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Technical Annex

Trade Agreements in the Americas: Regionalism Converging to Globalization

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This document is the technical annex to the full paper "Trade Agreements in the Americas: Regionalism Converging to Globalization," which is available separately.

Typology of Trading Blocs

Economists have classified trading blocs into four major types: free trade areas, customs unions, common markets, and full economic unions.

Free Trade Areas (FTAs)

In this type of arrangement, trade restrictions between signatory countries are reduced to zero (or placed on a reduction schedule) for either all goods or a set of goods agreed upon by the member countries. Each country is allowed to maintain its own trade and commercial policy towards the rest of the world (i.e., countries that do not belong to the FTA). Rules of origin are used in order to prevent trade deflection schemes, by which outsiders use the member country with the lowest trade barriers to transship products to the more protected market. A conflict resolution mechanism exists to resolve and possibly defuse potential conflicts among member countries.

Customs Unions

As in the case of an FTA, members in a customs union trade freely with each other. However, they adopt a common external tariff against nonmember countries. In this case, rules of origin are not as important and can be interpreted as equivalent to domestic content requirements. In trade negotiations with international organizations such as the WTO, member countries are required to co-ordinate their approaches and policies.

Common Markets

Common markets are customs unions with the addition of free movement of capital and labour. In order for this type of arrangement to be successful, a large degree of co-ordination in several areas is necessary. For instance, taxes and commercial policies must be harmonized in order to create a level playing field. The existence of a central body which arbitrates and co-ordinates policies is extremely important.

Full Economic Union

This type of arrangement includes all of the aspects of a common market, plus a total harmonization of government spending and taxation and operations of central banks. It also includes the elimination of national preference in government procurements. Although a single currency is not a required element, it might be a desirable one. It is important to note that as countries become integrated in this form, they give up some of their economic sovereignty. In other words, there is a trade-off between national sovereignty and that of the union.

The Regional Trade Agreements

The ALALC and the LAIA

This agreement, signed in February of 1960, was the first integrational scheme among developing countries (Macadar, 1992, 143).[10] The eleven signatory countries were Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela. The agreement, per se, was a simplified type of integration via free trade. The long-term objective was to create a Latin American common market, which would be achieved by first creating a free trade zone by 1973. This integrational proposition followed closely the ideas of the United Nations' Economic Commission for Latin America and the Caribbean. However, changes to the original concept doomed this treaty. The original idea had been to achieve a free trade zone in a gradual and flexible manner (i.e., a preferential trade zone initially). In the actual agreement, because of the GATT's Article XXIV, this flexibility was lost (ibid., 140). The instruments used were: market integration through tariff reduction in specific products, monetary and financial policy co-operation, co-ordination of industrial development policies, and special treatment for countries with a lesser degree of development.

This agreement only succeeded in a very limited way. Although tariff reduction was achieved on an individual basis (i.e., countries reducing tariffs unilaterally), not one of the attempts to achieve a common tariff reduction list was successful. With regard to monetary and financial co-operation, the treaty did succeed in creating an "agreement of payment and credit" through the member countries'central banks. It is not surprising that, given the economic and developmental heterogeneity of the countries in the region, aggravated by

the enormous geographical distances and the cultural-political diversity, the co-ordination of industrial policy and any special treatment for other countries was a complete failure.

In 1980, following the concessions achieved during the GATT's Tokyo Round, a new treaty was signed establishing the Latin American Integration Association (LAIA/ALADI). Its objectives were much more limited and more flexible in scope than those of the ALALC. Although this agreement kept the original long-term goal of forming a Latin American common market, no specific time or quantitative measures were imposed. Specific mention is made of the allowance for the creation of other types of bilateral and sub-regional trading arrangements, with the only condition that these agreements must allow the incorporation of new members (i.e., a convergence clause). Furthermore, LAIA members have made political compromises in order to maintain the viability of the organization. For instance, in June 1994, the Council of Ministers approved the Interpretative Protocol of Article 44 (LAIA's Most Favored Nation, or MFN, clause) in order to accommodate Mexico's entry into NAFTA. This new interpretation allows members who have granted preferences to third countries the right not to have to apply the MFN clause and not to have to extend these preferences to the other LAIA members, provided negotiations are launched to compensate LAIA members. Mexico invoked this clause in September 1994 to safeguard the concessions made to NAFTA partners from having to be extended to all of the LAIA members (OAS, 1998, 9). In addition, in 1998 the LAIA Council of Ministers approved Cuba's membership request. The full participation of this country is awaiting ratification from the Cuban parliament.

In the global context, the LAIA's future seems assured. Even if a South American free trade area comes into existence, it will likely be defined as a limited free trade area and registered in the LAIA. This procedure would avoid the creation of another bureaucracy and would ensure the viability of the LAIA, which would administer the agreement and register it with the WTO. Thus, although the LAIA might seem superfluous, it is not. It allows the countries of the region to enter into arrangements of limited reach, often more in line with their needs, while still being a member of the WTO. In that sense, it has been a successful agreement, even if its most important function is that of a regional "registrar." The evolution of this agreement provides evidence that is consistent with the four arguments made in the introduction. First, it accompanied the region's change in developmental model. Second, member countries see it as link with the WTO. Third, it is open to new members (e.g., Cuba's new membership), and finally, its bureaucracy is providing help towards globalization.

Andean Pact

The limitations and the conflict of interests within ALALC led some member countries to look for other venues for integration. The Andean countries, which had more of a need

to increase their market size than other larger countries in the region, decided in 1969 to implement a much bigger and faster type of integration.[11] Following the dictates of Article XXIV, this integration would be accomplished by the following instruments: (a) creation of an institutional body with executive power; (b) adoption of a timetable for commercial trade liberalization; (c) the gradual establishment of a common external tariff (CET); (d) co-ordination of industrial policy with specified distribution of costs and benefits among member countries; (e) special treatment for the two less developed countries in the group, Bolivia and Ecuador; and finally (f) the harmonization of policy with regard to foreign investment. These countries judged that they would be able to implement goals that were a great deal beyond those of the ALALC because they were more homogeneous in size, location and development than those countries in the ALALC. Unfortunately, these goals proved to be far too difficult to achieve, and although all member countries were aware that changes in the treaty were needed, it took twenty years to reach a consensus (Macadar, 1992, 165).

Then, in November of 1990, the Acta de la Paz was signed by the presidents of Bolivia, Colombia, Ecuador, Peru and Venezuela. This treaty reactivated the Andean Pact, and again, ambitious targets were established. These objectives were much like the ones established originally. In addition, there was a new objective: to liberalize air and maritime transportation (Edwards, 1994, 37). In this case again, the differences in economic structure as well as macroeconomic policy between the countries in the group have led to several difficulties. An agreement on the level and structure of CET was established in 1992 by the Act of Barahona (an act within the Andean Group but not including Peru and Ecuador). The CET had four levels and an extremely cumbersome mechanism. The whole process was flawed by contradictions and exceptions, and there was no clear legislation on rules of origin. On the positive side, a free trade area—with no goods exempted—went into effect in 1993 between Bolivia, Colombia, Ecuador, and Venezuela. Note that Peru was not part of this free trade area.

In May 1992, Peru suspended the preferential treatment granted to imports from within the pact and President Fujimori closed the Peruvian congress. As a consequence, the governments of Colombia and Venezuela suspended negotiations with Peru. The level of political-diplomatic tension in the region was further aggravated by border conflicts between Peru and Ecuador (Edwards, 1995, 155). In 1996 it appeared that the Andean Pact was at a standstill and its future uncertain. Nonetheless, member countries did not stand still. Colombia and Venezuela signed a free trade agreement with Mexico (the Group of Three) and Bolivia became an associate member of the Mercosur.

However, instead of fading, the Andean Group metamorphosed into the Andean Community in June, 1997. Among the several institutional changes that took place were

the creation of a Presidential Council, a Council of Foreign Ministers which had a critical role in the decision making process, and the consolidation of all its institutions and mechanisms under a new umbrella, the Andean Integration System. The practical changes that occurred in 1997 were also numerous. For instance, Peru rejoined the group and agreed to gradually join the Andean free trade area by completing its trade liberalization process vis-à-vis the other countries by the year 2000 for most tariff lines, and by 2005 for a few remaining sensitive products (Mendoza, 1998, 6). Other changes include the new common investment and patent rights regimes, and the enactment of new copyright protection legislation.

Regarding Andean Community relations with the international community, a landmark accord was reached with the Mercosur in 1998. This agreement aims at the creation of a free trade area between the two blocs, to be implemented by January 2000. It appears that the Andean Community has been putting negotiations with the Mercosur at the top of its priorities, a decision which, according to Mendoza (1998), has been questioned by several scholars on the basis of existing trade and trading patterns. Mendoza remarks that these criticisms fail to account for the new direction of regional trade agreements.

> Trade agreements are not made to lock in past patterns of comparative advantage, nor should they restrict their effects to the trade field. If the experience of the Latin American countries with the recent trade arrangements is any guide, greater economic integration between the Andean Community and Mercosur should lead to an important expansion of trade and investment flows (1998, 6).

The quote above frames this accord in terms of the four arguments central to this paper. First, clearly this agreement is about more than trade. Second, member countries have revived it partly in an attempt to have a stronger voice on the ongoing FTAA negotiations and the upcoming WTO Millennium Round. Third, although countries are not begging to become members of the Andean Community, openness could be measured by its desire to negotiate with the Mercosur. Finally, although it is not clear that its bureaucracy is contributing to the globalization process, the Andean Community is certainly helping member countries with their internal issues.

Mercosur

In 1991, Argentina, Brazil, Paraguay, and Uruguay signed the Treaty of Asuncion, forming a common market to be phased in by 1995. This treaty formed the basis for a geographic trading region which is now known as the Mercosur. Originally, the goals of this agreement were the free movement of goods, services, capital, and labour between member countries, a CET by 1995, and co-ordinated macroeconomics and exchange rate policies (Almeida, 1993, 15). A transition period, in effect until December 31, 1994, was established. An interesting change from other agreements in the region was that the program of

trade liberalization consisted of the elimination of restrictions to intraregional trade according to a gradual, linear, and automatic schedule. This automaticity permitted the accord to progress on schedule in spite of difficulties. Another difference consisted of the creation of an administration and implementation body, which then formed eleven subordinate negotiating sub-groups. This structure allowed for independence in sectoral trade negotiation, and a very efficient mechanism for reaching consensus. A common parliamentary commission was also formed. This action implied that, during the transitional period, there would be no plans for the formation of supranational councils (Hester, 1996, 5).

Most of the treaty's original goals were achieved. In the end of 1994, the "Ouro Preto Protocol" was signed, giving the accord an international legal identity. At the same time, a new administrative structure was created. This new structure served to solidify the Mercosur as a de facto entity (Almeida, 1998).

The CET implementation calendar, negotiated in 1993-1994, is being followed. The structural and developmental differences between countries in the accord led to agreement on a "convergence phase" (from 2001 to 2006) for national exclusion lists. For instance, capital goods' adhesion to the CET is scheduled for 2001 while the introduction of computer products (software and hardware) and telecommunication is slated for 2006.

Within the Mercosur, progress is being made in the development of a free trade area, but not without some setbacks. In 1994, when the customs union regime was established, two important sectors were excluded: automotive and sugar. By the end of 1998, a resolution had been reached regarding the automotive sector but not for the sugar sector. The recent devaluation of the Brazilian currency—in November 1998—and the recent Argentine presidential elections are causing some delays and disagreements. To date, Argentina and Brazil are still trying to resolve disputes in sectors or commodities such as footwear, rice, and automotive. These disputes are not unique to the Mercosur; they are part and parcel of any agreement that involves a high volume of transactions.

It is interesting to note that the Mercosur is also emerging as a "political" entity. The rationale for this statement is the adoption, by the member states and the associate member states—Bolivia and Chile—of the "democratic clause." This clause makes the existence of a democratically elected government a mandatory condition for participation in the bloc. This clause was legalized by its inclusion into the Ushuaia Protocol of 1997.

As mentioned before, the Mercosur is actively pursuing agreements with other regional blocs. It started negotiations for the eventual creation of a free trade area with the European Union in 1995, it is a participant in the FTAA negotiations, it is completing final arrangements with the Andean Community, and it is preparing for full participation in the WTO's Millennium Round.

Perhaps, of all the regional trade agreements in Latin America, the Mercosur is the one most often singled out as a detractor from multilateralism. However, according to the criteria set out by this study, this is not the case. First, Mercosur members are increasingly global players and the agreement is about a lot more than just trade. Second, it is being used as a leverage tool in multilateral negotiations. Third, as mentioned before, although the bloc is not completely open, it is making a concerted effort in that direction. Last, its bureaucracy is being used in multilateral endeavors by all of its member countries.

NAFTA

In June 1990, Mexican president Carlos Salinas de Gortari and U. S. president George Bush declared that the two countries were committed to negotiating a comprehensive bilateral trade agreement (Winham, G.R. and Heather A. Grant in Barry, ed. 1995, 16). Canada reacted defensively. Winham and Grant explain: "… the Mulroney government had narrowly survived a divisive national election in 1988 over CUSFTA, and was wary of entering what appeared to be a controversial negotiation for Canada …. [It did so, in the end, because it] wanted to ensure that the gains it had made under the CUSFTA were not diluted as a result of a bilateral deal between the U.S. and Mexico" (ibid., 1995, 17). Therefore, in February of 1991, Canada, Mexico and the United States decided to start negotiating NAFTA, and later that year the U.S. Congress approved the fast-track treatment for the agreement. In December 1992, the final agreement was signed; it was approved by the U.S. Congress a year later (Edwards, 1994, 40).

An important point about this agreement should be emphasized. Just like the CUSFTA, NAFTA is more than a free trade agreement: it is an accord over investment rules, and it creates a dispute settlement mechanism (Krugman, 1992 in King ed., 1995, 180). The scope of this agreement is wide. It covers areas such as: tariffs and non-tariff barriers, rules of origin, agriculture (through three separate bilateral agreements), energy, auto industry, textile and apparel, services, government procurement, financial services, intellectual property, dispute settlement, and investment. NAFTA also addresses the area of labour and environment protection in separate side agreements.

Although this agreement has been in effect for over five years, some provisions—particularly tariff reductions—have not been fully implemented. This follows from the fact that NAFTA was designed to have a gradual impact on the North American economy; thus, some tariff reductions have a phase-in schedule of five to ten years for implementation.

Opinions on the overall effects of the agreement vary greatly; however, most critics do not dispute the fact that NAFTA has helped increase trade among member countries. A 1997 report details that "trade between Canada, United States, and Mexico has increased by 43 percent since NAFTA took effect. For the United States, trade with Mexico and Canada comprises nearly one third of U.S. trade in goods with the world" (Bannister, 1997,

5). It is important to note that these results were achieved despite the fact that in 1995 Mexico experienced a severe economic recession. The NAFTA results stand out in contrast to the Mexican crisis of 1982. Following the 1982 financial crisis, Mexico raised tariffs by 100 percent, causing American exports to fall by half. That recovery took seven years. In 1995, Mexico continued implementing its NAFTA obligations even as it raised tariffs on imports from other countries. This time, the recovery of U.S. exports to Mexico took less than two years (OAS, 1997, 3).

The dispute resolution mechanism appears to be functioning well. The agreement stipulates that antidumping and countervailing duties disputes are to be resolved under Chapter 19, while violations of provisions of the agreement are addressed under Chapter 20. Up to the middle of 1997, according to Bannister, two cases had been brought forward under Chapter 20 and twenty-nine under Chapter 19 (1997, 3). This number might even be considered low when the magnitude of trade volumes covered under NAFTA is taken into account.

As with any "living" agreement, there are glitches and problems to be resolved. In the 1997 U.S. International Trade Commission's report on NAFTA, problem areas in each of the three countries are cited. Among these are: for Mexico, the unpredictable administration of tariff-rate quotas on agricultural products and the difficulties with testing procedures and technical standards for telecommunications terminals; for the United States, the failure to comply with NAFTA's timetable on trucking safety certification and access, and implementation of sugar quotas and the sugar re-export program; and for Canada, the protection of cultural industries and the subsidies for lumber and wheat (ibid., 10).[12] One suspects that if each government made its own problems list, there would be a great deal of overlap.

In sum, NAFTA is a landmark agreement in the Americas. It is the first agreement between developed and developing countries to cover areas such as services, investment, government procurement, intellectual property rights, and so on. Notwithstanding its potential, NAFTA's future growth is doubtful, due to the lack of fast-track powers of the current U.S. administration and other issues mentioned earlier. It will probably remain an agreement between three partners. Consequently, it is considered a closed bloc. Regarding multilateral negotiations, given that this is a free trade agreement, member countries negotiate individually.

CARICOM

The integrationist movement in the Caribbean dates back to 1965 when Antigua, Barbados, and British Guiana signed the Caribbean Free Trade Association (CARIFTA)[13]. By 1968, eight other countries—Dominica, Grenada, Jamaica, Montserrat, St. Kitts-Nevis-Anguilla, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago—ratified the agreement. Belize joined in 1971.

The agreement aimed at immediately freeing trade among its member countries and establishing a five year schedule for the phasing out of tariffs on the few import substituting products which were exempt from the first list. No attempts were made to create a CET. According to Edwards, gains were achieved from this integration, although they were strongly biased in favour of the more industrial members of the arrangement (1995, 157). As expected, the least favoured members exerted pressure for a different design that would benefit countries more equitably.

As a result, the Caribbean Community (CARICOM) was established in 1973.[14] Its objectives surpassed those of CARIFTA by acknowledging the different stages of development of its members and by including the coordination of foreign policies, the creation of planning agencies for agricultural and industrial development, and the adoption of a CET. However, the timing for implementation of the CET was poor, as the region was dealing with the impact of the oil shock. The deterioration of the region's terms of trade led several countries to impose protectionist measures, which provoked severe antagonism among member countries and led to the disintegration of the group.

In 1991 the CARICOM heads of state decided to revive the association. Among their new initiatives was the reduction of the CET upper band to 45 percent. In 1992 this upper band was further reduced to 20 percent within a period of four to five years (ibid., 158). Since then, CARICOM has been moving towards an approach more in line with the other Latin American regional agreements. A Single Market and Economy Initiative, signed in 1998, is expected to be implemented by the end of 1999. This initiative includes measures such as the enactment of legislation relating to the free movement of skilled CARICOM Nationals, the introduction of Double Taxation Agreements throughout the region, the removal of all remaining unauthorized barriers to intraregional trade, and the completion of a fourth phase of reduction of the common external tariffs.

This agreement serves as a good example of revival of a regional trade agreement in the Americas that is attempting to contribute to its members'inclusion in the global economy. Towards this end, it has moved with the region from import substitution to global participation; it accepts new members; it is providing some clout to its members in negotiations with non-members; and to the extent that it can, is providing logistical support in multilateral negotiations.

Central American Common Market (CACM)

In 1960 Costa Rica, Guatemala, Honduras, El Salvador, and Nicaragua set out to create the first customs union in Latin America. However, given the political volatility of the region and ambition of this project, its failure was not unexpected.

According to Bulmer-Thomas, "the architects of CACM hoped to use the customs union to reduce dependence on the external sector, improve the net barter terms of trade

and achieve industrialization at one and the same time" (1998, 314). Further, Nicaragua was a member of the GATT and had to follow the conditions stipulated in Article XXIV. The industrialization objective was pursued through the freeing of trade within the customs union, subject to a CET on third countries. Freeing of trade was targeted to industrial products, of which 94 percent were traded intraregionally free of tariffs by 1966 (Hansen, 1967 cited in Bulmer-Thomas, 1998, 314). The harmonization of tariffs necessary for the implementation of a CET resulted in large increases in average tariffs for consumer goods. These increases were not offset by the small decline in average tariffs on all other goods. Consequently, it was not surprising that, although initially intraregional exports of manufactured goods surged, many problems began to surface in the next decade. For instance, trade creation was limited to a very small manufacturing base—remember that trade liberalization did not include agricultural products—while trade diversion meant that locally made products from newly established industries replaced cheaper and higher quality imports. Another big problem was the fall in revenues as consequence of the reduction in tariffs. These revenues traditionally had constituted a large part of the Central American countries' budgets. Lastly, the total population of Central America in the 1960s numbered 11 million people, of which a large portion were excluded from the market by poverty. As a result, market demand did not support the economies of scale necessary for optimal production in most manufactured goods.

These problems, in combination with the fact that the few gains made were unevenly distributed, led to the withdrawal of Honduras at the end of 1970. Moreover, the movement lost momentum in the 1970s and sporadic efforts made to revive it never commanded the highest priority among the political elites. Political turmoil accompanied this deterioration, with the Somoza regime being replaced by the Sandinistas in Nicaragua and the left making gains in El Salvador. However, the real crisis arrived in the 1980s with the onset of the debt crisis. Most countries in the region responded to the crisis by imposing massive non-tariff barriers. In 1986, the CACM received a fatal blow when the Central American payment clearing mechanism collapsed (Edwards, 1995, 156).

Only in 1990 would talk of integration return to the region. A first step towards reconstruction was taken during the summit of Central American Presidents held in June 1990. The new CACM would have the return of Honduras as a full member, a new CET at much lower levels than before, and elimination of non-tariff barriers. As well, trade liberalization would include agricultural products. The next year saw the creation of a new legal and institutional framework through the new "System of Centro American Integration" which was housed in El Salvador in 1993. In addition, in 1994, the Central American Presidents adopted the "Alliance for Sustainable Development"—a program to promote sustainable development in the region.

Although the revival of the CACM has an export-promoting framework as opposed to the original import-substituting framework, it still suffers from excessive optimism. The region tends to embark on a series of commitments that are far beyond what it can realistically accomplish. For example, the original goal of "sweeping away non-tariff barriers" was imposed with no thought of how this would be accomplished. Adequate funding was never provided to the sustainable development program; consequently, it has gone nowhere. Finally, some countries in the region, particularly Costa Rica, did not seem interested in implementing a common external tariff, so that while three different common external tariff proposals have been made, none have been implemented fully.

All in all, success has been very modest. While "in letter," the CACM can be seen as contributing to its member countries' global aspirations, in spirit it does not. Perhaps past experiences will lead to a new sense of realism in any future plans.

Endnotes

10. In the decade of the 1960s, seven other integration movements were noted in Asia, Africa, and Latin America.
11. The original signatory countries were: Bolivia, Colombia, Chile, Ecuador, and Peru. Venezuela joined in 1974, while Chile withdrew in 1976.
12. Tariff rate quotas were established allowing a set amount (a quota) of goods into the country under reduced or no tariffs, with a tariff rate imposed when the quota is exceeded.
13. By 1968 British Guiana had become Guyana.
14. Antigua was the only original member that did not join the new association. In 1994 Suriname joined and in 1999 Haiti was accepted as a member. Note that the Bahamas is a member of the Community but not of the Common Market.

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