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ECONOMIC INTEGRATION IN THE WESTERN HEMISPHERE
A Rapporteurs' Report

Caren Addis and Mathew Verghis

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Caren Addis is Assistant Professor of Political Science at Rutgers University-Camden. She was a Kellogg Visiting Fellow in spring 1992 and Acting Academic Coordinator for the Institute during the 1992–93 academic year. **Mathew Verghis** is completing his PhD in Economics at the University of Notre Dame and is currently employed as a consultant at the Eastern Africa Department of the World Bank.

ABSTRACT

This paper summarizes the discussion at an academic workshop titled "Economic Integration in the Western Hemisphere," held at the Kellogg Institute on 17 and 18 April 1993. Debate centered around an overview paper and papers on the North American Free Trade Agreement (NAFTA), the South American Common Market (Mercosur), the Andean Pact, the Chilean experience, the Central American countries, and the Caribbean group.

RESUMEN

El presente trabajo hace un resumen de la discusión llevada a cabo en el seminario académico titulado "La integración económica en el hemisferio occidental", que se llevó a cabo en el Instituto Kellogg el 17 y el 18 de abril de 1993. La discusión giró en torno a un trabajo que proporciona una visión de conjunto, así como a otros trabajos sobre el Tratado de Libre Comercio de América del Norte, el Mercado Común Sudamericano (Mercosur), el Pacto Andino, la experiencia chilena y los países de América Central y del Caribe.

This paper summarizes the proceedings of an academic workshop titled "Economic Integration in the Western Hemisphere," held at the Kellogg Institute on 17 and 18 April 1993. The workshop, the first in the Project Latin America 2000 Series, was organized by Ernest Bartell, CSC, and Jaime Ros and hosted by Kellogg with the support of The Coca-Cola Company. Debate centered around an overview paper and papers on the North American Free Trade Agreement (NAFTA),[1] the South American Common Market (Mercosur), the Andean Pact, the Chilean experience, the Central American countries, and the Caribbean group.

Latin America has a rich history of efforts in regional economic integration, many of which have been unsuccessful. Recent political and economic events, both nationally and internationally, are stimulating new attempts and reviving old ones. This conference examined recent efforts at integration, including NAFTA and Mercosur, as well as new directions for existing agreements in Central America and the Caribbean.

There were themes common to many of the papers. One is a suspicion that the benefits of economic integration, especially for the smaller economies, may be much less significant than predicted by economic theory. Another area of agreement among the authors was the radically different context in which new efforts at integration are unfolding. The emerging trade agreements that span the most northern and most southern countries of the hemisphere, unlike past agreements, are among liberalized economies. Some countries, such as Chile, began liberalization well over a decade ago. Others, such as Brazil, began in the last few years. The

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[1] Abbreviations used in the text are as follows:

AD/CVD	Anti-Dumping/Countervailing Duties
ALADI	Association for Latin American Industrial Development
BOP	Balance of Payments
CACM	Central American Common Market
Caricom	Caribbean Community
CARIFTA	Caribbean Free Trade Association
CBI	Caribbean Basin Initiative
EEC	European Economic Community
EPI	Economic Policy Institute
EPZ	Economic Processing Zones
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
FTZ	Free Trade Zone
GATT	General Agreement on Trade and Tariffs
GDP	Gross Domestic Product
GNP	Gross National Product
IRS	Increasing Returns to Scale
ISI	Import Substituting Industrialization
Mercosur	South American Common Market
MFN	Most Favored Nation Status
OECD	Organization for Economic Cooperation and Development
NAFTA	North American Free Trade Agreement
NTBs	Non-Tariff Barriers
VAT	Value Added Taxes

upshot, however, is that even the most historically protectionist countries have drastically lowered tariffs. Although tariffs are lower and more uniform, there is still much work to be done. Nontariff barriers (NTBs), currency agreements, and other measures represent obstacles to true integration. Finally, many participants feared that the regional efforts, and in particular NAFTA, would lead to hub-and-spokes systems which preclude true multilateralism. The specter of trade and investment diversion stemming from NAFTA is a threat to many of the smaller Latin American countries, in particular the Central American and Caribbean economies.

The following sections present a summary of the conference papers. The conclusions will highlight matters raised in the discussion regarding issues that the participants felt remained unresolved.

Paper I

The North-South Variety of Economic Integration: Issues and Prospects for Latin America

Roberto Bouzas and Jaime Ros sketched out the characteristics of the 'new vintage' of economic integration agreements and reviewed the theoretical arguments regarding the impact of these agreements on Latin American economic performance. The benefits may be surprisingly low.

Old vs. New Integration

Old-vintage agreements, in particular those emanating from the United States, were largely nonreciprocal. In Latin America, the old-vintage integration agreements sought to expand protected domestic markets and spur economies of scale and specialization. The new-vintage agreements have bold new features: NAFTA has inaugurated economic integration between the North and the South, and the negotiations involve new types of NTBs, including those stemming from labor and environmental standards. Many of the new agreements are reciprocal. From the point of view of the Latin American countries, the goals of these efforts are to improve and secure access to markets, facilitate industrial restructuring, and attract foreign investment. Integration is emerging within a context of far-reaching trade liberalization in the South.

These new agreements are propelled by, among other things, changing international conditions: the decline of competitiveness in the United States; the need for Latin American economies to export to meet pressing debt services and principal payments; and protracted stagnation in multilateral negotiations.

Assessing the Impact of Integration: Allocative Effects vs. Dynamic Gains

Bouzas and Ros argued that static gains from integration are likely to be relatively minor. Rather, the dynamic effects—economies of scale, greater market competition and technological diffusion, less uncertainty, and changes in the location and volume of real investments—probably account for the lion's share of the impact, both positive and negative, of trade agreements. The most important of the dynamic effects of North-South integration is probably investment flows. The argument is that investment will flow to the South to take advantage of reduced uncertainty and guaranteed access to markets in the North. Simultaneously, firms can revitalize themselves by taking advantage of expanded and more competitive factor mixes.

It is difficult to model, quantify, and predict all of the dynamic effects, and the literature provides no clear-cut analyses or conclusions. For example, in the case of investment flows, assumptions about risk, uncertainty, the future of the agreements, the multilateral trading system, and the impact of rules of origin are only some of the factors that defy estimation. The issues are even more complicated because of the large discrepancies among the North-South partners. In sum, Bouzas and Ros believe that the gains from new-vintage agreements may not been as large as expected.

The experience of the European Economic Community (EEC) may provide a rough basis for estimating the impact of a regional Free Trade Agreement (FTA). Conditions in the EEC were more conducive to integration, and its experience can be considered a 'best case' scenario for a hemispheric FTA. Two conclusions can be drawn from this exercise. A comparison with Europe implies a marked improvement in growth rates compared to the crisis rates of the '80s. However, the fastest-growing countries, such as Brazil and Mexico, would not see higher growth than the precrisis rates of the '70s. That said, economic theory does not provide definite answers about the impact of FTAs. The final outcome will depend on investment and productivity in the countries that sign the agreement.

Assessing the Impact of Preferential Trade Gains (Economic Integration)

The impact of signing an FTA with the US will be different for each country. The gains will depend on the structure, content, and level of the individual country's trade with the US. Two rules of thumb, however, obtain:

(1) The larger the share of trade with the US, the larger the static gains from trade. Mexico, Central America, and the Caribbean will show the largest static gains.

(2) The larger the share of manufacturing in exports to the United States, the larger will be the dynamic gains. The big semi-industrialized countries will see the most dynamic gains.

The degree of openness of Latin American countries will also influence the costs and benefits of NAFTA. The static impact of removing trade barriers will be greater for small countries and for countries with high protection. By these two criteria Brazil and Colombia should gain the most and Mexico the least from signing an FTA. The dynamic effects, however, could change this ranking: a polarization effect may draw investment to the large Latin American countries and away from the small, poor ones.

The macroeconomic costs of the transition to the FTA must also be taken into account. They could be greater in highly protected countries. For example, trade liberalization usually has to be accompanied by real devaluation to avoid large trade deficits, but this may lead to inflation. The trade-off between internal and external goals may be worse for highly protected countries which will need larger devaluations. Devaluations often have strong fiscal effects, and a major factor in their sustainability is the size of the public external debt. Transition costs can be partially offset by capital movements towards the liberalizing country, as happened in the case of Mexico. Offsetting capital flows, however, are not a panacea. In Mexico they are so large that the currency is actually appreciating. This could lead to an exchange-rate misalignment, postponing the costs of liberalization. Finally, Bouzas and Ros suggested that there is a political-economy gap—most of the adjustment costs from NAFTA will be felt in Mexico, but most of the discussion about these costs are in the US.

Discussants' Comments

The Role of Corporations

Robert Lawrence complimented the authors on their incisive discussion of the new vintage of economic integration. He also suggested that the authors explore an additional dimension, the role of corporations in the process of integration. A quick review of integration in the mid-1980s in Europe, Asia, and North America (Canada and the United States) reveals that corporations (and the chambers of commerce) push for it. They seek lower costs or simply more accessible factors of production.

Once the agreements are in place, however, they engender a new push for reform, again, often by corporations. Often exchange rates become unstable, and companies agitate for institutional reforms to create stable currency arrangements. Companies also lobby at another level that is ignored by models which tend to focus on tariffs. In addition, companies fight to define issues such as rules of origin which often prove even more important than tariffs.

There is often regional integration even before there is a formal FTA. If companies believe that a market will emerge, they begin investing. Asia is an example. As a result of the outward-looking orientation of the economies, the government and corporations worked to ensure that exporters would have access to markets and capital. Finally, another element promoting integration is a defensive one. The United Kingdom joined the EEC for defensive reasons.

An Underwhelming Case for Integration?

Gary Hufbauer contended that the authors had presented an underwhelming case for economic integration. Like the authors, he agreed that the static gains from trade were quite small. Unlike the authors, Hufbauer believed that a stronger case could be made for the positive impact from dynamic gains. There are two strands of literature that examine the overall impact of trade:

(1) The ‘Convergence’ literature (Barro) asserted that the postwar growth in trade led to convergence among countries. The gap among them is disappearing at the rate of 2 per cent a year.

(2) The ‘Statistical Association’ literature (Balassa) found that when trade liberalization is accompanied by internal reforms the overall gains are approximately 1.65 times the increase in trade.

The conclusion from both strands is that overall gains from trade are large.

Like Bouzas and Ros, Hufbauer acknowledged that economists have an insufficient understanding of dynamic gains. If economists cannot make a convincing case for integration, he contended, then the issue should be handed over to the political scientists. Areas that need to be explored include the gains/losses associated with export-oriented growth, corporations, deregulation in nontradeables, and privatization. Some believe that corporations bring in technology and train workers to achieve 60 to 80 percent of home-country-level productivity yet pay only 10 percent of home-country wages. Others believe that wages go up with productivity. This issue needs more study. Finally, an additional benefit of integration is that it gets governments out of managing domestic industries.

Rebuttals

In response to Lawrence, Bouzas stated that the role of corporations was implicit in the analysis. Thus, it would be a mistake to overstate the role of corporations. They are not the ones pushing for labor and environmental standards.

Regarding Hufbauer's discussion of convergence, Bouzas contended that this is another example of our precarious grasp of the issues. The convergence between Latin America and the US may be a result of import-substituting-industrialization (ISI) policies rather than trade. The authors are not questioning NAFTA, but rather bringing to light often overlooked issues.

Bouzas clarified another point brought up by Hufbauer. The authors are not claiming that dynamic gains are small or unimportant but, rather, that they are less clear-cut than usually stated in the literature.

Other Comments

Robert Stern claimed that there was some confusion in the paper between static and dynamic gains. The New Trade Theory focuses attention on dynamic gains, but it is useful to note that these can also be modeled within the static framework. Models are better than analogies (i.e., the EEC), but they need to incorporate several issues. He agreed that investment flows are key to analyzing the gains from FTAs, but said that economists do not have good theories of the determinants of these flows. Other issues that need to be incorporated into models include labor migration, firms' reactions to macroeconomic policies, and US wages in light of wage suppression in Latin America.

Cardoso believed that static gains can be large, as they were in Central America in the 1970s.

Lawrence stated that the authors went too far in separating unilateral liberalization from regional liberalization. Mexico believes that NAFTA will make the country's unilateral liberalization credible and therefore the agreement is a natural extension of domestic policies.

Paper II
NAFTA: Potential Impact on Mexico's Economy and Beyond

By examining existing studies on the impact of NAFTA and discussing their relative shortcomings and strengths, Nora Lustig presented her assessment of NAFTA's potential effects on the Mexican economy.

The signing of NAFTA was the culmination of a reformulation of Mexican development strategy that began in the early ‘80s. As a result of the balance-of-payment crises of 1976 and 1982, Mexico shifted from a protectionist and import-substitution development strategy to one of trade liberalization and finally to NAFTA. There has not been a full assessment of the costs and benefits of the old strategy—it helped develop the industrial sector, but productivity growth has been slow. Liberalization, and ultimately NAFTA, are intended to raise productivity and diversify sources of foreign exchange.

Signing an FTA with the US is compatible with the liberalization strategy, but it also represents a sea change in Mexican attitudes toward ties with the US, and a change in US attitudes towards bilateral agreements. The Mexican attitude changed because its far-reaching domestic reforms and the signing of a debt agreement did not attract the desired foreign direct investment (FDI). The Mexican government believed that signing an FTA with the United States would attract FDI. It would signal a commitment to an open-economy strategy and also ensure access to the US market for goods produced in Mexico. The Mexican government has remained actively engaged in the General Agreement on Trade and Tariffs (GATT) and also seeks agreements with Latin American countries as well as Europe and Japan. The US did not previously seek bilateral agreements with Mexico because it supported multilateral arrangements and also because it was aware of Mexico’s reluctance.

Pre-NAFTA Trade Flows and Barriers

The US absorbs approximately 70 percent of Mexican exports and is far and away Mexico’s most important market. Mexican trade on the other hand, is only about 5–6 percent of US exports. Tariffs between the two countries are generally quite low. The highest Mexican tariff on imports from the US is 20 percent and the average tariff in 1989 was 12.6 percent. About 80 percent of Mexican exports enter the US duty-free and the average tariff is from 3–6 percent.

Removing tariffs, therefore, will have a relatively small impact on Mexican exports with the exception of the few goods that currently face high tariffs.

The removal of NTBs will probably be the more important benefit for both sides. About 20 percent of US exports to Mexico are subject to import licenses, most importantly in agricultural products, livestock, and automobiles. The US also places important restrictions on imports of steel and textiles. There are also Mexican concerns about US ‘contingent protectionism’—US retaliation against alleged dumping. Similarly, Canada has very low tariffs on Mexican exports but there are fears that Mexican exports will displace Canadian exports in the US market because of lower labor costs. Lustig believes that lower labor costs in Mexico will be offset by higher Canadian productivity.

NAFTA's Potential Impact

Most studies conclude that NAFTA will have a relatively greater impact on Mexico than on the US or Canada. As noted above, the impact in Mexico of removing tariffs will be positive but small, between 0.3 percent and 3 percent, depending on the assumptions made. The removal of NTBs and the increase in capital inflows will probably have the most significant impact on Mexican incomes. Estimates indicate that Mexican income will increase between 4 and 8 percent.

In the absence of capital inflows, the distributive impact of NAFTA will be regressive, especially if agriculture (particularly maize) is liberalized. With strong capital inflows and productivity gains, the poorest segments have the most to gain from NAFTA.

These results are based on studies done with Computable General Equilibrium models and are particularly sensitive to assumptions regarding consumer differentiation among products by place of origin (the Armington assumption) and returns to scale. If the former holds, it dampens the effect of NAFTA. In the latter case, the assumption of increasing returns leads to higher income effects. Assumptions about pricing behavior by imperfectly competitive producers also have an impact on gains in income. Finally, dynamic models incorporating attitudes towards risk tend to show larger gains than static models.

Assessing the Models

The most realistic models are probably those incorporating increasing returns to scale (IRS), monopolistic market structures, product differentiation, and capital and labor flows. Using these models, the potential impact of NAFTA on Mexico is between 5 and 8 percent of real income, which is equivalent with 2 to 3 years of 1989–92 gross domestic product (GDP) growth.

Impact of NAFTA beyond the Simulation Models

Lustig believes that there are two impacts not captured by the simulation exercises. One is a rise in foreign investor confidence, which is crucial to stimulating the capital inflows that are necessary to keep inflation low. This could eventually become a problem if capital inflows are supporting an exchange rate that is consistent with inflation goals but not growth targets. Secondly, the models have little to say about the impact of NAFTA on productivity. Lustig argues that history and theory indicate that large productivity gains can be expected due to technological change, organizational innovation, and learning.

There are also likely to be costs from NAFTA that are not fully incorporated into these models. Supplemental agreements, for example, could increase costs by trying to equalize environmental and safety standards. There will be winners and losers in sectors that are aggregated in the models, so disruptions could be greater than predicted. The pace of liberalization could also be more important than appears in the models. Industries that could survive with longer transition periods might be wiped out under short periods. Alternatively, individual industries may negotiate transition periods that are longer than those that they actually need.

NAFTA and Hemispheric Integration

NAFTA has created a lot of concern in Latin America about possible trade-diversion effects. While studies estimate this impact to be small (one estimate is that NAFTA will cause a 0.7 percent fall in Latin American exports to the US), these estimates may understate the case. Additionally, current Latin American trade preferences may be phased out. Alternatively, a subset of the more general NAFTA principles could serve as a base for a regional FTA.

Discussants' Comments

How Good Are Model Estimates of the Impact of NAFTA?

Herzenberg stated that Lustig's presentation of the Mexican side of the equation was very enlightening to US audiences. He argued, however, that she neglected the importance of technological and organizational issues that are absent from the models and from the political debate surrounding NAFTA. How, for example, does NAFTA affect issues such as negotiated flexibility, lean production, and networks of dynamic regions? Herzenberg questioned the extent to which Mexican productivity will be helped by NAFTA. Productivity gains will depend on such things as institutional factors, sector-specific policies, and whether firms incorporate workers or use them to lower costs as in center-periphery strategies. These aspects of organization and technology are central to productivity growth.

Will the US have the clarity and commitment to lead a process of regional integration? It must demonstrate a commitment to reverse declining US wages. For example, to US workers the maquilas are a terrifying symbol of first-world technology and third-world conditions. Labor in the United States perceives that this is the direction in which they are going; it increases anxiety over the FTA.

If fact, NAFTA is a symptom, but not a cause, of what workers will face. The current administration in the US should see this alarm as an indicator of the need to institutionalize the turn away from mass production or the polarized service-sector job structure.

Importance of Capital Flows

Primo Braga agreed with the findings of the paper, particularly the centrality of capital flows to understanding the impact of NAFTA in Mexico and their insufficient incorporation into the models. Especially important is what will happen to capital flows once the current round of privatization is completed. He also believed that the impact of NAFTA on intrafirm trade may be underestimated.

However, Primo Braga also asked about what was left out of Lustig's paper. He wondered about the specific content of NAFTA; for example, intellectual property rights, side agreements, and service liberalization. He questioned whether Mexico's macroeconomic stability was sustainable given Mexico's reliance on foreign inflows to keep inflation low and wondered if there were lessons to be learned from Chile's and Argentina's liberalizations of the late 1970s and the subsequent collapses of their banking systems. He asked whether NAFTA will be ratified. Could there be reverse financial flows if NAFTA does not pass?

Probing the Models

Stern emphasized the need to focus more attention on the assumptions of the models. In particular, he believed that estimates of the impact of removal of NTBs were unacceptable and depended on implausible pricing assumptions. He also pointed out that Lustig examined only some models and overlooked others such as the Economic Policy Institute models which showed smaller benefits from NAFTA. The overall impact of NAFTA may be quite small, even though most modelers look for big results, which tends to exaggerate the debate.

Other Issues

Hufbauer argued that investment diversion from US to Mexico has been small (as a percentage of total US investment). Also, most trade with Mexico is of a similar skill composition so it is not eliminating skilled jobs in the US.

Lawrence suggested that changes in US wages have been the result of domestic factors rather than NAFTA. Most US trade is with developed countries with high wages.

Saborío asked about the impact of NAFTA at the margin: Given the existing levels of trade and integration between Mexico and the US, what difference would NAFTA make?

Rebuttals

Lustig believed that productivity will be helped by trade integration, and that if NAFTA were not ratified, the effect on investor psychology would be very important. It is possible that Mexico's unilateral liberalization and increasing integration with the US may be enough to keep confidence high even without NAFTA.

Paper III
Mercosur: A Midterm Review

Argentina, Brazil, Paraguay, and Uruguay have embarked on a bold new integration initiative, Mercosur. If completed, the market will include over 60 percent of the total land area of Latin America and over 50 percent of the region's GNP. Winston Fritsch's paper reviewed the genesis of the process and the longer-term agenda; the problems of the transition period up to the end of 1994; prospects for longer-term conversion; and likely strategies of Mercosur toward the world trading system.

The Genesis of the Process and the Longer-Term Agenda

The process leading to Mercosur can be dated back to the mid-1980s, although some would go as far back as the late 1970s. It was conceived as a means to diffuse tense relations between Argentina and Brazil and as a means to solidify emerging democracies. In 1986 the Integration Act (Ata de Integracão) was signed, but it was based on the old Association for Latin American Industrial Development (ALADI) pattern, that is, sectorally managed preferences backed by domestic industrial policy. The goal was negotiated regional specialization through so-called complementarity deals.

After Menem and Collor came to power, the integration process underwent a sea change. In March 1990, Brazil embarked on a full-fledged liberalization program based on the abolition of NTBs followed by linear, across-the-board, and automatic tariff reductions through 1993. Bush's Enterprise for the Americas Initiative helped fuel the integration process. The Southern Cone countries, with the exception of Chile, decided to create Mercosur in November 1991. The June 1992 Las Lenas agreement accelerated the timetable for integration. The discussion of integration which was previously based on sectoral negotiations shifted to one based on a customs union—a common external tariff and trade policy in relation to third parties—that was to emerge by the end of 1994.

Fritsch categorized the issues into four groups: trade issues; governance framework; harmonization of nonborder regulations affecting trade; and longer-term macroeconomic policy coordination and harmonization of labor and social-security regulations. The issues in the first group include commercial matters (border procedures, residual NTBs, common anti-dumping/countervailing duties safeguards (AD/CVD), exchange-rate regimes, and safeguard rules. Exchange-rate regime measures include exchange-rate policy coordination among member countries and, secondarily, simplifying foreign trade transactions. Other issues include harmonizing special customs areas (Export Processing Zones [EPZ] and Free Trade Zones [FTZ]) within the integrated area and harmonizing administrative customs procedures, export promotion policies, and trade agreements with third countries.

To summarize, Fritsch sees little difficulty in eliminating the few remaining NTBs and most of the other issues. A common external tariff is also not insurmountable given that all countries involved have already embarked on trade liberalization and simplified their tariff structures: Argentina has 5 tariff levels; Uruguay and Paraguay, 4; and Brazil, 8. With some exceptions in Brazil (autos, informatics goods, fine chemicals, consumer electronics, and numerically controlled machinery), the maximum tariffs in the countries are already below 20 percent. Some sectors, autos in particular, will probably successfully negotiate new forms of managed trade. The problems of inhibiting the spread of EPZs and winding down the existing ones are sticky but do not necessarily threaten integration. Another issue is the building of a competent supranational bureaucracy that will participate in exchange-rate coordination and avoid trade distortions by keeping sectoral agreements and FTZs to a minimum.

Bilateral real exchange-rate coordination is the major obstacle as it leads to large shifts in intrazone competitiveness and trade imbalances. The Cavallo Plan froze the exchange rate at an overvalued level. The actual level of the Argentine peso became decreed by Congressional law, which makes correcting it is a thorny problem. The overvalued peso has led to a trade gap which includes a deficit with Brazil. That said, Fritsch contends that the imbalance with Brazil is temporary and stems not from the exchange-rate problem but from Brazil's recession and hysterisis effects caused by Brazilian firms adjusting to integration opportunities. Brazil, on the other hand, is delaying adjustment of its undervalued currency to avoid hyperinflation, promote exports, and maintain employment levels. Despite the total lack of coordination between the two countries, bilateral parity has been amazingly stable since the mid-1980s (with the exception of the early late 1980s and early 1990s). The small degree of trade interdependence between the two countries, however, does not provide the incentives to subordinate policies to the objectives of integration. Only a concerted political commitment can stabilize rates. Rate bands may be an instrument to achieve this goal. The absence of exchange-rate coordination is the single most important threat to Mercosur, but the more serious problems are in Argentina.

Beyond 1994 (1): The Long Road towards Economic Union

The main tasks facing the Southern Cone participants through the year 2000 are the issues broadly called the harmonization of nonborder incentives affecting locational advantages. These issues could possibly converge more quickly than they did in the case of the EEC because of a growing consensus in the countries. Bringing FDI, intellectual property, and technical standards into harmony is also likely to prove irresistible over time.

Beyond 2000, there are problems inherent in intracountry regional disparities (income levels and general welfare conditions) which can be boiled down to negotiating the required fiscal transfers. It is not clear to what extent other countries will pay for national disparities. Labor mobility may be a means of mitigating regional inequalities.

Beyond 1994 (2): Mercosur in the World Trade System

South American integration is important for two reasons. Manufactured exports in intraregional trade are high. Should the continent return to historic growth rates, integration would spur greater industrial efficiency and productivity. The second reason is a defensive one—to diminish trade diversion emerging from NAFTA and Chile's eventual participation. This threat from NAFTA could also be diminished via other multilateral arrangements.

Discussants' Comments

Stabilization Is a *sine qua non* for Integration

Albert Fishlow contends that Fritsch ignored the principal issue, that is, whether a sustainable agreement is possible. Given raging inflation in Brazil, over 30 percent per month, and overvaluation in Argentina, Fishlow believes that the possibilities are slim. On the one hand, Brazil's trade surplus with Argentina cannot persist; on the other, the large, highly speculative capital flows from the US that finance the Argentine trade deficit are not sustainable. Productivity gains in Argentina could make current values of the peso realistic, but Fishlow believes that any gains that may eventually arise could not be attributed to integration between Brazil and Argentina.

A more realistic assessment of the possibilities for Mercosur hinges on the macroeconomic environment. In Mexico, inflation was substantially reduced and productivity increased. The result was that the degree of overvaluation of the peso vis-à-vis the dollar was much smaller than in Mercosur countries.

The macroeconomic instability provides incentives for countries to look for other arrangements. Given the high overvaluation of the Argentine peso, Brazil has incentives to seek membership in NAFTA or similar agreements. In other words, the fate of Brazil's macroeconomic policy and the fate of Brazil-US relations are the issues that will decide the fate of Mercosur.

Mercosur as a Disciplinary Force

Eliana Cardoso contends that Fritsch's analysis was too pessimistic. Inflation in Brazil has been high, but the exchange rate has remained competitive. Furthermore, as Fritsch shows, the history of Mercosur has been one of steady progress, and despite the great macroeconomic instability of the last three years, negotiations have forged ahead. Mercosur, in fact, could be an instrument of discipline fueling macroeconomic stability.

Regarding the future of South American integration, Mexico and Chile should realize they would be better off with multilateralism, but they fall prey to the incentives of a hub-and-spokes system with the US. Chile's refusal to join Mercosur poorly serves Latin American interests.

Cardoso agreed with Fritsch that the large trade imbalances between Argentina and Brazil were a function of the recession in the latter and had little to do with the Brazilian exchange rate. Contrary to Fritsch's assertions, Cardoso argued that real exchange rates oscillate dramatically. For example, in 1990 the Brazilians complained that the Argentines were invading Brazil. The situation was reversed after 1991, and the Argentines attributed Brazil's surplus to its macroeconomic instability and Argentina's overvaluation. Argentina slapped taxes on all imports, essentially violating the spirit of Mercosur. The situation is unlikely to change because the Argentine government is committed to keeping down inflation and is using a classic deflationary policy rather than devaluation.

Cardoso was skeptical of Fritsch's proposal to use a band to regulate real exchange rates. If the band is too narrow it will not be sustainable. Conversely, if it is broad, it will not work. Cardoso disagreed with Fritsch's assertion that exchange-rate parity had been relatively steady since the mid-1980s. Since the end of 1991/92, appreciation in the real exchange rate is about 20 percent. That said, parity, is not necessary for economic integration and is not necessarily desirable. Monetary and trade agreements have their own purposes and should be dealt with separately.

Brazilian Obstacles to Mercosur

Damil believes that the issues surrounding exchange rates may be more intractable than Fritsch suggests. Secondly, Damil believes that Fritsch overemphasized the Argentine problems, the frozen exchange rate, while ignoring very serious problems on the Brazilian side, such as NTBs, which have been virtually eliminated in Argentina. Regarding exchange rates, Damil, like Cardoso, believes that Fritsch underestimated the deflator, making it appear that real rates and parity in the two countries are roughly constant. In fact, there has been real appreciation in Argentina leading to a current account deficit in 1992. This has been financed through the capital account but, as Fishlow stated, it is unsustainable and presents a real danger for Mercosur as Argentina will withdraw its support. Argentine business is emphatically attacking the exchange-rate policy, but it is simultaneously an indirect attack on Brazil and threatens the future of Mercosur.

Regarding the Brazilian side of the equation, Damil stated that political instability is a major factor. He stated that it is more realistic to think of Brazilian politics as a long transition from authoritarianism. In summary, Fritsch underestimated many of the threats to Mercosur coming from Brazil. Given the remaining problems in both countries, perhaps the period of transition should be longer than till 1994.

Other Comments

Bresser Pereira argued that the Brazilian surplus is due to increased productivity as well as the recession.

Bouzas commented on the issue of import penetration into Argentina. He stated that Argentina's exports were growing faster than Brazil's. Given that exchange rates between the countries are not out of line, if there is successful stabilization in Brazil the cruzeiro will appreciate, which will contribute to closing the gap between the two. In comparison to the NAFTA members, the differences between Brazil and Argentina may not be so great.

Rebuttal

Fritsch responded by emphasizing the relatively steady parity existing since the mid-1980s. That said, there is little incentive for the countries to coordinate their exchange-rate policies because they have their own internal problems and there is little trade interdependence between them. The tensions today stem from the Argentine side because they have made their commercial policy an instrument of stability. It is difficult to defrost the peso. If Brazil delays adjustment, however, it may also self-inflict a problem. Fritsch reiterated that an exchange-rate band may be a helpful means of organizing the discussion of adjustment. A crawling peg for both may be another solution.

Regarding Brazil's relatively slow rate of liberalization, Fritsch argued that it would be dangerous to accelerate the decrease in tariffs in recessionary Brazil. Growth will permit an accelerated liberalization and permit more room for negotiation.

What kind of bureaucracy is needed? The Organization for Economic Cooperation and Development (OECD)–type with a light framework might be good. Bureaucracies in Brazil have too much power.

Paper IV
Integration and Liberalization: The Andean Experience

Pilar Esguerra presented a paper written with José Antonio Ocampo on the evolution of the Andean Pact, which was created in 1969 to help consolidate import substitution. The idea was to link economies of similar size and growth prospects. The agreement included provisions for common policies towards FDIs, coordinated sector-specific industrial policy, trade liberalization and policies to increase competition without allowing competition from developed countries.

Evolution and Characteristics of Andean Trade, 1969–1981

These were the golden years of the Andean trade, mainly due to the export boom in the oil producing countries. At about this time two blocs developed within the Andean Pact—Colombia, Venezuela, and Ecuador, who traded 70 percent of their goods among themselves; and Peru and Bolivia, who traded mainly with their neighbors Argentina, Brazil, and Chile. One reason for this split was the lack of complementarity among the countries' productive structures.

Andean Crisis 1982–1989

The balance of payments (BOP) crisis spread throughout the region starting with the Ecuadorian devaluation in 1982. Rising international interest rates and current account crises led to devaluations and generalized import controls which hampered regional liberalization. Agreements on limiting FDI were also discarded as foreign exchange shortages became acute. In an attempt to avoid total collapse of the Andean Pact, authorities introduced a number of modifications that effectively signified retreats from regional FTAs.

Recent Integrations, 1989–1993

There has been a revival of the Andean group with an emphasis on trade liberalization rather than consolidation of import substitution. There have been a series of agreements signed between 1989 and 1993 to move towards a customs union, but implementation of these has been slow. Remaining difficulties include domestic problems and the inability to reach agreement in three different areas: customs tariffs, coordination of export activities, and rules for negotiations with countries outside the Andean Pact.

The inability to reach agreements led members to form subgroups where Colombia, Ecuador, and Bolivia agreed on a customs union. Colombia is starting to liberalize rules on FDI. Colombia, Venezuela, and Mexico became the Group of 3, agreeing to reduce tariffs, although substantial differences still remain between the two groups. Colombia and Venezuela also entered into agreements with Chile and the Central America countries. Colombia has also been pursuing GATT negotiations.

Revival of Andean Trade and Investment

Revival started in 1989 due to the renewed growth process and overall increased macro stability. Colombia in particular was helped by a depreciation, which combined with real appreciation in Peru to improve Colombia's BOP position. For the Andean Pact countries, total trade grew by 19 percent over the period 1989–1991, and nontraditional exports grew by 26 percent over that period.

Discussant's Comments

Manuel Agosín commented that the paper was good a description of policy changes but needed a stronger analytical discussion of the reasons for the changes in the agreements. He raised two questions in particular: Why did the Andean Pact fizzle out in 1989–1990? What is the future of the Andean Pact? These countries can be very useful to each other in diversifying their exports.

Paper V
Some Elements of Chilean Trade Policy: The USA or Mercosur?

Andrea Butelmann placed the discussion of the FTA in the context of a fifteen-year-old process of liberalization in Chile. In the absence of multilateral agreements, there are two (not mutually exclusive) options for Chile—to sign an FTA with the United States or to sign one with Mercosur.

Goals of Chilean Trade Strategy

Butelmann identified several goals of Chilean trade strategy. An important one is increasing access to markets where Chileans face high tariffs and ensuring stable access to these markets. A second major goal of trade strategy would be diversification of goods and markets for higher value-added products. Diversification will help provide macro stability in the event of international price fluctuations of primary goods and will also aid development of Chile's industrial sector. Diversification is already taking place; industrial exports are growing faster than primary-good exports. These goods tend to face higher tariff barriers than primary exports. There appears to be a consensus that trade policy cannot be allowed to affect macroeconomic stability or restrict Chile's freedom to deal with countries outside any agreement.

Composition of Chilean Exports

On categorizing Chile's exports into natural resources, processed natural resources, and other industrial products, Butelmann found that the majority of Chile's exports to the developed world are natural resources—61 percent of exports to the US and Japan and 71 percent of those destined to the EEC. About 30 percent of exports to developed countries are processed natural resources and the remainder are other industrial products. Chilean exports to the rest of Latin America are more balanced—35 percent, 38 percent, and 27 percent respectively. Butelmann also found that a rise in exports of processed natural resources to any market causes a fall in exports of natural resources to those markets.

These numbers indicate that Chile's comparative advantage with developing countries is in natural resources followed by processed natural resources. The comparative advantage with Latin America is in processed natural resources and certain other industrial products—metal mechanics, textiles, and chemicals.

Reasons to Sign an FTA with the US

Although there are not many US barriers to Chilean exports, the existing escalating tariff system inhibits the development of value-added goods. An FTA could have a significant impact on the composition of Chilean exports. Other benefits of signing an FTA with the US include a decrease in value-added tariffs, stable access to US markets, protection against trade diversion to Canada and Mexico, and incentives for FDI. Removing NTBs is more important than removing tariffs from the Chilean point of view.

Areas to be Worked Out

The US will apply pressure to protect intellectual property rights and the environment. Chile's agricultural sector is protected, and any attempt to lift this protection will be fought. Existing export subsidies will also become an issue. Chile would like protection against sharp increases in imports, and will have to set up mechanisms to address dumping.

Chile and Mercosur

The reasons for joining Mercosur are many. One is geography—the proximity of Mercosur countries makes them natural trading partners, and Brazil and Argentina are already Chile's two largest trading partners in Latin America. Secondly, according to economic theory, small countries will benefit proportionately more from trade agreements than the large ones. Finally, access to the largest markets in Latin America may generate FDI in Chile.

The costs of joining Mercosur include the possibility that Chile's exports to Mercosur countries could be diverted to other member countries; it could be affected by its neighbors' macro instability; and it would have to accept common higher tariffs on US exports.

Discussant's Comments

Relative Benefits of the Two FTAs

Agosín agreed with the thrust of Butelmann's comments but was more optimistic about Mercosur and less so about the effect of an FTA with the US. Given fifteen years of trade liberalization, Chile does not have much to gain from signing an FTA with the US. There would be some advantages in the form of lower value-added tariffs, but not much in terms of dynamic gains or FDI. An agreement with Mercosur on the other hand could help Chile develop manufactured exports without drastically increasing imports. Exchange-rate instability could be a problem.

Other Comments

In response to Agosín's comments on anti-dumping protection, Hufbauer argued that given Chile's market access abroad, anti-dumping programs may not work. A section 301 approach might be more appropriate than AV/CVD.

Fritsch suggested that Chile may be reluctant to join Mercosur because it was reluctant to give up its economic autonomy—a political economy problem.

Cardoso challenged Butelmann's view that joining an FTA would increase macro instability above current levels, given that Chile's economy is already so open.

Paper VI
Central America: Common Market, Trade Liberalization, and Trade Agreements

Ennio Rodríguez began by noting that the five Central American economies have always been open, even when compared to Chile, a fact illustrated by comparing trade-GDP ratios—Chile's is 55 percent, Central America's is 60 percent, and Costa Rica's is 90 percent. The single most important trading partner for the Central American countries is the US, accounting for about 40.2 percent of trade. Since 1985 Central America has had preferential access to the US as a result of the Caribbean Basin Initiative (CBI) I and II. The EEC is the second most important trading partner. Intraregional trade, meanwhile, has been falling. The negotiations on the Central American Common Market (CACM) have been going on at a time when there has been a general move throughout the region towards deregulation and tariff reduction. There are also concerns that the privileged access to the US market is eroding as a result of the Andean Pact and NAFTA.

Relaunching of CACM

The CACM was ruptured in the '80s because of political and economic crises. After 1987, efforts to relaunch the CACM began. The presidential summit included discussions of common markets and means of penetrating other markets. Meanwhile, the individual countries unilaterally began to liberalize their economies and lower tariffs. The Plan for Economic Action for Central America was signed in 1990, and in 1991 agreement was reached on a common tariff by 1993. The relaunching of CACM is a part of the overall export-promoting strategy in these countries. This can be labeled a supply-side strategy which helps the members become more competitive in international markets, as opposed to the old goal of expanding demand to aid an import-substitution strategy.

Besides the tariff agreement, CACM has also been developing strong institutions such as the Central American Economic Integration Secretariat and the Central American Bank for Economic Integration. Several private-sector regional organizations have also been launched. There are now a total of thirty-nine institutions that deal with issues of regional integration and development. Despite these successes, political will may be surpassing integration and several issues remain to be worked out.

The most difficult issue is the distribution of costs and benefits of intraregional trade. This has proven to be a thorny issue in previous negotiations and is not currently being discussed. Recent studies indicate that benefits will be shared mostly by El Salvador, Costa Rica, and Guatemala, while the costs, mostly due to trade diversion and less export diversification, will be disproportionately borne by Nicaragua.

Preferential Access to the US Market

The CACM countries currently receive preferential access under the CBI. The concern is that implementation of NAFTA will lead to trade and investment diversion. NAFTA could put 60 percent of CBI exports to the US at a disadvantage vis-à-vis Mexican exports. Spurring CACM trade with Mexico is an indirect way of benefiting from NAFTA, but it is not an acceptable substitute because Mexican-CACM trade is very small and even high growth rates would not allow Mexico to substitute as a trading partner. CACM needs to move from the unilateral concessions of CBI to a reciprocal agreement that would give the Central American countries the same access to US markets that Mexico will receive.

Extraregional Free-Trade Zones

The Central American countries are currently negotiating an FTZ with the US. Mexico, Venezuela, and the EEC have also proposed signing agreements with the Central American countries. In assessing these, benefits and costs have to be calculated.

Current estimates of the effects of an FTA with the US predict that the balance of trade will deteriorate in the Central American countries, so adjustment costs are likely to be quite high. Export gains are likely to be low because US tariffs are already low. Estimates of agreements with Mexico and the EEC yield similar, but smaller, results. Possible dynamic effects of an FTA include scale effects, external economies, increased efficiency due to increased competition and macroeconomic stabilization, and polarization effects if adjustment costs or investments are concentrated in one country or the other. It is the last effect that is of particular concern. Adjustment costs could be very high for less developed economies; careful attention has to be paid to the transition. The possibility that FDI will increase as a result of FTA is the big attraction, and the investment climate in the Central American economies will be a critical factor. Although a continentwide FTZ would be preferable to the development of a hub-and-spokes system with the US, except possibly for the first-comers, the hub-and-spokes system may be the only one achievable.

Conflicts may arise between the CACM and GATT, and between the CACM and other countries that sign bilateral agreements with the CACM members. Rules-of-origin negotiations are important because otherwise countries with the lowest tariffs become ports of entry to the other countries. Differing unfair-trade safeguards and dispute-settlement mechanisms could also cause conflicts among the various treaties.

Conclusions

Relaunching CACM can be justified to increase trade and secure market access. This makes bilateral negotiations among these countries redundant. Furthermore, multiple FTZs cause administrative and incentive complications. The consolidation of the CACM should take place before additional FTZs are negotiated. Signing an agreement with the US is a top priority, especially to prevent trade diversion from NAFTA, with Mexico as the next priority.

Discussant’s Comments

Rhetoric and Reality in the CACM

Saborío agreed that reigniting intraregional trade in Central America is a good idea and that there is an incompatibility between the Central American initiatives and the overlapping bilateral agreements that were emerging. She also agreed that NAFTA could be a problem by diverting trade, and that the CACM needed the same level of access to the US market as Mexico. She suggested that rhetoric in the CACM is far outstripping reality, and that perhaps the rhetoric should be scaled back to achievable levels—an FTA rather than a common market. The tendency to sign bilateral agreements like the ones with Mexico could lead to a splitting up and eventual reduction of total trade flows. The chief culprit in this regard is Costa Rica.

Other Comments

Lustig suggested that overlapping agreements had the advantage that they were possible, and that they created valuable experience that could be useful in signing more ambitious agreements. Mexico had signed several bilateral agreements with US before NAFTA was negotiated. Lustig also asked about the role the private sector is playing in Central America: could it start attracting investment from Mexico?

Fritsch argued that the scramble to sign an FTA as a defensive measure has been damaging to Central America, and that these countries need to find some way to act jointly.

Fr. Bartell argued that if the perceived individual interests are different enough to make an agreement unlikely, another route would be to collaborate without a formal common market.

Rebuttal

Rodríguez said that the private sector has indeed played a very important role in Central America, and that things are moving fast, especially in capital market integration and subcontracting ventures. Although bilateral measures may have learning effects, these countries would be better off if this learning takes place in a multilateral context.

Paper VII
Caricom

Richard Bernal gave a pessimistic assessment of the future of the Caribbean Community (Caricom) and stated that its effectiveness is contingent upon a further widening of the arrangements, rather than the traditional strategy of deepening them.

The Origins and Objectives of Caricom

Interest in a political federation and economic union in the Caribbean began after WWI and accelerated after WWII. In 1967 the Caribbean Free Trade Area (CARIFTA) was created. Tariffs and quantitative restrictions among member countries were lowered. Caricom was established in 1973. It currently has thirteen member countries. Its broad objectives are to increase intraregional trade and achieve greater economies of scale in production; promote some ISI; and increase the region's bargaining power in multilateral and bilateral negotiations. All these goals should be achieved in the context of avoiding the polarization of gains among member states.

The Structure of the Caricom Economies

The members of Caricom are small. Their total population is under six million; the geographic area, about 270,000 square kilometers; and the GDP, slightly over US $10 billion. For comparison's sake, Singapore and Hong Kong are often referred to as small economies. Singapore's GDP is about US $28 billion, and Hong Kong's population about 5.7 million. Jamaica, a Caricom member, has a population of about 2 million; Monserrat, about 12,000.

The Caricom countries are vulnerable to external events. Because they are small, there is insufficient scale for more than one producer. They are open economies. Their trade is 70 to 80 percent of their GDP. Their principal exports are primary products, and these are focused on two or three extraregional markets: Canada, the US, and the EEC. The United States is responsible for over 50 percent of the region's exports, much of it within the CBI.

Economic Performance of Member States

In the 1960s, as a result of favorable prices for exports and worldwide expansion, the Caricom economies were growing. By the 1970s, a less favorable international conjuncture caused a slowdown in economic growth. The 1980s showed little improvement, as balance of payments crises reduced import capacity, leading to a reduction in growth and exports. The negative transfer of resources to service the escalating external debt is an important obstacle to growth.

Intra-Caricom Trade

One goal of the Caribbean Community was to promote intraregional trade, which declined during the 1970s and most of the 1980s and only began to recover in the late 1980s. Nonetheless, inadequate regional payment systems, the lack of macroeconomic policy coordination, a reluctance to relinquish economic sovereignty, the adverse impact of external shocks, and exchange rate volatility are some of the factors behind lackluster intraregional trade.

The Current State of Caricom

There have been important Caricom initiatives in the last few years. In 1989 the heads of government adopted the Grand Anse Declaration and Work Program for the Advancement of the Integration movement. This establishes, among other things, a series of harmonization measures (external tariffs, rules of origin, fiscal incentives); the formation of a custom union; devising a plan for the free movement of capital and labor; a joint equity fund and mutual listings on stock exchanges; and greater cooperation on monetary, financial, and exchange-rate policies. Most measures have not been fully implemented.

The goals of Caricom, by and large, have not been met. The concentration of exports in a few products and in a few markets persists. Most Caricom trade is a result of preferential agreements: the CBI with the United States, and the Lome Convention with the EEC. These arrangements, however, are threatened. The Lome convention now embraces the Central American countries, and NAFTA could divert US demand for Caribbean products. Finally, there is little interaction and little diversification among Caricom countries. They tend to produce the same goods and cannot reach economies of scale.

Bernal believes that the small size of the economies and their external vulnerability against the backdrop of their colonial experience leads to a mind-set obsessed with sovereignty. This fixation paralyzes efforts to promote further integration. Bernal contends, however, that sovereignty cannot be achieved by small, highly vulnerable economies if they do not work together. Nonetheless, Caricom's efforts at deepening have not removed external vulnerabilities. He believes that the existing agreements must be widened, which means not only enlarging membership but also seeking access to existing regional blocs or countries. This is particularly important given the globalization of the international economy and the emergence of regional trade blocs.

Policy Challenges Facing Caricom

Caricom countries should collectively join emerging or existing regional trade initiatives in the Western Hemisphere, at a minimum for defensive reasons. To enhance bargaining power, negotiating access should be a collective rather than an individual effort.

The Caricom countries must negotiate parity with the NAFTA agreement to avoid trade diversion. They should not begin with full reciprocity, to avoid brusque adjustment costs, but this should be a longer-term goal. The agreements should help Caricom countries move to more dynamic export and service activities such as tourism and light manufacturing.

Discussant's Comments

The Need to Focus on the Social Impact of Integration

Pantin agreed with the thrust of Bernal's comments regarding the ineffectiveness of the Caricom arrangements, the external vulnerability of the region, and the precariousness of Caricom. In the EEC, for example, integration was pushed by companies. This is not the case for Caricom. Secondly, the emerging regional blocs in the hemisphere are undermining Caricom.

An issue that needs to be addressed further is the impact of GATT on regional negotiations. Pantin stressed the importance of understanding the impact of integration on social indicators and concluded with a pessimistic assessment of the future of Caricom.

Rebuttal

Bernal responded by saying that regional trading blocs were a way station on the road to globalization and within this context, Caricom strategies must be reconceptualized.

Wrap-Up: Panel Discussion

A Skeptic's View of Integration

Ajit Singh expressed skepticism regarding the benefits of economic integration. The goal of GATT was full employment, not trade integration. Will quick and complete liberalization help achieve full employment? Asia, an unquestionable success story, industrialized within the context of import controls, a vigorous industrial policy, and ISI: in other words, policies inimical to multilateral integration. There has been a trend toward falling productivity since 1973, a period of high global integration, while the highest productivity gains occurred before then, during a period of lower integration. The dangers of integration are also vividly illustrated in the case of the EEC. High rates of unemployment are endemic, raising the specter of fascism. Trade is not necessarily a handmaiden of growth. Singh is especially suspicious of financial integration, which he believes could increase financial instability.

Integration and the United States National Interest

Luis Carlos Bresser Pereira, speaking from the point of view of the US rather than Latin America, believes that integration with the latter is in the national interest of the former. The slowdown in the American economy is the result of the Reagan trap: the absence of fiscal discipline and industrial policy. The US needs to get out of this trap. Japan, on the other hand, had fiscal discipline, a market orientation, and an active trade policy. It was market oriented *and* state coordinated. Since globalization is a reality and the Japanese have created a formal trade bloc with East Asia, the US can counter with FTAs in Latin America. Bresser Pereira concluded that global trading blocs needed to be constructed to create functional equivalents of Japanese pragmatism.

GATT and Trading Blocs

Stern addressed the apparent contradiction between GATT and the emerging regional blocs. Although GATT is a multilateral agreement, it does not prohibit regional blocs as long as they do not increase protectionism. In fact, Article 24 of GATT specifically recognizes the importance of regional arrangements. Therefore, blocs per se are not a threat to GATT. Economic theory, unlike GATT, is ambiguous regarding its judgments of trade blocs. Theory focuses on the trade-enhancing vs. trade-diverting effects. Krugman has constructed a model suggesting that regional blocs can be trade-diverting, while Stern's and Deardorf's models suggest that they can be advantageous under certain circumstances. There has not been any work to suggest how to construct trade-enhancing blocs.

There is, however, disenchantment with GATT. After forty years of negotiation, multilateral agreements are still elusive. In the early years GATT was a process of tariff reduction. At the Tokyo and Uruguay Rounds there was a shift from liberalization to rule-making. During the Uruguay Round in particular, negotiators got stuck on agricultural protectionism, which is ironic because this is not as important as other issues. GATT may provide opportunities for free-riding as seen in some developing countries. Furthermore it is not always responsive to new issues. The recent efforts on intellectual property and services may represent change. Issues such as the environment remain to be addressed.

Is the expansion of trading blocs advantageous?

Other Comments

Christopher Lund (Lund Associates, São Paulo, and Kellogg Advisory Council member) asked Singh what a socially necessary rate of growth was and how to generate the high investment necessary for growth without international integration of financial flows. Singh responded that countries have to generate internal savings. Many Asian countries have been successful. The best thing that the US can do for Latin American countries is offer unilateral preferential agreements.

While Singh expressed doubt about the impact of NAFTA on Mexico's productivity, Lustig argued that capital flows will make the country's economy more competitive.

O'Donnell noted that issues of free-trade politics could be subsumed under the classical problem of overcoming short-term resistance to achieve long-term welfare. The difficulties of overcoming opposition from powerful short-term interests was an issue that so far had not been addressed in the discussion.

Conclusions
Uncertain Outcomes and Unresolved Debates

Economic theory does not take us very far in predicting the results of integration. Models are of limited usefulness in understanding the impact of trade agreements. They cannot reliably predict the potential dynamic effects of integration nor how the costs and benefits of integration will be distributed. They have little to say about politics: overcoming short-term but powerful interests to reach the benefits of integration, and how these short-term interests shape the content and impact of integration. They also have little to say about how to structure an agreement to increase the benefits of trade.

Little can be gleaned about productivity from models beyond issues of scale. While most of the participants believe that productivity increases will follow from integration, there is little understanding of these processes. What organizational and technological strategies, beyond changing the levels of production, do firms adopt when faced with new regional opportunities? Do they relentlessly drive down prices and wages? Do they try to segment markets and target particular niches? Comprehending firms' reactions is critical to understanding the impact of integration on the livelihood of workers and citizens.

There was no consensus as to whether macroeconomic stability was a prerequisite for successful integration. Some believed that integration was impossible without stability. Others believed that integration could precede stability and might even encourage it. Also unresolved was whether instability was 'contagious,' and if it was, what mechanism transmitted it. Some believed that since the economies were already quite open, the question of contagion was a moot one. Others believed that investor psychology could transmit macroeconomic instability. Coming to an understanding about rules of origin, tariffs, and NTBs will all determine how the costs and benefits of trade integration are distributed.

Manuel Agosín
Universidad de Chile
Santiago, Chile

Rev. Ernest Bartell, c.s.c.
Kellogg Institute

Richard Bernal
Jamaican Ambassador to the
United States and the OAS
Washington, DC

Roberto Bouzas
FLACSO
Buenos Aires, Argentina

Luiz Carlos Bresser Pereira
Fundação Getúlio Vargas
São Paulo, Brazil

Andrea Butelmann
CIEPLAN
Santiago Chile

Eliana Cardoso
Tufts University
Fletcher School
Medford, MA

Mario Damill
CEDES
Buenos Aires, Argentina

María del Pilar Esguerra
FEDESARROLLO
Bogotá, Colombia

Albert Fishlow
University of California, Berkeley
Berkeley, CA

Winston Fritsch
PUC
Rio de Janeiro, Brazil

Stephen Herzenberg
US Department of Labor
Washington, DC

Gary Hufbauer
Institute for International Economics
Washington, DC

Robert Lawrence

Harvard University
Cambridge, MA

Nora Lustig
The Brookings Institution
Washington, DC

José Antonio Ocampo
(unable to attend but his paper was discussed)
Minister of Agriculture
Bogotá, Colombia

Dennis Pantin
University of the West Indies
Trinidad, West Indies

Carlos A. Primo Braga
World Bank
Washington, DC

Jesús Reyes Heroles
GEA
Mexico, DF, Mexico

Ennio Rodríguez
CEPAL
Mexico, DF, Mexico

Miguel Rodríguez Mendoza
Instituto Venezolano de Comercio Exterior
Caracas, Venezuela

Jaime Ros
University of Notre Dame/Kellogg Institute

Sylvia Saborio
USAID
San José, Costa Rica

Ajit Singh
Cambridge University/University of Notre Dame
Cambridge, England

Robert Stern
University of Michigan
Ann Arbor, MI

John Whalley
University of Western Ontario
London, Ontario, Canada

Economic Integration in the Western Hemisphere

Introductory Remarks

Rev. Ernest Bartell, CSC
Kellogg Institute

I. The North-South Variety of Economic Integration: Issues and Prospects for Latin America

Roberto Bouzas
FLACSO
Buenos Aires, Argentina

Jaime Ros
University of Notre Dame/
Kellogg Institute

Discussants: **Robert Lawrence**
Harvard University, Cambridge, MA

Gary Hufbauer
Institute for International Economics, Washington, DC

II. NAFTA: Potential Impact on Mexico's Economy and Beyond

Nora Lustig
The Brookings Institution
Washington, DC

Discussants: **Stephen Herzenberg**
US Department of Labor
Washington, DC

Carlos A. Primo Braga
World Bank, Washington, DC

III. Mercosur: A Midterm Review

Winston Fritsch
PUC
Rio de Janeiro, Brazil

Discussants: **Albert Fishlow**
University of California, Berkeley, CA

Eliana Cardoso
Tufts University, Fletcher School, Medford, MA

Mario Damill
CEDES, Buenos Aires, Argentina

IV. Integration and Liberalization: The Andean Experience

José Antonio Ocampo (unable to attend in person)
Minister of Agriculture
Bogotá, Colombia

María del Pilar Esguerra
FEDESARROLLO
Bogotá, Colombia

Discussant: **Manuel Agosín**
Universidad de Chile, Santiago

V. Some Elements of Chilean Trade Policy: The USA or Mercosur?

Andrea Butelmann
CIEPLAN
Santiago, Chile

Discussant: **Manuel Agosín**
Universidad de Chile, Santiago

VI. Central America: Common Market, Trade Liberalization, and Trade Agreements

Ennio Rodríguez
CEPAL
Mexico, DF

Discussant: **Sylvia Saborío**
USAID, San José, Costa Rica

VII. Caricom

Richard Bernal
Jamaican Ambassador to the United States and the OAS
Washington, DC

Discussant: **Dennis Pantin**
University of the West Indies, Trinidad

Panel

Luiz Carlos Bresser Pereira
Fundação Getúlio Vargas, São Paulo, Brazil

Guillermo O'Donnell (chair)
Kellogg Institute

Ajit Singh
Cambridge University, England and University of Notre Dame/Kellogg Institute

Robert Stern
University of Michigan, Ann Arbor