Open regionalism in Latin America and the Caribbean

ECONOMIC INTEGRATION AS A CONTRIBUTION TO CHANGING PRODUCTION PATTERNS WITH SOCIAL EQUITY

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ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN

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INTRODUCTION

In recent years, the Latin American and Caribbean region has shown a growing capacity to counter the effects of the prolonged crisis of the 1980s and changes on the international scene. Governments and societies alike have sought new ways of adapting to shifting circumstances and tackling the many challenges that have arisen. One of the manifold expressions of that adaptation process has been a renewed interest in the potential of intraregional cooperation, particularly through formal economic integration agreements, both multilateral and, mainly, bilateral.

This phenomenon can be attributed to a number of factors, including the laborious, slow process of multilateral negotiations under the General Agreement on Tariffs and Trade (GATT) ending in December 1993, the examples set by the formation of the European Community and the creation of a free trade area between Canada and the United States –now joined by Mexico–, as well as the gradual convergence of the economic policies implemented in Latin America and the Caribbean and the growing political affinity among the region's civilian, democratically elected Governments.

All of these developments could imply that there is no further need to convince Governments and social actors of the benefits to be derived from integration. However, the plethora of agreements concluded thus far has given rise to many questions that must be answered. Some of these are of a general nature. Why should integration be encouraged? What kind of integration should be encouraged? Which mechanisms and instruments are most suitable for integrating economies at this point in time?

Other questions are more concrete. For example, how do the "new" integration plans differ from those adopted in the 1960s and 1970s? How can the objectives of national economic policy be reconciled with those of integration agreements? Should countries seek the gradual convergence of all of these agreements into a single, region-wide arrangement, or would it be preferable to respect the heterogeneity of different situations and abandon the express aim of eventually forming a Latin American free trade area?

These and other pending issues must be clarified in order to keep existing agreements from foundering and to make further headway in their implementation. In other words, it is important to determine the best ways of supporting these commitments so that they will lead to tangible results; to identify the obstacles and incompatibilities that could arise from the multiplicity of agreements so that they can be resolved in time; and, most of all, to propose guidelines for lending continuity and coherence to these arrangements, in order to take full advantage of their potential contribution to changing production patterns with social equity.

The answers to these questions, as proposed in this document, are based on the core premise that recent integration efforts have generally involved an interaction between two types of phenomena. First, the trade liberalization and deregulation policies introduced at the national level by virtually all the countries –topics which are dealt with in a separate document* have underlined the relative importance of foreign trade in their economies. These phenomena have helped to build up reciprocal trade and investment within Latin America itself, taking advantage of geographical proximity. Second, this "natural", non-discriminatory attitude towards other countries has been complemented by integration based on explicit agreements or policies, which do entail certain preferences with respect to the treatment accorded to other nations.

This study maintains that the way in which these phenomena interact is of decisive importance. Depending on their content and scope, formal agreements can prove to be either contrary or complementary to the shift towards a growing interdependence guided by market forces and aimed at better integration with the international economy. The aim, therefore, should be to strengthen the reciprocal links between the two elements in the context of what is termed herein "open regionalism", i.e., a process of growing economic 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. Nevertheless, even if this optimal scenario does not come to pass, open regionalism would still serve an important purpose as a defence mechanism against eventual protectionist pressures in markets outside the region.

The study is divided into three parts, preceded by a summary and conclusions section. The first part explores the relationship between multilateralism and regionalism; the second examines the foundations of open regionalism; and the third analyses the mechanisms, instruments, policies and institutional arrangements which, in the secretariat's view, will enable countries to make further progress in implementing existing integration agreements.

In sum, the study's purpose is to stimulate debate on Latin American integration in a context that is qualitatively different from the one prevailing in the 1950s and 1960s, when the countries of the region made their initial, pioneering efforts in that direction.

* See ECLAC, Latin America and the Caribbean: Policies to improve linkages with the global economy (LC/G.1800(SES.25/3)), Santiago, Chile, 1994.

SUMMARY AND CONCLUSIONS

1. Integration and changing production patterns with social equity

1. The effects of integration, whether positive or potentially negative, are well known. One positive effect is the chance to benefit from economies of scale, especially if protectionist practices prevent this in world markets. Integration also helps reduce non-productive rents deriving from a lack of competition, although this effect has an ambiguous influence in terms of the incentives needed to promote innovation. These effects are intensified under agreements that involve large trading partners and that provide for low levels of protection against third-party competition.

2. Integration may also yield significant benefits by influencing expectations of domestic and foreign investment, or by cutting transaction costs, which erode the competitiveness of goods and services produced in the region, as a consequence of geographic, institutional, legal and social barriers. In addition, greater efficiency may be reflected in higher levels of savings, in more investment and in greater productivity of the factors of production as a whole. Thus, integration may have a major, lasting impact on the growth rates of the participating countries.

3. Another important potential of integration lies in the area of absorption of technological progress and production linkages. This includes increasing the rate of return of innovative activities, lowering trade barriers, promoting uniformity of standards and regulations, fostering the creation of centres of excellence and reducing the costs of pure and applied research. The way in which each country takes advantage of these opportunities may vary significantly, and in some cases there is even a danger that integration may reinforce patterns of specialization in sectors where technological progress is slow. Together with further action to strengthen national and regional technological development capacity, another way of avoiding or minimizing this last-mentioned potential effect is to step up the flow of technological information between countries.

4. To further the changing of production patterns, intraregional trade liberalization should also be promoted in support of the intra-industrial specialization process currently under way, since the industrial goods exchanged within the region tend to be more technology-intensive than those exported to the rest of the world. Moreover, the specialization process can spur greater efficiency and generate externalities as a result of the employment of a skilled workforce, the strengthening of enterprises through various forms of linkage with foreign investment, and the existence of a closer relationship between suppliers and users. This specialization process has now become even more important, owing to the use of a series of

managerial practices associated with liberalization and deregulation in a context of globalization, which includes the deverticalization of firms and the consequent increase in linkages between firms and independent suppliers at various levels.

5. The development of these linkages associated with a spontaneous or "de facto" integration entails the acquisition and dissemination of information, training and financial services, and involves the establishment of networks with a potential for specialization and innovation that could become an engine of integration. This in turn implies a growing reciprocal flow of persons, capital, information and technology among firms and countries, in addition to the purely trade-oriented integration, based on the exchange of goods, which tended to predominate in the past.

6. Integration may help increase agricultural production and productivity. The expansion of intraregional trade in agricultural products would be even greater if international trade in these products were liberalized; otherwise, the subsidies in the member countries of the Organization for Economic Cooperation and Development (OECD) would continue to inhibit regional production. Selective protection may be justified in order to neutralize the distortional effect of such subsidies. A number of countries of the region have already taken such steps, in the form of systems of price bands. Likewise, support policies would be required (cold chains, means of transport, streamlined land and credit markets) to avoid the dangers of polarization or inequity that could arise from trade liberalization in the presence of imperfect or incomplete markets.

7. Integration agreements may also contribute to stability and increased investment by enhancing the efficiency of economic policy decision-making in the participating countries. This is because economic policies are strengthened when they are adopted jointly by several countries. This potential effect could justify the financial support provided by international agencies to large-scale integration processes, whose success could boost the credibility of all the participating countries.

8. The benefits of integration are not limited to firms, but also extend to the economic and institutional system in which they operate. For example, by undertaking joint physical and energy infrastructure projects, countries may also achieve economies of scale and obtain greater returns on their investment. Likewise, advantages can be gained from cooperation in such diverse areas as education and the development of capital markets.

9. With regard to social equity, it was widely held in the 1960s that while integration agreements could promote the modernization of production, the correction of social backwardness was exclusively the province of each country's domestic policy. Today, according to the ECLAC proposal on changing production patterns with social equity (ECLAC, 1992a), integration is seen as a way of achieving a development model in which economic growth and social equity are enhanced simultaneously. Accordingly, the horizontal expansion of aggregate demand as a result of market integration would be compounded by a vertical expansion of demand, owing to country-level social integration.[1]

2. Towards an open regionalism

a) *International linkages and integration agreements*

10. All the region's Governments have made strenuous efforts in recent years to improve their countries' linkages with the

1 This is also associated with the need to improve the organization of each country's labour, credit, education and land markets (ECLAC, 1992a). Both market expansion processes would benefit from a reduction in transaction costs.

international economy in response to growing economic globalization and to the fact that the previous industrialization strategy was in many cases inadequate. Public action in this regard has focused on the more efficient promotion of the international competitiveness of the goods and services which each country has to offer.[2]

11. In the mid-1980s, intraregional trade agreements did not play a relevant role in this process. This was due, first, to the persistent idea that trade agreements were more useful for import-substituting industrialization than for increasing exports; and second, to the fact that the Latin America and Caribbean market was relatively small as compared to the market of the main OECD economies, and showed little or no growth. This explains in part why efforts at that time concentrated on gaining access to wide-ranging, highly dynamic markets.

12. Nevertheless, at least in theory, it may be postulated that integration agreements between countries not only may be compatible with the goal of steadily increasing international competitiveness but also may be instrumental in achieving it. In fact, none of the countries –developed or developing– that have concluded integration agreements have seen them as alternatives to a more dynamic role in the international economy; they are viewed, instead, as processes that complement the effort towards that goal. Their purpose, for both groups of countries, is to usher in a more open, transparent international economy; in other words, integration is seen as a building block of a future international economy free of protectionism and barriers to the exchange of goods and services.

13. At the same time, it is universally acknowledged that the formation of economic blocs by developed countries could result in a fragmented world dominated by free trade within these groups and more managed trade between them and other countries. From this standpoint, integration still makes sense, this time as a defence mechanism to offset some of the costs of even greater isolation resulting from any increase in protectionism in the developed countries.

14. Thus, from a regional standpoint, Latin American and Caribbean integration is justified –though for different reasons– in both of these scenarios (ECLAC, 1992a, p. 48). In the first case, regional integration is consistent with a more open, transparent world economic order; in the alternative case, it becomes a mechanism for diversifying risk in an international economy fraught with uncertainty.

15. The North American Free Trade Agreement (NAFTA) should be evaluated from this perspective. To Mexico, in particular, it represents a means of gaining more stable access to the country's principal market, bolstering the credibility of its policies and guaranteeing its incorporation into the globalization process. As the first reciprocal free trade agreement concluded between a developed country and a developing one, NAFTA may set an important precedent for other countries of the region. It is hoped that the Agreement will be an open one, which the countries of the region will be able to join under clear, mutually agreed conditions, with preference given to those countries that are already participating in integration agreements in accordance with an open regionalism approach.

b) *De facto integration and policy-driven integration*

16. Whereas formal economic integration agreements in Latin America and the Caribbean were viewed with skepticism in the 1980s, the region is now witnessing a proliferation of different kinds of arrangements that vary widely with respect to their modalities and geographical configuration. This is demonstrated by the signing of numerous preferential trading

2 The broader topic of how to improve the linkages of the Latin American and Caribbean economies with global trade and financial flows is discussed in ECLAC (1994).

agreements, usually in the context of the Partial Scope Agreements provided for in the Montevideo Treaty of 1980, and also by initiatives to form reciprocal free trade areas (which do not necessarily involve the adoption of common tariffs), customs unions (free trade areas with common tariffs) or common markets (customs unions with free movement of labour and capital among countries, generally giving rise to the need to coordinate certain macroeconomic and migration policies).

17. In Latin America and the Caribbean, the various formal integration agreements have been accompanied by a parallel process of "de facto" integration impelled by a series of macroeconomic and trade policies which, although non-discriminatory with respect to trade with third countries, have had the effect of creating similar conditions in a growing number (now a majority) of countries in the region, and have thereby fostered reciprocal trade and investment. The ensuing increase in economic interdependence reflects a number of factors: a shared tendency towards the consolidation of a coherent, stable macroeconomic framework, unilateral trade liberalization, non-discriminatory promotion of exports, deregulation and elimination of obstacles to foreign investment, privatizations and the lifting of payment restrictions. This similarity of tendencies, in turn, has been bolstered by geographical proximity and cultural affinity.

18. In practice, private investment and reciprocal trade between countries in the region have grown significantly since 1990. As part of an internationalization process, many firms in larger countries are investing abroad, sometimes within the region; smaller countries tend to attract a larger share of investment of regional origin than bigger ones. A process of rationalization and deverticalization is also under way in many subsidiaries of transnational corporations, in keeping with their greater degree of international and regional specialization.

19. While formal integration agreements may, at times, contradict the de facto economic interdependence fostered by firms under the aforementioned conditions, mutual complementarity between the two elements is both desirable and feasible. Whether it becomes a reality depends, essentially, on the features of the agreements, whose content and scope should enable the two types of interdependence –officially negotiated and market-driven– to support each other. The conditions which formal agreements must meet to achieve this will be analysed later in this study.

c) *Open regionalism*

20. This document uses the term "open regionalism" to refer to a new process that results from reconciling the two phenomena described in the above paragraphs: the interdependence that stems from special, preferential agreements, and that which basically arises from the market signals that are produced by trade liberalization in general. What open regionalism seeks to accomplish is to make explicit integration policies compatible with, and complementary to, policies to enhance international competitiveness.

21. What differentiates open regionalism from trade liberalization and non-discriminatory export promotion is that it includes a preferential element, which is reflected in integration agreements and reinforced by the geographical closeness and cultural affinity of the countries of the region.

22. A complementary objective is to make integration a building block of a more open, transparent international economy, instead of turning it into an obstacle to such an economy, thus curbing the options available to the Latin American and Caribbean countries. This means that integration agreements should tend to eliminate the barriers applicable to most trade in goods and services among the signatories, in line with their trade liberalization policies towards third parties, while at the same time making it easier for new members to accede to the agreements.

23. However, as noted above, if a less optimistic international scenario should develop, open regionalism is still justifiable as the least objectionable alternative for dealing with an external environment which is unfavourable to the countries of the region, since it at least preserves the expanded market of the member countries of integration agreements.

24. In view of the foregoing, the open regionalism approach to integration means that agreements should be designed with certain characteristics in mind: they should contribute to a gradual reduction of intraregional discrimination, to macroeconomic stabilization in each country, to the establishment of suitable payment and trade-promotion mechanisms, to the building of infrastructure and to the harmonization or non-discriminatory application of trade rules, domestic regulations and standards. Moreover, the reduction of transaction costs and discrimination within the region could be reinforced by sectoral arrangements or policies to take advantage, in turn, of the synergetic effects of integration.

3. Characteristics favouring open regionalism

25. In order to promote open regionalism, integration agreements should first provide for an extensive liberalization of markets in terms of sectors. This means establishing few exceptions; i.e., drawing up negative lists of goods and services excluded from the regime rather than positive lists of those to which the intraregional free trade agreement applies. This does not, however, preclude the possibility of providing for various transition periods. Moreover, considering the beneficial effects of recent cases of unilateral liberalization on intraregional trade, it would seem advisable not to increase the tariff and non-tariff barriers applied to such trade.

26. Secondly, a broad liberalization of markets in terms of countries is also needed. This means formulating agreements that have flexible membership criteria. There are at least three mechanisms that would ease the expansion of these agreements' geographical coverage and also their harmonization: first, making the criteria for new members to join more flexible; second, harmonizing standards on the basis of those established at the multilateral level; and third, according investment of intraregional origin the same treatment as national investment.

27. The extensive liberalization of markets in terms of sectors and countries would reduce the economic costs entailed by restrictive sectoral agreements, investment polarization and contradictory, uncertainty-producing commitments, while at the same time encouraging the expansion of investment, the absorption of technological progress and the utilization of economies of scale.

28. Third, the integration process should be governed by stable, transparent rules, so that reciprocal integration agreements can serve as unequivocal guarantees against all possible risks or uncertainties about access to the expanded market. To this end, clear and precise rules must be elaborated on origin, safeguards, countervailing duties and dispute settlement. In this connection, the agreements discussed within the Uruguay Round should serve as a frame of reference for integration agreements.

29. Fourth, as stabilization is consolidated throughout Latin America and the Caribbean, less weight will be given to arguments in favour of restricting preferential trade liberalization agreements to those few countries which have made the most progress in terms of internal and external balances and therefore offer a stable, predictable and coherent economic environment. As more countries advance along the path of stabilization, it will be possible to reach more ambitious integration agreements; in other words, to multilateralize the process. In this sense, despite the diversity of current subregional integration

agreements, it is not unrealistic to suggest the possibility of launching an integration process that culminates –without a pre-established deadline– in the formation of a regional (or perhaps hemispheric) free trade area.

30. Fifth, in today's international context, common external tariffs and moderate levels of protection against third-party competitors are efficient instruments for reducing incentives for smuggling and avoiding accusations of unfair trade practices related to the use of inputs with different levels of protection. They also lessen the need for strict rules of origin, which can represent a serious obstacle to trade liberalization. Common tariffs, which can be phased in gradually, can give priority to sectors where their absence would cause the greatest distortions, and to nearby countries with which intensive reciprocal trade is carried on and whose production structures are similar.

31. Sixth, the possibility of wide-ranging intraregional liberalization of trade and investment should not obscure the danger that rules of origin could become a hidden instrument of protectionism that discriminates more against countries less able to take advantage of the expanded market's potential or against those with a greater proportion of extraregional investment. While these rules may be necessary, especially in the absence of common tariffs, considerations of competitiveness and equity imply that their requirements should be limited.

32. Seventh, the extension of national treatment to intraregional investment, which is also partially provided for in some integration agreements, may, as a side effect, create investment opportunities in formerly closed sectors (particularly services) and may boost the confidence of enterprises in the region that wish to invest outside their home countries. This effect may be strengthened by devising clauses or agreements that protect intraregional investment and avoid double taxation. Since privatization and deregulation of services may increase the number of firms that can provide these services, while opening up opportunities for taking better advantage of the geographical proximity and cultural affinity of the countries of the region, the conditions that favour an increase in trade in services and intra- and extraregional investment in this sector in particular would be strengthened.

33. Eighth, integration can also help to cut down on factors that make transactions more difficult or costly, which, in addition to tariff and non-tariff trade barriers, increase costs to regional suppliers and effectively obstruct reciprocal trade. Reducing these transaction costs involves building infrastructure to link countries together, eliminating or harmonizing rules and regulations and implementing institutional reforms that make it easier for incomplete or fragmented markets to become integrated. These actions may require considerable financial resources, meaning that they must be evaluated and prioritized in terms of their net benefits.

34. Ninth, in view of the existing trade imbalances among the countries of the region, it should be recognized that a country may have an intraregional deficit (or surplus) and at the same time a global surplus (or deficit) in its trade balance. This does not mean that an intraregional trade imbalance necessarily justifies special arrangements. However, if temporary intraregional and global imbalances exist, it is better to decide how to deal with them on the basis of negotiations or prior consultations, in order to avoid the risk of escalating reprisals. In one type of cooperative arrangement, countries with global surpluses could take various measures to facilitate the importation of goods from the economies running a deficit. This would be a desirable alternative to correcting macroeconomic asymmetries exclusively by cutting back on reciprocal trade.

35. Tenth, since intraregional trade is vulnerable to temporary global deficits in the balance of payments (and their potential impact on exchange rates),

regional institutions that work to shore up the balance of payments should be legally and financially strengthened. This would help the countries to adjust their external accounts by degrees, thereby encouraging their participation –and increasing their confidence– in integration processes.

36. Eleventh, payment systems could also become a basic tool for facilitating the expansion of reciprocal trade and investment flows. Their importance will decline as the convertibility of currencies is provided for, private foreign-exchange markets are re-established and national currencies become more attractive as means of payment; however, as long as the latter are not used extensively in the region for that purpose, instruments for creating regional liquidity will become more necessary.

37. Twelfth, to promote the absorption of technological progress, the harmonization of standards must be made a basic component of the integration process. In a context of open regionalism, integration agreements may serve as a mechanism for the adoption of international rules. Among other benefits, harmonization could be expected to free up resources which enterprises have had to use to cover differentiated standards, allowing them to invest in activities with a higher rate of return, such as research and development, including activities that help firms to adapt or absorb technological advances transferred from abroad.

4. The need for flexible, open sectoral arrangements

38. An integration process intended to promote the absorption of technological progress requires, in addition to the extensive liberalization of markets, flexible sectoral arrangements to help enterprises reap the potential benefits of integration. Governments should play a catalytic role in this respect by generating flexible business coordination structures that facilitate the intermediation of technology transfer, the creation of information networks and the opening of channels or forums for exchanges of views, reflection, consensus-building and mobilization of support resources. These forums could also serve to develop joint business projects or to promote other types of agreements between enterprises in different countries of the region. The Bolívar Programme, for example, is a proposal that points in this direction.

39. In this regard, the sectoral arrangements established under integration agreements should be reoriented so that they are no longer confined to trade regulation (including quotas, restrictive trade practices or stringent rules of origin) and become more flexible and open-ended, for purposes such as eliminating obstacles through projects (in the areas of transport and energy, for example), or facilitating trade and investment.

40. These commitments would thus become forums for cooperation between the public and private sectors, and could be designed to fulfil some of the systemic requirements of competitiveness in the participating countries. To correct certain distortions, including restrictive trade practices such as the distribution of markets among firms, policies to regulate competition might be needed. Other disparities, such as those resulting from the use of inputs whose costs vary widely (petroleum, for example) or from regulations that hamper reciprocal flows of trade in goods and services, could be a justifiable reason for concluding sectoral harmonization agreements.

41. In order to foster interdependence, the absorption of technologies should be expedited at the regional level by various means, such as through greater mobility of skilled labour from one enterprise to another, reciprocal investment, the joint use of infrastructure, the production of inputs that can be used in a number of different industries, the adoption of new technological systems and the exchange of technological data, experience and opportunities. Geographical propinquity and cultural affinity, whose importance

increases in the context of a more open integration process, will make it easier than in the past to take full advantage of these opportunities.

42. The process of technological dissemination and innovation which integration seeks to promote requires the strengthening of relations with countries outside the region where most major technological innovations originate. For countries like those of Latin America and the Caribbean, often limited to following these advances from a certain distance, this is a crucial point, since technology transfer in the context of trade opening is a basic component of their growth prospects. This fact underlines the desirability of encouraging the sort of intraregional integration that will help strengthen the Latin American and Caribbean countries' relationship with the rest of the world.

43. There is a need for mechanisms to make it easier for small and medium-sized enterprises, which may be among the prime beneficiaries of Latin American and Caribbean integration, to obtain financing and technology. This is one of the complementary efforts being made as part of the thrust to change production patterns with social equity, laying the groundwork for making the best possible use of the potential benefits of integration, while at the same time helping to cut some of the costs of adjusting to the trade liberalization resulting from the implementation of integration agreements.

44. In general, the aim should be to promote actions that stimulate the shoring up of supply to meet the greater, more exacting demand created by broadened, liberalized markets. The linkage of these activities, so that they will be both catalysts and beneficiaries of a dynamic integration process and will not be confined to specific, isolated measures, will depend largely on an extensive liberalization of trade in goods and services among the participating countries, as well as competition and favourable investment prospects. It will also involve national efforts to improve the functioning of local markets for merchandise, services and factors and the implementation of the institutional arrangements needed to reap all the potential benefits of trade liberalization.

45. Finally, social integration within each country, through the enactment of policies aimed at reducing marginalization, plays a crucial role in regional integration, not only by increasing the size of the markets being integrated, but also by making a contribution to a more participatory, solid development of international competitiveness. Moreover, to the extent that integration helps promote a change in production patterns with social equity, national and regional integration processes will complement and mutually reinforce one another.

5. Equality of opportunity for all countries

46. In the 1960s and 1970s, one of the main obstacles to economic integration among countries that were different from one another in terms of economic size or level of development was the uneven distribution of the costs and benefits of the process. Although in today's environment of trade liberalization there is less concern about the cost aspect, the problem of equality of opportunities to reap the potential benefits of integration persists, either among Latin American and Caribbean countries, or even between one of the countries of the region and a developed country. Thus, business associations in certain countries that are regarded for various reasons as backward point to their structural inferiority when it comes to competing with firms in countries that offer better conditions in terms of economies of scale, access to technology, access to inputs or the systemic circumstances in which the firms operate. This argument is relevant in a number of contexts, whether it is a question of the Latin American countries compared to the developed countries in the hemisphere, or of the relatively less

developed countries or smaller economic size compared to those with opposite characteristics.

47 One way of reconciling these viewpoints is to implement the tariff reduction processes that result from integration agreements gradually and progressively to ease the adjustment of production activities to the new circumstances. This would also imply that countries or sectors considered to be less able to take advantage of the broadened market would make this adjustment through slower, but clearly established, tariff reduction processes.

48. Another way of reconciling these differences would be to adopt agreements on special treatment that would generate benefits both for countries with less capacity to take advantage of the potential of integration and for the other countries.

49. It should be noted, in this connection, that certain integration actions may be desirable when they provide benefits for some countries, even if they do not affect the situation of others. This principle could be extended to situations where the countries that received the most benefits from integration would compensate those countries faced with higher potential costs; this would be a way of preventing integration from hurting the latter countries, while it would ensure benefits for the other countries. Thus, in addition to protection clauses and extension of national treatment to investment from within the region (if such treatment has not already been granted), credit or fiscal mechanisms could be used to provide incentives for intraregional investment in countries with less capacity to take advantage of the potential of integration. Possible measures include the financing of private-sector investment projects on somewhat softer terms, or providing fiscal incentives to private enterprises that invest in those countries. Both the mechanism chosen and the origin of the resources could be multilateral, and could use regional and subregional financial agencies as the institutional framework for applying these measures.

50. The foregoing reflects the fact that integration can play an important role in encouraging the imitation and spread of technologies by facilitating the mobility of skilled human resources among countries and promoting intraregional investment. The spread of technology helps reduce impediments to innovation in smaller or less efficient countries.

51. A third way of reconciling differences of opinion on the treatment of countries less able to take advantage of the potential of integration is to take steps to facilitate their integration without the need for discriminatory or special measures. One of these, as noted earlier, is to avoid very stringent rules of origin. Another is to forestall the generation of polarized investment and competitive advantages as a result of compartmentalized (bilateral or trilateral) free trade agreements that give a small group of countries access to larger markets and lower-cost inputs. To avoid this situation, it would be desirable –as indicated earlier– to include provisions that effectively enable the greatest possible number of members to accede to existing agreements.

52. As part of this last set of measures, countries less capable of taking advantage of the potential of integration should adopt appropriate policies to combat possible unfair competition from larger firms in the region. In the short term, this would involve anti-dumping policies which, through objective, non-discriminatory and transparent procedures –either national or subregional–, and based on the agreements negotiated within the Uruguay Round, would ward off the effects of predatory practices. For the longer term, the possibility of including a policy on competition as part of integration agreements could be considered, with the aim of discouraging these types of practices through punitive measures that do not involve restriction of trade.

6. Medium- and long-term policy coordination

53. Trade integration may increase the need to coordinate macroeconomic policies. However, although MERCOSUR has given a great deal of attention to the topic, such coordination tends to be limited in Latin America and the Caribbean, particularly where conditions of instability weaken a country's effective control over its own policy instruments. Moreover, it must be recalled that the most solid forms of coordination result from a somewhat lengthy process, during which integration gradually gathers momentum and macroeconomic policies constantly interact.

54. Current trade restrictions call for the definition of a coordination procedure that could begin with an exchange of information and an examination of the potential impacts of some economies on others. This would involve a learning process that would not only provide a multilateral perspective, but could also facilitate cooperation and help reduce the risk of actions and reactions that could create conflicts. As a complementary form of coordination, general rules could be established on the type of policies which the parties agreed to adopt and on the measures (multiple exchange rates, certain subsidies, surcharges) they agreed to avoid.

55. Furthermore, the lack of consensus on the best exchange rate regime, difficulties in achieving a convergence of fiscal and monetary policies, and the European experience suggest that the coordination of exchange-rate policy, in a narrow context, is not a practical option at the current early stage of Latin American and Caribbean integration processes. However, the progress of such a regime will require not only the use of monetary and fiscal policies to reconcile –within certain limits– the internal imbalances of the participating countries, but also the taking of similar steps with respect to external imbalances. Once trade between the partners has reached a significant volume, the establishment of a flexible exchange-rate alignment mechanism could be an operative element within the proposed scheme of loosely coordinated macroeconomic policies.

56. The growing interdependence that results from integration also heightens the need for cooperation and harmonization in new areas, including labour standards and regulations. Although there are wide differences of opinion on whether trade policy should be linked to the harmonization of labour standards, migration and the increased mobility of individuals call for complex regulations, particularly if different categories of workers are not to be treated in the same way.

57. Another topic that deserves attention concerns policies on competition, since they may complement liberalization policies and, at the same time, represent a preferable substitute for the protection instruments used thus far to combat unfair competition from imports. In particular, the implementation of supranational policies on competition, such as those applied within the European Community, could help to avert the anti-competitive dangers posed by the use of certain trade policy instruments, such as anti-dumping duties, among countries bound by an integration agreement.

58. Lastly, the thematic scope of future integration agreements will be conditioned by both increased interdependence in the region and the requirements of the international market. Apart from issues related to macroeconomics, labour and competition, other items on the world economic relations agenda, such as the environment and intellectual property, are likely to receive growing attention.

7. Institutional aspects

59. The institutions in charge of implementing economic integration processes must reflect the degree of advancement of those processes. If the aim

is merely to abolish obstacles to the free circulation of merchandise, those institutions can be predominantly intergovernmental and relatively simple. In contrast, more complex processes that contemplate policy coordination require more highly developed institutions of an intergovernmental nature.

60. At any rate, it would be advisable to avoid rigid commitments in favour of flexible schemes that are adaptable enough to ensure that the pace of institutional development is determined by the momentum of the process itself. It would also be desirable to encourage and facilitate greater participation by organizations representing various social interests, in accordance with the democratic spirit pervading the region. These considerations justify the establishment of authorities such as the Latin American Parliament, which place the topic of integration on the political agenda of each country in the region.

Chapter I

THE INTERNATIONAL ECONOMY AND REGIONALISM

A. THE INTERNATIONAL PANORAMA

In the past, ECLAC has projected different scenarios for the world economy in the light of globalization (ECLAC, 1992a, pp. 47-48). One such scenario presupposed a growing convergence of policies, in the framework of a more open and integrated economy. A second saw globalization as creating pressures that would accentuate protectionist trends and attempts to manage trade and financial flows. In their most extreme forms, these scenarios represent the opposite poles of a spectrum of intermediate possibilities.

The present recessionary environment in the developed countries lends credence to the possibility that the second scenario might be emerging, although it is by no means inevitable. The growth in output has been flat in recent years in the developed countries as a whole. Unemployment has been on the rise, averaging above 7% for OECD members and climbing to double digits for most of Europe by the end of 1992. The stagnation of the developed countries contrasts with the greater dynamism of the developing countries, owing mostly to the growth in Asian countries, especially China. The performance of the developed countries over the next few years is also projected to be below the sustained growth rates of the developing countries, even though these will differ greatly from one country to the next.

Besides increasing protectionist pressures, the recession has also contributed to weakening the flow of foreign investment at the international level, which is one of the main factors in the globalization process.[3] Even though foreign investment in Asia and Latin America continues to grow, its world-wide decline in 1991 and 1992 marked the end of an upswing that began in 1982 (UNCTAD, 1993, chap. IV). Cyclical elements, such as slower growth in the developed countries and the end of the rash of acquisitions and mergers that took place in the 1980s, seem to have been influential in this downturn.

However, other structural factors that previously contributed to increasing the flow of foreign investment probably will continue to manifest themselves. Some of these are the effects of policy changes, such as the removal of restrictions on foreign investment, privatizations and regional integration processes. Other

3 It is significant that at the regional level foreign investment is less highly concentrated than trade, which would indicate that investment depends less on regional factors than trade. One possible explanation is that trade has promoted regional integration, in which it has played a predominant role, whereas foreign investment tends more to promote global integration (UNCTAD, 1993, chap. I).

factors include the existing stock of foreign investment, which has the potential to attract new flows, and the uneven geographical distribution of the stock of investment; the latter, despite an overall decline, increased in Latin America and Asia in 1991 and 1992. These factors taken together support the supposition that foreign investment at the world level will continue to grow, even though it is subject to cyclical factors that might produce short-lived fluctuations (UNCTAD, 1993, chap. IV).

All this could lead one to conclude that the process of integrating production will be carried further by transnational corporations, taking ever more complicated forms in increasingly diverse geographical locations. This trend reflects new conditions arising from advances in information technology, a convergence of national patterns of demand, more intense competition and the easing of restrictions on trade and investments. The most complex integration processes are being driven by enterprises which are assessing their local activities in terms of their contribution to global goals, and not in terms of their earnings in each country.

Thus, regional and global strategies are replacing those geared to maximizing profits in each individual country. This kind of integration is particularly rapid in certain industries (automotive, electronics, banking, air transport and others) and activities (financial management). These processes have also multiplied and strengthened linkages between enterprises, creating networks that entail horizontal and vertical power relationships and transfers of resources, which gives further impetus to integrating production among countries.

In recent years, international trade has continued to grow at a faster rate than global output. However, this growth has been uneven: especially notable were the sustained import-export dynamism of the Asian countries, the increase in Latin American and United States imports, and the resurgence of external imbalances arising from Japan's current-account surplus.[4]

Tensions arising from this disparity and from the recession in Europe compounded the uncertainty produced by the multilateral trade negotiations in the framework of the Uruguay Round. The outcome was that the developed countries relied more on non-tariff barriers and anti-dumping and countervailing duties to limit imports, together with unilateral pressure tactics to open foreign markets. Also, the greater attention paid to bilateral or sectoral balances led to a proliferation of countertrade agreements. Generally speaking, while restrictions on agricultural exports and industrial sectors such as textiles are being maintained, recent protectionist measures have been concentrated in sectors such as the automotive industry, commercial air transport, steel and public service-related State purchases; the implementation of these measures has also coincided with a rise in intellectual support for the idea of managed trade (United Nations, 1993b, chap. III). New restrictions have also been imposed on agricultural products such as bananas and apples.

At the same time, regional agreements have become more important, particularly after the United States initiative to enter a free trade agreement with Canada, extended to Mexico under the North American Free Trade Agreement (NAFTA). Thus, the United States has joined the European countries in promoting regional agreements. This has led other countries, those of Asia among them, to formulate similar schemes, and in the case of Latin America and the Caribbean, has helped to strengthen a number of efforts that have been under way for decades. Regionalism is clearly a prominent feature of these times.

Unlike the first preferential agreements signed in the framework of the General Agreement on Tariffs and Trade (GATT), the main purpose of which

4 Unlike what occurred in the 1985-1987 period, external imbalances affected only Japan, not Germany. The recession in Japan stalled import growth, while exports, mostly to other Asian countries, grew faster than they did in 1985-1987 (OECD, 1993, pp. 46-47).

was positive since they sought to liberalize trade among the parties, the establishment or extension of regional agreements like NAFTA or the European Community seem to reflect a negative objective, which is the desire of some countries to avoid being affected by protectionist measures such as safeguards and anti-dumping duties which could proliferate without an agreement. They also express the frustration caused by the slow progress of multilateral trade negotiations under GATT (Jackson, 1993).

The foregoing is related to the discussion about how to make regionalism compatible with multilateralism. The traditional way has been to apply article XXIV of GATT, which basically establishes that a preferential agreement is acceptable to the extent that it eliminates barriers that apply to substantially all the trade among the contracting parties, and as long as it does not raise barriers to the trade of third countries. This provision, however, has proved to be ambiguous in practice, and perhaps more importantly, more and more trade policy instruments lend themselves to being used preferentially and do not come under any internationally accepted regulations (Jackson, 1993). These include rules of origin, safeguards, countervailing and anti-dumping duties, trade in services and dispute settlement.

All the above-mentioned factors highlight the importance, particularly for the countries with the most influence in GATT, of helping to strengthen multilateral rules, even after the Uruguay Round is over, in order to avoid the spread of an indiscriminate use of protectionist regulations. In this regard, it should be remembered that the benefits at the close of the Uruguay Round are expected to include not only the liberalization of tariff and non-tariff barriers, but also the extension of multilateral regulations to new areas, such as services and intellectual property and the strengthening of disciplinary rules or measures against anti-dumping practices, subsidies and safeguards, as well as multilateral dispute settlement and supervisory mechanisms.

The goal of consolidating and deepening the provisions of the Uruguay Round would be consistent with a scenario in which policies converge and progress is made towards a more open, integrated economy. In such a context, integration agreements can lay the foundation for a more liberal economic order and, at the same time, act as agents of such an order at the international level. They can also help achieve this objective by serving as testing grounds for resolving disputes that are pending in GATT and as tools for furthering integration among some countries, while leaving open the possibility for others to join. However, if such a scenario does not come to pass, it must be remembered that integration agreements will continue to have a role to play in Latin America and the Caribbean. Even though costs could rise and benefits fall, integration in such a context would be justified as a defence mechanism to help ensure access at least to some large markets and to assist the countries in adapting to globalization, so as not to remain excluded from that process.

This analysis explains why Latin America and the Caribbean need to try to achieve closer links with the main engines of growth in the world economy, such as Japan, China and the countries of South-East Asia, as well as Europe and the United States. At this time, such an option seems more viable in the case of the United States, because of NAFTA or because of eventual agreements signed in the framework of the Enterprise for the Americas Initiative.

B. RELATIONS WITH THE UNITED STATES AND CANADA

The relations of Latin America and the Caribbean with the United States and Canada are halfway between the international sphere and the intraregional sphere, the latter comprising existing relations among the countries of Latin

America and the Caribbean. Also, as was mentioned above, the NAFTA negotiations and the announcement of the Enterprise for the Americas Initiative by the Government of the United States in 1991 have had the effect, among others, of lending greater credibility to integration efforts in general. NAFTA also represents the first case of a reciprocal integration agreement between a developing country, Mexico, and developed countries.

Apart from the possibility of extending integration to the whole hemisphere as a result of the eventual accession of the Latin American and Caribbean countries to NAFTA, the Enterprise for the Americas Initiative could give rise to other kinds of trade association between the countries of the region and the United States. Therefore, the integration of Latin America and the Caribbean cannot be examined without reference to the whole hemisphere. The rest of this chapter will briefly analyse the reciprocal flows of trade and investment, and then present some thoughts on NAFTA.

1. Trade and investment

The United States is the main economic partner of Latin America and the Caribbean as a whole, as witnessed by the fact that it absorbed 30% of the region's total exports during the 1980s and approximately 40% at the beginning of the 1990s (ECLAC, 1991). The importance of trade with the United States has been particularly obvious in the case of manufactures exports. Also, in the early 1990s, close to half of total foreign direct investment in the region came from the United States.

However, two observations are in order. First, the situation varies considerably from one country to another, in terms of both trade and investment. Thus, the proportion of total exports from the countries of the region to the United States fluctuates between some 10% or less, as in the case of Argentina, and Paraguay, and more than 80% in such countries as Haiti and the Dominican Republic (see table I-1). Generally speaking, the percentage of sales to the United States and Canada is directly proportionate to geographical proximity to those countries. Nevertheless, in South America and in Central America and the Caribbean, some countries export more to others within the region than to the United States, which is another indicator of the importance of the regional market.

There are also key differences with respect to the origin of foreign investment in the countries of the region. About a third or less of total investment comes from North America (United States and Canada) in the cases of Brazil, Paraguay and Uruguay; close to half in Argentina, Chile, Ecuador, Peru and Venezuela; and approximately two thirds or more in Honduras, the Dominican Republic, Mexico, Colombia and Bolivia (Calderón, 1993). In some countries, the lower proportion of North American investments is offset by a greater share from Europe or Latin America. This also shows the impact that applying discriminatory rules to investments could have, in the framework of a hemisphere-level integration scheme.[5]

The second observation is that, in contrast with the growing flow of regional exports to the United States during the 1980s, trade and investment flows from that country diminished as a proportion of its total outflow. United States exports to the region dropped from 17% to 14% of total exports between 1980 and 1990, and imports from 15% to 13%. Exports recovered somewhat after 1985, an upswing that was consolidated in the early 1990s, returning to 17% of the total in 1992. That rise was mostly due to exports to Mexico, which accounted for 50.9% of total United States sales to the region in 1989, a proportion that rose to 53.6% in 1992. United States investment in Latin America and the Caribbean behaved

5 Rules of origin could affect investments if they applied to foreign enterprises that import inputs from countries outside the region.

Table I-1
LATIN AMERICA AND THE CARIBBEAN: EXPORTS ACCORDING TO DESTINATION 1980 AND 1991
(Percentages)

Country	United States		Canada		Latin America and the Caribbean	
	1980	1991	1980	1991	1980	1991
Argentina	8.9	10.4	0.5	0.6	23.6	29.3
Bolivia	29.1	21.9	0.8	0.1	35.7	48.4
Brazil	17.4	20.2	1.2	1.5	18.1	16.5
Chile	10.0	14.8	1.5	0.6	24.7	15.5
Colombia	27.1	38.8	1.5	1.1	16.6	21.6
Ecuador	32.5	49.2	0.1	0.1	19.2	17.1
Mexico	65.3	64.7	0.8	2.0	6.1	4.7
Paraguay	5.5	4.7	0.0	0.0	45.8	46.7
Peru	32.4	25.0[a]	0.7	1.7[a]	1.7	16.8[a]
Uruguay	7.8	10.1	0.7	1.1	37.3	40.7
Venezuela	27.3	39.1	9.6	1.5	14.1	10.7
Costa Rica	34.9	47.6	0.4	2.6	34.0	17.3
El Salvador	29.7	34.8	0.9	0.9	4.0	
Guatemala	28.7	37.8	0.5	1.2	30.3	38.8
Honduras	53.1	53.8	0.1	0.5	13.1	7.6
Nicaragua	38.7	20.3	0.4	8.7	19.8	27.0
Dominican Republic	63.4	82.9[a]	0.4	4.6[a]	14.8	4.6[a]
Trinidad and Tobago	59.9	50.0	0.7	1.8	16.5	23.9
Panama	49.9	41.4	0.3	0.9	18.6	21.8
Barbados	41.3	19.9	5.3	3.7	29.2	44.3
Guyana	29.3	0.7[a]	6.6	0.1[a]	16.1	21.4[a]
Jamaica	36.7	31.7	3.5	11.2	8.6	7.7
Bahamas	44.1	50.8[a]	0.6	3.8[a]	7.6	3.5[a]
Haiti	70.1	85.1[a]	1.5	3.7[a]	1.3	0.8[a]
Suriname	21.8	13.2[a]	1.1	0.4[a]	4.9	11.5[a]

Source: ECLAC, on the basis of information from the International Commodity Trade Data Base (COMTRADE) of the United Nations Statistical Division (UNSTAT), May 1993.
[a] IMF, *Direction of Trade Statistics, 1992*, Washington, D.C., 1992.2.539

similarly, dropping from 20% to 17% of the total between 1980 and 1990, and then turning upward to 18% in 1992.[6]

2. The North American Free Trade Agreement (NAFTA)

The North American Free Trade Agreement (NAFTA), besides its natural importance as a set of rules governing economic relations between the largest trading partners in the hemisphere (United States-Canada and United States-Mexico), stands out as the most comprehensive free trade agreement in the hemisphere and the first to be negotiated between a developed and a developing country. Its importance as a precedent and the possibility that it could lead to progress in hemisphere-level integration, if other Latin American and the Caribbean countries eventually joined, calls for a discussion of some of its more important elements.

NAFTA will gradually eliminate tariffs and non-tariff barriers over a period of 10 years, with certain extensions of up to 15 years (see box I-1).[7] These provisions

6 Note that the proportion of United States investment in some countries had increased already in the late 1980s; this was true of Mexico, in particular, although Brazil remained the country receiving the largest amount of investment (ECLAC, 1993).

apply to industry and agriculture. Trade between the United States and Mexico in agricultural products is liberalized by converting non-tariff barriers into new instruments, which combine tariffs with quotas, which will also be gradually eliminated within the same period. This is particularly noteworthy in the light of problems that have blocked progress in multilateral negotiations on trade in agricultural products.

NAFTA establishes a dispute settlement mechanism modelled on the one in the bilateral agreement between the United States and Canada. Disputes over countervailing and anti-dumping duties are resolved by a panel of experts, whose decisions the Governments are obliged to accept.[8] Special committees will also be formed to review allegations of non-compliance with the decisions of the panel of experts; if those committees rule that there is indeed non-compliance, they will have the power to authorize the country affected to adopt certain countervailing measures.

Tariffs and quotas in the textile sector will gradually be eliminated. However, probably one of the main limitations of NAFTA lies in the rules of origin applicable to goods benefiting from free trade, especially textiles, apparel and automotive products, which could even be contrary to the spirit of GATT (see box I-2) (Hufbauer and Schott, 1993, pp. 5-6 and 111). However, preferential tariff quotas will be maintained for certain textiles produced in Mexico that do not comply with rules of origin. Safeguards are also planned for this sector, consisting of re-establishing the tariff that was applied before NAFTA went into effect. Safeguards are subject to compensation, can be applied only once for each product and are limited to three years duration.

Besides the gradual reduction of trade barriers affecting the automotive sector, it was agreed that each country would gradually drop existing provisions on domestic content and foreign exchange and eliminate limits on foreign participation after a six-year period. In general, NAFTA commits all three countries to providing national treatment to investments from NAFTA partners, except in a few sectors, such as petroleum and railroads in Mexico, cultural industries in Canada, and commercial air transport and broadcasting stations in the United States. Most of the trade-related performance requirements are also phased out, leading to broader coverage than that allowed by the Uruguay Round's trade-related investment measures (TRIMs) (Hufbauer and Schott, 1993, p. 80), except for those concerning training and technological development. International mechanisms are also envisaged for settling disputes arising from foreign investment, a departure from the tradition of bringing such cases to national courts.

NAFTA reinforces the intellectual property reforms already in effect in Mexico, extends national treatment to the other partners with respect to the corresponding laws of the three countries and, in general, commits the signatories to complying with international obligations that they may have assumed in the framework of GATT and other multilateral forums. Compulsory licensing or mandatory linking of trade marks are eliminated, and patents have a minimum duration of 20 years. Canada's cultural industries and certain recreational services in Mexico are exempt from extending national treatment to the other two parties.

The financial sectors of the three countries are opened to enterprises from all three. There are, however, maximum levels of aggregate foreign participation and transition periods that vary between four and seven years. Temporary

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7 The bilateral free trade agreement between Canada and the United States provides that tariffs between the two countries will be eliminated by 1998.

8 Although no agreements have been reached on reforming countervailing and antidumping policies, the agreed mechanism reduces the possibility of arbitrary decisions when applying these laws in each country.

Box I-1

ASYMMETRIES IN THE NORTH AMERICAN FREE TRADE AGREEMENT

Even though NAFTA was negotiated on the basis of strict reciprocity, certain asymmetries in the trading relationship between the member countries were recognized, which led to the establishment of different time periods for liberalizing trade. This approach was particularly reflected in the lower proportion of Mexico's imports to be immediately declared duty-free. With respect to exports from Mexico, 7,300 United States tariff headings will be included in the group to be liberalized on the date the agreement takes effect. Of these, 4,200 correspond to a consolidation of the free market access provided for under the Generalized System of Preferences, but NAFTA will make them more secure and provide easier access. The number of items on which tariffs will be reduced represent 84% of Mexico's total non-petroleum exports to the United States during 1991 and 79% of those to Canada. Mexico, on the other hand, will declare only 5,900 headings to be duty-free, which corresponds to 43% and 41%, respectively, of its non-petroleum imports from the United States and Canada during that same year. With few exceptions, the liberalization of trade in the rest of the products will take place later, within periods of five, 10 and 15 years. Within five years, for example, Mexico will reduce tariffs on items equivalent to 18% of United States exports and 19% of those from Canada, while these countries will do likewise with 8% of Mexican exports to them.

In the case of textiles, the United States will immediately eliminate tariffs on products representing 45% of the value of Mexico's sales to it, while Mexico will lift tariffs on less than 20% of the exports it receives from the United States. In the automotive sector, approximately 81% of Mexico's parts exports to the United States will benefit from a total and immediate lifting of tariffs, around 18% will be liberalized within a five-year period, and only 1% will be liberalized over a 10-year period. Mexico, on the other hand, will immediately liberalize the equivalent of only 5% of its imports of parts and components, 70% over a period of five years and 25% over 10 years. Lastly, on the day the agreement goes into effect, the United States will lift tariffs on agricultural products representing 61% of Mexico's exports, whereas on that date Mexico will liberalize only 36% of its imports from the United States.

Source: J. Serra Puche, "Conclusión de la negociación del TLC", *El economista mexicano*, October-December 1992.

safeguards can be evoked to regulate the proportion of foreign participation. By the year 2000, Canadian and United States banks and insurance companies will have virtually unlimited access to the Mexican market, although only as subsidiary firms. Their entry will be subject to the application of a temporary safeguard if it endangers Mexican ownership of the system of payments; it will also be subject to restrictions in order to limit the purchase when the joint share of the acquiring foreign bank and the acquired bank exceeds 4% of the market. Regulations requiring a separation between commercial banks and investment banks in the United States will be maintained, as well as restrictions at the state level. The latter, if notified before 1 January 1994, will take the form of reservations to the agreement. Canada will apply rules of origin (nationality) –which are different from the more common residency requirements in effect in Mexico and the United States– under which financial institutions must be more than 50% owned by shareholders that are residents of NAFTA countries.

The agreement immediately enlarges the border area between the United States and Mexico in which trucks from both countries can move freely. In 1995, trucks from all three countries will have freedom of movement in the states along both sides of the Mexican-United States border. By the year 2000, the territories of all three countries will be completely open to cross-border cargo-vehicle traffic. After

Box I-2

NAFTA AND RULES OF ORIGIN

NAFTA uses three criteria for determining the origin of goods that will benefit from the treaty's preferential treatment. The first is that a good will be considered to originate in the region when it is *wholly produced* there. The second, which applies to more than half of dutiable items, stipulates that goods will be considered to originate in the region when their *customs classification is changed* by a production process.

The third criterion, based on the *regional content* requirement, is applied to merchandise not satisfactorily covered by the first two. Regional content, in turn, can be calculated in two ways. The first, the *transaction value* method, defines regional content on the basis of the invoice prices of the exported good and of its inputs imported from outside the region. The second, the *net cost* method, determines the regional content on the basis of the cost structure of the exported good and the invoice prices of inputs imported from outside the region. Royalties and sales promotion and packing costs are excluded, which limits the financial burden that can be included in the calculation. The exporter can choose the more favourable method, except in the automotive and footwear sectors and for those cases in which the GATT Customs Valuation Code prohibits the use of the transaction value method, in which cases only the net cost method can be applied.

At the end of the transition period, vehicles will benefit from the preferential trade scheme when they have 62.5% regional content. The main parts of an export vehicle will be subject to specific accounting procedures to determine the net regional content of its inputs, in order to establish with precision the net regional content of the whole vehicle. In some cases, the origin of automotive parts will be determined on the basis of a change in customs classification, and in others, according to the criterion of net regional content.

Most textiles and apparel will have to pass a "triple transformation test" in order to benefit from the free-trade regime. This criterion basically establishes that such products must be made with fabrics produced with yarns originating in NAFTA member countries, as well as cut and sewn in those countries.

Source: G. Hufbauer and J. Schott, NAFTA: An Assessment, Washington, D.C., Institute for International Economics, February 1993; J. Serra Puche, "Conclusión de la negociación del TLC", *El economista mexicano*, October-December 1992.

seven years, 100% foreign ownership of transport firms will be allowed in the United States, and the same will be true in Mexico after 10 years. Passenger transport will be liberalized in a similar way, but within shorter time periods. The agreement also establishes a committee to harmonize transport standards; its most difficult task will probably be to determine truck size and weight limits, a subject which has also been a highly contentious issue in the European Community (Hufbauer and Schott, 1993, p. 68).

The telecommunications part of the agreement is built on the model of the Uruguay Round. Non-discriminatory access to telecommunications networks is ensured. When NAFTA goes into force, restrictions will be eliminated on foreign investments in value-added services, except for videotext and enhanced packet switched data services, which will be liberalized in 1995. Public telecommunications services, however, will not be subject to negotiation (Serra Puche, 1992), and the three countries will maintain their restrictions on foreign investment in radio and television stations.

3. The effects of NAFTA on the Latin American and Caribbean countries

NAFTA is widely perceived as being likely to benefit the countries of the hemisphere, though the effects will clearly differ by country and, more importantly, by NAFTA scenarios –an open, inclusive NAFTA and a closed, exclusive NAFTA being the two extremes. The international context also plays a very significant role: as noted earlier, the complexion of regionalism here most certainly will be shaped by how the results of the Uruguay Round are put into practice.

Obviously Mexico needs to be differentiated from the rest of Latin America and the Caribbean. Mexico's signing of NAFTA, along with its accession to GATT, will help to consolidate the trend towards liberalization which it has already adopted unilaterally. The entry into force of NAFTA also guarantees, broadens and provides a stable foundation for Mexico's access to the United States market. Generally speaking, the country stands to gain significantly from NAFTA, in terms of trade creation, investment flows, economic growth and, more broadly, the promotion of the process of modernizing production.

There may be two opposing forces at work in the rest of Latin America and the Caribbean in the immediate term. First, the passage of NAFTA by the United States Congress will likely serve to further catalyze important domestic reforms in the region and revitalize the subregional integration processes. Freer trade with the United States is possible, perhaps in the framework of a free trade area.

The second trend is more troublesome. This is the likely diversion of trade and investment into Mexico and away from the rest of the Latin American and Caribbean countries. While the extent of this diversion will vary from country to country, there are some studies which indicate that on average, the effects of trade diversion will be minimal.

According to one study on the subject (Braga, 1992), "elimination of tariffs among the three NAFTA countries will cause exports from Latin America and the Caribbean to the United States to fall by about 0.7 percent." (Lustig, 1993.) Another study estimates that 94% of the trade diversion generated by NAFTA will affect countries outside the hemisphere (Erzan and Yeats, 1992).

It is doubtful that anyone has a firm grasp of the extent of investment diversion at this point, though the case of Spain highlights how substantially investment flows can increase into a country upon its entry into an integration scheme (Dornbusch, 1993). In addition, foreign investment figures for Mexico over the past several years seem to tell a similar story.

The amount of trade and investment diversion depends in large part on how NAFTA develops and how it fits into the hemispheric integration trends. Will other Latin American and Caribbean countries be able to dock onto NAFTA? Perhaps better still, will Latin American and Caribbean countries be able to join in groups, thus preserving existing subregional groupings? How long will the process take?

The range of potential effects on the rest of Latin America and the Caribbean of different outcomes of such questions is very large. While an "open NAFTA" would seem to be the best-case scenario for the hemisphere (coinciding with a successful Uruguay Round), a "closed NAFTA" could very well be worse for the region (less Mexico) than "no NAFTA" at all.

There do seem to be adequate indications that the Clinton Administration is amenable to widening NAFTA and that an open NAFTA will likely prevail, though the widening process can be expected to take some years. Assuming this to be the case, some observations can be made regarding the disaggregation of costs and benefits by country types in a wider hemispheric arrangement stemming from NAFTA. In other words, while all countries of the hemisphere can benefit from a Western Hemisphere Free Trade Area (WHFTA), some are better positioned to gain more.

Several considerations enter into the equation, including the following: 1) the direction of trade flows; 2) the composition of trade; 3) the status of domestic reforms, including the level of existing trade barriers between potential members as well as with non-members; 4) proximity to the North American market and investors; 5) the economic size of the country, 6) the country's level of development; and 7) the timing of membership in a WHFTA.

Many of these considerations are connected. For example, those countries that are more likely to be among the last to join a WHFTA –unless special provisions are made– will tend to be the smaller, less developed countries where domestic reforms remain in their infancy.

There seem to be three relevant observations that derive from this generality. First, inequalities between countries in the hemisphere may, at least initially, increase from a movement towards a WHFTA (Vernon, 1992; Singer, 1992; Blecker and Spriggs, 1993). Second, there is nevertheless much that any country can do through economic reform to better its position. Third, there seem to be merits in explicitly addressing the needs of the smallest and least-prepared countries of the hemisphere that would otherwise bear the brunt of the costs of a WHFTA in transition.

Chapter II

BASES FOR AN OPEN REGIONALISM IN LATIN AMERICA AND THE CARIBBEAN

Economic interdependence among the countries of Latin America and the Caribbean, measured in terms of trade and investment, has grown in recent years. This change is attributable not only to the plethora of formal agreements signed or implemented, which lay the foundations for policy-based integration, but also to the de facto integration brought about by countries' geographical proximity and existing markets in the new context of openness, deregulation and globalization. This section of the study will identify some of the factors that form the basis for a potential open regionalism[9] in Latin America and the Caribbean, and examines the links between economic integration and the process of changing production patterns with social equity.

A. GEOGRAPHICAL PROXIMITY, OPENNESS AND DEREGULATION

1. The global context

Globalization and the regional integration process that has occurred in South-East Asia (see box II-1) give reason to believe that the countries of Latin America and the Caribbean could use certain national and regional factors to attract foreign direct investment and enhance the competitiveness of their enterprises. Geographical proximity can become an increasingly important consideration in investment decisions, since the economies of neighbouring countries can benefit from the complementarity of their resources and products, as well as from a broader market. In view of the growing trend towards keeping production close to consumers and to sources of inputs, with minimum volumes of inventory, the region-wide division of labour makes it possible to use countries' comparative advantages and gain access to external markets.

In addition to the effects of globalization, geographical proximity and cultural affinity, a number of indicators reveal a trend towards liberalization in Latin America and the Caribbean that could lead to the gradual integration of production. One such indicator is the unilateral trade liberalization that has already taken place. As an alternative to the high levels of protection maintained in the past, countries implemented unilateral or gradual trade liberalization, beginning with regional trade. Currently, in view of

9 See the definition of open regionalism given in paragraphs 20-24 of the first section, *Summary and Conclusions*, of this document.

Box II-1

THE EXAMPLE OF ASIAN INTEGRATION

The regional integration of production in southern and South-East Asia exemplifies the new technical and economic paradigm. Although intraregional trade has increased in the process, its volume remains lower than that of extraregional trade, owing to those countries' success in penetrating United States and European markets. Thus, the intensification of open regionalism in Asia and the Pacific is accompanied by an even more marked trend towards globalization, especially in the Pacific Rim, where the participation of the United States is a decisive factor.

In the past, the regional division of labour between Japan and nearby Asian countries was *vertical*: Japan exported semi-manufactured products to those countries, which then re-exported many of the finished products to the United States market. Currently, the division of labour is becoming increasingly *horizontal*, owing to the upswing in manufactures exports from Asian countries and the incorporation of China into the region's manufactures trade. The integration of production in Asia, based on foreign direct investment from various countries, is reflected in a spatial restructuring and two or three different trade flows between investor countries and some recipient countries.

Japan has spearheaded the process of regional integration, steering it towards internationalization, while the newly industrialized countries have acted as an intermediate link. The influence of this phenomenon on the members of the Association of South-East Asian Nations (ASEAN) is similar to that exerted by Japan on the newly industrialized countries less than two decades ago. Since those countries have reached an advanced stage of development by accumulating skilled manpower and modern technology, in some markets their exports are displacing those from Japan, which still boasts superior levels of technology. However, higher labour costs, the appreciation of their currencies and the growing trade barriers they face have left the newly industrialized Asian countries out of the main markets for labour-intensive products; this, in turn, has helped the ASEAN countries to gain access to those markets.

Source: M. Kuwayama, "Regionalización abierta de América Latina para su adecuada inserción internacional", Documento de trabajo series, No. 20, Santiago, Chile, ECLAC, 1993.

the liberalization process that has already taken place (see table II-1), presenting unilateral and regional liberalization as alternatives appears less and less valid.

Therefore, even if the countries of the region were to apply tariffs to all imports, including those of regional origin, geographical proximity and lower transaction costs could create implicit preferences among those countries, especially neighbouring ones.[10] Special attention should thus be given to measures that can help countries take advantage of the current trade liberalization and reduce transaction costs. Indeed, countries could make an important contribution to the regional integration process simply by refraining from adopting new protectionist measures that hinder intraregional trade.

As trade has been liberalized, the most restrictive elements of policies on foreign capital have been eliminated and investment promotion activities have been intensified. Most countries have adopted rules on non-discriminatory treatment of foreign investors, abolished advance authorization requirements, gradually reduced the number of sectors reserved for the State and for national investors, and removed restrictions on external remittances by investors (Calderón, 1993).

10 However, if common tariffs were applied to intraregional imports, exports from the region would have greater access to developed countries with lower tariff levels.

Table II-1
AVERAGE TARIFFS IN LATIN AMERICA AND THE CARIBBEAN
(1992 percentages)

Argentina	15[a]
Bolivia	7[b]
Brazil	21[c]
Colombia	12[b]
Costa Rica	20[c]
Chile	10[c]
Guatemala	16[c]
Mexico	12[a]
Peru	18[c]
Venezuela	10[b]

Source: ECLAC, on the basis of national figures.
[a] Weighted by domestic production.
[b] Weighted by imports.
[c] Simple average of tariffs in force.

The new regional panorama is prompting transnational corporations to change their integration strategies, since their position as suppliers of highly protected local markets is being threatened by the prospect of international competition on both national and foreign markets. Moreover, the crisis and subsequent economic reforms in the region have variously repelled and attracted domestic and foreign capital. This means that the new regional circumstances and the new strategies of transnational corporations are promoting a process of de facto integration of production, guided by market forces and differentiated from formal integration, which is based on government policies and measures.

In short, the de facto integration carried out by corporations in Latin America and the Caribbean is being furthered by the trend towards the consolidation of a clear, stable macroeconomic framework, the unilateral trade liberalization already implemented, the non-discriminatory promotion of exports, deregulation and the elimination of restrictions on foreign investment, privatization and the abolition of payment restrictions. The processes of liberalization and deregulation have also helped to heighten the impact of variables such as geographical proximity and common history or culture on the current integration process.

The Free Trade Agreement between Canada and the United States and the North American Free Trade Agreement (NAFTA) seem to exemplify the interaction between policy-based integration and de facto integration by corporations. In both cases, a fairly open trade regime brought about a major degree of interdependence of both trade and production in the countries concerned. Once the process was well advanced, policies were adopted to promote the integration of production, including free merchandise trade agreements and provisions related to foreign investment (national treatment, performance requirements, selection procedures and rules applicable to services). In the case of Mexico, increased trade relations, particularly between corporations, and new direct investments were largely attributable to the country's trade liberalization policy, even though it was not especially designed to promote an integration process.

2. Liberalization and intra-industry trade

In the mid-1980s, regional trade agreements did not play an important role in efforts to improve the region's integration into the international economy. They may even have had the opposite effect, first because of the deep-rooted perception that they promoted import-substituting industrialization but not the development of exports; in some cases, they were even thought to stand in the way of enhanced international competitiveness for sectors with the greatest export potential in each country. Second, the regional market of Latin America and the Caribbean was smaller than that of the main OECD economies and showed little or no growth. Many of the region's governments therefore decided to concentrate on gaining access to large, dynamic markets.

This approach began to change when it became clear that integration agreements signed by groups of countries were not necessarily incompatible with a more open and transparent international economy. In fact, the suggestion that the ideal of an open international economy without artificial barriers to free trade in goods and services does not necessarily preclude integration agreements, and that the latter may even facilitate the achievement of the former and enhance the competitiveness of the countries involved, has begun to gain acceptance in both academic and government circles.

There is empirical evidence that the process begun by Latin America and the Caribbean could lead to a regional pattern of specialization that would enhance the international competitiveness of sectors with greater comparative advantages. Data for 13 Latin American and Caribbean countries show that good export performance within the region is not incompatible with good export performance outside the region. In other words, penetration of international markets and regional integration can be part of the same process, as long as they are both aimed at achieving international competitiveness (see box II-2).

Likewise, econometric data suggest that intraregional trade is not hurt by openness to trade with the rest of the world. Indeed, in most cases there is a significant positive correlation between intraregional export coefficients for industrial products and the proportion of domestic demand met by extraregional imports. This confirms that unilateral liberalization can stimulate intraregional trade, and illustrates the process of convergence between de facto, market-based integration and policy-driven integration.

One of the main objectives of changing production patterns with social equity is to generate exports with higher added value by absorbing technological progress. Horizontally-structured intra-industry specialization (based on the exchange of slightly differentiated finished products) tends to take place when trade relations are based on greater technological development and not on marked differences in countries' factors of production. In contrast, in inter-industry or inter-sectoral specialization, each country's advantages usually depend on the availability of factors of production such as natural resources and cheap labour. In light of the foregoing, the positive correlation between intraregional exports of industrial products and intra-industry trade, in contrast to extraregional exports, is significant.[11] Although the growing complexity of the process of industrial specialization is blurring the distinction between the traditional categories of intra- and inter-industry specialization, this finding would strengthen the argument that in most countries, industrial goods traded within the region are more technology-intensive than goods exported to the rest of the world. This apparently reflects the stimulus provided by similar demand patterns in nearby countries with similar factor endowments, as well as a globalization process that entails a high proportion of trade among subsidiaries of foreign corporations (YMSIDB, 1992, pp. 209-212).

To date, most extraregional exports have been semi-manufactured products and products made using fully developed technologies (foodstuffs, refined petroleum, iron and steel, textiles and footwear, among others). In contrast, the industrial sectors for which the regional market has been vitally important (chemicals, transport equipment, non-electrical machinery) are more diversified and technology-intensive; they are also the sectors where foreign direct investment is concentrated. This

11 The regression, which covers 28 industrial sectors in 13 countries during two periods (1978-1980 and 1988-1990), was based on the following equation: $g = c + a(X_r/Y) + b[M_r/(Y+M-X)] + e[M_e/(Y+M-X)]$. For each industrial sector, X represents exports; Y, production; and M, imports; "e" and "r" correspond to extraregional and intraregional, respectively. The dependent variable ("g") is the Grubel and Lloyd intra-industry trade index (1975). A predominantly positive (negative) correlation was observed between intraregional (extraregional) exports and "g" (Buitelaar, 1993).

Box II-2

LIBERALIZATION, EXPORTS AND INTRAREGIONAL TRADE

Below is a calculation of the intraregional exports coefficient (X_r/Y) of selected sectors to determine whether it has a positive correlation with each sector's extraregional exports coefficient (X_e/Y) and extraregional imports coefficient [$M_e/(Y+M-X)$]. The estimate covers 28 industrial sectors in 13 countries; the data represent averages for the three-year period 1988-1990. The equation used in the regression is as follows:

$$X_r/Y = c + a[M_e/(Y+M-X)] + b(X_e/Y)$$

X represents exports; M, imports; and Y, the gross value of production, while (r) refers to intraregional trade and (e) to extraregional trade.

The correlation between the regional exports coefficient and openness to extraregional imports has the expected sign (positive) in 12 out of 13 cases, and is statistically significant in five (95% confidence level) or seven (90%) out of a total of 13 cases. The correlation between the regional exports coefficient and the extraregional exports coefficient also has the expected positive sign in 12 cases, and is statistically significant in six (95%) or seven (90%). The results are also satisfactory for the region as a whole, with particularly robust correlations.

		c	a	b	r^2	SE	DW	F
Argentina	c	2.01	0.06	0.12	0.21	3.29	2.14	4.57
	T	(2.08)	(1.61)	(2.66)				
Barbados	c	-6.12	0.29	0.15	0.09	47.6	1.71	2.38
	T	(-0.31)	(1.02)	(1.28)				
Bolivia	c	4.19	0.03	0.01	-0.07	11.8	2.23	0.12
	T	(1.37)	(0.22)	(0.49)				
Brazil	c	0.56	0.10	0.03	0.35	0.86	1.95	8.34
	T	(2.10)	(3.69)	(1.41)				
Chile	c	0.11	0.13	0.11	0.48	5.96	1.51	13.22
	T	(0.07)	(3.03)	(2.99)				
Colombia	c	3.96	0.003	0.07	-0.02	6.39	2.02	0.80
	T	(2.41)	(0.04)	(1.21)				
Ecuador	c	-0.75	0.11	0.34	0.77	4.56	1.67	46.36
	T	(-0.60)	(2.90)	(9.58)				
Guatemala	c	13.09	0.15	0.05	0.03	12.53	2.02	1.46
	T	(2.89)	(1.70)	(0.20)				
Jamaica	c	5.10	0.04	0.22	-0.06	13.47	1.89	0.21
	T	(1.26)	(0.64)	(0.01)				
Mexico	c	-0.06	0.03	0.05	0.76	0.58	1.19	44.15
	T	(-0.39)	(3.44)	(5.10)				
Panama	c	2.36	-0.004	0.30	0.67	3.94	1.63	28.98
	t	(2.88)	(-1.15)	(5.76)				
Uruguay	c	13.54	0.04	-0.03	-0.04	19.21	1.26	0.49
	T	((3.24)	(0.82)	(-0.13)				
Venezuela	c	0.41	0.08	0.06	0.36	2.45	1.76	8.60
	T	(0.60)	(2.96)	(3.42)				
Total	c	**0.58**	**0.09**	**0.05**	**0.59**	**0.90**	**1.95**	**20.68**
Region	T	**(1.96)**	**(5.25)**	**(2.15)**				

Dependent variable: Xr/Y. Independent variables: 1 = Me/(Y+M-X), and 2 = Xe/Y

Source: R. Buitelaar, "Dynamic gains from intra-regional trade in Latin America", *NAFTA as a Model of Development: The Benefits and Costs of Merging High and Low Wage Areas*, Richard Belous and Jonathan Lemco (comps.), Washington, D.C., National Planning Association, 1993.

illustrates the symbiotic relationship that exists among foreign investment, intra-industry trade and economic integration in Latin America and the Caribbean, and is also consistent with the significant volume of foreign capital that has already entered the region, which, if used for industrial restructuring that leads to intra-industry specialization, could reduce potential capital losses. Thus, countries need not have widely differing economic structures, or make drastic adjustments to those structures, in order for integration to be possible.

3. The regional market and exports to the rest of the world

The correlation between intraregional and extraregional exports has already been shown to be positive; however, this correlation is complex and changeable. In order to analyse it in greater detail, the situation and development of 344 sectors (28 industrial sectors in 13 Latin American and Caribbean countries, excluding 20 cases on which information is not available) were classified according to two criteria (Buitelaar, 1993). The first is the orientation of production, which may be geared primarily to either the domestic market or the foreign market. The second criterion is related to exports, which may go primarily to either the regional market or the extraregional market. The combination of these two criteria yields a four-quadrant configuration (see figure II-1).

In both 1979 and 1989, most sectors were located in quadrant A, meaning that their production was geared mainly to the domestic market and their (marginal) exports to the regional market. A typical example of a sector in this category is printing and publishing (ISIC Rev. 2, 342), which was in this "baseline" situation in all but one of the countries in both 1979 and 1989.

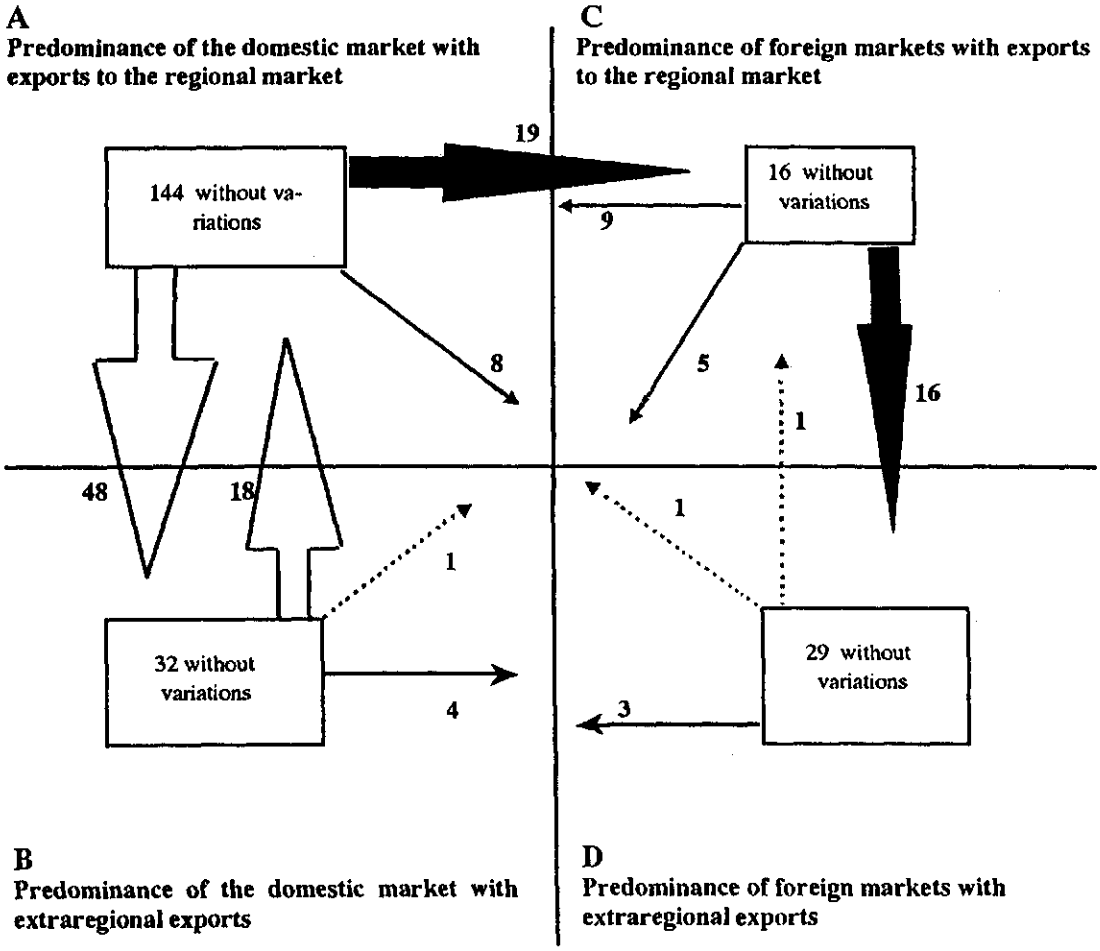
The principal change in the 1980s (from quadrant A to quadrant B) concerns the destination of exports: various sectors redirected their exports to extraregional markets, although without altering the relative orientation of production, which continued to go mainly to domestic markets. This kind of change occurred in 48 sectors. A typical sector is furniture manufacturing (ISIC Rev. 2, 332), which, in six out of 12 countries (one without information) exporting to regional markets, reoriented exports (which were relatively limited) to markets outside the region.

However, this position in quadrant B does not seem to lead to subsequent shifts to quadrant D, which is defined by a greater emphasis on exports. Of the 32 sectors that were already in this situation in 1979, only five specifically redirected their production to external markets. The domestic market is therefore likely to retain its primary importance for most of these sectors. In some cases (18) the trend was even reversed, with the sectors returning to their original situation. This was true of the transport equipment sectors in Ecuador, Guatemala, Panama and Barbados, which lost their marginal access to extraregional markets.

More competitive sectors seem to develop along different lines, from an original orientation towards the domestic market with marginal exports to intraregional markets (quadrant A) to a tendency to channel a larger proportion of production to external markets and to direct most exports to regional markets (quadrant C). This pattern was observed in 19 cases, seven of which were in the chemicals sectors (ISIC Rev. 2, 35).

The resulting position (quadrant C), characterized by an orientation towards exports and the predominance of regional markets, does not, as in the previous case, seem to be a final stage. Most (30) of the 46 sectors that were in this situation in 1979 changed their position; the most common of these changes (16 cases) was a shift to export-oriented production and the predominance of extraregional markets (quadrant D). This change was most prevalent in the garment-making, wood and metallic minerals processing sectors, although Mexico's transport equipment sector is also in this group. This bears out

Figure II-1



Fuente: R. Buitelaar, "Dynamic gains from intra-regional trade in Latin America", *NAFTA as a Model of Development: The Benefits and Costs of Merging High and Low Wage Areas*, Richard Belous y Jonathan Lemco (comps.), Washington, D.C., National Planning Association, 1993. II-1

the argument that exports to markets within the region can be a training ground for subsequent entry into extraregional markets, as long as regional demand becomes more important than domestic demand.[12]

4. Liberalization and intraregional trade in agricultural products

The recent liberalization and economic integration programmes in Latin America and the Caribbean have changed the

12 However, it is also possible that, from an initial concentration on domestic demand and marginal trade with the countries of the region (quadrant A), a country may move directly into the opposite situation, namely, concentration on exports, particularly those to extraregional markets (quadrant D). This pattern was observed in eight cases, *inter alia*, in Mexico's non-electrical machinery sector; in Colombia's footwear, iron and steel, and printing and publishing sectors; in Brazil's metallic minerals sector; in Jamaica's textile and garment-making sector; and in Jamaica's leather sector.

context of agricultural production in two ways. On the one hand, tariff reductions and the elimination of quantitative restrictions have significantly lowered the imported component of production costs, thereby helping to increase competitiveness; on the other, while tariff reductions have opened up new opportunities in neighbouring countries, they have also created new pressures, even in self-sufficient sectors. The reduction of tariffs and other barriers to the import of inputs usually brings fewer benefits to producers in traditional sectors, who are less dependent on such inputs, but measures to facilitate imports of agricultural products usually affect them as much as or more than more modern producers.

Spurred by the pressures exerted by trade liberalization, a number of countries have extended special treatment to certain agricultural products: they have postponed the levelling of tariffs (Venezuela), reinstated mechanisms involving advance licensing and restrictions (Bolivia, Mexico, Colombia), imposed agricultural surcharges in response to international price distortions (Peru) or, conversely, reduced agricultural tariffs more than other tariffs (Argentina). In addition, a number of countries (Chile, Colombia, Venezuela and some Central American countries) have established (or are about to establish) a system of price bands for the agricultural sector, with the basic aim of protecting producers from short-term fluctuations in international prices and from the effects of the production and export subsidies granted by several countries, especially the European Economic Community countries, the United States and Japan.

Despite these restrictions, the effects of the liberalization of trade in agricultural products seem to have predominated in the region. In fact, intraregional trade in those products has grown significantly in recent years; despite significant differences between countries as to the proportion of agricultural exports sold within the region, which ranged from 1% of total agricultural exports in Mexico to 76% in Bolivia, all the countries of Latin America and the Caribbean experienced an increase in the proportion (and the value) of their intraregional exports of agricultural products (SITC 0) between 1985 and 1991, as indicated in table II-2. This increase may also reflect the fact that agricultural products have easier access to markets within the region than to extraregional markets.

Various studies have concluded that intraregional trade offers vast opportunities which the countries of the region have yet to seize, although the analysis of trade flows on which these conclusions are based disaggregates sectors only to the three-digit level of the Standard International Trade Classification (SITC).[13] A more disaggregated analysis (Dirven, 1993), at the five-digit level of section 0 of SITC, concludes that intraregional trade accounted for 31.4% of the value of Latin American and Caribbean imports in 1990 and that it could have contributed a further 18.3% (see table II-3). Thus, the region's supply of available exports amounted to nearly 50% of its imports in 1990.

Nevertheless, only 8.7% of the region's exports were intraregional, although another 5.2% could have been exported to Latin American and Caribbean countries (see table II-4). Thus, there was no regional demand for 86.2% of the products exported in 1990. This suggests that in the short term, the effect which the liberalization of intraregional trade would have on exports would tend to be limited by other conditions of supply and demand.[14]

In the medium term, new incentives (relative prices, credit facilities, reduced

13 See, *inter alia*, Valdés (1984) and Food and Agriculture Organization of the United Nations (FAO) (1985).

14 However, a reduction of import barriers could allow countries to seize existing opportunities for trade in some products (such as certain fruits), which could reach a very high volume.

Table II-2
INTRAREGIONAL EXPORTS OF AGRICULTURAL PRODUCTS
(Percentage of total agricultural exports)

Country	1985	1986	1987	1988	1989	1990	1991	1992
Argentina	12.2	19.1	13.0	11.3	18.7	22.3	21.9	...
Bolivia	32.5	51.4	57.9	43.8	75.1	74.3	75.6	67.4
Brazil	2.2	5.6	4.2	3.1	4.3	2.8	4.4	...
Chile	8.6	11.8	8.2	6.1	9.2	11.8	11.9	...
Colombia	2.5	2.4	3.0	2.2	2.8	4.6	8.9	...
Ecuador	6.8	6.1	6.6	6.5	7.1	6.0	5.4	...
Mexico	0.4	0.4	0.8	0.5	0.7	0.7	1.0	1.2
Paraguay	54.0	79.8	68.1	59.0	66.7	75.4	61.9	...
Peru	7.4	8.7	6.7	3.0	4.9	6.1	...	...
Uruguay	32.2	51.7	28.6	26.9	38.6	46.4	44.6	44.2
Venezuela	4.2	7.0	2.9	2.5	12.8	19.9	11.4	29.7
Costa Rica	3.4	3.5	2.7	3.3	4.2	4.1	4.9	...
El Salvador	3.3	1.2	2.2	3.7	5.7	5.5	9.8	...
Guatemala	7.2	7.2	11.9	12.4	14.9	14.0	14.9	...
Honduras	1.9	0.5	1.1	0.6	1.2	1.5	2.0	2.6
Nicaragua	4.4	2.0		2.6	8.5	14.3	13.9	...
Barbados	0.4	4.9	3.4		6.6	7.2	8.1	...
Jamaica	4.4	4.5	4.2	4.7	5.8	5.1	5.5	...
Trinidad and Tobago	10.2	10.1	16.6	23.3	28.7	29.4	30.1	23.1

Source: International Commodity Trade Data Base (COMTRADE) of the United Nations Statistical Division (UNSTAT).
Note: Includes products classified in SITC0.

Table II-3
MAIN IMPORTS INCLUDED IN SECTION 0 OF THE STANDARD INTERNATIONAL TRADE CLASSIFICATION (SITC)
(1990)

SITC 2 sub-category	Total imports (thousands of (US$)	Imports from Latin America and the Caribbean (thousands of (US$)	Imports from Latin America and the Caribbean/ total imports (%)	Potential additional imports from Latin America and the Caribbean (thousands of US$)	Actual imports plus potential imports from Latin America and the Caribbean/ total (imports (%)
01	511 944	291 551	57	26 538	62
02	567 930	16 633	3	-	3
03	40 505	29 659	73	10 364	99
04	2 641 027	676 352	26	468 661	43
05	606 135	270 100	45	97 658	61
06	731 063	244 231	33	272 664	71
07	119 413	113 911	95	346	96
08	277 652	56 951	21	153 413	76
09	137 214	71 725	52	3 056	54
Total	**5 632 883**	**1 771 113**	**31.4**	**1 032 700**	**49.8**

Source: M. Dirven, "Comercio exterior de productos agrícolas y alimenticios de América Latina y el Caribe en 1990", Santiago, Chile, ECLAC, 1993, unpublished.

Table II-4
MAIN EXPORTS INCLUDED IN SECTION 0 OF THE STANDARD INTERNATIONAL TRADE CLASSIFICATION (SITC)
(1990)

SITC 2 sub-category	Totalexports (thousands of (US$)	Exports to Latin America and the Caribbean (thousands of (US$)	Exports to Latin America and the Caribbean/ total exports (%)	Potential additional exports to Latin America and the Caribbean (thousands of US$)	Actual exports plus potential exportsto Latin America and the Caribbean/ total (exports (%)
01	2 301 007	451 106	20	26 538	21
02	21 837	20 090	92	-	92
03	1 572 817	92 988	6	10 364	7
04	1 514 278	645 762	43	468 661	74
05	5 041 239	181 738	4	97 658	6
06	1 035 705	169 299	16	272 664	43
07	5 140 976	63 164	1	346	1
08	3 486 763	92 146	3	153 413	7
09	59 615	46 094	77	3 056	82
Total	**20 174 237**	**1 762 387**	**8.7**	**1 032 700**	**13.9**

Source: M. Dirven, "Comercio exterior de productos agrícolas y alimenticios de América Latina y el Caribe en 1990", Santiago, Chile, ECLAC, 1993, unpublished.

tariff and non-tariff barriers to trade), more services, lower transport costs, a streamlined market for land and the establishment of cold chains, combined with a reduction in subsidies for production and extraregional exports, could reorient both supply and demand in the region. Moreover, these complementary policies could facilitate the adjustment processes entailed by trade liberalization and, in particular, could keep the latter from adversely affecting small-scale producers.

Some categories, such as dairy products, cereals, certain oilseeds and probably fodder containing molasses and sugar, account for a low proportion of exports and a high proportion of imports owing to serious distortions in their marketing caused, *inter alia,* by high production and export subsidies in various OECD countries. This has inhibited local production, making its possible intrinsic advantages difficult to determine. If the Uruguay Round were to culminate in a significant liberalization of international trade in agricultural products, these distortions would be reduced and an increase in intraregional trade could be expected, demonstrating that multilateral liberalization and regional integration complement each other.

5. Privatization and trade in services

Countries with large-scale privatization programmes also have a larger proportion of privatizations in the services sector, often involving foreign corporations. For example, banking, telecommunications and air transport accounted for about 88% of the value of privatizations in Mexico in 1989-1991, while 95% of Venezuela's privatizations and about 72% of Argentina's during the same period were concentrated in telecommunications, air transport and land transport (Devlin, 1993). Only in Colombia and Brazil, whose privatization programmes have been less ambitious, did the manufacturing sector account for a larger proportion of privatizations in 1989-1991.

Furthermore, a significant number of foreign banks (mainly North American, European and Japanese) are present in most countries of the region and are in a good position to take advantage of the financial liberalization process currently under way (UNCTC, 1990, p. 130). However, liberalization of capital markets in the region remains limited. Although some efforts have been made to integrate stock markets through various agreements, this is still an incipient process owing to at least two basic problems related to the risks involved in liberalizing capital accounts. The first is that of identifying appropriate financial instruments and applying macroeconomic policies to neutralize constraints linked to macroeconomic instability. The second is that of defining rules to regulate markets and neutralize the imperfections that delay and undermine the impact of arbitrage incentives (Uthoff, 1992).

A subregional stock market has been established in the Caribbean, involving transactions among the three CARICOM members that have stock exchanges (Jamaica, Barbados and Trinidad and Tobago), but even though the subregional flow of capital holdings increased initially in 1991, it later declined sharply. Some of the obstacles to this integration process are the lack of regulations allowing shares to be offered on all stock markets, the exchange-rate risk posed by the quotation of shares in national currencies and the absence of agreements for avoiding double taxation of the profits and dividends of non-residents (Willmore, 1992).

In general, government regulations, the size of the market, cultural similarities and the existence of established corporations are the primary determinants of foreign investment in services (United Nations, 1993a). It is therefore likely that the current process of deregulation or privatization, which also helps expand the market and capitalize on cultural affinities, will bring about an increase in or a rationalization of foreign investment in the services sector, which will be geared increasingly to regional and not just national coverage. The region-wide organization and rationalization of the activities of the main airlines and the participation of Latin American companies in privatization processes in other countries of the region seem to be initial manifestations of this phenomenon.

The inclusion of services in integration plans can give renewed impetus and greater coherence to integration efforts by helping to boost merchandise trade. It can also promote the mobility of people and capital, facilitate the formation of Latin American multinational corporations, improve road, air, river and offshore transport, strengthen border and energy integration, and help open up new channels of cooperation (ECLAC, 1990b).

The chances of successfully concluding regional agreements will depend heavily on the practical implementation of the results of the negotiations on services conducted under the Uruguay Round. Special attention should therefore be given to the sectors considered by the Group of Negotiations on Services (telecommunications, professional services, financial services, construction, audiovisual services and tourism). These sectors are particularly important for integration, since their products have a strong impact on world trade and are highly marketable, dynamic and innovative.

Moreover, there are certain service areas in which an automatic preference should go to suppliers within the region, basically because the latter can respond more readily to certain local requirements than suppliers outside the region, or because countries decide independently to give priority to national or regional suppliers in order to strengthen local capacity to supply those services. These areas include land transport, power grid interconnection services, radio and television broadcasting and cultural exchanges, i.e., services that are closely related to local conditions or to cultural and specifically national values.

B. INTEGRATION AGREEMENTS IN LATIN AMERICA AND THE CARIBBEAN

1. The proliferation of agreements

Formal, policy-driven integration has made uneven progress in recent years. Three types of trade liberalization agreement can be identified. First, four subregional integration agreements have been concluded (the Central American Common Market (CACM), the Cartagena Agreement, the Caribbean Community (CARICOM) and the Southern Common Market (MERCOSUR)). Of these, MERCOSUR is the most recent, having been set up when Argentina, Brazil, Paraguay and Uruguay signed the Treaty of Asunción on 26 March 1991. Second, over 20 bilateral agreements have been signed (see table II-5), *inter alia*, in the context of the Latin American Integration Association (LAIA). Third, trade liberalization commitments have been formalized between groups of countries, for example, between the CACM member countries and Mexico, between the Central American countries and Colombia and Venezuela, and between the CARICOM member countries and Venezuela.

The common denominator of all of these agreements is preferential treatment in the form of lower duties on a list of goods targeted for trade liberalization through preferential tariff treatment in relation to similar products from third countries (Izam, 1993). Some agreements are relatively simple ("superficial integration"), while others involve broader commitments ("deep integration").

A comparative analysis of the various integration agreements (see tables II-6 and II-7) suggests that since 1990, the relative importance of agreements that take trade liberalization a step further has grown by contrast with the narrower trade agreements of the past. This can be seen in three areas: broadening of the range of products to which tariff reductions apply, by focusing negotiations on lists of exceptions rather than on lists of products eligible for trade liberalization; total lifting of tariffs under programmes intended to phase out tariffs, rather than reduce them; and possible removal of non-tariff barriers.

Many bilateral agreements (see table II-5) that use "positive" lists of products to be given preferential treatment are still in force. Moreover, a degree of fragmentation has occurred within some subregional groups, such as Central America or the countries of the Cartagena Agreement, which is reflected in bilateral or trilateral liberalization agreements or commitments with smaller geographical coverage than earlier subregional agreements. MERCOSUR, on the other hand, includes an ambitious commitment to extend free trade to all goods produced by member countries, while other subregional agreements operate with negative lists of exceptions (see table II-7). In the case of MERCOSUR, member countries agree to abolish, during the transition phase, all tariffs and restrictions applied in their reciprocal trade. To this end, a programme of progressive, linear, automatic lifting of tariffs is being applied according to a timetable whereby 82% of tariffs will have been lifted by December 1993 and 100% by the end of 1994. The number of products included in lists of exceptions will be reduced by 20% a year until these lists are completely abolished on 31 December 1994.[15]

Bilateral agreements, unlike subregional agreements, generally do not provide for the adoption of common external tariffs. However, no subregional agreement currently has a common external tariff applied by all of its members, because member countries are still pursuing unilateral liberalization at

15 MERCOSUR also includes safeguard clauses which do not limit the volume of total imports but only the quota of imports benefiting from tariff preferences; imports in excess of this quota are subject to the usual tariffs.

Table II-5
BILATERAL AGREEMENTS

Countries or agreements	Year signed	Tariff reduction on positive list products	Overall tariff reductions with exceptions
Argentina-Uruguay (ACE Nº 1)	1982	X	
Brazil-Uruguay (ACE Nº 2)	1982	X	
Argentina-Ecuador (ACE Nº 3)[a]	1984	X	
Chile-Uruguay (ACE Nº 4)	1985	X	
Mexico-Uruguay (ACE Nº 5)	1986	X[b]	X[b]
Argentina-Mexico (ACE Nº 6)	1986	X	
Argentina-Brazil (ACE Nº 7)[c]	1986	X	
Mexico-Peru (ACE Nº 8)	1987	X	
Argentina-Peru (ACE Nº 9)	1988	X	
Argentina-Venezuela (ACE Nº 10)[d]	1988	X	
Argentina-Colombia (ACE Nº 11)	1988	X	
Argentina-Brazil (ACE Nº 12)[c]	1988	X	
Argentina-Paraguay (ACE Nº 13)	1989	X	
Argentina-Bolivia (ACE Nº 19)	1989	X	
Argentina-Brazil (ACE Nº 14)	1990		X
Bolivia-Uruguay (ACE Nº 15)	1991	X	
Argentina-Chile (ACE Nº 16)	1991	X	
Chile-Mexico (ACE Nº 17)	1991		X
Bolivia-Peru	1992		X
Argentina-Venezuela (ACE Nº 20)	1992	X	
Argentina-Ecuador (ACE Nº 21)	1993	X	
Bolivia-Chile (ACE Nº 22)	1993	X	
Chile-Venezuela (ACE Nº 23)	1993		X
Chile-Colombia (ACE Nº 24)	1993	X	

Source: ECLAC, on the basis of available information.
[a] Agreement superseded by economic complementation agreement (CA) No. 21.
[b] Uruguay has a positive list of Mexican products eligible for reduced import duties, whereas Mexico has a negative list of exceptions.
[c] Agreement superseded by CA No. 14.
[d] Agreement superseded by CA No. 20.

different speeds and the diversion of trade still entails costs (cost of importing higher-priced products from a neighbouring country instead of similar goods from countries outside the subregion).

In the absence of common tariffs, rules on the origin of imported goods take on primary importance: if different levels of protection apply, goods from non-member countries can be imported into a low-tariff country and then re-exported to other members of an integration agreement without paying duty. To avoid this problem, bilateral agreements include commitments to adhere to the LAIA rules of origin, although most of these agreements, as well as subregional ones, envisage the possibility of formulating specific rules that do not necessarily reflect LAIA guidelines. The resulting possibility that a wide variety of rules will be adopted poses certain risks, since such rules could be used to restrict trade and could cause distortions in the allocation of foreign investments; this topic will be analysed later in this study.

Recent agreements tend to include greater sectoral commitments than the older bilateral agreements, although the relevant clauses establish commitments that are very different from the sectoral investment programmes launched under the subregional processes of the past, particularly those related to the Cartagena Agreement and the Central American Common Market. A number of recent sectoral clauses are restrictive, imposing special rules of origin that are more stringent than those applied to other

Table II-6
RECENT BILATERAL AGREEMENTS

	Argentina-Bolivia	Chile-Mexico	Bolivia-Peru	Chile-Venezuela	Bolivia-Chile
Date signed	13/12/89	22/09/91	12/11/92	02/04/93	06/04/93
Duration	Indefinite	Indefinite	Indefinite[a]	Indefinite	Indefinite
Tariff reductions:					
a) Positive list	X				
b) Negative list		X	X[b]	X	X
Type of tariff reduction:					
a) Partial	X				
b) Total		X	X	X	X
Non-tariff barriers:					
a) To be eliminated					
b) Not to be eliminated	X	X	X	X	Parties agreed not to adopt them
Common external tariff:					
a) Planned					
b) Not planned	X	X	X	X	X
Rules of origin:					
a) LAIA rules	General use	General use		General use	General use
b) Special rules		Possible	General use	Possible	Possible
Sectoral agreements -Sector	Industrial	-Automotive -Maritime and air transport	No	-Automotive -Maritime transport	Energy integration projects will be promoted
Instruments contemplated in sectoral agreements					
a) Goods					
- Special rules of origin		Yes (auto ind.)		Yes (auto ind.)	
- Quantitative restrictions		Yes (auto ind.)		No	
- Mechanisms to balance trade		No		No	
- Projects	Yes[e]				Yes[f]
b) Services					
- Same treatment as national enterprises		Maritime and air transport		Maritime transport and agreement to negotiate on air transport	
- Most-favoured-nation (MFN) treatment					
- Other preferential treatment					
General investment clause:					
a) Same treatment as national enterprises	No		No	X	X
b) MFN treatment		X		X	X

Table II-6 (concl.)

	Argentina-Bolivia	Chile-Mexico	Bolivia-Peru	Chile-Venezuela	Bolivia-Chile
Parallel agreement on protection of investments	No	No	No	No	No
Double taxation agreement	Yes	Agreement provides for negotiations	Yes [c]	Yes [d]	Yes [d]
Dispute settlement mechanism	Consultation and negotiation between countries	Two members per country & an outside arbiter	One individual as arbiter for safeguards	One member per country an outside arbiter	One member per country & an outside arbiter
Administration of agreement					
a) Supranational authority	X	X	X	X	X
b) Binational commission					

Source: ECLAC, on the basis of available information.

[a] The agreement may be revised in the light of changes introduced by decision No. 321 of the Board of the Cartagena Agreement, which frees Peru of obligations with respect to the Exemption Programme and Common External Tariff until 31 December 1993.

[b] The exceptions consist of a small number of agricultural products.

[c] Pursuant to decision No. 40 of the Board of the Cartagena Agreement, which remains valid for Peru.

[d] Pursuant to decision No. 40 of the Board of the Cartagena Agreement, which remains valid for Chile, even though that country is no longer part of the Andean Pact.

[e] The execution of industrial complementation projects will be facilitated through tariff preferences of up to 100% on imports of finished and intermediate goods, parts and components from third countries.

[f] The need to adopt new legal instruments for the execution of projects, particularly those based on the use of Bolivian natural gas, will be analysed.

products that enjoy preferences. This is true particularly of the automotive industry, but specific commitments involving more stringent rules or quantitative restrictions also exist in the cases of capital goods and natural gas. In other cases, sectors (including services) are identified with generic commitments which would have to be made specific later.

In general, there is a risk that the possibility of applying these restrictions, combined with the active participation of businessmen in sectoral forums, might translate into agreements on market distribution that would postpone indefinitely the rationalization and specialization expected from integration processes. It would therefore be desirable to have sectoral agreements which excluded administered trade and to combine integration policy with policies on competition (see section III-F).

Sectoral agreements concluded under wider agreements should make special reference to certain services, particularly transport, in order to create opportunities for extending integration to new areas. Provisions on reciprocal investment take on vital importance in such cases, as can be seen from recent bilateral agreements, which pay more attention to the topic than subregional agreements. In particular, the bilateral agreements which Chile has signed with Mexico, Venezuela and Bolivia envisage the extension of most-favoured-nation status to reciprocal investment, which, in the case of the latter two countries, is given the same treatment as national investment. When the

Table II-7
SUBREGIONAL AGREEMENTS

	Central American Common Market	Cartagena Agreement	CARICOM	MERCOSUR
Date signed	13/12/60	26/05/69	04/07/73	26/03/91
Duration	20 years; renewable indefinitely	Indefinite	Indefinite [a]	Indefinite
Tariff reductions:				
a) All tariffs				
b) Negative list	X	X	X	X
Type of tariff reduction:				
a) Partial				
b) Total	X	X	X	X
Non-tariff restrictions:				
a) To be eliminated	X	X	X	X
b) Not to be eliminated				
Common external tariff:				
a) Planned	X	X	X	X
b) Not planned				
Rules of origin:				
a) Own rules	X	X	X	X
b) Other rules				
Sectoral agreements: -Sector	-Industrial -Free transit and transport	-Industrial -Agricultural -Some services	-Industrial -Agricultural -Free transit	Commitment to adopt sectoral agreement
General investment clause:				
a) Same treatment as national enterprises	X (only for infrastructure projects)	No	X	No
b) MFN treatment				
Parallel agreement on protection of investments	No	No	No	No
Double taxation agreement	No	Yes	Members have agreed to adopt one	No
Dispute settlement mechanism	One arbiter for each member country	Tribuna of Justice [b]	3 arbiters (2 chosen by the countries concerned & the 3rd by the first 2)	Will be defined following adoption of Treaty [c]
Administration of agreement:				
a) Supranational authority	X	X	X	X
b) Intergovernmental council				

Source: ECLAC, on the basis of available information.

[a] Since the treaty does not specify an expiration date, its duration is assumed to be indefinite.

[b] Organ of the Cartagena Agreement.

[c] Following adoption of the Treaty, the Brasilia Protocol determined that during the transition period, an ad hoc arbitral tribunal would be established, consisting of three members –one for each country party to the dispute in question and a third (outside arbitrator) who would preside. The provisions in question also apply to complaints brought by individuals or legal entities.

enterprises of other countries in the region are given the same treatment as national enterprises in this respect, they can channel investment to neighbouring countries and provide services on terms similar to those of local enterprises. Treating investment of regional origin as national investment facilitates the execution of joint projects (which are explicitly considered in some agreements) and increases reciprocal investments in general.

Current agreements do not provide for investment protection, particularly against the possibility of expropriation, even though a number of countries in the region have recently signed bilateral investment agreements with OECD countries. In 1991-1992, OECD countries concluded 10 bilateral agreements with Argentina, four with Chile and Paraguay, three with Jamaica, one with Peru and one with Venezuela (UNCTAD, 1993, annex 5). Agreements or clauses on double taxation, deriving basically from the commitments made in that regard by the members of the Cartagena Agreement, have also been extended to former members of the Agreement, such as Chile. Other agreements do not include such provisions and, in any case, do not always indicate clearly how they are to be implemented.

Lastly, recent integration agreements seem to have a more limited institutional framework than earlier ones (Lahera, 1993). Bilateral agreements and MERCOSUR both provide for intergovernmental entities to supervise their application, but these entities are not secretariats or agencies like those established in other subregional agreements. Differences are also apparent between the more formal dispute settlement mechanisms of older subregional agreements, especially the Tribunal of Justice established under the Cartagena Agreement, and the less detailed provisions of newer integration agreements.[16]

2. Potential effects of agreements

Although many special agreements (mostly bilateral) were negotiated in the past, the trade liberalization measures they envisaged were applicable only to the most competitive products or to those least likely to affect the production sectors of importing countries, thereby avoiding genuine trade creation at the multilateral level. The new agreements now being negotiated may change this situation significantly, since they provide increasingly for near-total trade liberalization, although their markedly bilateral or subregional character could limit liberalization opportunities.

With the exception of some manufactures, particularly a large proportion of those traded among the smaller Central American and CARICOM countries, most of the main products traded within the region in the past (see table II-3) may have had comparative advantages at the global level. One indicator of this is the fact that, despite the current trade liberalization and the consequent growing competition from lower-priced imports from the rest of the world, exports of the 30 most important products (with the exception of spare parts for automobiles) satisfy at least one fifth of regional demand and, in half of these cases, nearly 40% or more of that demand.

For these products, in contrast to the situation for new non-traditional exports, the impact of tariff preferences as instruments that allow countries to compete with imports from other regions does not seem to have been fundamentally important. The share of products subject to negotiations (and to preferences) in total intraregional imports tends to confirm this conclusion. The share of these products rose substantially in the years following the creation of the Latin American Free Trade Association (LAFTA),

16 In the case of MERCOSUR, the Council of the Common Market adopted the Brasilia Protocol for the settlement of disputes which lays down general rules that, in certain circumstances, allow recourse to arbitration during the transition period to settle disputes arising from the interpretation, application or non-fulfilment of the provisions of the Treaty of Asunción.

from 77.9% in 1962 to a peak of 88.9% in 1966, but subsequently took a steady downturn, reaching just over 40% by the end of the 1970s. Despite the agreements signed in the context of LAIA after 1980, the relative share of products enjoying preferential tariffs fell to about 25% in 1982 (Heirman, 1993; INTAL, 1974 and 1980), edging up to 40% by the end of the 1980s.

These proportions vary widely from one country to another, depending on the degree of openness and trade liberalization. In more open countries, preferences tend to have less impact, whereas the exact opposite is true in countries with higher levels of protection. Since smaller countries historically have been more open, their imports have been less strongly affected by preferences. Thus, around 1990, products imported from the LAIA area represented barely 1% of total imports in Paraguay, 4.5% in Bolivia, 10.2% in Ecuador, about 20% in the three remaining countries of the Andean Group, 33.4% in Chile, 41.9% in Uruguay and 50.6% in Argentina (Heirman, 1993).

Chile's bilateral trade relations illustrate this phenomenon most clearly: in 1989, 98% of Chile's exports to Brazil and 76% of its exports to Argentina enjoyed preferences, but only 34% of its imports from Argentina and 14% of those from Brazil received equivalent treatment (Mizala, 1990 and 1991). However, the unilateral tariff reduction processes in Brazil and, particularly, Argentina suggest that the impact of these preferences is diminishing.

The effect of tariff preferences is also limited by non-tariff barriers, which still seem to be fairly significant. Some countries continue to apply special or informal measures which, because they are not announced in advance, can influence trade in unpredictable ways. Most of the new partial agreements on trade preferences contain provisions designed to reduce or eliminate non-tariff restrictions on the import of certain products that are considered sensitive; this suggests that such restrictions continue to affect some goods that are potentially marketable within the region.

In addition, imports of some products are still restricted to State or para-State entities, which therefore have considerable discretionary authority in this area. There is also a risk that the application of anti-dumping measures, countervailing duties, strict rules of origin, safeguard clauses and technical and phytosanitary standards will increase. Explicit non-tariff measures are confined to some quantitative restrictions applied by Venezuela and, to a lesser degree, by Mexico; certain prohibitions applicable to imports into Paraguay; and minimum or maximum prices in Chile. Other problems include infrastructural and institutional obstacles, lack of financing for exports and the likelihood that unfamiliarity and mistrust will persist among potential trading partners.

At present, there is no clear correlation between the existence of agreements, their coverage (positive or negative product lists) and increased trade between two countries. Table II-8 shows the growth rates for trade between pairs of countries that have signed agreements with negative lists (first group), countries with positive lists (second group) and countries without any agreement (third group). The data suggest that factors other than trade preferences may have had the strongest influence on the expansion of trade. In 1991-1992, fewer pairs of countries had negative growth rates of reciprocal trade. This was at least partially attributable to progress towards stabilization, the combination of various unilateral liberalization processes and the inflow of capital, all of which led to increases in demand and in the availability of foreign exchange. Moreover, as indicated earlier, geographical proximity also seems to have become an important variable where considering liberalization processes.

3. The dangers of bilateralism

As indicated in previous sections, bilateral or subregional agreements, concluded on the basis of various criteria, have proliferated in Latin America and the

Table II-8
RECIPROCAL EXPORTS (1985-1992)

	Annual growth rate						
	1986	1987	1988	1989	1990	1991	1992
1. Relations governed by broad liberalization agreements							
Argentina-Brazil	15.3	-4.5	18.4	24.2	22.1	43.3	59.0
Brazil-Uruguay	109.2	-4.0	24.7	34.1	-15.9	-10.0	10.7
Brazil-Paraguay	35.7	-20.0	14.7	64.8	-6.6	0.9	2.2
Colombia-Venezuela	5.6	35.6	6.2	15.6	31.9	27.1	47.1
Argentina-Uruguay	35.4	28.3	3.8	-2.4	20.8	37.5	33.7
El Salvador-Guatemala	-35.8	38.6	26.7	-25.7	10.7	2.4	40.2
Chile-Venezuela	-48.6	38.0	17.3	-41.8	55.8	5.5	-4.9
Argentina-Paraguay	16.7	11.5	-0.8	28.0	39.6	9.9	50.8
Colombia-Peru	6.9	44.7	-11.9	-7.5	33.8	73.9	-3.2
Chile-Mexico	-48.5	33.0	226.9	-17.8	16.2	13.6	44.9
Ecuador-Peru	-70.8	216.4	115.1	9.0	3.0	28.1	-32.2
2. Relations governed by limited liberalization agreements							
Argentina-Chile	52.1	7.8	33.3	7.7	25.0	29.2	40.2
Argentina-Bolivia	-9.9	-12.6	-10.4	-6.6	3.1	25.1	-16.9
Argentina-Peru	22.3	-25.7	6.7	-4.2	9.9	20.4	9.6
Argentina-Venezuela	-31.9	34.4	117.8	-19.8	26.8	73.0	-13.5
Argentina-Colombia	-24.3	-19.7	26.2	-14.5	-9.5	12.9	68.2
Mexico-Peru	38.7	158.2	-21.5	45.8	-4.0	35.0	5.6
Bolivia-Chile	152.8	22.4	-3.0	19.7	49.6	40.1	13.2
Mexico-Uruguay	87.9	54.3	-6.4	2.2	-23.0	-20.7	82.2
Argentina-Ecuador	46.9	-5.4	-10.9	100.4	-10.2	58.0	22.3
Chile-Uruguay	44.1	31.1	39.4	11.8	19.8	12.9	72.7
Argentina-Mexico	-8.6	-25.7	26.6	3.3	60.3	-3.7	-1.2
Bolivia-Uruguay	25.1	-29.6	116.2	18.6	119.5	0.0	-11.5
3. Bilateral relations not governed by agreements							
Brazil-Chile	32.8	28.4	25.6	25.5	-18.6	18.0	19.3
Brazil-Mexico	-32.3	-9.7	19.7	47.3	17.6	40.5	63.6
Brazil-Venezuela	-26.4	35.6	11.9	-7.6	9.0	24.5	-8.5
Brazil-Bolivia	135.7	-39.1	-6.2	33.1	-17.3	14.4	17.1
Brazil-Peru	93.5	14.7	-3.6	-1.1	-17.3	28.9	8.0
Brazil-Colombia	9.7	52.4	20.2	13.8	-22.8	8.7	92.8
Chile-Colombia	10.8	106.9	17.4	20.9	14.3	-3.7	-24.5
Mexico-Venezuela	-23.5	54.1	1.8	46.9	127.6	-19.9	54.3
Brazil-Ecuador	35.4	-13.5	38.3	-0.7	-32.4	5.2	7.1

Source: International Commodity Trade Data Base (COMTRADE) of the United Nations Statistical Division (UNSTAT), and other official sources.

Note: See tables 5 to 7, which indicate the dates on which these agreements entered into force.

Caribbean. In some cases, they evolved from the idea that macroeconomic equilibrium is a precondition for significant integration processes, but has not yet been achieved at the regional level. In other cases, political affinity, economic complementarity or geographical proximity were the main criteria. This illustrates the complexity of the network of agreements in force in the region and raises the question of whether it is appropriate to insist that they all eventually converge or, on the contrary, whether it would be preferable to allow the emergence of a variety of agreements reflecting the diversity of situations in the region.

It is well known that bilateral agreements and other agreements with very limited geographical coverage may entail certain costs if they do not lead to broader, less discriminatory arrangements (Duncan, 1950), including the political and economic costs deriving from unequal bargaining strengths, the wear and tear on countries as a result of repeated efforts at persuasion and the unproductive rents from sectoral agreements under bilateral arrangements. The costs of administering a network of agreements can also be higher, and transport costs can rise when traffic is diverted from routes which, in the absence of preferences, might be more economical. In general, if bilateral relations are increasingly concentrated, there is a risk that a small country may adjust its production structures to the conditions prevailing on the market of its main trading partner, instead of adapting them to the more competitive conditions of the world economy.

The emergence of certain "hub" countries with which most bilateral agreements are concluded can also create incentives for the concentration of investment (polarization) in those countries, since they will have access to more markets and cheap inputs (Wonnacott, 1991). The growing preference for bilateral agreements might also cause insecurity and instability as regards foreign investment. Alternatively, if bilateral sectoral agreements generate rents, some national and foreign corporations might oppose the effective expansion of markets at the regional level.

Lastly, it is important to consider the possibility that bilateral (or even broader) integration agreements signed within the region might have restrictive effects, just when the current unilateral trade liberalization and globalization process could significantly increase the flow of reciprocal trade, and even investment, without the need for preferential agreements. The considerable tariff reductions already implemented in the region lessen the impact of tariff preferences, whereas bilateral agreements on other trade policy instruments (safeguards, anti-dumping provisions and rules of origin) and sectoral agreements may discourage trade instead of promoting it. They may also result in regulatory disparities that create distortions which, in turn, adversely affect the allocation of resources in general, especially in trade, investment and services such as transport (Rubiato, 1993).

C. GROWING REGIONAL INTERDEPENDENCE

1. The increase in intraregional trade

Intraregional trade has increased substantially in recent years. In particular, unlike what happened in the 1980s, in 1990-1992 the intraregional exports of Latin America and the Caribbean grew faster than exports to the rest of the world. The intraregional exports of LAIA member countries increased from around 11% of the region's total exports in 1990 to 14% in 1991 and almost 17% in 1992. Central America's intraregional exports increased from 14% in 1990 to around 20% in 1992 (see table II-9). Only in the CARICOM countries did intraregional and extraregional exports grow at similar rates in 1991 and 1992.

Table II-9
MAIN CHANNELS OF INTRAREGIONAL AND BILATERAL TRADE IN LATIN AMERICA AND THE CARIBBEAN
(Proportion of exports)

Exports	1990	1991	1992
LAIA	10.8	13.6	16.7
MERCOSUR	8.9	11.1	14.1
Andean Group	4.1	6.2	7.6
Central American Market	14.2	18.4	20.1
CARICOM [a]	6.8	6.0	5.9 [b]
Argentina and Brazil	4.7	6.8	9.7
Argentina and Chile	2.8	3.5	4.5
Chile and Mexico	0.4	0.5	0.6
Colombia and Venezuela	2.4	3.2	4.3
El Salvador and Guatemala	13.7	15.0	17.4 [c]

Source: ECLAC, on the basis of official figures.
[a] Includes Barbados, Guyana, Jamaica and Trinidad and Tobago.
[b] Data for the period January-October 1992.
[c] Imports from Guatemala to El Salvador.

Although a number of factors influenced the expansion of trade, the fact that trade relations between neighbouring countries grew the most shows the importance of geographical proximity. The biggest increase was in trade between Argentina and Brazil, whose intraregional exports as a proportion of their total exports doubled, from 4.7% in 1990 to 9.7% in 1992. There was also a marked increase (in terms of the ratio of reciprocal trade to trade with the rest of the world) in the cases of Colombia and Venezuela, and Chile and Argentina. Reciprocal trade within the Central American Common Market likewise increased significantly, trade relations between El Salvador and Guatemala being the most dynamic during the period under consideration.

The importance of intraregional trade varies considerably from one country to another. Although intraregional exports accounted for around 19% of the region's exports in 1992 (see table II-10), this average does not reflect the very wide range of percentages that exists —from 6% in Mexico to 50% in Bolivia. There are also significant variations as regards the dynamism of each country's different exports (Gana, 1993). Small countries tend to be more dependent on exports to the Latin American and Caribbean market and exported 40% or more of their products to that market in 1991 (see table II-10).

The greater importance of intraregional trade for small countries contrasts with the technological dominance of the larger countries. While trade among the Central American countries and trade among the Caribbean countries mostly involves industrial products, the three largest and economically most diversified LAIA countries (Argentina, Brazil and Mexico) can be clearly differentiated from the less

Table II-10
INTRAREGIONAL EXPORTS OF THE LATIN AMERICAN AND CARIBBEAN COUNTRIES, 1991
(Percentage of each country's exports)

Origin	CACM	MERCOSUR	Andean Group	CARICOM	Latin America and the Caribbean	Bordering countries	
Argentina	0.3	16.5	5.6	0.2	29.3	21.5	(Bolivia, Brazil, Chile, Paraguay and Uruguay)
Bolivia	0.0	34.3	10.0	0.0	48.4	43.8	(Argentina, Brazil, Chile, Paraguay and Peru)
Brazil	0.4	7.3	3.8	0.3	16.5	10.7	(Argentina, Bolivia, Colombia, Guyana, Paraguay, Peru, Suriname, Uruguay and Venezuela)
Chile	0.4	9.3	5.0	0.0	15.5	6.1	(Argentina, Bolivia and Peru)
Colombia	1.5	1.3	10.7	0.3	21.6	11.3	(Brazil, Ecuador, Peru and Venezuela)
Ecuador	0.9	0.8	7.1	0.2	17.1	6.9	(Colombia and Peru)
Mexico	1.8	1.5	1.5	0.4	6.7	0.8	(Guatemala)
Paraguay	0.1	35.2	2.5	2.0	46.7	34.0	(Argentina, Bolivia and Brazil)
Peru [a]	0.7	3.6	6.5	0.3	14.6	9.6	(Bolivia, Brazil, Chile, Colombia and Ecuador)
Uruguay	0.1	35.4	1.6	0.1	40.7	34.8	(Argentina and Brazil)
Venezuela	1.8	2.1	2.3	1.9	10.7	3.3	(Brazil, Colombia and Suriname)
Costa Rica	11.0	0.1	0.8	0.7	17.3	6.9	(Panama and Nicaragua)
El Salvador	33.6	0.3	0.1	0.9	39.0	22.1	(Guatemala and Honduras)
Guatemala	27.0	0.1	1.5	1.6	38.8	22.0	(Belize, El Salvador, Honduras and Mexico)
Honduras	5.2	0.0	0.7	0.5	7.6	4.8	(El Salvador, Guatemala and Nicaragua)
Nicaragua	19.9	0.0	0.5	0.3	27.0	8.0	(Costa Rica and Honduras)
Trinidad and Tobago	0.3	2.0	5.0	12.8	23.9	0.0	
Panama (excluding Canal Zone)	13.9	0.2	3.3	0.5	21.8		
Barbados	0.0	0.0	0.0	44.2	44.3	0.0	
Jamaica	0.1	1.2	0.0	6.0	7.7	0.0	
Total	**1.6**	**7.3**	**4.3**	**1.0**	**18.6**		

Source: ECLAC, on the basis of information from the International Commodity Trade Data Base (COMTRADE) of the United Nations Statistical Division (UNSTAT).

[a] Data for 1990.

developed ones (Bolivia, Ecuador and Paraguay) as regards the proportion of manufactures imported from other member countries. Commodities and semi-manufactures clearly predominate among the imports of the first three countries, while most of the latter's imports are manufactures (Heirman, 1993).

The main goods traded in the region include fuel (crude petroleum, gas, gasoline, gas oil, fuel-oil), unprocessed or minimally processed commodities (cotton, copper, wheat, sugar, zinc, rice, iron and steel, soya and sunflower oil, meat, leather, beans, processed grains), some highly finished manufactures (motor vehicles and parts, telephone lines and equipment) and some intermediate products such as paper, chemical raw materials and fish meal (see table II-3).

2. Intraregional investment

In addition to the increasing flow of reciprocal trade, there is evidence of an increase in intraregional direct and indirect investment as a result of the opening up of stock markets. Although the proportion of foreign investment represented by Latin American and Caribbean investments has grown, it is still small. Moreover, there is a difference between the region's larger and smaller countries in this respect (see table II-11); the large countries are major sources of capital, but regional investments account for a smaller proportion of the foreign direct investment received. Brazil, Argentina and Mexico, in particular, have a much lower proportion of direct investment from within the region than countries such as Ecuador, Uruguay or

Table II-11
FOREIGN DIRECT INVESTMENT COMING FROM LATIN AMERICA
(Percentage of total)[a]

	Received [b]		Invested [c]	
	1980	1990	1980	1990
Argentina	1.8	2.67		
Bolivia	8.3	7.3		
Brazil	1.0	0.8	21.8	11.7
Chile	4.5	6.7	27.0	
Colombia	8.3	4.5	36.7	23.8
Ecuador	15.6	13.4		
El Salvador	7.5	10.2		
Guatemala	17.8			
Mexico [e]	0.5	5.6		
Paraguay [f]	45.2	36.9		
Peru	5.3	7.1	49.7	
Dominican Republic		1.0		
Uruguay	15.5[d]			
Venezuela	7.2	2.7		

Source: ECLAC, on the basis of available information.
[a] Excluding tax havens (Panama, Cayman Islands, Netherlands Antilles, Bermuda, etc.).
[b] Foreign direct investment in the country (proportion of total foreign investment in the country).
[c] Country's foreign investment abroad (proportion of investment in Latin America).
[d] Corresponds to 1989.
[e] Foreign direct investment in Mexico comes basically from the United States (63% in 1990), Western Europe (25%) and Japan (5%). According to statistics from Mexico's Ministry of Commerce and Industrial Development, other countries are grouped into a single category and it is assumed that most of them are from Latin America.
[f] Figures for 1984 and 1988.

Paraguay or the Central American countries.

This situation probably has to do with the growing importance of the region's countries, especially the closer or smaller countries, as channels or springboards for the gradual internationalization of many of the region's corporations. This process, combined with geographical proximity, seems to have been more important in recent years for Argentina and Chile than for Brazil, Mexico and Venezuela, with Colombia occupying an intermediate position (Peres, 1993b).

In Brazil, Mexico and Venezuela, an extensive process of globalization occurred which, prior to the crisis and assisted by Venezuela's and Mexico's oil revenues, increased the proportion of investments in the region's protected markets. In recent years, however, the proportion of these countries' investments in Latin America and the Caribbean has declined and the United States has become the main recipient. Colombia has undergone a similar, but less marked, process. This can be interpreted as part of a far-reaching process of liberalization or restructuring characterized by a degree of sectoral concentration and embracing primarily petroleum by-products in Venezuela, glass products and cement in Mexico and automotive parts, clothing and marketing in Brazil (see box II-3).

In the case of Argentina, the increasing sectoral diversification of its foreign investments reflects a long history of progressive globalization in which priority was given to investments in Latin America, especially Brazil (Bisang, Fuchs and Kosacoff, 1992). This process was accelerated by the industrial restructuring of the 1970s and 1980s. The establishment of MERCOSUR also seems to have consolidated Argentine companies' strategy of investing in Brazil, particularly in sectors related to agro-industry. The internationalization of Chilean companies, on the other hand, is mainly a very recent phenomenon and translates almost exclusively into investments in Latin America. This process is linked to the restructuring of Chile's economy, trade surpluses, the relaxing in 1991 of the regulations governing foreign investments and the seizing of opportunities offered by privatizations in other countries, especially Argentina.

D. THE CONTRIBUTION OF OPEN REGIONALISM TO CHANGING PRODUCTION PATTERNS WITH SOCIAL EQUITY

Starting from the proposal on *Changing Production Patterns with Social Equity* (ECLAC, 1990a), the ECLAC secretariat has developed an approach in which the absorption of technological progress is viewed as a basic instrument for simultaneously modernizing production facilities and distributing the benefits of this process more equitably. Instruments promoting the economic integration of countries of the region must be a fundamental part of policies geared directly to growth and social equity.

Consistency between these instruments and more general policies will promote integration by altering not only market structures and the resulting business dynamic, but also the environment in which businesses and markets operate. The systemic factors which determine productivity will be strengthened in a context in which integration increases information and trade flows and enables the region's production sectors to take advantage of economies of specialization and scale.

The contribution of integration agreements to the competitiveness of the region's economies will have to be reflected in an increase in investments and exports and in an absorption of technological progress based on regional or subregional processes of coordination of production and interaction between public and private agents. In particular, there is a need to promote the

Box II-3

STRATEGIC ALLIANCES

THE CASE OF THE MAJOR INDUSTRIAL CONGLOMERATES STABLISHED WITH DOMESTIC CAPITAL IN MEXICO

The new opportunities offered by Mexico's potential incorporation in a North American free trade area have aroused considerable interest among that country's major industrial groups in concluding alliances with the leading international producers in their respective sectors. The Government, for its part, has acknowledged the vital importance of alliances for enabling Mexican companies, large, medium and small, to compete in the global economy. This has been reflected in such recent policy instruments as the *Programa para promover la internacionalización de la industria textil y de la confección* (Programme for promoting the internalization of the textile and garment-making industry), published by the Ministry of Commerce and Industrial Development in May 1992.

The alliance strategies adopted by the major industrial conglomerates owned by Mexican businessmen, which are at the forefront of this process, can be classified into two groups. First, conglomerates such as Vitro and Fomento Económico Mexicano (FEMSA) have begun to take steps that may alter their competitive position on the domestic and external markets. Vitro, a conglomerate whose sales totalled US$ 3.3 billion in 1992, is Mexico's main producer of glass containers and sheet glass and one of the world's top three glass container producers. The group has a long history of alliances with leading companies in this sector, such as Owens-Corning Fiberglass, Ingersoll-Rand and Ford (production of car windshields). The alliance concluded in 1991 with Corning Inc. for the creation of a global corporation whose world-wide sales are expected to total some US$ 800 million deserves particular attention because of its importance and characteristics. Under this US$ 300 million agreement, Corning Inc. received US$ 130 million and 49% of Vitro's international kitchenware operations, while Vitro received a 49% share in the ownership of Corning Inc.'s international kitchenware division.

Under the agreement, Corning Inc. will own 51% of Corning Vitro Corporation (owner of the global assets of the Pyrex Table and Kitchen Products Division of Corning Inc.) and Vitro will receive 49%. These percentages are reversed in the case of Vitro Corning S.A., a corporation created in Mexico from a Vitro subsidiary (Vitrocrisa). This offers Corning Inc. an excellent opportunity to sell its products in Mexico through Vitro's distribution systems, while it can expand its line of products in the United States with those of Vitrocrisa. Vitro, in turn, benefits from the commercial experience of its partner, which already has alliances with Dow Chemical (special varieties of silicon), Siemens (optical fibres) and Samsung (television screens). The agreement involves technological complementarity, since Corning Inc. has specialized in technological development for the manufacture of new materials, while Vitro is applying advanced methods for liquefying and moulding glass products.

In the second group, we have the Sociedad de Fomento Industrial DESC, a conglomerate that has been very active in rationalizing plans prior to the conclusion of alliances. This conglomerate, whose sales totalled US$ 1.65 billion in 1992, concentrates its activities in the following areas: chemicals, automotive parts, foodstuffs and real estate. In anticipation of the North American Free Trade Agreement, DESC decided to amend the agreements it had reached. For instance, DESC and Dana, the company with which it produces automotive parts, differed in their assessment of the new prospects offered by the United States market, with the result that they took different decisions as to the advisability of expanding their activities in that country. DESC therefore decided to separate its joint operations with Dana from its other operations in order to enjoy greater autonomy in making new investments. At the same time, it decided to terminate other long-term agreements which had resulted in joint investments, such as those concluded with Monsanto (manufacture of adhesives) and Merck (medicinal products).

The case of Cementos Mexicanos (CEMEX) reflects an alternative strategy. This company has invested heavily in the United States and Spain and is the third largest cement and concrete producer in the world. However, because of the characteristics and competitiveness of this industry, none of the main international corporations operating in it have considered the possibility of concluding alliances. The scale of its operations enabled CEMEX to expand its international operations, a sphere in which it competes as an independent corporation. After it bought up two of Spain's biggest cement producers, its annual sales rose to around US$ 3 billion.

Box II-3 (concl.)

The cases of these Mexican firms demonstrate the importance not only of decisions on strategic alliances in a context of integration but also of carefully re-evaluating agreements that have proved successful in closed, non-integrated economies. Although alliances are a positive consequence of integration, not all of them offer the same possibilities.

Source: *Expansión*, No. 576, Mexico City, 16 October 1991; "America Inc. under Siege", *South*, December 1989; and annual reports of Cementos Mexicanos, Sociedad de Fomento Industrial DESC, Fomento Económico Mexicano and Vitro for 1992.

development of sectors whose output will operate in conditions of increasing returns, will meet demands with high income elasticity in the international market and will be able to make use of endogenous technological progress.

It is necessary to identify and evaluate the impact of integration on efficiency, investment, absorption of technological progress and regional production linkages in order to design policies that will make it possible to tap the potential of integration to the full (Peres, 1993a).

1. Impact on efficiency

Traditional analyses of integration show that if we want an integration agreement to result in the improved allocation of resources, it must promote a supply of products from sources whose costs are lower than those of previous sources. Given the low level of trade protection prevailing in Latin America and the Caribbean, the adverse or static effects normally attributed to integration, namely, the diversion of trade that occurs when regional suppliers whose products are more expensive replace extraregional suppliers, would be far fewer than in the past. However, the benefits will also be fewer when integration agreements involve countries that are only minor trading partners, for in such cases the potential for creating trade (replacement of one country's less efficient suppliers by another's more efficient ones) will not be as great. This means that preference would have to be given to integration with "natural partners", i.e., countries with which an important trade relationship already exists, while applying low tariffs to the rest of the world.

To the effects of creating or diverting trade must be added potential effects with regard to benefits or costs. For instance, trade diversion can help alter the terms of trade for countries parties to integration arrangements, by increasing the demand for and reducing the supply of goods that are traded with the rest of the world. For this to happen, however, the countries concerned must be among the world's main exporters of those goods or provide an important market for imports of those goods.

Expanded markets also usually offer economies of scale; when this happens, integration may bring benefits such as reduced costs to the producer and the consumer which could outweigh the costs of diversion or the traditional benefits of trade creation predicted in analyses that presuppose constant costs (Ffrench-Davis, 1993). The fact that these economies of scale may be related to a process of integration with countries of the region means that they would not apply to exports to the rest of the world if access to world markets were restricted. Traditional theory holds that, in the absence of such restrictions, unilateral trade liberalization may be more efficient than an integration agreement. However, in an increasingly protectionist international environment, the static benefits of an integration agreement would tend to outweigh those of unilateral liberalization.

Coordination of macroeconomic policies can heighten efficiency if it involves a transition from a situation in which different policies (externalities) interact and are therefore less than optimal, to an optimum situation in which coordination takes care of externalities (Heymann and Navajas, 1992). Such externalities may consist, *inter alia*, of frictions that hinder trade (payments-related obstacles and uncertainty about relative prices), excesses involving aggregate variations in short-term prices and quantities, and the creation of favourable expectations as regards stabilization and investments. However, the transition process needed to achieve effective macroeconomic policy coordination may also entail costs, such as the uncertainty aroused by protracted negotiations and the risk of taking inefficient measures as a result of mutual concessions. Restrictions on the freedom to apply domestic policies may, in turn, have political costs.

2. The investment dynamic

Traditionally, growth analyses have assumed that technological progress is the factor that makes it possible, in the long run, for the output growth rate to outstrip the population growth rate. In this context, if long-term growth hinges exclusively on endogenous technological progress, it will not be increased by removing barriers to trade and augmenting the market (Baldwin, 1989). However, even according to this logic, economic integration has dynamic effects that are not usually taken into account and that have to do with the medium-term impact of the improved allocation of resources (as a result of integration) on investment and growth rates, an impact that persists until the economy achieves stable growth.

Analyses of the static effects of economic integration generally show the gains that can result in terms of the allocation of production factors. These gains give rise to a one-time increase in the productivity of capital which, in turn, generates more investment, helps increase savings and expands output more than one would expect from considering the static effects alone. In the case of the European Community, for instance, it has been said that the 1992 programme could increase Community output as a result of two effects: i) an increase in efficiency, which would make it possible to obtain more output with the same amount of capital and labour; and ii) an increase in savings (because invested capital would be more productive) and investment, which would expand the capital stock and therefore output (Baldwin, 1989 and 1992). The second effect operates in the medium term, until the economy finds its new level of capital stock and a new, balanced capital-labour ratio. The approximate magnitude of this effect can be estimated empirically with a reasonable degree of accuracy (see table II-12 and box II-4).

The impact of the above effects increases dramatically when economies of scale are incorporated as a key growth factor. The presence of these economies gives rise to a capital productivity that does not decline in the long term as the capital-labour ratio increases (Romer, 1986 and 1987). A market expansion which enhances efficiency can increase the long-term growth rate. When efficiency is enhanced, the output achieved with a given capital stock increases, triggering a one-time rise in the capital-output ratio. If the savings rate remains constant, this rise directly increases capital and output growth rates. The static benefits of integration thus give rise to a *permanent* increase in the growth rate.

3. Absorption of technological progress

a) *Innovation and growth*

The driving force of an endogenous innovation process is investment in research and development in order to gain a competitive advantage that yields excess

Table II-12
DYNAMIC EFFECTS OF EUROPEAN INTEGRATION IN 1992 AND ITS PARAMETERS

Parameter	Range of estimation of parameters	Variation in growth rate	Equivalence in income terms (%) [a]
Static effect (Cecchini report)		0	2.5-6.5
Effect on medium-term growth[b]			0.6-8.9
Saving rate	10%		
Output-capital elasticity (a+b)[c]	0.2-0.6		
Depreciation	12%		
Effect on long-term growth (permanent)		0.28-0.92	9-29
Saving rate	10%		
Manpower growth[d]	-0.77%		
Economies of scale (b)[e]	0.32		
Depreciation	12%		
Effect of endogenous innovation		0.3-0.8	10-25
Elasticity of reciprocal substitution between present and future consumption	10%		
Standardization of regulations[f]	0.5-0.8%		

Source: R.E. Baldwin, "The growth effects of 1992", *Economic Policy*, October 1989, and "Measurable dynamic gains from trade", *Journal of Political Economy*, vol. 100, No. 1, 1992; W. Peres, "Efectos dinámicos de la integración económica. Aproximaciones analíticas", Santiago, Chile, ECLAC, 1993, unpublished.

[a] Discount rate: 5%.

[b] Approximate duration: 10 years.

[c] Includes economies of scale (b), in which b 0. PGB = j (capital) $^{a+b}$ (employed manpower) $^{1-a}$.

[d] Hours worked.

[e] Romer, 1987.

[f] Cost reduction.

profits because of a temporary monopoly of property rights to the innovation in question. A profit-motivated innovation process can give rise to major economies of scale when, because of an expansion of the market, the fixed costs of research and development can be divided among a greater number of sold units. In this case, integration has effects similar to, although potentially lesser than, non-preferential trade expansion. Overcoming trade barriers has its costs for companies, in that it reduces the return on their fixed research and development spending, while the market expansion resulting from integration tends to increase research and development productivity and also the long-term growth rate.

There are many mechanisms by which an integration process can influence innovation and long-term growth.

Box II-4

DYNAMIC EFFECTS OF INTEGRATION AND PARAMETERS THAT DETERMINE THEIR MAGNITUDE

Estimates of the dynamic medium- and long-term effects that European economic integration may have on the growth rate largely depend on the parameters used. Systematization of these parameters and of the results obtained is useful for establishing certain ranges within which similar results corresponding to Latin American and Caribbean integration processes could be placed. On the basis of this systematization, the following conclusions can be drawn:

a) In the case of both long-term endogenous growth and endogenous innovation, the impact of the dynamic effects more than triples the static effect of the increase in efficiency.

b) The effect of medium-term growth and investment, which is extremely important, depends on the theoretical approaches applied. The differences of opinion on this score are not as great as those concerning new growth models. To calculate the medium-term effect, the original level of efficiency which integration has corrected, in other words, the static impact, must be evaluated.

c) The estimation of some parameters is fraught with difficulties and involves the use of very imprecise methods. An extreme example of such difficulties is the calculation of the effect of harmonizing the regulations governing the programme of the European Economic Community for 1992 by extrapolating the cost reductions anticipated in a single industry (pharmaceuticals) (Baldwin, 1989).

d) The results obtained depend to a large extent on the existence of economies of scale at the aggregate level and on the estimation of their magnitude.

e) In extrapolating the above-mentioned calculations to Latin America and the Caribbean, it must be borne in mind that some of the parameters used for Europe (e.g., the depreciation rate) may be similar for Latin America and the Caribbean, while others are very likely to heighten the dynamic effect, instead of reducing it. The latter situation may arise more frequently in evaluating the magnitude of the economies of scale that have not been achieved. In the region's larger countries, the existence of markets that are relatively small in global terms, and of industrial structures dominated by capital-intensive industries that are financed with foreign capital and are miniature replicas of their foreign counterparts, would suggest that the dynamic impact of integration would be no less than that estimated for the European Economic Community.

Source: W. Peres, "Efectos dinámicos de la integración económica. Aproximaciones analíticas", Santiago, Chile, ECLAC, 1993, unpublished.

Generally speaking, growth rates are higher when the technical know-how that contributes to the productivity of industrial research flows freely between countries. In such cases, integration, by making suppliers in different countries compete directly, creates incentives for developing new ideas, facilitates exchanges of information and reduces duplication of research and development efforts, all of which increases the productivity of the resources devoted to this activity.

The standardization of rules and regulations that integration agreements usually envisage makes it possible to reduce the fixed cost of research and development and increase the productivity and dynamism of innovation. However, integration can also have adverse effects on this process, such as increased competitive pressures which reduce the excess profits that provide the incentive for innovation. Since empirical evidence and theoretical analyses differ significantly in their assessment of the impact of increased competition on business innovation, it is impossible to predict accurately whether the impact will be positive or negative.[17]

b) *Impact of integration on innovation*

Determining the impact that an integration-based trade expansion has on the innovation process involves identifying the trade-offs in terms of efficiency offered by the alternative uses of scarce resources, especially when it comes to the main production factor involved in the innovation process: highly skilled human resources (human capital). In particular, analysing cases where a choice exists between using these resources to develop innovations and using them to produce exportable goods yields findings such as the following (Grossman and Helpman, 1991).

i) The allocation of resources in countries parties to an integration agreement can undergo dramatic changes. For instance, in the specific case of a small-scale economy which imports goods that are human capital-intensive, integration could reduce the demand for this production factor and hence the costs of innovation. In such a country, trade integration would have an indirect positive impact on the growth rate. On the other hand, if the economy in question exports human capital-intensive goods, an increase in trade may cause a reduction in innovation if human resources are reassigned to the manufacture of exportables, to the detriment of research and development. In both cases, output and innovation growth rates could be changed by means of trade policies; however, using this method to assign more human resources to innovation can undermine efficient resource allocation.

ii) When the benefits of technology spillovers, are concentrated in certain countries (instead of being distributed widely among the parties to an agreement) and the parties differ markedly in size, a small country's participation in the world market may shrink over time. That country's firms may not be able to keep up with growing outside competition, and this will reduce the productivity of their investments in activities that generate know-how.

iii) In an initial situation similar to the one just described, a country which starts out at a disadvantage in terms of the productivity of its industrial research may, when faced with international competition from a technologically advanced country, see its rate of innovation and growth decline. In this case, human capital will tend to move from technology-intensive activities to mature production sectors.

iv) A country with a relatively plentiful supply of unskilled labour may be prompted by integration to specialize in the production of traditional manufactures; in this case, the growth rate of manufacturing output may decline as technological progress is made in technology-intensive activities. Despite this possibility, there is no reason to believe that the country's innovation growth rate would decline.

v) Even in a country with plentiful human resources, integration may so increase the return on this factor that the incentive to invest in research and development actually declines. As a result, the country would innovate more slowly in a situation of integration than in one of relative isolation. If the share of high-technology goods in industrial output does not rise significantly, the growth of output may itself slow down.

It is important to emphasize that even in cases where a country's output growth rate may slow down following integration, the latter process offers major benefits: i) external demand boosts domestic consumption of more modern goods developed abroad; and ii) the country can specialize in areas where it enjoys comparative advantages.

17 Analyses of the potential positive impact of an oligopolistic structure on the innovation process have their origin in Schumpeter. Geroski (1990) makes a critique of Schumpeter's arguments, based on what happened in the United Kingdom's manufacturing industry between 1970 and 1979. Scherer and Ross analyse the issue and the available evidence in depth (1990, chap. 17).

c) *Integration and product imitation*

In the specific case of integration between developing and developed countries, imitation processes need to be studied carefully, since much of the development of products and processes in the developing countries has to do with this mechanism of technological change. Firms tend to devote most of their resources in this area to learning and adapting technologies developed in other parts of the world. Product imitation is thus another way, in addition to technology spillovers, of spreading research findings internationally.

Imitation does not necessarily have an adverse impact on producers in developed countries, since there may be positive feed-back between innovation and imitation processes. When a developing country copies products from developed countries, the innovators in these countries can keep their monopolistic power for less time. However, this negative effect on the incentive to innovate in developed countries may be offset if competition from imitations reduces the number of competitors that must be faced by an innovative firm in its own market. Imitation in the developing countries could thus increase the rate of return to those innovators in the developed countries that remain in the market. When innovation results in a greater variety of available products, the positive effect may outweigh the negative: a higher rate of imitation increases the expected benefits of a new variety of product and also enhances the incentive to innovate.

In cases where imitation in a developing country is accompanied by an improvement in product quality which represents an advance in the product's its life cycle, and the difference in productivity between a generation of innovators and their potential followers is small enough that the latter are now in a position to conduct their own research, the increase in imitation-based production in the developing countries may act as a disincentive to innovation in the developed countries, and policies to promote greater productivity in the developing countries may have an adverse effect on the rate of technological progress in the more advanced countries.

Finally, there are two additional factors that have a particularly strong impact on the relationship between innovation and imitation: i) if the quantity and quality of information flows among countries increases as a result of a free trade agreement, this may encourage imitation; and ii) when an agreement involves a more stringent set of rules concerning protection of intellectual property, the countries that develop imitation processes may be profoundly affected. This means that the potential impact of integration agreements on imitation is greater than that of indiscriminate trade expansion in general.

4. The role of information flows

Most of the thinking on the impact of integration processes tends to focus on the analysis of merchandise flows between countries. However, the "ideas" input may be the most important factor of production in the innovation process; moreover, the proximity and cultural affinity of the countries of the region may help this factor play a key role in an integration process.

In studying the effect of the presence or absence of information flows among countries, it is helpful to distinguish between two situations: in the first, the pool of knowledge is the basic input for the production of innovations; in the second, production depends solely on capital and skilled or non-skilled labour (Rivera-Batiz and Romer, 1991). In the first case, the total pool of knowledge available to a society at a given moment may be used in any research project free of charge, and a balance is produced with technology spillovers, or with externalities in the research and development sector. In the second case, since knowledge is not a determining factor in the innovation-producing function, such effects do not exist. Three extreme examples are presented below, from which interesting conclusions can be drawn:

i) Existence of merchandise flows, but no information flows, in a context of knowledge-based production. In this case, an integration process that only includes merchandise trade, although it may raise levels of production and well-being, will not have an impact on the long-term growth rate.

ii) Existence of information flows in a context of knowledge-based production. The opening up of communication and information networks may bring about a permanent increase in the growth rate owing, first, to the expansion of the pool of knowledge available for producing innovation and, second, to the fact that the bigger pool of knowledge that can be used in research increases the productivity of the human capital devoted to this activity (without changing the productivity of others), inducing a shift of this factor towards research.

iii) Existence of merchandise flows in a context of production that is not based on knowledge. In this case, since the innovation-producing function does not take into account the pool of knowledge, the mere flow of goods makes it possible to obtain results equivalent to those of full integration, with a corresponding increase in the growth rate. It is important to note that in these circumstances, integration enhances the production dynamic even in the absence of technology spillovers.

Since intensive production of know-how appears to be more representative of the predominant situations in the current stage of technological change, the importance of networks for communicating knowledge, whose development should be a substantive part of any integration effort, must be underlined. However, in the case of certain lagged economies, it may be advisable to focus on the model that is not based on knowledge, where the mere integration of merchandise trade has a dynamic effect on the long-term growth rate.

5. Policy implications

On the basis of the above considerations as to the dynamic effects of trade on innovation, a series of factors can be identified which should be taken into account in order to maximize the beneficial effects of integration on innovation.

i) Integration agreements may contribute to efficiency in various ways. First, efficiency will be enhanced if large trading partners participate in the agreement and protection against third countries is moderate. Second, such agreements may make it possible to take advantage of economies of scale, and the benefits will tend to be greater if protectionist practices in the world market keep members from achieving such economies on their own. Lastly, the coordination of policies may generate additional benefits, although putting these policies into practice raises difficulties that may entail considerable economic and political costs.

ii) Integration agreements may be very favourable with respect to investment expectations. The greater efficiency stemming from integration may also be reflected in higher levels of saving and investment and in an increase in the productivity of investment. The process may therefore generate significant, lasting effects related to the growth rates of member countries, although these benefits will be meaningful only if large trading partners participate in the agreements.

iii) Radically different situations result, depending on whether technology spillovers are concentrated nationally or disseminated globally, when the generation of innovations is a function, among other factors, of the pool of knowledge of an economy. If the dominant factors promote the global spread of such benefits, the initial historical conditions of each country will tend to be less decisive for creating virtuous circles between market size, efficiency of innovation and growth rate at the purely national level. In these cases, countries that are relatively less efficient in the area of research may close the technological gap between themselves and more advanced countries more quickly. This is especially important in the case of small economies which have more limited pools of knowledge that can be used for research, or which have had little research experience and therefore have a low level of efficiency.

iv) There is a positive relationship between reducing the amount of overlap in research and development activities and raising the efficiency of innovative efforts in the group of countries participating in an integration process. The flow of knowledge may be more important than the flow of goods in terms of avoiding duplications that result in inefficient allocation of resources and less product diversity than an integrated economy could offer.

v) Policies designed to increase the efficiency of the innovation process are an appropriate tool for reducing the lags related to initial historical conditions. These policies are especially important in cases where the less advanced country's technology base could allow it to develop imitation strategies throughout the life cycle of a product. Policies that directly stimulate innovative activities tend to be more efficient than those that seek to promote relatively innovation-intensive economic sectors. In particular, the use of foreign trade policy to increase the dynamism of innovation may have a negative impact on the efficiency of resource allocation.

vi) It is useful to coordinate, or at least make compatible, policies for supporting productivity and innovation among the member countries of an agreement. Otherwise, the effects of these policies abroad may adversely affect the growth of output and innovation in some of them. In an economically integrated area, the government policies of the largest members countries influence the distribution of incentives to innovate among the various members and, therefore, the location of research activities and their rate of growth.

vii) The impact of integration on the price of scarce factors of production, such as human capital, may lead to unexpected results. The mobility of skilled human resources (human capital) among the countries involved in an integration process makes it possible to correct some of the negative effects that may result from an allocation of factors deriving from a rise in the price of these resources, that is detrimental to innovation and growth.

viii) There is no widely accepted evidence as to whether, in order to achieve successful integration, it is helpful for the countries involved to be relatively similar or very different. From the economic standpoint, differences make it easier to take advantage of specialization in activities with comparative advantages and to adopt technological strategies of imitation. However, too big a difference can generate negative processes that may prevent imitation from advancing throughout the product life cycle.

6. Regional production linkages

Given the systemic nature of competitiveness, the integration commitments now being concluded may also have dynamic effects on productivity, thanks to the improved environment, i.e., the physical, human, financial and institutional infrastructure, in which companies are operating. For example, cooperation in the energy area through the interconnection of electricity grids, shared use of port facilities, the development of common centres of excellence for training, education and research and the adoption of other similar cooperative arrangements could have a profound impact on the allocation of resources and on production costs. The refinement of legislation and institutions as a result of the application of integration agreements could also be an incentive to private investment, in an environment characterized by increasing stability.

This is because the obstacles to international trade are not only tariff and non-tariff barriers but also other impediments or transaction costs arising from geographical, institutional, legal and social constraints. Such obstacles tend to be greater in relations within the region –both between and within countries– than in trade relations with the rest of the world, reflecting a systemic weakness as regards competitiveness. Eliminating these transaction costs may be even more significant for integration than reducing tariffs (Reynolds, Thuomi and Wettman, 1993).

In particular, reducing these costs, *inter alia* by facilitating trade, building bridges and roads, enhancing credit markets and eliminating or harmonizing regulations, can transform apparently inefficient regional firms into more suitable suppliers than extraregional ones. This means that such action might make it possible to eliminate the adverse effects of trade diversion that are associated with preferential agreements, since the tariff preference would no longer be encouraging the purchase of regionally produced but more costly goods and services (Reynolds, Thuomi and Wettman, 1993). However, such initiatives require the mobilization of potentially costly resources, whereas "negative" action such as the reduction of tariffs does not entail any costs other than loss of fiscal revenues. This contrasts with "positive" actions, such as infrastructure works, whose high costs must be weighed in the light of their net benefits.

Furthermore, one sectoral or industrial determinant of competitiveness is the close relationship between sectors or groups of companies comprising what are, in effect, informal conglomerates, and within associations of companies and agencies of various kinds based on vertical (supplier-user) and horizontal (shared use of technological, financial, information or marketing services) ties. In both cases, we have what ECLAC has termed "production linkages" and a creative interaction between public and private agents in helping to disseminate technological advances (ECLAC, 1990a, chaps. IV and V).

The same is true of the integration process. Mobility of skilled manpower from one company to another, shared use of infrastructure, production of components that can be used in various industries, adoption of new technological systems or networks and exchanges of information on techniques, experiences and opportunities usually facilitate technology spillovers at the regional level. Geographical proximity and cultural affinity whose importance increases in a context of liberalization offer a chance to seize these opportunities more fully than in the past. If we add to this the various business practices that accompany liberalization and deregulation in a context of increasing globalization, which include the current move away from vertical relations towards closer relations between firms and suppliers, we get a new model of industrial organization characterized by increasing specialization and the creation of subcontracting networks linking small- and medium-scale enterprises in several countries with larger-scale ones. This offers the possibility of creating regional or subregional networks with an innovation potential whose development would require various services, such as the acquisition and dissemination of information, training and financial services. It also offers the possibility of an innovation-driven integration process.

Since most of these activities are based on stable relations between firms, it might also be appropriate to encourage or strengthen them by means of various institutional mechanisms (see box II-5). In recent years, frequent meetings between businessmen and a variety of dissemination and development activities have helped bring about joint investments and increased trade between countries of the region. It would be advisable, therefore, to replace the sectoral commitments made under integration agreements with coordination agreements between the public and private sectors, with a view to promoting investments and technology transfer. One practical way of doing this would be through private or mixed projects for production sectors and research centres or for removing obstacles in such areas as transport, energy and telecommunications. There are already

Box II-5

BOLIVAR PROGRAMME

The Bolívar Programme promotes technological, production, financial and commercial integration, competitiveness and industrial innovation. To this end, it encourages partnerships between companies and research centres in the Latin American and Caribbean countries and between these and similar institutions in other regions. In so doing, its purpose is both to provide the regional economy with the means to integrate itself in an increasingly competitive global environment and to help bring about, *inter alia*, an improvement in the quality of the goods and services produced and the production of new ones; a reduction in the costs of access to information about countries with which trade relations, technology transfers, markets and financing could be established; the adoption of uniform international quality standards; the creation of an environment conducive to a dialogue between corporations and institutions; and the execution of joint activities between companies and institutions of countries of the region and those of other regions.

The Programme is being implemented at three levels. The first comprises the national commissions in which the various decision-making bodies of each country are represented. The commissions seek to create a climate favourable to the Programme's activities and to the achievement of its objectives: regional integration, innovation, competitiveness, applied research and investment. To that end, they usually enlist the cooperation of prominent figures in the business world, trade unions, universities, scientific centres, State agencies and Parliament.

The second level comprises the liaison offices which are the Programme's operational nucleus. As of July 1993, the Programme had liaison offices in nine countries: Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Paraguay, Uruguay and Venezuela. The offices are run by highly qualified coordinators and perform outreach functions: they listen to the concerns of the various production sectors, establish contacts with countries to link them up with the Programme, support the work of the national commissions, and promote meetings and joint activities between companies and research centres and evaluate projects presented by them. Approved projects receive the Sello de Mérito Bolívar, which serves as a guarantee when seeking funding from financial institutions. The Programme also has an executive secretariat, based in Caracas.

The Programme's third level consists of financial activities. The Mesa de Consulta Financiera (board of financial consultants) comprises over 40 representatives of banking institutions who propose appropriate financial instruments for funding joint projects. A Liga de Bancos (banking league) has also been established which uses the information systems and inside connections of the Latin American banking system to obtain information for banks and countries on the financial situation of businessmen who apply for funding.

As of June 1993, 110 projects had been identified in the following areas: leather, biotechnology, health, agro-industry, petroleum, telecommunications, data processing, education via satellite, chemicals and pharmaceuticals, textiles, metal engineering, chemistry, construction techniques, plastics, foodstuffs, metallurgy, meat and automotive parts. These projects, in which European and United States firms might participate, were proposed by Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Paraguay, Uruguay and Venezuela. Some countries from outside the region (United States, Italy, Netherlands, France and Spain) have also joined in these projects.

Source: Programa Bolívar, "Integración tecnológica regional, innovación y competitividad industrial", Mecanismo Enlace, Caracas, 1993.

many examples of such initiatives in the region. The proposed set of actions could then contribute to production linkages among several countries that would include the production of goods and services and would not depend solely on the integration of markets.

The current widespread tendency to view market linkages as a key element of integration, agreements is attracting criticisms that too much importance is being attached to purely commercial agreements, to the detriment of other aspects of integration, such as the execution of joint projects and regional coordination of the public and private sectors. In this connection, it should be recalled that trade agreements are intended not so much to expand trade relations as to stimulate production and productivity. Moreover, whether the potential benefits offered by joint projects and by regional coordination of the public and private sectors are tapped in such a way as to form part of a dynamic process of changing production patterns at the regional level, rather than being limited to isolated measures, will depend to a large extent on there being a widespread liberalization of trade in goods and services between countries that integrate. Generally speaking, trade integration should create overall conditions conducive to the acceleration of informal integration. For instance, the absence of tariff and non-tariff barriers could stimulate road construction, while the adoption of practical, ongoing programmes of trade and investment promotion could enhance the application of pre-existing formal trade agreements and contribute to the expansion of reciprocal trade.

Chapter III

KEY PRINCIPLES: MECHANISMS, INSTRUMENTS AND POLICIES

A. STABILIZATION, FINANCE AND OPEN REGIONALISM

1. Strengthening the credibility of agreements and supporting balances of payments

As stabilization takes hold in Latin America and the Caribbean, not only will the costs and uncertainty occasioned by imbalances be reduced, but the arguments for restricting preferential trade liberalization agreements to bilateral agreements between pairs of countries that have made more progress in their internal and external equilibria will become less cogent. Once a country has overcome its macroeconomic imbalances, it becomes more attractive as a partner in integration initiatives to the governments and private sectors of other countries.

To effectively harness the risk that temporary macroeconomic imbalances present for individual countries, it is necessary, *inter alia,* to support balances of payments. As the experience of the 1980s showed, when the countries of the region have overall balance-of-payments deficits, intraregional trade suffers, even though it is not the main source of the deficit. As a result, regional mechanisms for supporting balances of payments, working in conjunction with multilateral financial agencies, can contribute significantly to the adjustment of a country's external accounts, thereby avoiding disproportionately adverse effects on intraregional trade (see box III-1).

However, with the exception of the Latin American Reserve Fund, mechanisms for supporting balances of payments, such as the Santo Domingo Agreement and the Central American Monetary Stabilization Fund, have not had the financial capacity to respond to a widespread demand for resources. So far, experience with these mechanisms has shown that in order for them to actually help correct balance of payments disequilibria, in the virtual absence of any long-term regional external resources, they must have their own organization and legal personality and sufficient resources to meet demand. In addition to financial cooperation in supporting balances of payments, other kinds of financing can be used, such as regional export financing channelled through, in particular, the Andean Development Corporation (ADC) and the Latin American Export Bank (BLADEX) (Jiménez, 1993).

2. Management of trade imbalances

Temporary macroeconomic imbalances may trigger trade imbalances that can cause considerable tension in an incipient integration process. Demands for correcting bilateral imbalances may be made even where the necessary conditions and experience for establishing a coordination procedure and regional financial mechanisms or sufficient

Box III-1

THE LATIN AMERICAN RESERVE FUND

The Andean Reserve Fund (FAR), in operation since 1978, was recently expanded and transformed into the Latin American Reserve Fund (FLAR), with the following objectives: i) to support member countries' balances of payments by granting credits and providing backing for them to obtain loans from third parties; ii) to enhance the liquidity of their international reserves investments; and iii) to help them harmonize their foreign exchange, monetary and financial policies.

FLAR loans in support of balances of payments are granted for a maximum term of four years, with a one-year grace period, at interest rates comparable with those offered by commercial banks. One condition for the granting of such loans is that the FLAR Board of Directors must approve a plan for remedying the situation that gave rise to the need for a loan. The principal benefit which member countries derive from FLAR is probably that of rapid access to a source of financing and to a greater amount of resources than they can put in. The following table shows the mid-year situation for credits of this kind.

Balance-of-payments credits granted by the Latin American Reserve Fund
(Millions of dollars)

Country	1984	1985	1986	1987	1988	1989	1990
Bolivia	48	31		100	92	42	8
Ecuador	101	61		175	131	73	15
Peru	195	130	65				
Colombia		229					
Venezuela					271	226	136
Total	**344**	**451**	**65**	**275**	**494**	**341**	**159**

Source: Andean Reserve Fund, *Memoria Anual*, various years.

The main source of FLAR resources is its own assets, with which it covers most of its outlays. A second source is deposits made by the central banks of member countries. Thanks to the efficiency of its operations, FLAR offers a higher return on these deposits than that available in the international financial market. This makes it an attractive alternative for central banks when they come to invest their international reserves. Moreover, unlike deposits made with international financial institutions, deposits with FLAR cannot be confiscated. FLAR also helps finance exports from the Andean subregion by means of discount lines on banker's acceptances from the Andean Development Corporation (CAF) and the Latin American Bank for Exports (BLADEX), with terms of up to 180 days. During the 1989-1990 financial year, discounts totalling US$ 58.7 million were achieved, representing a growth of 19.6% over the preceding period.

resources to tackle the problem do not yet exist. The situation is a complex one, for it requires countries to correct imbalances in intraregional trade flows when, presumably, none of the parties is prepared to alter its own macroeconomic management.

When few, if any, strictly macroeconomic instruments are available for dealing in a coordinated manner with the emergence of bilateral disequilibria, it seems natural that pressures should arise in the sphere of trade policy variables which may have a bearing on integration. For example, the parties may object to the existence of tariff preferences in sectors hurt by imports. Using trade policy instruments to solve short-term problems whose origin is presumably macroeconomic does not seem to be the best strategy. However, it is more than likely that such approaches are used in practice.

This situation creates dilemmas. If there has been no measure of flexibility from the outset, joining the integration process becomes an "all or nothing" option. The emergence of major imbalances, both at macroeconomic level and in certain firms, can throw the project into crisis. Conversely, if the management of the trade integration process is too flexible, this rarefies the atmosphere for trade and investment decision-making because it puts the continuity of economic signals in doubt. Exposing regional trade policy to the whims of cyclical fluctuations in prices and volumes makes no sense, except as a stopgap in the absence of other instruments. However, if we recognize that this possibility exists, it is important to establish advance guidelines in order to determine what action will be considered acceptable. It also seems advisable that the courses of action chosen should be the result of some kind of negotiation or at least prior consultation, so as to avoid the possibility of being drawn into a cycle of measures and countermeasures. One kind of cooperative solution, based on recognition of the relative restrictions on the use of instruments, might be for countries with an overall and bilateral surplus to agree to a temporary reduction of the preferences they enjoy and to facilitate access to their markets by goods from deficit countries. This would avoid a situation in which macroeconomic asymmetries were corrected exclusively by reducing reciprocal trade.

3. Strengthening of payment systems

Payment systems can play a vital role in the management of open regionalism in Latin America and the Caribbean. In theory, the main function of clearing houses is to reduce the number of bilateral transactions, thereby saving time and resources. However, they could also help reduce the uncertainty inherent in trade, particularly the likelihood that agents in the recipient country may not honour their financial commitments (Jiménez, 1993). It is foreseeable that, unlike traditional exports which are usually conducted through middlemen operating on a large scale, new intraregional exports will go to smaller buyers, thereby increasing the potential risks.

One of the main functions of the LAIA payments system has therefore been to reduce uncertainty by means of procedures that make it possible to establish which national banks are authorized to operate through the system and, secondly, to guarantee the payment, between central banks, of transactions related to intraregional trade. This helps to minimize the possibility that the regional exporter will not receive the payments owed by importers in other countries of the region, thereby eliminating most of the commercial risk. This leaves, in theory at least, the risk with regard to individual countries deriving mainly from the possibility that a central bank of the region might be unable to meet its external commitments. Since the system in question was established by an agreement among countries that have traditionally observed the agreed conditions, this risk can be said to have diminished.

Any attempt to revive the payment systems in Central America and the Caribbean, which stopped functioning in the 1980s, should take into account the experience of the LAIA system, particularly the fact that such a system, based as it is on bilateral lines of credit, automatically puts a ceiling on the indebtedness between pairs of countries by avoiding concentration of resources. This means that if a country cannot meet its commitments, only the two countries concerned will be affected directly, while the rest of the payments system can go on operating normally. Another way to put the payments systems in Central America and the Caribbean back into operation would be for the countries of the subregion to join the LAIA system.

Although payments systems help cut back on the use of internationally convertible currencies, their usefulness diminishes as private foreign exchange markets are reestablished and national currencies become more attractive as means of payment, as the experience of the European Payments Union shows (see box III-2). If national currencies are not widely used as a means of payment in Latin America and the Caribbean, however, a more important role may be played by the instruments for creating regional liquidity that are most attractive from the standpoint of their convertibility, liquidity, stable value and yield. Access to mechanisms that would make it possible to create external liquidity in the region could cushion the effects of fluctuations in the availability of international financial resources, thereby reducing the vulnerability of intraregional trade (see box III-3).

Likewise, if a regional means of payment becomes a viable alternative for those holding financial assets in the region, it can become the cornerstone for developing systems of intraregional export financing which work by attracting resources from the countries themselves (Jiménez, 1993). More specifically, it is possible, although not necessarily easy, to think in terms of creating a system of intraregional export financing based on the use of financial instruments, denominated in a regional currency, that would fulfil the necessary conditions of convertibility, liquidity and profitability.

4. Export financing

Given the need to integrate national firms, particularly small- and medium-scale enterprises, into the current globalization and regionalization process, ways should be found of promoting their linkage to this process, for instance by giving them ready access to financing. At present, commercial banks finance the bulk of the exports of countries of the region, but access to export financing is severely limited. Small- and medium-scale enterprises, which could be among the main beneficiaries of easier access to neighbouring markets, are hindered by the lack of real guarantees and by other factors. Banks give financing preference to final or direct exporters, who may have export credit letters or other similar documents, but ignore indirect exporters or suppliers of intermediate or imported inputs included in export orders. The supply of short-term credit that is characteristic of commercial banks also limits the amount of financing available after the shipment of capital goods and that available for investments in fixed assets for export activities.

This would seem to make a case for supplementing the export financing provided by commercial banks (Held, 1992). The customary procedure in countries of the region is to channel through the banking system specific export financing credit lines issued by international institutions such as the World Bank, IDB and the Andean Development Corporation. However, these credit lines generally go to direct exporters, only sporadically or partially cover the financing of capital goods exports and, unless guarantee funds and reliable credit insurance are available, reflect a marked bias against small- and medium-scale enterprise.

Progress towards widespread supplementing of bank financing (and promotion) of exports is a recent phenomenon in the region. For now, only some countries have guarantee funds (pre- and post-shipment), export credit insurance and other financing mechanisms which make funding widely available to direct and indirect exporters, as well as to small- and medium-scale enterprise, and permit the financing of capital goods exports or of investments in the fixed assets needed for export activities (see box III-4). The creation of comprehensive, rapid systems for financing non-traditional exports could hold great potential for the countries of the

Box III-2

THE EUROPEAN PAYMENTS UNION

After the Second World War, intra-European trade was heavily restricted by numerous bilateral agreements based on the need to limit external payments because of the acute shortage of foreign exchange. After some modest progress, in 1950 the countries of Western Europe laid the foundations for an effective multilateralism by creating the European Payments Union (EPU) and, on the basis of the Liberalization Code of the Organization for European Economic Cooperation (OEEC), proceeded to eliminate quantitative restrictions on trade.

Multilateral payments through the EPU were made monthly and liabilities had to be settled in gold and credits, in varying proportions. Following a gradual tightening of payment terms, by 1955 the settlement proportions were 75% gold and 25% credit. Action by the EPU made it possible to eliminate bilateralism within the area and save large amounts of foreign exchange for conducting transactions and, in fact, made the currency of each member country freely convertible to the currencies of the other members, with fixed parities in relation to gold.

After 1953, major changes occurred in the environment in which the EPU operated. As a result of the European Recovery Programme, OEEC output and exports increased significantly, and the liberalization process helped increase intra-European trade by 70% between 1950 and 1958. The gold and foreign exchange reserves of the OEEC countries also grew by 139% between 1952 and 1958.

The European Payments Union also evolved significantly, until its dismantling in 1958. One important development was the widespread relaxation of exchange controls and the reopening of private foreign exchange markets as a result of the introduction of a multilateral arbitrage system in May 1953 by eight EPU members, later joined by another four. Under this system, authorized banks of the countries in question were allowed to make foreign exchange and arbitrage transactions in the other countries' currencies, at exchange rates that fluctuated by 1% from parity. The main outcome of the new system was that an increasing proportion of intra-EPU transactions were settled on the foreign exchange market rather than through the Union. The new agreements also paved the way for the gradual elimination of exchange restrictions, with the result that, by 1958, most EPU countries' currencies were fully convertible, both among themselves and with the dollar. To sum up, the European Payments Union, the Liberalization Code and the European Recovery Programme gradually did away with the need for a mechanism originally designed to remedy the shortage of foreign exchange.

Source: Arthur Bloomfield, "La experiencia de la Unión Europea de Pagos y su posible aplicabilidad a América Latina", *Integración latinoamericana*, año 9, No. 95, October 1984.

region and have a particularly decisive impact on intraregional exports.

Lastly, the possibility of subsidizing the interest rate in order to bolster intraregional exports, or external sales in general, is subject to a number of limitations. The main objection is that this kind of measure does not solve the basic problem of providing access to financing for the large number of small- and medium-scale firms and the indirect exporters that have emerged in the wake of successes in the external sale of non-traditional exports.

B. REDUCING INTRAREGIONAL DISCRIMINATION

1. From bilateral to multilateral trade

The trade experience of other regions, especially Europe, suggests that bilateral agreements or limited geographic coverage may have net positive effects if, besides being between countries that have overcome macroeconomic imbalances

Box III-3

THE ANDEAN PESO

Introduced in 1984 as a result of efforts to create liquidity that was clearly regional in origin, the Andean peso is worth the equivalent of one United States dollar. It is a liability of the Latin American Reserve Fund, plays the role of a restricted international means of payment and is actually used to settle foreign exchange liabilities between holders.

Although the use of this payments instrument is absolutely voluntary among authorized holders, at the express request of the central banks that own the original issue an agreement has been signed making it compulsory to accept Andean pesos as payment for liabilities resulting from the clearance of trade within the subregion under the LAIA payments agreement. Its use puts a definitive end to the bilateral relationship between the debtor and each of his creditors. The convertibility of Andean pesos is guaranteed by the Fund, which maintains its own reserve for this purpose, covering 50% of the issue. The Fund's solid record in this area has enabled it to attract extraregional resources.

The Andean peso is not only a means of payment but also an interest-bearing asset. Its net holding yields a half-yearly interest equal to the LIBOR rate plus 1/8 of 1% and its net use yields the same plus 1/4 of 1%. This asset's main limitation on is that users are required to reconstitute the original holdings by buying Andean pesos with foreign exchange, since in practice this makes it a short-term credit mechanism. In present circumstances, even though the Andean peso actually increases regional liquidity, it cannot completely replace other currencies as an intraregional means of payment. The issue, which so far is equivalent to US$ 80 million, is small compared with the amounts required to sustain intraregional trade. However, if changes were made to reinforce its characteristics as an international reserve asset, especially changes in the method of setting its value, diversification of its use and the achievement of sustained, financially solvent performance by its issuer, this asset could become an effective means for creating regional liquidity, with positive consequences for trade.

Source: Luis Felipe Jiménez and Raquel Szalachman, *Las monedas comunes y la creación de liquidez regional* (LC/L.724), Financiamiento del desarrollo series, No. 12, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), joint ECLAC/UNDP project on "Políticas Financieras para la Transformación Productiva con Equidad", 1992.

and have trade regimes with limited protection against third parties, they are deeply involved in reducing discrimination and have developed concrete mechanisms to do so. Generally speaking, the most-favoured-nation (MFN) clause promoted the progressive multilateralization of agreements towards the end of the nineteenth century, despite the fact that its unconditional application between the two world wars blocked the gradual liberalization of trade (see box III-5). It should also be recalled that GATT negotiations were traditionally carried out bilaterally, between major suppliers, and that these have been multilateralized through the MFN system.

In Latin America, the Central American countries' experience with bilateral agreements in the past was positive, although of short duration. These countries entered into a series of bilateral free trade agreements with each other in the 1950s, but they soon converted them into a multilateral agreement, which then led to a dynamic surge of trade within the Central American subregion during the 1960s and 1970s.[18] Industrialization and trade liberalization took place simultaneously in the subregion. As a result, bilateral and subsequent

18 An agreement was signed in 1960 that replaced the prior bilateral agreements and the multilateral agreement of 1958; unlike these, instead of containing lists of products that could benefit from free trade, it contained a limited list of products that were excluded.

Box III-4

EXPORT FINANCING IN MEXICO

The Banco Nacional de Comercio Exterior (BANCOMEXT) is responsible for promoting supplementary export financing, with particular emphasis on small- and medium-scale enterprise and potential exporters. It operates as a bank at the first level by directly financing exporters through its network of offices, and at the second level by conducting export support operations through commercial banks. The purpose of its activities is to extend to Mexican exporters financial terms similar to those enjoyed by their international competitors, at competitive market interest rates.

The participation of BANCOMEXT in export financing by banks is considerable. During the 1991-1992 biennium, it covered 60% of short-term pre- and post-shipment financing and 100% of long-term financing of investment projects. Almost 75% of loans were channelled to manufacturing firms and export services. To facilitate the access of small- and medium-scale enterprise to export loans, BANCOMEXT reformulated its export guarantee to include provision for immediate, unconditional payment. It also introduced credit cards for use by exporters and other financial instruments, that would be accessible to indirect exporters, since Mexico's experience with national letters of credit had not achieved the desired results. In 1991 and 1992, these measures benefited 15,000 small- and medium-scale enterprises.

BANCOMEXT: FINANCIAL INSTRUMENTS TO SUPPORT EXPORTS

Instrument	Purpose
"EXPORTA I" card	To give immediate access to financing for working capital; includes indirect exporters
"EXPORTA II" card	To give immediate access to financing for the purchase of machinery and equipment by exporting firms
Factoring	To provide financing to indirect exporters by buying up their unpaid invoices
Leasing	To lease capital goods to small- and medium-scale firms involved in export activities
FACE	To finance the export portfolio with resources obtained abroad
PROFIME	To finance imports made by exporters

Source: G. Held, "Financiamiento de exportaciones e integración regional", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), joint ECLAC/UNDP project on "Políticas Financieras para la Transformación Productiva con Equidad", 1992, unpublished.

subregional agreements had to face fewer obstacles arising from interests created under national import-substitution policies.

The Latin American Free Trade Association (LAFTA) and the Latin American Integration Association (LAIA), however, were less fruitful. The LAFTA

Box III-5

BILATERAL AGREEMENTS IN EUROPEAN HISTORY

History shows that bilateralism is not necessarily harmful. Its favourable results in the second half of the nineteenth century, when the Anglo-French treaty of 1860 launched a gradual liberalization of trade in Europe, are well known. The European experience suggests that declining discrimination in a context of trade liberalization and macroeconomic stability are prerequisites for bilateral agreements to have net positive effects.

Discrimination was reduced during the second half of the nineteenth century by introducing the most-favoured-nation principle, which meant that France and the United Kingdom extended to each other any concession either gave to other countries. The most-favoured-nation principle was also maintained in the bilateral agreements made by France and the Zollverein (customs union) with other European countries between 1861 and 1866, thereby extending trade liberalization to all the countries that had bilateral agreements.

The bilateral agreements of that period also helped to initiate and consolidate widespread trade liberalization in Europe between 1860 and the late 1870s. In France, for example, the executive branch of government took advantage of its power to enter into trade agreements with other countries in order to avoid facing protectionist interests in the legislative branch. Germany unilaterally lowered tariffs in the 1870s after the Zollverein reached a bilateral agreement with France, which by liberalizing imports weakened the opposition of protectionist interests in the south of Germany to lowering the common external tariff.

The period between the two world wars also suggests that opportunities to launch trade liberalization processes by signing partial, geographically limited agreements should not be wasted. During the depression of the 1930s, financial instability in the industrialized countries led to harmful bilateralism, characterized by excessive exchange-rate controls, quotas and licenses, and resulting in a sharp contraction of trade. Existing asymmetries were reinforced when, for example, the Balkan countries' trade options were reduced, and Germany therefore found it easier to unilaterally impose trade conditions in that region. However, the insistence of certain countries, such as the United Kingdom and the United States, on the need to liberalize trade by unconditionally applying the most-favoured-nation principle seems to have worked against rather than for trade liberalization, since other countries (the Scandinavian and Benelux countries, for example) were willing to partially liberalize their trade, but not extend concessions to every country.

Source: D.A. Irwin, *Multilateral and Bilateral Trade Policies in the World Trading System: An Historical Perspective*, Washington, D.C., World Bank, 1992; League of Nations, *Commercial Policy in the Interwar Period: International Proposals and National Policies*, Geneva, Economic, Financial and Transit Department, 1942.

liberalization process, which attempted to transform bilateral trade concessions into multilateral agreements, subject to the terms of the Montevideo Treaty signed in 1960, eventually stalled. This was partly due to the fact that, during the import-substitution phase, countries protected their industrialization processes, thus creating interests opposed to the broad liberalization of markets at the regional level. This attitude and attempts to regulate industry at the subregional level slowed the expansion of intraregional free trade under the Andean Pact.

Once the rigidity of LAFTA became evident, an attempt was made to make the integration process more flexible by strengthening its bilateral dimension, which led to the foundation of the Latin American Integration Association (LAIA), with the signing of the Montevideo Treaty in 1980. By authorizing the signing of partial scope agreements, the Treaty facilitated bilateralism not only for trade concessions but also for rules governing intrazonal trade. At the same time, the power given to each country individually to establish rules also implied the right to administer agreements, which not only created the possibility of contradictory rules of the game but also caused confusion about who could make decisions and interpret rules (Zelada Castedo, 1983).

Two factors, which partially reflect the different positions of governments with regard to the multilateralization of bilateral schemes, worked against a convergence between bilateralism and the multilateral (regional) extension of the agreements reached by LAIA members during the 1980s. First, their harmonization depended basically on multilateral institutional forums (the Council of Ministers of Foreign Affairs, the Evaluation and Convergence Conference, the Committee of Representatives and the General Secretariat), whose powers had been questioned or reduced.

Second, with no explicit rules in this regard, less attention tended to be paid to the convergence of agreements between LAIA members than to the gradual disappearance of partial scope agreements and to their progressive, optional replacement by preferential tariff agreements and others of regional scope. Given the context of imbalances and adjustments conducive to the restriction of imports under bilateral agreements, it was highly unlikely that such a wide-ranging convergence could take place.

2. Flexible accession to agreements and "natural partners"

In the present context of trade liberalization, flexible and effective accession to preferential agreements could facilitate a gradual extension of preferences to other countries,[19] which would be consistent with an open regionalism approach that would help reduce intraregional discrimination. Promoting effective accession has two advantages. It lessens the overlapping of areas caused by a multiplicity of simultaneous integration agreements –even though it does not guarantee total convergence– and may lead to the formation of groups of countries that act as promotors of renewed processes of regional integration. The establishment of the Southern Common Market (MERCOSUR) as a result of the entry of Uruguay and Paraguay into a process of bilateral cooperation between Argentina and Brazil could be an example of how this may work. In other cases, such as the Central American Common Market (CACM) and Costa Rica in the early 1960s, an explicit accession clause was provided. Other examples are the General Agreement on Tariffs and Trade (GATT) itself, the European Economic Community (EEC) and the North American Free Trade Agreement (NAFTA) (Fuentes, 1993).

Flexibility of membership criteria reduces the probability of trade diversion, facilitates economies of scale and can also have a positive impact on investment. This implies giving priority, through flexible accession processes, to broad trade liberalization between countries that already engage in a significant amount of trade ("natural partners").

The heterogeneity of trade scenarios in the region and the fact that bilateral trade relations between countries of different sizes can lead to huge disparities in the relative weight of the participants have produced a situation where there is no bilateral trade relation in which the proportions of reciprocal trade are more than 25% for the two countries. In other words, if it is assumed that two countries having that particular proportion are "natural partners", then there are no natural partners in Latin America and the

19 Paragraph 4 a) of resolution 2 of the Council of Ministers of Foreign Affairs of the LAIA member countries establishes that partial scope agreements "shall be open for accession to the other member countries [following] prior negotiation". Establishing clear, objective entry requirements, rather than making membership subject to a vague negotiation process, could make it easier to accede to these agreements.

Caribbean. This situation may be approached in two ways. The first would be to establish preferential agreements among *several* countries of the region, in order to increase the proportion of actual trade subject to preferential treatment. The other would be to wait for the unilateral trade liberalization that has already taken place to gradually generate greater trade interdependence: only then, at a *subsequent* stage, would preferential agreements be signed based on the criterion of "natural partners".

3. Common external tariffs

The establishment of a common external tariff is more of an attempt to deepen rather than broaden an integration agreement. Therefore, it will be less feasible in a context in which the number of participants in an agreement is gradually increasing than in one in which existing commitments are being consolidated. The desirability of a common external tariff will depend on the characteristics of the member countries of an integration agreement. Low common tariffs would make more sense for countries with a high degree of reciprocal trade and similar economic structures. In such cases, the application of differential tariffs to different inputs would create unequal levels of effective protection for each member country and would generate conditions leading to charges of unfair practices and to the establishment of trade restrictions.

Also, differences in prices for products imported from the rest of the world would encourage contraband. A common external tariff also favours joint trade negotiations, although these negotiations do not require the existence of such a tariff. It reduces the need for strict rules of origin, and therefore the need for additional protectionist measures, since it eliminates the incentive for bringing in imports through a country with lower tariffs. An alternative would be to adopt common tariffs gradually, giving priority to those sectors in which the differences in incentives cause greater distortions (see box III-6).

4. The extension of national treatment to intraregional investment

There is a distinction between the application of national treatment to goods as compared to investments and services. Article III of GATT established the right to national treatment, but only for goods. Under this principle, once imported products have entered the national market and complied with any border requirements (such as tariffs), they may not be subject to taxes or regulations that are not applied to national products.

However, national treatment has become more important as transnational corporations have expanded their activities and trade in services has been gradually freed. These trends, which form part of the whole globalization process, have lessened the importance of trade measures applied at the border. In this context, some of the more important exceptions to national treatment include prohibitions or limitations on the activities of foreign firms in certain sectors, strict licensing procedures and restrictions on acquisitions of national enterprises. Other less strict forms of exclusion from national treatment are related to State purchases and the preferential concession of subsidies, foreign exchange and assistance to national enterprises. The physical presence of a foreign subsidiary also entails the application of regulations affecting aliens; this aspect is related to migration policies.

Since services are not subject to tariffs, protective measures relating to them tend to be limited to exceptions to national treatment; thus, reducing protection means eliminating such exceptions. Since the export of many services entails establishing a branch in the country that imports them, the right to do so tends to be the most important area of jurisdiction in national treatment. Unlike the most-favoured-nation regime applied to trade in goods, there has been no

Box III-6

NAFTA AND COMMON EXTERNAL TARIFFS

Even though the North American Free Trade Agreement (NAFTA) does not provide for a common external tariff, one was adopted, exceptionally, for computers. The measure helped to reach an agreement on relatively simple rules of origin, since when no different external tariffs exist, there is no incentive to introduce computers into a NAFTA country through a country with lower tariffs. Over a period of 10 years, Mexico will reduce its external tariff, which now fluctuates between 10% and 20%, to the levels applied in the United States and Canada, which are between 3.7% and 3.9%. Also, within a period of seven years, the drawback rights now enjoyed by the maquiladora (in-bond assembly industry) will be eliminated; most of the computers made in Mexico are produced by the maquiladora. The rule of origin simply establishes that computers will be considered to be North American if the circuit board is assembled in the region and is further transformed so as to change its tariff classification.

Source: G. Hufbauer and J. Schott, NAFTA: An Assessment, Washington, D.C., Institute for International Economics, February 1993, p. 7.

prolonged experience, either in the Latin American and Caribbean region or at the subregional level, with bilateral agreements for extending national treatment to trade in services.

There are sectors in which some countries in the region do not discriminate between foreign and national investment, treating both the same in practice. Some bilateral agreements explicitly extend national treatment to investments from another country; this not only favours investments in all sectors but also trade in services, which largely depends on foreign enterprises having the right to establish themselves in the country. The extension of national treatment to investments from the region, which can be gradually broadened through agreements with different geographic coverage, would be one concrete way to help advance the process of open regionalism.

Investment-protection and other types of agreements could be added to these measures to avoid double taxation. Investment-protection agreements would provide greater security, and the other types would help prevent the undesirable discriminatory effects produced by tax rate differentials.

An effort should be made to prevent a situation in which each country in the region extended national treatment to the others in different ways, producing overlapping and administrative complications. National treatment should probably be extended gradually to the countries of the region, but with a uniform application of the exception criterion.

5. Rules on unfair competition and GATT

Legislation on countervailing duties, anti-dumping and safeguards is another area that complements tariff policy, especially in a liberalization process which, by eliminating excessive protection, increases the possibilities of abuses stemming from unfair trade practices. Procedures to control such practices tend to involve complex measurement and organization methodologies. Therefore, it is difficult to imagine the legal and administrative difficulties and the uncertainty of economic agents that would be caused by a proliferation of integration agreements with different provisions on unfair trade practices.

Controversies in international trade relations tend to stem from provisions concerning non-tariff barriers. The most common controversies relate to the application of clauses on subsidies and countervailing duties (under GATT) and countervailing and anti-dumping duties (in United States-Canada relations). Procedures for settling such disputes normally establish arbitration panels, if prior consultation or mediation is unsuccessful.

Generally speaking, the basic problem caused by the existence of different dispute-settlement procedures is that the decision of an arbitration panel concerning a trade relation between country A and country B could contradict a decision of another panel concerning a dispute between country A and a third country. The problem is even more serious if legal provisions contained in the agreements are also different.

This question has already been raised. There is concern in GATT about the dispute-settlement mechanism in the Free Trade Agreement between the United States and Canada. It has been pointed out, in particular, that the conclusions of the binational group might enter into conflict with those of a multilateral group of GATT analysts, affecting the interests of third parties *(Inside US Trade*, 1991). When a member country of an integration area adopts bilateral procedures to settle differences with a third country, the interests of its integration partners could be affected.

One way to reduce the complexity and costs involved in the greater or lesser discrimination that may stem from different integration agreements is to have as few trade policy instruments as possible (tariffs and rules of origin, for example) that could generate preferential effects as a result of bilateral or subregional negotiations. This can be accomplished by using multilateral codes, such as those of GATT, to regulate other trade policy instruments. There is clearly a complementarity between progress in multilateral (GATT) negotiations and regional or subregional talks concerning preferential treatment. To the extent that advances are made under GATT on issues such as anti-dumping, subsidies, countervailing duties and safeguards, they could be applied at the national, subregional or regional levels, without having to adopt commitments that discriminate against third parties.[20] That way, potential overlapping or difficult bilateral or subregional negotiations about each of these issues could be avoided. GATT is also a supranational forum that could complement or replace, at least partially, the institutional capacity required by integration agreements.

Many integration treaties signed in the past, such as LAFTA and CACM, contain provisions taken directly from GATT. Thus, agreements reached in the Uruguay Round could also be incorporated into subregional or regional agreements that do not involve preferential treatment in the normative area. NAFTA illustrates this possibility to some extent, since it includes provisions proposed in Uruguay Round negotiations. To the extent that these precepts are adopted multilaterally in the framework of GATT, the discriminatory dimension of NAFTA will be reduced.

6. Simplifying rules of origin

As firms become more globalized and move away from verticality –processes that are reflected in the growing proportion of activities subject to subcontracting in a number of countries– rules of origin are often regarded as tools for avoiding these modes of action, and they help maintain activities that otherwise would be shifted to other countries where costs would be lower. However, rules of origin can become a protectionist instrument, cause distortions and have highly discriminatory effects (SELA, 1993) (see box III-7). More specifically, when products exported to a

20 Unfortunately, the results of the Uruguay Round were unsatisfactory with regard to anti-dumping; hence more precise, transparent agreements on the topic at regional or subregional level could be justifiable. Integration, consistent with open regionalism, could then serve as a building block for a more transparent, less protectionist world economic order.

Box III-7

RULES OF ORIGIN AND MULTIPLE INTEGRATION COMMITMENTS

The lack of a common external tariff in a free trade zone would create an incentive for diverting imports to the country with the lowest tariffs, in order to subsequently introduce them into the rest of the countries under the free trade regime. Thus, rules governing the origin of traded merchandise are more important in free trade zones than in customs unions. This could be particularly significant in the light of the growing tendency to use these rules as a protectionist tool, at the expense of the free trade officially promoted in agreements. Strict requirements concerning origin or domestic content can be used to block imports without having to apply a tariff or a non-tariff barrier.

Bilateral agreements on rules of origin can produce administrative complications, uncertainty, economic distortions and disputes. First, it will obviously become much more difficult for the competent public or private agencies to certify the origin of merchandise. Rules of origin create complications and involve costs for the enterprises that have to process and provide detailed information about the composition of the inputs contained in exported merchandise. For small firms with less accounting and computer capacity, this may present a serious problem.

Second, rules of origin may have greater protectionist effects in bilateral free trade agreements, since domestic origin is limited to the two countries involved. In a wider free trade zone, the larger number of participants makes it possible to include, in cumulative fashion, products of more diverse origin. For example, in a bilateral agreement or a free trade zone, trade could be limited to products with 50% or more domestic content. If a good traded by one of the parties to the agreement had only 25% national content, it could not be exported to the other party. On the other hand, if there were three partners, and if the domestic-content percentage of the product were 25% in the second and 25% in the third, then it could be imported by the first partner.

Lastly, differentiated rules of origin could have a negative effect on efficiency. To the extent that the rules of origin for one country are much stricter than those for another member, it is possible that local producers who use inputs imported from the second country, or buy exports from that country, would replace them with imports from the other one, without this being attributable to differences in efficiency; this would be a case of trade diversion.

Source: ECLAC, *La integración centroamericana frente a múltiples compromisos de negociación comercial* (LC/MEX/R.377), Mexico City, ECLAC subregional headquarters in Mexico, 1992.

given country are allowed to contain inputs only from that country, the enterprises of that country are favoured and others are prevented from benefiting from integration. This issue could be especially relevant when enterprises of different countries attempt to integrate production and import inputs from countries not included in the integration agreement. Also, a wide application of strict rules of origin could discriminate against small, relatively less developed countries having less integrated industrial sectors, by raising the costs of their exports, since they could obtain cheaper inputs from other countries.

There is good reason, therefore, to simplify rules of origin and turn to other explicit instruments of protection (tariffs), when trade liberalization is not advisable or possible.[21] In addition, dropping the requirement of certificates of origin for

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21 The draft agreement on rules of origin in the Uruguay Round includes the implementation of a harmonization programme only after the negotiations end and the signing of a "joint statement" on rules of origin applied to products with a right to preferential treatment.

imports that are valued at less than a given amount[22] would favour small producers and traders and reduce the administrative costs involved in enforcing these provisions.

7. Technical standards

The declining importance of border-applied measures (tariffs), more sophisticated technical knowledge in the health and environmental fields and the existence of a more affluent, demanding consumer base have all led to the growing use of technical standards in international trade. The abundance of rules and of the governmental and non-governmental agencies responsible for formulating and enforcing them, together with the different history and institutional and technical capacity of each country, have in turn created a situation in which the degree of transparency in the application of such standards is limited and the potential for protectionist abuses exists.

Acknowledging that standards are valid (see box III-8), in order to prevent these from becoming arbitrary barriers to trade and to ensure that they promote open regionalism, the relevant rules and evaluation procedures should be international, as far as possible. When international rules and evaluation procedures are lacking, or a given country prefers stricter national rules, these latter should be adopted. In such cases, it might be advisable to give the same treatment that is given to national producers or apply the most-favoured-nation regime granted to other countries. As in the case of rules on unfair trade, the application of the GATT agreements, especially those reached in the Uruguay Round, is particularly important; specifically, the expansion of the Code on Technical Barriers to Trade, concluded in the TokyoRound, and the code of conduct for the formulation, adoption and application of rules by institutions engaged in standardization, open to acceptance by public and private institutions.

8. Transport rules

Generally speaking, the lack of common rules in Latin America and the Caribbean –with regard to electric voltages, for example– a minor impediment to trade. However, in some cases, particularly overland transport, the lack of common rules increases transaction costs considerably, and is a serious obstacle to regional integration.

Subregional integration schemes in Central America, the Southern Cone, the Andean Group and MERCOSUR have attempted to standardize cargo vehicle weights and sizes in order to simplify international transport in their areas. Except in the case of MERCOSUR, however, such efforts have yet to produce legally binding agreements, apparently because the countries in these integration schemes object to rules because they are in one of three situations: i) their highway system does not meet the proposed standard for international transport and it would be very costly to upgrade it; ii) they find the rules too restrictive in comparison with their own rules, and their transport sector demands that their rules be accepted by the other countries; iii) their criteria for the acquisition of cargo vehicles have limited the size of vehicles in their fleets, and their transport sector fears that competition from larger vehicles would be harmful (Gould, 1993).

Because of the lack of roads through the Isthmus of Panama, Central America has little chance of engaging in overland trade with South American countries; therefore, harmonization of standards between the two subregions is not urgent. On the contrary, the countries of the Southern Cone, the Andean Group and MERCOSUR currently engage, to a greater or lesser degree, in overland trade. The differences in standards between these

22 The North American Free Trade Agreement does not require certificates of origin for imports that cost less than US$ 1,000.

Box III-8

STANDARDIZATION OF ELECTRONIC DATA INTERCHANGE

Electronic data interchange (EDI) refers to the automatic (requiring no human intervention) processing, transmission and reception of data between different computer systems. This technology is being increasingly used, *inter alia*, for international trade and transport operations, sales contracts, letters of credit, shipping documents, as well as for port and customs procedures.

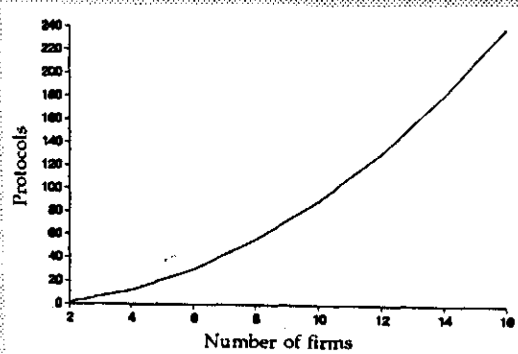
At present, EDI is already a basic tool for all agents involved in international trade and transport. EDI has not only saved time and reduced the cost of preparing and processing documentation, but has also led to better scheduling of shipping and therefore to more efficient inventory management. In practice, data processing and EDI have created the conditions for production and distribution methods such as "just in time" deliveries and "zero inventories". However, without prior standardization, EDI could not have spread as far as it has.

Indeed, for two distinct systems to "understand" each other, they need to share one "protocol" and carry out two conversions in order to transmit data from one format to another; therefore, four systems interconnected by pairs would require six protocols and 12 conversions, while 12 systems or enterprises would have to operate with 66 protocols and 132 conversions. The scheme quickly becomes more complex as the number of those who wish to communicate with each other increases (see figure).

This observation leads to the conclusion that if data interchange protocols are not standardized, in a trade context that increasingly uses data processing, a situation could soon be produced in which mechanized processes could be more inefficient than so-called manual processes.

Accordingly, the United Nations provided the bases for standardizing the three components of electronic data interchange: terminology, published in the *Trade Data Elements Directory* (UNTDED); recommended practices for data interchange, which appear in the *United Nations Trade Data Interchange Directory* (UNTDID), including the UN/EDIFACT (Electronic Data Interchange for Administration, Commerce and Transport) rules, which indicate how messages should be constructed; and the code of conduct for data interchange (UNCID), which establishes the legal principles that should be respected in such operations.

UNTDED and UN/EDIFACT have already been adopted by the International Organization for Standardization (ISO) and are widely used in the Organisation for Economic Cooperation and Development (OECD) countries and in South-East Asia. In the European Economic Community (EEC), where 12 data formats had to be processed in order to construct community-wide statistics, both regulations are obligatory for trade and transport information systems. Latin America has become increasingly interested in EDI; it should therefore be included in economic complementarity agreements as a trade instrument. In addition, government agencies should promote its standardization.



Function : n (n − 1)

Source: R. Gould, "Armonización de normas", Santiago, Chile, ECLAC, 1993, unpublished.

groups are not significant, but even so, they should be harmonized to facilitate international transport. Doing so would also eliminate certain domestic disputes in Bolivia and Peru.

Another area that needs standardization is that of railway gauges (Gould, 1993). When lines with different gauges meet, the cars cannot move from one to the other without adjusting the distance between the wheels on the axle or replacing the boogie with another that fits the new track. In Argentina, Brazil, Chile and Peru, for example, the main railways have two or three different gauges, which obviously complicates domestic transport in those countries. The problem is normally solved by transshipment. Only in Chile do they change the axles when transporting wood for wood pulp production.

At the international level, Guatemala, El Salvador and Mexico, and the countries of the Southern Cone of South America –Argentina, Bolivia, Brazil, Chile, Peru, Paraguay and Uruguay– have different railway interconnections. Of these, the ones between Argentina and Brazil, Brazil and Uruguay, Bolivia and Peru, and Guatemala and Mexico have different gauges. There are no facilities for changing the distance between the wheels or replacing the axles, which prevents direct transborder transport in box and passenger cars, making transshipment necessary. This makes rail transport more costly and less competitive with highway transport, to the detriment of the contribution that railways in each country could make to regional integration.

C. EQUALITY OF OPPORTUNITY TO BENEFIT FROM THE POTENTIALITIES OF INTEGRATION

The continuity and financial stability of regional and international integration efforts depend on whether their costs and benefits are distributed equitably among all participants and, in particular, whether the countries less able to benefit from integration are given a chance to seize the opportunities it offers. The nature of the issue has changed in the current context of trade liberalization, since liberalization has reduced the trade diversion costs that the relatively less developed countries had to pay if they signed preferential agreements with other countries. It is still true, however, that the more economically backward countries of the region or hemisphere are still likely to have fewer opportunities to tap the potential of integration agreements than more advanced countries. Arguments against this position are also being advanced, to the effect that other countries will be less interested in establishing agreements with countries that are not in a good position to compete, in so far as these last-mentioned demand preferential treatment and therefore forego the chance to generate the benefits that their firms would enjoy if they had access to broader markets. The following section explores some options that might reconcile these two positions and, at the same time enhance the participation of relatively less developed countries in integration processes.

1. Reciprocity and asymmetry

Recently, the practice of waiving the requirement of reciprocity or granting special conditions to countries less able to benefit from the potentialities of integration has fallen out of favour. One reason for this is the recognition that the total absence of reciprocity and, consequently, of interdependence can give rise to unstable situations that create uncertainty about access to the markets of trading partners. In fact, the need for reciprocity with developing countries has been explicitly considered in the negotiations of both the Uruguay Round and NAFTA.

Nevertheless, a sudden sweeping liberalization of trade between countries or sectors at different stages of development still runs the risk of polarizing investments and eliminating production facilities in the relatively less developed countries, which, if given more time to adjust, could improve their competitiveness. This could occur, in particular, in the industrial sectors of the smaller Latin American and Caribbean countries, given the predominance of Argentina, Brazil and Mexico in intraregional manufactures exports.[23] However, competition from regional imports does not seem to entail the same risk that national producers will be driven from the market as does unbridled competition from imports coming from countries such as Japan, Korea and China.

In general, it is also important to consider the capacity to reassign factors of production freed up by sectors that are declining as a result of a trade liberalization process. How fast this reallocation can proceed depends on the dynamism of overall investment, the flexibility of the enterprises concerned in adapting and in increasing intra-industry specialization, and the effectiveness of production restructuring programmes, including worker training. In other words, the benefits of trade creation can be tapped only if there is mobility and substitution of factors of production and goods. This means that countries that have more difficulty in changing their production and consumption patterns are not in a position to reap the potential benefits of trade creation in the short term. In such cases, specialization is increased not by the expansion of one industry at the expense of another, but simply by the dismantling of industries that have lost protection and by the resulting unemployment.

This suggests that it would be advisable to allow more time for the adjustment process in the more backward countries that liberalize their trade with other, more advanced, economies in the region or hemisphere, and to supplement this process with further measures, particularly at the national level. In practice, the need for a longer adjustment period is explicitly recognized in the agreements concluded between Venezuela and the CARICOM members and between Mexico, Colombia and Venezuela and the Central American countries. It should also be noted that there may be sectors in the relatively more developed countries that may also require longer periods to adjust to the liberalization of trade with other countries (see box I-1).

The countries having less capacity to take advantage of the potential of integration should also take steps to deal with any unfair trade practices adopted by the larger firms in the region. On the short term, this means promoting anti-dumping policies which are capable of warding off the effects of predatory practices through objective, non-discriminatory and transparent procedures —accepted at the national or subregional level—, taking the Uruguay Round agreements as a frame of reference. On the longer term, a policy on fair competition could be envisaged as part of any eventual integration agreement, for the purpose of discouraging this type of practice through punitive actions that do not involve trade restrictions.

Lastly, to promote a measure of balance in reciprocal trade relations and to keep rules of origin from becoming serious trade barriers, it would also be desirable for such rules to be generally lenient, although without ignoring the existence of special cases; otherwise, they would discriminate against economies that are not very well integrated or are less likely to generate significant proportions of added value.

2. Spread of technology and intraregional investment as a means of compensating for inequalities

In the absence of factors that spur the global dissemination of technology, the

23 In this connection, there also tends to be a certain asymmetry with regard to negotiating power, since smaller, less developed countries are generally more dependent on intraregional trade than larger ones.

initial conditions historically prevailing in each country will tend increasingly to strengthen the correlation between a country's size, capacity for efficient innovation and national growth rate, thereby possibly widening the gap between the less developed countries and other countries when they come to integrate their markets.

This means that the integration process must provide not only for trade liberalization, but also for appropriate, compatible laws on industrial property, openness of information networks, mobility of skilled human resources and promotion of foreign investment among the countries of the region, with the aim of encouraging imitation and the transfer of technology.[24] In addition to facilitating the spread of technology, integration agreements should allow less developed countries to reap the full benefit of their relative advantages, such as the low cost of labour or other resources. The need for special efforts to promote the inflow of foreign investment from within the region is particularly apparent in connection with the creation of channels for the spread of technology. There already appears to be a larger proportion of such investment in the region's small countries than in the rest; this could attenuate the negative effect of asymmetries between widely divergent economic structures.

The promotion of foreign investment from within the region, as a way of increasing the capacity of all the countries of the region to seize the opportunities created by integration, would require an agreement to establish mechanisms that discriminated in favour of intraregional investment. Such a decision could be justified if it generated not only the benefits deriving from investment *per se*, but also other advantages (externalities), in other words, if these investment flows furthered a sustainable, synergetic integration process that was not interrupted by acute trade imbalances and the resulting tensions. However, the potential costs of favouring less efficient investments, especially by comparison with private investments that could be made in a context of growing internationalization, would also have to be borne in mind.

Assuming that net benefits would be generated, the preference given to intraregional investment would have to take the form of some kind of incentive (subsidy) or discriminatory mechanism that translated into the availability of a certain amount of resources and guaranteed that compensatory investments would, in fact, be made in relatively less developed countries. Such resources could be channelled to those countries through a variety of mechanisms, such as the creation of one or more funds to finance new investment projects undertaken in less developed countries by enterprises from more developed ones. Resources would have to be made available on somewhat concessional terms to offset the (opportunity) costs incurred by private entrepreneurs in investing in relatively less developed countries of the region instead of in others where their investment productivity would be higher (or the risks lower).

Another mechanism for promoting private investment, and one which does not necessarily exclude others, would be to use available resources to finance fiscal incentives for intraregional investment. Such incentives could include tax exemptions (on income, for example) in the case of reciprocal investments, or tax credits for Latin American and Caribbean enterprises that invested in relatively less developed countries. Regional or subregional financial institutions or development banks could provide the institutional bases for implementing some of these systems.

Lastly, blatant long-standing trade imbalances could be linked to the granting of resources on preferential terms for

24 Traditionally, economic theory has tended to emphasize the superiority of policies that directly stimulate innovative activities over those that favour relatively innovation-intensive economic sectors. Special emphasis is placed on the adverse effects of using foreign trade policy to speed up innovation.

public and private investment projects. Experiments of this kind have already been carried out in the case of intraregional oil exports, as shown by the example of Venezuela's Investment Fund, which converted part of the debt incurred by the Central American and Caribbean countries through oil purchases into concessional financing for investments in infrastructure projects. Similar initiatives encompassing trade in all sectors, as well as public and private investment, could be implemented in the future and could give priority to countries particularly hard hit by the economic crisis and, at the same time, by serious political conflicts, such as El Salvador, Nicaragua and Haiti. In these cases, the determining factor would be the need to not only preserve the continuity of integration efforts or enhance equity, but also help consolidate democracy in Latin America and the Caribbean through regional solidarity.

3. Support for the balance of payments in relatively less developed countries

The existence of consolidated internal and external balances has become a basic criterion for identifying the countries with the best chances of being parties to successful formal integration agreements based on trade preferences. Its application tends to promote integration among parties that present the least risk at the country level. However, this criterion should include different gradations. For example, when the parties to an integration agreement are a large country and other countries of equal or smaller size, it is important that the internal and external equilibria in the large country be consolidated. Otherwise, the spillover effects of macroeconomic imbalances and the perception of the risks involved could spread to the other countries that are integrating with the one that has yet to strengthen its internal and external equilibria.

Conversely, when a small country that has not yet fully consolidated its internal and external equilibria enters into a relationship that is asymmetrical, but governed by criteria of reciprocity, the fact that it is joining an integration process with countries whose macroeconomic equilibria are better consolidated can enhance its credibility and help it improve its own equilibria; this, in turn, reinforces the integration process and the solvency of all the participating countries. Credibility, for its part, can lead to increased investment, particularly if favourable expectations spread to the rest of the region or subregion (and give rise to externalities, as occurred in South-East Asia). The foregoing explains why providing smaller, less developed countries with the financial support they need to consolidate stabilization processes should be a priority; moreover, since the amount of resources required is relatively limited, it is possible to have a decisive impact without significantly diverting the flow of financing away from other countries.

D. COORDINATION OF MACROECONOMIC POLICIES

1. The demand for coordination

One precondition for coordination in any form is that the parties should manifest both a demand for and a supply of common actions. Trade integration not only increases the demand for coordination by intensifying the transmission of macroeconomic effects, but also makes national policies interact more closely than before and highlights the parties' economic performance. Moreover, as unilateral liberalization expands intraregional trade, countries' macroeconomic interaction becomes more intense, whether trade preferences are applied or not.

In turn, the characteristics of trade can affect the forms of macroeconomic linkage that exist between countries. In particular, when trade leads to intra-industry specialization and each country's production processes are supplied with intermediate goods from the other, it is probable that, once the necessary investments have been made, that merchandise flows will vary more according to activity levels and less according to relative prices than when the countries' production structures are not equally integrated. The incipient process of open regionalism seems to point in this direction.

The demand for coordination arises in each country from the perception of a potential benefit to be gained if the others take a given action (Heymann and Navajas, 1992). This excludes situations where macroeconomic interdependence between countries is weak, or where economic dimensions are highly asymmetrical. In the latter case, the demand for coordination arises in smaller countries, but not in larger ones: the former can opt to harmonize their policies with those of the latter, but are not in a position to demand that the larger countries do likewise.

Where an agenda for integration exists, macroeconomic coordination can be viewed as either a result of the development of trade or a basis for it. According to the first viewpoint, the main problem is how to organize coordinated management of each country's policy instruments so as to internalize the effects transmitted by each economy to the others. The demand for coordination also tends to arise sporadically, when circumstances make the countries' macroeconomic goals more remote. This means that even if coordination exercises are carried out fairly frequently, the execution of jointly determined actions is important only at specific times. According to the second viewpoint, the demand for coordination reflects not the desire to correct a temporarily adverse situation, but the need to provide integration with a macroeconomic framework by means of relatively permanent agreements or even institutional commitments on the joint administration of certain economic policy instruments.

Although the two approaches are not mutually exclusive, an examination of the coordination initiatives already taken reveals a distinction between those corresponding primarily to one viewpoint or the other. For example, the Group of Seven functions largely as a forum where the parties deal with specific policy problems, but do not relinquish their autonomy in decision-making (see box III-9). In the European Economic Community (EEC), on the other hand, macroeconomic coordination is considered a basic component of integration, and institutionalized rules have been formulated for managing the different variables involved.

2. The supply of coordination

Coordination requires that participating countries be willing to expose their economic policy instruments, i.e., to risk a possible loss of autonomy in decision-making, in exchange for reaching a cooperation agreement; they must also be in a position to change the values of those instruments in line with any commitments they make to the other parties. This presupposes, in particular, that each country's authorities exercise effective control over these instruments. Since macroeconomic instability is often a symptom of loss of control over the main policy variables, countries in that situation generally have no supply of coordination. Also, the restrictions on the use of these instruments stipulated in tied loans granted by credit institutions can limit the capacity to coordinate policies.

In general, the coordination of macroeconomic policies can be seen as a process of give-and-take in which each country takes certain actions that it would not have taken were it acting autonomously, based on which the other parties adjust their economic policy instruments in its favour. From this viewpoint, coordination is no longer just a reciprocal adaptation of policies (which

Box III-9

POLICY COORDINATION IN THE GROUP OF SEVEN

Although the countries of the Group of Seven "negotiate" their macroeconomic policies, the commitments they adopt are of a general nature. This reflects two features of the participating economies. First, economic policy regimes in most of the European countries allow the authorities a considerable margin of flexibility: the maintenance of macroeconomic balances is based not so much on "rules" as on short-term administration, whose priorities change over time. Secondly, the parties do not seem to perceive international coordination as a mechanism for enhancing the credibility of their policies, nor is the degree of asymmetry between them large enough to induce any one of the countries (or "blocs") to adapt its conduct unilaterally to that of the others. The large blocs, for their part, are not so open among themselves that countries would agree to make their macroeconomic management dependent on an agreement with the others. This means that, while the demand for coordination exists and is manifested in specific forums, it is not strong enough to result in the "multilateral" definition of policies; instead, Governments determine their courses of action autonomously and cooperate through more or less marginal adaptations thereof.

The evidence suggests that no precise forms of policy coordination have been generated in the Group of Seven, but that practical exercises in cooperative action have been carried out and have tended to become repeated interactions. Furthermore, the Group acts as a forum for reviewing individual and joint policy decisions; the information this generates seems to be rapidly incorporated into market perceptions, especially when tensions or disagreements are observed among the participants. This means that the expectations of economic agents seem to respond more strongly to situations in which the authorities do not reach consensus than to announcements of future coordinated measures. This pattern implies that the Group of Seven has not generated confidence in the application of cooperative policies, but that if national authorities act in a way that manifestly lacks coordination, they must pay a price; this gives them an incentive to avoid, at the very least, overly aggressive competition among policies. It is possible that this situation can be extrapolated to other cases of incipient coordination.

Source: ECLAC, *Ensayos sobre coordinación de políticas macroeconómicas: inferencias para la integración latinoamericana* (LC/G.1970-P), Santiago, Chile, December 1992. United Nations publication, Sales No. S.92.II.G.15.

occurs only when economies are interrelated and when one country's policies respond to stimuli from the others), but a process of granting mutual concessions with a view to furthering the parties' objectives.

More specifically, unified policy management through joint decision-making systems must be based on converging views of the measures that should be adopted in each case, and on a sufficient level of confidence that costs and benefits will be distributed fairly. It seems unlikely that these conditions will be met, except in the case of integration experiences where considerable progress has been made towards establishing solid links among the economies of member countries and where policies have interacted for a long time with favourable results. Moreover, the most consistent forms of coordination are the outcome of fairly lengthy processes in which integration progressively gathers momentum and macroeconomic policies repeatedly overlap, as illustrated by the process of European monetary union.

3. Initial conditions that favour coordination

When countries undertake a coordination exercise with definite goals in mind, the parties can either agree to coordinate their management of specific instruments or set objectives related to the behaviour of endogenous variables in each country, leaving the respective authorities free to decide on the means of achieving the desired results. In fact, examples of both approaches exist: exchange-rate coordination in the EEC involves coordinated management of a policy instrument, while the debates of the Group of Seven in the 1970s on the "locomotive effect" were aimed at reaching broad agreement as to whether the orientation of each country's aggregate demand policies should be more or less expansive. In general, coordination does not necessarily mean that countries' policies must constantly follow similar paths; a collective response to a disturbance may require those instruments to work in opposite directions.

However, as regards the supply of coordination, the capacity to execute policies of macroeconomic regulation and, especially, to fine-tune them has been severely limited in Latin America and the Caribbean. In particular, the fiscal and monetary instruments on which the Group of Seven (among others) focuses its attention are often overly conditioned in the countries of the region. In any case, they are usually defined more in response to short-term pressures or emergencies than to precise planning. Although the situation may be different in countries that have achieved a degree of macroeconomic normalization, an overall analysis of the possibilities for coordination in Latin America must take into account the limited availability of economic policy instruments.

The obstacles facing macroeconomic coordination may increase the distance between the development of trade integration and the real possibilities for macroeconomic coordination. In these circumstances, although it would be unrealistic to set overly ambitious goals for coordination, it is important to define a sequence of progress that reflects the idiosyncrasies of each integration process. In the case of newer processes[25] or of steady progress towards open regionalism, this sequence should provide for fairly frequent contacts among economic policy makers, which would presumably begin with an exchange of information and a study of each economy's potential impact on the others, without a rigidly pre-defined agenda or the intent of making rigorous commitments. The effects of these activities are not insignificant, for they fuel a learning process as to how policies behave; at the same time, policies take on a multilateral dimension as their main points are debated among the parties. Agencies that provide financial support for balances of payments could promote more cooperation in the area of macroeconomic policies on this issue, especially in their forums (Jiménez, 1993).

Forums for this type of loose coordination would also be useful for reconciling differences of opinion on general policy approaches and for dealing with cases where there is a risk of actions and reactions detrimental to cooperation (such as escalating exchange-rate or trade measures against another member country) as a result of differences in the parties' economic trends or of external shocks. In order to reach concrete agreements on the management of policy instruments, each participant must be familiar with the goals, restrictions and policy approaches of the others, this can be achieved through ongoing interaction which, under certain conditions, can also lead to the establishment of mechanisms that help enhance each party's credibility with the others.

Although it is unrealistic to expect countries to give up instruments they consider effective, an initial form of coordination –which could precede efforts to reach a consensus on the numerical values of policy variables– would be to establish, by common consent, general rules on the type of policies to be adopted by the parties. This initial agreement

25 Striking differences in this area can be seen in the region, as shown by the fact that the member countries of the Organization of Eastern Caribbean States (OECS) have a common currency and a single central bank, whereas some Latin American countries do not participate in any subregional integration arrangement.

would presumably take the form of a negative commitment, listing the measures to be avoided in order not to obstruct bilateral relations.

For example, each of the parties could agree not to use multiple exchange rates to offset tariff preferences granted to the others. Subsidies, which have a significant impact on trade between countries, could also be dealt with in this category of instruments. In other words, a generic, qualitative agreement on how to manage macroeconomic policies can pave the way for quantitative coordination. Common rules could also be established through a two-stage procedure based on a set of indicators: the first stage would involve identifying coordination needs and the second would involve identifying the necessary corrective measures.

4. Coordination of exchange-rate policy

Since the domestic public debt market is generally limited in the countries of the region and since the level of international capital mobility (formal or informal) is often considerable, monetary management operates within narrow limits. As a result, fiscal and exchange-rate instruments largely set the tone of macroeconomic policy. The leeway available for coordinated action will therefore depend on the degree of freedom enjoyed in managing these instruments.

However, coordination of exchange-rate policy, which is linked to that of other macroeconomic policies, is plagued by the basic problem of a lack of consensus on which exchange-rate regime is best equipped to maximize the net benefits of such coordination.

The most important coordination experiments carried out within the Group of Seven were intended largely to influence exchange rates, on the basis of flexible criteria. These efforts –which met with varying degrees of success– involved regulating exchange-rate floats on the basis of qualitative judgements as to whether rates were out of line, but without explicitly defining criteria for intervention by central banks. No initiatives were taken to set up a regime of fixed parities: the various proposals on reforming the exchange-rate system (such as the establishment of "bands" or a direct return to generalized fixing of rates) have not reached the stage of being analysed with a view to their actual implementation.

Moreover, the fact that the Group of Seven has based its system on (more or less "dirty") currency floats, despite the objections raised to the international exchange-rate regime, seems to point to difficulties in reaching an alignment of fiscal and monetary policies in major economic areas. It may also reflect the implicit idea that if relative prices in these areas are subject to real shocks, nominal parities should have the flexibility to vary in order to hold down the costs of adjustment.

Furthermore, participation in a common monetary regime requires that members be highly compatible with regard to long-term budget management. They must be willing to impose tight restrictions on domestic policies, especially during the transition period. For example, in the specific case of European monetary union, fairly strict limits would be set on the size of the fiscal deficit and the public debt; for some countries, meeting the latter condition would require a strenuous effort to generate primary surpluses to finance liabilities (see box III-10).

Fixing exchange-rate parities is a common practice under stabilization programmes, especially –but not exclusively– under those implemented to deal with very severe inflation. Fixed-rate regimes impose strict limits on government financial management; they are often used to give fiscal and monetary management a definite framework and to improve the expectations of economic agents. When countries choose a foreign currency as a monetary model, they are generally seeking to take advantage of the increased credibility that this measure

Box III-10

FISCAL AGREEMENTS UNDER THE MAASTRICHT TREATY

Under the Maastricht Treaty, special importance is attached to national fiscal policies in connection with European monetary union and to alignment criteria for joining that union. Procedures are established to identify excessive fiscal deficits, which countries must correct; supervisory authority is assigned to the Council of the European Communities, which is also empowered to request more information from members with large deficits, recommend that the Community reconsider its credit policy with respect to those countries, require the latter to make non-interest-bearing deposits in specified amounts until the imbalances are corrected and, lastly, impose suitable penalties. The protocol on the treatment of budget deficits stipulates that these cannot exceed 3% of GDP, while the nominal value of domestic debt is limited to no more than 60% of GDP. These rules also constitute requirements which countries must meet in order to join the system. Thus, the fiscal position of each country, price patterns and interest rate movements are the three basic elements of the protocol on alignment criteria for joining the monetary union.

Source: Council of the European Communities, *Treaty on European Union*, Luxembourg, 1992.

gives their monetary policies in the reference country.

Although it is theoretically possible for a group of countries whose currency management is unstable to set up a joint monetary system without succumbing to inflation, it seems that the institutional requirements this would entail are too strict to make this a viable option. It is therefore more probable that an alignment of exchange-rate policies among countries that are traditionally unstable in macroeconomic terms will involve, rather than jointly floating their currencies, pegging them to one or more major foreign currencies. Even so, the destination and origin of these countries' trade would have to be similar.

Moreover, as suggested by the recent monetary disturbances in Europe, fixed parities can be difficult to maintain indefinitely, even among countries with similar macroeconomic structures.

E. INTEGRATION AND LABOUR

The relationship between the development of trade and working conditions (Charnovitz, 1987) has been a subject of concern for decades, reflected in various attempts (most of them unsuccessful) to link the issue of labour rights to multilateral trade policy. Despite the existence of numerous links between flows of trade, investment and migration on the one hand, and working conditions on the other, there is virtually no mention of the issue in international trade regulations.[26]

1. Labour and trade conditions

Problems of transition and adjustment and considerations related to unfair competition are especially relevant in this regard. With respect to the former,

26 In fact, GATT allows Governments to impose unilateral trade bans linked to labour problems only in relation to the products of prison labour (article XX(e)).

economic theory still has serious difficulties in accurately explaining the effects of integration on labour markets. In particular, the assumption of full employment on which much of traditional microeconomic theory rests ignores one possible effect of transition and adjustment processes and assumes that changes in economic structures to reflect new patterns of specialization occur without friction. However, integration (both regional and international) makes it necessary to undertake this arduous process of restructuring, whose success depends in good measure on the application of domestic policies to help enterprises move from one sector to another, while stimulating the design of financial and training plans that promote industrial restructuring.

The debate on ways of attracting investment or on the unfair trade competition that could result from keeping working conditions or wages at very low levels is also fraught with controversy.[27] Some argue that because countries that establish high labour or wage standards do so voluntarily, they cannot contend that other countries that maintain lower levels are acting unfairly. Moreover, such differences are thought to be inherent in the international division of labour and specialization. The alternative view is that differences between countries can obstruct progress towards better labour and wage standards by placing the countries that make the most progress in these areas at a disadvantage on world markets.

Thus, the first argument, which is equally applicable to subregional integration processes and to the international context, implicitly denies the need to link trade policy to labour conditions. This position may also (though not necessarily) lead to the conclusion that harmonization in social matters conflicts with the principle of national sovereignty, that it foments hidden protectionism, that poverty prevents more economically backward countries from raising social standards and that increased trade will automatically bring about a gradual improvement in labour practices, without the need for agreements of a subregional or international nature, as the case may be.

The second perspective tends to translate into proposals involving various types of harmonization in the labour or social spheres. While not denying the possibility that labour practices and conditions may be used for protectionist purposes, this approach maintains that higher standards are not necessarily a natural outgrowth of growing trade and income.

In practice, very little progress has been made towards establishing a direct link between trade policy and labour conditions at the multilateral level. However, some Governments have taken unilateral measures in this regard; for example, the United States has banned imports of goods produced by child labour. At the bilateral level, the United States also introduced elements of conditionality into the Caribbean Basin Initiative and the Generalized System of Preferences by making respect for labour rights a pre-condition for preferential access to its market.

It can be argued that such harmonization is more feasible or logical when it involves only a limited number of countries, since dispute settlement is more effective and predictable in these circumstances and it is easier to consolidate coalitions in support of broader integration agreements. Indeed, the effort to reach an agreement on labour standards parallel to NAFTA and the movement to formulate a Social Charter specifying basic social rights in the European Community (despite the opposition of the United Kingdom) were intended, *inter alia*, to win support –or at least avoid opposition– from trade unions for integration processes.

27 Note that analyses of labour standards have much in common with analyses of environmental standards (Charnovitz, 1992).

2. Migrations and integration

The possibility of linking trade or integration policy to labour conditions also has a bearing on the phenomenon of migration. According to traditional economic theory, merchandise trade can, under certain conditions, inhibit migratory flows. To put it more simply, this means that trade allows countries with abundant manpower to specialize in the production of labour-intensive goods, thereby preventing migration and, at the same time, helping to reduce wage disparities between countries. Conversely, the absence of opportunities for trade would increase migration and the probability of social tension.

In practice, this substitution effect between trade and migration, which may arise in the long term and is one of the justifications for NAFTA, is not the only way in which migratory movements and economic integration can interact. The trend described above may be accompanied by other, seasonal phenomena, such as transborder migration to neighbouring countries at harvest time, which are assuming growing importance throughout Latin America. In such cases, the regulation of working conditions can become a complex matter for negotiation, as in the case of Haitians who migrate to the Dominican Republic.

Wage differences can also cause concern in connection with more permanent migratory flows, especially in the context of integration arrangements that envisage an eventual agreement on the free movement of workers, as in the case of MERCOSUR. The strength of the incentive to emigrate created by wage differences depends on the influence of other factors, such as language barriers (important in Europe, for example), changes in labour supply and demand brought about by the integration process itself and the existence of networks which facilitate contact between established and potential migrants. Moreover, practical application of the principle of non-discrimination on grounds of nationality involves complex rules, particularly if it is to be implemented gradually and if it is to include exceptions that may vary according to different categories of workers (Ramos Olivera, 1993).

Changes in migration policy may lead to subsequent changes in trade policy. For example, when a programme allowing the seasonal migration of Mexican workers to the United States was abandoned in 1964, a programme of industrialization along the Mexican border (which fuelled the maquila industry) was launched as a partial substitute, with the support of a special tariff regime granted by the United States. Other trade policies can also influence migration, such as the policy to protect the sugar industry in the United States, which leads to the employment of temporary workers, mostly from Jamaica. Lastly, migratory flows can also affect trade flows, particularly in services such as transport and banking.

In sum, because integration comprises reciprocal flows of trade, investment and migration, it is closely related to the issue of working conditions. However, the precise degree to which these flows affect employment is difficult to determine and there are wide differences of opinion as to the importance and implications of unequal labour conditions among countries.

In practice, no significant progress towards closely linking trade policy to working conditions has been made at the multilateral level, although such efforts have made headway at the unilateral and bilateral levels. The European Community and NAFTA represent further attempts by small groups of countries to move in this direction. Additional relationships between integration and working conditions can be identified in connection with the topic of migration, which comprises issues such as transborder migrations, agreements on the free circulation of workers and the changing relationship between trade and migration policies.

F. POLICIES ON COMPETITION

1. Market expansion and competition

The experience of the European Community during the 1980s suggests that the formation of a market unified by free trade can trigger a series of take-overs and mergers. However, the adverse effect of mergers on competition tends to be diluted in areas where other foreign enterprises are already present. Moreover, because an expanding market can attract more new investment, additional enterprises may enter the market even in sectors where mergers have taken place.

The results of mergers involving smaller enterprises will probably be positive, since a specific minimum size, particularly in industries that benefit from economies of scale, seems to be a necessary (but insufficient) condition for adequate incorporation into economies that are well advanced in the globalization process. In so far as take-overs and mergers help to increase rivalry within the regional or subregional market being integrated, they may benefit both consumers and the development of competitiveness.[28]

In addition, the possibility of lowering the domestic entry and exit barriers that result from the application of government policies should be borne in mind. On the one hand, the reduction of tariff and non-tariff barriers to imports would lead to an increase in producers' ability to compete. On the other, standards and regulations such as licenses should be reduced or eliminated, as should cumbersome bankruptcy laws and bureaucratic procedures established under import-substitution strategies. Progress in this direction, involving a reduction in transaction costs, is already being observed in some countries of the region, and would give producers more flexibility to enter markets or sectors that offer good prospects and to leave those in which they cannot grow or are threatened by competition against more efficient foreign producers; this would create favourable conditions for meeting intraregional competition and for changing production patterns in general. Moreover, the reduction of entry and exit barriers through deregulation and the rationalization of rules would enhance the potential effect of lowering trade barriers and help to expand intraregional trade.

2. Trade liberalization and restrictive practices

Even when trade between countries is liberalized, restrictive trade practices that lead to the segmentation and distribution of markets among enterprises may exist. In the European Community, for example, cases of anti-competitive practices have been reported in sectors such as fertilizers (pricing agreements), liquors (market distribution) and food (exclusive distribution), on the basis of articles 85 and 86 of the Treaty of Rome.

There is evidence that such practices also exist in Latin America and the Caribbean, particularly in the form of contracts that restrict the use of certain technologies to the production of goods that can be distributed only in specific markets.[29] However, the only regional integration treaty containing provisions

28 In theory, broadening of markets in conditions of imperfect competition has two basic effects: an increase in mergers, with the resulting reduction of consumer surpluses amply offset by higher output as a result of economies of scale; and a reduction of the monopolistic power exercised by some enterprises in national markets, which boosts net benefits by combining the advantages of a larger scale with those of increased competition (Commission of the European Communities, 1989, pp. 18-19).

29 The UNCTAD code on restrictive trade practices, adopted in 1980, represented an attempt to confront the problem at the international level. Also, early integration initiatives tended to stress the need to form large enterprises, often in the context of programming efforts that constituted alternative

on the promotion of competition is the 1973 Treaty of Chaguaramas, which established the Caribbean Community. Article 30 of its annex, like the Treaty of Rome and the Stockholm Convention, which founded the European Free Trade Association, indicates that agreements between firms that restrict competition, as well as actions aimed at unfairly acquiring a dominant position in the market, are incompatible with the agreement "in so far as they frustrate the benefits expected from such removal or absence of duties and quantitative restrictions as is required by this Annex". Decision 285, adopted by the Commission of the Cartagena Agreement, in 1991 deals with concerted, parallel practices and abuse of a dominant market position; its coercive power, however, is limited.

Trade liberalization processes may reduce the need for policies on competition, in so far as they help to impose limits on practices based on the abuse of dominant positions in the market. However, for various reasons, trade liberalization in itself may prove insufficient. First, import barriers may persist owing to the existence of a concentrated distribution sector,[30] or as a consequence of the high cost of transport, both of which limit the potential impact of trade liberalization. Second, trade liberalization does not directly affect non-tradeable goods and services.

Regional or subregional legislation may facilitate mergers that are considered necessary. In the absence of such laws, enterprises must conform to the multiple specifications and rules laid down in the various national regulatory systems. Moreover, if mergers are approved by a multinational mechanism, the acquisition of a national enterprise by a foreign one is less likely to spark nationalist reactions against the integration process.

Lastly, changes in the use of certain trade or foreign investment policy instrument may require a stronger policy on competition (SELA, 1992 and Vernon, 1992). New instruments –including those designed to combat unfair trade practices, such as countervailing duties and anti-dumping measures– have become increasingly important in the light of trade liberalization and deregulation. Although, in principle, laws on competition represent the national version of measures used as a defence against unfair trade practices at the international level, the two types of policies have been applied differently. While the former have been oriented towards ensuring free competition, the latter have tended to protect national producers, thereby, in effect, restricting competition. This explains why a number of Governments, especially in Europe, have indicated that they would rather apply a harmonized policy on competition than be subject to anti-dumping measures.

The European Community's decision not to apply anti-dumping measures within its market and to confine itself, instead, to supranational policies on competition reflects its recognition that trade policy may endanger competition. Canada also tried, though unsuccessfully, to replace the anti-dumping measures in its Free Trade Agreement with the United States and in NAFTA with agreements on competition. This initiative resulted only in the conclusion of general commitments within NAFTA, with no provision for the means of enforcing them.[31] Towards the end of the 1980s, a debate began within the

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oversight mechanisms.

30 This is particularly important in countries whose domestic market is small; however, it has also been a subject of debate in negotiations between the United States and Japan, for example.

31 See chapter XV of NAFTA, which is divided into four sections. The first concerns the need to promote consultation, cooperation and coordination to ensure that each country's laws on competition are enforced (section 1501); the next two provide for guarantees that monopolies designated as such by the Governments (section 1502) and State enterprises (section 1503) will not act in a manner inconsistent with the content of NAFTA. The parties also agreed to establish a working group on trade and competition, which would formulate recommendations on future tasks, within five years after the agreement's entry into force (section 1504).

European Free Trade Association on the relationship between policies on competition and anti-dumping measures. All of this suggests that policies on competition and on trade liberalization are not necessarily interchangeable, but rather complementary.

G. INSTITUTIONAL ASPECTS

1. Institutional structures for integration

The Latin American and Caribbean countries have a great deal of experience in designing institutions to expedite economic integration processes; these institutions have generally been established by the constitutive instruments or treaties signed to initiate those processes.[32]

In the 1960s, the institutional set-up established in official agreements normally consisted of an intergovernmental (usually ministerial- level) body with decision-making authority, supported by a permanent secretariat. The Latin American Free Trade Association (LAFTA) and the Central American Common Market (CACM) were structured in this way. Later, the Andean Group became the subregional integration plan with the most complex structure. Like the European Community, it has a community organ and a permanent tribunal and parliament (Aninat, 1992). The Caribbean Community, for its part, was established with not only a ministerial council and a permanent secretariat, but also a Conference of Heads of Government, the supreme decision-making authority. The Conference appears to have set a precedent, since all of the current subregional integration schemes in Latin America provide for presidential summit meetings.

An evident shift towards less formal arrangements can be seen in the institutional structure of more recent integration processes in the hemisphere. This trend is above all manifested in the institutional arrangements for implementing subregional integration processes, such as MERCOSUR, NAFTA and some bilateral agreements.

Neither MERCOSUR nor NAFTA has a permanent entity, such as a community organ or even a secretariat, in its institutional structure. Under both plans, ministerial-level government bodies head these structures, and have primary responsibility for taking initiatives and actions to implement the constitutive agreements.

In the case of MERCOSUR, the most recent subregional integration process in Latin America, the constitutive agreement establishes two intergovernmental authorities: the supreme decision-making body, called the Common Market Council and consisting of ministers of foreign and economic affairs; and the executive body, the Common Market Group, which consists of four representatives of ministries of foreign affairs, ministries of economic affairs and central banks. The only permanent organ provided for in the Treaty of Asunción, which formed MERCOSUR, is an administrative secretariat, staffed by employees of the Government of Uruguay and responsible for providing documentation and communications services to the various intergovernmental bodies established.

MERCOSUR includes many government bodies. The Common Market Group supervises 11 executive sub-groups in charge of areas such as trade, tariffs and technical standards, monetary and fiscal policies, maritime and land transport, industry and technology and agricultural and energy policies. Instead of creating permanent forums for dispute settlement, MERCOSUR decided to use arbitration as a last resort in a procedure that includes direct negotiations and the submission of cases to the Common Market Group.

32 A recent compilation of such constitutive instruments can be found in Marcelo Halperín (1992).

The institutional set-up established in NAFTA coincides with that of MERCOSUR in some ways, especially in its preference for government bodies over permanent institutions. Its structure closely follows the precedents set by the United States' previous free trade agreements with Israel and Canada.

The highest authority of NAFTA is a commission made up of ministers or their representatives. Among its primary duties is that of monitoring the functioning of a secretariat consisting of national offices based in each of the member Governments of the agreement. The composition of this secretariat is the clearest indicator of the parties' preference for keeping the administration of NAFTA in the hands of the Governments themselves. Thus, it appears that the traditional formula of establishing permanent organs that are separate from Governments, have their own staff and enjoy some power of initiative has been abandoned.

Like MERCOSUR, NAFTA provides for dispute settlement through normal arbitration procedures; it also follows a precedent set in the agreement between Canada and the United States by providing for the establishment of binational groups of experts to analyse the application of anti-dumping measures and countervailing duties. The most recent institutional structures of NAFTA were developed even before its ratification. The complementary agreements required by the new United States administration manifest a reversion towards the establishment of permanent instruments, though only in certain specialized fields as yet. For example, the ministerial-level intergovernmental commissions established to deal with labour and environmental issues are to have permanent secretariats.

The many bilateral agreements signed in recent years tend not to include a common authority or secretariat from the institutional frameworks they establish, and put intergovernmental commissions in charge of monitoring compliance with the agreement.

Finally, against the backdrop of a greater commonality of interests among civil, democratic Governments in Latin America and the Caribbean, a certain tendency towards closer ties between political parties and legislative powers can be noted in the region. This is exemplified by the existing subregional parliaments and the Latin American Parliament.

In sum, regional integration agreements comprise a wide spectrum of institutional structures, ranging from community organs to simple bilateral intergovernmental commissions. The lessons to be learned from this experience in the institutional sphere could serve to facilitate the consolidation and future progress of integration agreements in Latin America and the Caribbean.

2. Conceptual aspects

The new realism with which institutional issues are being viewed seems to reflect a change of perspective concerning the role befitting institutions. This approach is characterized, in particular, by its divergence from that which views institutions as a means of filling in gaps or shortfalls in the economic or political spheres.

The clearest example of this perspective is manifested by some neo-classical economists, who perceive institutions as substitutes for absent or imperfect markets (Stiglitz, 1988, pp. 18-29) or as a means of reducing the costs of transactions between economic agents. The assumption that a causal relationship exists between market characteristics and the establishment of institutions tends, in practice, to translate into a deterministic attitude. This attitude can also arise from the perception of institutions as a crystallization or superstructure generated by economic and social relations. In practice, both views can lead to the adoption of a technocratic posture. In the extreme, this tendency can lead to the imposition of powerful institutions "by decree" to compensate for the limitations created by the force of circumstance.

At the other end of the spectrum of possibilities is the view that institutions are products of values and culture. For example, Seymour M. Lipset says that although Canada and the United States are two highly similar nations, they are based on markedly different organizing principles that account for the differences in their institutions (Lipset, 1990). According to this approach, institutions should reflect the values and culture of the real context surrounding them.

The goal of this greater institutional realism, which views the creation of new permanent institutions with skepticism, is to avoid the dangers of premature institutionalization, thus averting some of the consequences of trying to make institutions effective "by decree". Basically, the objective of more realism and less formalism is an expression of the old principle that form should follow function (Monnet, 1976).

This new, less formalistic (or more realistic) conception recognizes that it is within institutions that interests are crystallized and conflicts are manifested most clearly. Thus, because institutions are the arena in which social interaction is ritualized, they have the potential to make a decisive contribution to both stability and change.

Institutional considerations are even more complex at the multilateral level, owing to the absence of a single authority with a monopoly on power. For this reason, conflicts and opposing interests are more intense and varied in the multilateral sphere. It can even be argued that an underlying factor in the creation of many international and regional institutions is some type of "traumatic experience" that stimulates creativity and leads to the establishment of effective institutions (Haas, 1990). This, in turn, explains the fact that there are no "blueprints" for the design and establishment of international institutions.

The foregoing implies that institutions are more relevant and effective when there is a shared perception, supported by values and culture, that they are needed. This explains why attempts at institutional engineering that do not reflect the concrete circumstances of individual situations are fraught with risk and frustration.

One of the most common dangers involved in the exercise of creating a new institution is that it may result in plans which, though perfect in theory, are so inadequate in practice that they serve as no more than testimonies to their own ineffectiveness. The risk is even costlier when the institutions themselves are expected to generate circumstances in which they can be effective. At best, these ambitious goals are ultimately revised and replaced by other, more modest ones.

Nevertheless, despite such dangers, it is always tempting to suggest that new institutions be established, on the grounds that existing ones are ineffective. For example, a debate is in progress on whether to establish a new institution to promote the trade liberalization process in the hemisphere.[33] Deliberations are also under way on the restructuring of various existing institutions in the context of Latin American integration.

In short, there are no precise rules or preconceived formulas for the design and establishment of international or regional institutions. Ultimately, Governments are the ones that determine the scope and features of institutions, through negotiations and according to their perception of their own interests (Haas, 1990).

3. Conclusions

The less formalistic, more realistic spirit of recent integration plans in the hemisphere indicates that certain basic principles have been assimilated. At the root of this trend is an apparent acceptance of the fact that

33 The debate was triggered by the proposal made by Richard Feinberg and Peter Hakin (1991) to create an "Americas Commission".

institutions must appropriately reflect the nature of the integration process to be carried out. Thus, processes whose only aim is to abolish obstacles to free trade in goods should provide for institutions that are predominantly intergovernmental and relatively modest.

Similarly, if the objective is to create a common currency, an integrated system of central banks or a single central bank –as exemplified by the structure of the United States Federal Reserve– is a minimum requirement. If the initiative involves policy coordination, it evidently must provide for some centralization of decision-making power if common industrial or agricultural policies are to be implemented, or for the coordinated management of indicators if a joint macroeconomic policy is envisaged.

In any case, the wisest course would be to avoid adopting rigid commitments, and instead favour schemes that are adaptable enough to ensure that the pace of institutional development is set by the momentum of the process itself. This would ensure that form reflects function and that institutions fulfil their primary role of acting as instruments of both stability and change.

Lastly, institutions cannot respond to contemporary values and culture in Latin America and the Caribbean unless they reflect the hemisphere-wide trend towards democratization and representative government. This means that they must allow and facilitate greater participation by organizations representing various social interests. Along the same lines, it would be desirable to support the joint forums, such as the Latin American Parliament, that help bring political processes into line with economic integration.

These considerations also apply to the process of de facto integration –fuelled mainly by enterprises and their investments– of recent years, which brings a wider variety of actors into play in the integration process. This de facto phenomenon, which largely conditions the evolution of policy-driven integration, especially when it occurs in a context of globalization, liberalization and deregulation, also requires more active participation by non-governmental organizations, such as business, labour and cultural groups, in the design and implementation of integration policies.

As the participation of non-governmental organizations increases, the decision-making process becomes more complex, since appropriate mechanisms must be devised to give new actors timely opportunities to voice their opinions. If the institutions created under integration processes make this effort, they will enhance their legitimacy by increasing their capacity to respond to the aspirations of all the various social groups.

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