ANDEAN REPORT

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Institute for the Integration of Latin America and the Caribbean - INTAL

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PRESENTATION

In the early 1990s, establishment of the Andean Community of Nations was launched afresh with the aim of expanding the ambitious integrationist process first envisaged in the Cartagena Agreement. Since that time, the Presidents, the foreign ministers, and senior foreign trade and economic policy officials have met regularly with a view to moving ahead in establishing an enlarged subregional political and economic area.

The governments of the five countries, Bolivia, Colombia, Ecuador, Peru, and Venezuela, have often reaffirmed their support for further integration of the five countries, and have achieved important agreements in diverse areas related to trade in goods and services, and the circulation of capital and of people. However, in the view of many private sector players and many observers of the process, doubt remains regarding the depth of the countries' effective commitment to Andean integration. Some analysts consider that the complex international context, marked by successive financial crises affecting the region's countries, and the manifest political instability of several countries pose the question as to whether Andean subregional integration remains a valid option in the context of international economic liberalization. Defenders of open regionalism consider that integration among countries is a means of facilitating liberalization and greater participation in globalization. Its critics fear that protection within integrationist schemes impedes that process. Thus far, the results of the process have not borne out either position.

The aim of this paper is to take a first look at the status of the Andean integration process. That look is taken at a time when the Andean Presidents have decided to give significant impetus to implementation of a four-tier Common External Tariff (CET) by the end of 2003, but without yet having taken a binding Community decision on tariff levels and mechanisms to prevent potential distortions that might arise in the Member Country adjustment process. The decision has also been taken to consolidate and perfect the Free Trade Area by 2002, and Peru has undertaken to move forward the deadlines for the elimination of tariffs for some lines. The Special Meeting of the Andean Presidential Council, held in Santa Cruz de la Sierra, on January 31, 2002, established the obligation of the governments to develop a clear and pragmatic position regarding one of the process' key issues: conclusion of the adoption of a CET that defines a general framework for the formation of an enlarged market. Thus, 2002 is a key year on the Community negotiations agenda, not only as regards the Common External Tariff issue, but also regarding the issues of business facilitation and reduction of transaction costs, harmonization of macroeconomic policy, and strengthening Andean jurisdictional and common foreign policy mechanisms. The credibility of the process depends on whether this policy objective is fulfilled. Leaders face a formidable challenge, especially in a context where negotiations are at the same time under way for an agreement with MERCOSUR to establish a South American free trade area and final efforts are under way to establish a hemispheric free trade area.

The moment is not necessarily the most propitious for the achievement of definitions. The international context has negatively affected growth prospects in the Andean countries. Integration as a concept tends to prosper in times of expansion, not recession. The two countries whose economies are most integrated, Colombia and Venezuela, are faced with instability. Without their leadership, it will be difficult to convince Peru to bring itself into line with the common vision, for Bolivia to prefer Andean integration over integration into MERCOSUR, and for Ecuador to promote its competitiveness rather than protecting its industry. A difficult task awaits the Presidents.

Thus far, headway in the process has been made essentially in defining the institutional structure of the Andean system through adoption of legal provisions that establish the rules of the game for entrepreneurs, the principal players of effective subregional integration. These provisions have gradually gained wider acceptance in the countries and further application at the subregional level. However, much doubt remains regarding the commitment of national authorities to applying such provisions at all of their levels, and of supranational authorities to imposing effective sanctions against those failing to comply with such provisions.

The information available on implementation of the integration process focuses on describing the institutional system. The lack of in-depth evaluation of compliance with the provisions means that there is a large gap in our understanding of how the system is actually working. Critics of the process rarely conclusively document the existence of the problems for which they demand solutions. It is not known whether the provisions are defective in themselves, or in their implementation, or whether they are being evaded. To establish the true situation, much further study must be made of how the system works in practice. It is hoped that future reports may dwell on this area at greater length. Here, however, we present the background by focusing on a description of the institutional system, that is, the series of provisions determining how the process operates and the organizations responsible for applying and enforcing such provisions.

Many specific questions may be asked concerning the Andean process, among them: Has the Free Trade Area become a reality? What impact has it had on trade in the Andean countries? Has progress been made towards the establishment of a Common Market? Is there a Common External Tariff (CET)? Are Community provisions in place for its application? Does joint and common negotiation take place with third countries based on a CET? What negotiations have been conducted? What system exists for the settlement of disputes? Does it work? Apart from trade liberalization, have steps been taken towards deregulation of trade in services? Have measures been taken regarding the free circulation of capital within the subregion? Has progress been made in harmonization of subregional economic policy? How much, and what remains to be done? What progress has been made in the area of free circulation of people, and in Community employment provisions and free access to employment? We will begin to take up such questions below. Some will be answered in considerable depth. Others will have to be left to future works. Much scope remains for further study.

This document comprises six chapters. The first sets out the transition from Andean Group to Andean Community by presenting the main institutional changes, and factors generating them. The second chapter seeks to provide an overall assessment of the Andean integration process, defines its main strengths and weaknesses, and discusses the key variables to be evaluated in the following chapters. The third chapter broadly outlines the main macroeconomic trends, and the macroeconomic policies undertaken by the Andean countries in recent years, with their consequent impact on the integration process. It also studies the Andean countries' position as reflected in competitiveness indicators. The fourth chapter examines the relationship between flows of trade and investment throughout the 1990s and the Andean integration process to determine whether integration has had any impact on such flows and, if so, what types of industry it affects, and how. The fifth chapter examines the evolution of the foreign policy applied by the Andean Community in recent years, both political and on integration and trade-related issues. The sixth chapter sets out prospects and the pending agenda for the Andean integration process.

The Subregional Integration Report Series, which includes this first Andean Report, is an INTAL effort aimed at promoting understanding and dissemination of information on the dynamic integration process now under way in Latin America and the Caribbean.

As part of this integrationist trend, the Andean Community of Nations, comprising Bolivia, Colombia, Ecuador, Peru, and Venezuela, is a test case to evaluate the achievements and challenges encompassed by this initiative.

INTAL's aim in publishing this annual series is to facilitate access to information for a wide range of potential readers interested in the Andean integration process, to include the public and private sectors and the subregional community as a whole. INTAL also aims to go beyond the interest aroused by the process at the subregional level by facilitating information dissemination to the international community through publication of this report in English.

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Mr. Juan José Taccone, INTAL's Director, and Mr. Uziel Nogueira, INTAL's Senior Economist, were responsible for the coordination and general and technical editing of the Report. We also would like to thank Mrs. Josefina Monteagudo, Economist, Integration, Trade and Hemispheric Issues Division of the IDB, for her valuable comments.

With a view to continuing to meet the expectations aroused by the publication of the Reports included in this Series, readers are invited to forward their comments and/or suggestions in order to improve the scope and contents of these publications in the future.

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EXECUTIVE SUMMARY

In 2002, the Andean Community of Nations (CAN), comprising Bolivia, Colombia, Ecuador, Peru and Venezuela, is developing definitions that may be central to its potentially active participation in the formation of a free trade area with the MERCOSUR countries, as well as in the formation of the Free Trade Area of the Americas (FTAA).

If the five countries are to act as a truly integrated group, they must reach a consensus as to their degree of political and economic commitment. Such commitment is reflected essentially in the complete liberalization of trade among the Member Countries and the adoption of a Common External Tariff (CET) with provisions governing competition.

As described in this report, the Andean Community has been making gradual progress in shaping an institutional and organizational framework by adopting various provisions to regulate the trade in goods, seeking to harmonize policies, particularly economic policies, and beginning a process to deregulate services and capital markets and even the circulation of people among their countries. Despite progress made in designing the general framework, many of those involved in the process share the view that the desired degree of compliance with the provisions is not being attained in all cases or in all countries. Because the actual status of the integration process has not been assessed, it is difficult to appreciate to what extent this view reflects gaps in the regulatory framework, problems in the interpretation of that framework, or a true failure to comply with the commitments undertaken by the countries.

This work does not claim to be an exhaustive assessment of the status of the integration process. More in-depth knowledge is needed to reach conclusions on the actual extent of progress made toward integration, particularly with respect to factors positively and negatively affecting the trade in goods. Although the Community's General Secretariat has produced progress reports in different areas of regional integration, it would be advisable for it to issue a comprehensive report on the process to shed more light on the benefits and costs to Member Countries. It is also important that international organizations supporting integration, and the governments themselves, conduct and publish further studies so that the integration process is truly transparent and thus gains credibility in the eyes of investors and the business community. They will then see the Andean Market as a single consolidated and enlarged market, rather than as the sum of five individual markets.

Studies conducted thus far suggest that Andean integration has been a gradual process. The 1990s saw important achievements in accelerating trade liberalization, in establishing a CET and taking the first steps towards deregulating trade in services. However, not all trade has been deregulated; the liberalization process must be completed in Peru, and the CET is only partially implemented in terms of both products and countries.

Firstly, a Free Trade Area is in place for all Andean countries except Peru, which elected to withdraw from the process in 1992, but reincorporated itself in 1997. Peru's inclusion in the Free Trade Area is planned as part of a Liberalization Program to be concluded by 2005 at the latest, in a process wherein a true Andean Free Trade Area, without exceptions, would be consolidated early in that year. At the recent meeting of the Andean Presidential Council, held in Santa Cruz (January 2002), Peru agreed to move forward the dates for elimination of certain tariffs, particularly those applicable to oil and its derivatives, which account for a significant percentage of its subregional trade, which will accelerate the Peruvian market's deregulation vis-à-vis the other Member Countries.

Intra-Andean trade grew at a significantly faster pace than world trade during the 1990s, although it slackened during the latter half of that period, primarily as a consequence of factors unrelated to the integration process. The loss of momentum in the latter 1990s reflected the impact of external crises on the Andean economies. The figures for 2000 show a clear recovery in intra-subregional exports. In addition, there has been intra-Community specialization in manufactured good exports, as opposed to Andean exports to the rest of the world, where the bulk are natural resource-based products, without significant added value.

The CET, the first version of which was adopted only in the first half of the decade after long and difficult negotiations, has a distance to travel to become a true Common External Tariff, given its number of exceptions, perforations, and differentiated treatments. Undeniably, the adoption of a true Common External Tariff is the biggest challenge in the process of Andean integration, given its impact on determining the conditions for investment resource allocation in the context of the enlarged market, as well as its impact on the relative competitiveness of its producers. In addition, it is only with a Community tariff instrument that the group will be able to present a united front in international negotiations, such as the ongoing negotiations with MERCOSUR, the proposed South American free trade area, and the FTAA. The Andean countries are currently revising the tariff to perfect it and eliminate its defects. The recent Andean Presidential Council meeting in Santa Cruz reached some important decisions on the configuration of the CET, particularly with respect to tariff levels and structure, as well as deadlines for implementation. Nonetheless, there are still various key points to be discussed among the Andean countries in 2002, and in coming years. Some of the most important issues are the products to comprise the four agreed upon tiers, the degree of tariff dispersion, and the treatment of relatively less developed countries, such as Bolivia and Ecuador. It has already been determined that Bolivia's tariff structure will not include the 20% rate initially to apply only to some sensitive products to be determined by the Community countries. Also to be defined are, *inter alia*, the products to be included in the List of Goods not Produced and the tariff applicable to Member Countries, given that differentiated treatment can create unilateral distortions; a Common Agricultural Policy where the number of price band headings differs from country to country; the automotive regime, which applies to only three of the five countries; and the List of Exceptions, which must be eliminated. In addition, the countries apply different customs mechanisms, such as regimes suspending the payment of import duties and duty rebate arrangements, which constitute a perforation of the CET, as importers pay lower than established tariffs, but can include the products in the goods they later offer on the enlarged internal market. A similar situation arises where duty free zones with special customs regimes exist which may generate intra-subregional trade. In addition, the problem of sanitary and fitosanitary barriers erected as hidden barriers to trade must be resolved. The conclusions reached at the Santa Cruz meeting indicate that the political will exists to move ahead fairly quickly, within the established deadlines. However, difficult and arduous negotiations lie ahead.

The delay in establishing the CET is leading to the loss of promising opportunities for trade negotiations with other blocs and forums, such as MERCOSUR and FTAA, mentioned above. Steps toward consolidating tariffs and preference margins have been taken only in the case of MERCOSUR, through Partial Scope and Economic Complementation Agreements with Argentina and Brazil in the context of LAIA. However, true joint Community action can be achieved only on the basis of effective national tariffs derived from agreements adopted regarding the CET. The recent nature of these agreements makes it difficult to state that whether Community exporters have in fact benefited more than they had in the past.

In coming years, the Andean Community faces significant challenges in the area of trade negotiations. In addition to forming a free trade area with the MERCOSUR countries, which would be enlarged to a South American free trade area, negotiations are under way to form a hemispheric free trade area, along with a new round of trade negotiations in the context of the World Trade Organization (WTO). This is not only an intensive agenda implying great national and Community effort in determining positions, but one with serious implications for purely Community issues, such as the adoption of the CET and the provisions regulating both internal trade and trade with third countries.

CAN's manifest intent to enter into negotiations with other countries or groups of countries – such as the members of the Central American Common Market, Panama, the Caribbean or those of the Asian area– can only take concrete form if the integration process at the CAN level is consolidated. Without this, the Andean countries would be negotiating effectively as a group of individual countries rather than as an integrated market.

There are two reasons why joint and coordinated participation in ongoing multilateral trade negotiations in the context of the WTO is now becoming a possibility for the CAN countries. They have the political will, and all have been WTO members since 1996, when the accession process was completed with the incorporation of Ecuador. This will has been demonstrated in various ways, such as the declaration signed by the CAN Ministers of Trade and sent to the Director-General of the WTO in February 2001, advocating the launching of a new Round of Multilateral Trade Negotiations at the Fourth WTO Ministerial Conference held in November 2001.

With respect to disputes settlement provisions – such as in cases of dumping, subsidies, and trade restrictive practices – there are certain legislative gaps. Some provisions are in place governing dispute resolution between one or more Member Country and third countries not included in WTO provisions. Accordingly, studies are being conducted to amend Decision 283 (dumping and subsidies) and Decision 285 (trade restrictive practices) in order to eliminate these problems. Application of Decision 285 is generally limited in scope. It refers to restrictive practices based on collusion or abuse of dominant position, provided that such practices affect competition in more than one of the subregion's countries. However, that Decision does not deal with issues such as vertical restrictions or mergers, topics addressed in treaties such as those establishing CARICOM and MERCOSUR. The increasing activity, since its reform, of the Andean Court of Justice, and of the General Secretariat as a decision-making body, are laying the groundwork for greater compliance with existing provisions. However, compliance with the rulings of these bodies must be ensured, or there must be agreement that sanctions may be imposed in cases where Member Countries do not abide by the respective Decisions and Resolutions.

With respect to trade in services, in 1998, the general framework of principles and provisions was established deregulating all services sectors (except for services provided in the performance of government functions and in air transportation) and their various modes of delivery, through progressive elimination up to 2005 of restrictive measures affecting both national treatment and market access. Some sectoral developments were also included. Provisions on telecommunications and tourism were adopted in 1999, to supplement those on transportation adopted earlier. Others are being developed, such as those on financial services and recognition of professional licenses, certifications, degrees, and accreditations. Guidelines were released in 2000, to ensure full compliance with the deregulation of services, as well as development of intra-Community trade in services.

The deregulation envisaged in Andean legislation on services will be based on an inventory in which each Member Country lists national provisions affecting the principles of market access and national treatment, to be incorporated in Community legislation through a Decision. Such provisions will be eliminated gradually and progressively in annual rounds until the process is completed in 2005, with the lifting of all measures contained in the inventory.

As to the free circulation of capital, the countries, individually and within the Community framework, have adopted measures to create conditions necessary to open to foreign and intra-Community investment. However, investment flows among the Andean countries remain relatively small. In 2000, the Andean Presidents agreed that this issue would be addressed through cooperative and consultative action among national sectoral entities.

Application of convergent macroeconomic policies promotes consolidation of the integration process. Coordination efforts made by the respective authorities with a view to making their policies even more consistent are a positive factor to be underscored. The decline in inflation is a clear indication that the process is moving along the correct path. The introduction of measures facilitating market operation in each country enhances their attractiveness to Andean and third country investors. Such measures facilitate investors' corporate operations because they help to generate an integrated market governed by Community provisions. However, in order to enhance the attractiveness of the Community market, significant progress must be made in various areas, such as coordination of fiscal policies to avoid excessive tax burdens on trade and investment, and the adoption of agreements that, at the least, limit the potential negative effect on trade of abrupt exchange rate fluctuations.

The free circulation of people is an objective that will be approached gradually by making national provisions more flexible, taking account of the specific nature of movements across the respective border areas by entrepreneurs and the business community, students, tourists, and the general public. This is requisite for the gradual establishment of an Andean Common Market and, under internal immigration provisions, is a right of Andean nationals and foreigners permanently resident in any Member Country. Two important steps were taken in 2001 in the area of free circulation of people: creation of the Andean Passport and of the national Community identity document.

With respect to development and the social agenda, in June 2001, the Andean Presidents instructed the ministers responsible to formulate an Integrated Social Development Plan. Subsequently, an order was issued to draw up a proposal on establishing a committee for concerted social action to expand public participation in the integration process and allow citizens to contribute their views to the formulation of the Social Development Plan. With respect to social and labor aspects of the Andean social agenda, five thematic areas have been defined for the Andean subregion: generation of employment, job education and training, labor health and safety, social security, and labor migration.

Lastly, it should be pointed out that the countries, with support from regional financial organizations and multilateral institutions, have been taking decisions to invest in physical infrastructure to create conditions to facilitate trade, particularly an integrated multimodal transportation system to reduce the cost of subregional freight transport, considered by many entrepreneurs to be one of the greatest obstacles to trade.

Clearly, in view of the foregoing, substantial progress has been made toward the formation of the Andean Common Market but, if it is to be fully achieved, key issues remain to be addressed. The Common Market constitutes the highest stage of integration, implying the free circulation of goods, services, capital and people. Based on the political agreement set forth in the Declaration of Santa Cruz, negotiations on the new CET system have been relaunched. Agreement will be difficult to reach and will involve sacrifices from the five countries at a time when they face an uncertain international economic environment and complex domestic political situations. Adoption of a true Common External Tariff is the only way to gain international and national credibility. Without it, trade and investment flows cannot be expected to increase significantly, thereby truly furthering Community competitiveness. The recent reinforcement of the integrationist positions of the Andean Presidents fosters the belief that the Andean Community is on the eve of a very propitious period in which to consolidate and further the Common Market and that, over the next few years, much progress will be seen in this area.

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CHAPTER I. ANDEAN GROUP TO ANDEAN COMMUNITY

The Andean Community is one of the most institutionally advanced projects for the integration of developing countries. Its objective is to promote the balanced and harmonized development of its Member Countries and to facilitate the subregional integration process. Known originally as the Andean Group, it began in 1969, with the signing of the Andean Subregional Integration Agreement (Cartagena Agreement or Andean Pact) between Bolivia, Colombia, Chile, Ecuador, and Peru. In 1973, Venezuela joined the Cartagena Agreement, while in 1976 Chile withdrew.[1] The initial objective was to establish a customs union within 10 years, and, in that connection, while that objective has not been fully achieved, important agreements have been concluded in areas pertinent to the subregional economic process, such as harmonization of policies, tariff liberalization, industrial programming, common external tariff (CET), agricultural regime, commercial competitiveness, and physical integration.

The Agreement was concluded with a view to facilitating the process of Latin American integration begun in 1960, with the Montevideo Treaty, which established the Latin American Free Trade Association (LAFTA) and sought to create a hemispheric free trade area. This was not a viable project owing, among other things, to the disparity and asymmetry existing among Latin American economies. In such a context, the original aim of the Andean Group was to improve the position of its members and reduce differences among them. The goal was industrialization, and the integration process was originally designed with a view thereto. Over time, as conditions in the international environment changed, along with domestic policy, the Andean Group moved from a system based on the classic import substitution model, with high tariffs and restrictions on foreign investment (late 1960s and the 1970s) to a liberal integrationist model, with Community provisions in keeping with international standards (in the 1990s).

Since its inception, the Andean Group has gone through different stages. Initially, its strategy was subregional import substitution, taking an inward approach to industrial integration. The aim was to go beyond trade schemes by seeking to introduce sectoral planning instruments and creating redistribution mechanisms that would correct asymmetries and enable the region's least developed economies to take off. It was also sought to maintain common policies against third countries, and there was progress in creating financial institutions, such as the Andean Development Corporation (CAF) to finance development projects and the Andean Reserve Fund (FAR) to finance requests for balance of payments assistance, along with other supranational legal organizations.[2]

The debt crisis of the 1980s led to severe recession in many Latin American countries with a resulting reduction in imports. Thus, as intra-subregional exports constitute "the reverse side of the coin" of intra-subregional imports, this had strong negative impact on Andean trade and led to a crisis in the implementation of agreements already concluded. Nonetheless, Andean integration adapted to the changing international conditions through successive agreements among Andean Group members, which were implemented through a series of meetings of representatives of the five member countries. In 1989, meeting in Galapagos, the Presidents of Bolivia, Colombia, Ecuador, Peru, and Venezuela approved the Strategic Design of the Group to consolidate the Andean economic area and strengthen the Group's international ties and to contribute further to Latin American unity by taking the political decision to create a common market. In 1990, with the signing of the Act of La Paz, it was decided to step up measures to achieve integration by moving ahead the deadlines for establishing the Andean Free Trade Area. In 1991, the Presidents signed the Act of Barahona, in which it was agreed to step up the integration process by implementing the Andean Free

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[1] As a result of the military regime established in Chile in 1973, the Andean Group, in applying the Community Liberalization Program, distanced itself from the economic policy applied by the country, which caused friction that led to the signing of the Additional Protocol to the Cartagena Agreement (October 5, 1976) and, later, to Decision 102.

[2] The FAR later became the Latin American Reserve Fund (FLAR).

Trade Area as of 1992, and providing for the establishment of the CET, among other important topics. The "open skies" policy was also approved and it was agreed to intensify integration in various areas in addition to trade. In 1992, owing to disparities of implementation, Peru temporarily suspended its obligations under the CET Liberalization Program until December 1993, which barred it, *inter alia*, from participating in decisions on improvement of the Andean Free Trade Area, and changed its status to that of observer.

The Andean Free Trade Area[3] and the CET[4] were created to prevent distortions, unify protection mechanisms, strengthen the Customs Union, and facilitate the functioning of the enlarged market. However, as will be seen in this paper, although the Liberalization Program has moved ahead significantly, application of the CET is partial, both as regards countries utilizing it and as regards the tariff universe it includes. In the economic area, in the context of the opening of markets to international trade, it was agreed to begin a policy harmonization process.

In addition, to promote its external trade, especially in non-traditional exports needing to be more competitive in order to enter new markets and supplement its internal saving, the decision was issued to eliminate obstacles to foreign direct investment (FDI), along with several measures to facilitate trade flows and reduce export costs, among which may be mentioned the adoption of the Common Tariff Nomenclature (NANDINA), based on the Harmonized System for the Designation and Codification of Goods, adopted by most of the world's countries, and provisions on customs valuation, included in the Valuation Agreement of the General Agreement on Tariff and Trade (GATT). Measures were issued with a view to deregulation of the different modes of transportation services; Community provisions began to be applied, designed to eliminate technical and health obstacles to harmonization of health legislation in general, and legislation on pharmaceuticals, packaged food, and cosmetics in particular. Subsidies to intra-subregional exports were also eliminated to prevent distortions within the enlarged economic area. Provisions were also issued to correct retroactively distortions of competition resulting from dumping and subsidies, export restrictions, and restrictions of free trade, and revision is under way of subregional provisions in force on the origin of goods. In addition, since 1994, a Common Industrial Property Regime has been in place governing, *inter alia*, the granting of trademarks and patents and protecting industrial secrets and appellations of origin.

In 1995, the Act of Quito was signed, containing Presidential guidelines for the institutional reform of the Andean Pact and the New Agenda for Andean Integration or Strategic Design. The objective of creating an Andean Common Market was thereby reaffirmed. In keeping with the open integrationist model, the need was reasserted to seek competitive development in an international economy, move towards Latin American and hemispheric integration, strengthen ties with the European Union (EU), and act jointly and in coordination in international forums.

The levels of progress achieved by Andean integration and the new challenges posed by changes in the world economy suggested a need for reforms of the Cartagena Agreement, of both its institutions and the plan of action. Thus, in 1996, the Act of Trujillo, a protocol modifying the Cartagena Agreement, was signed, which introduced important institutional changes and changes of function, thereby according clearer political direction to the process. This reorganization involved the establishment of the Andean Community of Nations (CAN) to replace the Andean Group, along with the Andean Integration System (SAI) and a General Secretariat whose functions were in keeping with the group's new purposes. Its objectives are to promote the balanced development of the Member Countries, spur their growth through integration and economic cooperation, promote ongoing improvement in standards of living of their peoples, and promote subregional integration. The central focus was to ensure that, as a group, the countries were capable of meeting the challenge of effective participation in an increasingly globalized world, where the competitiveness of its productive sectors would

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[3] On January 31, 1993, the Free Trade Area came into full operation for Bolivia, Colombia, Ecuador, and Venezuela.

[4] Since February 1, 1995, the Andean Group has applied a CET to goods of third-country origin, approved by Bolivia, Colombia, Ecuador, and Venezuela on November 26, 1994. Peru has not yet adopted the CET.

define how far it was possible to promote accelerated growth while generating employment and reducing poverty and extreme poverty.

The reforms expanded the scope for integration beyond purely trade and economic issues. In 1997, the Sucre Protocol was adopted, which added three new chapters to the Cartagena Agreement: the Foreign Relations chapter, the Trade in Services chapter, and the Associate Members Chapter.[5] In addition, an agreement was concluded for the gradual incorporation of Peru into the Free Trade Area (Decision 414).

All this took place in an increasingly complex international context. According to Devlin and Estevadeordal [2001], a "new regionalism" emerged: an altered perception of development strategies for the countries and the objectives of integration. The strategy essentially includes economic opening towards international markets, promotion of investment and private initiative, and the withdrawal of the state from economic activity, regional integration being the key mechanism for furthering unilateral and multilateral liberalization and ensuring the market economy. In that context, in 1991, the Southern Common Market (MERCOSUR) emerged in the region, a process bringing together the economies of Argentina, Brazil, Paraguay, and Uruguay and, in 1994, the North American Free Trade Agreement (NAFTA) was established, through which Mexico was integrated into the process of establishing a free trade area begun by Canada and the United States. At the international level, the negotiations process begun in Uruguay was concluded, a new framework was adopted for trade in goods and services, and the World Trade Organization (WTO) was created (established in 1995). The WTO would become the entity that would serve as international technical secretariat for an integrationist process involving all its member countries, one that would benefit from the international settlement of disputes to achieve full application of the provisions adopted by its member countries. In 1994, at the First Summit of the Americas, held in Miami, the basis for the creation of the Free Trade Area of the Americas (FTAA) was established, whose completion by 2005, if successful, would create a hemispheric free trade area; and, in 2000, in Brasilia, at the First Meeting of South American Presidents, the heads of state took the political decision to establish a free trade area between CAN and MERCOSUR by the end of 2002.

Dynamic interaction among the Andean Presidents and foreign ministers is also generating a new subregional agenda on issues of singular importance for the countries, both individually and collectively. Strengthening of democratic processes and respect for human rights, regional and subregional security, the fight against drug trafficking, violence, terrorism, corruption, and international organized crime are high priorities for the countries, which are faced with difficult challenges in these areas. Attaining sustainable development while conserving natural resources has emerged as an international and subregional issue. In addition, in the framework of a Common Foreign Policy (CFP), intensifying subregional political integration has acquired importance, as have proposals on institutional aspects of the integrationist process which reinforce its Community character.

The CFP is an essential tool for consolidation of the process and for strengthening joint action by the countries in addressing the many challenges facing them. Based on that Policy, a process of convergence of Community action in the international arena was launched. Such convergence is also reflected in increasing joint Community action in achieving market liberalization for products of Community origin. Initiatives are being continued, such as better utilization of preferences granted by the United States and the European Union, and contacts with Canada are being established. Processes have been launched to facilitate trade with countries of the region, such as El Salvador, Guatemala, and Honduras in Central America, CARICOM, and Panama, and negotiations and agreements with the MERCOSUR countries are being promoted, in which the ambitious aim is to establish a free trade area covering the nine countries.

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[5] Under this amendment, the Andean Community has great flexibility in accepting Associate Members.

The new dynamics mean that the Andean institutional and organizational framework must be reorganized. The Meeting of South American Presidents has been institutionalized. The role of the foreign ministers has been formalized. The work method of the Commission and Executive Secretariat (previously the Board) has been restructured. The action of the Andean Court of Justice has been made more effective. The process of restructuring the Andean Parliament has begun, and review is under way of the status of integration agreements signed to promote activity in the areas of education, health, and labor. The FLAR, previously limited to the Member Countries, has broadened its horizons, while the CAF is expanding its client base and scope of action. A large part of the restructuring of the institutional framework has been concluded. Progress has been made in other areas, although work remains to be done.

In 1999, the CAN established priorities for expanding integration over the coming years and agreed to establish a Common Market by 2005. It also undertook to achieve economic stability of the Member Countries and, to that end, to agree on inflationary goals of under 10%. In 2000, in Peru, a political declaration and the Act of Lima were signed, containing two attachments, including a 2000-2001 action program for the establishment of the Andean Common Market. Attaining that goal implies not only completing the liberalization process, but perfecting the CET, fulfilling the goals of liberalization of services, promoting border integration, eliminating barriers to the free circulation of goods and people, implementing a Common Foreign Policy, and commitment by the countries to furthering the Andean Integration Agreement and achievements in political, economic, social, and cultural areas. Promotion of the process involves making significant progress in policy coordination, which involves systematic inclusion of the ministries of economy and Andean central banks in implementation of the agreements.

Under the Trujillo Protocol, the SAI unifies and coordinates the work of a series of bodies and institutions to attain the objectives of furthering Andean subregional integration, promoting its external influence, and furthering activities related to this process beyond the establishment of an economic area by committing its Member Countries to integration of political, cultural, and social aspects. The SAI comprises the bodies and institutions shown in Table 1 which, prior to its establishment, operated independently without interacting, often with duplication of effort. The mechanism established by the Protocol to improve Community internal functional relations is a meeting of representatives of the institutions comprising the SAI, under the direction of the President of the Andean Council of Foreign Ministers, who convene and direct the said meeting. Its objectives are information exchange, coordination of activities, and accountability in the guidelines issued by the Presidents.

Much progress has been made, as not only are the technical bodies and the role of the plenipotentiary representatives taken into account in drafting provisions binding on the Member Countries, but also foreign ministries now have greater authority to promote integration agreements. Similarly, the Countries have moved forward significantly in achieving convergence of economic and social policy through meetings of their different ministers, such as economy, trade, health, etc.

Lastly, the Trujillo Protocol of amendment reformulated the work that the Board had been carrying out until that time by strengthening its technical, political, and executive capacities and by assigning it General Secretariat functions with enhanced powers to provide technical support for the other Community bodies and institutions. The Secretariat comprises a Secretary General, who directs it, and a group of Directors General, as well as a technical and administrative body supporting its functions. This reform overcame the legal lacunae, and the operational deficiencies and deficiencies of political independence of the Board of the Cartagena Agreement, with its three "*juntos*." These reforms, in keeping with the WTO regime, promote the Community's technical operational and adjudicatory capacity.[6]

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[6] More detailed analysis of the reform may be found in Gutiérrez Reinel [1996], pp. 28-38.

In that connection, the recent Andean Presidential Council meeting, in Santa Cruz, Bolivia (January 2002), held subsequent to the interministerial meeting held with the participation of the foreign, trade, economy, and agriculture ministers, demonstrated a renewed integrationist intent on the part of all Community leaders, including Peru which, on previous occasions, was reluctant to participate in a Common External Tariff and intensify its participation in the Free Trade Area. The Declaration of Santa Cruz took the Andean Community to the point of determining the formation of a true enlarged economic area, with more equitable rules for all Member Countries, while taking into account their individual realities and retaining the most favorable concessions for those Members. It also establishes specific deadlines for implementation of the CET (December 2003) and mechanisms to consolidate and enhance the Free Trade Area (June 2002), among other things. Thus, it may be said that 2002 is a crucial year for the strengthening of the Andean Community, which will depend on the success of the technical bodies of each country in proposing realistic solutions to the divergent interests of the Member Countries, thereby promoting the development of a more competitive integrated market.

An initial overview of the status of the Andean Community's process of integration is provided below. It does not seek to be exhaustive or to go into great detail regarding many activities now under way. The objective, on this occasion, is to provide an outline to the process in relation to its own objectives by utilizing information available both in the CAN Secretariat and other freely available sources. Many topics warrant much more detailed discussion. In later reports, the most crucial topics will be studied, which define the extent to which the Andean Community may progressively contribute to true integration of the countries comprising it, thereby contributing to the development of their economies and the welfare of their peoples.

TABLE 1A
BODIES COMPRISING THE ANDEAN COMMUNITY OF NATIONS

Body	**Definition** (a)	**Functions**
Andean Presidential Council	(1990) Highest-level body of the Andean Integration System (SAI). It comprises the Presidents of the Member Countries and issues guidelines on different areas of subregional integration, which are implemented by the bodies and institutions of the SAI.	Defines subregional integration policy, orients and promotes actions on matters of interest to the subregion, and evaluates the development and results of the integration process, among other functions.
Andean Council of Foreign Ministers	(1979) The Council comprises the Ministers of Foreign Affairs of the Member Countries. It is the political leadership body, which has responsibility for ensuring that the objectives of Andean subregional integration are attained, and for making and carrying out the foreign policy of the CAN.	Signs conventions and agreements with third countries or with international organizations, coordinates the joint position of the Member Countries in international forums and negotiations. Expresses its will through Declarations and Decisions.
Commission of the Andean Community	The policy-making body of the SAI. It is made up of one plenipotentiary representative of each Member Country and one alternate. Its legislative role, expressed through the adoption of Decisions, is shared with the Andean Council of Foreign Ministers.	Makes, implements, and evaluates general Andean subregional integration policy in the areas of trade and investment; adopts the necessary measures for attaining the objectives of the Cartagena Agreement; and coordinates the joint position of the Member Countries in international forums and negotiations.
General Secretariat of the Andean Community	The executive body of the CAN. Formerly the Board of the Cartagena Agreement (JUNAC), the technical body of that Agreement, which carried out proposal and implementation functions. In August 1997, it took on the functions of the Board of the Cartagena Agreement. It is under the direction of a Secretary General elected by the Andean Council of Foreign Ministers, and expresses its will through Resolutions.	Formulates Draft Decisions and proposes them to the Andean Council of Foreign Ministers and to the Commission, and passes on initiatives and suggestions to the Council meeting in enlarged session to facilitate compliance with the Cartagena Agreement. It manages the subregional integration process, resolves issues submitted to it for consideration; and ensures that Community commitments are fulfilled, among other functions.
Andean Court of Justice	(1979) Established on January 5, 1985, as the judicial body of the Cartagena Agreement. It currently comprises five Judges, each representing one Andean Member Country, and has territorial jurisdiction in the five countries.	Ensures the legality of Community provisions through nullity actions, interprets Andean Community laws to ensure that they are applied uniformly in the territories of the Member Countries, and settles disputes. In 1999, it was assigned new spheres of competence, among them, Appeals for Omission or Inaction, Arbitration, and Labor Jurisdiction.
Andean Parliament	(1980) The deliberative body of the SAI. At present, it is comprised of representatives of the National Congresses but, in five years' time, its members will be elected through implementation of the direct and universal vote mechanism (Venezuela has already put this mechanism into practice).	Participates in the legislative process by putting forward to the bodies of the System draft provisions of common interest. It also promotes the harmonization of Member Country legislation and the growth of cooperative and coordinated relations with the Parliaments of the Andean countries and of third countries.

Note: (a) indicates the main characteristics of these bodies, apart from their functions, details of which are provided in the third column.

TABLE 1B
INSTITUTIONS COMPRISING THE ANDEAN COMMUNITY OF NATIONS

Institutions	Definition	Functions
Andean Business Advisory Council	(1983, Dec. 175) This is the advisory institution of the SAI. It comprises four delegates elected from among the heads of representative business organizations of each Member Country. It seeks to attain greater participation by the business sector in the construction of an integration process leading to the creation of a common market.	Issues opinions to the Andean Council of Foreign Ministers, the Commission, or the General Secretariat of the CAN, at their request or on its own initiative, with regard to programs or activities of the Andean subregional integration process that are of interest to the business sector.
Andean Labor Advisory Council	(1983, Dec. 176) This is the advisory institution of the SAI. It comprises delegates elected directly by the representative organizations of the labor sectors of each Member Country. It seeks to attain greater participation by the labor sector in the construction of an integration process leading to the creation of a common market.	Issues opinions to the Andean Council of Foreign Ministers, the Commission, or the General Secretariat of the CAN, at their request or on its own initiative, with regard to programs or activities of the Andean subregional integration process that are of interest to the labor sector.
Andean Development Corporation (CAF)	(1968) Established prior to the signing of the Cartagena Agreement, through the Establishing Agreement signed by representatives of Bolivia, Colombia, Chile, Ecuador, Peru, and Venezuela. It now comprises twelve countries of Latin America and the Caribbean. Its principal shareholders are the five Andean countries, along with seven partners outside the subregion: Brazil, Chile, Jamaica, Mexico, Panama, Paraguay, Uruguay and Trinidad and Tobago. Argentina is close to incorporation.	Serves as an intermediate financial institution by raising funds in industrialized countries for the subregion; finances the development of productive infrastructure, especially infrastructure facilitating physical and border integration; promotes the development, consolidation, and integration of financial and capital markets in the subregion; promotes trade, investment, and new business opportunities, and provides support to the business sector.
Latin American Reserve Fund (FLAR)	(1976) Founded as the Andean Reserve Fund. Adopted its current name through an agreement signed in 1988, which entered into force in 1991.	Provides balance of payments assistance to Member Countries by granting credits or guaranteeing loans to third countries; promotes financial development by granting credits to first-tier banks to finance external trade operations within the subregion.
Simón Bolívar Andean University	(1985) Its main campus is located in Sucre, Bolivia, with branches in La Paz, Bolivia; Cali, Colombia; Quito, Ecuador; and Caracas, Venezuela.	Devoted to research, teaching, post-university training, and provision of services.
Andrés Bello Convention	(1970) In 1998, the General Secretariat of the CAN and the Executive Secretariat of this Convention signed a Cooperation Agreement to coordinate and implement activities of common interest in the areas of technology, education, culture, and science.	To preserve Andean cultural identify in the context of Latin American cultural heritage. Carries out joint educational, scientific, and cultural activities.
Hipólito Unánue Convention	(1971) Its purpose is to promote cooperation and integration among Member Countries of CAN to improve their people's health. It joined the SAI in 1998.	To improve the health of the peoples of the Andean countries.
Simón Rodríguez Convention	(1976) Its purpose is to promote labor cooperation among the Member Countries of CAN.	To adopt strategies and plans of action to improve living and work conditions in the Member Countries. The process of updating this Convention is under way.

Contents

CHAPTER II. BUILDING THE COMMON MARKET AND THE ANDEAN COMMUNITY

This chapter discusses the main steps taken by the Andean Community since its establishment to build gradually first a free trade area, then a common market and, finally, a community of nations. Since the signing of the original Cartagena Agreement, the scope of integration has expanded significantly. Today, in addition to advances in the free circulation of goods within a market having a Common External Tariff, a process is being launched to define provisions for the free circulation of services, capital, and even people.

Much progress has been made in defining a legislative framework for integration. Nonetheless, many areas remain where legislation needs to be developed. There is none, for example, providing for an ongoing evaluation system to enable the lead authorities of the process and the governments to determine more precisely which provisions need to be adjusted, to assign priorities among those yet to be drafted, the order in which they are to be drafted, and what mechanisms should be used to impose sanctions for failure to comply with Andean provisions.

Views on legislative compliance vary widely, among both national authorities and those directly involved in the integration process: companies hoping to benefit from the enlarged market. It has not been possible on this occasion to ascertain those views, or to assess which are valid, which relate to problems stemming from a lack of appropriate provisions, and which reflect true lack of compliance with existing provisions. One urgently needed measure to give current and potential investors a more transparent view of how the enlarged market is actually functioning is to collect systematic data thereon, establish the validity of the perception of lack of compliance, and determine the cause of particular situations, and solutions appropriate thereto.

A. Free Trade Area

Trade in goods among Bolivia, Colombia, Ecuador, and Venezuela has been completely deregulated, meaning that goods produced within one country enter the territory of the other three duty-free. The four countries thus have a free trade area, to which Peru is being incorporated under a Liberalization Program. Community activities are focused on administering and perfecting this enlarged market and ensuring that it functions well. Rules of origin, technical regulations, and measures to prevent and correct competition-distorting practices are designed to attain this objective.

Implementation of the Liberalization Program, complicated by the different deadlines for and forms of tariff elimination, was accelerated in 1989 by the Presidents, who issued provisions designed to simplify it and achieve equal participation therein by the five countries. As a result, on September 30, 1992, Bolivia, Colombia, and Venezuela completed their market deregulation by eliminating tariffs, in transactions with their trading partners, for those products still subject to them on that date. For its part, on January 31, 1993, Ecuador completed that process when it opened its market to Venezuelan imports (Decision 324).

Peru is gradually incorporating itself into the Free Trade Area. On August 27, 1992, the country suspended all commitments under the Liberalization Program (Decision 321). On July 30, 1997, Peru and the other Andean Community partners reached an agreement for full incorporation of the country into the Andean Free Trade Area. In Decision 414, the Commission approved a tariff elimination schedule, whose implementation began in August 1997, to become fully effective in 2005. Pursuant to that Decision, in October 1998, Ecuador and Peru signed the Agreement to Accelerate and Intensify their Free Trade and, in August 1999, signed the corresponding executing instrument, thereby completely eliminating tariffs, in trade between these two countries, for a large number of NANDINA subheadings.[7] With the implementation of this Decision, the establishment of the Free Trade Area was thus concluded, thereby establishing basis for the formation of a Customs Union and, subsequently, the Common Market.

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7 Decision 451 of the Andean Commission supported the implementation of the above mentioned Agreement.

The program to liberalize trade between Peru and the other Andean Community Member Countries for all products in the tariff universe established a tariff elimination schedule for the different products listed in eight annexes. It also provided that tariffs were eliminated for trade in products not included in those annexes, and that tariff elimination established in bilateral trade agreements signed between Peru and the other Member Countries would remain effective where such agreements accorded more favorable treatment than that provided for in the Decision. This process was accelerated still further through application by Colombia, Peru, and Venezuela of the Most Favored National Clause, referred to in Article 155 of the Cartagena Agreement.

Note that the earlier trade agreement between Bolivia and Peru, which liberalized trade in certain areas, remains in effect as regards tariff elimination. Thus, the universe of products complying with the rules of origin enter Bolivia duty free. For their part, goods originating from Bolivia also enter Peru duty free, except products listed in Annex 2 of that agreement, for which 50% of variable specific duties were eliminated.

In addition, Colombia has eliminated 98.8% of the tariff universe applied to Peru; only 78 NANDINA subheadings remain, for which tariff elimination is under way. Peru has eliminated 89.5% of the tariff universe applied to Colombia; 686 subheadings remain, for which tariff elimination is under way. For its part, Ecuador has eliminated 94.1% of the tariff universe applied to Peru; 388 NANDINA subheadings remain, for which tariff elimination is under way. Peru, for its part, has eliminated 93.7% of its tariff universe for Ecuador; only 414 NANDINA subheadings remain, for which tariff elimination is under way. In the case of Venezuela, 98.7% of the tariff universe has been eliminated for Peru; 85 NANDINA subheadings remain, for which elimination is under way. Peru has eliminated 91.0% of the tariff universe for Venezuela; 590 subheadings remain, for which tariffs are to be eliminated. This data is summarized in Tables 2 and 3.

TABLE 2
LIBERALIZATION PROGRAM OF COLOMBIA, ECUADOR, AND VENEZUELA WITH PERU

Annex to Decision 414	Preference margin	Colombia	Ecuador	Venezuela	Comments
Annex IV	40%	48	304	43	Preferences rose from 20% to 40%
Annex V	15%	6	13	10	Preferences rose from 10% to 15%
Annex VI	15%	24	45	22	Preferences rose from 10% to 15%
Annex VII	20%		14	10	Preferences remain at 20%
Annex VIII	75%		12		Preferences rose from 50% to 75%
		78	388	85	

Source: Activity report of the General Secretariat of the Andean Community (June 2000 - June 2001).

TABLE 3
LIBERALIZATION PROGRAM OF PERU WITH COLOMBIA, ECUADOR, AND VENEZUELA

Annex to Decision 414	Preference margin	Colombia	Ecuador	Venezuela	Comments
Annex IV	40%	575	325	483	Preferences rose from 20% to 40%
Annex V	15%	16	16	13	Preferences rose from 10% to 15%
Annex VI	15%	47	45	47	Preferences rose from 10% to 15%
Annex VII	20%	14	14	14	Preferences remain at 20%
Annex VIII	75%	34	14	33	Preferences rose from 50% to 75%
		686	414	590	

Source: Activity report of the General Secretariat of the Andean Community (June 2000 - June 2001)

In general, the items not deregulated representing a large amount of trade are oil and its derivatives (NANDINA Section 2710). In fact, an average of 45% of Peruvian imports from the Andean countries in the 1994-1999 period involved these products,[8] thus reflecting their weight among Peruvian imports.[9]

Existing provisions authorize the countries to accelerate the liberalization process. However, it has been Peru's position that deregulation may be accelerated only when agreement has been reached regarding certain provisions that are generating trade distortions, provisions essential to resolving existing differences regarding the establishment of the Common Market through the adoption of the Common External Tariff.[10] This was reflected in the commitment made by Peru at the recent Meeting of the Andean Presidential Council in Santa Cruz de la Sierra, Bolivia to move forward deadlines for the elimination of tariffs on oil and fuels to December 31, 2003, while undertaking to eliminate tariffs on agricultural products as of December 31, 2005. This, in fact, demonstrates the Community's political intent to ensure consolidation of the Free Trade Area and strengthen the Customs Union, as will be discussed in the next section.

B. Common External Tariff (CET)

One of the most important instruments for the establishment of the Andean Community is the CET, which defines the degree of effective protection that Member Country producers will enjoy against other countries' producers and which, in turn, affects their competitiveness on those countries' markets in determining the higher costs included in their products as a result of tariff protection.

The CET issue has been discussed and debated within the Andean Community from the outset. In the 1970s, what was known then as the Board prepared several CET proposals. The countries were unable to reach agreement regarding any of them owing to great divergence among national policies. In part, it was sought to remedy this situation through the sectoral programming mechanism, in which it was sought to define effective protection by production chain across sectors key to development. However, not even this mechanism was implemented, and the CET issue remained among the process' most contentious.

The macroeconomic crisis of the 1980s led most Andean countries to reformulate their economic policy. Among structural changes introduced was the decision to open their economies to greater international competition. This led to the gradual elimination of non-tariff barriers and reduction of tariffs applied to third country imports. By the end of that decade, convergence of economic policy and, in particular, attainment of agreement on a uniform tariff structure for the region had become more feasible.[11]

Thus, after long and arduous negotiations, the Andean Community adopted Decision 370, which entered into force in February 1995. This Decision may be considered an intermediate step in establishing a true CET, as it defines regimes differentiated by country. The main features of the agreement adopted are set out below.

- A general regime was established, accepted by Colombia, Ecuador, and Venezuela, with four basic tiers: 5, 10, 15, and 20%, averaging 13.6%.

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8 Calculated for Section 3 of SITC Classification Rev. 3: fuel, mineral lubricants, and related products.

9 Prior to the signing of Decision 414, the Peruvian position consisted of not granting preference margins for raw materials, as it was felt that this implied allowing a partner country to "profit excessively" and that it would generate severe fiscal restrictions.

10 This is especially important for agricultural goods, which are subject to a special regime in the Andean framework, in contrast with the Peruvian regime, which has fewer tariff lines and less dispersion in the price bands.

11 As a result of tax reforms, reliance on the collection of customs duties was reduced in most countries, thereby giving negotiators more room to maneuver.

- For Bolivia, an exceptional, two-tier CET was defined: 5 and 10%, not shared by the rest of the countries.[12]

- For Ecuador, a special regime was defined, enabling the country to move away by five percentage points from established levels for a group originally including 990 tariff subheadings.[13]

- The CET adopted was established for a total of 6,617 NANDINA subheadings, distributed as follows:

Tariff	CET subheading number
5%	513
10%	2,509
15%	1,914
20%	1,681

- Peru did not agree with the other countries of the subregion on the configuration of the CET, and therefore decided not to implement it. After many attempts to reconcile positions, the countries agreed that Peru would suspend implementation of the CET, which also led to the configuration of a special liberalization program, as described above.

The general regime described above made provision for additional exceptions agreed by the Community as a whole. These are summarized below.

- First is the so-called List of Zeros, containing 31 subheadings accorded special treatment, as they are essential health, education, and media-related products, and are subject to international agreements or social policy within the countries.

- Secondly, is the List of Exceptions, containing products for which the countries individually do not apply the general CET. Initially, Ecuador included 400 subheadings on this list, and Colombia and Venezuela up to 230 each. The number of subheadings was reduced at a rate of 50 per year, with complete elimination envisaged for early 1999. However, through Decision 466, the deadline for complete elimination was extended. As of October 2001, Ecuador still had 247 subheadings to be withdrawn from this list, and Colombia and Venezuela had 64 and 33 subheadings respectively to withdraw.

- Third is the "List of Goods Not Produced," for which the countries are authorized to defer 5% of the general CET[14] For raw materials and capital goods, the countries may reduce the CET down to 0%, after informing the other countries. The regime also makes provision for temporary suspensions in two cases: temporary insufficiency of subregional supply and national emergency. In the first case, suspension may last for six months; and, in the second, for up to three. According to information from the CAN General Secretariat, both Colombia and Venezuela have been availing themselves of this option to defer tariffs for some tariff lines included on this list. The list contains 2300 NANDINA

[12] The national tariff applied by Bolivia is 10%, except for a group of tariff lines classified as capital goods, for which tariffs are 5% or, in some cases, 0%.

[13] Under the new NANDINA nomenclature, this list has become 1,033 tariff lines.

[14] It first must be established that the goods are not produced within the subregion. One difficulty with this is that, in the case of inputs, substitute goods exist, thereby complicating interpretation of the concept of "not produced." There are also problems when the definition of a NANDINA subheading is relatively broadly defined and covers a range of products.

subheadings (35% of the total), of which over 200 include final consumer goods and over 220 are tariff lines for which the countries do not take advantage of the deferral of the general CET. For the others, most countries defer 5%.

- Fourth is the CET adopted by the three countries participating in the Automotive Regime, which establishes the applicable tariffs for this sector, which reach a maximum of 35% for final goods. Under the regime, payment of import duties is suspended in the case of auto parts.

In addition to the points outlined above, it should be noted that the countries apply different customs mechanisms, such as regimes suspending payment of import duties and duty rebate arrangements, which constitute a perforation of the CET, as importers pay lower than established rates, but may include products entering at reduced tariffs in the goods they later offer on the enlarged internal market. Another such case is duty free areas with special customs regimes that may generate intra-subregional trade.

It should be recalled that the Andean CET was defined after the countries had negotiated trade agreements with third countries that granted concessions perforating the CET. According to the CAN Secretariat, these have no significant impact on Andean trade; however, they constitute departures from Community provisions.

Government procurement is another topic requiring more in-depth study. Although in most countries, state enterprise and autonomous entities pay import tariffs, this does not apply in the case of central government agencies. This constitutes another perforation of the CET. It should be noted that in recent years, privatization and reduction of the role of the state has led to a general reduction in the level of imports in this area.

In view of the foregoing, it is hard to agree that the CET adopted thus far may be considered a Common External Tariff appropriate to an integration system. Having seen the diversity of regimes the countries may apply, even leaving aside the Peruvian case, it may readily be seen that there must be great differences in effective protection for some goods produced within the subregion. A situation of this type creates conditions for potential conflict when one producer may import inputs at lower tariffs than another in a neighboring country. This is a source of dispute, both those brought before national authorities seeking to modify national tariffs to eliminate distortions and those brought before the Andean authorities, as anti-competitive conditions are being generated.

To address this situation, the five Andean Community Presidents, in May 1999, agreed to achieve a true Andean Common Market. The new deadline proposed by the Presidents to that end is 2005, at the latest. The decision was ratified in June 2000. Based on this political agreement, the Secretariat drafted a proposed new CET regime. Studies conducted thus far indicate that the countries, by merely applying the mechanisms in force, have been bringing their national tariffs into line in a gradual and independent process of convergence. This is true both for average national tariffs and for their dispersion.[15]

There are several key issues in determining the new Common External Tariff. The most important aspects, some of which were discussed above, are:

- CET levels, which must be lower than those originally adopted, and should be less dispersed, so as to reduce levels of effective protection and bring it a more even, and therefore neutral, level in terms of resource allocation.

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[15] Bolivia has the lowest average, of 9.6%, while Venezuela has the highest, at 11.9%.

- Treatment of relatively less developed countries, especially as regards the provision allowing Ecuador to apply up to 5% less than the CET, and the general treatment accorded Bolivia.[16]

- The List of Goods Not Produced, enabling unilateral distortions to be generated. Here consideration might be given to a reduced tariff level, for full common application, after the current list has been rationalized.

- The automotive regime, currently in force for only three countries.

- Effectiveness and application of special customs regimes at the national level, which would have to be regulated in detail to prevent perforations of the CET. One option is to eliminate customs regimes for trade among the partners and to harmonize their application in trade with third countries.

- The status of state procurement regimes, for which the CET is not applied. Consideration here could be given to equal treatment for Andean products and afforded national products.

- A decision regarding continued application of the price band for agricultural products (see details in the following section).

- Lastly, establishment of deadlines for full application of the new CET, which, as decided by the Presidents, must be implemented by 2005.

Adoption of a truly Common External Tariff is undeniably the most important challenge to be addressed in the Andean integration process, as regards its impact on conditions for investment resource allocation at the level of the enlarged market, and its effect on the relative competitiveness of its producers, and because it would enable the group to form a common front in international negotiations, such as those being conducted with MERCOSUR, the proposed South American free trade area, and the FTAA.

In this context, the Special Meeting of the Andean Presidential Council was held in Santa Cruz de la Sierra, Bolivia (January 28-30, 2002), and the Community's new CET was defined. This presidential summit had been preceded by two days of meetings of ministers of trade and integration, foreign affairs, agriculture, treasury, and economic development, who had discussed, along with the CET and special regimes, other timely aspects of integration related to the Andean System of Price Bands and agricultural policy. The main results of these meetings related to consolidating and perfecting the free trade area, commitment to formation of a Customs Union by December 31, 2003, agreement on the adoption of a common agricultural policy, harmonization of macroeconomic policy, and strengthening Common Foreign Policy, to be discussed below, in addition to certain items on the Community's political and social agenda.[17]

The Declaration of Santa Cruz is significant, as the countries make very serious commitments therein to further the Common Market vis-à-vis the subregional and regional negotiations in which the CAN is involved, not only through the establishment of a CET, but through specific commitments to comply with short deadlines (60 days) by which to overcome many existing barriers to trade, such as the Community rules of origin based on analysis of production chains, harmonization of sanitary and phytosanitary requirements, shipment of freight by road, and a commitment not to grant more favorable concessions to third countries which, as indicated above, had become virtually the rule within the subregion owing to the many bilateral or subregional agreements to which each Community country is Party.

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[16] It should be recalled that Bolivia is also an associate member of MERCOSUR, which has its own CET.

[17] See Annex II, which contains the Declaration of Santa Cruz de la Sierra.

As regards the CET, the Declaration of Santa Cruz finally established a Common External Tariff of four tiers: 0%, 5%, 10% and 20% for the five countries, with the exception of Bolivia, which does not apply the 20% level. It also established an adjustment rule for Ecuador for raw materials and inputs not produced in the subregion, taking into account its exchange policy, but not permitting the other countries to apply origin requirements or countervailing duties when distortions are generated, such as those generated by unfair competition. The list of products to comprise each tier of the proposed tariff structure has not yet been established. This is the topic for immediate negotiation and one that may prove contentious. For example, as soon as certain industrial associations heard the news, they complained that five tariff lines (including one of 15) had not been approved (*El Universal* of Caracas, January 31, 2002). It may be gathered from the presidential Declaration that tariff lines at the 0% level will be capital goods not produced in the region, and that the tariff lines at 20% level will probably be those most sensitive to protectionism at the international level and subsidies, such as textiles, garments, and footwear, and some agricultural products, but it is not known how inputs not produced in the subregion will be handled, or what steps will be taken to reduce current levels of protection, as in the case of the special automotive regime.

C. Supplementary provisions for formation of the Common Market

From its inception, the Andean Community adopted numerous provisions as part of its integration process to regulate the conditions in which entrepreneurs would conduct their business activities in the deregulated market. Some provisions were in keeping with agreements negotiated in the framework of the LAFTA (later, LAIA), while others were of an internal nature. While some were relatively widely accepted at the internal level, others were questioned in view of their complexity.

The Andean integration process was facilitated when a broad range of international provisions of common application were agreed, first in the framework of the GATT and later, when the WTO was established.[18] In response to this change in the international environment, different provisions existing at the Andean level were gradually brought into line with the new provisions. Also of significant impact was the policy adopted by the countries gradually to open their market to greater international competition.

In the origin area, one of those traditionally most contentious, provisions defined at the Andean level are currently being applied, essentially through Decision 416, adopted in 1997, which replaced earlier provisions. This Decision establishes the requirements for products to be considered of subregional origin and, therefore, to benefit from the Andean market. Current provisions bear more similarity to those accepted at the international level, although for certain cases, provision is made for the establishment of specific rules of origin where the general rules are inadequate.

In addition, Andean provisions have been established on a wide range of issues crucial to the free circulation of goods (for greater detail, see Annex I of this Report). The most pertinent are:

- Technical rules on recognition and acceptance of product certificates, which contributes to the elimination of technical barriers to trade. Progress has also been made in establishing an Andean system of standardization, accreditation, testing, certification, technical regulations, and metrology.

- Sanitary rules. The Andean Agricultural Health System promotes harmonization in phytosanitary and zoosanitary legislation. This mechanism is now being brought into line with WTO provisions.

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[18] Ceilings on national tariffs were also set in line with the lists negotiated in the WTO framework, which affected CET negotiations, as no Andean country may raise tariffs established in the said lists.

- Customs rules, notable among which the Common Tariff Nomenclature (NANDINA), rules for customs valuation, the Andean Declaration of Value, rules on customs transit, and a system for mutual assistance and cooperation among Member Country customs administrations.

- Rules to facilitate transportation between countries. In this area, however, there remain many problems to be resolved regarding the free circulation of goods.

- Rules on intellectual and industrial property. In this area, modern and complete rules exist, contained in several Decisions, among which may be noted the new Common Industrial Property Regime, adopted in 2000.[19]

As regards the institutional framework, settlement of disputes is another aspect where progress was made. When one of the parties considers that his interests have been affected, he may have recourse to the Andean Court of Justice. The General Secretariat is the body with responsibility for administrative investigation (also known as the pre-contentious phase), for determining state responsibility for failure to comply and for monitoring of the consistency of the provisions comprising the Andean Community's legal system, consisting of the Cartagena Agreement, the Protocols thereto, the additional instruments, the Treaty Creating the Court of Justice, the Decisions of the Commission, and the Resolutions of the General Secretariat. The Court has responsibility for ensuring compliance with the provisions. It may nullify them if they contravene Community legislation, may rule on compliance with rules, and has responsibility for interpreting such provisions as may be adopted when their intention is unclear. Based on the Protocol of Cochabamba, which entered into force in August 1999, natural persons and legal entities may have direct recourse to the Court in cases of a Member Country's failure to comply with Andean Community provisions.

Since early 2000, the Court has ruled in 26 cases of non-compliance, Ecuador (10) and Venezuela (7) being the countries against which most cases were brought; 4 nullity actions, two of which were brought by Ecuadorian companies, and the two others by Colombian firms; 129 prejudgment interpretations, requested mainly by Colombia and Ecuador, and one request for review made by Ecuador. Most of the cases reaching the Court relate to trade in the agriculture and livestock sector where, among other things, surcharges and import licenses have been imposed. This activity clearly indicates that the Court is becoming an important institutional authority in deciding cases and imposing sanctions for failure to comply with Andean provisions.

Complete or partial provisions exist in several areas. The authorities of the Andean system are empowered to issue decisions in these areas. Among the most important are:

- Dumping, subsidies, safeguards, and free competition: although provisions exist, there are several legal lacunae in this area. (Such provisions are Decision 456, when products affected by dumping and subsidies are of Andean origin, Decision 283, when products affected by dumping and subsidies are of third country origin; and Decision 457 and Decision 285 on trade restrictive practices). Different studies are being made of Secretariat proposals to correct existing defects.

- From 1991 to late 2001, the CAN Secretariat investigated only 16 dumping cases, although recently, the rate has been increasing. Of these, two cases related to third countries. Only one dumping case is now under investigation.

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[19] For greater detail, see Annex I.

- From 1992 to 1999, 12 cases involving safeguards were brought, most by Colombia.

- Decision 285 regulates free competition. From 1996 to 1997, only two cases were brought under Community provisions.

As may be seen from the cases summarized in Table 4, cases of disputes over application of Community provisions officially brought before its legal system are relatively few considering the scale of trade. This may stem from various factors, among which may be mentioned the legal system's long-term lack of credibility, lack of awareness on the part of those concerned regarding their rights under the system, the search by governments for negotiated solutions before recourse is made to the legal system, and lack of capacity to provide conclusive evidence in some cases. This is another topic warranting more in-depth study in the future.

TABLE 4
ANTI-DUMPING, SUBSIDY, AND SAFEGUARD CASES
BROUGHT BEFORE THE ANDEAN COURT OF JUSTICE

OrigIn of product	Country making complaint	Provisional Decisions	Final Decisions
Anti-dumping 1991 - May 2001			
Bolivia = 1	Bolivia = 0	Yes = 4	Yes = 7
Colombia = 8	Colombia = 4	No = 9	No = 4
Ecuador = 4	Ecuador = 2	Pending = 0	Pending = 2
Peru = 1	Peru = 5	Investigation suspended = 3*	Investigation suspended = 3*
Venezuela = 4	Venezuela = 5		
Other = 2			
Total cases = 16			
Number of cases from 1998 to July 2000 = 8			
Subsidies 1992 - November 2001 (two cases in 1992, one in 1999)			
Venezuela = 2	Colombia = 2	Yes = 0	Yes = 0
India = 1	Peru = 1	No = 2	No = 1
Total cases = 3		Investigation terminated by country making complaint = 1	Investigation terminated by country making complaint = 2
Safeguards 1991 - 1999			
All = 5	Colombia = 8		Yes = 2
Bolivia = 2	Ecuador = 1		No = 4
Colombia = 1	Peru = 2		Duties suspended = 6
Ecuador = 5	Venezuela = 1		
Venezuela = 1			
Total cases = 12			

Notes: *Investigations were terminated in three cases from 1992 to 1994 at the request of the country making complaint.
Source: Echavarría and Gamboa [2000] CAN

D. Sectoral programming in the automotive sector

Sectoral programming was incorporated into the original version of the Cartagena Agreement as a resource allocation mechanism designed to promote balanced distribution of investment opportunities. Pursuant to the provisions of the Agreement in this area, a Decision was adopted that allocated investment projects to Member Countries. Subsequently, in 1993, Colombia, Ecuador, and Venezuela adopted a Community policy which, in 1999, gave rise to a new Complementarity Agreement, which entered into force on January 1, 2000, with a life of 10 years. The agreement is renewable for a further 10 years. This new Agreement brings the Andean regime into line with WTO provisions by eliminating, among other adjustments, provisions on subregional content. The Agreement contains CET provisions for sector products, ranging from 35% for heavy vehicles to 15% for lighter vehicles (10% in the case of Ecuador). The Agreement provides for the incorporation of other Member Countries, who may accede on accession conditions that would be negotiated at the time.

The agreement essentially governs trade between Colombia and Venezuela. The ratio of exports towards the subregion to total exports for the three signatory countries to the Agreement is nearly 100%, in contrast to the situation of Peru and Bolivia which, moreover, produce almost none of these goods. Trade in these products takes place mainly among the three signatories, as Bolivia and Peru satisfy national demand with vehicles of third country origin. Venezuela is the largest exporter to the region, with annual exports of nearly US$ 200 million. Colombia's annual exports average US$ 80 million and Ecuador's annual exports average US$ 53 million.

E. Agricultural development program

The Community's agricultural sector has shown signs of stagnation, with moderate growth in some countries. The after effects of the El Niño phenomenon and international crises, with the resulting impact on prices for the main primary agricultural products has had heavy impact on sector development. There have been no major changes in Andean agricultural policy applied in recent years. Notable is the diversity among the countries as regards their degree of involvement in policy formulation. Colombia applies a variety of agricultural support mechanisms (additional variable duties, countervailing duties, minimum import prices, approvals, safeguards, warehousing incentives, crop absorption agreements, among others). Bolivia's support policies are limited to public expenditure made by the state.

Even at a time when policies applied by the countries are limited by commitments made by the countries in the framework of the WTO's agriculture agreement, their heterogeneity as regards their extent of intervention indicates the need to follow up on such policies and promote their harmonization in cases implying distortions of competition.

The Andean countries apply a common agricultural policy whose main elements are the Andean System of Price Bands (ASPB), the Andean Agricultural Health System, and other sectoral instruments. In 2000, provisions were issued for the adoption and implementation of a new Andean Common Agricultural Policy. In 2001, this mandate was renewed and the Andean Presidents agreed on the need to adopt it with a view to moving ahead in building a Common Market.

The Andean Agricultural Health System establishes the principles, criteria, and procedures for the protection of the condition of plants and animals, and facilitates trade in these products and some of their inputs.

The ASPB is a mechanism adopted through Decision 371 to stabilize import prices for a group of special agricultural products, characterized by marked international price instability. Stabilization is achieved by increasing the *ad valorem* tariff when the international price falls below the floor, and reducing the tariff down to zero when the price rises above the ceiling. That is, the price band in effect converts the tariff into a variable adjusted automatically to offset international price fluctuations. The System's mechanism has been applied mainly by Colombia, Ecuador, and Venezuela.

The system has, however, been criticized on various fronts which are summarized by Echavarría and Gamboa [2000]. The ASPB includes variable tariffs, which perforate the CET agreement. This is also a practice prohibited in theory by the WTO. In addition, application of the ASPB generates trade distortions. First, it has led to excessive protection of trade in the goods it includes, in both nominal and effective terms, rather than confining itself to price stabilization. Secondly, the tariff commitments made by Ecuador and Venezuela are lower than those made by Colombia, which has contributed to diminishing still further the ASPB's stabilization capability as, in comparison with Colombia (the only country where the ASPB is fully operational without exception), their prices for primary agricultural products are lower, thereby generating distortions in intra-subregional trade. Third, the protection afforded farmers under this system has worked to the detriment of the processed food industry, as it does not allow it to procure inputs at more competitive prices. Lastly, the high levels of protection have generated problems with countries exporting such products towards the Andean countries.[20]

The Andean Presidents have been highly pragmatic in addressing this wide-ranging criticism. At the recent Meeting of the Andean Presidential Council, in Santa Cruz, a Common Agricultural Policy was proposed providing for reduction of range of products to the price band applies and for the creation of mechanisms guaranteeing transparency in the price stabilization system, to effectively guarantee such transparency better than a protection mechanism does. Negotiations must immediately be launched in connection with the Declaration; what the reaction of some interest groups may be remains unclear. What is important is that the Declaration establishes that the integral competitiveness of agribusiness chains must be preserved.

The third element of the Common Agricultural Policy deals with production chains created to promote sector development. Based on this policy, Ad Hoc Groups have been formed by agribusiness chains, comprising representatives of agricultural producers, agribusiness, and the government of each Member Country. The following groups have been established thus far: Rice (created in 1999), Sugar (created in 2000), Feed Grains – Balanced Feed - Poultry (created in 2000), and Feed Grains for Human Consumption (created in 2001). There has been a request to set up a Coffee Group and overtures have been made to create the Oil Seeds Group. The purpose of these groups is to make recommendations for the consolidation of the Andean Customs Union, to move towards building the Common Market in the framework of their chains, and to handle cases of Community policy instrument administration and operation. Another of their functions is to design and possibly follow up on subregional competitiveness programs for the chain as a whole. Since their creation, these groups have met frequently. Mention must be made of the work of the Feed Grains – Balanced Feed – Poultry Group, which prepared recommendations that have resulted in the approval of Decision 496 to modify the adjustment factor for yellow corn and Decision 497 to include seasoned chicken parts in the chicken parts price band.

F. Liberalization of trade in services

In 1998, the CAN Commission approved Decision 439, which establishes the general framework of principles and provisions for liberalizing the trade in all service sectors (except those provided in carrying out government functions and air transportation) and diversifying the supply of services, by gradual elimination until 2005 of restrictive measures affecting national treatment and market access.

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[20] For further information on this and other criticism, see Echavarría and Gamboa [2000].

Decision 439 also addresses certain sectoral developments. Under that Decision, in 1999, provisions on telecommunications and tourism were adopted, in addition to the transportation provisions adopted earlier. Others are in process of adoption, such as those on financial services and recognition of professional licenses. In June 2000, directives were issued to ensure full compliance with deregulation of trade in services and for the development of intra-Community trade in services.

As regards exceptions, Decision 439 adopts measures aimed at safeguarding public morals, maintaining public order and protecting the life and health of human beings, animals, and plants, etc. Such measures are to be implemented in proportion to the objective sought, may not have the purpose of protecting national services or service providers, and may not be applied in such a way as to constitute an unnecessary barrier to intra-subregional trade in services or a means of discriminating against Andean Community services or service providers as compared with the treatment afforded other countries.

The liberalization process established in Community provisions will be based on an inventory in which each Member Country sets out its national measures affecting the principles of market access and national treatment, which will be incorporated into Community legislation through a Decision to be adopted by the Commission. Such measures will gradually and progressively be phased out in annual rounds, until the process concludes in 2005, with the lifting of all measures contained in the inventory.

Andean provisions call for intensifying the liberalization and harmonization of provisions through specific activities. They also stipulate that any benefits obtained from the acceleration or deepening of the deregulation and harmonization of given service sectors or subsectors by agreement of two or more Member Countries will be extended immediately to any country in which that sector has already been deregulated and, by negotiation, to the rest of the Andean Community Member Countries.

As was established in the Cartagena Agreement, Decision 439 affords Bolivia and Ecuador special treatment, giving them longer deadlines by which to fulfill their obligations, and affording them temporary exemptions.

As regards origin, for services to enjoy the benefits of deregulation, Decision 439 provides that only those supplied by natural persons residing permanently in any of the Member Countries or by entities legally constituted, authorized or domiciled under national law and effectively conducting substantial operations in the territory of any Member Country or supplying such services directly across the border from the territory of any Member Country shall be considered subregional in origin.

In addition to the general provisions, specific agreements have been concluded for the transportation, tourism, and telecommunication sectors. The progress made is described below.

Transportation

In the 1990s, the Andean countries focused efforts on the gradual deregulation of transportation services. The main Decisions adopted pertained, in maritime transportation, to elimination of reserved cargo; in air transportation, to application of the open skies policy; and, in ground transportation, to the principles of freedom of operation and deregulation. These were later supplemented with other Community provisions.

In 2000 and 2001, the activities mandated by the Andean Presidents to develop this sector were implemented, such as studies for the development of a Community transportation policy for all modes of transportation; completion of the inventory of measures affecting deregulation of maritime transportation; establishment of criteria to facilitate the implementation of international flights by subregional airlines; and updating provisions for the use of the Andean Highway System, among others. Several of these activities are now under way. The Community adopted a series of provisions to facilitate and deregulate transportation services in their different modes, thereby spurring the growth of intra-subregional trade and reinforcing subregional physical integration.

Today specific provisions are in place for all modes of transportation, including multimodal, which establish clearly and precisely the principles and criteria needed for efficient delivery of such services. For example, Decisions were approved to ensure the efficiency of transportation by road by spelling out the contractual terms and the responsibility of both carriers and users. For international transportation of goods by road, violations and the system of sanctions applicable to authorized carriers and criteria for rating the carrier's competence were also established. This was also the case for the minimum useful cargo capacity of vehicles, and the requirements of association contracts. The forms to be used by both national authorities and carriers were also developed.

In the case of international road transportation of passengers, a draft Decision on violations and the system of sanctions applicable to authorized carriers is now in the final stages of adoption, as are draft Resolutions on criteria for rating carrier competence. This is also the case for control of international road transportation of passengers. In early 2001, the CAN countries adopted the Andean Technical Regulations on Weight and Size Limits of the Vehicles used in the International Road Transportation of Passengers and Cargo to make for greater safety in transportation, as well as to maintain Member Country highway systems.

In the area of maritime transportation, the reserved cargo was eliminated at the subregional level, thereby reducing freight costs significantly and increasing hold capacity for the trade in goods. Subsequently, the Policies for the Development of the Merchant Marine in the Andean Countries were established to harmonize maritime transportation policies and to enhance the competitiveness of companies working in that sector.

Improvements were also made in mechanisms to enable the Member Countries to act as a Community in dealing with third countries that commit discriminatory acts against subregional ocean carriers. In particular, in 1996, regulations were approved to be applied by all Community countries regarding the principle of reciprocity in maritime transportation.

In late 2000, Decision 487 on Maritime Guarantees and the Arrest of Ships was adopted to promote and strengthen merchant marines of the subregion by providing modern legislation in this area (mortgages and maritime liens) with a view to affording sufficient maritime transportation investment guarantees.

As regards air transportation, the open skies policy within the subregion was established. The Community moved from exclusive rights for national airlines to provide international air service to such rights being enjoyed by a larger number of companies, with free access to the market, unimpeded by discrimination of any kind. New routes, new airlines, and better customer services were the result. In addition, the concepts of "scheduled fights" and "non-scheduled flights" were defined, in accordance with International Civil Aviation Organization (ICAO) guidelines. Provisions were also established for "multiple designation" of airlines in Andean subregional air transportation. However, this topic is being evaluated by the Andean Committee of Aviation Authorities (CAAA) and the General Secretariat.

In the area of multimodal transportation, community provisions have been adopted that regulate intra-subregional operations. These provisions create the appropriate legal conditions to promote and bolster the supply and delivery of multimodal transportation services. To that end, the regulations on the Register of Multimodal Transport Operators have also been approved.

As regards Community provisions regulating multimodal transportation, it has become necessary to update those pertaining to international customs clearance to facilitate the free circulation of goods, with a view to streamlining customs procedures. This includes the use of international customs clearance documents and information exchange systems, and the establishment of post-clearance controls.

Tourism

A three-pronged approach is being taken to the development and integration of tourism in the Andean Community: deregulation of tourism services, implementation of tourism projects of Community interest, and elimination of obstacles to intra-subregional tourism flows. In order to move ahead in each of these areas, the Andean Committee of Tourist Authorities has taken measures to eliminate the barriers to free access to the market and to national treatment of tourism services and services providers; to identify priority projects, particularly those linked to intra-subregional and border tourism; and to eliminate obstacles to tourism flows, all of which should be completed by December 31, 2002.

Telecommunications

The Andean Presidents have issued guidelines on and mandates for the implementation of a series of activities to promote telecommunications and information technologies, and have adopted provisions on e-commerce and interconnectivity among the Member Countries, approved a program to promote the Global Information Society, and to create CAN centers of excellence, among other things.

Recent years have witnessed a rapid growth in subregional telecommunications due, among other things, to worldwide technological changes, national privatization efforts launched in the 1990s, and the rapid deregulation of basic telecommunication services. Progress made within the Community is based on a broad series of provisions, together with Presidential guidelines and mandates.

In 1999, the Andean countries agreed to deregulate all telecommunications services, with the exception of radio and television broadcasting, as of January 1, 2002, in order to eliminate all barriers to free trade in the sector. In June 2000, the Indicative Actions for the Creation of the Andean Common Market were established, setting out lines of action to promote telecommunications and information technologies, and Community provisions were approved on electronic commerce; harmonization of requirements and procedures for granting professional licenses and common definitions of telecommunication services; establishment of common standards for interconnectivity among Member Countries; harmonization of the use of the radio spectrum, numbering and portability; creation of CAN centers of excellence; awarding of service plans for satellite broadcasting and fixed satellite service; and approval of a program to promote the Global Information Society.

The Andean Committee of Telecommunication Authorities (CAATEL) has moved ahead in several of these areas. In July 2000, a work plan was adopted that includes four priority tasks: the Strategic Plan for the Development of Andean Telecommunications; identification of Community projects to be implemented through the use of the Simón Bolívar satellite system capacity; a study on implementation of IMT-2000 bands in the Andean region; and a review of CAATEL’s regulations to update them to reflect the new Andean Community organizational structure.

Satellite project

The regulatory framework for the establishment, operation, and exploitation of Community satellite systems was established in 1996, and supplemented and expanded in June 2000. First, companies were authorized to establish, operate, and exploit satellite systems indirectly, in the exercise of rights granted to them under Community authorizations, and to adopt business schemes involving partnerships with third parties, in keeping with Community provisions. Later, the application submitted by the firm ANDESAT, S.A. EMA was approved to operate the Simón Bolívar Andean Satellite System indirectly. This included the establishment of BOLIVARSAT, S.A. a consortium under the strategic leadership of the French firm ALCATEL SPACECOM.

ANDESAT S.A. EMA comprises 44 Bolivian, Colombian, Ecuadorian, Peruvian, and Venezuelan firms that have undertaken to implement the project by drawing on their own funds of roughly US$ 350 million. The company has also made significant headway toward the establishment, operation, and development of the satellite system and expects to put the Simón Bolívar satellite into orbit and have it operational by the third quarter of 2003.

In general, it may be said that the process of deregulating trade in services is in the initial phase of establishing an institutional framework. The progress made in certain areas, such as those described above, reflects the specific interests that have been brought to the fore by the countries or the Secretariat rather than comprehensive deregulatory activity. As soon as existing restrictions have been lifted completely and the process of gradual elimination is agreed, it will be seen whether it is possible to attain the objective of free trade in services by 2005.

G. Free circulation of capital

The Andean countries have opened their doors fairly widely to foreign investment and have begun the process of deregulation of financial flows, including flows of foreign capital into banking and financial entities. This in recent years has led to a degree of general opening to capital flows. In contrast to earlier decades, there is considerably more free circulation of capital, both intra-subregionally and capital of third country origin. This results more from the adoption of national policy than from activity directly related to integration. As will be seen in further detail in the following chapters, this has given rise to a greater, though still reduced, flow of intra-subregional investment, and has led authorities to focus on launching efforts to harmonize policy in areas such as bank supervision.

In that connection, in 2000, the Andean Presidents agreed that the approach to the free circulation of capital would be based on cooperation and consensus activities carried out by national sectoral entities. They agreed to affirm that the elimination of restrictions on the circulation of capital was a fundamental factor in the operation and development of the Andean Common Market. Two specific areas are discussed below: Community provisions adopted on investment; and Andean Multinational Enterprise.

Investment

Provisions on the adoption of a common investment regime were included in the Cartagena Agreement as a policy harmonization measure for the integral development of the Andean area. In 1970, Decision 24 was adopted which, in keeping with the import substitution model in vogue at the time, contained restrictive elements. However, this Decision was amended on different occasions until the adoption of the text currently in force.

In 1991, the Regime for the Common Treatment of Foreign Capital and Trademarks, Patents, Licensing Agreements and Royalties was approved in Decision 291. The provision grants foreign investors the same rights and obligations as Andean nationals (without prejudice to the provisions of national law in this area), along with the right to transfer net profits abroad upon substantiation that they derive from investors' direct investment; eliminates all types of prior authorizations to which foreign investors had been subject (only the "register" remains so that states may verify compliance with technology contracts); and opens the subregional market to products produced by foreign companies, provided they comply with the corresponding rules of origin.

It should be noted that, for example, according to *Investment Policy Review* of Peru (UNCTAD [2000]), in a survey conducted by UNCTAD in 1998 on standards of treatment of foreign investors, Peru received relatively high marks, even higher than average marks for the OECD countries, the non-OECD countries, and the general average. The principles evaluated in the survey were national treatment, non-discrimination, repatriation of profits and currency convertibility, expropriation and compensation. This would indicate that, relatively speaking, Peru has a more open investment regime than those of its Andean neighbors. UNCTAD conducted a similar study in Ecuador, and its contributions have been considered by authorities in strengthening their investment promotion policy.

Uniform regime for multinational enterprises

The association of national investors in the Andean Community Member Countries is promoted by CAN in Decision 292 on the uniform regime for Andean Multinational Enterprises, in force since 1991. This Community provision grants a series of benefits for and incentives to the formation of Andean Multinational Enterprises (AMEs), which are companies including capital of subregional origin so as to benefit more fully from the enlarged market.

The AMEs and their branches enjoy national treatment as regards preferences and in the public procurement of goods and services. They also enjoy access to export promotion mechanisms in their area of activity on the same terms as national enterprises, provided that they satisfy the requirements imposed on such companies under the corresponding legislation. They may also take advantage of special import-export regimes established in the national legislation of the Member Country where the AME is headquartered and of the Member Country of its branch(es). They also have the right to establish branches in Member Countries other than the country of domicile. Their operations are subject to the provisions of the legislation of the Member Country in which they are domiciled.

In addition, foreign and subregional investors in an AME have the right to transfer abroad all net profits upon substantiation that they derive from their direct investment and payment of the corresponding taxes.

In regard to national taxation, AMEs and their branches enjoy, the same treatment as that established or as may be established for national enterprises in their area of economic activity, provided that they meet the same requirements imposed on such companies under the corresponding national legislation.

For purposes of establishing and operating AMEs, the right to enter and to remain in the territory of Member Countries is facilitated for promoters, investors, and executives of such companies for the time necessary to carry out their work.

H. Liberalization of the labor market: free circulation of people

One of the provisions of the Act of Lima, issued at the Twelfth Andean Presidential Council, held in 2000, indicates that the free circulation of people is an objective to be pursued progressively through the adjustment of national provisions, and taking into account the special characteristics of the traffic the respective border areas, entrepreneurs and businessmen, students, tourists, and the general public. The free circulation of people is one of the conditions necessary for the gradual establishment of the Andean Common Market, which is to be operational by December 31, 2005, at the latest and, in keeping with internal migration provisions, is a right of Andean nationals and foreign permanent residents in any Member Country. To that end, harmonization is needed of provisions on identification of persons within the subregion to facilitate the adoption of measures for their free circulation. Significant progress was made in 2001, in this area: creation of the Andean passport and of the Community national identity document.

Decision 503, which came into force on January 1, 2002, provides for the creation of the Andean national identity document. With that document, nationals of any Member Country may enter any of the others as tourists, without a consular visa, on the terms and conditions indicated in the Decision. Nationals of any of the Member Countries will enjoy the same rights as nationals of the Member Country that they have entered as tourists, without prejudice to national migration, public order, national security, and public health provisions. The competent national authorities will progressively standardize the national documents of the Member Countries and, with the support of the Andean Committee of Immigration Authorities (CAAM), will proceed to harmonize their respective immigration legislation. In that process, priority will be given to immigration requirements for students, businessmen, investors, and artists.

Decision 504 provides for the creation of the Andean passport as an instrument contributing to the consolidation of a Community mentality and cohesion among Member Country nationals and to identify the Andean Community internationally as a group of countries committed to a shared integration project. As indicated in the Decision, the passport will come into force no later than December 31, 2005, and may be used by nationals of the Member Countries in their migratory movements. The CAAM will follow up on the development of this matter in each Member Country every six months, as provided in the Decision, until use of the Andean Passport is fully instituted.

It should be noted that, in practice, only Venezuela requires visas for all persons entering its territory from Andean countries. However, none of the other countries require visas for Community nationals, apart from Bolivia, which has applied reciprocal requirements for Venezuelan nationals. Nonetheless, as a direct result of Decision 504, Venezuela has undertaken to lift this restriction on the unimpeded movement of people by December 31, 2004.

It will be seen that the process of creating an institutional framework for the free circulation of persons is at a very incipient stage. The steps being taken reflect the difficulty of creating a Community framework providing for the free circulation of labor in conditions of high levels of underemployment and unemployment in all Member Countries. The formation of an open market cannot be expected in the short term.

I. Integration and border development

The Community Policy for Border Integration and Development was adopted in 1999, as an essential element in strengthening and consolidating subregional and regional integration. In 2001, the Andean countries took an important step forward in this area in establishing the Community framework for the creation of Border Integration Zones (BIZs) and general provisions on the establishment, operation, and implementation of integral control via Binational Border Service Centers (BBSCs).

The immediate tasks are early implementation of the BBSCs with a view to facilitating the unimpeded movement of people, goods, and vehicles within the Andean Community, and the establishment of at least one BIZ. Social and economic development projects identified and evaluated by the Border Integration and Development Projects Bank will be carried out in these zones. That Bank started operations in late 2001, with the backing of the IDB and the CAF.

For the Member Countries, the border areas are natural places where their economies may be linked. They also constitute the point where national road networks may be linked, networks used for much of their trade and tourism. In view of this, provisions were issued to develop a work plan for the implementation of priority physical integration projects without delay. Provisions were also issued to prioritize integration and border development projects each year, along with those involving road and rail interconnection. Lastly, the Andean Regional Advisory Group – Inter-American Development Bank was created to define and present a partial list of joint projects for financing, with a view to border development in particular. The Advisory Group has been working – at the countries' request – on border development and integration by making assessments in border areas and designing strategies to move ahead in these areas.

For its part, the General Secretariat has issued provisions for the creation of a work team to manage the project on border development and depressed areas, whose aim is to develop an integral approach to Andean border areas and to formulate proposals on programs to incorporate border areas into the Andean economies. Work must be done to establish priorities among infrastructure development and risk investment projects in border areas. In particular, the General Secretariat will promote the improvement and efficiency of existing Binational Border Service Centers, and the installation of others at border crossings most used.

The criterion to be used in assigning priority among border integration projects is whether they contribute to strengthening the Community integration process by creating conditions for the consolidation of shared borders, by fostering progress in bilateral relations and enabling Community economies to involve themselves more fully in the international arena via road systems and port facilities.

J. Infrastructure

The Community has a road network of over 378,000 km in length, a rail network of some 10,000 km, and a river system linking some cities of the Amazon region. Community provisions governing the Andean Highway System are now being updated, which includes the incorporation of the respective road maps.

The development of adequate physical infrastructure and achieving free-flowing cross-border traffic is one of the most important approaches in the formation of an effective and well-organized Andean subregional area, especially if this takes place in the areas of energy, transportation, and communications, as these are areas of great impact in the economic integration process. All tasks undertaken in these areas will result in an increased share of Community products on subregional and global markets and, still more importantly, will promote trade, interlinking of Member Countries, greater circulation of people, and greater tourism activity.

Based on a CAF study of road infrastructure in the five Andean countries, some 45 projects to link the countries were identified, which will make it possible to establish a stable network communicating the subregion's countries. In 1993, of these 45 projects, 14 priority projects were selected, for a value of US$ 650 million, for which the engineering development phase has now been completed, and several projects are now under construction.[21]

In September 2000, the South American Presidents assigned priority to identifying infrastructure works of bilateral and subregional interest, and stipulated that financing of infrastructure projects for integration was to be shared by the governments, the private sector, and multilateral financing institutions. Thus, the Plan of Action for Regional Infrastructure Development in South America emerged, whose objective is to improve infrastructure for South American integration in three areas: energy, transportation, and telecommunications, with a view to promoting productivity and competitiveness.

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[21] Of the 14 projects selected, two will be executed in Peru and three in each of the other countries. Most are road construction projects. For further project details, see: *http://www.caf.com/espanol_old/05d01/cafset0.html*

At the two meetings of ministers for those sectors (2000 and 2001), the Plan of Action was established, which defined 12 priority integration areas and six sectoral processes. For each priority integration area and sector process, Executive Technical Groups (ETGs) will be organized, comprising experts from the countries. Thus far, three multilateral organizations (IDB, CAF, and FONPLATA) comprising the Technical Coordination Committee (TCC) have mobilized the launching of the three first integration priorities: the Andean Route, the MERCOSUR-Chile Route, and the Transoceanic Route; and the sectoral process of harmonization of regulatory frameworks for regional energy markets.

Through the operation of the Plan of Action, an exhaustive list has been drawn up of infrastructure projects, as has a multinational network for project identification, implementation, and follow-up. The national meetings consolidated the processes of planning; interministerial coordination in the three initiative areas (transportation, energy, and telecommunications); identification of infrastructure requirements; and dissemination of this regional integration process.

K. Social agenda

A basic objective of the Cartagena Agreement is ongoing improvement in the standard of living of the people of the subregion. Accordingly, the Community has undertaken to design and implement a Social Agenda promoting social welfare, health, labor, education, culture, and housing, by creating decent living conditions for the subregion's inhabitants, which enable them to develop their potential fully and comprehensively.

In that context, in June 2001, the Andean Presidents instructed the ministers responsible to draw up an Integrated Social Development Plan. In July 2001, instructions were issued to formulate a proposal to establish a committee for concerted social action to expand citizen participation in the integration process and to contribute views for the drawing up of the Social Development Plan.

As regards the welfare and labor aspects of the Andean Social Agenda, five thematic areas have been defined for the subregion in the area of welfare and labor: generation of employment, employment education and training, job health and safety, social security, and labor migration.

In May 1999, the Labor Ministers were asked to prepare a Draft Protocol Amending the Simón Rodríguez Convention, to adjust it to the new Community institutional system and the region's current socioeconomic environment. In May 2000, the formation of a network for coordination, information, and consultation among Community labor ministers was approved, with a view to follow up of policy coordination activities in the Social Agenda's five identified priority areas essential to the approaching entry into force of the Andean Common Market. Accordingly, in the May 1999-June 2000 period, priority items were identified that could be taken into account in implementing those five areas.[22]

L. The fight against illicit drugs

Meeting in April 2001, the Andean Presidents agreed to draw up a common Andean strategy in the fight against drugs and related offenses, and instructed the General Secretariat to prepare a draft. To that end, a workshop was held in Lima, Peru in May 2001, with the participation of competent officials in this area,

[22] For further detail, see the Andean Community's Web site, especially*: www.comunidadandina.org/agenda/sociolaboral.htm*

where a draft Andean strategy for the fight against drugs and related offenses was discussed and a document presented for approval at the following meeting of the Andean Council of Foreign Ministers.

M. The process of consolidation of Andean provisions

The Commission is the main Community body responsible for adopting provisions promoting the formation of the Common Market. Based on the treaty in force and the different protocols and additional instruments, an agenda for action has been established, which is translated each year into a program of activities by the Secretariat. This is approved by the Commission and serves as the basis for the technical work of the Secretariat and for certain other Community bodies. At this level, the governments define the legislative aspects of the integration process for priority consideration. The progress made in a given period therefore depends on governmental will to address any remaining legislative obstacles to perfecting the enlarged market.

The Decisions of the Commission cover many areas. For example, in 2001, Decisions were approved on institutional topics (such as the Statute of the Court of Justice), trade deregulation (updating of the Andean nomenclature, recognition and acceptance of certificates for products marketed in the enlarged market, and topics related to the agricultural price band), deregulation of trade in services (extending the deadline for drawing up national inventories, and tourism and transportation-related topics), and free circulation of people (Andean Passport and recognition of national identity documents).

For its part, the General Secretariat, in addition to preparing Draft Decisions that it proposes to the Commission and the Andean Council of Foreign Ministers, issues Resolutions on different topics assigned to it by the system's legal institutions. Most Resolutions issued by the Secretariat in 2001 related to agricultural development (in particular, the price band), while deregulation of trade is another area generating Resolutions under this mechanism. Resolutions are also issued, *inter alia*, on the Common External Tariff, trade competition, rules of origin, and intellectual property.

Under the Treaty, protocols, agreements, and additional instruments, Decisions of the Commission and the Court of Justice, and the Resolutions of the Secretariat, a series of legal provisions and precedents are being generated that establish the institutional framework for the formation of the enlarged market and the Community of Nations. The process is necessarily a gradual one, reflecting to a considerable extent the intent and will of the governments to continue to define the institutional framework. Despite the significant progress made in recent years, the process is still criticized, as the corresponding framework has not yet been formalized for some key aspects of the process, such as the definition of the Common External Tariff and elimination of certain national policy measures generating trade distortions.

N. Final remarks

Since its relaunch, the Andean integration process has made significant headway in defining its institutional framework, both legal and organizational, for the formation of the enlarged market and even a community of nations. This has been a gradual process, reflecting the level of intent on the part of Member Country governments to accept that the benefits of integration may and must be greater than the costs involved in making companies more competitive and ceding some degree of national sovereignty to a system wherein decisions are taken as a Community.

Progress is most visible in the establishment of the institutional framework through the adoption of provisions and in the establishment of a juridical system for the settlement of disputes, fostered in particular by the enhanced effectiveness of the Court of Justice. Many aspects related to the functioning of the enlarged market have been defined, especially in the area of trade deregulation. Nonetheless, gaps remain to be filled in crucial areas, such as the definition of the Common External Tariff and its supplementary provisions eliminating distortions of trade. The Presidents have determined that this topic is of highest importance to the process, and it will be the focus of Commission and national authority attention in 2002.

It is much more difficult to assess the contribution of the enlarged market to the development of trade and investment and the development of the countries. One of the system's biggest deficiencies is that there is a lack of evaluation of the institutional framework to establish whether in practice it is producing the anticipated results in terms of trade flows and the establishment of a framework that promotes subregional investment, whether by Community or international entrepreneurs. In the following chapters, an initial review of the situation will be made based on the information available, while underscoring that there is insufficient information regarding both Community entities and national governments. Conducting an open and in-depth study and evaluation of the effects of the Andean integration process must move to the top of the Community agenda, particularly within the General Secretariat. This evaluation process must include all those concerned, especially entrepreneurs who have to make decisions based on the existing institutional framework.

The recent meeting of Santa Cruz has given new impetus to negotiations to consolidate the process in an environment that had generated uncertainty regarding its future. However, a long and complex series of in-depth negotiations lies ahead, which must be concluded in 2002. It is to be hoped that the impetus given by the Presidents will enable that objective to be met, despite continued resistance on the part of some entrepreneurs, who fear losing certain advantages they enjoy under current arrangements.

Contents

CHAPTER III. MACROECONOMIC ENVIRONMENT OF THE ANDEAN SUBREGION

A. The Andean economies: recent trends

As a preliminary to analyzing various aspects of the Andean economies, Table 5 summarizes their main indicators in the 1998–2000 period in order to provide an overview for each country. The examination presented here is very superficial and seeks only to outline the general environment, affecting the involvement of the countries in the proposed formation of a Common Market.

Whether due to the effects of the international financial crisis or of the El Niño phenomenon, the Andean countries suffered the ravages of external phenomena, which became more marked in 1999 (while already exacerbated by each country's internal problems), followed by a brief recovery in 2000. This points to the vulnerability of the Andean countries, associated with their economies' dependence on raw material prices, particularly in the case of Venezuela. The fact that the trade balance relies upon the price of a few products puts the Andean countries in a very vulnerable position in the face of any external crisis. This is more pronounced when each country's inherent problems are considered, such as unemployment problems in Peru and Colombia or the banking crisis in Ecuador, further complicating efforts to address the crises.

In 1998, against a backdrop of international financial crisis – which led to the decline in prices for the principal Andean exports – these countries suffered a decline in prices for their exports, with a resulting expansion of the trade deficit. This problem was dealt with by national accounts adjustments, which generated widespread recession (with the exception of Bolivia, whose engine of growth was foreign direct investment (FDI). The crisis worsened in 1999, when these countries experienced even greater declines in product (with the exception of Peru, where growth was slight). In 2000, owing both to recovery in international prices and economic measures taken in each country, the countries showed a recovery in the level of product.

TABLE 5
RECENT TREND IN THE ANDEAN ECONOMIES, 1998-2000

Country	1998	1999	2000
Bolivia	The economy grew by 5.5% against a backdrop of price stability and low inflation. However, the trade deficit grew (resulting from a decline in prices for the main export products), as did the fiscal deficit, which was financed with external resources. Foreign investment, as part of the privatization process, spurred growth, which reached levels of over 10% of GDP.	Grew by 0.6%, due to the international crisis affecting external sector transactions, and to domestic factors, which led to a fall in domestic demand. Foreign direct investment (FDI) continued to grow. Although exports declined, the decline in imports was greater, with the result that the current account deficit fell to 6.5% of GDP.	Growth of 2.4%, fostered by the recovery of the external sector and increased exports of natural gas to Brazil. The crawling peg exchange policy was the most active in recent years. The current account deficit fell slightly to 5.7% of GDP.
Colombia	Year marked by unfavorable external factors that forced authorities to make macroeconomic adjustments against a backdrop of fiscal and foreign trade deficits. Monetary adjustments negatively affected the productive and financial sectors, and increased unemployment. The slowdown in economic activity and the consequent financial losses were reflected in growth of 0.5%.	Harsh cutbacks in private sector spending, provoked by the international financial crisis, resulted in the 4.3% decline in product and a leap in the unemployment rate to 19%. A reversal in capital flows led to a current account adjustment through devaluation and recession.	Moderate recovery (2.8%), but unemployment did not fall. The fiscal deficit of the non financial public sector (NFPS) fell to 3.7% of GDP, the balance of payments on current account closed in equilibrium and the downward trend in inflation continued. Industrial production and oil and non-traditional exports led the economy's growth. The financial situation continued to be fragile.

TABLE 5 (continued)
RECENT DEVELOPMENT OF THE ANDEAN ECONOMIES, 1998-2000

Country	1998	1999	2000
Ecuador	GDP practically stagnant, with meager growth of 0.4%. Inflation rose to 43.4%, the NFPS deficit reached 5.7% of GDP and the current account deficit in the balance of payments reached 11%.	Profound financial and exchange crisis, with serious monetary, fiscal and productive sector repercussions. GDP contracted by more than 7%, imports plummeted, unemployment increased to 15% and inflation accelerated to 61%. Toward the end of the year, the authorities suspended service of the external public debt due to the fiscal effect of sharp depreciation of the sucre.	The law on the economic transformation of Ecuador was enacted, laying the legal foundation for dollarization. Financial, labor and fiscal reforms as well as measures relating to privatization were adopted. Public debt held by private creditors was restructured. Dollarization was not reflected in an immediate drop in inflation, which reached 91%.
Peru	Economic growth fell by 0.5% as a result of the negative effects of the El Niño phenomenon on fishing and agriculture and the decline in prices for ores. In addition, the Russian default contracted capital flows toward the region and the Brazilian crisis increased the region's perceived risk. The government devalued the currency to address international reserve losses, but even so the current account deficit was 6.3% of GDP.	Product grew by 0.9%. Inflation reached a historical minimum of 3.7%. Economic recovery took place mainly in the primary sector. Credit austerity, financial difficulties in some sectors of activity and the persistence of negative expectations during much of the year led to a fall in domestic demand (-3%), which led to in a fall in employment (-6%) and a crisis in the financial sector.	Product grew by 3.1%. Private sector demand did not recover due to the political uncertainty and supply factors that had maintained the primary sectors dried up. Fiscal policy was more austere in order to control a fiscal deficit of 3% of GDP. The current account deficit fell to 3.3% of GDP and inflation held steady. Nonetheless, growth was insufficient to improve the labor situation.
Venezuela	The economy suffered a decline in oil prices, whose effects were exacerbated by the international financial crisis. The loss of one-third of the unit value of Venezuelan oil was the main cause of the recession (the year closed with growth at 0.2% of GDP). Public expenditure had to be cut as a result of the fall in oil tax revenues. Credit became more expensive as a result of the need to defend the exchange rate to fight inflation.	Economic recession combined with a rise in prices for oil exports. The 6% decline in product is explained by cuts in oil production implemented jointly with the main oil exporting countries, the goal being to reverse the price decline. Private activity remained depressed despite the decline in interest rates prompted by monetary policy. There was a substantial rise in unemployment.	Production rose by 3.2%, stemming from a rise in oil production, higher oil prices and, to a lesser extent, expansive fiscal policy based on greater income derived from oil sales. The crawling peg exchange rate policy helped to limit pressure on domestic prices. In this context, the current account showed a surplus. The high levels of unemployment fell somewhat.

Preparation: In-house.

Sources: CAN General Secretariat, ECLAC.

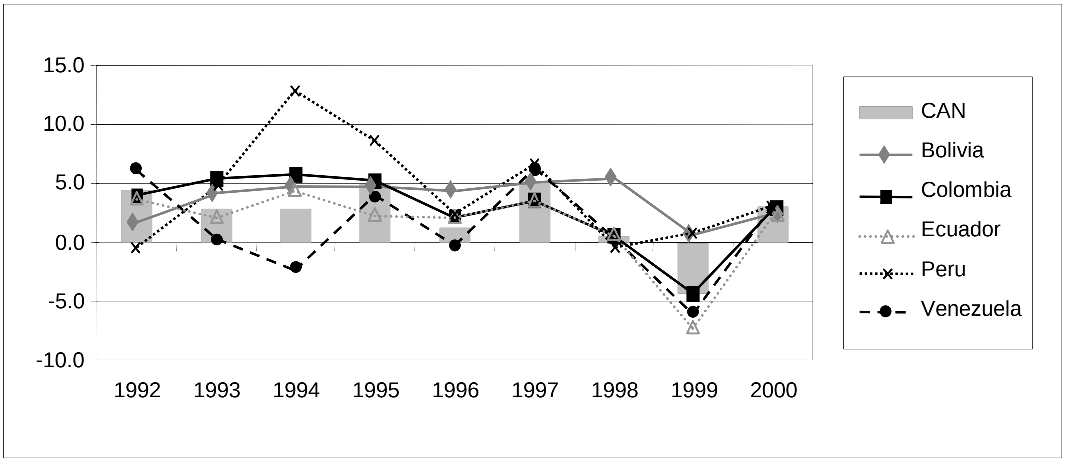
B. The dynamics of production

During the 1990s, the Andean subregion's average annual growth rate was 2.9%, higher than the world average of 2.5%[23] (see Graph 1 and Table 6). The country that grew most during the decade is Bolivia, with an annual average rate of 4.1%. Since 1985, Bolivia has been implementing intensive structural reforms and macroeconomic policies designed to stabilize its economy and expand production capacity. Ecuador, in contrast, showed the lowest growth rates, of an annual average of 1.9% for the same period. The average is so low owing mainly to the results for 1999, when the country showed a growth rate of -7.3%. The Ecuadorian economy contracted severely in 1998, and still further in 1999, due to internal and

[23] According to World Bank figures.

external factors: the presence of the El Niño phenomenon, the drop in oil prices, domestic and international financial crises and the growing fiscal deficit.[24]

GRAPH 1
DOMESTIC PRODUCT
(Annual growth rates, in millions of 1995 dollars)



Preparation: In-house.
Source: Andean Community.

TABLE 6
GROSS DOMESTIC PRODUCT
(billions of current dollars)

Countries	Bolivia	Colombia	Ecuador	Peru	Venezuela	CAN
1992	6	49	12	36	60	164
1993	6	56	15	35	60	171
1994	6	82	17	45	58	208
1995	7	93	18	54	77	248
1996	7	97	19	56	71	250
1997	8	107	20	59	89	282
1998	9	99	20	57	95	279
1999	9	87	14	52	102	263
2000	8	82	14	54	120	278

Preparation: In-house.
Source: Andean Community General Secretariat Subregional Statistical Information System, Decision 115.

The largest Andean economies are those of Colombia and Venezuela. Together they represent 69% of Community gross domestic product (GDP). While Colombia has an average GDP of US$ 83 billion for the 1992-2000 period, Venezuela averages US$ 81 billion over the same period. Peru occupies an intermediate position: it represents, on average, 20% of Andean GDP, twice that of Bolivia and Ecuador together.

In per capita terms, Venezuela has the highest GDP (US$ 3,614 on average for the period studied), followed by Colombia and Peru (US$ 2,112 and US$ 2,060, respectively). According to Warner (2001), in terms of

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[24] The Ecuadorian crisis will be discussed later.

per capita GDP growth rates for the period 1990-1999, the performance of the Andean countries is low within a 57-country ranking. Colombia occupies 46th place, Ecuador 51st, and Venezuela 52nd. Peru holds 17th place, but this results mainly from strong improvement based on the recovery from a severe recession in the late 1980s, rather than from long-term growth prospects.[25] Bolivia occupies 28th place, also resulting in part from its economic recovery after the difficulties encountered in the preceding decade

In the mid-1960s, the Andean countries showed per capita GDP at levels similar to those of the East Asian countries. Only three decades later, their per capita GDP was under half that of the Asian countries, which had achieved rapid growth. If they do not succeed in promoting more rapid growth in the next decade, the Andean countries may fall still further behind that group of countries. The Andean growth pattern is not consistent with the outward looking model of the Asian countries, because it has historically been linked to new natural resource discoveries and natural resource development, mechanisms that provide slow relative growth and great vulnerability to external shocks, together with the fact that these countries do not have industrial policies enabling their products to be promoted on foreign markets.

As for GDP by type of expenditure, it should be noted that on average for the 1991- 2000 period, in Bolivia, Ecuador and Venezuela, gross fixed capital formation showed the greatest rise, while in Peru and Colombia exports showed the greatest rise. The breakdowns are given in Table 7.

TABLE 7
GDP BY TYPE OF EXPENDITURE
(Average annual growth rates, 1991-2000)

	Bolivia	Colombia	Ecuador	Peru	Venezuela
Total GDP	3.8	2.7	1.8	4.1	2.1
Private consumption	3.5	1.7	1.1	3.5	1.3
Public consumption	3.3	8.4	-2.3	4.8	1.3
Gross capital formation	9.1	6.2	5.0	6.8	12.5
Gross fixed capital formation	8.7	5.2	1.6	6.5	4.1
Procurement minus transfer of valuables		70.1			
Exports	4.0	5.9	4.2	8.7	4.5
Imports	5.5	10.2	2.2	8.9	10.8

Preparation: In-house.
Source: Andean Community General Secretariat Subregional Statistical Information System, Decision 115.

As a group, the Andean countries did not experience rapid growth rates in the 1990s. The growth achieved was mainly associated with natural resource exploitation (both improvements in international prices and new strikes) or greater access to new sources of external financing, both of which are temporary by their nature. What that the subregion has not yet experienced is sustained growth associated with exports and external competitiveness. According to Warner [2001], two factors explain the slow growth of the Andean economies. The first is relative backwardness in terms of innovation and structural change generated by barriers to entry and limited incentives to innovation or technology transfer. The second is the high cost of

[25] For example, Van Ginhoven, Carrillo and Araoz [2001] show that the growth rate in the 1990s was linked more to expansion in demand than to a change in the pattern of growth. Although some important structural reforms were carried out, they were either not completed or were reversed at the end of the decade.

capital associated with import costs—including tariffs and domestic taxes—and the effect of a deficient communications and transportation infrastructure.

As will be seen later, the Andean economies must generate the conditions for sustained growth based on external competitiveness and exports, and the Andean integration process could contribute to this. This means that the barriers delaying this transformation in these countries individually and as a group must be eliminated. The data on the economies showing significant development in Southeast Asia, Europe and even the Americas suggests something quite logical: countries that have combined innovation, technology transfer, and flexibility (measured as the ease of businesses start-ups) showed favorable sustained growth trends in the 1990s.[26] Growth strategy must thus be based on technology transfer, flexibility, and exports (with high technological content), which would lead to accelerated growth in the Andean countries. Thus, the challenge is to build an integration process that will assist in developing national policies designed to improve the countries' ability to compete.

As for the first explanation of the slow growth shown by the Andean economies, barriers to entry and the lack of technological absorption, this is not just a matter of perception, as might seem to be the case based on various surveys conducted in this area, but is confirmed by data recently compiled by the World Bank (Djankov *et al.* [2000]), which include the average number of procedures required to begin a business, as well as the average time and cost invested in business start-ups. Of 55 countries included in the list compiled by the World Bank, arranged in the order of difficulty in starting a business, with the countries with the greatest barriers heading the list, Ecuador occupies second place and Venezuela third, while Colombia, Peru and Bolivia occupy sixth, seventh and eighth place, respectively. In Ecuador, for example, a businessman must carry out 12 procedures that take an average of 14 working days and costing an average of 15.5% of annual per capita income.

The fact that the Andean countries have low technological absorption and little innovation is also reflected in the composition of their exports, which do not contain high percentages of goods of high added value, but rather of raw material exports. The Andean countries depend to a large extent on primary activities such as agriculture (Ecuador and Colombia), mining (Peru), and oil and hydrocarbons (Bolivia, Venezuela, Colombia and Ecuador). However, some policies have been adopted to develop manufacturing activities of higher added value, so as to reduce vulnerability vis-à-vis fluctuations in raw material prices. This effort has been particularly successful in the case of Colombia, where manufactured products have come to represent a significant share of exports.[27] It is thus important to study production trends in these sectors. The agriculture, mining and oil, and manufacturing GDP is discussed briefly below.[28]

Agricultural GDP[29]

Before discussing growth in the agricultural GDP, it is important to have an idea of the scale of this activity within each country. Agriculture's percentage of GDP is highest in Bolivia, Colombia and Ecuador, at 14, 15 and 12% respectively,[30] for the 1991-2000 period. As will be seen below, Bolivia exports mainly soy-based products, while Colombia's main export is coffee. Fresh bananas are first

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26 Examples are Poland, Singapore, Ireland, and Chile.

27 This subject will be discussed in the chapter on trade and investment flows in the subregion.

28 The tables for these areas provided below only include data 1991-1999, the latter year being the last for which this breakdown was available when this report was being prepared.

29 Given the limitations of the data, the table presented below, whose source is the CAN General Secretariat, groups together agriculture, hunting and fishing, all primary activities.

30 Based on GDP at current prices.

among Ecuador's exports. For Peru and Venezuela, agricultural activity is not as significant, representing under 10% of GDP.

Growth in agricultural GDP for the subregion averages 2.5%. Average annual growth was more dynamic in Peru, at 5.4%, 1994 and 1999 being particularly successful years.

Agricultural production in the CAN Member Countries usually varies considerably, as shown in Table 8. This is one of the elements of macroeconomic instability that must be taken into account when studying the situation of the Andean countries.

TABLE 8
GROWTH IN AGRICULTURAL, HUNTING AND FISHING GDP (1)
(Average annual growth 1991-2000)

	Subregion *	Bolivia	Colombia	Ecuador	Peru	Venezuela
1991	4.9	9.9	4.2	5.9	1.9	2.5
1992	-1.5	-4.2	-1.9	3.4	-6.8	2.0
1993	3.5	4.1	3.2	-1.7	8.6	3.0
1994	4.8	6.7	0.9	3.9	13.9	-1.1
1995	3.1	1.4	3.7	3.2	7.5	-0.5
1996	3.1	6.7	-1.2	3.5	4.5	2.0
1997	3.3	4.6	0.7	4.1	5.0	2.4
1998	-0.9	-4.5	0.1	-1.4	0.7	0.6
1999	2.5	2.9	0.2	-1.3	12.6	-2.1
2000	2.3	3.0	5.2	-5.3	6.4	2.4

Preparation: In-house.
Note: (1) Includes forestry and logging. * Average.
Source: Andean Community General Secretariat.

Mining and oil GDP [31]

Growth trends in Peru in mining have been quite dynamic, showing an average annual growth of 8.1% for 1991-2000, i.e., five times the Bolivian growth rate and three times that of Venezuela. Peruvian traditional mining exports represent an average of 45% of total exports in 1991-2000 (Central Reserve Bank of Peru). This was possible owing to large FDI flows absorbed by the mining sector in the decade, with the consequent discoveries of new deposits. In recent years, Peru has been among the world's leading producers of the principal metals. For example, in 1998, it was the second highest producer of silver and the third highest producer of lead, tin and zinc (as for data from *Sociedad Nacional de Minería, Petróleo y Energía del Perú*). In the 1993-1999 period, the Peruvian mining sector received almost one-fifth of the total FDI flows (UNCTAD [2000]).

As for oil, Bolivia was the most dynamic country in the 1991-2000 period, with an average growth of nearly 8%, directly related to its annual volume of fuel exports.[32] The oil sector represents 2% of Bolivian

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[31] There is a problem in analyzing this section: in Colombia and Ecuador mining and oil are lumped together for purposes of GDP calculations. Thus, these figures can only be broken down for Bolivia, Peru, and Venezuela, rather than for all five countries.

[32] According to information from the DATAINTAL System of Statistics on External Trade. SITC Rev. 3, Chapter 3.

GDP (at current prices) and accounts for 9% of that country's exports.[33] Venezuela, a country where the oil sector accounts for a larger percentage of the GDP (16% on average for the 1991-2000 period, at current prices), showed less momentum, and Peru showed negative growth (Table 9). The Peruvian oil and natural gas sector represents 1% of GDP (at current prices).

TABLE 9
GROWTH IN MINING AND OIL GDP

	Bolivia		Colombia		Ecuador		Peru		Venezuela	
	Mining	Oil	Mining (1)	Oil	Mining (1)	Oil	Mining	Oil (2)	Mining	Oil
1991	3.3	0.7	-0.6		5.0		5.6	-1.2	-18.8	10.3
1992	1.6	0.9	-3.8		6.7		0.8	1.3	17.0	-1.2
1993	8.3	2.4	-1.5		5.9		10.9	7.4	11.4	7.1
1994	0.0	8.6	1.6		7.6		15.2	-0.6	10.6	4.7
1995	10.1	3.3	14.6		0.6		7.2	-9.5	8.4	-14.0
1996	-4.8	2.2	7.3		-0.5		6.8	-4.0	2.6	8.4
1997	0.2	14.1	3.7		1.8		10.8	-2.0	6.7	9.9
1998	0.3	13.0	14.1		-3.1		4.4	-0.2	-4.4	2.1
1999	-5.4	-4.5	5.1		-0.7		15.7	-6.9	-10.4	-9.5
2000	1.9	38.5	-5.4		6.8		3.4	-6.5	8.2	4.6

Preparation: In-house.

Notes: (1) Mining and oil GDP growth rate. (2) Includes gas.

Source: Andean Community General Secretariat.

Colombia and Ecuador include mining and oil in the national accounts as a single sector. These sectors occupy a very important place within the Ecuadorian economy (17%), as compared with the Colombian case (4%). In terms of momentum, the reverse is the case; on average these sectors are growing twice as fast in Colombia as they are in Ecuador.

Manufacturing GDP

The manufacturing sector accounts for a significant percentage of GDP in the Andean countries, from a minimum of 14% in Colombia to a maximum of 23% in Ecuador. Although Colombia's manufacturing sector has a lower relative weight as compared with its Andean neighbors, it is notable for its specialization in manufactured goods exports. As we shall see below, these reflect a smaller percentage of natural resource exports and are more diversified than the exports of the other Andean countries.

Table 10 shows manufacturing GDP growth rates, the Peruvian manufacturing sector having the highest average (3.8%) among Andean countries in the 1991-2000 period. As will be seen in the next chapter, Peruvian manufactured exports are basically derived from extraction activities, such as mining. Bolivia and Ecuador show similar rates of growth (3.4% and 3.3% respectively).

[33] *Ibidem.*

TABLE 10
GROWTH IN MANUFACTURING GDP (1)

	Subregion	Bolivia	Colombia	Ecuador	Peru	Venezuela
1991	5.6	4.8	0.8	6.3	6.2	9.8
1992	1.0	0.1	4.5	1.3	-3.3	2.5
1993	3.6	4.1	1.6	6.9	3.4	1.9
1994	5.1	5.4	1.6	6.9	16.6	-5.3
1995	6.5	6.8	5.5	6.9	5.5	8.0
1996	0.9	4.9	-1.4	2.7	1.5	-3.0
1997	3.8	2.0	0.5	6.1	5.3	5.1
1998	-0.8	1.7	0.3	1.2	-3.2	-3.9
1999	-4.5	2.4	-10.2	-7.8	-0.5	-6.4
2000	4.6	1.7	9.9	2.4	6.7	2.1

Preparation: In-house.

Note: (1) Includes the primary and non-primary manufacturing sector.

Source: Andean Community General Secretariat.

C. Price stability, monetary management, financial market and interest rates

In recent years, Ecuador's inflation rates were unquestionably the highest among the CAN countries (see Graph 2). From 1996-2001, inflation averaged 50% in Ecuador, beginning to accelerate rapidly in the 1997-2000 period. In 1996, the Consumer Price Index (CPI) increased by 12% and nearly twice that (20%) in 1997 (According to data from the CAN General Secretariat). In 1998, the inflation rate doubled to 42%, declining thereafter. There were two events in 1998 that contributed to the rise in Ecuadorian inflation. The first was the climatic disaster (the El Niño phenomenon), which raised prices for many agricultural products and transportation costs. The second was the elimination of some subsidies, a measure taken as part of a stabilization program under an agreement with the International Monetary Fund (IMF). Thus, the year ended with inflation at 43.4%, quite far from the 25% target.

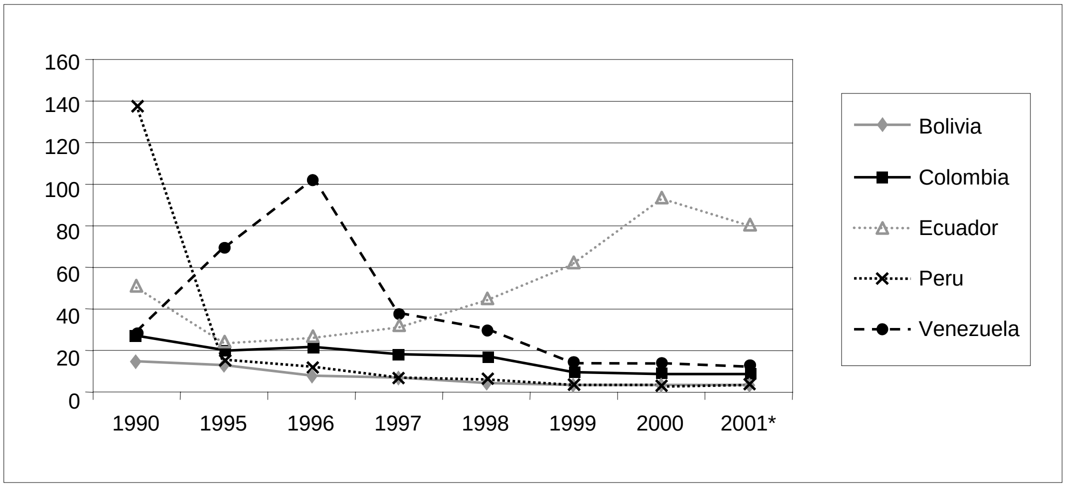
In 1999, sharp depreciation of the sucre and the large currency issues during the banking crisis generated strong inflationary pressures, which were not fully reflected in that year's CPI, owing to the contraction of domestic demand. In late 1999, the CPI rose by 60.7%, while the Producer Price Index (PPI) showed an increase of 186.9%. Although depreciation and large currency issues were suspended with dollarization, there was a drag effect, with annualized inflation increasing continuously during the first half of 2000, peaking at 107.9% in September, after which it began to fall until reaching an annualized level of 91.0% at year end. In turn, the PPI fell to 64.9%, reflecting a reduction in inflationary pressures.[34] During first quarter 2001, inflation fell to 3.3%, a marked decline in comparison with the previous quarter (data from IMACRO, CAN General Secretariat).

Venezuela, for its part, in mid-1997, managed to reverse the upward trend in its inflation levels. The moderate pace of nominal depreciation of the bolívar restrained rising import prices and led to a slackening in inflation, producing an annual increase of 13.4% at the end of 2000, the lowest level in the preceding 14 years. Thus ended four years of consecutive decline in inflation, falling from the three-digit level recorded in 1996 (103%).

The trend in inflation is generally downward, with the exception of Ecuador, where inflation has been rising. The situation in Ecuador, which differed from that of its Andean neighbors, is summarized in Table 11.

[34] ECLAC [1999], whose figures are consistent with those provided by the CAN General Secretariat.

GRAPH 2
INFLATION RATE
(as a percentage)



Preparation: In-house.

Source: Andean Community.

TABLE 11
THE ECUADORIAN CRISIS, A BRIEF REPORT

In 1998, Ecuadorian monetary policy played a part supplementing that played by exchange policy, and interest rates were used to defend the exchange rate band. Monetary policy was restrictive for most of the year, a period during which the principal monetary aggregates grew at rates below the rate of inflation. However, inflation continued to rise, as seen in the previous graph, accompanied by the growing instability of the banking system. Against this backdrop, nominal interest rates tended to rise throughout the year.

The Ecuadorian financial system had grown significantly during the 1980s, stimulated in part by incoming foreign capital flows attracted by high interest rates and the relative exchange rate stability provided by the exchange rate band. Weak bank supervision failed to note the growing weaknesses of the system, which were exacerbated by factors such as linked loans and uncontrolled offshore operations. Starting in 1998, the effects of the El Niño phenomenon on the productive sector's ability to pay, reductions in external capital flows caused by successive international crises, the repercussions of the tax imposed on flows of financial intermediation capital and the resulting effects on public confidence led to a crisis that affected the financial system as a whole. The Deposit Guarantee Agency [*Agencia de Garantía de Depósitos* - AGD),[35] created in 1998, reorganized 14 financial institutions, with holdings representing 65% of the system's assets.

In March 2000, fearing an imminent run on the banks, the authorities froze some deposits. Lifting of the freeze began in August, with different timeframes depending on the type of account. Measures to assist the banks reorganized by the AGD were financed by the Ministry of Finance, which issued bonds for bank reorganization and the payment of deposit guarantees. The bonds were sold to the Central Bank, which had a strong expansion effect and neither the decline in net international reserves (NIR) nor the open market policy[36] were sufficient to offset it. In addition, the situation was complicated by the fact that the banks paid off their obligations to the Central Bank with government securities or real estate. As a result, the monetary base grew by 136%. The weakness of the financial system and the freezing of bank deposits led to a strong preference for cash and money in circulation grew by 160%, while near money contracted by 3%.

To rein in the expansion of the money supply, in late 1999, the required reserve for sucre deposits was increased and interest rates were then raised. Given the ineffectiveness of these measures, the country opted for dollarization.

The fiscal cost of the banking crisis was some US$ 2.6 billion (20% of GDP in 1999, according to the IMF, without taking account of rescue operations undertaken by the AGD, the costs of the recapitalization of some banks by the AGD, or the interest rate differential between government bonds held by the Central Bank and market rates).

Sources: IMF, ECLAC.

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[35] This agency was created by the Economic and Financial Restructuring Law, which entered into force in December 1998. The AGD's mission was to reorganize financial institutions unable to honor their commitments and, with some exceptions, to guarantee savings deposits.

[36] Monetary stabilization bonds, which, according to ECLAC, increased by 236% from December 1998 to December 1999.

In the case of Peru, according to the IMF [2001], prudent monetary policy, combined with the structural reforms of the early 1990s (such as the start of privatization, allowing exchange and interest rates to fluctuate, and the elimination of distortions that limited financial intermediation) led to sustained reduction in inflation levels, increased net international reserves and an increase in financial intermediation. Real interest rates, which were negative in the late 1980s and in 1990, return to positive territory, and the extremely high nominal interest rates for the sol fell, with declining inflation.

In the Venezuelan case, the Central Bank's anti-inflationary policy is based, as mentioned above, on maintaining the exchange rate within a band of 7.5% either side of parity, a rate that had been devalued at the rate of 1.5% per month since January 1998, consistent with inflationary targets. In 2000, inflation continued its downward trend, reaching 13.4% per year (CAN Secretariat). The gap between the two rates had been shrinking, leading to pressures on the financial system, particularly the banks. The banking sector, with over 40 banks, was undergoing a consolidation process led by banks with foreign capital. The monetary base grew at 18% for the entire year, but concentrated in the final months of the year. Increased demand for money and bank lending activity was reflected in a 41% increase in sight deposits, revealing the active creation of secondary money that caused liquidity (M1) to grow by 31% (source, ECLAC). Greater liquidity meant that, in an environment of falling inflation, nominal interest rates continued to fall. The real active interest rates of the six major banks stabilized at 9.6%, while passive interests rates at 1.1% (IDB [2001]). However, the rates did not yield in real terms, and passive rates remained negative until late 2000.

In the Colombian case, in 2000, monetary policy sought to reduce the rate of inflation in a context of economic recovery. This was complicated by the country's monetary strategy, based on intermediate targets, as the type of monetary management used makes flexible and timely management difficult. Toward the end of 2000, the Central Bank of Colombia discarded this strategy and replaced it with a strategy based on the inflationary target. The "target inflation" scheme is based on setting multi-year inflationary goals, the purpose being to inform economic agents of the intent of the issuing institution, to lend greater transparency to monetary management, and thus to increase the credibility of the policy. In order to provide liquidity, the Bank engaged in open market operations. As for the monetary base, the money supply (M1) had expanded by 30% by the year's end, while the broadest monetary aggregate (M3+bonds) grew by only about 3%.[37] This is due to a reorganization of the demand for money that primarily reflected greater preference for liquidity caused by the tax on financial transactions, imposed in 1998, as well as the modest return on savings accounts as a result of low passive interest rates. The financial sector had encountered difficulties in the 1997-2000 period, but reorganization and capitalization measures were applied, which allowed for a gradual improvement in the quality of the portfolio (past-due portfolio/gross portfolio) which reached 16%, its highest level, in November 1999, and fell to 11% at the end of 2000. However, the financial sector's total portfolio continued to decline at the rate of 10% per year (IDB, ECLAC).

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[37] Data according to ECLAC. According to the IDB, the growth rate of M1 for the period between August 1999 and August 2000 was 38%, while the M3 + bonds aggregate remained relatively constant in nominal terms over the same period.

TABLE 12
INFLATION RATE
(as a percentage)

Country	1990	1995	1996	1997	1998	1999	2000	2001*
Bolivia	14.5	12.6	7.9	6.7	4.4	3.1	3.4	3.1
Colombia	26.8	19.7	21.6	17.7	16.7	9.2	8.7	8.5
Ecuador	49.0	22.8	25.6	30.6	43.4	60.7	91	78.7
Peru	139.0	15.4	11.8	6.5	6.0	3.7	3.7	3.9
Venezuela	31.0	70.8	103.0	37.6	29.9	13.4	13.4	12.0

Preparation: In-house.

Note: * Annualized inflation from January 2000 to January 2001.

Source: Andean Community General Secretariat.

In 2000, in view of Bolivia's economic condition, the Central Bank's monetary policy was designed to provide liquidity to the financial system and to keep money market interest rates low. That policy, without departing from objective of controlling inflation, sought to inject funds into the financial system in order to maintain the necessary liquidity in the money market and contribute to reactivating the intermediation of financial sector funds to the private sector. Monetary aggregates, which had contracted during the preceding fiscal period, continued this trend for much of the year, but recovered in the final months of 2000. In addition, a very important factor in the domestic performance of the Bolivian economy was the reduction of private sector bank debt, as credits extended to the private sector by the financial system fell by US$ 445 million (ECLAC). Thus, as the banks did not carry out portfolio operations, their liquidity levels rose, thereby reducing interest rates on deposits.

D. Fiscal policy

With respect to fiscal pressure—a central aspect in managing public finance equilibrium—Bolivia and Venezuela have, on average, higher levels of tax revenues as a percentage of GDP, 16% and 14% respectively. Ecuador has the lowest average, 10% (see Table 13).

In Bolivia, tax revenues rose to 18% of GDP, the highest level achieved in the review period (1998). In that year, government tax revenue rose faster than the GDP. Current revenue (which, according to the IMF rose by 33% over 1997) grew primarily because of higher taxes on hydrocarbons, whose percentage of GDP rose from 4.4% to 5.4%.[38] This rise was associated with the structural reform program undertaken by Bolivia, as well as privatization of the oil and gas company, Yacimientos Petrolíferos Fiscales Bolivianos (YPFB).[39] Domestic income also rose and a program to collect overdue tax was successfully implemented.

[38] IMF [2001]. The figure represents tax revenues from the hydrocarbons sector.

[39] Increased tax collection offset the reduction in YPFB transfers, which had previously been the main element of public finance in the past.

TABLE 13
CURRENT CENTRAL GOVERNMENT TAX REVENUE
(as a percentage of GDP)

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Bolivia	14.6	15.5	15.7	16.5	16.9	16.2	16.3	16.2	18.2	16.8
Colombia	9.3	10.6	11.2	11.5	10	9.7	10.1	10.8	10.5	n.d.
Ecuador	8.1	7.9	8.1	7.8	8.9	10.8	9.2	11.2	11.8	12.9
Peru	10.8	11.1	12.1	12.2	13.1	13.4	13.9	14.1	13.8	12.6
Venezuela	16.6	17.2	12.9	12.7	13.4	12.1	13.3	16.6	11.4	11.8

Preparation: In-house.
Source: IMACRO. Andean Community General Secretariat.

Noteworthy in the case of Venezuela is the decline in 1998 in tax revenues, which were 11.4% of GDP, as compared with 16.6% in 1997. Financial management of the Venezuelan central government was impacted by the sharp decline in tax revenues, resulting from plummeting world oil prices. Central government revenues from the oil sector fell from 13.3% to 7.6% of GDP.[40] Attempts to offset part of the decline in oil revenues with higher collections from other sources met with little success, although revenue from non-oil sources rose slightly from 9.9% to 10.3% of GDP.

As for fiscal results, on average, all the Andean countries showed deficits for the 1990-2000 period. Bolivia had the highest average fiscal deficit in the 1990s, of 3.7%. After having reached historic lows in 1995 and 1996 (Graph 3), beginning in 1997, the deficit began to grow. This was mainly due to the rise in pension costs, from 0.9% of GDP in 1995-1996 to 2.5% in 1997 (IMF [1998a]). Pension system reform replaced the previous system (a "pay as you go" system) with a private system based on individual retirement accounts, which raised the retirement age and increased coverage of the formal labor force.[41]

Venezuela, which in the 1991-1995 period was characterized by a decline in oil prices, political instability, and the banking crisis, in 1996 was already experiencing rapid inflation, pressures on its international reserves, a decline in non-oil GDP, and weakened confidence. Thus, in 1996, it implemented the "Agenda Venezuela" program of reforms designed to reduce levels of inflation, restore confidence, and generally improve resource allocation within the economy. Under that program, the Venezuelan economy underwent significant deregulation, to positive effect, particularly in 1996 (IMF [1998b]). Public finance grew much stronger, as the country moved from a deficit of 7% in 1995 to a surplus of that amount in 1996. This great change resulted mainly from the reversal of the state oil company's deficit, as well as those of other public companies. In addition, in contrast with earlier years when the banking crisis occurred (1994-1995), the central government did not provide financial assistance to banking institutions in crisis.[42]

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[40] IMF [1998b]. The figure for 1998 is preliminary.

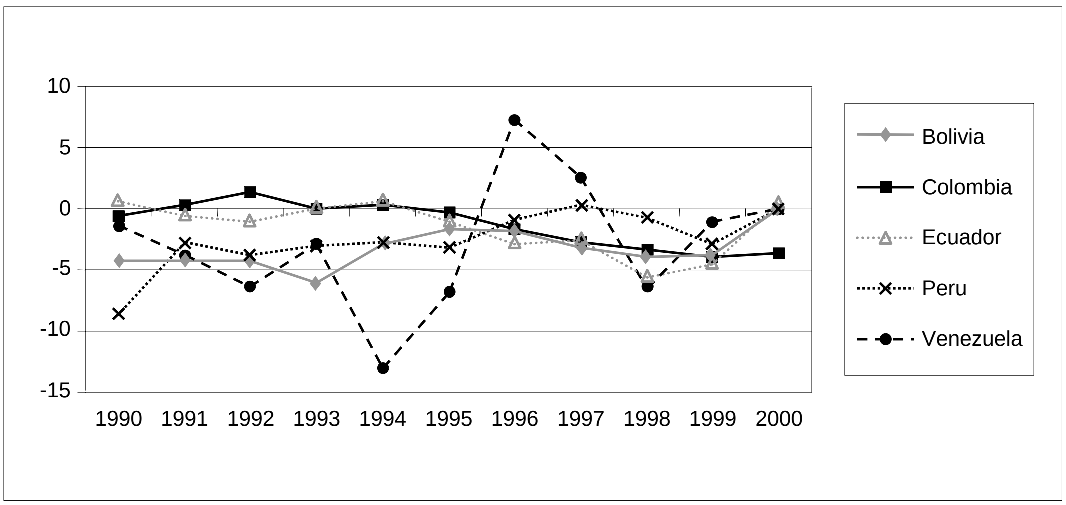
[41] For greater detail on reform of the Bolivian pension system, see IMF [1997].

[42] Representing 16.5% of GDP in that period.

Later, in 1998, the Venezuelan economy suffered the full impact of the fall in oil prices, a phenomenon with effects directly exacerbated by the international financial crisis. This created fiscal and current account deficits, in contrast with the surpluses of 1997. The situation improved in 1999, with the recovery of oil prices.

In Ecuador, the fiscal deficit reached its highest level of the review period in 1998, so much so that it was practically double that of the preceding year. The climatic disaster occurred in 1997, with damage - including losses of crops and the destruction of 2,500 km of roads and 19 bridges- amounted to approximately US$ 2.6 million (or 13% of GDP in 1998). In addition, the decline in oil prices caused the public sector to lose 3.5% of GDP in oil sector revenues as compared with 1997 (IMF [2000]). Public debt service continued to be a heavy burden, representing about 25% of current spending in the NFPS (ECLAC [1999]).

GRAPH 3
OVERALL EARNINGS OF NFPS
(As a percentage of GDP)



Preparation: In-house.
Source: Andean Community.

The debt situation of the Andean countries is summarized in Table 14. In Venezuela, there is a clear downward trend in public debt as a percentage of GDP; the trend is similar for total external debt as a percentage of GDP. In the other countries, although these indicators tended to improve early in the decade, they rose slightly at its end (in the case of Bolivia, Colombia and Peru). In Ecuador, these indicators showed a clear decline, stemming from the aforementioned crisis.

TABLE 14
DEBT INDICATORS

Year	Bolivia		Colombia		Ecuador		Peru		Venezuela	
	ED/GDP*	PD/GDP**	ED/GDP	PD/GDP	ED/GDP	PD/GDP	ED/GDP	PD/GDP	ED/GDP	PD/GDP
1991	75	68	41	34	89	87	75	64	68	54
1992	70	67	35	27	81	79	73	61	64	52
1993	69	66	34	24	70	66	75	63	69	57
1994	73	70	27	17	64	60	67	56	73	61
1995	71	67	27	15	76	68	63	50	51	44
1996	62	59	30	16	75	65	61	47	38	26
1997	57	53	30	15	75	62	49	33	35	25
1998	59	55	34	18	81	65	53	36	33	25
1999	56	55	40	22	113	95	55	39	37	24
2000	---	56	44	26	95	79	53	37	26	17

Preparation: In-house.
Notes: * External Debt / GDP. ** Public Debt / GDP.
Source: Andean Community General Secretariat.

TABLE 15
BALANCE OF PAYMENTS
(Millions of dollars)

Year	Subregion		Bolivia		Colombia		Ecuador		Peru		Venezuela	
	Curr.Acct.*	BP**	Curr.Acct.	BP	Curr.Acct.	BP	Curr.Acct.	BP	Curr.Acct.	BP	Curr.Acct.	BP
1991	1,559	5,417	-311	-124	2,347	1,876	-708	-356	-1,505	-788	1,736	3,182
1992	-5,574	194	-488	-140	876	1,167	-122	-467	-2,090	-716	-3,749	-1,139
1993	-7,814	-793	-462	-102	-2,221	206	-845	-673	-2,292	-657	-1,993	-653
1994	-4,714	1,458	-127	-50	-3,672	199	-901	-776	-2,555	-2,978	2,541	-893
1995	-8,070	-1,688	-368	-44	-4,599	-6	-994	-1,452	-4,123	-929	2,014	-1,126
1996	361	10,405	-332	292	-4,753	1,726	-38	-72	-3,429	-1,932	8,914	6,527
1997	-6,454	5,125	-553	103	-5,852	277	-459	-517	-3,056	-1,733	3,467	3,530
1998	-14,816	-6,073	-667	125	-5,162	-1,389	-2,100	-787	-3,634	-1,006	-3,253	-2,915
1999	1,863	-1,002	-488	26	-179	-319	942	-945	-1,969	775	3,557	1,049
2000	12,253	749	-463	-39	304	869	928	-5,708	-1,627	190	13,111	5,818

Preparation: In-house.
Notes: * Balance on current account. ** Balance of payments position.
Source: Andean Community General Secretariat.

E. External sector performance and exchange policy

Table 15 summarizes Andean balance of payments accounts in the 1991-2000 period. On average, the subregion showed unfavorable current account results, of over US$ 3 billion, while their balance of payments results have been positive, exceeding US$ 1 billion. Peru and Colombia have the highest average current account deficits.

In annual terms, it is important to note the decline in the current account balance between 1996 and 1997, stemming from the fact that imports rose much faster than exports in that year (19% vs. 5%), with the sole exception of Venezuela. Conversely, in 2000, the Andean current account balance was more than US$ 12 billion, due primarily to the high trade surplus of more than US$ 20 billion.

In addition, a change may be observed in the composition of the flow of capital to cover the balance on current account, which now consists essentially of foreign direct investment.[43] In particular, the importance acquired by FDI is reflected in two specific areas: in external sector financing and in support for the investment process.

The most marked changes in balance of payments figures are those of Peru and Colombia in 1998. In the case of Peru, the balance of payments closed with a positive balance of nearly US$ 1 billion, in contrast to previous years when the change in net international reserves (NIR) was negative. This despite the fact that the current account deficit rose by 19%. The trade deficit also rose by 43%, despite the decline in imports (3%), as the decline in exports was proportionally higher (15%).[44] This was one of the years in which incoming capital flows were higher. In the case of Colombia, in contrast to that of Peru, the balance of payments result was negative by more than US$ 1.3 billion, in contrast to results obtained in the preceding years. The capital account position fell as compared with 1997, when it was over than US$ 7 billion, while in 1998 it was US$ 4.2 billion. This was primarily due to a reduction in long-term financial flows, which fell from US$ 8.165 billion in 1997 to US$ 4.47 billion in 1998.

As for net international reserves (NIR), Venezuela showed the highest levels, averaging over US$ 11 billion for the 1992-2000 period. Colombia took second place, with an average of over US$ 8.6 billion, while Peru showed an average of over US$ 6.8 billion. However, the situation among the three countries changes when net international reserves in terms of imports are analyzed. Peru was the country able to import for the most months, taking account of its NIR, with an average of 12 months of coverage for the review period. Venezuela could purchase an average of 11 months of imports, while Colombia could only purchase 9 months. The most critical situation was that of Ecuador (Table 16).

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[43] This trend will be discussed in the chapter on trade and investment flows in the subregion.

[44] Data from the CAN General Secretariat.

TABLE 16
MONTHS OF IMPORTS BASED ON NET INTERNATIONAL RESERVES

Countries	1992	1993	1994	1995	1996	1997	1998	1999	2000
Bolivia	2	4	5	5	7	7	5	7	7
Colombia	13	10	8	7	8	8	7	9	9
Ecuador	4	6	6	4	6	5	4	5	4
Peru	6	8	12	11	13	15	14	15	13
Venezuela	8	9	10	7	15	14	11	12	11
CAN	9	8	9	7	11	11	9	11	10

Preparation: In-house.
Source: Andean Community General Secretariat Subregional Statistical Information Service, Decision 115.

TABLE 17
EXCHANGE REGIMES IN THE CAN COUNTRIES

Year	Bolivia	Colombia	Ecuador	Peru	Venezuela
1990	CF*	CP	CP	CF	CF
1991	CF	CP	CP	CF	CF
1992	CF	CP	CF	CF	CP
1993	CP**	CP	CF	CF	CP
1994	CP	Band	Band	CF	CP-Fixed
1995	CP	Band	Band	CF	Fixed
1996	CP	Band	Band	CF	Band
1997	cp	Band	Band	fc	Band
1998	CP	Band	Band	CF	Band
1999	CP	Band	Band	CF	Band
2000	CP	Float	Dollarization	CF	Band

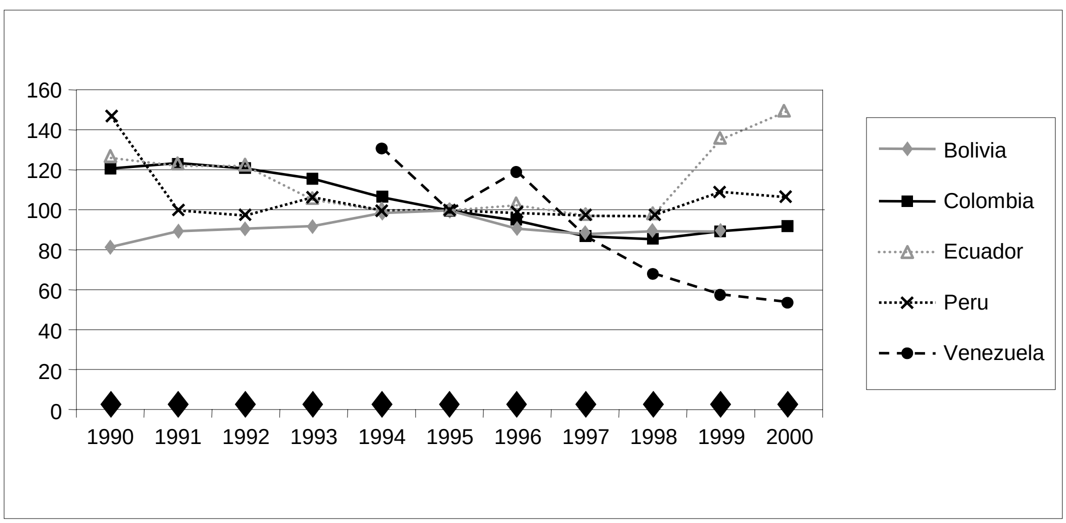
Preparation: In-house.
Notes: * Controlled Float. ** Crawling Peg (mini-devaluations).
Source: Andean Community General Secretariat [2001b].

As regards exchange policy, Table 17 summarizes the exchange regimes applied from 1990 to 2000 in each country. In the 1990s, in the North and South American context, the Andean countries had a unique statistic: they showed the highest average rates of inflation, above those in the Southern Cone and Central American countries. In that decade, the Andean countries also tried out different exchange regimes, moving from a crawling peg to an exchange band to a floating exchange rate system, seeking systems better suited to the stabilization efforts necessary for economic development. At the same time, in these years, the dollarization process moved ahead rapidly in three of the five Andean countries.

If we analyze trends in dollarization indicators, such as foreign exchange deposits/total deposits or foreign exchange portfolio/total portfolio, there is an upward trend for Bolivia, Peru and Ecuador (Andean Community [2001]). Based on the first indicator, Bolivia and Peru were already the most dollarized countries at the beginning of the 1990s. In 1990, 80% of Bolivian bank deposits were held in foreign currency, while 60% of Peru's deposits were held in foreign currency. In Ecuador, under 10% of bank deposits were in foreign currency. Nonetheless, that percentage grew markedly in Ecuador throughout the decade, to the point where, in 1999, slightly over 60% of bank deposits were held in foreign currency. Similarly, if we analyze foreign exchange portfolio/total portfolio, we see that both Bolivia, Peru, and Ecuador have high levels of dollarization: in 1999, the most recent year for which data is available, over 95% of Bolivia's bank portfolios were held in foreign exchange, while in Peru and Ecuador, the foreign exchange portfolio was some 80% of total portfolio (as for data from the CAN General Secretariat).

Graph 4 shows real exchange rate trends in the Andean countries. Two cases are to be noted: Venezuela, where the exchange rate deteriorated considerably, and Ecuador, where the reverse was the case. The remaining countries show a common trend. In the first case, in 2000 the real exchange rate fell to nearly half its 1995 value (in 1995, it was 100; in 2000, it was 53.5). This stemmed from the exchange policy applied in Venezuela of maintaining the nominal exchange rate of the bolivar against the U.S. dollar within the limits of a 7.5% band around a parity that had been devalued by 1.5% each month since 1996 (IMF [1998]). Within these parameters, the Central Bank of Venezuela intervened in the exchange market as a means of sustaining the reduction in inflation. This, in 1999, caused the dollar to rise from 564 to 648 bolivars, a rise in real terms of 10% over the preceding year (1998). Thus, the real exchange rate appreciated by over 50% over the decade.[45]

GRAPH 4
REAL EFFECTIVE EXCHANGE RATE
(base 1995 = 100)



Preparation: In-house.
Source: Andean Community.

[45] The rise in the real exchange rate is consistent with the figure provided by the CAN General Secretariat and shown in Graph 4. Source: ECLAC.

In Ecuador's case, the real effective exchange rate remained relatively stable until 1999, when it rose by 39%. In 2000, it rose by 11%. This rise resulted essentially from the depreciation of the sucre, i.e., to the rise in the nominal exchange rate, which was more than proportional to the rise in inflation, particularly for 1999, when the rise in the real exchange rate was higher. In 1999, the nominal exchange rate appreciated by 116%, while inflation rose by 40%. In 2000, the nominal exchange rate appreciated by 112%, while inflation rose by 50%. In this case, it should be noted that with dollarization, Ecuador has established parity, and any adjustment for inflation must be offset by decreased costs or increased productivity.

F. General characteristics of the economic process in the last decade

A review of the macroeconomic information outlined in the above pages enables us to draw certain general conclusions regarding the behavior of the economy in the Andean Community countries in the 1990s:

- The focus of economic policy in most CAN countries over nearly the entire review period was on attaining a significant reduction in inflation. This led to the adoption of policies that sought, through different methods and usually with the support of international financial organizations, to reduce the fiscal deficit, control expansion of the money supply, and reduce the current account deficit. Efforts to reduce inflation may be considered successful, even in Ecuador, where the last figures available indicate that it is managing to reduce significantly the price rise that occurred after the economic adjustment and dollarization.

- Growth rates in the Andean economies varied greatly during the review period, both from country to country and throughout the 1990s. Contributing factors include the effect of adjustment measures (Ecuador, Peru), fluctuating international fuel prices affecting some countries at specific times (spurring growth in Ecuador, Colombia and Venezuela and curtailing growth in Peru), the renewed international financial crises and their impact on access to credit and international investment flows, and the periods of political instability undergone by several countries, among other factors.

- In general, most of the policies adopted—such as tariff reductions, cutting back trade restrictions, simplification of tax structures and increased competition in the financial system and in services formerly provided by government—have been directed to improving the competitive position of producers. However, such measures have been applied with varying intensity in the countries, so that the impact on business costs has also been quite uneven. It is difficult to determine the impact on competition in the different sectors involved in intra-Andean trade. In order to determine how much the competitive position of the five countries has changed, particularly the sectors producing the majority of trade, it would be necessary to examine national and sectoral cases more thoroughly.[46]

- Although progress has been made in introducing structural reforms, more steps need to be taken to improve the competitiveness of Andean producers. It should be pointed out that, along with macroeconomic measures that might be considered, more attention must be paid to microeconomic measures affecting company start-up costs, growth, technological development and productivity.

- The countries show healthy growth in exports, with an interesting diversification among them, and a significant percentage of products of greater added value. However, exports of raw materials and

[46] Some work has been done in this area, but cases tend to be isolated.

light manufactured goods remain the principal source of foreign exchange. This means that the Andean economies are still highly susceptible to international price fluctuations, which is a potential source of external sector instability and means that sufficient international reserves are needed to cover falls in foreign earnings, thereby curtailing their negative impact on growth.[47]

- To be noted in the area of external debt is situation of Ecuador, which remains complex. Two countries, Peru, and particularly Bolivia—owing to their access to the Highly Indebted Poor Countries Initiative (HIPC)—have managed to reduce external debt ratios, while Colombia and Venezuela have indicators well below those of the countries in the region that are considered to most be at risk of default.

- With respect to tax policy, there is a wide range of available instruments. With the exception of Bolivia, with a fiscal pressure indicator much higher than that of the other countries, tax revenue as a percentage of GDP is low. In the case of Ecuador and Venezuela, the rise in oil prices has had marked favorable impact on collection levels. In this context, while the countries have been applying deregulation policy, they have also been reducing fiscal dependence on tariff revenues. However, as the value added tax is also applied to imports, in tax collection, considerable dependency on import levels persists.[48]

- In the financial sector, several of the countries faced severe bank solvency crises. This involved government intervention and considerable fiscal resources. It occurred despite the fact that most of the countries were taking prudent measures more consistent with international standards, along with steps to strengthen their regulatory authorities.

- Lastly, the countries have been adopting more liberal exchange policies. Policies currently vary among the countries, from dollarization in Ecuador to Central Bank interventions, more pronounced in some countries than in others. To be noted in this area is the impact of such policies on competitiveness, especially when account is taken of intra-subregional Andean trade, and the potential negative impact of a bonanza in foreign exchange revenues, whether resulting from transitory increases in export prices or a significant increase in remittances from abroad.

G. The convergence of macroeconomic policy in the integration process

The economic environment faced by the Andean countries both domestically and internationally has not facilitated the adoption of agreements for the pursuit of further integration at the CAN level. Economic authorities have had to focus efforts on handling complex situations so as to promote economic stability and generate structural conditions more conducive to development. However, this process has also led to propitious conditions for convergence which, in the future, may facilitate the harmonization of economic policy.

Declining inflation clearly suggests that the process is moving along the right path. The introduction of measures to facilitate market operations in each country enhances their attractiveness to Andean and third-country investors. Such measures facilitate investor's corporate operations because they help to create an integrated market governed by common provisions. However, to enhance the attractiveness of the Andean Community market, significant progress must be made in various areas, such as coordination of fiscal

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[47] In Venezuela, for example, a stabilization fund has been created that operates by creating reserves when oil prices are high, The aim is to be able to offset price declines for these products.

[48] The ease of collecting import duties makes it tempting to raise them in addressing a fiscal crisis.

policy to avoid excessive tax burdens on trade and investment, and the adoption of agreements that, at the least, limit the potential negative effect on trade of abrupt exchange rate fluctuations.

At the 1998 Meeting of the Andean Presidential Council, the Andean Presidents agreed to seek greater cooperation and convergence of macroeconomic policy among the Member Countries, and instructed the Advisory Council of Treasury or Finance Ministers, Central Banks and Economic Planning Officers to draw up an agenda to harmonize monetary, exchange, financial and fiscal policies. The first meeting of this Council was held in March 1998. The Ministers agreed to take harmonization measures with a view to greater price stability and equilibrium of the main macroeconomic variables. There were also agreements to coordinate action in the fiscal policy area, including duties and taxes. The second meeting of the Council was held in October 1998. At that time the Ministers approved an annual work schedule designed to define convergence criteria, evaluate the Common External Tariff, modernize customs administrations and streamline procedures affecting trade within the subregion.

The third meeting was held in May 1999, and the topic of economic stability was again underscored. This implied greater cohesion and consistency of economic policy. To achieve this, the Ministers agreed to set a preliminary convergence inflation target of under 10% per year and to keep it below that level. In June 2001, the Council set December 2002 as the target date for all CAN countries to meet the goal of single digit inflation. At that time, the new goal for the countries would be announced. Estimates for 2001 suggest that three countries have reached that target: Bolivia, Colombia, and Peru. Ecuador, after dollarization, managed to reduce the rate of inflation to about 1% per month, so that it would be in a position to reach the target by 2002. For Venezuela, in 2000, inflation was 13.4%. Projected inflation is at a similar level, which implies a drop as compared with the year when the Community target was adopted. The current environment suggests that the goal of single-digit inflation by 2002 is within the reach of Venezuelan authorities if sound fiscal and monetary management is achieved.

The Council has also made headway in defining a second convergence criterion in the fiscal area. This has two aspects: adoption of two macrofiscal rules and implementation of a Community monitoring system. The first rule involves establishing a fiscal deficit ceiling (in the non-financial public sector - NFPS) of 3% of GDP starting in 2002, although a transitory rule was included, which sets a slightly higher ceiling of 4% for the 2002-2004 period. If this target is compared with the results for the last three years (Graph 3), most of the countries in the Andean subregion should be in a position to reach the target.[49]

The second rule relates to levels of indebtedness, both domestic and foreign which, by 2015, should not exceed 50% of GDP. Each country will individually determine the fiscal year as of which it will implement the target, up to 2015 at the latest. This means that here again provision is made for a transition period to achieve the respective adjustment. Currently, two countries, Ecuador and Bolivia, have not reached the target level, although both have received substantial international support in renegotiating and reducing their debt. It should be noted that if the current net value of foreign debt resulting from implementation of the Highly Indebted Poor Countries Initiative were used to calculate Bolivia's level of indebtedness, this country would meet the established target.

With respect to the monitoring mechanism, a Permanent Technical Group has been formally established, comprising officials from the Central Banks, Ministries of Finance and economic planning agencies that must regularly analyze compliance with targets. This is a reflection of transparency in Community activity, and may eventually be of international impact, if the results of such assessments are made public. During the third quarter of each year, each country will submit to the Group a program of macroeconomic harmonization and cooperative measures, which specifies macroeconomic assumptions and the economic

49 This assumes prudent management of fiscal spending in the international context.

policies they plan to implement in the following year. Group reports will be presented at the corresponding Council meeting for its information. Attention will focus on efforts needed to fulfill the convergence commitments adopted.[50]

Based on these definitions, the Secretariat, with financial support from the IDB, has been moving ahead with efforts in the areas of tax harmonization, double taxation, and harmonization of basic banking regulations, with the assistance of the Andean Development Corporation (CAF). With respect to treatment of double taxation and options for avoiding it, Decision 40, issued in the early 1970s, was in place in the Community, obviously reflecting the economic trends of the time, i.e., protectionist in nature, meaning that it is not utilized by the Member Countries. Prior to the publication of two studies appearing in 1999, that Decision had not been amended to reflect current circumstances. The studies suggested that the Decision should be amended so that the Member Countries could apply it. With respect to tax harmonization, the studies summarized the necessary conditions for the feasibility of such harmonization as regards indirect taxation. A phased timetable was also established for the preparatory and implementation phases of such harmonization.

H. General considerations

Application of convergent macroeconomic policies promotes the consolidation of the integration process. Coordination efforts made by the respective authorities with a view to making their policies even more consistent are a positive factor to be underscored. Achievements in critical areas such as taxation can create still more favorable conditions for securing the process of subregional competition on an equal competitive footing.

However, there are certain inherent risks of policy convergence. First, there is the period of international instability faced by the Member Countries, which may mean that economic authorities must have the ability to make quick response in order to at least mitigate impact on the productive system. It may be expected that there will be cases where measures are adopted that generate new barriers to trade in the factors of production. This could prove detrimental to the integration process, particularly as regards subregional investor-entrepreneurs, as well as those from third countries.

Secondly, there is a perceived need for a process of exchange policy alignment or harmonization, an area where no in-depth subregional dialogue has yet been sustained. If Member Country exchange rates are allowed to fluctuate wildly, this may substantially alter bilateral trade flows, with consequent impact on trade. In harmonizing macroeconomic policy at the Community level, real exchange rate movements must be addressed as a priority topic and on an ongoing basis.

Third, an unfavorable international environment might impede the pursuit of the structural reforms process, which fosters reduction in costs for productive activities, thereby leading to negative impact on the competitiveness of such products. In the Andean countries, cost-increasing factors persist that could be overcome through decisive action, either through greater efficiency of utility services or private sector delivery of such services, under competitive conditions.

Instability in the international energy market is another factor that may have negative impact on subregional macroeconomic policy convergence targets, particularly in countries where fiscal revenues are heavily dependent on taxation associated with the production and international marketing of such products.

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[50] FLAR is working to substantiate, via studies, the importance of macroeconomic harmonization for the Andean integration process. See minutes of the Fifth Meeting of the Council.

Despite these issues, interaction among Council authorities must enable the countries to move in the same direction so as to continue making headway in convergence of their economic objectives and policies. Under such conditions, it is more feasible to continue with the subregional trade deregulation process and implementation of a true Common External Tariff.

I. Financial support for Andean integration: the role of FLAR and CAF

The Latin American Reserve Fund (FLAR) is a financial institution whose objective is to support Member Country balances of payments by extending credit or guaranteeing loans to third parties. It also contributes to harmonization of the countries' exchange, monetary and financial policies, and to improving conditions for investment of international reserves by the Andean countries. FLAR extends five types of credits: balance of payments support, liquidity support, contingent support, support for external public debt restructuring, and export financing.

The Andean Development Corporation (CAF) is an international financial institution comprising Latin American and Caribbean shareholders; it is considered the financial arm of the CAN. Its mission is to support sustainable development and the integration of its shareholder countries by mobilizing resources to provide multiple financial services.

The CAF operates mainly by extending loans. Particularly important are the infrastructure loans for public and private road, transport, telecommunications, power generation and transmission, water and environmental health projects. In some cases, finance is also provided for trade operations, particularly for export promotion. In the area of industry, the CAF finances corporate projects and loans for the expansion and modernization of productive capacity and for the incorporation of companies in shareholder countries in regional and world markets.

Contents

CHAPTER IV FLOWS OF TRADE AND INVESTMENT IN THE SUBREGION AND THEIR RELATIONSHIP TO COMPETITIVENESS IN THE REGION

A. Competitiveness in the Andean subregion

Competitiveness, meaning a country's ability to gradually raise its inhabitants' standard of living, or a country's potential for growth given its relative level of development, can be enhanced, in a dynamic context, through the formation of a customs union. We underscore "dynamic context" as, initially, the costs associated with integration may outweigh the benefits, stemming, for example, from the loss of relatively uncompetitive industries, or potential short-term diversions of trade, in contrast with long-term trade generation potential. Over time, the situation generally reverses itself. The existence of an enlarged market allows companies to reduce their unit production costs by generating economies of scale, most notably in the manufacturing sector. When companies specialize in producing specific elements in the value chain, such economies of scale lead countries to obtain returns at the international level. The benefits of specialization are reflected in the greater variety and quality of products on the market. In addition, there is an international division of labor and demand is generated for production and marketing-related services. There are also other benefits, such as the formation of clusters or industrial conglomerates, which lead to external static or dynamic economies of scale, which themselves may lead to yet further benefit. For example, investment in industrial projects may provide access to new technology and research and development -- for the same industry and for other related subregional industries (Araoz [1997]).

As we have seen, another aspect of economic integration is physical integration–an important component of the Andean Community's agenda. This reduces the costs of transportation, energy and communications among countries. Yet another aspect is simplified customs procedures and the reduction of other foreign trade-related services and procedures. Thus, the subregion as an economic bloc gains competitiveness by reducing its transaction costs, thereby avoiding potential diversions of trade, as its own subregional producers might, in the last analysis, be the least-cost producers, but the high costs of intra-subregional trade would render it nearly impossible. Should its physical integration become a reality, the subregion would become an attractive area for investment, as this would promote the intra-subregional export market and enhance its competitiveness.

In addition, integration through a customs union, as sought by the Andean Community, can also contribute to securing more balanced and coordinated macroeconomic policies, and to the formation of an enlarged economic area and subregional market as an economic policy tool for further deregulation of trade and competition. In earlier chapters, we discussed subregional efforts to achieve greater convergence of macroeconomic policy, to solidify Community intent not reverse the deregulation process and to secure its capacity to negotiate.

Thus, a crucial question addressed in this report is whether the competitiveness of the Andean countries has increased as a result of its integration process. This section seeks to provide some answers to that question, based on study of the results of the *Global Competitiveness Report* (GCR), published by the World Economic Forum (WEF) in collaboration with Harvard University's Center for International Development (CID), and on studies conducted in the hemisphere in this area.

The GCR seeks to measure the countries' potential growth over a five-10 year period based on "competitiveness," defined as a country's ability to achieve high growth rates on a sustained basis. While the GCR's methodology is often questioned because it has been based primarily on opinion surveys, although increasingly on internationally recognized official statistics, its results may generally reflect the position of the Andean Community countries compared to the other countries evaluated, thereby providing an idea of their capacity to attract investment and trade flows. As may be seen below, CAN countries' results shown in the GCR are not very positive, as nearly all are in the lowest fifth of the country ranking. However, many of the reasons for their lack of competitiveness relate to their respective national macroeconomic and microeconomic policies, rather than to the integration process itself.

On the contrary, in most cases, the integration process has played a marginal part, although this stems from a lack of significant progress in its consolidation. In any event, countries that have in some way profited from the integration process have enhanced the competitiveness of their exports of manufactured goods. In that connection, the Meeting of the Andean Presidential Council in Colombia in early 2002 showed that the leaders of the Member Countries have taken a pragmatic approach to the integration process to bolster their competitiveness by availing themselves of the options available to them in the context of globalization. That is the approach taken in some of the mandates of the Presidential Declaration, which promotes transparency in trade, equal opportunity for all Member Countries and Andean subregional integration in the areas of energy, physical infrastructure, and financing.

Table 18 sets out the GCR's results for the 1996-2001 period[51] for the five Andean countries, showing their relative position for each year, adjusted for the variations in sample size, i.e., the number of countries taken into account in preparing the GCR each year.[52] As can be seen, Venezuela gained in competitiveness between 1996 and 2001, despite a decline in 2000 (this is seen more clearly in Graph 5).[53] It moved from 47th place out of 49 countries to 62nd place out of 75 countries, an advance of 13% in the adjusted index. Peru gained in competitiveness until 1999, which dropped dramatically in 2000, recovering in 2001. Colombia and Bolivia are the only two countries that gained competitiveness in 2000, in that, as will be explained later, the GCR's method for calculating these indicators changed, affecting Peru most, with a decline of 20% in its adjusted position (Table 18).

Graph 5 shows the relative trends in the Andean countries, adjusted for sample size. Note that Peru is a country that has always ranked higher than its Andean neighbors, basically stemming from its striking macroeconomic stability during the 1990s and progress made in structural reforms up to the mid-1990s. In contrast, Colombia, Ecuador, Bolivia and Venezuela maintain similar relative positions over time. However, to be noted are their macroeconomic weaknesses, accompanied by a lack of trade deregulation and export strategies.

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[51] The 2001 data come from the GCR 2001. Detailed data for each country were not yet available at the time this report was written, and thus more general information is used for that year.

[52] The adjusted index is the result of dividing the position occupied by a given country by the number of countries in the sample each year.

[53] Note that the graph does not precisely use the adjusted position (AP) from Table 18 (meaning the country's ranking divided by the number of countries in the sample), but rather the difference between the unit and the sample, in order to graph the idea of greater competitiveness as an increase (if the index as such had been used, greater competitiveness within the ranking would have appeared on the graph as a lower numerical value).

TABLE 18
RELATIVE POSITION OF THE ANDEAN COUNTRIES IN THE COMPETITIVENESS RANKING (GCR) AND PROJECTED GROWTH

Year	Position	Bolivia	Colombia	Ecuador	Peru	Venezuela
1996	RP (1)	n.d. (4)	40.00	n.d.	38.00	47.00
	AP (2)	n.d.	0.82	n.d.	0.78	0.96
1997	RP	n.d.	41.00	n.d.	40.00	47.00
	AP	n.d.	0.77	n.d.	0.75	0.89
1998	RP	n.d.	47.00	n.d.	37.00	45.00
	AP	n.d.	0.89	n.d.	0.70	0.85
1999	RP	55.00	54.00	53.00	36.00	50.00
	AP	0.93	0.92	0.90	0.61	0.85
2000	RP	51.00	52.00	59.00	48.00	54.00
	AP	0.86	0.88	1.00	0.81	0.91
2001	RP	67.00	65.00	68.00	55.00	62.00
	AP	0.89	0.87	0.91	0.73	0.83
2000-2008	GP (3)	2.11%	1.17%	1.76%	3.34%	1.47%

Preparation: In-house

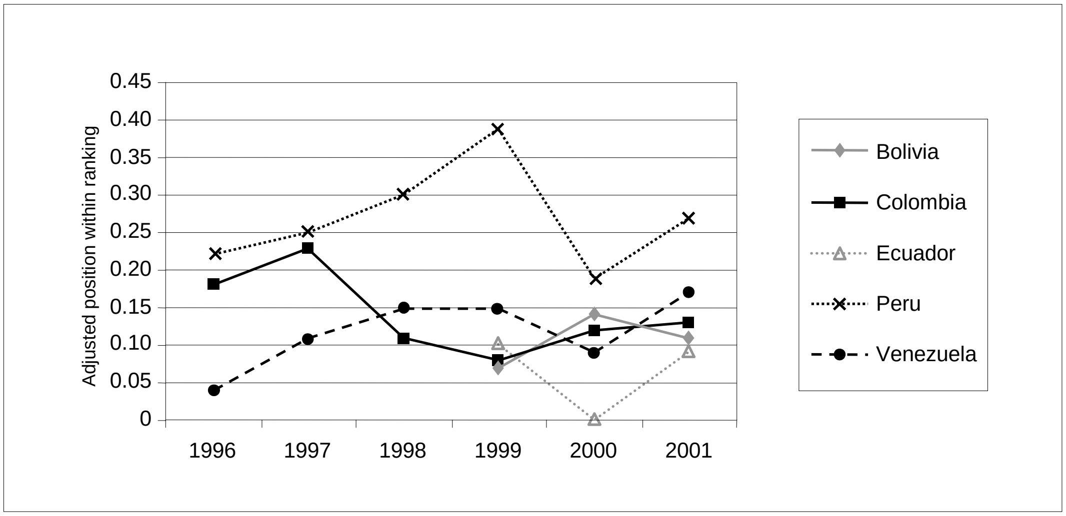
Notes: (1) RP = relative position in the competitiveness ranking. (2) AP = adjusted position in the competitiveness ranking. (3) GP = per capita GDP growth projections for the 2000-2008 period. (4) n.d. = no data

The bottom row in Table 18 shows projected growth rates for these economies in the 2000-2008 period. These figures were calculated based on the countries' Competitiveness Index,[54] income levels, and growth rates for the last eight years (according to GCR data, 1999). As taking account of per capita income also means taking account of the convergence effect among countries with different income levels[55], the results show that the projections for Bolivia and Ecuador are more favorable than those for Colombia and Venezuela. However, while Peru has income similar to that of Colombia and Venezuela, it has the best growth prospects within the Andean subregion in coming years. This is consistent with the country's constant rise in competitiveness rankings, despite a decline in 2000. Thus, if the improvement made in the structural factors now enhancing Peruvian competitiveness is at least maintained, it may be expected that their impact on medium-term growth will be better than convergence would indicate.

[54] This index, used in the GCR, seeks to measure the principal structural characteristics that may indicate medium-term growth, adjusted for each economy's initial income level.

[55] According to neoclassical theory and empirical evidence, if two countries show a positive differential in this variable, it would be expected that the less developed country would grow at a faster pace than the more developed country, owing to a process of convergence resulting from the diminishing returns encountered by economies before reaching steady state (Araoz, *et al*. [2001]).

GRAPH 5
COMPETITIVENESS TRENDS IN THE ANDEAN COUNTRIES ACCORDING TO THE GCR*
(Percentages)



Notes: * Bolivia and Ecuador have been included in the GCR since 1999. ** The y-axis variable corresponds to 1-AP, for reasons of graphics.

The index shown here is based on eight competitiveness factors related to the so-called Porter Diamond. These are: the economy's openness to trade and international finance; the role of the state budget and regulation; development of financial markets; quality of infrastructure; quality of technology; the quality of corporate management; labor market flexibility; and the quality of institutions. The surveys and data used by the WEF enable indicators for these factors to be obtained which, when weighted, yield the overall indicator. The Annex of this chapter shows the trend in each factor for each Andean country.

As indicated, since its inclusion in the GCR, Peru has generally occupied a better position than the other Andean countries, ranking in the fourth fifth as compared with the lowest fifth ranking for the rest of the subregion's countries. This largely reflects the extensive economic adjustments of the first half of the 1990s and relatively stable fiscal and monetary policies, which allowed Peru to achieve high ratings in the government performance area. Since 1996, based on attainment of the targets agreed with the International Monetary Fund (IMF), Peru has been ranked among the first seven countries in terms of scale of budgetary expenditure. This result is important because recurring fiscal deficits erode a country's competitiveness as they generate over-indebtedness of its economy, making it more vulnerable to exogenous shocks. Prudent management of public finance is thus a key factor lending the country stability and enabling sustained medium-term growth to take place. In recent years, the Fiscal Austerity Law that limits Peruvian state expenditure has reinforced such prudent management.

The other factor that resulted in a high competitiveness ranking for Peru was its labor market flexibility. Various indicators show improvements made in this area, as Peruvian labor legislation became considerably more flexible in the early 1990s, allowing for free hiring and firing, in contrast to earlier rules under which it was virtually impossible to dismiss employees. In addition, while the rate of growth in the employment/population ratio was –1.3% in the 1990-1995 period, in the 1994-1998 period, it was 5.09%, the highest figure among the 59 countries included in the 1999 report. This caused Peru's unemployment rate to drop from 8.5% to 7.0% from 1995 to 1998, although it rose slightly to 7.7% in 1999. However, underemployment rates are very high in Peru, even by Latin American standards. This means that although the reforms begun in the early 1990s have improved labor market structure, in practice labor market operations are adversely affected by key factors such as low productivity, the workforce's low educational level and underemployment. Added to this is weak technological development, ranking Peru among the lowest for this indicator.

In 2000, the GCR changed its method of calculating competitiveness indicators, making comparisons with earlier years difficult. The change involved assigning heavier weight to technological change, trade deregulation, and facilities for new start-ups. In addition, the GCR now has two indicators for each country: the index of competitive growth and the index of current competitiveness. The first indicator is similar to the indicator used in earlier years (i.e., ranking), although it incorporates methodological improvements; the second indicator measures the microeconomic fundamentals of competitiveness. Under the new methodology's weighting, the results for 2000 for the Andean countries are not very positive, although this does not apply merely to the Andean, but to all developing countries. This is to be expected if we assume that such countries, on average, have more market rigidities acting as barriers to structural economic change. Based on this information, it may be inferred that although the Andean countries are focusing their economic policies on deregulation and (to a lesser degree) on technology, the rest of the world is doing so as well, but more efficiently and more rapidly. This makes the Andean countries, in comparative terms, the least competitive countries of the GCR sample.

Only Bolivia and Colombia gained ground in the adjusted index of competitiveness (moving from 0.93 to 0.86 from 1999 to 2000 in the case of Bolivia, and from 0.92 to 0.88 in the case of Colombia). The other Andean countries lost competitiveness based on the adjusted index, with Peru losing the most (20%). In considering the current competitiveness index which, as noted, measures the microeconomic fundamentals of competitiveness, we see that Colombia and Peru were comparatively the most competitive countries in the subregion, even though they were in the lowest fifth in the sample. The situation deteriorated in 2001, when the trend in competition in the Andean countries was very poor, with the exception of Peru, which managed to buck the trend. Nonetheless, based on the current competitiveness index, Colombia was the most competitive country. It gained 7% in current competitiveness based on its adjusted position as compared with 2000. This stems basically from its advantage over its Andean neighbors in terms of entrepreneurial strategies. Competitiveness as measured by this indicator increased by 12% in comparison with 2000 (company sophistication). The quality of the Colombian corporate environment also showed a relative—although a lower rate of—improvement, rising by 2%.

Based on the foregoing results, the trade liberalization variable was not highly significant for the Andean countries[56] nor has the integration process played a preponderant part in their attaining greater competitiveness. Rather, it is their structural microeconomic fundamentals that have relegated them to their positions in the GCR, while an appropriate consolidation of integration might help to reverse this trend.

An IDB report on competitiveness (IDB [2001]) also used the GCR competitiveness indicator and others to study the Latin American countries, comparing them to the regional average and taking account of per capita income in each country. Four items were compared: competitiveness, macroeconomic environment, quality of institutional environment, and technological capacity. With respect to the competitiveness index, Bolivia and Peru had performance comparable to the Latin American average,[57] while Colombia, Venezuela and Ecuador were below average. These results are consistent with those of the adjusted index for 2000, shown in Graph 5. With respect to the quality of macroeconomic environment, Ecuador, Peru and Venezuela were average, while Bolivia and Colombia were below. As for the quality of the institutional environment, only Ecuador and Peru were average compared to the rest of the Latin American countries in the calculation, while the other Andean countries were below. Finally, with respect

[56] Except for Peru and, since 2000, for Colombia, Ecuador and Bolivia.

[57] In calculating this average, twenty countries were taken into account: Argentina, Bolivia, Brazil, Colombia, Costa Rica, Chile, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago, Uruguay and Venezuela.

to technological capacity, only Bolivia was considered average in comparison with its Latin American neighbors, while the remaining Andean countries were considered below.

To summarize, we have seen that trends in competitiveness in the Andean economies have not been very positive when compared with other countries, at least up to 2000. Why was this? The answer has more to do with the countries' domestic deficiencies in competitiveness than with the integration process. While integration was formally relaunched in the early 1990s, apparently there has been no progress in its consolidation, with the result that integration thus far has played only a marginal part in the competitiveness of the subregion as a whole.

B. Magnitude and direction of total trade flows and intra-subregional trade flows

In the 1990s, the trade flows of CAN Member Countries with the world[58] practically doubled, rising from US$ 49 billion in 1990 to US$ 97 billion in 2000, a growth of 98% for the period as a whole (Table 19). Although these flows declined from 1998 to 1999 owing to two exogenous factors, the El Niño phenomenon and the Asian financial crisis,[59] the levels achieved in 1997 were surpassed in 2000, renewing the decade's upward trend.

TABLE 19
TOTAL TRADE FLOWS
(US$ million)

Countries	1992	1993	1994	1995	1996	1997	1998	1999	2000
Bolivia	1,820	1,928	2,237	2,572	2,721	3,164	3,707	3,256	3,306
Colombia	13,958	16,964	20,264	23,622	24,917	26,992	25,468	22,208	24,579
Ecuador	5,474	5,615	7,375	8,554	8,832	10,219	9,644	7,022	8,391
Peru	7,150	7,535	9,990	13,025	13,610	15,111	13,738	12,504	14,195
Venezuela	27,339	27,099	25,118	28,454	32,446	36,174	32,049	33,396	46,580
CAN	55,741	59,141	64,984	76,227	82,526	91,660	84,606	78,386	97,051

Preparation: In-house
Source: Andean Community

In the 1991-2000 period, trade in Community goods with the world grew at an average annual rate of 7%, a rate similar to the growth rate of world trade in goods (6%).[60] However, it should be noted that CAN represents only 0.7%[61] of total world trade in goods. The Andean subregion, with growth rates such as those indicated here, has lagged behind in incorporating itself in the global market, if trade flows achieved are taken into consideration. However, there was marked growth in intra-Andean trade flows, which averaged 18% per year for the period indicated. This greater momentum may in part be explained by

[58] Meaning the sum of imports and exports.

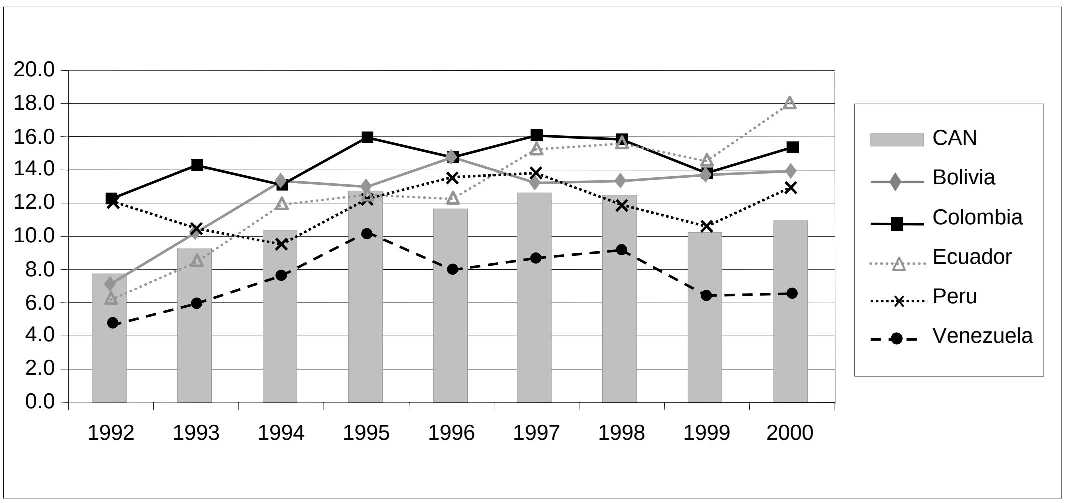
[59] The El Niño phenomenon raised the temperature of ocean currents, leading to serious floods and droughts in different parts of Latin America, damaging the productive base and infrastructure. For its part, the Asian crisis led to a decline in the volume of exports to Asia, lower raw material prices, and competition from cheap Asian exports.

[60] The calculation was based on data from the United Nations, IDB-INTAL and the WTO for the 1992-1999 period.

[61] Based on information from the CAN Secretariat and the WTO for 1999.

economic growth in the Member Countries in the period, and by the renewed impetus given to the integration process in the early 1990s. Nonetheless, levels of intra-subregional trade remain very low as compared with those of the rest of the world and therefore do not yet provide a platform for the subregion's insertion in the world market. Graph 6 shows the trend in intra-subregional trade as a proportion of total trade which, on average, remained constant at about 11% between 1992 and 2000. For example, if intra-Community exports and imports as a proportion of total Community exports and imports are compared to the equivalent calculation for MERCOSUR, in CAN they amounted to 8.9% of exports, whereas in MERCOSUR they amounted to 20.3%. Imports represented 11.7% in the case of CAN as compared with 19% in the case of MERCOSUR (according to WTO data). However, note that the significant relative weight of trade in subregional raw materials, particularly oil, masks the increasing importance of intra-subregional trade in manufacture goods in the 1990s, a period when the subregion had an average index of openness compared to other subregions of the hemisphere, and when the Andean countries made significant efforts to lower their trade barriers vis-à-vis the world.

GRAPH 6
INTRA-SUBREGIONAL TRADE/TOTAL TRADE
(US$ million)

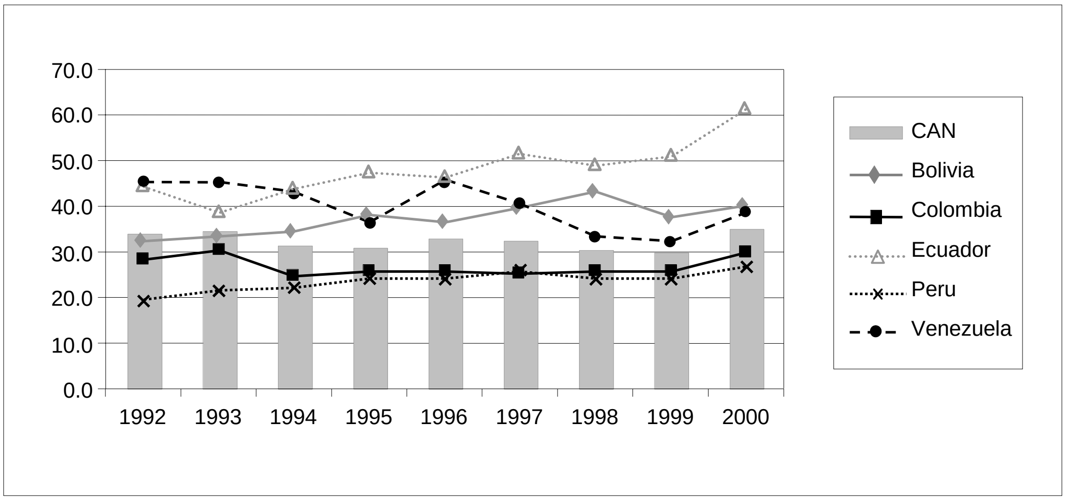


Preparation: In-house
Source: Andean Community

As can be seen, the index of economic opening, measured as the total flow of trade/GDP ratio, rose from 34% in 1992 to 35% in 2000, remaining stable throughout the decade (Graph 7). Although, in formulating economic policy, efforts have been made to reduce subregional protectionism, the result of this indicator seems to show no clear trend as regards the Andean Community's insertion in the world economy, nor has the subregional integration process targeted that end, primarily as concerns policy that would enhance the share of Andean non-raw material exports to the world. Ecuador, as the second smallest economy, after Bolivia, in terms of GDP, and its high volume of oil and banana exports, would appear to be relatively the most open economy in that it trades an average of 48% of its GDP. It is followed by Venezuela and Bolivia, in order of openness. Venezuela showed an average annual index of opening of 40%, explained mainly by its oil exports. Bolivia, owing to its position as the relatively least developed country and its dependence on raw material exports, such as soy, trades an average of 37% of its GDP.

If the CAN results are compared with those of the CACM, we see that the latter's openness to trade index in 1998 was 72%, over twice that shown by CAN during the same year (INTAL [2000]). One explanation for this might be its important trading relationship with the United States. MERCOSUR showed an openness index of 16% although, as indicated earlier, intra-area trade is quite representative of its share of total trade. However, this is no reason to consider this phenomenon a trade-off between openness to the world and the regional market, but rather that the subregional market could be developed as a platform for including new products with economies of scale in the global market.

GRAPH 7
INDEX OF OPENNESS TO TOTAL TRADE
(Percentages)



Preparation: In-house

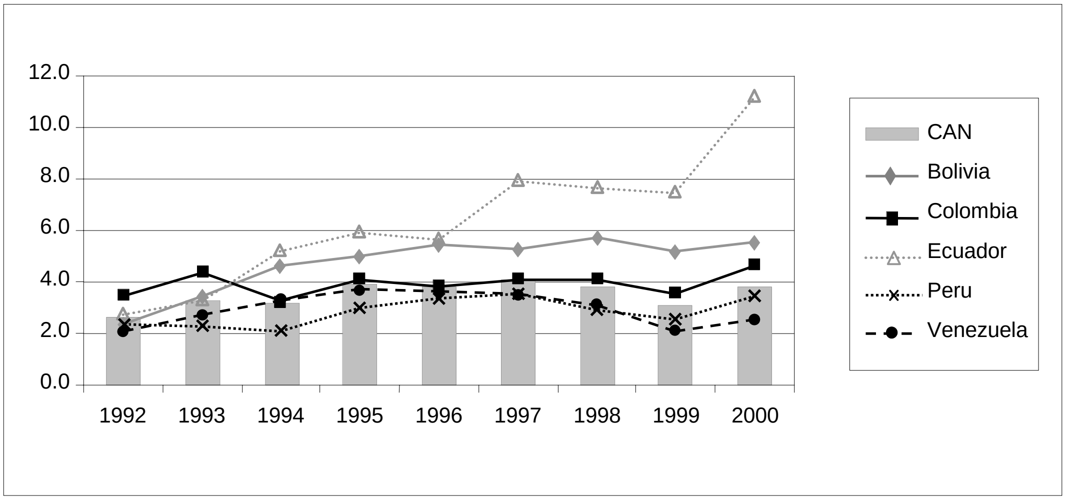
Source: Andean Community

As seen in Graph 6, the importance of intra-Community trade as a proportion of total trade did not change very much during the 1990s. However, it is clear that Colombia plays a relatively larger part in intra-subregional trade than did its Andean neighbors. Venezuela, which followed Ecuador as the most open country in terms of total trade, traded least with its Andean neighbors, again largely reflecting the impact of oil exports. In contrast, Ecuador's part in intra-subregional trade continues to increase, to the extent that, in 2000, 18% of its trade flows involved its Andean neighbors.[62]

In examining Graph 8, which shows the index of opening to intra-subregional trade, Graph 6, described above, may be more readily understood. Ecuador, along with being the subregion's most open country in terms of total trade, is the most open country in terms of intra-Community trade, which averages 6.3% of its GDP. Bolivia follows it with an average of 4.7% of GDP. Although in observing total trade, Colombia did not appear to be an open country, it shows a high degree of openness to the subregion because it accounts for a large share of intra-Community exports, with average trade of 3.9% of its GDP. This makes it the third most open country in terms of Andean trade and, as discussed below, manufactured goods account for a high percentage of such trade.

[62] It should be underscored that since the border tensions between Ecuador and Peru ended, trade between these two countries has increased markedly and there are numerous bilateral projects which, in the future, will foster relations between them.

GRAPH 8
INDEX OF OPENING TO INTRA-SUBREGIONAL TRADE
(Percentages)



Preparation: In-house
Source: Andean Community

As pointed out, an important characteristic to be underscored as regards intra-subregional trade is the proportion of manufactured goods, which averaged 83% of exports within CAN in 1994-1999 (according to data from the Andean Community and DATAINTAL). Although this figure cannot be taken at face value, as it in part reflects primary manufactured goods, such as processing of base metals, petroleum products, and natural-resource-based food products, it is nonetheless in marked contrast with extra-subregional exports. This might be an interesting indicator of whether consolidation of integration might generate significant economies of scale in manufactured goods which, in turn, would promote better incorporation in the world market. Although such manufactured goods are primarily associated with the processing of primary goods, this might represent a step forward as regards the inter-industry trade on which the Community's trade with the rest of the world is based. Peru and Venezuela show a higher level of trade in primary goods with some degree of secondary manufacturing. In the case of Peru, processed base metals account for 39% of its manufactured goods exports, while for Venezuela, processed base metals and refined petroleum products account for 35% of such exports. Colombia constitutes the reverse side of the coin, which has specialized in trade in more highly manufactured goods, such as chemical substances and products (27%). This last case is worthy of note, as it confirms that Colombia has been able to benefit from integration by directing efforts toward developing manufactured exports to the subregion on an increasingly competitive basis. According to Araoz, Bonifaz, Casas and González Vigil [2001], this is reflected in the revealed comparative advantage indices.

According to González-Vigil and Kuriyama [2000], manufactured goods exports to the Andean Community as a proportion of total exports of these products to the world rose from 14% in 1990 to 36% in 1997, excluding foods, metals, minerals and fuels. This contrasts with the basically primary composition of Andean exports to other regions of the world. However, in view of the volume of trade, this rise in manufactured goods exports is still not sufficient for substantive development of Andean industrial competitiveness, nor does it imply balanced development among the countries of the subregion, as it is concentrated in the larger countries. However, it might mean that consolidation of Andean integration would make it possible to generate trade of greater added value and to diversify exports to include more sophisticated products, including gains in momentum due to the learning and technology transfer effects involved for these countries.

Trade transaction costs are one reason why such intra-subregional trade flows remain insignificant. These remain high and not transparent. For example, Warner [2001] notes the existence of barriers in addition to the tariff level making Andean trade more expensive, such as port costs, license fees, transportation costs, bank interest, etc., ranking them among the most expensive countries in terms of import costs. Although tariffs may average about 11%, additional costs of importing exceed 30%, with the exception of Colombia, where they are 26%.[63] These barriers have not been overcome even at the level of intra-Andean trade. This, together with weakness in definition of the Common External Tariff, with its numerous exceptions and perforations, readily explains the low level of development of the subregional economic area.

C. Exports

After a period in the 1980s when the Andean integration process slackened, there was renewed impetus in the first half of the 1990s, reflected in a rapid expansion of intra-Community exports, at a faster pace even than that of extra-Community exports, as seen in Graph 9. This level declined due to the Asian crisis and the loss of momentum and consolidation of the integration process itself (Steinfatt and Contreras [2001]). It is worth noting that this trend was common to all the Member Countries in the first half of the 1990s. The sole exception was Peru, where extra-Community exports rose. This is explained by Peru's decision in 1992 to isolate itself from the subregional integration process and from the proposed process of unilateral deregulation. However, in the second half of the decade, with the exception of the 1998-1999 crisis, Peru witnessed a growth in its intra-Community exports, reflecting its gradual reincorporation in the process. Colombia's intra-subregional exports expanded rapidly in 1995 (75%), the year when the CET took, albeit imperfect, effect. The second half of the 1990s was not a promising period for exports from the CAN Member Countries nor for intra-subregional exports. The notable exception was Venezuela, which saw its extra-Community exports grow, mainly stemming from its oil exports. Although in 2000, intra-Community trade expanded significantly, this cannot be considered a trend in that it largely reflects the recovery of levels existing prior to the world financial crisis.

As can be seen in Graph 9, the value of intra-Community exports in this period represented an average of only 12% of extra-Community exports. It is thus interesting to examine total CAN exports to establish their target markets and the specialization of such exports towards the subregion and towards the rest of the world.

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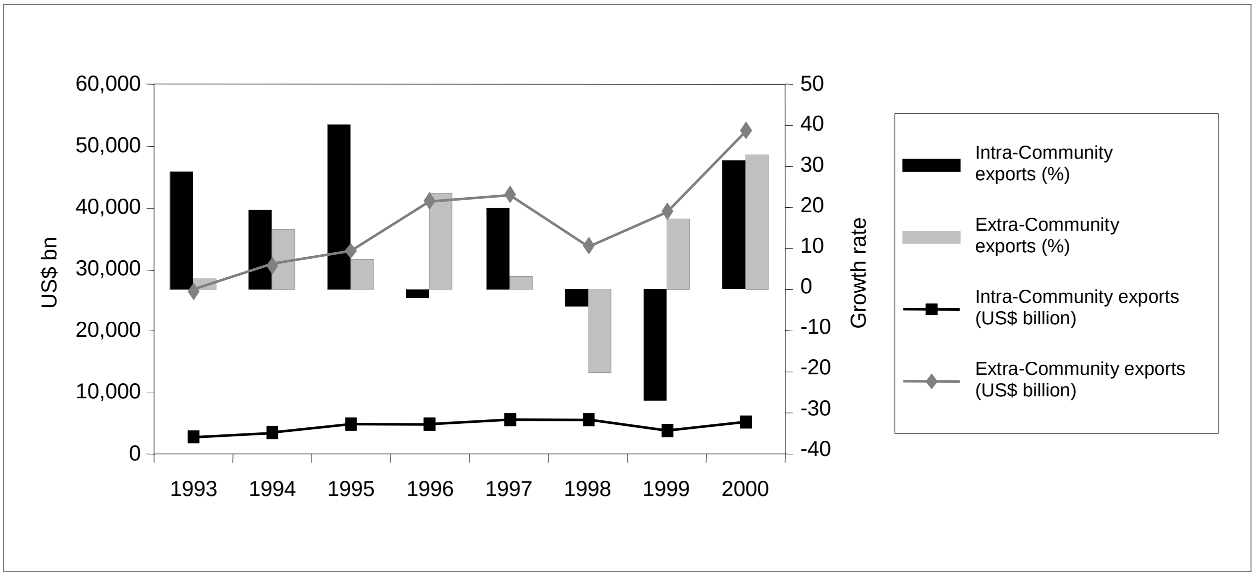
[63] For greater detail, see national competitiveness studies at *http://www.cid.harvard.edu/andes*

GRAPH 9
DEVELOPMENT OF CAN EXTRA-COMMUNITY EXPORTS
(US$ million and growth rates)



Preparation: In-house
Source: Andean Community

Table 20 shows that exports from the Community countries doubled in the nine years up to 2000. Exports fell by 18% in 1998, but recovered in the following years. The value of subregional exports fell in 1998 as a result of lower prices in many cases. In fact, the Community's volume of exports rose from 110,584,873 MT in 1997 to 120,842,547 MT in 1998, a 9% increase (based on data from the DATAINTAL System of Statistics on External Trade). However, the decline in prices was not fully offset by the increase in export volumes, ultimately reducing the total value of exports.

TABLE 20
WORLD EXPORTS OF GOODS
(US$ million)

Countries	1992	1993	1994	1995	1996	1997	1998	1999	2000
Bolivia	705	751	1,041	1,138	1,078	1,272	1,325	1,402	1,457
Colombia	7,072	7,123	8,408	9,759	10,562	11,511	10,790	11,549	13,049
Ecuador	3,057	3,062	3,725	4,361	4,900	5,264	4,141	4,207	4,822
Peru	3,360	3,344	4,361	5,441	5,835	6,744	5,640	5,973	6,794
Venezuela [4]	14,184	15,459	16,717	17,204	23,125	22,886	17,001	20,076	31,302
CAN	28,378	29,739	34,252	37,903	45,500	47,677	38,897	43,207	57,424

Preparation: In-house
Source: Andean Community

Among Community countries, a significant percentage of exports from Peru (20%) and, to a lesser extent, Ecuador (10%), are sent to Japan and the Southeast Asian countries (ECLAC [1998]). In view of the effects of the Asian crisis discussed above, it was predictable that some of the drop in exports would be explained by declining exports to the Southeast Asian countries. This is very clear in both cases. Peru's exports to ASEAN fell from US$ 195 million in 1997 to US$ 85 million in 1998, a decline of 56%. Exports from Ecuador to that bloc fell by 64% over the same period.

For Colombia, Ecuador and Venezuela, where oil is an important component of exports,[64] the 1999 recovery resulted from the rise in oil prices, which raised the unit value of such exports, as well as the real terms of trade (Table 21). For Venezuela, the unit value of exports rose from US$ 929 per MT in 1998 to US$ 1,128 per MT in 1999. For Ecuador, that value rose from US$ 219 per MT in 1998 to US$ 228 per MT in 1999. However, in Colombia it remained at US$ 165 for the same period. The main explanation for this is that while oil prices rose, the coffee prices fell, offsetting the positive effect of higher oil prices.[65]

In 2000, trade recovered markedly from its 1999 decline. The recovery resulted both from export price determinants (primarily raw material prices) and determinants of the volume of foreign sales (such as world and regional economic activity) (based on ECLAC data). The economic recovery was also reflected in increased imports, as shown below.

TABLE 21
TERMS OF TRADE
(Base 1995 = 100)

Year	Bolivia	Colombia	Ecuador	Peru	Venezuela
1992	92.0	87.4	116.3	95.0	108.0
1993	88.3	91.0	106.4	89.1	100.9
1994	102.5	104.9	108.9	95.7	100.0
1995	100.0	100.0	100.0	100.0	100.0
1996	111.7	103.8	109.6	96.5	115.6
1997	115.6	104.4	111.9	103.2	110.8
1998	109.9	98.8	99.6	89.7	79.9
1999	109.8	102.6	106.2	83.3	107.0
2000*	112.0	115.8	123.8	80.9	157.4

Preparation: In-house
Note: * Estimates
Source: ECLAC, Web page database.

[64] In Venezuela, exports of fuels, mineral lubricants and related products represent 77% of total annual exports, while in Ecuador and Colombia they represent about 30% of exports, respectively.

[65] On average, nearly 20% of Colombia's annual exports fall under the heading of coffee, tea, cocoa, spices and manufactures thereof, according to SITC Revision 3, Chapter 07.

TABLE 22
THE 10 PRINCIPAL PRODUCTS EXPORTED BY CAN
(Percentage share of exports)

Product	1995	1996	1997	1998	1999
Crude oil	30.1	37.3	34.0	27.7	48.4
Raw or roasted coffee, and coffee substitutes containing coffee	5.8	4.3	5.8	5.8	3.8
Fresh plantains (including bananas)	3.2	3.2	3.8	4.0	3.5
Non-monetary gold (including platinum plated gold), in semi-worked crude or in powder	2.2	2.1	1.7	3.4	3.0
Coal (anthracite, bituminous coal)	1.8	1.8	1.8	2.7	2.2
Flowers and cut buds for decoration		1.3	1.4	1.8	1.7
Fresh, refrigerated, frozen, salted, dried crustaceans and mollusks	1.7	1.4	1.9	2.2	1.7
Refined copper (including cast copper)	1.9	1.6	1.7	1.6	1.4
Petroleum derivatives	16.0	14.9	13.5	11.5	1.3
Aluminum and its alloys, unworked	1.8	n.d.	n.d.	1.3	1.3
Total percentage	64.5	67.9	65.6	62.0	68.3

Note: n.d.: no data

Source: ECLAC, *Statistical Yearbook of Latin American and the Caribbean, 2000*

Table 22, showing the 10 main Community exports, provides a better understanding of the weight of raw materials in Andean exports. Crude oil and petroleum derivatives alone account for an average of 50% of Andean exports. As we have seen, Venezuela, Colombia and Ecuador are the countries exporting most under these headings. Venezuela is the largest oil exporter. The average annual value of its fuel exports, mineral lubricants and related products[66] for the 1994-1999 period was US$ 15 billion, 77% of the average annual value exported in the same period. For Colombia, in the same period, the average annual value exports for the same category of products is much lower, but still significant, at US$ 3.253 billion, or 31% of the average annual value of exports. Ecuador's case is similar, as its exports under the same heading represent 32% of the average annual value of its total exports (Ecuador exported on average US$ 1.409 billion of total average exports of US$ 4.443 billion per year).

Coffee and bananas are the next most important exports. While coffee averages 5% of Andean exports, bananas account for 3.5%. The main coffee exporters are Colombia, Peru and Ecuador. Colombian exports of coffee, tea, cocoa, spices and manufactures thereof have an average annual value of US$ 1.961 billion,[67] or 64% of its food product and live animal exports. Peru exports an average of US$ 302 million each year, representing 20% of its exports under the same heading. However, the main food export from this country is animal feed (fish meal), with exports at US$ 733 million per year, or 49% of Peru's food product and live animal exports. Ecuador exports an annual average of US$ 298 million in coffee, tea, cocoa, spices, and manufactures thereof. However, this represents only 12% of its food product and live animal

[66] According to data from the DATAINTAL System of Statistics on External Trade, using SITC Rev. 3.

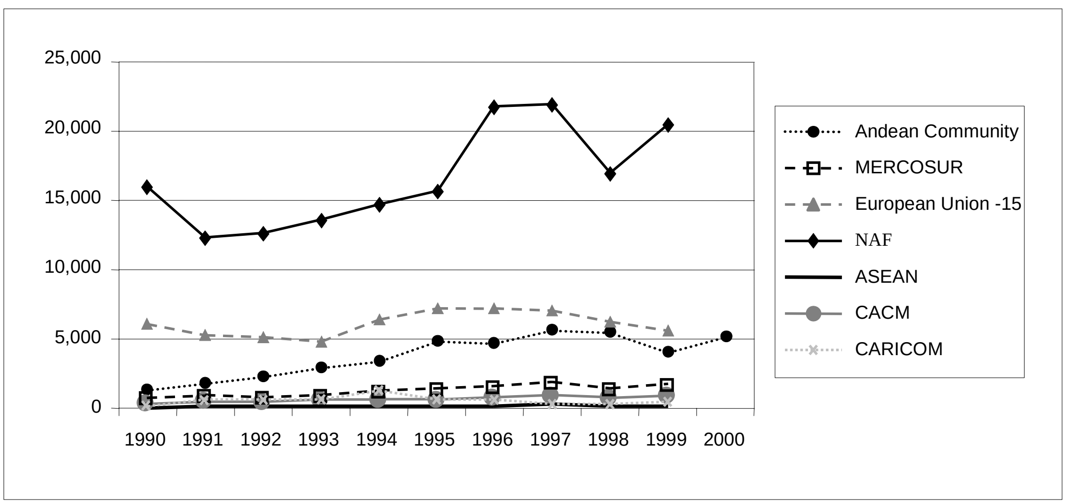
[67] That heading corresponds to Chapter 7 of SITC Revision 3, according to data provided by the DATAINTAL System of Statistics on External Trade.

exports, as the largest element of such exports are vegetables and fruit. These account for 44% of its food product and live animal exports, amounting to US$ 1.052 billion per year (according to data from the DATAINTAL System of Statistics on External Trade), with banana exports predominating.

Exports by target economic bloc

The Community's main trading partner is NAFTA (comprising Mexico, the United States and Canada). The Community exports an average annual value of US$ 16.6 billion to that region, particularly the United States, exports which grew at an average annual rate of 4% in the 1991-1999 period. Exports to the Community's principal trading partner far exceed exports to other economic blocs. The trend in exports to NAFTA has been upward, if account is not taken of the external shock resulting from the Asian crisis, which led to a decline in exports in 1998. Exports from the Asian countries in fact became more competitive than Andean exports during that crisis. The Community's second most important trading partner is the EU. Each year, the CAN exports an average of US$ 6.095 billion to that region. As can be seen in Graph 10, in the review period, on average there was no growth in those trade flows. Note that intra-subregional trade is the third largest element of exports. Those trade flows will be discussed below. This might be a positive indicator of the integration process that has taken place since the 1990s.

GRAPH 10
CAN EXPORTS TO EACH ECONOMIC BLOC
(US$ million)



Preparation: In-house
Source: Andean Community

The Andean countries' trade patterns differ among their different trading partners. First, Venezuela, Ecuador and Colombia export substantial volumes to the NAFTA countries (González-Vigil and Kuruyama [2000]). These are, in fact, the more northern Andean countries. For Colombia and Venezuela, the United States is the largest market. Of Andean exports to the United States, 23% is of Colombian and 58% of Venezuelan origin. Bolivia has traditionally traded primarily with South American countries, so it is not surprising that it was the first country to form a Free Trade Area with the MERCOSUR countries. As noted above, the Pacific region is one of the most important for Peruvian exports. Thus, from 1995 to 1996, Peruvian exports to that region were 21.9% of its total exports. Peru is the top exporter to every country within that region, apart from Japan, whose main Andean trading partner is Colombia. Peruvian exports are also the most diversified in terms of region of destination, with significant percentages of its exports going to NAFTA, the EU and APEC. The Asia-Pacific region is an important source of imports to Colombia (39% of its imports came from that region in 1995 and 1996), so that Peru and Colombia are that region's first two sources of trade (measured as the sum of imports and exports).

Intra-Community exports

From 1992 to 2000, intra-Community exports rose from US$ 2.225 billion to US$ 5.166 billion, a rise of 132%. Average annual growth of such exports was 13% from 1993 to 2000. Colombia and Venezuela export most to the subregion, on average over three times the exports of Peru, Ecuador and Bolivia taken together. Bolivia has the lowest intra-subregional export flows on average, but in terms of average annual growth rates in intra-Community exports, Bolivia ranks second, after Ecuador.

If bilateral export flows of the Andean Community Member Countries are examined, it is possible to some extent to note the importance of trade deregulation among these countries. As seen in Table 23, Colombia and Venezuela are the foremost countries in terms of bilateral trade, Colombia being the more diversified as regards Community Member Countries to which it exports its products. Colombia and Venezuela trade significant amounts with each other, reflecting ties established in 1992, the year of their reciprocal tariff elimination (Steinfatt and Contreras [2001]). Colombia's exports are better distributed among the Andean countries in terms of value, although while Venezuela exports considerable amounts to Ecuador and Peru, it does so in relatively much smaller amounts as compared with its exports to Colombia. Also to be noted is the increase in exports from Ecuador to Peru, stemming from the settlement of their historical border conflicts in 1998. These exports consist basically of crude oil. The two countries are now negotiating with a view to strengthening trade ties. Also significant is the flow of exports from Bolivia to Peru, stemming from a trade agreement concluded in 1992. That agreement provides for duty-free entry into Bolivia of the tariff universe of Peruvian products, while Bolivian goods enter Peru duty-free except for certain tariff headings. In that connection, while Peruvian exports to the Andean countries are comparatively small in volume, their distribution among the countries is quite homogenous, with the exception of Ecuador.

TABLE 23
BILATERAL INTRA-COMMUNITY EXPORTS, 1995 AND 1999
(US$ million)

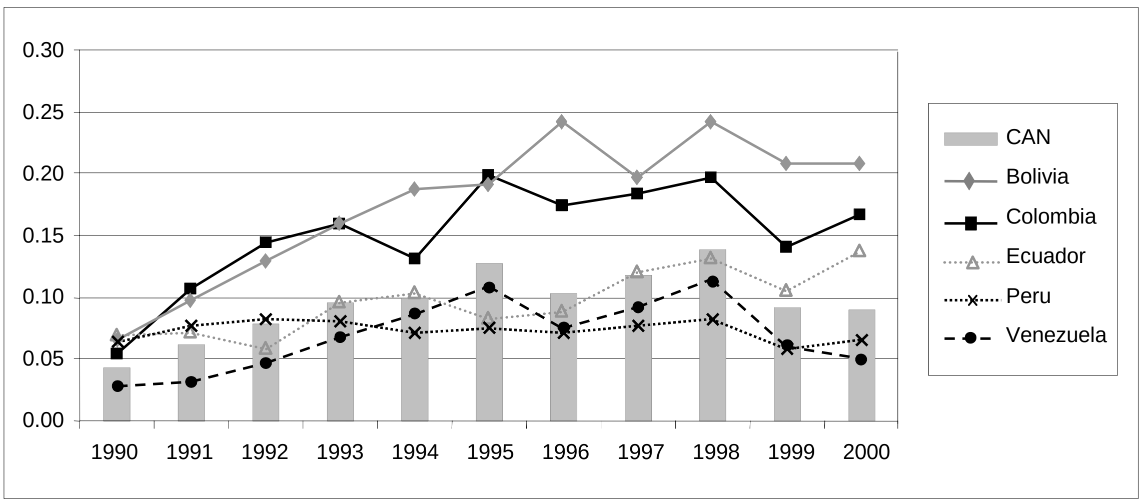
Exporting country	Bolivia		Colombia		Ecuador		Peru		Venezuela	
	1995	1999	1995	1999	1995	1999	1995	1999	1995	1999
Bolivia	0	0	64	127	7	80	142	75	6	19
Colombia	24	40	0	0	419	324	558	357	935	913
Ecuador	4	6	252	218	0	0	69	163	34	58
Peru	77	100	118	104	47	51	0	0	163	92
Venezuela	9	2	1,422	789	214	144	237	286	0	0

Preparation: In-house
Source: Andean Community

In addition, as regards Peru's tariff liberalization program vis-à-vis the other Andean Community countries (as seen earlier, trade among the other countries is totally deregulated, and Peru is the only country that has yet to fully join the Free Trade Area), note that Peru has not liberalized 686 headings for Colombia, 414 for Ecuador and 590 for Venezuela. It is thus expected that bilateral trade between those countries and Peru will increase with the progressive deregulation of those headings. At the Meeting of the Andean Presidential Council of January 2002, Peru agreed to move forward the deadlines for eliminating tariffs on oil derivatives and fuels to late 2003.

Although intra-Community exports as a percentage of world exports rose during the first half of the 1990s, in 1995 and following years, they clearly lost momentum in the Community integration process (Graph 11), with the striking exceptions of Bolivia and Colombia. In 1996 and 1998, nearly 25% of total Bolivia exports were to the CAN countries,[68] whereas Colombia exported one-fifth to those countries in 1995 and 1998. The trading relationships among the other Member Countries represent low percentages of their total exports, which would indicate a certain degree of stagnation in the process of forming the enlarged economic area.

GRAPH 11
INTRA-COMMUNITY EXPORTS AS A PERCENTAGE OF TOTAL EXPORTS
(Percentages)



Preparation: In-house
Source: Andean Community

Exports of manufactured goods

This is the most salient feature of intra-subregional trade, from which the countries should profit more fully if the integration process is appropriately consolidated. Evidently, Venezuela exports most manufactured goods to the Andean Community (Graph 12).[69] It exports twice as much of such products as do its neighbors, Colombia and Peru. However, its production is clearly concentrated in natural resource-based products, of relatively little added value. Over half the annual exports of both Venezuela and Peru are oil or mining-related. For Venezuela, petroleum products account, on average, for over half of annual exports, while the processing of base metals accounts for nearly one-fifth. Nearly half of Peru's exports

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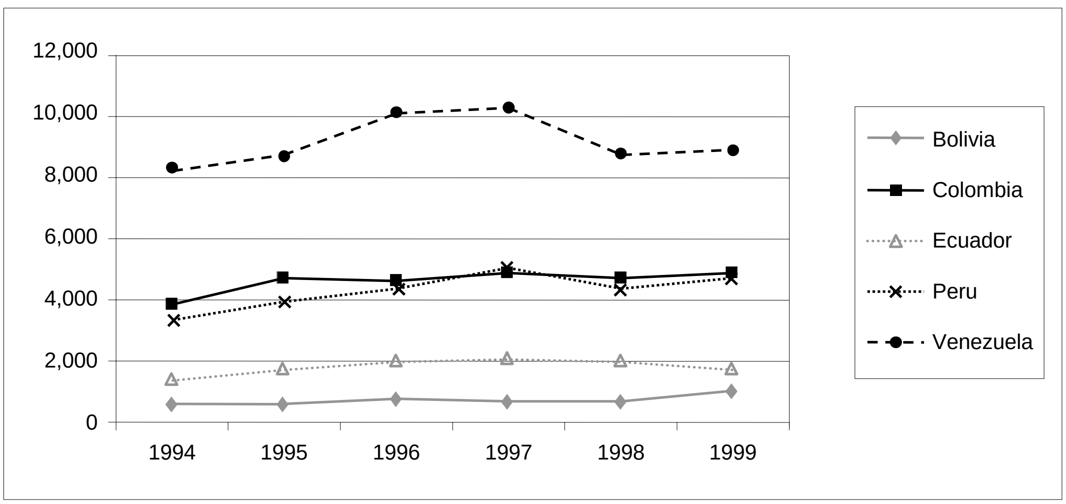
[68] Plant products (Section 02 of the Harmonized System) and prepared foodstuffs (Section 04 of the Harmonized System) represent an average of 52% of Bolivia's exports to CAN. Within those sections, the main products exported include subheadings 1201 (soy beans, whether or not broken), 1208 (flour and meal from oil seed and oleaginous fruit) and 2304 (soybean oilcake and other solid residue, including grounds or pellets).

[69] This section bases its analysis on data from ISIC Rev. 3, Category D, which corresponds to manufacturing industries. This information has been obtained from the DATAINTAL System of Statistics on External Trade.

are concentrated in base metals, while food products and beverages account for nearly one-third of annual exports. Colombian exports, in contrast, are much more diversified. Chemical substances and products account for nearly one-fifth of its annual exports, but Colombia also exports significant amounts of food products and beverages, as well as garments, and tanned and dyed leather. Clearly, Columbia has more interesting strategy, as its exports are not markedly affected by external shocks generating fluctuations in raw material prices. A recent *Universidad del Pacífico* study (Araoz, *et al.* [2001]) calculated the Revealed Comparative Advantage Index (RCA)[70] of different manufacturing industries in Peru and Colombia in 1996. While Peru had only four industries (of a total of 28) with revealed comparative advantage—three of them in current consumer goods industries and only one intermediate goods industry—Colombia had nine, five of which were intermediate goods industries. This confirms Colombia's specialization in manufacturing activities other than natural resource extraction, whose products have targeted mainly the Community market.

Ecuador and Bolivia export relatively few manufactured products.

GRAPH 12
WORLD EXPORTS OF MANUFACTURED GOODS *
(US$ million)



Preparation: In-house

Note: * According to ISIC Rev. 3, Category D (Manufacturing industries)

Source: DATAINTAL

From 1994 to 1999, Andean exports of manufactured goods as a percentage of total exports to the rest of the world averaged 54%. The notable case here is Peru, 76% of whose exports to the rest of the world were of manufactured goods.[71] However, at the intra-Community level (i.e., manufacturing exports to CAN as a percentage of total exports to CAN), the specialization in manufactured goods is evident, as the proportion rises to 83% for the same period. Accordingly, we now turn our attention to an analysis of intra-Community trade in manufactured goods.

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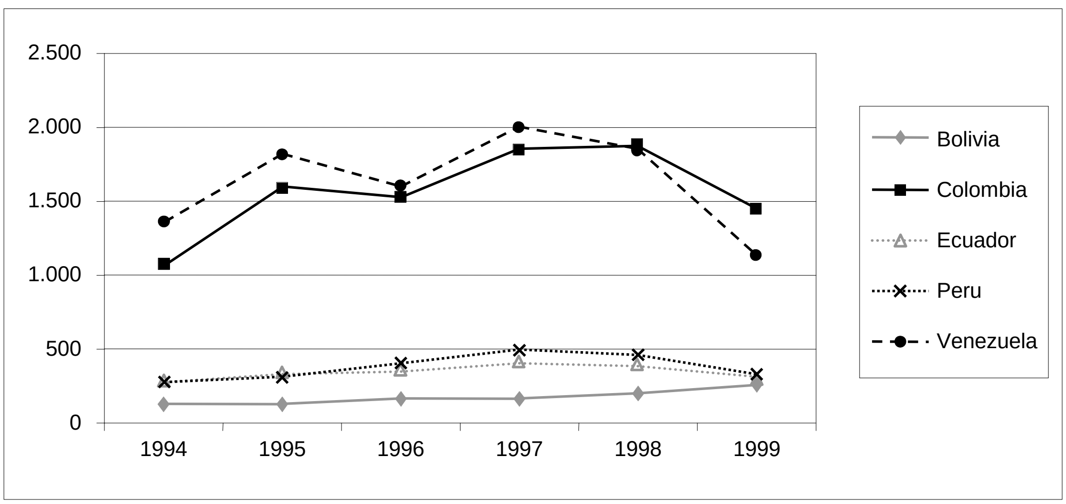
70 This index enables the trade specialization of a particular country to be studied.

71 However, these data must be used with caution because, as discussed above, a large proportion of manufactured exports are associated with natural resource extraction-related activities, such as mining for Peru and oil for Venezuela.

In this period, Colombia and Venezuela were the main exporters of manufactured goods both to the Community and to the world (Graph 13). Their exports are about four times the exports of Bolivia, Ecuador and Peru taken together. Colombia exported essentially the same products as it exported to the world, i.e., chemical substances, chemical products, food products and beverages. The study mentioned above (Araoz, *et al.* [2001]) also calculated the RCA for Colombian and Peruvian intra-Community exports for 1996. Colombia had 20 industries with revealed comparative advantage, eight in intermediate goods and four capital goods industries. In contrast, Peru had only seven, two in intermediate goods and two durable consumer or capital goods industries. This indicates Colombia's specialization—even more marked than the general case—in goods of this type, which may be linked to Peru's decision to withdraw from the Andean integration process. The range of Venezuela's manufactured goods is more homogenous. As in Colombia, chemical substances, chemical products, food products and beverages account for a significant percentage of its manufactured goods exports to the subregion, but on a somewhat smaller scale, which suggests the possibility of manufacturing development in Venezuela towards the Andean Community, benefiting from integration, particularly with neighboring Colombia. Most of the rest of Venezuela's manufactured exports are base metals, petroleum products and automotive vehicles.

GRAPH 13
INTRA-COMMUNITY MANUFACTURED GOODS EXPORTS *
(US$ million)



Preparation: In-house

Note: * Corresponds to Category D (Manufacturing industries) in ISIC Rev. 3

Source: DATAINTAL System of Statistics on External Trade

The scale of exports of automobiles, trailers and semi trailers may be explained by joint industrial programming policy for the automotive sectors of Venezuela, Colombia and Ecuador, in place since 1993[72], which was successful in generating exports of such products. They account for 16% of Venezuelan, 17% of Ecuadorian and 7% of Colombian intra-Community manufactured exports (although the percentage is not very large, the values are quite high).

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[72] This subject was discussed above.

D. Imports

Table 24 shows Community import trends. The trend was generally upward until 1999, when imports dropped dramatically. Although recovering in 2000, they did not reach 1998 levels. Up to 1998, the average rate of growth of imports was 9%, with rates that were quite high in 1995 (25%) and 1997 (19%). However, these rates dropped by 23% in 1999, a recessionary year for the Community countries. Andean GDP fell by 4.4% over 1998 levels. The impact of the drop in GDP was also reinforced by the depreciation of many currencies: Ecuador (116%), Colombia (23%) and Peru (15%), as shown in Table 25.

TABLE 24
IMPORTS OF GOODS FROM THE WORLD
(US$ million)

Countries	1992	1993	1994	1995	1996	1997	1998	1999	2000
Bolivia	1,115	1,177	1,196	1,434	1,643	1,892	2,382	1,854	1,849
Colombia	6,886	9,841	11,856	13,863	14,355	15,481	14,678	10,659	11,530
Ecuador	2,417	2,553	3,650	4,193	3,932	4,955	5,503	2,815	3,569
Peru	3,790	4,191	5,629	7,584	7,775	8,367	8,098	6,531	7,401
Venezuela	13,155	11,640	8,401	11,250	9,321	13,288	15,048	13,320	15,278
CAN	27,363	29,402	30,732	38,324	37,026	43,983	45,709	35,179	39,627

Preparation: In-house
Source: Andean Community

TABLE 25
NOMINAL EXCHANGE RATE
(Unit of local currency per US$)

Year	Bolivia	Colombia	Ecuador	Peru	Venezuela
1992	3.9	679	1,534	1.25	68
1993	4.3	787	1,919	1.99	91
1994	4.6	827	2,197	2.20	149
1995	4.8	913	2,564	2.25	177
1996	5.1	1,037	3,189	2.45	417
1997	5.3	1,141	3,998	2.66	489
1998	5.5	1,426	5,447	2.93	548
1999	5.8	1,756	11,787	3.38	606
2000*	6.3	2,166	25,000	3.50	691

Preparation: In-house
Note: * Estimated
Source: ECLAC, Web page database

Table 26 shows annual Community imports by category, according to SITC Rev. 3 (based on DATAINTAL data). The table is organized by the main categories imported in 1999. The most important category based on annual average values of products imported by the CAN countries was transportation machinery and equipment, accounting for 40%. This was followed by chemicals and related products, and manufactured goods, accounting for 16% each. The food product and live animal category accounted for 10%.

Road motor vehicles accounted for 25% of machinery and transportation equipment imports. The rest of such imports were industrial machinery and industry-specific machinery. Thus, nearly one-fifth of imports were of general industrial machinery and equipment, including machine parts. Telecommunication devices and equipment and special industry-specific machinery were imported on a smaller scale. Organic chemicals accounted for a quarter of imports of chemicals and related products. These were followed by imports of medicinal and pharmaceutical products; chemical substances and products; and finally plastics in their primary form.

As for manufactured products by material, imports of iron and steel predominated, followed to a lesser extent by paper and cardboard articles, and articles made of yarn, fabrics, and textile fibers. Thus, generally speaking, the type of trade of the Andean region with the world remained inter-industrial, exporting mainly raw materials in exchange for manufactured goods, particularly capital goods and intermediate manufactured goods. Subregional trade is more a nascent intra-industrial trade, and suggests that, with greater integration, it would be possible to promote the development of a more diversified export supply.

TABLE 26
PRINCIPAL PRODUCTS IMPORTED BY THE CAN COUNTRIES *
(US$ million)

	1994	1995	1996	1997	1998	1999
Machinery and transportation equipment	13,090	14,594	14,314	17,926	18,398	13,557
Chemicals and related products	4,593	6,261	5,872	6,754	6,481	5,882
Manufactured articles, primarily by material	4,591	6,362	5,949	6,923	6,927	5,353
Food products and live animals	2,815	3,572	4,168	3,984	4,432	3,694
Miscellaneous manufactured articles	2,195	2,953	2,917	3,573	3,652	3,295
Fuels and mineral lubricants and related products	944	1,484	1,508	2,382	1,596	1,530
Inedible raw materials, except fuels	1,069	1,555	1,268	1,383	1,184	994
Oils, fats and waxes of animal and plant origin	349	424	358	382	545	425
Beverages and tobacco	198	240	253	302	318	295
Goods and operations not classified under other headings	746	856	357	361	480	150
Total	30,590	38,301	36,964	43,970	44,013	35,175

Preparation: In-house
Note: * According to SITC Rev. 3 and arranged by 1999 values
Source: DATAINTAL System of Statistics on External Trade

Intra-Community imports in fact grew by an average of 15% per year from 1993 to 2000 (Table 27), with an upward trend until 1998, when they began to decline, stemming from the crises discussed above, the recession that spread through the subregion and the depreciation of Andean currencies. In 1998, the currencies of the Andean countries were depreciated at the average annual rate of 17%. The rate was 34% in 1999, a figure distorted primarily by depreciation in Ecuador that year, which was 116%. In that connection, in that year general Ecuadorian imports fell by 49%, while intra-Community imports fell by 40%.

TABLE 27
INTRA-COMMUNITY IMPORTS
(US$ million)

Country	1992	1993	1994	1995	1996	1997	1998	1999	2000
Bolivia	40	77	103	116	141	166	175	154	157
Colombia	694	1,292	1,542	1,845	1,848	2,232	1,900	1,438	1,612
Ecuador	160	181	494	706	653	918	965	578	859
Peru	596	522	646	1,190	1,433	1,564	1,175	980	1,399
Venezuela	618	573	494	1,023	832	1,027	994	945	1,439
CAN	2,108	2,646	3,279	4,880	4,907	5,907	5,209	4,095	5,466

Preparation: In-house
Source: Andean Community

E. Trade balance

Table 28 shows trade surpluses or deficits in the Andean countries from 1992 to 2000. Bolivia and Peru remained in deficit throughout the period, while Venezuela showed surpluses throughout, owing to the aforementioned oil exports and the fact that the value of such exports far exceeded the value of exports from its Andean neighbors. Ecuador showed a positive trade balance in all years (except for 1998), also owing to its oil exports, and food product and live animal exports.[73] Although these results are not very encouraging, it should be recalled that the 1990s was a decade when the subregion opened up after a period of very high levels of protectionism. It was also a period of economic reform, harsh fiscal and monetary adjustments, appreciating currencies, at least until 1998, and significant capital inflows to the subregion, both short-term (speculative) capital and direct foreign investment in privatizations and new projects. Thus, the current account deficits also reflect other phenomena not related solely to the subregion's relative lack of competitiveness, but rather to macroeconomic factors of both positive and negative impact.

The terms of trade were relatively stable, and favorable for Ecuador and Venezuela (see Table 21). However, in 1998, they fell markedly for all Andean countries, the only year when Ecuador showed a trade deficit of over US$ 1.3 billion (the terms of trade deteriorated by 11% in 1998), while the Venezuelan surplus declined by 80%.

[73] On average, that group represented 54% of total Ecuadorian exports for the 1994-1999 period according to SITC Revision 3. Eighty-four percent of Ecuadorian exports for the category of food products and live animals were fish, crustaceans, mollusks and aquatic invertebrates and manufactures thereof (40%); and vegetables and fruits (44%), notable among which were exports of bananas and prawns.

TABLE 28
GENERAL TRADE BALANCE
(US$ million)

Country	1992	1993	1994	1995	1996	1997	1998	1999	2000
Bolivia	-410	-426	-155	-296	-565	-620	-1,057	-452	-392
Colombia	186	-2,718	-3,448	-4,104	-3,793	-3,970	-3,888	890	1,519
Ecuador	640	509	75	168	968	309	-1,362	1,392	1,253
Peru	-430	-847	-1,268	-2,143	-1,940	-1,623	-2,458	-558	-607
Venezuela	1,029	3,819	8,316	5,954	13,804	9,598	1,953	6,756	16,024
CAN	1.015	337	3,520	-421	8,474	3,694	-6,812	8,028	17,797

Preparation: In-house
Source: Andean Community

The trade balance results in the Andean context are discouraging (Table 29), which may to some extent explain the trade tensions among the countries and the cases brought before the Community's General Secretariat or the Andean Court of Justice. Venezuela and Bolivia are the only countries that continuously showed a surplus in their intra-Community trade balance during the review period, with the Venezuelan surplus averaging six times that of Bolivia. In contrast, Peru is the only country that continued to show a deficit for the entire period analyzed, with an average deficit of US$ 672 million, even greater in absolute terms that the average Venezuelan surplus. Peru has recurring deficits with all Andean countries (except for a few years in its trade relations with Ecuador and Bolivia), particularly with Colombia and Venezuela, with average deficits of US$ 276 million with Colombia and US$ 184 million with Venezuela. This result may be explained by the unilateral decision taken by Peru regarding trade integration with the Andean countries.

TABLE 29
INTRA-COMMUNITY TRADE BALANCE
(US$ million)

Country	1992	1993	1994	1995	1996	1997	1998	1999	2000
Bolivia	51	43	93	102	119	85	144	139	147
Colombia	320	-153	-432	92	-9	-118	230	196	555
Ecuador	18	113	-109	-347	-224	-282	-425	-132	-196
Peru	-321	-253	-336	-785	-1.016	-1.049	-706	-633	-953
Venezuela	48	472	932	859	916	1.084	960	275	147

Preparation: In-house
Source: Andean Community

F. Foreign direct investment (FDI) in CAN [74]

In general, taking into account the size of the Andean economies, it may be said that average investment flows in the subregion (as a percentage of GDP) were higher in the 1990s than the Latin American average, representing about 3% of GDP (Araoz, *et al.* [2001]). Foreign companies that invest in

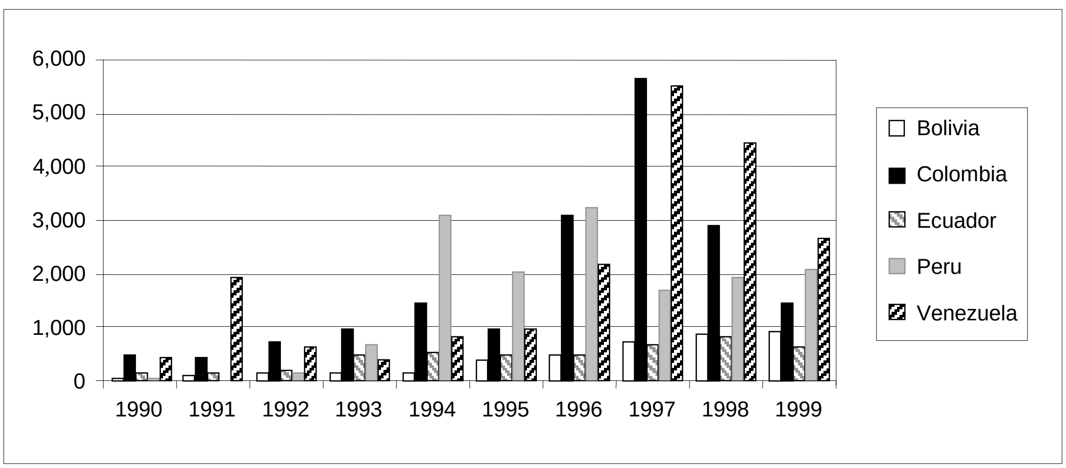
[74] This section was prepared based on Andean Community document SG/dt 111, 2001.

Community countries do so in natural resource-based sectors[75] or, when they invest in other types of sectors, they do so, as an investment-promoting alternative, with a view to meeting local market, not necessarily subregional market, demand. Nonetheless, consolidation of subregional integration coupled with physical integration might be seen as an investment-attraction opportunity, investment more diversified in terms of sectors targeted, ones of greater added value for the subregion's enlarged market.

In that connection, in a survey of executives from foreign companies operating in the Andean countries, Vial [2001] determined that the main variable considered by foreign companies when investing in these countries was the local market. The results of that study also indicate that certain transportation cost-related variables are perceived as very negative, among them deficient road infrastructure, foreign trade transaction procedures, port operations, land and air transportation markets, and others. Other problems noted are corruption and inefficiency in government agencies and in justice administration. However, it is paradoxical that although investors have a negative view of various FDI-related aspects, FDI in the subregion multiplied between 1990 and 1999 (Graph 14), which would suggest that the Andean market is important and that the Andean integration strategy coincides with what foreign firms are looking for, i.e., broad markets.

Despite a clear positive trend in the flows of FDI in the review period, there were marked fluctuations stemming from the privatization process. In fact, from 1993 to 1997, FDI for privatizations represented --exclusive of FDI in Bolivia-23% of the total.[76] Discounting this component, FDI grew steadily until 1998, when it reached US$ 11 billion, with virtually no privatization funds.

GRAPH 14
FLOWS OF FDI RECEIVED
(US$ million)



Source: Andean Community

If trends in FDI in each country are examined, in Ecuador's case, there is remarkably little growth, particularly since 1993. It must be pointed out that Ecuador has not begun a large-scale privatization process and, since 1996, has had an unstable political climate, doubtlessly acting as a disincentive to FDI. The other countries showed marked growth, particularly since 1994.

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75 To be noted are the cases of Bolivia and Ecuador, where FDI in primary sectors, measured as a percentage of GDP, represented 5.8% and 3.1%, respectively.

76 The data available to the Community Secretariat do not break down income to reflect privatizations in Bolivia and therefore these figures are not included in Community aggregates. For Ecuador, information on privatizations is available beginning only in 1993.

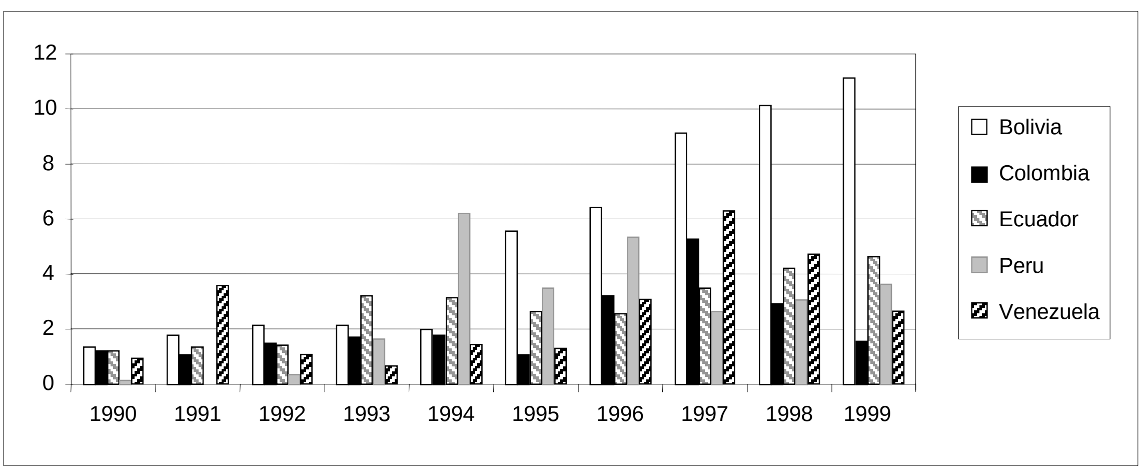
Graph 15 shows flows of FDI received as a percentage of GDP. Clearly, FDI is increasingly important for the Member Countries. Bolivia is the country where FDI grew most, from 1.4% in 1990 to more than 11% of GDP in 1999, while for the other countries, FDI ranged from 1% to 6% of GDP. As for the sectoral composition of that FDI, it should be underscored that Bolivia, Colombia and Venezuela had significant amounts of FDI in the manufacturing sector measured as a percentage of GDP, at 0.7% in Bolivia and Colombia and 0.6% in Venezuela. Also to be noted are investments in the Bolivian and Colombian service sector, at 3.6% in Bolivia and 2.5% in Colombia. Investments in the primary sectors are largest in the case of Bolivia, at 5.8% and Ecuador at 3.1% of GDP (Table 30).

TABLE 30
SECTORAL COMPOSITION OF FDI IN THE ANDEAN COUNTRIES
(Average for 1996-1999, as percentages of GDP)

Country	Sectors			
	Primary	Manufactures	Services and others	Total
Bolivia	5.8	0.7	3.6	10.1
Colombia	1.0	0.7	2.5	4.2
Ecuador	3.1	0.1	0.4	3.7
Peru	0.3	0.3	0.9	1.4
Venezuela	0.1	0.6	0.4	1.1

Preparation: In-house
Source: Vial [2001]

GRAPH 15
ANNUAL FDI AS A PERCENTAGE OF GDP



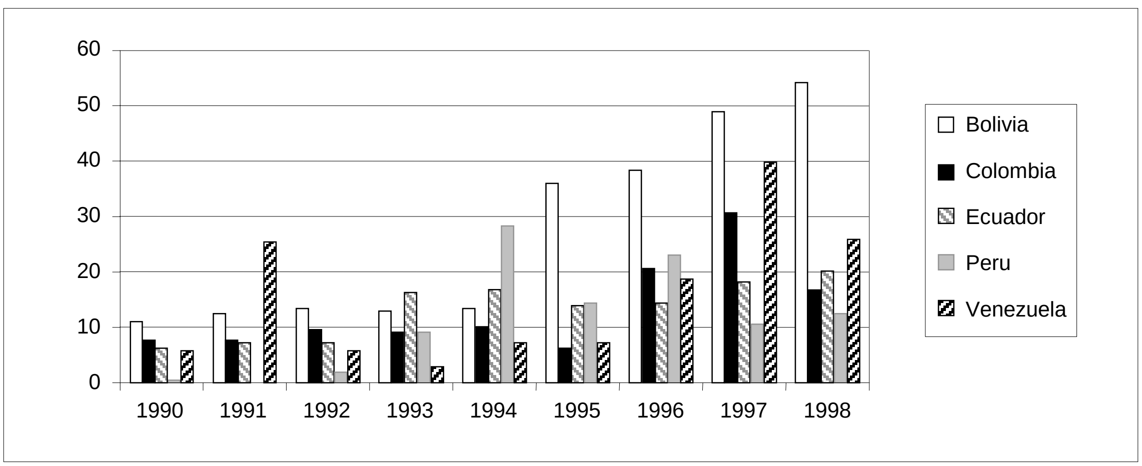
Source: Andean Community

The CAN countries have not been immune to the global trend affecting developing countries since the 1990s wherein external financing primarily takes the form of FDI. The importance acquired by FDI is reflected particularly in two areas: external sector financing and investment support.

The first area is particularly important in the context of trade deregulation; it generally resulted in a gradual deterioration in the trade balance (as in Bolivia, Colombia, Peru and, to a lesser extent, Ecuador). This trend helped to weaken the current account position, with deficits, in recent years, of about 5% of GDP in the first three countries named. In that connection, an important relationship was established between current account deficits (for years when it was over 2% of GDP) shown by the countries since 1993[77] (with the exception of Venezuela, whose trade balance was rather ample) and FDI received in those years, which was decisive as a source of external financing.[78]

In the second area, investment support, FDI provided impetus to gross fixed capital formation (GFCF). However, as, in some privatization processes, FDI acquires existing assets, not all FDI results in the creation of fixed capital, and it is thus impossible to quantify the direct impact of FDI on this variable. Nonetheless, even when there is no impact on GFCF at the time FDI enters a country, there is a medium- and long-term impact on modernization and expansion processes in the companies to which it is directed.[79] It is thus interesting to analyze the FDI/GFCF ratio, as shown in Graph 16. Again, Bolivia is a remarkable case, moving from the reduced level of barely 12% of GDP in 1990 to 18% in 1998 (growth of 150%). At the same time, its FDI/GFCF ratio rose from 10% to over 50%.

GRAPH 16
RATIO OF FOREIGN DIRECT INVESTMENT TO GFCF
(as a percentage of GDP)



Source: Andean Community

The policy of the Community countries was to attract investment by demonstrating, through investment banks or "road shows," their macroeconomic stabilization policies and the results generated by them. However, in the 1990s, there were, generally speaking, no vigorous investment promotion strategies and efforts. Nonetheless, public asset sales-related activities were organized, with little or no investor services, and many efforts scattered among various public entities.[80] The only exception was Colombia, with the

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77 Except for Ecuador in 1996.

78 For more detail on this subject, see the document prepared by the CAN General Secretariat [2001c].

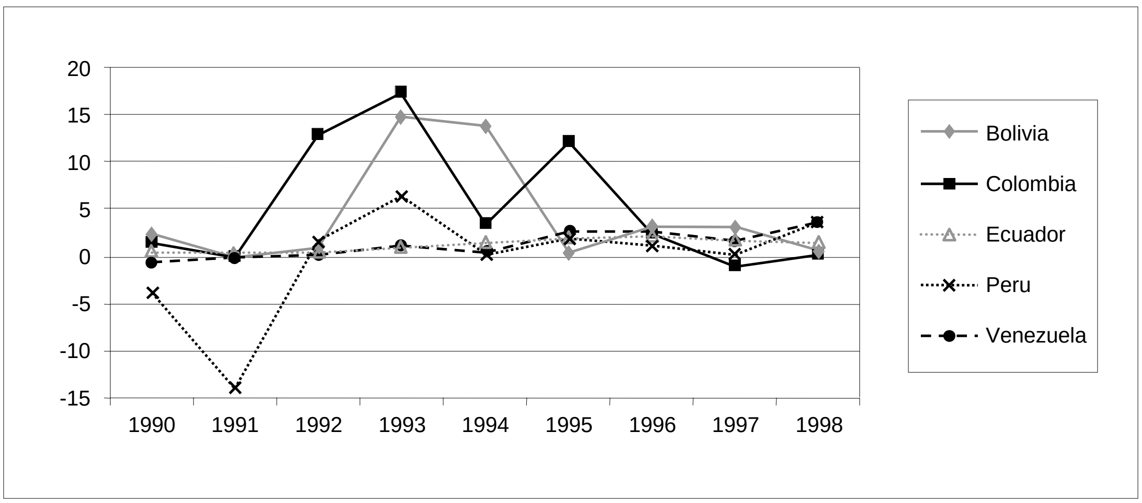
79 As mentioned in the document prepared by the CAN Secretariat [2001c], this is the fundamental logic supporting privatization.

80 For example, see Araoz, *et al*. [2001], which examines the Peruvian case and discusses activities of investment promotion agencies carried out in the subregion.

COINVERTIR agency, as the achievements of its investment attraction strategy are to some extent reflected in the type of investments received, basically in sectors of greater added value and for regional export. In 2001, after having undergone UNCTAD's investment policy review Ecuador established an agency of this type. Peru has also been discussing this possibility.[81]

In this context of rapid growth in FDI, there was no parallel development in intra-Community investment, as available figures[82] indicate that only in Colombia and Bolivia was the ratio of such investment to total FDI significant, in some years (Graph 17). For Colombia, it was significant in 1992, 1993 and 1995, when it represented between 12% and 17% of total FDI. For Bolivia, it represented about 14% in 1993 and 1994. In other years, the proportion of intra-Community investment in total investment was virtually nil (averaging 1.7% in the 1996-1998 period).

GRAPH 17
RATIO OF SUBREGIONAL FDI TO FDI RECEIVED
(as a percentage)



Source: Andean Community

If direct intra-Community investment is broken down by country of origin,[83] we see that it is linked to trade relations. Colombia appears as the largest investor country in the CAN countries, with significant investments in Venezuela and Ecuador, an upward trend in investment in Venezuela and a trend to maintain or even reduce its investment in the case of Ecuador. Colombia was also the largest investor in Peru, although its relative share fluctuated considerably. In 1992, 1993 and 1995, Colombia was also the major target of intra-Community investment, primarily of Venezuelan and, to a lesser extent, Ecuadorian origin. Such investment targeted the financial sector. Venezuela invested heavily in 1992, 1993 and 1995, but this declined notably in later years, until there was actually disinvestment in 1997. More recently (1996-1998), Colombia's volume of subregional investment declined substantially.

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81 *Ibid*., Chapter 5.

82 As no information was available on FDI in the balance of payments broken down by country of origin, except for Ecuador, other sources were used for the remaining countries (Bolivia, INE; Colombia, net flow of FDI shown, BRC; Peru, FDI shown, CONITE; Venezuela, FDI shown, BCV).

83 Values broken down by year for 1990-1997 are not available for Bolivia.

The limited investment in Bolivia came primarily from Peru. As mentioned above, investment in Ecuador was essentially of Colombian origin—with investment increasing systematically up to 1997, but then declining—and of Venezuelan origin.

G. Final observations

As seen in this part of the report, the Andean Community is still not benefiting from the integration mechanism as a tool to enhance its competitiveness. Although intra-subregional commercial transactions rose significantly, in particular, in more highly manufactured goods, this was still insufficient to create Community momentum in intra- and extra-subregional trade. There were also repercussions for the attraction of subregional investment. Although the initial headway in Andean integration might suggest that an enlarged economic area was being formed, the dynamics of decision-making rendered the market as a whole less attractive than other Latin American markets.

However, there is very clear and pragmatic intent on the part of the subregion's political leaders and the corporate sector to establish the Customs Union without delay and to eliminate bureaucratic barriers to trade and investment, particularly in the context of the imminent FTAA negotiations, which will test the consolidation of subregional economic relations. Such intent is manifest in the signing of the Declaration of Santa Cruz, and later statements by the region's business leaders urging acceleration of implementation of the CET.

If conditions result in the definitive formation of a Common Market, trade and integration of production would develop in the subregion, and the Andean area would become more attractive to FDI. However, the Member Countries will have to exert themselves to expand their trade, lend stability and convergence to their macroeconomic policies, and cooperate with a view to microeconomic changes to enhance their competitiveness, particularly in connection with physical integration and technological development.

ANNEX

PRINCIPAL RESULTS ACCORDING TO THE GCR: 1998 - 2001

Results according to GCR 2001					
Criterion	**Bolivia**	**Colombia**	**Ecuador**	**Peru**	**Venezuela**
Competitive growth	67	65	68	55	62
Technology index	67	56	69	62	55
Public institutions index	62	57	68	45	65
Macroeconomic environment index	70	66	62	58	53
Current competitiveness	75	56	72	63	63
Company strategy index	75	52	71	65	65
Quality of business environment index	74	59	72	62	62

Results according to GCR 2000					
Criterion	**Bolivia**	**Colombia**	**Ecuador**	**Peru**	**Venezuela**
Competitive growth	51	52	59	48	54
Economic creativity	59	56	58	51	54
Innovation	59	53	57	54	56
Technology transfer	57	54	58	40	47
Business start-ups	57	54	59	56	56
Finances	43	53	57	48	52
Openness	34	35	39	40	50
Current competitiveness	58	48	57	49	54
Company sophistication	58	48	55	53	49
Quality of corporate environment	57	48	58	51	55

Results according to GCR 1999					
Criterion	**Bolivia**	**Colombia**	**Ecuador**	**Peru**	**Venezuela**
Ranking	55	54	53	36	50
Openness	41	49	44	38	39
Government	34	55	38	10	37
Finances	56	52	54	40	48
Infrastructure	54	48	55	39	52
Technology	59	57	58	52	50
Management	59	43	51	49	47
Labor market	54	58	44	22	52
Institutions	58	53	54	44	57

Results according to GCR 1998					
Criterion	**Bolivia**	**Colombia**	**Ecuador**	**Peru**	**Venezuela**
Ranking	n.d.	47	n.d.	37	45
Openness	n.d.	44	n.d.	37	36
Government	n.d.	39	n.d.	9	28
Finances	n.d.	46	n.d.	45	41
Infrastructure	n.d.	45	n.d.	41	48
Technology	n.d.	49	n.d.	50	48
Management	n.d.	38	n.d.	43	40
Labor market	n.d.	32	n.d.	21	49
Institutions	n.d.	50	n.d.	40	52

Preparation: In-house

Contents

CHAPTER V. COMMON FOREIGN POLICY

A. Introduction

Since its inception, the Andean Community has taken steps to improve access for its products to the international market for the benefit of Member Country producers. This was true both in the context of the Latin American Free Trade Association (LAFTA)—now the Latin American Integration Association (LAIA)—and in the international context of negotiations for the General Agreement on Tariffs and Trade (GATT) and later in the World Trade Organization (WTO). At the bilateral level, there have been concerted efforts to obtain special treatments under the generalized systems of preferences (GSP) of developed countries, such as the United States and the EU.

Such efforts were sustained and gained in importance after the conclusion of agreements established at the presidential and foreign ministerial levels, agreements adding new topics to the Community agenda. This led to Decision 475, adopted by the Commission in February 2000, which defined the Common Foreign Policy (CFP). The Decision establishes the CFP's general principles: its objectives, basic criteria, implementation mechanisms, modalities, and areas of action in the political, economic and socio-cultural spheres. The CFP is implemented through three authorities: the Andean Presidential Council, the Andean Council of Foreign Ministers, and the Meeting of Vice Ministers of Foreign Affairs or of High-Level Officials.[84] The Commission of the Andean Community has responsibility for carrying out actions within its sphere of competence, in coordination with the Andean Council of Foreign Ministers.

Decision 475 provides for a broad range of fields of action. In the political sphere, it covers subregional unity, relations with extra-subregional areas, democracy and human rights, strengthening of multilateralism, confidence- and security-building, sustainable development, and the fight against drug-trafficking, corruption, terrorism and illegal arms trafficking. In the economic sphere, the CFP focuses on promoting subregional integration and free trade, preferential access for Member Country products, intensification of international cooperation, promotion of trade and investment, joint action in international forums, definition of common positions on the architecture of the international financial and monetary system and on intellectual property rights, and promotion of a common position as regards the agricultural, energy and transportation sectors.

In February 2000, the Andean Council of Foreign Ministers adopted Directive 475, which established criteria and guidelines for the programming and implementation of the CFP. In April 2000, mechanisms were established for follow-up of the Common Foreign Policy (Decision 476). Decision 499 of June 2001 updates the Directive on the formulation and implementation of the CFP.

B. Promoting the foreign trade of the Member Countries

The Andean Community has taken steps in many areas to promote the interests of its Member Countries. Nonetheless, this study focuses on the opening of markets and participation in international efforts to establish a framework for the promotion of greater trade flows and enhanced competitiveness at the Andean level.

CAN has engaged in successful negotiations with the United States and Europe for the opening of markets, and is currently engaged in negotiations for improved access to the Canadian market. To that

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[84] The Andean Council of Foreign Ministers was established in November 1979 and, in 1996, was incorporated in the legal framework of the Cartagena Agreement under the Trujillo Protocol. The Council is authorized to adopt Decisions of a binding nature. The Protocol of Sucre, signed in 1997, contains a new chapter on foreign relations.

end, CAN has included groups of products of particular interest to its exporters in the generalized systems of preferences of these countries.

United States

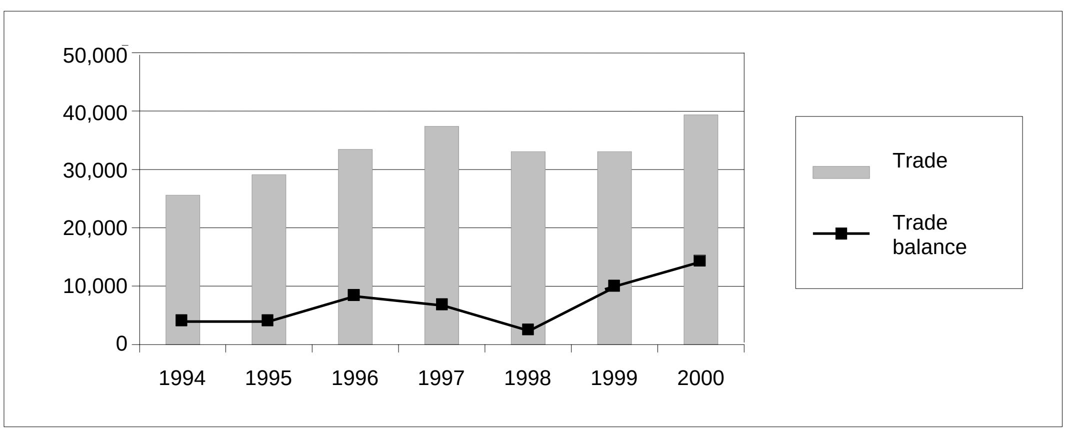
CAN interacts with the United States on three fronts: first, opening up that market to Andean products of interest; secondly, joint action to attract investment from that country to subregional markets; and third, joint deliberations on topics pertaining to the CFP that are also of interest to United States authorities.

The United States is the foremost trading partner of the Andean Community's Member Countries. Forty-four percent of Andean exports go to that country, while 35% percent of its imports come from the United States. CAN's trade balance with the United States was positive throughout the entire 1990s (Graph 18). The years when it was most favorable were years when sales to that country of oil and its derivatives were highest. In 2000, it achieved a surplus of over US$ 14 billion.

In 2002, the value of trade between the United States and CAN was US$ 40 billion, of which US$ 27 billion represented exports from CAN to the United States and US$ 13 billion represented imports to CAN from the United States The main export products were crude oil (22.5% in 1999), petroleum derivatives (5.6%), caffeinated coffee (1.4%) and bananas (1.1%). In order of importance, these are followed by refined copper cathodes, shrimp and prawns, powdered pigments, and sheet metal. The range of imports is very diversified, mainly hard yellow corn, telephone transmission and reception equipment, wheat and vehicles (according to CAN data). Venezuela is the lead exporting country, the exports being mainly oil and petroleum derivatives, followed by Colombia, Peru, Ecuador and, to a lesser extent, Bolivia.

Growth rates for Andean exports to the United States in the 1990s were dynamic. Colombia was most dynamic, with average annual growth of 10%. It is followed by Peru (9%), Bolivia (6%), Venezuela (5%) and finally Ecuador (2%).

GRAPH 18
CAN TRADE BALANCE WITH THE UNITED STATES
(US$ million)



Preparation: In-house
Source: DATAINTAL (IDB), CAN

In terms of market access, in 1991, the United States granted the CAN countries greater preferences under its Generalized System of Preferences, when Congress passed the Andean Trade Preference Act (ATPA), as support for the war against drugs. The Act authorizes tariff reductions for most imports from Bolivia, Colombia, Ecuador and Peru.[85]

Increasing use is being made of trade preferences. It is estimated that over 30% of Andean exports to the United States enter under this mechanism. According to CAN, nearly 50% of U.S. imports take advantage of this prerogative, which covers 6,400 products. The preferential rates granted by ATPA are 0% in most cases and 2.5% *ad valorem* for certain products. Some products, such as beef, sugar and some farm products, must satisfy some criteria in addition to those contained in the ATPA, such as quotas and sanitary requirements established by the U.S. Government. In addition, although they cannot enter the United States duty-free, products such as luggage, leather briefcases, wallets, portfolios, gloves and leather clothing may be eligible to enter at reduced rates. In addition, APTA preferences do not apply to some products, such as most textiles and clothing, specific footwear, canned tuna, oil and petroleum derivatives, some watches and watch parts, some sugar-based products and rum. The Member Countries are requesting that these products be included in part to place them on equal competitive footing with that of the Central American and Caribbean countries, which currently enjoy preferential treatment, prior to the launch of the FTAA.

The main U.S. imports that benefited from the ATPA from 1995 to 1999 were live trees and other plants, flowers and ornamental foliage; copper and its derivatives; natural or cultured pearls and certain precious stones; dyes and dye derivatives; fish, mollusks and other marine invertebrates; zinc and zinc derivatives; some vegetables and tubers; plastic items; wood and wood articles. Taken together, they represented 86% of U.S. imports under ATPA in 1999 (U.S. International Trade Commission [2000]).

The U.S. International Trade Commission did two case studies for Peru and Bolivia, along with a study of the general trade balance for all the beneficiary countries. It determined that the benefits of ATPA for the beneficiary countries are small but positive. In particular, the model detected three effects: growth of exports of agricultural products and manufactured goods and a slight decline in exports of other raw materials; a slight improvement in the terms of trade; and a slight increase, of under 0.1%, in the GDP of the Andean region.[86]

The U.S.-Andean Community Trade and Investment Council was established in 1998 to promote investment and trade flows. Other Council objectives include the promotion of measures to improve the effectiveness of the Andean Trade Preference Act and fostering collaboration among the countries' business communities.[87] The first meeting of this consultative body was held in May 1999 and, since that time, the Andean Community has expressed its interest in continued application of the Andean Trade Preference Act which, under U.S. law, expired in December 2001. The CAN Executive Secretariat and the Member Countries have been negotiating to extend the life of this instrument and to expand the list of products that may benefit from it.

FDI from the United States is very important for CAN. From 1996 to 2000, flows of FDI received by the Andean countries from the United States were somewhat uneven (Graph 19), but amounted to an average of over US$ 1.6 billion per year. Venezuela receives the most FDI from the United States and, in 2000, such investment basically targeted the services (29%), financial (28%) and petroleum (23%) sectors. In 2000, FDI from the United States to Colombia targeted primarily the manufacturing sector, while in Peru it targeted the

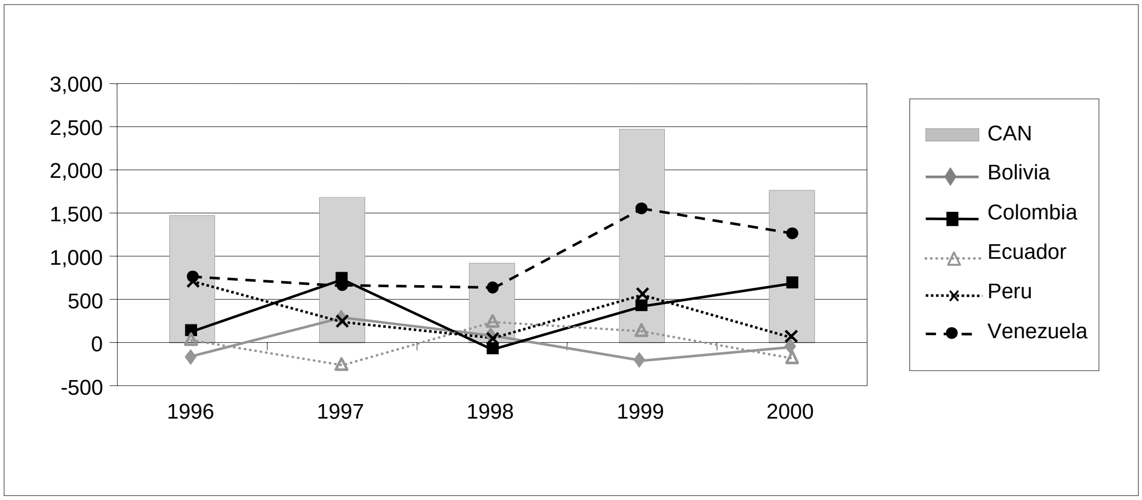
[85] These countries already enjoyed the special system of preferences. Under the ATPA, the list was enlarged, thus opening up the market for an additional group of products of special interest to the Andean countries.

[86] This analysis used a static general equilibrium model developed by the *Global Trade Analysis Project* (GTAP) to simulate application of the ATPA in the Andean region. The study took 1995 as the base year. For greater detail, see the abovementioned document.

[87] For greater detail, see Article 2 of the Agreement signed on October 30, 1998.

services sector. In fact, CAN is making efforts to obtain a progressive increase in such flows, and for these flows to target Andean economic sectors of higher added value.

GRAPH 19
FLOWS OF FDI FROM THE UNITED STATES TO THE ANDEAN COUNTRIES
(US$ million)



Preparation: In-house
Source: Bureau of Economic Analysis

Trade and investment ties with the United States will continue to be highly significant to the Community. Accordingly, the formation of a hemispheric free trade area is gaining in importance. This is an area of coordinated CAN effort, as will be discussed below. One topic on the agenda for the immediate future is renewal of the Andean Trade Preference Act, whose extension and expansion is very important for numerous exporters of non-traditional subregional products.[88] The delay in renewing both the GSP and the ATPA has implied the suspension of benefits received by the Andean countries under these schemes. Views in the U.S. Congress differ regarding the future of these instruments, particularly the ATPA. While for some legislators, the ATPA should be renewed and even expanded, for others there should be certain limits, even on previously agreed benefits. This situation works to the detriment of Andean producers, who, for the time being, have not only lost benefits but, in the face of such uncertainty, also face difficulties in continuing their sales. This could lead to the loss of markets that may be difficult to regain in the future. It is hoped that this situation will be resolved in 2002, particularly in the light of the Bush Administration's support for continued Congressional deliberations in this area.

European Union (EU)

The European Union countries are CAN's second most important trade partner. This group has been a faithful ally in Andean efforts to form first a common market and then a community of nations. The EU has supported numerous technical cooperation programs, which have facilitated analysis of the problems of integration and promoted specific actions of benefit to the CAN countries.

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[88] For several of the Andean countries, the principal issue is the inclusion of textile and food products under the ATPA system of preferences.

In 1998, the value of trade between the Andean Community and the EU was over US$ 14.5 billion, an increase of 41% over 1990 trade values. In the latter 1990s, the balance of trade was in deficit for the Andean countries, although a small surplus had been achieved from 1994 to 1996. The principal CAN exporter to the EU was Colombia (35% of total exports), followed by Venezuela (28%), Peru (21%), Ecuador (11%) and Bolivia (5%). Total exports in 1998 were US$ 6.325 billion, exceeding the value of intra-Community trade, which was US$ 5.333 billion in that year. The principal exports were coffee, bituminous coal, gold in various forms, shrimps and prawns, zinc ores, copper cathodes, fishmeal and canned tuna.

Since 1990, the products of four Andean countries (Bolivia, Colombia, Ecuador and Peru) have enjoyed preferential access to the EU under an Andean Generalized System of Preferences (Andean GSP) granted by the EU as support for the fight against illicit drug trafficking. As of 1995, Venezuela was incorporated into the system of preferences. In late 1998, the Andean GSP was renewed until December 31, 2001.[89] In June 2001, legislation was adopted to continue the preferences scheme, including the Andean preferences, for the January 1, 2002-December 31, 2004 period. This proposal provides for possible renewal of the Andean Generalized System of Preferences for the ten-year period 2005-2014, based on an evaluation to be made of the application of the system in the three-year period after extension of the preference system.

If the extent to which the Andean countries avail themselves of the GSP is measured by Andean exports under that system, Colombia makes best use, as its share is 31.7% of the total, followed by Ecuador with 28.9% and Peru with 22.6%. Bolivia has achieved only minimal participation, of 0.1%, of the total (virtually limited to wooden doors and alpaca clothing). However, estimates published by CAN indicate that Bolivia channeled 94% of its sales to the EU under this scheme, while for the remaining countries, the rate was 95% for Ecuador, 87% for Venezuela, 83% for Colombia and 82% for Peru.

Existing information indicates that the CAN countries avail themselves of the Drug GSP for a significant portion of their exports. Although part of the trade may possibly be explained by the additional margin of preference granted to the Andean countries under the system, without more in-depth study, it is difficult to establish the system's precise benefit.

In addition to purely trade matters, the EU and CAN have maintained ongoing political ties. In 1996, this situation was formalized within the signing of the Common Declaration Regarding the Political Dialogue between the European Union and the Andean Community, thereby creating an institutional framework in which to implement such dialogue. Since that time various meetings have been held at the level of foreign ministries, political representatives and Secretariats. In 1999, a working meeting was held with the participation of the Andean Foreign Ministers and three EU representatives. In February 2000, the Foreign Ministers of the two groups met in Vilamoura on the occasion of the Rio Group meeting. At that time, it was agreed to evaluate economic and trade relations before embarking upon a more advanced negotiation process with a view to an association agreement. The European Commission and the CAN General Secretariat were assigned responsibility for this study. There has been headway in this area and it was hoped that the status of relations could be reviewed at the Madrid Summit, held recently.

Finally, it should be emphasized that a Framework Cooperation Agreement is in place between the blocs. This was concluded in 1992 and, under it, ongoing technical and financial support has been provided to the CAN Secretariat. This framework promotes trade relations and the fight against drugs from a perspective of shared responsibility.[90]

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[89] The main characteristics of the Drug GSP are 0% tariff for all the industrial products and a list of agricultural products, regional accumulation of preferences, and inclusion of donor countries (i.e., products of EU origin are included as Andean products).[See *www.comunidadandina.org*, under Trade in Goods, rules of origin section, "Complementary Aspects," second paragraph.]

[90] The Framework Agreement is broad and very detailed as regards the objectives to be achieved and activities to be implemented through cooperation. It underscores promotion of trade and industry, and of science and technology. This Framework enables cooperation agreements to be established in many areas.

European cooperation has evolved over time. In the 1970s, it was limited to trade. In the 1980s, it emphasized cooperation for development, and in the 1990s, it focused on building mechanisms for industrial, scientific and technological cooperation as well as cooperation between companies. Such an approach is characteristic of advanced economic cooperation.

With support from the EU, a program is being developed to support the promotion of trade so as to be able to take fuller advantage of emerging trade opportunities.

Canada

In May 1999, CAN and Canada signed a Cooperation Understanding on Trade and Investment. The two parties agreed to establish a Consultative Group comprising authorities with responsibility for international trade, and approved an Action Plan defining three priorities: trade expansion and strengthening economic cooperation, promotion of trade and investment, and coordination of their respective positions concerning international trade negotiations, such as those with the FTAA and the WTO.

To be noted among topics contained in the Action Plan is cooperation among government agencies responsible for trade in order to profit more fully from Canada's Generalized System of Preferences. The Secretariat is currently preparing a list of products of interest to the Andean countries so that they can enter the Canadian market duty-free. This would be submitted to Canadian authorities for evaluation, and steps would be taken to secure inclusion of the list in the Canadian GSP.

A second tier of action has taken place at the regional level. The negotiations of greatest potential impact are those underway with the MERCOSUR countries. Contact has also been established with some of the Central American countries, CARICOM, and Panama.

South American Free Trade Area

The Meeting of South American Presidents, held in Brasilia, in late 2000, agreed to implement five areas leading to the establishment of a regional area of integration and cooperation. The areas are political cooperation, the fight against drugs, economic integration through the formation of a South American free trade area, construction of infrastructure for integration, and joint progress by the countries towards an information society. With a view to implementation of the regional area, CAN and MERCOSUR are joining efforts (the deadline of 2002 was set for the establishment of a free trade area between the two blocs) through a process of progressive convergence, in which Guyana, Suriname and Chile may be incorporated, although bearing in mind the participation of the first two in the Caribbean integration systems. In Brasilia, the Presidents agreed that the establishment of an enlarged South American economic area would strengthen their countries' position in important negotiations, such as the negotiations for the FTAA (to be concluded in 2005), negotiations seeking stronger ties with the EU, negotiations in the context of the WTO, and others.

MERCOSUR

The first meetings between CAN and MERCOSUR to discuss the formation of a free trade area were held in early 1995. After these meetings, each of the CAN countries met individually with MERCOSUR, either to discuss extending bilateral agreements concluded in the context of the LAIA or, in the case of Bolivia, to negotiate a free trade agreement. In that case, negotiations were concluded in late 1996 with the signing of Economic Complementarity Agreement No. 36, establishing a Free Trade Area between Bolivia and MERCOSUR. The agreement does not prevent Bolivia from participating in Andean Community-MERCOSUR negotiations, as Bolivia's objective was rather to make that agreement compatible, in pertinent areas, with such agreements as the parties may conclude.

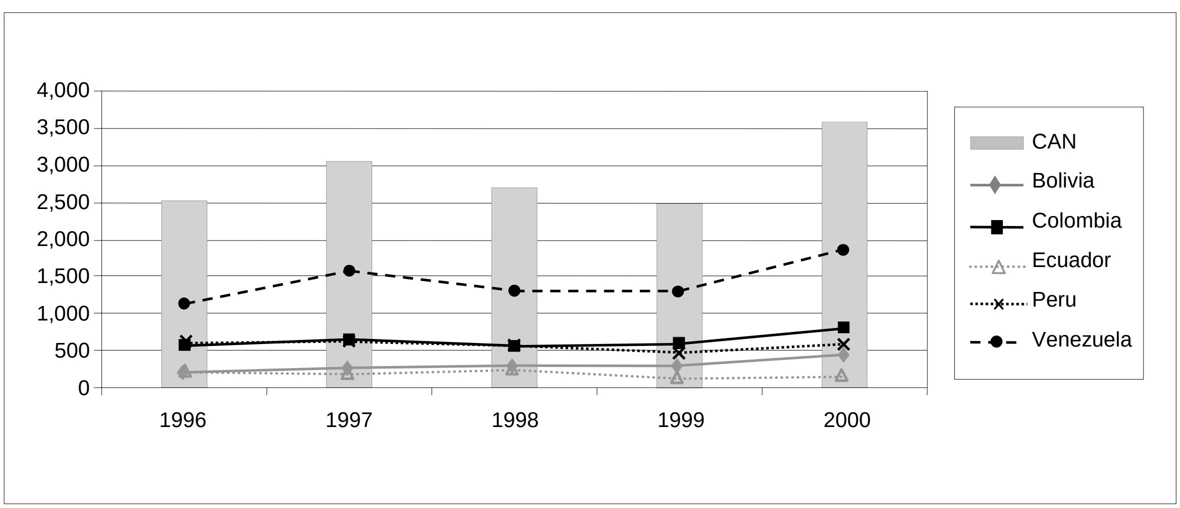
In October 1996, CAN and MERCOSUR met again for a new exchange of proposals and held additional technical meetings, in December 1997 and March 1998, to reconcile their positions regarding how to move toward a free trade area. In that connection, in April 1998, the five Andean Community countries and the four MERCOSUR countries signed the Framework Agreement for the Establishment of a Free Trade Area between the two blocs, which would benefit 300 million inhabitants, with a Gross Domestic Product of US$ 1.2 trillion (according to CAN data).

Based on the general principles of the Framework Agreement, in mid-1998 CAN and MERCOSUR launched negotiations for a Tariff Preferences Agreement. These negotiations continued until March 1999, when Brazil announced its decision to negotiate the Tariff Preferences Agreement unilaterally with the Andean Community, a proposal accepted by that group. Accordingly, Brazil extended its bilateral agreements until June 1999, as did Argentina, while Paraguay and Uruguay extended theirs until December 1999.

After meetings in early 1999, in August of that year Brazil and the Andean Community signed a Partial Scope Economic Complementarity Agreement (ECA No. 39). In that agreement, as a first step in establishing a free trade area between CAN and MERCOSUR, the two parties set margins of preference for a universe of 2,734 products, representing over 90% of Andean exports to Brazil and nearly 50% of Brazilian exports to CAN. In 2000, two meetings of the Administrative Commission were held which, among other things, assessed the increase in trade under the agreed preferences (Graph 20. Note particularly the increase in trade flows from 1999 to 2000, when the ECA was in effect). The scope of the Agreement was expanded to include new products or to improve preferences. In addition, in mid-2001, the parties exchanged lists of products of interest with a view to a fresh revision of ECA No. 39.

From 1999 to 2000, trade flows between the Andean countries and Brazil increased by 44%, with most growth in trade between Colombia and Brazil (45%), followed by trade between Ecuador and Brazil (43%).

GRAPH 20
CAN TRADE WITH BRAZIL
(US$ million)



Preparation: In-house
Source: CAN (SICEXT)

Similarly, in June 2000, Argentina and CAN, concluded a Tariff Preferences Agreement (ECA No. 48) with 2,608 subheadings which, in terms of trade, represented about 92% of total exports from Colombia, Ecuador, Peru and Venezuela to Argentina (according to CAN data). As regards the types of product negotiated, most relate to the industrial sector, which has 2,019 subheadings. These are followed agriculture-related products, with 550 subheadings and automotive-related products, with 37 subheadings. Andean products exported to the Republic of Argentina include oil, bananas, coffee, canned tuna, palm hearts, zinc ores, silver, flowers, books and underwear. CAN in turn imports soy and sunflower oil, wheat, medications, milk, rice, cotton, aluminum and iron tubing from Argentina.

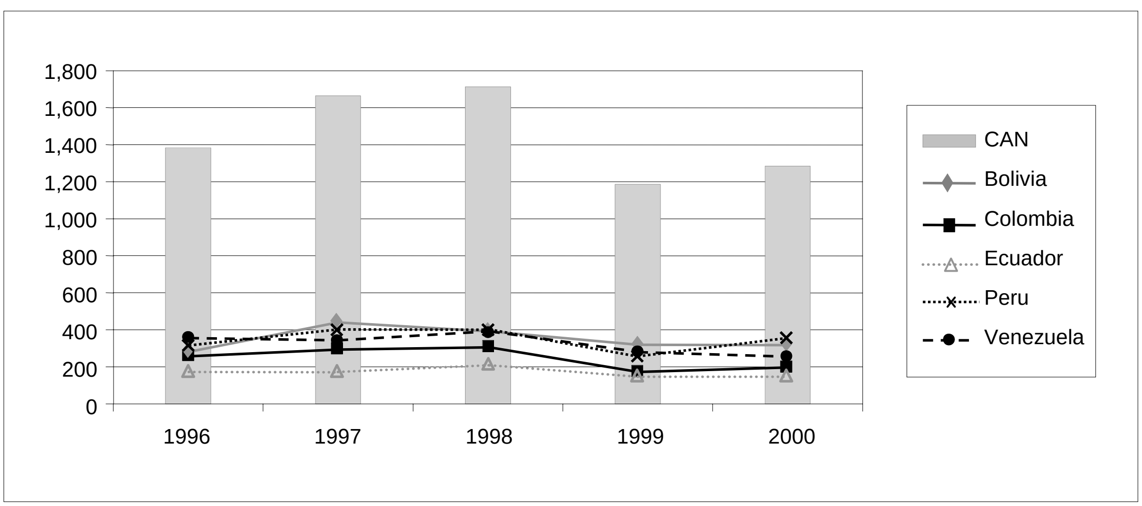
In 2000, the value of trade between Argentina and the Andean countries was over US$ 1.2 billion. However, as the ECA was only signed in that year, Graph 21 does not reflect the impact of that agreement, which may be observed as of the final data for 2001.

CAN's Economic Complementarity Agreements with Brazil and Argentina benefit over 300 million inhabitants (102 million in the Andean subregion and 205 million in the two largest MERCOSUR countries).

In the case of Paraguay, a meeting was held in April 2001, at which both Paraguay and CAN reiterated their interest in negotiating, without delay, a fixed preferences agreement. At that meeting, commitments were made to exchange lists of products of interest and regulatory texts, which took place in May 2001. However, Paraguay felt that the Andean margin of preference proposals did not meet its expectations.

In the Uruguayan case, negotiations did not move ahead because in April 2001, the country indicated that it was not interested in negotiating a fixed preferences agreement, and that it would put forward its interests during negotiations for the Free Trade Agreement.

GRAPH 21
CAN TRADE WITH ARGENTINA
(US$ million)



Source: CAN (SICEXT)
Preparation: In-house

As for negotiations for the establishment of a Free Trade Area between Andean Community and MERCOSUR, in April 2001, the two groups met to discuss aspects related to the Agreement's scope and the negotiations timetable. In late August 2001, they met again to discuss, among other items, issues relating to dispute settlement, safeguards, rules of origin and sanitary and phytosanitary measures. The Member Countries of CAN and MERCOSUR are now taking necessary steps for conclusion of the Free Trade Agreement, which was one of the commitments made at the Meeting of South American Presidents of Brasilia. Events in Argentina, now being assessed within MERCOSUR, may delay discussions on the establishment of the South American free trade area. The initial agreement reached by the Andean Presidents at the Santa Cruz meeting in the area of CET levels also provide a better basis for future discussions between the two groups.

Member Countries of the Central American Common Market

CAN is seeking to establish a broad relationship with the Central American Common Market (CACM), an integration scheme comprising Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua. However, trade relations between the Andean Community and the CACM have been limited essentially to the Partial Scope Agreements signed by Colombia and Venezuela in the framework of LAIA's Treaty of Montevideo of 1980. Since May 1997, the two groups have engaged in negotiations on technical aspects.

The Secretariats of the two blocs drafted a trade and investment agreement between the two subregional integration systems, which contains the basic elements of an economic complementarity agreement. The draft presented for consideration by their Member Countries contains detailed and prescriptive rules of origin.

Since March 2000, CAN has been negotiating to conclude economic complementarity agreements with three CACM countries—El Salvador, Guatemala and Honduras (known as the Northern Triangle)—with which it has already exchanged lists of products of interest and to which it has submitted a draft agreement for consideration. It should be noted that Andean Community trade with the member countries of the CACM is insignificant in terms of total or regional CAN trade.

CARICOM

Historically, there has been no significant rapprochement between CAN and CARICOM, except for that between Colombia and Venezuela and the Caribbean countries in the context of LAIA. However, one of CAN's objectives is to revitalize relations with CARICOM and to relaunch the negotiations begun in 1997 for the conclusion of a trade agreement. To that end, information exchange has been intensified between the CAN and CARICOM Secretariats. The Secretaries General of the two blocs have discussed the possibility of negotiating a cooperation agreement between the two Secretariats and establishing a trade and investment council. A draft cooperation agreement has been prepared. In addition, CAN is moving ahead with steps to sign a trade and investment agreement with Guyana.

Panama

Since 1996, Panama has participated in meetings of the Andean Presidential Council. At the Eleventh Summit, held in Sucre, a Declaration was signed instructing the Commission to initiate discussions with a view to conclusion of a free trade treaty. In this context, in April 1998, the Andean Community and Panama signed an agreement known as the General Framework Accord for the Negotiation of a Free Trade Agreement. This agreement does not establish a timeframe for attaining that objective, but it does define the general principles, bases for negotiation, and issues to be negotiated. The discussions initiated have been suspended. Information has been exchanged on the trade policies of the two parties and Panama has submitted a draft free trade agreement, while CAN has submitted a draft agreement on customs.

Mexico

Mexico has no trade agreement with the CAN Member Countries as a group. However, it has entered into bilateral free trade agreements with the individual Andean countries. It signed the Group of Three Treaty with Colombia and Venezuela, which provides for gradual elimination of tariffs and establishes privileges for sensitive sectors in each country for which tariffs are established.[91] The treaty with Bolivia provides for rapid liberalization of the trade in goods. As of the treaty's effective date, tariffs were lifted for 97% of Mexican exports to that country and 99% of Bolivian exports to Mexico. As for Peru and Ecuador, processes have been established for negotiations to achieve free trade agreements, which will enable existing ties to be strengthened through the partial scope agreements already in effect. Mexico's strategy is primarily directed to integration with Central America, reflected in the Puebla–Panama Plan, one of whose objectives is to promote strategic public and private investment in those regions, in order to redirect productive activities toward activities of greater added value.

Chile

Like Mexico, Chile has not signed any agreement with CAN as a whole, but has bilateral agreements with each of the five Andean countries. Bolivia granted Chile tariff preferences for 306 items, while Chile granted Bolivia preferences for 393 items. With Colombia, Peru, Ecuador and Venezuela it was agreed to eliminate tariffs and duties of equivalent effect affecting reciprocal trade for the universe of goods. To that end, liberalization programs were established using different methods and timeframes, ranging from immediate and total tariff elimination on the effective date of the Agreement to total tariff elimination over a specific number of years, in different cases.

The third tier of action of the Andean Community is international negotiations being conducted in the context of the WTO and the negotiations to consolidate the Free Trade Area of the Americas.

CAN participation in FTAA negotiations

For the CAN countries, the negotiations to establish a free trade area in the hemisphere—launched in Miami in December 1994—are of moment, not only because such an area would enable trade flows to be increased to its principal trading partner, the United States, but also because new opportunities would be created to enter the markets of the other countries of the region. In the FTAA forum, significant headway has been made in the preparatory phase of the negotiations and, in this regard, CAN has been acting jointly and with a single voice and has thus strengthened its presence at the various meetings and forums. The Andean countries serve as chairs (in the case of Peru, subsidies, anti-dumping and countervailing duties and, in the case of Colombia, competition policies), and as vice chairs (in the cases of Colombia, Bolivia, and Venezuela) of the negotiating groups. Following the Buenos Aires meeting, Ecuador assumed the Chair of the FTAA and will be in charge of the Seventh Ministerial Meeting scheduled for October 2002.

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[91] According to data from Mexico's Under-Secretariat for International Trade Negotiations, *http://www.economia-snci.gob.mx/tratados/tlcg3/frame3.ht.* Data can also be obtained from INTAL's web page at: *http://www.iadb.org/intal/tratados/tratados.htm.*

Negotiation of a hemispheric free trade area constitutes a significant challenge for the Andean countries, both because of the need to do technical work related to the preparatory work for the negotiations, and to the need to defend its interests with a view to maximum liberalization for their products with export potential and determining an appropriate timeframe for their products to achieve competitive levels in adapting to more demanding levels of competition.[92] This means not only promoting trade but also ensuring internal conditions that will place companies on an equal footing with their competitors in other countries in the hemisphere.

It is very likely that the agreements on various FTAA provisions will necessitate adjustments to Community provisions. This is being studied by the Secretariat and by the Member Countries and will be a topic for discussion in coming years as the negotiating process is stepped up. Also associated with this process are the issues of negotiations with MERCOSUR and the possible establishment of a South American free trade area, as decisions made in these negotiations will have an impact on the Andean position in the FTAA forum. For the Andean countries, the recent definition of the bases for a CET is bringing closer the possibility of achieving a consolidated Community position regarding the ATPA negotiations. However, some Community provisions are still to be defined, in keeping with the Santa Cruz Agreement, which may influence the group's decision-making as regards the ATPA negotiations.

CAN participation in the WTO negotiations

The provisions initially adopted under GATT and later under the WTO address various topics interrelated with provisions adopted in CAN. This has led the Commission to gradually make adjustments to internal provisions to bring them into line with the international system. It should be underscored that, as of Ecuador's accession to this forum, all CAN Member Countries are now members of the WTO.

There is also a proposed new round of negotiations on complex issues, which will demand a new effort on the part of the experts from the Member Countries and the Secretariat in preparing common positions. In 1997, at the Ninth Meeting of the Andean Presidential Council, the Andean Council of Foreign Ministers and the Commission were instructed to define mechanisms and procedures to reinforce Community participation in this forum. The Member Countries have determined that they will act in coordination and jointly in any new process of negotiations launched within the WTO framework.

Contact with Asian Countries

Lastly, it should be noted that the CAN Member Countries have engaged in efforts to intensify relations with the Asian region. To that end, CAN has stepped up contact with the Secretariat of the Association of Southeast Asian Nations (ASEAN), the Asia-Pacific Economic Cooperation (APEC) forum, China and other countries of the region. In that context, in March 2000, an agreement was signed to establish a political consultation and cooperation mechanism with the People's Republic of China. Peru is a member of APEC, while Ecuador and Colombia are currently negotiating for membership, although there is a ten-year moratorium on the admission of new economies to this forum since the entry of Peru in November 1998.

Some general contact has also been established with Russia with a view to stepping up trade in the future.

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[92] This covers both para-tariff barriers and restrictions on trade in the region, many of which are protected under sanitary, technical or anti-dumping provisions.

C. Conclusions

From the outset, the Andean countries felt that the establishment of a common market would provide opportunities to access external markets based on the consolidation of a joint internal market that would be attractive to third country exporters and thus would encourage them to urge their governments to open up their own markets. Despite numerous efforts, the delay in adopting and consolidating an Andean Common External Tariff has prevented the utilization of this potential negotiating instrument, as discussed earlier. Nonetheless, the decisions taken at Santa Cruz represent the launch of the final stage of CET adoption. This would have significant impact on the group's ability to act as a bloc in negotiating access to the markets of other integration groups and countries in or outside the region.

Only in the case of MERCOSUR—where through Partial Scope and Economic Complementarity Agreements with Argentina and Brazil in the context of LAIA there has been headway in consolidating tariffs and margins of preference, but based on national tariffs in force and on agreements adopted on the CET—is it possible to find truly common Andean action.[93] The recent nature of these agreements makes it difficult to indicate whether true benefit has been obtained for CAN exporters, beyond what had been gained before their implementation.

In the case of access to markets of developed countries, the United States and EU member states, their generalized systems of preferences are granted unilaterally and date from periods prior to the formation of CAN. Undeniably, the terms negotiated regarding the inclusion of new products and facilities in the rules of origin have favored an interesting selection of Andean exporters. However, these are market access negotiations that rely more on the political willingness of one country to grant concessions than they are negotiations involving the exchange of market access opportunities. Therefore, it cannot be said that they stem from true trade negotiations between the parties. Moreover, as unilateral concessions, they can be removed or reformulated at the discretion of the parties granting the preferences, as they are not negotiated agreements providing for trade preferences that have been granted by the Andean nations. The failure on the part of the United States to extend the GSP and ATPA suggests the vulnerability consequent upon unilaterally granted agreements on preferences, which the Andean countries are unable directly to influence other than through political negotiation.

CAN is faced with significant challenges in the area of trade negotiations in the coming years: the establishment of a free trade area with the MERCOSUR countries, which could be enlarged to a South American free trade area, the negotiations to establish a hemispheric free trade area, and a new round of trade negotiations in the WTO framework. This is not only an demanding agenda involving great national and Community effort in defining positions, but also has crucial implications for purely Andean matters, such as the adoption of the CET and the series of provisions governing both internal trade and trade with third countries.

CAN's demonstrated intent to involve itself in negotiations with other countries or other groups of countries—such as the members of the Central American Common Market, Panama, the Caribbean countries, or ASEAN—can only be take concrete form if the integration process is consolidated effectively at the CAN level. If this does not take place, these countries would be negotiating as group of individual countries rather than as an integrated market.

It is not clear how CAN may profit from establishing elements of commercial, economic and political cooperation with a wide range of countries. The Member Countries may benefit greatly, but it would limit the potential benefit to be gained if Community efforts are successful in truly consolidating the process and generating joint action based on an Andean market that is attractive both to those involved in foreign trade activities and to national and foreign investors.

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[93] Even in this case, Bolivia, as an associate member of MERCOSUR, has a special regime. Peru has not adopted the CET and the national tariff schedule of Ecuador differs from that of Colombia and Venezuela. Thus consolidation is needed at the national tariff level.

Contents

CHAPTER VI. FINAL REMARKS

For the Andean Community, the 1990s represented a period of extensive consolidation of its institutions and expansion of internal trade. Now, however, at the dawn of a new century, the time has come when the Member Countries will have to take crucial decisions regarding the CAN's future direction.

First, the Common Market must be consolidated. Without this, not only will the process lose national and international credibility, but also Andean producers will be left without a clear reference framework enabling them to take national and intra-subregional investment decisions, and even decisions regarding the attraction of extra-subregional capital. The formation of the Free Trade Area must thus be concluded, a true Common External Tariff (CET) defined, and the basic rules of the regulatory framework for intra-subregional trade and trade with third countries definitively established and applied. Efforts now focus on the adoption of an institutional framework to be used in drafting a broad range of binding provisions and in establishing a system for monitoring and imposing sanctions concentrated in the General Secretariat and the Andean Court of Justice.

The governments and entrepreneurs involved in the process have widely divergent views on how the institutional framework should operate. Some claim that for most products and countries, the enlarged market has been consolidated, and that it only remains for Peru to complete its deregulation process through the Liberalization Program adopted. Others claim that the countries have failed to comply fully with provisions, and that certain national practices persist that are generating barriers to trade. Lack of in-depth study in these areas makes it difficult to establish when trade is impeded owing to lack of provisions, to defects in existing provisions, to problems of interpretation, or to true national non-compliance. However, the recent Declaration of Santa Cruz refers explicitly to these barriers[94] and proposes immediate solutions to eliminate barriers to trade and promote full compliance with the rulings of the Andean Court of Justice.

Provisions must also be implemented to govern trade in services, capital flows, and the subregional labor market. As was discussed in detail in earlier chapters, work has begun in all these areas and, in some areas, much headway has been made, both in technical terms, and in terms of national policy formulation. However, in other areas, only the very first steps have been taken towards the formation of a Common Market.

The Andean Community has in place formal mechanisms to define a Common Foreign Policy (CFP) and, in the framework established, some progress has been made in consolidating the Community position and launching negotiations with third countries with a view to obtaining market access for Andean products. However, in the absence of a CET as the foundation for Community negotiations in this area, the Community is moving ahead based on consolidation of national tariffs, as it did in negotiations in the framework of the World Trade Organization (WTO) and is doing in negotiations under way with the MERCOSUR countries. This means that the Member Countries will conclude agreements for opening their markets with their different trading partners on different terms. This would imply that national (and therefore Community) tariffs are perforated on different fronts, thereby generating terms of competition based on national tariffs that generate different levels of effective protection in each country. This amounts to an assault on the foundation of the Common Market, and generates distortions of competitive terms to be faced by the different countries' producers.

At the recent Meeting of the Andean Presidential Council, held in Santa Cruz, new CET levels and criteria for the reorganization of the tariff system were established so as to prevent perforations, whether through the lists of exceptions or the numerous agreements concluded by the Member Countries in this area. Thus, at the stage of negotiations now being launched, the Member Countries will have to examine the concessions granted to

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[94] Among them is mentioned a need to review Community rules of origin, sanitary and fitosanitary restrictions, importation procedures applicable to subregional goods, and transportation of freight by road.

individual countries in international trade negotiations with a view to formulating a gradual and progressive strategy for renegotiation of third country concessions generating distortions of competition. This matter is now more delicate at a time when the Community is involved as a bloc in hemispheric negotiations for the Free Trade Area of the Americas (FTAA) and the opening of a new round of multilateral negotiations.

It is clear that one aspect fostering the integration process is gradual convergence of macroeconomic policy among the five Member Countries. A discussion forum has also been established to continue the convergence process, and the first steps have been taken towards defining common targets, especially in the area of low inflation in all countries. There is a long way to go in this area, especially in adopting fiscal and taxation frameworks, to include subsidies, so as to prevent negative and uneven impact on entrepreneurs' ability to compete. Efforts must also be made in the area of exchange policy convergence, where the existence of different exchange systems may generate trade cycles in flows of goods and services through the Common Market. The Meeting of the Andean Presidential Council set a two-year deadline for harmonization of macroeconomic policy and compliance with convergence criteria.

Trade among the CAN Member Countries showed considerable momentum in the 1990s. The average rate of growth of Community trade in goods with the world was 7%, similar to the growth in world trade (6%) in a decade where such trade partly reflected many countries' policy to open their markets and the opening resulting from Uruguay Round negotiations organized by the WTO. Intra-Andean trade was much more dynamic than international trade, and grew at an annual average rate of 18% in the 1990s.

The Andean countries remain heavily dependent on raw material exports, especially oil, gas, petroleum derivatives, and ores, and on agricultural products, such as coffee and bananas, although the percentage of intra-subregional trade in manufactured goods is substantial and increasing. However, a fair percentage of these are traditional exports, such as petroleum products and less processed ores. Apart from these products, growth in trade in non-traditional manufactured goods has been increasing at a faster pace within the subregion than in trade with third countries, which may be explained by the general opening of the countries' economies and by further opening resulting from the Andean deregulation process. Increased intra-subregional exports may stimulate the growth of world exports, as it provides Andean entrepreneurs with an enlarged initial market, thereby enabling them to profit from economies of scale and go through the learning process involved in competing in an external market.

For the Andean countries, the NAFTA market continues to be the most important, followed by that of the European Union (EU). Exports to the Andean market rank third, but this market showed dynamic growth up to 1999. If the momentum of the mid-1990s were restored, which would occur if the deregulation process were to continue with full incorporation of Peru in the Liberalization Program, it is highly likely that intra-subregional exports would move to second place in coming years.

Trade between Colombia and Venezuela is the most dynamic element of intra-subregional trade. Ecuador is also an important market for these two countries, and Ecuador exports substantial volumes to them. Trade between Ecuador and Peru has been increasing since the most recent deregulations between the two countries, stemming from agreements concluded after the signing of the peace accord. Lastly, the free trade area between Bolivia and Peru is facilitating substantial trade between the two countries.

For Bolivia and Venezuela, the intra-subregional balance of trade was positive for much of the 1990s. Colombia and Ecuador had equal numbers of years of positive and negative balances, but for Ecuador, in the 1992-2000 period, the balance was consistently negative. Peru is the only country with a negative subregional trade balance throughout that period, in part reflecting its dependence on oil imports from the other countries and in part its marginalization for some time from the process, which limited its access to the subregional market.

During the 1990s, the subregion attracted FDI, although mainly for raw material production. Another important element of foreign capital inflows related to privatization of state enterprises in some countries, such as Bolivia, Colombia, and Peru, especially in utility sectors, such as energy and telecommunications. Investment in sectors producing more highly manufactured goods generally targeted national markets rather than the Andean market as a whole. Intra-subregional investment is not yet on a large scale, but there are upward trends in this area, chiefly in investment flows between Colombia and Venezuela. Among the subregion's countries, in recent years, investment has been most dynamic in Colombia.

In the course of preparing this report, there was an evident lack of in-depth evaluation of intra-subregional trade, especially assessments of how Andean producers have responded to the scale of the Liberalization Program's deregulation, the establishment of the enlarged market, and preliminary adoption of the CET. The CAN General Secretariat and other entities involved in the process or those studying its effects should study this area in greater depth to enable the countries to assess their participation and take steps with a view to enhancing the competitiveness of their enterprise in the context of Andean market deregulation and the formation of an enlarged market.

In 1997, with the reincorporation of Peru in the Liberalization Program, and the completion of the process in 2005, a process that has accelerated since the signing of the Declaration of Santa Cruz, an important phase in the Andean integration process will be concluded. Although there are few products that do not enjoy trade preferences, and these do not appear to have great trade potential, apart from oil and oil derivatives, the mere fact that the process has not been completed and mechanisms of exception remain creates a distorted view in some forums regarding the extent of effective market integration. Apart from these exceptions, it may be considered that products of Community origin have free access to the Member Country market.

In the short term, the central challenge of the Andean integration process is the adoption of a CET. After long and complex dialogue and negotiations sustained since the signing of the Cartagena Agreement, the Commission adopted Decision 370, which entered into force in February 1995. On that occasion, the countries were unable to reach consensus regarding the CET, and it was therefore agreed that Peru would withdraw temporarily from the process. This enabled Colombia, Ecuador, and Venezuela to adopt a tariff, which was an important step forward in the formation of an enlarged market, but a relatively high number of exceptions remain, such as the lists of exceptions themselves for individual countries, the List of Zeros for products involved in utility services, the List of Goods Not Produced, and the automotive regime list.

Despite the fact that, since that time, much headway has been made, such as the reduction in number of items on the lists of exceptions, there remain, among these three countries, differences for a large number of NANDINA headings, which create different levels of effective protection for local producers. In addition, over the years, the countries have negotiated preferential tariffs in different bilateral agreements.

Bolivia must be considered a special case, as for this country, a much less dispersed, two-tier tariff structure was agreed, differing from that adopted by the other three. In the Peruvian case, although different rounds of negotiations have been launched that were unsuccessful, to the extent that at one point, consideration was given to Peru's withdrawal from the process, many issues remain to be resolved before that country is fully incorporated into the process under an agreement on tariffs and Andean legislation.

In May 1999, the Presidents agreed to move forward hoping to reach agreement on a truly common External Tariff. The Secretariat initiated a process of consultation with the countries on the parameters of a CET, which finally was defined in the Declaration of Santa Cruz. However, a Community Decision has yet to be issued that would establish the levels of the respective tariff headings, a process it is hoped to complete in 2002, with a view to attaining the Presidents' goal of forming the Common Market by 2005.

This consultation not only covers tariff levels and their dispersion, but also key legislative aspects, such as subregional exceptions, special treatment for the relatively less developed countries, special customs regimes, and treatment of goods not produced.

As soon as the CET is adopted and Andean and foreign entrepreneurs interested in investing in the subregion have a more defined framework governing market conditions, the image of Common Market will take fuller shape, thereby leading to resource allocation decisions targeting the Andean market itself, with a view to using it as a springboard for its involvement on a more competitive basis in the international market.

In the area of Andean legislation, a wide range of steps has been taken defining the conditions for the deregulation of trade. Many of the provisions adopted have been brought into line with those adopted in the framework of the WTO, where there is also active joint participation by the Andean countries. The Cartagena Agreement and its amended versions contain provisions on dispute resolution, an area in which both the Secretariat and Andean Court of Justice play a part, bodies which, since 1999, have enjoyed a more appropriate institutional framework, in which cases brought have been reviewed and Andean judicial decisions issued.

The Community has provisions in place in important areas, such as dumping, subsidies, safeguards, and free competition. Only a small number of cases has been brought, lending the impression that Community provisions are being violated on a regular basis. This, however, should not be the only indicator that the legislative system is addressing all problems faced by producers. To establish this, information would have to be made available by the entrepreneurs themselves regarding their view of cases of unfair competition and it should be ascertained how effective the Andean system is in dealing with them. In a later evaluation of the Community, a survey should be conducted of a sample of entrepreneurs from the five countries to ascertain what barriers to trade are created by the legal framework itself.[95] In addressing these topics, the Andean Presidents have proposed to strengthen the compulsory authority of the Andean Court of Justice, establish a conciliation entity to supplement the Court, and, along the same lines, establish common trade defense mechanisms to maintain the CET vis-à-vis unfair third country practices.

International studies have noted that in terms of relative competitiveness, the Andean countries are at a disadvantage as compared with most cases that have been studied in some depth. Progress made in national deregulation and subregional integration has enhanced some competitive conditions in the countries, but many additional measures remain to be taken to improve the countries' competitive environment. Most measures are national, but there are areas where joint action is feasible, whether by adopting Community provisions or assisting individual governments to take action to reduce costs affecting the competitiveness of their entrepreneurs.

The Community has just begun to create conditions for the promotion of the trade in services. There has been headway in some areas, such as transportation, tourism, and telecommunications, but most sectors are just beginning to conduct research on existing trade restrictions to be able to launch gradual deregulation by sector in keeping with the initial inventory to be adopted by the Commission. The Community has proposed to move ahead with an accelerated deregulation process through sectoral negotiations, a process it is hoped will be concluded by 2005.

One Community issue where most headway has been made in market access is the virtual elimination of barriers to intra-subregional investment flows. Decisions taken by the Community countries reflecting their degree of deregulation are facilitating intra-subregional and third country investment. A Community legal framework is also in place for the creation and operation of Andean Multinational Enterprises. Community

[95] This survey should also cover other aspects that may be of negative impact on the generation of greater trade flows.

provisions on intellectual and industrial property are another area with some bearing on attraction of investment.

The Community has also been implementing activities to facilitate the intra-subregional circulation of people, in keeping with the Presidential mandate emerging from the Twelfth Meeting of the Andean Presidential Council in 2000. Progress in this area is limited for the moment to the creation of a national identity document and an Andean Passport. For true deregulation of labor flows, additional measures must be taken on the rights and obligations of workers from one country who are resident in another, including complicated areas such as Community social security.

To be noted in the area of international negotiations is joint Community action in international forums such as the WTO and the FTAA, and the formation of a joint pressure group to improve conditions of access to the markets of developed countries, such as the United States, the EU, and Canada, by enhancing the benefits afforded by the different generalized systems of preferences, directed and adopted by such countries. The most important joint negotiations are those in progress to establish a MERCOSUR/CAN free trade area. This will constitute a milestone in joint Community trade negotiations and an important step forward in defining both a possible South American common market and common positions vis-à-vis FTAA negotiations. In addition, the Community has made contact with different regional groups and countries to propose market deregulation through free trade mechanisms, including the formation of new free trade areas.

The Community institutional framework has been restructured and strengthened. Frequent interaction among the Presidents is facilitating the adoption of joint policies and international activities in important areas. The Ministers of Foreign Affairs have been promoting a broad agenda of activities at the regional and the international levels, thereby creating a space for Community action. The Commission has been implementing its agenda to consolidate the formation of the enlarged market. The Andean Court of Justice has been consolidated and the Andean Parliament is being restructured. Financial support entities, such as the Andean Development Corporation (CAF) and the Latin American Reserve Fund have been providing support to the countries, in terms of finance and in creating more competitive terms, especially in developing infrastructure to facilitate subregional trade.

With all the headway made in recent years, a more positive national and international image of the Community integration process has emerged. This must be promoted and enhanced through the adoption of decisions central to the process:

- The free trade area must be consolidated, the provisions still having negative impact on the flow of goods (and, in the future, services) determined in detail, and trade barriers eliminated. As policies are harmonized, existing problems will gradually be overcome. However, it cannot be expected that all disputes arising, real or apparent, will be resolved. To that end, the existence of a dispute settlement system, one effective in decision-making and time-efficient, is key in preventing disruptions of trade flows, which create uncertainty among entrepreneurs and potential investors.

- A Common Market cannot exist without a truly common External Tariff, one in which all countries participate, and one generating equal competitive terms so that national producers may act on the basis of productive efficiency. It is hoped that the Community will overcome existing differences among governments in this area and that agreement is soon reached. Based on the political impetus received from the Presidents, the CAN Secretariat has put forward a proposal that may lead to a final decision in 2002. This topic will be crucial, not only in determining the characteristics of the Common Market, but also in its ability to engage in trade negotiations with third countries in the regional, hemispheric, and global frameworks.

- The international negotiations agenda constitutes a significant challenge for the Community countries. That agenda includes negotiations for the establishment of a South American common market based on an agreement between the Andean Community and MERCOSUR for a free trade area, negotiations for a Free Trade Area of the Americas, and the new round of negotiations in the WTO framework. To these must be added bilateral efforts already launched by the Community through contacts with different countries and integration entities, including the EU. The Community Secretariat and the Member Country governments will have to set priorities for action, establish the subregional legislative framework, and strengthen Andean and national capacity to engage in these negotiations, with the active participation of the subregion's entrepreneurs to that end.

- Complex decisions must be taken regarding the formation of a common market for trade in services. This involves adopting a common starting point based on an inventory of existing barriers and determining the sectors for and methods of negotiation, along with a list of priorities to be addressed in coming years. Interesting steps forward have been taken in complex areas, such as all modes of transportation, telecommunications and tourism, suggesting that, if the political will is present, it will be possible to deregulate the services market.

- All Member Countries have adopted policies to increase their participation in world trade. However, their competitive position relative to other countries leaves much scope for the introduction of measures to enhance the competitiveness of their enterprise. This is another area where the Community may adopt joint measures or create conditions facilitating the introduction of such measures at the national level. Joint studies of conditions in all countries affecting competitiveness and establishing a Community agenda for action may be highly pertinent topics in facilitating the active participation of Andean enterprise in world trade.

- The defense of democracy and the fight against drugs and terrorism have been gaining prominence at the regional and international levels in recent years. Through action by the foreign ministers, the Community has undertaken a series of activities in these areas. As part of the Community agenda, the countries must to continue efforts and joint action.

This agenda must be accompanied by reinforcement of the Community's institutional and organizational framework. To that end, it will be crucial to have not only the political direction provided by the regular meetings of the Presidents, foreign ministers, and the Commission, but to include in decision-making the representatives of the countries to the Andean Parliament, and to promote participation by civil society organizations and members of its main groups, particularly entrepreneurs and workers.

In defining the Community's future, much more information will be needed on the process and the conditions necessary to accelerate it. Studies are clearly lacking on many aspects of Andean integration, foremost among them, factors promoting and inhibiting trade. There is also a need to determine factors affecting the competitiveness of subregional producers and how specific measures may be implemented to reduce their costs, and to promote technological innovation and company modernization. To that end, an agenda must be drawn up of Andean integration topics for evaluation and study, so that use may be made subregional research capacity to supplement the contributions to be made by the Community's organizational system, at the outset, by the Secretariat.

Contents

ANNEX I
ANDEAN LEGISLATION

Relations with the WTO

The CAN Member Countries intend to work jointly and in coordination in the framework of the World Trade Organization (WTO). To that end, they have been carrying out activities with a view to developing a common Andean position to put forward within this forum. Such activities include conducting different workshops and courses on trade and trade negotiations-related topics and following up on an ongoing basis the topics discussed and meetings held in the framework of this multilateral organization.

The possibility of joint and coordinated participation by the CAN countries in multilateral trade negotiations conducted in the framework of the WTO has arisen for two reasons: their political intent, and the fact that, since 1996, all have been members of this multilateral organization, with the accession of Ecuador.

The CAN countries are aware that the WTO's sphere of competence takes in areas key to their development strategies and that the topics addressed within that forum are intimately linked to topics on the Andean integration agenda. Accordingly, in 1997, the Andean Presidents instructed their foreign ministers and ministers of trade to develop mechanisms and procedures designed to strengthen Community participation in negotiations pertaining to international forums, particularly the FTAA and WTO. In 1998, the heads of state of the CAN countries also agreed to step up Community coordination within the WTO. In 1999, government experts from the five Andean countries on multilateral negotiations in the WTO framework exchanged views on coordination among their countries vis-à-vis that forum. This trend, designed to strengthen a coordinated Andean position, has been gathering speed through events held by the different entities involved.

For their part, the CAN trade ministers, in a declaration signed and sent to the Director-General of the WTO in February 2001, advocated the launch of a new round of multilateral trade negotiations on the occasion of the Fourth WTO Ministerial Conference, held in November 2001. They underscored the fact that, for the Andean Community, among the most important topics for negotiation was special and differentiated treatment, that went beyond extension of deadlines and enabled some production policy instruments in force for each country to be retained indefinitely. In June 2001, the Andean Presidents instructed the Commission to foster coordination among the Andean countries within that forum so that future negotiations would produce the result that the development aspect became the guiding principle of mutlilateral trade negotiations.

For the CAN countries, the regulatory framework adopted in the different negotiation GATT and WTO negotiation rounds establishes a series of obligations which must then be incorporated into Andean provisions or which affect on the countries' freedom to adopt their own provisions, especially as regards trade with third countries. One example is that, without a specific exception being made, CAN may not adopt a Common External Tariff that includes tariff levels higher than those negotiated by the countries in the WTO framework. Other areas where the WTO framework has a bearing on CAN definitions are rules of origin, subsidies, countervailing duties, and dumping.

Rules of origin

For nearly two decades, trade among the Andean countries was governed by the provisions on origin of the former Latin American Free Trade Association (LAFTA), in force since 1960. In December 1987, in Decision 231, Andean Community rules of origin were adopted. In March 1991, that Decision was amended in Decision 293. The rapid progress of trade integration, in particular, the formation of a customs union, brought to the fore the need to update legislation to establish origin criteria, simplify and organize procedures and shore up sanctioning mechanisms. This was accomplished in Andean Community Commission's Decision 416 of July 30, 1997. That Decision establishes the conditions products must meet to be considered of subregional origin and thereby benefit from the enlarged market. If the Special Provisions for Determining and Certifying the Origin of Goods are not applicable in certain cases, Specific Requirements of Origin may be established. Decision 417, establishing the respective criteria and procedures, is available for such purposes.

From December 1997 to August 2001, the General Secretariat signed 21 Resolutions on origin criteria. While 20 of these relate to Decision 416 (with the sole exception of Resolution 481, which relates to a judgment of non-compliance pursuant to Article 155 of the Cartagena Agreement), only three relate to Decision 417, corresponding to the automotive and motorcycle sectors (two to the first sector).

Decision 416 also provides for complementary aspects, such as direct shipment of merchandise, permitting invoicing from a third country for trade in native products, and the case of re-exports. It also provides for cumulative origin, by which, in determining the origin of merchandise, imported native materials from the other Member Countries are considered as native of the Member Country. It regulates declaration and certification procedures, the use of certificates of origin, the responsibility of the institutions designated by the respective governments and the control that should be exercised, as well as the procedures to be followed in cases of disputes.

Technical regulations

The adoption, in June 2001, of Decision 506 on "Recognition and acceptance of certificates of products marked in the Andean Community" was an important step toward removing unnecessary technical barriers to trade. Those barriers are the result of, among other things, the compulsory application of conformity evaluation rules, technical regulations and procedures or any other required regulatory instrument, except for those concerning sanitary, phytosanitary and zoosanitary aspects.

Decision 506 simplifies conformity evaluation activities by Member Countries, while advances are made in harmonizing the regulatory technical instruments stipulated in Decision 419 on the "Andean System of Standardization, Accreditation, Testing, Certification, Technical Regulations and Metrology." Its application will enable interested commercial agents to inform themselves regarding the technical requirements that products must meet in order to be accepted in a given Andean country. In this connection, the countries have committed themselves to updating periodically the inventories of products that must meet such technical regulations and the accredited and recognized certification institutions that are responsible for evaluating their conformity. Conformity certificates for products that must meet mandatory requirements such as those mentioned may be issued by the recognized and accredited certification institutions in each country.

The Andean Community has a quality system in effect that enables it, on the one hand, to clear the way for intra-Community trade by eliminating unnecessary technical barriers and, on the other, to bring about improvement in the quality of the goods and services produced in the Andean subregion. The quality system covers all elements of quality infrastructure: standardization, accreditation, testing, certification, technical regulations, and metrology of all of the subregion's products and services, except for those in the phytosanitary and zoosanitary areas. The Andean Quality System is also planning to set up an Information and Registration Center on standards, technical regulations, procedures for evaluating conformity, System bodies, and other pertinent legal provisions and general information.[96]

Agricultural health

The main objectives of the Andean Agricultural and Livestock Health System, which was established in Decision 328, are to coordinate and implement subregional agricultural health activities; promote harmonization of phytosanitary and zoosanitary legislation applicable to trade; monitor the risk to the Community of attacks by pests and exotic diseases; prevent the spread and contagion of those presently existing within its territory; implement joint action programs; and support the settlement of sanitary and phytosanitary disputes arising in the context of trade between Member Countries.

The Andean Community and the General Secretariat have updated and perfected Decision 328 and the process of adopting a new Decision is under way. That Decision would redefine criteria, procedures, and deadlines for the enhanced application thereof and compliance with it at both the national and the subregional levels. The draft brings Community provisions into line with the new international agricultural health requirements by incorporating the principles established in the WTO's Agreement on Sanitary and Phytosanitary Measures. The Andean Agricultural and Livestock Health System serves as a framework for the maintenance and improvement of the health of agriculture and fisheries in the Member Countries, and as a legal instrument to prevent sanitary and phytosanitary measures from constituting hidden barriers to trade in agricultural products.

In that connection, note that there are cases where phytosanitary and zoosanitary measures are applied with insufficient grounds, thereby creating barriers to trade in agricultural products. Three examples are given below. The first case involved white sugar, and arose in 1999 between Ecuador and Colombia. Ecuador imposed a requirement of import permits for Colombian exports of this product, and Colombia took the case to the General Secretariat. While Ecuador claimed that such authorizations ensured the quality of imported sugar, the Secretariat sustained that Ecuador could not apply sanitary measures in the case of sugar, as it was neither a plant nor a manufactured good, nor was it covered by Ecuador's Plant Health Act. Secondly, the 1998, Colombia suspended, in violation of CAN legal provisions, the issuing of zoosanitary permits for imports from Ecuador of cattle, pigs, and other animals susceptible to foot-and-mouth disease. In addressing this situation, the Government of Colombia put a stop to the non-compliance, but the measure suspending the issuing of animal health permits was renewed twice. The third, and noteworthy, case arose in Venezuela which, in 2000, imposed health restrictions on the entry of meat and meat products from Colombia. After a delegation from the independent Agricultural Health Service of Venezuela established that the main Colombian cold storage plants complied with the required health measures, the Colombian and Venezuelan ministries decided to eliminate the said restrictions.

The Andean Community's most noteworthy accomplishments in agricultural health include the establishment of harmonized requirements and procedures for registering and controlling chemical pesticides for agricultural use and regulations for registering, controlling, marketing and using veterinary products, permitting their proper use and handling in order to avoid and minimize damage to health and to the environment under authorized conditions and facilitating trade in those items in the subregion. In the area of harmonization, to be noted is the establishment of common requirements to facilitate trade within

[96] The Center, still in the project phase, would be a CAN General Secretariat virtual center, bringing together information from the respective WTO national information centers on technical standards topics. However, according to information from the CAN General Secretariat, for this virtual center to be implemented, the information centers of the respective Andean countries would have to be fully operational. Information is now available on the CAN Web page on each country's technical requirements, the entities with responsibility for standards compliance, etc.

the subregion and with third countries in 31 agricultural products, which represent a significant percentage of the subregion's imports. As regards animal health, to be noted is approval of common requirements for all species of domestic animals and products and byproducts of the animal kingdom covered by the NANDINA classification in effect in order to contribute to trade in those items within the subregion and with third countries and to protect the subregion from possible negative effects of pests and diseases.[97]

Customs instruments

The Andean Community possesses customs instruments for facilitating trade between Member Countries. These include the NANDINA Common Customs Classification, the provisions on Customs Valuations, the Andean Declaration of Value, International Customs Traffic (Decision 477) and Mutual Assistance and Cooperation between the Customs Administrations of the Andean Community Member Countries. The NANDINA Classification is used to designate, classify and code goods uniformly. The Customs Valuation provision enables the countries to apply customs tariffs to imported goods using the same tax base. The Decision on Customs Traffic establishes the procedures to be followed in the departure, in-transit, and destination customhouses and the provision on Mutual Assistance establishes the procedure to be used by customhouses for preventing, controlling, and fighting smuggling and other customs crimes.

The Common Classification of the Andean Community Member Countries (NANDINA) is based on the Harmonized System, used and implemented by the World Customs Organization (WCO). Decision 507, approved in June 2001, rescinds Decisions 381 and 422 and incorporates the sole text of the NANDINA, taking into account the latest amendments introduced by the WCO to the legal texts of the Harmonized System, which entered into force on January 1, 2002.

The Andean provision on Customs Valuation was initially approved in 1992 in Decision 326 and was partially amended in Decision 364. These Decisions incorporated the stipulations of the GATT Value Agreement resulting from the Tokyo Round. However, as a result of the conclusion of Uruguay Round negotiations and of the entry into force of the Agreement on the World Trade Organization, it was the obligation of the countries to implement the Agreement regarding the application of Article VII of the General Agreement on Tariffs and Trade (1994 GATT Value Agreement). Accordingly, and to bring the Andean provision into line with the WTO Agreement, Decision 378 of 1995 on Customs Valuation was approved, replacing Decisions 326 and 364. Decision 378 stipulates that the Member Countries shall be governed by that Decision and by the content of the text of the "GATT 1994 Value Agreement." The provisions of the said Decision 378 refer to the permitted reserves and to the options to that agreement, which were left up to the countries' decisions (such as minimum prices or values, choice of a CIF base in determining value, treatment of interests in customs value). Lastly, the Commission approved Decision 379 on the Andean Declaration of Value in order to harmonize the documentation that is requested to accredit value at customs. This shall be no more than what can reasonably be requested to fulfill the stipulations of the GATT 1994 Value Agreement.

To facilitate international transport operations and ensure the free circulation of goods, the CAN countries adopted, in 1992, Decision 327, regulating international customs traffic. Decision 477, replacing that provision, brings it into line with the new modalities of transport, including the multimodal, and sets down the procedures to be followed when goods cross two or more CAN countries.

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[97] Zoosanitary requirements are updated on an ongoing basis in keeping with changes in the health status of animals and their products.

However, despite formal progress made in this area, it is not reflected in reality. In a study conducted in the framework of the of the Andean Competitiveness Project,[98] which involved a survey of executives of foreign companies that had invested in Andean countries,[99] one of the topics evaluated was the relative state of systems of transport, customs, and foreign trade. The results suggest that transport systems are in particularly critical condition in Bolivia, Ecuador and Venezuela. As regards customs and foreign trade procedures, the results for the Andean countries are again very unfavorable, and are consistent with the results obtained by Warner.[100] As a whole, the Andean subregion is very marginally attractive in transport-related areas, which has negative effect on its competitiveness within the region, thereby limiting inflows of investment that might be attracted by the subregional market. In addition, that situation lies at the root of concerns as to whether steps taken by CAN in the customs area and in facilitating international transportation and infrastructure in general have in fact had any positive impact and are correcting local deficiencies.

In addition, in June 2000, the CAN Commission approved, in Decision 478, the Mutual Assistance and Cooperation program between the Customs Administrations of the Andean Community Member Countries, which allows for joint efforts in preventing and fighting customs crimes, such as smuggling. In the framework of this program, activities may be implemented such as the supply of information and reciprocal assistance on procedures that include the use of precautionary measures against goods or means involved in customs crimes. The Customs Administrations will also cooperate in setting up and maintaining clear two-way channels of communication, in developing training programs, and in exchanging experts and information.

Although this program is very new and will it is certainly too soon to see any impact, it should be underscored that evidence suggests that many problems must be addressed in preventing customs crime. For example, estimates are that an average of US$ 700 million in smuggled goods enter Peru each year101 (the newspaper *Gestión*, Peru, September 29, 2001), much of which enters from Bolivia. That figure has not dropped over time, according to Peruvian authorities.

In addition, as mentioned in the report, Warner [2001] indicates that there are obstacles other than tariff levels making Andean trade more expensive, such as port costs, licensing fees, transportation costs, bank interest, etc., which make the Andean countries' importation costs among the most expensive. Although tariffs may average about 11%, other costs exceed 30%, with the exception of Colombia, where they are 26%.[102] This indicates a general lack of competitiveness at the regional level and the need to implement measures or policies that have truly observable impact on customs, foreign trade procedures, and on all trade-related costs.

Provisions on trade protection and on practices that restrict free competition: Dumping, subsidies, safeguards, and free competition

Among CAN provisions, there are certain legislative gaps in the area of unfair competition in trade (such as dumping and subsidies), possible losses of competitiveness (safeguards) and practices that restrict free competition. Some regulations exist on dispute settlement between one or more Member

98 Vial [2001], and national studies, which may be found at *http://www.cid.harvard.edu/andes*.

99 This survey was conducted in the last quarter of 2000, except for Peru, whose data collection period was extended until late January 2001.

100 Some of Warner's results in this area are discussed in the chapter on trade and investment.

101 *Diario Gestión, Perú. http://ww.gestión.com.pe/html/www/archivo/2001/set/29/5econ.htm.*

102 See national studies on competitiveness at *http://www.cid.harvard.edu/andes*.

Countries and third countries not covered by WTO provisions. Accordingly, studies are being conducted with a view to amending Decisions 283 (dumping and subsidies) and 285 (practices that restrict free competition) to eliminate these defects. In general, Decision 285 is of limited scope. It deals with restrictive practices, either effected in concert or those involving abuse of dominant market position, when such practices or behaviors affect competition in one or more country of the subregion. However, that Decision does not address topics such as vertical restrictions and mergers, which are addressed in treaties such as those establishing CARICOM and MERCOSUR and, as regards sanctions, applies trade measures rather than imposing direct sanctions for anti-competitive practices. It should be noted that only Colombia, Peru and Venezuela have agencies serving as national authorities on competition. Neither Bolivia nor Ecuador yet has policy in this area.

In general, many authors (Araoz [1997] and Tavares [2001]) claim that the best approach to policy to prevent anti-competitive practices is gradually to strengthen competition policy at the subregional level, while eliminating anti-dumping mechanisms and replacing them with contingency mechanisms, such as safeguards. This is because application of anti-dumping measures creates market distortions.[103] They argue that replacing anti-dumping measures with anti-monopolistic measures should be a mandatory step incorporated in all trade treaties. However, to eliminate such measures, other barriers to trade must be completely eliminated.

Dumping

The Community provisions pertaining to imports involving dumping are Decision 456, when the imports affected by dumping are native to an Andean Community Member Country, and Decision 283, when such products originated in a third country and involve products exported from one Member Country to another, or when two or more Member Countries are affected by dumping practices and the product is subject to the Common External Tariff (CET).

From 1991 to early 2001, the CAN Secretariat had investigated 16 dumping cases. The number of cases has been increasing: while from 1991 to 1998, one or two cases were brought each year, in 1999, five were brought. In addition, all cases were brought by industrial sector companies, and were concentrated in Member Country enterprises. They involved the following products: polypropylene bags, stainless steel sinks, tin containers, disposable plastic syringes, broken polyester fibers, chipboard bulletin boards, crown lids, surgical products, fiberglass wool, locks, and electric motors. Only two cases were brought against third country companies, both by steel industry firms. Peru and Venezuela are the countries whose companies brought the most cases, five in each case. Colombia is the country against whose companies most cases have been brought: eight of the total of 16 cases. Cases were brought against both Ecuadorian and Venezuelan companies: four in each case.

As of March 2002, the CAN Secretariat is investigating one dumping case. The case was brought in June 2001 and pertains to the aluminum sector. Both the complainant and the party against which the complaint was brought are Peruvian companies, but the company against which the complaint was brought is a company importing from Colombia and Ecuador.

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[103] Investigation of anti-dumping cases does not usually include an analysis of market structure, which would establish whether the company responsible for this practice in fact occupies a dominant market position. By definition, only within a monopolistic market structure does price discrimination among markets arise. Failure to study this may result in restrictions of free competition, rather than the imposition of sanctions on a monopoly.

Subsidies

Community provisions that are applicable to imports affected by subsidies are Decision 457, when imports affected by subsidies are native to an Andean Community Member Country, and Decision 283, when such products originated in a third country and involve products exported from one Member Country to another, or when two or more Member Countries are affected by subsides and the product is subject to the CET.

As of November 2001, in the Andean Community, three cases have been brought: two of them in 1992 and the third in 1999. The first involved plastic industry products – phthalic anhydride and its derivatives – the complainants were Colombian companies, which brought the case against a Venezuelan company. The second case involved rice, and the complainant was the Government of Colombia, bringing the case against the Government of Venezuela. The third case involved chemical substances (ampicillin trihydrate, amoxycillin trihydrate and sodium dicloxacillin). The complainant was a Peruvian company, bringing the case against Indian companies.

Safeguards

The case of safeguards is interesting because Andean provisions in this area were implemented at the beginning of the Andean Pact (1969) and have undergone only minor amendment. They have not been brought completely into line with WTO provisions, and significant differences remain. For example, Andean provisions are more lax that those of the WTO as regards making complaints, as there are far fewer requirements, such as evidence of injury, etc., which the WTO requires. In addition, sanctions are applied for shorter periods than those of the WTO (one to two years), but, for example, contingency plans are not required on the part of affected sectors to counteract possible lack of competitiveness. In practice, the Andean Court of Justice proposes to bring procedures more into line with WTO guidelines. However, no formal provision has yet been made in this area.

From 1992 to 1999, 12 cases involving safeguards were brought. Eight were brought by Colombia, while Peru brought two, and Ecuador and Venezuela brought one case each. Although the number of cases is not very large, the conditions under which they may be brought may allow recourse to the Court of Justice to become an instrument limiting subregional trade.

Free competition

Decision 285 is applicable when restrictive practices originate in the subregion or involve a company carrying out its economic activity in a Member Country. "Originate in the subregion" means that the companies carrying out their economic activity effect the restrictive practice in one or more Member Country. "Involve" means pertaining to companies carrying out their economic activity in one or more Member Country and to companies located outside the subregion. Member Countries and companies with a legitimate interest are authorized to make complaints.

As of November 2001, two cases had been brought in area, one in 1996 and one in 1997.[104] The first case involved sugar and the second polypropylene resins. However, in both cases, the petitions were denied and, therefore, no corrective measures were imposed. In the first case, the company making the complaint was a Venezuelan company, which brought the case against another Venezuelan company and an

[104] In 1992, information was submitted with a view to making a complaint involving a product called ortho-xylene. The company bringing the case was a Colombian plastics industries association. However, the case was not pursued.

Ecuadorian company. In the second case, the complainant was an Ecuadorian company, which brought the case against a Venezuelan and a Colombian company.

Dispute settlement

Procedures

The Cartagena Agreement signed by the Member Countries in 1969 and amended through its respective Protocols, establishes the legal and institutional framework for the Andean integration process. The jurisdictional function within the integration process is assigned to the Court of Justice of the Andean Community. The General Secretariat is charged with administrative investigation (also known as the pre-litigation phase) to determine whether State Parties are responsible for non-compliance, and with monitoring the Andean juridical system to ensure that it remains consistent.

The Treaty creating the Court of Justice of the Cartagena Agreement, signed by the Member Countries in 1979, establishes that body and defines its spheres of competence. The first part of the Treaty establishes what is called the "Andean Juridical System," which is made up of: (a) the Cartagena Agreement, its Protocols and Additional Instruments; (b) the Treaty creating the Court of Justice; (c) the Commission Decisions; and (d) the Resolutions of the Board (today replaced by the General Secretariat of the Andean Community). That Treaty also establishes the supranational characteristics of Community provisions, namely their direct application (horizontal and vertical) and immediate effectiveness in the Member Countries. As a result, the Decisions of the Council of Foreign Ministers and of the Commission and the Resolutions of the General Secretariat of the Andean Community do not require ratification by national parliaments in order to become operative and enter into force on the date of their publication.

The Treaty also establishes the general obligation of Member Countries to take the necessary measures to ensure compliance with the rules and regulations that constitute the juridical system of the Cartagena Agreement. They also may not adopt or implement any measure whatsoever that is at variance with those provisions or that hinders their application in any way.

Under the Treaty, the Court has jurisdiction today over actions of three kinds: nullification, non-compliance, and pretrial interpretation. In the first case, the Court is responsible for declaring the nullity of Commission Decisions and General Secretariat Resolutions that violate the provisions of the Andean Community's juridical system, even those resulting from diversion of power, if challenged by a Member Country (provided that the Decision was not adopted with its affirmative vote), the Commission, the General Secretariat, or natural or juridical persons to which they are applicable and detrimental. This action must be brought during the year following the Decision or Resolution's entry into force.

Decision 425 of the Council of Foreign Ministers contains the Regulations for the Administrative Proceedings of the Andean Community's General Secretariat. They stipulate that the General Secretariat must, by administrative initiative or at the request of a Member Country or of a citizen, send its written observations to the Member Country that is allegedly failing to comply with Andean provisions, setting a deadline for its answer. On receiving that answer or at the expiration of the deadline, the General Secretariat should go on record with a justified opinion. Regardless of the opinion or of whether or not it was issued, the option of turning to the Court exists as of that moment.

Under the pretrial interpretation procedure, national judges trying a case in which a provision of the Andean juridical system should be applied must obligatorily request the interpretation of the Andean Court of Justice with regard to the content and scope of that provision. They should then, in keeping with that interpretation, judge the facts and settle the dispute. The aim of this mechanism is to ensure that Andean provisions are applied uniformly throughout the territory of the Member Countries.

In 1996, the Member Countries signed the Protocol Modifying the Treaty creating the Cartagena Agreement's Court of Justice, known as the Cochabamba Protocol. Its ratification by the five Member Countries will broaden the Court's spheres of competence and amend the non-compliance action. In August 1999, the Protocol entered into force, and now natural and juridical persons may appeal directly to the Court should a Member Country fail to comply with Andean provisions, provided that the cited pre-litigation proceedings before the General Secretariat are first carried out. The Cochabamba Protocol also establishes a new legal recourse for cases of omission or failure to act, under which the Council of Foreign Ministers, the Commission, the General Secretariat, and natural or juridical persons may request the Court's verdict if one of those Community bodies fails to carry out an activity for which it is expressly responsible under the Andean Community's juridical system. It also gives the Court the competence to settle via arbitration any disputes that may arise as a result of the application or interpretation of contracts, accords, or agreements signed between bodies and institutions of the Andean Integration System or between the latter and third parties, if the parties so agree. The Court and the General Secretariat may also settle via arbitration any disputes citizens may submit to them with regard to the application or interpretation of aspects contained in private contracts regulated by the Andean Community's juridical system. The Cochabamba Protocol, in addition, gives the Court the jurisdiction to try labor disputes that arise in Andean Integration System bodies and institutions.

Although the entry into force of the Protocol is an important step forward in facilitating dispute settlement, it has only recently been taken. Its impact on the dispute settlement system has therefore not yet been felt.

Since early 2000, the Andean Court of Justice has decided 26 cases of non-compliance, Ecuador (10) and Venezuela (7) being the countries against which most cases in this connection were brought; 4 nullity actions, two of which were brought by Ecuadorian companies and two by Colombian companies; 129 pre-litigation rulings, requested mainly by Colombia, followed by Ecuador; and one request for review filed by Ecuador.

In general, the greatest problems of non-compliance with Andean provisions arise in the agricultural and fishing sector (imposition of surcharges, import licenses, etc.). For the service sector, the most salient problem relates to transport of goods, i.e., smuggling; while in the case of manufactured goods, difficulties are most pronounced in the automotive sector.

Intellectual and industrial property

The Andean Community has full and up-to-date provisions on Intellectual Property, including the following: the Common Industrial Property System, which regulates trademark and patent registration and protects industrial secrets and appellations of origin; the Common Regime on Copyright and Related Rights, which guarantees authors and other rights holders adequate protection of creative literary, artistic and scientific workers; the Regime for Protection of the Rights of Obtentors of new Plant Varieties, which safeguards new plant varieties obtained by plant improvers; and the Common Regime on Access to Genetic Resources, which regulates the obtaining and use of these resources in order to ensure more equitable distribution of their benefits. This right is linked to the protection of the traditional know-how, innovations, and practices of indigenous communities.

The Andean Community's new Common Industrial Property System, adopted in Decision 486, entered into effect on December 1, 2000. It replaced Decision 344. With its approval, the Andean countries' negotiating capacity is strengthened in its relations with third countries, particularly the Free Trade Area of the Americas (FTAA), as it sends a positive signal to investors in establishing improved protection of intellectual property rights and providing legal security. This Decision deals with precise aspects of patents of invention, industrial designs, trademarks, appellations of origin, and unfair competition related to industrial property, among other things. The new system incorporates substantive aspects of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), adopted in the framework of the WTO's Uruguay Round, such as national treatment, most-favored-nation treatment, layout designs of integrated circuits – with reference to the treatment of microchips – and the observation of national border measures for better control of smuggling. It also stipulates in detail all procedures for registration, licensing, canceling, and nullifying rights to ensure that they are identical in the five Andean countries.

The most important aspects that were amended in the new Decision to bring it into line with TRIPS are exclusions of invention (that is, "invention" is defined), the duration of utility models (which was extended from eight to ten years) and border measures (essentially, to check at borders whether the goods it is sought to bring into the territory of a Member State infringe the legitimate intellectual property rights of third parties). Other substantive topics relates to second patents, Andean opposition (that is, to enable the holder of a registered trademark in any Member Country to prevent the registration of an identical or similar trademark both in the country where it was first registered and in the other Member Countries), coexistence of trademarks, business secrets, well-known trademarks and advertising slogans.

The Common Copyright Regime and Related Rights was adopted in 1993 in Decision 351 of the Commission of the Cartagena Agreement. Protection covers artists that interpret or execute the works (reciters, singers, announcers, actors, dancers, musicians, narrators); producers of phonograms (natural persons who fix exclusively the sounds of a performance or other sounds); and broadcasting companies (firms that broadcast public radio or television programs).

The Common Regime on Access to Genetic Resources was approved by the Commission of the Cartagena Agreement in Decision 391, to guarantee the fair and equitable participation of the Andean Community countries in benefits stemming from the use of genetic resources. Prior to the adoption of this Decision, in 1996, access to such resources was not legislated. As a result, the countries of origin of the rich genetic heritage of the Andean subregion did not obtain a fair share of the economic benefits it produced, not to speak of the traditional communities responsible for their improvement. Under that Decision, henceforth those wishing to use and develop the active principles of plants and microorganisms must first secure the necessary authorization and sign an Access Contract with the state. The Community rule expressly recognizes the rights of native, Afro-American, and local communities to their traditional know-how, innovations, and traditional practices with regard to genetic resources and their by-products.

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ANNEX II

DECLARATION OF SANTA CRUZ DE LA SIERRA

We, the Presidents of Bolivia, Colombia, Ecuador, Peru and Venezuela, assembled at the Special Meeting of the Andean Presidential Council, in reaffirming the commitment to establish a Common Market, have approved the following:

Free Trade Area

1. Agreement to consolidate and perfect the free trade area by June 1, 2002 at the latest.

2. Peru will move the dates ahead for reducing customs duties on oil and fuels to December 31, 2003. Agricultural products will be free of customs duties on December 31, 2005.

3. To make all possible efforts not to place any new restrictions on free trade and to carry out agricultural, agroindustrial and industrial complementarity programs.

4. Agreement to revise the Community's rules of origin within 60 days and/or to set up compensatory mechanisms or specific origin requirements, as the case may be, as a condition for eliminating quotas and any restriction on quantity that is currently in effect, based on an analysis of the production chains.

5. Agreement not to extend to third countries concessions that are more favorable than those granted to Andean Community Member Countries.

6. Application of the principle of positive administrative silence for short periods of time to ensure rapid handling of administrative procedures for importing goods from the subregion.

7. Agreement to settle conflicts created by the imposition of sanitary and phytosanitary restrictions.

8. Agreement to harmonize sanitary and phytosanitary requirements within a period of sixty days.

9. Agreement to ensure cargo transportation by road and to adopt the necessary internal mechanisms for that purpose.

10. To set up a conciliation body to supplement the work of the Andean Court of Justice and to commit themselves to carry out fully all judgments handed down by that jurisdictional organ. They agreed to call a meeting for the purpose of examining the reasons why judgments of the Andean Court of Justice fail to be carried out and for arranging for the political and administrative measures that are needed to ensure their fulfillment.

Customs Union

11. Bolivia, Colombia, Ecuador, Peru and Venezuela will put a common external tariff into effect no later than December 31, 2003. It will have a four-level structure: 0, 5, 10 and 20%. Bolivia will not apply the 20% level.

12. Agreement whereby each country will, in the degree to which its fiscal possibilities permit, apply a 0 tariff to the capital goods it does not produce. Ecuador is authorized to gradually reduce customs

duties on raw materials and inputs that are not produced in the subregion, to allow it to maintain the competitiveness of its exchange policy. Any distortion created by this authorization will be corrected through the application of requirements of origin or countervailing duties that will avoid generating unfair competition with the other Andean partners and that will not cancel the application of the agricultural price stabilization mechanism.

13. Agreement to harmonize temporary importation regimes for active perfecting that the five countries apply to the importation of capital goods, raw materials and inputs that are used to produce goods intended for export to the Andean Community. In order to apply this special Community export-import customs mechanism, the appropriate rules of origin must be defined to avoid creating distortions in intra-Community trade. A Commission Decision must be approved within 60 days to review and define the afore-mentioned mechanism, after which it will be immediately applied.

14. Agreement to harmonize the special intra-subregional trade regimes and to create common trade defense mechanisms for safeguarding the CET and counteracting the effects of the application of such regimes by third countries.

Common Agricultural Policy

15. Agreement for the adoption of a common agricultural policy.

16. Agreement for the adoption of agricultural price stabilization mechanisms by all of the countries, reducing product coverage and establishing mechanisms to guarantee their more transparent application.

17. Agreements among the production sectors will be taken into account if they reflect the sensitivity of the agricultural products and provided that they maintain the overall competitiveness of the agroindustrial chains.

Macroeconomic Policy Harmonization

18. Agreement to harmonize macroeconomic policies and to fulfill the criteria for macroeconomic convergence within a period of two years, as an essential element for the formation of the Andean Common Market.

19. Agreement to extend the coverage of article 110 of the Cartagena Agreement with regard to the foreign exchange safeguard, in order to make it applicable to competitive devaluations of Andean Community Member Countries.

Common Foreign Policy

20. They reiterated the need for continued diplomatic overtures to secure the United States Congress' renewal and expansion of the Act governing Andean Trade Preferences that are granted due to the continuous efforts of the countries in the subregion to control the world drug problem, by including products and sectors that are of fundamental importance to the Andean countries. They likewise reiterated the importance to the subregion of Venezuela's incorporation in that preferential system. In this connection, they instructed their Foreign Ministers to reiterate these proposals in the course of their meetings in Washington in February with the Secretary of State, the US Trade Representative, the National Security Council, and Congressional officials.

21. The Presidents underscored the need to continue high-level political overtures and the corresponding technical efforts for the purpose of consolidating an association with the European Union that will open up a new dimension in relations between the two regions in the political, economic, and cooperation spheres. They requested the Pro Tempore Secretariat to coordinate the position of the Andean countries for the forthcoming Madrid Summit. They likewise instructed their Foreign Ministers to make overtures for the same purpose to the Chair of the European Union, the Troika and other member countries of the Union.

22. They reaffirmed the need to perfect a comprehensive strategy for the participation of the Andean countries in the FTAA negotiations and reiterated their willingness to continue negotiating jointly and with a single voice in that process.

23. They consider that the best way to make advances in the subregion's negotiations in the WTO is to arrive at concerted positions. They accordingly decided to adopt a common strategy on the pertinent issues, in order to address the commitments acquired in Doha in a coordinated way.

24. In light of the importance to the Andean Community of its political dialogue with the MERCOSUR, the Presidents reiterate their full solidarity with the Republic of Argentina in the face of the political situation it confronts and express their unrestricted backing for the democratic institutions and the Constitutional Government of that country.

    The Presidents agreed to ask the President of Bolivia, as Chairman of the Andean Presidential Council, to transmit to the Presidents of the MERCOSUR member countries at the next Summit Meeting of MERCOSUR, Bolivia and Chile, to be held in Buenos Aires on February 18, the intention of the Andean Community countries to continue the trade negotiations between the two groups.

25. The Presidents drew attention to the sustained and financially sound growth of the Andean Development Corporation and to the role it plays as the principal source of multilateral financing for the Andean countries and as an important promoter and coordinator of the Latin American integration process.

    They expressed their satisfaction at the incorporation of all of the MERCOSUR member countries as shareholders of the Andean Development Corporation's C Series, which will facilitate the financing of regional integration programs and projects, particularly in the areas of infrastructure and logistics. They also welcomed the forthcoming accession of Costa Rica and Spain to the Corporation's shareholding.

    Convinced of the need to substantially broaden the role played by the Andean Development Corporation in the sustainable development and integration of the region, the Presidents ordered an increase in its authorized capital from 3 to 5 billion dollars and the underwriting and respective payments in keeping with a timetable prepared to meet future financing needs.

26. The Presidents discussed the issues to be addressed at the Summit on Development Financing to be held in Monterrey, Mexico in March and decided that their Foreign Ministers would propose the consideration of this subject at the next meeting of Foreign Ministers of the Rio Group, for which they would have access to the studies entrusted to the Andean Development Corporation. They also deem it necessary for the Foreign and Treasury Ministers to take part in the Monterrey Meeting because of the political and financial connotations of that event.

27. The Presidents agreed that their countries would put forward a common proposal on the topics of the agenda for the Summit on Drugs, in which the Andean countries, the United States, Brazil, Mexico, Panama and the Chair of the European Union will participate. The results of the drug control efforts

made since the meeting in Cartagena de Indias in 1990 are to be evaluated at that Summit. The Andean Foreign Ministers will take up those issues at the Meeting of the Foreign Ministers of the Rio Group, scheduled for this coming February 15 in San José, Costa Rica.

28. They underscored the immense challenge for the developing countries and especially the Andean countries, of effectively implementing the concept of sustainable development in both the multilateral and the national spheres. As a result, they decided to start Andean coordination efforts in preparation for the South Africa Meeting on Sustainable Development.

29. Aware of the growing strategic importance of energy to the hemisphere and of its interest in boosting Andean Subregional, Latin American and hemispheric integration, the Presidents agreed to request the Andean Development Corporation, the Latin American Energy Organization, the Inter-American Development Bank and the United Nations Conference on Trade and Development to prepare a comprehensive examination of the subregion's energy potential as a strategic factor in regional and hemispheric energy security. In this connection, the Andean leaders asked for an initial report to be presented at the Second Summit of Heads of State and of Government of South America, to be held in Guayaquil, Ecuador on July 26, 2002.

Social and Political Agenda

30. The Presidents consider it a priority to move ahead with the tasks on the social agenda. To that end, they instructed the pertinent Ministers to meet during the course of this semester for the purpose of designing a Community strategy to supplement national efforts in this area.

31. The Heads of State welcomed the initiative of Peruvian President Alejandro Toledo to hold a Conference of Foreign and Defense Ministers of the Andean Community Member Countries in Lima this coming April in order to examine the proposal for reducing spending on defense, bearing in mind domestic security needs and existing spending levels, in order to allocate more funds for social investment and anti-poverty efforts.

32. The Presidents agreed to hold a Summit Meeting in Caracas on May 4, 2002 to examine the issues of Andean political integration and the standards and guidelines for its treatment.

Santa Cruz de la Sierra, Bolivia, 30 January, 2002

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