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FREE TRADE IN LATIN AMERICA AND THE CARIBBEAN

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FREE TRADE IN LATIN AMERICA AND THE CARIBBEAN

INTRODUCTION

Negotiations on a North American Free Trade Agreement (NAFTA) between Canada, the United States and Mexico had barely been announced when U.S. President Bush proposed a bold plan to extend free trade from Alaska to Argentina, as part of the "Enterprise for the Americas Initiative" (EAI) announced on 27 June 1990. The proposal has been greeted by some Latin Americans as "the most important initiative from the U.S. in 30 years."(1) The extremely favourable response to the Bush proposal by countries in Central and South America was surprising, given Latin America's historical fear of U.S. economic domination.

Free trade is not a new concept in Latin America. In the 1960s there were a number of attempts at regional economic integration, most of which met with limited success. These early trade arrangements were essentially inward-looking import substitution schemes to encourage industry to develop within the regional groupings. Tariffs against imports from outside countries remained high, foreign investment was viewed with suspicion and there was significant state intervention in the economies of member countries.

Recently, Latin America has discarded the costly (and ineffective) import substitution model of economic development in favour of an export-oriented strategy involving trade liberalization with outside countries. Foreign investment is being actively encouraged and there is increased reliance on the market – rather than state intervention – to allocate resources. The promise of free trade with North America held out by the Enterprise for the Americas Initiative has given an additional boost to Latin American regional integration.

The paper begins with a brief description of the economic mess in which most Latin American countries found themselves during the 1980s – soaring inflation, cripplingly large external debts and negative economic growth. The kind of solutions adopted – liberalization of barriers to trade and foreign investment, privatization, monetary and fiscal

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(1) Alieto Guadagni, Argentina's Secretary for International Relations, quoted in: Stephen Fidler, "Trouble with the Neighbours," *The Financial Post*, 20 February 1993, p. 51.

restraint – were not typical of the economic policies hitherto followed by these countries. While these policies were not painless, they did manage to stabilize the macroeconomic environment, reduce external debt and increase economic efficiency. These reforms also made countries like Mexico and Chile suitable candidates for free trade negotiations with the U.S.

The second part of the paper reviews the major Latin American trade agreements since 1960 highlighting both the early problems and recent efforts to rejuvenate regional free trade. The formation of a new trading bloc, MERCOSUR, the Southern Cone Common Market, in 1991 and recent bilateral trade agreements involving Mexico, Chile, Venezuela and Colombia are also evidence of renewed enthusiasm for free trade in the region.

BACKGROUND

A. The Lost Decade

The 1980s have been called the "lost decade" for Latin America; regional economic output per capita declined by an average of 1.3% annually and by a total of 12%.(2) Among the worst-performing economies were Argentina, where real GDP per capita declined by an average of 3.2% annually, Bolivia (-2.6%), and Venezuela (-2.3%). Gross domestic investment in the region fell by a total of 30% over the decade ending in 1990.(3)

Inflation escalated during the 1980s as the region's central banks monetized huge government deficits. Hyper-inflation reached more than 8,000% per annum in Bolivia in 1985, and more than 3,000% in Argentina and 1,200% in Brazil in 1989.

Latin America's poor economic performance during the 1980s has been linked to two main factors: a decline in most countries' terms of trade and the international debt crisis. Latin America's terms of trade – the price of exports relative to imports – declined by 21% between 1980 and 1989.(4) Export prices dropped for exports of beef, coffee, cocoa, cotton, iron ore, sugar and oil. The price of sugar, for example, fell by 22.1% between 1980 and 1989 while oil prices, as set by OPEC, collapsed by 50% between 1981 and 1988.(5)

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(2) United States International Trade Commission, *U.S. Market Access in Latin America: Recent Liberalization Measures and Remaining Barriers (with a Special Case Study on Chile)*, USITC Publication 2521, Washington, D.C., June 1992, Chapter 2, p. 3.

(3) *Ibid*. Chapter 2, p. 4.

(4) *Ibid*. Chapter 2, p. 8.

(5) *Ibid*.

During the 1970s, Latin America, along with much of the developing world, borrowed heavily on international markets, notably from foreign commercial banks. Much of the money was spent on ill-conceived projects which did little to increase the productive capacity of these economies. The money was also used to prop up inefficient state-owned enterprises where the economic rationale for government involvement was unclear.(6)

The total stock of foreign debt owed by Latin America and the Caribbean increased from US$242.2 billion in 1980 to US$445.8 billion in 1987. As a result, the region's external debt to GNP ratio rose from 35.1% to 64.9% over the same period. Moreover, the ability of these countries to meet interest and principal payments, as measured by the ratio of debt service payments as a proportion of exports of goods and services, rose as high as 43.6% for the entire region.(7) For individual countries like Mexico, the debt service ratio was much higher and the burden became unbearable.(8)

Table 1
Debt Indicators for the Region
of Latin America and the Caribbean

	1980	1985	1987	1989	1991	1992*
Total Stock External Debt (billions US$)	$242.2	$390.1	$445.8	$422.7	$439.7	$446.9
External Debt as % of GNP	35.1%	61.3%	64.9%	47.8%	41.4%	37.6%
Total Debt Service as % of Exports	37.1%	38.2%	38.0%	30.7%	29.5%	30.3%

* 1992 data are projections.

Source: World Bank, *World Debt Tables 1992-93*, *External Finance for Developing Countries*, Volume 1, Washington, D.C. 1992.

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(6) Since the 1960s, Latin American governments had nationalized firms in many economic sectors including utilities, transportation, telecommunications, the media, energy, mining, fishing, manufacturing, tourism and finance.

(7) World Bank, *World Debt Tables, 1992-93*, *External Finance for Developing Countries*, Vol. 1, The World Bank, Washington, D.C., 1992.

(8) In 1982, Mexico's debt-service ratio was 56.8%; Brazil's was 81.3%; Bolivia's was 59.2%; and Chile's was 71.3%, Argentina's debt servicing peaked in 1986 at 76.2% of total exports.

Latin America's economic situation worsened as individuals and firms shifted their assets out of the region into more secure foreign bank deposits, securities and real estate. According to the World Bank, the outflow of flight capital from Latin America between 1976 and 1984 roughly offset dollar for dollar the inflow of new loans. Capital flight, combined with low domestic savings rates and increasingly scarce foreign financing, drove down investment in the region during the 1980s.

In 1982 an international debt crisis was precipitated when Mexico notified its bankers that it was unable to meet the country's debt service obligations. Subsequently, other Latin American countries, including Brazil, the developing world's largest debtor, withheld debt-servicing payments. Between 1980 and 1991 a total of 18 countries in Latin American and the Caribbean reached debt restructuring agreements with their creditors.(9)

During the 1980s two major initiatives, both named after U.S. Treasury secretaries, were launched to deal with the international debt problem. The first initiative, called the Baker plan, stressed "concerted lending" by the multilateral institutions (the International Monetary Fund, World Bank, regional development banks) and the commercial banks. It soon became clear, however, that the major debtor countries would not be able to grow their way out of debt and new commercial bank financing began to dry up.

The Brady plan, introduced in 1989, contained an important new element – the promotion of "voluntary" debt reduction through negotiations between the banks and debtor countries. Another key component of the Brady plan was the requirement that participating countries introduce market-based economic reforms designed to encourage domestic savings, to repatriate flight capital and to attract other foreign investment.

The International Monetary Fund (IMF) also encouraged debtor countries to undertake economic reforms by making access to funds conditional on the adoption of structural adjustment programs (SAPs). Designed to bring countries' external payments into balance, the SAPs contained austerity measures like cutting government spending to reduce the demand for capital inflows, devaluing the exchange rate to improve the trade balance and constraining the money supply to control inflation.

At the microeconomic level, the IMF (and World Bank) prescription was to encourage more reliance on market signals and less on state intervention. Thus, deregulation,

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(9) *World Debt Tables*, *1992-93*, p. 47.

privatization, exchange rate adjustment, reducing barriers to foreign direct investment and allowing the market to determine interest rates were common elements in IMF/World Bank adjustment plans.

B. The Market Solution

The IMF/World Bank market-oriented economic prescriptions have long been criticized by many development specialists. Clearly, however, it is not the IMF/World Bank programs that are now out of step with Latin America but the traditional highly interventionist development ideas. The debt crisis revealed to Latin Americans the inefficiency and inflexibility of their economies. They could not help noticing that countries with a strong export-orientation, like the Asian "tigers" – South Korea, Taiwan, Singapore and Hong Kong – had weathered the debt crisis with only a brief pause in economic growth.

Throughout Latin America a kind of economic revolution has now caught fire based largely on the type of neo-classical economic principles that most of the region had spurned during the 1960s and 1970s. First, the tide of nationalization of business has been reversed. Government-owned enterprises have been privatized on a large scale, so far raising an estimated US$32 billion for the treasuries of Latin America.(10) One privatization alone – that of Telemex, the state-owned telephone company – raised US$6.8 billion for the Mexican government.(11)

While recent privatizations in Mexico have received the most publicity, Chile began selling off state assets in the 1970s, including eventually the banks and the state pension fund. Argentina has become one of the most zealous recent privatization advocates raising US$7.6 billion from the sale of 200 state companies from 1990-1992.(12) Throughout much of Latin America, banks, airlines, telecommunications companies, utlities and other state-owned companies have been placed on the auction block.

The sale of loss-making state-owned assets can reduce the drain on the public purse as well as provide the means for countries like Mexico to pay down their international debts. Beyond this, turning state-owned assets over to the private sector means that firms'

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(10) "A new Era for Privatisation," *Latin American Economy and Business*, Latin American Newsletters, London, July 1993, p. 11.

(11) *Ibid*.

profits are more likely to be based on efficiency rather than on how effectively their managers influence government policy.

Second, Latin America has taken a liberal approach to international trade. Most countries have joined the GATT, tariffs have been slashed and import licensing drastically reduced. This is increasing the efficiency and lowering the costs of domestic industries.(13) The outstanding example has been Mexico, which lowered its maximum tariff rate to 20% from the previous high of 100% and all but removed the requirement for import licensing. Chile has lowered its average rate of duty from 35% during the debt crisis to a recent level of 11%.

Third, compared to the recent past, the macroeconomic environment has stabilized in most Latin American countries. The size of the public sector deficit has been reduced significantly. Argentina, for example, has lowered the public sector deficit from an average of 11.9% of GDP during 1978-82 to 0.9% of GDP in 1990-92; Mexico's deficit has been reduced from 11.7% of GDP in 1978-82 to 1.2% in 1990-92.(14)

With the reduced need to monetize government deficits, inflation has also been substantially lowered throughout much of the region. With the exception of Brazil, where consumer prices rose by more than 1000% in 1992, annual inflation in Latin America, overall, is now running at double digits – a significant improvement from the 1980s.(15)

The liberalization of trade and foreign investment restrictions, combined with an improved macroeconomic environment and less direct government economic involvement, has re-ignited the "animal spirits" of investors. Since 1989, flight capital has been returning to the region from Florida and other safe havens and multinationals have begun to make significant investments in Latin America.

Direct investment inflows to Latin America and the Caribbean in 1992 are projected at US$13.8 billion, or almost four times the amount registered in 1986. Indeed, direct investment, which typically is carried out by multinational corporations and involves a

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(12) "Privatization," *Latin American Economy and Business*, February 1993, p. 17

(13) For example, Brazilian protection had driven up the price of (technologically inferior) computers to five times that of world prices for computers. Import regulations were such that vendors had to complete a three-page typewritten tax form in order to sell an $8 imported plug: see "Latin America – The Big Move to Free Markets," *Business Week*, 15 June 1992, p. 53.

(14) Clive Crook, "New Ways to Grow- A Survey of Third World Finance," *The Economist*, 25 September 1993, p. 6.

(15) See Tables 2-6 in next section.

longer-term financial commitment, is being welcomed as a more stable source of funds than debt financing.[16]

Privatizations and liberalization of foreign investment regulations, together with a loosening of exchange rate controls, have boosted Latin American capital markets. Over the past several years, Latin American stock markets were among the world's hottest performers. The Argentinian stock market, for example, soared 392% in 1991 while the Colombian market increased 174%; the Brazilian market, 151%; the Mexican market, 103%; and the Chilean market, 90%.[17] Portfolio investment[18] is now a major source of financing as portfolio flows into Latin America have quadrupled from US$3.8 billion in 1990 to US$15.3 billion projected for 1992.[19]

REGIONAL TRADING BLOCS IN LATIN AMERICA

A. Latin American Integration Association

Preferential trade agreements promoted in the 1950s by the UN Economic Commission for Latin America and the Caribbean (ECLAC) were essentially import substitution schemes extended to a regional grouping. In order to nurture regional industries, trade barriers within the regional grouping were lowered but external tariffs against outside countries were maintained. The idea was to provide industries with a wider market in order to achieve economies of scale before exposing them to global competition. The problem with this plan, indeed for most import substitution schemes, is that sheltered industries rarely seem to mature sufficiently to face international competition.

The roots of the Latin American Integration Association (LAIA) lie in an earlier attempt at economic integration called the Latin American Free Trade Association (LAFTA), which was implemented through the Treaty of Montevideo signed in 1960. The original treaty

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(16) A "direct investment" is one in which the investor may exercise some influence on the management of the company. Statistics Canada defines a direct investment as ownership of at least 10% of the equity in an enterprise and that covers claims intended to remain outstanding for more than one year.

(17) Based on indexes constructed by the International Finance Corporation. See: *Latin American Economy and Business*, July 1992, p. 15.

(18) Portfolio investment refers to international transactions in stocks and bonds that take place without conferring influence on the management of the company.

(19) *World Debt Tables, 1992-93*, p. 24.

signatories were Argentina, Brazil, Chile, Ecuador, Mexico, Paraguay, Peru and Uruguay. Bolivia and Venezuela subsequently joined the pact in 1966 and 1967 respectively.

The LAFTA was supposed to gradually eliminate most barriers to intra-regional trade over a 12-year period of continuing negotiations on a product-by-product basis. This gradual approach to trade liberalization soon bogged down, however, as participants were more willing to grant tariff concessions for primary products, which had been the traditional mainstay of intra-regional trade, than for manufactured goods. The reluctance of major countries like Brazil and Argentina to liberalize trade quickly is also explained by their high degree of macroeconomic instability.(20)

Intra-regional trade initially increased after LAFTA's formation – exports to destinations within the trading bloc rose from 7.5% of total exports in 1962-64 to a share of 11.4% in 1971-72. Growth in intra-regional trade subsequently slowed, however, as the trade liberalization schedule suffered setbacks. By the time the LAFTA was dissolved in 1980, the share of intra-regional trade had stablized at less than 14% of total trade.

In 1980, the LAFTA members changed the organization's name to the Latin American Integration Association (LAIA) and established a more realistic agenda for the new organization. The main features of the LAIA are:

- an outward orientation which permits members to liberalize trade with outside countries;
- tariff preferences among members instead of outright free trade;
- partial-scope agreements between individual members which can be extended later to other members. These agreements cover trade and economic cooperation in specific sectors such as tourism, agriculture, trade promotion, science and technology, services and transportation and communication.
- a reciprocal trade credit system that permits member countries to settle most of their trade accounts on intra-regional trade without using scarce foreign exchange reserves. In 1990, 75% of LAIA trade was cleared through this system.

With renewed interest in regional integration throughout Latin America, in May 1990 the LAIA Council of Ministers approved guidelines on a stronger role for the organization. Among the measures to be implemented were:

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(20) Sebastian Edwards, "Latin American Economic Integration: A New Perspective on an Old Dream," *The World Economy*, May 1993, Oxford, England.

- harmonization of macroeconomic policies;
- expansion of preferential tariffs and eventual elimination of partial-scope agreements;
- strengthening of customs cooperation;
- working jointly for regional trade in primary products, minerals, and agricultural products;
- developing common sanitary and phytosanitary regulations;
- improving and strengthening the intraregional payments system; and
- seeking cooperative solutions to the region's foreign debt payments problems.[21]

Despite this initiative, it is unclear what role the LAIA will play in regional integration. With the rise of new trade groupings like the MERCOSUR, the Group of Three, and other bilateral trade alliances, all LAIA countries are currently members of other agreements. Furthermore, the LAIA has had limited success in stimulating intraregional trade, perhaps because the proportion of goods covered by the regional agreements has been limited. In 1980, LAIA exports to other members amounted to 13.5% of their total exports; by 1989 this share had dropped to 10.8% of total exports.[22]

Some LAIA members have become dissatisfied with the group's progress. The Group of Rio, a consultative organization with the same membership as the LAIA, recommended in October 1990 that the Association be restructured because it was ineffective.[23]

B. The Andean Group

The Andean Group (AG), which was created by the Cartegena Agreement of 1969, now comprises Bolivia, Colombia, Ecuador, Peru and Venezuela.[24] The AG was formed because of dissatisfaction with the LAFTA arrangement which the Andean countries believed had delivered most of the benefits to the largest member countries (Brazil, Mexico, Argentina).

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(21) United States International Trade Commission (1992), p. 3-4.

(22) OECD, *Regional Integration and Developing Countries*, Organisation for Economic Co-operation and Development, Paris, 1993, p. 44.

(23) "Latin American Integration Association," *The Europa World Year Book 1993*, Volume I, Europa Publications Limited, London, 1993, p. 163.

(24) Chile was a founding member but withdrew from the Group in 1976 in order to pursue trade liberalization more agressively with outside countries.

The primary objectives of the AG were:

- to liberalize intraregional trade gradually;
- to phase-in a common external tariff against outside country imports;
- to establish regional industrial development programs to distribute the benefits of integration among members;
- to develop a common investment policy in order to discourage intraregional competition for foreign investment;
- to establish common protection for intellectual property.

In contrast to the LAFTA's gradual method of tariff elimination through continuous negotiations, the AG tariffs were to be phased out in an automatic fashion. The more developed countries (Colombia, Chile, Peru and Venezuela) were expected to reduce their tariffs on intraregional trade by 7% per year until these were completely removed by 1980. The less developed members (Bolivia and Ecuador) were given until 1990 for full liberalization of their trade.

The Andean Group's trade liberalization had a limited impact as intraregional trade increased from 2.3% of total exports in 1970 to 5.5% in 1987 before declining to 4.9% in 1989. Part of the explanation lies in the relatively small size of the combined internal market (US$121.9 billion) as well as the inadequate intraregional transportation links. Regional integration also fell short of original intentions due to: the number of exemptions granted from trade liberalization; delays in implementing the common external tariff; and failure to implement the regional industrial strategy calling for reallocation of plants among countries.

The Quito Modifying Protocol of 1987 liberalized investment policies and moved the Andean Group away from the import-substitution model of economic development. It also placed less emphasis on the common industrial policies envisaged by the Cartagena Agreement.(25) In 1989, the Andean Group announced plans to establish a free trade zone by 1995 to be followed by a common market by 1997.

In recent years, the Andean Group has revived its plans for regional integration in response to international trade developments such as the Enterprise for the Americas Initiative, the GATT Uruaguay Round negotiations, and speedier integration plans by the Southern Cone

(25) United States International Trade Commission (1992), p. 3-5.

Common Market (MERCOSUR).(26) The "Caracas Declaration" of May 1991 put forward the Andean free trade zone's establishment to 1 January 1992 from the earlier proposed 1995 date. Ecuador was given until June 1992 to abolish its tariffs on intra-regional trade.

Table 2
Basic Indicators of ANDEAN GROUP Countries (1991)

	Bolivia	**Colombia**	**Ecuador**	**Peru**	**Venezuela**
Population (millions)	7.4	32.9	10.5	22.1	20.2
GNP (US$ billions)	$4.8	$41.9	$10.8	$38.3	$52.8
GNP per capita (US$)	$650	$1,280	$1,020	$1,020	$2,610
Average annual GNP growth (1980-1991)	0.5%	3.2%	2.0%	-0.4%	1.1%
Exports, US$ million (1992)	$705	$7,226	$3,327	$3,484	$15,710
Imports, US$ million (1992)	$864	$8,251	$2,825	$3,744	$12,261
Ave. inflation (1980-91)*	263.4%	25.0%	38.0%	287.3%	21.2%
Inflation in 1992**	21.4%	27.0%	54.6%	73.5%	31.4%

* average annual change in GDP deflator.
** one year change in consumer prices; price change for Bolvia is 1991.

Sources: World Bank, *Atlas*; World Bank, *World Development Report 1993*; IMF, *International Financial Statistics*, Sept. 1993; IMF, *Direction of Trade Statistics, Yearbook*, 1993.

In December 1991, the Andean Group of Ministers signed the *Act of Barahona* which will implement certain changes to the arrangement agreed to earlier in the year. Under the Act, a common external tariff scheme will be established with four different tariff levels of 5%, 10%, 15% and 20% rather than a minimum external tariff.(27) This is intended to set the stage for eventual reductions in the regional external tariffs. Changes were also made that would end discrimination against foreign investment and protect intellectual property.

Yet the future of the Andean Group has become uncertain. While Colombia and Venezuela have moved forward by establishing free trade with each other, there is trouble with

(26) *Ibid*.

(27) Bolivia's two-level tariff structure of 5% and 10% would remain.

the Group's other members. Ecuador and Peru have been delaying lowering tariffs on intra-regional trade and Ecuador claims its industries are not competitive, while Peru's problems are economic and political in nature.

Peru's relations with the other members of the Group have been strained since the suspension of the Peruvian Constitution in April 1992. Peru's request for a suspension of its rights and obligations under the Agreement was approved in August 1992. It is unclear whether this stemmed from political considerations or, as Peru's economy minister Carlos Bolona claimed, because the Group's external tariff was too high.(28) Peru, which trades very little within the Group anyway, could now follow Chile's lead. Chile left the Andean Pact in the 1970s and instead successfully pursued trade liberalization with the rest of the world.

For its part, Bolivia has suggested that it might wish to join MERCOSUR while still remaining part of the Andean Group. Bolivia trades more than twice as much with Argentina as with all the members of the Andean Group put together. Before Bolivia had a chance to formally apply, however, the idea was rejected by MERCOSUR's executive committee.(29)

C. MERCOSUR

The Treaty of Asuncion, signed by Argentina, Brazil, Paraguay and Uruguay in 1991, will create the Mercado Comun del Sur (MERCOSUR) or Southern Cone Common Market.(30) The MERCOSUR will have eliminated all internal tariffs between member countries by 1 January 1995. Agreement has been reached on the establishment of a common external tariff on 85% of the items traded. Some of these external tariffs will be implemented in January 1995 while others will be phased in until the year 2001. There is still disagreement, however, over the height of external tariffs needed to protect sensitive sectors such as computer and telecommunications equipment and petrochemicals. A new deadline of June 1994 has been established for overall agreement on the external tariff.(31)

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(28) "No Go – Focus on the Andean Free Trade Zone," *Latin American Economy and Business*, July 1992, p. 28.

(29) "Mercosur Thumbs Down," *Latin American Economy and Business*, June 1993, p. 10.

(30) MERCOSUR is the Spanish acronym; MERCOSUL is the Portuguese acronym.

(31) "Mercosur Nations Delay Tariff Agreement," *The Globe and Mail* (Toronto), 17 January 1994.

Table 3
Basic Indicators of MERCOSUR Countries (1991)

	Argentina	Brazil	Paraguay	Uruguay
Population (millions)	32.6	153.2	4.4	3.1
GNP (US$ billions)	$91.2	$447.3	$5.4	$8.9
GNP per capita (US$)	$2,780	$2,920	$1,210	$2,860
Average real GNP growth (1980-1991)	-0.2%	2.5%	2.3%	0.2%
Exports, US$ million (1992)	$12,366	$36,207	$593	$1,620
Imports, US$ million (1992)	$15,557	$23,260	$1,237	$2,010
Average annual inflation (1980-1991)*	416.9%	327.6%	25.1%	64.4%
Inflation in 1992**	24.9%	1008.7%	15.1%	68.5%

* average annual change in GDP deflator
** one year change in consumer prices.

Sources: World Bank, *Atlas*; World Bank, *World Development Report 1993*; IMF, *International Financial Statistics*, Sept. 1993; IMF, *Direction of Trade Statistics, Yearbook*, 1993.

Since the MERCOSUR envisages not just free trade but the creation of a common market, it would remove impediments to the free flow of labour and capital as well as barriers to trade in goods and services. The ten Working Groups established under the Treaty are supposed to discuss trade and sectoral issues as well as the co-ordination of macroeconomic policies.

The significant differences in size between the countries – Brazil's economy is almost 80 times larger than that of Paraguay – means that the extent and pace of integration will depend on Brazil. Yet Brazil's failure to achieve macroeconomic stability may threaten the Pact's survival. Argentina's efforts have lowered inflation from more than 3,000% in 1989 to 25% by 1992,(32) but Brazil's inflation rate was still running at over 1,000% in 1992. Large differences in inflation and widely fluctuating exchange rates were blamed for many of the difficulties that plagued earlier Latin American integration efforts.(33)

Brazil also tends to be more protectionist than the other MERCOSUR members. In 1991, Brazil's average tariff was 32% compared to Argentina's tariff of 10%, Paraguay's

(32) International Monetary Fund, *International Financial Statistics*, IMF, September 1993, Washington D.C.

(33) Edwards (1993), p. 326.

16%, and Uruguay's 12%. Given Brazil's economic weight in MERCOSUR, the Pact may end up adopting a relatively high common external tariff. This would tend to divert trade away from outside countries as the smaller members of the Pact were forced to harmonize their tariffs upwards. If this trade diversion exceeded the amount of trade created by the removal of internal trade barriers, it could make some members worse off.

A multilateral framework agreement between the MERCOSUR countries and the United States was signed at the White House Rose Garden on 19 June 1991. The so-called "Rose Garden Agreement" is not a free trade accord but will provide a framework for consulting on trade and investment matters with a view to relaxing barriers between countries. The Rose Garden Agreement has been credited with improving the MERCOSUR countries' relationship with the international financial community. The Agreement may also encourage foreign investment and provide a boost to MERCOSUR's regional integration plans.

D. Central American Common Market

The five countries of Central America began the process of economic integration in the 1950s with a number of bilateral commercial accords. In 1960, the countries of Guatemala, El Salavador, Honduras and Nicaragua created the Central American Common Market (CACM) through the General Treaty of Economic Integration. Costa Rica joined the CACM in 1964. The UN Economic Commission for Latin America, which conceived the idea of a Central American common market, believed that, although import substitution might be inefficient when pursued individually by small developing countries, the market scale problem could be overcome if countries joined regional groupings.

Table 4
Basic Indicators of CACM Countries (1991)

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua
Population (millions)	2.9	5.3	9.5	5.3	4.0
GNP (US$ billions)	$6.2	$5.7	$8.8	$3.0	$1.9
GNP per capita (US$)	$1,930	$1,070	$930	$570	$340
Average real GNP growth (1980-1991)	3.4%	1.1%	1.0%	2.6%	-1.4%
Exports, US$ million (1992)	$2,234	$739	$2,002	$515	$346
Imports, US$ million (1992)	$2,682	$1,854	$2,860	$668	$845
Average annual inflation (1980-1991)*	22.9%	17.4%	15.9%	6.8%	583.7%
Inflation in 1992**	21.8%	11.2%	10.1%	8.8%	75.4%

* average annual change in GDP deflator.
** one year change in consumer prices; data for Nicaragua apply to change in GDP deflator for 1990.

Sources: World Bank, *Atlas*; World Bank, *World Development Report 1993*; IMF, *International Financial Statistics*, Sept. 1993; IMF, *Direction of Trade Statistics, Yearbook*, 1993.

By 1969 the CACM had removed tariffs on 95% of traded items with the remaining 5% covered by international agreements and other special arrangements.(34) As a result, intraregional trade expanded from 7.5% of total exports in 1960 to 26.8% in 1970.(35) After this, however, the share of intraregional trade declined – by 1989 it fallen to 13.1% – as trade disputes arose due to political differences among the members.

As a result of the 1969 war with El Salvador, Honduras actually withdrew from the pact in 1970 and carried on trade with the other CACM members by means of bilateral agreements. In another case, Costa Rica was temporarily expelled in 1972 because of a trade dispute. The international debt crisis also put a strain on the CACM as members blocked imports by erecting non-tariff barriers in order to preserve scarce foreign exchange.

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(34) "Central American Common Market – CACM," *The Europa World Year Book 1993*, Volume 1, Europa Publications Limited, London, 1993, p. 104.

(35) OECD (1993), p. 44.

Recently, the CACM has been revitalized. In July 1990, Honduras was re-admitted to the CACM and one year later the members agreed to establish a new common market. Panama, which had never been a member of the CACM, has also agreed to join the Pact. Besides removing most quantitative restrictions and liberalizing agricultural trade, the CACM intends to adopt common external tariffs ranging from 5% to 20%. These new tariff rates, which are considerably lower than the earlier rates of most CACM countries, are being heralded as "a clear move towards trade liberalization."[36] Another sign that the central American countries have left costly import substitution behind is that all CACM members except Nicaragua have recently joined the GATT.

All CACM members have also signed framework agreements with the U.S. which establish negotiating principles for trade and investment issues. The receptiveness of CACM countries to the idea of free trade with the United States reflects the fact that the U.S. is their largest trading partner and Mexico is their greatest competitor in that market. NAFTA would erode the trade preference that Central American enjoys with the U.S. as a result of the Caribbean Basin Initiative. It is estimated that after Brazil, Central America will suffer the most trade diversion as a result of NAFTA.

E. Caribbean Community and Common Market (CARICOM)

The Caribbean Community originated in 1965 with the Caribbean Free Trade Association (CARIFTA), which was formed by Antigua, Barbados and Guyana. These three members were joined in 1968 by eight other Caribbean countries (Jamaica, Trinidad and Tobago, Grenada, Dominica, St. Lucia, St. Vincent, Montserrat and St. Kitts-Nevis-Anguilla). The CARIFTA immediately removed most barriers to intra-regional trade and provided a five-year phase-out of duties on certain exempted products. There was no provision under CARIFTA for a common external tariff.

The CARIFTA was successful in raising the amount of trade among Caribbean countries; intraregional trade as a share of total exports rose from 4.5% in 1960 to 7.3% in 1970.[37] Nevertheless, dissatisfaction arose among the less developed countries in the group because of the perception that most of the benefits of integration were flowing to the richer members. In 1973 the Caribbean Community and Common Market (CARICOM) was formed in response to the shortcomings of CARIFTA.

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(36) Edwards (1993), p. 331.

(37) OECD (1993), p. 44.

The Treaty of Chaguarmas establishing CARICOM envisaged a more comprehensive type of regional integration involving not only a common external tariff but harmonization of economic policies, establishing a common market and cooperating in certain fields such as education, health, transportation, research and trade relations with outside countries. CARICOM divided members into developed countries (Barbados, Guyana, Jamaica, Trinidad and Tobago) and less developed members (all the others), who were given a longer period in which to phase-out tariffs on intraregional trade.

The common external tariff schedule established rates of duty ranging from 5% to 45% on goods imported from outside countries. In order to encourage economic development, lower rates of duty were applied against imported capital equipment and intermediate products, while the higher duties were reserved for finished goods. The adoption of the CET met with some delays as Antigua and Barbuda, Montserrat, St. Christopher and Nevis, and St. Lucia had tariff rates of up to 70% on imports from outside countries. Non-tariff barriers also add significantly to the level of protection afforded by these stated tariff rates.

Table 5
Basic Indicators of Major CARICOM Countries (1991)

	Antigua& Barbuda	Bahamas	Barbados	Belize	Guyana	Jamaica	St. Lucia	Trinidad and Tobago
Population (Thousands)	80	259	258	193	802	2,440	152	1,249
GNP (US$ millions)	$355	$3,044	$1,711	$389	$233	$3,365	$380	$4,525
GNP per capita (US$)	$4,770	$11,720	$6,630	$2,050	$290	$1,380	$2,500	$3,620
Ave. GNP Growth (1980-1991)	4.4%	3.3%	1.6%	5.3%	-3.8%	1.0%	4.8%	-3.9%
Exports, US$ million (1992)	$17	$995	$222	$136	$367	$1,371	$153	$1,847
Imports, US$ million (1992)	$178	$2,679	$454	$274	$354	$1,845	$203	$1,415
Ave. inflation (1980-1991)*	6.9%	5.9%	5.2%	2.9%	35.0%	19.6%	4.6%*	6.5%
Inflation in 1992**	7.8%**	5.7%	6.0%	1.1%**	62.0%**	77.3%	5.0%	6.5%

* average annual change in GDP deflator; data for St. Lucia apply to 1980-1990 period.

** one year change in consumer prices; data for Antigua, Belize and Guyana apply to the change in the GDP deflator in 1990.

Sources: World Bank, *Atlas*; World Bank, *World Development Report 1993*; World Bank, *World Tables*; IMF, *International Financial Statistics*, Sept. 1993; IMF, *Direction of Trade Statistics, Yearbook*, 1993.

Members of CARICOM now include the following countries: Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines and Trinidad and Tobago.

Integration of the regional market was hurt during the 1980s by a number of barriers to trade. Chief among these were currency fluctuations, import licensing by members, the failure of the Multilateral Clearing Facility and ineffective rules of origin. As a result of these barriers, intra-Community trade declined from US$555 million in 1982 to about US$290 million in 1986.(38)

The leaders of CARICOM countries agreed in June 1991 to create a true single market by removing all barriers to intraregional trade, allowing free movement of skilled workers and professionals, developing a common currency and establishing a regional investment fund. Concerns about NAFTA also motivated the CARICOM countries to begin discussions with Central American leaders about integrating the Caribbean and Central American regions.

With CARICOM rejuvenated, other countries are expressing interest in joining the group. The British Virgin Islands and the Turks and Caicos Islands have been granted associate membership while Mexico, Puerto Rico, Venezuela and Colombia have received observer status.(39) Venezuela offered to negotiate a free trade agreement with CARICOM and subsequently requested that it be granted full membership in the group.

F. The Group of Three and Other Free Trade Areas

As important as the rejuvenation of the established Latin American trading blocs is the rise of new free trade agreements criss-crossing the region. The Group of Three, comprising Mexico, Venezuela and Colombia, decided in 1989 to establish a regional association. One aim of the three energy-producing countries is to establish an "energy basin" by linking power grids and pipelines from Mexico through Central America to Colombia and Venezuela.

The second goal of the group is to form a free trade area among the three countries. Mexico has indicated its intention to extend free trade concessions to the other

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(38) *The Europa World Year Book 1993*, p. 102.

(39) Cuba has also requested observer status in CARICOM.

Andean Pact countries of Bolivia, Ecuador and Peru.[40] Effectively, there would be free trade between the entire Andean Pact and Mexico.

Another free trade agreement – this one between Mexico and Chile – was initiated in January 1992. Tariffs on most imports will be phased out by 1996. Tariffs on other items (textiles, glass, chemicals and petrochemicals) will be removed by 1998. Mexico has also initated bilateral free trade negotiations with the five individual members of the Central American Common Market.

Table 6
Basic Indicators of Chile and "Group of Three" Countries (1991)

	Chile	Mexico	Colombia	Venezuela
Population (millions)	13.4	87.8	32.9	20.2
GNP (US$ billions)	$28.9	$252.4	$41.9	$52.8
GNP per capita (US$)	$2,160	$2,870	$1,280	$2,610
Average real GNP growth (1980-1991)	3.4%	1.5%	3.2%	1.1%
Exports, US$ million (1992)	$9,956	$42,700	$7,226	$15,710
Imports, US$ million (1992)	$11,691	$58,545	$4,955	$12,261
Average inflation (1980-1991)*	20.5%	66.5%	25.0%	21.2%
Inflation in 1992**	15.4%	15.5%	27.0%	31.4%

* average annual change in GDP deflator
** one year change in consumer prices.

Sources: World Bank, *World Atlas*; World Bank, *World Development Report 1993*; IMF, *International Financial Statistics*, Yearbook 1993; IMF, *Direction of Trade Statistics, Yearbook*, 1993.

With Mexico ready and willing to undertake bilateral free trade agreements with any country in the region, it is rapidly becoming the centre of trade liberalization. Now that the North American Free Trade Agreement has been approved by the U.S. Congress, it may be Mexico, rather than the U.S., that will become the centre of a hub-and-spoke trading

(40) See: "Delayed Start-up for Northern Axis," *Latin American Special Reports*, Latin American Newsletters, London, June 1992, p. 8.

arrangement. As a "hub" country Mexico would enjoy preferential access to the U.S., Canadian markets and other Latin American countries, while Canada and the U.S. would enjoy free access only to the other two NAFTA-country markets. One author comments: "This is not the way it was supposed to happen ... The hub-and-spoke model, even with the United States as the hub, was deemed to be suboptimal on equity, efficiency, and political grounds. On all these counts, A Mexico-centered hub would be even less desirable."(41)

Apart from Mexico, the most attractive free trade partner may be Chile because of its stable economic environment (low inflation, high growth). So far, Chile has shown little interest in joining regional trade groupings like MERCOSUR in order to avoid fouling free trade negotiations with the U.S. As noted, however, it has signed a pact with Mexico and has undertaken other bilateral negotiations with Venezuela and Colombia. For its part, Venezuela has initiated trade discussions with six countries in Central America.

CONCLUSION

Democratic rule and pro-market policies are becoming the standard rather than the exception in Latin America. A recent article in the *OECD Observer* noted that the region's prospects for "future growth, political stability, and economic prosperity are better now than they have ever been."(42) Nevertheless, the region's reforms are not written in stone and must still be encouraged by the developed countries. One of the best ways to lock in reforms would be for Canada and the U.S. to liberalize trade with the region.

A softening of U.S. foreign policy toward the region made possible by the end of the Cold War, together with former President Bush's Enterprise for the Americas Initiative, has generated a significant measure of goodwill towards the United States. This goodwill, combined with Latin American economic and democratic reforms, provides a window of opportunity for Canada and the United States to undertake negotiations to lower trade and investment barriers with Latin America.

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(41) Sylvia Saborio, "The Long and Winding Road from Anchorage to Patagonia," in Sylvia Saboria *et. al.*, *The Premise and the Promise: Free Trade in the Americas*, Transaction Publishers, New Brunswick, U.S.A., 1992, p. 20-21.

(42) Linda Likar, "Trade and the Transformation of Latin America," *The OECD Observer*, No. 183, August/September 1993, p. 13.

One of the criticisms circulating during the NAFTA debate was that Mexico would be made worse off by freeing trade with the United States and Canada. However, trade liberalization clearly represents the Less Developed Countries' best hope for attaining a level of prosperity comparable to that enjoyed by the industrial countries. A World Bank study estimates that removing industrial countries' trade barriers would raise the national income of developing countries by about twice the amount provided by official development aid.(43)

But trade agreements are about more than just access to markets.(44) Aside from opening U.S. markets, the NAFTA provides Mexico with a "seal of approval," which is expected to encourage continued access to foreign capital – the oxygen of President Salinas's development strategy. In the international contest to attract foreign investment, a free trade agreement with a large industrialized country like the U.S. is regarded as a major asset.

For their part, Latin American and Caribbean countries are liberalizing trade with each other by rejuvenating some existing free trade arrangements and also creating new trade relationships. Furthermore, the new outward-looking model of regional integration is consistent with the reform of these countries' external economies being achieved through the reduction of tariffs and simplification of tariff structures, lowering of non-tariff barriers, liberalization of foreign investment restrictions, and implementation of more competitive exchange rate systems. Achieving an open trade regime is a necessary pre-condition for Latin American countries if they are to be eligible for free trade with the U.S. in the way envisaged by the Enterprise for the Americas Initiative.(45)

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(43) Michael J. Finger and Patrick A. Messerlin, "The Effects of Industrial Countries' Policies on Developing Countries," *Policy and Research Series*, No. 3, The World Bank, Washington, D.C., June 1989.

(44) This is an important point since analysis suggests that the short-term trade effects of free trade with the U.S. may not be large for most Latin American and Caribbean countries, with the possible exceptions of Brazil and Mexico. See: Refik Erzan and Alexander Yeats, "U.S.-Latin America Free Trade Areas: Some Empirical Evidence," in Saborio (1992).

(45) The Canadian government also appears favourably disposed to expanding the NAFTA to other Latin American countries. In January 1994, Canadian International Trade Minister, Roy MacLaren, discussed with Chilean officials that country's possible accession to the NAFTA.

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