not of themselves be a sufficient or necessary condition for this.

In the case of both institutional arrangements of a sectoral nature and those of geographical origin, there would be room for agreements on common rules or standards, preferential public sector purchases, financial institutions which facilitate the conversion processes and give wide dissemination of information on their features, subsidies for projects in which several enterprises participate, and legislation favouring the mobility of skilled personnel between countries. Generally speaking, and in view of the fact that the cost of establishing a close (strategic) cooperation relationship between enterprises is considerably reduced once that relation has been established, especially when initial relations of competition exist, there would be justification for giving temporary public incentives to promote progress in this direction.

2. Public institutional arrangements

In the light of what was stated in the foregoing sections, the subregional integration institutions should be reformed in two ways. Firstly, their technical capacity for international trade negotiations should be strengthened, bearing in mind the links between the subregional, hemispheric and multilateral negotiations and the economies of scale resulting from the joint procurement and processing of information, as well as joint technical work. Secondly, steps should be taken to increase their capacity to arrive at agreements with the public and private sectors, including the achievement of agreements aimed at furthering innovation.²³ This latter objective would call, in particular, for an increase in their capacity to handle the coordination of technological development at the sectoral and subregional level.

The above reforms would involve internal reorganization and measures designed to give the institutions greater flexibility and capacity to provide a rapid response, together with information facilities which would permit the ongoing exchange of information among institutions, between them and their governmental forums, and between both of these areas and the productive sectors. This exchange of information could reduce the uncertainty regarding what each country, group of countries or group of entrepreneurs plans to do, thereby facili-

tating collective action. Reforms might also be needed in the intergovernmental forums governing these institutions, so as to secure the direct involvement of the national authorities responsible for inter-American and multilateral economic negotiations and to ensure that national priorities with regard to competitiveness are reflected in these forums.

F. The process of transition

With a reduction in the diversion of trade, accompanied by more efficient resource allocation due to the creation of trade and more demanding and competitive markets, a process of transition involving substantial costs may be expected. One potential negative effect of the establishment of a hemispheric free trade area would be the elimination, as a result of trade liberalization, of incipient, recently established or developing industries whose failure or elimination because of their currently negative performance would not be justified if account were taken of their higher performance in the long term. The same would be true of the failure of established industries which, if there were a longer transitional process, could turn themselves into competitive industries. Because of the imperfections in capital markets, or simply the unsuitable policies applied in the past and the absence of reliable information on what will effectively happen with regard to various industries or firms in the future, the elimination of certain industries may be seen as one of the costs (and not one of the benefits, associated with better resource allocation) of the liberalization process.

In addition, there will generally also be a process of transition which involves the reallocation of investments and labour to new activities, but with a certain delay. This will mean temporary unemployment, which is an issue of importance not only for Latin America and the Caribbean but also for the United States and Canada. Thus, a sudden process of trade liberalization may, in the short term, require very large amounts of financial resources in order to facilitate the process of adaptation and training of labour and the conversion of enterprises which could eventually become competitive, as may be seen from the case of East Germany.

²³With regard to the relation between innovation and institutions, see Pérez (1989).

Prior subregional integration could facilitate this transitional process by three means. To begin with, the liberalization of trade in goods and services within the subregions and possibly between some of them would represent a prior transition which, because of its smaller geographical coverage, would involve, *ceteris paribus*, a smaller need for adjustments than at the hemispheric level.

Facilitating *gradual* transition may also be negative for Latin America and the Caribbean, however. In the free trade agreement between Mexico and the United States, the Administration of the latter country foresees transitional periods—even longer than the periods of up to ten years provided for in the agreement with Canada—in order to facilitate the adjustment of its industries and the adaptation of its workers in some sectors considered to be sensitive to imports, as well as providing for the application of safeguard clauses in the event of increased imports which damage local production (United States, 1991). Since there is some reciprocity at the hemispheric level, the scope and duration of the transitional process should be such as to ensure effective access within a fixed term in order to avoid an indefinite transitional process which might result from perverse application of such reciprocity.

The second form of contribution of the subregional integration processes, then, would be to ensure rapid transitional processes at the subregional level, as a precedent, and to help, through negotiation, to define transitional processes which are not incompatible with subsequent firm and secure access to the North American market.

The third potential contribution by Latin American and Caribbean integration could be in the area of reciprocity. It should be borne in mind that the negotiations between Latin America and the Caribbean and the United States will involve reciprocity, even though this may not be on a totally even-handed basis. The achievement of such reciprocity would give greater security to the trade concessions obtained, because there would be North American export interests which would benefit from the agreement by gaining access to other markets and which would form a pressure group in favour of keeping the North American market open. In more general terms, reciprocity directly links the current actions of a country with the benefits that may be expected in the future, thus reducing the advantages of possible unilateral abandonment of what has been agreed upon and improving the prospects for cooperation. Where there are different levels of development, however, rapid simultaneous liberalization may be prejudicial to the country of lower relative development involved. In this respect, prior agreements among groups of countries in Latin America and the Caribbean can be used to establish precedents with regard to reciprocity: Venezuela's offer to open up its market to the exports of the members of the Central American Common Market and CARICOM in the short term in exchange for *subsequent* liberalization of the Central American and Caribbean markets could be useful when the moment comes for reaching agreement on liberalization between the various countries of Latin America and the Caribbean and the United States and Canada.

V

Conclusions

On the one hand, subregional integration can serve as a precedent for subsequent non-discriminatory agreements, while on the other it can create favourable conditions for growth on the basis of greater efficiency and competitiveness, as well as promoting national and foreign investment. As far as the relationship between subregional and hemispheric integration and the multilateral trade system is concerned, it must be acknowledged that

both of them involve more than one exception to the GATT rules if evaluated in line with the terms of Article XXIV on customs unions and free trade areas. Not only may they have effects which go beyond the (static) reallocation of resources on the basis of the criteria of creation and diversion of trade laid down in that article, but they also involve a number of economic policy instruments extending from a wide range

of non-tariff barriers to regulations on services and foreign investment.

Although some subregional arrangements on subsidies, countervailing duties, antidumping practices, safeguard clauses and rules on origin may serve as negotiating instruments within the inter-American and multilateral trade negotiations, an effort should be made to ensure that the corresponding agreements are not excessively restrictive, since if that were so they would constitute favourable precedents for the use of such instruments as protectionist measures at the international level, as well as having a negative effect on efficiency. The establishment of precedents with regard to services, foreign investment and reciprocity may be of particular importance, without necessarily having protectionist implications.

On the other hand, it would be useful to promote the reciprocal strengthening of subregional integration actions and negotiations at the hemispheric or multilateral level, with a view to ensuring the achievement of arrangements that could later become non-discriminatory agreements at the international level. This would depend on the particular issue involved, however, since there may be greater affinity between subregional integration and hemispheric integration in some cases (recognition of unilateral liberalization as a credit factor in favour of the countries of the region in their negotiations, and liberalization of the trade in agricultural products, for example), whereas there may be more affinity between subregional integration and the multilateral trade negotiations in others (countervailing duties).

With regard to the contribution of subregional integration to competitiveness, there is an obvious need for the existence of a certain degree of prior macroeconomic stability. Once this has been achieved, it would be possible to progress towards the establishment of competitive subregional markets through the liberalization of intra-regional

trade, the elimination of non-tariff barriers, and the establishment of standards in keeping with a demanding market. In order to reduce the costs due to trade diversion, it would be worth carrying on negotiations with such areas as Japan and the European Community in order that they, like the United States, should give due recognition to the process of unilateral liberalization which has already been carried out in Latin America and the Caribbean.

The standardization of certain environmental regulations could help to establish demanding subregional markets which would facilitate intensive intra-regional trade in environmental goods and services, thus creating a base for future exports to the rest of the world. Likewise, common legislation on foreign investment and intellectual property, together with arrangements on the provision of services which facilitate the mobility of skilled labour, could favour the development of competitiveness. This could also be promoted through institutional arrangements of a subregional nature which, on the basis of sectoral or geographical criteria and the stimulus of competitive and demanding subregional markets, could promote the establishment of stable vertical and horizontal relations among enterprises and bodies of importance in the generation and dissemination of technology in the region, in order to further the generation and appropriation of technological externalities. In line with this, it would be desirable to endow the subregional economic integration bodies with the necessary capacity for promoting agreements among the various enterprises and bodies, while at the same time strengthening their capacity to manage or promote the coordination of subregional technological development action. This could also be combined with the strengthening of their technical capacity in the area of the international trade negotiations and the adaptation of their governmental forums to the new tasks.

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