

**AN EXAMINATION OF THE CHILE-MEXICO AGREEMENT:
A VIABLE FORM OF INTEGRATION?**

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INTRODUCTION

In recent years, economic integration has gathered momentum in the world trading system. To this end, the world economy has witnessed a proliferation of free trade areas, customs unions and bilateral agreements among developed countries, among developing countries and between developed and developing countries as well. Some of these moves towards integration are scheduled to be implemented in the months and years to come; others have already taken place. The rush to merge has created a sense of urgency in countries that are not part of such schemes to follow suit, sometimes without fully understanding the implications and risks involved. What type of integration would be most beneficial to a given country or region? What form should these arrangements take? Why is there reason to believe that this new wave of integration attempts will be more successful than previous ones? No one really seems to know. Regardless of what the answer may be, the consensus is that nobody wants to be left behind, and Latin America is no exception.

Within the complex world of economic integration lies the Chile-Mexico agreement, which was the most comprehensive bilateral agreement in the region at the time it was signed. Government officials and private agents alike in both countries have made reference to this agreement as an example of a successful trade policy. The argument to support this contention is that the agreement has been directly correlated with major increases in trade flows and trade diversification between the two countries. While this argument is something of a simplification, it is not however, one without force among certain groups.^{1/} This article will provide empirical evidence to test such hypotheses. The basic theme to explore is how successful this agreement has been. Has it produced increased trade or would it have occurred without an agreement? To that end, this paper will a) examine overall increases in trade between Chile and Mexico; b) assess changes in trade flows with other countries in the region; and c) present a sectoral analysis of products traded between the two countries.

The article will begin with an overview of past and present integration schemes in Latin America. The second part will closely analyse the bilateral agreement between Chile and Mexico. It will examine the most important components of the agreement. In addition, it will address whether both partner countries have benefited in the same manner. In a concluding section, a summary of other forms of integration currently available to the region will be presented, emphasizing their strengths and weaknesses.

^{1/} See for instance, " Comercio Chile-México creció entre 80% y 85%", *Estrategia*, 4 March 1992, "Es un éxito el tratado", *El Mercurio*, 23 November 1992; Isabel Figueroa c. and others, Inserción de Chile en la economía mundial: tendencias recientes, Santiago, Chile, Ministry of Foreign Affairs, November 1993, among others.

I. OVERVIEW

Regional integration among developing countries and between developed and developing countries has increased significantly in response to world trading conditions. Since the mid-1980s, there has been a marked increase in bilateral agreements and the formation of regional groupings, and there is every indication that this trend will continue.

The resurgence of integration schemes coincides with the economic liberalization and democratization of the region. There is a marked shift in economic thinking in favour of less interventionism and a greater role for market forces. The macro-crisis of the 1980s led to micro-reforms. These changes have combined with the conviction that to make integration work, active participation from private economic agents is fundamental. The democratization of the region also played an important role in boosting investors' confidence and prompting the industrialized countries to develop closer ties with the region. This new approach signals a stronger second wave of regionalism -one with greater potential.

Enthusiasm for regional integration is nothing new. Since the 1960s, Latin American and Caribbean countries have formed and reformed integration schemes (LAFTA, CARIFTA, CACM, CARICOM and the Andean Pact). Yet, they were not highly successful.^{2/} At that time, domestic suppliers were often protected from more efficient partner countries. In that scenario, trade diversion, and not trade liberalization, was each country's aim. The lack of **competitive** supply patterns meant that little or no structural upgrading took place during that period. As a result, there was a continued reliance on imports from outside these groupings.^{3/}

It is important to clarify, however, that a growing share of intraregional trade in and of itself may not be beneficial. It may be the result of substantial trade diversion from more efficient producers outside the country groupings. Intraregional trade should increase due to competitive supply patterns, product differentiation and quality in production. Otherwise, the international competitiveness of the group as a whole might suffer and its share in world trade decline, especially in the case of developing countries with little market power. This is an important aspect to consider when analysing future integration schemes.

Furthermore, the implementation of many agreements was inefficient. For instance, trade agreements were written in a general manner, and were at times overly ambitious, attempting to cover all areas of potential cooperation rather than concentrating on a limited number of priorities. More importantly, these agreements lacked a legal and institutional enforcement mechanism, while political considerations held more weight than economic efficiency.

The radical changes which have taken place in the past three years in favour of regionalism in the United States, the European Union and Asia help explain the apparent comeback of the idea of

^{2/} However, the poor performance of the past changed in the last five years when an increasing trend in intra-regional trade was noted, especially within the LAIA and the CACM groupings. In 1992 trade increased to 17% and 20% respectively. (For detailed figures, see annex 1.)

^{3/} This contrasts sharply to other integration schemes, such as the European Union where much of the increased trade occurred through product differentiation. More than 60% of its trade is among Union members.

regional integration and cooperation. This raises two questions of significance to the region: a) Where does Latin America fit in with respect to these countries? and; b) What is Latin America's own identity as a community? It is not yet clear where Latin America fits in, nor what its objectives and priorities are in the complex world of integration schemes. This is clear from the divergent integration strategies pursued in the region.

There are currently at least 20 different types of trade arrangements in the western hemisphere (some of which are indicated in annex III.) Some are aimed at revitalizing existing groupings; others are based on the formation of entirely new arrangements. In and of themselves, these agreements are very complicated and at times contradictory. For instance, a country, upon signing an agreement with another country, can grant trade preferences to a competing product of a third country with which it has also signed an agreement. A good example of this is Mexico's imports of apples and wines. Mexico granted trade preferences to Chile's apples and wines. At the same time, it is part of NAFTA. Florida and California apple and wine producers are competing for the same market share in Mexico as Chile in these products. From the Mexican perspective, the following questions arise: Would both countries receive the same preference? Which country should enjoy the highest preference? Would this imply an erosion of preferences for one of the two countries? A variety of strategies are presently being followed, and more are contemplated for the future. The various strategies commonly under discussion in many countries in the region can be classified into three broad categories, as described below: NAFTA, subregional groupings and bilateralism.

a) NAFTA

Economic integration modelled on NAFTA and, in principle, open to any country in the hemisphere has been widely discussed.^{4/} In this case, NAFTA would serve as a key component and integral part of this process, and Mexico, as the model for other countries to follow. Interested countries would join directly to form a single economic community in the Americas. The idea that NAFTA should be used as a core around which to build a free trade pact for the western hemisphere is very appealing to some policy groups in the region. They believe that by joining NAFTA, they would assure themselves of market access to the United States and provide stimulus to foreign investment. Some countries believe that rejecting this NAFTA-style approach would only cut them off from the core of a future hemispheric trading bloc.

b) Subregional groupings

Other models are based on the conviction that countries outside NAFTA need to strengthen their own pair or bloc arrangements. This could be undertaken as a final goal, or as a progressive step **prior** to negotiating with the NAFTA countries. In this way, Latin American countries could improve their bargaining position as a group. Integration into subregional groupings such as the MERCOSUR would eliminate the current patchwork inherent in bilateral agreements and have the advantage of uniting similar economies and cultures.

^{4/} See Widney Weintraub, Jagdish Baghwati, John Whalley and others referenced in the bibliography.

c) **Bilateralism**

The final model is based on bilateralism, at least in the short run. In this case, the hemisphere would be crisscrossed by a web of overlapping trade agreements. Bilateral agreements are faster to sign and may generate quicker results in the short run because they are undertaken by only two countries. However, they are more prone to contradictions and erosion of preferences. This can happen in a variety of ways.

First, when negotiating an agreement, the smaller country of the two does not have the leverage it would have as part of a larger trading bloc, such as MERCOSUR. For example, during the negotiations between Chile and Mexico, Chile accepted the exclusion of apples because the United States requested that, California apple growers be given preference, as part of the agreement. Not surprisingly, when Chile proposed to export apples to Mexico after the EC placed a 203,000-ton ceiling on Chilean exports, the request was denied.^{5/}

Were one country such as the United States, to form a network of bilateral agreements throughout the region, the outcome could be reminiscent of the European Union and the ACP/Mediterranean countries; i.e., a mosaic of different rules and preferences for exporters and investors. In the European Union's trade policy, there is a constant reshuffling of preferences because any change in preferences for one country triggers a demand for changes by the others. In this setting, the United States would be at the centre entering into a separate bilateral agreement with each country in the region.

Intriguingly, it has also been suggested that the regional centre does not necessarily have to be the United States. Mexico could very well be the hub of a set of bilateral agreements between it and other Latin American countries.^{6/} In line with this approach, Mexico has proposed a free trade agreement with Central America and is undertaking separate agreements with the Group of Three - Mexico, Colombia and Venezuela-, and Costa Rica.

Similarly, just as Mexico could be the regional centre in the North, Chile could be the regional centre in the South. Chile is actively pursuing bilateral agreements with neighbouring countries and countries outside the region. Investment framework agreements have been signed with Germany, Belgium, Spain, France, Denmark and Italy. Also at the bilateral level, special efforts have been made to establish closer ties with Japan, Korea and Taiwan.^{7/} By establishing itself as a regional hub at the centre of a series of bilateral relationships, Chile would likely receive additional investment in the short run. The inertia of corporate infrastructures and continuing growth in Chile might be sufficient to maintain an ongoing lead, once established.

^{5/} See "Europa ampliará cupo para manzanas chilenas", *Estrategia*, 3 March 1993 and "Chile gestiona exportación de manzanas a México", *Estrategia*, 4 March, 1994.

^{6/} See Roberto Bouzas, "Apertura económica, integración subregional y la Iniciativa para las Américas", FLASCSO, July 1992.

^{7/} On this topic, see *Inserción de Chile en la Economía Mundial: Tendencias Recientes*, Santiago, Ministry of Foreign Affairs, November 1993.

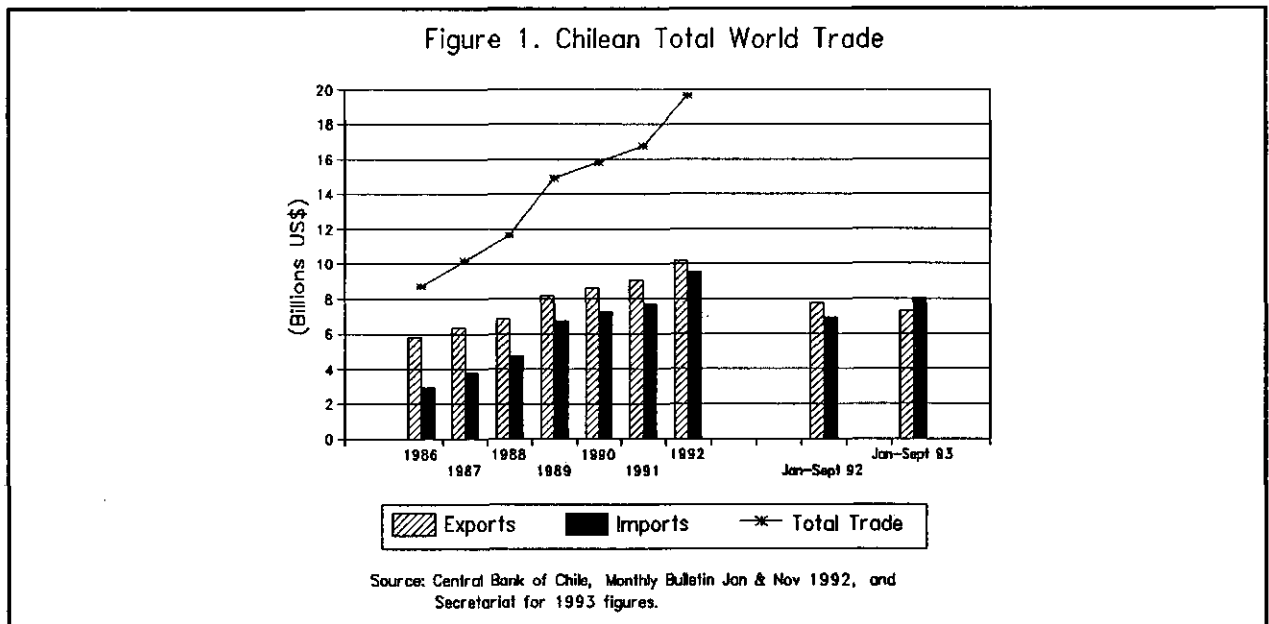
As a result of these developments, the need for regional integration and diversification grows and agreements such as Chile-Mexico, Chile-Venezuela, and MERCOSUR have all become more appealing than before. The Chile-Mexico agreement was signed in September 1991 and went into effect on 1 February 1992. The following section will closely examine this agreement. Given that Chile's economy is smaller than Mexico's, this agreement will be analysed from the Chilean perspective; that is, from the perspective of the smaller trading partner. The analysis will begin with a review of Chile's international trade, followed by a look at its trade with Mexico.

II. THE CHILE-MEXICO BILATERAL AGREEMENT

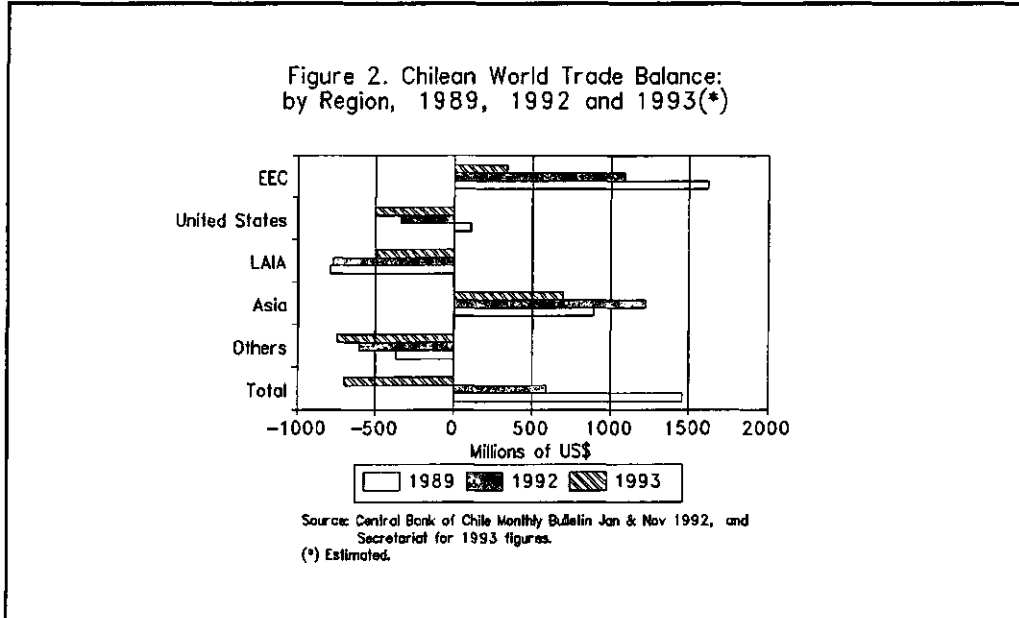
1. Chilean world trade

In the past four years, Chile's foreign trade has steadily increased from US\$14.9 billion in 1989 to US\$19.7 billion in 1992. However, there was a marked deterioration in export performance in 1992 and 1993. A modest 3.7% increase in trade registered in the first three quarters of 1993 as compared to 1992 has been attributed solely to an increase in imports, while exports actually contracted in absolute terms. As a result, Chile's net balance as a percentage of total trade declined from its 1989 level of 10% to 3% in 1992. In the first three quarters of 1993 it contracted by 4% as compared to the same period in 1992 (see figure 1), although the trade balance appears to be improving early in 1994.

At the regional level, throughout this period, Chile's largest regional trading partner has been the European Union, followed by Asia^{8/} and the United States. Generally, in all three regions, import growth has rapidly outpaced export growth. For instance, in 1992, imports from the Union grew by 31% while exports grew by a mere 1.8%. In the first three quarters of 1993 as compared to the last quarter of 1992, imports grew by 16% while exports contracted by 16%. To a lesser extent, export performance in Asia has also slowed down. In 1992, imports grew by 28% while exports increased by 9%. In the first three quarters of 1993 as compared to the same period in 1992, imports grew by 9%, and exports contracted by 12%. Export performance with the United States was also sluggish. In 1992, imports grew by 25% against 3% for exports. This tendency continued during the first three quarters of 1993 as compared to the same period in 1992, when imports increased by 32% and exports by 1% (see annex II).



^{8/} In this case, Asia does not include the People's Republic of China. If that country were included, the largest regional trading partner for 1992, would be Asia and not the European Union.



The major exception in trade performance has been in intraregional trade. In this regard, an interesting development has been taking place in the past three to four years. Firstly, Chilean trade with LAIA has had a higher growth rate than its trade with any other region— 19% in 1991 and 23% in 1992. In the first three quarters of 1993, after the United States, it was the area that grew the fastest at 9%. Secondly, even more interesting is that this was the only region where export growth outpaced imports. Exports increased by 13% while imports increased by 6% in the first three quarters of 1993. In short, while imports have been rapidly outpacing export growth in trade with the United States, Asia and the European Union, the opposite was true in intraregional trade.

Is this trend cyclical or a result of structural changes in the economy? The sluggish export performance is in part explained by a slow-down in economic growth in the industrialized economies, resulting in a slow-down in demand and a reduction in prices of Chilean commodities such as copper, fish-meal and cellulose. It is also partly explained by the appreciation of the peso in the last three years. It also seems to indicate that the export sector was unable to adapt quickly to changes in the economy through increases in productivity. This loss of dynamism and diversification appears in all export sectors. According to a World Trade Center study,^{9/} while the number of new export products increased by 43% in 1991 it increased by only 5% in 1992. The slow-down occurred not only in products but in the number of exporters and export markets as well.

2. Country background

Why Chile and Mexico? Given the distance between the two countries and the low levels of trade and political ties between the two, at first glance it might not seem like a logical choice for an FTA. However, several factors explain the signing of the agreement. Both Chile and Mexico undertook broad

^{9/} See "Cae diversificación de exportaciones chilenas", *El Mercurio*, 19 May 1993. See also "Precio de la celulosa", *Estrategia*, 26 October 1993 and "El deterioro de las exportaciones es generalizado", *Estrategia*, 15 March, 1993.'

and long-term liberalization programmes at a relatively fast pace, including capital, trade and privatization reforms. Chile began its reform process in the 1970s, while Mexico began implementing reforms in the early 1980s. At the time the agreement was signed, across-the-board duties of 15% were in effect in Chile, which were lowered to 11% in 1991; there were very few non-tariff barriers. In Mexico, various tariff levels averaging about 10% were in effect and still are; in 1989 import licensing was abolished. In 1993 annual inflation rates were 8.7% in Mexico, and 12.2% in Chile. In both countries, real exchange rates have been generally stable, but on a rising trend; unemployment has decreased; and economic growth has been steady, although Chile's economy has been growing faster than Mexico's. All of these factors facilitated the reaching of an agreement of this type.

	Chile	Mexico
Size (Km ²)	756,629	1,967,173
Population (millions)	13,286	84,575
Average population growth, 1982-1992	1.7%	2.3%
GDP (US\$B) ^{a/}	40.0	294.0
Real GDP growth 1993	6.5%	1.0%
Per capita GDP Thousands of US\$	3,010	3,480
Consumer price inflation	12.2%	8.7%
Unemployment rate	4.7%	3.4%
Literacy rate	93.4%	87.3%

Source: Central Bank of Chile and INEGI, Mexico.
^{a/} ECLAC estimates.

Mexico is the second largest market in the region after Brazil. Its population is over six times that of Chile, its surface area more than twice as large and its GDP around seven times higher. From the Mexican point of view, trade with Chile is negligible compared to its trade within NAFTA. In this regard, NAFTA has attracted more attention from Mexican businessmen and the population in general than the Chile-Mexico agreement. However, Mexico views the agreement as an important way of reaffirming its cultural ties with Latin America and, politically, as a way of balancing NAFTA.

The Mexican market is attractive to Chile because of its size and location. It can also be seen as a stepping-stone towards joining NAFTA and as a way of gaining market access to previously protected markets. In this regard, the agreement is viewed not only as a strategic economic move but also, more importantly, as a means of strengthening political relations with Mexico.

3. Characteristics of the agreement

When the Chile-Mexico bilateral agreement was signed, it was the second most comprehensive trade accord to be signed in the Americas after the 1989 Canada-USA agreement, and the first agreement of its type in the region. Its principal objective is to remove all import tariffs and non-tariff barriers for the

purpose of diversifying and increasing trade between the two countries. At the same time, it aims to stimulate investment and increase maritime and air transport services.

The agreement is very comprehensive and as such is substantially different from past agreements in the region. It has 21 sections, the most important of which concern trade liberalization. Tariffs are being gradually phased out over four years. They were scheduled to start at 10% on 1 January 1992 and to diminish by 2.5% each year until they are phased out completely in 1996. There is also a group of products whose tariffs will be reduced more slowly and will be given two more years to be phased out. On the Chilean side, they include varnish, paint, glass, polyester fibre, bricks and tiles. On the Mexican side, they include eggs, grapes, furniture, wood, butter and animal fats. There is also a group of products --46 Chilean and 59 Mexican-- which are considered highly sensitive to competition and were therefore excluded from liberalization. Since the agreement is bilateral and effectively set up a free trade area, each country retains separate trade policies with third countries. Third-country barriers are not being increased, and either country is free to lower its barriers to outside countries.

Well-defined rules of origin require that products have a minimum of 50% national content, with the exception of automobiles. Chile was permitted transshipment from a non-member country, given that the shipping routes first pass through the United States and then Mexico.^{10/} The possibility of reducing foreign-content requirements to accommodate changing market conditions was also incorporated. A safeguard clause was included whereby a country can take protective measures against a sudden influx of imports which could threaten its balance of payments or harm local production. Such emergency measures would last no more than one year and could be extended one more year if warranted.

A dispute settlement mechanism is one of the most innovative components of the agreement. It consists of three parts. Firstly, the aggrieved party can contact its counterpart and try to solve the problem directly within a 15-day period. Secondly, if no solution is reached, the complaint can be turned over to an Administrative Commission which has authority to recommend changes, nominate mediators and even appoint them, if necessary. The parties have 30 days in which to find a solution to the problem, either directly or through a mediator. Lastly, if the case is still unresolved, it is referred to an arbitration panel consisting of five experts: two from each country and a fifth from a third country to be agreed on by both sides. The panel of experts has a 30-day period to arrive at a final solution. In sum, controversies must be resolved within 75 days and there is no appeal, once a decision is taken.

The Administrative Commission also ensures the proper functioning of the agreement. It has authority to oversee the accord, review and propose rules of origin, and establish and propose mechanisms with a view to stimulating the involvement of the private sector. Visa requirements have been waived by both countries in order to facilitate trade and investment. In addition, as an incentive to stimulate investment, steps have been taken to avoid double taxation. The agreement can be terminated at any time by either of the two parties upon 180 days' notice, and it is also open to membership by other LAIA countries.

^{10/} ECLAC, "Los Servicios de Transporte de Carga entre Chile y México", (LC/L.725), Santiago, Chile, Transport Unit, 1993.

4. Changes in trade flows with Mexico

Two years after the signing of the Chile-Mexico agreement, the main question is whether the agreement has been the cause of increases in trade or whether increases in trade would have occurred without an agreement. To answer this question, this section will a) examine overall increases in trade between Chile and Mexico; b) assess changes in trade flows with other countries in the region; and c) present a sectoral analysis of products traded between the two countries.

The signing of the agreement was expected to stimulate trade for three reasons: a) following liberalization, price reductions would increase demand for these products, thereby producing trade-creating effects; b) purchases from the two countries would be preferred over third-country products, creating diversionary effects; and c) since, there were no diplomatic relations between the two countries, in the past, more trade and investment would result from better contacts and information.

Has this in fact occurred? Historically, trade between the two countries has been low compared to other countries in the region. In 1986, Mexico ranked ninth as a trading partner with Chile relative to other LAIA countries, and between 1988 and 1991, it alternated between fifth and sixth place. Following the signing of the agreement, in 1992, it occupied third place after Brazil and Argentina. This trend has continued into the third quarter of 1993 (see table 2).^{11/} Furthermore, in 1992 trade between Chile and Mexico increased by almost 50%, from US\$182 million in 1991 to US\$271 million. Estimates indicate that in 1993, trade increased 25%. The increase in trade appears to suggest that the Chile-Mexico agreement was a success. However, a more detailed examination of the changes in trade flows reveals the following points.

- Over the last six years, trade between Chile and Mexico has increased sharply with and without an agreement. For example, trade increased by 99% between 1987 and 1988 and again by 73% between 1988 and 1989, an increase larger in percentage terms than the increase for 1992 (see table 3). Hence, the dramatic growth in trade for 1992 was not significantly different from growth in earlier years. It should also be noted that Chilean exports in 1991 were unusually low at US\$44 million, down from US\$58 million in 1990. It was in 1991 that Mexico barred the entry of Chile's most important export item, beans, which had represented 32% of total export value the year before. This action was largely responsible for the doubling of the trade deficit with Mexico in a single year. As a result, the low base figure for 1991 gives the impression that trade growth for 1991-1992 was more spectacular than it really was. Trade growth for 1992-1993 levelled off to 25%.

- A look at Chilean trade flows with other countries in the region shows that total trade increased substantially without the benefit of a wide-ranging free trade agreement. During 1992, trade with Argentina increased by 35 per cent -much more in absolute terms than trade with Mexico because the volume of Argentine trade is four times larger-. With Brazil, trade also increased substantially, albeit at a slower pace than trade with Argentina. While Chile has signed a complementary agreement with

^{11/} Mexico continued to rank third taking into account the last-quarter figures for 1993.

Table 2. Chilean trade with LAIA countries
(Millions of US\$)

Partner	1991		1992*/		3/4 1992		3/4 1993	
	Value	Rank	Value	Rank	Value	Rank	Value	Rank
Brazil	1,145	1	1,447	1	1,043	1	1,113	1
Argentina	811	2	1,095	2	805	2	869	2
Mexico	182	6	271	3	200	3	244	3
Peru	209	5	240	4	172	4	203	4
Ecuador	253	3	206	6	155	5	167	5
Venezuela	180	7	216	5	137	7	153	6
Colombia	213	4	180	7	137	6	134	7
Bolivia	132	8	168	8	122	8	127	8
Paraguay	97	9	104	9	79	9	88	9
Uruguay	48	10	85	10	60	10	70	10

Source: Central Bank of Chile.
*/ Following the Agreement.

Table 3. Total trade between Chile and Mexico
(Millions of US\$)

	Total	Growth %	Net	Net % Total Trade	Exports	Growth %	Imports	Growth %
1986	29.8		-10.4	-34.9%	9.7		20.1	
1987	46.8	57.0%	-41.2	-88.0%	2.8	-71.13%	44.0	118.91%
1988	92.9	98.5%	-44.9	-48.3%	24.0	757.14%	68.9	56.59%
1989	160.3	72.6%	-72.7	-45.4%	43.8	82.50%	116.5	69.09%
1990	158.5	-1.1%	-43.1	-27.2%	57.7	31.74%	100.8	-13.48%
1991	181.7	14.6%	-94.7	-52.1%	43.5	-24.61%	138.2	37.10%
1992	270.7	49.0%	-85.9	-31.7%	92.4	112.41%	178.3	29.02%
1993	340.5	25.8%	-78.9	-23.0%	130.8	42.00%	209.7	18.00%

Source: Central Bank of Chile, *Indicadores de comercio exterior* Sep 1990, Oct 1992 and Jan 1993. Central Bank Secretariat for 1993 figures.

Argentina,^{12/} it much more limited in scope than the Chile-Mexico agreement, and no agreement has been signed with Brazil as yet. Given that the value and volume of trade with either Brazil or Argentina

^{12/} This agreement was signed in 1991. It is not as comprehensive as the Chile-Mexico agreement. Tariff reductions are more limited. Technical obstacles and non-tariff barriers were not covered and there is no dispute settlement mechanism.

are many times larger than the figures for trade with Mexico, these increases could be considered more of an achievement than those in trade with Mexico. Although Chile has had historical ties with these two countries, which partly explains their strong trade performance, other neighbouring countries also fared very well in the period 1990-1992, and also without an agreement. For instance, while Mexican trade grew at a rate of 24.9%, Peru and Ecuador had similar growth rates of 24.4% and 25.7%, respectively. Within this category trade with Bolivia grew even faster at 34.3%.^{13/}

- Examining the product mix between the two countries, it appears that Chile's exports have mainly consisted of agricultural products and raw materials both before and after the agreement, while Mexico has exported more processed and intermediate goods^{14/} (see table 4). It is very revealing that, when faced with the loss of a key agricultural exports -beans- Chile appears to have responded by substituting other agricultural exports -grapes-, among others. Moreover, even though another important export, fish-meal, doubled each year from 1991 to 1993, the 1993 figure is merely a return to the level already reached in 1989, prior to the agreement. Exports of dried plums increased in the first three quarters of 1992 following the agreement, but then declined in the first three quarters of 1993. The same occurred with animal oils and fats, forestry products and unprocessed copper. The last item was replaced by a moderate gain in exports of refined copper in the first three quarters of 1993. Exports of iron ore pellets dropped to zero following the agreement, and increased moderately in the first three quarters of 1993. On the Mexican side, distilled gas oil exports jumped following the agreement during the first three quarters of 1992, but dropped to zero in the same period of 1993. Data processing machines dropped following the agreement during the first three quarters of 1992 and regained their share in the same period of 1993. Heavy-duty cars almost doubled following the agreement, then dropped again in 1993.

Examining both sides, it appears that there have been fluctuations from one year to another following the agreement. Some products gained market share in the first three quarters of 1992, only to lose it in 1993. On the Chilean side, the products which have continuously gained market share following the agreement have been grapes and fish-meal, and plums, peaches and nitrates at a more moderate rate. (There is presently a dispute between Chile and Mexico regarding increases in fish-meal exports. Mexico is proposing to introduce measures based on what it claims are "dumping" practices by Chile.) On the Mexican side, the products which have continuously gained market share following the agreement have been polychloride, acrylic fibres, colour television sets and passenger automobiles, and titanium dioxide at a more moderate rate.^{15/}

^{13/} ECLAC, COMTRADE database, October 1993 figures.

^{14/} At the global level, mining, agriculture, forestry and fishing account for 90% of total exports. See World Trade Center study, El Mercurio, 19 May 1993.

^{15/} The automobile sector was subject to a special, slower pace of tariff reduction. There will be no reduction until 1996 when the tariff will be eliminated entirely. The rules of origin for automobiles in 1996 will be 32%, but only 16% for vehicles subject to quotas. This measure was taken to accommodate the Chilean assembly plant, for General Motors, Peugeot and Renault. It will also benefit Mexico which is one of the main suppliers of automobiles to Chile. At 7%, it ranked fourth in market share during the January-September 1992 period after Japan (49%), Brazil (14%), and Russia (10%). In fact, one of the best-selling cars in Chile was the Sunny and later the Sentra, produced in Mexico by Japan's Nissan.

TABLE 4

Products traded between Chile and México
(in millions of US\$)

	1990	Jan-Sep 1991	Jan-Sep 1992	Jan-Sep 1993	% for 1993
KEY EXPORTS TO MEXICO					
<u>Agriculture</u>					
Beans	19,387	0	0	0	0.0
Grapes	0	0	10,364	20,164	21.4
Canned peaches	347	444	2,927	3,568	3.8
Peaches	51	456	2,021	2,559	2.7
Plums	8	331	2,150	2,473	2.6
Dried plums	2,206	3,009	5,188	4,519	4.8
Fish-meal	12,088	4,518	9,467	18,042	19.1
Animal oils & fats	1,457	5,486	6,076	3,139	3.3
<u>Minerals</u>					
Iron ore pellets	9,385	2,868	0	1,661	1.8
Copper (unprocessed)	0	0	927	35	0.0
Forestry	0	65	1,442	259	0.3
<u>Chemicals</u>					
Sodium nitrate	80	0	1,380	1,529	1.6
Potassium nitrate	1,765	1,278	632	1,000	1.1
Sub-total	46,774	18,455	42,574	58,948	62.5
Other products	10,996	9,876	26,439	35,328	37.5
TOTAL	57,770	28,331	69,013	94,276	100.0
KEY IMPORTS FROM MEXICO					
<u>Transport equipment</u>					
Passenger cars	23,314	17,074	24,436	42,320	28.3
Heavy-duty vehicles					
8,805	8,378	15,814	5,210	3.5	
Other vehicles	5,292	2,332	1,787	3,082	2.1
<u>Distilled oil</u>	4,696	0	10,364	0	0.0
<u>Chemicals</u>					
Polychloride (vinyl)	1,798	3,402	8,965	8,990	6.0
Isocyanides	1,240	1,505	1,610	1,103	0.7
Titanium dioxide	654	447	1,535	3,784	2.5
Sulphuric acid	3,428	1,522	929	0	0.0
<u>Industrial goods</u>					
Cotton fibres for cigarettes	3,785	2,558	2,476	2,951	2.0
Acrylic fibres	1,754	1,979	3,095	4,827	3.2
Mineral compounds	1,797	2,196	1,575	1,478	1.0
<u>Manufactured goods</u>					
Data processing machines	3,272	3,241	1,685	5,809	3.9
Colour television sets	7	23	2,345	7,473	5.0
Sub-total	59,842	44,657	76,620	87,027	58.2
Other products	40,956	48,712	54,408	62,463	41.8
TOTAL	100,798	93,369	131,028	149,490	100.0

Source: Central Bank of Chile.

Observing the products traded between the two countries, reveals a marked tendency on the Chilean side, and to a lesser degree on the Mexican side, to concentrate on a few export items. For instance, in 1993, 13 items made up 63% of Chile's total exports to Mexico, of which grapes accounted for 21%; fish-meal 19%; plums 4.8%; and animal oils and fats, 3.3%. Twelve items originating from Mexico accounted for 58% of all imports, 28.3% of which were passenger cars, 6% polychloride, and 5% television sets. This marked concentration of products traded indicates that the agreement has not been used to its full potential, but also that it offers further possibilities for exports and product diversification for both countries, if fully exploited.

Regarding the trade balance between the two countries, there has been a persistent disequilibrium in the trade balance in favour of Mexico.^{16/} The deficit ranged from US \$43.1 million in 1990 to US \$94.7 million in 1991 and US \$85.9 million in 1992. However, after the agreement, the trade deficit improved as Chilean exports grew faster than imports in 1992; this trend continued into 1993.

Nevertheless, given that processed goods carry a higher component of value added, Chile will need to increase the productivity of its exports in order to overcome its trade deficit with Mexico or else find a way to promote greater diversification into higher value-added products. During negotiations to establish a free trade agreement, it is important, especially for the smaller partner, to maintain those products which have proved to be successful in generating export revenues and, at the same time, to include those with export potential. For example, the potential volume of Chile's exports was significantly reduced by Mexico's exclusion of exports such as apples and beans. The exclusion of beans is for the protection of Mexican farmers. As mentioned earlier, the exemption of apples is directly attributable to NAFTA.

5. Changes in foreign investment

Historically, foreign investment between the two countries has been low. There was a modest increase in foreign investment following the agreement concentrated mainly in services and communications. Among the major Mexican investments in Chile is "Marbella Resort" a tourist compound with an estimated investment of US\$30 million. In the area of telecommunications, the Mexican television station Televisa merged with Chile's Megavisión, while in the food industry the Mexican group Bimbo bought the Chilean food chain Cena. In the transport sector, Dinamex, an important manufacturer of trucks and buses, also established itself in Chile in a joint venture with the Chilean group Grunwald.

On the Chilean side, foreign investment is more modest and has focused on establishing refrigeration facilities in the port of Manzanillo, where Chilean fruit enters Mexico. However, it is expected that following the ratification of NAFTA, there will be growing interest on the Chilean side in investing more in Mexico, both as a way of exploiting the new opportunities opening up in Mexico and as an indirect route to gain market access to the United States and Canada.

^{16/} Already in 1991 a study done by the Centro de Información Comercial in Santiago noted this trend. See "Desequilibrio en intercambio Chile-México", Estrategia, 15 October 1991.

III. CONCLUSION

This article shows that, in the years following the signing of the Chile-Mexico agreement, there were increases in trade between the two countries. From the point of view of Chile, exports in particular increased following the agreement, although the low base figure for 1991 makes the gain for 1991-1992 appear more spectacular than it really was.

It seems that the agreement, in and of itself, was not the determining factor in the 1992 and 1993 trade increases. Trade between the two countries had increased at similar levels in the previous years prior to the agreement, and it increased nearly as much with other countries that were not parties to an agreement of this type. Furthermore, there are sharp fluctuations in each country's exports from one year to another. Some products gained market share following the agreement, only to lose market share the next year and vice versa. There is also a marked tendency to concentrate on a few export items, indicating that the agreement has not been used to its full potential. Chile has continued to export agricultural products and raw materials, while Mexico has been exporting intermediate and processed goods. Lastly, a persistent disequilibrium in the trade balance in favour of Mexico has been noted, although it has narrowed slightly under the agreement.

This analysis covers a short time span, since the agreement was signed only two years ago. In this regard, it could represent the preliminary groundwork for further regional integration. More importantly, the agreement indicates a political desire for closer ties between two countries in the region which had not interacted much in the past. It is also a step towards creating a trade-and investment-liberalizing background against which hemispheric free trade will be easier to achieve.

IV. FINAL REMARKS

Within the different integration schemes presently taking place, the following points serve to summarize some of the strengths and weaknesses of bilateral agreements such as that of Chile and Mexico and other forms of integration as a basis for further discussion and study.

There is a broad range of bilateral agreements presently in force in the region. Some are partial agreements, such as the one between Argentina and Chile, while others are more comprehensive such as the Chile-Mexico agreement. There are also countries such as Brazil and Mexico that trade with each other without any specific bilateral agreement. Moreover, some agreements involve countries of similar size and geographical proximity such as Argentina and Brazil, Colombia and Venezuela, Ecuador and Perú, and El Salvador and Guatemala, while others are concluded between a small country and a large one with geographical proximity such as Argentina and Bolivia and still yet others between a large and small country without geographical proximity such as like Chile and Mexico. The diversity of bilateral agreements particularly those between different-sized economies, are more prone to limitations and difficulties than broader forms of integration.

i. First, in negotiating such an agreement, the smaller country of the two does not have the leverage it would have as part of a larger trading bloc. This is demonstrated by the exclusion of apples and beans from the Chile-Mexico agreement.

ii. A second instance of this occurs when a regional bloc chooses to protect the interests of its member countries over the interests of a non-member country, even though they have a bilateral agreement. The interpretation of the agreement and any expansion of it may be highly dependent on the goodwill of the stronger trading partner and on the interests of its most protectionist sectors. As part of a larger bloc of countries, smaller countries could better protect their interests and exports. For example, French farmers had a limited effect on the multilateral GATT negotiations, but they could not stop them. However, over many years, EC farmers have had a definite, harmful effect on the entry of Chilean agricultural and marine products into Community markets, and it is difficult to see how this could be remedied by a simple bilateral agreement.

iii. Another kind of problem can occur when a bilateral agreement erodes the preference of an earlier agreement. This might occur in the western hemisphere if, for instance, the United States or Mexico were to conclude separate bilateral agreements with a large number of Latin American countries. This would be reminiscent of the European Union and the ACP/Mediterranean countries. In this setting, the United States or Mexico would become the regional hub of a set of bilateral agreements, and a single integrated market would be less likely to be formed.

iv. Conversely, bilateral agreements can be signed and implemented faster because they are undertaken by only two countries. This approach avoids the complexities of dealing with many countries. Chile, for instance, is actively pursuing bilateral agreements with neighbouring countries and the United States. The Chile-Mexico, Chile-Venezuela, Chile-Argentina and Chile-Bolivia agreements are some examples. At this time, Chile believes that the bilateral approach to trade is a more effective means of gaining market access to countries with stable macroeconomic policies and open trade regimes without having to surrender autonomy in its overall trade policy.

v. Taking into account the inherent difficulties and contradictions of bilateral agreements and the features of the Chile-Mexico agreement as an example of this type of integration, it is of paramount importance for the countries of the region to look further into the other forms of integration presently available to them when selecting a trade policy. These are based on subregional groupings like MERCOSUR and NAFTA models.

vi. Regional groupings such as MERCOSUR eliminate the current patchwork inherent in bilateral agreements and have the advantage of uniting similar economies and cultures. They could be undertaken as a final goal or as a way to improve the countries' bargaining position with other regional groupings. However, there seems to be skepticism among the smaller economies. The different structural adjustment policies implemented in the two major countries, Brazil and Argentina, and disagreements between smaller and larger economies have created uncertainties and delays in the implementation of MERCOSUR.

vii. The NAFTA model is more reminiscent of what the European Community began 40 years ago: a gradual association of countries within the same region to form a large regional bloc. This type of integration would work best if accompanied by a sound redistributive policy to homogenize the different levels of development, a clear encouragement of complementary economies and a requirement that all countries promote democratic principles. If this were the case, and if negotiations were based on reciprocity, allowing for differences in levels of economic development, this model would appear to represent a sound approach under the present global conditions. However, all the countries involved must demonstrate their commitment and interest. At the very least, in this case the major economy, the United States, must be willing to push this type of integration. In a large market, authorities tend to be uninterested in expanding, given the risk of greater complications when more countries are involved. Interest groups are another important factor in determining whether an FTA or customs union may expand. Protectionist lobbying groups that profit from trade-diverting effects of an FTA may be reluctant to include further competition. In addition, the United States having had such difficulties ratifying NAFTA could opt to postpone or delay indefinitely entry to other countries.

In the case of integration based on NAFTA, the prime movers seem, by and large, to be the smaller countries seeking to protect large exports to the United States, for they are concerned about rising protectionism and with hope to increase investment. That is, before the world enters further into regional groupings, smaller countries want to assure themselves of access to negotiations and benefits. This places the United States in an unusually strong negotiating position. It has been said that in some ways, during the NAFTA negotiations, the Mexican Government conceded more than it bargained for in order to secure market access and facilitate the signing of the agreement.

In the end, when selecting one model over another, countries should remember several basic points. There is a direct correlation between the benefits of free trade agreements and a) how steep existing protectionist barriers are; b) the size of the free trade area and; c) the competitiveness of a country's productive structure. However, there is no panacea whereby positive or negative effects necessarily result from following a specific model. Sound macroeconomic and microeconomic policies, good transportation networks and stable political regimes, among other things, play a more dominant role. In short, free trade areas stimulate but do not necessarily create growth.

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ANNEXES

Annex I

Trade performance of economic cooperation
and integration in Latin America, 1960-1992
(Millions of US\$)

	1960	1970	1980	1983	1985	1987	1990	1991	1992
LAIA									
Total exports	7 348	12 796	80 313	79 760	85 433	80 024	112 700	110 603	116 249
Exports to LAIA	567	1 264	10 928	7 000	7 125	8 574	12 209	15 085	19 366
% exports intra-LAIA	7.7	9.9	13.6	8.8	8.3	10.7	10.8	13.6	16.7
Andean Group									
Total exports	3 587	5 419	30 602	23 427	24 299	20 348	30 795	28 583	28 068
Exports to A.G.	25	97	1 137	809	768	1 028	1 253	1 775	2 129
% exports intra-A.G.	0.7	1.8	3.7	3.5	3.2	5.1	4.1	6.2	7.6
CACM									
Total exports	444	1 106	4 812	3 850	3 568	3 656	4 672	4 247	4 507
Exports to CACM	31	287	1 174	782	488	525	664	780	906
% exports intra-CACM	7.0	26.0	24.4	20.3	13.7	14.2	14.2	18.4	20.1

Source: ECLAC, International Trade, Finance and Transport Division. 1990-1992 figures: LAIA secretariat. For CACM: SIECA.

Annex II. Chilean world trade and by region

Region	Total trade US\$M	% growth	Net balance US\$M	Net balance % total trade	Imports US\$M	% growth	Exports US\$M	% growth
World								
1989	14,926.9		1,458.5	9.8%	6,734.2		8,192.7	
1990	15,852.4	6.20%	1,308.2	8.3%	7,272.1	7.99%	8,580.3	4.73%
1991	16,734.2	5.56%	1,362.6	8.1%	7,685.8	5.69%	9,048.4	5.46%
1992	19,658.6	17.48%	592.4	3.0%	9,533.1	24.04%	10,125.5	11.90%
Jan-Sep 92	14,684.5		830.8	5.7%	6,926.9		7,757.6	
Jan-Sep 93	15,229.4	3.71%	-590.1	-3.9%	7,909.8	14.19%	7,319.6	-5.65%
LAIA								
1989	2,713.0		-794.6	-29.3%	1,753.8		959.2	
1990	2,745.4	1.19%	-716.8	-26.1%	1,731.1	-1.29%	1,014.3	5.74%
1991	3,270.6	19.13%	-793.4	-24.3%	2,032.0	17.38%	1,238.6	22.11%
1992	4,012.7	22.69%	-772.1	-19.2%	2,392.4	17.74%	1,620.3	30.82%
Jan-Sep 92	2,910.0		-540.4	-18.6%	1,725.2		1,184.8	
Jan-Sep 93	3,166.5	8.81%	-491.0	-15.5%	1,828.7	6.00%	1,337.7	12.90%
United States								
1989	2,803.9		108.1	3.9%	1,347.9		1,456.0	
1990	2,842.6	1.38%	95.8	3.4%	1,373.4	1.89%	1,469.2	0.91%
1991	3,178.2	11.81%	14.4	0.5%	1,581.9	15.18%	1,596.3	8.65%
1992	3,634.3	14.35%	-335.5	-9.2%	1,984.9	25.48%	1,649.4	3.33%
Jan-Sep 92	2,687.3		-66.1	-2.5%	1,376.7		1,310.6	
Jan-Sep 93	3,147.5	17.12%	-499.3	-15.9%	1,823.4	32.45%	1,324.1	1.03%
EEC								
1989	4,273.3		1,617.5	37.9%	1,327.9		2,945.4	
1990	4,721.5	10.49%	1,684.7	35.7%	1,518.4	14.35%	3,203.1	8.75%
1991	4,289.1	-9.16%	1,473.5	34.4%	1,407.8	-7.28%	2,881.3	-10.05%
1992	4,779.1	11.42%	1,084.3	22.7%	1,847.4	31.23%	2,931.7	1.75%
Jan-Sep 92	3,638.8		914.2	25.1%	1,362.3		2,276.5	
Jan-Sep 93	3,504.3	-3.70%	339.1	9.68%	1,582.6	16.17%	1,921.7	-15.59%
Asia								
1989	3,288.4		894.4	27.2%	1,197.0		2,091.4	
1990	3,178.1	-3.35%	1,313.7	41.3%	932.2	-22.12%	2,245.9	7.39%
1991	3,926.5	-19.63%	1,352.7	34.5%	1,286.9	-51.25%	2,639.6	17.53%
1992	4,515.7	15.01%	1,217.3	27.0%	1,649.2	28.15%	2,866.5	8.60%
Jan-Sep 92	3,669.6		1,088.8	29.7%	1,290.4		2,379.2	
Jan-Sep 93	3,503.1	-4.54%	693.3	19.8%	1,404.9	8.87%	2,098.2	-11.81%
Source: Central Bank of Chile, Monthly Bulletin Jan., and Nov. 1992, and Central Bank Secretariat for 1993 figures.								

Annex III

Recent trade policy within the Americas

Bilateral

United States-Canada. The agreement went into effect on 1 January 1989. All tariffs are to be eliminated by 1 January 1998. Tariffs are to be phased out over a 10-year period. Includes a bilateral dispute settlement mechanism and covers a wide range of topics. Some products are exempted.

Costa Rica, Venezuela and Ecuador have initiated bilateral negotiations with the United States for a free trade agreement.

The following countries have concluded or are pending agreements: Brazil- Argentina; Mexico-Venezuela; Venezuela-Chile, Chile-Argentina; Peru-Chile; Ecuador-Venezuela; Argentina-Venezuela; and Chile-Mexico. These agreements provide for bilateral tariff elimination. The Chile-Mexico and Chile-Venezuela agreements include non-tariff barriers and dispute settlement mechanisms, and cover a wide range of topics.

Trilateral

Canada-Mexico-United States: the North American Free Trade Agreement.(NAFTA). Negotiations were initiated in 1991. The NAFTA treaty announced in August 1992 that phased out import duties would be over a period of 15 years. Current membership is limited to the three countries, but the agreement stipulates that other countries may join in the future. In that case, the agreement would become regional or multilateral.

The Group of Three, made up of Colombia, Mexico and Venezuela, has agreed to establish a free trade area by July 1994.

Regional

Andean Pact. First signed in 1969, it consists of Bolivia, Colombia, Ecuador, Peru and Venezuela. The objective was to create a common external tariff by the end of 1993 and a common market by 1995.

Southern Common Market (MERCOSUR) treaty signed in March 1991 by Argentina, Brazil, Paraguay and Uruguay to create a subregional common market for Argentina and Brazil by the end of 1994 and for Paraguay and Uruguay by the end of 1995. The main policy objectives are free trade in goods and services, a common external tariff at 20% and coordination and harmonization of macroeconomic policies. A Council of Ministers and a full secretariat have already been established in Montevideo.

Central American Common Market (CACM). Revitalization efforts were undertaken through an agreement to establish a Central American Integration System (SICA). Countries are presently discussing the modalities of the restructuring process. CACM signed a free trade agreement with Mexico, in January 1991, to become effective by 1996, and also with Venezuela. Discussions are under way regarding an FTA between CACM and the Group of Three. In July 1991, members agreed to liberalize regional trade in most agricultural products.

Caribbean Community (CARICOM). Established in 1973 to replace CARIFTA, which dated from 1965. In 1991, a revised common external tariff was implemented. Venezuela has proposed the formation of an FTA with CARICOM and Colombia has requested observer status.

Latin American Integration Association (LAIA). In an effort to promote regional trade, the member States agreed in 1990 to double the regional tariff preference from 10% to 20% before the end of 1992.

Hemispheric

Enterprise for the Americas. Announced in 1990, it covers trade, investment and debt issues. As part of the agreement, the United States has negotiated a number of framework agreements with various countries in the region.

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