ANDEAN REPORT

2002-2004

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Intal
Integration and Regional Programs Department
Institute for the Integration of Latin America and the Caribbean - INTAL

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PRESENTATION

The Subregional Integration Report Series, which includes this second 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 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.

This Report N° 2 was prepared by the economist Fernando González Vigil, currently professor and researcher of the University of the Pacific, Peru. The author would like to thank the following people for their contributions in the preparation of this report: Daniel Alfaro (Chapters II and III), Manuel Hernández and Juan Manuel de los Ríos (Chapter I), and Rubén Cáceres (Chapter IV).

Mr. Juan José Taccone, former INTAL's Director, and Mr. Uziel Nogueira, INTAL's Senior Economist, were responsible for the coordination and general and technical editing of the Report.

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.

C O N T E N T S

EXECUTIVE SUMMARY

Contents

The Andean countries have made significant progress in their external agenda, above all because of the achievements with their main economic and political counterparts. Andean negotiations contributed to having the United States adopt the Andean Trade Promotion and Drug Eradication Act, renewing and enhancing other tariff preferences granted to the Andean Community of Nations (CAN), save for Venezuela. Furthermore, Bolivia, Colombia, Ecuador and Peru initiated negotiations with the U.S.A. for a free trade agreement (FTA). Such negotiations started with Colombia, Ecuador and Peru, with Bolivia attending as an observer authorized to fully join in when it is ready to do so.

The five CAN members signed an Agreement on Political Dialogue and Cooperation with the European Union (EU), which broadens and deepens long-standing, important cooperation between both integration schemes. Moreover, they were able to extend the Andean Generalized System of Preferences ("Drugs") for three years, with the possibility of renewing its enforcement for ten years, from 2005 to 2014. Additionally, negotiations for an Association Agreement with the European Union, which includes an inter-group FTA, seem to be on the right track although in this regard CAN will have to show it has reached a sufficient level of integration.

Likewise, the five CAN member countries were accepted as MERCOSUR Associate Members and as Participants at the Presidential Summits as a result of the Economic Complementation Agreement (ECA) signed by Bolivia, Peru, Colombia, Ecuador and Venezuela with that sub-region's countries. Upon completion of this report, there were negotiations underway for implementing Free Trade Areas (FTAs). Should they end successfully they would mark the beginning of a decisive stage in the building of the South American Community of Nations (SACN). Furthermore, South American physical integration has continued within the framework of the Initiative for Regional Infrastructure Integration in South America (IIRSA), with the financial and technical support of the Inter-American Development Bank (IDB), the Andean Development Corporation (CAF) and the Financial Fund for the Development of the River Plate Basin (FONPLATA). Progress has been made in the implementation of the pertinent projects after they were grouped into three Integration and Development Hubs involving the CAN countries.

Regarding the domestic agenda, the main non compliances and delays have happened in core issues of Andean trade integration. Firstly, the deadline for the adoption of a Common External Tariff (CET) among the five CAN members was postponed until 10 May 2005. Such postponement means that the objective of the customs union is still in force, although Peru is applying its national tariff while the other four countries are implementing the CET adopted as from 1994. Secondly, the lack of significant progress in the clearing of forests or the harmonization of non tariff measures did not help to put forward the date for tariff relief on hydrocarbons imported by Peru from the sub-region. Thirdly, not only was there an unmet deadline for the adoption of a new system of agricultural price bands, with less product coverage and with a more transparent application methodology but, moreover, no other deadline was fixed for overcoming the current situation of two parallel systems: the Peruvian one and the Andean System of Price Bands (SAFP, its acronym in Spanish) applied by Colombia, Ecuador and Venezuela. Resulting distortions, increased by those stemming from the two above-mentioned non compliances have brought about a proliferation of trade defense measures against the intra-sub-regional free trade of oilseeds.

It is necessary to note the positive side in the progress made regarding trade in services liberalization, border integration and macroeconomic convergence. With regard to border integration, progress was made in the interconnection of electricity networks with the approval of the pertinent overall sub-regional framework and its implementation between Colombia and Ecuador, to be joined by Ecuador and Peru, as well as the new land transport regulations (technical conditions for passenger buses) and those for maritime guarantees (naval mortgages and maritime privileges). With respect to the circulation of persons, national identification documents were recognized for traveling within the sub-region for tourism and so was the approval of the Andean instrument for labor migration, which envisages the establishment of seven Bi-national Border Service Centers. With regard to macroeconomic convergence, reasonable progress was made in converging inflation goals, fiscal deficit and public indebtedness.

Institutional Agenda: the Challenge of Consolidating the Customs Union

The difficulty of establishing a customs union is one of the main challenges for CAN. The economic benefits, which are not insignificant at the individual level and certainly important as a whole, show that the *raison d'être* of the CAN is not merely "political". However, the centripetal forces are still small since the sub-regional market only absorbs 10% of total exports, and they are even more discrete as a source of attraction of Foreign Direct Investment (FDI). Therefore, the leveraging of such beneficial economic effects has been unequal among the member countries, which was predictable in view of the undoubtedly unequal national capabilities, possibly worsened by the joint acceptance of participatory modalities in the core trade integration mechanisms which are maybe "too tailor-made".

The above-mentioned facts, combined with the highly intrinsic requirements of the promoted integration model has had ambiguous repercussions in facing the challenge of consolidating the customs union: on the one hand, the political will of leveling the field to ensure such consolidation and, on the other hand, the repetitive postponement of such consolidation probably reflects the specific influential interests, favored by the uneven field and/or that envisage the external and internal agendas as substitutes of one another instead of supplementary. Under such circumstances, the CAN General Secretariat is currently proposing the formulation of a new strategic design, an Andean integration for development and globalization which, to a certain extent, will "eliminate tariffs" in the process, through a new common market model which emphasizes the pertinent normative and promotion actions, competitiveness (rural and agricultural, SMEs, area of influence of IIRSA Hubs and border areas, plus the technological innovation this entails), and other strategic issues such as energy, sustainable development, the society of information and connectivity.

Therefore, the above places the integration model at the core of the current Andean debate. It can be said that there are two integration models with greater influence particularly on the Latin American scenario. One is the EU model which represents something like the "orthodoxy" of knowing about integration, with its supranational institutions and mechanisms to guarantee the effectiveness of the ground rules of a process based on legality and not on domination or imposition, and with the classical break-down of the process into sequential stages where a customs union is previous to the common market, because it is presupposed that setting up a single trade entity is essential for the feasibility of the rest of the construction of a single economic space and for the credibility of such commitment. Another is the model of the North American Free Trade Agreement (NAFTA), whose objective is that of a comprehensive FTA where all components are built simultaneously -or without predetermined stages-, encompassing and going beyond the wide range of topics of the current World Trade Organization (WTO) agenda. In the Andean sub-region, since the entry into force in 1995 of the "G-3" group (Colombia, Mexico and Venezuela) and the Bolivia-Mexico Free Trade Agreement, and more so now that an FTA is being negotiated with the U.S.A., there is in fact a blending of both models or, to be more accurate, between the Andean version of the European model and the adaptations of the NAFTA model to Latin American realities.

Contents

CHAPTER I. ANDEAN ECONOMIC OUTLOOK

A. The International Context during the Period

The international economic context during the 2002-2003 period was characterized by a slow and difficult recovery after the downturn of the economy in 2001, a year in which the world gross domestic product (GDP) grew at a rate of only 1.3% or 2.3% as measured by purchasing power parity (PPP) (World Bank [2003a] Table 1.1). This growth improved only slightly in 2002 (1.9% or 3.0%) as a result of the expansionary monetary and fiscal policies implemented by the United States of America (USA) and other developed countries to offset the contractionary effects of the terrorist attacks of September 11, 2001 and the bursting of the bubble in the stock price of information and communication technology companies. Moreover, the invasion of Iraq added to the uncertainty, due to which the world GDP could only pick up later to stand at around 2.8% (3.9% at PPP) in 2003, pushed by the improvement in investment rates and consumption in the USA and Japan, together with the continuous expansion of China (IMF [2004] Table 1.1). At the same time, the combination of rising global competition, and installed capacity and labor supply surpluses in the member countries of the Organisation for Economic Co-operation and Development (OECD) has kept inflation at a low level in those countries, despite the already mentioned expansionary polices that contributed to the acute depreciation of the dollar against the euro, which partly explains the steady drop of the growth rate in Europe during 2003.

The recovery of world trade from the sharp contraction that made the stunning growth rate of 12.4% recorded in 2000 plummet to -0.7% in 2001 (a year in which it performed below the world GDP for the first time since the 1980-1982 recession) was also slow and difficult to come, to then be followed by expansions of 3.1% in 2002 and 4.5% in 2003 (World Bank and IMF [*Idem*, and previous years]), which, however, are too modest when compared with the annual average growth of 6% recorded during the 1990s.

The performance of the external sector of Latin America and the Caribbean (LAC) reflected those international circumstances. The region’s exports also shrank in 2001 (-0.1% after a vigorous 9.7% expansion in 2000) and recorded a meager growth (0.7%) in 2002 (UNCTAD [2003] Table 3.1), due above all to the slowdown of developed economies (especially the United States) and to the associated deterioration of the terms of trade of the region’s net importers of oil and petroleum derivatives. Moreover, there was the exchange and financial crisis that ripped through major MERCOSUR economies, which added yet more reasons for external private financing to dwindle and become more expensive (ECLAC [2003b] pp. 48-53). The adjustment had then to be made on the side of imports, which in LAC countries as a whole grew only 2.7% in 2001 and decreased markedly (-8.3%) in 2002 (UNCTAD [*Idem*]).

Only in 2003 did the costs of external financing come down and its flows increase (although foreign direct investment continued on the downward trend that started in 2001), due to the improvement of both the international economic situation and the region’s macroeconomic balances; LAC countries’ exports increased by 8.3% due to generalized increases in selling volumes and prices; and the growth of regional GDP (that had fallen from 3.7% in 2000 to 0.4% in 2001 and -0.4% in 2002) picked up slightly (1.5%), but still not enough to make the average GDP per capita remain below the 1997 level, nor was the recovery enough to boost imports. All this has resulted in the region posting not only a trade surplus but also a current account surplus. The latter had not taken place for half a century (ECLAC [2003c] pp. 9-11; ECLAC [2004] pp.1-2).

B. The Macroeconomic Environment of the Andean Region

In such an international and regional environment, the member countries of the Andean Community of Nations (CAN) have performed from a macroeconomic viewpoint as summarized in Table 1.

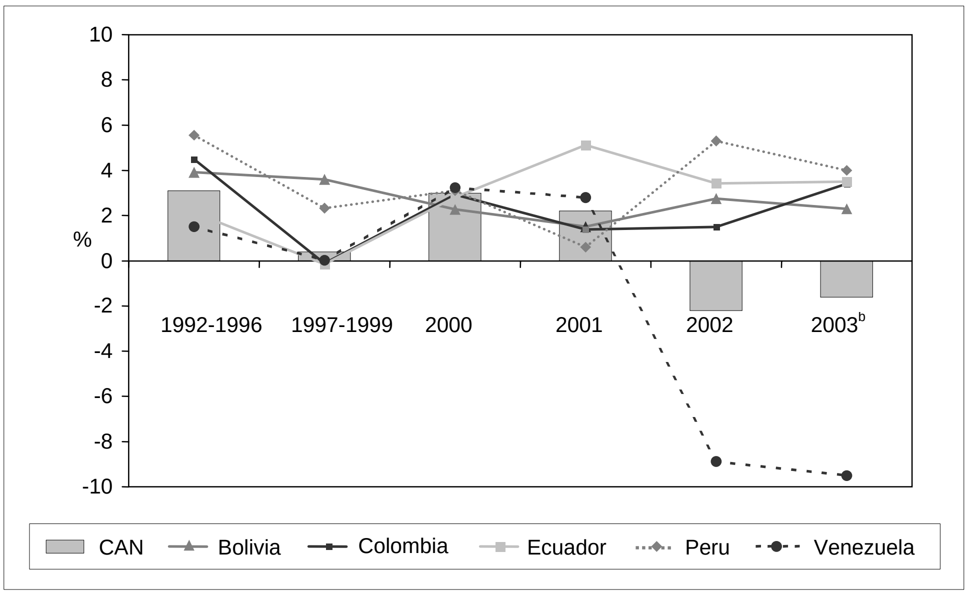
TABLE 1
SUMMARY OF TRENDS IN THE ANDEAN ECONOMIES, 2000-2003

	Production	Prices	Fiscal situation	External sector	Foreign debt and Reserves	Employment
Bolivia	Annual average growth of 2.1% for the 2000-2002 period. A 2.3% growth is projected for 2003.	Stable rate of inflation in the last few years, at around 3% per annum.	High and growing fiscal deficit, up from -3.7% in 2000 to -9.1% in 2002 (as a percentage of GDP).	Steady reduction of the current account deficit (from -5.3% in 2000 to -0.6% in 2003, as a percentage of GDP) due to lower trade deficits.	Public foreign debt/GDP ratio of around 54%. Annual average drop in Net International Reserves (NIR) of -22.1% during 2000-2003.	Rising urban unemployment level, from 7.7% in 2000 to 11.6% in 2002.
Colombia	Annual average growth of 1.5% for the 2000-2002 period. A 3.4% growth is projected for 2003.	Inflation remained on a downward trend as in previous years, falling from 8.8% in 2000 to 5.5% in 2003.	Slight drop in the fiscal deficit, from -4.2% in 2000 to -3.6% in 2002.	From a current account surplus of 0.7% in 2000, it posted a -2.2% deficit in 2003. Widening negative trade gap in the last three years.	Slight increase of the external debt/GDP ratio, up from 39.7% in 2000 to 42.7% in 2002. Andean country with the highest average annual growth rate of NIR (7.7%).	High urban unemployment levels in the last few years, of around 15%.
Ecuador	Andean country with the highest growth rate (4.3%) for the 2000 -2002 period. A 3.5% growth is projected for 2003.	Significant reduction of inflation after dollarization of the economy, down from 91.0% in 2000 to 7.7% in 2003.	Only Andean country with a fiscal surplus, of 0.8% of GDP on average.	Current account deficit of around 3% in the last three years, after a surplus in 2000. Deterioration of the balance of trade.	Considerable reduction in the level of external debt, although it is still the highest in the subregion (66.5% in 2002). Annual average drop of -0.6% in NIR.	Andean country with the lowest unemployment rate (around 5.5%).
Peru	Average annual growth rate of 2.9% for the 2000-2003 period. However, in the last two years, it has been the Andean country exhibiting the highest growth rate: 5.3% in 2002 and 4% in 2003.	Andean country with the lowest inflation rate (1.9% in 2003). In 2001, it even experienced a deflation of -0.1%.	Steady reduction of the fiscal deficit, from -3.2% in 2000 to -2.3% in 2002.	Slight drop in the current account deficit, from -2.9% in 2000 to -2.1% in 2003. Positive balance of trade in the last two years.	Reduction of the external debt/GDP ratio (48.9% in 2002). Average annual growth of NIR, up by 6.2%.	Slight increase in the urban unemployment rate (8.9% in 2002).
Venezuela	Only Andean country which GDP fell during the 2000-2002 period, at an average annual rate of -3.2%. An even more pronounced drop (-9.5%) is projected for 2003.	Relatively high and growing inflation, up from 13.4% in 2000 to 35.5% in 2003.	From a fiscal surplus in 2000 (4.3%), it plunged into a deficit in 2001 (-4.5%) and in 2002 (-1.1%).	Current account surplus during the period, ranging from 8% to 12% of GDP except in 2001 (1.6%). Favorable balance of trade.	Andean country with the lowest external debt / GDP ratio, although with a rising trend (38.8% in 2002). Average annual increase of 3.9% in NIR.	Significant increase in the unemployment rate (16% in 2002).

Sources: CAN General Secretariat [2003j and 2003k]; ECLAC [2003c]. In-house preparation.

Concerning production, Figure 1 shows that the negative performance of the GDP of the CAN as a whole during the years 2002 and 2003 (-2.2% and -1.6% respectively; both lower than the GDP of the LAC region) is, above all, attributable to an internal factor: the pronounced drop of the GDP in Venezuela in those years (-8.9% and -9.5% respectively), as a consequence of the difficult political situation endured by that country, which is depressing its investment, private consumption and external trade. Given the importance of the Venezuelan economy, which GDP accounted for 39.3% of total CAN's GDP in the years 2000 through 2002 (followed by the Colombian economy, with 30.1%), its crisis is the main explanatory factor behind the subregional economic downturn discussed above.

FIGURE 1
GROSS DOMESTIC PRODUCT, 1992-2003[a]
(Growth rate at constant values)



Notes: [a] Based on annual averages for the periods.

[b] Estimated figures. Cut-off date: Q3 2003 for Bolivia and H1 for Colombia 2003.

Source: CAN General Secretariat [2003k]. In-house preparation.

In contrast, the GDP of each one of the four CAN member countries has grown during the 2002-2003 period, notwithstanding the above-mentioned adverse global and regional environment, and has performed better than the LAC average. Ecuador is the Andean country that registered the fastest growth pace in the last few years (4.3% for the 2000-2002 period), led by its manufacturing sector (Table 2) that benefited from the realignment of relative prices between tradable and non-tradable goods as a result of its dollarization. In Peru, the high growth recorded in 2002 (5.3%) was greatly related to the implementation of the Antamina mining project, apart from the fact that it was the Andean country that was impacted the least by the Argentine crisis; and the growth projected for 2003 (4%) would be the highest in the subregion. The growth of Bolivia was arrested by its cumbersome political environment, similar to the Colombian case, where such a situation made a similar impact, through less active upstream and downstream activities in the hydrocarbon sector. Table 2 also shows the good performance of agricultural production in almost all Andean countries and the Venezuelan manufacturing sector as the most severely hit by that country's crisis.

TABLE 2
GROSS DOMESTIC PRODUCT BY SECTOR, 2000-2002
(Average annual growth rate)

	Bolivia	Colombia	Ecuador	Peru	Venezuela
Agriculture, hunting and fishing	2.2	0.6	3.9	2.7	2.1
Mining[1]	-2.3	-7.3	-0.9	12.6	0.8
Oil extraction [2]	4.1			-0.7	3.7
Manufacturing	2.0	-0.1	9.8	1.6	-18.4
Total GDP	2.1	1.5	4.3	2.9	-3.2

Notes: [1] Includes oil extraction in the cases of Colombia and Ecuador.

[2] Includes gas in the case of Peru.

Sources: CAN General Secretariat [2003k]; Central Reserve Bank of Peru [2003]. In-house preparation.

As for Andean GDP by type of expenditure (Table 3), there is a noticeable increase in gross capital formation in Ecuador and Colombia, and, in the former, there is also a significant growth in private consumption and imports, as a consequence of the appreciation of its currency after dollarization and the rise in its imports for the construction of the Heavy Crude Oil Pipeline. On the other hand, GDP growth in Bolivia and Peru has been driven to a great extent by the buoyancy of their respective exports, especially gas and soybean in the case of the former and mining and non-traditional products in the case of the latter. By contrast, public consumption has been the only rising expenditure in Venezuela, although this type of expenditure recorded the greatest rise in Bolivia.

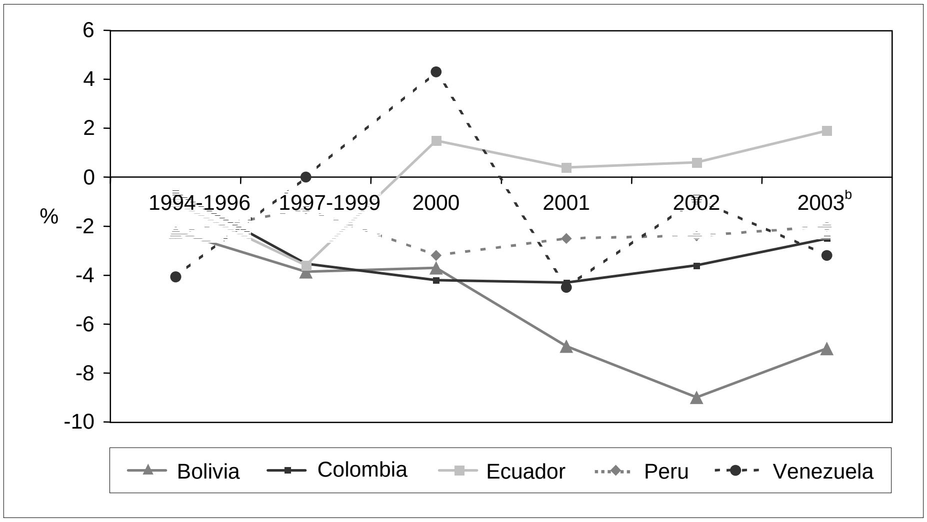
TABLE 3
GROSS DOMESTIC PRODUCT BY TYPE OF EXPENDITURE, 2000-2002
(Average annual growth rate)

	Bolivia	Colombia	Ecuador	Peru	Venezuela
Private consumption	1.6	2.1	5.1	3.1	-1.0
Public consumption	2.9	1.2	1.8	1.0	1.8
Gross capital formation	-5.6	6.9	14.8	-0.3	-19.8
Exports	11.9	-0.9	-0.2	6.5	-4.4
Imports	1.3	6.1	17.2	2.6	-9.8
Total GDP	**2.1**	**1.5**	**4.3**	**2.9**	**-3.2**

Sources: CAN General Secretariat [2003k]; Central Reserve Bank of Peru [2003]; Central Bank of Venezuela 2003]. In-house preparation.

Consequently, the Venezuelan fiscal position has shown a deficit in recent years and Bolivia's long-standing fiscal deficits have widened further as a result of the lack of success in tax collection initiatives, compounded by the 40% increase in the pension income granted in 2001 (Figure 2). Ecuador, however, unlike the past decade, registered a positive fiscal position in the last two years driven by oil revenues, while in Colombia and Peru the fiscal deficit has been gradually reduced as a result of cutbacks in public spending.

FIGURE 2
NON-FINANCIAL PUBLIC SECTOR: OVERALL BALANCE, 1994-2003[a]
(Percentage of GDP)



Notes: [a] Based on annual averages for the periods.

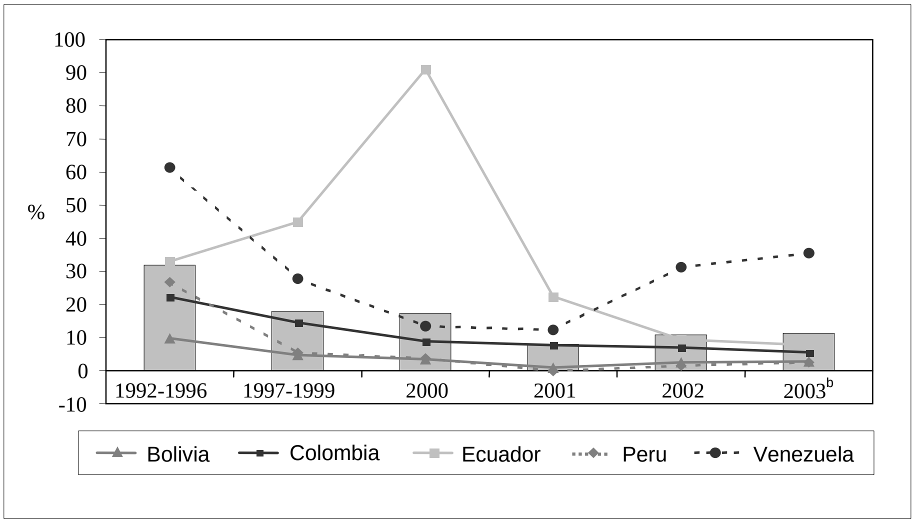
[b] Estimated figures.

Source: CAN General Secretariat [2003k]. In-house preparation.

As to general price level stability, noteworthy in Figure 3 is the steep fall of the average inflation rate for CAN, from 31.9% in the 1992-1996 period to 10.8% in 2002 and to 11.3% in 2003, rates similar to the average inflation for LAC of 12.1% and 9% for those years respectively (ECLAC [2003c] Table 1). This is mainly due to the significant reduction of inflation in Ecuador (from 91% in 2000 to 9.4% in 2002 and 7.7% in 2003) after the dollarization of its economy and thanks to a prudent macroeconomic management policy. In fact, the average Andean inflation rate would have stayed below one digit during the 2002-2003 period, had it not been for the inflationary rebound in Venezuela (as a consequence of the already-mentioned crises), since, apart from the situation prevailing in Ecuador, inflation in Bolivia and Peru has stayed below 3% per annum and in Colombia it went down from 7% to 5.5%, although in Bolivia it was due to the weak performance of private consumption and in the other two countries to cautious monetary and fiscal policies.

The current account balance of the external sector has improved quite significantly in Bolivia but has deteriorated greatly in Ecuador (Figure 4), as a result of the trend followed by exports in the former and by imports in the latter. On another note, the slowdown of the American economy and the Venezuelan crisis had a negative impact on Colombian exports of oil and coffee to the USA and of non-traditional products to Venezuela. Because of its oil exports, Venezuela continues to be the only CAN country posting a current account surplus, which has grown as a proportion of GDP. Peru is the other Andean country that also showed a positive balance of trade during the 2002-2003 period, although it has maintained a current account deficit of around -2%.

FIGURE 3
INFLATION RATE, 1992-2003
(Percentage)

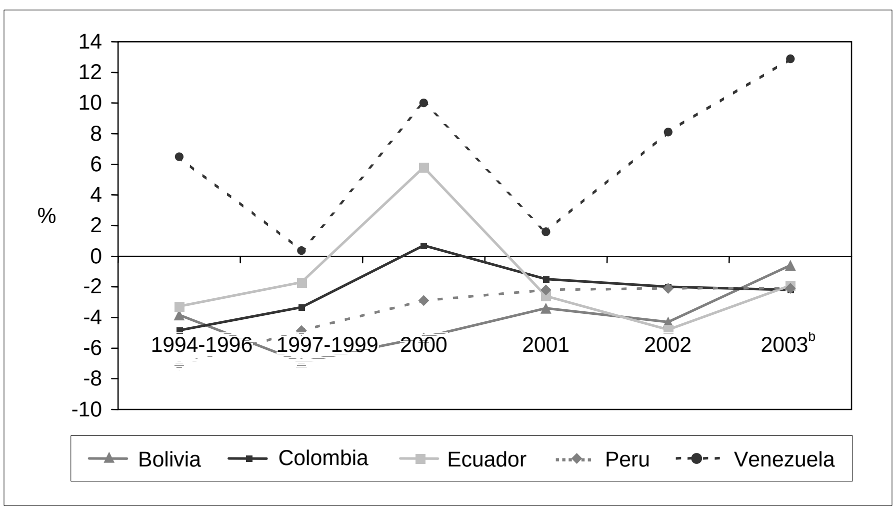


Notes: [a] Based on annual averages for the periods.

[b] Estimated figures.

Source: CAN General Secretariat [2003k]. In-house preparation.

FIGURE 4
CURRENT ACCOUNT BALANCE, 1994-2003[a]
(Percentage of GDP)



Notes: [a] Based on annual averages for the periods.

[b] Estimated figures.

Source: ECLAC [2003c]. In-house preparation.

By 2002, the total external debt of the CAN countries amounted to US$ 116.052 billion, of which US$ 84.184 corresponded to the public debt. As to the debt/GDP ratio, Table 4 shows that there is a clear downward trend in the Andean countries when compared with the last decade, except for Colombia.

TABLE 4
DEBT INDICATORS, 1994-2002[a]
(As a percentage of GDP)

Periods	Bolivia		Colombia		Ecuador		Peru		Venezuela		CAN	
	TED	PED	TED	PED	TED	PED	TED	PED	TED	PED	TED	PED
1994-1996	70.4	67.2	28.1	15.7	65.9	58.8	63.5	48.9	72.5	60.4	51.5	39.4
1997-1999	58.7	55.9	34.4	18.2	76.2	63.1	52.3	34.6	33.9	25.6	41.6	28.3
2000		55.3	39.7	24.1	82.9	69.0	51.9	35.6	26.8	18.5	37.9	27.4
2001		55.5	44.0	27.8	68.4	53.9	49.3	34.4	25.1	18.9	37.7	28.0
2002		53.8	42.7	27.3	66.5	46.4	48.9	36.4	38.8	26.4	43.7	31.7

Notes: [a] Based on annual averages for the periods.

TED= Total External Debt/GDP; PED = Public External Debt/GDP.

Source: CAN General Secretariat [2003k]. In-house preparation.

Another indicator of external vulnerability is the ratio of Net International Reserves (NIR) to imports. Table 5 shows that Peru was able to cover imports with its reserves for the most months: 15, followed by Venezuela and Colombia with 11 and 10 months worth of imports respectively. Also noteworthy in the same table is the recent sharp decline of NIR in Bolivia, a reflection of the financial problems brought about by political instability, as well as the significant growth of NIR in Colombia (7.7% per annum) and in Peru (6.2%). In absolute terms, however, Venezuela continues to be the CAN country showing the highest NIR level, despite the major losses incurred in the years 2001 and 2002.

TABLE 5
NET INTERNATIONAL RESERVES, 1992-2003[a]
(Billions of current dollars)

	1992-1996	1997-1999	2000	2001	2002	2003[b]	%AAGR[1]	MI[2]
Bolivia	0.541	1.081	1.065	1.076	0.854	0.503	-22.1	7
Colombia	8.423	8.916	9.004	10.192	10.841	11.248	7.7	10
Ecuador	1.427	1.555	1.406	0.812	1.008	1.379	-0.6	3
Peru	5.128	9.252	8.180	8.613	9.598	9.810	6.2	15
Venezuela	8.599	14.557	15.651	12.263	10.649	17.555	3.9	11
CAN	24.119	35.360	35.306	32.956	32.949	40.495	4.7	10

Notes: [a] Based on annual averages for the periods.

[b] Preliminary figures. Cut-off date for Ecuador, Peru and Venezuela: October 2003.

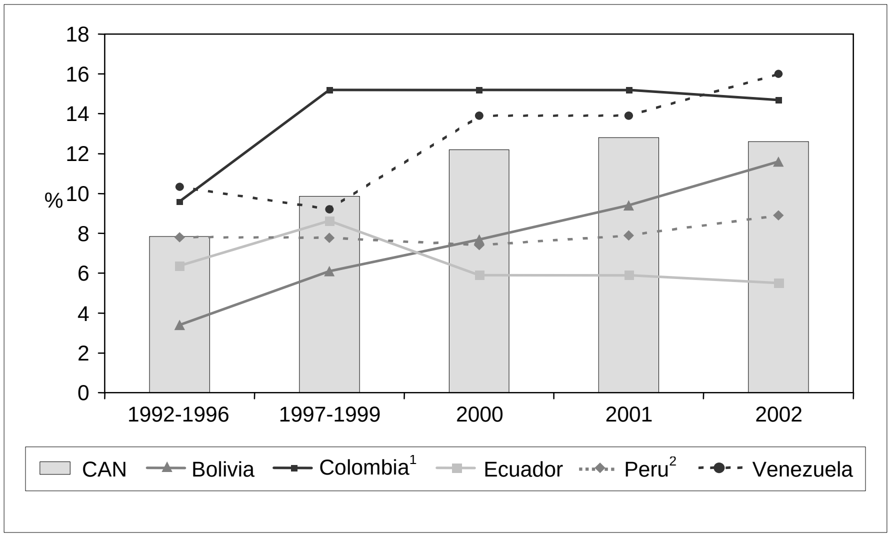
[1] Average annual growth rate for 2000-2003.

[2] Months of imports covered by 2000-2002 NIR.

Source: CAN General Secretariat [2003k]. In-house preparation.

Finally, it is of concern to observe that unemployment has been on the rise in the Andean subregion for the last decade (Figure 5). Moreover, between 2000 and 2002, the urban unemployment rate was higher in the CAN countries (12.5%) than in all LAC countries (10% according to ECLAC [*Idem*]). During those years, the countries that showed a rate above that average were Venezuela and Colombia, although with a rising trend in the case of the former and a stable one in the case of the latter. Among the other three countries with urban unemployment rates that were lower that the Andean average, noteworthy is the downward trend in Ecuador vis-à-vis the rising ones in Bolivia, and to a lesser extent in Peru.

FIGURE 5
URBAN UNEMPLOYMENT RATE, 1994-2002[a]
(Percentage)



Notes: [a] Based on annual averages for the periods.

[1] Until 1999 it includes hidden unemployment in 7 metropolitan areas estimated as of December each year. Since then, open unemployment in thirteen metropolitan areas has been considered.

[2] Metropolitan Lima.

Source: CAN General Secretariat [2003k]. In-house preparation.

C. Total and Intra-CAN Trade Flows: Trends and Patterns

Andean trade flows (total exports plus imports) rose significantly -by 71.9% between 1991 (US$ 52.619 billion) and 2002 (US$ 90.449 billion). During that period, both Andean exports to and imports from the rest of the world in general were very dynamic vis-à-vis the poor performance that they had in the 1980s, the former expanding at an annual average rate of 5.1% and the latter at a rate of 4.9% against 0.4% and -2.3% respectively in the previous decade (Table 6). However, although the overall trade balance of the Andean Community showed a surplus, Andean trade flows still account for a minimum share of world trade, representing only 0.9% on the exports side and 0.6% on the imports side over the 2000-2002 period. In addition, Andean economies' degree of openness to trade (measured by the ratio of total trade flows to GDP) remained below the one witnessed in 1980 and it even fell from 38.7% in 1991 to 35.5% in 2002. In view of the dynamic trade pattern mentioned before, such poor performance can be attributed to what will be described in this section with regard to the traditional pattern of Andean trade integration into the world market, which is predominantly based on the exports of primary products. Such a pattern is one of the factors that best explains why the share of the CAN subregional market in total Andean exports is still low (9.6%) in spite of having increased in the 1990s (Table 9).

TABLE 6
TOTAL TRADE FLOWS AND DEGREE OF OPENNESS, 1980-2002[a]
(Billions of current dollars)

	1980	1985	1990	1991-1993	1994-1996	1997-1999	2000-2002
Exports	30.640	24.300	31.829	29.541	40.281	43.348	54.666
Imports	23.095	16.487	18.354	26.849	36.119	41.815	38.050
Degree of openness (%)	39.0	30.3	38.4	36.1	32.5	30.8	33.9

Note: [a] Based on annual averages for the periods.

Sources: IMF (several years); World Bank [2003]; CAN General Secretariat [2003k]. In-house preparation.

Section C will also seek to show that intra-CAN trade is in positive contrast to such pattern due to the predominantly manufacturing nature of its exports. Therefore, the fact that this trade has grown faster than extra-CAN trade (at an average annual rate of 10.1% as compared with 4.5% between 1991 and 2002) is highly significant. This took place in four Andean countries (Bolivia, Ecuador, Colombia and Venezuela, in that order), Peru being the only case where the opposite was true both in the case of exports and imports (Table 7). In order to fully understand this, it is worth remembering that those four countries were prompt to finalize their free trade area (FTA), adopting a common external tariff (CET), both mechanisms from which Peru excluded itself only to reenter that FTA as a latecomer, but remaining outside of the CET (INTAL [2002] pp. 9-12). This key difference with regard to the participation in basic mechanisms to strengthen the Andean trade integration, which was in part a consequence of different tariff policies, constitutes one of the explanatory factors behind the difference in trade and investment performances in each country to be analyzed in the present chapter. Besides, it provides a revealing common thread to untangle the underlying web of dissimilar interests that are discussed in other chapters of this Report in relation to important external and internal CAN agenda items.

TABLE 7
INTRA- AND EXTRA-CAN EXPORTS AND IMPORTS
Annual Growth Rate by country and subregion, 1991-2002 (%)

	Intra-CAN exports	Intra-CAN imports	Extra-CAN exports	Extra-CAN imports
Bolivia	17.4	14.2	4.8	2.4
Colombia	10.4	10.2	3.6	6.9
Ecuador	10.6	15.5	5.8	6.6
Peru	6.6	4.6	7.1	8.2
Venezuela	9.4	10.7	4.5	1.3
CAN	10.1	10.1	4.7	4.3

Source: IMF (several years). In-house preparation.

Regional Directions of Andean Trade

Colombia is the best positioned country in the subregional market, accounting for over 46% of the intra-CAN exports in the 2000-2002 period, followed by Venezuela and Ecuador (Table 8). These three countries also represent the largest share of intra-CAN imports. From this it follows how important the trade relationship between them is.[1] As will be analyzed further on, Colombia and Venezuela are, in addition, the main Andean exporters of manufactured goods both inside and outside the Andean Community. On the other hand, Peru and Bolivia's participation in intra-CAN trade is quite small; however, the latter was one of the two Andean countries showing an intra-CAN trade surplus over that three-year period, Colombia being the other one. This would indicate a better utilization of the Andean enlarged market by the four countries that made the decisions discussed above regarding the FTA and the CET.

TABLE 8
INTRA- AND EXTRA-CAN EXPORTS AND IMPORTS
Share of CAN countries, 2000-2002

	Total CAN[1] (US$ billions)	Bolivia (%)	Colombia (%)	Ecuador (%)	Peru (%)	Venezuela (%)
Intra-CAN exports	5.224	6.9	46.1	11.2	9.5	26.3
Intra-CAN imports	5.224	2.8	27.1	19.0	17.6	33.6
Extra-CAN exports	49.442	2.1	20.3	10.1	13.2	54.2
Extra-CAN imports	32.826	3.9	27.8	11.3	16.1	40.9

Note: [1] Average for 2000-2002.

Source: IMF (several years). In-house preparation.

Venezuela is the Andean country with the highest share of extra-CAN trade, accounting for 54.2% and 40.9% of exports and imports respectively. Colombia comes second but with a more diversified export structure than that of Venezuela (clearly concentrated in oil and petroleum derivatives), which is partly due to the fact that Colombia skillfully used the Andean subregional market as a platform to develop comparative trade advantages in manufactured goods (as will be analyzed in Section E). Peru occupies third place in extra-CAN trade participation. This country intensified trade relations with East Asia and, thus, exhibits a more diversified range of destination markets than its Andean partners (Table 9).

Table 9 analyzes the regional patterns of Andean trade more in depth. First, it shows that the relative importance of intra-CAN trade is low, though higher at the end of the 1991-2002 period than at the beginning of the period. This growing trend has been sustained on the side of imports and for all Andean countries, especially for Ecuador. With respect to Andean exports, the 1997-1999 period represented a marked reversal of such a trend, from an initial rise in CAN's share as a destination market (except for Peru's exports as a result of the circumstances discussed before) to a later drop; although in the 2000-2002 period the rising trend continued in the case of Bolivia and Colombia and only plummeted in the case of Venezuela (due to the events discussed in Section B). As the relative weight of intra-CAN trade is generally greater than that of the Andean trade with MERCOSUR (except in the case of Bolivian imports),[2] this paragraph serves as a comprehensive introduction to what will be discussed below about the developments of the relative importance of the Andean trade with ALADI as a whole.

1 For example, considering the average intra-CAN exports over the 2000-2002 period, Colombia sent 57% of its exports to Venezuela, and Venezuela 58% to Colombia, while Ecuador sent 51% of its exports to Colombia.

2 Section C in the following chapter outlines the most outstanding features of Andean trade with MERCOSUR.

TABLE 9
REGIONAL DIRECTIONS OF ANDEAN TRADE, 1991-2002
(Percentage)[a]

	Exports[1]				Imports[1]			
	1991-1993	1994-1996	1997-1999	2000-2002	1991-1993	1994-1996	1997-1999	2000-2002
CAN								
Bolivia	12.4	19.2	21.5	25.7	5.0	8.0	8.1	10.2
Colombia	13.6	16.8	17.4	19.5	10.5	12.5	12.5	13.5
Ecuador	7.5	9.1	11.0	10.6	10.7	16.9	19.1	21.1
Peru	7.7	7.1	7.2	7.1	14.3	12.7	13.9	14.8
Venezuela	4.9	8.5	9.2	4.8	5.5	9.2	8.6	11.5
CAN	7.8	10.7	11.6	9.6	8.5	11.9	12.0	13.7
MERCOSUR								
Bolivia	25.3	15.2	16.2	24.9	44.2	53.0	48.3	45.2
Colombia	1.7	1.8	1.9	1.8	5.7	4.7	4.7	7.7
Ecuador	1.7	3.1	3.2	2.6	8.4	7.7	5.7	6.0
Peru	4.7	4.6	4.0	3.5	13.2	9.4	8.5	11.6
Venezuela	2.5	3.9	5.0	2.3	5.2	7.3	7.3	8.1
CAN	3.1	3.7	4.2	3.0	8.3	8.6	8.5	9.7
ALADI								
Bolivia	41.0	37.4	41.5	53.8	63.1	76.0	68.4	67.7
Colombia	17.9	21.2	22.1	24.9	20.1	21.4	22.1	28.4
Ecuador	14.4	18.1	19.4	17.6	23.9	30.7	30.5	34.4
Peru	16.4	16.2	15.9	16.4	34.4	29.3	29.9	36.9
Venezuela	9.5	14.4	16.7	8.7	12.8	20.9	21.1	25.7
CAN	13.6	17.3	19.1	15.5	20.7	25.9	26.3	30.9
NAFTA								
Bolivia	20.6	27.9	26.8	19.0	20.6	17.9	18.6	17.9
Colombia	41.5	39.4	44.7	49.6	45.8	38.6	38.8	41.2
Ecuador	48.3	42.9	40.3	42.6	44.8	38.8	33.9	32.9
Peru	26.2	22.9	32.9	31.0	30.5	26.0	29.4	31.0
Venezuela	57.4	56.7	58.8	55.9	44.4	52.6	52.1	41.8
CAN	48.0	45.8	48.5	48.8	41.7	39.0	39.8	37.9
NEA[2]								
Bolivia	0.3	0.5	0.5	0.6	6.2	4.6	6.4	3.8
Colombia	3.8	4.8	3.3	2.3	11.6	10.0	9.3	9.9
Ecuador	6.5	10.0	7.6	9.2	13.3	11.0	9.9	11.5
Peru	17.1	15.8	9.1	9.1	8.7	5.8	8.3	9.2
Venezuela	2.8	1.8	1.5	0.7	10.2	6.5	7.9	7.6
CAN	5.0	5.2	3.7	3.0	10.4	8.0	8.6	8.8

TABLE 9 (continued)

SEA[3]								
Bolivia	0.7	0.2	0.2	0.8	0.4	0.4	0.5	0.9
Colombia	0.2	0.2	0.2	0.3	0.5	0.7	1.2	3.0
Ecuador	0.1	0.6	2.0	0.9	1.3	1.4	2.0	3.6
Peru	6.4	9.6	7.1	9.7	1.9	2.2	1.9	4.0
Venezuela	0.1	0.1	0.1	0.2	0.6	0.9	1.6	2.7
CAN	0.9	1.4	1.3	1.5	0.8	1.1	1.5	3.0
EU[4]								
Bolivia	33.7	25.0	22.9	11.5	16.9	16.1	12.4	10.8
Colombia	26.1	26.1	20.8	13.7	21.5	17.9	17.1	17.1
Ecuador	16.5	19.5	19.9	15.6	24.9	18.4	14.6	14.6
Peru	28.3	29.4	23.9	23.0	16.0	16.0	16.4	15.1
Venezuela	9.7	8.9	7.7	6.6	21.0	23.0	20.9	20.9
CAN	17.2	17.4	15.2	11.4	20.5	18.8	17.7	17.8

Notes: [a] Percentages defined as $B_{ij} = X_{ij} / X_i$ where X_{ij} represents the exports from the country or group of countries i to the country or group of countries j and where X_i represents i's total exports. For imports, the same calculation is carried out considering imports instead of exports.

[1] Based on annual averages for the periods.

[2] Includes Japan and NIEs (Korea, Hong Kong, Singapore and Taiwan -except for 2002).

[3] Includes China and ASEAN-6 (Brunei, the Philippines, Indonesia, Malaysia, Thailand and Vietnam).

[4] Includes Germany, Austria, Belgium, Denmark, Spain, Finland, France, Greece, the Netherlands, Ireland, Italy, Luxemburg, Portugal, Sweden and the United Kingdom.

Source: IMF (several years). In-house preparation.

With regard to traditionally important regional trade directions, North America (NAFTA) is still first on both sides of CAN trade, although with a dwindling participation as supplier of imports to all Andean countries, except for Peru, while the 1997-1999 period bucked the previous downward trend of its participation as a destination market for Andean exports. The North American market is very significant for Venezuelan exports (mostly oil) and it increased in the second half of the 1990s for exports from Colombia, Ecuador and Peru, all benefiting together with Bolivia from the trade preferences granted by the USA to support the efforts made by those countries to combat drug trafficking.[3] The European Union (EU), by contrast, has lost its second place on both sides of Andean trade, except as a destination market for Peru's exports.

As to non-traditional regional trade directions, it should be noted that ALADI ranked second in relative importance for the two trade flows of the CAN, especially as supplier of its imports. This role has grown in a sustained and significant manner from 1991 onwards to such an extent that in the 2000-2002 period, it recorded a relative weight (30.9%) close to that of the NAFTA (37.9%) and this region has established itself as the first supplier of imports not only to Bolivia and Peru (which is not news) but also to Ecuador. These developments reflect the revival of economic growth and the deepening of the economic integration in the region since 1991, as well as the deepening via some ALADI member countries of Andean imports previously coming from East Asia, the USA and the EU (González Vigil and Kuriyama [2000] pp. 114-

[3] By means of the ATPA (Andean Trade Preference Act), and then the ATPDEA (Andean Trade Promotion and Drug Eradication Act). See INTAL [2002] pp. 82-84 and Section A in the following chapter of this Report.

119). On the other hand, the increasingly important role of ALADI as buyer of exports from CAN came to a halt in the 2000-2002 period as a result of the negative factors analyzed in Sections A and B, although this was not the case of the exports from Colombia. It is well known that as regards Bolivia, given its geographical location, ALADI is its first trading partner on both sides of trade, and on an upward trend after the signing of an Association Agreement with MERCOSUR and its active participation in the basic mechanisms of Andean trade integration.

East Asia's relative weight in CAN's trade is still small although not that small as a supplier of Andean imports and, as a whole, it is bigger than that of MERCOSUR. A downward trend has been observed in the case of North East Asia and upward one for the South East Asia. However, the participation of North East Asia is relatively important in the trade flows of Ecuador, Peru and Colombia, and that of South East Asia in the Peruvian trade flows.

Intensity of Andean Trade

A more exact appreciation of the relative importance of the various trade counterparts of the Andean countries can be obtained by using Anderson and Norheim's trade intensity index [1993]. A value higher than 1 of this index shows that there is a bias towards trade between two countries or groups of countries rather than with the world in general. If applied to intra-CAN trade, this index shows a growing bias on the part of the Andean countries as a group towards exporting and importing among themselves in the 1991-2002 period (Table 10), reflecting that the expansion rate of intra-CAN trade has been faster than that of the participation of Andean countries in world trade. Noteworthy is the pronounced intra-CAN bias of Bolivian and Colombian exports, and of Ecuadorian and Peruvian imports; Venezuela being the only country with both biases at a lower level than the Andean average.

TABLE 10
INTENSITY OF INTRA-CAN TRADE, 1991-2002[a]

	Exports[1]				Imports[1]			
	1991-1993	1994-1996	1997-1999	2000-2002	1991-1993	1994-1996	1997-1999	2000-2002
Bolivia	16.8	26.2	28.8	42.4	6.2	9.7	10.4	11.8
Colombia	18.4	22.7	23.1	32.1	13.1	15.2	16.2	15.5
Ecuador	10.2	12.3	14.6	17.5	13.3	20.5	24.6	24.4
Peru	10.7	9.6	9.5	11.7	17.6	15.5	17.9	17.0
Venezuela	6.5	11.5	12.1	8.0	6.8	11.1	11.1	13.4
CAN	10.5	14.5	15.4	15.9	10.5	14.5	15.4	15.9

Notes: [a] The intensity index is defined in a simplified manner as Iij = (Xij / Xi) / (Mj / X) where (Xij / Xi) denotes the relative share of the country or group of countries j in i's exports. Mj represents j's total exports and X, total world trade. To calculate this index for imports it suffices to replace exports by imports and vice versa.

[1] Based on annual averages for the periods.

Source: IMF (several years). In-house preparation.

In the extra-CAN context, total Andean trade shows biases only with NAFTA, though decreasing for both trade flows, and with MERCOSUR and, thus, with ALADI with regard to the intra-CAN bias (Table 11). The import bias in favor of MERCOSUR that has recently been on the rise stands out, in contrast to the steady decline of the corresponding export bias, in which case the development of the export bias with ALADI (falling since the 1997-1999 period, but greater at the end than at the beginning of the 1991-2002 period) would be influenced by what happened with the respective intra-CAN bias as well as by the development of Andean exports to Mexico and Chile. With regard to the EU, there is no bias in either of the two trade flows and both indexes are going down, especially on the side of exports. There is no trade bias towards East Asia either, although both indexes for South East Asia are growing and the import bias with the Northeastern Asian region has been showing a recovery since 1997-1999. In general, it should be pointed out that the downward trends that these indexes have shown mean that the share of the mentioned regions or subregions in CAN trade flows has not been in line with the their participation in world trade.

TABLE 11
INTENSITY OF EXTRA-CAN TRADE, 1991-2002[a]

	Exports[1]				Imports[1]			
	1991-1993	1994-1996	1997-1999	2000-2002	1991-1993	1994-1996	1997-1999	2000-2002
MERCOSUR	2.78	2.38	2.42	2.37	6.04	6.03	5.91	6.80
ALADI	3.49	3.93	3.59	3.60	5.54	6.26	5.63	6.06
NAFTA	2.32	2.18	2.04	2.06	2.44	2.28	2.16	2.07
NEA[2]	0.31	0.30	0.24	0.23	0.56	0.42	0.50	0.57
SEA[3]	0.15	0.21	0.21	0.21	0.14	0.17	0.20	0.34
EU[4]	0.41	0.47	0.40	0.31	0.50	0.48	0.45	0.48

Notes: [a] Intensity index defined as in Table 10.

[1] Based on annual averages for the periods.

[2] Includes Japan and the NIEs (Korea, Hong Kong, Singapore and Taiwan – except for 2002).

[3] Includes China and ASEAN-6 (Brunei, the Philippines, Indonesia, Malaysia, Thailand and Vietnam).

[4] Includes Germany, Austria, Belgium, Denmark, Spain, Finland, France, Greece, the Netherlands, Ireland, Italy, Luxemburg, Portugal, Sweden and the United Kingdom.

Source: IMF (several years). Preparation: In-house.

Composition of Andean Trade by Sector

What should be highlighted here is that manufactured products have come to represent the most significant share of intra-CAN trade. There was a sustained increase in the share of manufactured products in intra-subregional exports, from 57.8% in 1991-1993 to 60.6% in 2000-2001 (Table 12). Even more significant was the increase in the relative importance of the CAN market as the destination of manufactured products exported by its member countries, from 23.7% in 1991-1993 to 32.2% in 1997-1999 (Table 13) and, despite the fact that it then showed a moderate drop to 30.6% in 2000-200, those levels point to the fact that the Andean subregional market is already competing with the NAFTA market (with 31.7%) for the first place as a buyer of Andean manufactured exports. Among primary goods, only food and fuels have gained a share in intra-CAN exports (although the latter have not done so on an on-going basis) and the subregional market is increasingly demanding Andean food; while the relative weight of agricultural products and metals and minerals in such exports is clearly on a downward path. It should be added that the concentration by product[4] of intra-CAN exports is relatively high (68.9% in 2001), but significantly

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[4] Measured by the share of the fifteen main categories of products (at the 2-digit SITC level) in the respective trade flow, based on Data INTAL [2004]. Information that is not detailed here for reason of space, although the essence thereof can be summarized as follows: of intra-CAN exports in 2001, road vehicles (SITC 78) were the main category (10.5%), due to the automotive agreement entered into between Colombia, Ecuador and Venezuela, Colombia being the main exporter; followed by oil and petroleum products (SITC 33, with 9.3%) from Venezuela; and behind them plastics (SITC 58, with 5.3%) exported mainly by Colombia. The other 12 categories have shares ranging between 4.5% and 2.6% each and are mostly manufactures.

lower than that of extra-CAN Andean exports (90.9%). This bears out the qualitative importance of economic integration processes for the sake of the development of a more diversified, exportable supply with a higher value added, by granting preferential access to an enlarged market that serves as a learning platform to generate new exports.

TABLE 12
COMPOSITION OF INTRA- AND EXTRA-CAN EXPORTS BY SECTOR, 1991-2001
(Percentage)[a]

Category	Intra-CAN[1]				Extra-CAN[1]			
	1991-1993	1994-1996	1997-1999	2000-2001	1991-1993	1994-1996	1997-1999	2000-2001
Primary goods	42.2	41.2	40.8	39.4	82.5	84.1	83.9	84.7
Food	16.9	17.4	18.6	19.9	20.6	19.3	20.0	11.7
Agriculture, other than food	3.2	2.0	1.4	1.2	2.6	2.4	2.6	2.1
Metals and minerals	9.3	6.5	4.7	4.2	10.5	8.7	7.9	6.7
Fuels	12.9	15.3	16.1	14.2	48.7	53.8	53.5	64.2
Manufactured goods	57.8	58.8	59.2	60.6	17.5	15.9	16.1	15.3
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Notes: [a] Based on the classification used by Kuwayama *et al*'. [2000].
[1] Based on annual averages for the periods.
Sources: World Trade Analyzer [2000] and INTAL [2004]. In-house preparation.

TABLE 13
DISTRIBUTION OF INTRA- AND EXTRA-CAN EXPORTS BY SECTOR, 1991-2001
(Percentage)[a]

Category	Intra-CAN[1]				Extra-CAN[1]			
	1991-1993	1994-1996	1997-1999	2000-2001	1991-1993	1994-1996	1997-1999	2000-2001
Primary goods	4.6	5.5	5.9	4.9	95.4	94.5	94.1	95.1
Food	7.2	9.7	10.7	15.9	92.8	90.3	89.3	84.1
Agriculture, other than food	10.5	9.4	6.6	5.8	89.5	90.6	93.4	94.2
Metals and minerals	7.7	8.2	7.2	6.5	92.3	91.8	92.8	93.5
Fuels	2.4	3.3	3.7	2.4	97.6	96.7	96.3	97.6
Manufactured goods	23.7	30.5	32.2	30.6	76.3	69.5	67.8	69.4
Total	**8.6**	**10.6**	**11.4**	**10.0**	**91.4**	**89.4**	**88.6**	**90.0**

Notes: [a] Based on the classification used by Kuwayama *et al*'. [2000].
[1] Based on annual averages for the periods.
Source: World Trade Analyzer [2000] and INTAL [2004]. In-house preparation.

In sharp contrast to all of the above, extra-CAN Andean exports have a basically primary composition, especially fuels, the participation of which in such exports started to increase in the 1997-1999 period to reach 64.2% in the 2000-2001 period (Table 12); while there has been a drop in the respective shares of the other three categories of primary products, though more pronounced in the case of food (11.7%).

NAFTA is, by far, the main market of destination for Andean fuels, absorbing 58% of fuel exports (Table 14), and this is also the case for agricultural products, and metals and minerals, although East Asia already absorbs 20.5% in the latter category. The regional destinations of Andean food products can be said to be more balanced, with ALADI already accounting for 21.6%, due to the fact that 19.9% is absorbed by Andean countries themselves. Meanwhile, the most worrisome trend in extra-CAN Andean exports has been the decline in the already low share of manufactured products, from 17.5% to 15.3% (Table 12). This is a drop that, in view of the fact that ALADI as a whole already absorbs 41.3% of Andean exports of manufactured products (Table 14), does not refute the assertion made above that economic integration acts as a learning platform, but rather points to the fact that this phenomenon can be attributed not only to the burgeoning competitiveness of the Andean economies but also to the protectionism that those Andean manufactured products that are really competitive face in major world markets.

TABLE 14
SECTORAL DISTRIBUTION OF EXTRA-CAN EXPORTS BY REGION, 2000-2001
(Percentage) [a]

Category	MERCOSUR	ALADI	NAFTA	EU	East Asia
Primary goods	3.9	10.7	51.4	10.3	6.0
Food	2.9	21.6	25.1	28.7	14.6
Agriculture, other than food	2.4	11.7	65.4	13.2	6.5
Metals and minerals	5.9	18.8	37.4	17.2	20.5
Fuels	3.9	7.4	58.0	5.6	2.5
Manufactures	3.5	41.3	31.7	13.4	1.8
Total	**3.8**	**16.8**	**47.4**	**10.9**	**5.1**

Notes: [a] Based on the classification used by Kuwayama *et al*. [2000]. Based on annual averages.

Sources: World Trade Analyzer [2000] and INTAL [2004]. In-house preparation.

However, not all Andean countries have equally exploited the opportunities offered by the preferential access to an enlarged market for the development of manufactured exports. Colombia stands out in this regard, since it accounts for 57.8% of intra-CAN manufactured exports (Table 15) and exhibits a more diversified supply of those products than Venezuela, the second in line, with 24.5%;[5] while the respective shares of the other Andean countries are significantly lower. The fact that Colombia is also the largest Andean extra-CAN exporter of manufactured goods (35.8%), and the fact that it is so with a more diversified supply than those countries following it, Peru and Venezuela (Table 16), is a sign that a significant part of Colombian competitiveness in this field is solid and that in order to develop it, this country knew how to make the most of the Andean subregional market as a learning platform and generator of economies of scale (see Section E). These results, plus the fact that Peru is surpassed by Ecuador in intra-CAN exports of manufactures (7.9% *versus* 8.8%) - despite the fact that the former far surpasses the latter in extra-CAN exports (28.4% *versus* 2.2%) - evidences one of the main consequences of the key difference regarding the participation in the Andean FTA and CET previously discussed in this Section C.

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[5] Based on the data given in the previous footnote it can be observed that in intra-CAN supply of manufactured goods, Colombia stands outs in the following products, among others: road motor vehicles, apparel, paper, pharmaceuticals, various manufactured items and textile yarns; while Venezuela is more concentrated in natural-resource-based and lower value-added manufactures.

TABLE 15
INTRA-CAN EXPORTS BY SECTOR, 2000-2001
SHARE OF MEMBER COUNTRIES

	Total CAN[1] (US$ billions)	**Bolivia (%)**	**Colombia (%)**	**Ecuador (%)**	**Peru (%)**	**Venezuela (%)**
Primary goods	2.136	14.4	26.2	19.8	10.5	29.1
Food	1.077	26.8	37.6	15.3	6.6	13.7
Agriculture, other than food	0.063	10.7	39.8	7.5	28.6	13.4
Metals and minerals	0.227	5.2	10.6	3.3	48.9	32.1
Fuels	0.770	0.2	13.6	31.9	3.2	51.1
Manufactures	3.280	0.9	57.8	8.8	7.9	24.5
Total	**5.416**	**6.3**	**45.3**	**13.1**	**8.9**	**26.3**

Notes: [1] Average for 2000-2001.

Source: INTAL [2004]. Preparation: In-house.

On the other hand, in Tables 15 and 16, it can be observed that natural-resource-based specializations, as traditionally prevailing in world trade, are validated in the Andean subregional market. Thus, Colombia turns out to be the main exporter of food and agricultural products both at the intra- and extra-CAN level; Venezuela follows suit in the case of fuels and Peru, in the case of metals and minerals.

The sectoral composition of Andean imports by region, at the intra-subregional level, is noteworthy for the predominantly manufacturing nature of intra-CAN imports (Table 17) and the increase between 1991-1993 and 2000-2001 of the relative importance of CAN as the origin of the imports absorbed by its member countries in all categories of products; an increase that has been proportionally higher in the two headings with a higher relative weight in Andean imports: manufactures and food (Table 18). In the extra-CAN context it is not news that Andean imports predominantly consist of manufactured products and have NAFTA as their main supplier, but what is curious indeed is that ALADI ranks as the second largest supplier in the 2000-2001 period, ahead of the EU, which in turn was closely followed by East Asian countries (Table 19). Certainly, this performance can be attributed to the deepening of the economic integration within CAN and within MERCOSUR, to the gradual liberalization of trade between these two subregions, to the web of new preferential agreements with Mexico and with Chile, and to the already mentioned deepening by some ALADI member countries of imports that used to be extra-regional. Moreover, ALADI has already become the main supplier of CAN in all primary goods, except for agricultural raw materials, of which NAFTA is the main supplier. The bottom line is that Andean economies are importing more from ALADI and CAN itself in all but one product category, which is agricultural raw materials.

TABLE 16
EXTRA-CAN EXPORTS BY SECTOR, 2000-2001: SHARE OF ANDEAN COUNTRIES

	Total CAN[1] (US$ billions)	Bolivia (%)	Colombia (%)	Ecuador (%)	Peru (%)	Venezuela (%)
Primary goods	41.233	1.6	18.4	9.1	10.3	60.6
Food	5.687	2.0	34.5	28.9	29.4	5.2
Agriculture, other than food	1.022	3.1	59.7	18.6	13.5	5.1
Metals and minerals	3.257	8.6	2.1	0.1	62.7	26.4
Fuels	31.267	0.8	15.8	6.1	1.3	76.0
Manufactures	7.438	5.3	35.8	2.2	28.4	28.3
Total	**48.671**	**2.2**	**21.1**	**8.0**	**13.1**	**55.6**

Notes: [1] Average for 2000-2001.

Source: INTAL [2004]. In-house preparation.

TABLE 17
COMPOSITION OF INTRA- AND EXTRA-CAN IMPORTS BY SECTOR, 1991-2001
(Percentage) [a]

Category	Intra-CAN[1]				Extra-CAN[1]			
	1991-1993	1994-1996	1997-1999	2000-2001	1991-1993	1994-1996	1997-1999	2000-2001
Primary goods	42.2	41.2	40.8	39.4	15.6	16.7	17.0	17.8
Food	16.9	17.4	18.6	19.9	9.3	10.8	11.1	10.4
Agriculture, other than food	3.2	2.0	1.4	1.2	2.2	2.4	2.0	2.1
Metals and minerals	9.3	6.5	4.7	4.2	1.8	1.7	1.3	1.2
Fuels	12.9	15.3	16.1	14.2	2.3	1.8	2.5	4.2
Manufactures	57.8	58.8	59.2	60.6	84.4	83.3	83.0	82.2
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Notes: [a] Based on the classification used by Kuwayama *et al*. [2000].

[1] Based on annual averages for the periods.

Sources: World Trade Analyzer [2000] and INTAL [2004]. In-house preparation.

TABLE 18
DISTRIBUTION OF INTRA- AND EXTRA-CAN IMPORTS BY SECTOR, 1991-2001
(Percentage) [a]

Category	Intra-CAN[1]				Extra-CAN[1]			
	1991-1993	1994-1996	1997-1999	2000-2001	1991-1993	1994-1996	1997-1999	2000-2001
Primary goods	19.3	25.4	24.6	24.6	80.7	74.6	75.4	75.4
Food	13.8	18.1	18.5	22.0	86.2	81.9	81.5	78.0
Agriculture, other than food	11.5	10.5	8.7	7.5	88.5	89.5	91.3	92.5
Metals and minerals	31.5	34.6	32.6	34.1	68.5	65.4	67.4	65.9
Fuels	32.6	54.0	46.2	33.5	67.4	46.0	53.8	66.5
Manufactures	5.7	8.9	8.8	9.8	94.3	91.1	91.2	90.2
Total	**8.1**	**12.1**	**11.9**	**12.8**	**91.9**	**87.9**	**88.1**	**87.2**

Notes: [a] Based on the classification used by Kuwayama *et al*. [2000].

[1] Based on annual averages for the periods.

Source: World Trade Analyzer [2000] and INTAL [2004]. In-house preparation.

TABLE 19
SECTORAL DISTRIBUTION OF EXTRA-CAN IMPORTS BY REGION, 2000-2001
(Percentage) [a]

Category	MERCOSUR	ALADI	NAFTA	EU	East Asia
Primary goods	12.7	48.1	29.6	9.1	2.3
Food	16.7	47.9	35.5	11.8	1.0
Agriculture, other than food	12.2	32.3	45.1	8.0	8.3
Metals and minerals	8.2	54.3	30.1	12.7	2.6
Fuels	6.0	52.0	11.4	2.8	2.8
Manufactures	7.4	24.5	41.3	17.6	15.2
Total	**8.5**	**29.3**	**38.9**	**15.9**	**12.6**

Notes: [a] Based on the classification used by Kuwayama *et al*. [2000]. Based on annual averages.

Sources: World Trade Analyzer [2000] and INTAL [2004]. In-house preparation.

Of all Andean countries, Venezuela is the main purchaser of Andean manufactured goods with 41.1% of the total in 2000-2001, followed by Colombia and Ecuador (Table 20). This proves the relatively intense trade relationship existing between these three Andean countries, which significant intra-industrial trading level, especially in transport equipment, has already been evidenced by the gravity analysis carried out by Carrillo *et al*. [1999]. Likewise, Venezuela is also the main consumer of Andean agricultural products (34.9%), while Colombia is the main consumer of food (42.8%) and of metals and minerals (56.1%). Peru, for its part, is by far the largest purchaser of Andean fuels (80%). Meanwhile, in the extra-CAN context, Venezuela continues to be the main purchaser of manufactures (40%), as well as of almost all categories of primary goods except for agricultural raw materials, of which the largest purchaser is Colombia (Table 21).

TABLE 20
INTRA-CAN IMPORTS BY SECTOR, 2000-2001:
SHARE OF MEMBER COUNTRIES

	Total CAN[1] (US$ billions)	Bolivia (%)	Colombia (%)	Ecuador (%)	Peru (%)	Venezuela (%)
Primary goods	2.136	1.3	31.7	9.3	34.3	23.4
Food	1.077	1.5	42.8	8.4	8.5	38.8
Agriculture, other than food	0.063	9.7	26.5	18.0	10.8	34.9
Metals and minerals	0.227	0.8	56.1	14.1	8.4	20.6
Fuels	0.770	0.6	9.3	8.3	80.0	1.7
Manufactures	3.280	3.6	22.5	21.5	11.3	41.1
Total	**5.416**	**2.7**	**26.1**	**16.7**	**20.4**	**34.1**

Notes: [1] Average for 2000-2001.

Source: INTAL [2004]. Preparation: In-house.

TABLE 21
EXTRA-CAN IMPORTS BY SECTOR, 2000-2001: SHARE OF ANDEAN COUNTRIES

	Total CAN[1]	Bolivia	Colombia	Ecuador	Peru	Venezuela
	(US$ billions)	(%)	(%)	(%)	(%)	(%)
Primary goods	6.551	5.5	24.1	9.8	21.8	38.8
Food	3.808	6.2	26.1	7.6	21.7	38.4
Agriculture, other than food	0.777	2.9	37.7	13.5	16.6	29.3
Metals and minerals	0.439	1.9	33.4	7.4	5.8	51.6
Fuels	1.528	6.2	9.6	14.3	29.2	40.6
Manufactures	30.199	4.2	30.3	9.6	15.9	40.0
Total	36.750	4.4	29.2	9.6	17.0	39.8

Notes: [1] Average for 2000-2001.

Source: INTAL [2004]. In-house preparation.

D. Total and Intra-CAN Foreign Direct Investment: Trends and Patterns

At the beginning of this decade, the significant expansion of foreign direct investment (FDI) flows attracted by CAN countries that took place in the last decade was reversed (Table 22), due in part to the general slowdown of FDI resulting from the unfavorable cyclical factors already discussed in Section A. Even so, inward FDI into the Andean subregion increased by 28% between 1994 (US$ 6.255 billion) and 2002 (US$ 8.007 billion); i.e. they grew at an annual average rate of 3.1% during that period. However, the growth rate of FDI received by the LAC region as a whole was almost twice as fast (6.1%) over the same period and CAN was a minor destination within LAC, accounting for only 15%, a share widely surpassed by the 47.7% that went to MERCOSUR and down from the 26.7% corresponding to Mexico (ECLAC [2003b] Tables I.1 to I.3).

TABLE 22
TOTAL FDI INFLOWS INTO CAN BY MEMBER COUNTRY, 1994-2002[a]
(US$ billions)

	1994-1996	1997-1999	2000	2001	2002	AAGR[1]
Bolivia	0.311	0.963	0.832	0.877	0.999	29.0%
Colombia	1.842	3.300	2.299	2.500	1.974	4.0%
Ecuador	0.509	0.747	0.720	1.330	1.275	10.4%
Peru	3.109	1.816	0.810	1.070	2.391	-3.9%
Venezuela	1.327	4.440	4.465	3.448	1.368	6.7%
CAN	7.098	11.267	9.125	9.225	8.007	3.1%

Notes: [a] Based on annual averages for the periods.

[1] Average annual growth rate for 1994-2002.

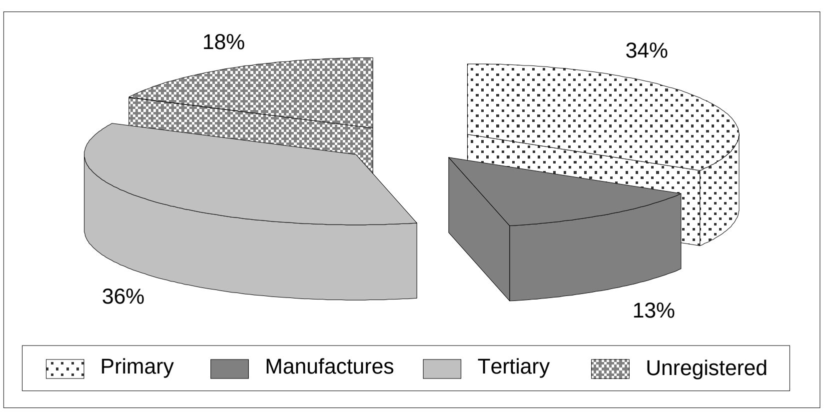
Source: CAN General Secretariat [2003k and 2004c]. In-house preparation.

If we add up the inflows of FDI during the 1994-2002 period, as shown in Table 22, Venezuela appears as the first recipient within CAN, accounting for 33% of the cumulative total, followed by Colombia with 27% and by Peru with 23%. It is thus possible to better understand the influence that internal factors inherent to the Andean countries exert on the trends of FDI in CAN because, as a consequence of the political and/or macro-economic problems mentioned in Section B, those two largest Andean recipients saw their respective inflows decline early this decade and, in the case of Peru, although there was a major increase in 2002 (attributable to the acquisition of a beer company, according to ECLAC [*Idem*] p. 38), the second half of the 1990s registered a drop and growth was negative in the end (-3.9%). At the same time, it was in the two Andean countries (Bolivia and Ecuador) with an even smaller share in CAN's total FDI (of 8% and 9%, respectively) where FDI inflows grew the fastest (at rates of 29% and 10.4% on an annual average, respectively), as a result of the capitalization of state-owned companies in the case of the former and of recent oil investments in the case of the latter.

FDI by Economic Sector

The analysis of the FDI composition by sector provides an additional insight into the low share of the Andean subregion in the total inward FDI to the LAC region as a whole. In effect, 36% of the total of FDI attracted by the Andean subregion between 1994 and 2002 went to the tertiary sector (especially, to finance with 12.3%; transport and communications with 8%; electricity, gas and water supply with 7%) and 34% to the export primary sector (mainly to mining and quarrying, with 33.1%) (Figure 6 and Table 23). Undoubtedly, it is a major achievement that the measures for the privatization of state-owned companies, the liberalization of domestic markets, and new modalities of association with foreign capitals - which were part of the reforms implemented in the 1990s - have not only merely reinforced the pattern of FDI in CAN, that has traditionally been concentrated in export-oriented primary activities, but have also made the arrival of fresh FDI possible in tertiary activities (or services, as they are generally referred to), in which modernization is indispensable for the development of systemic competitiveness. However, as other countries in the region also privatized even more valuable utilities since they operate in markets bigger than the Andean ones, and/or are also rich in natural resources, it is then understood that such an achievement has not been enough for the subregion to cease being a comparatively minor destination of FDI into the region.

FIGURE 6
SECTORAL DISTRIBUTION OF FDI IN CAN, 1994-2002



Note: [a] Based on the cumulative flow for the period.

Source: CAN General Secretariat [2003k and 2004c]. In-house preparation.

TABLE 23
FLOWS OF FDI RECEIVED BY SECTOR, 1994-2002:[a]
SHARE OF ANDEAN COUNTRIES
(Percentage)

Sector	CAN[1]	Bolivia	Colombia	Ecuador	Peru	Venezuela
Agriculture, forestry, hunting and fishing	0.331	0	39	22	12	28
Mining and oil	26.990	12	14	21	4	49
Manufacturing industry	10.432	5	44	4	13	34
Electricity, gas and water supply	5.729	0	69	0	28	4
Services	3.729	74	15	8	3	1
Construction and Housing	0.572	0	38	14	13	35
Trade	2.591	0	46	13	24	17
Transport and Communication	6.503	0	39	3	48	11
Tourism	0.046	0	0	0	100	0
Finance	10.028	0	53	0	16	31
Unregistered Investments	14.501	0	0	0	65	35
Total	**81.451**	**8**	**27**	**9**	**23**	**33**

Notes: [a] Based on cumulative flows for the period.
[1] In US$ billions.

Source: CAN General Secretariat [2003k and 2004c]. In-house preparation.

Following this line of reasoning, one can understand why most FDI into the tertiary sector of the subregion went to the Andean countries having markets of a larger relative size and being comparatively bolder in terms of privatization and liberalization, especially to Colombia and Peru in electricity, gas and water supply, transport and communications, and trade; as well as to these two countries and to Venezuela in finance. However, Colombia's attractiveness has exhibited the best diversification by sector, since the FDI it received was distributed among the different sectors as follows: 24% to finance, 21% to manufactures, 18% to electricity, gas and water supply, and 17% to mining and oil; while Venezuela and Ecuador have been traditionally attractive for their hydrocarbons, and Peru and Bolivia for their service-related activities.

Another important factor that explains why the subregion as a whole performed below the regional average with regard to the attractiveness for FDI is its low level of manufacturing FDI inflows, which accounted for only 13% of the respective total. Inasmuch as the manufacturing FDI is the kind of FDI that can, in principle, be influenced by preferential trade agreements, in general, and by economic integration agreements, in particular, such performance signifies that CAN has been much less of a catalyst for investment than MERCOSUR and NAFTA. However, this does not mean that such catalytic effects have been insignificant for those CAN member countries that were better able to take advantage of them. Colombia was by far the leader in this sense, attracting 44% of the manufacturing FDI in the subregion during the 1994-2002 period, followed by Venezuela with 34%, as a result of its performance in the 1990s. As it might be recalled, both countries are the main Andean exporters of manufactures at the intra-CAN level especially.[6] This implies that several investors were drawn by the opportunities opened by the

[6] The interrelations between manufacturing FDI inflows and manufactured exports are discussed in the following section.

Andean enlarged market and, in that sense, there is evidence substantiating the cases of major multinationals that chose to set up their manufacturing plants in Colombia and Venezuela to serve the subregion, influenced by the leadership exhibited by these two countries within CAN, partly thanks to the skillful strategy they developed in order to participate in the Andean FTA and the CET (González Vigil [2001] pp. 38-40 and 63-69; ECLAC [2003b] pp. 70-71).

FDI by Origin

Over the entire 1994-2002 period, the EU was the main investing region in CAN, accounting for 26.9% of FDI inflows into the subregion (although in the 2000-2002 period it was somewhat outshone by NAFTA). Most European investment was channeled into Peru, Colombia and Venezuela (Table 24), in Peru and Colombia especially through Spanish investments following the privatization or concession of utilities (telecommunications, electricity and finance), and in Colombia and Venezuela also through oil investments by the Netherlands and the United Kingdom. NAFTA's investment was more concentrated in hydrocarbons and was mostly channeled into Venezuela, Ecuador and Colombia. Venezuela was, in turn, the preferred destination for Asian investments, although this region's declining share (2%) in the total FDI of CAN[7] is still a cause for concern. The region that held the third place in the ranking of FDI by origin was ALADI, with a 7.2% share, most of which corresponded to investments made by MERCOSUR countries in Bolivia and Venezuela. Indeed, this was a remarkable position and yet the share was low, which shows that, given the intricate web of preferential trade agreements interconnecting the countries in the region, the incipient catalyzing effects of investment are a problem not exclusive to CAN but also present in this kind of web.

TABLE 24
FLOWS OF FDI RECEIVED BY ORIGIN, 1994-2002:[a]
SHARE OF ANDEAN COUNTRIES
(Percentage)

Origin	CAN[1]	Bolivia	Colombia	Ecuador	Peru	Venezuela
CAN	1.026	13	38	6	21	21
MERCOSUR	3.027	42	5	13	6	34
ALADI	5.858	29	18	11	17	26
NAFTA	18.610	13	21	22	8	37
EU	21.887	9	29	6	29	27
East Asia	1.525	4	10	2	10	74
Others	33.813	1	33	3	30	33
Total	**81.451**	**8**	**27**	**9**	**23**	**33**

Notes: [a] Based on the cumulative flow for the period.

[1] In US$ billions.

Source: CAN General Secretariat [2003k and 2004c]. In-house preparation.

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[7] It should be noted that these figures may be misleading, since most of the resources that arrived in CAN during the period have an unknown origin or else come from financial centers (42%) and are therefore taxable. For this reason, these centers usually conceal significant amounts of resources often coming from industrialized countries, including Asian ones.

With regard to the intra-CAN FDI flow, the total share of which is minimal (1.3%), it is interesting that Colombia was the main recipient with 38% of the total, followed by Peru and Venezuela (Table 25) and that, although in the 2000-2002 period Peru was the largest recipient of such FDI with 68% of the total, this was due to Colombian investments in the electric power industry. In fact, Colombia was at the same time the largest intra-CAN investor, accounting for 41% of the total, followed by Ecuador and Venezuela. The main Andean destinations for Colombian capital have been Peru and Venezuela; for Ecuadorian capital, Colombia and Venezuela; and for Venezuelan capital, Colombia and Ecuador; while the overwhelming majority of intra-CAN Peruvian investments went to Bolivia. From all of the above, two important conclusions can be drawn: first, that the comparatively intense trade relationship between the three North Andean countries also applies in the case of intra-CAN FDI; and secondly, that Colombia has become not only the most attractive Andean country for FDI in many economic activities but also the dominant player of intra-CAN FDI, especially in its capacity as an investor. Both facts can be attributed in part to Andean integration and, more specifically, to the way each one of the member countries utilized its basic mechanisms (FTA and CET).

TABLE 25
INTRA-CAN FDI, 1994-2002.[a] DISTRIBUTION BY MEMBER COUNTRY
(US$ millions)

Origin/Destination	Bolivia	Colombia	Ecuador	Peru	Venezuela	Total	% By Origin
Bolivia	--	3.1	0.1	1.3	0.0	4.5	0
Colombia	38.0	--	51.5	188.0	146.0	423.5	41
Ecuador	1.0	154.3	--	30.7	70.0	256.0	25
Peru	87.9	36.7	1.6	--	0.0	126.1	12
Venezuela	5.0	199.9	11.4	-0.6	--	215.8	21
Total	**131.9**	**394.0**	**64.6**	**219.4**	**216.0**	**1,025.9**	**100**
% By Destination	**13%**	**38%**	**6%**	**21%**	**21%**	**100%**	

Notes: [a] Based on the cumulative flow for the period.

Source: CAN General Secretariat [2003k and 2004c]. In-house preparation.

E. Competitiveness of Andean Economies

One way to analyze the dynamic impact of a given trading group on the competitiveness of its member economies is through the constant market share (CMS) analysis proposed by Yamazawa [1990] and applied by Ichikawa [1997], according to which the growth in the exports of a member country to its trading bloc can be decomposed into the following three effects: (1) the "demand effect", i.e. as a result of the general increase in total imports in the given bloc; (2) the "commodity composition effect", which will be positive if the country in question concentrates on the exports of commodities for which markets are growing faster in the given trading group; and (3) the "trading terms" or "preferential effect", where the reciprocal preferential tariff reduction agreed upon makes the exports of member countries competitive.

TABLE 26
DYNAMIC IMPACT OF THE ANDEAN TRADE INTEGRATION: CMS ANALYSIS[1]
(US$ thousands)

	Demand Effect	Composition Effect	Trading Terms Effect	Total
Short-term (1993-1995)				
Bolivia	35,785	1,889	64,926	102,600
Colombia	215,596	17,228	478,278	711,102
Ecuador	84,838	-31,335	118,778	172,282
Peru	94,756	2,010	1,744	98,510
Venezuela	372,211	-21,096	729,080	1,080,195
Medium-term (1998-2000)				
Bolivia	50,331	11,682	138,851	200,864
Colombia	377,907	173,573	706,007	1,257,487
Ecuador	123,360	35,710	200,595	359,665
Peru	133,437	28,844	10,498	172,779
Venezuela	439,250	48,103	614,140	1,101,493

Note: [1] Through this analysis, the change in country *A*'s exports to *B* between period *0* to period *t* can be expressed as $X(t) - X(0) = mX(0) + \Sigma_i[(m_i - m)X_i(0)] + \Sigma_i[X_i(t) - X_i(0) - m_iX_i(0)]$, where *X* is the variable defining country *A*'s total exports to *B*, where X_i is commodity *i* exports of country *A* to country *B*, where *m* is the percentage increase in country *B*'s total imports from period *0* to period *t*, and m_i is the percentage increase in country *B*'s imports of commodity *i* between period *0* to period *t*. The analysis has been based on the three-digit Standard International Trade Classification Rev.2.

Sources: World Trade Analyzer [2000] and INTAL [2004]. In-house preparation.

Table 26 shows the results of the application of this analysis to the CAN case, in a short-term scenario, understanding by short-term the first three years (1993-1995) following the establishment of the FTA between four Andean countries only (given Peru's self-exclusion), and in a medium-term scenario, comprising the 1998-2000 period (with Peru on board since August 1997). It can be observed that all Andean countries have increased their intra-CAN exports both in the short and medium terms, although to a different extent, and that most of the growth registered by the four Andean countries that joined the FTA earlier can be accounted for by the trading terms effect, which reflects the price competitiveness resulting from the ensuing tariff reductions. Venezuela has shown the highest increase in the short term and Colombia, in the medium term, which is yet further proof that the latter is the Andean country that has best taken advantage of the subregional enlarged market, both followed by Ecuador and Bolivia, with significantly lower increases. In contrast, Peru - certainly because of its already discussed initial self-exclusion from the FTA - is not only the country that comes last but it is also the only Andean country where the demand effect triggered most of the growth in the respective intra-CAN exports.

Trade Comparative Advantages in the World Market

So as to gain a more disaggregate insight into trade competitiveness by sector and into the changes in the trade specialization of the CAN member countries over time, the revealed comparative advantage index (RCAI) proposed by Balassa [1965] has been calculated for the 1991-2001 period. This index measures the relative export performance by country and industry, defined as a country's share of world exports of a good divided by its share of total world exports; therefore, if the index exceeds 1 the country is said to have comparative advantages in a given sector or industry at the global level. The Notes to Table 27 detail the formula used for the purpose of calculating the RCAI in each one of the 28 manufacturing industries pursuant to the three-digit International Standard Industrial Classification Rev. 2 (3-digit ISIC Rev. 2), and include a list of these industries with their codes and their grouping by category of goods (current consumption, intermediary, and durable consumption or capital goods); but in this document, for brevity's sake, we will simply refer to the respective ISIC codes and/or to those categories of goods. The first two lines in Table 27 show the number (and the corresponding 3-digit ISIC codes) of the industries with a RCAI in excess of 1, giving an account of what happened during the period in question differentiating the gain cases (increase of the index) from those where the RCAI remained stable; while the third line signals the industries that lost RCAI (the index value becoming less than 1), and the fourth line illustrates the number of industries without an RCAI (with an index value below 1) over the entire period.

TABLE 27
TRADE COMPARATIVE ADVANTAGES IN THE WORLD MARKET[a], 1991-2001[1]
(Three-digit ISIC) [2]

	Bolivia	Colombia	Ecuador	Peru	Venezuela	CAN
Industries that gained comparative advantage	1 (332)	3 (351, 356, 371)	1 (331)	0	0	0
Industries that maintained their comparative advantage	5 (311/12, 323, 331, 354, 372)	8 (311/12, 322, 323, 353, 354, 361, 362, 369)	3 (311/12, 353, 354)	4 (311/12, 321, 322, 372)	4 (353, 354, 371, 372)	4 (311/12, 353, 354, 372)
Industries that lost comparative advantage	0	2 (314, 324)	0	0	2 (314, 362)	2 (314, 323)
Rest of industries	22	15	24	24	22	22

Notes: [a] The Revealed Comparative Advantage Index (RCAI) is expressed as $RCAI_{ih} = (X_{ih} / X_i) / (W_h / W)$, where X_{ih} are the exports of good *h* by country *i*, *Xi* are *i*'s total exports, W_h is good *h* world trade, and *W* is world trade.

[1] This analysis is based on the changes in RCAI between the periods 1991-1993 and 2000-2001.

[2] It includes the following 28 3-digit ISIC that classify industries into: *Current Consumption Goods* Industries: food products (311/12), beverages (313), tobacco (314), textiles (321), wearing apparel (322), leather manufactures and fur (323), leather footwear (324), wood and cork (331), furniture (332), paper (341), printing and publishing (342); *Intermediary Goods* industries: industrial chemicals (351), chemical products (352), refined petroleum (353), coal and petroleum derivatives (354), rubber products (355), plastic products (356), pottery, china and earthenware (361), glass (362), non-metallic mineral products (369), iron and steel (371), non-ferrous metallic products (372); *Durable Consumption or Capital Goods* industries: metal products (381), machinery (382), electrical machinery apparatus, appliances and supplies (383), transport equipment (384), professional and scientific equipment (385) and other manufactures (390).

Sources: World Trade Analyzer [2000]; INTAL [2004]; ITC/UN [2001]. In-house preparation.

CAN's total exports have comparative advantages worldwide in only four industries and lost advantages in another two, the six of them being natural-resource-based industries. Colombia is the Andean country whose total exports have a RCA at a global level in a higher number of industries: eleven, the majority of which (eight) are manufacturers of intermediate goods and inputs and the remaining three of current consumption goods. Likewise, it is the Andean country that gained world RCA in more industries: three (351, 356, 371), all of them being manufacturers of intermediary goods that are key links for the development of higher value-added industries. Besides, in five of those eleven industries (351, 356, 361, 362, and 369) Colombia is the only Andean country to have world RCA, all of these in intermediary good-related industries; while in the two industries where it lost RCA the loss was inflicted on the CAN as a whole because the same happened in the other member country that had it (Venezuela, for the case of 314) or because no other member country had it or obtained it (324). The next outstanding performance is the one shown by Bolivia, which, in spite of being the smallest economy in CAN, has world RCA in six industries, two of them manufacturers of intermediary goods and four of current consumption goods. Ecuador, Peru and Venezuela follow, each with four industries that have world RCA, although Ecuador was the only one that gained world RCA in an industry (331). It should be noted that no Andean country has world RCA in durable consumption or capital goods industries.

Trade Comparative Advantages in the Andean Subregional Market

The RCAI may as well be calculated for the subregional or intra-CAN context, in the manner described in the Notes to Table 28. It is thus observed that Colombia is the dominant country within the Andean market, where its intra-CAN exports exhibit a subregional RCA in as many as 19 of the 28 industries at the 3-digit ISIC level, comprising a broad range of products since they include seven current consumption goods industries, six intermediary goods industries and six capital goods industries. Moreover, in nine of these 19 industries (323, 332, 341, 352, 361, 362, 369, 383 and 385) Colombia is the only Andean country to have subregional RCA, and most of these are in intermediary goods or durable consumption and capital goods. The second best performing country is Venezuela, with subregional RCA in ten industries: seven of which in intermediary goods, two in current consumption goods and one in capital goods. Peru follows closely with nine industries, Ecuador farther off with six, and finally Bolivia with a surprising result of only one industry (food) with subregional RCA despite having RCA in six industries worldwide, a performance that might be worth examining.

TABLE 28
TRADE COMPARATIVE ADVANTAGES IN THE ANDEAN SUBREGIONAL MARKET[a], 1991-2001[1]
(3-digit ISIC)[2]

	Bolivia	Colombia	Ecuador	Peru	Venezuela
Industries that gained comparative advantage	0	2 (381, 384)	2 (324, 355)	6 (322, 331, 342, 355, 382, 390)	4 (314, 353, 354, 356)
Industries that maintained their comparative advantage	1 (311/12)	17 (321, 322, 323, 324, 332, 341, 342, 351, 352, 356, 361, 362, 369, 382, 383, 385, 390)	4 (331, 353, 354, 384)	3 (321, 372, 381)	6 (313, 351, 355, 371, 372, 381)
Industries that lost comparative advantage	2 (323, 331)	3 (311/12, 314, 355)	1 (313)	1 (352)	1 (384)
Rest of industries	25	6	21	18	17

Notes: [a] The subregional or intra-CAN RCAI is calculated in a similar manner as the world RCAI, although dividing the share of good *h* in the total exports to CAN by country *i* by the share of the same good in intra-CAN trade.

[1] This analysis includes the changes in the index between the periods 1991-1993 and 2000-2001.

[2] *Idem* Table 27.

Sources: World Trade Analyzer [2000]; INTAL [2004]; ITC/UN [2001]. In-house preparation.

Regarding the cases where there was a subregional RCA gain, Peru stands out with six industries (two of these being manufacturers of durable consumption or capital goods: 382 and 390); it should be pointed out that most of these gains were achieved by Peru after it joined the Andean FTA in 1997. Although Venezuela follows with four industries, Colombia is the only other Andean country that also gained subregional RCA in two durable consumption or capital goods industries (381 and 384). On the other hand, concerning the industries where there was a loss of subregional RCA, it is interesting to note that whenever a country lost RCA, another country gained it or at least maintained its own,[8] unlike what happened at the world market level. This may be a consequence, in part, of the relocalization of investments following the relocation of manufacturing plants within CAN as evidenced by the studies conducted by González Vigil [2001] and ECLAC [2003b].

Of special significance are the cases in which the subregional RCA have matured to become world RCA. During the 1991-2001 period, the three most outstanding cases were the Colombian industries manufacturing industrial chemicals (351) and plastic products (356) (temporarily joined by the chemical products industry (352) in the 1997-1999 period), and the Ecuadorian wood industry (331). Indeed, during the same period Colombia posted 19 industries with subregional RCA versus 11 with world RCA and in 7 of the latter it also recorded subregional RCA, while Ecuador, Peru and Venezuela gained subregional RCA that are yet to be modified, depending on whether they develop or not into world RCA. More indications on the subject may be provided by research covering longer periods that include the 1980s at least. In the meantime, the results shown herein provide some clear evidence in the sense that the Andean enlarged market has effectively served as a learning platform and generator of economies of scale for the purpose of incubating manufacturing competitive advantages that would be later validated in larger and more demanding markets.

Comparative Advantages in Attracting FDI

Considering that the sustainability of a competitive position depends on the accumulation of production factors and on the increase of total productivity, and that both things require more and, above all, better quality investment, it has been deemed appropriate to apply the RCAI to the FDI-related data, adapting it in the manner explained in the Notes to Table 29. In this case, the index compares the relative importance that a sector or industry has in the total FDI stock received by a country with the relative importance it has in the world FDI stock; therefore, when the index exceeds one it can be asserted that the country in question is comparatively more attractive for FDI in that sector or industry. Given the well-known limitations regarding the availability of disaggregate FDI data in the CAN member countries, it has only been possible to calculate the respective RCAI for Colombia and Peru in the years 1997-1999, in accordance with 2-digit ISIC Rev. 2.

The results in Table 29 illustrate that Colombia has more sectors with RCA in attracting FDI: eleven in total, of which five are manufacturing sectors (31, 32, 33, 34, 35 and 36), four are tertiary (4, 5, 7 and 81-82) and two are primary (1 and 2); while Peru's respective total is only of four sectors, two in services (4 and 7), one manufacturing (31) and the other primary (2). When confronting these results on RCA in attracting FDI with the ones analyzed above on trade RCA the following three interesting conclusions are drawn:

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8 To quote only a few examples: in chemical products (352) Peru lost subregional RCA leaving Colombia as the only country to exhibit such RCA; in transport equipment (384) Venezuela lost subregional RCA but Colombia gained it and Ecuador maintained its own; and in rubber products (355) Colombia lost to the advantage of Ecuador, Peru and Venezuela.

TABLE 29
COMPARATIVE ADVANTAGES IN ATTRACTING FDI,[a] 1997-1999[1]

2-digit ISIC	Colombia		Peru	
	1997	1999	1997	1999
1 Agriculture, hunting, fishing and forestry	1.797	2.403	0.191	0.956
2 Mining and quarrying	3.354	2.243	3.269	3.609
31 Food, beverages and tobacco	2.670	2.359	2.457	2.721
32 Textiles, apparel and leather industries	1.120	1.015	0.620	0.682
33 Wood and wood products	0.082	0.023	0.050	0.063
34 Printing, publishing and reproduction of recorded material	4.719	3.089	0.649	0.593
35 Chemical, Petroleum, Coal, Rubber and Plastic Products	1.274	1.106	0.560	0.530
36 Non-Metallic Mineral Products	1.738	4.526	0.306	0.394
37 Basic Metal Industries	0.219	0.329	0.107	0.093
38 Fabricated Metal Products, Machinery and Equipment	0.975	0.527	0.274	0.185
39 Other Manufacturing Industries	0.428	0.511	0.037	0.048
4 Electricity, gas and water supply	5.571	7.992	9.919	6.676
5 Construction	1.487	1.837	0.377	0.591
61-62 Trade	0.615	0.642	0.599	0.563
63 Restaurants and Hotels	0.204	0.262	0.391	0.689
7 Transport and Communication	3.803	1.490	12.738	4.795
81-82 Financial services	0.966	1.060	0.746	0.945
83-9 Other services	0.158	0.185	0.058	0.075

Notes: [a] The comparative advantage index with regard to the attraction of FDI is defined as $RCAI_{ih} = (S_{ih} / S_i) / (S_h / S)$, where S_{ih} is the inward FDI stock in country *i* in sector *h*, S_i is the total FDI stock in *i*, S_h is the world FDI stock in sector *h*, and *S* is the total world FDI stock.

[1] Based on the information of FDI accumulated stock. No annual flows are used because they are volatile and could even give rise to negative indexes.

Sources: UNCTAD [1999 and 2001]; PROINVERSIÓN [2002]. In-house preparation.

First, ten of the eleven Colombian manufacturing industries (at the three-digit level) with RCA in the world market by the end of the 1991-2001 period were part of the sectors (at the two-digit level) with RCA in attracting FDI during the 1997-1999 period; a situation that in Peru only applied in the case of the food industry. Second, of all the Colombian manufacturing sectors with RCA in attracting FDI, only 34 (paper and printing industries) does not have trade RCA at the worldwide level although it does have RCA at an intra-CAN level. Third, Peru has trade RCA (at world and subregional levels) in the basic non-ferrous metallic industry (372) and although its sector 37 does not have RCA in attracting FDI, its sector 2 does, a fact that could be explained by the structure of incentives existing in that country that encourage the registration of FDI in the primary stage of vertically integrated companies. From all of the above it is inferred that the generation of trade RCA in certain industries is in many cases contingent on having a RCA in attracting FDI in the same industry or in its main sectoral linkages.

Interrelations between Trade and FDI

To the traditional debate about whether international trade leads FDI or vice versa and about whether the relationship between both variables is one of complementarity or substitution, the latest studies based on empirical data and information about the last two decades offer varied answers, according to which trade and FDI can be complementary to each other or substitute for each other depending both on the specific factors inherent to the international strategies developed by companies and to the type of economic sector in which they operate, and on the specific factors that render one place in particular (country, region or subregion) attractive for the localization of certain economic activities. This becomes especially relevant when these are value-added activities because in this case the company's localization decision is a decision involving FDI and trade simultaneously (UNCTAD [1996] p. 120). For example, a complementary relationship between FDI and trade is the one that prevails in the manufacturing sectors of East Asia, according to the empirical studies carried out by Chunlai [1997] and by Kawai and Urata [2001]. With this background information in mind, it was considered appropriate to complete this section by evaluating the correlation between the annual average flow of manufacturing FDI received by Andean countries and the annual average growth rate of its manufactured exports during the 1992-2001 period; an analysis that was only possible in the case of Colombia, Peru and Venezuela, due to the scarcity of data about FDI broken down by industry (at 3-digit ISIC Rev. 2) in Bolivia and Ecuador.

TABLE 30
CORRELATION BETWEEN MANUFACTURING FDI AND MANUFACTURED EXPORTS, 1992-2001

	Total[1]			Intra-CAN[2]		
	Colombia	**Peru[3]**	**Venezuela**	**Colombia**	**Peru[3]**	**Venezuela**
Correlation coefficient	0.36	0.05	-0.10	0.51	0.04	-0.15
Level of significance	0.06	0.82	0.63	0.01	0.85	0.45
Number of observations	28	28	28	28	28	28

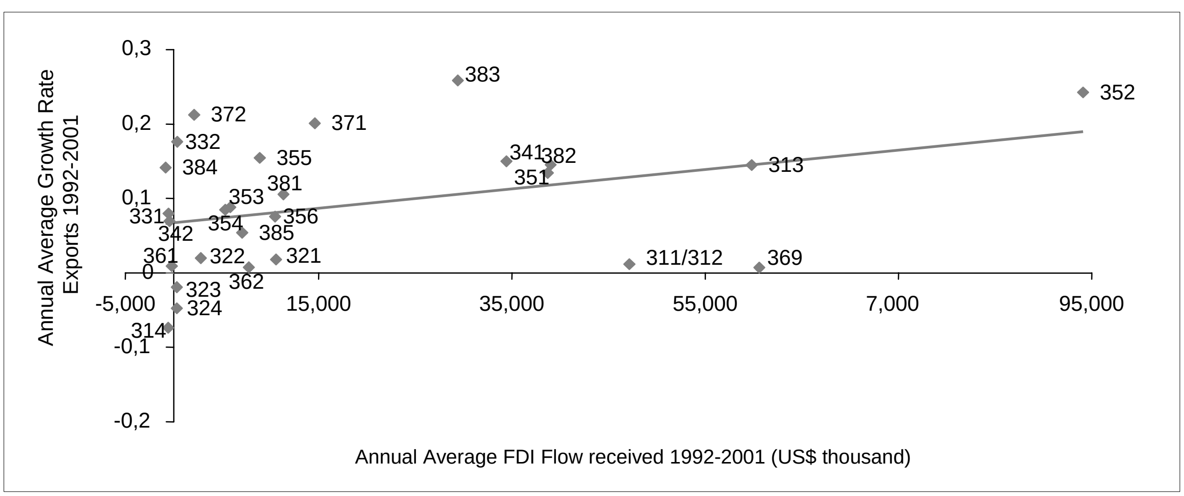
Notes: [1] Correlation between the annual average flow of manufacturing FDI received (at 3-digit ISIC) and the annual average growth rate of total manufactured exports (also at 3-digit ISIC).

[2] Correlation between the annual average flow of manufacturing FDI received (at 3-digit ISIC) and the annual average growth rate of intra-CAN manufactured exports (also at 3-digit ISIC).

[3] 1992-2002 period.

Sources: World Trade Analyzer [2000]; INTAL [2004]; PROINVERSIÓN [2002]. In-house preparation.

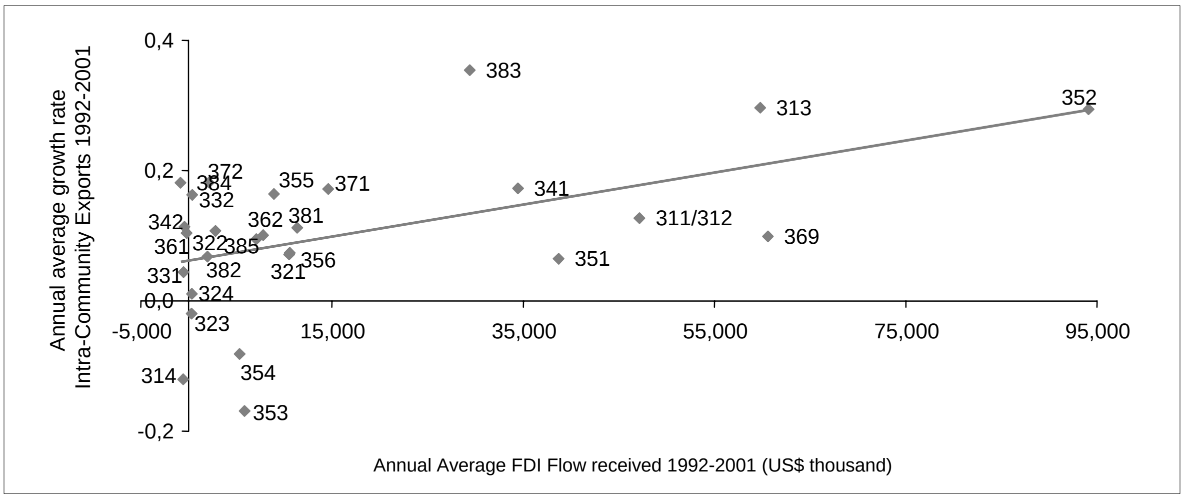
FIGURE 7
COLOMBIA: MANUFACTURING FDI AND TOTAL MANUFACTURED EXPORTS, 1992-2001, 3-DIGIT ISIC



Sources: World Trade Analyzer [2000]; INTAL [2004]; PROINVERSIÓN [2002]. In-house preparation.

The results shown in Table 30 indicate that only in the case of Colombia is there a positive (0.36) and significant (94%) correlation between manufacturing FDI and total manufactured exports of that country, which points to the existence of a complementarity relationship between both variables in the Colombian case during the period being analyzed. In contrast, the respective correlations are not significant for Peru and Venezuela. That is why only the results for Colombia are included in Figure 7, where it is possible to observe that its industries, which on average received more FDI annually, were the ones that showed more dynamic exports to the world market, and vice versa. The most outstanding cases were the Colombian industries of diverse chemical products (352) and beverages (313), and to a lesser extent electrical machinery and apparatus (383), industrial chemicals (351), paper and paper products (341) and transport equipment (384).

FIGURE 8
COLOMBIA: MANUFACTURING FDI AND INTRA-CAN MANUFACTURED EXPORTS, 1992-2001, BY 3-DIGIT ISIC



Sources: World Trade Analyzer [2000]; INTAL [2004]; PROINVERSIÓN [2002]. In-house preparation.

The results shown in Table 30 also evidence that at intra-CAN level the complementarity relationship is even stronger (with a positive correlation coefficient of 0.51) and more significant (at 99%) in the case of Colombia; and that at that level there is no significant correlation either in the cases of Peru or Venezuela. This is why only the results for Colombia are included in Figure 8, where it is possible to observe that its industries - which on average received more FDI annually - were the ones that showed more dynamic exports to the Andean subregional market, and vice versa. This time, the most outstanding cases are the industries 352, 313, 341 and 384 mentioned above, to which we should now add industries 369 and 311/12, whose exporting dynamism in the subregional market was greatly superior to the one exhibited in the world market, while the opposite held true for industries 351 and 383.

Although the lack of significant correlations for Peru and Venezuela (plus the absences of Bolivia and Ecuador for information-gathering problems) oblige us to look at these results with caution and prevent us from drawing generalized conclusions for the CAN as a whole, concerning Colombia there is little doubt that the manufacturing FDI in this country was intended to target not only the domestic market but also larger markets, the world market in several cases and particularly the Andean enlarged market in the same and other cases. This leads us to conclude that Colombia’s capacity - bigger than that of its Andean peers - to attract manufacturing FDI has been a key element accounting for its top-of-the-line performance at the CAN level in most of the trade and investment indicators analyzed in this chapter; this bigger capacity includes knowing how to take advantage of the opportunity offered by the CAN's FTA and the CET and, therefore, using the subregional enlarged market as a learning platform to consolidate its manufacturing competitive advantages and generate new ones not only at the intra-CAN level but also at the world level.

Contents

CHAPTER II. ANDEAN EXTERNAL AGENDA

Between January 2002 and May 2004, the Andean Community member countries were fairly successful in pursuing an external agenda that emphasized the relationship with the USA, the EU and the MERCOSUR, as well as the participation in negotiations to create the Free Trade Area of the Americas (FTAA) and multilateral negotiations at the World Trade Organization (WTO). That emphasis reflected the priorities for implementing the Common Foreign Policy (CFP)[9] laid down by the Andean Presidential Council in the Declaration of Santa Cruz (January 2002), and subsequently supplemented by the Quirama Declaration (June 2003). However, although the Andean Community subregional bodies and institutions have promoted or assisted in the outstanding achievements reported in this chapter, most of them were not attained by its member countries executing common external actions in the strict sense (that is to say, as a subregional group) but by joint actions not always involving all Andean countries on an equal footing; rather, they consisted in diverse instances of intergovernmental consultations or coordination.

In the guidelines of the Declaration of Santa Cruz concerning the CFP, the Andean Presidents agreed to prioritize ongoing efforts to attain the following top goals: free trade with the USA; renewing the Andean Trade Preference Act (ATPA) and expanding its product range; reaching a CAN-EU Association Agreement; and concluding, for the same purpose, the trade negotiations with MERCOSUR. Other objectives are perfecting an overall strategy for the Andean countries' participation in negotiating the FTAA and adopting a coordinated strategy regarding the commitments undertaken at the WTO and the Doha Round multilateral negotiations. After achieving the goal relating to the USA and in order to facilitate those referring to the EU and MERCOSUR, the Andean Presidents entrusted the Andean Council of Foreign Ministers, in the Quirama Declaration, with the continuation of negotiations to sign a Political Dialogue and Cooperation Agreement with the EU, and to hold the First Andean Community-MERCOSUR Political Dialogue and Cooperation Meeting.

This focus of the Andean external agenda during the period under review was supported by well-grounded political and economic reasons. Its rationale become more than evident, with respect to the USA and the EU, in light of their decisive influence on the world political and economic scene in general, and, on a level more directly related to the Andean Community, because the USA is the leading country in Andean foreign trade and the European Union is the main regional investor in CAN. These are extremely significant economic relationships that, in the case of the EU, have been supplemented and strengthened by its sustained, decisive support of Andean integration, as reflected by the EU's recognition of the Andean Community as a legitimate regional partner; this is a status that MERCOSUR also grants to CAN, which leverages the political significance of the economic integration process underway between the two South American subregional schemes.

A. United States of America

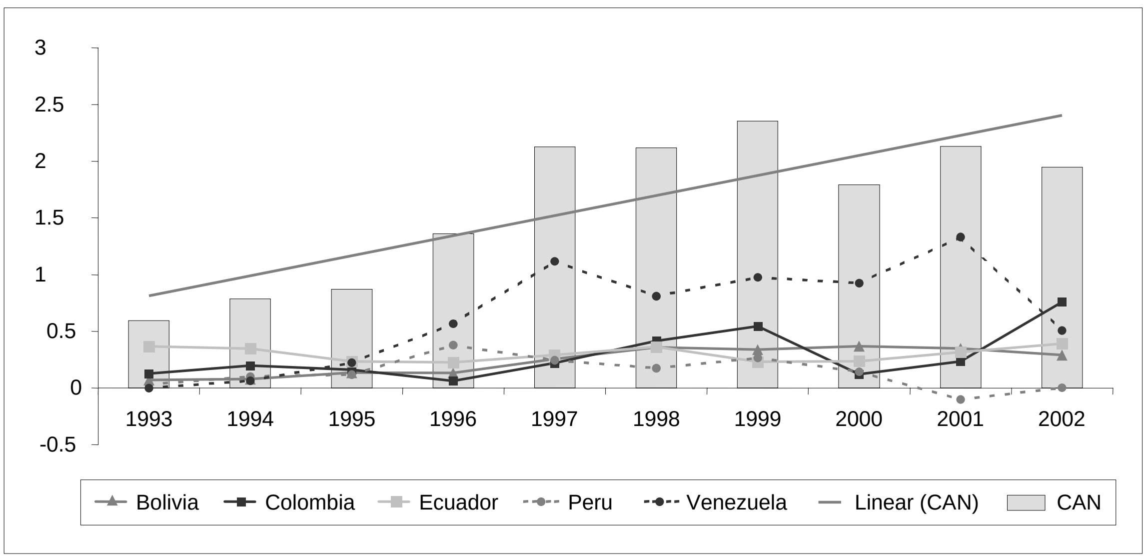
The USA represents 89.9% of the aggregate trade flows (exports plus imports) between the Andean Community and the NAFTA (both blocs taken as a whole), and 83.2% of the foreign direct investment (FDI) by NAFTA in the Andean Community. For that reason, the development and features of the Andean Community-USA trade relationship and investments fully explain the development and features of the relationship between the Andean Community and the North American subregion that were already reviewed in Sections C and D, Chapter I, of this Report. Likewise, as already stated in the above sections concerning the increasing relative weight of the Latin American Integration Association or ALADI

[9] For more information on the CFP, whose broad guidelines were set by the Andean Council of Foreign Ministers in Decision 458 (May 1999), please refer to (INTAL [2002] pp. 81-92).

(including Mexico) as a supplier of Andean imports, the participation of the USA in the Andean Community-NAFTA trade is much more significant as a market for the Andean exports (93.5%) than as a supplier of the Andean imports (83.4%).

The allegation that the USA is CAN's main trading partner and leaves other countries far behind as a destination for total Andean exports is supported by the fact that, between 1999 and 2001, the USA received 44.5% of such exports. However, this significance of the USA as a market for Andean products differs among member countries, being considerably greater for the total exports of the three northernmost CAN countries (Venezuela, 50.4%; Colombia, 47.1%; and Ecuador, 36.2%) than for those of Peru (27.1%) and Bolivia (21.4%). Also, the USA's importance as the main market for the manufactured exports of CAN members as a whole is much lower (28.7%), and is already being challenged by the Andean subregional market itself (28.5%), although the USA is the main buyer of the manufactured goods of Bolivia (50%), Venezuela (33.8%) and Peru (29%). As regards the other side of the trading coin, although the USA is still the main provider of total Andean imports (32.8%), ALADI follows close on its heels (as shown above) and the USA only keeps the upper hand in the case of Colombian and Venezuelan imports (representing 36.8% of each of these countries' imports).

FIGURE 9
US FDI IN THE ANDEAN COUNTRIES, 1993-2002
(In US$ billions)

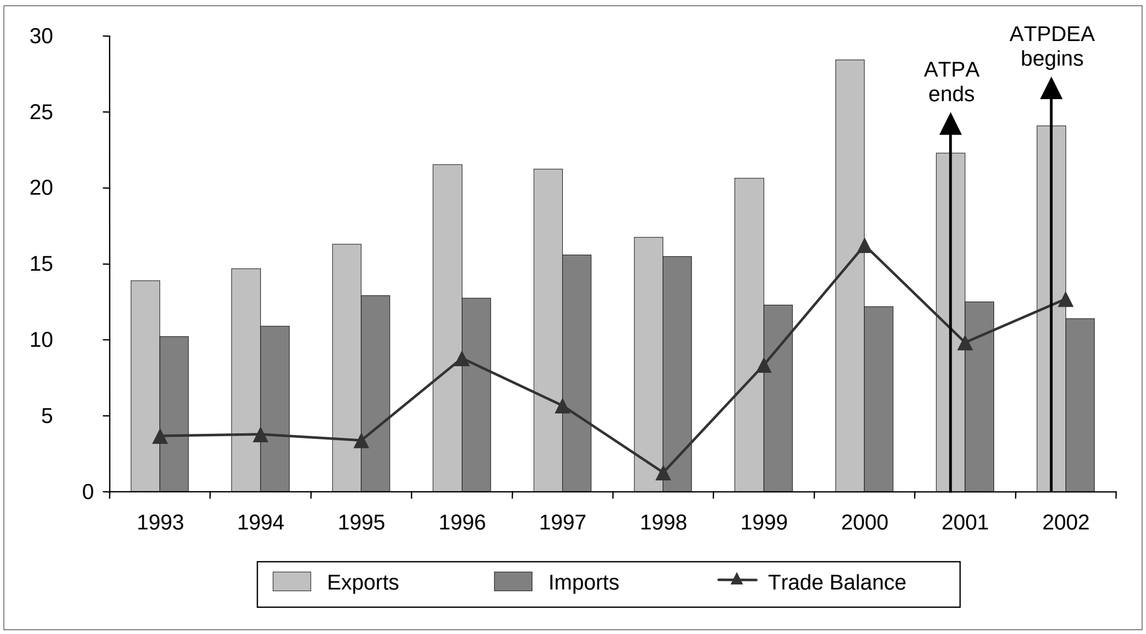


Sources: General Secretariat of the Andean Community [2004d]; PROINVERSIÓN [2002]. Preparation: In-house.

US FDI represented 19% of the total FDI inflows into the Andean Community in 1993-2002, and was mostly made in primary export activities. The highest percentage (42%) went to Venezuela and the lowest (9%) to Peru; the percentages of the other Andean countries were: 18% for Colombia; 17% for Ecuador and 15% for Bolivia. As shown by Figure 9, Peru is the only Andean country where the US FDI has remained stagnant at comparatively low levels, while the increasing trend towards Venezuela sustained a strong downside reversal during the last year (2002), as a result of the political and economic difficulties referred to in Section B of Chapter I.

Going back to trade, Figure 10 evidences the collapse brought about by the two years of international financial crises (1997-1998) which put a stop to the previously rising trends of both Andean exports to, and Andean imports from the USA. It also shows that, while import figures have remained unchanged during the last few years, exports experienced a strong recovery in 2000 and then fluctuated, but with a rising trend in 2001-2002, which may be explained by the transition from the Andean Trade Preference Act (or ATPA) to the Andean Trade Promotion and Drug Eradication Act (or ATPDEA), a subject which is dealt with below.

FIGURE 10
USA-CAN TRADE FLOWS AND TRADE BALANCE, 1993-2002
(In US$ billions)

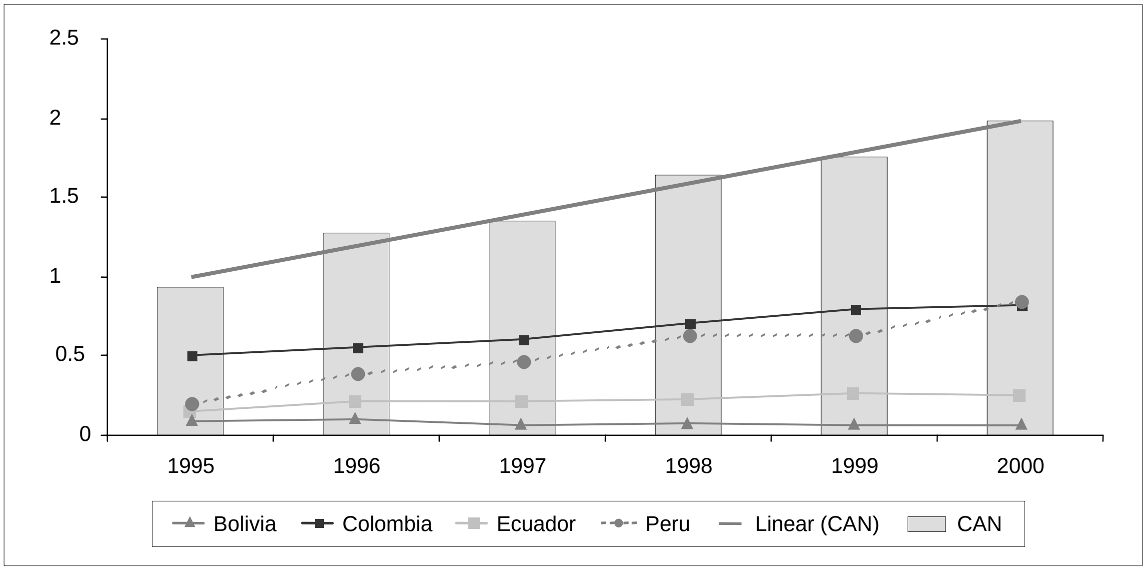


Source: IMF (several years). Preparation: In-house.

From ATPA to ATPDEA

As indicated in Andean Report No. 1 (INTAL [2002] pp. 82-83), under the ATPA passed by the US Congress in 1991, the USA unilaterally granted tariff preferences - which, in most cases, consisted in duty-free entry - to a set of products exported by four Andean countries (Bolivia, Colombia, Ecuador and Peru). The basic purposes of such unilateral concession were to assist in a concerted fight against illicit drug trafficking and related crimes, as well as against terrorism, and to contribute to the creation of alternative jobs and sources of income in these Andean countries by increasing trade and investment, all in accordance with the national security goals of the USA and of those Andean countries (General Secretariat of the Andean Community [2002a] p. 1). As the expiration date of the ATPA (December 4, 2001) grew closer, the four Andean beneficiary countries took steps to secure not only the renewal of the then existing tariff preferences, but also their extension to a longer list of products they exported. In that, they had the support of the Andean Community subregional bodies and institutions, for whom an important additional objective was to include Venezuela as a country benefiting from the same US trade preferences. This was stated by the Andean Presidential Council in guideline 20 of the Declaration of Santa Cruz (January 2002).

FIGURE 11
EXPORTS BENEFITTING FROM ATPA TARIFF PREFERENCES: 1995-2000 GROWTH
(In US$ billions)



Source: General Secretariat of the Andean Community [2001] p.3. Preparation: In-house.

Such steps were prompted by both the significant increase of the Andean exports under the ATPA during the second half of the 90s (Figure 11) and the sharp drop experienced by Andean exports in 2001 (Figure 10) due to not only the then generally unfavorable economic environment (see Section A of Chapter I of this Report) but also the uncertainty about the future of the US tariff preferences. The main economic benefits derived from the ATPA were substantiated by a study carried out by the CAN General Secretariat (SGCAN [2001]), which shows that the beneficiary countries' exports doubled during the effectiveness of the Act, with an actual 111% increase, representing 14.3% of the total Andean exports to the USA. Also, it is estimated that this expansion in trade under the ATPA brought about a production increase equivalent to 6.9% of the four Andean beneficiary countries' combined GDP, jointly with the creation of new jobs equivalent to 7.7% of the entire gainful employment they generated. Additionally, since the ATPA's tariff preferences were granted to non-traditional export products or products that were rarely exported, the same study concludes that such preferences contributed to diversify the Andean products exported to the USA, as evidenced by the 58% increase in the number of tariff subheadings (at eight digits in the NANDINA nomenclature).

The steps taken by the Andean countries were successful, except for the inclusion of Venezuela. By means of the ATPDEA, contained in the new US Trade Act signed into law on August 6, 2002, the USA renewed and expanded the tariff preferences granted to the exports of the four Andean countries benefiting from the ATPA. The date of such enactment and the expansionary macroeconomic policy applied by the USA in 2002 (see Section A of Chapter I of this Report) explain the recovery of the Andean exports to that market during 2002 (Figure 10). The basic purposes of the ATPDEA were the same that gave rise to the ATPA (as already described), to which was added such consolidation of the democratic values, principles and practices in the Andean subregion as may ensure a peaceful coexistence in the American continent (or Western Hemisphere, in Anglo-Saxon terms); the latter, in line with the Americas Plan of Action signed by the Heads of State and Government at the Summit of the Americas in Miami (December 1994).

The renewal of tariff preferences for all products under the ATPA was approved retroactively to December 4, 2001, for which reason tariffs already paid on the Andean products exported between that date and

August 6, 2002 were returned to the importers. In addition, the ATPDEA expanded the duty-free entry benefit to a new set of products including some important Andean manufactured exports, such as apparels (for instance, those listed in the first column of Table 31). The new group of included products potentially comprises some which are sensitive to the US economy (second column), whose duty-free entry will depend on the decision of the President of the USA. The third column shows those products of special interest to the Andean Community that were excluded from the benefits of the ATPDEA.

TABLE 31
ATPDEA: SIMPLIFIED LIST OF RECENTLY INCLUDED AND OF EXCLUDED PRODUCTS

New Products Accorded Duty-Free Entry[1]	Products Sensitive to the US Economy[2]	Excluded Products
• Apparel assembled from US fabrics. • Apparel assembled from regional fabrics. • Apparel assembled from fine alpaca, llama and vicuna fleece. • Air-tight flexible tuna containers (for instance, "tuna pouches", aluminum foil bags).	• Footwear. • Petroleum or some petroleum derivatives. • Watches and watch parts. • Handbags and luggage, work gloves and leather wearing apparel.	• Textile (fabrics and yarn) and apparel. • Rum and tafia (sugar cane liquor). • Sugars, liquid concentrates and sugar-containing products (such as syrup). • Tuna prepared or preserved in any manner in air-tight containers (for instance, canned tuna).

Notes: [1] The limit to the imports of the second product is up to 2% of the total number of apparel imported by the USA from the world. This figure will be increased every year, until reaching 5% in 2006. There is no import quota for the rest of the products.

[2] The President of the USA will determine whether or not these products are allowed duty-free entry.

Source: ATPDEA. Preparation: In-house.

According to a recent study (General Secretariat of the Andean Community [2004b] pp. 67-70), the product coverage extension granted by the ATPDEA is allowing a significant increase in the utilization of tariff preferences by the Andean beneficiary countries (considering it as the percentage of their total exports to the USA under such preferences), as it rose to 48% in January-October 2003 from the mere 18% reached during the same months in 2001, when the ATPA was still effective; although, naturally, the utilization rate varies from country to country and from product to product, as shown in Table 32 for flowers, apparel, petroleum and petroleum derivatives.

TABLE 32
ATPDEA: UTILIZATION LEVEL OF TARIFF PREFERENCES IN SELECTED PRODUCTS BY THE ANDEAN COUNTRIES
(January-October 2003)

Countries	Flowers	Apparel	Petroleum and Derivatives
Bolivia	25%	89%	0%
Colombia	99%	49%	68%
Ecuador	99%	74%	87%
Peru	92%	88%	47%
Total	99%	70%	72%

Source: General Secretariat of the Andean Community [2004b] Table 30.

However, the same study also shows that the Andean products which had the greatest share of the ATPDEA benefits in 2003 were not the less traditional and more job creating export manufactures (save apparel) but products from capital-intensive extractive industries (mainly petroleum and derivatives), as shown in Table 33. This calls for more efforts on the part of the Andean beneficiary countries to industrialize and move forward with their production processes in order to become more competitive, diversify their exports even more and succeed in making preferences such as those of the ATPDEA be increasingly enjoyed by new manufacturing activities having a greater impact on their national economies.

TABLE 33
EXPORTS UNDER THE ATPDEA: PARTICIPATION OF SELECTED PRODUCTS
(January-September 2003)

	%
Bolivia	
Manufactures, wood and cork	11.1
Clothing and accessories	35.8
Colombia	
Animal or vegetable raw materials	12.3
Petroleum and derivatives	69.5
Clothing and accessories	8.3
Ecuador	
Animal or vegetable raw materials	7.5
Fish	2.6
Vegetables and fruit	3.3
Wood and cork manufactures	2.2
Petroleum and derivatives	81.9
Peru	
Non-ferrous metals	38.6
Vegetables and fruit	8.5
Clothing and accessories	37.3
Petroleum and derivatives	9.3

Source: General Secretariat of the Andean Community [2004b] Table 29.

Towards a Free Trade Agreement with the ATPDEA Countries

Notwithstanding the great success that its approval meant for the four included Andean countries and the clear benefits it is bringing to them, the *ATPDEA* has an important drawback: its expiration, scheduled for December 31, 2006. Such limited effectiveness does not ensure the continued application of the tariff preferences it grants, which, on the other hand, as soon as the FTAA enters into force, will be either promptly lost or phased out as the free trade program is implemented in the continent. Neither does it provide a time horizon for promoting the investments needed by the Andean beneficiary countries to afford the generation of new exports of improved quality and greater volume. When looked upon in a positive light, the push for the removal of these restrictions reveals the basic economic reasons behind the renewed efforts of Colombia and Peru, as of the year 2002, when the ATPDEA was approved, to secure their inclusion in the list of countries with whom the USA would negotiate bilateral or multilateral free trade agreements in the near future. This was so by reason of the fact that the USA had already made it clear by then that the FTAA was not its only choice to secure free trade in the Americas, as evidenced by the bilateral free trade agreement it was already negotiating with Chile and its announcement that in 2003 it would start negotiating a multilateral free trade agreement with the Central American countries.

The steps separately taken by Colombia and Peru began to bear fruit when, in March 2003, United States Trade Representative (USTR) Robert Zoellick suggested that the competent national authorities of both Andean countries review the wording of the Chile-USA free trade agreement to determine if they could successfully negotiate a similar agreement. These two Andean countries applied themselves to this task for the following months, on their own but holding consultations with each other, and including in their review the wording of the USA-Singapore free trade agreement and closely following the negotiations for the Central American Free Trade Agreement or CAFTA which were then in progress. Mr. Zoellick took the good results of such preparatory work as the basis for the official letter he sent to the US Congress, on November 18, 2003, notifying it that it was the intention of President George W. Bush to start negotiating a free trade agreement with the four ATPDEA's beneficiary countries, starting with Colombia and Peru, and including Bolivia and Ecuador as soon as they were ready to join such agreement.

The purposes of this decision by the USA were explained in the USTR's letter; they include both the general and specific economic objectives per area of negotiation stipulated for such agreements by the US Congress in the 2002 Trade Promotion Authority or TPA, and the political and security objectives that previously supported the ATPA first and then the ATPDEA. Added to this was the will to adjust the FTAA negotiating process to have it end within the established term (January 2005). The purposes of Colombia and Peru have already been discussed above, and, since they are shared by Bolivia and Ecuador, these countries began making their arrangements as soon as the USTR's communication was made known, although the steps taken by Peru were temporarily blocked by lawsuits it had pending against US companies. Once these lawsuits were fully resolved or put on track and Ecuador's preparation was rated satisfactory, Colombia, Peru and Ecuador took part in the first round of negotiations with the USA in Cartagena (May 17-18, 2004), which Bolivia attended as an observer country entitled to become a full member when it was ready. This first round agreed on organizational and administrative items, the subdivision of the negotiation into 17 issues (industrial tariffs; agriculture; rules of origin; customs procedures; technical obstacles; sanitary and phytosanitary measures; investments; intellectual property; financial services; other services; government procurement; trade defense; competition policies; environmental matters; labor issues; dispute settlement and institutional matters; cooperation), and their scheduling in other five rounds throughout 2004, plus any other rounds necessary to bring negotiations to a close in February 2005.

As regards the potential economic impact of this free trade agreement on the Andean Community members, according to a recent study conducted by experts of the Inter American Development Bank or IDB (Monteagudo *et al.* [2004] Table 6), such impact would be slightly negative for the excluded country (Venezuela) and quite positive, generally speaking, for each of the four countries included. In any case, the benefits derived from this free trade agreement would be fewer than under the FTAA,[10] which underpins the importance of the FTAA for the group of Andean Community members and suggests that those four countries should not consider their free trade agreement with the USA as a replacement for but as a supplement to the FTAA.

Concerning other likely implications for the Andean Community, the constructive reaction of Andean subregional authorities should be highlighted. As soon as the USTR's letter was released (November

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10 Applying a computable general equilibrium model, these IDB experts compared the impact of the USA-ATPDEA Countries Free Trade Agreement with the impact of the FTAA on trade, the real rate of exchange, production, employment, customs revenues and economic welfare. Citing as an example here the resulting percent changes in the real GDP, they would be 0.70% *versus* 1.86% for Bolivia; 1.18% *versus* 2% for Colombia; 0.73% *versus* 2.42% for Ecuador; 1.46% *versus* 2.87% for Peru; and -0.10% *versus* 2.07% for Venezuela.

2003), the then General Secretary of the Andean Community, Guillermo Fernández de Soto, declared to the press that the opportunities afforded by the free trade agreement to turn the ATPDEA preferences into permanent benefits was the recognition by the USA of the strategic role played by Andean countries in the fight against illicit drugs, terrorism, unemployment and poverty, and in strengthening democratic institutionality and the protection of the environment. Sharing these views, his successor, Ambassador Allan Wagner Tizón, drew up an International Trade Negotiations Support Program for member countries (General Secretariat of the Andean Community [2004c])[11] and told the press (05/25/04) that negotiations as broad as those encompassed by the free trade agreement with the USA will allow for the updating and perfection of the legislation of the Andean Community. Very similar were the remarks made to the press a few days before (05/21/04) by Regina Vargo, the head of the US negotiating team, who also stated that the free trade agreement with the ATPDEA countries will contribute to Andean integration by policies that guarantee business stability and cost reduction, and that open up dynamic investment and joint production opportunities.

It is undoubtedly very important to keep such constructive consensus and to make it work in the direction of further development of economic integration within the Andean Community. What can be noted so far is that its member countries' freedom of choice to negotiate tariffs and other trade policy instruments in negotiations such as those of the Free Trade Agreement with the USA seems one of the reasons behind the delay (this time until May 10, 2005) in making key decisions regarding the future of the Andean customs union, as will be seen in Chapter III of this Report.

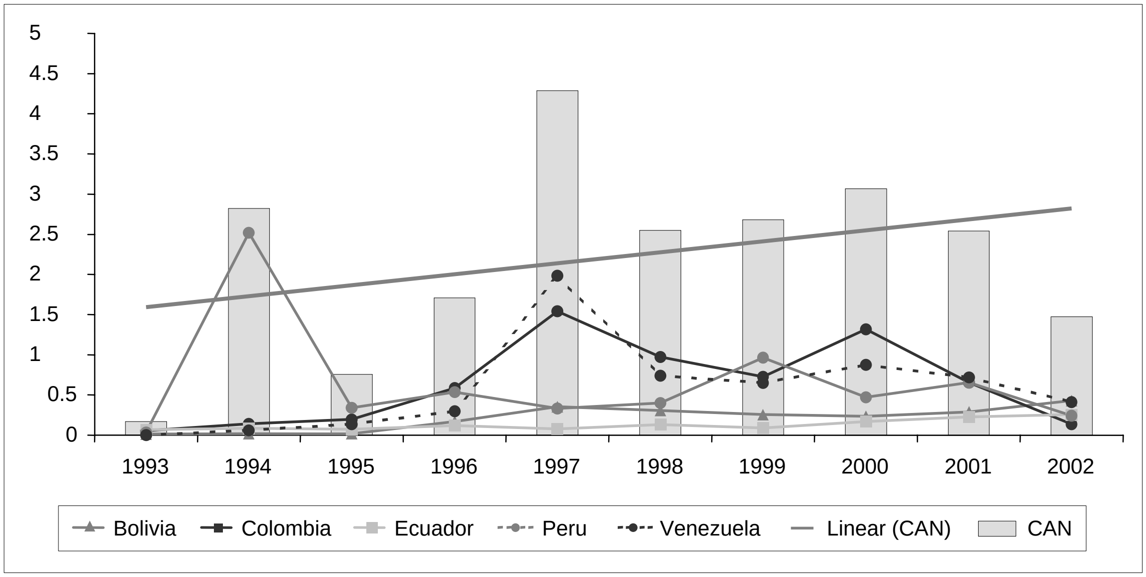
B. European Union

In the first chapter of this report (Sections C and D of Chapter I) it is indicated that the EU was, during the 90s, the main source of the FDI received by the Andean Community as a whole (representing up to 26.9% of FDI inflows in the 1994-2002 period), although it was displaced by ALADI from the second place it held in the overall Andean trade. The European FDI has fluctuated quite a lot year to year, since most of it arrived in the Andean Community attracted by utilities privatization or concession programs, and its performance therefore depended on the schedule of such programs in the various Andean countries. Figure 12 illustrates the two big peaks in 1994 and 1997, the first of which was due to the privatization of the telecom companies in Peru and the second to the privatization of electric power companies in Colombia. It also illustrates the downward trend in FDI in 1998-2000 and its fall in 2001-2002, both of which are explained by the lack of dynamism of such programs in the Andean subregion. Taken as a group, the main countries of origin of the European FDI during this period were Spain (39%), the United Kingdom (20%), the Netherlands (15%) and France (11%); the main Andean destinations were Peru (29.5%), Colombia (28.7%) and Venezuela (26.8%).

Figure 13 shows the scant dynamism of the CAN-EU trade, particularly with respect to Andean exports which reached an average annual growth of only 3.1% in the 1993-2002 period, almost half the 6.3% recorded by Andean exports to the USA during the same period. The EU has dropped to third place in the ranking of relative importance as destination market for Andean Community exports as a whole, both total and manufactured, which shares in the 2000-2002 three-year period have respectively been 11.5% and 13.1%. Peru is the sole CAN member which still has the EU as its second regional destination market, more so for its manufactured exports (28.4%) than for its total exports (23%). As shown in Table 24, the EU has also slipped down to third place as provider of Andean imports and, within the ALADI, the Andean Community itself has forced it out of the third place for Ecuadorian imports and is about to repeat the same performance with respect to Bolivian and Peruvian imports.

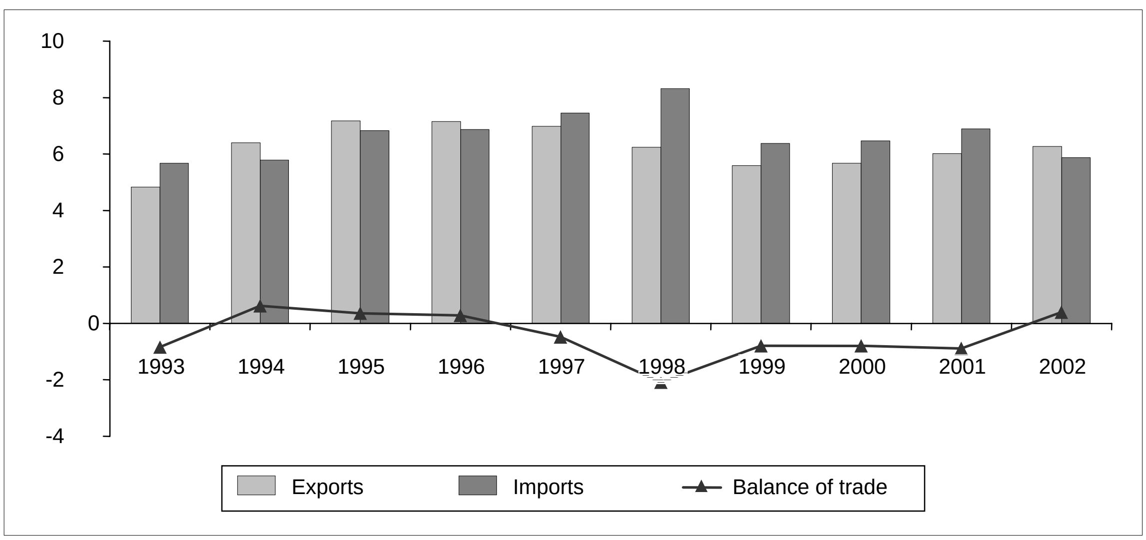
[11] Program including negotiations such as those for a free trade agreement with the USA, the FTAA and an eventual free trade agreement with the EU, involving an investment of approximately one million dollars in technical and financial resources supplied by the IDB, the Andean Development Corporation (*Corporación Andina de Fomento* or CAF), the EU and the General Secretariat of the Andean Community itself.

FIGURE 12
EUROPEAN FDI FLOWS TO THE ANDEAN COUNTRIES, 1993-2002
(In US$ billions)



Source: General Secretariat of the Andean Community [2004d]. Preparation: In-house.

FIGURE 13
EU AND ANDEAN COMMUNITY: 1993-2002 TRADE FLOWS AND BALANCE OF TRADE
(In US$ billions)



Source: General Secretariat of the Andean Community [2004d]. Preparation: In-house.

The above claim, that is to say, the EU's status as top regional investor in the Andean Community and the sluggishness of the trade between them provide a basic economic insight into the significance of the action taken (described below) by Andean subregional bodies during the period encompassed by this report in three areas of the Andean countries-EU relationship that, unlike the case with the USA, involve all the Andean Community member countries: renewing the tariff preferences currently enjoyed by Andean exports in the

European market; seeking their expansion and continued effectiveness by an eventual Andean Community-EU free trade agreement; and advancing the existing political dialogue and economic cooperation between both parties. Such parties relate to each other as groups in these three areas because they are both integration blocs, for which reason, the underpinning and effectiveness of this particular characteristic of the Andean countries' relationship with the EU as a group is mainly dependent on the Andean Community's credibility as an integration project.

Economic Cooperation between the EU and the Andean Community

Among the projects being executed on the recommendation of the EU-Andean Community Joint Committee charged with implementing the Framework Cooperation Agreement approved in 1992 between both integration blocs (INTAL [2002] p. 85), the most prominent is the Programme to Strengthen the Customs Union of the Andean Group of countries, also known as "GRANADUA Programme", because of its broader, more direct connection to the three priority objectives set by that Joint Committee at its Fifth Meeting (February 1999), namely: strengthening the Andean common market; developing the Andean subregional institutionality, and developing the Andean social agenda.

The action areas of the "GRANADUA Programme" have been divided into the following: technical assistance actions, to exchange experiences between the EU and the Andean Community; educational actions, to train expert instructors of the Andean Community who will be able to ensure the project continuity; and follow-up actions, to draw up proposals on how to attain the set objectives. The latter type of action, resulting from the two previous ones, allowed the program submit to the General Secretariat of the Andean Community bases for Decision Proposals (by the Commission of the Andean Community) on subjects which are important for strengthening the Andean customs union, such as: origin of goods; customs appraisal of goods; harmonization of customs regimes; customs transit; the Single Administrative Document (SAD); the Andean Common Tariff Nomenclature (NANDINA); the Andean Integrated Tariff (ARIAN); customs control; combating customs fraud; foreign trade statistics; customs training; and a Customs IT Management system (AIGA).

Andean GSP

All industrial products and a long list of agricultural products exported from the Andean Community enjoy duty-free access to the EU market and a regional accumulation of origin that includes products originating from the EU itself, by virtue of the Andean Generalized System of Preferences ("Andean GSP") unilaterally granted by the EU in 1990 to exports from Bolivia, Colombia, Ecuador and Peru but which, unlike the systems created by the *ATPA* and the *ATPDEA*, also included Venezuela as of 1995 (INTAL [2002] p. 85). The effectiveness of this regime, also known as "GSP-Drugs**",** established to support the concerted fight against illicit drug trafficking under the shared responsibility principle by promoting the development of alternative lawful economic activities, was extended a number of times during the last decade, although for periods too short to clear up the uncertainty associated with its continued existence and, particularly, to boost the investments needed to achieve its purposes.

That explains the repeated Andean efforts to secure a term sufficiently long enough for the "Andean GSP", whose efforts contributed to having Regulation 2501/2001, approved by the European Union Council on December 10, 2001, not limit itself to extending the effectiveness of the regime from January 1, 2002, up to December 31, 2004, but to also contemplate its eventual renewal for a ten-year period (2005-2014). Such renewal would depend on a general evaluation of its results during the 2002-2004 three-year period, particularly bearing in mind whether the beneficiary countries have fully availed themselves of these preferences, their progress in the struggle against illicit drugs, and their compliance with the main labor regulations agreed upon by the International Labour Organization (ILO). As a result, a Joint Andean Community-European Commission Technical Evaluation Meeting was held on the utilization of the "Andean GSP" in Quito (November 2002), at which the Andean Community pointed out the several factors impacting on such utilization, and both parties agreed to exchange, periodically, statistical and other information required to expedite both the possible extension of the regime for a longer term and the expansion of its product coverage.

However, Section 12 of the European Regulation provided for the application of a grading mechanism to the entire Generalized System of Preferences of the European Union, which entailed the gradual phasing out of tariff preferences for certain products. On January 15, 2003, the Andean Council of Ministers of Foreign Affairs formally requested that this regime not be applied to the Andean countries, on the basis of the co-responsibility, integrality, balance and multilaterality principles upon which the "Andean GSP" is founded as a means to contribute to the world fight against drug trafficking and related crimes. Thus, they secured the extension of the term set for the regime until December 31, 2005, without application of the grading mechanism, while its eventual extension for a further ten years will be postponed pending the outcome of the other steps being taken, as described below.

Political Dialogue: Moving Towards an EU-Andean Community Free Trade Agreement?

According to guideline 21 of the Declaration of Santa Cruz (January 2002), the Andean Presidential Council reaffirmed the purpose of consolidating an association with the EU and entrusted the Andean Council of Foreign Ministers with the task of coordinating the Andean position in this respect and expediting the high level political arrangements before the Chair of the EU, the Troika and other European countries, in order to discuss this issue during the II Summit of Heads of State and Government of Latin America, the Caribbean and the European Union to be held in Madrid (May 2002). At this summit, the CAN and the EU agreed to negotiate a Political Dialogue and Cooperation Agreement as a prior step to the eventual commencement of negotiations for an Association Agreement between both parties. On the latter point, the European position taken up in the Madrid Declaration was extremely clear when stating that the "progress of regional integration" (meaning the deepening of the Andean subregional integration, in particular) was a precondition for beginning to negotiate such an agreement. And this was a relevant condition because the joint Andean position sought to include a CAN-EU free trade agreement in the Association Agreement; this position was formalized in the "Priorities in the Andean Community’s Relationship with the European Union Aide Memoire" submitted by the Andean Council of Foreign Ministers to the European Troika in September 2002.

Notwithstanding this joint Andean position, the national authorities of some CAN member countries (particularly Ecuador and Peru) were in favor of their respective countries taking parallel steps before the EU to negotiate bilateral free trade agreements, perhaps because they foresaw difficulties in moving forward on the Andean customs union process (see Section A of Chapter III) that would prevent compliance with the European condition for a group free trade agreement. In any case, this parallel work did not preclude the joint Andean foreign action, so that the foreign affairs ministers of the Andean Community and the European Union countries were able to meet in Athens (March 2003) where they announced the commencement of negotiations for signing the Political Dialogue and Cooperation Agreement provided for in the Madrid Declaration. Those negotiations were conducted in two rounds (Brussels and Quito, respectively) and ended on October 15, 2003. The resulting agreement, signed in Rome (on December 15 of the same year), is better than its 1992 preceding version because it envisions a well-structured political dialogue on several fronts and expands cooperation beyond trade and economic issues to include new areas, such as peace and security, political and social stability, democratic governance, and migrations.[12]

As regards the possibility of a CAN-EU Association Agreement including an free trade agreement between both integration blocs, the European Commission, probably bearing in mind the bilateral work that some Andean countries were undertaking in parallel, sent a Communication to the European Parliament and the European Council (April 7, 2004) on its objectives regarding the Third Summit of Heads of State and Government of Latin America, the Caribbean and the European Union, to be held in Guadalajara (May 28-29, 2004). This Communication reiterates that a precondition for such intergroup agreement is that a sufficient degree of integration be reached, and specifies the three respective evaluation criteria: the existence of a fully operational institutional framework; the creation, and notification to the WTO, of a customs union consistent with Article XXIV of the GATT; and the reduction of non-tariff barriers to intra-regional trade. Paragraph 53 of the Guadalajara Declaration resulting from the Third Summit, at which the CAN submitted a joint work program proposal for opening these negotiations, salutes the decision to start a process conducive to the conclusion of association agreements with CAN and Central America, and states that this process will begin with a joint assessment of the respective economic integration processes.

C. MERCOSUR

Figure 14 shows the upward trend of the CAN-MERCOSUR trade in the 1993-2002 period, especially as regards the Andean imports (which grew at an average annual rate of 7.4% during that period). The Andean exports to the other South American subregion, of which petroleum and its derivatives alone accounted for more than 50 percent, did not increase that much. Unlike Andean imports, they were negatively affected not only in 1998 (as a consequence of the financial crises of that year) but also over the 2001-2002 period in particular, because of the Argentine crisis and the other adverse factors already described in Section A of Chapter I, in addition to Brazil’s increasing oil production.

However, the relative importance of MERCOSUR as a CAN trading partner is still quite modest. As shown by Table 9 (Section C of Chapter I), its 9.7 percent share of Andean imports (in the 2000-2002 three-year period) puts it in fifth place as regional provider of CAN, after the NAFTA, the EU, CAN itself and East Asia as a whole. After the same regions or subregions arranged in the same order, MERCOSUR is also the fifth market of destination for Andean exports, in this case with a very small share (3%). Such a weak positioning as being ranked fifth at both ends of the Andean trade chain applies to four CAN member countries; in the case of Bolivia, however, MERCOSUR is its first import provider by far and its second market of destination, although it is closely followed by CAN itself. But the vast majority (in excess of 80%) of all Andean countries’ exports to MERCOSUR are commodities, which is a worrisome repetition, at the level of the South American inter-subregional trade, of the primary exporting pattern that has traditionally distinguished Andean countries’ integration into the world market.

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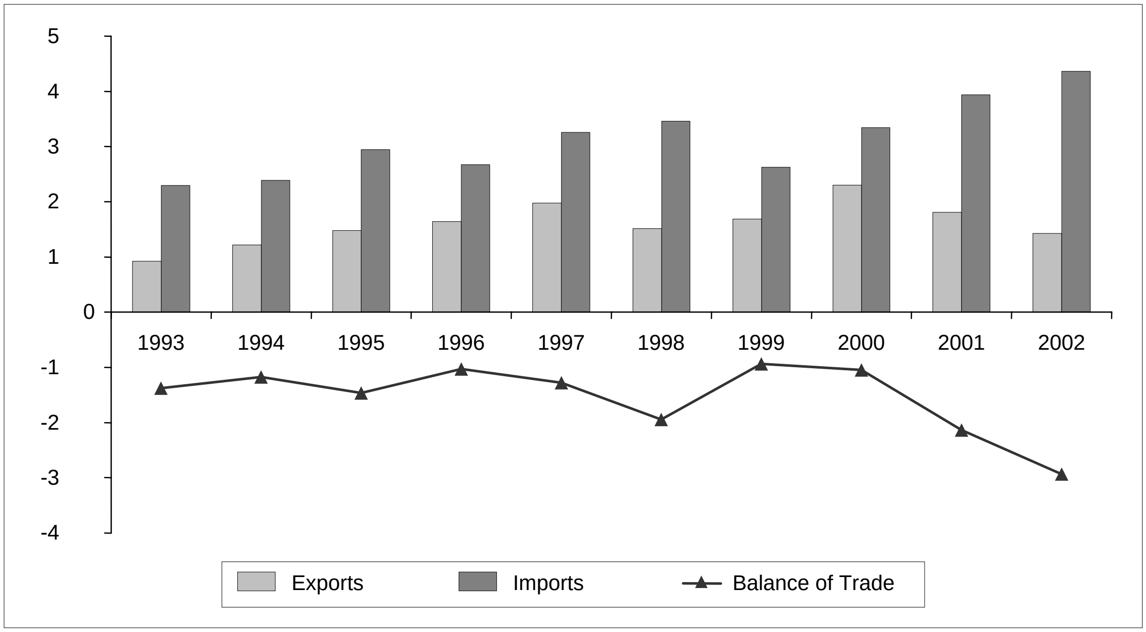
[12] Under this new framework, the discussions of the Secretary General of the CAN with the Commissioner for External Relations and the Commissioner for Trade of the European Commission, in April 2004, led to the conclusion of a technical assistance agreement to strengthen the Andean subregional trade integration and policy-making, and to support the international trade negotiations of the Andean countries.

FIGURE 14
MERCOSUR-CAN: 1993-2002 TRADE FLOWS AND BALANCE OF TRADE
(In US$ billions)



Source: General Secretariat of the Andean Community [2004d]. Preparation: In-house.

In spite of that, the up side is that the above is already showing a correlation in the area of investments. Indeed, Table 24 (Section D, Chapter I) shows that the FDI of the MERCOSUR countries in the CAN reached US$ 3.027 billion in 1994-2002 (which represented a 3.7% of the total FDI flow into the Andean subregion during that period), and that more than three fourths of that amount went to Bolivia (42%) and Venezuela (34%), mostly into primary exporting activities. In addition, since that amount almost equals the US$ 3.120 billion of Canada and Mexico taken together (resulting from deducting the US$ 15.490 billion of the USA from the US$ 18.610 of the NAFTA), there is, then, a virtual tie between these two North American countries combined and MERCOSUR in the third place (after the EU and the USA) as regional source of the FDI received by the CAN during the same period, which is unheard of in the recent history of the economic relations between both South American subregions.

Therefore, the economic rationale for the efforts to strengthen the CAN-MERCOSUR integration, whose recent achievements are reported below, is based on the generally increasing trends in trade and investment between both subregions and promotes the full development of these trade flows. To this end, it is necessary to remove the barriers of different nature that still contribute to the low relative importance of the CAN-MERCOSUR trade and that, particularly, prevent their manufacturing composition from being comparable with the trade and investment profile within each of the two subregions. This economic rationale is reinforced by the political rationale of moving forward towards the amalgamation of the two main South American integration blocs, this being a specific goal whose particular validity and significance seem to be emphasized, instead of diminished, by the current process of trade liberalization in the rest of the American continent.

New Foundations for the CAN-MERCOSUR Integration

Taking as a basis the first phase of negotiations that ended with the signing of the Economic Complementarity Agreements (ECAs) between CAN and Brazil (August 1999) and Argentina (June 2000) (INTAL [2002] pp. 86-89), the Andean Presidential Council decided to relaunch such negotiations in guideline 24 of the Declaration of Santa Cruz (February 2002). To that effect, the Andean foreign ministers met with their MERCOSUR counterparts at the XVI Summit of Heads of State and Government of the Group of Rio (San José, April 2002) and issued a joint communication stressing the economic, social and political priority their governments accorded to the convergence of both integration processes in the South American continent. This expedited the resumption, on May 10, 2002, of trade negotiations aimed at creating a free trade area (FTA) between the two subregions, which were accompanied by a political dialogue at the highest level as part of the agreements concluded at the Second Summit of South American Presidents (Guayaquil, July 2002).

The trade negotiations led to the execution of a CAN-MERCOSUR Framework Agreement (ECA No. 59, December 2002) which set the following objectives: creating an FTA; promoting investments and developing the physical integration of the Parties; fixing December 31, 2003 as the deadline for negotiating the liberalization program required to achieve the first objective. It was pointed out that Bolivia could take such steps as deemed necessary to harmonize the relevant parts of its ECA No. 36 with MERCOSUR (in December 1996) with the agreements to be reached by the other Parties. Drawing up the working arrangements and schedule to conclude negotiations for the Free Trade Area within the agreed term was, on the Andean side, entrusted by the Andean Presidential Council to the Commission of the Andean Community, with the support of the General Secretariat, in guideline 17 of the Quirama Declaration (June 2003). In turn, guideline 7 of the same Declaration instructed the Andean Council of Foreign Ministers to hold the First Political Dialogue and Cooperation Meeting between the Andean Community and MERCOSUR countries, and Chile (which participates as a full member in the so-called Political MERCOSUR).

It was at this time that Peru, the only CAN member that had not yet adopted a Common External Tariff (CET), decided on bilateral negotiations with MERCOSUR. Thus, it became the second Andean country (Bolivia had been the first) to sign an ECA No. 58 (on August 25, 2003) with, and to be admitted as an Associate Member of, MERCOSUR, status that was formalized at the Summit of MERCOSUR Presidents (Montevideo, December 16, 2003), at which meetings it has participated ever since. However, the implementation of the FTA provided for in ECA No. 58 was suspended pending certain specific issues (particularly the tariff phaseout lists, rules of origin, and non-tariff measures) were negotiated by Peru with the four MERCOSUR members. Such negotiations were successful with three of those members, but the fact of conducting them in sequential order made it more difficult to reach consensus with Uruguay. By May 2004, Peru had not yet been able to bring these last negotiations to a successful conclusion.

On the other hand, the joint and simultaneous trade discussions held in the second half of 2003 by Colombia, Ecuador and Venezuela with the four MERCOSUR member countries led, after four monthly rounds, to the seven countries signing an ECA on December 16, 2003, and successfully reaching agreement, on April 3, 2004, on almost all of the specific FTA implementation issues, with the intention that the ECA become effective on the scheduled date (July 1, 2004).

It is interesting to note that the above-mentioned study by IDB experts found, applying the computable general equilibrium model, that the potential economic impact that an FTA with the four MERCOSUR members could have on each of the five CAN members would, as regards the real GDP, provide fewer benefits than the FTAA or a free trade agreement between the USA and the ATPDEA Countries (except for Venezuela in the latter case). But, in exports, the resulting benefits compared with that free trade agreement would be greater for Bolivia (and Venezuela, obviously), almost the same for Ecuador and clearly lower only for Colombia and Peru, although, in all cases, they would be definitely lower than those of the FTAA (Monteagudo *et al.* [2004] Table 6).

D. Negotiations at the WTO and on the FTAA: Andean Participation

In the area of multilateral arrangements, in guideline 23 of the Declaration of Santa Cruz, the Andean Presidents considered that the best method of making headway in the negotiations with the WTO was to arrive at concerted positions. Thus, they decided that the strategy to be adopted concerning similar issues should allow a coordinated approach to the agenda outlined at Doha (November 2001). As regards the hemispheric issues, in guideline 22 of the same Declaration, the Andean Presidents reasserted the need to perfect an overall strategy for their countries' participation in FTAA negotiations and reaffirmed their intention to continue working jointly and under a single spokesmanship for such process. Subsequently, in guideline 20 of the Quirama Declaration (June 2003), the Andean Presidents referred to the significance of trade negotiations and the advancement of the integration process with third countries and economic blocs for their integration into the world market, and affirmed the need "to foster a process of political reflection within the Enlarged Andean Presidential Council in reference to the FTAA and the Andean Community's international positioning, without neglecting the advancement of the negotiations being furthered by the countries within the FTAA".

WTO

Despite the above-mentioned guideline of the Declaration of Santa Cruz, no Andean strategy has been adopted so far to develop a coordinated approach to the Doha Round negotiations. However, the joint CAN members defense of the GSP-Andean system before the WTO should be noted, in view of India' complaint against this preferential system on the grounds that it was inconsistent with the non-discrimination principle due to the difference it establishes among developing countries. The Andean countries filed a joint defense on February 2, 2004, which probably influenced the ruling of the WTO Appellate Body in April of the same year which, although upholding the allegation of inconsistency, decided that the EU might maintain the preferential regime provided certain conditions were established that justified the differential treatment of a group of developing countries under specific circumstances.

FTAA

Discussions on the scope and extent of the commitments to be assumed under the FTAA formation treaty escalated during the months prior to the VIII Meeting of the Ministers Responsible for Trade in the Americas (Miami, November 2003). The opposing positions were led, on the one hand, by the USA, which wanted this treaty to have a comprehensive thematic coverage similar to the NAFTA and the subsequent free trade agreements negotiated by the USA, and, on the other, by MERCOSUR members, particularly Brazil, according to which, since the USA intended to transfer the negotiations over the sensitive issue of agricultural subsidies and domestic support of agriculture to the WTO, the same should be done with other sensitive issues such as investments, intellectual property, government procurement and services. The latter position implied that the FTAA negotiations would be focused on some areas, such as tariff phaseout, sanitary and phytosanitary measures, trade facilitation, and dispute settlement procedures, all the time considering the application of the special, differential treatment in light of each economy's size and relative level of development. For that reason, this position was characterized as a "Light FTAA".

Under such circumstances the XV Meeting of the Members of the Trade Negotiations Committee (TNC) of the FTAA (Port-of-Spain, October 2003) took place, charged with reaching a concerted position for the above-mentioned ministerial meeting in Miami, at which three Andean countries (Bolivia, Colombia and Peru) plus other ten countries of the Americas (Canada, Costa Rica, Chile, El Salvador, Guatemala, Honduras, Nicaragua, Mexico, Panama and the Dominican Republic) jointly presented a document entitled "Vision of the FTAA". This document was quite close to the US position, in that it stressed that negotiations had to set a goal as ambitious as possible, since only by getting commitment in all areas was it going to be possible to achieve the required balance for participating countries to benefit from them. It also pointed out that negotiations had to take into account the needs of the smaller economies and the different levels of development, and had to be conducted so as to prioritize the exchange of constructive ideas in all areas in order to reach consensus among the delegations.

As is known, the Miami ministerial meeting failed to solve the substantive issue of the FTAA structure being discussed, which could not be settled by the subsequent XVII TNC Meeting (Puebla, February 2004) either. But, in compensation, the Miami Declaration adopted flexibility in the scope and extent of commitments (by sector and/or negotiation subject) as the new guiding principle in the formation of the FTAA and, as a valid basis for that formation, the bilateral or multilateral free trade agreements among countries of the Americas ready to assume broader and more in-depth commitments. At the same time, it also acknowledged as valid the choice of other countries in the region not to take that route without thereby being bypassed by the FTAA process. This pragmatic, bridge-laying flexibility allowed the CAN members to issue a Joint Communication (March 2004) with the MERCOSUR members and with Chile in which they reassert the guiding principles consolidated in the Miami Declaration; stress the fact that the FTAA negotiations need flexibility to take into account the needs and sensitivities of all participating countries, particularly the small economies; and pledge their efforts to have the forthcoming TNC meeting (June 2004) reach results satisfactory to all, on the basis of a joint, balanced set of rights and obligations, and of the procedures required to negotiate multilateral agreements among such countries as may be willing to do so.

Insofar as the Andean subregional institutions are concerned, in addition to the above-mentioned Program of Support for International Trade Negotiations created by the General Secretariat and the Andean Development Corporation (CAF) with the cooperation of the IDB and the EU (CAN General Secretariat [2004c]), both the General Secretariat and the CAF are actively supporting the implementation of the Hemispheric Cooperation Program (HCP) approved at the VII Meeting of the Ministers Responsible for Trade in the Americas (Quito, November 2002). Its aim is the capacity building in the case of those countries requiring assistance to properly participate in negotiations; to carry out their trade commitments; to face hemispheric integration challenges; and to take advantage of any benefits deriving from such integration, thus improving the competitiveness of their economies. At the end of the Initial Meeting with Donors held in Washington D.C. (October 2003), the CAN delegation announced a forthcoming subregional board meeting at their institutional headquarters in Lima, to move forward in the design of the strategies guiding the FTAA's HCP implementation in the Andean subregion.[13]

At the same time, the General Secretariat promoted studies on the potential economic impacts of the FTAA on the CAN members. Among them is a study which also applies the general computable equilibrium model and takes into account that the FTAA will dilute the preferences of the four Andean countries in the US market (previously under the *ATPA* and now under the *ATPDEA*), also enjoyed in other markets in the continent jointly with Venezuela (through existing trade agreements). Therefore, the results of this study show that, although consumer welfare should increase due to the removal of tariffs, any additional trade benefits to producers attributable to the FTAA would obviously be fewer than under a hypothetical scenario that disregards existing preferences and, in addition, could be offset by the increased competition resulting from the leveling of preferential access to all hemispheric markets. For this reason, even the net total excess amount could be reduced (Light [2003] p. 43). In any case, this study acknowledges that the

[13] For more information, please refer to the resource materials for the Regional Seminar entitled "*La CAN en las negociaciones del ALCA*" (*http://www.comunidadandina.org/exterior/alca.htm#Programa*).

model used only captures the static effects deriving from the trade of goods, not the trade of services, or any other potential benefits resulting, for instance, from greater competition, foreign investment or the transfer of technology.

Note that, unlike the study conducted by the IDB experts, this study does not focus on benchmarking the economic impact of the FTAA with that of other future agreements, such as the free trade agreement between USA and the ATPDEA Countries, and the CAN-MERCOSUR FTA, but on reviewing the commercial impact of the FTAA in light of the already existing continental agreements. However, the results of both studies coincide in that the intra-CAN trade is part of the continental trade whose current direction would be changed by leveling the hemispheric preferences. Indeed, the IDB experts (Monteagudo *et al.* [2003]) find that the intra-CAN trade would diminish, particularly with respect to the Andean exports that enjoy greater preference margins in the subregional market. Of these, the exports of Ecuador and Venezuela would sustain the most damage, and the benefits would be reaped by the exports of Colombia and Peru to each other, and the exports of Bolivia to all CAN members (Table 34).

TABLE 34
IMPACT OF THE FTAA ON THE GROWTH OF ANDEAN INTRA-CAN EXPORTS AND EXPORTS TO THE AMERICAS MARKET
(Percentage)

Origin Destination	FTAA	Bolivia	Colombia	Ecuador	Peru	Venezuela
Bolivia	15.30	--	1.89	3.16	13.92	3.60
Colombia	7.62	-9.27	--	-0.67	3.02	-1.65
Ecuador	9.11	-10.96	-4.74	--	-0.08	-1.91
Peru	15.96	-1.96	7.29	-0.05	--	7.76
Venezuela	6.99	-10.45	-2.91	-2.82	-0.81	--

Source: Monteagudo *et al.* [2003] Slides 16 and 21.

Another study deals with the fiscal impact of the FTAA on the Andean economies. Bearing in mind that the resulting reduction in tariff revenues would only be relatively significant to the imports from the USA and Canada, but not so in the case of other imports from most of LAC, due to the already existing preferential agreements in the region, the study concludes that the impact caused by losing tariff revenues would be limited in terms of the GDP, as it would range between 0.4% (Bolivia) and 1% (Ecuador) (General Secretariat of the Andean Community [2003d] p. 41). In terms of public revenues, however, such loss would be significant because tariffs represent between 6% and 11% of the CAN member countries' tax receipts (Light [2003] p. 4). Trade liberalization processes on a large scale, such as the FTAA or the free trade agreements between the Andean countries and their main economic counterparts, make it mandatory, therefore, for the Andean countries to restructure their permanent sources of tax revenues as soon as possible.

Contents

CHAPTER III. ANDEAN INTERNAL AGENDA

The previous chapter testified to the top priority accorded by members of the Andean Community of Nations to their arduous and, in general, fairly successful efforts in recent times to negotiate free trade agreements with third countries or groups of countries, particularly with the great powers traditionally more prominent in the political and economic relations of Andean countries. Undoubtedly, this priority is logical, given both the considerable relative weight these powers still carry in the trade and investment flows of Andean economies, and the little quantitative weight intra-CAN trade and investment still have in such flows, despite their rising trend in the past decade, as seen in Chapter I of this Report. On the other hand, that chapter also highlighted the great qualitative significance of intra-CAN trade, which, being mainly composed of manufactured exports, is clearly differentiated from the traditional primary-product export pattern which is still the distinctive feature of the Andean incorporation into extra-subregional markets. Andean countries are fully aware of this qualitative significance, especially those which, due to, among other factors, their more skillful participation in the Andean FTA and the CET have been able to take better advantage of the enlarged subregional market as a platform to enhance their attractiveness for manufacturing FDI and to industrialize their production processes, thus developing competitive advantages both at an intra-CAN level and in larger markets that are more difficult to penetrate.

Nonetheless, the Andean Community advocates an ambitious integration model, which, being European in inspiration, includes supranational standards and Community instruments, starting with those necessary to establish a Customs Union, as a critical stage in the way to the creation of a common economic area. This stage is still foremost among the Andean Community objectives, possibly due to the fact that its Member Countries are aware of the qualitative significance of their Andean integration, but at the same time they are also aware that their largest interdependency is not on themselves but rather on third countries or regions. These are the economic fundamentals of the dilemma posed by some circles in the Member Countries regarding world or Andean Community integration. Others reply by claiming that it is not "or" but rather "and". This dilemma is more specifically translated into whether the Customs Union should be perfected or not. If the answer were affirmative, the next question would be to what extent. As will be seen below, the dilemma is still valid for the Andean countries, which accounts for the postponement, during the period covered by this report, of the objective of perfecting the Customs Union, an objective that has not, nonetheless, been abandoned, nor have the countries ceased moving forward in other areas related to the building of the Andean Common Market.

A. Towards Perfecting the Andean Customs Union?

In accordance with the above-mentioned integration model, which regards the Customs Union as a necessary stage for the establishment of a Common Market, the Andean Presidential Council, which reaffirmed its commitment to establish a Subregional Common Market in the opening paragraph of the Declaration of Santa Cruz in January 2002, devotes guidelines 11 to 14 of this declaration to those tasks still pending for perfecting the Andean Customs Union. The first ten guidelines are aimed at concluding one of its basic components: the subregional FTA. These political mandates were later supplemented with the Quirama Declaration, resulting from the Fourteenth Andean Presidential Council, held in June 2003. This declaration sets out guidelines on the areas of action also linked to the Customs Union, such as the harmonization of customs regulations and special sectoral policies.

Free Trade Area

During the period under review, CAN's FTA has consolidated, together with NAFTA, its status as one of the two most advanced subregional FTAs in the American Continent as regards the proportion of subheadings pertaining to the trade in goods among Member Countries which are already fully duty-free.[14] At the beginning of this period, in January 2002, the total elimination of some lists of exceptions in the FTA established by four Member Countries (Bolivia, Colombia, Ecuador and Venezuela) since 1992-1993 was yet to be concluded in order to complete the Andean FTA. Furthermore, the Liberalization Program agreed on between Peru and its Andean partners was going through its final stages. This program was adopted by means of Decision 414, in July 1997, with the reincorporation of Peru into the subregional FTA. It was then determined that the process was to be completed by December 31, 2005, as described in Andean Report 1 (INTAL [2002] pp. 9-11).

The issue of exception lists was implicitly addressed in Guideline 1 of the Declaration of Santa Cruz de la Sierra, which established that the Andean Free Trade Area was to be consolidated and perfected by June 1, 2002. In accordance with this mandate, the pending lists of exceptions that existed among Bolivia, Colombia, Ecuador and Venezuela were eliminated (even if not all the countries did so within the stipulated timeframe). As a consequence of this, all trade among these four countries is carried out with a 0-base tariff.

Regarding the Liberalization Program, as of January 1, 2002, Peru granted a 0 tariff to its intra-subregional imports of the products included in Annex VIII of Decision 414. These include medicines, insecticides, fungicides, herbicides, disinfectants and raticides. Following that, and as part of the intra-Andean negotiation that enabled the agreements provided for under the Declaration of Santa Cruz, Peru made a commitment to move the deadline for the elimination of customs duties on oil and fuels forward, from December 31, 2005 to December 31, 2003. However, December 31, 2005 is still the deadline for agricultural products to be free of customs duties, as was set out in Guideline 2 of the same declaration. The significance of this Peruvian concession is evident, considering that oil and its derivatives account for about 50% of intra-subregional Peruvian imports and that the tariff level this country applies to these products is 20%. This is why Peru agreed to put this concession into force provided that other commitments on non-tariff restrictions and trade defense measures creating distortions in subregional trade were fulfilled. These commitments were registered in several of the first fourteen guidelines of this same declaration, especially in Guidelines 3, 7, 8, 9 and 14. Nonetheless, CAN has not made substantive progress in this regard. In particular, Member Countries have reacted in a slow and incomplete manner to the inventory of barriers to trade that the General Secretariat submitted to them during the 113th Special Session of the CAN Commission, in July 2002. It is, therefore, not surprising that the Commission has not yet been able to adopt a Decision based on Proposal 80/Rev. 1 (July 2002), which was submitted to it by the General Secretariat to implement the advancing of the deadline for the elimination of oil and fuel customs tariffs set out in Guideline 2 of the Declaration of Santa Cruz, moving forward the date of December 31, 2005 stipulated under Decision 414. As a result, this deadline is still in force.

This explains the current situation of the Liberalization Program agreed on between Peru and its Andean partners, detailed below in the latest report on this issue by the General Secretariat, which includes data up to January 2004 (SG-CAN [2004a] p. 3 ff.). It is worth mentioning that, under Article 2 of Decision 414, the liberalization agreed on through the bilateral agreements signed by Peru with its Andean partners between 1992 and 1993 remains in force in all cases, as long as this liberalization grants a more favorable treatment. It is for this reason that the liberalization adopted by Peru and Bolivia under the relevant bilateral agreement, renewed in November 2001, is kept in force. This agreement provides for duty-free entry into Bolivia of all Peruvian products complying with the rules of origin established by Decision 416 (July 1997). For its part, Peru, has already eliminated 99.8% of its tariff universe with Bolivia, with just 13 NANDINA subheadings remaining to be totally free of tariffs (*Idem*, pp. 3-5).

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[14] In fact, an analysis of the trade in goods liberalization programs implemented by preferential trade agreements in force in the continent (Devlin and Estevadeordal [2001] p. 11 and Figure 3) has found that by 2005, 100% of the universe of intra-Community trade subheadings will have been granted zero tariff, a reflection of a perfect subregional FTA in goods, only comparable in the whole continent with NAFTA, as well as with a few bilateral agreements in the Central American Common Market, and with the bilateral agreement between Chile and Mexico.

Table 35 shows the situation of the liberalization program of Colombia, Ecuador and Venezuela with Peru, while Table 36 shows the state of affairs of the liberalization program of Peru with each of these three Andean countries. In the case of Peru with Ecuador, in accordance with Decision 414, and with the application of the Agreement to Accelerate and Intensify Free Trade signed between these two countries in November 1999, Ecuador has already eliminated 99.5% of the tariff universe applied to Peru; only 33 NANDINA subheadings remain, for which, tariff elimination is under way. In turn, Peru has totally eliminated 99.1% of the tariff universe applied to Ecuador; only 59 NANDINA subheadings remain, still going through a deregulation process.

TABLE 35
LIBERALIZATION PROGRAM OF COLOMBIA, ECUADOR AND VENEZUELA WITH PERU
Updated: January 2004 (in number of NANDINA subheadings)

Annex to Decision 414	Colombia		Ecuador		Venezuela	
	Deregulated	Deregulation under way[1]	Deregulated	Deregulation under way[1]	Deregulated	Deregulation under way[1]
	6,531		6,525		6,516	
Annex V		6		2		9
Annex VI		21		22		22
Annex VII				9		10
	6,531	27	6,525	33	6,516	41

Note: [1] All NANDINA subheadings for which tariff elimination is still under way have a 20% tariff that is applied to third countries.
Source: CAN General Secretariat [2004a] pp. 3-5. In-house preparation.

TABLE 36
LIBERALIZATION PROGRAM OF PERU WITH COLOMBIA, ECUADOR AND VENEZUELA
Updated: January 2004 (in number of NANDINA subheadings)

Annex to Decision 414	Colombia		Ecuador		Venezuela	
	Deregulated	Deregulation under way[1]	Deregulated	Deregulation under way[1]	Deregulated	Deregulation under way[1]
	6,484		6,499		6,484	
Annex V		13		2		12
Annex VI		47		43		47
Annex VII		14		14		14
	6,484	74	6,499	59	6,484	74

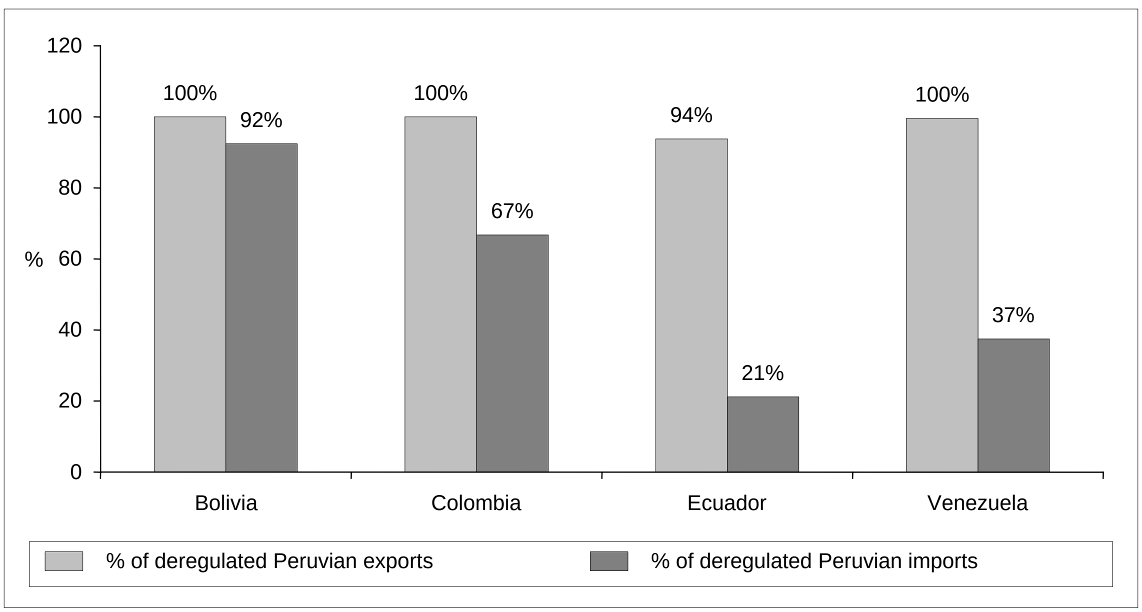
Note: [1] All NANDINA subheadings for which tariff elimination is still under way have a 20% tariff that is applied to third countries.
Source: CAN General Secretariat [2004a] pp. 3-5. In-house preparation.

As for Colombia and Venezuela, in accordance with Decision 414, as well as with the Most Favored Nation Clause of the Cartagena Agreement (set forth in its Article 139, according to the text in Decision 563 of June 2003), applied in these cases due to the preferences granted to third countries in the region by these two countries, Colombia has completely eliminated 99.6% of the tariff universe applied to Peru, while Venezuela has done the same with 99.4%. Peru has eliminated 98.87% of the tariff universe applied to Colombia and 98.89% of that applied to Venezuela.

From this it follows that, in accordance with the staging of the liberalization program agreed on through Decision 414, up to January 2004 Peru had completely deregulated a smaller proportion of NANDINA subheadings with tariffs applied to each of its Andean partners than they had with Peru, although, in all cases, the difference was slight in terms of the number of subheadings. However, the difference is significant in terms of the proportion of trade yet to be completely deregulated, in particular regarding bilateral Peru-Ecuador and Peru-Venezuela trade. The main reason for this lies in what was explained above about oil and its derivatives.

In fact, while 100% of Peruvian exports enter Bolivia, Colombia and Venezuela duty-free, the 9 Peruvian fuel subheadings not yet deregulated in Ecuador account for 6.23% of this trade flow. The proportion of Peruvian imports from Bolivia of the 13 subheadings of agricultural products for which tariffs are still being charged in this trade flow is not large either (7.55%). The reverse is the case, however, in terms of the pending Peruvian deregulation with Colombia, which has a significantly higher weight of trade (33.15%: 26.87% are hydrocarbons and 6.28% are agricultural products). This weight is much more significant for hydrocarbons that have not yet been deregulated in Peruvian imports from Ecuador (77.86%) and from Venezuela (62.50%) (*Idem*, pp. 8-9). Figure 15 shows in greater clarity the differences between the proportions of Peruvian import-export trade that have been completely deregulated with each of its four Andean partners.

FIGURE 15
PROPORTION OF DEREGULATED PERUVIAN INTRA-CAN TRADE



Source: CAN General Secretariat [SGCAN 2004a] p. 7. In-house preparation

Common External Tariff

The Declaration of Santa Cruz (January 2002) is a landmark for CAN because it sets forth Peru's political decision of ending its long period of self-exclusion from the Common External Tariff (CET) mechanism, a fact that kept it out of the CET adopted by its four Andean partners through Decision 370 of November 1994. This new CET applying to all CAN members was outlined in Guidelines 11 and 12 of said declaration, in which the Andean Presidents point out that the CET will have a general four-tier structure (0%, 5%, 10% and 20%). The main difference between this new CET and the one provided for in Decision 370 is the elimination of the 15% tier. Within this structure, an exception is partly made for the Bolivian case, since this country is not forced to apply the 20% level. The Presidents also state that each country may apply, in the degree to which its fiscal possibilities permit, a 0 tariff to the capital goods it does not produce; that Ecuador is authorized to gradually reduce its customs tariffs on raw materials and inputs not produced in the subregion; and that the new CET is to be put into effect by all five Member Countries no later than December 31, 2003.

In compliance with this political mandate, CAN's Enlarged Commission (body which comprises the Ministers of Foreign Trade and Foreign Affairs) approved Decision 535 in October 2002, which provided legal implementation of the new CET, structured according to the four tiers mentioned in the Declaration. This CET was adopted for 62% (4,171 NANDINA subheadings) of the tariff universe listed in Annex I of this Decision,[15] with the exception that Bolivia may apply a 10% tariff on all subheadings placed in that Annex within the 20% tier. A deadline was established for the CET to be effective: not later than January 1, 2004. As regards the 38% of the tariff universe on which agreement among the five Andean countries could not be reached, Decision 535 prescribes that Bolivia, Colombia, Ecuador and Venezuela will continue applying the tariff structure stipulated under Decision 370, whereas Peru will continue applying its national tariff. Furthermore, the five CAN members were bound to try and reach an agreement on the remaining 38% within the above-mentioned deadline for the new CET to be put into effect. Decision 535 also specifies that all Member Countries may defer down to 0% both tariffs on raw materials and inputs not produced in the subregion (provided these are included in the list of goods kept by the General Secretariat), and tariffs on the capital goods that are not produced in the subregion listed in Annex II of this Decision.

Approval of Decision 535 proved that CAN is flexible enough to operate with an incomplete CET, which, nonetheless, involves all Member Countries. It also indicated the Andean willingness to maintain a joint position in the negotiations with the FTAA, since this decision was approved in the full knowledge that the deadline for communicating the base tariff (or the deregulation starting point) was drawing nearer. This would the basis for the exchange of customs tariff deregulation proposals and requests within the framework of these negotiations, and CAN Members were determined to keep, as far as possible, their Andean CET as their base tariff for the FTAA. Actually, this determination spurred negotiations in the following months about the pending 38% and it explains the fact that, even if these negotiations proved fruitless, on April 14, 2003, CAN Members sent a joint notification to FTAA's competent authorities whereby they reported that their base tariff would consist of the new CET agreed on by the five countries for 62% of the tariff universe. Furthermore, for the remaining 38%, Peru notified that it would apply its national tariff, whereas Bolivia, Colombia, Ecuador and Venezuela stated that they would use the tariff tiers provided for by their CET under Decision 370, including all exceptions, amendments and updates introduced at a later date through Decisions 396 and 465. What this means is that these four Andean countries communicated a CET they all had agreed on for 100% of their tariff universe.

In the next months of 2003, as January 1, 2004, the deadline for putting the new CET into effect, was approaching, it became increasingly apparent that this deadline would not be met due to difficulties in achieving an agreement not only on the 38% of the tariff universe not included in Annex I of Decision 535 such as would please all five CAN Members, but also on the tariff levels of some products included in that annex. The difficulties related mainly to tariff increases Colombia and Peru had to apply on some products in accordance with the new CET and also to the Ecuadorian reluctance to abandon the special regime provided for under Decision 370, which granted it a tariff lower than its Andean partners by five percentage points for a significant set of 990 tariff subheadings (1,033 under the new NANDINA nomenclature) listed in Annex 4 of said Decision (SGCAN [2003i] p. 25).

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[15] This Annex I amends the Annex I of Decision 465 of May 1999, which, in turn, amended and updated Annexes 1, 2, 3 and 4 of Decision 370 and of Decision 396 of September 1996. See CET background in Andean Report No. 1 (INTAL [2002] pp. 11-15).

In this context, the CAN Commission preferred not to give up the CET goal, a possibility some authorities were raising, but to extend the deadline for it to become effective. This date was first postponed until March 1, 2004, through Decision 569 of December 2003, which establishes that so long as the new CET does not enter into force, Colombia, Ecuador and Venezuela may apply the tariff tiers included in the Annex of that Decision on the goods under Article 9 of Decision 370 and listed in its Annex 4. Then, the deadline was deferred until May 10, 2004, through Decision 577 of February 2004. And, finally, it was extended until May 10, 2005, through Decision 580 of May 2004, whereby the five Member Countries reiterated their commitment to continue strengthening the FTA and advancing towards the Andean Common Market.

For all practical purposes, Bolivia, Colombia, Ecuador and Venezuela are still applying among themselves the CET under Decision 370 (with the above-mentioned subsequent amendments and updates, including partial adaptations resulting from Annex I of Decision 535), while Peru remains outside the CET mechanism. Nevertheless, this time, the different approaches to tariff issues (flat tariff *vs.* staged tariff) are no longer the main cause for the delay in the adoption of a CET by the five member countries, something that was the case during the past decade. In fact, Peru, because of the reforms introduced in its national tariff as of 2001 (Fairlie, Torres and Cuadra [2003] p. 22), dealt with the negotiations leading to Decision 535 with a national tariff staged in 7 tiers (4%, 7%, 9%, 12%, 17%, 20% and 25%), which facilitated convergence with its Andean partners' CET, which was also staged, as expressed in Annex I of that Decision.

From a purely technical viewpoint, it would have been easier to make this convergence effective for 62% of the tariff universe, or even a larger percentage, had the 15% tariff level not been removed from the new general CET structure negotiated in Santa Cruz. This absence of the 15% tier made the implementation task more difficult not only for Peru but also for Colombia, since they were forced to increase their tariffs more than they would have liked to or more than it was necessary. Added to this was Ecuador’s inconvenience concerning the elimination of its special regime as a consequence of the new CET. This elimination, together with the one of the 15% tier, within the new general CET structure seem to be two of the factors that have most hindered the agreement on a CET by the five CAN Members, and that have contributed to its recent postponements. It is, however, likely that there have been other factors. A significant one appears to be the convenience of being able to change tariffs freely in a context in which negotiation of free trade agreements with third countries is given top priority, particularly when the five Andean countries do not negotiate jointly, as in the negotiations with the USA and MERCOSUR, as seen in Chapter II of this report. Chapter V of this Report provides an analysis of other possible factors.

From a technical point of view, it is interesting to analyze the characteristics of the CET in Annex I of Decision 535 and the implications of its adoption as benchmarked with the current tariff in CAN countries. This is what we will do below drawing on a summary of the most outstanding findings of an important study carried out by the General Secretariat (SGCAN [2003i] pp. 24-42). Firstly, it is worth mentioning that, while the Annex covers 62% of the tariff universe, its coverage in terms of trade is significantly narrower: just 34% of Andean total exports and 39% of Andean total imports (in both cases, the figures refer to annual averages during 1997-2002), as shown in Table 37. This means that most of both trade flows (66% and 61%, respectively) would still be covered by the tariffs in effect in each CAN Country. In 2002, the year considered for this calculation, being the year of Decision 535 approval and also because of data availability, these tariffs were the Peruvian national tariff and, for the other four countries, the CET under Decision 370. In fact, these tariffs are still effective, as seen before.

Secondly, it its worth highlighting the general adequacy of the coverage of that Annex to the realities of Andean trade, given that, intra-CAN trade, mainly dealing with manufactured goods, is logically more widely covered by exports (38%) than imports (32%), whereas, the opposite is also logically the case for the trade with third countries, in proportions (33% and 40%, respectively) not indicative of possible burdensome effects either on the costs of importing goods from third countries or for the basically primary composition of Andean exports to the world. In addition to this, as far as Peru is concerned (the Peruvian case is worth pointing out, since it is the only CAN Member not applying the CET mechanism), the proportion of coverage for its imports from third countries would be smaller (37%) and that of its intra-CAN imports (21%) would be even smaller. Moreover, this would be the country whose intra-CAN exports would be more widely covered (47%). This may be of benefit to a country that, partly due to its self-exclusion from the CET, has had a smaller participation within the Andean enlarged market than in the world market (as may be inferred from the analysis in Chapter I).

TABLE 37
CET UNDER ANNEX I OF DECISION 535 AND CURRENT TARIFF (2002): TRADE COVERAGE
(Average intra-CAN, extra-CAN, and total flows, 1997-2002)

Country	Area	Imports		Exports	
		CET under Decision 535	Current Tariff[1]	CET under Decision 535	Current Tariff[1]
Bolivia	3rd Countries	36%	64%	45%	55%
	CAN	38%	62%	23%	74%
	Total	36%	64%	41%	59%
Colombia	3rd Countries	45%	55%	47%	53%
	CAN	21%	69%	44%	56%
	Total	43%	57%	47%	53%
Ecuador	3rd Countries	33%	67%	54%	46%
	CAN	32%	68%	35%	65%
	Total	33%	67%	51%	49%
Peru	3rd Countries	37%	63%	54%	46%
	CAN	21%	79%	47%	53%
	Total	34%	66%	53%	47%
Venezuela	3rd Countries	41%	59%	11%	89%
	CAN	44%	56%	29%	71%
	Total	41%	59%	12%	88%
TOTAL	3rd Countries	40%	60%	33%	67%
	CAN	32%	68%	38%	62%
	Total	**39%**	**61%**	**34%**	**66%**

Note: [1] Current Tariff = CET under Decision 370 for Bolivia, Colombia, Ecuador and Venezuela; national tariff for Peru.
Source: CAN General Secretariat [2003i] Table 6.

What was suggested above regarding the cost of importing goods is further proved when comparing the current tariff average with the one that would be obtained if Annex I of Decision 535 were adopted. The latter, estimating the number of subheadings, would be significantly lower than the former for Bolivia in all categories of goods, whereas its total would be slightly lower for the remaining four Andean countries (Table 38). For these four countries, however, the reduction in the tariff average would not be insignificant for capital and intermediate goods, while the moderate increase in the tariff average on consumer goods would be very much related to the high percentage of agricultural products in this category. These results remain valid when the tariff average is trade-weighted, since in this case, the average is also lower for capital and intermediate goods, but moderately higher for consumer goods (Table 39). In this scenario, the total trade-weighted tariff average would remain the same for Ecuador, but it would be reduced by one percentage point for Bolivia, Colombia and Venezuela. Furthermore, while it would increase by one percentage point for Peru, this would be the consequence of what would happen with the dual-use goods and those not otherwise specified (the content of which is explained in the note to Table 38) (*Idem*, pp. 26-27).

TABLE 38
CET UNDER ANNEX I DECISION 535 AND CURRENT TARIFF (2002): TARIFF AVERAGE
According to subheading number (total and by category of goods)

Category	No. of Subheadings	CET Average		Tariff Averages (2002)				
		Dec. 535	Dec. 535 (Bolivia)	Bolivia	Colombia	Ecuador	Peru	Venezuela
Capital goods	426	5.82%	5.40%	6.00%	7.41%	6.96%	6.85%	7.62%
Intermediate goods	2,477	8.60%	6.67%	9.85%	9.18%	9.23%	9.43%	9.43%
Consumer Goods	1,243	18.78%	9.73%	9.97%	17.84%	18.03%	17.31%	18.00%
Dual-use Goods[1]	1	20.00%	10.00%	10.00%	35.00%	3.00%	12.00%	35.00%
Goods not otherwise specified[2]	24	12.71%	8.54%	10.00%	14.38%	14.58%	10.96%	13.33%
Universe 535	**4,171**	**11.38%**	**7.46%**	**9.50%**	**11.62%**	**11.65%**	**11.63%**	**11.83%**

Notes: [1] Subheading number 87031000, including special vehicles for the snow, for transportation in golf courses and similar vehicles.
[2] Includes several products, such as monetary gold, parachutes, ammunition for firearms, cutting and thrusting weapons, etc.
Source: CAN General Secretariat [2003i] Table 7.

TABLE 39
CET UNDER ANNEX I OF DECISION 535 AND CURRENT TARIFF (2002): TARIFF AVERAGE
Trade-weighted (total and by category of goods)

	Subheadings	Bolivia	Colombia	Ecuador	Peru	Venezuela
Trade-weighted Average of National Tariffs in 2002						
Capital goods	426	7%	6%	6%	7%	8%
Intermediate goods	2,477	10%	9%	9%	10%	9%
Consumer goods	1,243	10%	18%	18%	16%	19%
Dual-use Goods[1]	1	10%	35%	3%	12%	35%
Goods not otherwise specified [2]	24	10%	19%	19%	12%	15%
Universe 535	**4,171**	**9%**	**10%**	**11%**	**11%**	**12%**
Trade-weighted CET Average						
Capital goods	426	5%	5%	5%	5%	6%
Intermediate goods	2,477	8%	8%	8%	10%	8%
Consumer goods	1,243	10%	19%	19%	20%	20%
Dual-Use Goods[1]	1	10%	20%	20%	20%	20%
Goods not otherwise specified [2]	24	9%	15%	19%	19%	14%
Universe 535	**4,171**	**8%**	**9%**	**11%**	**12%**	**11%**

Notes: [1] Subheading number 87031000, including special vehicles for the snow, for transportation in golf courses and similar vehicles.
[2] Includes several products, such as monetary gold, parachutes, ammunition for firearms, cutting and thrusting weapons, etc.
Source: CAN General Secretariat [2003i] Table 8.

Based on what was mentioned above, it is possible to claim that, while the new CET would reduce consumer surplus due to increases in prices in the category of consumer goods, its net effect on the total surplus of Andean economies might as well be positive, not only because this category of goods includes labor-intensive activities that might be bolstered up by the stronger protection, but also because of the general improvement in production process competitiveness, which would enable a reduction in capital and intermediate goods import costs.

To obtain a better approximation to the potential impacts on the productive structures of Andean economies it is advisable to estimate the effective protection, calculated as the difference between the value added of a given product at its international and its domestic prices. These calculations were made in the study by the General Secretariat for all CAN Members excepting Venezuela (owing to the unavailability of the input-output table for this country). Total effective protection averages are shown in Table 40, which also indicates that, if Annex I of Decision 535 were put into effect, effective protection would be reduced for Bolivia, Colombia and Ecuador. Moreover, effective protection calculations by sector made as part of the study (and which are not detailed in this report, due to space constraints) lead to two significant conclusions. Firstly, while the Peruvian effective protection total average would be increased by 2.4%, this would be mainly due to increases in effective protection to export sectors such as non-ferrous metals, fish meal, and textiles and apparel (*Idem*. pp. 28-33 and Table 12). Of these three sectors, as shown in Chapter I Section E (Tables 27 to 29 of this report), Peru only has a consolidated comparative advantage in the first one, both in its world trade and its intra-CAN trade, and in the attractiveness for foreign direct investment (FDI), but not in the other two sectors. In fact, these two sectors might as well benefit from being underpinned by a greater effective protection. Secondly, in the four Andean countries under review, most of the increase in effective protection would take place in export sectors, particularly exports to the Andean subregional market (*Idem.* p. 42). Thus, the CET under Annex I of Decision 535 would play the important roles of preserving intra-CAN manufacturing exports, as well as of reducing the cost of capital and intermediate goods imports.

TABLE 40
CET UNDER ANNEX I OF DECISION 535 CET AND CURRENT TARIFF (2002): CHANGES IN EFFECTIVE PROTECTION

Countries	Effective protection		
	Current Tariff	CET under Decision 535	Change in effective protection
Bolivia	9.9%	9.6%	-0.3%
Colombia	14.93%	13.19%	-1.7%
Ecuador	19.42%	18.09%	-1.3%
Peru	18.5%	20.9%	2.4%

Source: CAN General Secretariat [SGCAN 2003i] pp. 29-32. In-house preparation.

The results summarized above, and other similar ones, point to the fact that there are seemingly no well-grounded technical reasons to justify the non-adoption to date of CET under Annex I of Decision 535. Indeed, while some sectors in particular might see their interests threatened by the required tariff changes, the general welfare would be served by the previously analyzed benefits that the CET would provide to each Andean economy. Since the practical corollary of postponement is the continuation of the CET under Decision 370 in four CAN Members and of the Peruvian self-exclusion from this Andean Customs Union mechanism, and since the differences in performance of the Andean countries regarding the trade and investment issues analyzed in Sections C through E of Chapter I may be partly explained by how they have availed themselves of this situation, it is not hard to understand Colombia and Ecuador's reluctance to change conditions. By contrast, what is difficult to understand is Peru's reluctance, at least from a technical standpoint.

Harmonization of Customs Regulations

Nonetheless, the reluctance of the five CAN Members to adopt a CET has not prevented them from making further progress towards the harmonization of their customs regulations, an important component for the creation of a Customs Union, which, as is widely known, implies, among other things, "the substitution of a single customs territory for two or more customs territories", as stated under Article XXIV-8-a of the General Agreement on Tariffs and Trade (GATT).

Pursuant to the instructions of the Andean Presidential Council in Guideline 26 of the Quirama Declaration (June 2003) on the implementation of the GRANADUA Project recommendations (see Chapter II Section B) related to the interconnectivity among customhouses and the uniform application of their regulations to reduce distortions and effectively fight smuggling and tax fraud in intra-subregional trade, the CAN Commission approved the following decisions in December 2003: Decision 570 on the Updating of the Common Nomenclature (NANDINA); Decision 571 on Imported Goods Customs Value; Decision 572 on the Andean Integrated Tariff (ARIAN); Decision 573 on the Andean Common Customs Training Program; and Decision 574 on the Andean Customs Control Regime.

B. Special Sectoral Programs

Agricultural Development Program

Another objective CAN Members have yet to attain is the establishment of an Andean Common Agricultural Policy. With this aim in mind, they have adopted a program comprising three elements: the Andean System of Price Bands (ASPB), the Andean Agricultural Health System, and the production chains created to promote the development of the subregional agricultural sector. However, the ASPB is still being applied by just three Andean countries (Colombia, Ecuador and Venezuela), while Peru uses its own system of agricultural price bands, and Bolivia does not apply any such mechanism. The ASPB and the Peruvian system differ mainly in that the latter includes a significantly narrower (45) tariff subheading base than the former (144). The Peruvian system makes use of a single methodology for calculating the bands of three out of its four marker products. The ASPB, on the other hand, works with thirteen bands and the nominal protection is not uniform, since band width varies upon different adjustment factors for certain marker products. And another difference is that floor and ceiling band prices are updated biannually in the Peruvian system vis-à-vis the annual update under the ASPB (Fernández and Honorio [2003] pp. 19-21). These ASPB traits and others have been criticized on various fronts. Andean Report 1 deals with these characteristics (INTAL [2002] pp. 18-19).

Through the Declaration of Santa Cruz (January 2002), the Andean Presidential Council sought to redress the situation described above. After reiterating the agreement for the adoption of an Andean Common Agricultural Policy (Guideline 15), the declaration provides for the establishment of agricultural price stabilization mechanisms reducing product coverage and guaranteeing their more transparent application (Guideline 16). It is also stipulated, immediately afterwards, that "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 agro-industrial chains" (Guideline 17). The latter phrase gives a clear indication of what the prevailing criterion should be for deciding between agricultural protection and agro-industrial competitiveness when it comes to amending the ASPB pursuant to the afore-mentioned mandate. This decision is, doubtlessly, not easy at all in some cases. It is, thus, not surprising that Guideline 24 was included in the Quirama Declaration (June 2003), in which the CAN Commission is instructed by the Andean Presidents to work with the Ministers of Agriculture so that "no later than September 30, 2003 [it take] a decision regarding the Common Andean Agriculture Policy, based on the consultations with the corresponding organizations and with the production sectors".

Agreement for the application of a new ASPB on the products listed in Annex III of Decision 535 (October 2002) by January 1, 2004 is expressed in Article 5 of this decision. However, this deadline was not met and no mention of that article was made in the subsequent Decisions 569 of December 2003, which amended Decision 535, or 577 of February 2004, which amended Decision 569. As a consequence, the date for the adoption of a new ASPB is unspecified or open and so, in keeping with Article 8 of Decision 535, according to which the continuation of the current agricultural price stabilization system is permitted until the new Community system enters into effect, the ASPB established in February 1995 by Decision 371 is, in fact, still effective among Colombia, Ecuador and Venezuela. The reasons behind this are, on the one hand, what was mentioned above regarding the delicate decision between agricultural protection and agro-industrial competitiveness, on the one hand, and, the differences in coverage and methodology between the ASPB and the Peruvian system, on the other hand. In view of the different WTO bound tariffs (higher in the three ASPB countries than in Peru), these differences must be settled so that the Andean Free Trade Area for the agricultural sector may be completed and sustained over time.

Nonetheless, it is undeniable that CAN has made progress as regards the other two elements involved in the adoption of a Common Andean Agricultural Policy. The Andean Agricultural Health System[16] was regulated by Decision 515 of March 2002, establishing the Andean legal framework for the implementation of sanitary and phytosanitary measures for intra-subregional trade and for the trade with third countries in plants, vegetables, regulated items, animals and their products. This decision, replacing Decision 328 of October 1992, brings the Andean legislation into line with the international one on the subject, by incorporating the disciplines established in the WTO Agreement on Sanitary and Phytosanitary Measures. In June 2002 Decision 519 was approved, dealing with the Andean Subregional Foot-and-Mouth Disease Eradication Program (2002-2009), replacing Decision 255 of September 1989. Moreover, pursuant to Article 70 of Decision 436 (June 1998), the CAN General Secretariat adopted, through Resolution 630 (June 2002), the Andean Technical Manual for the Registry and Control of Chemical Pesticides for Agricultural Use, which compiles the agreements reached in the Governmental Expert Group Meeting on Pesticides (April 2002).

In connection with the third element, referring to Ad Hoc Groups established by agribusiness chains, comprising both private sector and governmental representatives, the formation of the Coffee Ad Hoc Group is worth mentioning, particularly because it created, in August 2003, the "Andean Program for a Sustainable, Competitive and Integrated Coffee Chain". The program aims at improving Andean coffee market positioning through a diversified supply based on quality, promoting Andean coffee consumption within CAN countries, and diversifying coffee production systems, through the promotion of products with an Andean identity and high market potential. All this is focused on the development of an Andean coffee policy capable of improving competitiveness in all the links of this production chain. By contrast, during the period covered by this report, the formation of an Oil Seeds Ad Hoc Group could not be accomplished, which reflects the problems facing this agribusiness chain, leading to the recent proliferation of trade protection measures summarized below under the first heading of Section C, Chapter III.

Automotive Regime

As reported in Andean Report No. 1 (INTAL [2002] p. 18), in November 1993, Colombia, Ecuador and Venezuela signed the Complementarity Agreement in the Automotive Sector, which was later extended and updated in May 1994 and in September 1999 respectively. The 1999 update entered into force on January 1, 2000, with a life of ten years and renewable for a further ten years. It should be added that the three countries involved signed this new agreement in order to increase their global automotive production to about 500 thousand units per year within ten years. In this connection, Table 41 shows that, there was indeed a considerable subregional automotive production increase (68.8%) from 2000 to 2001, but in the two following years, production declined, owing to the sharp drop in the Venezuelan production: Venezuela was traditionally the largest producer (64.6% of the total in 2000), and then Colombia became production leader in 2003 (42.9%).

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[16] For further details on the Andean Agricultural Health System, visit *http://www.comunidadandina.org/politicas/paca.htm*

TABLE 41
SUBREGIONAL AUTOMOTIVE PRODUCTION (1999-2003)
(Number of vehicles)

		1999	2000	2001	2002	2003
1st Category[a]	Colombia	24,906[c]	31,041	68,024	72,633	58,339
	Ecuador	9,764	13,076	28,356	27,181	31,201
	Venezuela	65,902	81,906	117,885	76,307	50,478
2nd Category[b]	Colombia	3,547	3,642	6,849	6,038	6,468
	Venezuela[1]	5,293	5,358	6,748	4,090	4,536
	Total	109,412	135,023	227,862	186,249	151,022

Notes: [a] The first Category comprises: cars; jeeps; passenger vehicles for transporting up to 16 persons, including the driver; and cargo vehicles with a maximum loaded weight of not over 4,537 tons (or 10,000 U.S. pounds), together with their cabined chassis.

[b] The second Category comprises all vehicles not included in the first Category.

[c] Based on updated production and export figures.

[1] Production figures are those of domestic vehicle sales.

Source: CAN General Secretariat [2004d]. In-house preparation.

C. Other Regulations regarding Trade and Free Competition

Trade Defense Mechanisms

The previous section addressed the topic related to the agro-industrial chain component of the Agricultural Development Program, making reference to the proliferation of trade defense mechanisms that have recently restricted the intra-subregional trade of products belonging to the oilseed chain. All CAN members have imposed these kinds of measures. They argue that they need to face the distortions caused in this trade by the non-uniform application of the CET among the four countries that adopted Decision 370 and by the differences between this CET and the Peruvian tariff, as well as by the lack of harmonization within the subregion in terms of agricultural price-band systems and special trade regimes (temporary admission, inward processing and drawback). Consequently, while Andean Report No. 1 registered a total of 12 cases involving safeguards over the entire 1991-1999 period (INTAL [2002] Table 4, p. 17), in the comparatively short period from October 2001 to January 2004, and taking into account only the products belonging to the oilseed chain, there have been at least 10 cases of trade defense mechanisms,[17] which are listed below, based on the information gathered by Amemiya and Béjar ([2004] pp. 13-16):

- Venezuela triggered this proliferation when in October 2001 it ordered the application of non-automatic import licenses to products from Bolivia and Ecuador included in the subheadings of soy, palm, sunflower oils, mixed vegetable fats and oils, and margarines, as well as a 29% tax on the imports of these subheadings from Colombia and Peru. After investigating the case, the General Secretariat disallowed the application of licenses to Bolivia and only authorized it for a subheading in the case of Ecuador.

- Ecuador took advantage of this so as to impose the requirement of import licenses on five subheadings of oilseed products from other member countries, in December 2001. After an investigation, the General Secretariat ordered the removal of this measure.

[17] Put simply, this figure results from taking the measures imposed by a member country at a certain date as one case. However, as will be seen in the account below, several of these measures affected more than one of the other member countries and/or more than one subheading of oilseed products, due to which, strictly speaking, the actual number of cases is quite larger.

- In July 2002, Colombia applied a tax surcharge to the imports of three refined soy and sunflower oil subheadings, originally at 29% and later modified to the equivalent of the lower tax imposed on the corresponding imports from outside CAN. After an investigation, the General Secretariat ordered the suspension of this measure.

- In October 2002, Ecuador applied a six-month provisional safeguard consisting of a 29% surcharge to the imports from member countries in five oilseed subheadings. After an investigation, the General Secretariat disallowed this measure.

- As of November 2002, Peru imposed a provisional safeguard consisting of a 12% *ad valorem* duty on its imports from member countries in three oilseed subheadings. The General Secretariat dismissed the case, sustaining this measure on procedural grounds.

- In February 2003, Bolivia informed the CAN General Secretariat that, in addition to import licenses, Colombia was applying a monthly quota to its imports of soy and sunflower refined oils and mixed vegetable oils from member countries. After an investigation, the General Secretariat decided once again that the measure had to be lifted.

- In May 2003, Ecuador requested permission to apply a six-month provisional safeguard consisting of a tax equivalent to the total tariff imposed under ASPB - that is, CET plus a variable duty - to the imports from member countries in five oilseed subheadings. The General Secretariat rejected this request on procedural grounds.

- In July 2003, Ecuador replied that it was applying restrictive measures to several agricultural products from CAN, including its oilseed imports from Bolivia, and requested permission to apply automatic corrective duties equivalent to the total tariff under ASPB to its imports of soy, corn and soybean oilcake from Peru.

- In November 2003, Peru ordered the application of a provisional safeguard consisting of a 12% tax surcharge to its imports from member countries in six oilseed subheadings. After an investigation, the General Secretariat only allowed a tariff quota for butter and fats from Colombia and ordered the suspension of the rest of the measure.

- Finally, in January 2004, Ecuador reported that as of November 2003 it had been applying provisional safeguards, consisting of a tax equivalent to the whole tariff under ASPB, to its imports from CAN in six oilseed subheadings. After an investigation, the General Secretariat ordered the suspension of this measure.

By applying some indicators (trade intensity and revealed comparative advantage indexes, among others) to intra-subregional bilateral trade in eight of the subheadings of oilseed products more affected by the measures listed above, the aforementioned authors (*Idem*, Table 5.6) find seven indications of potential trade diversions, of which four are in favor of trade with third countries and the other three are in favor of the member country that imposed the measure. By applying a gravity model, they also find evidence of the negative impact such measures had on the above-mentioned intra-subregional bilateral trade (*Idem*, Table 5.8).

Technical barriers to trade

On the basis of the WTO Agreement on Technical Barriers to Trade (TBT), the CAN Commission adopted Decision 562 (June 2003) on the "Directives for the preparation, adoption and application of Technical Regulations in Andean Community Member Countries and at Community level". This Decision provides a harmonized structure between the technical regulations issued by each Andean country and those issued by the Commission; it promotes the principle of transparency by letting anyone interested have access to the technical requirements that have to be met by the products included in the technical regulations; and, for such purposes, it describes the records, procedures, and proceedings needed to comply with such regulations.

Free competition

The Fourth Meeting of Government Experts on Free Competition (Lima, July 2003) was held within the framework of the "Competition Project" led by the CAN General Secretariat with the assistance of the European Commission in order to improve and harmonize Andean countries' legislation on competition. The objective of the meeting was to present the comments of the member countries about the project to modify Decision 285 (March 1991), and to review the respective full text to be submitted for its consideration before the CAN Commission. The aim of this modifying project is to protect and promote free competition in the Andean Community, seeking market efficiency and consumers' welfare.

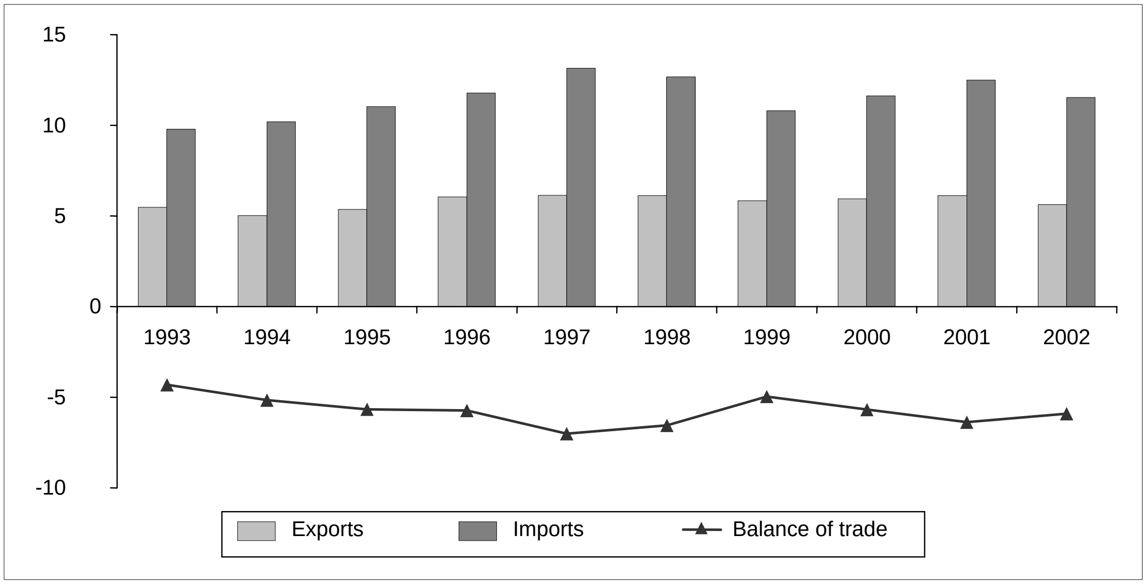
D. Liberalization of Trade in Services

The liberalization of trade in services is another important area for building a common market. To what was included on this topic in Andean Report No. 1 (INTAL [2002] pp. 19-20), it should be added that in October 2001 the CAN Commission approved Decision 510 with the Adoption of the "Inventory of Measures that Restrict Trade in Services" so as to put into practice what was agreed upon by means of Article 14 of Decision 439 (June 1998), though not within the period specified under this Article (31 December, 1999). This inventory contains a list of measures to be gradually and progressively phased out in annual rounds, until the process is concluded in 2005.

In order to facilitate this process, the General Secretariat has recently developed, among other things, statistics on the trade in services in the 1993-2002 period (CAN General Secretariat [2004d]), based on which Figure 16 and Table 42 were compiled. The former shows the stagnation of the corresponding Andean exports and imports, and the persistent deficit of the balance of trade in services over the period. Venezuela represented 40% of the annual average imports of Andean services, followed by Colombia (27.7%), Peru (18.2%), Ecuador (10.8%), and Bolivia (3.8%), whereas Colombia is the leading country in exports of services with 34.9% of the annual average, followed by Venezuela (24.3%), Peru (24.2%), Ecuador (13.1%), and Bolivia (3.8%).

Travel services (for tourism and business), transportation and communications have been the three most important service sectors, jointly accounting for 85% of Andean exports of services and 62% of Andean imports of services during the above-mentioned period. Table 42 shows the share of each CAN member in the trade in these three lines of business and other services. It can be observed that Colombia is the main exporter of these three lines of business and Peru is the leader in the case of other services; Venezuela is the largest importer of transportation, travel and other services, whereas Colombia is the largest importer of communications services. It should be added that the Andean balance of trade in services only runs a surplus in communications services and that this surplus declined due to the fall in Colombian exports.

FIGURE 16
ANDEAN TRADE IN SERVICES, 1993-2002
(US$ Billions)



Source: CAN General Secretariat [2004d]. Preparation: In-house.

TABLE 42
SHARE OF MEMBER COUNTRIES IN EXPORTS (X) AND IMPORTS (M) OF SERVICES BYCATEGORY, 1993-2002

	Transportation		Travel Services		Communications		Other Services	
	X	M	X	M	X	M	X	M
Bolivia	4%	6%	3%	2%	6%	4%	7%	3%
Colombia	37%	28%	34%	27%	45%	45%	28%	26%
Ecuador	17%	11%	12%	7%	17%	9%	8%	14%
Peru	17%	20%	24%	11%	28%	25%	35%	23%
Venezuela	25%	35%	28%	53%	4%	19%	24%	34%

Source: CAN General Secretariat [2004d]. Preparation: In-house.

These figures reflect the great effort that the CAN countries still have to make so as to create the conditions to boost their trade in services not only internationally but at an intra-subregional level as well, since the long-running stagnation and deficit of this trade is an evidently unsatisfactory result in view of the great Andean potential in service activities such as tourism and energy. Based on this, the progress made in these two activities and in telecommunications is summarized below, whereas transportation and physical integration are described in Chapter IV of this Report.

Telecommunications

As mentioned in Andean Report No. 1 (INTAL [2002] p. 22), by means of Decision 462 (May 1999), the Andean countries agreed to deregulate all telecommunications services, with the exception of radio and television broadcasting, as of January 1, 2002. It should be added that, although this objective has not yet been reached - i.e. the elimination of all barriers to free trade in the sector and the promotion of its development -, the Andean Committee of Telecommunication Authorities (CAATEL) approved the Strategic Plan for the Development of Andean Telecommunications for the 2001-2006 period (March 2001), which sets out the priorities, long- and medium-term objectives and short-term goals, as well as the corresponding follow-up and control mechanisms. The long-term objectives include the signing of regional integration agreements related to this sector and the establishment of high-speed networks and satellite services infrastructure for Community use by these countries, among others. The medium-term objectives that are mentioned are: promoting interconnection agreements in order to build the Andean network infrastructure and establishing cooperation mechanisms for the education and training of human resources working in the area.

As regards CAATEL's recent actions related to the Simón Bolívar Andean Satellite System project, Section B of the next chapter provides information that deals with infrastructure and services for Andean physical integration.

Tourism

The information given about this sector in Andean Report No. 1 (INTAL [2002] p. 22) should be supplemented here by pointing out that the three-pronged approach for the development and integration of tourism in CAN (deregulation of tourism services, implementation of tourism projects of Community interest and the elimination of obstacles to tourism flows in the subregion) was established through Decision 463 (March 2001), together with the Andean Committee of Tourist Authorities (CAATUR) in charge of programming and performing the corresponding actions. It has been added that CAATUR's efforts resulted in the adoption of Decision 498 by the CAN Commission (March 2001), which decreed May 24 to be Andean Tourism Day, and Decision 503 (June 2001), which establishes national identification documents as the only requirement for intra-subregional tourism.

CAATUR intends to stimulate youth tourism in the Andean subregion as well. Thus, it promoted an agreement between the ISTC *(International Student Travel Confederation)* and the CAN General Secretariat (May 2003), in which framework the CAN General Secretariat organized the Seminar on Youth Tourism in the Andean Community (November 2003). In this seminar, it was recommended to advance coordinated efforts by the different actors with a view not only to promoting policies that foster youth tourism, but also to encouraging the young people to travel, thus developing a culture of educational tourism. Furthermore, mechanisms have been identified so that all the young and not only those with a high socioeconomic level can have access to tourism.

Additionally, the General Secretariat has fulfilled its reporting function by publishing a statistics document on the Andean tourism sector (CAN General Secretariat [2003f]), on which basis Table 43 and Figure 17 have been compiled. The first shows that in the 1998-2002 period, Peru was the Andean country that received the largest share (28%) of the total of 14,328 tourists attracted by the CAN during those years, followed by Colombia and Ecuador (with 20% each), Venezuela (19%) and Bolivia (12%). It should be added that 27% of the total of tourists were from the USA, 26% from Europe, 24% from the Andean countries and the rest from several other countries.

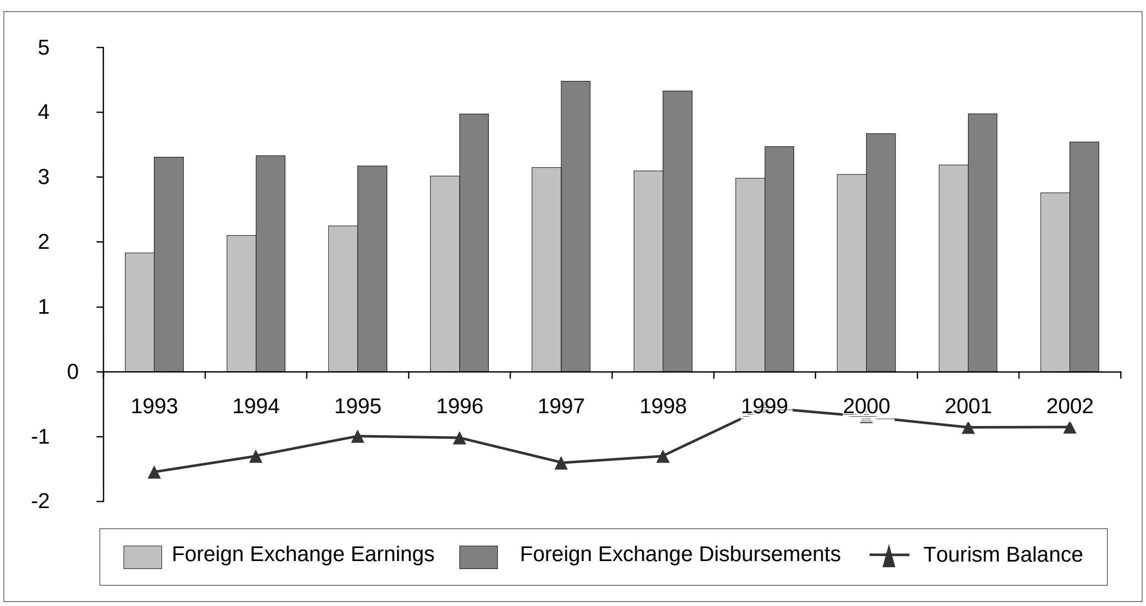
TABLE 43
INBOUND TOURISM (IT) AND OUTBOUND TOURISM (OT) IN THE CAN
(Thousands of tourists)

	1998		1999		2000		2001		2002	
	IT	OT	IT	OT	IT	OT	IT	OT	IT	OT
Bolivia	388	299	342	253	317	203	316	222	334	217
Colombia	674	1,093	546	1,098	557	1,235	615	1,382	541	1,241
Ecuador	511	330	518	386	627	520	609	553	654	598
Peru	771	654	727	608	828	837	825	741	871	936
Venezuela	685	751	587	754	469	954	584	933	432	881
CAN	3,029	3,127	2,719	3,100	2,799	3,749	2,949	3,831	2,832	3,873

Source: CAN General Secretariat [2003f] p. 9. Preparation: In-house.

Nonetheless, as regards foreign exchange earnings from tourism, Colombia was the Andean country with the largest share (33%) of the total of US$ 27.404 billion received by the CAN members over those years, followed by Venezuela (27%), Peru (24%), Ecuador (12%) and Bolivia (3%), whereas Venezuela was the leading country in foreign exchange disbursements, accounting for 53% of the total (US$ 37.239 billion), followed by Colombia (27%), Peru (11%), Ecuador (7%) and Bolivia (2%). In Figure 17 it can be observed that the deficit of the Andean tourism balance fell due to the fact that the corresponding foreign exchange disbursements tended to decline as of 1997 and they only grew at a 0.8% annual average rate over the 1993-2002 period, whereas during the same period the annual average growth of foreign exchange earnings from tourism was 4.6%. It should be pointed out that because of this growth tourism became the third most important source of foreign currency earnings in the CAN, after crude oil and petroleum derivatives exports.

FIGURE 17
ANDEAN TOURISM BALANCE, 1993-2002
(US$ billions)



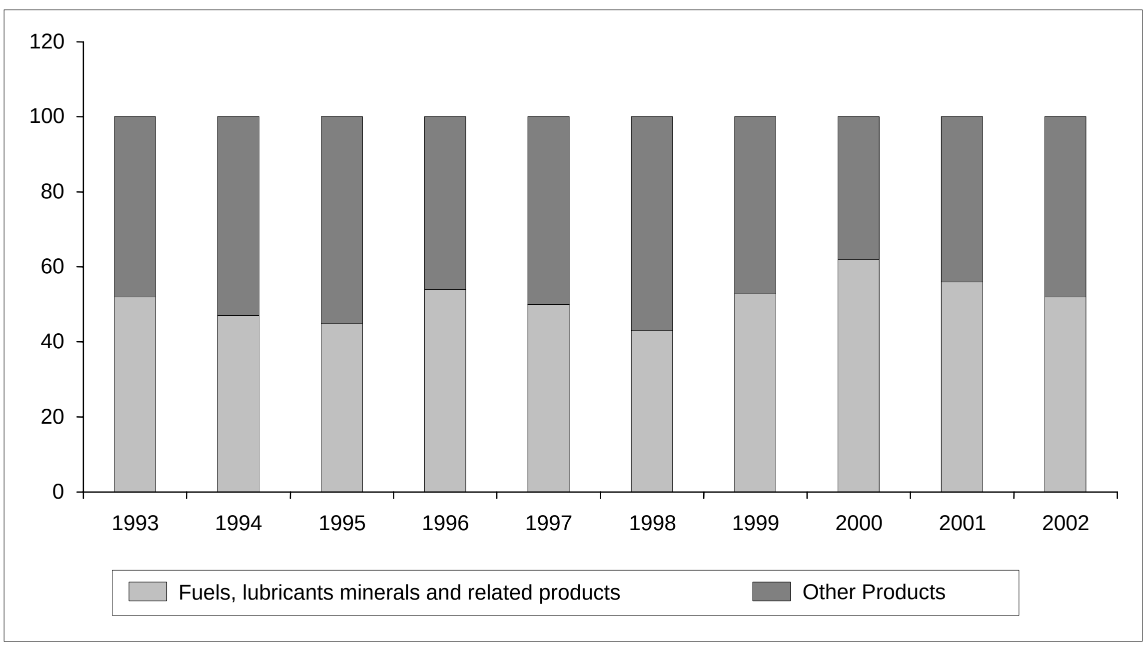
Source: CAN General Secretariat [2003f] p. 9. Preparation: In-house.

Energy

Figure 18 is a good supplement to what has been examined in Section C of Chapter I of this Report and what has been showed in Table 12, especially, as one can clearly see the great significance that energy generating products (fuels, lubricants and related products) have in the total trade (at the extra and intra-subregional level) of Andean countries. Exports of these products accounted for more than half of Andean total exports during 1993-2002, and in the last year of that period they exceeded US$ 25 billion, according to General Secretariat statistics (CAN General Secretariat [2003c] p. 1 ff.). Oil, which has historically been the main Andean export product, represented US$ 23.6 billion; coal, coke and briquettes, US$ 1.3 billion; gas, US$ 281 million; and electric power, US$ 14 million. In 2002, these products were exported mainly to NAFTA countries (US$ 14.3 billion, chiefly from Venezuela to the USA), the group of other countries in the Americas that are not part of a subregional integration agreement (US$ 4.3 billion), EU member countries (US$ 1.7 billion), MERCOSUR member countries (US$ 864 million), CARICOM member countries (US$ 765 million), CACM member countries (US$ 715 million) and CAN member countries themselves (US$ 615 million).

This reality and the significant Andean energy potential, which is summarized in Table 44, explain the actions with respect to this sector assigned by the Andean Presidential Council through guideline 29 of the Declaration of Santa Cruz (January 2002), in which, after remarking the growing strategic importance of energy and the consequent need to boost its integration throughout the continent, it requested the preparation of a comprehensive assessment of the Andean energy potential (a task that is well served by the above-mentioned document of the CAN General Secretariat). Similarly, guideline 32 of the Quirama Declaration (June 2003) provides for the construction of a Community energy market, the development of energy services with high value added, and the adoption of a strategy of international integration centered on hydrocarbon trade and energy security.

FIGURE 18
ENERGY GENERATING PRODUCTS:
PARTICIPATION IN TOTAL ANDEAN EXPORTS, 1993-2002
(Percentage)



Source: CAN General Secretariat [2003c] p. 2.

TABLE 44
ENERGY POTENTIAL IN THE CAN

Line of Business	Energy Potential
Oil	• The CAN's oil reserves amount to more than four times the reserves of the United States and eight times those of the Mercosur. • Production climbed almost 80% over the past fifteen years (1985-2000), from 2.5 to 4.5 million barrels per day (MBD). • Consumption in the Andean subregion rose 40%, from 1.3 to 1.8 MBD and net exports doubled, rising from 1.3 to 2.7 MBD.
Natural Gas	• There are more than 5 billion cubic meters, of which 77% belong to Venezuela.
Coal	• Colombia and Venezuela are the main producers, accounting for nearly 8 billion tons of high quality coal reserves. • The subregion produced 46 million tons of coal in 2000 and is estimated to possess 171 years of coal reserves.
Hydroelectric Potential	• Both the potential being exploited today and that still to be exploited have been estimated by OLADE at 267 GW. • Other estimates in sites with economic feasibility amount to 566 TWh.

Source: CAN General Secretariat [2003c].

So that these Presidential mandates could be appropriately implemented together with the General Framework for the subregional Interconnection of the Electric Systems and the Intra-Community Exchange of Electricity previously adopted through Decision 536 (December 2002), the CAN Commission approved Decision 557 (June 2003) creating the Council of Andean Community Ministers of Energy, Electricity, Hydrocarbons and Mines. At its first meeting held the same month, this Council approved an Action Plan that incorporates the interconnection of natural gas as a new element of Andean energy integration policy and provides for a series of actions to be taken, such as that aimed at achieving a balance in the development of the electric, hydrocarbon and mining sectors within a framework of sustainable development, and harmonizing project contracting processes in those sectors. The first concrete result in terms of electric interconnection in the Andean subregion was achieved in March 2003 when the electric systems of Colombia and Ecuador were interconnected. As a result of that interconnection, Colombia is receiving US$ 316 thousand a day, which means US$ 115 million a year, while Ecuador will save US$ 74 million.

E. Liberalization of the Circulation of Factors

As regards all the progress made in relation to this other essential element for the creation of a common market, the following should be pointed out:

Circulation of People

According to Andean Report No. 1 (INTAL [2002] pp. 24-25), in June 2001 the CAN Commission approved Decision 503 (June 2001) "Recognition of national identification documents" (as already mentioned under the Tourism subheading, in the previous section), and Decision 504 creating the Andean Passport that will come into force no later than December 2005. Subsequently, significant progress was made towards free circulation of people in the subregion, especially as regards recognition of the national identification documents, which has already come into effect in all the Andean countries, with the exception of Venezuela - the only CAN member requiring visas for all persons entering its territory from Andean countries (CAN General Secretariat [2003e] p. 26). Furthermore, the airport incoming booths for foreign residents in the subregion are already operating - although differently in each country -, as stipulated by Decision 526 (July 2002) of the Andean Council of Foreign Ministers.

As part of the necessary actions to be taken in order to make the Andean Passport come into force within the stipulated deadline, in Annex I of Decision 525 (July 2002), the Andean Council of Foreign Ministers approved a list of basic rules concerning the technical characteristics of the Andean Passport nomenclature and security, based on the proposal presented by the Andean Committee of Immigration Authorities (CAAM), in compliance Article 3 of Decision 504. This proposal followed the guidelines established by the General Secretariat based on recommendations made by the International Civil Aviation Organization with the assistance of the International Organization for Migration.

Additionally, based on Proposal 95/Rev.1 of the General Secretariat (June 2003), the Andean Council of Foreign Ministers adopted Decision 545 (June 2003) which approves the Andean Labor Migration Instrument in order to establish provisions that will progressively and gradually permit the unhampered movement and temporary residence of Andean nationals in the subregion as wage workers; it also adopted Decision 548 (June 2003) establishing the Andean Cooperation Mechanism on Consular Assistance and Protection and Migratory Matters in the interests of the nationals of any of the Andean Community Member Countries.

Investments

In order to supplement the information given on this topic in Andean Report No. 1 (INTAL [2002] pp. 24-25), it should be mentioned that, in the late 1990s, the CAN members envisioned the possibility of updating their common investment regime, that was adopted through Decision 291 (March 1991). For this purpose, two meetings of government experts were held in April and August 2000, whose results were presented for consideration before the member countries in December that year. Nevertheless, the government experts' meeting that was to perfect the draft proposal of the new common regime has been repeatedly postponed and finally suspended at the request of the countries themselves. According to the General Secretariat (SGCAN [2003b] p. 19), this suspension was due to the fact that the CAN members thought it fit to maintain the regime under Decision 291 until the prospects for investments in negotiations of the FTAA became clear. Moreover, they thought that the above-mentioned draft proposal was somewhat intricate.

In the successive Andean coordination meetings held throughout the FTAA negotiations, the position of the CAN members has been to advance in the negotiations concerning the topic of investments, thus updating the Andean regime in this subject, aiming at a hemispheric regime that makes it easier for them to coexist. A landmark in this respect was the approval of provision 6 b) "Community Treatment of Investments" in the Record of the Eighty-second Regular Session of the Commission (June 2002), and its presentation before the FTAA Seventeenth Meeting of the Negotiating Group on Investment (Panama, July 2002). At the same time the General Secretariat has sought to keep an additional and independent forum to debate the Andean regime of investments (*Idem* p. 3), as stated during the Training Workshop for Negotiators of International Investment Agreements organized by UNCTAD and INTAL (Lima, October 2002).

In order to promote investments, the Andean Investment Promotion Strategy was designed with the support of the UNCTAD and the participation of Andean competent organizations, and it was presented in a work meeting that was held in the headquarters of the General Secretariat (Lima, December 2003).[18] Such strategy shall take into account related actions taken by the Andean Committee of Export Promotion Authorities (CAAPE), created by the Commission through Decision 566 (September 2003).

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[18] Information on this matter can be downloaded from *http://www.comunidadandina.org/politicas/inversiones5-12-03.htm.*

Intellectual Property

During the period analyzed in this report, the Andean efforts in the area of intellectual property that should be outlined here are related to two aspects of this topic regulated by Decision 391 (July 1996): genetic resources and traditional knowledge. As a matter of fact, the five CAN member countries have been part of the Group of Like-minded Megadiverse Countries[19] since it was created at the WTO level in February 2002 as a consultation and cooperation mechanism in order to promote their common interests and priorities related to the conservation and sustainable use of biological diversity; and within that framework they signed the Cuzco Declaration on Access to Genetic Resources, Traditional Knowledge and Intellectual Property Rights (August 2002). Later, in May 2003, the Andean government experts presented a series of recommendations so as to improve the protection of traditional cultural expressions and folklore in the subregion. These included assigning the Intergovernmental Committee on Intellectual Property and Genetic Resources a permanent status and taking the necessary steps to obtain the technical support from the World Intellectual Property Organization (WIPO) to make a regulatory proposal in order to strengthen the protection of traditional knowledge, innovations and practices of indigenous, Afro-American and local communities. The CAN Commission has not yet issued any pronouncements on such recommendations.

On the other hand, as regards trademarks, it should be mentioned that, on February 27, 2003, the online consultation system for trademarks was implemented as a pilot project by interconnecting the offices of Colombia and Peru; afterwards the other Andean countries will be added and, at a later stage, the system will become accessible to public users.

F. Macroeconomic Coordination

Guideline 18 of the Declaration of Santa Cruz (January 2002) records the agreement of the Andean Presidential Council "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". In this sense, the CAN Commission complied with the adoption of Decision 543 (April 2003) on Convergence Action Programs according to a standardized format, so as to facilitate the work of the Permanent Technical Group (PTG). The PTG was created to keep track of the three targets (inflation, fiscal deficit and public debt) for macroeconomic convergence among the member countries that were set in the Report of the Fifth Meeting of the Andean Community Advisory Council of Treasury or Finance Ministers, Central Bank Presidents, and Economic Planning Officers (June 2001). Later, the Commission adopted Decision 565 (September 2003) on the compilation of statistics of the Quarterly National Accounts according to the format of the Convergence Action Programs.

The convergence inflation target originally required that all CAN members achieve and maintain a single-digit annual inflation rate by December 2002, measured by their own indexes of consumer prices. Subsequently, it was modified by the Fourth GTP Meeting (October 2003) to an annual rate below 5% as of 2006, subject to the exception that the national inflation targets shall prevail if stricter. Meanwhile, the other two convergence targets have remained as described in Andean Report No. 1 (INTAL [2002] p. 50); that is, the fiscal deficit target is still that, as of 2002, the non-financial public sector (NFPS) deficit shall not exceed 3% of GDP, though that ceiling could temporarily be raised to 4% of GDP during the 2002-2004 period. The third goal still is that the balance of the public debt (external and internal) of the consolidated public sector shall not be in excess of 50% of GDP at the end of each fiscal year, though each country will individually determine the fiscal year as of which it will implement the target, up to 2015 at the latest.

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[19] The countries that belong to the Group are: Bolivia, Brazil, China, Colombia, Costa Rica, Ecuador, the Philippines, India, Indonesia, Kenya, Malaysia, Mexico, Peru, South Africa and Venezuela.

TABLE 45
MACROECONOMIC CONVERGENCE TARGETS IN THE CAN
DEGREE OF COMPLIANCE IN 2003

	Inflation (%)		Balance of NFPS (% of GDP)		Public Debt (% of GDP)	
	Effective	Target	Effective	Target	Effective	Target
Bolivia	3.94	5	7.9	-4	85.5	50
Colombia	6.49	5	3.3	-4	53.3	50
Ecuador	6.10	5	1.7	-4	54.0	50
Peru	2.50	5	-1.9	-4	47.5	50
Venezuela	n.a.[1]	5	-2	-4	47.2	50

Note: [1] The report of the CAN General Secretariat has not taken the opinion of the Venezuelan expert into account because Venezuela had not officially nominated him until the report was published.

Source: CAN General Secretariat [2003g] p. 159. Preparation: In-house.

Table 45 shows the degree of compliance with these targets by each of the CAN members in 2003. Even though the official document (CAN General Secretariat [2003g]) that was used as a basis to compile it does not record the inflation rate in Venezuela - due to the reason explained in the note to this table -, it is known that in 2003 the rate was 27.08%. This Andean country was the only one that highly exceeded the subregional target of an annual 5% rate for 2006. Colombia was not far from its national target (6%) and, as regards the two countries that have reached the subregional target in advance, Peru has also reached its stricter national target (2.5%) while Bolivia has not (2.8%). As to the NFPS deficit, the subregional target of 3% of GDP has been already met by Ecuador, Peru and Venezuela, all of which have also reached their stricter national targets under their corresponding Convergence Action Programs for 2003. Colombia met the transitory subregional target (4%) but not its national target (3.1%), nor did Bolivia (7%) due to the high costs (4.9% of GDP in 2003) of the pension system reform. With respect to the public debt, the subregional target has been met only by Peru and Venezuela; although Colombia improved its performance (54.4% of GDP in 2002) and so did Ecuador in particular, which has been reducing its public debt level since 2000. Despite the fact that the above-mentioned document records a high level of 85.5% of GDP for Bolivia, it also admits that due to the particular characteristics of the Bolivian external public debt (high levels of concessionality and its eligibility for debt relief under the terms of the Highly Indebted Poor Countries Initiative), the present net value of its debt is a more relevant indicator and, by applying it, the total public debt burden turns out to be 50.7% of GDP (*Idem*, p. 159).

G. Social Agenda

In guideline 30 of the Declaration of Santa Cruz (January 2002), the Andean Presidents reaffirmed the priority to move ahead with the tasks of the social agenda and, to that end, they instructed the corresponding Ministers to design "a Community strategy to supplement national efforts" in this area. The Andean Council of Foreign Ministers adopted Decision 553 (June 2003), which lays down the Guidelines for Formulating the Integrated Social Development Plan, after having established through Decision 524 (July 2002) the Andean Working Group on the Rights of Indigenous Peoples "as a consultative entity within the Andean Integration System to promote the active participation of indigenous peoples in the economic, social, cultural and political spheres of subregional integration". It also established through Decision 539 (March 2003) the Andean Working Table on the Protection and Promotion of Consumers' Rights "to promote the active participation of institutions (...) in the processes of concerted social action and decision-making of the subregional integration in its areas of interest".

As regards social and labor issues, Decision 541 (March 2003) established the Guidelines of the Andean Plan for Health in Borderlands, as a "comprehensive element of the Andean Social Agenda and of the Community Policy for Border Integration and Development". Likewise, Decision 546 (June 2003) presents the Regulations for the Andean Social Security Instrument so that the basic social security benefits may be made fully available to Member Country migrant workers. Next, the regulations for the Andean Instrument on Safety and Health at Work were adopted with Decision 547 (June 2003) so as "to promote and regulate the actions that should be taken in Member Country workplaces to reduce or eliminate damage to workers' health by taking control measures and carrying out the necessary activities to prevent work risks".

H. Andean Financial Cooperation

It's a well-known fact that the Andean Integration System has two specialized institutions to provide financial support - and the technical support required - to the integration process within the CAN and to the member countries: the Andean Development Corporation (CAF) and the Latin American Reserve Fund (FLAR). As regards this aspect of the CAN, which is absent in most existing integration processes in the Americas, it is necessary not only to update the information in Andean Report No.1 (INTAL [2002] p. 52) but also to add important information. This is what will be done next, taking into account a recent document of the General Secretariat (SGCAN [2004b]).

Andean Development Corporation

The CAF was created in 1968 (a year before the signing of the Cartagena Agreement) as a development bank for Andean integration. Nowadays, 96% of its paid-in capital belongs to the five CAN members, while the other 4% belongs to other shareholder countries (Argentina, Brazil, Chile, Costa Rica, Spain, Jamaica, Mexico, Panama, Paraguay, Trinidad and Tobago, and Uruguay) and to private banks. The CAF financing of the Andean countries has significantly increased since the 1990s. In fact, while in 1990 the total portfolio of loans to the CAN countries was US$ 543 million; in 2002 it increased ten-fold (US$ 5.636 billion). Likewise, while in 1990 operations by CAN and its members were approved for US$ 772 million, the authorized amount in 2002 was four times as high (US$ 2.920 billion). Around 58% of such operations were for long-term projects, and the share of the ones intended for the public sector has increased from only 36% in 1998 to 77% in 2002 (*Idem.* pp. 70-71). The next chapter will address the significant support given to the development of Andean and South American physical integration and infrastructure by the CAF, individually as well as with IDB.

Latin American Reserve Fund

Originally created in 1976 as the Andean Reserve Fund, it later became the Latin American Reserve Fund (FLAR) by virtue of an agreement signed in 1988 and in force since 1991. Nowadays, its members include the five CAN countries and Costa Rica, which joined it in 2000. Its main role is to support the balance of payment of its member countries, together with the support of the bank financing of external trade operations until September 2002, when the corresponding Board decided to cancel it. The flow of loans granted by FLAR has fluctuated due to their nature and according to the situation of the external accounts and international reserves of each country. In 1994 and 1995 there were peaks that exceeded US$ 1 billion each year. In 1994, they were due to credits to finance exports from Ecuador, Colombia and Peru; in 1995, they resulted from Ecuador's debt restructuring. There were other peaks in 1998 and 1999: in 1998, they were due to credits for Ecuador's balance of payments and to finance exports to Peru, and in 1999, they resulted from loans for Colombia as contingent financing and liquidity credit to its Central Bank. Generally, during the 1978-2002 period, the countries that have benefited the most from FLAR loans were Peru and Ecuador with 38% and 27% of the total, respectively, followed by Colombia (16%), Bolivia (12%) and Venezuela (5%) (*Idem.* pp. 71-72).

Advantages of this cooperation

From the information included in the above-mentioned document of the General Secretariat it follows that this dimension of the CAN presents advantages for its member countries and for their integration with each other and with other countries, with characteristics such as the following (*Idem.* pp. 73-75):

(a) *Alternative source of resources*. This availability of CAN's own resources for financial cooperation has been an especially valuable advantage in times of crises or distress, when the access to the international financial markets is closed or difficult and when it is necessary to rely on additional support to that provided by other multilateral financial institutions. This is why, for instance, CAF financing share in the total financing by multilateral institutions has increased between 1990 and 2002 from 6.6% to 13.5% for Bolivia, from 1.2% to 20.5% for Colombia, from 4.9% to 24.5% for Ecuador, and from 1.7% to 27.9% for Venezuela; whereas in the case of Peru it rose from 10.4% to 16.9% between 1995 and 2002.

(b) *Streamlining procedures*. This characteristic is due mostly to the fact that decisions on extending loans are made by the CAN countries themselves. These are represented by 10 of the 13 members that are part of the CAF Board now. In the case of FLAR, while big countries have the right to one vote when they reach a paid-in capital of US$ 250 million, small countries have the same right when they reach US$ 125 million and, if they have not reached that amount, they can combine their contributions so as to obtain a seat on the Board or join any of the seats of the countries that already have a vote.

(c) *Asymmetry recognizing treatment*. In accordance with Article 118 of the Cartagena Agreement, it is established that CAF should allocate its regular and special resources "in such a way that Bolivia and Ecuador are given a substantially larger share than they would receive if the distribution were to be proportional to their contribution to the Corporation's capital". For those two countries the ratio between the debit balance and the paid-in capital is 7.8 and 13.2 respectively, while this ratio is 5.1 for Colombia, 4.3 for Peru, and 3.6 for Venezuela, in spite of the fact that the contribution to the paid-in capital of each of the three Andean countries of a higher level of relative development is 26.39%, and only 7.53% for each of the other two Andean countries. In the case of FLAR, Bolivia and Ecuador are allowed to have access to the credit for a higher multiple of their paid-in capital (3.5) than the one applied to each of the other three Andean countries (2.5), notwithstanding that each national contribution to the paid-in capital is 11.3% in the two first cases and amounts to 22.6% in the other three.

(d) *Better access to the international capital market*. CAF and FLAR have managed well as financial institutions and entities in particular. This is why, despite the particular characteristics of the support they provide, such as the above-mentioned, they have a very favorable rating that allows them access to the international capital market with more advantages than its member countries. For instance, while *Moody's Investor Service* assigned CAF an A2 long-term rating and a P-1 short-term rating and it assigned FLAR an Aa2 and a P-1 respectively, its long-term ratings for the Andean countries are much lower: Ba2 for Colombia, Ba3 for Peru, B3 for Bolivia, Caa1 for Venezuela and Caa2 for Ecuador. These ratings for CAF and FLAR - that, by the way, are higher than the ones for other Latin American countries such as Chile (Baa1), Mexico (Baa2) and Costa Rica (Ba1) - mean an international financial recognition, which, among other effects, accounts for the fact that CAF, for instance, has been able to manage and allocate catalytic resources from other international financial institutions for US$ 1.990 billion.

Contents

CHAPTER IV. BORDER AND PHYSICAL INTEGRATION, AND INFRASTRUCTURE

This field of action is discussed in a separate chapter in this Report, since one of the key lessons learned from integration processes among developing countries such as the Andean countries is that inadequate physical support, in terms of insufficient infrastructure, logistics and physical planning, imposes serious limitations on actual interdependencies of all kinds and, in particular, those of the higher levels inherent to the ambitious objective of creating a common market. Although the task of contributing towards overcoming such inadequacies has been part of the Andean integration process since its emergence, priority has increasingly been assigned to solving the resulting bottlenecks that arose over the past decade both as a result of new opening-up and competitiveness challenges and the progress of subregional trade integration per se. Hence, towards the end of the decade, CAN started to intensify its action in this field as outlined in Andean Report No. 1 (INTAL [2002] pp. 25-27).

During the period under review in this second Report, the work done in this area by Andean subregional institutions and bodies continued to be oriented towards two basic objectives: subregional border integration and development, and infrastructure development as well as physical integration among CAN member countries, and between these and other South American countries. Regarding the first objective, the structure used was that set forth by Decisions 501 and 502 (June 2001) for development programs at member countries' border points, based on the projects of Border Integration Zones (BIZs), Binational Border Service Centers (BBSCs) and the Border Integration and Development Projects Bank (BIDPB). As regards the second objective, the internal Andean agenda has been focused on planning and policy-making tasks put together by the committees of competent national authorities and their respective expert groups. Project design and execution were mostly performed within the framework of the Initiative for South American Regional Infrastructure Integration (IIRSA). The following three sections provide an outline of the progress made towards both objectives, pointing out, when applicable, the significant financial and technical support provided by the Andean Development Corporation (CAF) and the IDB in furtherance of these objectives.

A. Border Integration and Development Programs

Border integration within CAN is aimed at advancing the integrated development of border regions by incorporating them into the subregional integration process through an interaction between economic agents and local institutions - an interaction that contributes to the rational use of the territory and the existing infrastructure. To that end, the creation of the BIZs, the BBSCs and the BIDPB is promoted.

Border Integration Zones

Decision 501 (June 2001) seeks to advance integration in border zones by creating BIZs to be built upon existing socio-economic ties and understood as a mechanism for institutional consolidation and cooperation as well as the exchange of experiences and infrastructure with a view to strengthening both mutual trust among populations and their commitment to the Andean integration process. To date, 5 BIZs - described in Table 46 below - have been designed, of which only one has not yet been formally established, namely that comprising Colombia and Venezuela. These two countries must make progress in reaching agreements regarding their respective development plan and in exchanging the corresponding diplomatic notes.

TABLE 46
BORDER INTEGRATION ZONES (BIZs)

Bolivia - Peru	Departments of the Southern macro-region of Peru (Tacna, Puno, Moquegua, Madre de Dios, Cusco and Arequipa) and the region comprising the Bolivian departments of Pando, La Paz, Oruro, Potosí and Beni.
Colombia - Ecuador	Three strategic development areas: the Pacific area, consisting of 3 Southwestern municipalities of the Nariño Department and the province of Esmeraldas in Ecuador; the Andean area, consisting of the 23 municipalities of the Southern region of the Nariño Department in Colombia and the province of Carchi in Ecuador; and the Amazon area, which includes the Department of Putumayo in Colombia and the province of Sucumbíos in Ecuador.
Colombia - Peru	BIZ of Putumayo: it includes all of the Department of Loreto (Peru), all of the Department of Amazonas and the Municipality of Puerto Leguízamo (Colombia). It is structured into 4 development areas: Puerto Leguízamo-Soplín Vargas; the area of Tarapacá-Arica-El Álamo; the area of El Encanto-Puerto Alegría-El Estrecho; and the area of Leticia-Atacuari-Caballococha.
Colombia - Venezuela	It includes the Colombian Department of Norte de Santander and the VenezuelanTáchira State, municipalities of Semprúm, Catatumbo and Colón in the Zulia State, and part of the Páez municipality in the Apure State.
Ecuador - Peru	It is structured according to the Binational Development Plan for the Border Region between Ecuador and Peru. It comprises, on the Peruvian side, 130 districts in the departments of Amazonas, Cajamarca, Loreto, Piura and Tumbes and, on the Ecuadorian side, 68 cantons located in the provinces of El Oro, Loja, Zamora, Morona, Orellana, Pastaza, Sucumbíos and Napo.

Source: *Http://www.comunidadandina.org/fronterizo.asp*. In-house preparation.

The other 4 BIZs were formally established from 2002 to 2003. The BIZ between Colombia and Ecuador, which comprises the 3 strategic development areas described in Table 46 above, was established by the exchange of notes DM/DDF-44552 from the Ministry of Foreign Affairs of Colombia and 54679/02 from the Ministry of Foreign Affairs of Ecuador, both countries having committed themselves to submitting their respective Binational Development Plan by March 2004. The BIZ of Putumayo between Colombia and Peru was established by the exchange of notes DM/DDF-42562 from the Ministry of Foreign Affairs of Colombia and (GAB-SAA) RE 6-8/50 from the Ministry of Foreign Affairs of Peru, with the formulation of the respective Binational Development Plans due by mid-2004. The BIZ between Ecuador and Peru, which was structured based on the Binational Development Plan for the Border Region between Peru and Ecuador (1999), was established by the exchange of Verbal Notes (May 2002) and, as part of the respective implementation plan, a Binational Training Center has already been set up and opened in the district of Mallares (Peru), in which 3-year courses will be taught on Agricultural Business Administration and Agricultural Production, and for the operation of which Spain has committed its financial support in the equivalent of US$ 560,000.

The exchange of notes formalizing the establishment of these first 3 BIZs was published in issue No. 888 (January, 2003) of the Official Gazette of the Cartagena Agreement. Finally, the BIZ between Bolivia and Peru announced in the respective presidential meeting of January 2003 was formalized by exchange of notes GM-413/2003/6760 from the Ministry of Foreign Affairs and Worship of Bolivia and (GAB-SAA) RE No 6-7/35 from the Ministry of Foreign Affairs of Peru, published in issue No. 1003 (October, 2003) of said Official Gazette.

A coherent and orderly implementation of these BIZs requires strategic planning. For this reason, Guideline 28 of the Quirama Declaration issued by the XIV Andean Presidential Council (June, 2003) urged the High-Level Task Force on Border Integration and Development (GANDIF) to establish a Comprehensive Border Integration and Development Plan defining the corresponding legal, technical and financial instruments.

Binational Border Service Centers

The purpose of these Binational Border Service Centers (BBSCs) is to facilitate the transit of people, goods and vehicles under integrated border crossing controls. In accordance with Decision 502 (June 2001), during the period under review, progress was made in designing and preparing the necessary engineering studies and policy frameworks for the operation of the 7 BBSCs listed in Table 47 below. It was estimated that by 2004, several of these centers would have moved into the pilot operational phase, while the most advanced ones would have moved into the final phase. Thus, the Desaguadero BBSC between Bolivia and Peru was structured in two modules to record exit and entry operations respectively. The study commissioned to XPERTA S.R.L. consulting firm from Bolivia on the location of both modules has been completed, while the Specific Agreement and By-laws for the BBSC's Management Board are being prepared for it to move from the current temporary operating phase to the final phase.

TABLE 47
BINATIONAL BORDER SERVICE CENTERS (BBSCs)

Bolivia - Peru	Desaguadero BBSC
Colombia - Ecuador	Puente Rumichaca Ipiales (Colombia) and Tulcán (Ecuador) BBSC Río Mataje BBSC
Colombia - Venezuela	Paraguachón (Maicao - La Guajira) BBSC
Ecuador - Peru	Huaquillas - Aguas Verdes BBSC La Tina - Macará BBSC Namballe - Zumba BBSC

Source: *Http://www.comunidadandina.org/fronterizo.asp*. In-house preparation.

Puente Rumichaca BBSC between Colombia and Ecuador has been designed as an coordinating center for the national border centers of Ipiales (Colombia) and Tulcán (Ecuador), for which the competent national authorities of both countries have performed inspections for the assessment of works, and technical and investment needs. The same scheme has been used for evaluating the location of the Río Mataje BBSC and for designing the construction of the La Espriella-Río Mataje highway to facilitate the location of this center. In turn, the establishment of the Paraguachón (Maicao) BBSC in the area of La Guajira, whose reference model is the Argentine-Brazilian binational center operating in San Tomé, is at the level of technical consultations between Colombia and Venezuela. These consultations take place through 4 working groups - on migratory, regional, sanitary and customs issues. Venezuela has appointed a representative of the Wayuu ethnic group with the purpose of involving the civil society.

Three BBSCs have been designed between Ecuador and Peru: in Huaquillas-Aguas Verdes; in La Tina-Macará; and in Namballe-Zumba. The most progress has been made in the first one, since a Pilot Plan was approved in July 2003 by a Specific Agreement resulting from the technical meetings that decided on matters of location, procedures, agenda approval and training of officials. These issues are defined in the Border Plan, which is part of the above-mentioned Binational Plan. This work experience is being used for the La Tina-Macará BBSC, which is likely to consist of two modules, one on each side of the border, namely in Cachaquito (Peru), 5 kilometers from the international bridge, and in Macará (Ecuador). The technical documents required to build both modules were issued in June 2003. Likewise, after the building of Puente Integración bridge over the Canchis river, the Namballe-Zumba border crossing was established with an agreement to set up a pilot BBSC on the Peruvian side, taking advantage of the existing infrastructure made available to that end.

Border Integration and Development Projects Bank

Decision 501 (June 2001) placed the Border Integration and Development Projects Bank (BIDPB) on the Andean agenda to serve as a vehicle for the development of the BIZs. During the period covered by this report, the BIDPB was at the experimental phase. Thus, starting in the months of March and April 2002 respectively, work was undertaken to publicize the BIDPB and gather the first set of potential investment projects for all the borders within CAN; this work was conducted by the GANDIF through the BIDPB Committee. This resulted in authorities and populations alike being sensitized in favor of the BIDPB, with a total of 64 potential projects announced by private and public, national and binational entities. It further included establishing contact with institutions from the Andean Integration System, which led, among other things, to the Andean Health Body "Convenio Hipólito Unanue" (ORAS-CHU) drawing up the Guidelines for the Andean Plan for Border Health, adopted through Decision 541 (March 2003). Although not a direct component of the BIDPB, this outcome proves the will for progress towards an integrated working methodology for borders.

A second working phase followed, guided by the agreements reached during the VIII Meeting of GANDIF (March 2003) whereby, with a view to appropriately selecting from among the 64 potential projects, the BIDPB Committee suggested that priority be given to binational projects having a high degree of socio-economic benefits for border populations and either having low budgetary requirements or being affordable to the entities involved. For this reason, the subsequent task of selecting such projects for their presentation at the IX Meeting of GANDIF (October 2003) involved the respective participation of the National Public Investment Systems (SNIP), contacts with private sector entities, as well as the participation of the IDB and the CAF so that their financial and technical support could be secured. The IDB and the CAF had been requested to provide support for GANDIF-defined actions by Guideline 29 of the Andean Presidential Council's Declaration of Quirama (June 2003). Likewise, conversations were initiated with the European Regional Development Fund under the European Commission, which has vast expertise in border integration projects, although said cooperation had not yet materialized at the time this report was written.

Eleven projects were selected upon completion of the second working phase, of which the first 6 projects with a short lead time - from 3 to 12 months - that have already been approved**,** are shown in Table 48 with their respective funding. Note that the combined contributions of proposing and managing institutions cover at least 42.5% (US$ 40,200) of the aggregate cost of the 6 projects, which has been estimated at a preliminary amount of US$ 94,650, whereas the remaining 57.5% is funded with IDB and CAF contributions that add on to the BIDPB contribution of US$ 54,450. It is worth mentioning that this amount represents 85.8% of the experimental revolving fund (US$ 63,486) initially set up by the IDB and CAF to begin responding to the above-mentioned request from the Andean Presidential Council.

Five of these first projects operate on the Bolivian-Peruvian border, and of these projects, three are targeted at the Aymaran communities from the *Altiplano* (Bolivian highlands) as direct beneficiaries: the productive potential assessment of the area is targeted at 4 Bolivian and 5 Peruvian municipalities (BO-PE 1); training in rational water use reaches 22 communities (BO-PE 2); and institutional and business orientation for micro and small producers is aimed at 8 Peruvian and 4 Bolivian communities (BO-PE 3). For their part, BO-PEs 4 and 5 are seeking university level thesis that might be useful in pre-feasibility projects on border integration and development. The project between Colombia and Ecuador is aimed at assessing the technical and socio-economic feasibility of an integrated plan for solid waste management in the two municipalities involved, as well as pollution management of the binational Carchi-Guaitara river.

TABLE 48
BORDER INTEGRATION PROJECTS BANK (BIDPB): SELECTED PROJECTS AND GRANTED FUNDS

Project	Managing-promoting institution and border	IDB contribution (US$)	CAF contribution (US$)	Aggregate BIDPB contribution (US$)	Managing institution contribution (US$)	Aggregate project cost (US$)
BO-PE/01 Generating the development plan for the binational sector of the border area	Binational Autonomous Authority of Lake Titicaca Water System (ALT) - Bolivia-Peru	5,500	1,500	7,000	10,000	17,000
BO-PE/02 Water use and management in Aymaran communities	Union of Aymaran Communities (UNCA)	4,500	500,000	5,000	8,000	13,000
BO-PE/03 Integrating Cojata-Pelichuco communities	Andean Women Center from Peru and Bolivia	3,400	3,550	6,950	----	6,950
BO-PE/04 General Secretariat of the Andean Community-National Altiplano University Agreement	National Altiplano University (UNA) - Bolivia - Peru	6,000	---	6,000	n.a.	n.a.
BO-PE/05 General Secretariat of the Andean Community-Bolivian Catholic University Agreement	Bolivian Catholic University (UCB) - Bolivia - Peru	6,000	---	6,000	n.a.	n.a.
CO-EC/01 Solid waste management	Municipalities of Ipiales and Tulcán - Colombia-Ecuador	---	23,500	23,500	22,200	45,700
Total		**25,400**	**29,050**	**54,450**	**40,200***	**94,650***

Notes: n.a.: No values available for the contribution of the universities concerned.

* Preliminary (excluding valuation of the contribution from managing-promoting universities).

Source: Report of the IX Meeting of GANDIF (October 2 and 3, 2003), at *Http://www.comunidadandina.org/fronterizo.asp*. In-house preparation.

For the near future, the objective of GANDIF in connection with this matter is to consolidate the BIDPB's operations. To this end, it has undertaken to perform the following tasks: evaluating the outcome and experiences of the above-mentioned experimental phase; reinforcing the binational scope of the projects, and including trinational projects in the portfolio of selected projects; encouraging each country's SNIPs to consider such projects when negotiating external financial support; and assessing the feasibility of creating a permanent border integration fund based on the experimental revolving fund set up by the IDB and the CAF.

B. Infrastructure and Services for Physical Integration

As stated at the beginning of this chapter, given that major specific projects on physical integration are being developed under the IIRSA (see next section), during the period discussed in this Report, the agenda of Andean subregional bodies relative to infrastructure and services for said integration was focused on planning and policy-making efforts that resulted in the Decisions listed in Table 49. Chapter III, Section D, reviewed the energy integration process; this Section will now describe the progress made in land, water and air transportation, as well as in telecommunications - thus supplementing the information provided on telecommunications in Chapter III, Section D - by the respective competent authorities' committees on the basis of the work prepared by their expert groups and during enlarged meetings including the civil society (managers and workers unions). However, it should be noted that these authorities have not yet taken stock of the goals and outcomes, which is essential for an adequate evaluation of the methodology and efficiency of the work done so far, as well as its effective progress over time.

TABLE 49
INFRASTRUCTURE AND SERVICES FOR PHYSICAL INTEGRATION: ANDEAN LEGISLATION (DECISIONS), 2002-2003

Decision 561 (June 2003)	Amendment to Decision 398 (January 1997): International Road Transportation for Passengers – Technical Requirements for the authorization and continuation of bus and coach service.
Decision 560 (June 2003)	Amendment to Decision 509 (August 2001): Approval for indirect operation of Simón Bolívar Andean Satellite System.
Decision 559 (June 2003)	Declaration of the expiration of rights granted to the ANDESAT S.A. E.M.A. company under Decisions 429 (February 1997) and 480 (June 2000), with the exception of the rights granted under Decision 509 (August 2001).
Decision 557 (June 2003)	Creation of the Council of Ministers of Energy, Electricity, Hydrocarbons and Mines of the Andean Community.
Decision 555 (June 2003)	Financial Agreement between the European Community and the Andean Community for Cooperation Project ASR.B7.3100.99.313, "Support for Preparation against and Prevention of Disasters in the Andean Community".
Decision 544 (April 2003)	Compilation of Andean Community Water Transportation Statistics.
Decision 536 (December 2002)	General Framework for Subregional Interconnection of Electricity Grids and Intra-community Electricity Exchange.
Decision 532 (October 2002)	Amendment to Decision 487 (December 2000): Maritime liens and mortgages and vessel arrest.

Source: SGCAN [2004e]. In-house preparation.

The agenda on land transportation, in charge of the Andean Committee of Land Transportation Authorities (CAATT) and its working groups, has been mostly focused on developing the guidelines for a common policy applicable to this kind of transportation. Short-, middle- and long-term objectives were determined. The short-term objective is to reduce non-compliance with relevant Decisions; the middle-term objective is to work towards harmonizing common policies and eliminating the lack of safety; and the long-term objective is to promote multimodality, reducing operating cost overruns and strengthening cooperation within the framework of IIRSA. Additionally, technical requirements were established for international passenger coaches, which requirements were laid down in Decision 561 (June 2003). In addition, a common statistics system was planned, for which purpose consulting services were retained from the Universidad Politécnica de Valencia, and work was carried out relative to an Andean driver's license and policy, hazardous cargo transportation, and the format of cargo manifests and other customs documents. Likewise, in April 2003, the Secretary General issued Resolutions 718 on grading carrier qualifications, 719 on International Road Transportation Regulations and 720 on the updating of the Andean Carrier Registry.

The working agenda of the Andean Committee of Water Transportation Authorities (CAATA) and its expert groups led to Decision 532 (October 2002) amending Decision 487 (December 2000) relative to Maritime liens and mortgages and vessel arrest, and Decision 544 (April 2003) on Water Transportation Statistics within CAN. Furthermore, enforcement of Decisions 288 (March 1991) and 314 (February

1992) on sea transportation was analyzed; a report was prepared on safety at the ship-port interface with cooperation from the Inter-American Ports Committee of the Organization of American States; the Andean committee participated in reviewing the draft project on door-to-door transportation promoted by the United Nations (UNCITRAL); other specific issues were advanced such as training in port management, recognition of degrees and licenses of seafarers and coordination with water transportation projects from IIRSA.

The Andean Committee of Air Authorities (CAAA) and its expert groups have addressed the issue of safety, although the EU failed to materialize the approval of a five-year cooperation program in this field, which was to include institutional and legal support for air traffic management and training. Promotion of border flights continued to be on the agenda, this time including items such as: operation control issues, given that said flights would be considered domestic; the technical headquarters to supervise compliance with the respective requirements; and unfair competition from airlines with state participation. However, no agreement was reached, as a result of which the possible amendment of some related Decisions is still pending.[20] Also pending are definitions relative to initiatives such as designing an Air Transportation Operating System in coordination with the Technical Coordination Committee of IIRSA and drafting regulations about environmental measures relevant to this kind of transportation. Still pending as well is the enforcement of Annex 4 of the WTO for the purpose of liberalizing taxes on subregional commercial air navigation. Furthermore, no results are yet known about the proposed linkage with the Andean Committee's Tourism Authorities' (CAATUR) working agenda.

The agenda of the Andean Committee of Telecommunications Authorities (CAATEL) and its expert groups continued to be focused on the issue of satellite communications established by the "Simón Bolívar Satellite System" project.[21] The ANDESAT S.A. company (an Andean multinational with 48 partners from all 5 CAN member countries) had originally planned to insert into orbit and operate satellite Simón Bolívar (slot 67º West, C-band and KU-band) in the first quarter of 2003, but in May 2002, this company and its Brazilian partner STAR ONE announced its postponement until 2004. In view of this, in June 2003, Decision 559 was approved declaring the expiration of the rights granted to the Andean multinational company ANDESAT S.A. on the establishment, operation and management of said slot or orbit-spectrum resource and entitling national authorities to take the necessary steps to ensure the project's feasibility. Decision 560 was also approved, upholding ANDESAT S.A. EMA's rights relative to indirect satellite use and opening up the possibility of recruiting new operators such as INTELSAT, PANAMSAT, SES AMERICOM, STARONE, HISASAT, NEW SKIES, SKYNET, TELESAT, SATMEX and NAHUELSAT, setting a deadline of up to one year for them to launch the satellite into orbit. Another still unresolved issue is related to the rights of CAN members on orbit-spectrum resource 61º West (C-band and KU-band), which have not been taken into consideration by Brazil upon their decision to launch into orbit Amazonas Satellite in said slot. CAATEL issued a recommendation that this case be decided pursuant to the Radio Regulations of the International Telecommunications Union.

C. IIRSA Hubs with CAN Countries

IIRSA intends to contribute to the creation of an integrated South American area by means of the implementation of ten "Integration and Development Hubs", so called by virtue of the fact that they include not only the development of physical infrastructure and that of related logistics operations, but

[20] That is, Decisions 297 (May 1991), 320 (June 1992), 360 and 361 (May 1994).

[21] Its regulatory background is contained in Decisions 395 (August 1996), 429 (February 1998), 479 and 480 (June 2000) and 509 (August 2001).

also policy harmonization regarding the different ways and modalities of transportation, telecommunications, energy and border crossings, as well as the promotion of real economic interdependencies among the inland regions of the countries involved through the creation of macro-regional areas from the geo-economic integration perspective.

The work done on these hubs during the period covered by this report has enabled the reaffirmation of the strategic vision of regional collective action as a means to solve the problem for poor infrastructure as initially proposed by the Executive Management Committee (CDE) of IIRSA. Likewise, the efforts of the Technical Coordination Committee (CCT) composed of the IDB, the CAF and the Financial Fund for the Development of the River Plate Basin (FONPLATA), as well as those of the Technical Executive Groups (GTE) composed of country experts have led to a more profound technical dialogue among the countries with a view to defining regional projects that facilitate the necessary strategic planning to execute them. The tools necessary to put together a single analytical methodology for each of these projects were: each hub's business visions, prepared by the respective retained experts; the data sheets submitted by each country relative to the national components of the hubs, which made it possible to advance in terms of the identification of the core aspects of each hub; and, since the meeting of the GTEs of the Andean and Amazon hubs in Quito (October 2003), the breakdown of the hubs' design by clusters of national projects having a direct and effective impact on the respective hubs with a view to facilitating their execution in the face of possible differences either in the assessment of said impacts or in the speed of completion of the technical studies that might be undertaken among the countries involved.

Figure 50 below lists the clusters of specific national projects proposed for 3 IIRSA hubs engaging CAN countries either wholly or partially: the Andean hub, including all 5 members; the Amazonian hub, comprising Brazil, Colombia, Ecuador, and Peru; and the Peru-Brazil-Bolivia hub. It is worth adding that the 9 clusters of the Andean hub described in this Table leave room for various projects that shape 2 major sub-hubs - a coastal hub prioritizing road access to the capital cities in the Andean countries, and an inland hub that in Peru is subdivided into an Andean highlands section (which this country prioritizes given that it joins the departmental capitals) and an Amazonian lowlands section to be developed at a later stage. In addition to these 9 clusters of road projects, an energy integration system (Cluster 10) and a telecenter and connectivity system (Cluster 11) have been considered, which are still at the design level.

Following a similar methodology, several project clusters have been proposed for the Amazonian hub. Cluster 1 involves projects in connection with access to Putumayo, laying the emphasis not only on roads but also on the development of the Tumaco and San Lorenzo ports as well as an electric interconnection between Leticia (Colombia)-Tabatinga (Brazil). Cluster 2 includes projects regarding access to the Napo river, which links port projects (Francisco Orellana, Manta, Esmeraldas) and airport cargo infrastructure projects (Nueva Rocafuerte and El Tena) with that of a potential BBSC for Nueva Rocafuerte (Ecuador)-Cabo Pantoja (Peru). Cluster 3 deals with projects providing access to the Huallaga and Marañón rivers, wholly located on Peruvian territory and connecting projects of road sections (El Reposo-Saramiriza, Bagua-Rioja) with airports (Piura, Yurimaguas, Tarapoto), of seaports (Piura, Bayovar) or river ports (Saramiriza) and of logistics centers (Paita, Yurimaguas). Cluster 4 refers to projects concerning the access to the Ucayali river (Cluster 4), reaching the coast via Lima and thus including the improvement of the Callao port, together with infrastructure development (port, airport and logistics center) in Pucallpa; consultations are underway regarding an energy and road integration option between this Peruvian city and Cruzeiro do Sul in Brazil. Clusters 5 and 6 refer to the Amazonian river network and encompass regulatory, environmental, operating, safety and transportation issues on the Putumayo, Napo, Ica, Marañón, Huallaga, Morona and Ucayali rivers, as well as studies for a logistics center at Iquitos.

TABLE 50
IIRSA: HUBS WITH CAN COUNTRIES

Andean hub	Cluster 1: Venezuela-Northern Colombia connection.
	Cluster 2: Caracas-Bogotá-Quito corridor.
	Cluster 3: Low altitude Barinas-Bogotá corridor (Venezuela-Colombia III connection).
	Cluster 4: Intermodal Río Meta corridor (connection Venezuela-Colombia IV).
	Cluster 5: Tumaco Port-Esmeraldas Port - Guayaquil-Lima.
	Cluster 6: Bogotá-Mocoa-Tacna-Zamora-Palanda-Loja (connection Colombia-Ecuador III).
	Cluster 7: Quito-Puente Integración-Tingo María (connection Peru-Ecuador II).
	Cluster 8: Huancayo-Ayacucho-Tarija-Northern Argentina (Peru-Bolivia connection).
	Cluster 9: Lima-Arequipa-Tacna, Ilo-Desaguadero-La Paz.
Amazonian hub	Cluster 1: Access to Putumayo.
(Brazil, Colombia,	Cluster 2: Access to Napo river.
Ecuador, Peru)	Cluster 3: Access to Huallaga-Marañón rivers.
	Cluster 4: Access to Ucayali river.
	Clusters 5 y 6: Amazonian river network.
Peru-Brazil-Bolivia hub	Cluster 1: Corridor from Puerto Velho up to a seaport on the Pacific.
	Cluster 2: It would connect Río Branco (Mato Grosso) and La Paz.
	Cluster 3: Integrating river Madeira's navigation (Brazil) with river Guayaramerin's (Bolivia)

Source: *Http://www.iirsa.org*. In-house preparation.

The first of the 3 project clusters proposed for the Peru-Brazil-Bolivia hub refers to a corridor from Porto Velho up to a seaport on the Pacific Ocean; the second one would connect the Branco river (Mato Grosso) and La Paz; and the third one seeks navigational integration of the Madeira river (Brazil) and the Guayaramerin river (Bolivia), in addition to using these waters for energy integration in the service area.

The bottom line is that, although the foregoing shows that progress has been made at the joint design and planning levels, completion of several of the projects has encountered serious hurdles in the imbalanced execution capabilities among the countries. For this reason, IIRSA's working plan was revisited in early 2004 in view of the forthcoming Third Summit of South American Presidents (Cusco, December 2004) in order to enter a new phase prioritizing the execution of investment projects. To this end, a proposal was made to focus on a relatively small project portfolio (from 20 to 30 projects at the most, of a total of over 335 project outlines) with a system targeted at monitoring and management, and to improve the business vision substantiating each hub by seeking direct involvement of private businesses in the specification of such visions.

Contents

CHAPTER V. SUMMARY AND FINAL REMARKS

In closing this report, we deem it appropriate to present a brief account of the progress made by the Member Countries and the subregional bodies of the Andean Community during the January 2002-May 2004 period, and share some thoughts regarding the current status of the Andean integration process and its prospects for the near future. We do not intend to conduct an in-depth, overall analysis of such process; our purpose is simply to highlight its main achievements and the obstacles encountered in the implementation of some of the political mandates issued by the Andean Presidential Council in the two meetings it held during the period this report focuses on: the Special Meeting of Santa Cruz (January 2002) and the Fourteenth Regular Meeting of Quirama (June 2003). This analysis takes into consideration a vast array of factors - technical, institutional, economic and political - that explain CAN's accomplishments and failures during the period under review.

A. Overview of the January 2002-May 2004 Period

Table 51 below follows the same order as the Santa Cruz and Quirama Directives, as it intends to portray synoptically the actions - compliances, deferrals or non-compliances - taken in response to such presidential mandates. However, the comments that appear after Table 51 are arranged in accordance with the layout of the preceding chapters (II to IV) of this Report, to show how subjects interrelate with each other and, in addition, to include in our review some significant actions in relation to matters that have not been explicitly mentioned in those presidential directives.

External Agenda[22]

It is in this area where the Andean countries have made the most significant headway, particularly as a result of the achievements reached with their major economic and political counterparts. The Andean Community's efforts were instrumental in the United States' approval of the Andean Trade Promotion and Drug Eradication Act (ATPDEA), enacted in August 2000, which renewed and expanded the preferential tariff treatment that, under the Andean Trade Preference Act (ATPA), the USA had unilaterally accorded to all CAN members but Venezuela. In spite of the hard work to have this Andean country included in this preferential treatment regime, the persistence of such exclusion was somehow predictable in light of the USA's long-standing policy of differentiating its relations with Venezuela from those it maintains with the other Andean Community countries. Going beyond the directives of the Andean Presidential Council, the four ATPDEA beneficiary countries also attained a far more ambitious goal: the USA announced the launch of negotiations for a cutting-edge free trade agreement with them (November 2003). Negotiations were initially held with Colombia, Ecuador and Peru (May 2004), while Bolivia participates as an observer entitled to full incorporation as soon as it meets the necessary requirements to such effect.

[22] This topic was examined in Chapter II hereof and also encompasses the question of South American physical integration mentioned in Chapter IV (Section C) in relation to the IIRSA Hubs. Table 51 refers to this topic under the heading "Common Foreign Policy" and to IIRSA under the heading "Services and Infrastructure for Border Integration".

TABLE 51
SUMMARY OF PRESIDENTIAL DIRECTIVES AND RESULTING ACTIONS: JANUARY 2002-MAY 2004

Andean Presidential Council Declarations		Actions (January 2002 - May 2004)
Santa Cruz (January 2002)	**Quirama (June 2003)**	
Free Trade Area (FTA)		
Directive 1: Perfect the Andean FTA by June 1, 2002 at the latest.		Trade in goods among Bolivia, Colombia, Ecuador and Venezuela is fully duty-free (for Peru, see Directive 2). The Andean FTA and the NAFTA are the two most advanced subregional FTAs in the Americas.
Directive 2: Peru will move the dates ahead for reducing customs duties on oil and fuels to December 31, 2003.		This Directive was not implemented via a Decision, as it was dependent upon the fulfillment of other presidential Directives. The December 31, 2005 deadline is still effective (Decision 414, July 1997); hence, by Jan. 2004, Peru had not yet applied the 26.87%, 77.86% and 62.5% tariff reductions on hydrocarbon imports from Colombia, Ecuador and Venezuela, respectively.
Directives 3,4,6,7 and 8: Non-tariff restrictions on trade: quantitative, administrative, sanitary, phytosanitary and technical.		Slow and incomplete compliance by Member Countries with the inventory of restrictions put forward by the SGCAN (July 2002). The Andean Agricultural Health System was brought into line with the WTO's Agreement on Sanitary and Phytosanitary Measures (Decision 515, March 2002), and the Technical Regulations were adopted (Decision 562, June 2003) within the framework of the WTO's Agreement on Technical Barriers to Trade.
Customs Union		
Directives 11 and 12: Adoption by all Member Countries of a new CET no later than December 31, 2003.		The January 1, 2004 deadline for the adoption of the new CET agreed upon for 62% of the tariff universe (Decision 535, Oct. 2002) was not met; it was successively postponed and finally set for May 10, 2005 (Decision 580, May 2004). Meanwhile, Peru applies its domestic tariff and the remaining CAN members apply the CET established as per Decision 370 (Nov. '94).
Directives 13 and 14: Harmonize special customs regimes and customs regulations.	Directive 26: Implementing the recommendations of the GRANADUA Project.	Strongly conflicting positions persist with respect to special customs procedures. As for customs facilitating instruments, the following December 2003 decisions stem from the GRANADUA Project: Update of the Andean Common Customs Classification-NANDINA (Decision 570); Value of Imported Goods at Customs (Decision 571); Andean Integrated Tariff (Decision 572); Andean Customs Training Program (Decision 573), and Andean Customs Control Regime (Decision 574).
Andean Common Agricultural Policy		
Directives 15 & 16: Implementation of an Andean Common Agricultural Policy as well as common agricultural price stabilization mechanisms reducing product coverage and ensuring more transparent application.	Directive 24: Definition of the Andean Common Agricultural Policy no later than September 30, 2003.	The January 1, 2004 deadline as established in Decision 535 (October 2002) was not met and a new one has not yet been specified or has been left open for the adoption by Member Countries of a system of agricultural price bands covering fewer products and ensuring a more transparent application methodology. These two distinctive features (coverage and methodology) set the current Andean System of Price Bands (ASPB) for Colombia, Venezuela and Ecuador apart from the Peruvian system.
Directive 17: Agreements among production sectors that ensure competitiveness of all agricultural chains.	Directive 22: Design of coffee chain policies.	The Ad Hoc Coffee Group was set up and it drafted the "Andean Program for a Sustainable, Competitive and Integrated Coffee Chain" (August 2003). No similar progress was made with oilseeds, where unresolved distortions (see Directives 3-4, 6-8 and 11-16 above) triggered the proliferation of trade defense measures.

TABLE 51 (continued)

Services and Infrastructure for Physical and Border Integration		
	Directives 28-31: Implementation of border integration projects and backing for the IIRSA.	Three Border Integration Zones (BIZs) were formally established. Actions were adopted for the operation of seven Binational Border Service Centers (BBSCs). The creation of an IDB-CAF revolving fund facilitated the approval of six projects of the Border Integration and Development Projects Bank (BPIF). To facilitate their implementation, the projects were grouped into three CAN-IIRSA hubs.
Directive 29: Energy potential as a strategic factor.	Directive 32: Construction of the Community energy market.	Adoption of the General Framework providing for the subregional interconnection of electric systems and the exchange of electricity among Community members (Decision 536, December 2002) and approval of the Action Plan of the Council of Andean Community Ministers of Energy (Decision 557, June 2003).
Macroeconomic Policy Harmonization		
Directive 18: Compliance with criteria for convergence.		Adoption of Programs of Harmonization Measures (Decision 543, April 2003). Peru has already met the three targets established therein (inflation, fiscal deficit and public debt). Venezuela has met the last two ones; Bolivia, the first one, and Colombia and Ecuador, the second.
Common Foreign Policy		
Directive 20: Securing the renewal and expansion of the ATPA, with the inclusion of Venezuela.		In August 2002, the United States' President approved the 2002 Trade Act, which provides for the renewal and expansion of Andean trade preferences (ATPDEA). However, Venezuela remains excluded from such benefits.
Directive 21: Consolidating an association with the EU.	Directive 7: Political Dialogue and Cooperation Agreement, which should facilitate negotiations of a Free Trade Agreement with the EU.	A CAN-EU Political Dialogue and Cooperation Agreement was signed (December 2003), which expanded and reinforced the previous one (1992). According to the Declaration of Guadalajara (May 2004), the commencement of negotiations for an association agreement that includes a Free Trade Agreement was dependent upon the achievement of a sufficient degree of integration by the CAN.
Directive 24: Continuing trade negotiations with MERCOSUR.	Directive 19: Completing negotiations for the CAN-MERCOSUR FTA no later than December 31, 2003.	Peru entered into a bilateral Economic Complementarity Agreement (August 2003) under which it acquired the MERCOSUR Associate Member status. Colombia, Ecuador and Venezuela did likewise by signing a joint Economic Complementarity Agreement (December 2003). Negotiations to implement each FTA and make them operational are underway. Bolivia has its own bilateral Economic Complementarity agreement (December 1996) providing for similar terms.
Directive 22: To continue negotiating jointly and with a single voice in the FTAA.	Directive 20: Andean political reflection (Presidential and Enlarged Councils) in reference to the FTAA.	FTAA negotiations continued under a single spokesmanship. Bolivia, Colombia and Peru, together with other ten American countries submitted their "Vision of the FTAA" to the Fifteenth Trade Negotiations Committee Meeting (October 2003) prior to the Miami Ministerial Meeting (November 2003).
Directive 23: Concerted positions before the WTO.		A joint Andean "Drugs" GSP defense was submitted before the WTO (February 2004), in response to a claim lodged by India against this scheme of tariff preferences.
Social Agenda		
Directive 30: Moving ahead with the tasks on the social agenda.	Directives 8 & 10: Design of an Integrated Social Development Plan.	Creation of the Working Groups on the Rights of Indigenous Peoples (Decision 524, August 2002) and on Promotion and Protection of Consumer Rights (Decision 539, March 2003). Adoption of the Guidelines for Formulating the Integrated Social Development Plan (Decision 553, July 2003).
	Directive 9: Promotion of measures on labor migration as well as occupational safety and health.	Adoption of the Guidelines of the Andean Plan for Health on Borderlands (Decision 541, March 2003); the Andean Social Security Instrument (Decision 546, July 2003) and the Andean Instrument on Health and Safety at Work (Decision 547, July 2003).

Sources: Chapters II to IV of this Report. In-house preparation.

Not only did the CAN Member Countries and the EU reach the Political Dialogue and Cooperation Agreement (December 2003), which expands and strengthens the long-standing cooperation ties existing between both integration schemes, but also they agreed on a three-year extension of the Andean "Drugs" GSP, from January 1, 2002 to December 31, 2004. The EU has also consented to consider the possible renewal of the GSP for ten additional years, from 2005 to 2014, further expanding its product coverage. Also, the talks for a CAN-EU Association Agreement - including an intergroup Free Trade Agreement - seem to be headed in the right direction, a pre-condition being**,** therefore, that CAN's show that a sufficient level of integration has been attained.

Likewise, the five CAN Member Countries achieved MERCOSUR Associate Member status - which entitles them to attend its Presidential Summits as participants - as a result of the Economic Complementarity Agreements signed by MERCOSUR and Peru bilaterally in August 2003, and by MERCOSUR and Colombia, Ecuador and Venezuela, acting jointly, in December 2003. These two agreements were preceded by the Economic Complementarity Agreement made in 1996 between Bolivia and MERCOSUR. At the moment of closing of this report, negotiations were underway for the implementation of the FTAs contemplated in the two latest Economic Complementarity Agreements mentioned above. Should such negotiations prosper, a critical instance will begin in the construction of the South American Free Trade Area, as there are other FTAs at their implementation stage by virtue of the Economic Complementarity Agreements signed by Chile with the MERCOSUR as well as with each of the Andean countries. Steps have also been taken towards the South American physical integration within the framework of the Initiative for the Integration of the Regional Infrastructure in South America (IIRSA), an effort that has the financial and technical backing of the International Development Bank (IDB), the Andean Development Corporation (CAF) and the Financial Fund for the Development of the Rio de la Plata Basin (FONPLATA). In this respect, great strides have been made towards the execution of such integration projects by categorizing them into the three Integration and Development Hubs involving the CAN countries.

It seems reasonable to ascribe the absence of similar progress in other common foreign policy ventures - such as CAN relations with Canada and the Central American and Caribbean countries, for example, among others mentioned in the previous report (INTAL [2002], pages 86, 89-90) - to the considerable investment of time and effort that the pursuit of the objectives mentioned in the two preceding paragraphs has required.

Negotiations with the Asia-Pacific bloc were launched in January 2004 for a Peru-Thailand Free Trade Agreement, a development that, in spite of its bilateral nature, is explained in part by this Asian country's interest in gaining access to the markets of the Andean subregion and the rest of South America. The five Andean Community countries did act jointly, however, to make a submission before the WTO (February 2004) to defend their "Drugs" GSP with the EU following a claim filed against such regime by India. And they also acted under a single spokesmanship in the FTAA talks, in relation to the majority of the items in the agenda, as well as to the guiding principles that were incorporated into the Declaration of Miami (November 2003).

In light of all these achievements, the development of the Andean foreign agenda has been quite successful. However, it is fair to recognize that, even though the Andean Community countries held intraregional consultations and made coordinated efforts of different natures in their pursuit of the above-mentioned goals and the Andean subregional bodies played an active role, the only goals that the five CAN members sought and achieved acting on an integrated basis are the EU-related objectives. This means that on most occasions the Common Foreign Policy was not carried out through common foreign policy actions *strictu sensu* but rather via bilateral or sub-group actions that were partially coordinated according to *ad hoc* needs. This mismatch between CAN's common aspiration to gain international projection and its actual foreign practice constitutes a tell-tale sign of a fledgling group and, in the internal sphere, of a lack of correspondence between the objectives in respect of the level of economic integration and the attainment thereof.

Internal Agenda[23]

The main noncompliances and delays involved core Andean trade integration issues. To begin with, the deadline for the adoption of the CET by all five CAN members was extended until May 10, 2005, upon the expiration of the January 1, 2004 timeframe established under Decision 535 (December 2002), Annex I of which contained the promising headway of a new CET agreed upon by the five Member Countries for 62% of their tariff universe. Such postponement implies that the challenge of creating a customs union is still present and that Peru continues to apply its national tariff, while the other four countries apply their own CET as set forth in Decision 370 (November 1994). In the second place, the lack of major progress towards the dismantling or harmonization of non-tariff measures worked against the decision to move forward the deadline (to December 31, 2003) for the reduction in tariffs on hydrocarbons imported by Peru from the subregion. Hence, the deadline is the same as the one originally established by Decision 414 (July 1997): December 31, 2005. Thirdly, not only did the Andean Community fail to meet the January 1, 2004 deadline for the adoption by the five CAN countries of a new system of agricultural price bands covering fewer products and using a more transparent methodology as provided for in Decision 535, but also no new deadline was set to resolve the current overlapping of two systems (the Peruvian system and the ASPB applied by Colombia, Ecuador and Venezuela), which are clearly inconsistent with each other as to their coverage and methodology. The resulting distortions, in turn compounded by the distortions caused by two above-mentioned major noncompliances, have triggered the proliferation of trade defense measures against the intra-subregional free trade in oilseed products.

Even though this phenomenon is product-specific, as it only affects oilseeds, and we should therefore not overestimate its impact, we should not underestimate it either because it affects a sector to which all Member Countries are extremely sensitive. This trend is a worrisome sign of what the future may be like if no action is taken to correct the distortions in intra-subregional trade resulting from the coexistence of different tariffs for third countries and the lack of intra-subregional harmonization of non-tariff restrictions, special customs procedures (temporary admission, inward processing, drawbacks) and agricultural price band systems; all this has to do with the major noncompliances summarized in the preceding paragraph. The ensuing distortions might at any moment prove to be detrimental to the Andean FTA in sensitive sectors or products having a significant weight in intra-subregional trade. All this would imply a terrible regression due to their intrinsic harmful effects and the risk of spoiling the single major achievement the Andean trade integration can genuinely take pride in today: the FTA in goods, which - together with the NAFTA - is the most advanced subregional free trade area in the Americas.

There is no doubt that on the plus side is the active role assumed by the CAN on many other fronts of the construction of the Andean common market: liberalization of the trade in services; free circulation of goods, services and production factors; border integration; macroeconomic convergence, and social agenda. The following are but a few of the major accomplishments in the internal agenda. With respect to the liberalization of the trade in services, we should point out the approval of the subregional general framework of the interconnection of electrical systems and its effective implementation between Ecuador and Colombia, to which the Peru-Ecuador interconnection will soon be added, as well as the new land transportation regulations (technical requirements to be met by land transportation coaches) and maritime guarantees (maritime liens and mortgages). As to the second front, in relation to the free circulation of persons, we should mention the recognition of national identification documents as the sole requisite for tourist travel in the subregion, as well as the approval of the Andean labor migration instrument. Moving on to the third front, we should highlight the establishment of the first three BIZs, the advanced preparatory work for the set-up of seven

[23] This topic was addressed in Chapter III and Sections A and B of Chapter IV of this Report. In terms of Table 51, this heading deals with all the subjects not included in the preceding footnote.

BBSCs and the approval of the first six projects of the Border Integration and Development Projects Bank (BPIF), the execution of which will be facilitated by the creation of an experimental IDB-CAF revolving fund. In the field of macroeconomic convergence, we must applaud the adoption of the pertinent programs of harmonization measures and the reasonably significant headway made in the attainment of the inflation, fiscal deficit and public debt targets. Finally, as to the social agenda, credit should be given to CAN for the adoption of the guidelines for formulating the integrated social development plan and the Andean plan for border health, as well as the Andean social security, and the health and safety at work instruments; in addition to the creation of two working groups: one to advocate the rights of indigenous peoples and the other to promote and protect consumer rights (the latter with respect to competition policy).

When contrasting these achievements with the delays or noncompliances concerning key trade integration matters, certain considerations should be borne in mind. Firstly, it is not yet possible to measure or assess accurately the actual progress made on most of the fronts of the construction of the Andean common market, because the pertinent criteria or indicators remain to be defined, in part due to their procedural nature and their many qualitative components. Conversely, the extent of the progress made in trade integration is easier to assess because of the availability of specific evaluation criteria and indicators. In addition, as trade integration is already going through its most critical or sensitive phase, any step forward or backwards is all the more evident. Second, dynamism outside the backbone of trade integration has been shown in areas that are mostly within the sphere of competence of the corresponding Sectoral Ministries or Foreign Affairs Ministries, the heads of which, meeting in the Andean Council or in the Enlarged Session or Commission, as the case may be, were empowered to legislate, by adopting decisions at the subregional level on matters within their jurisdiction, in accordance with the institutional and legal reforms established by the Trujillo Protocol (March 1996). These reforms further strengthened the role of the General Secretariat as the Andean Community's executive body, including its settlement power in disputes, without which the proliferation of trade defense measures would have been greater and with far worse implications, and institutionalized the roles of the Andean Presidential Council and the Andean Council of Foreign Affairs Ministers as the Andean Community's highest-level and political steering bodies respectively (INTAL [2002] pages 4-6). The ensuing legacy of a fairly well-rounded Andean institutionality - unparalleled among the existing integration processes in the Americas -constitutes an asset that has counterbalanced the shortfalls in the CAN's internal agenda, in addition to its decisive contribution to many of the most outstanding achievements in the Andean external agenda.

To be fair, however, we cannot but admit that it is the CAN's Commission - made up of the Foreign Trade Ministers of its member countries - that has the most delicate task: defining the most crucial trade integration issues, for which the "moment of truth" has come. It is at this moment when the ambitious integration model advocated by the CAN is felt to be an overwhelming task. The ensuing (and to a certain extent "natural") dilemmas or uncertainties have translated into the fact that, while the necessary flexibility was demonstrated by the agreement on a CET project (listed in Annex I of Decision 535), which did not cover the whole tariff universe but yet involved all the CAN countries, the Member Countries lacked the determination required to adopt it in part or in whole, even when doing so was technically justified (as examined in the pertinent subheading of Section II.A of this Report). In case such reluctance was due to the perception that CAN-derived economic benefits do not merit taking that decisive step towards its consolidation as a customs union, the following is a brief account of the major benefits**;** and, to have a clear idea of the interests at stake, we also include a succinct review of the extent to which each Member Country has taken advantage of the opportunities arising from Andean integration.

B. Economic Effects of the Andean Community: How does each Member Country Benefit from them?

Our analysis should begin with a review of trade integration, an undoubtedly essential component of any economic integration process which, in the case of CAN, in view of its aim to form a customs union, is based on two central mechanisms: the FTA and the CET. Table 52 summarizes many of the issues reviewed in the first chapter (sections C to E of Chapter 1) of this Report, in addition to others taken from a recent study by the General Secretariat (SGCAN [2004b]) and shows briefly that Andean trade integration has contributed positively to producing at least three beneficial effects on its Member Countries:

TABLE 52
TRADE INTEGRATION: EFFECTS AND BENEFITS BY ANDEAN COUNTRY

		Bolivia	Colombia	Ecuador	Peru	Venezuela	CAN
Exports (X)							
CAN destination in total Xs (TX), 2000-2002.		22.7%	19.50%	10.60%	7.10%	4.80%	9.60%
AAGR difference (TX_{CAN} - TX_{Rw}), 1991-2002.		12.6%	6.80%	4.80%	-0.50%	4.90%	5.40%
Manufactured Xs (MX): Importance 2000-2001.	$(MX / TX)_{CAN}$	8.70%	77.30%	40.70%	53.80%	56.40%	60.60%
	$(MX / TX)_{RW}$	36.80%	25.90%	4.20%	33.10%	7.80%	15.30%
MC Share in TX (2000-2002) and MX (2000-2001).	TX_{CAN}	6.90%	46.10%	11.20%	9.50%	26.30%	100.00%
	MX_{CAN}	0.90%	57.80%	8.80%	7.90%	24.50%	100.00%
	MX_{RW}	6.30%	35.80%	2.20%	28.40%	28.30%	n.a.
	TX_{RW}	2.10%	20.30%	10.10%	13.20%	54.20%	---
RCA: Number of sectors at the 3-digit ISIC level, 1991-2001.	RCA_{WORLD}	6	11	4	4	4	4
	RCA_{CAN}	1	21	6	9	10	---
Imports (M)							
CAN origin in total M (TM), 2000-2002.		10.20%	13.50%	21.10%	14.80%	11.50%	13.70%
AAGR difference (TM_{CAN} - TM_{RW}), 1991-2002.		11.80%	3.30%	8.90%	-3.60%	9.40%	5.80%
AAGR difference (TX_{CAN} - TM_{CAN}), 1991-2002.		3.00%	0.20%	-4.90%	2.00%	-1.30%	0.00%
MC share in TM (2000-2002) and MM (manuf., 2000-2001).	TM_{RW}	3.90%	27.80%	11.30%	16.10%	40.90%	---
	TM_{CAN}	2.80%	27.10%	19.00%	17.60%	33.60%	100.00%
	MM_{RW}	4.20%	30.30%	9.60%	15.90%	40.00%	---
	MM_{CAN}	3.60%	22.50%	21.50%	11.30%	41.10%	100.00%
FDI (1994-2002)							
MC Share in Total FDI (TFDI) and Manufacturing FDI.	TFDI	8.00%	27.00%	9.00%	23.00%	33.00%	100.00%
	Manufacturing FDI	5.00%	44.00%	4.00%	13.00%	34.00%	100.00%
Intra-CAN FDI (FDI_{CAN})	FDI_{CAN} / TFDI	2.05%	1.77%	0.84%	1.15%	0.80%	1.26%
	MC as destination	13.00%	38.00%	6.00%	21.00%	21.00%	100.00%
	MC as origin	0.40%	41.00%	25.00%	12.00%	21.00%	100.00%
RCA_{TFDI}: number of sectors at the 2-digit ISIC level, 1997-1999.		n.a.	11	n.a.	4	n.a.	---

TABLE 52 (continued)

Effects on Protection							
Simple Average Tariff	In 1988	16.60%	46.30%	44.50%	70.50%	42.20%	44.00%
	In 1991	9.20%	16.40%	16.60%	16.20%	15.10%	14.70%
	In 1994	9.70%	11.30%	11.00%	15.60%	11.30%	11.80%
	In 2002	9.30%	11.70%	11.40%	10.60%	12.10%	11.00%
Protection granted: TM_{CAN} according to nominal protection levels versus TM_{RW}, 2002.	Low (0%-5%)	2.40%	18.30%	28.20%	9.60%	6.80%	---
	Medium (7%-12%)	97.60%	43.50%	31.60%	84.80%	33.10%	---
	High (20%-35%)	0.00%	240%	34.90%	3.50%	41.20%	---
	Agricultural bands	0.00%	14.30%	5.30%	0.60%	18.80%	---
Protection received: TX_{CAN} according to nominal protection levels versus TM_{RW}, 2002.	Low (0%-5%)	2.30%	14.40%	2.00%	24.10%	25.10%	---
	Medium (7%-12%)	14.40%	39.70%	63.10%	39.10%	57.20%	---
	High (20%-35%)	2.60%	41.00%	26.60%	31.70%	15.00%	---
	Agricultural bands	80.50%	4.70%	8.20%	5.20%	2.60%	---
"Platform Effect" [1]							
Benefited Xs: number (No.) of subheadings and amounts (US$ billions), 2002.	No. of Subheadings	48	515	137	275	262	---
	X_{CAN}	2.941	395.115	75.560	87.769	115.166	676.551
	X_{RW}	25.250	669.042	82.066	193.092	248.685	1,218.135

Notes: AAGR: Average Annual Growth Rate; MC: CAN Member Country; RW: Rest of the World.
RCA: Revealed Comparative Advantage; n.a.: not available.
[1] "Platform Effect", calculated on the basis of products whose intra-CAN Xs (CANX) accounted for more than 75% of the respective total Xs in 1993-1998 but less than 75% in 2001-2002, in spite of the fact that such CANX showed a growing trend in 1993-2002.

Sources: Several Tables in Chapter I (Sections C to E) of this Report; SGCAN [2004b] Tables 17, 20-21and 25. In-house preparation.

In the first place, we must acknowledge the diversification and industrialization of CAN exports, as evidenced by the predominantly manufacturing composition of total intra-CAN exports (60.6%), in beneficial contrast to the overwhelming majority (84.7%) of the primary-product pattern in extra-CAN Andean exports. Secondly, the enlarged subregional market has served as a specialization field that has allowed the CAN countries to gain the experience required to compete more successfully in larger, more sophisticated markets - the so-called "platform effect" that is measured as explained in the note to Table 52. By virtue of this platform effect, the share of extra-CAN exports in the products involved increased, from 12% of total exports in 1993 to 62% in 2002 (SGCAN [2204b], pages 47-48). In the third place, CAN contributed to the two previously mentioned benefits not only without increasing the tariff protection level, but also - and on the contrary - by helping to reduce it. Indeed, the most significant decrease in the simple average tariff was registered between 1988 and 1991 and therefore is not attributable to the general economic reforms (which only became widespread in the Andean subregion in the latter half of the 1990s), but rather to a more favorable position towards "outward" integration that the CAN adopted following the Strategic Design drawn up by the Andean Presidential Council in Galapagos (December 1989). The implementation of this Strategic Design involved the approval of the Act of La Paz by such Council in November 1990, which provides for the intensification of the work towards the creation of the FTA as the previous step to the establishment of a CET. In addition, such CAN instruments have mostly agreed on a low to medium protection level, both in terms of imports ("protection granted") and exports ("protection received") of intra-CAN trade. In contrast to such beneficial trade effects, CAN has not yet been able to generate sufficient investment incentives, as the intra-CAN foreign direct investment (FDI) still accounts for an insignificant share (1.26%) of the total FDI inflows into the subregion.

We must bear in mind that not all Member Countries have been equally able to take advantage of the opportunities created by the Andean trade integration. The various extents to which the Member Countries are able to profit from such opportunities are ultimately dependent upon their respective national capacities, particularly their business capacities and the ones that are reflected in the quality of their general trade policy and, in this particular case, of their specific trade policy with reference to the CAN. In this respect, we should remember (INTAL [2002], pages 9-15) that while Peru decided to exclude itself from the subregional FTA and CET (Decision 321, August 1992), Bolivia, Colombia and Venezuela have been part of an FTA since September 30, 1992, with Ecuador joining in on January 31, 1993, and that these four countries applied the CET under Decision 370 (November 1994). Of the Member Countries that first adopted the two core mechanisms of Andean trade integration, Colombia is the one that has benefited the most from the subregional market. In effect, Table 52 shows in brief that, at intra-CAN level, this country is not only the largest exporter in general (46.1%) but also the leading exporter of manufactured goods (57.8%) in particular. Furthermore, it is the Andean partner with the highest number of sectors of world trade RCAs (11) as well as the largest quantity of subregional RCA sectors (21). Lastly, in terms of FDI, it has attracted the greatest portion of manufacture-related investments (44%) and has been the leading player in intra-CAN’s FDI both as an investor (41%) and as a recipient thereof (38%), and that it has been the one that has reaped the greatest benefits from the "platform effect" generated by the expanded Andean market.

In contrast, only after Decision 414 (July 1997) came into effect did Peru start to rejoin the FTA, from which it had initially withdrawn on account of trade policy differences, particularly non-tariff restrictions, special customs procedures and systems of agricultural price bands (differences that in practice are still unsolved, as reviewed in this Report). And this country still remains excluded from the CET - a decision that was initially due to the pro-flat rate option it then had. All such factors may have had a bearing on Peru’s incapacity to benefit from Andean trade integration as much as it might have been expected, given its intra-CAN relative economic size. In fact, it has been the only member whose intra-CAN exports grew less dynamically than its extra-CAN exports (-0.5%); its intra-CAN manufactured exports share has been lower than Ecuador’s (7.9%); it has exhibited little attractiveness for FDI in general (as for number of RCA sectors [4%]) and for manufacturing FDI in particular (13%), and it has performed poorly in comparison with Ecuador as an intra-CAN investor (12%). Peru’s intra-CAN exports, however, had a high manufacturing composition (53.8%) and grew more dynamically than its intra-CAN imports (2%). In addition, Peru obtained the second best profit from the "platform effect". All these factors seem to indicate that some of the most beneficial effects of the enlarged subregional market were reaped even by the country with the least Andean trade integration.

An interesting contrast is observed with Bolivia, the smallest economy in the Andean community. In spite of having a very similar trade policy to Peru’s, Bolivia did not choose to exclude itself but rather to take on an active role in the negotiations to ensure an early incorporation favorable to its interests both into the FTA (for instance, without applying agricultural price bands) and into the CET (by having its motion for applying a less scaled tariff approved). This may have contributed to its attaining the highest "received protection" level (83.1%, almost totally due to the agricultural price bands applied by its Andean partners), the largest difference in terms of dynamism in favor of its intra-CAN exports with respect to its extra-CAN exports (12.6%), and the largest share of intra-CAN FDI in its total inward FDI (2.05%).

As to other economic repercussions of the Andean integration, the above-mentioned General Secretariat’s report estimates that the increase in intra-CAN trade led to the generation of gainful employment, creating 323,000 new direct or indirect jobs in the 1992-1997 period, and that the Andean countries that benefited the most from this "employment effect" were Colombia, Ecuador and Venezuela (SGCAN [2004b] pages 49-51), i.e. the three countries that most comprehensively adopted the two core trade integration mechanisms. The same study further demonstrates that in 1990-1991 and 2001-2002 economic integration grew, and so did the multiplying effects produced by the changes that occurred in the aggregate demand among member countries (the so-called "boomerang effect") According to this study, Colombia and Venezuela are the countries that are most affected by what happens in the rest of the CAN, while Ecuador and Venezuela are the most influential in the rest of the subregion (*idem*, pages 77-79). This is probably explained by the fact that the two former countries are the leading intra-CAN exporters of manufactured goods, as well as by the incidence of oil and fuels in the intra-subregional trade with the latter two. In addition, even though this study also establishes that the asymmetries in economic size (total and per capita GDP) persist among the Andean countries and, in this respect, Andean integration has failed to attain its objective of reducing existing differences in levels of development among member countries (as set forth in Article 1 of the Cartagena Agreement) (*idem*, pages 7 and 15-17), we should make two comments in this regard. The first is that via its contribution to the diversification and industrialization of exports, Andean integration has indeed met the objective (also included in such Article) of promoting the balanced and harmonious development of its Member Countries. And the second is that through the CAF and the Latin American Reserve Fund (FLAR), Andean integration has indeed favored a less asymmetric access to financial and technical cooperation, as reviewed in Section H of Chapter III of this Report.

C. Towards a Common Market without a Customs Union?

These beneficial economic effects - all valuable individually, and all the more decisive when considered as a whole - show that the *raison d'etre* of the CAN is not simply "political" (in the derogatory sense of the word, hence the quotes) and they underpin the centripetal forces that explain its very well-advanced FTA for trade in goods as well as its persistently active role in the efforts to build the common market that are not strictly related to the consolidation of the customs union. However, the centripetal forces generated are still weak (it should be borne in mind that the subregional market only absorbs 9.6% of total Andean exports and has an even smaller impact as an FDI attracting force), as compared with the centrifugal forces strengthened by the significant weight of the economic and political relations with third countries or regions. Moreover, not all Member Countries have profited equally from the beneficial economic effects, a predictable unfolding because this was dependent upon evidently unequal national capacities; however, this condition was probably worsened by the joint acceptance of excessively "custom-made" core trade integration participation mechanisms.

Those two aspects, coupled with the intrinsic high demands of the integration model being pursued, have impacted ambiguously on the way in which the challenge to consolidate the customs union was faced: on one hand, the highest-ranking political willingness to level the playing field to ensure such consolidation (as established in the presidential directives of the Declaration of Santa Cruz); and, on the other hand, the reiterated procrastination of such consolidation, which probably results from the existence of powerful interests that are favored by the uneven field and/or that view the internal and external agendas as mutually exclusive rather than complementary. Two statements made by members of the Commission of the Andean Community clearly illustrate the immanent tension underlying this ambiguous situation and of the understandable resulting frustration. The Minister of Foreign Trade of Ecuador, Mrs. Ivonne Barki, said on December 17, 2003 that her country would rather maintain the CET as set forth in Decision 370 and focus on establishing and strengthening relations with the countries with which it conducts most of its trade, such as the USA and the EU, while the Minister of Foreign Trade and Tourism of Peru, Mr. Alfredo Ferrero, held on December 15, 2003 that he found it very unlikely - not to say impossible - that a common CET could ever be agreed upon by the five countries, and consequently expressed the need that a new CAN agenda be devised that does not consider the CET as a priority.

In such circumstances, one of the Andean Community's major assets, its institutionality, has become instrumental in the resolution of this dilemma. The General Secretariat is now seeking to formulate a new strategic design, devising an Andean integration for development and globalization that may somehow "detariff" the process via a new common market model that places the emphasis on the respective regulatory and promotion actions, on competitiveness (of the rural and farming sectors, of SMBs, of the IIRSA hubs service areas and border areas, in addition to the technological innovation that all this entails), and on other strategic subjects such as energy, sustainable development, information society and connectivity (Wagner [2004] pages 7-13).

The question of the integration model is, then, at the center of the ongoing Andean debate. To put it simply, we can say that two integration models prevail on the world and Latin American scenes. One of them is the EU model, which embodies the "orthodox" position in terms of integration, with its supranational institutions and mechanisms that ensure the efficacy of the rules of the game of a process that is based on legality rather than domination or imposition, and with its typical phasing of the process in sequential stages. Under this model, the creation of a customs union is prior to the establishment of a common market because it is understood that becoming a single trade entity is essential in order to ensure the viability of the remaining process of building a single economic area as well as the credibility of such an undertaking. The other model is the one adopted by NAFTA, whose aim is the creation of an integrated FTA, the components of which are to be built simultaneously - or without predetermined stages - and encompass or even exceed the vast range of subjects included in the current WTO agenda. Thus, such FTA can be likened to a "heterodox" common market in as much as it includes all the pertinent ingredients with the exception of the supranational ones. In the Andean subregion, since the inception in 1995 of the "Group of Three" (Colombia, Mexico and Venezuela) and the Bolivia-Mexico free trade agreement, and particularly nowadays when negotiations are underway for a Free Trade Agreement with the USA, a sort of blending of both models is being put together or, to be more precise, the Andean version of the European model and the adaptation of the NAFTA to the Latin American realities.

It is not unthinkable that such *de facto* crossbreeding may end up being acknowledged *de jure* through the adoption of a new hybrid model of Andean common market. History shows that the members of the CAN were realistic enough from the outset to adapt their integration model by way of the 1989 Strategic Design, in response to the "outward" integration requirements resulting from the new development strategies. And that very realism might well drive them to a new adaptation to better face the challenges of today’s globalization. Likewise, they had to resort to their flexibility - some would say excessively - to weather difficult situations. For instance, the approval of Decision 321 in August 1992 to accept Peru’s self-exclusion; the approval of Decision 322, which loosened the community procedures for bilateral negotiations with the ALADI countries; the approval of Decision 370 in November 1994, which adopted various special procedures and "tailor-made" exceptions, or the approval of Decision 535 in October 2002 that provided for a CET that did not cover the whole tariff universe, to mention but a few examples. And they might as well draw on this resilience once again to devise a common market version that combines the components of today’s two major integration models.

However, we should not ignore that the construction of a common market worthy of that name, regardless of how hybrid it may be, is always a formidable challenge whose complexity goes beyond the mere definition of tariffs, as it involves the harmonization of domestic policies or intra-border measures. This also applies to competitiveness and other strategic issues, such as the ones mentioned above, which call for wide-ranging efforts and responsibilities as they involve acting on each country’s microeconomic internalities; it is for this reason that very few countries have attained major success in second and third generation structural reforms. Since all this must be done in accordance with rules of the game based on legality, given that within the Andean Community no Member Country has sufficient power to impose its will upon the others, such mammoth tasks require a highly effective integration scheme as regards its regulatory framework and mechanisms as well as unquestionable credibility. Will the Andean Community attain such an ambitious goal if it keeps procrastinating the consolidation of its customs union? Alternatively, if it decides to abandon this objective, many CAN insiders and outsiders may wonder: if it failed to attain the minimum - the customs union - how will it manage to reach the maximum - i.e. a common market, however "heterodox" it may be? Therefore, effectiveness and credibility seem to be the most concrete and pressing challenges facing the Andean Community today.

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