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**OPEN REGIONALISM, NATION-STATES AND THE LEARNING PROCESS
OF INTEGRATING INTO A GLOBAL TRADING SYSTEM**



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OPEN REGIONALISM, NATION-STATES AND THE LEARNING PROCESS OF INTEGRATING INTO A GLOBAL TRADING SYSTEM

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1. INTRODUCTION

The Uruguay Round was successfully concluded on April 15, 1994, in Marrakesh, when more than 100 countries signed the Final Act and the World Trade Organization (WTO) Agreement.² These legal texts, including Ministerial Decisions and Declarations, provide detailed rules for traditional areas in the international trading system. More important, new multilateral rules to include the protection of intellectual property rights and trade in services considerably enlarged the scope of international obligations. Furthermore, an improved dispute settlement mechanism became integrated into the new WTO.³ A recent assessment prepared by UNCTAD underlined the significance of these accomplishments in the normative area: "A major result has been that a range of measures previously viewed as falling within the scope of domestic policy has been brought under multilateral discipline, and linked to the rights and obligations governing international trade and access to markets."⁴

In 1995, when the World Trade Organization (WTO) will become operational, multilateralism will be in a situation without parallel in history. Never before, a single institution with contractual obligations binding its members encompassed such a wide array of issues and conflictive interests of a near universal set of nations.⁵ Difficulties to reach agreement on equitable and

¹ Acting Director of the Brazilian office of the Economic Commission for Latin America and the Caribbean, ECLAC. The views and opinions expressed in this paper are personal and may not necessarily coincide with those of ECLAC.

² In December 1994, the Final Act was ratified by the European Parliament, by the United States Congress and by the Japanese Parliament. In the same period it was also formally approved by the Brazilian Congress.

³ The Marrakesh agreement establishing the World Trade Organization includes four annexes. The legal texts are composed of a large number of multilateral agreements which can be summarized as follows: (1) The General Agreement on Tariffs and Trade 1994 consolidating several amendments to provisions of the General Agreement on Tariffs and Trade of 1947 (six understandings on the interpretation of several articles and a Marrakesh Protocol); (2) Multilateral Agreements on technical barriers to trade, trade-related investment measures, dumping investigation (article VI), customs valuation (article VII), preshipment inspection, rules of origin, import licensing procedures, subsidies and countervailing measures and safeguards; (3) Multilateral agreements to improve market access on textiles and clothing and agriculture with the purpose of integrating those sectors to the international legal trading system; (4) a General Agreement on Trade in Services; (5) an Agreement on Trade-Related Aspects of Intellectual Property Rights; (6) the adoption of integrated rules and procedures governing the settlement of disputes and (7) Plurilateral Trade Agreements including trade in civil aircraft, government procurement, international dairy and international bovine meat agreements. Several Ministerial Decisions and Declarations were also adopted. See GATT (1994), The Results of the Uruguay Round of Multilateral Trade Negotiations - The Legal Texts, Geneva.

⁴ UNCTAD (1994), Trade and Development Report 1994, United Nations Conference on Trade and Development, Geneva, p. 121.

enforceable solutions will be inevitable but the outcomes of trade and trade-related disputes are indeterminate. The expansion of private corporations' activities has increased not decreased the need for an orderly and predictable economic environment. A larger number of enterprises from all regions are competing for markets globally. Moreover, powerful economies as the United States, are as much dependent on foreign markets for their sustained growth as the world is dependent on their markets.⁶ However, the linkages between economic interdependence and political actions are not straightforward. Industrial countries are reluctant to have their capacity to respond to domestic interests curtailed by supranational norms. Consequently, developing countries are afraid that the WTO will not provide the protection they need from arbitrary unilateral actions emanating from powerful trading partners. During the Uruguay Round negotiations, they found themselves in the awkward position of replacing industrial countries in the defense of a multilateral legal order. They had to defend a rule-based system with no **real** power to enforce it.⁷

Uncertainties over the future of multilateralism underscored the emergence over the past years, and in parallel to multilateral negotiations, of a variety of regional and subregional trade arrangements. At the same time, the membership of past arrangements was extended and their coverage widened. Fears were expressed that those regional trade arrangements could act as **stumbling blocks** to the multilateral trading system. However, several studies have already shown that the dynamics of trade of most regions contradicted the proposition of global fragmentation.⁸

In my perception, the recent moves towards cooperation at the regional and subregional levels have one important aspect that should not be neglected. It is the learning dimension that adds to other dynamic gains from regional economic integration. Those dynamic components of regional initiatives are beneficial to multilateralism in the new environment of international competition. As mentioned elsewhere, regional initiatives may "represent positive integrative responses to the pressures exerted by globalization. If accompanied by parallel progress at the GATT, regionalization could be a potent mechanism for freeing world trade and investment and harmonizing national

⁵ Although United Nations agencies deal with complex sets of issues at the multilateral level there are no contractual obligations on member countries.

⁶ I thank Prof. Albert Fishlow for pointing this point out to me, although I am sceptical on the political results of such economic interdependence.

⁷ In the words of a Brazilian Ambassador who participated in the Uruguay Round Negotiations: "Hay en esa situación una paradoja de difícil solución ya que la razón que debe llevar a estos países a interesarse en mantener el sistema, es decir, la falta de poder y su mayor vulnerabilidad, es la misma que los hace incapaces de asumir dicho papel, en caso de que no haya cooperación por parte de los grandes" (Ricupero, Rubens (1994), "Los Países en Desarrollo y la Ronda Uruguay: Desencuentros de un Amor no Correspondido?" in Leiva, Patricio (ed.) La Ronda Uruguay y el Desarrollo de América Latina, CLEPI, Santiago, p. 71).

⁸ Fishlow, Albert and Stephan Haggard (1992), The United States and the Regionalisation of the World Economy, OECD, Development Center, Paris; Frankel, Jeffrey A. (1991), "Is a Yen Bloc Forming in Pacific Asia?" in Finance and the International Economy, n. 5, pp. 5-20; Lawrence, Robert Z. (1991), "Emerging Regional Arrangements: Building Blocks or Stumbling Blocks" in Finance and The International Economy, n. 5, pp. 23-35. Recent data show, however, that Asian markets have become more important for Asian countries, for goods, services and investment. Intra-Asian trade accounted for 42.4% of all Asian merchandise exports in 1990 and for 44.5% in 1992 (GATT, 1993, International Trade, Geneva, table II.51, p. 36).

institutional practices."⁹ Globalization and the interdependence of economies have created the need for higher levels of policy coordination and harmonization among countries. If regionalism evolves within the framework of **open regionalism**, smaller groupings can be effective instruments for developing countries to cope with the complexities of **deep integration**.¹⁰

The characteristics of smaller and more homogeneous groups may allow developing countries to become more familiar with the requirements of policy coordination and harmonization. This experience becomes relevant when levels of integration previously associated with customs union formation are demanded at the multilateral level.¹¹ Policy coordination and harmonization are part of the negotiations of the topics of the future agenda of negotiations: the link between trade and environment, trade and competition policies, trade and internationally recognized labour standards, among others.¹² Industrial countries, non-governmental organizations and some international agencies look forwards to introducing extra-trade but trade-related issues in one multilateral organization such as the WTO. Contractual obligations and the application of economic sanctions are the most attractive features of WTO. In many ways, this is the result of the successful inclusion in the Uruguay Round agenda of non-trade topics such as the protection of intellectual property rights. If the protection of those rights could be assured by the threat of legal trade sanctions, then the protection of other rights such as those of internationally recognized labour standards or environmental protection could also be enforced multilaterally.

High and stable levels of long-term unemployment in major European countries, the nature of new jobs and downward trends in wages in all industrial countries have created demands for urgent actions to protect existing levels of employment. Mostly, to protect them from foreign competition. Multilateralism will be under growing difficulties to separate measures aiming at protecting legitimate domestic interests from mere protectionism. There is weak evidence of linkages between job losses and foreign competition. But, even though there is no adequate framework to analyse current trends, the process of globalization, technological innovation and changes in the labour process are related to the dynamics of job destruction and creation.

Developing countries, particularly the more industrialized such as Brazil, are worried with the attempts of industrial countries to include issues such as "social protection" in trade discussions to accommodate domestic pressures from trade unions and politicians. Those attempts are perceived

⁹ Lawrence, 1991: 23.

¹⁰ See ECLAC (1994) Open Regionalism in Latin America and the Caribbean (Economic Integration as a Contribution to Changing Production Patterns with Social Equity); LC/G.1801/Rev.1-P, September, Economic Commission for Latin America and the Caribbean, Santiago, Chile, United Nations publication Sales n. E.94.II.G.3; Lawrence, Robert Z (1991a), "Perspectivas del Sistema de Comercio Mundial e Implicaciones para los Países en Desarrollo" in Pensamiento Iberoamericano, n. 20, pp. 53-78.

¹¹ In 1957, the Rome Treaty established as one of the objectives of the European Community ... "the gradual convergence of the economic policies of the member states."

¹² See UNCTAD (1994a), The Outcome of the Uruguay Round: An Initial Assessment/ Supporting Papers to the Trade and Development Report, 1994, United Nations Conference on Trade and Development, Geneva:221-225, for a review of future issues.

as new bargaining leverages that industrial countries want to establish to maintain their **status-quo**. The dissemination of expressions such as "social dumping" contributes to obscure the terms of the debate.

Brazil has been traditionally active in international economic diplomacy. The country (with Chile) was among the few independent developing countries who were the founding members of GATT (and also of all other international organizations). Brazilian diplomacy played an important role in the Tokyo Round negotiations and in the whole process of the Uruguay Round.¹³ The country is classified as a global trader by the diversification of its exports and markets. As such, the expansion of its trade requires open markets and also, clear and enforceable multilateral rules. Therefore, Brazil is totally committed to the strengthening of a multilateral order. Nevertheless, Brazilian diplomacy has been behind the revival of the LAIA (Latin American Integration Association) and, the creation and consolidation of the Southern Cone Common Market (MERCOSUR). In 1994, the Brazilian government put forwards a proposal for a Southern American Free Trade Area (ALCSA) to integrate countries from the MERCOSUR with those of the Andean Group plus Chile.¹⁴

In spite of having established a national industry behind protective tariff and non-tariff measures, Brazilian economy has always been very open to foreign capital. In 1987 Brazil went into a process of unilateral liberalization of its trade policy, moving from a nominal average tariff rate of 90% for manufactured products in 1984 to 14.2% in 1994.¹⁵ The construction of the MERCOSUR began almost simultaneously with the liberalization of trade policies of Brazil and Argentina.

This paper is exploratory and provocative. It will take some years for the impact of WTO on world trade to be felt. Therefore, there are only expectations on its future effectiveness. The new issues present important normative aspects. Most of the questions raised by the new competitive environment are interdisciplinary by nature and lack a solid theoretical framework for a positive analysis.¹⁶ Topics such as the economics of environment or the rights and obligations related to environmental protection are controversial. In addition, it is difficult to include the subject of policy coordination and harmonization in the free trade framework.

First, I hold that globalization and the complexities of interdependence are transforming the content of international negotiations. This is to say, that the inclusion of issues of policy coordination and harmonization changes the characteristics of negotiations originally aimed at freer trade and

¹³ See Winham, Gilbert R. (1986) International Trade and the Tokyo Round Negotiation, Princeton University Press, Princeton, New Jersey; Leiva, Patricio (ed.) (1994) La Ronda Uruguay y el Desarrollo de América Latina, CLEPI, Santiago.

¹⁴ See Edwards, Sebastian (1993), "Latin American Economic Integration: A New Perspective on an Old Dream" in The World Economy, vol. 16, n. 3, May, pp. 317-338 for a recent review of Latin American integration initiatives. See also ECLAC, 1994; Bouzas, Roberto et al. (1993), Los Procesos de Integración en América Latina, Fundación CEDEAL, Madrid.

¹⁵ Fritsch, Winston and Gustavo H. B. Franco (1993), "The Political Economy of Trade and Industrial Policy Reform in Brazil in the 1990s" in ECLAC, Serie Reformas de Política Pública, n. 6, Santiago, Chile, pp. 14 and 30.

¹⁶ As a side effect of the inclusion of new themes in trade negotiations, trade analysts' were forced to enlarge their knowledge and to become more familiar with a multidisciplinary approach to trade questions.

market liberalization. Second, I think that the difficulties of policy coordination and harmonization are better handled within smaller and more homogeneous groups. Therefore, the negotiating process of regional and sub-regional economic arrangements can be a preparatory stage to the global debate of similar topics in WTO. Finally, I claim that there is a consensus in Latin America and particularly in Brazil that their economies should move from **spurious** to **legitimate competitiveness**.¹⁷ However, trade sanctions are not adequate instruments to correct deep and ingrained problems. Ultimately they are the expression of lower levels of national economic integration in developing countries and moreover, of world asymmetries.

The next section will elaborate on the difficulties for an effective enforcement of multilateral rules dealing with a broad array of domestic policies. Nevertheless, I hold that interstate cooperation is possible and necessary although large heterogeneous groups and complex trade-related issues may reduce its effectiveness. The debate on policy harmonization generates two sets of dilemmas: (i) the accommodation of the domestic policies of industrial countries or groups of countries to principles, norms, rules and procedures multilaterally agreed and (ii) the requirement by industrial countries that developing countries adopt higher standards of "social protection". Section 3 examines the state of the policy harmonization debate. Some questions raised by the inclusion of trade and environment and trade and internationally recognized labour standards in the future negotiating agenda are examined. In section 4 selected normative aspects of the recent process for the creation of the Southern Cone Common Market (MERCOSUR) are summarized. Finally, section 5 presents a few concluding remarks.

2. POLITICS, POWER AND LAW

Uncertainty, complexity and ambiguity characterize contemporary international relations. On the economic side, administrative decisions to correct or to reinforce market signals have contributed to alter the composition and volume of trade flows. Consequently, international competition patterns have also been transformed with new industrializing countries competing in world markets. On the political side, the multipolarity in power configuration created challenges and opportunities to small economies while introducing instability to the multilateral system.¹⁸

¹⁷ These concepts were developed by Fernando Fajnzylber in several books and articles starting with (1983), La industrialización trunca de América Latina, Editorial Nueva Imagen, Mexico. Spurious competitiveness is that based on the predatory exploitation of natural resources and low-wage labour. Legitimate competitiveness is that based on the introduction of technical change and innovation in products and production processes. See also, ECLAC (1990) Changing Production Patterns with Social Equity: The Prime Task of Latin American and Caribbean Development in the 1990s, (LC/G.1601-P), Economic Commission for Latin America and the Caribbean, Santiago, Chile, March. United Nations publication, Sales n. E.90.II.G.6.

¹⁸ Other trends in the domains of money and finance, transnational corporation strategies, technological innovation and obsolescence, and in information technology are behind the complexities of world economy.

The United States ceased to be a **primus inter pares** to become one of the three countries or groups of countries concentrating world production, trade, investments and income.¹⁹ Second, the growing number of players in world scene has upset the power hierarchy that prevailed at the end of the Second World War. Although the most important new players are countries such as Germany, Japan, China, and groups of countries as the European Union, the opportunities opened by new technologies and by the international liquidity of the 1970s allowed some developing countries to "leap frog" and become competitive exporting economies. This is the case of Brazil. In addition, interdependencies created by trade and investment allowed the same developing countries to improve their bargaining power vis-à-vis industrial countries. Furthermore, the protracted multilateral trade negotiations taught countries to identify common interests and to establish effective coalitions between small economies beyond their classification as industrial or developing countries.²⁰

After cultivating a culture of isolation and self-sufficiency, the firms and workers of the United States became more exposed to foreign competition. Competition came from goods originated in industrial and developing countries and from foreign production in domestic soil.²¹ Changes in United States hegemonic power²² and also in its trade policy and trade policymaking process have raised concerns on the stability of **international regimes**.²³ Particularly worrisome were: (i) the increasing dominance of local interest groups in shaping the United States trade policy;²⁴ (ii) the adoption by the country of a multi-track strategy that included unilateral, bilateral, and plurilateral initiatives addressing to issues that were simultaneously being dealt with in the multilateral forum of the GATT; and (iii) the aggressive attitude of the United States to force foreign governments to change their domestic policies considered detrimental to the interests of the United States.²⁵

¹⁹ The so-called **triad** - United States, the European Union and Japan - accounted for 44% of world exports, 43.8% of world imports and 70.5% of world income in 1992 (World Bank (1994), World Development Report 1994; and GATT, 1993, International Trade, table I.5, p. 4).

²⁰ The Cairns Group is a good example of a successful coalition between industrial and developing countries.

²¹ See Reich, 1987, Tales of a New America, Times Books, New York.

²² In the theory of hegemonic stability, the **hegemon** is a country able and willing to supply a **public good** such as international security or trade liberalization rules. A public good has several characteristics in the literature one of which is the inevitable presence of **free-riders**. Lately, the United States became increasingly concerned with the "consumption" of trade liberalization by developing countries. Those countries being small suppliers could by the principle of nondiscrimination take a **free-ride** in trade negotiations. Therefore, they received trade concessions without "paying" for them.

²³ Keohane, Robert (1984), After Hegemony (Cooperation and Discord in the World Political Economy), Princeton University Press, Princeton, New Jersey.

²⁴ Low, Patrick (1993), Trading Free (The GATT and US Trade Policy), The Twentieth Century Fund, New York; Destler, I. M. (1986/1992), American Trade Politics, Institute for International Economics, Washington, D.C.; and Winham, (1986) hold that the Reciprocal Trade Act of 1934 provided the United States Congress with an effective net to insulate itself from sectoral protectionist interests. The delegation of the exercise of its Constitutional trade policy powers to the President permitted some maneuvering capacity to the Congress towards their constituencies without endangering the international negotiating process. At least from the 1930s and up to the 1960s, "the main story of American trade policy making was the story of the construction and elaboration of a pressure-diverting policy management system." (Destler, 1986/1992: 37).

²⁵ Low (1993); Destler, (19896/1992).

It is not my intention to review the literature on hegemonic stability. The debate on the determinants of economic and political cooperation in the absence of a dominant single nation has been inconclusive. For some authors, the hegemonic decline argument can at most have a descriptive value. First, it is unlikely that the historical conditions that originated the absolute hegemony of England and the United States could be reproduced in the near future.²⁶ Second, the theory fails to analyse the dynamics of internal processes in hegemonic countries and the longer-term systemic implications; and finally, it does not explain the dynamics of the interaction between special interests groups and governments' responses to these internal pressures.²⁷

Other analysts prefer to lay emphasis in the privileged situation of the United States at the end of the Second World War. If 1955 is used as a benchmark, changes in the relative position of the United States in world trade are not so dramatic: the country accounted for 16.5% of world exports in 1955; this share decreased to roughly 11% in the 1980s to increase again to 12% in 1992-3. The situation on the import side bears more significance: in 1955, the country accounted for 12.2% of world imports and this share was stable until the early 1980s; then, it increased to almost 17% (due to an overvalued dollar) and reached 14.4% in 1992-93.²⁸ Furthermore, a point that is less stressed is that trade is a two-way avenue. The integration of the United States economy in world economy can only increase, not decrease.²⁹ The export coefficient increased from 4.9% in 1960 to 10.6% in 1992 and the trade coefficient increased from 9.3% to 21.7% (when the sum of exports and imports is considered).³⁰ Moreover, export growth explained more than 60% of the past recovery of the United States economy.³¹

Besides, international cooperation can be studied as a form of collective action, borrowing concepts and approaches from the theory of rational-choice and the theory of institutions. Institutions are necessary because they reduce uncertainties of the economic environment. Under the assumptions of bounded rationality and imperfect information of individual participants, it can be shown that cooperation will be maintained even after the conditions that permitted its existence have disappeared. Individual countries will cooperate because they judge that they will have more to lose by not joining the proposed institutional framework or international regime. However, cooperation does not imply the absence of conflicts. This is to say that it does not imply "harmony of interests".³² There is nothing

²⁶ "Hegemonic leadership is unlikely to be revived in this century for the United States or any other country. Hegemonic powers have historically only emerged after world wars..." (Keohane, 1984: 9). England hegemony began after the end of the Napoleonic wars and that of the United States after the Second World War.

²⁷ Low (1993: 18).

²⁸ Data from Fishlow and Haggard (1992) and GATT, 1993, opus cit..

²⁹ That point was recognized by the United States Administration: "There is simply no way to close America's borders and return to the insular days of the 1950s and 1960s" (United States Government (1994), Economic Report of the President, Washington, p. 45).

³⁰ In 1992, one in each six United States manufacturing jobs was directly or indirectly related to exports (United States Government, 1994, opus cit. p. 207).

³¹ A report by the International Trade Administration estimated that "between 1988 and 1992 export growth accounted for almost 60% of overall growth in the United States" (The Journal of Commerce, September 30, 1994).

³² This expression is due to Carr, (1939/1984), The Twenty Years' Crisis 1919-1939, The Macmillan Press, London., pp. 41-62. He criticized the doctrine of the harmony of interests as part of the liberal utopia of the eighteenth- and nineteenth-centuries.

to assure that all divergent interests of participating nations can become mutually compatible. Therefore, the stability of international regimes is not granted and power solutions are not excluded. This is the dilemma faced by the new WTO.

But, even accepting that multilateral cooperation is feasible, it is important to point out to critical changes that have occurred in its content. Also, to suggest the role that the state and state policies have played in shaping those changes.

Over the entire postwar period, governments and private corporations concurred to change the structure of international production and trade. Through the adequate manipulation of domestic prices and markets, and the use of incentives designed to channel investments to desired industries, governments have systematically changed a "given" comparative advantage pattern. Simultaneously, private and public corporations accumulated resources to organize production in different countries. Those large corporations move goods and services across frontiers and yet these transactions remain within the domain of the firm.³³ Intrafirm transactions are internal to the corporation; they do not occur via the market.³⁴ Equally important, subsidies and regulations could, *inter alia*, persuade transnational corporations to start export operations in the country and/or to increase the domestic content of their final products. On the other extreme, income policies by industrial countries aiming at preventing structural adjustments as dictated by market factors introduced dramatic distortions in international specialization trends.³⁵

It took more than seven years for Uruguay Round negotiators to reach an agreement. Actually, the period of negotiations exceeded twelve years when the four years of technical and diplomatic preparatory work are added. In addition, the Tokyo Round took another seven years and at its conclusion in 1979, negotiators were already defining a new agenda of negotiations. Therefore, that Round of Multilateral Trade Negotiations ended up being just the beginning of a long period of trying to cope with the complexities of the new trading issues.³⁶ Consequently, trade specialists and diplomats have spent more than two decades trying to frame principles, norms, rules and procedures for the new competitive environment of production, investment and trade.

Although, both private and public agents' growth strategies have influenced trade and investment flows, trade negotiations are about public policies and instruments. In the GATT,

³³ "By 1990, multinational firms accounted for over 75 percent of total U.S. merchandise trade, and around 40 percent of U.S. merchandise trade was intrafirm." (United States Government, 1994, opus cit., p. 207).

³⁴ Intra-firm trade accounted for 46.3% of United States imports from Europe, 75% of United States imports from Japan and 45% of total United States imports (United States Government (1994), Economic Report of the President, Washington, table 6.6, p. 218). The high level of intrafirm transactions in United States imports from Japan was used in the Report as evidence of Japanese imperfectly competitive practices and markets. The fact that intra-corporate transactions are less responsive to normal price and cost determinants than arm's length transactions and the importance of Japanese **keiretsu** in Japanese trade could explain the resilience of Japanese exports regardless of the overvalued yen.

³⁵ Raul Prebisch forecasted in 1964: "A new order is thus emerging among the more advanced industrialized States and the next few years will reveal its ultimate significance more clearly." ("Towards a New Trade Policy for Development", Report by the Secretary General of UNCTAD, 1964, p.8).

³⁶ For a detailed description of the learning process in the Tokyo Round see Winham (1986).

negotiations moved first from tariff reduction to non-tariff measures, subsidies and government procurement. Later, in the Uruguay Round, "trade-related effects of" non-trade-related domestic policies such as those associated with the protection of intellectual property rights or several others pertinent to trade in services were introduced to the negotiations. In many ways, the international convergence of technological information and capabilities among developed and a small number of developing countries promoted by domestic policies changed the nature of the multilateral debate. Ultimately, the purpose of the negotiations is not the reduction of governmental intervention for improved market operation anymore. The debate is now on improved policy instruments to prevent competition patterns to alter.

Lawrence (1991a) has diffused the concepts of shallow and deep integration. Accordingly, shallow integration is associated with trade measures applied at the border. Deep integration includes measures beyond the border. Tussie (1994: 4) in a very insightful article, recalled that the ideas of negative and positive integration were part of traditional customs union literature. Negative integration should be pursued to prevent tariff negotiations to be nullified by non-tariff barriers such as technical or health standards, customs rules or procedures. Therefore, during the process of integration, governments would agree to eliminate policy instruments that could offset the liberalization effects. Positive integration refers to rules relating to the conditions of production that should be negotiated *ex-ante* to the negotiations for freeing trade.³⁷

The underlying framework of the GATT system was that of negative integration.³⁸ Tariffs and quantitative restrictions should be removed to permit international trade specialization according to market signals. The base of the GATT system has been the Most Favoured Nation (MFN) clause (nondiscriminatory treatment) which converts bilateral trade concessions into multilateral trade liberalization. In the postwar, the process of tariff reduction through mutually advantageous negotiations guaranteed the permanence of the GATT as the major forum for multilateral trade negotiations, at least for manufactured products and for trade among industrial countries.

Several authors agreed that GATT was successful in providing guidelines for national trade policies in the first two or three decades of existence. However, that success had to be qualified. GATT was in many ways the victim of its success in lowering tariffs and limiting the use of quotas. These accomplishments weakened the very instruments that had made the success possible since tariff reductions made the impact of active policies by governments more visible.³⁹ Another author underlined that the negligible levels of the import weighted average tariff rates of industrial countries, after the Tokyo Round, rather than suggesting the victory of trade liberalization pointed to the redundancy of tariffs as trade instruments.⁴⁰ In addition, liberalization affected mostly sectors

³⁷ "Negative harmonization aims to ensure that governments honour agreed-upon market access. It serves to lay the ground for tariff reductions to operate more effectively. Yet border measures are seen here to be the ultimate trade policy tool. Positive harmonization would aim at enforcing specific common rules that will define how exactly economic affairs are to be conducted." (Tussie (1994), "The policy harmonization debate: what can developing countries gain from multilateral negotiations" in *UNCTAD Review* p. 4).

³⁸ Tussie, 1994: 5.

³⁹ Destler (1986/1992:34-35)

characterized by intraindustrial specialization, economies of scale, product differentiation, imperfect competition and intra-firm trade.⁴¹

Governments tried to reduce socially disruptive domestic adjustments costs and national economic and political potential vulnerabilities that could result from international functional differentiation. This is the differentiation derived from Ricardian interindustrial comparative advantage that could benefit developing countries.⁴² Consequently, commodities, resource-based goods, textile and clothing remained outside GATT rules for a long period. Developing countries were consciously discriminated in their access to industrial country markets.⁴³ The Marrakesh agreements did very little to redress that situation.

There are costs and benefits associated with trade; however, their nature is remarkably divergent. Eventual benefits from trade are broad, undifferentiated and conjectural whereas costs are real, measurable and concentrated. In the theory of comparative advantage, no costs of adjustment exist.⁴⁴ There is instantaneous adjustment. In real life, firms, workers and whole cities will bear the costs of adjustment to changing comparative advantage in world markets. Governments will benefit from their unequal power bargaining to transfer these costs away from their constituencies. The major question on the future operation of the new WTO refers to the administration of those adjustment costs.

The fact that non-tariff instruments of trade distortions are more intertwined with issues of domestic policies and national sovereignty make negotiations difficult and inject more instability to the system. It is important to stress that one central quality of the GATT was its "policy tolerance"

⁴⁰ "By 1987, when the full extent of the Tokyo Round tariff reductions became effective during the course of the Uruguay Round, import weighted average tariff rates reached about 4.3% for the USA and 6% for the EEC of Nine. For Japan which had brought forward the full implementation of its cuts by March 1983, the equivalent figure was 2.9%. The tariff thus lost much of its traditional significance as an effective means of protection." (Tussie, 1994: 3).

⁴¹ Ruggie, John Gerard (1982), "International regimes, transactions, and change: embedded liberalism in the postwar economic order" in International Organization, vol. 36, n. 2, Spring, pp. 398-404; Tussie, Diana (1989) The Less Developed Countries and the World Trading System: A Challenge to the GATT, Pinter Publishers, New York, pp. 38-63.

⁴² "Intraindustry trade, it is sometimes argued, is of particular importance because the adjustment costs associated with an expansion of intraindustry trade are thought to be lower than for a comparable expansion of interindustry trade - import-competing firms can retool and specialize rather than disappear. If this is so, expansion of intraindustry trade should be more compatible with trade liberalization" (United States Government (1994), opus cit. p. 217).

⁴³ Quoting Raul Prebisch again: "The measures adopted in those countries and the social motives underlying them are understandable: they do not wish the benefits of greater productivity to be transferred to other sectors to the detriment of producers. It is not this policy we have to discuss but rather the fact that the harmful effects of such measures on the primary exporting countries do not appear to be taken sufficiently into account" (Report of the Secretary General of UNCTAD, 1964. p. 10).

⁴⁴ According to Hagelstam (1991:100) the Ricardian theory of trade was essentially consumer-oriented. The full use of comparative advantage would ensure that consumers had the largest volume of products at their disposal at the best prices. However, economists are blind to the fact that the promotion of consumption is rarely a primary objective of trade policy. (Hagelstam, Jarl, 1991 "Mercantilism still influences practice trade policy at the end of the twentieth century" in Journal of World Trade, vol. 25, April, n. 2, pages. 95-105).

regarding domestic policies of industrial countries.⁴⁵ Domestic policy diversity was admitted and no previous policy harmonization was required outside the realm of tariffs and quotas.⁴⁶ That was part of the international consensus that provided stability to the international trading system. In other words, international trade policies conformed to domestic policies and were compatible with the requirements of domestic policies. Current pressures on nations to change their domestic subsidy, regulation, and procurement policies take a different path.

During the first phase of its existence, the GATT was often criticized for validating mercantilist behaviour and practices by individual countries. Yet, despite the attraction of free trade for trade theorists countries have always been concerned with **freer trade** and reciprocity of concessions in terms of market access. These were measurable aspects of the **quid-pro-quo** that enabled governments to restrain domestic interest groups. For the United States, changing from tariff negotiations into negotiating non tariff barriers removed part of the leverage that the GATT could exert in domestic bargaining.⁴⁷ When non-tariff policies are introduced, the domestic costs of making concessions are easier to estimate than to evaluate the gains from "reciprocal" national concessions. Additionally, when trade instruments moved away from tariffs into a wide array of non-tariff measures, free trade was replaced by subjective concepts, such as **fair trade** and **effective market access**.

The general debate on the domestic regulatory systems that emerged from the Uruguay Round opened a new area of policy convergence. Negotiations moved from tariff negotiations to rule-making negotiations; from measures applied at the border to the harmonization of national rules and standards. In other words, "Global harmonization of domestic practices has become an internationally negotiable proposition."⁴⁸

Two major aspects of enlarging the scope of trade negotiations have to be considered. They are related to the dilemmas created by the ambiguous nature of the policy harmonization debate. A first set of questions refers to the effectiveness of a rule-based system of economic international relations. This is to say, the effectiveness of WTO to protect small economies from actions unilaterally defined by stronger partners. For that to be true, industrial countries should adjust their domestic policies to make them compatible with multilaterally agreed norms, rules and principles. There are doubts that the new trade organization can discourage domestic sectoral interest groups in industrial

⁴⁵ "The GATT system had not been predicated on making all countries identical. Like the principle of equal treatment before the law, it was justified on the opposite proposition that differences were many and various." (Tussie, 1994: 5).

⁴⁶ Tussie (1994: 5) concluded that in WIPO (World Intellectual Protection Organization), the protection of intellectual property rights, accepting the principle of national treatment, obliged countries to follow disciplines on the form of protection, but countries were free to legislate on the subject matter and on the level of protection they thought that should be accorded.

⁴⁷ Destler (1986/1992:35-37).

⁴⁸ Tussie, 1994:2.

countries or groups of countries from asserting the power of those nations (and their high income markets) in countervailing multilateral obligations.⁴⁹

The other set of questions follows from the first. Politicians in the United States and in European countries have to assure their constituencies that rather than to use a minimum common denominator in international integration higher standards in "social protection" will prevail. Hence, seriously or not, industrial countries are decided to uniformize **ex-ante** the conditions of production in developing countries. As mentioned, the agreement on the protection of intellectual property rights already represented an important step towards the extension of industrial country domestic policies to developing countries. The current debate on generalizing to all countries both the levels of environment protection and of labour standards of industrial countries will expand further the expectations of policy harmonization as a precondition for market access, although not necessarily for freer trade.

3. POLICY HARMONIZATION AND DEVELOPING COUNTRIES

Developing countries and other small economies are aware of the issues at stake when power regulates international relations. After being virtually neglected, in the first decade of the GATT and becoming politely tolerated in the following two decades, developing countries were converted in scapegoats of the crumbling international order of the 1980s. To shift the discussion away from the impact of their own macro and microeconomic policies on trade and investment flows, industrial countries insisted that developing countries should accept new multilateral obligations. Positive and defensive reasons gradually led developing countries to replace their stance concerning the GATT by a firm commitment to a rule-based multilateral trading system.⁵⁰ They hope that a rule-based trading system can "restrain the exercise of power" and preempt unilateral policy making.⁵¹

⁴⁹ The editorial of The New York Times, November 29, 1994, "For Freer Trade and Better Jobs" stated: "First, critics say that the W.T.O. threatens U.S. sovereignty because it can rule that U.S. environmental and safety laws are forms of backdoor protectionism. In one sense, the criticism has to be true: any agreement with other nations necessarily restricts U.S. action. But the danger is grossly exaggerated. GATT panels can rule against U.S. laws even under existing rules. These rules would survive even if the new accord were defeated. There is one difference. Under existing rules the U.S. can veto an adverse ruling; under the new accord it cannot. **But in practice this is a minor distinction. Even though countries can now retaliate against the U.S. for such a veto, most do not do so out of fear that the U.S. would retaliate in turn. That is likely to be the case under the new GATT; in that sense, the accord poses no new threat...**" (my stress).

⁵⁰ The phrase of Lacordaire explains the defense of multilateralism by developing countries: "Entre le faible et le fort, c'est la liberté qui opprime et la loi qui libère".

⁵¹ A recent assessment by the Brazilian Minister of Foreign Relations stressed the importance of multilateral norms to protect small economies from arbitrary actions from stronger partners: "Without minimizing the importance of quantitative gains, the most important results from the Uruguay Round are those related to the normative part. The Final Act reduces considerably the margin of arbitrariness concerning the application of anti dumping and countervailing duties measures, and safeguards, eliminating gray area measures." (Amorim, Celso (1994), "América Latina en el nuevo orden económico después de la Ronda Uruguay" in Leiva (ed.), p. 65, my translation).

During the negotiations, Brazil and India had a leading role in the heroic attempts by developing countries to block unfair requirements of "paying" for the restoration to GATT rules of areas, such as agriculture, textile and clothing, withdrawn by industrial countries. Power relations forced developing countries to accept an undesired exchange of concessions in new areas of trade policy, such as trade in services and protection of intellectual property rights, for past due access to industrial countries' markets.

The protection of intellectual property rights (PIPR) was discussed within multilateral trade negotiations aiming at linking PIPR to multilateral trade rights and obligations as a component of the international trading system. It is not my intention to discuss the costs and benefits of a harmonized legal system on intellectual property rights. A preliminary evaluation by UNCTAD (1994a: 197) estimated that the acceptance by all countries, despite their level of technological development, of a pattern of stronger legal protection will have important implications for the transfer and diffusion of technology in technology-importing countries. Although the longer-term systemic implications might be positive, in the short run costs will increase.⁵²

The policy harmonization debate emerged in the Uruguay Round in connection with PIPR.⁵³ After the successful introduction of PIPR into the GATT system, groups differently motivated wanted to benefit from the binding obligations of the new WTO, including trade sanctions, to force countries to accept "adequate levels of social protection". In other words, to use the trade system for purposes other than trade. Regardless of the moral significance of those issues, however, the focus of the solution should not shift away from the specific objectives such as the reduction of environmental destruction or the upgrading of labour conditions. Moreover, the multilateral trading system should not be used to force countries to accept domestic preferences of other countries via trade measures.

There are fundamental differences between negotiating market liberalization and improved "social protection". Such objectives move in opposite directions as far as market forces and state actions are concerned. As Bhagwati underlined, trade and environmentalism do not share the same fundamentals: "Trade ...suggests abstention from governmental intervention, whereas environmentalism suggests its necessity".⁵⁴ Market liberalization indicates a movement towards the removal of policies and obstacles to the full operation of market forces. Negotiations for the extension

⁵² ... (i) stronger protection may be used by foreign intellectual property holders to preserve import rights rather than to work the technology locally or to licence it to other firms; (ii) even where suppliers are interested in transferring their protected technology stronger protection would further enhance their bargaining power and allow them to charge higher prices. (Additionally, increases in such payments are sought by reducing the potential number of imitators and therefore the potential number of competing suppliers of protected technologies) (UNCTAD, 1994a: 197).

⁵³ A recent document by ILO states that "The protection of intellectual property was once a matter for voluntary action of States within the framework of the WIPO. The value of goods and services that are put on the international market increasingly lies in their intellectual component... This is why a very important chapter on this matter was included in the Final Act of the Uruguay Round, which lays down for the first time international standards of protection and the procedures and **coercive** measures that governments should make provision for in their domestic law..." (ILO (1994), The social dimensions of the liberalization of world trade, International Labour Office, Governing Body, Working Party on the Social Dimensions of the Liberalization of International Trade, doc. GB.261/WP/SLD/1. Geneva, November, p. 6, § 4).

⁵⁴ Bhagwati, Jagdish (1993), "The Case for Free Trade" in Scientific American, November, p. 42.

of domestic regulations in industrial to developing countries assume a greater role of the state in counteracting market-determined results.

Trade and Environment

Issues related to trade and environment were initially introduced into GATT and UNCTAD as part of the preparatory work for the United Nations Conference on Environment and Development, (UNCED) which was held in Rio de Janeiro, on June 1992. A Group on Environmental Measures and International Trade was created in GATT by November 1991. Later, its working programme was extended in July 1992 to integrate the activities defined for the follow-up of the UNCED.⁵⁵ During the past three years of discussions their members tried to identify the compatibility and a positive relationship between policies aimed at environmental protection, trade and sustainable development.⁵⁶ Several legal documents approved at the Conference contain provisions dealing with trade and sustainable development. As it is usual in United Nations documents, broad and balanced principles were part of the Rio Declaration.⁵⁷ Commitment to sustainable development was expressed in the Preamble of the WTO Agreement.⁵⁸ In addition, a Ministerial Decision was approved according to which a Committee on Trade and Environment will be established at the first meeting of the General Council of the WTO.⁵⁹

GATT documents affirmed that the trade organization should not engage in the revision of national environmental priorities, neither in establishing environmental norms nor in the elaboration

⁵⁵ Chapter 2 of the Agenda 21 (International Cooperation to Accelerate Sustainable Development in Developing Countries and Related Domestic Policies) stated in 2.3. "The international economy should provide a supportive international climate for achieving environment and development goals by: (a) promoting sustainable development through trade liberalization; (b) making trade and environment mutually supportive; (c) providing adequate financial resources to developing countries ...; (d) encouraging macroeconomic policies conducive to environment and development". Programme Area B of chapter 2 deals with "making trade and environment mutually supportive" and refers to the role of agencies as GATT and UNCTAD in the follow-up.

⁵⁶ The Group was not conceived as a negotiating forum but to examine and to analyse trade-related questions derived from the documents approved in UNCED 92 (See Trade and the Environment, TE 004, 26.11.1993, p. 3)..

⁵⁷ Principle 12 of Rio Declaration asserts: "States should cooperate to promote a supportive and open international economic system that would lead to economic growth and sustainable development in all countries, to better address the problems of environmental degradation. Trade policy measures for environmental purposes should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade. Unilateral actions to deal with environmental challenges outside the jurisdiction of the importing country should be avoided. Environmental measures addressing transboundary or global environmental problems should, as far as possible, be based on an international consensus."

⁵⁸ "Recognizing that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development..." (GATT, 1994: 6).

⁵⁹ GATT, 1994: 470-471.

of global policies for the environment. The work programme should be focused on trade-related effects of environmental policies encompassing three major aspects: (i) possible conflicts between GATT/WTO provisions and trade measures adopted in conformity with multilateral environmental agreements (MEAs); (ii) the impact of GATT/WTO provisions and decisions on MEAs; and (iii) the role of trade policies in the promotion of sustainable development.

In GATT terms, MEAs proved to be a constructive approach to provide strong international action on global environmental problems.⁶⁰ Questions associated to trade measures can be summarized as: (i) the criteria to include trade measures in MEAs and (ii) their consistency with GATT/WTO rules. A discussion paper was circulated in one of the Group's meeting in which concerns were expressed that GATT rules could impede the accomplishment of legitimate trade obligations in MEAs. For instance, a country may decide not to join a MEA which has broad and representative international support with the deliberate purpose of obtaining a commercial advantage from its non-participation. If this conduct threatens to undermine the environmental objectives of the MEA should not it be legitimate to include trade discrimination measures to discourage such behaviour?

Environmentalists were enraged when in 1992 a GATT Dispute Settlement ruled in favour of Mexico and against the United States (and the welfare of dolphins). In February 1991, the United States placed an embargo on the import of Mexican tuna because Mexicans had used purse seine to catch the fish.⁶¹ This kind of net had been banished in the United States because dolphins are killed cruelly and in greater number than United States legislation (The Marine Mammal Protection Act of 1972) permits. The GATT panel ruled against the unilateral actions by the United States for several reasons: 1. because the country was unilaterally intervening in the methods by which Mexico could harvest tuna (Art. III of the GATT); 2. because the country was extending its domestic laws to extraterritorial waters and 3. that the United States had imposed a quantitative restriction violating Art. XI of the GATT. In addition, the measure was discriminatory because the embargo only affected a part of the fishing area where the United States fleet was not allowed and only a particular kind of tuna. The panel also suggested that trade measures are not the best instruments to enforce environmental norms; bilateral cooperation between parties with compensatory provisions for low-income countries could be a more adequate way to address the problem.

GATT rules can adapt to environment-related trade measures aiming at reducing the negative **product** effects of trade. The purpose of trade restrictions is then to regulate the international flows of particular goods to control their environmental effects. There are examples of multilateral trade measures to moderate the detrimental effects of the disposal of wastes and to limit the extinction of species: the Basel Convention on the Control of Transboundary Movements of

⁶⁰ The Swedish delegation in one meeting of the Group on Environmental Measures and International Trade, proposed that the negotiation of MEAs continued to be an active area of environmental policy-making. Most delegations insisted that MEA was an effective and durable approach to environmental problems of a transboundary or global nature and less disruptive to the multilateral trading system than unilateral trade measures. "However, the United States reiterated that it saw real practical limitations in certain cases to multilaterally-based solutions" (Trade and the Environment, TE 004, 26.11.1993, p. 3).

⁶¹ Other countries (Venezuela, Costa Rica, France, Italy, Japan and Panama) were also affected by the embargo, but only Mexico required a GATT Panel in September 1991.

Hazardous Wastes and the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES). Proposals for trade measures to restrain the use of processes and production methods are more problematic. Trade restrictions linked to processes and production methods can be multilaterally agreed when the environmental practices of one country have impacts on the domestic environment of another country or when the global environment or common resources are at stake. This is the case of the Montreal Protocol on Substances that Deplete the Ozone Layer. Countries agreed that production processes using CFCs should be curtailed.⁶²

There are multiple questions associated to the best way that trade could contribute to sustainable development. This debate has been sometimes confused by moralist and retrograde conceptions of how the environment should be "conserved". Radical conservationists are against growth simply because growth increases the supply of pollution. Therefore they are against trade and international specialization that eventually will lead to growth in the use of resources and pollution. A major problem arises when environmentalists do not separate environmental problems confined within domestic boundaries from transboundary or global environmental problems. As with Mexican tuna, some of them assert that a higher-standard country can decide on the production methods of its trading partners. The rationale is that if foreign countries do not raise their standards up to higher-standards countries the consequence will be that factories will relocate their production to lower-standards countries and ultimately, pressures from corporations in the higher-standards countries will force down the environmental standards. Moreover, lax environmental requirements by foreign governments are perceived as **unfair subsidies** allowing for unfair competition.

The concept that gained acceptance in the UNCED 1992 and was included in Principle 16 of the Rio Declaration is called "internalization of external costs".⁶³ Some environmentalists would like to enforce the principle unilaterally without including the qualifications that were carefully drafted by negotiators of the Rio declaration.⁶⁴ There are statements such as: "The most practical solution is to permit nations that internalize costs to levy compensating tariffs on trade with nations that do not" therefore "protecting an efficient national policy of full cost pricing from standards-lowering international competition". If countervailing duties are allowed by GATT rules to discourage countries from trading in goods at prices below their production costs, "The only real difference is the decision to include the costs of environmental damage and community welfare in that reckoning."⁶⁵

Governments of higher-standard countries could prevent the spread of lower standards of environmental protection without limiting free trade "by insisting that their businesses accede to the

⁶² Stevens, Candice (1993), "The Environmental Effects of Trade" in The World Economy, vol. 16, n. 4, July. pp. 448-449.

⁶³ See UNCTAD (1994), The effect of the internalization of external costs on sustainable development, Report by the UNCTAD secretariat (doc. TD/B/40 (2)/6, 7 February).

⁶⁴ Principle 16 of the Rio Declaration states "National authorities should endeavour to promote the internalization of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost of pollution, with due regard to the public interest and without distorting international trade and investment".

⁶⁵ All quotations from Daly, Herman E. (1993), "The Perils of Free Trade" in Scientific American, November, p.53.

higher standards when they go abroad. Such a policy lies entirely within the jurisdictional powers of a higher-standards country. Moreover, the governments of lower-standards countries would be most unlikely to object to such an act of good citizenship by the foreign investors."⁶⁶ Instead, environmentalists prefer to suggest the adoption by the higher-standards country of a tariff sufficient to remove the competitive advantage of lower standards.⁶⁷

It should be emphasized that industrial countries still produce, export and import the bulk of pollution-intensive products.⁶⁸ An empirical study by Low and Yeats (1992) analysed the imports of such products for the period 1965 to 1988. They found that the share in world trade of pollution-intensive goods originating in industrial countries fell from 77.7% to 74.3%; the share of similar products originating in South East Asian countries rose from 3.4% to 8.4% whereas the share of other developing countries remained constant. Other studies showed that pollution-intensive imports in the United States and Japan account for a larger share of total imports in those two countries.⁶⁹

GATT Working Group has shown that GATT provisions allow for the maintenance of higher standards of environmental protection through tariffs if two basic principles are not infringed: (i) national treatment - imported goods should have the same treatment as locally produced goods and (ii) nondiscriminatory treatment. Nevertheless, products and not processes can be the objects of trade measures. Moreover, a country is not allowed to impose its own environmental standards on others. As mentioned, when there are transboundary environmental impacts countries should undertake internationally agreed measures.

A recent review by Markandya (1994) of empirical studies on the relation between trade and environment attempted to analyse two basic questions: (i) if actually freer trade and capital flows conflict with sustainable development and (ii) if the enforcement of policy instruments for sustainable development results in a reduction in the volume of trade.

Time series and cross-sectional studies on the impact of trade liberalization measures on environmental degradation were not conclusive. Short-term effects of trade liberalization will be adverse to the environment but there are longer-term advantages of an open economy. On the investment side, some empirical studies evaluated the hypothesis of whether firms locate in countries

⁶⁶ Bhagwati (1993: 46),

⁶⁷ Daly, 1993: 53.

⁶⁸ Principle 7 of the Rio Declaration reflects the explicit acknowledgement by industrial countries of their role as the major causes of environmental pollution: "States shall cooperate in a spirit of global partnership to conserve, protect and restore the health and integrity of the Earth's ecosystem. **In view of the different contributions to global environmental degradation, States have common but differentiated responsibilities. The developed countries acknowledge the responsibility that they bear in the international pursuit of sustainable development in view of the pressures their societies place on the global environment and of the technologies and financial resources they command.**" (my stress).

⁶⁹ Low, P. and A. Yeats (1992), "Do dirty industries migrate?" in Low, P. (ed.), International Trade and the Environment, World Bank Discussion Papers n. 159, Washington, D.C.; Sorsa, P. (1992), "GATT and the environment: basic issues and some developing country concerns" in Low (ed.); Robison, H. (1988), "Industrial pollution abatement: The impact on the balance of trade" in Canadian Journal of Economics, vol. 21 as quoted in Markandya, Anil (1994), "Is free trade compatible with sustainable development?" in UNCTAD Review 1994, p. 15.

to take advantage of lax environmental regulations. Those studies showed that location decisions by transnational corporations are most influenced by factors such as labour costs, access to markets and the existence of a developed industrial base. Environmental regulations and corporate tax rate are not as important locational factors. A quantitative analysis on the direct foreign investment by pollution-intensive industries in developing countries provided weak support to the pollution-migration hypothesis; between 1973 and 1985 there was a slight increase in the share of chemical and mineral industries in total direct foreign investment in all industries (from 25.7% to 26.5%). Other recent studies concluded that there was little evidence of industrial relocation because of different environmental regulations.⁷⁰

The second set of questions is more relevant to Brazil. It concerns the impact of environmental regulations in industrial countries on competitiveness, employment and growth in developing countries. There are two important issues (i) the costs of adjusting production processes to domestic environmental regulations of importers and (ii) the arbitrary criteria for labeling of environmentally sound programmes - the so-called ecolabeling programmes. Although no conclusive studies exist, there are no doubts that adjustments to environmental preferences of importers raise costs to exporters. It is not clear, however, whether these costs affect the competitiveness of exporters.

A study recently prepared by Motta Veiga et al. (1994) on the relationships between trade and the environment in the Brazilian case reached the following conclusions: (i) the level of specialization of the Brazilian economy is high; (ii) its exports are predominantly composed of products intensive in the use of natural resources and energy; (iii) a significant part of products exported by Brazil are homogeneous products with high scales of production, and minor possibilities of product differentiation and, (iv) price differentials explain most of the Brazilian competitiveness in international markets. Therefore, Brazilian exports are vulnerable to the imposition of environmental standards by importers. In particular, for steel industries, environmental restrictions will reduce the comparative advantage of Brazilian industry if importers decide to impose technical standards and energy requirements that are incompatible with the availability of resources in the country.⁷¹

Both public and private sectors in Brazil are aware of the importance of environment preservation.⁷² A recent survey among Brazilian large corporations showed that there has been increasing concern within those companies for the importance of environmental variables in the

⁷⁰ Markandya (1994: 13) quoted a study by Grossman and Krueger on the maquiladora programme which allowed United States firms to locate in Mexico, near the frontier with the United States, on advantageous terms. The study found "that pollution abatement costs were not a significant determinant of the trade generated by the programme" (Grossman, G. and A. Krueger (1992), "Environmental impacts of a North American Free Trade Agreement" in P. Garber (ed.), The US-Mexico Free Trade Agreement, MIT Press, Cambridge, Massachusetts).

⁷¹ Motta Veiga, Pedro da, Marta Reis Castilho e Galeno Ferraz Filho (1994), Relationships between trade and the environment: The Brazilian case, Fundação Centro de Estudos do Comércio Exterior (FUNCEX), Rio de Janeiro, Texto para Discussão n. 93, July, pp. 5-31.

⁷² The new Brazilian Constitution of 1988 included environmental protection in several of its provisions. Article 225 §3, 5, LXXIII and 225 §1, IV. In 1981 Brazil defined a national policy on environment (May 31st) (Law 6.938) and established a National Environmental System.

definition of their competitive edge.⁷³ It is important to stress that the main Brazilian development bank (the National Bank of Economic and Social Development - BNDES) offers credit lines for pollution abatement programmes developed by public agencies, and also for projects to rectifying environmental liabilities incurred by industries, besides environmental investments within new industrial projects.⁷⁴ As expected, the major recipients of those credit lines were the industries of pulp and paper, iron and steel and chemicals and petrochemicals.⁷⁵

The study showed that the good export performance of Brazilian iron and steel industry resulted from intensive exploitation of natural resources, with a technology that is potentially polluting and without investments in liquid wastes control equipment. Moreover, Brazil makes intensive use of charcoal, which includes the forest devastation as an additional problem for the sector.⁷⁶ However, the industry is getting prepared to invest more in pollution-reducing equipment. And, on the other hand, due to the widespread use of hydroelectric sources of energy Brazilian steel mills produce low CO2 emission levels.

A survey conducted by Motta Veiga et al., early in 1994, with the major iron and steel companies concluded that they had not yet faced environmental obstacles from importers, mostly because the European Union is not the principal market for those Brazilian exports. Only one firm was expecting that up to 50% of its exports could be subject to environmental restrictions from European countries. However, the steel industry, as a whole, has faced important non-tariff mechanisms such as voluntary export restriction and anti-dumping investigations.⁷⁷ Besides, Brazilian iron and steel industry sought international outlets for its products due to the stagnation of Brazilian market. Entrepreneurs prefer to sell homogeneous iron and steel goods in the domestic market and compete in international markets for higher valued added products.

Another sector that may be vulnerable to environmental restrictions is pulp and paper.⁷⁸ More than 87% of Brazilian pulp exports go to OECD markets. European Union countries are major

⁷³ The survey covered the 23 major Brazilian industrial groups operating in 34 industrial sectors. Sixty one per cent of the sample had sales greater than 200 million dollars and most of them had significant export activities. Almost 80% of the firms interviewed answered that they already had implemented some form of environmental policy and 74% stated that they had objective knowledge of their environmental liabilities. The companies were aware of the need to preempt restrictive trends related to environmental protection both in the country and abroad (Motta Veiga et al. (1994), 1994: 52).

⁷⁴ The powerful National Confederation of Industry (CNI) created a Permanent Commission of Environment and Soil Use (Comissão Permanente de Meio Ambiente e Uso do Solo - COPEMA). The COPENA is the representative of CNI in the GANA (Supporting Group to Environmental Standards). The GANA is part of the International Standard Organization (ISO), which is responsible for the elaboration of international environmental standards (Technical Committee 207)

⁷⁵ Motta Veiga et al. (1994), 1994: 56.

⁷⁶ Brazilian legislation requires that all charcoal consumed by steel mills should originate from non-native forests. Reforestation or forest management will become mandatory after 1998 (Motta Veiga et al. (1994), 1994: 71).

⁷⁷ Motta Veiga et al. (1994), 1994: 67.

⁷⁸ Brazil ranks the 13th among world paper producers and the 8th among world pulp producers. In 1993, Brazilian paper production totalled 5.4 billion of tons while pulp production totalled 5.0 billion of tons (Motta Veiga et al. (1994), 1994: 89).

consumers of those Brazilian exports (45%); the United States absorb almost 30% and Japan 14%. The geographical distribution is a little different for paper exports: Latin American countries account for 34% whereas European countries account for another 31%. Large and vertically integrated companies produce paper from their own forests. They have introduced environmental elements in their corporate strategies. They developed timber growing techniques and new species. Those firms have encouraged the production of high yield pastes; upgraded paper quality while reducing the discharge of liquid waste and the level of chlorine in finished products. A major problem that the industry may face in the future will be the imposition of more stringent environmental standards and regulations with the mandatory use of recycled fibers.⁷⁹ Also, the international campaign by NGOs against massive forest devastation in Brazil affects negatively the Brazilian imports of pulp and paper products in spite of high investments by Brazilian companies in the administration of manmade, ecologically sustainable forests.⁸⁰

A major concern among pulp and paper producers is their vulnerability to trade barriers aiming at changing production methods.⁸¹ For instance, the Brazilian Pulp Exporters Association finds that ecolabeling and environmental quality certifications are important instruments but that they should be based on transparent, nondiscriminatory and technical criteria that include non-European conditions of production. Currently, to qualify for an eco-label, a product has to show that it does not have more than a given amount of "load points" (penalties) which are the result of a set of parameters. It is in the formulation of those parameters that Brazilian producers fear that there is great opportunity for discretionary action.⁸²

The Motta Veiga et al. (1994) study concluded that Brazilian exports are less vulnerable when restrictive standards refer to products but more vulnerable when importers decide to act on production methods. Therefore, environmental restrictions which discriminates against productive processes act as trade barriers. They cannot be considered legitimate since the emission of pollutants is confined within domestic boundaries and are not global in nature.⁸³

Trade and Labour Conditions

The United States tried unsuccessfully to introduce the topic of workers' rights in 1986, at the end of the preparatory work for the Uruguay Round. More recently, backed by France, the United States delegation tried to include the "social clause" in the final draft on the mandate of the future WTO. In the first case, Brazil and India led the reaction against that inclusion. In the second case, Brazil, India and other Asian countries such as Malaysia and Indonesia were helped by the opposition of Germany and England to state-promoted convergence in labour standards. Nevertheless, the

⁷⁹ In 1991, Germany adopted a legislation forcing manufacturers to consume secondary fibers - scraps and recycled materials (Motta Veiga et al. (1994), 1994: 102).

⁸⁰ Motta Veiga et al. (1994), 1994: 101- 103.

⁸¹ See Procópio Filho, Argemiro (coord.) (1994), Ecoprotecionismo: Comércio Internaiconal, Agricultura e Meio Ambiente, Relatórios de Pesquisas, Estudos de Política Agrícola n. 17, IPEA, Brasília, (Projeto PNUD/BRA/91/014).

⁸² Motta Veiga et al. (1994), 1994: 107.

⁸³ Motta Veiga et al. (1994), 1994: 121.

discussion was just postponed. It cannot be ignored that the issue of labour conditions, social protection or social clause is part of the WTO negotiating agenda.

The debate is framed in North-South terms as all industrial countries had the best labour conditions and all developing countries had none. That represents a drastic change with the past since as the late Ambassador Nogueira Batista remarked: (i) attempts to create uniform labour standards and uniform international competitive conditions are as old as the introduction of domestic social legislation in individual countries; and (ii) historically the "social clause" debate started as a problem between industrial countries, which were the first to introduce labour legislation.⁸⁴

Switzerland was the first country to introduce working hour regulations and also a specific legislation for female and children labour in 1877. The enactment of that legislation led the Swiss government to promote the discussion of uniform labour standards in Europe. That country tried to gain the support of other major European countries for an international conference on that issue, first in 1881 and later in 1889. It was only after Germany had adopted, under Bismarck, a broad social legislation that the first intergovernmental conference on labour conditions was held in 1890. Later, in 1919 the equalization of labour costs through uniform labour regulations was sponsored by the newly created agency, the future International Labour Organization (ILO).⁸⁵

Labour conditions were equalized among advanced European countries mostly due to pressures from workers organized in trade unions, but also because of higher levels of productivity allowed by technological change. International agreements on labour conditions were not major instruments for greater convergence on labour conditions across countries. Moreover, while developing countries remained commodity exporters, no concern for the adoption of "internationally recognized labour standards" was expressed by industrial countries. Only recently, with the emergence of newly industrializing countries able to compete in international markets those concerns were trivialized in ambiguous expressions such as "social dumping".

Trade and fair conditions of labour were linked in the Havana Charter but the wording was cautious.⁸⁶ Besides, the focus was on the quality of the employment to be created and not on unfair practices from trading parties. Although statements of intentions to upgrade labour conditions patterns were introduced in some commodity agreements, the first agreement to contain clauses related to

⁸⁴ Nogueira Batista, Paulo (1994), "Cláusula social e comércio internacional: uma antiga questão sob nova roupagem" in *Política Externa*, vol. 3, n. 2, September, pp. 36-54.

⁸⁵ However, only in 1934 the United States became a formal member of ILO (Nogueira Batista, 1994: 40).

⁸⁶ The title of Chapter II was *Employment and Economic Activity* in which the importance of the maintenance of domestic employment and the avoidance of unemployment and underemployment should not be a matter of domestic concern only. Article 7 on Fair Labour Standards stated that : "(1). The Members recognize that measures relating to employment must take fully into account the rights of workers under inter-governmental declarations, conventions and agreements. They recognize that all countries have a common interest in the achievement and amintenance of fair labour standards related to productivity, and thus in the improvement of wages and working conditions as productivity may permit. The Members recognize that unfair labour conditions, particularly in production for export, create difficulties in international trade, and, accordingly, each Member shall take whatever action may be appropriate and feasible to eliminate such conditions within its territory."

labour standards was the Caribbean Basis Initiative, in 1983, in the context of preferential trade agreements. Later, in 1984 the United States legislation included minimum labour standards that a developing country should fulfill to benefit from preferential access to United States market.

The 1988 Omnibus Trade and Competitive Act in Section 1001 established several negotiating objectives regarding workers' rights.⁸⁷ Nevertheless, the landmark is the NAFTA side agreement on labour standards (as well as one on Environmental Cooperation).⁸⁸ The Agreement includes issues such as restrictions on child labour, health and safety standards, and minimum wages. In addition, the agreement established procedural mechanisms for enforcement. "Moreover, the United States retained its right to use domestic trade laws, such as Section 301 of the 1974 trade act, with respect to labour issues not covered under NAFTA."⁸⁹

There are several aspects of that emphasis on labour standards that should be considered. First, it is unlikely that any nation would be willing to compete on low-wage labour if a different alternative were available.⁹⁰ Historical factors explain a prevailing pattern of income distribution that have to be analyzed if a better distribution is wanted. Second, labour standards and wage levels do not seem to keep a positive correlation. Also, market-oriented policies for greater efficiency and those for higher labour standards do not necessarily converge. Market-oriented policies demand greater flexibility in labour markets whereas labour standards create rigidities for labour mobility.

Income distribution in Latin American has been a major concern of ECLAC from its inception. A vast amount of empirical and theoretical work on income distribution in Latin America over several decades refined the number and quality of explanatory variables. Domestic variables such as agrarian structure, consumption patterns of the ruling classes, together with exogenous variables such as international demand and the terms of trade between commodities and manufactured goods were introduced to explain the structure of income distribution. The region has the worst income distribution among developing countries: the share of total income received by the poorest 20% in the

⁸⁷ "(A) to promote respect for worker rights; (B) to secure a review of the relationship of worker rights to GATT articles, objectives, and related instruments with a view to ensuring that the benefits of the trading system are available to all workers; and (C) to adopt, as a principle of the GATT, that the denial of worker rights should not be a means for a country or its industries to gain competitive advantage in international trade." (UNCTAD (1988), The U.S. Omnibus Trade and Competitiveness Act of 1988: Its Implications for Developing Countries and the Uruguay Round of Multilateral Trade Negotiations, doc. UNCTAD MTN/INT.CB.12, October, p. 89.)

⁸⁸ The North American Agreement on Environmental Cooperation maintains all existing U.S. health, safety, and environmental standards. "It allows States and cities to enact even tougher standards, while providing mechanisms to encourage all parties to harmonize their standards upward..." (United States Government, 1994: 228-229).

⁸⁹ United States Government, 1994: 228.

⁹⁰ The definition of international competitiveness in the 1985 Report of the United Nations President's Commission on Industrial Competitiveness has a broad consensus: "Competitiveness is the degree to which a nation can, under free and fair market conditions, produce goods and services that meet the test of international markets while simultaneously maintaining or expanding the real incomes of its citizens." (United States Congress (1992), Competing Economies, America, Europe, and the Pacific Rim, Office of Technology Assessment, Washington, D. C., p. 3).

late 1970s was lower in Latin America than in any other part of the developing world. Moreover, that percentage was systematically reduced over the period 1960 to 1978.⁹¹

Brazil is outstanding in terms of its impressively skewed income distribution.⁹² Nevertheless, the country has signed, ratified and implemented most of the international labour conventions.⁹³ In addition, abundant raw materials and cheap energy rather than pure labour exploitation explain part of the country's comparative advantage.⁹⁴

Contrasting to that debate, a recent study by the World Bank concluded that market-oriented policies in Latin America should include labour deregulation. The study described Latin American highly regulated labour market as opposed to the extreme flexibility of the successful East Asian economies - Hong Kong, Indonesia, the Republic of Korea, Malaysia, Singapore, Taiwan (China), and Thailand.⁹⁵ Therefore, it is remarkable that East Asian countries, with lower labour standards could present a continuously better pattern of income distribution than Latin American countries.⁹⁶

Finally, it is ironic that labour standards in developing countries could become a threat to those of workers in industrial countries. In 1948, Raúl Prebisch before joining ECLAC as the Executive Secretary, wrote the seminal study The Economic Development of Latin America and Its Principal Problems.⁹⁷ There, Prebisch analysed the distribution of productivity gains between industrial and developing countries. Institutional arguments were put forwards to explain the persistence of higher wages in industrial countries despite the economic cycle. Higher levels of labour organization in industrial countries prevented the contraction of wages in those countries whereas lack of organization among the workers employed in primary production prevented them from increasing their income.⁹⁸ A continuous fall in the terms of trade of commodities exported by developing countries and

⁹¹ The share of the lowest 20% of Latin American population in the total income received in the region was 3.7% in 1960, 3.4% in 1970 and 2.9% in 1978 (World Bank (1993), Latin America and the Caribbean A Decade After the Debt Crisis, Washington, D. C., table 8.1, p. 118).

⁹² Gini coefficient in Brazil is the highest in South America and it deteriorated further over the 1980s: it was 0.575 in the early 1980s and it increased to 0.625 in the late 1980s (World Bank, 1993, table 8.5, p. 120).

⁹³ The experienced Ambassador Nogueira Batista believed that Brazil and other Latin American countries were in a good position to preempt further moves by industrial countries. Latin American countries should advance a precise definition of "social dumping" in WTO. He suggested that a first step could be the GATT definition of dumping. A relationship between GATT/WTO and ILO analogous to that of GATT/IMF could also be adopted. He mentioned that Brazil and other Latin American countries rank first among countries with the highest number of ratification of ILO Conventions. In contrast, the United States ratified just nine out of 170 conventions (Nogueira Batista, 1994: 52-53).

⁹⁴ See Coutinho, Luciano and Joao Carlos Ferraz (coords.) (1994) Estudo da Competitividade da Indústria Brasileira, Papirus, Sao Paulo, pp. 261-310.

⁹⁵ World Bank, 1993: 92-97.

⁹⁶ The share of income for the highest 10% was 27.5% in the Republic of Korea (1976) whereas it was 50.6% in Brazil (1972) (World Bank, 1993: table 8.2, p. 118).

⁹⁷ He had been hired as a consultant for ECLAC, to prepare a background paper for the Havana Conference on Trade. (Furtado, Celso (1985), A Fantasia Organizada, Editora Paz e Terra, São Paulo, pp. 53-63).

⁹⁸ "The greater ability of the masses in the cyclical centres to obtain rises in wages during the upswing and to maintain the higher level during the downswing and the ability of these centres, by virtue of the role they play in production, to divert cyclical pressure to the periphery (causing a greater reduction of income of the latter than in that

exchanged by manufactured goods imported from industrial countries underscored income levels discrepancies. For many decades, an emotional debate on the impact of the **unequal exchange** between industrial and developing countries on higher income of workers in industrial countries was pursued until eventually it faded out by the end of the 1970s.⁹⁹ It was implicit that the quality of life of workers in industrial countries was based upon lower wages in developing countries. On the other hand, the latter were a consequence of unequal terms of trade between unprocessed and processed goods.¹⁰⁰ By the end of the 1970s, the debate became irrelevant because of the rapid deterioration of employment and workers' income in industrial countries.¹⁰¹

4. THE REGION AS A SMALL GROUP FOR POLICY HARMONIZATION

It was explained elsewhere that the motivations for nations getting into regional arrangements are radically different from those that attracted them to preferential trading blocs in the interwar period.¹⁰² Therefore, analogies with the past do not provide insights to the current movement of regionalism. The current trend occurs within a wide process of trade liberalization, in terms of tariff reductions and drastic elimination of non-tariff barriers. Consequently, those regional arrangements do not aim at preferential access only, but to facilitate the free movement of goods, services, capital and labour. Nevertheless, it should not be neglected that current regionalism emerged in the environment of uncertainties and complexities of world politics. Therefore, there is an implicit defensive aspect in the reinforcement of regional and subregional initiatives between developing countries as the result of protectionism in industrial countries and the attempt by powerful nations to consolidate regional areas of influence.

The General Agreement on Tariffs and Trade provides for customs unions and free trade areas, as the major exception to the fundamental principle of MFN treatment. As of the beginning of 1994, almost all of GATT's 115 contracting parties were members of at least one preferential trade agreement, with the preferred vehicle being free trade areas (free-trade areas outnumbered five-to-one customs unions). There were several areas of concern: (i) the potential for diversion of investment capital away from third parties to members of regional agreements; (ii) that demands for protection by sectors undergoing adjustment within the regional arrangement could be borne primarily by third

of the centres) explain why income at the centres persistently tends to rise more than in the countries of the periphery, as happened in the case of Latin America." (Prebisch, Raul (1950), "The Economic Development of Latin America and Its Principal Problems" in *Economic Bulletin for Latin America*, vol. VII, n. 1, February, p. 6)

⁹⁹ See Emmanuel, Arghiri (1972) *Unequal Exchange A Study of the Imperialism of Trade*, Monthly Review Press, New York.

¹⁰⁰ A logical consequence of Prebisch's argument was that the working-class of developing countries was "exploited" by the working-class in industrial countries.

¹⁰¹ "From 1947 to 1973 the real income of the median American family increased by a robust 2.8% a year, more than doubling. In contrast, from 1973 to 1992 the income of the typical American family was essentially stagnant, rising by only 0.1 percent a year after adjusting for inflation." (United States Government, 1994: 115).

¹⁰² Lawrence, 1991: 31.

party suppliers and, (iii) the scope for trade diversion linked to the rules of origin that members of such arrangements are required to agree and administer.¹⁰³

ECLAC, in a recent document called **open regionalism** "a process of growing interdependence at the regional level, promoted both by preferential integration agreements and by other policies in a context of liberalization and deregulation, geared towards enhancing the competitiveness of the countries of the region and, in so far as possible, constituting the building blocks for a more open and transparent international economy."¹⁰⁴

Another aspect which should not be overlooked is that regional initiatives can be functional to the process of unilateral liberalization, as it happened in major Latin American economies. On the one hand, regional and subregional free-trade arrangements lend credibility to domestic liberalization policies. Commitments at a regional and subregional levels will necessarily raise the costs of violating agreements. Foreign investors, but also local entrepreneurs and interest groups will take seriously the liberalization intentions of governments when these domestic intentions are sanctioned by regional and subregional instruments. On the other hand, they may contribute for a more gradual opening of the economies and help governments to better identify the impact of exposing the local industry to foreign competition. In the case of the MERCOSUR (the Southern Cone Common Market) formed by Brazil, Argentina, Uruguay and Paraguay, the establishment of an effective timetable for tariff reduction, which was automatic and applied across-sectors sent a clear message to Brazilian entrepreneurs that governments of those countries were seriously decided to open their markets to foreign competition.¹⁰⁵ Later on, the negotiations for a common external tariff reinforced the message.

Latin American countries accounted for a great part of Brazilian exports up to the debt crisis of the 1980s: those markets consumed roughly 18% of Brazilian exports in 1980; that share decreased to 8.7% in 1985 to increase gradually to 23.5% in 1993. Furthermore, this is a direction of trade for Brazilian exports with a higher proportion of manufactures: 85% of those exports are composed of manufactured goods.¹⁰⁶ The four countries of the MERCOSUR accounted for an average of 4% of Brazilian exports in the period 1982-1990, whereas in 1993 they accounted for almost 14% of the

¹⁰³ Speech of the Director-General of the GATT on Regional Integration and the WTO, given to the third Euro-Latin American Forum in Sao Paulo, July 7, 1994, GATT WTO News, July 7, 1994 (GW/03).

¹⁰⁴ ECLAC, 1994: 8.

¹⁰⁵ The Asuncion Treaty was signed on March 1991. It contained a Programme of Trade Liberalization (Annex I, article 3, which defined a timetable of tariff reduction starting in June 1991 with a reduction of 47% and finishing at 31st December 1994 with 100%. A reduced list of exceptions for each country was defined in article 6, but that list should be decreased yearly by a given proportion defined in article 7. For more information on the MERCOSUR formation see Hirst, Monica (1993), "Avances y desafios en la formación del MERCOSUR" in Bouzas, R. (ed.) Los Procesos de Integración Económica en América Latina, CEDEAL, Madrid, pp. 35-76; Brazil, Ministry of Foreign Relations, Boletim de Integração Latino-Americana, various issues.

¹⁰⁶ See Ventura-Dias, Vivianne (ed.) (1989) South-South Trade - Trends, Issues, and Obstacles to Its Growth, Praeger, New York, for a discussion of the composition of exports according to directions of trade.

total.¹⁰⁷ Argentina is now the second largest Brazilian trading partner and that bilateral trade amounts to \$ 6.34 billion.¹⁰⁸ Brazilian exports to Paraguay (\$ 1.2 billion) are now greater than those to France and the bilateral trade with Uruguay is greater than that with Canada or Spain.¹⁰⁹ Moreover, trade with Latin American countries explained most of the recent growth of Brazilian exports, since the value of its exports to other directions of trade has remained almost stable.

There is no space in this paper for a review of the MERCOSUR experience that is manifold. My purpose here is to highlight the interesting learning process that has been taking place in the subregion on the subject of policy coordination and harmonization.¹¹⁰ Initially, emphasis was laid on macroeconomic coordination, particularly because the high levels of inflation in Brazil until the middle of 1994, as compared with the successful stabilization programme in Argentina, could threaten the sustainability of integration efforts. Moreover, trade unbalances between Brazil and Argentina between 1992 and 1993 favoured Brazil, due to Argentine overvalued exchange-rate. These trade superavits created frictions between the two countries.¹¹¹ Therefore, the coordination of macroeconomic policies gained prominence in academic and governmental spheres.

Although the topic of macroeconomic coordination is extremely important, I am more concerned with the harmonization of microeconomic and non-economic domestic policies that eventually will affect the competitiveness of member countries.¹¹² The information is scanty and can only be inferred from the available documentation on the various negotiations.

It should be explained that the Asumpcion Treaty is an instrument for the establishment of the MERCOSUR. Therefore, the institutional structure created with the Treaty, including a dispute settlement mechanism, is of provisional nature.¹¹³ The organization is intergovernmental with

¹⁰⁷ The share of the subregion on Brazilian imports remained almost stable around 10 to 13% over the period 1989-1993 (data from Ministério da Industria, do Comércio e do Turismo, Secretaria do Comércio Exterior, Departamento Técnico de Intercâmbio Comercial).

¹⁰⁸ The United States is the first importing market accounting for 20.3% of Brazilian exports in 1993 whereas Argentina accounted for 9.4% (MICT/SECEX/DTIC).

¹⁰⁹ Denot Medeiros, José Arthur (1994), "A Area de Livre Comércio Sul-Americana: O Imperativo e a Lógica da Cooperação Econômica Regional" in Boletim de Integração Latino Americana, n. 13, April-June, p. 2.

¹¹⁰ The Asumpcion Treaty defines in its article 1 that a Common Market implies the free movement of goods, services and productive factors between countries...; the establishment of a common external tariff and the adoption of a common trade policy for third countries ...; the coordination among countries (Estados Partes) of macroeconomic and setoral policies, including those related to foreign trade, agricultural, industrial, fiscal, monetary, exchange-rate and capital policies, besides those policies related to services, customs, transportation and communication and others as agreed, with a view to ensure adequate conditions of competition among member countries and a commitment of member countries (Estados Partes) to harmonize their legislations, in pertinent areas to strengthen the integration process (my translation).

¹¹¹ Parallel negotiations between the two countries led to the reduction of trade surplus favouring Brazil and to the a more equilibrated bilateral trade.

¹¹² See ECLAC (1992) Ensayos sobre Coordinación de Políticas Macroeconómicas, Economic Commission for Latin America and the Caribbean, Santiago, Chile LC.G. 1740-P, December, United Nations Publication sales number S.92.II.G.15, for general discussion on the coordination of macroeconomic policies.

minimum levels of supranationality.¹¹⁴ Drafters of the Asumpcion Treaty were careful in not overburdening countries that did not have much experience in integrating their economies. The creation of one international organization preceding the establishment of the common market would be incompatible with the level of cooperation and integration linkages relating future member countries.¹¹⁵ There is a Common Market Council (CMC) composed by Ministers of Foreign Relations and Ministers of Economy of member countries and the Common Market Group (GMC), coordinated by the Ministry of Foreign Relations, with eight members nominated by each country¹¹⁶. The Decisions enacted by the CMC prevail over the Resolutions and Recommendations emanating from the GMC.¹¹⁷ That institutional structure is extremely flexible since the Council can also create other organisms as required to fulfill the objectives of "the final constitution of the Common Market".¹¹⁸

The Annex V of the Treaty created ten Working Groups with the stated purpose of coordinating macroeconomic and sectoral policies covering the following issues: 1. trade; 2. customs; 3. technical norms; 4. trade-related aspects of fiscal and monetary policies; 5. land transportation; 6. maritime transportation; 7. industry and technology policies (including the protection of intellectual property rights); 8. agricultural policy; 9. energy policy and 10. coordination of macroeconomic policies. The four years of preparation for the MERCOSUR have resulted in a variety of norms and uniform procedures in areas such as technical measures, sanitary and phytosanitary measures, labeling and packaging, integration of customs procedures, and transportation modes. These legal norms, however, do not capture the richness of the discussions in the Working Groups.¹¹⁹

Concerns with sustainable development and with the protection of the environment are part of the MERCOSUR initiative. The Asumpción Treaty contains a statement in its Preamble mentioning

¹¹³ Grebler, Eduardo ((1994), "O Mercosul Institucional e a Solução de Controvérsias" in Boletim de Integração Latino Americana, n. 12, January-March, p. 45) refers to the fact that the MERCOSUR was not created as an entity with a legal personality but, as an agreement between States implying rights and obligations from one country to each other, to be complied by their respective governments.

¹¹⁴ There are no provisions in the Treaty for an automatic internalization of decisions taken at the MERCOSUR level. In other words, there are no mechanisms to transform a regional norm into a domestic law. (Soares, Guido (1994), "A Atividade Normativa do Mercosul, nos dois Primeiros Anos de Vigência do Tratado de Assunção: Um Balanço Positivo" in Integração Latino Americana, n. 12, January-March, p. 10).

¹¹⁵ Grebler, 1994: 45.

¹¹⁶ Four permanent members and four replacements.

¹¹⁷ Soares (1994: 11-12) recalled that according to the European Community Law there is a difference between uniformize and harmonize. Rules aim at uniformizing the Community legislation whereas the directives aim at harmonizing legislative, regulatory and administrative measures in member countries. Rules are automatically enforced whereas directives depend on domestic institutions of country members.

¹¹⁸ Article 10 of the Treaty. In the first two years, the CMC created several Ministerial Conferences to solve problems of specific areas (among others, Treasury and Central Banks, Education, Justice, Labour and Agriculture). The stated objective of the Decision when it created a Ministerial Conference of Ministers of Agriculture was to discuss the necessary measures for the harmonization of agricultural policies of member countries. The Decision n. 03/1991 of the CMC provided the normative framework for the establishment of sectoral agreements which should become a framework for the negotiations of convergence and conflicts of interests between member countries in productive sector (Soares, 1994: 12-13).

¹¹⁹ The quarterly publication by the Brazilian Ministry of Foreign Relations, Boletim de Integração Latino-Americana, presents a summary of the major events in each Working Group.

that the objective of economic development should be met by the preservation of the environment and a more effective use of available resources. Cooperation in environmental protection has been discussed in various Working Groups dealing with: energy, agricultural and industrial and technological policies. In 1992, an specialized mechanism, a Conference (Reunión) on environmental matters was created (REMA). The first meeting was held in November 1993 with quarterly meetings ever since. The Conference was created as an instance of consultation between governments of member countries. Its objectives are to contribute to establish adequate competitiveness conditions in environmental matters (i) between member countries and (ii) vis-à-vis third countries.¹²⁰

By the end of 1994, the REMA decided that the disparities among the four countries, in terms of environmental legislation, were too broad for any serious attempt of harmonization in the short run. Of the four countries, Brazil is that with the most advanced and comprehensive environmental legislation. Brazil has a whole Chapter in its Constitution dedicated to the environment. States and local municipalities have also their own regulations.¹²¹

There is no explicit reference to social legislation in the Asumpcion Treaty. The Preamble contains vague allusions to social justice as part of economic development and to the improvement of social conditions of the population of the subregion. In 1991, the Working Group 11 was formed to respond to pressures from trade unions and NGOs. Initially, its objective was primarily to deal with labour matters, but later its mandate was extended to cover topics such as labour relations, employment and social security. Workers and employers have equitable representation in the Commissions.¹²² A special group was created to study a Charter of Fundamental Rights, inspired

¹²⁰ The functions of REMA are: (i) to identify and reach agreement on general and operational criteria to approach the environmental question in MERCOSUR; (ii) to formulate and propose basic guidelines in environmental policy to contribute to the development of a concerted management between member countries; (iii) to coordinate environment-related work in the various Working Groups of the GMC; (iv) to identify and analyse, with the support of various Working Groups of GMC International Acts dealing with environmental matters and directly related to the objective of MERCOSUR with the purpose of formulating proposals to enable the harmonic internationalization of the principles, mechanism, and procedures emanating from those Acts in member countries; (v) to promote the incorporation of environmental aspects in regional projects of international cooperation in MERCOSUR; (vi) to analyse the environmental legislation in member countries based on criteria agreed upon in REMA with the purpose of identifying possible asymmetries or differentiated treatment and of proposing the adoption of common criteria to approach the problem; (vii) to identify and propose actions, related to the objectives of MERCOSUR to improve environmental conditions and (viii) to promote activities to support environmental management when such activities will be related to more than one area in MERCOSUR, such as education, research, information, capability creation, etc. (Boletim de Integração Latino-Americano, January-March 1994, n. 12, pp. 125-126, my translation from Spanish).

¹²¹ In the final negotiations for the MERCOSUR a "destination rule" (regra de destino) accommodated the concerns of higher standard country. Any country member will have to comply with the regulations of the importing country.

¹²² Santos, Roberto A. O (1994), "Perspectivas do Mercosul: Direito Social do Tratado de Assunção" in Boletim de Integração Latino-Americana, n. 13, April-June, pp. 37-38) showed that trade unions had difficulties to be included in the negotiations. Workers' participation was not part of bilateral cooperation initiatives between the Argentine and Brazil from 1986 on. It was only in 1992, after a series of seminars was launched by NGOs and trade unions that employers and workers representatives were formally integrated in the Working Group. This Working Group was subdivided into eight Commissions focused on the following topics: labour and individual relations; labour and collective relations, employment and labour migrations, professional formation; occupational health and safety of workers; social security;

by the Community Charter of the Fundamental Rights of Workers (Social Charter)

The programme of harmonization of policies and legislations within the MERCOSUR is vast. Each Working Group covers more than 10 items broken down in four to eight steps on average with a timetable attached (cronograma de Las Leñas).¹²³ Negotiators from the four countries involved start their search for greater harmonization by the identification of relevant domestic legislation and domestic policies. The second step is to proceed to a thorough examination of **asymmetries** in the legislation and policies of member countries as far as they affect the relative competitiveness of each country. Although poorly documented, asymmetry studies proved to be an educational experiment for Brazilian academics and bureaucrats. Methods have tended to select the most comprehensive and integrated approach. In the evaluation of relative Brazilian competitiveness in agriculture, for instance, agroindustry and agroindustrial systems were the basis of those studies. Technical studies have tended therefore to emphasize the set of interindustrial relations of a given industry or sector rather than the industry itself. Therefore, the relevant legislation and policies usually cover a wide spectrum of legal and technical instruments.

The process towards MERCOSUR formation has been characterized by transparency of methods and intense consultation among the four governments involved with a growing participation of representatives of legitimate social, economic and political interests of the four nations. Moreover, the richness of the process cannot be measured only by the above mentioned levels of trade and investment nor by the evolution of interfirm agreements. The consolidation of the MERCOSUR, against all odds, is being pursued through a process of learning and transformation in which market and state forces are reinforced to solve conflicts between member countries and create new opportunities for mutually advantageous cooperation.¹²⁴

5. CONCLUDING REMARKS

The Miami Summit was concluded on last December 11 with a commitment by 34 Latin American Heads of government and of States and the President of the United States to create a Free Trade Agreement of the Americas (FTAA) until 2005.¹²⁵ In 1988 the Bush Administration had

labour conditions in specific sectors and International Principles and Conventions. The ILO was formally invited to participate as Observer in Working Group 11.

¹²³ The Working Group on Technical Measures (n. 3) covers 20 items.

¹²⁴ In the first week of December 1994, the four Presidents of MERCOSUR country members signed the Ouro Preto Protocol that determined the end of the transition period to the formal beginning of the MERCOSUR (January first, 1995). The Ouro Preto Protocol supplements the Asumpcion Treaty and defines the new institutional system of the MERCOSUR. Most of the existing institutions will remain: The Common Market Council (CMC) and the Common Market Group (GMC). A new organism created in August 1994 was added: the Trade Commission. It will be in charge of the common external tariff, rules of origin and the instruments for improved competition. The Protocol created a Consultive Social and Economic Forum, with representatives of entrepreneurs and workers to formulate recommendations to GMC. After the Protocol, the MERCOSUR has a legal personality. It is entitled to sign trade agreements with other countries or groups of countries.

¹²⁵ The FTAA will be built up from trade agreements between existing subregional integration schemes such as MERCOSUR, the Andean Group, CARICOM, NAFTA, the Central American Common Market.

launched a Western Hemisphere Free Trade Area. However, the WHFTA was not converted into a major component of the United States foreign policy. Negotiations with the United States Congress for the ratification of the NAFTA and the Uruguay Round Agreements were time and energy consuming. In addition, Mexico was not willing to lose the advantages from preferential access to the United States market so soon.

Also, by middle November, representatives of eighteen economies in the Asia-Pacific Economic Cooperation (including two Latin American countries, Chile and Mexico) met in Indonesia. The APEC has Japan, the United States and China among its members.¹²⁶ They decided to create a free trade area by 2020.¹²⁷

Free trade areas have become so complex that regionalism cannot pose a threat for multilateral order. Regionalism and multilateralism shall continue to be partners and not opponents. GATT rules have ensured that regional groupings develop in an open way by providing a framework of guidelines and procedures. Discussions on antidumping and countervailing duties in MERCOSUR, for instance, are based on GATT definitions, rules and procedures. Besides, agreements reached with the completion of the Uruguay Round reduced the scope for granting preferential market access in a customs union or free-trade area.¹²⁸ The Uruguay Round clarified and strengthened Article XXIV of GATT, which provides rules and disciplines for customs unions and free-trade areas.¹²⁹

However, intense competition in international markets for similar products, globalization and interdependence are changing the nature of the multilateral debate with the implicit purpose of making competition harder for low-income countries. Linkages between trade measures, environment and labour protection affect the very determinants of comparative advantage in developing countries. Demands for higher environment and labour standards have cost implications for exporters.

Just after the end of the Miami Summit, Republicans and Democrats began to discuss the inclusion of environmental and labour standards clauses in the FTAA. Republicans will approve it if no such clauses are included and Democrats will only approve it if the clauses are included. Latin American representatives asserted clearly that they would appreciate overall discussions about labour and environmental standards but only if they were not related to the FTAA.¹³⁰

Developing countries became objects of moralist campaigns that transform complex and historically rooted social problems into mere caricatures. Moreover, industrial countries deal with

¹²⁶ APEC members are Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, Malaysia, Mexico, New Zealand, Papua New Guinea, the Philippines, Singapore, South Korea, Taiwan, Thailand and the United States.

¹²⁷ "APEC countries face challenges in creating Asian free-trade area" in The Journal of Commerce, November 16, 1994.

¹²⁸ This is true only for industrial countries.

¹²⁹ Speech of the Director-General of the GATT on Regional Integration and the WTO, given to the third Euro-Latin American Forum in Sao Paulo, July 7, 1994.

¹³⁰ "GOP Congress may block some Clinton trade goals" in The Journal of Commerce, December 12, 1994.

those problems as their capital and their enterprises were not deeply involved in the dynamics of income concentration, environmental degradation and low labour standards in most developing countries.

Except in text books of international theory, countries are not supposed to face similar conditions of production for trade to occur. It is the other way around. Differences in relative endowments of productive factors determine the comparative advantages of countries. Therefore, countries rich in raw material and unskilled labour would produce and export products intensive in those factors and import products intensive in factors which are scarce in the country.

The recent debate on levelling the playing field in terms of "social protection" turns the theory upside down. First, the debate ignores differences in development levels of countries involved; second it demands greater state participation for regulating and upgrading environment and labour conditions. Traditionally, freer trade depended on more market and less state. Finally, pressures from organized labour and environmentalists in industrial countries may force policy-makers in those countries to adopt unilateral trade measures, therefore disrupting multilateral rules.¹³¹

Environment and labour conditions are important topics for the quality of life of human beings to be transformed in threats to the trading system. There are already multilateral agreements on environmental protection that gradually industrial and developing countries will transform in domestic regulations. In the same way, the ILO is the multilateral forum for negotiating labour standards. The employment of unilateral measures to deal with any of those issues will not contribute to improve international relations. Developing countries will look forwards to see how WTO will perform betting on its effectiveness to protect them from arbitrary actions from powerful trading partners.

There are costs of adjusting to a new global order; they are painful and normally, the most vulnerable social groups are those who bear the full costs. Workers in more traditional, import-competing industries like textiles and clothing are on average less skilled, less educated, lower paid, older, and more likely to be female or members of minority groups. Trade can create new jobs in a greater proportion than it destroys. But those are completely different jobs, requiring different skills.

There are no short term solutions for complex problems. More and better education plans are required to upgrade the labour force so that the jobs created by the new information age will be matched by the pool of existing resources. It will take a long period for this kind of policy to produce the desired effects. In the context of long-term unemployment it will be difficult to form a consensus in industrial countries, on the importance of trade, globalization and international competitiveness.

¹³¹ The United States legislation for the protection of turtles (Public Law 101-162, November 21, 1989) prevents imports of prawns from countries that use fishing methods that may endanger certain species of turtles. Countries are "convinced" to adopt a turtle excluder device (TED). This device increases oil consumption to up to 30%. Brazil, together with other 14 Latin American countries are supposed to adopt the TED. In the Brazilian case, field work demonstrated that there were no turtles in the area where prawns were fished. However, United States representatives were not convinced. Moreover, even though only the prawn production of the North of Brazil is exported, the United States required that the whole Brazilian prawn fishing fleet adopted the TED. (In Procópio Filho, (coord.) (1994), pp. 148-151).

Several recent events suggest that ordinary people in those countries perceive market access, free trade and globalization as threats to their quality of life: (i) the intense debate in the United States preceding the approval of the NAFTA and the Marrakesh Agreements and the difficult negotiations that followed for the approval by the Congress of both agreements; (ii) the emergence and popular appeal of populist politicians with protectionist and nationalist platforms¹³² and (iii) the rejection by Norwegian voters of European Union membership.¹³³

Slow growth and relatively high unemployment rates lead policymakers to provide short-term answers to long-term problems. However, those may compound the problems rather than to be a path to construct real solutions. Imports from low-wage developing countries are perceived as threats to jobs and income levels of workers even though, in the United States, there is no conclusive evidence on the impact of these imports on job losses.¹³⁴ Also, as stated in the Economic Report of the President Clinton, "most U.S. trade - about 60 per cent - still involves other industrialized countries whose skill levels and wages are similar to those in the United States".

Brazil has one of the worst income distribution patterns in the world. The minimum wage in the country is also one of the lowest by international standards and the lowest in the MERCOSUR. Nevertheless, the country has one of the most advanced legislations on environment, consumer protection, labour protection and social security. Production conditions are very heterogeneous in such a large and regionally contrasting country. Brazilian comparative advantage is still based on abundant raw materials, high scale of production and cheap energy. The willingness of importers to define methods of production and inputs will necessarily affect the future export performance of the country.

¹³² In the United States, Ross Perot achieved an expressive number of votes in the Presidential election of 1992.

¹³³ Norwegian voters (52.5% voted No) expressed fears of exposing their welfare programmes, their political system, stringent environmental rules and generous farm subsidies to European rules and procedures.

¹³⁴ For Krugman, Paul and Lawrence, Robert (1994) the reasons for the slowing down of real income in the United States are domestic ("Trade, Jobs and Wages" in *Scientific American*, April, pp. 22-27). Sachs, Jeffrey and Howard Shatz. (1994), "Trade and Jobs in U. S. Manufacturing" in *Brookings Papers on Economic Activity*, pp. 1-84, found instead a positive association between foreign competition and job losses, particularly in low-skilled jobs although they agreed with Krugman and Lawrence that technological change plays a role independently of internationalization.

