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Regional Trade and Cooperation in Latin America and the Caribbean

Robert Devlin, Antoni Estevadeordal,
Juan José Taccone

Over the past twenty years, multilayered trade policy has been a core component of Latin America and the Caribbean's structural reforms. The first step was a very substantial unilateral opening, illustrated in the decline of average tariffs from over 40 percent in the mid-1980s to about 12 percent today.¹ This has been combined with a strategy of reciprocal opening through active participation in multilateral trade negotiations and regional integration initiatives. The latter have been especially prolific with nearly thirty regional trade and integration agreements being launched since 1990 and many more in different stages of negotiation.

This opening contributed to Latin America and the Caribbean's trade expanding faster than world trade during the 1990s. However, the fastest growth by far occurred in intra-regional trade, mostly linked to formal regional integration agreements that ranged from free trade areas to customs unions and common market projects in the sub-regions. In some agreements, such as Mercosur, the level of trade grew dramatically and reached relatively high levels of around 25 percent of total exports.²

While regional trade expanded markedly in the context of regional integration, so did cooperation in a broader sense of the

Robert Devlin is Deputy Manager of the Integration and Regional Programs Department at the Inter-American Development Bank.

Antoni Estevadeordal is Senior Economist for the Integration and Regional Programs Department at the Inter-American Development Bank.

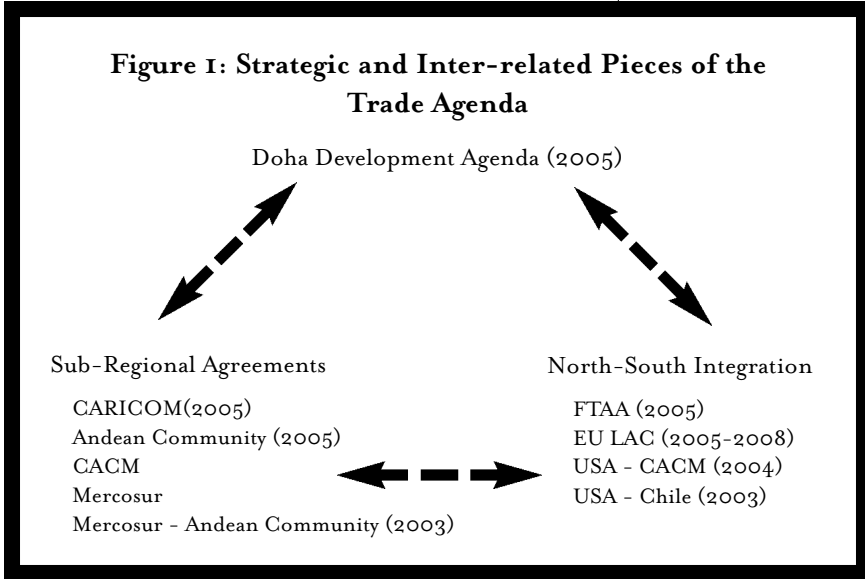
Juan José Taccone is Director of the Institute for the Integration of Latin America and the Caribbean (INTAL).

term. Cooperation between governments can be defined as a mutual adjustment of policies to achieve an outcome that all prefer to the status quo. It requires some

national sovereignty. Fourth, they do not generally involve resource transfers among member countries. Fifth, the difficulty of negotiating non-trade issues is

related to the very nature of such issues: whereas preferential trade arrangements are concerned with the removal of trade-distorting policies, cooperation in other economic areas as well as in social and cultural fields requires the introduction of additional policies, which is more difficult to deal with. Finally, a critical

Figure 1: Strategic and Inter-related Pieces of the Trade Agenda



degree of subordination of the members' sovereignty to the interests of the group. Mutually-beneficial regional cooperation is possible in practically any single field of public policy, ranging from security matters to environmental and labor standards, and includes bundles of cooperation arising out of formal regional integration—a form of cooperation itself.

Trade agreements are invariably the point of departure for more comprehensive regional economic integration for several reasons. First, trade can attract support from well-organized private business communities. Second, unlike many other economic arrangements, the mutual benefits of trade agreements and their distribution can be reasonably assessed *ex-ante* by participants and monitored and enforced *ex-post*. Third, trade agreements accommodate nationalistic sentiments of society as they can be designed in ways that initially involve only very limited loss of

mass of regional trade among partners acts as a "hanger" on which other forms of cooperation can be functionally draped.

This article will explore the relationship between trade and cooperation, what we call the "trade and cooperation nexus." The following section will outline the strategic pieces of Latin America and the Caribbean's trade agenda—the "wiring" for the regional cooperation referred to above. The third section will examine how trade and cooperation can be linked into a "nexus." Finally, the last section will look at some concrete examples of that nexus.

The Strategic Pieces of the Trade Agenda.

The region's trade negotiations currently are staged on three major strategic fronts. First is the multilateral Doha Development Agenda(DDA) in Geneva. The second involves sub-regional common market building. The third front is the pursuit of comprehensive

North-South free trade areas that seek to build reciprocal commercial links with industrialized countries (Figure 1).

The importance of the DDA cannot be overemphasized. Through it, the countries of the region are negotiating market access to the world economy and improving rules for world trade and investment. Of special interest to Latin America is the removal of barriers and distorting measures in agriculture-related trade, an area where the region has a strong international comparative advantage. Peak tariffs, quotas, and subsidies for export and domestic support in industrialized countries greatly restrict agricultural trade and distort world prices. Bound tariffs of OECD countries for agriculture products are four times higher than those of industrialized goods. Meanwhile, trade-distorting subsidies are equivalent to \$700 million a day, almost four times all official development assistance.³

Agricultural trade was the "orphan" of the GATT until the Uruguay Round, when it was put on the negotiating table for the first time. But progress in liberalization as such was modest and most of the real work must be done in the DDA. The word "development" in the DDA will ring hollow if major advances are not produced in Geneva in terms of eliminating measures that are restricting the region's agriculture-related exports, and hence its development potential. Other critical areas in the DDA for Latin America and the Caribbean include public health issues in the Trade Related Aspects of Intellectual Property agreement, such as access to generic drugs for national health emergencies; disciplines for contingent protection, such as anti-dumping measures; and regional rules, such as the incorporation of rules of origin in multi-lateral rules for regional integration.

The second front involves sub-regional integration. Throughout the 1990s, sub-regional agreements were remarkably successful in achieving, relatively rapidly, the elimination of tariffs on sub-regional trade.⁴ However, advancing further on the road ahead has proven difficult. Some sub-regions have had their programs set back by macroeconomic and political problems in member countries; nevertheless, all share ambitious common market objectives. Thus, the past success of improving market access is now being overshadowed by the need to advance the agenda in other, more politically sensitive, areas that often impinge on national sovereignty. These areas include further elimination of non-tariff barriers, greater liberalization in services, further macroeconomic coordination, increased regional infrastructure coordination, and the completion of common external tariffs and customs unions. Progress is also needed in the strengthening of regional institutions and national counterparts, particularly in the areas of rule making, compliance and dispute resolution, technical secretariats, and standards setting.

The third piece, North-South integration, would have been politically inconceivable fifteen years ago, but now has become a strategic focal point of action for the region. There are the Free Trade Area of the Americas negotiations, the negotiation of association agreements with the European Union,⁵ as well as bilateral free trade areas with the United States and Canada,⁶ and attempts by Mexico to link up with Japan in a regional agreement. These North-South negotiating agendas can be considered WTO "plus-plus" as they often go deeper than similar obligations at the multilateral level and because many of the issues being discussed are not even on the WTO negotiating table as of

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yet (e.g., competition policy). However, due to strong asymmetries between the industrialized and industrializing countries, many of these agreements are quite challenging for the region. This is mainly because of the disparity between the respective capacities of the negotiating partners and the fact that most of the effective liberalization will have to take place in the developing countries, since the industrialized economies are already relatively open.

The region’s strategic trade agenda is extremely challenging to manage. Each front has a very comprehensive and complex trade negotiating agenda. In addition, target dates for completing many of the negotiations on all three fronts are bunched in and around 2005.⁷ Nonetheless, each negotiating front has its own logic and benefits, and there are positive synergies among them; hence, picking and choosing among agendas is often not an option, requiring all fronts to move forward simultaneously.

For example, the WTO regulates trade in the world market, supports non-discriminatory liberalization, and establishes some basic common rules for regional integration—the improvement of which will enhance the complementary nature of regionalism and the multilateral system. Also, many feel the WTO has better prospects than regional North-South agreements for advancing liberalization of so-called systemic issues, such as export subsidies, domestic support in agriculture, and in disciplining anti-dumping practices. Lastly, as the multilateral system

succeeds in reducing trade barriers, the pull of geography in trade patterns becomes more important and generates incentives for further regional integration initiatives.

The benefit of sub-regional integration is that it is much more than trade, since common market projects are fundamentally political initiatives in which regional trade facilitates advances in broader strategic objectives among like-minded countries. These include export development and diversification, as well as providing outlets for goods that face inordinate international protection. Sub-regional agreements also facilitate treatment of non-trade related “neighborhood” issues that fall out of the purview of commercially-based multilateral arrangements, such as free trade areas and the WTO. Lastly, the deepening of common markets promises to enhance the member countries’ capacity to compete internationally and allows them to take fuller advantage of their opportunities in both North-South free trade areas and the multilateral system.

Finally, the major benefits of North-South integration agreements is that they help to secure and improve access to major markets, attract foreign investment, and lock-in policy reforms. By exposing the sub-regions to a broader spectrum of comparative advantage, these agreements also reduce residual trade diversion in sub-regional agreements. Moreover, North-South agreements often set new precedents for liberalization that migrate to the WTO negotia-

tions, as was the case of NAFTA during the Uruguay Round.

The Trade and Cooperation Nexus.

Growing and mutually beneficial commercial interdependence among partners typically induces demands for expanded economic cooperation, in order to exploit more fully the revealed advantages of a maturing regional market. Moreover, demands for non-economic and even political cooperation arise from the social externalities generated by closer economic ties.⁸ In effect, the centripetal forces of trade among partners can be an effective handmaiden of deeper integration, whether planned or not. There is the contemporary example of Western Europe, where growing interdependence through trade has served to drive forward a political agenda of certain partners for very deep integration and broad-based cooperation. As a result, regional market opening led the way to widening the scope of cooperation, or in the words of Garcia and Glickler, to "integration by stealth."

While trade liberalization and non-trade cooperation can evolve independently, in many cases the two components are closely related. One would expect that when economic integration is launched with the far-reaching objectives of a common market or more, the agreement will not only anticipate regional free trade, but also systematic cooperation in trade-related and non-trade areas, thus, creating a trade and cooperation nexus (T+C). This approach may save costs associated with negotiations and the administration of the cooperation programs. However, it also entails the risk of getting bogged down with a large number of complex issues.

However, a strictly "business only" free trade area may capture and bind the

mutual interest of the parties more quickly and serve in practice as a solid beachhead for more comprehensive future cooperation. In this scenario, the relationship evolves from trade (T) to a trade and cooperation nexus [(T) -> (T+C)]. An opposite model involves agreements where an initial framework of cooperation only (C) predominates until it reaches a point where parties eventually launch a formal trade and integration agreement [C -> (T+C)].

Post-World War II initiatives in Latin America and the Caribbean more or less bear out the models suggested above. Agreements launched with an initial official framework, or objective, of "very deep integration" have typically started out with a trade and cooperation nexus (T+C) built into the initiative. This is illustrated in the Latin American and Caribbean "old" sub-regional integration schemes that were committed to developing a common market, as well as the "new" sub-regional schemes such as the Andean Community. The other extreme is shallow agreements such as free trade areas that are "business only" (T) in their initial intent. NAFTA, the new bilateral trade agreements in Latin America, and the Latin American Free Trade Association (LAFTA) of the 1960s, are all examples. In contrast, Western Europe is a good example of where deepening trade interdependence through (T) evolved into comprehensive (T+C). One also now observes increasing pressures on NAFTA partners to move from (T) to the direction of (T+C). The movement from (C) to (C+T) is a less frequently observed model; ASEAN is perhaps the most outstanding example.

Other scenarios can be found in recent inter-regional North-South initiatives. Those agreements can be divided into agreements that only cover trade

(T), agreements for cooperation without a trade component (C), and agreements that cover both preferential trade and cooperation simultaneously (T+C). In particular, there are three modern North-South plurilateral initiatives involving Latin American countries that are interesting variants of the (T+C) model: The Western Hemispheric Summit process, which we will review in the next section, the APEC process that includes a package of trade and non-trade cooperation initiatives, and the EU-bilateral Inter-regional Association Agreements, which propose the novel EU approach of a “single undertaking” that would systemically integrate several initiatives through political dialogue, cooperation, and reciprocal free trade under a single umbrella agreement.

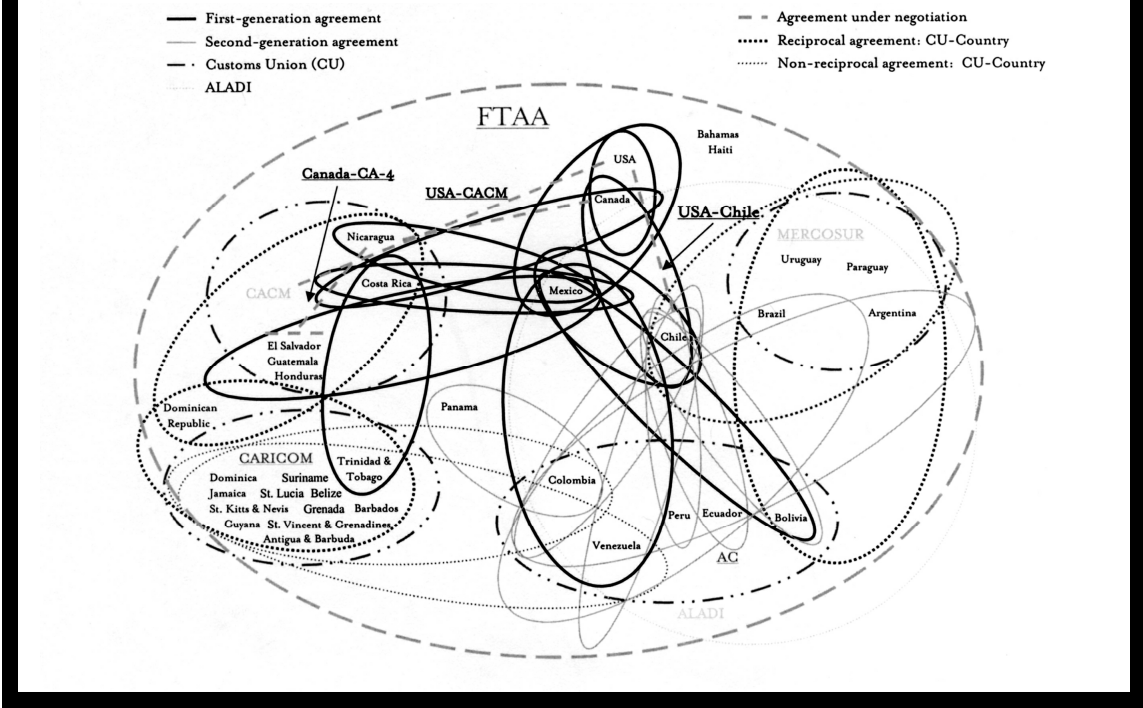
It is important to emphasize that in these initiatives, the two components of the nexus are mutually supportive. As an example, a reciprocal cooperation program which helps exporters of the partner countries identify trade and investment opportunities in the inter-regional market could provide an impetus to the trade negotiations and energize trade once an agreement is reached. Another example would be reciprocal cooperation in education and best practices, which is generally supportive of the development and trade objectives. Meanwhile, donor assistance type programs could, for instance, provide technical support to the developing countries in the negotiation and implementation of agreements, thereby ensuring more sustainable commitments and more effective participation. Likewise, cooperation that aids infrastructure development and democratic processes can help foster trade and investment. So there is no doubt that a trade and cooperation nexus is a desirable

objective in initiatives designed to deepen North-South relationships, although simultaneously advancing in both tracks in a comprehensive way can be extremely difficult at times, as the hemispheric initiative has shown.

Experience suggests that the success of any one initiative depends on a number of conditions. There is a need, *inter alia*, to give priority attention to a limited number of programs at any one time; to have clearly identified objectives and work programs, quantifiable targets, political leadership in the particular program areas, capable national counterparts, and a support structure—including adequate technical, logistical, and programmed financial backing. Moreover, there are reasons to believe that an ambitious trade and cooperation initiative will have a higher chance of prospering if there is a dynamic trade component at its core that leads the way. Indeed, the forward momentum in the FTAA negotiations is a major reason for Latin America and the Caribbean’s continued interest in the broader hemispheric initiative, despite the poor performance of many of the cooperation programs to date. Likewise, the loss of momentum in APEC may be partially explained by weakness in the motivation and design of its free trade component.

Finally, one of the major results of the proliferation of regional trade agreements in Latin America and the Caribbean and around the world has been the formation of the so-called “spaghetti-bowl,” a concept that is usually associated with the negative effects of regional trade agreements, especially due to the lack of transparency and complexity of overlapping trade rules (Figure 2). While we cannot dismiss the costs associated with the “spaghetti-bowl” in the region, we must also measure potential benefits. In the framework sug-

Figure 2: The Spaghetti Bowl. Trade Agreements Signed and Under Negotiation in the Americas



gested above, the “spaghetti bowl” is a reflection of the revealed preferences by like-minded nation-states in search of their commercial and economic interests. In this sense, the explosion of regionalism may have created the infrastructure, or the *wiring*, for an effective provision of regional cooperation, or more generally, regional public goods.¹⁰ This view downplays the potential negative effects of the “spaghetti bowl.” The final “use” of this infrastructure for regional cooperation will depend on the complex outcome of a dynamic process that includes the politics of inter-state bargaining for the provision of regional cooperation. This will build on existing regional trade agreements and the degree of absorption of “minor” connections by larger ones; that is, the effect of larger trade agreements on pre-existing sub-regional and bilateral agreements.

In the next section we will review three major trade and cooperation nexus initiatives. First, two important South-South initiatives: the Puebla-Panama Plan (PPP) and the Initiative for the Integration of Regional Infrastructure in South America (IIRSA), which have emerged around trade agreements and correspond to the [(T) -> (T+C)] model. Second, we review the Summit of the Americas process that we have identified as a variant of the pure (T+C) model under North-South initiatives.

Some Recent Experience on Regional Cooperation. Just as regional trade and integration underwent unprecedented expansion in the 1990s, so too did regional cooperation in other areas such as peace and security, protection of democracy, institutional

capacity building, infrastructure, and tourism, among others. Indeed, along with trade, cooperation has become a hallmark of a new regionalism in Latin America and the Caribbean.

Puebla-Panama Plan (PPP). The Mesoamerican region has both potential in the form of cultural wealth, biodiversity, and its geographically privileged location, as well as significant lags in terms of its economic and social development. Such inter-relations lead to a series of positive and negative externalities that pose a challenge in terms of coordination in those cases in which collective and relational action with the international cooperation community is justified.

The interconnection of Mesoamerica with the outside world takes place under suboptimal conditions, as the countries of the region do not take full advantage of their proximity to major markets to strengthen, among other things, their competitive position, participation by small and medium-sized firms, human development, and the potential for the sustainable use of their natural resources.

The PPP emerged as a political mechanism for coordinating actions involving the approval and implementation of regional projects: "The objective of the Puebla-Panama Plan is to leverage the human and ecological wealth of the Mesoamerican Region within a framework of sustainable development that respects cultural and ethnic diversity."¹¹

In this context, the PPP defines twenty-nine separate projects under eight Initiatives, including: (1) Sustainable Development, (2) Human Development, (3) Prevention and Mitigation of Natural Disasters, (4) Tourism, (5) Trade Facilitation, (6) Highway Integration, (7)

Energy Interconnection, and (8) Telecommunication Services.

The countries participating in the PPP consist of eight small nations: Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama, and Mexico. With regard to Mexico, most PPP programs involve only the nine Mexican states from its southern-southeastern region, while others, such as those involving trade, include all of its states. The PPP was formally launched in San Salvador in June 2001.

Mexico's cooperation with its Southern neighbors was led both directly and indirectly by trade. First, Mexico's experience with NAFTA resulted in uneven growth and development within Mexico, as the North enjoyed most of the benefits and the south stagnated. The seeds of the PPP had its origins in Mexico's interest to stimulate growth in the South by enhancing links with Central America through a wide range of issues, including infrastructure. The "wiring" for the initiative was prior free trade agreements with each country, which would service growth of trade and investment and in turn benefit from the non-trade links established by the PPP itself.

Initiative for the Integration of Regional Infrastructure in South America (IIRSA). IIRSA was created as a result of the mandate generated at the First Meeting of South American Presidents held at the city of Brasilia, Brazil, on August 31 and September 1, 2000. On that occasion, the heads of state agreed to promote the integration and modernization of the region's physical infrastructure as an essential factor in South America's economic and social sustainable development process, seeking to increase the global competitiveness of their economies.

In this context, IIRSA is a multinational, multi-sectoral and multi-disciplinary initiative. Its multinational character is based on the participation of the governments of the twelve countries of South America (representing members of three sub-regional integration agreements) and of potential private investors at a regional and international level. It is multi-sectoral because it encompasses the improvement and modernization of infrastructure in three sectors: energy, telecommunications, and transport. And it is multi-disciplinary since it includes the coordination of plans and investments; the harmonization of, or rendering compatible, regulatory frameworks and the public or private financing of investments, all with proactive attention to the environment.

Currently, the Initiative has begun work organized around eight Integration and Development "Hubs" and seven Sectoral Integration Processes.¹² To date, major progress has been recorded in the joint work of the countries, marked by the creation of an institutional framework to support the Initiative, as well as by the identification of an extensive portfolio of infrastructure projects.

Trade played a major role in launching the initiative. The seeds of this initiative emerged out of Mercosur (including associate members Chile and Bolivia) where intraregional trade exploded but was slowed by overwhelmed regional infrastructure and outdated regulatory arrangements. As an example, more than half of the time for land-based cargo travel between S o Paulo, Brazil and Valparaiso, Chile was due to delays at border crossings. Meanwhile, the Andean Community countries suffered similar infrastructure bottlenecks to their expanding intraregional trade. Moreover, Mercosur and the Andean Community

were negotiating a free trade area between them where expansion of trade would depend very much on better regional infrastructure between the two sub-regions.

Summit of the Americas. The Summit of the Americas is a process of institutionalized meetings at the highest political level among the thirty-four democratic states. Their aim is to develop comprehensive hemispheric cooperation in strategic areas, including trade, democratization and human rights, terrorism, corruption and drugs, and infrastructure.

The First Summit took place in Miami in December 1994 and produced a Declaration of Principles and a Plan of Action signed by all heads of state and government. National programs to support the Summit commitments are undertaken and reviewed by each country. Building upon the Miami Summit, the subsequent Summits in Santiago and Quebec expanded the scope of cooperation and adjusted the activities under each initiative. It is clear that the Free Trade Area of the Americas is the leading initiative in the area of economic integration and probably the most consistently dynamic component of the entire Summit process. The FTAA process has steadily advanced and far surpasses progress in other economic areas. Areas that are not directly related to economic integration for which a maturing Summit process has brought some progress are democratization, human rights, justice, combating drugs, the fight against terrorism, education and disaster management. Nevertheless, the overall process has had very uneven results due to the very broad number of initiatives and the heterogeneity of the countries involved; mandates that are not always easily quantifiable and subject to results-ori-

ented evaluation; lack of preprogrammed funding; and a tendency to add mandates before consolidating past ones. If the FTAA materializes in 2005, it should generate pressure for truly effective hemispheric cooperation in other areas of the Summit agenda. It already is generating pioneering programs in trade related capacity building.

The next few years will be a very critical juncture for trade and the region's structural reforms. The outcome of all these trade negotiations are enormously critical for the development prospects of Latin America and the Caribbean since

they will establish market access and rules that will regulate the private sector's articulation with the world economy for decades to come. That is why good preparation is essential and now should be one of the highest priorities in the countries' development strategy and budgetary allocations. Finally, as one can see from the above examples, such agreements can be a handmaiden for important cooperation on many other issues down the road.

Author's Note: The opinions expressed here are those of the authors and do not necessarily reflect the opinions of the Inter-American Development Bank.

NOTES

1 Robert Devlin and Antoni Estevadeordal, "What's New in the New Regionalism" in V. Bulmer-Thomas, ed., *Regional Integration in Latin America and the Caribbean* (London: Institute of Latin American Studies, 2001).

2 "Integration and Trade in the Americas: Periodic Note," Inter-American Development Bank, Department of Integration and Regional Programs, Washington DC, December 2000.

3 "Beyond Borders: The New Regionalism in Latin America," Inter-American Development Bank, Report on Economic and Social Progress in Latin America, Washington DC, 2002.

4 Devlin and Estevadeordal (2001).

5 Chile and Mexico already have agreements.

6 Already has agreements with Chile and Costa Rica.

7 "Beyond Borders" (2002).

8 Cooperation programs can be reciprocal or involve one-way transfers (technical assistance). An example of the first would be EU-LAC joint sponsorship of programs (in which both parties financially support the process) to bring the two regions' investors together to expose market opportunities. An example of the latter would be the trade-related capacity building that is being undertaken in the FTAA Hemispheric Cooperation Program.

9 Alicia García Herrero and Gabriel Glickler, "Options for Latin America in a Globalized World," European Central Bank, Frankfurt, May 2000.

10 The concept of "wiring" as opposed to a "spaghetti-bowl," which tries to capture the positive effects of a proliferation of RTAs, was first introduced in Devlin and Estevadeordal (2002) with an analysis of the nexus between trade and cooperation in the context of the regional public goods literature. See Robert Devlin and Antoni Estevadeordal, "Trade and Cooperation: A Regional Public Goods Approach," paper presented at the IDB-ADB-USAID Conference on Regional Public Goods, Inter-American Development Bank, November 2002.

11 Declaration of the Summit of Tuxtla (2001), San Salvador.

12 Integration and Development Hubs: (I) Andean; (II) MERCOSUR/Chile; (III) Talcahuano-Concepción-Neuquén-Bahía Blanca; (IV) Inter-Oceanic; (V) Porto Alegre-Asunción-Jujuy-Antofagasta; (VI) Peru-Brazil-Bolivia; (VII) Amazon Multimodal Hub and (VIII) Venezuela-Brazil-Guyana-Suriname. Sectorial Integration Processes: Normative Frameworks for Regional Energy Markets; Operating Systems for Air Transport; Operating Systems for Multimodal Transport; Operating Systems for Maritime Transport; Facilitation of Border Crossings; Harmonization of Interconnection, Spectrum, Technical Standards and Internet Universalization Regulatory Policies; and Instruments for the Financing of Regional Physical Integration Projects.