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Regional integration
in the 1990s

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The renewed interest sparked by the potential for intraregional cooperation in Latin America and the Caribbean today has been reflected in numerous agreements regarding trade preferences and in attempts to establish free trade areas, customs unions or common markets. The possibility has even been discussed of setting up free trade arrangements on a hemispheric scale. This plethora of proposals inevitably raises a great many questions. What is the reason for this renewed interest? Are the differences between the schemes of today and those of the 1960s and 1970s significant enough to avert the obstacles and difficulties encountered by those earlier schemes? What are the most suitable mechanisms and instruments for promoting intra-Latin American integration? What are the defining characteristics of the various categories of integration initiatives, such as free trade areas, customs unions and common markets? Is it feasible to set up free trade areas involving countries having very dissimilar levels of development or macroeconomic policies? Would it be wise to work towards a gradual convergence of all these initiatives into a single, regionwide scheme? And most importantly: Just how functional would integration be in terms of the development strategies and policies adopted by the individual countries of the region? The various sections of this article attempt to answer, albeit tentatively, these questions.

I

Introduction

As a consequence of the protracted crisis of the 1980s and of changes in the international scene, in recent years Latin America and the Caribbean have exhibited a steadily increasing response capacity. Governments and civil societies have sought out new ways of adapting to changing circumstances and of responding to the numerous challenges they face. One of the many manifestations of this adaptation process is a renewed interest in the potentials of intraregional cooperation. In contrast to the atmosphere that surrounded the conclusion of formal economic integration agreements in the 1980s, lately the region has witnessed the proliferation of quite different sorts of arrangements, arrangements that display a high degree of heterogeneity in terms of both their modalities and their geographic configurations.

Indeed, numerous trade preference arrangements have been made, in most cases as part of the limited-scope agreements provided for under the terms of the 1980 Treaty of Montevideo; attempts have been mounted to establish free trade areas (without necessarily adopting a common tariff); and efforts have been made to form customs unions (free trade areas combined with a common tariff) or common markets (customs unions involving some degree of macroeconomic-policy coordination, especially with respect to foreign exchange matters, taxes and interest rates). For the first time ever, extending the coverage of free trade agreements to encompass the entire hemisphere has become a possibility; on a selective basis, the free trade agreement among Mexico, Canada and the United States which is now awaiting ratification and, on a more general level, the Enterprise for the Americas, announced in mid-1990 by the United States Government, both point in this direction.

II

Reawakened interest in integration

What accounts for this resurgence of interest in integration when, just a few years ago, the subject had virtually disappeared from the Governments' agenda of priorities? The continued development of the European Community and the formation of a free trade area between Canada and the United States have certainly helped to legitimize agreements aimed at establishing trade-preference groupings. In addition, the laborious, slow-moving progress of the multilateral negotiations being held within the framework of the General Agreement on Tariffs and Trade (GATT) has prompted many Governments to work towards the same objectives by means of partial-scope agreements with like-minded countries. In order to reconcile such initiatives with GATT, article 24 of the Treaty is usually cited, since this provision permits the establishment of trade groups among countries which grant each other reciprocal trade preferences without requiring that they necessarily be extended to the rest of the countries.

In Latin America and the Caribbean, a number of additional factors have helped to further enhance the legitimacy which the idea of integration as such has acquired at the international level. Some of these factors have arisen in response to the possibility of extending the free trade area existing between the United States and Canada to Mexico and, eventually, to other countries in the region. Others are discrete phenomena. Examples of the latter include the gradual convergence of the economic models being applied, the growing political affinity to be observed among democratically-elected civilian governments, a decrease in the potential costs of trade diversion thanks to an increasing degree of trade liberalization in almost all the countries of the region and, in general, a priori assessments of the situation which indicate that the potential benefits of such agreements will far outweigh their possible costs.

III

International positioning and integration commitments

It is also helpful to examine recent integration commitments within the broader context of the determined efforts being made by all the Governments of the region to improve their countries' positions within the international economy. This has been their response to the increasing globalization of the economy and to the shortcomings of the industrialization strategy followed by many countries in the past. In recent years, government action has been directed towards enhancing the international competitiveness of the goods and services that each country has to offer.

In the mid-1980s, intraregional trade agreements did not play a major role in the countries' efforts to improve their international positions; on the contrary, some experts maintain that they were leading in quite the opposite direction. This was because, first of all, the idea had taken firm hold that such agreements served the purposes of import-substituting industrialization but were of no help in an export drive; in some cases it even came to be believed that they actually hindered progress towards greater international competitiveness. Secondly, the Latin American and Caribbean regional market was smaller than that of the major economies of the Organization for Economic Cooperation and Development (OECD) and exhibited slow or zero growth. In the eyes of many Governments, the best course of action was therefore to concentrate on gaining access to large, fast-growing markets.

This view began to change for the reasons mentioned earlier and, above all, because enough information had become available to show that integration commitments among a given group of countries are not necessarily incompatible with the establishment of a more open and more transparent international economy. Thus, in recent years the idea has begun to gain acceptance, in both academic and government circles, that an open international economy free of artificial barriers to a free flow of trade in goods and services does not necessarily exclude the possibility of integration commitments and, in fact, that such arrangements may even contribute to the achievement of that goal.

This is indeed plausible. From a conceptual viewpoint, integration commitments can contribute to the accomplishment of the main tasks on the regional development agenda. This statement is based on a number of well-known arguments, including the potential contribution of expanded markets to an increase in efficiency (as a result of economies of scale and the elimination or reduction of monopolistic rents) and to technical progress and innovation, as well as their effect on investment levels. Moreover, an implicit part of this reasoning is the assumption that the potential costs of trade diversion will tend to decrease markedly in the presence of widespread trade liberalization.

It is also true, however, that intraregional agreements and any future arrangements of a hemispheric scope need to be designed in such a way as to be conducive to the achievement of an international economy free of protectionism and of barriers to trade in goods and services. At the same time, we must be cognizant of the risk that the formation of economic blocs of developed countries may lead to a fragmented world in which trade flows freely within these groups but is subject to a greater degree of regulation between one bloc and another.

It is important to note that Latin American and Caribbean integration is justified –albeit for different reasons– in both cases, i.e., whether the formation of large groupings of developed countries helps facilitate the establishment of an integrated world economy or whether it contributes to the fragmentation of that economy. In the first case, integration would contribute to the achievement of the objective pursued by all the Governments of the region in the Uruguay Round; in the second case, at least it would place the region within one of the groups making up that fragmented international economy. From a regional standpoint, integration also offers a way of diversifying risk in an international economy that is rife with uncertainty.

IV

Main features of the new integration commitments

If we are to describe existing integration schemes, we must first know what type of integration we are dealing with. The initiatives taken in the developed world have been exceedingly varied in nature. For example, the characteristics of the European Community's broad-ranging accords, which are leading it towards the formation of a regionwide economy, are a far cry from the types of commitments made by Canada, the United States and Mexico in the North American Free Trade Agreement. In East Asia, where no formal integration agreements have been concluded, trade liberalization and geographic proximity are none the less contributing to a steady increase in reciprocal trade, which is, moreover, being augmented by reciprocal investment. In this instance, geographic proximity and lower transaction costs are creating implicit preferences among the countries of that region and are thus facilitating the formation of another bloc of interdependent countries.

Along the same lines, the Latin American and Caribbean region of today abounds in agreements of widely differing characteristics and contents. At the risk of oversimplification, we may identify at least four types of trade-preference arrangements which can be defined in terms of the degree of commitment made among the countries concerned. The simplest category includes agreements for the reduction of tariffs on a given list of products, which are thus accorded preferential treatment *vis-à-vis* similar products coming from other countries. This type of bilateral or multilateral agreement does not involve any significant degree of economic policy coordination.

The second type of agreement calls for a more comprehensive form of tariff reduction, and in this case the corresponding negotiations therefore focus on the lists of exceptions rather than on the products to be subject to liberalization measures. The result is the creation of a free trade area that does not set up a common level of protection in respect of non-member countries. In such cases it is possible that products from the rest of the world may be brought into the country with the higher tariffs via an indirect route by taking advantage of the lower tariffs of the other member countries of the free trade area; to this end, the products in question are first exported to the lower-tariff member countries and are then re-exported to another country under the provisions of the free trade agreement. The conventional method of blocking this indirect flow of imports from the rest of the world is to establish rules of origin for products included in the free trade regime; under such rules, a given level of processing or a specified percentage of national content is required.

The third category of agreements are those that not only set up a free trade area but also add to it a common tariff in order to forestall the relative price distortions that can be caused by tariff-generated cost differences. The advisability of setting up a common external tariff for the members of an integration scheme –which is the main difference between a customs union and a free trade area– will depend on the characteristics of the countries involved. Assuming that their levels are low, common tariffs would be more justified for countries having a large volume of reciprocal trade and similar economic structures. Under these circumstances, the application of differentiated tariffs to the various products would create unequal levels of effective protection for each party and would set the stage for charges of unfair trade practices and the establishment of trade restrictions, as well as encouraging contraband trade.

In the fourth category of agreements, a free trade area and common tariff are coupled with a programme of macroeconomic policy coordination. The aim of such a programme is to avert distortions in relative prices caused by cost differences attributable to the exchange rate, export subsidies, rates of taxation or interest rates.

V

Some requirements

The foregoing suggests that the level of commitment which any given group of countries will be prepared to make will depend on how economically interdependent they are, how similar their approaches to macroeconomic and policy management are, how complementary their economic structures and stages of development are, how much they trust each other, and many other factors. The economic ramifications of each type of arrangement in terms of potential costs and benefits will vary from one situation to another.

This underscores the complexity of the many arrangements currently existing in the region and raises the question as to whether it would be wise to seek an eventual convergence of all these schemes or whether it would be better to permit the emergence of a range of different types of agreements reflecting the different types of situations which do, in fact, exist in the region. The second option would appear to be more realistic, at least for the foreseeable future, although it would be advisable to promote the adoption of some common standards regarding the application of mechanisms and instruments in order to pave the way for any subsequent bid to expand the geographic scope of existing agreements.

What is true for Latin America as a whole is not necessarily valid for subregional processes which have already generated a high degree of economic interdependence, however. The fact, for example, that some countries in Central America seem to want to move forward more rapidly than others could at some point jeopardize the consolidation of their subregional integration process. There is, then, a limit to the feasibility of allowing many different agreements to coexist within a single subregional process. This limit is reached when commitments which some countries wish to make will adversely affect the commitments already made by all the countries participating in a given subregional integration process.

VI

Trade mechanisms and instruments

With respect to mechanisms and instruments, if the economic subregions being formed are to be in keeping with the principle of multilateralism, some requirements regarding the content of bilateral and to be subject to liberalization measures. Furthermore, the areas of activity or products placed on those lists of exceptions are usually limited to those regarded as "sensitive" such as the automobile indus-