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Regional integration *in the 1990s*

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The renewed interest sparked by the potential for intraregional cooperation in Latin America and the Caribbean today has been reflected in numerous agreements regarding trade preferences and in attempts to establish free trade areas, customs unions or common markets. The possibility has even been discussed of setting up free trade arrangements on a hemispheric scale. This plethora of proposals inevitably raises a great many questions. What is the reason for this renewed interest? Are the differences between the schemes of today and those of the 1960s and 1970s significant enough to avert the obstacles and difficulties encountered by those earlier schemes? What are the most suitable mechanisms and instruments for promoting intra-Latin American integration? What are the defining characteristics of the various categories of integration initiatives, such as free trade areas, customs unions and common markets? Is it feasible to set up free trade areas involving countries having very dissimilar levels of development or macroeconomic policies? Would it be wise to work towards a gradual convergence of all these initiatives into a single, regionwide scheme? And most importantly: Just how functional would integration be in terms of the development strategies and policies adopted by the individual countries of the region? The various sections of this article attempt to answer, albeit tentatively, these questions.

I

Introduction

As a consequence of the protracted crisis of the 1980s and of changes in the international scene, in recent years Latin America and the Caribbean have exhibited a steadily increasing response capacity. Governments and civil societies have sought out new ways of adapting to changing circumstances and of responding to the numerous challenges they face. One of the many manifestations of this adaptation process is a renewed interest in the potentials of intraregional cooperation. In contrast to the atmosphere that surrounded the conclusion of formal economic integration agreements in the 1980s, lately the region has witnessed the proliferation of quite different sorts of arrangements, arrangements that display a high degree of heterogeneity in terms of both their modalities and their geographic configurations.

Indeed, numerous trade preference arrangements have been made, in most cases as part of the limited-

scope agreements provided for under the terms of the 1980 Treaty of Montevideo; attempts have been mounted to establish free trade areas (without necessarily adopting a common tariff); and efforts have been made to form customs unions (free trade areas combined with a common tariff) or common markets (customs unions involving some degree of macroeconomic-policy coordination, especially with respect to foreign exchange matters, taxes and interest rates). For the first time ever, extending the coverage of free trade agreements to encompass the entire hemisphere has become a possibility; on a selective basis, the free trade agreement among Mexico, Canada and the United States which is now awaiting ratification and, on a more general level, the Enterprise for the Americas, announced in mid-1990 by the United States Government, both point in this direction.

II

Reawakened Interest in Integration

What accounts for this resurgence of interest in integration when, just a few years ago, the subject had virtually disappeared from the Governments' agenda of priorities? The continued development of the European Community and the formation of a free trade area between Canada and the United States have certainly helped to legitimize agreements aimed at establishing trade-preference groupings. In addition, the laborious, slow-moving progress of the multilateral negotiations being held within the framework of the General Agreement on Tariffs and Trade (GATT) has prompted many Governments to work towards the same objectives by means of partial-scope agreements with like-minded countries. In order to reconcile such initiatives with GATT, article 24 of the Treaty is usually cited, since this provision permits the establishment of trade groups among countries which grant each other reciprocal trade preferences without requiring that they necessarily be extended to the rest of the countries.

In Latin America and the Caribbean, a number of additional factors have helped to further enhance the legitimacy which the idea of integration as such has acquired at the international level. Some of these factors have arisen in response to the possibility of extending the free trade area existing between the United States and Canada to Mexico and, eventually, to other countries in the region. Others are discrete phenomena. Examples of the latter include the gradual convergence of the economic models being applied, the growing political affinity to be observed among democratically-elected civilian governments, a decrease in the potential costs of trade diversion thanks to an increasing degree of trade liberalization in almost all the countries of the region and, in general, a priori assessments of the situation which indicate that the potential benefits of such agreements will far outweigh their possible costs.

III

International positioning and integration commitments

It is also helpful to examine recent integration commitments within the broader context of the determined efforts being made by all the Governments of the region to improve their countries' positions within the international economy. This has been their response to the increasing globalization of the economy and to the shortcomings of the industrialization strategy followed by many countries in the past. In recent years, government action has been directed towards enhancing the international competitiveness of the goods and services that each country has to offer.

In the mid-1980s, intraregional trade agreements did not play a major role in the countries' efforts to improve their international positions; on the contrary, some experts maintain that they were leading in quite the opposite direction. This was because, first of all, the idea had taken firm hold that such agreements served the purposes of import-substituting industrialization but were of no help in an export drive; in some cases it even came to be believed that they actually hindered progress towards greater international competitiveness. Secondly, the Latin American and Caribbean regional market was smaller than that of the major economies of the Organization for Economic Cooperation and Development (OECD) and exhibited slow or zero growth. In the eyes of many Governments, the best course of action was therefore to concentrate on gaining access to large, fast-growing markets.

This view began to change for the reasons mentioned earlier and, above all, because enough information had become available to show that integration commitments among a given group of countries are not necessarily incompatible with the establishment of a more open and more transparent international economy. Thus, in recent years the idea has begun to gain acceptance, in both academic and government circles, that an open international economy free of artificial barriers to a free flow of trade in goods and services does not necessarily exclude the possibility of integration commitments and, in fact, that such

arrangements may even contribute to the achievement of that goal.

This is indeed plausible. From a conceptual viewpoint, integration commitments can contribute to the accomplishment of the main tasks on the regional development agenda. This statement is based on a number of well-known arguments, including the potential contribution of expanded markets to an increase in efficiency (as a result of economies of scale and the elimination or reduction of monopolistic rents) and to technical progress and innovation, as well as their effect on investment levels. Moreover, an implicit part of this reasoning is the assumption that the potential costs of trade diversion will tend to decrease markedly in the presence of widespread trade liberalization.

It is also true, however, that intraregional agreements and any future arrangements of a hemispheric scope need to be designed in such a way as to be conducive to the achievement of an international economy free of protectionism and of barriers to trade in goods and services. At the same time, we must be cognizant of the risk that the formation of economic blocs of developed countries may lead to a fragmented world in which trade flows freely within these groups but is subject to a greater degree of regulation between one bloc and another.

It is important to note that Latin American and Caribbean integration is justified—albeit for different reasons—in both cases, i.e., whether the formation of large groupings of developed countries helps facilitate the establishment of an integrated world economy or whether it contributes to the fragmentation of that economy. In the first case, integration would contribute to the achievement of the objective pursued by all the Governments of the region in the Uruguay Round; in the second case, at least it would place the region within one of the groups making up that fragmented international economy. From a regional standpoint, integration also offers a way of diversifying risk in an international economy that is rife with uncertainty.

IV

Main features of the new Integration commitments

If we are to describe existing integration schemes, we must first know what type of integration we are dealing with. The initiatives taken in the developed world have been exceedingly varied in nature. For example, the characteristics of the European Community's broad-ranging accords, which are leading it towards the formation of a regionwide economy, are a far cry from the types of commitments made by Canada, the United States and Mexico in the North American Free Trade Agreement. In East Asia, where no formal integration agreements have been concluded, trade liberalization and geographic proximity are none the less contributing to a steady increase in reciprocal trade, which is, moreover, being augmented by reciprocal investment. In this instance, geographic proximity and lower transaction costs are creating implicit preferences among the countries of that region and are thus facilitating the formation of another bloc of interdependent countries.

Along the same lines, the Latin American and Caribbean region of today abounds in agreements of widely differing characteristics and contents. At the risk of oversimplification, we may identify at least four types of trade-preference arrangements which can be defined in terms of the degree of commitment made among the countries concerned. The simplest category includes agreements for the reduction of tariffs on a given list of products, which are thus accorded preferential treatment *vis-à-vis* similar products coming from other countries. This type of bilateral or multilateral agreement does not involve any significant degree of economic policy coordination.

The second type of agreement calls for a more comprehensive form of tariff reduction, and in this case the corresponding negotiations therefore focus on the lists of exceptions rather than on the products to be subject to liberalization measures. The result is the creation of a free trade area that does not

set up a common level of protection in respect of non-member countries. In such cases it is possible that products from the rest of the world may be brought into the country with the higher tariffs via an indirect route by taking advantage of the lower tariffs of the other member countries of the free trade area; to this end, the products in question are first exported to the lower-tariff member countries and are then re-exported to another country under the provisions of the free trade agreement. The conventional method of blocking this indirect flow of imports from the rest of the world is to establish rules of origin for products included in the free trade regime; under such rules, a given level of processing or a specified percentage of national content is required.

The third category of agreements are those that not only set up a free trade area but also add to it a common tariff in order to forestall the relative price distortions that can be caused by tariff-generated cost differences. The advisability of setting up a common external tariff for the members of an integration scheme—which is the main difference between a customs union and a free trade area—will depend on the characteristics of the countries involved. Assuming that their levels are low, common tariffs would be more justified for countries having a large volume of reciprocal trade and similar economic structures. Under these circumstances, the application of differentiated tariffs to the various products would create unequal levels of effective protection for each party and would set the stage for charges of unfair trade practices and the establishment of trade restrictions, as well as encouraging contraband trade.

In the fourth category of agreements, a free trade area and common tariff are coupled with a programme of macroeconomic policy coordination. The aim of such a programme is to avert distortions in relative prices caused by cost differences attributable to the exchange rate, export subsidies, rates of taxation or interest rates.

V

Some requirements

The foregoing suggests that the level of commitment which any given group of countries will be prepared to make will depend on how economically interdependent they are, how similar their approaches to macroeconomic and policy management are, how complementary their economic structures and stages of development are, how much they trust each other, and many other factors. The economic ramifications of each type of arrangement in terms of potential costs and benefits will vary from one situation to another.

This underscores the complexity of the many arrangements currently existing in the region and raises the question as to whether it would be wise to seek an eventual convergence of all these schemes or whether it would be better to permit the emergence of a range of different types of agreements reflecting the different types of situations which do, in fact, exist in the region. The second option would appear to be more realistic, at least for the foreseeable future, al-

though it would be advisable to promote the adoption of some common standards regarding the application of mechanisms and instruments in order to pave the way for any subsequent bid to expand the geographic scope of existing agreements.

What is true for Latin America as a whole is not necessarily valid for subregional processes which have already generated a high degree of economic interdependence, however. The fact, for example, that some countries in Central America seem to want to move forward more rapidly than others could at some point jeopardize the consolidation of their subregional integration process. There is, then, a limit to the feasibility of allowing many different agreements to coexist within a single subregional process. This limit is reached when commitments which some countries wish to make will adversely affect the commitments already made by all the countries participating in a given subregional integration process.

VI

Trade mechanisms and instruments

With respect to mechanisms and instruments, if the economic subregions being formed are to be in keeping with the principle of multilateralism, some requirements regarding the content of bilateral and subregional agreements will have to be met; in essence, this means that the regulations and standards established by such agreements need to be in accordance with the provisions of GATT, to which the vast majority of the countries in the region have adhered.

Integration arrangements' common denominator is that they seek to reduce tariffs with a view to the formation of a free trade area. The agreements signed in recent years tend to cover a wide range of products, and negotiations have therefore centred around the lists of exceptions rather than the lists of products

to be subject to liberalization measures. Furthermore, the areas of activity or products placed on those lists of exceptions are usually limited to those regarded as "sensitive", such as the automobile industry in Mexico or grain crops in many countries.

Tariff preferences are usually granted on the basis of a tariff reduction timetable which, starting from the maximum tariff rates in effect, gradually leads to full trade liberalization (a zero tariff rate) among the parties concerned. These agreements should also include precisely defined rules of origin to facilitate customs operations and prevent indirect importation, as well as setting up transparent, non-discriminatory, permanent safeguards and clear, flexible procedures for settling trade disputes. Such agreements are usually accompanied by commitments

regarding the gradual elimination of non-tariff trade barriers and other subjects on the GATT agenda, such as trade in services and standardized regulations in the area of intellectual property.

If such agreements are limited to the creation of a free trade area, and if they also give rise to large-volume reciprocal trade flows, there will be a tendency to broaden their scope in order to prevent price differences attributable to disparate conditions in the various signatory countries—tariffs, export subsidies, tax rates, interest rates—from heightening relative price distortions and influencing decisions regarding the location of new production activities designed to supply this expanded market.

This is why the parties to an agreement aimed at promoting trade, investment and cooperation may feel it is necessary to establish a common tariff and align some of their macroeconomic policies (MERCOSUR, the Central American Common Market, the Caribbean Community, the Andean Group). However, although such measures will help to align conditions in the member countries, they will also result in a greater subordination of domestic policy to these integration commitments.

VII

Other integration mechanisms

As stated earlier, today there is a widespread tendency to regard the pooling of markets as the pivotal element in integration agreements. This frequently prompts charges that excessive importance is being attributed to trade arrangements at the expense of other potential benefits of integration. The first factor to be borne in mind in this regard is that the primary purpose of these arrangements is not to increase trade as much as it is to stimulate production and boost productivity.

Secondly, trade arrangements do not preclude the promotion of other more specific cooperation initiatives; in fact, they may help bolster such efforts. For example, joint projects aimed at improving infrastructure and transport services, electrical power generation and distribution systems, technological

By the same token, some of these accords provide for plans to phase out export subsidies and discriminatory taxes, the elimination of transport-related barriers to foreign trade, and the adoption of agreements regarding services and investment. In the case of the North American Free Trade Agreement concluded by Mexico, Canada and the United States, a marked emphasis on agreements concerning intellectual property, environmental protection and workers' rights is also to be observed.

This does not mean, however, that as the commitments made by the countries are fulfilled, this process will inevitably give rise to new and deeper commitments. Indeed, the experiences of the 1960s suggest that it may be unfounded to take a linear view of integration commitments as leading to greater and greater levels of interdependence.

It should also be noted that agreements regarding tariff levels are sometimes supplemented by other measures—e.g., in the area of government purchasing—which tend to give preference to the acquisition of goods and services from other signatory countries.

research and human resources development, especially in highly specialized fields, can obviously benefit all parties concerned.

Moreover, the implementation of integration agreements will be furthered by the adoption of specific, ongoing programmes to promote trade and investment. In recent years meetings of entrepreneurs and employers, dissemination activities and development agencies have all helped to promote co-investment and to step up trade among various countries of the region. An effort should also be made to encourage intra-Latin American investment, which could become an important vehicle for technological innovation regardless of the types of formal agreements concluded by groups of countries.

VIII

Hemisphere-wide agreements

No analysis of contemporary integration agreements can fail to mention a subject that would have been completely unthinkable just 10 years ago: the incorporation of Latin American countries into a free trade area with highly developed countries or, in other words, into an arrangement of reciprocal concessions. What makes it possible even to entertain this possibility, from the standpoint of the Latin American countries, is that unilateral processes of trade liberalization have reached such a point that national producers are now faced with competition from the most efficient of international producers regardless of whether formal integration agreements are in place or not.

In other words, by way of example, it was probably more traumatic for Mexican industry to make the transition from the unbounded tariff protection it enjoyed in the mid-1980s (such as was afforded by import permit requirements) to its present moderate levels of protection (tariff rates of about 10%, on average) than it will be for it to move from the present situation to the zero tariff rate that is to apply to imports from the United States and Canada. In return, Mexican producers will have more secure access to those countries' markets and will have the opportunity to join in new production activities that will be set up to supply this larger shared market.

Of course there will also be risks. Many activities –on both sides of the border– will succumb to

the increased competition, and the Governments may find that they have less manoeuvring room in their management of macroeconomic policy. But in an imperfect world, and in view of the protectionist winds that are blowing in many parts of the world, the possibility of joining in a free trade area with the United States and Canada would seem to be an attractive option for many Latin American countries, especially in an international setting that does not afford an abundance of opportunities. This is all the more so in view of the fact that the act of signing integration agreements with the United States and Canada will not necessarily prevent the region from expanding its commercial and financial ties with other centres of growth in the international economy.

As we said at the outset, the United States' sudden interest in signing agreements to set up a free trade area with its neighbours has had a profound impact on intra-Latin American integration schemes. Moreover, the instruments provided for under the North American Free Trade Agreement (NAFTA) are essentially the same as those being applied under the terms of subregional integration agreements in Latin America. Hence the need to continue to explore regional integration and hemispheric integration as two facets of the same subject.

IX

The problem of the less developed countries

The greatest obstacle to integration during the 1960s and 1970s was probably the poorest countries' opposition to the planned distribution of the presumed costs and benefits of integration. Today, however, to our astonishment, we see that these same countries are willing to undertake commitments for integration with such highly industrialized countries as the United States and Canada.

This is one of the many consequences of the wave of trade liberalization that has washed over the world. In fact, even the doctrine of non-reciprocal preferences for the poorest countries has begun to give way to the principle of reciprocity in such agreements. In this respect, the nature of the problem posed by the less developed or smaller countries has changed radically in recent years.

None the less, we should not allow ourselves to be carried away by this new trend, since common sense still tells us that, due to diseconomies of scale and shortcomings in the areas of organizational capacity and financial soundness, many firms in the region are not in a position to compete with their United States counterparts. At the very least, one would hope that longer transition periods would be provided for firms in the less developed countries to gear up to face this new type of competition, and

X

Conclusions

A great many conclusions can be drawn from the above discussion. Perhaps the main one is that, just as economic integration played a functional role in the import-substitution model of decades past, it can also do so in the contemporary model for enhanced competitiveness in the international market. It may even be that the potential benefits of integration are greater than those suggested by a static analysis of trade creation and diversion, since the impact of these broader arenas for economic activity in terms of innovation and improved resource allocation—at the company level and within the overall system to which those firms belong—will surely contribute to an increase in productivity and efficiency.

Secondly, recent intra-Latin American (and, some day, intra-hemispheric) integration pacts are compatible with the stated objective of virtually all the countries of the region of improving their position within the international economy. For the most part, these agreements abide by the spirit and letter of GATT while seeking to raise the level of competitiveness and promote market diversification in order to reduce the risk represented by total reliance on the demand of OECD countries. Indeed, these agreements can be viewed as a sign of the fact that the countries are exercising their right to choose options which will enable them to develop their potentials in an uncertain and fiercely competitive international economy. None of the agreements signed to date is being pursued “at the expense of” another grouping but rather as a means of making progress, in the company of a group of similar countries, towards the achievement of the major objectives of the

perhaps more flexible rules regarding value added (origin). In addition, integration initiatives should not only promote trade liberalization but should also serve to create conditions conducive to a broad-ranging dissemination of technologies by means of such measures as the enactment of flexible legislation in the area of intellectual property, the establishment of information networks, the mobilization of skilled human resources and the promotion of foreign investment.

multilateral negotiations being conducted within the framework of GATT (the Uruguay Round).

A third conclusion concerns the present way in which the countries are approaching their integration commitments. What is different is not the agreements' means of implementation, but rather the context in which they are being applied. In other words, as the globalization of the economy proceeds, tariff preferences as well as rules of origin and safeguards are taking on a very different meaning from what they signified in a situation marked by high levels of tariff protection. On the one hand, the costs of trade diversion are now much lower than they used to be; on the other, the substantial reduction in tariff levels already carried out in the region makes tariff preferences less important than before, while bilateral agreements regarding other trade policy tools—safeguards, anti-dumping measures and rules of origin, as well as sectoral arrangements—may hinder trade rather than promoting it.

Fourthly, existing integration agreements in the region are notable for their diversity, inasmuch as they range from relatively simple agreements involving few formal requirements (superficial integration) all the way to initiatives calling for the formation of an advanced form of economic union (comprehensive integration). This makes it difficult to envision the configuration of a regionwide free trade area in the foreseeable future; instead, it would seem wise to encourage the conclusion of a number of different agreements whose contents would vary according to the relevant parties' degree of similarity and as the circumstances of each country grouping would appear to dictate.

This having been said, a fifth conclusion is that there is a limit to how many agreements there can be, since, under certain circumstances, different agreements could conflict with one another. What is happening at the present time in Central America is an example: no country in that subregion can enter into negotiations on its own regarding tariff concessions with an outside country because this would infringe upon the common Central American tariff. In these cases, the procedure is for the member countries of a given group that have a greater commitment to integration to negotiate agreements with third-party countries on a joint basis. The interests of eventual convergence would also be served, at least in some cases, if integration groups agreed to abide by common rules and procedures.

A sixth observation is that, in situations where the countries engage in a considerable volume of reciprocal trade, have similar production structures and are geographic neighbours, there will be a strong tendency to complement a free trade area or a system of trade preferences with a common tariff in order to ward off distortions in resource allocation and to avoid encouraging contraband trade. In such situations, it is also important to align the countries' macroeconomic policies, since marked differences in

exchange rates or regulations, interest rates or taxation levels can produce as much distortion as differences in tariff levels can. This undoubtedly introduces a greater degree of complexity into the administration of integration agreements.

A seventh conclusion is that trade preferences can and should be complemented by other joint measures to resolve shared problems in a wide range of areas, including the development of infrastructure, technological research, marketing, finance and training.

Finally, we can see that Latin America is currently going through a period of innovation in respect of integration-oriented institutional arrangements. It would seem that the Governments prefer to work with existing mechanisms rather than establishing common institutions. Accordingly, some processes are being guided by intergovernmental commissions while others receive support from ad hoc secretariats. There is apparently some resistance to delegating authority to intergovernmental or supra-national agencies. Private enterprise has also gained in importance as a leading actor in the integration process, both through investment in neighbouring (or more distant) countries and in its role as a vector of technology.