

EU AND US REGIONALISM: THE CASE OF LATIN AMERICA

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I. BACKGROUND ON REGIONAL TRADE AGREEMENTS IN LATIN AMERICA

Open markets and regional trade agreements¹ are a relatively new phenomenon to Latin America where there has been a long history of regulated markets and protectionism. For the most part, countries in the region did not begin to open their markets to international trade and investment until the early 1990s. Prior to that time they followed a policy of protectionism consistent with an import substitution strategy. This strategy appeared to work initially with GDP per capita increasing steadily at an average annual rate of 3 percent between 1950 and 1980. However, during this same time period there was a considerable buildup of debt. As the foreign debt crisis erupted, beginning more visibly with Mexico in 1982 and spreading throughout the region afterwards, there

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¹This article will follow WTO convention and use the term “regional trade agreement” (RTA) to encompass both reciprocal bilateral free trade or customs areas and multicountry (plurilateral) agreements. RTAs are commonly divided into several basic categories, according to the degree of economic integration. A Free Trade Area (FTA) eliminates barriers to trade in goods (and increasingly services) among members, but each member is free to maintain different MFN barriers on non-members. A Customs Union extends a free trade area by establishing a common external tariff on all trade between members and non-members. A Common Market deepens a customs union by providing for the free flow of factors of production (labor and capital) in addition to the free flow of outputs. And finally in an Economic and Monetary Union members share a common currency and macroeconomic policies.

were such negative effects that the 1980s became known as “the lost decade” in Latin America. GDP per capita during this time period declined at an average annual rate of 0.7 percent and hyperinflation was widespread. By 1986, three out of four Latin American countries had inflation rates above 30 percent.

The crisis of the lost decade spearheaded a policy debate and a movement toward market reforms and different economic strategies. Emphasis on market reforms pushed import substitution policies by the wayside and as a consequence trade opened up. There were certainly differences between the countries in the region regarding the degree and procedures to implement these economic reforms, but there was great coincidence in the overall approach. Williamson (1990) has synthesized this economic reform scheme as the Washington Consensus.

In addition to the economic reforms there were even more significant institutional and political changes that replaced dictatorships with democracies. Latin America began the 1980s with 10 democracies (out of 26 countries) and by 1990, all but four countries were democratic, and by 2000, only Cuba was not.

As the economic and political reforms continued there were several privatizations turning over government institutions and activities to the private sector, domestic financial systems were deregulated, and controls on capital flows and foreign currency transactions were eliminated. Latin America appeared to have a dramatic turnaround in the 1990s with GDP per capita growth moving into to positive numbers and inflation declining. By the end of 1996, only one country had an annual inflation rate over 30 percent. However there is some debate as to whether the economic and political reforms were the cause of this market improvement. Although GDP per capita in the 1990s grew at rates that were higher than in the 1980s, they were still about half the growth rates of the import substitution era. The beginning of this decade again saw the region’s GDP shrink by 0.6% in 2002, after growth of just 0.4% in 2001.

Table I
 Years of Openness for Latin American Countries

Country	Years of Openness
Argentina	1991–
Bolivia	1956–1978; 1986–
Brazil	1991–
Chile	1976–
Colombia	1987–
Costa Rica	1952–1961; 1987–
Ecuador	1950–1983; 1992–
El Salvador	1950–1960; 1990–
Guatemala	1950–1960; 1989–
Honduras	1950–1961; 1992–
Mexico	1987–
Nicaragua	1950–1960; 1992–
Paraguay	1990–
Peru	1950–1967; 1992–
Uruguay	1991–
Venezuela	1990–

Source: Sachs and Warner (1995).

Although the protectionism from the 1950s is consistent with an import substitution policy, there is evidence that even prior to this time, before the Great Depression era, Latin America had some of the highest levels of protectionism in the world (Coatsworth and Williamson, 2004). Thus the movement toward more open markets has been a significant historical break with the past for countries in the region.

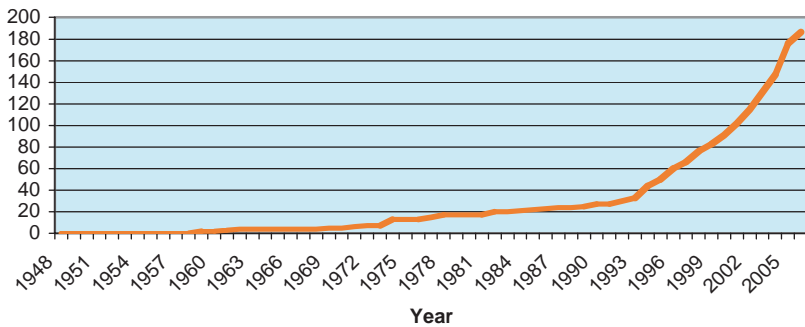
Several studies have measured the degree of openness and the timing in which this occurred. Sachs and Warner (1995) have categorized several countries according to the timing of trade liberalization, that they defined by the absence of certain characteristic impediments to open trade. Their study found that although there were times of liberalization of trade prior to the 1990s for some of the countries in the region, it was not until the beginning of the last decade that Latin America as a region began to open their markets (see Table 1).

So even though the region did experience growth during the 1990s with more open markets it was clear that these countries were not protected from crises as evidenced by the decline in their growth during the 1998–2002 era. More recently attention has focused on other “crisis-proofing” measures. Mexico and Chile were the only two of the region’s larger countries to have double-digit annual increases in the volume of their exports through the 1990s and they also escaped the worse of the turmoil of 1998–2002. So attention toward increasing exports and securing market access through regional trade agreements has been a growing emphasis (Kuczynski and Williamson, 2003).

Although prior the 1990s Latin America did have some regional integration initiatives, participation in international trade agreements, both multilaterally within GATT/WTO and regionally among themselves and with other trading partners, they did not comprehensively begin until this past decade as a part of their overall policy shift toward open markets.

As of November 22, 2005, the GATT/WTO has received notification of 186 regional trade agreements (RTAs) that are in force, as shown in Figure I. However, they also estimate that over

Figure I
RTAs in force by date of entry into force

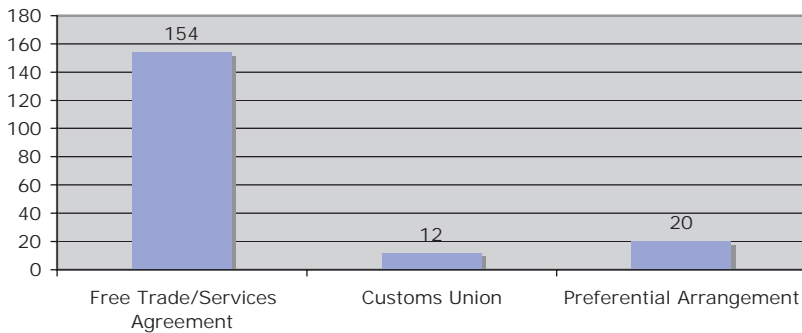


Source: WTO, Regional Trade Agreements.

70 RTAs are operational without formal WTO notification,² so the official data underestimates the extent of this growth. The World Bank estimates that the total number in force is closer to 300 agreements (World Bank, 2005). Most of the agreements, or accessions to agreements, involve Free Trade Areas (Figure II).

Since 1958, Latin American countries have been involved in 13% of the RTAs currently reported to the WTO. All but five of these 34 agreements have taken place in the last 10 years indicating the newness of such agreements for the region. NAFTA, starting in 1994, was the first free trade agreement that included a Latin American country (although there were earlier Customs Unions established within the region). There are many more agreements in-force, but not yet concluded in their reporting process to the WTO. Table II shows those Free Trade Agreements and Customs Unions in the Americas that are currently signed and/or ratified.

Figure II
Type of RTA Agreement January 1, 1958–November 22, 2005



Source: WTO, Regional Trade Agreements.

²Although GATT/WTO was founded on the principle of non-discriminatory trade and RTAs violate this principle they are supported. When countries enter into RTA agreements they are to notify the WTO but there is inconsistent compliance. The World Bank estimates that the average gap between the agreements entry into force and notification to the WTO is 354 days (World Bank, 2005).

Table II
Trade Agreements in the Americas

FREE TRADE AGREEMENTS IN THE AMERICAS	
—	Argentina
—	Bolivia
—	Brazil
—	Chile
—	Colombia
—	Costa Rica
—	Dominican Republic
—	Ecuador
—	El Salvador
—	Guatemala
—	Honduras
—	Mexico
—	Trade Agreements with Chile (1991), Ecuador (1993); Colombia, Ecuador, Peru, and Venezuela (as Members of the Andean Community-2000) FTA with Mexico (1995)
—	FTA with Canada (1997), Costa Rica (2002), El Salvador (2002), with EFTA (2004), South Korea (2004), Mexico (1999), United States (2004)
—	FTA with Mexico, Venezuela-Group of Three (1995)
—	FTA with Canada (2002), Chile (2002), CARICOM (signed 2004), Dominican Republic (2002), El Salvador (2004), Honduras (2005), Guatemala (2005), Mexico (1995), Nicaragua (2005), United States (2005)
—	FTA with CARICOM (signed 1998), Costa Rica (2002), El Salvador (2001), Guatemala (2001), Honduras (2001), Nicaragua (2005), United States (2005)
—	FTA with Chile (2002), Dominican Republic (2001); As part of the Northern Triangle with Honduras and Guatemala: Mexico (2001); Nicaragua (2005), Panama (signed 2002), United States (2005)
—	FTA with Dominican Republic (2001); As part of the Northern Triangle with Honduras and El Salvador: Mexico (2001), Honduras (2005), Nicaragua (2005), Panama (signed 2002), United States (2005)
—	FTA with Dominican Republic (2001); As part of the Northern Triangle with Guatemala and El Salvador: Mexico (2001), Nicaragua (2005), Panama (signed 2002), United States (2005)
—	FTA with United States and Canada as a part of NAFTA (1994); Bolivia (1995), Chile (1999), Costa Rica (1995), Group of Three: Colombia, Mexico, Venezuela (1995), EFTA with Norway, Switzerland, and Iceland (2001), EU (2000), Israel (2000), Japan (2005), Nicaragua (1998), Northern Triangle: El Salvador, Guatemala, Honduras, Mexico (2001), Uruguay (signed 2004)

–	Nicaragua	El Salvador (2004), Honduras (2005), Guatemala (2005), Mexico (1998), Panama (signed 2002), United States (2005)
–	Panama	FTA with Central America (signed 2002), Taiwan (2004)
–	Paraguay	
–	Peru	
–	United States	FTA with Australia (2005), Bahrain (signed 2004), Central America and the Dominican Republic (2005); Israel (1985); Jordan (2001), Morocco (signed 2004); Singapore (2004)
–	Uruguay	FTA with Mexico (signed 2003)
–	Venezuela	FTA with Colombia and Mexico-Group of Three (1995)

CUSTOMS UNIONS IN THE AMERICAS

– – – – – Mercosur

Members (1991):

- Argentina, Brazil, Paraguay, Uruguay
- Economic Complementatation Agreement with the Andean Community (signed 2002)
- Economic Complementatation Agreement with Peru as a member of the Andean Community (signed 2003)
- Economic Complementatation Agreement with Colombia, Ecuador and Venezuela as members of the Andean Community (2004)
- Economic Complementatation Agreement with Bolivia (1997)
- Economic Complementatation Agreement with Chile (1996)
- Preferential Trade Agreement with India (signed 2004)
- Economic Complementatation Agreement with Mexico (signed 2002)
- Framework Cooperation Agreement with EU (1999)

– – – – – **Andean Community**

Members:

- Bolivia, Colombia, Ecuador, Peru, Venezuela
- Partial Scope Agreement with Mercosur (signed 1998)
- Political Dialogue and Cooperation Agreement with the European Union (signed 2003)

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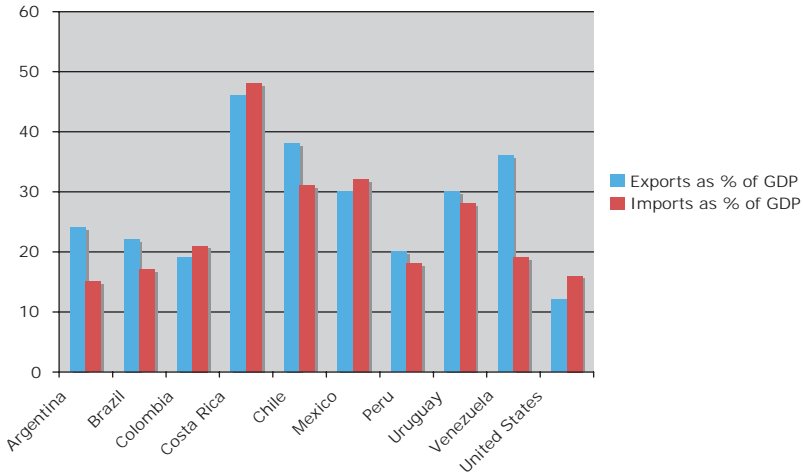
Table II
(Continued)

	Central American Common Market (CACM)
CUSTOMS UNIONS IN THE AMERICAS	
Members:	
Guatemala, El Salvador and Nicaragua (1961)	
Honduras (1962)	
Costa Rica (1963)	
Free Trade Agreement with the United States and the Dominican Republic (signed 2004)	
Free Trade Agreement with Panama (signed 2002)	
Caribbean Community and Common Market (CARICOM)	
Members (1973):	
Antigua and Barbuda	
The Bahamas	
Barbados (Member of the Community but not the Common Market)	
Belize	
Dominica	
Grenada	
Guyana	
Haiti	
Jamaica	
Montserrat	
Saint Lucia	
St. Kitts and Nevis	

St. Vincent and the Grenadines
Suriname
Trinidad and Tobago
Associate Members
Anguilla (1998)
Bermuda (2003)
British Virgin Islands (1991)
Cayman Islands (2002)
Turks and Caicos Islands (1991)
Free Trade Agreement with:
Costa Rica (signed 2004)
Dominican Republic (signed 1998)

Source: Organization of American States, Foreign Trade Information System, Trade Agreements, 2005.
Note: Unless otherwise noted, the date is when the agreement entered into force.

Figure III
Trade in Goods and Services as % of economy size, 2004



Source: World Bank, WDI Data Query.

International trade is an important aspect of the overall economy for most Latin American countries. Figure III shows that exports, for the larger Latin American economies, are on average about 25% of GDP. As a comparison, for the US this was about 12% of GDP. Hence it has been very important for these countries to seek guaranteed access for their export markets via trade agreements.

Table II also shows that there are some specific countries that have been very active in setting up RTAs. Chile and Mexico are two countries that are particularly prolific in establishing these agreements. In addition to free trade agreements and customs unions, there are also many more economic complementation agreements, preferential trade agreements, or cooperation agreements that attempt to reduce trade barriers. It is estimated that the average Latin American country now belongs to seven RTAs. This can create a “spaghetti bowl” of overlapping arrangements

where each agreement has different rules of origin, different tariff schedules, and different periods of implement, and together they complicate customs administration which could result in longer processing times and drive up the cost of trade (World Bank, 2005). For example, US corporations took advantage of the rules set up for textile trade with Central America by shipping US fabric to Honduras and then discovered that the resulting product, although it met the rules of origin for shipment to the United States, it could not enter duty free into Mexico under the rules of origin in the Honduras-Mexico agreement.

In addition to export market access, there are several reasons for the emergence of a growing network of regional trade agreements in Latin America. One is based on a learning-curve theory in which economies of scale can be gained through signing additional agreements once the investment is made by government authorities and economic agents to negotiate the initial agreements. Government agents become more efficient and knowledgeable with regards to the various issues of market access, customs procedures, the scheduling of liberalization, special treatment of various industry sectors and simultaneous negotiations with domestic business leaders, dispute resolution mechanisms, etc. As many trade agreements have similar policies and procedural frameworks there are some gains for negotiating additional agreements.

A second reason is for economic diversification, a reduction of dependence on one or two markets for exports. Related to this is to secure access to those markets to which a country already may have a lot of trade occurring or new markets for desired expansion through a formal trade agreement. In addition to locking in agreements with the partners of an RTA, countries can also secure that their own domestic reforms are secure which they have visible external treaty commitments.

Entering into a regional agreement might also be more politically motivated than economic. They could be part of a larger

political effort to deepen economic relations with neighboring countries. (Devlin and Estevadeordal, 2004; Schiff and Winters, 2003) As such, the RTAs can create opportunities to expand trade through joint action to overcome institutional as well as policy barriers to trade. Or it could be desire to deal with a region or border specific issue such as immigration, energy, or water. Although these issues could be dealt with without a special trade agreement the RTAs may provide institutions and frameworks to make progress on these specific issues achievable (World Bank, 2005).

Another politically motivated reason for the expansion of the agreements is a desire to increase the bargaining position of members of a RTA. Being a part of a larger group could be beneficial within a multilateral framework of negotiating and setting policies with other governments, agencies, or multinational companies (World Bank, 1999).

II. US AND EUROPEAN REGIONAL TRADE IN LATIN AMERICA

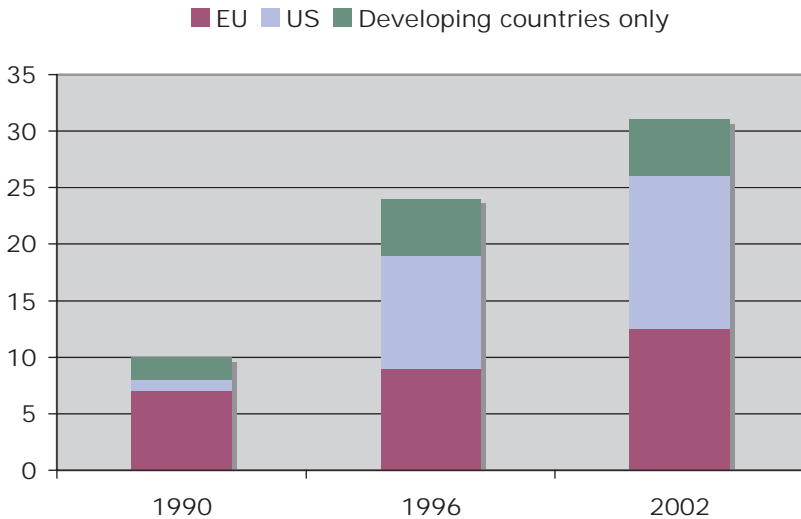
As a consequence to the dramatic economic and political reforms adopted throughout Latin America, both Europe and the United States have expanded and deepened their various trade initiatives in the region. Although the United States and the EU might have different reasons for pursuing these expanded initiatives and the corresponding partners in the region have different motivations for developing relationships with the EU and the United States.

US policy toward RTAs was slow to start worldwide and began in Latin America with some of the smaller countries of the region. This resulted in the Caribbean Basin Initiative (CBI) and the Andean Trade Preference Act. The CBI was formed to assist with the economic development and export diversification of the Caribbean Basin countries. It was initially launched in 1983

through the Caribbean Basin Economic Recovery Act (CBERA), and substantially expanded in 2000 through the U.S.-Caribbean Basin Trade Partnership Act (CBTPA). The CBI currently provides 24 beneficiary countries with duty-free access to the US market for many goods. Various framework agreements were also established which set the stage for future talks. In 1990 the Enterprise for the Americas, now referred to the Free Trade Agreement of the Americas (FTAA), was first discussed with the idea to integrate bilateral and regional agreements under a more comprehensive regional agreement. A free trade agreement with Mexico, resulting in the NAFTA, was to be the first such regional agreement. Although other agreements were long in coming, partly because President Clinton was not able to get “fast track” authority to conclude any additional agreements.

Historically, the United States has pursued a reduction in trade barriers vis-à-vis a multilateral framework through GATT/WTO, rather than through bilateral or regional agreements. Other than the NAFTA agreement with Canada and Mexico, at the turn of this century the United States had only one other RTA and that was with Israel. The motivation for that agreement clearly was for political, rather than economic objectives. The US stance toward RTAs has recently changed with trade agreements signed with Jordan, Chile, Singapore, Australia and Morocco. The United States has also completed agreements with nine other countries (Australia, Bahrain, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Morocco, and Nicaragua) and negotiations are continuing with ten additional countries, including Colombia, Ecuador, Peru, Panama, Thailand, and the five nations of the Southern African Customs Union (SACU). Eleven of the 24 recently concluded and on-going agreements are with Latin American countries. In addition the United States is also working to open markets regionally with the Free Trade Area of the Americas (FTAA) negotiations.

Figure IV
 % of World Trade Covered by RTAs involving the EU/the United States/developing countries only

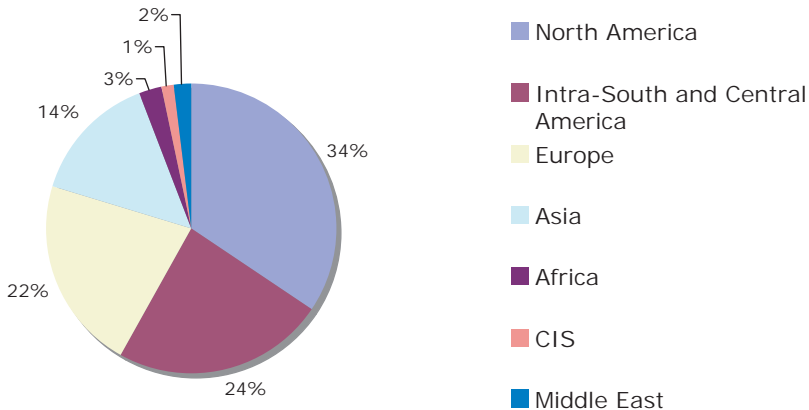


Source: World Bank, 2005.

So although the United States began slowing to develop RTAs, Figure IV shows that the United States is now is about on par with the EU as to the amount of world trade covered by RTA in which they are partners.

The United States is a likely target for Latin American countries to partner in RTAs as the region itself is strongly tied economically, historically and geographically to the United States. Figure V shows that in 2004, 34% of all the merchandise exports of South and Central America went to North America, primarily the US. This compares to 22% going to Europe. If Mexico is included the distribution of exports to the United States is even greater (Figure VI). In 2004, 89% of Mexico's exports were destined to the US, with only 3% going to Europe.

Figure V
 Merchandise exports of South and Central America by destination, 2004



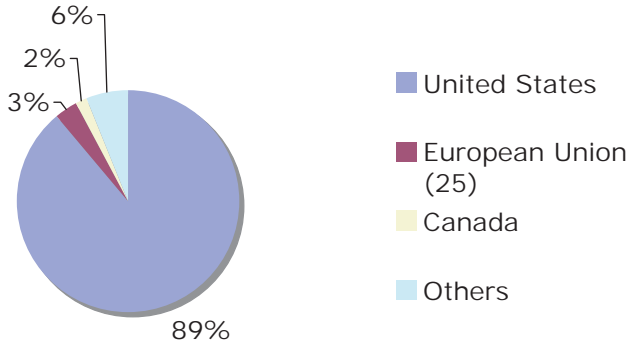
Source: WTO, International Trade Statistics 2005.
 Note: Mexico is included as North America.

Although the United States remains the number one trading partner for the region, the EU has established and built up links with Latin America since the 1960s, developing relations at the national, regional and sub-continental levels. It is Latin America’s second trading partner, and the first partner for Mercosur and Chile.

With regards to foreign direct investment the EU has taken an important role in the region. Figure VII shows that for many years in the 1990s the EU invested more in the region than US organizations. This may result in greater pressure from European firms to insist on securing additional access via formalized commercial agreements. This flow of investment peaked in 2000, but the stock of investment continues to increase and is greater than for the United States.

In many ways the past initiatives of the EU trade policies vis-à-vis Latin America are very similar to the United States. Although

Figure VI
Merchandise trade of Mexico by destination, 2004 (percentage)

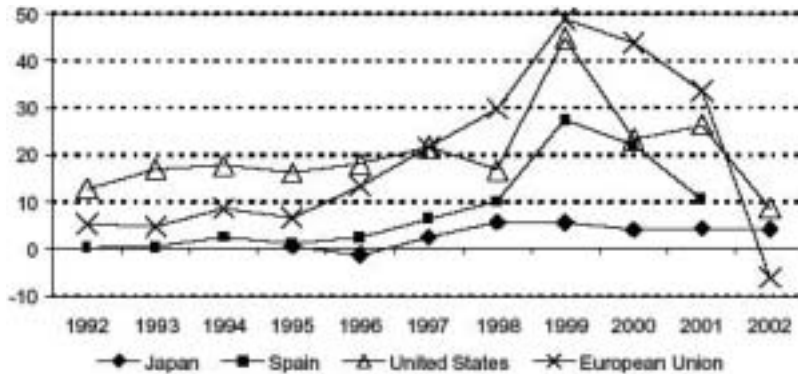


Source: WTO, International Trade Statistics 2005.

the EU has a greater tradition of RTAs in general, with regards to Latin America they have gotten off to a slower start than the United States. As did the US, the EU first began with framework agreements to begin the process of later RTA agreements. To that end they have concluded RTAs with Mexico and Chile, and are under negotiation with Mercosur, Andean Community, CARICOM, and Central America. What differs is that the EU does not have a comprehensive trade initiative with the region similar to that of the United States with the FTAA. Although there is no regional initiative planned there have been a series of summits between the EU and Latin America. In 1999 the heads of state from Latin America and the EU meet in Rio de Janeiro for their first summit to develop strategic partnerships between the regions. The summit was repeated in Madrid in 2002 and Guadalajara in 2004.

The EU is Latin America's second largest trading partner with trade more than doubling over the last decade. The main goods exported from the region to the EU are agricultural products, transport material, and energy. The EU has traditionally had a

Figure VII
 FDI outflows from major home countries to Latin America and the Caribbean, 1992–2002 (billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).
 Note: FDI outflows from the EU as a group to Latin America and the Caribbean in 2002 were -\$6 billion due to large negative flows from Germany (\$1 billion) and the United Kingdom (\$5 billion).

trade deficit with Latin America and the Caribbean in agricultural products and energy and a trade surplus in the other sectors. EU exports to the region are more diverse and include machinery, transport material, and chemical products as the main commodities.

Both the United States and the EU are actively seeking stronger regional ties with Latin America. Specific initiatives with regional groupings and some of the larger countries will be examined.

III. ANDEAN COMMUNITY

The Andean Pact (now called the Andean Community or CAN) was formed in 1969 to address the development needs of the Andean countries (Venezuela, Colombia, Chile, Ecuador, Peru, and Bolivia). Venezuela actually became a part of the agreement in 1973 and Chile withdrew from the Pact in 1976 to pursue

more liberal trade policies. The Andean countries today represent a significant market, with a population of nearly 100 million and a collective GDP near \$500 billion when measured on a purchasing power parity basis.

The original formation of the Pact was consistent with the policies of import substitution of the 1970s. The focus was on regional independence and integration, particularly from the United States. The initial stage of the Pact was considered inefficient as many products were exempted from the tariff liberalization process, the markets themselves were very small, levels of protection of each Andean country was high vis-à-vis the rest of the world, the production requirements established by the Andean Pact did not match the trade need of each country, and the countries were very limited in their capacity to generate new foreign exchange which became very important as their foreign debt increased. Figure VIII shows that there has not been much interregional trade within the community itself. However, as a bloc

Figure VIII
ANDEAN Merchandise Trade with Total Exports and
Interregional Exports (millions of dollars)



Source: WTO, International Trade Statistics 2005.

the group is becoming more effective in negotiating with other regions and countries. So although the benefit might not be additional trade creation within the community, they are using their increased bargaining strength to extend relationships, including those with the United States and Europe.

Since they were initially formed, they are no longer pursuing a regional independence strategy and have opened their markets. The Andean Free Trade Area (AFTZ) was formed in February 1993, with Bolivia, Colombia, Ecuador, and Venezuela. Peru became a part of that agreement in July 1997 and since then has been gradually opening its trade with its Andean partners. Extending integration further the countries formed an Andean Customs Union in 1995, when a common external tariff was approved by Colombia, Ecuador, and Venezuela. Bolivia has not agreed to fully adopt the common external tariff and has preferential treatment. Peru did not sign the agreement.

Since January 2004, trade negotiations with the Andean countries and the rest of the world have grown and are stretching them beyond their capabilities. They are currently participating in five negotiations scenarios—WTO, FTAA, and FTA negotiations with the United States, initial negotiations towards establishing an FTA with the European Union and FTAs with Mercosur and other countries of the region, as well as continuing their own internal negotiations within the Andean Community to deepen that integration process. They have made statements that the next step is toward the Asia-Pacific Region and will be having a third round of communications with China in 2006 and is developing ties with the Asian-Pacific Economic Cooperation (APEC). Peru is the one member of the Andean Community that belongs to APEC but Colombia and Ecuador are currently negotiating their entry.

As mentioned, they are currently negotiating with the United States for a free trade agreement to include Colombia, Peru, and

Ecuador, with Bolivia participating as an observer. With the United States these four countries are part of the 1991 Andean Trade Preference Act (ATPA), a unilateral trade preference program that was enhanced and expanded by the 2002 Andean Trade Promotion and Drug Eradication Act (ATPDEA) with the United States. The free trade agreement would extend trade liberalization efforts. The four Andean countries collectively represent a market of over \$7 billion for US exports, and are home to over \$8 billion in US foreign direct investment. During 2002, \$995 million in US imports from the four Andean Trade Preference Act (ATPA) beneficiary countries entered the United States duty-free under provisions in the ATPA; however, a significant portion of these duty-free entries (26 percent or \$260 million) probably would have qualified for duty-free entry under other existing US trade preference programs such as the Generalized System of Preferences. Thus, approximately 74 percent (\$735 million) of these duty-free entries represent the unique benefits of the ATPA to the ATPA-beneficiary nations. These unique ATPA benefits represented 7.6 percent of total US imports from the ATPA beneficiary nations and 0.06 percent of total U.S. imports from all nations in 2002. The ATPA duty-free provisions allowed the ATPA beneficiaries to save approximately \$20.7 million in U.S. tariffs. For items uniquely eligible for ATPA duty-free treatment, approximately 43 percent actually entered ATPA duty-free (US Department of Labor, 2003).

The Andean region was the first region in Latin American that the European Union concluded a regional co-operation agreement in the Americas. The EU-Andean Community relations first focused on commercial issues, then on development cooperation (first regional co-operation agreement in 1983) and now encompass a large spectrum of cooperation fields. In the late 1990, the EU provided preferential access for exports from the Andean Community to help assist in the war against drugs in the region.

Many industrial and a number of agricultural products enter the EU market duty free. This regimen for Andean trade preferences, which was scheduled to expire at the end of 2004, has been extended until the 31st of December 2005. The Andean Community and the European Community signed a joint declaration in Rome on the 30th of June 1996, A Joint Declaration on Political Dialogue, providing as such an institutional framework for a dialogue that had been held informally up to this point.

The EU is a major trading partner for the Andean Community. Trade between the regions has almost doubled over the last decade. The Andean Community's overall exports to the EU are predominately raw materials (agriculture, agro-industry and mining), while manufactured products (mailing machinery and chemical products) represent the majority of the EU imports into the region.

IV. MEXICO AND NAFTA

The North American Free Trade Agreement (NAFTA) among Canada, Mexico, and the United States came into effect on January 1, 2004. Since that time there have been substantial increases in inter-regional trade and investment flows (see Figure IX). From 1994 to 2004, US exports to Mexico rose 91%, compared to 41% to the world. US imports increased by 179%, compared to 89% from the world.³ Foreign direct investment also increased considerably. The World Bank (2005) noted that NAFTA was one of the factors responsible for this increase and estimated that it led to a 40% annual increase to Mexico without diverting from other countries. NAFTA also led to the creation of an institutional

³Some studies have claimed that NAFTA itself had a modest effect on US-Mexico trade growth. The Congressional Budget Office (2003) estimated that 85% of the US export growth and 91% of U.S. import growth would have occurred without NAFTA. However, the World Bank (2005) stated that NAFTA reinforced existing trends in trade growth and estimated that Mexico's global exports would have been 25% lower without NAFTA.

Figure IX
 NAFTA Merchandise Trade with Total Exports and Interregional Exports (billions of dollars)



Source: WTO, International Trade Statistics 2005.

framework to address common concerns brought to the forefront by closer economic integration, ranging from dispute settlement to border infrastructure and environmental protection. NAFTA has served as a model for a number of subsequent trade agreements in the Americas as group members have unilaterally embarked on negotiating NAFTA-like bilateral agreements with other nations. As there was a substantial learning curve for the development of the original agreement, this knowledge was taken and extended elsewhere.

Mexico—the world's 10th largest economy—represented Europe's first RTA in the Americas and was concluded in late 1999 and entered into force on July 2000. The agreement took over a decade of negotiations. Like NAFTA it is very comprehensive. The agreement covered trade in industrial goods, services, investment, intellectual property rights, dispute settlement, government procurement, etc. Absent is free trade in agriculture.

One primary driver for the EU in developing this trade agreement with Mexico could have been a defensive strategy in the face

of NAFTA and the free trade Mexico enjoyed with the United States. The EU was facing a rapidly falling market share of Mexico's imports. In 1985 the EU accounted for 16 percent of Mexico's imports and this had fallen to just 9% by 1998. European firms in the automobile sector were also seeking to use Mexico as a base for exporting to North America and Europe.

Mexico has positioned itself as a "hub" and has been prolific in developing agreements. Mexico has signed 11 free trade agreements (not all are in force) with 42 countries, including the European Union. This expansion of agreements might be an effort to create a hub, but it could also be a defensive strategy to reduce its reliance on the United States. Currently almost 90% of Mexican exports are destined for the US market. A popular saying is that when the United States sneezes, Mexico gets pneumonia. At the same time NAFTA, and the close ties to the United States might also have insulated Mexico against the financial instability that swept through Argentina, Brazil, and other Latin American countries at the beginning of this century. Mexico has an investment-grade credit rating that has allowed it to issue long-term local currency bonds and mortgage-backed securities. This is not the norm for the region and can perhaps be credited to the strong economic ties it enjoys with the United States.

V. CENTRAL AMERICAN FREE TRADE AGREEMENT (CAFTA)

The most recent free trade agreement in the Americas is the Central American Free Trade Agreement (CAFTA), which is designed to eliminate most tariffs between the United States and Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua, plus the Dominican Republic. Together, the six Central American countries have a population of 46 million with a gross domestic product totaling only \$85 billion (for perspective, this is about half the size the county of San Diego's \$170 billion economy in the State

of California). From the viewpoint of the US, this was very a hotly debated trade agreement, in spite of the small size of the combined economies of these countries and their potential economic impact. Some of the primary proponents of CAFTA were US clothing manufacturers, many of whom have been shifting factories to Central America. Under the Caribbean Trade Initiative, signed in 2000, textile mills in the United States can ship raw materials to factories in Central America duty free. Once manufactured into clothing, goods could return again to the United States, duty free. This duty-free relationship was set to expire in 2008. In addition, since the beginning of 2005, the protection against textile imports from China to the United States and Europe expired, so countries such as those in Central America, are trying to assure that they can receive special treatment to compete against the influx of textile imports from China into the United States and European markets. The WTO has estimated that China will take over 50% of the textiles market in the United States and 29% in Europe. The CAFTA agreement was very important for the Central American countries to assure access to the US market. As trade is minimal with the US, the greatest benefit is anticipated to be growth in foreign direct investment, as companies use Central America as a platform for production and exporting to the United States.

VI. MERCOSUR

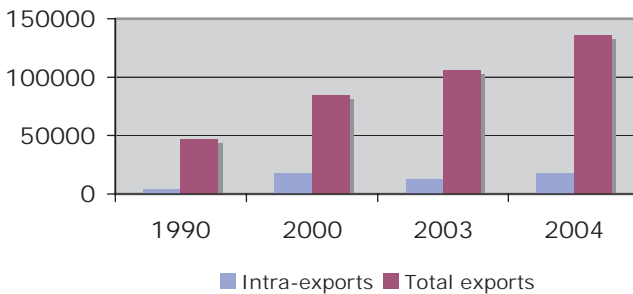
Exactly one year after the formation of NAFTA, on January 1, 1995, another major free trade agreement, known commonly as Mercosur (Mercado Común del Sur), went into effect among the four countries in the Southern Cone region of South America—Argentina, Brazil, Paraguay, and Uruguay. Since that time Mercosur has grown. Venezuela became a full fledged member at the end of 2005. Colombia and Ecuador became associate members in late 2004, joining Bolivia, Chile, and Peru. Associate members do not take part in Mercosur's most important negotiations and can

choose whether or not to abide by its trade rules. With the new associates, almost all of South America belongs to Mercosur.

Originally, Mercosur was set up with the ambitious goal of creating a common market/customs union between the participating countries on the basis of various forms of economic co-operation that had been taking place between Argentina and Brazil since 1986. Even though membership is growing, reduction of trade barriers has stalled. The countries have dealt with their differences and disputes by constructing an “imperfect customs union.” The “common external tariff” has 800 exceptions. Inter-regional trade has actually declined since 1998 (see Figure X). Brazil and Argentina still have higher import tariffs than the smaller members and associates. Chile, for example, has an average tariff of 5 percent, and Bolivia’s is slightly higher. Brazil’s tariffs compare at 14 percent. Chile’s former president, Ricardo Lagos, said his country would not apply for full membership to the bloc because it would have to increase its import tariffs.

Part of the problem is that the customs union has been set up without the appropriate institutions. Although Brazil’s economy is much larger than its partners, it is not economically able to

Figure X
MERCOSUR Merchandise Trade with Total Exports and Interregional Exports (millions of dollars)



Source: WTO, International Trade Statistics 2005.

subsidize the smaller countries or willing to lose any sovereignty, for example as Germany has done to promote European unity. Alternatively, Argentina is too small to play the strong sponsoring role as France does in the EU. In addition, the four members are prone to economic crises, which they spread to each other, triggering every-country-for-itself reactions.

The biggest tensions erupt between Brazil, South America's largest economy, and Argentina, in the No. 2 position. The two are also the biggest players by far in Mercosur, and home to 216 million of the zone's 225 million people and 97 percent of the bloc's \$727 billion in gross domestic product. Ever since Argentina's economy collapsed in 2001, the country has imposed quotas and tariffs on imports of Brazilian washing machines, stoves, refrigerators, and televisions. Argentina's economy is now rebounding, but the barriers remain. The battle, now lasting years, has been nicknamed the "Refrigerator War" in the South American press and few see an end to it anytime soon.

In spite of these challenges and constraints Mercosur is growing and talks are continuing. Mercosur has managed to voice a common front on important issues like opposition to the agricultural subsidies rich nations give their farmers. Brazil and the United States jointly chair the negotiations for the Free Trade Agreement of the Americas (FTAA), indicating that Brazil, as the largest country within Mercosur, yields strong influence. However conflicting priorities have also kept Mercosur's member nations from presenting a unified front in negotiations with Europe and the United States over the proposed Free Trade Area of the Americas. For example, sugar isn't covered by the Mercosur agreement as a result of an Argentine demand to protect its domestic producers. As a result, Mercosur's proposal on agricultural FTAA issues excluded sugar—even though Brazil, the world's largest producer and exporter, is eager to increase exports.

Although the countries of Mercosur have formed a formidable bloc, their talks on a free-trade agreement with the EU stalled in October 2004. Another deadline passed in 2005 with the United States for a 34-nation free trade zone deal that would span the Americas. This has sparked a near-rebellion by some Brazilian businesses against both Mercosur and the Brazilian government. They accuse the government of pursuing deals with other developing countries at the expense of trade with the EU and the United States, the biggest markets.

In 1995 the EU and Mercosur signed an Interregional Framework Cooperation Agreement in order to “strengthen existing relations between the parties and to prepare the conditions enabling an “inter-regional association to be created.” From April 2000 to January 2004, eleven rounds of negotiations took place. The agreement, which was set to be concluded by October 2004, was to create the world’s largest free-trade area. Both sides are to blame for the impasse. Europe offered less liberalization of agricultural trade than Mercosur had hoped. The Mercosur four—Brazil, Argentina, Uruguay, and Paraguay—are fearful of competition and divided among themselves, and have put up their own shields for domestic firms.

For Mercosur this is a grave disappointment. Most of its member governments would rather have an agreement with the EU than sign up to the Free Trade Area of the Americas (FTAA). For Brazil, access to Europe’s vast market is second in importance only to the multilateral Doha talks, which offer hope of cutting agricultural subsidies in the developed countries. Mercosur risks losing trade and investment to countries that are more successful in negotiating deals with the two biggest markets.

For the EU the issue was greater access for its companies in government purchases, services and several industrial sectors. An objective was to consolidate the EU’s position as the main supplier of industrial and capital goods and to expand new lines of exports in consumer goods and cars in a large, unified, and relatively protected

market. How the EU proceeds may depend on what happens in other negotiations. Agricultural talks will go more smoothly if the Doha round deals with subsidies. If the FTAA talks increase so will pressure on the EU to make progress with Mercosur. Mercosur's trade with the United States is 20% smaller than with the EU, but it is growing faster. Fear of losing out to the United States and its partners was what prompted the EU to start the talks in the first place and may push them to renegotiate. However, the issue will come down again to opening up trade in agriculture.

The United States is one of the few countries not currently negotiating with Mercosur. However, Brazil and the United States have been cooperating to relaunch the Doha talks. The US is also taking the position that a negotiated trade agreement with Brazil and the other countries of the Southern Cone will take place through the FTAA. However, the United States recently announced an investment accord agreement with Uruguay, so individual country agreements could be forthcoming.

VII. FTAA

Just as the EU has focused on Mercosur as its inroad into a broad agreement throughout the Americas, the United States has focused on the "Free-Trade Area of the Americas" (FTAA) encompassing all 34 countries in the Americas, minus Cuba. It may be the most ambitious regional trade agreement yet to be proposed and has a total population of 800 million and a market of \$13 trillion. Similarly just as the EU-Mercosur talks have stalled, so has the January 2005 deadline for the FTAA has come and gone.

Difficulties between Brazil and the United States, co-chairs of the negotiations, have resulted in compromises from the original version that allows countries to opt out of certain contentious areas like agriculture subsidies, investment, intellectual property rights, and anti-dumping. According to the Ministerial Declaration issued November 20, 2003 in Miami, countries that

agree to additional obligations are eligible for additional benefits. The scaled down version of the agreement is due in part to domestic political pressures: because of a strong domestic farm lobby, the United States has always refused to negotiate agriculture subsidies outside of the WTO, while Brazil's domestic business interests do not want to deregulate foreign investment or tighten enforcement of intellectual property rights.

Opponents of this scaled down agreement, mainly Canada and Chile, criticize the attempt to limit the scope of FTAA, arguing that it makes the free trade area meaningless. Their frustration is that United States and Brazil are setting the agenda at the expense of the other participating members who are interested in liberalizing more than just import tariffs. However, since the United States and Brazil are the co-chairs, and also the two largest markets in the hemisphere, they are responsible for setting the agenda for what will be negotiated. The result has been a two-tiered framework, with all participating countries agreeing to tariff reductions on foreign imports, and some countries opting out of negotiations on intellectual property rights, investment, and agriculture liberalization. While the FTAA talks have been bolstered by this new compromise, the deadline keeps getting pushed ahead of the January 2005 date, which has come and gone.

VIII. CONCLUSIONS

During the last decade, the countries of Latin America experienced significant political and economic transformations. Beginning in the early 1980s, the military dictatorships were replaced by competitively elected governments. Economic reforms within the region were also equally dramatic. By the early 1990s countries that had relied for decades on import substituting strategies lowered trade barriers, privatized state-owned enterprises, liberalize financial markets, and undergo fiscal reforms. The initial result was the inflow of international investment and expanded trade.

Across the Atlantic, the Western European countries were working toward a fully integrated Common Market (Europe 1992) and later had a vision of a Monetary Union. To counter the growing regionalization efforts in Europe and to further unite with the emerging markets of Latin America, the United States, fresh from its relatively recent success negotiating the US-Canadian Free Trade Agreement, announced a vision for a Free Trade Agreement for the Americas (FTAA), beginning with Mexico. Thus the race to establish RTAs in the region began and has continued at a rapid pace.

The United States has, for the most part, been consistent in its strategy. The RTAs have been negotiated with the intent to begin bilaterally working toward the vision of the FTAA. However, there have been some new developments. For the past two years, US trade policy has become intertwined with the political objectives of rewarding allies in the war against terrorism and promoting national security. For example, the US Trade Representative delayed signing RTAs with Chile and New Zealand after the countries openly opposed the US war in Iraq.

For both Europe and the United States there has also been mixed signals regarding the commitment to open markets. The United States has imposed tariffs on products such as steel whereas Europe continues to heavily protect its agricultural sector, making it increasingly difficult for Latin exports to find their way onto European consumers' tables. It is too early to know whether this sense of unfairness in trade will be eventually translated into serious reform backtracking.

The EU was later than the United States getting into Latin America to establish RTAs, but has been aggressive in pursuing agreements. The motivation is to secure market access for their industries and to not be left behind in the region by the United States.

Both the United States and Europe face domestic pressures which hinder the implementations of meaningful agreements. President Bush had to gather support for re-election in 2004 in the Mid-west farming states of the United States so it is unlikely that the United States will make concessions on its massive agriculture subsidies. Europe faces some similar pressures. And the issue of concessions in agriculture is key not only to the Doha round, but also to further integration in the Americas, especially to Brazil, one of the regions largest markets.

The Latin American countries are learning from their negotiations and the observations of other agreements. They are insisting on a longer phase-in process for the trade liberalizations. They are viewing RTAs on a more regional basis to extend their bargaining power vis-à-vis larger economies, such as the EU and the United States. However, they are becoming overextended to manage all the agreements and the economic benefits may be diminished as the “spaghetti” factor increases.

The larger regional agreements, namely Mercosur—which has more involvement from the EU—and the FTAA—strongly supported by the United States, seem to have stalled in their ability to significantly reduce barriers. This is probably a preview to the continued difficulties the Doha rounds will face as they involve more parties and more diverse interests.

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