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Introduction

For ECLAC, integration is both a foundational and a constantly renewed topic, since it formed part of the recommendations which the institution made to the Latin American countries from its earliest years. The circumstances then were different, but the main concern, then and now, was the enhancement of the regional economic space.

The Economic Survey of Latin America, 1949 affirmed the need to increase intra-Latin American regional trade. Subsequent events — those accompanying the Korean War—caused this assertion to seem less urgent, but it became a valid issue once more when the region’s exports to the United States fell again.

In a statement made in 1959, Prebisch noted that:

“The idea of a possible common market had been taking shape for a number of years, until in November 1956 the Latin American governments, in the ECLAC Trade Committee, asked our Secretariat to set up two expert groups, one for the gradual establishment of a multilateral payments system, and the other to define the characteristics of the regional market… the common market is not something which can be carried out or not carried out at will in the face of this growth problem... a most intensive effort must be made to technify agriculture and advance resolutely in the industrialization process, not only in the big countries but also in the medium-sized and small ones. A big increase in the capital stock will be needed, and it will be necessary to tackle in all its magnitude the generally neglected problem of technical training at all levels of productive effort.

“Even if all this were carried out effectively, however, we do not believe that it could be achieved and maintained in practice... if the industrialization process continues to operate within the relatively narrow limits of each national market and if each country seeks to achieve full supply of its requirements for agricultural products, no matter how high the cost to the consumer.

“It is not just a problem of productivity, however, although this problem is indeed very important. There is another aspect which I should also like to highlight: that of the economic vulnerability of the Latin American countries... I do not see any fundamental solution to this serious problem and to that...
of the high cost of the substitution process, other than breaking out of this outmoded system through the gradual and progressive formation of a common market and the consequent diversification of imports and exports" (United Nations, 1959).

In that same year, the ECLAC Executive Secretariat put forward as a long-term objective the free circulation of "goods and services, labour and capital, without any kind of hindrance, in a vast Latin American Common Market" (United Nations, 1959). The analysis and specific proposals of ECLAC on integration were partly accepted and partly rejected in the proposals that were closer to the GATT approach (Wionczek, 1964).

Attempting to make an evaluation of the whole integration process is beyond the possibilities of this article. It may be noted, however, that this process has had both positive and negative aspects. Between 1960 and 1980, and above all in the first of these two decades, the integration process in Latin America and the Caribbean registered significant progress. At the beginning of the 1960s, trade among the countries of the region was only incipient, and there was practically no complementation in terms of production activities. During subsequent years, however, mutual trade became a dynamic element in the external trade of the region. At the same time, there was an increase in the levels of economic interdependence, especially in the subregional processes involving countries with small and medium-sized economies. Intra-regional cooperation found many other varied expressions in the development of the various sectors of production and of the physical infrastructure, as well as in the emergence of intergovernmental institutions and subregional or regional associations representing various groups and interests. The increase in mutual trade also facilitated the expansion, diversification and modernization of industrial production, as well as some specialization of activities at the subregional level.

At the same time, integration has also suffered shortcomings and setbacks, especially the reluctance of governments and of some groups to open national production to the competition of goods from other countries of the region; unequal distribution of the costs and benefits of integration and, in general, the difficulties in ensuring reciprocity between countries of different economic size and levels of development; and finally, the conflicts between the undertakings entered into under integration agreements and the objectives of national development strategies and policies, especially when national decisions must be subordinated to those of a multilateral nature (Rosenthal, 1989).

When all the deadlines for the original undertakings had run out and the situation had become unsustainable from the legal point of view, it was decided to adapt the legal framework formally to the actual situation by extending the deadlines and making the instruments more flexible. Examples of this are the conversion of the Latin American Free Trade Association (LAFTA) into the Latin American Integration Association (ALADI) and the protocols modifying the Cartagena Agreement. Thanks to these adaptations, in the 1980s there was a fresh proliferation of bilateral understandings (ECLAC, 1991). These understandings, which have further increased in the 1990s, are different from the traditional agreements, especially with regard to the scope of the trade covered by them.

The Latin American economy requires right now "second generation" ideas which go beyond adjustment and fiscal discipline. It is not a question of taking the place of these policies, which would be very undesirable and harmful, but rather of turning them into a prerequisite for policies aimed at growth with equity. It is possible that in the 1990s trade, production and financial integration will have more opportunities than they did in previous decades.

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1 This analysis is based on Rosenthal (1989).
The actuality of integration

Almost all the countries of Latin America have committed themselves to efforts aimed at mutual free trade; a number of them have done so through guarantees for the investments of the respective countries and the harmonization of their economic policies. By the mid-1990s, the region could be organized into a small number of economic groupings complemented with bilateral free trade areas, and direct investment of regional origin could increase very significantly. It is probable that later on the subregional groups will tend to become unified and that there will also be regional or national progress towards free trade with the United States and Canada. These possibilities represent unprecedented developments.

1. Is this really integration?

Is there a common denominator for all these processes? A point which is frequently overlooked is that the concept of integration is quite broad. It may be recalled in this respect that the publications on this subject distinguish various degrees of economic integration (Belassa, 1964; Frenche-Davis, 1979). The lowest level of integration is represented by a free trade area: the members of the area agree on the mutual reduction or elimination of customs tariffs, but each member country retains its own tariffs with regard to third countries. Another option is that of forming a customs union, which differs from a free trade area in that its member countries establish a common tariff with regard to third countries. Still greater integration is that represented by a common market: controls on movements of capital and labour are eliminated, so that not only goods but also factors can move freely. The stage of economic union is reached when the common market is complemented with supranational regional policies and the coordination of all branches of economic policy.

The present integration processes are clearly different from those of the 1950s and 1960s. The objectives have changed and have been reduced to a single aim: that of economic development; the orientation is now also outward-looking and aimed at world markets; the instruments have been changed into a macroeconomic framework with greater exchange and tariff transparency; among the agents involved, the private sector is now the main source of dynamism of the process; and the international political and economic environment with regard to integration processes has changed.

2. The reasons for its actuality

A set of both domestic and external circumstances affecting the countries of Latin America has placed integration in the foreground of the current regional economic debate.

Among the domestic circumstances are the new emphasis on export-oriented activities, within a framework of growing internationalization of the national economies. Integration boosts trade and —even more important in the medium term— favours growing international specialization in production, thus making it an important factor in the modernization of the latter. Its current objective, rather than giving integration an "outward-looking" attitude—as proposed in contrast with the type of integration which accompanied the import substitution process—is to speed up the changes in production patterns in the region.

An export strategy must take account both of primary commodities—which, although registering sluggish growth, are the goods which give the region its static comparative advantages—and products with greater added value. Incorporation into the international economy through dynamic exports of growing complexity seems to be the most promising way of increasing productive employment and the payroll in a rapid and sustained manner, thereby contributing both to growth and equity. This second export phase is closely linked with the internationalization of production and direct investment. Expanded markets make possible optimum levels of production which minimize average costs and make it possible to increase the international competitiveness of the countries' economies in various ways; this new integration is aimed at strengthening the incorporation into the international economy, favouring production linkages, and bringing about creative interaction between public and private agents (ECLAC, 1992).
Among the external circumstances, the enhancement of various regional trade agreements is to be observed at the world level, and in the case of Latin America, a noteworthy development has been the launching of the Enterprise for the Americas by President Bush. The region cannot fritter away the advantages of liberalizing its economic space and securing economic complementation within it, when other regions are striving to achieve this. At the same time, in order to negotiate better trade agreements with the industrialized countries it is necessary to achieve strengthened bargaining power, and this could be facilitated through the existence of broader associated markets. It is foreseeable that, other things being equal, the industrialized countries will prefer to come to agreements with larger integrated trade areas.

Looking at the situation from another point of view, the orientations of the national economic policies of the countries of the region are tending to converge, and this acts as an endogenous factor favouring the integration process. The great diversity and inconsistency of those policies in the past, which represented a formidable obstacle to integration, are giving way to efforts—albeit with very different starting points and paths—to achieve high and stable real exchange rates, low and even tariffs, interest rates not too far out of line from international ones, and few or no restrictions on foreign investment. In this way, the trade flows provide solid and durable bases for development and for the international specialization of production, including direct investment (Lahera, 1992).

The future of this still incipient process is not yet assured, since although the international economy will continue to be the "great coordinator" of macroeconomic policies (through the costs involved in departing from it), there will undoubtedly be some countermarches. A number of effects have already taken shape, through the expectations which this process has generated, but their consolidation is a matter which remains to be seen.

The various factors referred to above mutually strengthen each other, and it is possible that none of them may be determinant on its own. This explains the diversity of the present integration process, which is one of its most outstanding features. In some cases, the main impulse in favour of integration is the similarity of macroeconomic conditions; in others it is the enormous potential for economic complementation, in spite of macroeconomic divergences; in other cases, it is the advantage of being able to negotiate collectively with the United States and Europe; and in still others it is the renewal of long-standing commitments. Moreover, with regard to free trade agreements with industrialized countries, it is not so much a question of trying to obtain tariff reductions as of eliminating non-tariff barriers for some products and, in general, achieving better and more stable trade and investment relations with those countries. As a very minimum, efforts must be made to ensure that the present level of protection in those countries does not increase, especially as a reaction to the export successes of developing countries.2

This continuity of efforts to promote regional and hemispheric integration, which was unthinkable only a few years ago, is also a result of the factors already noted in this article (Juan Alberto Fuentes, 1991). Henceforth, it would be highly undesirable for the liberalization process to stop at this point and exclude other economic areas of the world on a permanent basis.

3. Integration and international trade

From one point of view, integration may be analysed as a specific aspect of international trade theory. From another viewpoint, such trade may be placed within the framework of integration, with the latter being understood as a dynamic factor for economic development, with all its aspects in terms of specialization of production, both for the region and for the world economy.

In international trade theory, integration was a suspicious expression for a long time, particularly because the integration process, if successful, has an indisputable, although temporary, effect of diverting trade. This would mean leaving aside the optimum free trade scenario, which permits the best possible international specialization in line with the comparative advantages of each country. This optimum scenario would be obtained by integrating all markets, without restrictions such as tariffs, managed exchange rates, prior import licenses, etc. In this way, the theory asserts, goods would be produced where it was cheapest to do so, for the benefit of all.

2 This idea was suggested to me by Joseph Ramos.
In principle, a correct manner of judging the general economic effects of a free trade area would be to compare the real income that would be obtained if it existed with that which would be obtained if no such changes were made. This totalizing approach is difficult to apply, however, so that in evaluating the effect of integration on international trade it is usual to distinguish, in line with Jacob Viner's studies, between the trade creation and trade diversion effects (Viner, 1950).

In general terms, international trade provides benefits by making goods available to users at lower cost. When a free trade area is formed, however, two different movements are generated: one member purchases from another goods which it previously produced domestically, thus improving efficiency by reducing costs. Trade also suffers some diversion, however, since one member may purchase from another goods which it previously imported from third countries.

Creation of trade normally brings benefits for all the countries involved, thanks to the increase in exports and the acquisition of imports at lower costs, thus promoting more efficient resource allocation. At the same time, however, the distribution of the benefits between the countries cannot be determined in advance. Diversion of trade involves a loss of well-being because of the importation of products which are more expensive than those produced outside the integration area; at all events, its net impact on consumption will depend on the variation in tariffs. By increasing the product, however, the diversion may benefit third countries whose exports thereby increase. The general theoretical conclusion is that if creation of trade predominates, then efficiency will improve; if trade diversion predominates, then the efficiency will go down. This issue arises differently in a free trade area compared with a customs union. The conditions needed for the phenomenon of diversion to take place are more restrictive, and their application almost always differs from one country to another.

However, there are reasons why integration may be an appropriate course even in the second case (Wonnacott and Lutz, 1989). Three different situations may arise in this respect: in the first case, the diversion of trade is the result of a selective reduction of tariffs and the new prices may be lower, even when the production costs of the exporting country are higher than those of the previous suppliers.

In the second situation, the economies of scale achieved through integration may allow the costs of the third producers to become competitive. In the final analysis, the undesirability of trade diversion is based on the assumption that tariffs form the main trade barrier. To the extent that other protectionist measures proliferate, however, it is no longer so clear that trade diversion will necessarily reduce efficiency.

In the third situation, the lack of transparency of exchange rate regimes and balance of payments disequilibria may mean that the imports which have the lowest monetary costs may not precisely measure the economic costs. They are not always the imports with the lowest opportunity costs.

From another point of view, the success of an integration programme in the region may not only create new exports, but also increase the global import capacity of the group. Thus, the dilemma between creation and diversion of trade may be rather artificial in the case of countries with imbalances and scarce resources.

If the protectionism against third countries is not increased, integration is an approach which will bring closer relations than free trade, rather than divergence: this possibility is recognized in article XXIV of the General Agreement on Tariffs and Trade (GATT). This point of view is also gaining ground in the literature on this subject. The countries forming part of such agreements can gradually attain a situation where they can conduct their external trade and their investments abroad with fewer restrictions. The process of convergence of economic conditions facilitates investment flows to and from other countries and allows discussion to be focused on the other economic, legal and administrative conditions which are of decisive importance for such productive investment.

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3 This article states that for the purposes of GATT, free trade agreements must fulfill four requirements: they must be of broad scope, that is to say, they must cover a substantial part of the trade between countries; they must be applied over a reasonable transitional period; they must not raise barriers to the trade of other contracting parties, and they must contain rules to identify the origin of the goods covered by the Treaty.
4 See the arguments in this sense in Lawrence (1991).
It is for these reasons that integration is seen less and less as an option which is in contradiction to international free trade. The truth is that it would not be realistic to assume that both are equally viable, or that economies of the size of the Latin American ones can freely choose in this respect. In practice, integration may be considered as an effective way of coming closer to freer trade, in view of the existence of distortions and imbalances whose total elimination is outside the reach of the member countries alone.

From another point of view, to the extent that the effects of trade liberalization are greater than those of geographical discrimination, integration will contribute to the formation of a less discriminatory international economy.

4. Integration and changing production patterns with equity

Integration and intra-regional cooperation are functional to the achievement of broader development objectives. Outstanding among these is the transformation of production patterns, as proposed by ECLAC (1990a).

Integration commitments may facilitate the application of the systemic approach which is characteristic of this strategy; increase the efficiency of the production process and help to incorporate technology in it; give rise to economies of scale in both production processes and in the infrastructure; reduce monopoly and oligopolistic rents, and give rise to new investments. Integration is compatible with the objective of increasing international competitiveness, and it can help to attain it.

Enhanced trade would help to lay the basis for systems of specialization and competition which would facilitate changes in the production patterns of each country. This would make it possible to take more advantage of intra-regional comparative advantages and of the opportunities for sectoral and intra-sectoral complementation.

Mutual cooperation would help to strengthen exports to countries outside the region, thus enabling many medium-sized or small countries to achieve advances that would be almost impossible for them in other circumstances.

From another point of view, by causing the participating economies to be more closely related with each other, expansion of mutual trade would make them more similar in their cyclical fluctuations, thereby requiring similar monetary and fiscal policies. Consequently, speculation on short-term interest rates and exchange rates would be reduced, and there would be more freedom in the balance of payments for long-term investments seeking greater marginal productivity of capital.

Integration can expand the effects of innovation by reducing the average costs of technological research and development, increasing the efficiency and use of specialized inputs or support services, and generating technological externalities. Thus, an expanded market would make it possible to derive greater advantage from investment in research and development by exploiting economies of scale and reducing the cost/sales ratio.

II

Obstacles to integration

1. Macroeconomic policy

A prior condition for furthering a broad integration process in the medium or long term is that there should be a minimum degree of macroeconomic stability. Moreover, it has traditionally been recognized that growing harmonization of economic policies must be sought in order to progress in the integration process. This is a difficult objective to attain, however, since it is conditioned by the existence of various imbalances, for some of which integration itself is proposed as a remedy. Thus, the argument takes on a circular form and may give rise to structuralist pessimism or technocratic voluntarism.

Exchange rate instability gives rise to uncertainty about the evolution of relative prices, and this in turn causes higher risks for investments, creates maladjustments in the allocation of resources
between tradeable and non-tradeable goods, and gives rise to financial instability, with its well-known effects on the monetary sector. At the same time, imbalances lead to the failure to fulfill commitments that have been entered into, thus undermining the very idea of integration. Finally, financial imbalances may cause variations in the real exchange rate and obscure the transparency of policies, hindering reciprocal flows of trade and capital; moreover, they can also heighten the differences already existing between countries by leading to concentration of foreign investment in the most stable countries (Alfredo Fuentes, 1991).

2. Trade and investment policies

The possibility of selecting only a certain set of products in some integration agreements favours the granting of preferences in sectors where there is little trade potential, in order to obtain greater openness than that normally granted. It also gives rise to a permanent review of the preference lists with a view to their possible expansion or rebalancing, which brings a constant element of uncertainty into the agreements and complicates the negotiations, as well as discouraging the participation of the private sectors. Furthermore, in those cases where the opening-up is not of a general nature, it leads to inter-sectoral distortions which favor unjustified privileges and make better resource assignment impossible (Noyola, 1991).

As in the case of tariff preferences, non-tariff barriers have traditionally been eliminated in respect of a limited number of products which are normally not those offering the greatest opportunities for trade.

Moreover, the current agreements have generally not defined machinery for settling trade disputes, which has facilitated failure to fulfill commitments entered into, trade reprisals, and general uncertainty about the application of the concessions negotiated.

Nor is there currently a full system of statistical information on the exports and imports of Latin America and the Caribbean. The external trade statistics come from customs registers, and this decisively affects the quality and nature of the information in them: it affects the quality because this depends on the degree of reliability of the registers; and it affects the nature of the information, because these registers are used for the ongoing adaptation of customs duties, that is to say, they are designed to fit in with the characteristics of tariff systems and are not suitable for economic analysis. Moreover, some external trade practices, such as the operational and marketing systems for carrying out external trade transactions, have certain special features which make it difficult to keep proper registers and affect the type of statistics thus compiled.

3. Sectoral policies

There is a great variety of special regimes for specific economic activities, industrial branches and geographical locations of enterprises in the region, and these regimes also differ from one country to another. This complex system of regulations, as well as not being very efficient as a means of promotion in the present circumstances, makes it difficult to build up common economic spaces and favours the consolidation of anti-integration interests.

4. Consistency and convergence

The simultaneous—or even consecutive—negotiation of various different agreements entails considerable difficulties of coordination and adaptation. Moreover, there are serious difficulties in managing an excessive number of bilateral or subregional agreements, and if these also include special conditions, they will present serious problems of transparency for exporters, importers and investors.

A particularly complex matter is the joint administration of new agreements and "inherited" commitments already negotiated. Article 68 of the Cartagena Agreement—the Treaty which gave rise to the Andean Group—lays down that trade agreements established outside the Cartagena Agreement must have the approval of all its members. In 1991, however, the Guayaquil Commitment confirmed the possibilities of bilateral or community negotiations with other countries and referred to the desirability of regulating the application of article 68. In the case of ALADI, agreements can be made at various levels—regional, bilateral and sectoral. Each one includes different lists of products with levels of preferences varying from 2% to 100%. This makes it a very complex matter to administer, understand and make use of the agreements, thus making it difficult to take full advantage of them and consequently limiting their impact on trade flows (ALADI, 1991).
The possibility is now being proposed of a free trade agreement with the United States under the Enterprise for the Americas Initiative launched by President Bush. The question of integration between economies of different levels of development is such a novel matter that it has not yet been covered by the specialized literature. A central issue in this type of agreement is that the developing countries cannot obtain unilaterally discriminatory treatment, except in a few expressly agreed cases. For example, they cannot take advantage of the rights laid down in GATT without also accepting its obligations. Moreover, it is also necessary to include such matters as services, which are of great interest to the developed countries. Another matter is the extension, extent and speed of application of the agreements.

Various countries and groups of countries of the region have special trade relations with some developed country or group of countries. Examples of this are the relations of the Caribbean countries and territories with the United States under the Caribbean Basin Initiative; the tariff preferences granted by the United States to the Andean countries, and the participation of some countries in the Lomé IV Treaty with the European Community. These are unilateral trade systems, different from the dynamics of an integration process. A similar case is that of the Generalized System of Preferences. Conversely, there are countries which are affected by United States trade sanctions: Nicaragua, until recently, and Cuba.

The countries of the region encounter a very low tariff structure in the United States which is almost without exception lower than their own. Thus, generally speaking quantitative and non-tariff restrictions may be of greater sectoral importance, and they will also be the most difficult ones to dismantle. In some economic sectors and subsectors, a free trade agreement with the United States will be particularly complex to negotiate, or will require longer transitional periods (in the case of agriculture, for example).

Although it is unlikely that the region’s exports to the rest of the world will be affected by a free trade agreement with the United States, it is possible that part of its imports from the rest of the world will be reduced in favour of imports from the latter country. The United States and Canada currently provide only one-third of Latin America’s imports, so that there is big potential for diversion of trade; consequently, under no circumstances should the agreements arrived at involve the application of common barriers to imports from other areas.

5. Aspects concerning financial matters and clearance of payments

In the last two years, ALADI, the Central American countries and the Andean Group have considerably improved the operation of their respective systems of payments and financing of trade. Basic problems still persist, however, with regard to the nature of mutual trade, and these demand further advances in this financing. The current difficulties with regard to intra-regional financial cooperation are due both to the influence of exogenous elements which affect the economies of the region and to the macroeconomic instability of the countries themselves (ECLAC, 1990b).

6. Physical integration

Most of the transport infrastructure of the Latin American countries has been constructed in order to export to the rest of the world the basic commodities produced by the region. This characteristic means that, in spite of the advances in integration achieved in recent decades, nearly all the countries of the region have higher transport costs in their intra-regional trade than in their trade with countries outside the region. This is so in spite of the shorter distances involved in intra-regional transport and is due largely to the lower density of transport within the region, since this is strictly subject to the principle of economies of scale and decreasing costs.

Progress in border integration is hindered by the lack of suitable institutional support. There are 16 South American and Central American countries with a total of 27 various kinds of projects for border integration, affecting most of these countries’ borders. In a further 19 cases there are suitable conditions for such integration or efforts are being made by governments to reach formal agreement on border integration. Of the 27 projects backed up by formal agreements, however, only 12 have specific, permanent institutional organization, and of these 12, only four are actually structured as programmes (Bolognesi-Drosdoff, 1990).
III

Policy guidelines

1. Macroeconomic policy

The harmonization of economic policies is not usually exclusively the result of increased and closer trade relations. Indeed, on the contrary, in conditions of imbalance policy coordination measures precede those for trade liberalization. In these conditions, it is hard to see how there can be any considerable expansion of trade simply as a result of the removal of tariff obstacles. Moreover, the elimination of tariff and non-tariff barriers makes mutual trade still more sensitive to exchange rate fluctuations.

In the short term, it is unlikely that the bigger trade and investment deriving from integration will be sufficient on their own to lessen economic policy divergences to any marked extent, since both the external trade and mutual trade coefficients of the countries of the region and the flows of direct investment are still only at a low level. The key to progressive harmonization of economic policies seems to lie rather in the achievement of relative macroeconomic balance in the countries making up the group; consequently, its main factors would be the elimination of fiscal imbalances and the application of a more prudent monetary policy. At the same time, more realistic exchange rates and reduction of what Fernando Fajnzylber called "frivolous" protection would also aid the convergence of regional costs. These conditions would facilitate fuller application of the present mutual payments systems.

Some forms of partial harmonization of policies in economic preference areas have been suggested, including self-restrictive clauses for preferential treatment in favour of particular economic activities (industrial and regional promotion, for example) and the establishment of consultation and coordination machinery with regard to certain national economic policy decisions, especially on exchange rate matters (Halperin, 1990).

2. Integration for changing production patterns

The integration agenda could be reviewed and expanded so that its various items would tend to strengthen the process of changing production patterns rather than foster import substitution.

With regard to the interaction of the public and private sectors, experience shows that governments can create various conditions which are favourable to increased trade and investments, but it is up to the private sector to turn them into reality. Integration will not progress without the active participation of the private entrepreneurs of the respective countries, and this should take place from the earliest stages of formulation of the integration options, rather than merely being the result of the perception of new trade or investment opportunities by these agents. In view of the need for active links between the private and public sectors, at both the national and regional levels, which will frequently call for the coordination of entrepreneurial organizations representing the interests involved, it would seem advisable to set up bilateral entrepreneurial councils. The labour sector should also be informed and consulted, and the effects that various aspects of integration may have on the workers must be taken into account.

Integration must go beyond the mere reciprocal sale of surpluses; it must raise the international competitiveness of the economy by transforming the production sector itself and exposing it to greater competition in an expanded market, and it can lead to growing international specialization in production (Lahera, 1984). International competitiveness will improve to the extent that external trade goes beyond marginal levels and helps to modify national systems of production both in terms of the investments which have already been made and new investments. This is a process which must be strengthened if integration is to lead to growing international specialization in production.

The internationalization of production may take the form of horizontal expansion, in order to produce the same goods in the recipient country, or vertical integration— involving inputs or greater added value of products— which brings establishments in the recipient country into the global production process.

The prototype of horizontal integration corresponds to full local production, including local production of inputs, of a final good for the same market. The opposite extreme is internationally integrated production, with mostly imported inputs, of a product which in turn complements the production of
a final good to be marketed in various national markets. Obviously, there are also various intermediate types of specialization in production, as well as combinations of the two types already referred to (Lahera, 1988).

It would be unrealistic to try to remove from the influence of the market the distribution of production activities among the countries involved. Consequently, efforts to promote modernization of production and raise competitiveness must be directed more towards the generation of positive externalities than towards special treatment for particular products or sectors. There are extensive possibilities for cooperation in this field, especially with a view to technical change and environmental protection.

Agreements on double taxation and protection of investments are necessary complements to free trade agreements. There are still only a few of them, and this not only represents a barrier to specialization of production but also discriminates against local firms compared with transnational corporations from developed countries, which are increasingly protected by such agreements.

The elimination of subsidies on Latin American and Caribbean exports to member countries of subregional groups, which in fact already occurs in the case of the Central American countries, would avoid conflicts between exporters and domestic producers and obviate a struggle over incentives in the region. It is necessary to reach agreements on the subjects of services, investment and intellectual property, the clear definition and gradual liberalization of which will be of fundamental importance for promoting the interaction of some spearhead sectors of the economies of the area. The question of mobility of factors should also include that of the mobility of labour and should take account of various aspects of the labour market. At the same time, negotiations on subsidies and countervailing duties should continue within GATT, where the advantages of a multilateral forum for the weakest countries are evident. Moreover, it will be necessary to keep watch in order to ensure that industrial technical standards, and regulations on security and public health applied by the members of the agreement, do not artificially hinder mutual trade (Juan Alberto Fuentes, 1991).

3. Trade policies

Economies which are in a relatively balanced situation have more leeway for developing a broad range of integration policies, while at the same time increasing their international economic liberalization. In these conditions, external trade policy could combine unilateral tariff reductions with multilateral free trade negotiations and with subregional or bilateral free trade agreements, as long as these do not involve raising barriers against third countries (Lahera, 1991). The same is true in the area of direct investment, the positive effects of which are further strengthened by similarities between local and international conditions, by non-discrimination between national and foreign investment, and by the elimination of export subsidies and discriminatory fiscal charges.

The debate on integration instruments should be broadened. The application of various instruments which could be considered as being of a strictly trade nature depends on other more general policies, while international production specialization depends on variables which go beyond the field of trade, and sometimes even on specific or sectoral policies.

Except for a few very sensitive products, the fixing of a maximum tariff and the elimination of non-tariff barriers will guarantee a certain level of openness and give greater confidence to importers and exporters. Starting from the maximum tariff, which does not necessarily need to be common to all the countries, a tariff reduction process with precise deadlines can be established which will eventually lead to total trade liberalization among the parties. The negotiations must concentrate on lists of exceptions to liberalization rather than on the lists of products to be liberalized. With regard to direct investment, it is desirable to guarantee non-discrimination on the grounds of origin of the capital and to simplify the conditions for its repatriation.

Likewise, the rules on origin must be clearly defined and flexible, in order to be better adapted to the characteristics of some sectors. They must permit the compatibilization of two objectives—that of high regional content, and that of growing internationalization of production—in order not to hinder the latter process. The safeguard clauses must be of a general and temporary nature, and they must be gradually reduced with the passage of time. Moreover, it is essential to create legal instruments for the solution of trade disputes, with flexible and transparent procedures and the ability to compel the fulfilment of agreements, thus guaranteeing exporters access to the market. A suitable mechanism for these purposes is that of arbitration with decisions against which there can be no appeal.
Administratively, the handling of non-tariff barriers is more complex than that of tariffs, and it is more open to arbitrary action, distortions and pressure by interest groups. Consequently, from the first moment when subregional markets are set up, it would be necessary to promote the total elimination of non-tariff barriers, even if this were accompanied by some increase in tariffs in order to facilitate the transition process. On these issues, it is not possible to accept proportionality, but instead the need for total elimination must be spelt out in an unmistakable manner.

The negotiation of a free trade agreement with the United States and Canada must be complemented with simultaneous negotiations with other areas. Latin America should begin free trade negotiations with the European Community and with Japan as soon as possible, as a way avoiding the trade and production distortions that could arise from the successful conclusion of the negotiations with the United States and Canada.

In this process, it is necessary to avoid the consolidation of trade blocs which are inwardly open but outwardly protectionist. The trade diversion effect can take place both through the fixing of a common external tariff for the subregional or bilateral agreement which is higher than that previously prevailing in some of the countries, and through the elimination of tariffs within the respective grouping, while maintaining them with respect to third countries.

4. Consistency and convergence

The task of combining various forms of integration calls for careful handling in order to avoid possible inconsistencies. In order to coordinate external trade policy, there should be a centralized technical body, probably in the area of economic policy management. It would seem necessary to progress towards the establishment of an international trade office, like those which exist in some developed countries, as has recently been proposed in some countries of the region.

The new regional spaces could be formed on the basis of an integration process simultaneously advancing in a number of directions at different rates, but with a single consistent overall orientation (CLEP, 1991). It is also foreseeable, however, that options of high complexity may arise, including situations in which the “prisoner dilemma” occurs, especially with regard to countries which have few tariffs to eliminate and few tariff barriers to dismantle. It might even seem a bad deal not to have tariffs to lower; this is an economic mirage, of course, but it is a political reality. Consequently, greater imagination is required in the negotiations, with broader definition of the objectives, instruments, deadlines and forms of integration.

The attempt to establish free trade with developing countries has specific elements which no general argument can remove, and it differs from the same process involving industrialized countries, but one process must not be subordinated to the other.

Integration with the countries of the North American Free Trade Area may take place through the formation of subregional groups, but there are also various possible combinations, including intermediate or simultaneous stages in this process. These stages could cover integration between existing subgroups and also the integration of subgroups with the North American Free Trade Area, with various Latin American and Caribbean countries, and with various countries of the North American area. If progress towards hemispheric integration were more rapid than regional integration, this could lead to massive diversion of trade from Latin American to North American products, especially because most of the countries of the region compete with the United States in markets in the area in a wide range of products (Lizan and Yeats, 1992). Looking at the matter from another point of view, a country which is in a position to sign a free trade agreement with the United States could normally also do so with the other countries of the region.

The pre-existing agreements between countries of the region and some industrialized countries, in which special conditions are granted on a unilateral basis, must be gradually incorporated into a general framework which takes account of the different situations and compensates for them.

5. Trade facilitation

In addition to conditions of a macroeconomic type, other factors which facilitate integration are the elimination of administrative hindrances and improvement of the physical, transport and telecommunications infrastructure.

The effective integration of the region makes it necessary to link together the transport systems more closely, thus advancing towards the creation of a land, sea and air transport market which is
increasingly integrated and open and in which there is equality of conditions.

In land transport, it is necessary to promote the liberalization and facilitation of passenger and cargo transport in order to make the available supply of these services broader and more flexible. In air transport, it is necessary to expand freedom of traffic in order that all the airlines of the region may have the possibility of operating and competing in line with the conditions of each country.

In sea transport, it is necessary to take measures to give South American shipping companies freedom of access and facilities for improving their capacity to compete, while respecting the principle of reciprocity. The geographical characteristics of the region make sea transport the most appropriate form for international trade, over 90% of which is carried by this means. Without a coordinated policy on ports and sea and land transport, the countries of Latin America and the Caribbean would run the risk of being limited to only minority participation in the sea transport consortia from outside the region or to the mere provision of linking services with ports where the cargo would be transferred to bigger ships, or to the provision of land transport services in the region (ECLAC, 1989).

The participation of the private sector is of key importance for the development and maintenance of the physical infrastructure, but the public sector must make available its technical and financial resources if these objectives are to be reached.

6. The relatively less developed countries

As experience shows, reciprocity in the benefits of integration is both an objective and a condition for the success of the process, since a country cannot be expected to participate in it if, in the long term, its costs exceed its benefits. It is improbable that integration will have completely even-handed effects, however, since the initial differences may tend to increase rather than diminish. It must not be forgotten that changes in trade policies and in the form of insertion in the international economy normally cannot automatically eliminate differences in the specific situations of each country, including its resource endowment—especially of human resources—and its level of development.

There are no technical recommendations which can alter this basic economic fact, although it is possible to suggest compensatory or balancing measures which do not represent any impediment to the integration process. Moreover, the dynamism deriving from the integration process affects each participant’s view of the medium-term effects of this process on the various economic sectors. The very concept of reciprocity must be defined more broadly and must incorporate a bigger time dimension.

It will therefore be necessary to adopt compensatory or balancing measures. Some degree of flexibility in fulfillment of the integration objectives and support for increasing the exportable supply of countries of relatively less development could be considered for this purpose.

Small economies are characterized by their higher degree of openness and are therefore more vulnerable to fluctuations in the economies of their trading partners. Their export sectors are relatively weak and encounter serious structural obstacles on the supply side when they try to increase their exports (Salazar and Lizana, in the press).

Moreover, the application of very strict rules of origin would adversely affect the weakest economies, which generally have less capacity to export products with a higher proportion of added value or of domestically produced materials. The application of rules which are not excessively strict would therefore be justified.

Conclusions

Economic integration cannot give short-term responses to the problems of adjustment, stabilization and growth of the Latin American countries. Indeed, it could hardly be expected to do so. The integration process has its own particular type of complexity, and its results are not automatic. To begin with, its effects will necessarily be limited, in view of the low global coefficient of external openness of the countries of the region (around 25%) and the limited share of intra-regional trade in the product (between 10% and 15%). As changes in production patterns become more pronounced and
the structure of production of the countries making up integration groups becomes more diversified, however, integration will be more viable, since it will expand the base for trade and specialization in production.

Moreover, taking another point of view, integration is not a linear process. In some cases, it might be possible to make very rapid progress. In contrast, however, severe setbacks could be suffered in the event of a major economic crisis: in this case, intra-regional trade would be affected, but not so severely as intra-regional direct investment, which perforce follows the ups and downs of the recipient economies.

To sum up, integration is a winning idea, and its management is a complex but perfectly possible matter. It will be necessary to move very carefully, respecting the specific features of bilateral or regional economic relations and the need to avoid inhibiting the global trend towards free trade. By following this strait and narrow path, with the difficulties that have always marked the development process, integration will become a factor in the economic modernization of Latin America.

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