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Latin American South-South Integration and Cooperation: From a Regional Public Goods Perspective

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Abstract

The present level of intra-regional trade of Latin America and the Caribbean in relation to their total exports is still low when compared to the peak of 21.1% registered in 1997, despite its rebound in 2003 and continued recovery into 2004. While this trade holds a high potential for future growth, there are a series of problems to be addressed in order for regional integration to continue on the paths of recovery and “deep” integration. The countries in the region should keep working on the constraints that its regional integration process continues to suffer from the persistence of non-tariff barriers, perforations of common external tariffs (CET) and failure to complete customs unions.

In addition to these aspects in the trade spheres, regional integration agreements should tackle several dimensions of “deep integration” in a context of “open regionalism” by intensifying efforts on the provision of regional public goods (RPGs): (i) addressing “behind-the-border” measures, while harmonizing regulatory regimes in areas such as services, investment, intellectual property rights, rules of origin, anti-dumping, safeguards, sanitary and phyto-sanitary norms, customs procedures, and factor mobility; (ii) advancing the efforts on the coordination of macroeconomic policy; and (iii) improving various kinds of infrastructure and providing crucial public goods. These efforts will enhance systemic competitiveness of each country and the region as a whole. These initiatives, which would result in the reduction of production and transaction costs inside the region and the avoidance of unnecessary competition among the countries, will likely facilitate inter-regional South-South trade as well.

Introduction

South-South trade of Latin America and the Caribbean (LAC), composed both by intra-regional and inter-regional trade with other developing regions, expanded at a rate similar to that of North-South trade during 1990 and 2000, thereby constituting a very significant trade component for the countries of the region. After downturns suffered during 1998 and 2002, a strong recovery of intra-regional trade observed in 2003 and first half of 2004 and a big push of inter-regional trade with other developing regions registered in the same period seem to be confirming once again the great potential that South-South trade holds for LAC.¹

The main trait of LAC trade performance in the 1990s, especially up to 1997, was an impressive expansion in trade both within and among the four customs unions (Andean Community, MERCOSUR, Central American Common Market and CARICOM). However, until the year 2002, the economic problems plaguing most of the members of sub-regional integration arrangements forced the countries to suspend or postpone some of the commitments that had been undertaken to strengthen free trade among the partners and form customs unions in the respective sub-regions. In this sense, the four customs unions within and among themselves still have a long way to go in order to reach a more enhanced stage of “deep integration”. To

¹ Preliminary data for the first half of 2004 show that the growth rate of merchandise exports of the region has doubled compared to the same period in 2003 and both intra- and extra-regional trade have increased with dynamism. Therefore, the region seems to be experiencing a strong export boom during the biennium 2003-2004, in the aftermath of a two-year long stagnation (2001-2002). This robust performance has been influenced by the following three factors: (i) demand expansion in almost all export markets, including not only the countries of the North (Canada, USA, EU and Japan principally) but also developing countries, especially China, India, Africa and Middle East; (ii) increases in commodity prices; and (iii) recovery of intra-regional trade, which forms part of the South-South trade circuits.

advance towards this goal, LAC countries should keep perfecting the integration process not only by way of deepening trade-related commitments but also strengthening the provision of regional public goods (RPG). With respect to the latter, as Devlin, Esdevadeordal and Krivonos (2003) argue, a formal regional integration agreement such as a free trade area or a customs union should be considered as a type of RPG.²

The sub-regional integration schemes are, by definition, integration arrangements whose scope goes much further than those assumed under regional trade agreements (RTAs) or free trade agreements (FTAs), whether bilateral or plurilateral. The integration agreements, which are often non-reciprocal in terms of preference provisions, have a clear nexus between “trade” and “cooperation” built explicitly into their original framework. The EU-bilateral Association Agreements systematically integrate several initiatives through political dialogue, cooperation and reciprocal trade under a single umbrella agreement. The recent FTAs that Japan has signed with Singapore and Mexico as well as those FTAs being negotiated with other South countries, also incorporate in its official framework elements of cooperation (Aoki 2004). These orientations on North-South trade are in strong contrast to that of more mercantilist, “business-like”, reciprocal FTAs such as NAFTA, the new bilateral trade agreements in the region existing or being signed with the United States, and the Latin American Free Trade Association (LAFTA) of the 1960s (Devlin and Estevadeordal 2002). From this perspective, in order to reactivate the regional integration process, it is vital for LAC to revisit the issue of the nexus between trade and cooperation in trade agreements from the perspective of RPG as a vehicle for further regional integration.

² Devlin and Estevadeordal (2002) define RPG as “transnational public goods whose non-rivalry and non-exclusive properties extend beyond national borders, but are contained in a well-defined set of states or a geographic region.” As examples, they cite: cleaning up a lake; a transnational park; preserving a rain forest; airport hub-spoke networks; transportation infrastructure; transnational diseases; agricultural and other research; and policy standards (financial; labor, etc.).

I. South-South Trade

A. The Overall Picture

Trade among developing countries (South-South trade) increased rapidly in recent years, at an annual average rate of 8.0% between 1990 and 2002, raising its share in world trade from 9.4% to 12.5% —in nominal terms, from \$318 billion dollars in 1990 to more than 800 billion in 2002 (Table 1). Accordingly, the growth rate of South-South trade was 2.2 times greater than that for North-North trade during the same period. As a result, during 2000-2002, South-South trade (SST) came to represent 37% of total global trade of developing countries. It is important to note that about two-thirds of South-South trade has Developing Asia (DA) either as origin or destination (\$ 466 billion dollars), followed in importance by Middle East (\$ 103 billion dollars), LAC (84 billion) and the Central and Eastern European countries (CEE) (79 billion). During the period, the growth rate of SST for CEE was negative while the other regions, especially DA, reported a high rate.

Table 1
SIZE OF SOUTH-SOUTH TRADE: AVERAGE OF 2000-2002

(billion US dollars and percentages)

2000-2002	LAC	CEE	Africa	ME	DA	S-S-T	Growth 1990-2002
Latin America and the Caribbean (LAC)	58.5	3.0	3.6	3.8	14.8	83.8	7.5
Central and Eastern Europe ^a (CEE)	4.8	53.3	2.3	4.4	14.4	79.2	-1.2
Africa	4.7	0.8	11.2	3.3	18.3	38.3	9.4
Middle East (ME)	3.2	1.9	9.8	15.8	72.0	102.7	7.7
Developing Asia (DA)	27.5	14.7	18.4	30.9	374.0	465.5	11.9
South-South Trade (S-S-T)	98.8	73.7	45.3	58.2	493.5	769.5	8.0
Share of region in total world exports							
In 1990	1.3	2.9	0.6	0.7	3.9	9.4	
In 2002	1.5	1.2	0.7	1.0	8.0	12.5	

Source: ECLAC, International Trade and Integration Division, based on data of WTO.

^a Include Russia

Among the various South-South intra-regional trade flows, intra-DA trade (excluding Japan) was by far the most important, with an intra-regional trade share of 34.6%, followed by the intra-CEE trade of 22.6%, much higher than the level registered for LAC of 16.6%. In general terms, these coefficients point to the increasing importance of intra-regional trade, with a possible exception of Africa and Middle East, which maintain stronger trade links with Developing Asia than with the proper region (Table 2).

By disaggregating SST by region, one can observe that at the beginning of the present decade, Developing Asia represented 60.5% of total global South-South exports, 49% of which was accounted for by its own intra-regional trade. On the side of imports, the importance of DA was even more marked, with 64% of total South-South imports. In the cases of LAC and CEE, only 1.9% of total South-South trade was accounted for by DA, although the coefficient for other regions (Middle East, Africa and CEE) were even smaller (see Table 3). The upsurge in 2003 of certain SST including intra-DA and the LAC-DA bi-regional flows might have modified the relative importance of each SST circuit flow.

Table 2
SOUTH-SOUTH TRADE: SHARES OF SST IN EACH SOUTH REGION'S TRADE, 2000-2002
(Percentages)

2000-2002	LAC	CEE	Africa	ME	DA	S-S-T
Latin America and the Caribbean (LAC)	16.6	0.9	1.0	1.1	4.2	23.7
Central and Eastern Europe (CEE)	2.0	22.6	1.0	1.9	6.1	33.5
Africa	3.4	0.6	7.9	2.3	12.9	27.1
Middle East (ME)	1.3	0.7	3.9	6.3	28.6	40.7
Developing Asia (DA)	2.5	1.4	1.7	2.9	34.6	43.1
South-South Trade (S-S-T)	4.8	3.6	2.2	2.8	23.9	37.3

Source: ECLAC, International Trade and Integration Division, based on data of WTO.

Table 3
SOUTH-SOUTH TRADE: SHARES IN TOTAL S-S-T, 2000-2002
(In percentage of total S-S-T)

2000-2002	LAC	CEE	Africa	ME	DA	S-S-T
Latin America and the Caribbean (LAC)	7.6	0.4	0.5	0.5	1.9	10.9
Central and Eastern Europe (CEE)	0.6	6.9	0.3	0.6	1.9	10.3
Africa	0.6	0.1	1.5	0.4	2.4	5.0
Middle East (ME)	0.4	0.2	1.3	2.1	9.4	13.3
Developing Asia (DA)	3.6	1.9	2.4	4.0	48.6	60.5
South-South Trade (S-S-T)	12.8	9.6	5.9	7.6	64.1	100.0

Source: ECLAC, International Trade and Integration Division, based on data of WTO.

B. LAC South-South trade

Despite great heterogeneity among countries, LAC as a region already shows a high dependence on SST. In 2003, close to 74% of the region's exports were directed to the North (USA, Canada, EU and Japan), the rest being accounted for by the South. This overall regional picture changes dramatically when Mexico is excluded: Mexico accounted for close to 45% of total regional merchandise exports, and more than 93% of Mexican exports were destined to the North markets, with only 6% towards South markets. When Mexico is excluded, in the same year, close to 49% of total regional exports found their markets in the South (see Table 4). The importance of the South as an export market has increased over the years, when compared, for example, to 1990 when the share of the South was a little over 35%. Generally, Mercosur and Andean Community countries depend less on the North markets, whereas Central American countries show a greater dependence on the North markets, especially the United States Table 5).

Therefore, excluding Mexico, almost half of region's exports are of a South-South nature. The South-South trade was split almost evenly between intra- and inter-regional trade, the former representing more than 27% while the latter, 21% of region's total trade. These figures confirm that

South-South trade is already significant for the region as a whole, and that this trade holds a high potential for future growth.

Table 4
LAC (INCLUDING MEXICO): EXPORT STRUCTURE BY MAJOR DESTINATIONS, 1980-2003
(In percentages of total exports)

Regions / World	LAC (including Mexico)				LAC (excluding Mexico)			
	1980	1990	2000	2003	1980	1990	2000	2003
LAC – North	63.3	70.9	78.0	74.1	56.8	63.8	57.8	51.5
North America	36.2	40.9	64.4	56.8	30.3	33.1	36.6	30.8
European Union	22.9	24.0	11.4	11.1	25.7	29.2	20.6	20.4
Japan	4.2	5.9	2.3	6.2	0.9	1.6	0.6	0.3
LAC – South	36.7	29.1	22.0	25.9	43.2	36.2	42.2	48.5
Intra-regional	22.0	14.6	16.3	14.3	26.4	18.2	31.0	27.3
inter-regional	14.7	14.5	5.7	11.6	16.7	18.0	11.2	21.2
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: ECLAC, International Trade and Integration Division, based on data of WTO.

As pointed out earlier, the relative importance of the North for LAC (including Mexico) as export destination in the present decade has been in a range of 70% with a share of 74.1% in 2003, 56.8% of which was accounted for by North America, and 11.1% by EU and 6.2% by Japan (Table 4). The share for the United States has been on a discernible rise while that for EU has been on a steady decline. Despite rebounds in recent years, the relative importance of Japan as export destination for the region when Mexico is excluded is insignificant. The impacts of FTAs that LAC countries have signed, or are in process of signing, with the North countries are yet to be substantiated, but it is likely that they divert LAC South-South trade especially for more developed countries in the region, at least in the short-run, for a number of manufactures (Nogués 2004).³

³ Examining four RTAs involving LAC (i.) a South American Free Trade Area encompassing MERCOSUR, Chile, and the Andean Community countries, ii) an FTA between the Andean Community and the United States, iii) an FTA between the EU and MERCOSUR; and iv) the FTAA, Monteagudo and Watanuki (2003) argue that although the North-South agreements are in general better options than those of South-South, for more advanced developing countries of the region, South-South agreements can be superior to North-South ones from the perspective of productive specialization in value-added goods.

Table 5

**LATIN AMERICA (16 COUNTRIES): EVOLUTION OF EXPORTS BY MAJOR DESTINATIONS,
1990, 2000 AND 2003**
(In Percentages of total in each year)

	1990			2000			2003		
	North ^a	South ^b	Total	North ^a	South ^b	Total	North ^a	South ^b	Total
MERCOSUR	59.5	40.5	100.0	45.2	54.8	100.0	46.1	53.9	100.0
Argentina	48.2	51.8	100.0	31.0	69.0	100.0	32.6	67.4	100.0
Brazil	65.7	34.3	100.0	53.2	46.8	100.0	52.4	47.6	100.0
Paraguay	37.3	62.7	100.0	17.6	82.4	100.0	11.2	88.8	100.0
Uruguay	36.7	63.3	100.0	27.3	72.7	100.0	38.5	61.5	100.0
Chile	70.8	29.2	100.0	56.6	43.4	100.0	53.8	46.2	100.0
Andean Community	71.7	28.3	100.0	63.5	36.5	100.0	61.3	38.7	100.0
Bolivia	49.4	50.6	100.0	36.1	63.9	100.0	24.3	75.7	100.0
Colombia	76.4	23.6	100.0	65.3	34.7	100.0	60.8	39.2	100.0
Ecuador	65.9	34.1	100.0	51.8	48.2	100.0	59.1	40.9	100.0
Peru	69.7	30.3	100.0	54.9	45.1	100.0	59.5	40.5	100.0
Venezuela	72.3	27.7	100.0	67.3	32.7	100.0	64.8	35.2	100.0
Mexico	90.8	9.2	100.0	92.5	7.5	100.0	93.9	6.1	100.0
MCCA	68.4	31.6	100.0	63.4	36.6	100.0	67.9	32.1	100.0
Costa Rica	76.0	24.0	100.0	75.2	24.8	100.0	68.0	32.0	100.0
El Salvador	64.0	36.0	100.0	71.1	28.9	100.0	65.0	35.0	100.0
Guatemala	57.3	42.7	100.0	50.2	49.8	100.0	64.2	35.8	100.0
Honduras	85.3	14.7	100.0	68.0	32.0	100.0	73.7	26.3	100.0
Nicaragua	50.6	49.4	100.0	64.2	35.8	100.0	67.1	32.9	100.0

Source: ECLAC, International Trade and Integration Division, based on official data of countries.

^a Include region's exports to the United States, Canada, European Union and Japan.

^b In addition to intra-regional exports, include exports to Developing Asia, Africa and Middle East.

C. Intra-regional integration schemes⁴

The hallmark of the region's trade performance in the 1990s, especially up to 1997, was an impressive expansion both in trade within each of the four customs unions (Andean Community, Mercosur, CACM and CARICOM) and in imports from the rest of the world. During this period, government authorities frequently resorted to regional integration to signal their continued commitment to liberalization, even when economic conditions for further unilateral opening were difficult, or when reciprocal multilateral initiatives were in a transition phase, as was the case since the end of the Uruguay Round.

⁴ LAC countries have a long history of regional integration. First in the 1950s, there was much discussion of a Latin American Common Market. After a decade of negotiations, the Latin American Free Trade Association (LAFTA) was launched in 1960. The Central American Common Market was created in the same year, followed by the Andean Group established in 1969. By the second half of the seventies, all of these initiatives were in great difficulties and most of them became policy instruments of reduced relevance for the countries when the debt crisis of the early 1980s induced a deep recession in Latin America and a severe contraction of intra-regional trade. These integration regimes were characterized by: (i) the state-led import substitution industrialization model of development; (ii) an inward-looking orientation; (iii) a high level of selectivity with the application of multiple positive lists; and (iv) skepticism regarding private markets and great concern about the presence of, and dependence on, foreign firms (IDB 2002). The approach was to eliminate internal barriers while maintaining high external protection and expanding industrial planning.

Nonetheless, as can be appreciated from Figure 1-A and Table 6, despite a rebound in 2003, intra-regional trade in LAC has experienced a strong setback in recent years, and still remained at a relatively low level when compared the share experienced a decade ago; the level of intra-regional trade (Mexico included), which accounted for 16.0% of total regional trade in 2003, was still low compared to the peak of 21.1% registered in 1997 or the 16.4% level of 1980. Furthermore, these trade flows tend to follow a pro-cyclical trend whereby intra-group trade expanded and contracted in line with third-party trade.

This unsatisfactory performance reflects in large parts economic instability experienced by the majority of the countries in the region as well as the limited progress made in strengthening ties, fulfilling objectives and improving compliance with the rules adopted. Other hurdles on this front have been the incompleteness of and weakness in the design of the original agreements themselves and difficulties in securing a consensus to remedy these constraints, economic and partisan-politics crises, and asymmetries in the benefits and costs accruing to the partner countries (IDB, 2003). In sum, although the four customs unions have been progressively deepened since the 1990s with the inclusion of non-border issues, there is much to be done to reach a higher stage of “deep integration”.

The contraction pattern of Mercosur is even more severe; the degree of intra-MERCOSUR trade was less than 12% in 2003, in contrast to a 25% level registered in 1998 (Figure 2-A). Trade integration of the Andean Community member countries is even lower; at the peak of 1998, the degree of intra-group trade reached almost 13% and continued to decline to 9% in 2003 (Figure 2-B). The CACM and CARICOM show a relatively brighter situation because the share of all manufactures⁵ exported within each sub-region is larger than the share exported to industrialized countries with a sustained growth in terms of volume, but a standstill from the viewpoint of the degree of intra-group trade in recent years (Figures 2-C and 2-D). In sum, no integration agreement of the region seems to come close to reaching the long-run impact of the EU (Figure 1-B), and the sub-regional agreements, which sparked intra-regional trade for some time, has important challenges ahead in order to foster trade and growth of each member country. Interestingly, ASEAN figures much more favourably than MERCOSUR, though the two regions are similar in terms of trade volume (Table 6).

The trade structure of each sub-regional integration scheme also suffers from a heavy trade concentration by member countries. In the case of MERCOSUR, for example, in 2003, Brazil represented more than 45% of total intra MERCOSUR trade, while this market accounted for only 8% of Brazil’s total exports. In the same year, Argentina accounted for 44% of total MERCOSUR exports, while MERCOSUR partner countries absorbed only 19% of total Argentinean exports. The remaining 10% of intra-MERCOSUR trade was accounted for by Paraguay and Uruguay, whose dependence on this sub-regional markets was much higher, with 36% and 30%, respectively.

A comparable phenomenon occurs in intra-Andean Community trade. In 2003, Colombia (38%), Venezuela (22%) and Ecuador (21%) together represented more than 80% of total intra sub-regional trade, the rest being accounted for by Bolivia (8%) and Peru (11%). However, the highest sub-regional dependence was observed in Bolivia, which exported 27% of its total exports to this integration scheme. A similar case can be made for CACM as well: while the share of intra-CACM trade for Costa Rica, the largest exporter in this sub-regional group, was substantially lower (13%)

⁵ In 2002, of the twenty major export products within CACM, seventeen were manufactures, representing 36% of total intra-CACM exports (ECLAC, 2003c, Table 29). In the case of CARICOM, top fifteen intra-CARICOM exports in 1998 were manufactures representing 72% of total exports. It is notable that primary agricultural products do not feature among the list in the case of CARICOM (see CARICOM, 2000, pp. 58-60). The relatively sophisticated manufactures that are important in both sub regions include chemical and pharmaceutical products, mineral fuels, lubricants and related materials, soaps, pigments, paints, building cement; iron and steel, paper an paper board, water and organic surface active agents, non alcoholic beverages and miscellaneous and edible products and preparations.

than that corresponding to the other four countries, over 31% of Nicaraguan exports were absorbed by this group while representing only 8% of intra-CACM trade. In the case of CARICOM, over 76% of intra-sub-regional trade was accounted for by Trinidad and Tobago, but less than 10% of its exports were directed to its own sub-region. The level of reliance on the sub-regional market is correlated strongly with the level of GDP per capita of the country in question, pointing to the very important question of asymmetry and the distribution of benefits and costs of regional integration.

Table 6
INTRA-REGIONAL TRADE: LAC, NAFTA, FTAA, ASEAN (10), EU (15):
1980, 1985, 1990, 1995, 2003
(In percentages)

REGIONS / SUB-REGIONS	Intra-regional trade					Export Share in World Exports				
	(A) = $(X_{intra}/X_{Toti}) * 100$					(B) = $(X_{Toti}/X_{world}) * 100$				
	1980	1985	1990	1997	2003	1980	1985	1990	1997	2003
LAC	16.4	10.6	14.4	21.1	16.0	5.1	5.0	3.8	5.1	5.2
Andean Community	3.7	3.2	4.1	12.1	9.0	1.6	1.2	0.9	0.8	0.8
MERCOSUR	11.6	5.5	8.9	24.9	11.9	1.6	1.8	1.3	1.5	1.5
CACM	23.1	14.4	14.1	13.3	20.7	0.3	0.2	0.1	0.2	0.2
CARICOM	8.3	11.3	12.4	16.7	21.3	0.3	0.2	0.1	0.1	0.1
NAFTA	33.6	43.9	41.4	49.1	55.0	16.3	16.7	15.9	18.1	15.6
FTAA (34)	33.6	43.9	41.4	49.1	60.1	20.5	20.6	18.9	21.2	18.7
ASEAN (10)	17.4	18.6	19.0	24.0	22.7 ^a	3.8	3.7	4.2	6.4	6.3 ^a
EU (15)	55.6	59.9	64.9	62.9	62.7	37.0	36.3	43.9	38.4	38.7

Source: ECLAC, International Trade and Integration Division, based on official data of the respective integration scheme secretariats and IMF, Direction of Trade Statistics, May 2003.

^a Coefficient corresponds to the year 2002.

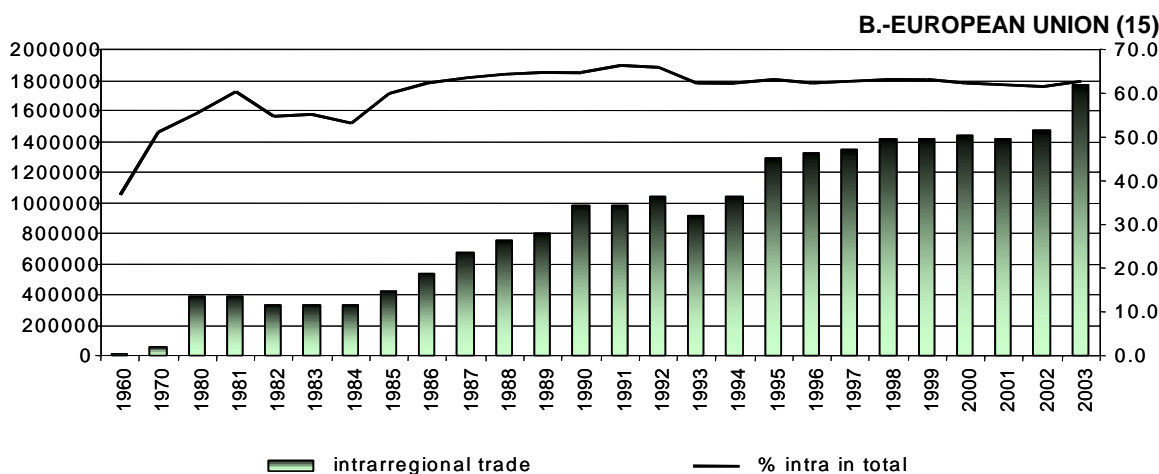
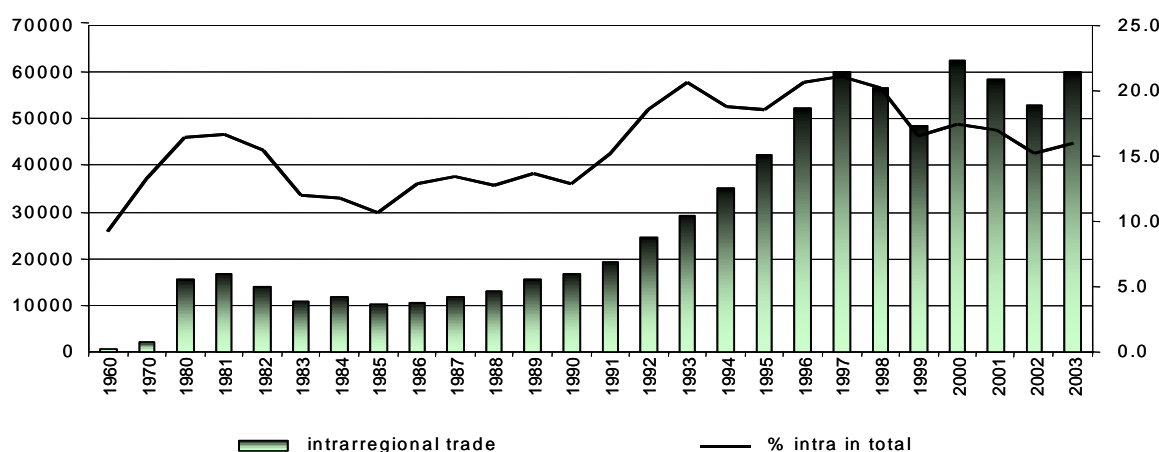
It is also disquieting that for the four customs unions, the relative importance of intra-regional trade in the overall trade that takes place at the regional level has been declining over the years. Trade among LAC countries may be divided into two categories: (i) trade between members of sub-regional groupings (intra-group trade) and (ii) trade between countries that are parties to the economic complementarity agreements of the Latin American Integration Association (LAIA) or free trade agreements (inter-group trade). Whereas inter-group trade accounted for less than half the exports absorbed by the region in 1998, the proportion rose to 57% in 2000 and 63% in 2003 (ECLAC 2004b). In short, within the declining intra-LAC trade, the combined shares of intra-group trade of the four customs unions have been declining.

D. Impediments to Intra-Regional Trade

In light of the above, much remains to be done if LAC is to more fully exploit the potential benefits of regional integration. The countries in the region should keep working on the constraints that its regional integration process continues to suffer from: (i) the persistence of non-tariff

barriers; (ii) perforations of common external tariffs (CET) and failure to complete customs unions;⁶ (iii) inadequate regional infrastructure; (iv) weakness in the national and regional institutional apparatus; (v) limited coordination of macroeconomic and sector policies, as well as tax systems that do no work for integrated markets and fail to stimulate external trade and investment; and (vi) few mechanisms to promote a socio-economic development that would compensate for asymmetries in the distribution of the benefits of integration (IDB 2003). The modernization and simplification of customs procedures, the strengthening of sub-regional dispute settlement mechanisms, and the building of institutional and human capacities in matters related to certification/verification of technical barriers and sanitary and phyto-sanitary measures would also be important elements of such RPG (ECLAC 2002).

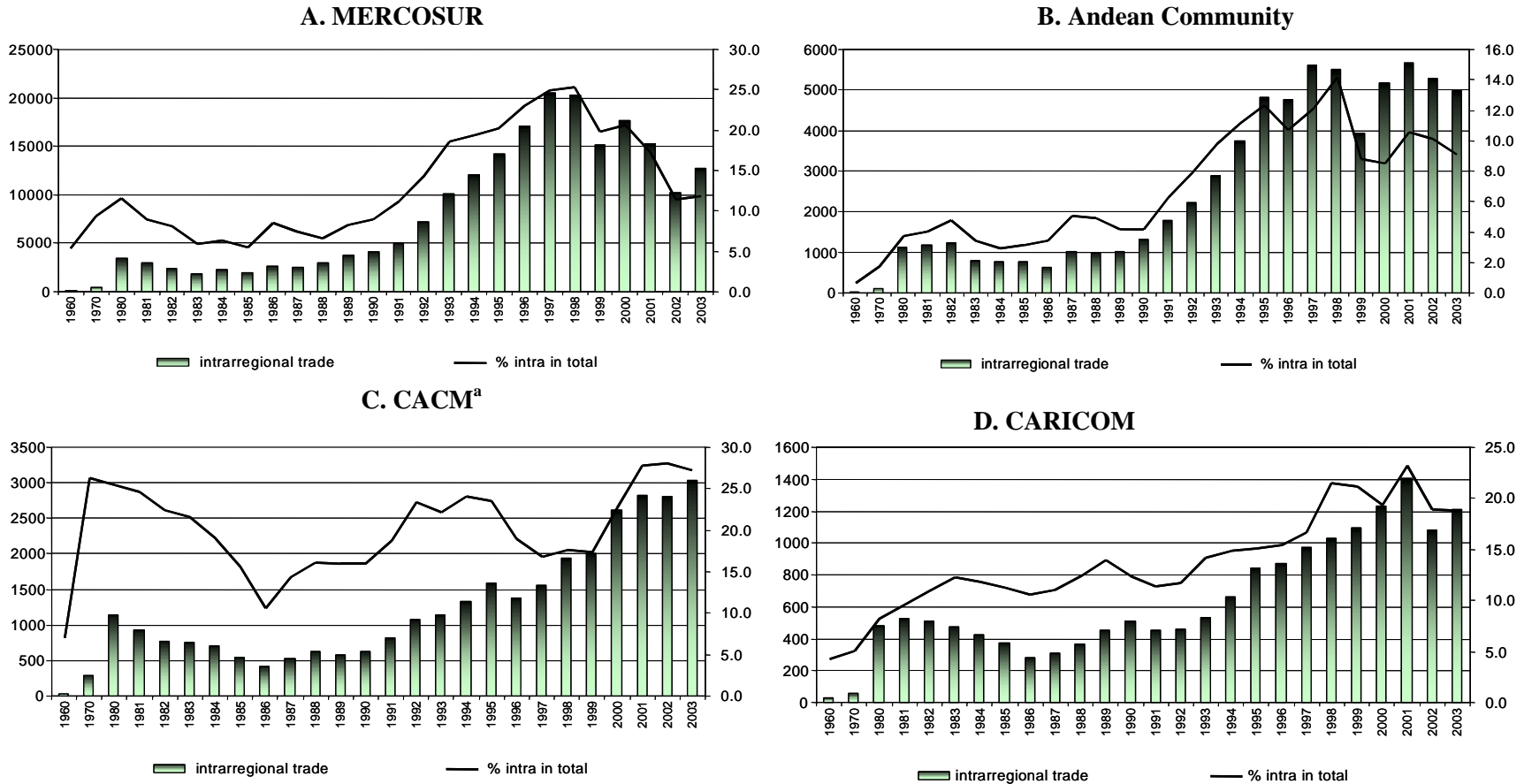
Figure 1
EVOLUTION OF LAC VS. EU INTRA-REGIONAL TRADE: 1960-2003
A.-LATIN AMERICAN AND CARIBBEAN



Source: ECLAC Database to the LAC countries, and IMF and WTO for the EU countries

⁶ In the case that the FTAA ends up being a shallow, much less ambitious agreement, sub-regional agreements should play a larger role in raising the economic and social welfare of the countries in the region. This is especially so when the goals of LAC integration schemes to establish customs unions and common markets are fully met. Moreover, within the context of a complete customs union project, once agreement has been reached on the implementation of the CET, bilateral deals with third parties by individual members of the union should be avoided. Regardless of the success and scope of the FTAA, sub-regions with common market tariffs should continue to reduce external tariffs, which can benefit all members, but especially smaller ones that are more prone to being affected by unwanted trade diversion (IDB, 2002, p.16).

Figure 2
LATIN AMERICA AND THE CARIBBEAN: INTRA-SUB-REGIONAL TRADE EVOLUTION IN SUB-REGIONAL SCHEMES: 1990-2003
(Millions of current dollars and percentages —right axis—)



Source: ECLAC, Division of International Trade and Integration, on the basis of official data

^a In the case of Central American Common Market, intra-regional exports excludes maquila, whereas total exports include it.

The new agendas of the MERCOSUR and Andean Community (the 2006 Objective and the Quirama Declaration of 2003, the Action Plan of Central American Common Market, and the Single Market Initiative of CARICOM, respectively) take into account the majority of the above mentioned RPG matters and aim to remove the existing obstacles to sub-regional trade and investment flows. Though the four customs unions have been progressively deepened since the 1990s with the inclusion of non-border measures, they still have a long way to go in order to reach a next stage of “deep integration” which in part involves the provision of RPG (see Boxes 1, 2 and 3).

E. Impediments to Inter-regional S-S Trade

Two interrelated problems provide possible explanations for the level and moderate growth of trade flows for LAC’s inter-regional South trade: country composition and product composition. Trade flows between LAC and Developing Asia (DA) and Central and European countries (CEE), for example, are concentrated in a few countries (Kuwayama, Mattos and Contador 2000, and Maldonado and Durán 2004), although import and export markets for both regions have become more diversified, and this process is expected to continue in the future. Regarding product composition, trade flows are remarkably different according to the direction of trade: imports from DA and CEE are composed of manufactured goods, whereas LAIA exports are mainly primary commodities. The nature of those flows is almost purely inter-industrial. This problem has been coupled by geographical distance, in general, and the lack of direct transport and irregularity of services offered across the Pacific, in particular, which have rendered trade exchanges between the two regions difficult, negatively affecting the competitiveness of export products.

Given the divergent pattern of international specialization between LAC and DA and CEE, future trade expansion of LAC to these two regions will likely involve mainly traditional product areas, rather than those of intra-industry nature, which theoretically possess high value-added and technology contents. However, as has been demonstrated in several LAC countries (Kuwayama and Durán 2003), it is quite possible to increase value-added and technology and knowledge contents in traditional export products by incorporating high quality services and other production methods such as information technologies.

On the other hand, a better intra-industry articulation between the South regions is especially promising between countries that are less asymmetric in terms of development levels and industrial capabilities, promoted by *de facto* productive and financial integration by way of investment or joint ventures. This process is expected to provide another means for LAC countries to insert themselves more effectively, especially in DA. It should also promote investment and the incorporation of technology and management skills, which will be facilitated by involving countries that have rapidly closed the “technology gap” with the developed world.

Moreover, given the present low level of economic interchange, discussions of trade accords or agreements should incorporate, from the outset, economic cooperation schemes for deeper inter-regional interaction. Cooperation could incorporate instruments such as trade and investment promotion schemes, training programmes for managers, scientific and technical cooperation and energy cooperation. The broad heading of “business facilitation” should be encouraged, with special emphasis on customs rules and procedures and technical standards and related testing and certification. Programmes on small and medium-sized enterprises (SMEs) should be also encouraged, including human resources development, information access, technology and technology sharing, financing and joint-ventures.⁷ It is also urgent to resolve problems related to

⁷ The traditional thirteen areas of economic and technical cooperation that APEC has addressed can be the major component of these efforts: human resources development; industrial science and technology; small- and medium-sized enterprises; economic

the system of cargo and passenger transportation, identify areas of bottlenecks and elaborate proposals for improving transportation and promoting cooperation agreements. With respect to the enhancement of inter-regional trade for LAC, the provision of several RPG is also essential.

Box 1**SUMMARY OF THE MECOSUR PROPOSAL “TARGET 2006”****Political, social and cultural programme**

- Increasing participation of civil society
- Mercosur Parliament, which could be elected by direct voting by 2006
- Boosting cultural cooperation
- Setting up a social institute
- Enhancing “Mercosur Ciudadano” (civil society)

Customs Union Programme

- Dealing with development asymmetries
- Common external tariff (perforations eliminated by 2006)
- Special common regimes (negotiated until 2006)
- Free trade zones
- Common external negotiations
- Common commercial defence, including safeguards for extra-zone trade (regimes negotiated until 2004 and adopted in 2006)
- Definition of instruments for the gradual elimination of antidumping measures and countervailing measures for intra-group trade (negotiated until 2004, entry into force by 2006)
- Policy on common defence of competition (entry into force by 2006)
- Productive integration with promotion of competitiveness forums; definition of financing instruments; training programmes; and mutual recognition of conformity assessment systems
- Discipline on incentives (negotiated until 2004, entry into force in 2006)
- Macroeconomic coordination
- Reinforcement of institutions
- Bases for a Common Market
- Liberalization of services
- Regional capital market
- Promoting regional investment

Bases for a common currency

- Government procurement (agreement scheduled for conclusion in 2003)
- Circulation of labour force and promotion of workers' rights

Programme on new integration

- Education for Mercosur
- Cooperation programmes in science and technology
- Advanced productive integration
- Physical integration

Source: Mercosur Administrative Secretariat, MERCOSUR/XXIV CMC/DI N° 01/03.

infrastructure; energy; transportation; telecommunications and information; tourism; trade and investment data; trade promotion; marine resource conservation; fisheries, and agricultural technology. Though not included as an independent area, environmental protection is mentioned in relation with several areas.

SUMMARY OF QUIRAMA DECLARATION (ANDEAN COMMUNITY)

The aim of this general programme is to enhance the process of embarking on a second generation of policies and to establish the following lines of strategic action and guidelines:

Political dimension

- Construction of a governance agenda.
- Preparation of Andean Common Security Policy guidelines.
- Start up of the Andean Plan for the Prevention, Combating and Eradication of Small, Light Weapons.
- Adoption of a Programme to Disseminate and Implement the Andean Charter for the Promotion and Protection of Human Rights.
- Implementation of the Operational Plan for the Control of Illegal Drugs and Related Offences.
- Preparation of guidelines for an Andean Plan to Fight Corruption.
- Adoption of an Andean Plan to Fight Corruption.
- Laying down the guidelines for a Subregional Food Security Policy and action plans against poverty and marginalisation.

Social and cultural dimension

- Formulation of the Integrated Social Development Plan.
- Establishment of regulations for the Decisions on labour migrations, social security and safety and health at work. The adoption of the necessary legal provisions for mutual recognition of professional licenses, degrees and accreditations.
- Ensuring social participation in the integration process and defence of consumer and indigenous rights.
- Preparation of policy guidelines to improve the quality, cover and relevance of education.
- Promoting the creation of an Andean commission on investment in health.

Economic dimension

- Fostering a process of reflection on the Free Trade Area of the Americas (FTAA) and the Andean Community's international positioning.
- Analysis of the causes and proposal of solutions for non-compliance with Community regulatory provisions.
- Assessment of the integration process for each country.
- Formulation of a common agricultural policy.
- Formulation of programmes for the liberalization of Sub-regional trade in services and implementation of actions for linking customs.

Border integration and development

- Establishment of a comprehensive plan for border integration and development.
- Support for implementation of South American Regional Infrastructure Integration Initiative (IIRSA).
- Promotion of border integration zones.

Sustainable development

- Design and execution of programmes on the environment, energy development and disaster prevention and assistance.
- Design an Andean Plan to follow up the World Summit on Sustainable Development held in Johannesburg and that Summit's Plan of Implementation.

Institutions

- Supporting and strengthening the Andean Integration System.
- Preparing proposals for extrajudicial conflict settlement.
- Acceleration of the direct election of an Andean Parliament.

Source: Andean Community, Quirama Declaration [on line], General Secretariat, 28 June 2003 (<http://www.comunidadandina.org/ingles/document/Quirama.htm>).

Box 3

SUMMARY OF CENTRAL AMERICAN COMMON MARKET ACTION PLAN AND CARICOM SINGLE MARKET INITIATIVE

Central American Common Market Action Plan, 2002 (Advances)

The action plan on Central American economic integration was adopted on 24 March 2002. The plan is a political vehicle for a deep integration in several dimensions:

Political, Institutional and Law dimensions

- Work in a comprehensive agenda to achieve the goals of the Action Plan
- CET tariff harmonization (tariff changes by consensus)
- Adoption of Treaty on Investment and Trade in Services (actually in force)
- The Central American Uniform Customs Code (CAUCA) has been approved
- Approve Dispute Settlement Mechanism
- Integration of the Executive Committee of the Central American Integration System (SIECA)

Economic dimension

- Macroeconomic convergence, specially in the achievement of:
 - reciprocal financing supervision;
 - harmonization of Central American public debt markets to eliminate barriers to capital flows

Border integration and development

- Support for implementation of the Puebla-Panama Plan to improve infrastructure of the region to achieve and promote regional development and integration of Central American countries with Mexico in energy, infrastructure, Telecommunication, and Trade Facilitation.

Sustainable development

- Support for implementation of the Puebla-Panama Plan to strengthen the Meso-American initiative for Sustainable Development, Human Development and the Prevention and Migration and Natural Disasters.

CARICOM Single Market Initiative (Advances)

The region has pursued and intensified its efforts to consolidate the Caribbean integration and has established the CARICOM Single Market and Economy (CSME).

Political, Institutional and Law dimensions

- CARICOM authorities decided to establish a work unit within the CARICOM Secretariat
- Joint action to maintain a single voice in international and hemispheric bodies (Regional Negotiating Machinery)
- Harmonization of customs legislation, regulations and forms
- Establishment of the Caribbean Court of Justice
- Establishment of the CARICOM Regional Organisation for Standards and Quality
- Approval of measures to avoid double taxation

Economic dimension

- Macroeconomic convergence, specially in the achievement of:
 - External reserves requirement (three month's import coverage of 80% of foreign currency bank deposits in central banks for a 12-month period);
 - Exchange rate requirement (stable against dollar with 1.5% band for 36-month period); and
 - External debt-servicing ratio (no more than 15%).

Source: SIECA webpage and ECLAC (2003), Latin America and the Caribbean in the world economy 2002-2003.

II. Proliferation of PTAs and South-South Trade

A. Introductory remarks

Among the various routes towards trade liberalization (i.e., unilateral, sub-regional, multilateral and hemispheric) that have been applied in the region, bilateral and plurilateral FTAs have predominated over customs unions since the mid-1990s. Moreover, LAC governments have been working actively to put together a web of these arrangements with countries both within and outside the region, while proceeding with the negotiations on the creation of Free Trade Area of the Americas (FTAA). Mexico and Chile have concluded FTAs with a number of countries and regions that are not geographically contiguous, such as the European Union, as well as with the European Free Trade Association (EFTA). Chile has signed an FTA with the United States, and other FTAs have been implemented with Canada, and several other parties. Central American countries have negotiated an FTA with the United States. Mercosur is building up an interregional association with the European Union, and there are initiatives to cover India and China, among others.

Using the PTAs in existence as of 31 of March 2004, including those PTAs that have been signed but not yet ratified,⁸ ECLAC estimates suggest that approximately 61% of LAC exports in the first quarter of 2004 were covered by PTAs (i.e., bilaterals as well as

⁸ This includes the Central America Free Trade Agreement (CAFTA), which has already been signed, and the FTA between the Republic of Korea and Chile, which has already entered into force.

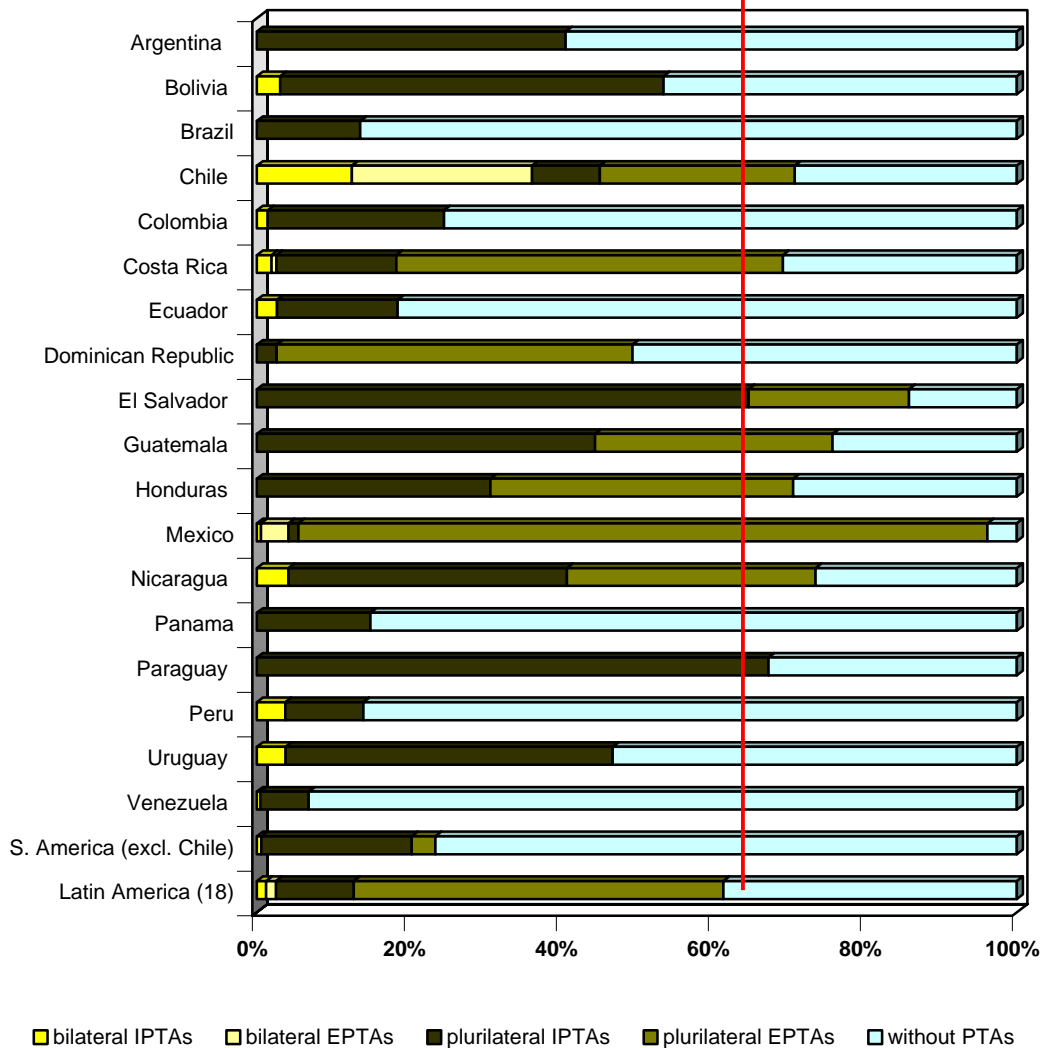
plurilaterals) in one way or another, and that the increase in this coefficient has been especially sharp since the mid-1990s and continuing on into the present decade. It is important to point out that during this period, the most marked progress has been seen in the conclusion of FTAs with countries outside the LAC proper region (Figure 3), especially with the North countries such as the United States, Canada, the EU and EFTA countries. In the course of this process, Chile and Mexico have become true “semi-hubs” for FTAs in the hemisphere. Of the 61% of LAC exports mentioned above, 49.5% corresponds to extra-regional markets, in contrast to a small portion (11.6%) for intra-regional markets. In the former category, the North-South type predominates.

B. “Deep” Integration in North-South and South-South Agreements

Perhaps the most dramatic change in the LAC integration process has been the shift from an intra-regional focus (South-South) to a growing interest in inter-regional agreements (North-South). This change has meant that LAC is now trying to link up with North countries via reciprocal FTAs, in contrast to the traditional non-reciprocal approach that these countries were more accustomed to. This increased tendency to pursue bilateral trade agreements (BTAs) parallel to the FTAA negotiations, especially the recent interest by the United States in initiating and/or concluding bilateral FTAs with Chile, Central America, the Andean Community and others, poses potential risks for a comprehensive and balanced WTO agreement and FTAA. In addition, there has been a proliferation of South-South FTAs in the region, led principally by Chile and Mexico as regional hubs. The progress of hub-and-spoke regionalism in the Western Hemisphere has been rapid despite the recognition that preferences obtained by BTAs would be gradually perforated and diluted by other PTAs over time. These strategies, in turn, could stifle the formation of a balanced FTAA and can have a negative effect on economic and social welfare.⁹

⁹ The Santiago Declaration repeats the Declaration of the IV Ministerial Meeting on Trade in San José, Costa Rica stipulating that the FTAA can co-exist with bilateral and sub-regional agreements to the extent that the rights and obligations under these agreements are not covered by or go beyond the rights and obligations of the FTAA (building blocks approach); and that the FTAA should be constructed based on commitments that are balanced, equitable and advantageous for each of the members.

Figure 3
LATIN AMERICA (18 COUNTRIES): EXPORT FLOWS, BY
PREFERENTIAL TRADE AGREEMENT, 2004^a
(Percentages of total trade)



Source: ECLAC, Division of International Trade and Integration, on the basis of trade information from the United Nations COMTRADE database.

^a For the 2004 estimate, the two-year average of exports for each country was used to determine the trade structure, and the PTAs in existence as of 31 March (including those for which negotiations have been concluded) were taken into account.

It is important to take note of several aspects of these BTAs with the North. First, they tend to establish and consolidate the access that the LAC countries already have through the Generalized System of Preferences (GSP). Secondly, those FTAs include provisions in investment, competition policy, government procurement and trade facilitation that are of special interest to the North with “WTO-plus” disciplines for which there are no multilateral rules in place. Thirdly, issues that affect Latin American signatories, such as internal support measures in agriculture or anti-dumping legislation, are remitted to the multilateral negotiating forum.

Therefore, LAC countries pursue North-South FTAs to secure more stable and greater market access, to attract foreign direct investment and to “lock-in” and add credibility to the often “WTO-plus” trade-related disciplines contained in FTAs. However, trade liberalization commitments contained in these FTAs with the North tend to reinforce comparative advantages of the countries of the South either in primary commodity sectors (e.g., South American countries) or in unskilled labour-intensive manufacturing sectors (e.g., Mexico and Central American and several Caribbean countries). At the same time, these FTAs are likely to divert intra-LAC trade in several important manufacturing sectors. Likewise, South-South FTAs with other developing countries outside the region (e.g., Chile-Korea FTA) would also reinforce comparative advantages of LAC countries in traditional sectors, while they increase complementarities in inter-industrial rather than intra-industrial trade relations.

Another important characteristic of North-South FTAs involving the United States is that these FTAs generally do not contemplate a “cooperation” component, thereby being solely mercantilist, business-oriented in their initial intent, though this orientation might change in the near future (Devlin and Estevadelordal 2002). From the perspective of exclusion of cooperation aspects from their commitments, NAFTA, the new BTAs and the LAFTA of the 1960s (see the note 4 of this paper) can still be considered “shallow”, despite their broad coverage of disciplines and comprehensive nature of commitments.

In contrast, the conventional LAC sub-regional integration schemes contemplate cooperation schemes in their initial commitments. Meanwhile, Western Europe is a good example of where deepening trade interdependence through trade evolved into comprehensive mix of trade and cooperation. NAFTA partners seem to be moving from a pure trade orientation to a mix of trade and cooperation. APEC is rather unique with its strong emphasis on cooperation but with voluntary commitments on trade liberalization. ASEAN may be a special case where the focus shifted from cooperation to a combination of trade and cooperation. The Western Hemispheric Summit process, which involves a free trade negotiation coupled with a confederation of somewhat autonomous non-trade cooperation initiatives involving more than twenty areas, might be considered as another type.¹⁰ On the other hand, Japan begins to apply the already established pattern of the Agreement between Singapore and Japan for a New Age Economic Partnership, which has a strong focus on economic cooperation, to other FTA negotiations the countries of the South (Aoki 2004), including Mexico.¹¹ From the perspective of LAC South-South trade, several cooperation schemes are contemplated within the framework of an India-Mercosur Agreement.¹² An inter-regional South-South FTA, the Chile-Korea FTA, contemplates in its official text a series of initiatives on bi-national cooperation in areas such as phyto-sanitary and sanitary measures, conformance and standards, information technology, and others.

It should be stressed that in addition to the mercantilist approach, most of the FTAs signed in the 1990s and during the present decade that include developing countries in the Americas, follow the NAFTA model in terms of thematic coverage, with a possible exception for competition policy. South-South FTAs existing in the region are no exception to this rule. These second-generation FTAs are more comprehensive in scope, not only because they are “broad” in terms of the number of sectors negotiated and incorporated, but also because of the “depth” of the commitments they

¹⁰ As outlined in the Hemispheric Cooperation Program, endorsed by trade ministers attending the meeting held in Quito, Ecuador, on 1 November 2002, the technical cooperation available will be fundamental to ensure that the FTAA brings benefits to its members. This should not be limited to providing technical assistance, but should also include strengthening productive capacity and stimulating competitiveness, innovation and technological transfers.

¹¹ In the case of Japan-Mexico FTA, the Mexican government sources state that this agreement will have a strong emphasis on economic cooperation especially in the area of enhancement of Mexican SMEs.

¹² For instance, India and Brazil signed five agreements that include bilateral cooperation in peaceful use of outer space, tourism, culture and other diversified areas.

entail in those sectors that are “WTO-plus” disciplines. This is especially true for services,¹³ investment and intellectual property (Blanco and Zabludovsky 2003). These FTAs are, of course, not identical to NAFTA and take into consideration the specific interests of the relevant trading partner(s), thereby establishing a realistic agenda for the parties involved. However, not only do all these FTAs share the philosophy and format of NAFTA but that some texts in certain disciplines are almost identical to those of NAFTA (Blanco and Zabludovsky 2003). These FTAs also introduce new approaches to older issues such as rules of origin, contingent measures for imports and dispute settlement.

In sum, BTAs, especially of North-South nature, improve market access, consolidate and expand trade preferences, establish mutual rights and obligations (dispute settlement mechanisms), lock-in liberalization efforts, and may favour institutional modernization. Nevertheless, multiple BTAs do have some costs: intra-regional trade diversion, administrative costs (“spaghetti bowl”), reduced bargaining power for smaller countries, some countries agreeing to certain demands in areas that go beyond commonly accepted trade issues, etc. They also reduce the incentives to push the regional envelope and the willingness of the developed world to push multilateral negotiations. Besides, it should be kept in mind that FTAs (and FTAA) are an opportunity, but they are not a “*panacea*”, much like the structural reforms of the 1990’s were not.

In the same context, ECLAC (2004a) has argued that to ensure their development, countries generally must hold onto some flexibility to stimulate productive development, boost competitiveness and manage the capital account as a tool in macroeconomic regulation. Moreover, to ensure that participating countries’ levels of development eventually converge, new initiatives are vital, among them the creation of cohesion or integration funds¹⁴ and increasing international labour mobility (Assael 2004, Bustillo and Ocampo 2003). The countries of the region should maintain a certain margin of flexibility within the sub-regional, WTO and FTAA disciplines in order to adopt active policies for productive development and thus increase their systemic competitiveness.

¹³ In the case of services, for example, the scope of BTAs tends to be similar to that of NAFTA, and a fundamentally compatible relationship thus exists between this agreement and those signed by the countries in the region (Kuwayama 2003).

¹⁴ With respect to the FTAA on this issue, in the Third Summit of the Americas, (April 2001, Canada) various leaders called for the convenience of creating distinct funds for social cohesion or integration that would allow a greater support to the hemispheric agreement. In that meeting, the President of Mexico referred to a cohesion fund, while various prime ministers of the Caribbean highlighted the importance of funds for integration. The Government of Ecuador, which was in charge of coordinating negotiations until November 2002, later proposed the creation of a fund for the promotion of competitiveness (Assael 2004). Venezuela has put forward a number of proposals regarding the issue of structural convergence funds (see: FTAA.TNC/w/242, Feb.16, 2004 in the FTAA website).

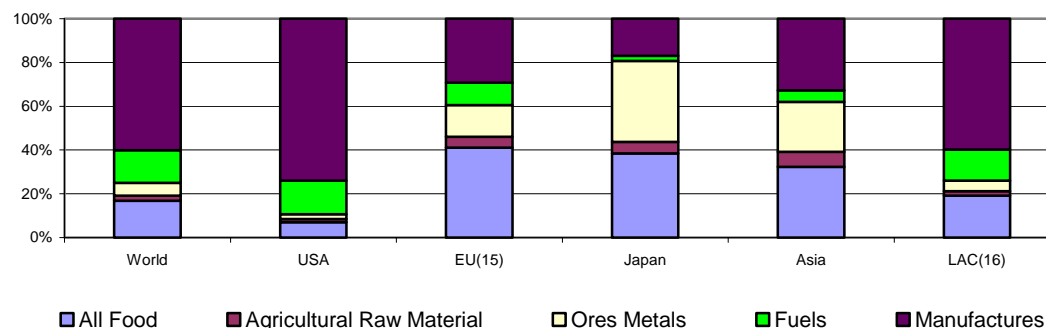
III. Deep Integration Agenda and South-South Agreements

A. South-South Agreements as Solutions for Supply-Side Constraints

It is often pointed out that the product composition of intra-regional trade differs substantially from that of inter-regional trade with the rest of the world, and that intra-regional trade is mainly composed of manufactured goods with higher value added, in contrast to trade with the rest of the world.

This is precisely the case for LAC: almost 60% of intra-regional trade consists of manufactures, 20% of food products, 2% of agricultural raw materials, 5% of ores and metals, and 14% of fuels. In contrast, the production composition of LAC exports to the US market is skewed toward manufactures (74%) when Mexico is included, while the share of manufactures for the EU market is quite small (29%) and even smaller for Japan (17%). LAC exports to EU (15) and Japan consist mainly of foods, and ores and metals. Interestingly, the share of manufactures with DA is substantially higher (33%), highlighting once again the importance of South-South trade as a potential source of technological learning for LAC countries (see Figure 4).

Figure 4
LAC'S EXPORTS STRUCTURE BY DESTINATION AND MAJOR COMMODITY GROUP, 2002
 (percentages)



Source: ECLAC, International Trade and Integration Division, based on official data. Major product classifications are those of the UNCTAD.

The product composition of LAC exports by destination (intra-regional markets vs. North markets) and by technology intensity has experienced a substantial change over the years. Between the period 1990-1992 and 2000-2002, the share of manufactures in LAC-North trade increased from 56% to 74%, due mainly to the impressive expansion of Mexican exports to the US market. This maquiladora type trade for Mexico and several Central American and Caribbean countries with the United States translates into a relatively high ratio of 20.5% registered for high technological intensity (HTI) products (see Table 7.A). It is noteworthy that the share of manufactures in intra-regional trade increased to 75% for the 2000-2002 period from an already high level of 71% of the earlier period (1990-1992).

The breakdown of intra-regional trade in manufactures in 2000-2002 was as follows: natural resource-based manufactures (NRBM) products (29%) and intermediate technological intensity (ITI) category products (14%) were dominant, while the share of HTI remained at a low level (7%), but was rising. The picture gets more clear-cut when Mexico is excluded (Table 7.B): the share of manufactures in LAC-North trade was around 50%, and NRBM products accounted for another 25%. In contrast, intra-regional trade showed a high manufactures share, composed primarily of NRBM (27%) and ITI products (28%). Meanwhile, the difference in HTI products between North-South and South-South trade almost disappeared due to the exclusion of Mexico.

Looking at the export structure of each sub-region by technology intensity, in South America, the trend towards diversification of the products that make up the export basket was particularly strong in the 1980s, but then stabilized in the early 1990s. The sub-region continues to be heavily dependent on commodities (see Figure 5.d). Although the share of ITI- and HTI manufactures has increased, it still falls far short of the increases observed in Central America and Mexico. This positive trend is largely due to the expansion of trade in consumer durables and manufactures in MERCOSUR and the Andean Community.

Table 7
**LAC : EXPORT STRUCTURE BY NORTH/SOUTH AND TECHNOLOGY INTENSITY,
 1990-1992 AND 2000-2002**
(In percentages of total exports)

A.- LAC (including Mexico)

Destinations Sectors	1990-1992			2000-2002		
	LAC-North ^a	LAC – South ALC	Rest ^b	LAC-North ^a	ALC – South ALC	Rest ^b
Primary products	43.6	29.3	28.9	26.0	24.8	43.8
Manufactures	56.4	70.7	71.1	74.0	75.2	56.2
Manufactures based on NR.	21.4	25.5	23.1	13.0	26.2	29.3
Low technology	9.4	14.3	10.9	12.7	13.7	5.9
Intermediate technology	20.3	26.2	27.7	27.8	28.3	13.9
High technology	5.3	4.7	9.4	20.5	7.0	7.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

B.- LAC (excluding Mexico)

Destinations Sectors	1990-1992			2000-2002		
	LAC-North ^a	LAC - South		LAC-North ^a	LAC– South	
		ALC	Rest ^b		LAC	Rest ^b
Primary products	51.6	28.2	44.0	50.6	26.2	46.2
Manufactures	48.4	71.8	56.0	49.4	73.8	53.8
Manufactures based on NR.	27.3	25.5	29.5	25.4	27.2	32.0
Low technology	9.8	15.6	11.6	7.9	13.2	6.2
Intermediate technology	9.3	26.8	14.1	9.9	27.6	10.1
High technology	2.0	3.9	0.8	6.2	5.9	5.5
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: ECLAC International Trade and Integration Division, based on Comtrade data.

^a Include trade with the United States, Canada and the EU and Japan.

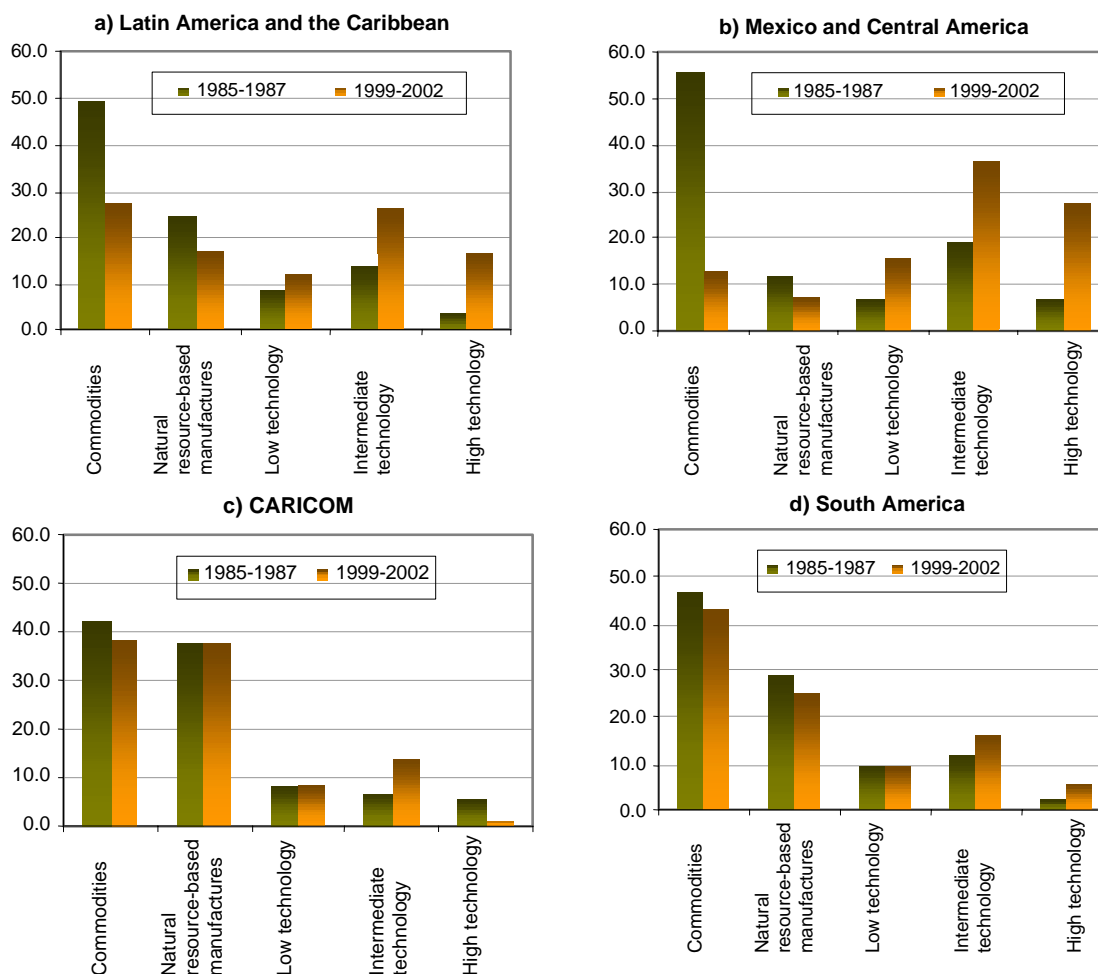
^b Include trade with Developing Asia, Africa and Middle East.

Central America and Mexico have made much more progress in reducing their dependence on commodities. As shown in Figure 5.b, they have completely changed their export pattern, moving from a basket in which commodities accounted for approximately 56% to one in which manufactures, including technology-intensive products, account for 87%. A similar, albeit much more limited, process has been observed in the Caribbean countries (see Figure 5c). But a more detailed look at LAC intra-regional trade by sub-regional groupings suggests that the importance of manufactures, and of ITI products in particular, applies to each of the four integration schemes (MERCOSUR, Andean Community, CACM, and CARICOM) (see Table 8).

In 2000, for example, ITI and HTI products accounted for more than 34% and 7%, respectively, of total intra-MERCOSUR trade. Similarly, CACM showed remarkably high ratios of intra-zone trade in each of the three technological intensity categories (i.e., low, intermediate and high). An interesting case is Chile, which showed relatively high ratios for manufactures goods including ITI products for its intra-regional trade, in a strong contrast to this country's export basket to the North, in which primary commodities outweigh. The above observations seem to support the thesis that at least for LAC, regional integration has been, and can be, a device that

fosters a diversification of exports towards non-traditional exports, diversified products and even products of more value-added and intensity in knowledge. In fact, the learning curve associated with experience in regional markets can serve as a platform for new international markets (Devlin and Ffrench-Davis 1998). This idea has been a major force of the concept “Open Regionalism” which ECLAC has been advocating since the mid 1990s (ECLAC 1994).

Figure 5
EXPORT STRUCTURE BY DEGREE OF TECHNOLOGY-INTENSITY,
1985-1987 AND 1999-2002
(Percentages of total)



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

North-South FTAs tend to reinforce comparative advantages of the South, as in the case of South America, whose major exports are based on NRBM goods, or Mexico, Central American and some Caribbean countries whose comparative advantage is based mostly on price differentials, especially low wage labour. Though Mexico and some Central American and Caribbean countries have increased their exports in fast-growing high-tech sectors, the maquila manufacturing contributes little value added to the economy; imported inputs represent between 70% and 80% of the gross value of maquila activities (Kuwayama and Duran 2003). While it is true that free trade

zones make contribution in terms of job creation and the generation of foreign exchange, these zones should play a more dynamic role in the development process.

Table 8
LAC INTRA-REGIONAL TRADE EXPORTS BY TECHNOLOGICAL INTENSITY, 2000

	LACs	MERCOSUR	Andean Community	CACM	CARICOM	Mexico	Chile
A.- Primary Products	25.0	26.5	37.2	12.3	21.0	7.4	24.8
B.- Manufactures	75.0	73.5	62.8	87.7	79.0	92.6	75.2
Manufactures based on N.R.	26.4	19.8	32.4	30.5	52.1	16.5	46.8
Low technology	13.3	12.3	12.1	23.4	12.5	14.7	9.7
Intermediate technology	26.9	34.2	15.0	23.0	12.6	36.1	16.0
High technology	8.3	7.3	3.3	10.7	1.8	25.3	2.7
Total (A+B)	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: ECLAC International Trade and Integration Division, based on Comtrade data.

As pointed out earlier, in many LAC countries, natural resources can be an important source to increase value-added and knowledge content in exports, emphasizing natural resource endowments such as landscape, climate and biodiversity as an element of international competitiveness. To foster this process further, it is desirable to: (i) create networks and clusters in natural resources areas; (ii) to encourage the emergence and incorporation of technology intensive services to support the production process and tourism; (iii) promote SMEs and their involvement in export activities; and (iv) encourage the use of information and communication technologies as a tool for export promotion. In sum, the role of natural resources has to be readdressed and re-examined as a potential promoter of technology transfer from a viewpoint of advantages of FTAs, North-South and South-South alike.

B. South-South RTAs/FTAs as Support for “Systemic Competitiveness” of LAC as a Region

Regional integration should tackle several dimensions of “deep integration” in a context of “open regionalism” by way of enhancing the provision of regional public goods (RPG). This involves reducing tariff dispersions and non-tariff barriers, and addressing “behind-the-border” measures, while harmonizing regulatory regimes, improving infrastructure (e.g., transport, communications, cooperation in energy via regional interconnection, and ports), and strengthening dispute settlement mechanisms. Harmonization of rules among the member countries on areas such as services, investment, intellectual property rights, rules of origin, anti-dumping, safeguards, sanitary and phyto-sanitary norms, customs procedures, and factor mobility should enhance the systemic competitiveness of each country and the region as a whole. In addition, this approach to integration requires the adoption of agreements that will contribute to macroeconomic stability and productive development in each country. In sum, government provision of many of these public goods is a key determinant of the enhancement of regional competitiveness.

In the area of trade in services which already represents close to 20% of total exports of the region and which is particularly important for the Caribbean countries because of tourism and financial services, it is desirable to explicitly incorporate services exports into the trade promotion

strategy of each country, which will result in establishment and/or harmonization of rules related to trade in services at the regional level. It is also important to adopt measures to expand services exports involving: (i) mutual recognition of academic degrees, records and technical standards; (ii) agreements on double taxation and double social security contributions; (iii) protection and promotion of investments; and (iv) facilitation of the temporary movements of individuals, especially business people and their representatives, through initiatives such as the issuance of a regional business visa (Prieto 2003).

1. Macroeconomic Coordination in Sub-Regional Integration Schemes

Financial instability and market inefficiency are an important “global public bad” for developing countries and efforts at the regional level to construct regional instruments and mechanisms for macroeconomic coordination can be perceptibly considered as a RPG.

Since the early 1990s, the idea of complementing the trade-related aspects of regional integration processes through the coordination of macroeconomic policy has been gaining force. The renewed interest in this area has been promoted by: (i) the recognition that the incorporation of macroeconomic variables into trade integration schemes has come to be a key factor in deepening and ensuring the continuity of sub-regional agreements; and (ii) the acknowledgment that growth impulses are increasingly being transmitted through financial variables rather than being confined to commercial conditions as in the past.

In the LAC region, the efforts in macroeconomic policy coordination have been intensified in all integration schemes, but have stopped short of original expectation, with mixed results. Nonetheless, the European solution clarified three important empirical points with respect to a number of diverging theoretical positions; (i) macroeconomic convergence is feasible even among countries with significant asymmetries in terms of levels of development levels and vulnerability to external disturbances; (ii) macroeconomic stability is essential in order to deepen trade integration, and conversely, dynamic trade is a prerequisite for macroeconomic convergence; and (iii) individual solutions, especially competitive devaluations, are suboptimal from both the domestic and the regional points of views. The European experience has shown that it is not necessary to wait for the achievement of theoretically optimal conditions before coordinating policies. As the European case seems to suggest, the prerequisites for successful cooperation in this area include a minimum level of intra-regional trade and mobility in labour and capital, and price flexibility in goods, services and factors of production, and the political will to carry out such cooperation over time.

2. Competition Regulation

Until recently, most LAC countries operated without a formal competition policy. If a government perceived uncompetitive behaviour, it often intervened directly. However, the latest wave of deregulation, privatisation and liberalization has changed the situation. It is increasingly recognized that domestically, without appropriate national competition policies, privatisation can reduce social welfare, especially in public services, while from an international perspective the boom in cross-border mergers poses a potential threat to competition in the region. Likewise, along with the potential benefits of inward foreign direct investment come potential risks; in the absence of an appropriate and effective domestic competition policy, foreign firms can crowd out domestic investment, stifle domestic competition, and reduce domestic productivity growth. Stronger trade flows propelled by the integration process and potential conflicts are challenging trade policies and demanding more attention to the contestability of markets. Aware of such a need, in the 1990s many Latin American countries created or reinforced their competition institutions and have begun

coordinating and sharing information, and even have begun to include an element of competition in the sub-regional integration agreements (e.g., MERCOSUR, Andean Community, CARICOM) or with dispositions on competition in those agreements (NAFTA) and in bilateral agreements. But some countries lack such regulation, while others are still in an incipient stage of their implementation. There is a wide scope for regional cooperation in this area (Silva, 2004).

3. Social Cohesion and Structural Funds

Despite the recognized importance, social dimensions have not been adequately treated in the Latin American regional integration schemes. The implementation of the social agenda is usually slow or postponed, while the concern for distributive effects has been taken up only sporadically. The mechanisms of the regional and sub-regional agreements provide only small financial resources aimed at improving the cohesion among social groups and supporting regions. Therefore, one of the major challenges in Latin American regional integration has been the adoption of effective, sustainable economic development policies and social integration policies for all social sectors that have suffered cumulative marginalisation in the last twenty years.

In effect, the integration processes have been significantly influenced by the following realities: (i) disparities among the States and regions pose a risk for the integration process itself; (ii) the market by itself does not promote economic integration when the States and regions are charged with such disparities; (iii) growth, competitiveness and employment are the principal instruments to achieve social cohesion; (iv) there is a strong need to integrate economic and social policies in order to guarantee the citizenry an universal social protection system; (v) the reduction of disparities by way of better access to training, education, employment (of women, the youth, and the unemployed for an extended duration) as well as of closing income and wealth gaps is an important base for social cohesion; and (vi) a strong political will to support the States and less developed regions is necessary in order to achieve the conditions of convergence.

4. Inclusion of Border-Region Migration Issues in the Regional Agenda

Though rather insufficiently, the regional schemes (MERCOSUR, Andean Community, CACM, CARICOM) have already made some progress toward extending their fields of operation beyond the matters of trade and are beginning to advance in matters connected with their social agenda, which must include a specific recognition of the importance of migration. In this sense, the sub-regional integration agreements offer opportunities, since they represent especially suitable spaces for dealing with migration as a vital component of partnerships between members whose asymmetries are smaller than in the case of developed countries. Matters of mutual interests for countries, such as cross-border transit, circulation of workers, social security, return of migrants and the recognition of courses of study and professional qualifications can be more effectively addressed in sub-regional or bilateral agreements. There are important precedents in various blocks of integration, the examination and renovation of which is a pending task: this is the case of the Andean Instrument of Migratory Labour, in the framework of the Simón Rodríguez Convention, which promises to provide the basis for an equalitarian treatment of working migrants.

5. Trade Facilitation

The LAC region as a whole has an evident and urgent need for additional measures to facilitate trade and business activity. Most importantly, special emphasis should be placed on standards and regulations relating to the modernisation of customs systems. However, reforming the customs of countries at a low level of development requires complex and significant institutional changes in the public sector that are generally systemic in nature and very costly. As a

result, coordinated and efficient international technical and financial cooperation is required in order to enable these countries to create the necessary capacities to achieve an appropriate degree of modernisation. This is also relevant at the interregional and sub-regional—as well as bilateral and national—levels, but is particularly important for the facilitation of international transactions by small and medium-sized enterprises (Izam 2003).

6. Sanitary and Phyto-Sanitary Measures and Technical Barriers to Trade

In order to ensure that negotiations on enforcing sanitary and phyto-sanitary measures and technical regulations achieve their goal and make it possible for the region to reap the benefits of integration, it is essential for countries to have suitable domestic institutional structures in place to administer the agreements and enforce the commitments that have been made. Most Latin American countries need to strengthen and modernize their institutional structures, to enable them to maintain a suitable and flexible system for timely diffusion of national, regional and international data, making it possible to fully exploit economic advantages. The countries of the region could therefore be well advised to make progress in harmonizing sanitary and technical rules and regulations, first in the regional domain and then internationally. The establishment of equivalence between measures adopted by the signatories of regional or sub-regional agreements is advantageous, partly because it reduces the potential for product discrimination among them and streamlines the import process (Larach 2003). As this is likely to benefit national consumers in addition to regional or sub-regional importers, such measures should be viewed as public policies that are highly beneficial for production, consumption and trade.¹⁵

7. Physical Infrastructure and Sustainable Development

In LAC, there are many issues and major challenges in the field of infrastructure and sustainable development that have motivated regional cooperation. Transport and tourism are representative examples. The issue of transport has gained importance in the debate on instruments to promote trade and investment in a world of low tariffs and progressive elimination or harmonization of non-tariff barriers, since lower transport costs directly encourage exports and imports and are equivalent in effect to a tariff reduction. At the same time, market failures and imperfections that raise transport costs tend to concentrate industrial and economic activity in areas that are already endowed with suitable human and physical infrastructure (Venables and Gasiorok, 1998). Some major initiatives include the South American Regional Infrastructure Integration Initiative (IIRSA) and the Puebla-Panama Plan (PPP). The Association of Eastern Caribbean States has also set up a programme entitled “Unifying the Caribbean by Air and Sea”, which aims to harness public and private efforts among member countries, and stimulate regional cooperation mechanisms. Caribbean countries will also cooperate in implementing air transport training programmes.

In terms of sustainable development, the LAC region has a characteristic that distinguishes it from all others, both in terms of the wealth and importance of its natural resources and in the global risks implied by the rapid process of environmental degradation (ECLAC, 2002a). In recent years, several major regional proposals have emerged in this domain. The eight signatory countries of the (PPP) adopted the Meso-American Sustainable Development Initiative as a strategic and

¹⁵ For example, Andean Community countries have agreed to implement the Andean System of Standardization, Accreditation, Testing, Certification, Technical Regulations and Metrology (Decision 376). An earlier resolution (Decision 238) defined the equivalence of national sanitary and phyto-sanitary regulations between member countries. This type of agreement, in which the Andean countries signed a pact on trans-border movements of genetically modified organisms, is an example of the harmonization of national regulations on biotechnological safety. MERCOSUR has a commitment to harmonize sanitary and phyto-sanitary measures, and maintains a technical standardization committee whose mission is to deepen regional cooperation on this issue.

crosscutting framework to ensure that all relevant projects, programmes and measures contain appropriate environmental management practices and promote conservation and sustainable management of natural resources. Another important example is the Regional Biodiversity Strategy for the Tropical Andean Countries a wide-ranging initiative for this sub-region that represents one of the world's richest zones in terms of natural resources, containing about 25% of the biological diversity of the entire planet. The strategy is one of the first attempts by the sub-region to develop a comprehensive platform of community action, promoting cooperation between member countries and projecting them with a new and unique identity to the international community. It is also one of the first community strategies adopted on this issue by a group of signatory countries of the Convention on Biological Diversity, and makes a specific contribution towards fulfilling its objectives (Andean Community 2003).

Conclusions

South-South trade already constitutes an important segment of LAC trade, especially when Mexico is excluded from the picture; almost half of region's exports are of a South-South nature. The South-South trade of the region is split almost evenly between intra- and inter-regional trade, the former representing more than 27% while the latter, 21% of region's total trade. It should be noted, however, that the present level of intra-regional trade is still low when compared to the peak of 21.1% registered in 1997, despite its rebound in 2003 and continued recovery into 2004. While this trade holds a high potential for future growth, there are a series of problems to be addressed in order for regional integration to continue on the paths of recovery and "deep" integration.

By their nature, regional trade agreements (RTAs) divert trade by creating preferential treatment for member countries vis-à-vis non-members. However, regional integration can foster economies of scale: in the presence of economies of scale, what otherwise is a costly trade diversion can become a cost-reducing and welfare-enhancing trade creation. At the same time, regional integration can be a device that fosters a diversification of exports towards output that is more connected to the overall competitiveness of the economies concerned, creating dynamic comparative advantages. It serves to "lock-in" improved access to regional markets, fostering economies of scale. It can enhance non-traditional exports, differentiated products and products of more value added and intensity in knowledge.

The concurrent existence of an FTAA and sub-regional and bilateral FTAs with countries in and outside the region will surely increase the complexity and reduce the transparency of the multilateral

trading system. Making the rules across sub-regional agreements and between these agreements and the WTO more compatible might lessen the negative effects that arise from the myriad of FTAs of distinct depths and scope. However, in some cases, coordination among the FTAs facilitates the convergence and compatibility process with regional and multilateral agreements. It may be possible to pursue a multi-track strategy of multilateral, regional and bilateral aspects that might lead to free and fair trade quicker than relying on just one track.

RTAs should tackle several dimensions of “deep integration” in a context of “open regionalism” by intensifying efforts on the provision of RPG: (i) addressing “behind-the-border” measures, while harmonizing regulatory regimes in areas such as services, investment, intellectual property rights, rules of origin, anti-dumping, safeguards, sanitary and phyto-sanitary norms, customs procedures, and factor mobility; (ii) advancing the efforts on the coordination of macroeconomic policy; and (iii) improving various kinds of infrastructure and providing crucial public goods. These efforts will enhance systemic competitiveness of each country and the region as a whole.

These initiatives, which would result in the reduction of production and transaction costs inside the region and the avoidance of unnecessary competition among the countries, will likely facilitate inter-regional South-South trade as well. Given the relatively low level of economic interaction of LAC with other developing regions seen so far, there is a need to institutionalise the mechanism of consultation and implement joint actions. In this perspective, future RTAs/FTAs between LAC countries and other developing regions should incorporate from the outset economic and technical cooperation as an integral part of the trade and investment liberalization effort. Some possible areas are: (i) human resource development; (ii) science and technology; (iii) promotion of SMEs; (iv) information technology (IT) and E-commerce; (v) tourism; (vi) food security; (vii) transport infrastructure; and (viii) environmental protection.

As for other regions of the South, Developing Asia is still an under-exploited market for LAC on the export side. But as the experiences of some LAC countries in the 1990s and recent years demonstrate, there seems to be a good potential for expanding natural resource-based exports from the region. However, LAC’s trade with Developing Asia exhibits the same limitations that the region has in international trade in general: its exports are mostly primary and semi-manufactured goods. LAC needs find ways to increase the degree of processing of these natural resource-based export products and seek new outlets in Asia for more value-added differentiated products. The present product composition is extremely sensitive to economic cycles of importing countries and does not help stabilize export earnings, as evidenced in drastic drops in export earnings in the Asian markets during the financial crisis. What is important in these product areas, however, is to find strategic alliances to augment value-added across the production chain, and to increase market access.

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