Trade Liberalization in the Western Hemisphere

INTER-AMERICAN DEVELOPMENT BANK (IDB)
ECONOMIC COMMISSION FOR LATIN AMERICA
AND THE CARIBBEAN (ECLAC)

Project Executive Summary
Preface

Trade liberalization has become most relevant for the development of Latin American and Caribbean economies. Global trade policy and intraregional trade agreements raise issues that contain many common features. The 1991 Enterprise for the Americas Initiative not only called for a detailed analysis—especially from the Latin American and Caribbean perspective—but it also acted as a catalyst for revisiting the topic of preferential trade agreements.

It was natural for the Inter-American Development Bank and the Economic Commission for Latin America and the Caribbean to combine their resources to promote analysis and debate of the multiple implications of hemispheric trade liberalization. The two organizations have collaborated frequently to deal with major development issues. Each brought to this new association its unique assets to generate a set of issues papers and to provide venues where the issues could be aired and ideas discussed.

Both institutions are committed to the concept of trade liberalization, but they recognize that there is ample scope for debate regarding the content, sequence, and extent of liberalization. In selecting the consultants for the project, care was taken to offer many points of view from distinct perspectives. The purpose of the project was not to defend a particular point of view but to establish the parameters of the debate and help clarify the issues.

Several hundred officials and other leaders of Western Hemisphere nations were involved in the discussions. We are convinced that the debate is not over, but is only now beginning.

Enrique V. Iglesias
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OVERVIEW

The Inter-American Development Bank (IDB) and the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) executed a project between June 1991 and December 1994 to promote a dialogue on trade liberalization in the Western Hemisphere. The project organized several colloquia and conferences with the participation of government officials, entrepreneurs, academics, and other experts. The themes discussed were developed in analytical working papers covering a wide array of subjects related to hemispheric trade liberalization.

This summary describes the activities undertaken by the project and is organized as follows. Section 1 describes the organization of the project. Section 2 describes project activities such as the colloquia, conferences, and dissemination of working papers. Section 3 presents general findings of the project. Section 4 lists project staff, and section 5 lists the working papers.

1. ORGANIZATION

1.1 Executing Agency

The project was executed by ECLAC through its Washington office. This office was responsible for hiring the consultants, the organization of the colloquia and conferences, and dissemination activities. The director of ECLAC's office in Washington served as the project coordinator.

1.2 Steering Committee

The Steering Committee, consisting of the President of the IDB, Enrique V. Iglesias, and the Executive Secretary of ECLAC, Gert Rosenthal, or their designated representatives, Nohra Rey de Marulanda and Isaac Cohen, provided overall guidance for the activities carried out within the framework of the project. The committee was responsible for establishing the lines of action, approving the work program, and ensuring operational, administrative, and technical coordination between the two institutions. The Committee met several times formally and informally throughout the duration of the project.
1.3 Advisory Committee

The Advisory Committee made recommendations on the work program and agenda. The committee consisted of five members, well known for their expertise in the field of international trade:

Mr. William Cline, Senior Fellow, Institute for International Economics;

Ms. Louise Fréchette, Assistant Deputy Minister, External Affairs, Canada;

Mr. Jorge Gallardo, Consultant and Entrepreneur, Ecuador;

Mr. M. Alister McIntyre, Vice-Chancellor, The University of the West Indies and Former Deputy Secretary-General of UNCTAD;

Mr. Rubens Ricupero, Ambassador of Brazil to the United States.

Ms. Sylvia Ostry, Chairman of the Centre for International Studies, University of Toronto replaced Ms. Fréchette after the latter was appointed Canada's Ambassador to the United Nations.

The Advisory Committee held seven meetings and one informal discussion luncheon.

1.4 Liaison Committee

To maintain effective links with the countries of the region, each member country of the IDB was asked to appoint a person to act as liaison with the program. These persons were responsible for channeling the results of the activities to the various public- and private-sector agencies in their countries and for bringing to the attention of the project coordinator the interests of their governments.
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2. ACTIVITIES

2.1 Colloquia

The colloquia brought together experts which included entrepreneurs, academics, and government officials from North, South and Central America, the Caribbean, Japan, and Europe to consider the basic trade policy and technical issues implicit in hemispheric trade liberalization. Of the seven colloquia, five were held in Washington, D.C., one in Toronto, Canada, and another in Sao Paulo, Brazil.

1st Colloquium: (February 23-24, 1992) discussed the project's goals with the Project Liaison Committee.

2nd Colloquium: (April 30-May 1, 1992) addressed the implications of hemispheric trade policy for the multilateral trading system, and for relations with the rest of the world, particularly Europe and Japan.

3rd Colloquium: (May 31-June 2, 1992, Toronto, Canada) discussed the wide range of trade liberalization efforts already under way in the hemisphere (CARICOM, CACM, Andean Pact, MERCOSUR, and NAFTA) and their relation to a Western Hemisphere Free Trade Area.

4th Colloquium: (July 27-28, 1992) analyzed costs and benefits by country. The discussion emphasized the relevance of economic size, level of economic development, proximity to the North American market, and macroeconomic readiness.

5th Colloquium: (September 28-29, 1992) highlighted potential negotiation issues, with an emphasis on safeguards and unilateral trade remedy actions, rules of origin, market access, environment and labor.

6th Colloquium: (December 1-2, 1992) focused on how hemispheric trade liberalization could be brought about, emphasizing the role of domestic policies in facilitating the transition.
7th Colloquium: (April 19-20, 1993, Sao Paulo, Brazil) stimulated dialogue with Brazilian entrepreneurs on Brazil's integration into a hemispheric free trade arrangement.

2.2 Conferences

The conferences complemented the colloquia expanding on the issues raised earlier with a wider group of participants.

**First Conference:** (May 24-25, 1993, Santiago, Chile) considered trade liberalization arrangements, cost-benefit analyses at the country and sector levels, the negotiating agenda, and the transition.

**Second Conference:** (November 1-2, 1993) assessed conditions and policies for maximizing the gains of a hemispheric free trade area and reviewed estimates of two computable general equilibrium (CGE) models applied to trade liberalization in the Western Hemisphere.

2.3 Participants

Four hundred and nine participants from forty-one countries, from public and private sectors, research and advocacy institutions, international organizations, and the press participated in the activities of the project. The diagram on the facing page shows the distribution of the participants according to their affiliation by sector. The public sector included trade officials and other experts, who were not members of the liaison committee; regional and advocacy organizations included academicians, researchers, and not-for-profit advocates; private includes experts from the private sector, notably multinational corporations, export-import businesses, and law and consulting firms involved in international trade.

2.4 Working Papers

The Project produced seventy working papers. Sixty were commissioned to public and private sector experts from Latin America, the United States, Canada, Europe, and Japan. Ten were written by ECLAC staff.

Approximately 24,000 copies of the working papers have been distributed. Documents were made available at the six colloquia and the two conferences. Also, they were distributed through ECLAC's Washington,
D.C., office. The working papers were listed in the following newsletters: CEPAL News of ECLAC Washington; Development Policy of the IDB’s Economic and Social Development Department; and Washington Report of the Council of the Americas.

The figure on the following page shows a breakdown of the distribution of working papers by sector.

2.5 Publication

The final activity of the project is the publication of an edited volume of twenty project working papers. The volume is to be published in English and Spanish.
3. FINDINGS

When the IDB-ECLAC project was launched in 1991, the Enterprise for the Americas Initiative (EAI) of the Bush Administration was one year old. The initiative envisioned a process of trade liberalization that would lead to a free trade area in the Western Hemisphere, built around the principle of reciprocal, rather than unilateral, trade concessions. The EAI proposed what amounted to a new form of integration between developed and developing countries through a partnership built around equivalent concessions.

The proposal aroused great enthusiasm, but it also raised many questions about its content, scope, and implementation. The IDB-ECLAC Project was designed to promote a dialog on the process of trade liberalization in the Western Hemisphere, with the hope of shedding light on the options opened by such a process.

Over the course of the project, the participants addressed numerous conceptual, methodological, and practical topics related to hemispheric trade liberalization. Of great interest was its compatibility with the ongoing Uruguay Round negotiations and how liberalization would affect the global
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trading system; the conditions for its success, particularly the methods and sequencing of alternative negotiations; and the negotiating agenda and sequence for the participation of individual countries or groups of countries.

Most discussions, however, centered on three basic issues: What might a country hope to achieve from participating in the process of hemispheric trade liberalization? What conditions are essential in order to maximize potential gains? And, How best to go about liberalizing trade in the Hemisphere?

Potential Gains

In theory, unilateral trade liberalization can make it possible for a country to attain the maximum income. However, without global liberalization, unilateralism is not as powerful, even though it is beneficial in aggregate terms. In a world of trade restrictions, a free trade agreement can open markets, a gain that is not necessarily available via unilateral trade liberalization. When trading groups are strengthening themselves and nontariff restrictions are rising, reciprocal opening, or the commitment to keep markets open, can be an advantage of a circumscribed free trade agreement.

A commitment to establish a free trade area can also bolster the credibility of sustaining economic policies and solidifying past reforms. This is the so-called locking-in effect, and it offers more than the conventional efficiency gains associated with unilateral liberalization. It is also plausible that these gains may not be substantial. This is particularly true for some Latin American and Caribbean countries that have already undertaken unilateral trade liberalization as part of a deliberate—and often painful—strategy of relying on the market, privatizing state enterprises, and improving macroeconomic performance.

Inclusion in a continental free trade agreement is a far better option than exclusion. The costs of exclusion are likely to encompass the diversion of trade and investments, as well as lost opportunities for growth through economic cooperation in a broad range of issues. This is more obvious for smaller economies that have relatively lower potential to benefit from economies of scale. At a time when regionalism is growing and free trade faces new challenges, it makes sense to undertake simultaneously the creation of a free-trade area and unilateral trade liberalization.
What Kind of Trade Liberalization?

The formation of trading blocs can help or hinder global trade liberalization. Some fear that a free trade agreement could create a prisoner's dilemma, whereby rational actions at the regional level produce a negative global outcome. Preferential schemes, it is argued, violate the spirit of multilateralism, breed defensiveness, and can become insular trading blocs.

A move toward liberalization is said to be GATT-compatible if it does not violate provisions of the GATT, especially Article XXIV, and GATT-plus if it moves further toward liberalization than required by the GATT.

There is, however, a growing consensus that the multilateral system does not represent a unique track toward freer trade. Circumscribed, as opposed to global, trade liberalization can be trade-creating, GATT-compatible or, better still, GATT-plus. Regional trade liberalization should not be a threat to multilateralism. Rather, regional agreements may break down barriers on a limited regional scale, and this can create precedents and generate competitive forces that help propel broader liberalization efforts.

ECLAC advocates an “open regionalism” that results from the interdependence of special, preferential agreements and market signals produced by trade liberalization. What open regionalism seeks to accomplish is to make explicit integration policies compatible with, and complementary to, multilateralism.

Whether regional arrangements in general are positive or negative for the global trading system will likely remain a matter of dispute. Widespread certainty exists, however, that complete free trade in the world is the best outcome and, consequently, trade agreements that complement multilateralism are better than those that do not. The question that must be answered is, What kinds of circumscribed trade agreements are GATT-plus and therefore more likely to generate increased gains?

First, it is essential that a regional trade agreement be based on a partnership and built on the principle of reciprocal concessions. As such, it will demand commitments and obligations over a broad range of issues. For instance, if the recently approved North American Free Trade Agreement (NAFTA) is taken as a guide, countries interested in undertaking regional trade negotiations should be prepared to address both traditional obstacles such as tariffs and quotas and new issues such as investment, intellectual property rights, government procurement, and rules to deal with unfair trade practices. The environment and labor, as well as governability or the rule of law, can also be part of the expanded agenda.
An innovative regional agreement has the potential of providing precedents in areas not yet covered by global trading rules. More important, the inclusion of issues that are part of the political agenda of modern open economies can be viewed as an opportunity to continue along the path of economic modernization. To the extent that changes in domestic policies are beneficial, modernizing countries will be able to sustain their commitments in these areas by forming strategic alliances with analogous groups from their trading partners.

Other essential characteristics of a GATT-plus trade agreement are equal treatment to new members, clear terms of accession, and precise rules. A regional trading agreement that does not offer new membership on terms equal to those of existing members can generate instability in foreign investment flows and perhaps cause trade and investment diversion.

When countries of different sizes and degrees of development are called to operate on reciprocal, rather than unilateral, terms and concessions, the principle of equality among members and of open access to new members means that there is equality of opportunity for all countries to reap the potential benefits of economic integration. Smaller or relatively less-developed newcomers may require more phased phase-in terms instead of the special, nonreciprocal treatment they once demanded. Present circumstances indicate that demands for such special, nonreciprocal treatment may hinder the possibilities of concluding regional integration agreements.

Members that are less able to take advantage of the broadened market could explore the possibility of moving gradually, but progressively, in their commitment to the process of reduction of obstacles and easing, to some extent, the costs of adjustment. Lengthier terms and conditions may facilitate the emergence of genuine partnerships between members of different sizes and levels of development.

It is essential that terms of accession be clearly spelled out for the benefit of potential members. Stable and transparent terms of accession will help those interested in engaging negotiations. Beyond accession, it is also desirable that a regional free trade agreement be governed by rules that are transparent, precise, and clearly spelled out. This is especially important in areas such as dispute settlement mechanisms, safeguards, and rules of origin. For example, different types of dispute settlement procedures and their implementation in various regional trading arrangements should be observed carefully. Experience reveals that a carefully constructed and effective dispute settlement mechanism can help equalize differences in relative economic weight. This is true even for agreements that do not attain the most advanced supranational legal regimes that govern trade and other
economic relations among the member countries of the European Union (EU).

A free trade agreement aimed at reducing friction among its members should have an effective dispute settlement procedure should at its core. Disputes could arise from use of unilateral remedies, which are often part of national legislation and therefore are not affected directly by an international agreement.

Clear rules on safeguards are also necessary in a good trade agreement. Safeguards provide both the means to minimize adjustment costs and political flexibility for decision makers. Without an agreement on safeguards, negotiators of a free trade agreement will be limited in what they can accomplish.

Finally, poorly negotiated and obscure rules of origin can limit the gains to members of a free trade agreement, especially for smaller countries. It is essential to avoid rules of origin that are restrictive and rigid. One of the best ways to overcome some of the problems generated by overly restrictive rules of origin is to reduce their importance by reducing barriers to trade from sources outside the free trade area.

**How to Proceed**

Over the course of the project the questions of how to move toward a future hemispheric free trade area and what to do at the present received much attention. The current stage of transition, although still somewhat ambiguous, offers countries the opportunity to prepare for mutually beneficial negotiations in the future.

Central to the discussion about how to proceed is whether "widening" or "deepening" existing subregional integration schemes should come first. Whatever path is taken, hemispheric negotiations will test the cohesion of the subregional integration schemes. Tensions and strains are already present, since the mere possibility of undertaking negotiations has exacerbated some of the differences, particularly because of uneven speeds of unilateral trade liberalization.

Some believe that priority should be given to strengthening subregional arrangements to make them the building blocks of hemispheric free trade. However, even if the deepening of subregional integration arrangements becomes a primary vehicle for hemispheric trade liberalization, laggards could slow the process. An alternative, more viable strategy could be to deepen subregional groupings and at the same time proceed to liberalize trade in the hemisphere. The two processes could become mutually supportive.
Furthermore, different countries or subregions find themselves at different levels of readiness to move forward. This readiness level, based on the consolidation of macroeconomic stability and the market orientation of policies, could influence a country’s ability to reap the benefits of hemispheric trade liberalization.

There appears to be a degree of consensus in Chile, for example, that the country is ready to reap a net welfare gain by increasing and diversifying its exports. No similar consensus yet exists, however, in the case of Brazil. Doubt remains as to whether hemispheric trade liberalization would best serve the country’s interests.

Even if Brazil were, after Mexico, the country that stands to benefit the most from liberalization, skeptics point out that it would face significant trade diversion, given Brazil’s high level of import and export diversification. The potential for retaliation by the European Community, Brazil’s largest trading partner, as well as an unstable macroeconomic situation have been obstacles to closer hemispheric trade relations.

In contrast, others argue that the major advantage for Brazil (and for the rest of Latin America) of joining a hemispheric free trade agreement is to end the marginalization and isolation they have experienced. The major danger is described as being excluded from emerging blocs, and hemispheric liberalization is perceived as offering the best, if not the only, opportunity available to eliminate that danger.

Some tasks could be carried out during the present stage of transition despite individual variations in levels of readiness: for example, consolidation of domestic reforms and adding to mutual knowledge.

Trade liberalization by itself would not become the “driver” of the development process and, while it is a necessary condition, it is not sufficient. However, if free trade is combined with other appropriate domestic policy measures, synergism is possible and the benefits can be significant. Consolidation of domestic economic reforms is seen as the principal task; a country’s own policies are at least as important as a trade agreement for the improvement of its efficiency and insertion into the international economy.

A second major task consists of increasing the mutual knowledge that is required by beneficial negotiations. Countries require access to information germane to commercial integration to proceed with any kind of hemispheric liberalization. Mutual knowledge implies increased awareness of the negotiating processes, some of which are fully open and subject to intense debate and pressures from a wide array of interests.

Besides increased mutual awareness and identification of possible sources of opposition, it is necessary for negotiators to understand fully the sources of the skepticism that still exists about hemispheric trade
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liberalization. Some of these arguments were on full display during the debate that took place before approval of NAFTA. From these debates it was clear that hemispheric trade liberalization is far from being a free lunch, and it is far from certain to be a panacea.

Finally, hemispheric trade liberalization demands caution. It is a journey into unknown territory, and costs and benefits cannot be accurately assessed in advance. However, it also demands serious attention since it clearly supports the broad objectives of development.

4. PROJECT STAFF

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S. LIST OF WORKING PAPERS

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