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INSTITUTE FOR THE INTEGRATION OF LATIN AMERICA AND THE CARIBBEAN

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Second Annual Conference

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FOREWORD

The process of economic reform and trade liberalization in Latin America and the Caribbean, under way since the end of the 1980s, has brought about an increasing integration of the countries in the region into the world economy, both in terms of commercial and investment flows. At the same time, Latin American countries have been pursuing the process of deepening economic integration at the subregional level, negotiating trade liberalization at the regional and hemispheric level, as well as engaging in multilateral trade negotiations. Latin American countries are also negotiating cooperation and free trade agreements with other countries and regions of the world, both developing and industrial ones. These developments, as well the emergence of new powerful players on the international arena, such as China and India, represent opportunities but also enormous challenges for Latin America.

In facing these challenges, the countries of Latin America and the Caribbean are open to ideas, experiences and good practices that may contribute to their successful integration into an increasingly open and competitive international economy. In this regard, the rich European experience in the process of regional integration over the last decades that has brought about not only mutual trade liberalization, but also the establishment of joint institutions, a common currency as well as political cooperation and a strong component of solidarity among member countries could be of benefit for the region. Moreover, Latin America is an important market for the European Union as it positions itself in global competition and seeks partners for economic as well as political cooperation.

With this in mind, in 2002, the Inter-American Development Bank, through the Special Office in Europe and the Integration and Regional Programs Department, through the Institute for the Integration of Latin America and the Caribbean (INTAL), launched the Euro-Latin Study Network on Integration and Trade (ELSNIT). The Network operates with the collaboration of partner European centers, leaders in research in the area of integration and trade. ELSNIT represents a platform for an exchange of ideas between European and Latin American experts, and ultimately a source of support for policy makers on both sides of the Atlantic. This publication provides an account of the main findings of the second cycle of activities of the Network during 2004/2005.

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INTRODUCTION

In October 2002 the Inter-American Development Bank (IDB), through the Special Office in Europe (SOE) and the Integration and Regional Programs Department (INT), through the Institute for the Integration of Latin America and the Caribbean (INTAL) in Buenos Aires and the Integration, Trade and Hemispheric Issues Division launched the Euro-Latin Study Network on Integration and Trade (ELSNIT). This initiative creates in Europe a forum on integration and trade issues relevant to Latin America and the Caribbean. The main objectives of the Network are to generate research, studies and debate on these issues, draw on a rich European experience and increase interaction between European and Latin American researchers.

Latin America, like much of the world has been opening its economies, while simultaneously pursuing regional integration both of the South-South and North-South variety. European perspectives can provide important policy insights on these processes as well as in areas such as trade; the behavior of investment and FDI; macroeconomic coordination, exchange rate management and monetary cooperation; growth and convergence; labor market dynamics; migrations; regional institutions and compensatory mechanisms. Moreover, developments in Latin America are important for Europe in the context of global competition and cooperation.

The Euro-Latin Study Network on Integration and Trade has involved the establishment of a Steering Committee that includes leading European research centers and the IDB (represented by SOE and INT). The Steering Committee currently incorporates the Institute for World Economics (IfW), Kiel, Germany; the Center for Research in International Economics (CREI), Barcelona, Spain; the Robert Schuman Centre for Advanced Studies of the European University Institute (RSC), Florence, Italy; and the Centre d'Etudes Prospectives et d'Informations Internationales (CEPII), Paris, France.

The first cycle of ELSNIT was launched in January 2003 with a call for papers on three topics: macroeconomic dimensions of regional integration; European Union enlargement and adjustment policies during the transition, and the impact of regional integration on economic convergence and growth.

Twelve papers were selected for the first Annual Conference[1] of the Network that was held in Barcelona in November 2003. The event was hosted by the Center for Research in International Economics (CREI), under the sponsorship of and in co-organization with the IDB. The conference was organized in three sessions, corresponding to the three topics in the call for papers, and chaired respectively by the representatives of the research centers members of the Steering Committee. Each paper was commented on by an organized discussant from Latin America.

The findings of the first Annual Conference, together with policy indications for Latin America and future research agenda proposals, were discussed at a follow-up seminar on April 27-28, 2004 in Buenos Aires, organized by IDB/INTAL. The coordinators of the sessions of the Annual

[1] The agenda of the first Annual Conference, the papers presented, as well as the discussants' comments, can be viewed at the Network's webpage at *http://www.iadb.org/europe* or *http://www.iadb.org/intal/foros/foro23_2003*

Conference each prepared an issue paper for this occasion. The papers and the comments of Latin American experts were published in "ELSNIT - Issues Papers, First Annual Conference".[2]

The second cycle of ELSNIT launched in February 2004 involved two major additions. First, the topics covered by the Network were broadened to three areas, or tracks: Macroeconomic Dimensions of Integration and Trade, Empirical Dimensions of Integration and Trade, and – this being the new area added – Institutional Dimensions of Integration and Trade. Second, the call for papers was extended, besides Europe, to Latin America and the Caribbean. Following the call for papers, for which close to ninety submissions were received, the Steering Committee selected eighteen papers – six per each track – for the second Annual Conference of ELSNIT held in Florence on October 29-30, 2004.[3] The conference was hosted by the Robert Schuman Centre for Advanced Studies of the European University Institute and was organized jointly with the IDB.

On the basis of the papers and discussion in the Florence conference, the coordinators of the three tracks prepared issue papers, which were subsequently presented at a follow-up seminar in Santiago de Chile on May 6-7, 2005, co-organized by the Economics Department of the University of Chile and the IDB (see agenda in Appendix). The issue papers and the comments by discussants are presented in this publication.

The coordinators of the first session of the Conference, on Macroeconomic Dimensions of Integration and Trade, were Omar Licandro of the European University Institute and Jaime Ventura of CREI. They group the six papers from Florence into two recurrent themes: integration and the economic role of institutions, and the growth of world trade and the emergence of China. In the issue paper, they briefly summarize the main issues raised by the conference papers, place them in the context of the wider literature, and conclude by presenting some ideas with regard to possible lessons for Latin America. In the context of the first theme, the papers discussed cover the topics of import substitution industrialization (ISI), the growth effects of intellectual property rights (IPR) protection in developing countries, the impact of differences in regulations between countries on bilateral flows of foreign direct investment (FDI), the political economy of immigration and the welfare state, and finally, the issue of optimal design of monetary policy coordination.

As regards ISI policies, their impact on the poor performance of Latin America from the sixties to the eighties has led to the introduction of more orthodox policies over the last two decades, which, nevertheless, have not helped Latin America to raise growth rates and converge to the life standards of the developed countries. Licandro and Ventura point out that a better understanding of Latin American specificities is still missing, and that in this context in the formulation of growth strategies it would be helpful to implement primary economic principles, taking into account local idiosyncrasies. Concerning IPR, the authors note that a well-designed IPR policy may be considered as a good example of high-quality institutions, but that the relation between the quality of institutions and growth is highly non-linear. If in the initial stages of development technical progress is mainly guided by imitation, protecting IPR is not growth enhancing.

[2] Also available at *http://www.iadb.org/Europe* or *http://www.iadb.org/intal/ingles/i-default.htm.*

[3] The agenda of the Conference, the papers presented and the discussants' comments, are posted on the link: *http://www.iadb.org/europe.*

However, at some point in development, the protection of IPR eventually does become a requirement for growth. The paper on FDI stresses that, from the normative point of view, similar national regulations are efficient since they encourage local entrepreneurs to invest abroad; harmonization thus raises productivity, output and wages. While less efficient local producers may oppose harmonization, workers and potential investors, on the other side, can be seen as political supporters of harmonization. As a general rule, it is noted that regional integration agreements may be seen as the result of a step-by-step harmonization of regulations.

On the second recurrent theme on changes in the world economy, one paper looks at the underlying forces behind the growth of world trade, analyzing the impact of the reduction in trade costs on the growth of US trade with non-OECD countries. It identifies two effects: a static one, in which for given factor endowments import prices fall due to a reduction in trade costs, and countries specialize further in industries in which they have a comparative advantage. There is nevertheless a second, dynamic effect with a stronger impact – the reduction in trade costs raises the price of each country's abundant factor and therefore induces countries to accumulate more of this factor, leading to a divergence in factor endowments that deepens comparative advantage and further reduces import prices.

The entrance of China into the world economy also has static and dynamic effects. While the static effects take factor endowments and technology as given and lead to further specialization and raise the efficiency of the world economy, through the dynamic effects the emergence of China alters the incentives to accumulate factors and technology worldwide, pushing the global production frontier outward. The discussion in Florence focused on the dynamic effects, in particular on the effects on factor accumulation and the rates of innovation and imitation and their effect on relative incomes of the North and the South. The paper presented sees the effects of the entry of China as an increase in the rate of imitation – in the model the North innovates and China (the South) imitates – concluding that this leads to a permanent improvement in world technology as there is an increase in the growth rate and a reduction in the technological advantage of the North. At a certain stage the South will however be expected to start innovating, and this is seen as having two implications – the global rate of innovation will increase, meaning that the above model underestimates the impact of China on world technology; and second, the rate of imitation will increase less and the world will use less resources on the task of copying already available technology, thus further increasing the positive effects of China's entry into the world economy.

Licandro and Ventura conclude by noting that a fundamental issue for Latin America is the design of a development strategy in a global world, or, in a related way, the issue is how Latin America would react in a global world by building dynamic comparative advantages. It does not appear clear that the prediction, as stated in some papers, that foresees dynamic comparative advantages moving Latin America towards more labor intensive technologies would be highly beneficial in the long term. Another issue seen as of major relevance is the design of a common migration policy between the United States and Latin America. Interregional distribution policies may however not be feasible in the medium term (as those implemented in the European Union), making it difficult, according to the authors, to believe that the FTAA may in the near future play this role. Regional integration agreements are the natural vehicle to the harmonization of regulations concerning FDI flows; the European experience over the last decades has shown that the adoption of North institutions by South countries may be growth enhancing.

Claudio Bravo of the University of Chile commented on the Licandro and Ventura paper. His comments also refer directly to the papers presented in Florence, on which he makes a number of observations. As regards the relationship between economic growth and institutions, and the characterization of appropriate institutions for development, he does not share the opinion of the issue paper authors who postulate that "highly performing economies implicitly converge to similar institutions", noting instead that different institutions might be optimal at different stages of development (with given factor endowments). This would imply, according to Bravo, that optimal institutions are related to income levels and not to growth rates, e.g. environment regulations. On IPR, he points out that in general there is a lack of theoretical models addressing the role of institutions in shaping IPR regimes in developing countries. He presents some results of his research with Lederman on the relationship between IPR regimes and institutions and R&D levels, noting that while the mechanisms through which this relationship operates have not been clearly examined, there is preliminary evidence that institutions matter for R&D activities. Turning to China and its emergence in the world economy, Bravo notes that assuming three factors of production – labor, capital and natural resources – Latin America appears as natural resource abundant. This then raises the question whether the region would continue to specialize in exporting primary products.

The second session of the Florence conference focused on Empirical Issues of Integration and Trade. The session was coordinated by Michel Fouquin of CEPII and Rolf J. Langhammer of IfW; they are, together with Rainer Schweickert of IfW, the authors of the issues paper presented herewith. The process of regional integration and the ensuing liberalization of intra-regional trade in goods lead to changes in trade patterns; at the same time, real sector integration may influence macroeconomic coordination and monetary integration, with possible feedbacks from monetary integration to trade integration. Of the six papers in this session of the conference, three predominantly deal with issues linked to changes in trade patterns both regarding intra- and extra-regional trade, including the methodology of measurement of intra-regional trade, border effects, and the growth impact of regional trade agreements among developing countries. The remaining three papers deal with the second issue, i.e. the interaction between trade integration on one side and macroeconomic and monetary integration on the other.

The paper on border effects compares domestic trade to international, with domestic trade as the benchmark of trade without any borders. In general, bilateral trade depends on the size of the two partners, on relative prices, tariff and non-tariff barriers, geographical distance, cultural links, etc; once these factors are accounted for, the residual is identified as the border effect. This concept could be seen as a benchmark for the ultimate stage of development of trade without borders. The paper further compares the border effect in trade between the high and low- and middle-income countries, with the results showing that it is more difficult for a developing country to gain access to the industrial countries' market than vice versa. The tariff equivalent of the differences in border effects is around 35% points, rising to 50% points in the case of the least-developed countries. These results show, according to the authors, that the normal tariff is not the most important issue for the developing countries. Nevertheless, it is noted that the border effects have been decreasing over the decades, particularly in the case of regional trade agreements and intra-regional trade. The discussion on this issue pointed out that there are natural obstacles to full integration as consumer tastes, habits and needs differ between countries, and that it may not be possible (nor desirable) to achieve the benchmark.

Another issue discussed in Florence was the link between regional trade and business cycles. A way to empirically measure market integration is to identify the degree of harmonization of national business cycles and the role, which trade plays in harmonization trends. Growing inter-industry trade (exchange of goods originating from different sectors) would lead to more specialization making national shocks idiosyncratic, driven by the peculiarities of specific sectors in which a country specializes. As a result, countries would not share common shocks. On the other hand, more intra-industry trade (exchange of similar but differentiated goods within a sector) is expected to expose countries to the same industry-specific shocks and thus contribute to business cycle harmonization and the exposure to common shocks. One of the papers presented deals with the co-movement of industrial output cycles in Europe and their correlation with intra-industry trade indices. It also raises the question whether a monetary union is instrumental in promoting intra-industry trade, thereby contributing to the harmonization of business cycles and thus bringing a union closer to an optimal currency area (OCA) state. Another paper analyzes the aggregate fluctuations and cyclical co-movements in the Mercosur area, looking as well at the issue of macroeconomic policy coordination. It asks whether regional actions can be taken to reduce the volatility of some variables, such as the real bilateral exchange rate, thereby facilitating the integration process, and what institutional framework at the regional level and domestic policy regimes can be introduced to support the coordination effort. A third paper indicates the need to apply the concept of value-added economic integration (VEI), as opposed to gross economic integration (GEI), i.e. that only intra-regionally originating trade flows should be used as a measure for the "true" degree of regional integration and as a criterion for entering into monetary integration. In general, the authors of the issue paper point out that the results from the papers presented imply that monetary integration is a reasonable option for the Mercosur countries, although economic integration is rather low. As regards theory, the challenge is to explain how a monetary union influences trade and trade patterns, other than the well-established reverse causality of trade intensification through free trade areas or customs unions which create OCA conditions and thus facilitate monetary integration. The "endogeneity" vs. "non-endogeneity" debate remains open.

The third session on Institutional Dimensions of Integration and Trade was coordinated and chaired by Helen Wallace of the Robert Schuman Centre for Advanced Studies of the European University Institute. The issue paper was co-authored with Jacques Ziller, also of the European University Institute. It represents the views of the authors on the main issues that emerged out of the six papers, the discussants' comments and the general discussion that took place during the session. Also included are some reflections on policy implications of the identified issues.

To function as a solid base for regional integration, a major requirement for institutions is the provision of an efficient system for the peaceful settlement of interstate disputes. Such a system provides not only for security and the resolving of political disputes, but also for the stability and predictability of the business environment, as well as for disputes of an economic nature, whether they relate directly to trade or only its policy environment. A further central issue in the design and effectiveness of regional institutions for economic integration is finding the right combination between respecting the equal rights of states of different size and acknowledging differences in economic and political size and weight of countries. Ways and means to take into account especially powerful partners should receive more attention. The conference in Florence pointed to the centrality of the issue of asymmetries between participating countries. In this regard, the case of Mercosur was mentioned as particularly striking. The same was said to be true for the influence

of third countries or groupings which are the partners of Latin America in free-trade agreements, and which have a much bigger role in trade than any of the Latin American countries; these are the United States or the European Union in the present, and perhaps China and India in the years to come.

An issue that is not given enough attention by policy makers, and – according to the authors – is too often ignored by academic writings, is the first step in choosing and setting up institutions, i.e. identifying what are the functions to be exercised by an institution. The characteristics of institutions should differ according to their functions. A thorough examination of the objectives, which are being pursued, and a realistic assessment of available resources which condition the sustainability of an institution are essential. For sustainability, it is imperative to think ahead about implementation before setting goals and thresholds. Linked to this is the issue of coordination, i.e. of coordination deficits in Latin America. No specific definition was brought forward at the conference, and in this regard the authors note that it might be useful to apply more precise analytical instruments in order to set up a diagnosis of these deficits and to come up with proposals to address them (the coordination scale developed by Metcalfe in the framework of the EU could be considered in this respect). Three aspects of coordination received special attention at the Conference: coordination between countries, within countries, and conflict resolution in regional integration.

The legal dimension of regional integration is generally assigned a high importance by academics, as well as by politicians and practitioners. The development of a genuine and specific law of regional integration needs time and stability of institutions. The treaties establishing regional economic cooperation need to be translated into the law of the member states in order to acquire the formal qualities, which are indispensable for their effectiveness. The inability of a quick and efficient translation into national law within a framework of legitimate democratic accountability is perceived as one of the major obstacles to the development of regional integration. The existence of regional institutions also creates a need for the adaptation of the political and administrative institutions at national and sub-national levels. In the European case this experience has included a tendency to underestimate the national and sub-national institutional dimensions of integration, in academia as well as in the practice of institution-building and management. A further important aspect of multi-level governance is the impact of different modes of regional integration on domestic policy making and public management within member states. Taking integration seriously means allocating resources, including human resources, to both policy preparation and coordination, and also to the monitoring of policy implementation. The availability of human resources is conditioned by the structure and functioning of civil service systems. In this regard, of key importance is the availability of training programs and institutions. The authors point to ELSNIT as a possible complement to the work of international and regional organizations in the area of public administration, given the possibility within the Network to carry out multidisciplinary studies involving economists with specialists of public management.

The authors also raise the question of the relevance and transferability of the European experience for Latin America, noting that given the specific context and setting of the EU, many of its features are hard to replicate in other regions of the world. They thus indicate the need for awareness of the limited scope for drawing lessons. A solid understanding of the European experience in Latin America is nevertheless important, so that decision-makers in the region can rely upon the necessary knowledge in order to resist proposals to take up the European model when it is not relevant, but also in order to consider it when the European experience may be

useful. As regards technical assistance that the EU provides/finances for regional integration in Latin America, the authors point out that more attention could be devoted to assessing the nature of the actors involved, their techniques and tools. The actors involved need have the knowledge of both the European experience and of the recipient region. This match may result from specific programs developed by the EU, regional institutions and governments in Latin America, and the IDB.

The authors see ELSNIT as a forum for research on the institutional aspects of regional trade and integration, carried out on a pluri-disciplinary basis and bringing together multidisciplinary teams of social scientists. In this regard, a manageable method would be to try to identify a set of topics, which would be the subject of several studies conducted separately in different disciplinary fields, and then confronted in terms of their results.

In her comments on the Ziller and Wallace paper Alicia Frohmann, of the Ministry of Foreign Affairs of Chile, agrees that the Latin American countries, in most cases, do not fulfill a number of conditions necessary for building strong and relevant regional institutions. Among them she notes the need for strong political and economic institutions at the national level, and the need for acceptance of the necessary delegation of powers to regional institutions. She nevertheless argues that this does not mean that efforts towards regional institution building should not be attempted. She further notes that informal mechanisms of integration in the region have often worked out better than the formal ones (for example within the business community, unions, legislators, NGOs etc.). As regards the transferability of the European experience, Frohmann points out that awareness of the role of stakeholders and civil society in the development of regional institutions in Europe is of great relevance, in order to facilitate the creation of legitimate and accountable regional institutions in Latin America. She also mentions that the Strategic Association Agreement currently discussed between Chile and Mexico, and which seeks a more comprehensive integration mechanism, would closely follow the model of the Association Agreements that both countries have signed with the European Union. Looking at the case of Chile, the priorities of institution-building are said to be clearly shifting from trade-negotiating institutions to trade-implementation institutions. The implementation of trade agreements involves, among other, the implementation of commitments through legislation and administrative rules, as well as the definition of policies to translate new business opportunities created by trade agreements into real benefits for the business community, especially small and medium–sized enterprises (SMEs).

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FIRST SESSION: EMPIRICAL DIMENSIONS OF INTEGRATION AND TRADE

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EMPIRICAL DIMENSIONS OF INTEGRATION AND TRADE[1]

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I. INTRODUCTION

At its early stage, one of the focal elements of each regional integration process is the liberalization of intra-regional trade in the context of forming free trade areas or customs unions. Such formation can reduce the size of the non-traded sector relative to the traded sector in each country, favor diversification within industries through the development of intra-industry trade, reduce trade costs between members and give rise to income-raising productivity increases if intra-regional trade expansion is based on trade creation and not on trade diversion. In order to minimize trade diversion, extra-regional trade liberalization must proceed parallel to intra-regional trade liberalization. This is indispensable for otherwise free trade areas will be trapped in regional import substitution. Many integration schemes outside Europe and North America, which either failed or stagnated, bear witness to this link between intra-regional and extra-regional trade liberalization.

Once this process is under way, two things may happen. First, within the real sector, trade patterns will change, and second, real sector integration may influence macroeconomic coordination and monetary integration, eventually with feedbacks from monetary integration to trade integration. Papers in the empirical dimensions part of the Florence Conference were either predominantly

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[1] The authors of this paper gratefully acknowledge comments and suggestions received by the participants of the Second Annual Conference. In his critical comments, Patricio Meller contributed an essential issue to the discussion, that is, the policy relevance of the papers invited to the sessions. He strongly held and criticised that market access of Latin American exports to the European Union (EU) markets should have ranked much higher on the policy agenda than on the one hand the distinction between domestic and international trade and the policy barriers driving this distinction and on the other hand the issue of monetary integration in Latin America in general and MERCOSUR countries in particular. This critic is derived from a different understanding of the role of the session papers on which the authors summarised and commented. The authors' decision to select the papers was ruled exclusively by the endeavour to document scholarly work in progress rather than to pinpoint their actual policy relevance. Such work in progress was both of technical nature (for instance, the Iapadre paper) and policy-oriented nature (for instance, the Mayer/Zignago paper). Patricio Meller's critics of a trade-off between analytical and empirical quality and political (ir) relevance will give rise to a debate among the coordinators of the sessions whether or not to aim at a better mix and balance of scholarly work and political relevance. One essential issue addressed by Mayer and Zignago is developing countries' access (not only Latin American countries) to developed markets (not only EU markets) for manufactured goods. Unlike Patricio Meller who in his comments raised the critics that the paper neglected protectionist barriers of the EU against agricultural products from developing countries, we think that industrial goods' access to developed markets is at least as important as the question of agricultural goods' access to developed markets. Without such possibilities of access there would have been no industrialisation process for Korea, Taiwan, Mexico, China and Brazil. Primary specialisation has often proved to be associated to income generation foregone. In this respect, Patricio Meller's comments have been appreciated by the authors.

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concerned with changes in trade patterns alongside intra- and extra-regional integration and their driving forces such as Iapadre [2004] and Mayer and Zignago [2004], or concentrated on the growth impact of regional trade agreements among developing countries -Lo Turco [2004], or dealt with the second issue, the interactions between trade integration on the one hand and macroeconomic coordination and monetary integration on the other hand- (Garnier [2004]; Wang [2004]; Fanelli and Gonzáles-Rozada [2004]).

II. REGIONAL TRADE AGREEMENTS, MARKET ACCESS AND GROWTH

A. How to Measure Intra-Regional Trade

At a time of mushrooming regional trade agreements all over the world, it is necessary to measure intra-regional trade as opposed to extra-regional trade and then to explain the reality and nature of intra-regional trade. The question is not only a macro-economic one referring to the traditional macro-economic trade off between trade creation and trade diversion effects, but it is also a question of the kind of specialization encouraged by intra-regional or extra-regional trade. Between similar countries, trade develops as intra-industry trade (as it did within the European Union (EU)-15), while between countries of different income levels, it tends to develop as an inter-industrial trade or some kind of a vertical division of labor such as the one seen within Asian countries. There is also an institutional question behind trade agreements, that is, of "deep" integration such as the European Single Market as opposed to "shallow" integration such as Free Trade Agreements (FTAs).

Over time, many authors have tried to answer these questions first by trying to measure trade integration starting with Balassa [1964] through Gaulier *et al.* [2004]. One of the most popular instruments is the so-called trade intensity index sometimes referred to as the delta index: it compares the share of intra-regional trade with the share of the region in world trade. If international trade was the product of pure economic factors the index should be equal to one, that is to say that the share of intra-regional trade should be equal to the share of the region in world trade. This is the "neutral geography" hypothesis. In reality, geography is a strong component of trade patterns, and the index value varies largely according to geographic distance. Therefore, divergences to value one of the index are explained by distance measures (Freudenberg, Gaullier, Unal [1998]). But once geography has been taken out it still appears that there are differences between "natural trade" and observed trade taking into account not only geographical distance but also some other measurable factors such as tariff and non-tariffs barriers, language etc., and real trade patterns.

The index is relatively well suited to the analysis of the bilateral trade pattern applied at an individual country level, but it has several technical defaults for intra-regional trade analysis. The first reason is that intra-regional trade will be affected by the number of member countries: EU-15 intra-regional trade will be lower relative to EU-25 intra-regional trade but we will not be able to decide if intra-regional intensity is higher in EU-25 compared to EU-15. It goes without saying that comparison with the North American Free Trade Agreement (NAFTA) integration grouping using trade intensity index would be meaningless. The second problem is that we do not know whether we should consider intra-regional trade as usual international trade or whether it is something closer to ordinary domestic trade. The EU is pretending to have achieved the completion of a single European market. Nevertheless we know that even in the case of the EU-15 internal trade there are still large border effects remaining probably due to the fact that consumer tastes remain different between the two sides of the border and because consumers still make a difference between national products and non-national products. Can we compare NAFTA intra-regional trade with intra-EU trade? The answer is probably no. But nevertheless we want to have an idea of the degree of regional integration through trade integration and have a comparative measure.

The Iapadre paper is a tentative approach to these problems. Starting with the trade intensity index, Iapadre finds there is a first set of problems to be resolved:

The range variability problem: the values taken by the index range from 0 (in case there is no intra-trade), to the inverse of the regions' total trade share in world trade when there is no extra-regional trade. Therefore, there cannot be a comparison between index values for different regions. The solution is then to replace the denominator value - i.e. the share of the region in world trade - by the share of the region in extra-regional trade to the rest of the world trade. The index value then takes values between 0 and Infinity (when there is no extra-regional trade) whatever the partners are.

The range asymmetry problem: the minimum value is zero while the maximum value is variable or infinite if we accept the previous transformation. Then the solution is purely technical. Our new index (NI) in terms of the previous one (PI) is: NI=(PI-1)/(PI+1), which takes the value of -1 when there is no intra-trade (PI=0), and +1 when extra-trade is null PI=∞ and the value of one in case of geographic neutrality.

The dynamic ambiguity problem: under the condition that changes in intra-trade are lower than the total change in the trade flow, and then it is possible that both intra-trade and extra-trade intensity falls. One solution would be to calculate the complementary index of intra-regional trade intensity that is to calculate the extra-regional intensity index and then to calculate the ratio between the two values.

Another series of problems arise if we want to take into account the fact that countries may be more or less willing to be open to trade. That will have influences on the dynamics of trade flows. The author, following Deutsch and Savage [1960], introduces an accounting decomposition in order to take into account the variations in trade openness which influence the changes in trade flows in order to disentangle the trade creation effect from the trade diversion effect. A region's weight in world trade can be defined as the product between the country's share of world output and the trade openness of that country:

$$W_i= G_i*O_i= (y_i/Y)*((t_i/y_i)/(T/Y))= t_i/T$$

The country's share in world production and its evolution mark the relative dynamism of the country. It should have a positive impact on the trade share for a given level of openness, and the more open an economy is the higher is its trade share. Iapadre then proposes to introduce the same correction as for the former indicators: the propensity to intra-trade intensity, the propensity to extra-trade intensity and, finally, what is called the symmetric index of intra-regional trade plus its relative version.

The second part of the paper is dedicated to the analysis of intra-regional trade evolutions for EU-15, Association of South-East Asian Nations (ASEAN)-10, Southern Common Market (MERCOSUR)-4 and NAFTA-3 for the years 1990-2000.

Starting with the intra-regional trade share, the author finds that the intra-EU trade share is slowly decreasing from a very high level of 65% in 1992 to 60% in 2000, of which 2% may be due to a change in the way data were collected following the start of the Single Market in 1993. The other regions show a more or less pronounced upward trend, NAFTA being the most dynamic zone with a gain of 9% on intra-regional trade share to 48% in 2000. ASEAN and MERCOSUR lag to a little more than 20%. So the number and size of the member countries of a region seem to influence the level of intra-regional trade.

The most interesting index is the intra-regional trade intensity index, which shows the following results:

MERCOSUR is by far the most inward-oriented region, and this phenomenon tends to become more distinct as time passes by: the maximum value of that index being 1, MERCOSUR index is valued at 0.9 compared with ASEAN 0.7, NAFTA 0.5 and EU 0.48. All groupings are clearly valued at higher than 0, which is the neutral value of that index. The fact that MERCOSUR and ASEAN comprise developing countries with higher levels of protection than the two other groupings may explain the fact that these two regions are more inward-oriented than NAFTA and the EU. This reveals the ambiguity of these indicators: high inward-orientation of a country does not mean that the country is more integrated. On the contrary, if one trades with only one country while being closed to the rest of the world as, for example, North Korea with China, does not mean that the two countries are integrated but only that North Korea is highly dependent on China.

If we account for trade openness with the relative intra-regional trade propensity index we find a different picture: once again ASEAN and MERCOSUR are the most inward-oriented regions but for different reasons as the author suggests: ASEAN includes (relatively) open economies while MERCOSUR does not. This explanation is debatable. In fact, trade openness varies considerably within ASEAN countries -Indonesia and Thailand are relatively closed countries, while Singapore is very open.

At the other end of the spectrum is NAFTA, which is clearly the most outward-oriented region.

One may conclude that this paper provides a detailed analysis of openness indicators. Nevertheless, the discussion revealed that there are some aspects, which have not been taken into account in the analysis. This applies, e.g., to trade in components and migration influencing trade by facilitating transactions within ethnic groups. Both aspects could spur trade without being related to openness. Moreover, complementarities between trade and investment are to be considered.

Another set of remarks applies to the appropriate use of data. Using trade data only has the merit of homogeneity of data sources and statistical methods but one fails to take trade openness into account. Admittedly, the trade openness measure is very difficult to set up and to interpret, not to speak of isolating the effect of institutionalized integration. Additional problems arise because of the use of trade to gross domestic product (GDP) ratios.

The first problem with this variable is that we compare a value-added variable (GDP) with a gross output value (export or import value).

The second problem is that we use international prices for trade values and domestic values estimated in dollar through the use of current exchange rates instead of purchasing-power-parity (PPP) exchange rates. For that reason, openness in developing countries is overvalued while it is undervalued in the case of developed countries.

The third problem is that GDP refers to all activities the majority of which are non-traded services while export and import data are only available for goods. Therefore, doubts can be raised regarding the magnitude of the results using such ratios. While the starting point is interesting, the estimate seems very disputable.

A minor point is that one would like the author to elaborate on what is his preferred index and why.

B. Market Access in Global and Regional Trade

The Iapadre paper is about the measurement of intra-regional trade and comparing natural trade to real trade. The Mayer/Zignago paper starts from a very different point of view. It intends to compare domestic trade to international trade. Domestic trade is said to be trade in a completely homogenous and transparent market; it is the ultimate stage of development of trade integration. So domestic trade is the benchmark of trade without any border. The authors use a database matching domestic trade and international trade. It allows to evaluate the domestic market based on local sales (output less exports). Then the authors use these data to compare domestic trade intensity with external trade intensity. Naturally, bilateral trade depends on the size of the two partners, on relative prices, on tariff barriers and non-tariff barriers, on geographic distance and cultural distance etc.; once all these elements are taken into account there is still a residual called the "border effect". One of the most interesting aspects of this concept is that it gives a benchmark for what is the ultimate stage of development of trade without border measures.

Subsequently, the authors compare the border effect in trade between rich countries with trade between rich and low-income or middle-income countries in order to find out whether developing countries have an equal or fair access to the northern markets.

The trade model can be summarized by equation (1):

$$\ln\left(\frac{m_{ij}}{m_{ii}}\right) = -(\sigma-1)[\beta+\eta] + \ln\left(\frac{v_j}{v_i}\right) - \sigma\ln\left(\frac{p_j}{p_i}\right) - (\sigma-1)\ln(1+t_{ij})$$

$$-(\sigma-1)\ln(1+ntb_{ij}) - (\sigma-1)\delta\ln\left(\frac{d_{ij}}{d_{ii}}\right) + (\sigma-1)\lambda L_{ij}$$

$$-(\sigma-1)[\varphi-\eta]\mathrm{NS}_{ij} - (\sigma-1)[\psi-\eta]\mathrm{SN}_{ij} + \varepsilon_{ij}, \qquad (1)$$

Where mij/mii is the ratio between the total import of country i from country j and mii is the production of country i for its own market (that is local production less total export: Qi-Xi);

$-(\sigma-1)[\beta+\pi]$ is the border effect; β is the home bias of customers in country i and η is the level of protection of the importing country i;

v_j/v_i is the relative value of production;

P_j/P_i are the relative prices measured as the relative real exchange rates;

t_{ij} are bilateral tariff of country i towards imports from country j;

nt_{ij} are bilateral non-tariff barriers of country i towards imports from country j;

d_{ij} is the bilateral distance (and dii is an average distance within country i);

L_{ij} is the common language variable;

NS_{ij} is a dummy approximating southern countries barriers to access northern markets;

SN_{ij} is a dummy approximating northern countries barriers to access southern markets.

The empirical results of Mayer and Zignago show that the border effect is very large, much larger than any tariff or non-tariff barriers (Table 1).

TABLE 1
NORTH-SOUTH MARKET ACCESS, BY INCOME LEVELS

Model	Dependent Variable: Ln Imports Partner/Own					
	World	World	North imp.	North imp.	South imp.	South imp.
Border	-4.49 [a]	-6.05 [a]				
	(0.08)	(0.12)				
Ln Rel. Production	0.79 [a]	0.76 [a]	0.79 [a]	0.76 [a]	0.78 [a]	0.80 [a]
	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.03)
Ln Rel. Prices	0.02	-0.63 [a]	-0.28 [a]	-1.09 [a]	-0.38 [a]	-0.10
	(0.03)	(0.05)	(0.05)	(0.08)	(0.06)	(0.13)
Ln Rel. Distance	-0.70 [a]	-0.51 [a]	-0.53 [a]	-0.46 [a]	-0.83 [a]	-0.55 [a]
	(0.03)	(0.03)	(0.03)	(0.03)	(0.03)	(0.06)
Contiguity	1.44 [a]	0.85 [a]	1.51 [a]	0.86 [a]	1.00 [a]	1.16 [a]
	(0.05)	(0.04)	(0.06)	(0.04)	(0.06)	(0.14)
Common Language	0.37 [a]	0.09 [c]	0.63 [a]	0.02	0.71 [a]	0.64 [a]
	(0.04)	(0.05)	(0.06)	(0.06)	(0.05)	(0.08)
Ln (1+Tariff)	-6.90 [a]	-4.34 [a]	-3.62 [a]	-5.36 [a]	-2.72 [a]	-2.49 [a]
	(0.35)	(0.36)	(0.44)	(0.62)	(0.39)	(0.60)
NTBs Freq. Index	-0.37 [a]	-0.67 [a]	-0.22	-0.60 [a]	-0.35 [a]	-0.62 [a]
	(0.10)	(0.12)	(0.14)	(0.15)	(0.13)	(0.21)
Same Country	0.22 [a]	0.63 [a]	0.74 [a]	-0.08	0.83 [a]	1.60 [a]
	(0.06)	(0.15)	(0.11)	(0.18)	(0.08)	(0.25)
Colonial Link	0.79 [a]	0.40 [a]	0.44 [a]	0.37 [a]	0.67 [a]	0.21 [b]
	(0.06)	(0.05)	(0.07)	(0.06)	(0.07)	(0.10)
Common Colonizer	1.53 [a]	-1.25			1.00 [a]	-0.58
	(0.12)	(0.93)			(0.12)	(0.94)
Bilateral FDI		0.25 [a]		0.24 [a]		0.23 [a]
		(0.01)		(0.01)		(0.01)

TABLE 1 (continued)

Model	Dependent Variable: Ln Imports Partner/Own					
	World	World	North imp.	North imp.	South imp.	South imp.
Ln Aid Given		-0.05 [a]		0.07 [a]		
		(0.01)		(0.02)		
Ln Aid Received		-0.06 [a]				0.00
		(0.01)				(0.02)
Northern Exporters			-4.11 [a]	-5.09 [a]	-4.64 [a]	-6.53 [a]
			(0.08)	(0.12)	(0.12)	(0.23)
Southern Exporters			-5.64 [a]		-5.70 [a]	
			(0.10)		(0.12)	
Upper Mid. Inc. Exp.				-6.20 [a]		-6.16 [a]
				(0.13)		(0.21)
Lower Mid. Inc. Exp.				-6.63 [a]		-5.96 [a]
				(0.15)		(0.23)
Low Inc. Exporters				-6.30 [a]		-6.03 [a]
				(0.18)		(0.32)
N	164101	48619	105913	38153	58188	10466
R^2	0.482	0.517	0.908	0.894	0.905	0.902
RMSE	2.639	2.072	2.549	2.008	2.517	2.187

Note: [t]5 in Standard errors in parentheses: *a*, *b* and *c* represent respectively statistical significance at the 1%, 5% and 10% levels. The reported standard errors take into account the correlation of the error terms for a given importer. Other things being equal, a rich country is shown to buy 351 times more domestic products than products originating from a developing country, and 41 times more than from another rich country. Results also show that it is more difficult for a developing country to gain access to a rich market than vice versa. The tariff equivalent of these differences in border effects is around 35% points. This asymmetry is worse (50% points) when it comes to the relations with the poorest countries. These results tend to demonstrate that the normal tariff is not the most important issue for developing countries.

Nevertheless, the border effects have considerably declined since the seventies. Regional trade agreements have been effective in reducing border effects as concerns intra-regional trade.

Comments by Ricardo Faini start by questioning the topic of the paper indicating that there are natural obstacles to full integration as consumer tastes, habits and needs differ between countries, and that it is neither possible nor desirable to have a homogenized world. So the benchmark is probably not achievable.

The second problem is that we do not know about the causes that limit market access. We know that it is much more expensive to transport a product from Dakar to Rotterdam rather than from Shanghai to the same destination. The local infrastructure problem is probably one of the major obstacles to trade from developing towards rich countries. Inter alia this is witnessed by the

difficulties which the poorest countries face in penetrating northern markets in spite of privileged market access.

Faini also notes that foreign direct investment (FDI) links are not taken into account: vertical FDI tends to boost exports in case they benefit from special customs treatment. So does migration.

C. South-South Trade Agreements and Growth

Among the objectives behind trade facilitating agreements there is the hypothesis that trade openness will, in the end, encourage macro-economic stability and growth and therefore foster development.

First, international trade theory comprising a long chain of trade theorists from Ricardo to Krugman teaches that there are global static gains from trade, even if some categories of people might lose.

Second, there will be dynamic gains from an increase in efficiency through increase in competition. Best practice tends to spin-off worldwide.

Third, regional liberalization agreements are second best compared to multilateral agreements.

Empirical literature finds it difficult to bring clear evidence on these issues although there are strong pros and cons contenders. After years of debates, it seems that there is a consensus that trade fosters growth when some basic conditions are fulfilled, notably reliable institutions, but still there are doubts about its role in the fight against poverty as growing inequality may come with it.

The Lo Turco [2004] paper addresses the question of the link between regional trade agreements (RTAs) and growth applied to three Latin American RTAs: The Andean Community, the Central American Common Market (CACM) and MERCOSUR. The history of RTAs in Latin America shows that they failed when they were not associated with global liberalization. Closed regionalism was a failure. From the point of view of regional organizations, the period starting in the nineties can be qualified as a period of open regionalism, as regional trade liberalization went hand in hand with a reduction of protection *vis-à-vis* extra-regional partners.

Literature review does not bring clear evidence on the individual impact of RTAs. This holds even for the EU case as the most advanced experience of regional integration. The reason is that it is difficult to disentangle the effect of a RTA with other economic changes occurring at the same time. Econometric methods are thought to be of little use in that case. The determinants of growth are for the larger part domestically rooted: investment and consumption. The contribution of trade is in general positive but very marginal as imports tend to grow parallel to exports, and RTAs are taken into account by means of a dummy for "before and after".

The author argues that with the use of longer time series (including the nineties), with a new technique applied -namely panel data generalized method of moments (GMM) estimator to take into account the countries' fixed effects such as the initial level of efficiency, it might be possible to shed new light on the growth effects of RTAs.

The model estimated is of a traditional neo-classical type (variables are expressed in natural log):

$$y_{it} = \alpha 0 + \tilde{}\beta yit\text{-}\tau + \delta\text{'}Xi,t + \alpha 1Dt + \gamma 0Dt * Gi + \eta i + \varepsilon it$$

Where y_{it} is the per capita product (expressed in PPP), τ is the time period chosen for the estimate, generally four or five years in order to eliminate cyclical effects;

Xit is made of variables supposed to represent the structural characteristics of each particular country; the idea being that per capita output depends on national characteristics; the "usual suspects" are: the investment ratio, the human capital stock, the openness indicator, the size of the domestic market, etc.

D_t is a dummy valued at 1 from the starting date of the regional agreement;

G_i represents another dummy to distinguish between members and non-members of the agreement.

In doing so, the author sets up a reference group or a control group with no connection with the agreement and compares the behavior of the members to the performance of the control group, the differences being the RTA impact on growth.

The difficulty here is to find a group of countries representing what would have happened to the member countries if they had not been part of the agreement (counterfactual). Most countries are from the Latin American (LA) region.

Estimates were made using three different measures of growth, but the author does not explain the reason for such choice. These measures give very different values for growth. In the sixties, for example, growth of GDP per capita is -0.025 for the whole group of countries for the Laspeyres index, +0.025 for the Term of Trade corrected index and -0.154 for the current prices index.

In Tables 2 and 3, we show only two sets of results for the GDP Laspeyres per capita real growth, which is the usual variable used in the convergence literature, one for annual data (Table 2), the other for the five year average series (Table 3).

The CAN1 variable (for the first version of the Andean Community) is never meaningful, while CAN2 (for the renewal of the Andean Community in 1991) is, in two cases: when the investment variable and human capital are taken into account and when prices are added. The coefficient is negative meaning that if the countries had not been part of the agreement they would have achieved higher growth by around 20%. This seems to indicate an adverse selection process: the Andean countries showing a weak and inefficient macroeconomic record have chosen to implement a regional trade agreement to try to improve their policies.

The MERCOSUR variable is never significant, this is probably due to the financial crisis (emerging countries' financial crisis starting in Asia in 1997).

For the CACM again, the variable is only significant for the Laspeyres measure, it is also negative which is again probably a case of adverse selection.

TABLE 2
ANNUAL DATA

V ar.[a]	(1)	(2)	(3)	(4)
y0	.921***	.902***	.898***	.899***
	(.013)	(.014)	(.014)	(.014)
CAN1	.011	.010	.003	.002
	(.018)	(.016)	(.015)	(.013)
CAN2	−.027***	−.021**	−.024**	−.020*
	(.010)	(.009)	(.009)	(.010)
CACM	−.018*	−.028***	−.028***	−.023**
	(.010)	(.010)	(.010)	(.010)
MERCO	.005	.002	.010	.009
	(.010)	(.010)	(.011)	(.011)
dummy69	.017**	.013	.011	.015**
	(.008)	(.008)	(.007)	(.007)
dummy91	.005	.007	.011	.007
	(.012)	(.013)	(.013)	(.013)
dummy80	−.029***	−.023**	−.023***	−.022***
	(.006)	(.007)	(.007)	(.007)
Inv.		.028***	.017***	.014**
		(.006)	(.006)	(.006)
Pop.Gr.		−.659**	−.634**	−.719***
		(.271)	(.268)	(.268)
Hum.Cap		.023**	.029**	.030***
		(.011)	(.012)	(.011)
Real			.050***	.066***
Openness			(.019)	(.020)
Ext.Market			−.004**	−.004**
			(.002)	(.002)
Prices				−.021**
				(.010)
Gov.				.012
				(.008)
Const	.0004	.0001	.0003	..0002
	(.0005)	(.0006)	(.0006)	(.0006)
$1/(1-\tilde{\beta})$	12.6	10.2	9.8	10
Obs.:	741	741	741	741
Sargan test	$\chi2(779) = 693.35$	$\chi2(893) = 709.92$	$\chi2(969) = 740.16$	$\chi2(1045) = 756.29$
PValue	0.91	0.98	1.00	1.00
ArelBondI	z=10.00	z=10.35	z=10.33	z=10.29
PValue	0.00	0.00	0.00	0.00
ArelBondII	z=1.16	z=0.77	z=0.78	z=0.90
PValue	0.24	0.44	0.43	0.36

Notes: [a] Dependent variable log of the GDP per capita (Laspeyres).

[b] *** significant at 1%; ** significant at 5%; * significant at 10%.

TABLE 3
FIVE-YEAR AVERAGES

V ar.[a]	(1)	(2)	(3)	(4)
y0	.699***b	.510***	.541***	.573***
	(.106)	(.073)	(.063)	(.066)
CAN1	.073	.015	.012	.011
	(.074)	(.051)	(.048)	(.047)
CAN2	.071	−.121**	−.116**	.069
	(.065)	(.047)	(.045)	(.047)
CACM	.029	−.106**	−.097*	−.088*
	(.070)	(.052)	(.050)	(.050)
MERCO	.034	.032	.059	.028
	(.068)	(.052)	(.051)	(.053)
dummy69	.021	.018	.023	.025
	(.044)	(.039)	(.037)	(.038)
dummy91	.106	.060	.054	.103
	(.072)	(.067)	(.065)	(.047)
dummy80	−.181***	−.146***	−.136***	−.150***
	(.037)	(.037)	(.036)	(.036)
Inv.		.076***	.043	.048
		(.038)	(.035)	(.036)
Pop.Gr.		.400	.622	.474
		(.422)	(.390)	(.379)
Hum. Cap.		.104*	.114**	.111**
		(.056)	(.051)	(.051)
Real			.276*	.331*
Openness			(.096)	(.096)
Ext.Market			−.022**	−.026**
			(.010)	(.010)
Prices				−.097**
				(.043)
Gov.				.052
				(.047)
Const.	.033**	.031**	.041**	.047***
	(.016)	(.016)	(.017)	(.017)
1/(1 − ˜β)	2	2.3	2.4	2.3
Obs.:	133	133	133	133
Sargan test	χ2 (27) = 52.46	χ2(101) = 118.9	χ2(155) = 128.95	χ2(209) = 134.19
PValue	0.002	0.1079	0.93	1.00
ArellanoBond I	z=2.86	z=3.37	z=3.45	z=3.87
PValue	0.00	0.00	0.00	0.00
ArellanoBond II	z=0.26	z=0.37	z=0.48	z=0.27
PValue	0.79	0.71	0.63	0.78

Notes: [a] Dependent variable log of the GDP per capita (Laspeyres).

[b] *** significant at 1%; ** significant at 5%; * significant at 10%.

Trade openness always shows a positive impact on growth. This could indicate that multilateral efforts are superior to regional agreements. If this should be the case one can ask why these countries are so eager to negotiate regional agreements.

Critically, one can note that there is no idea whether the agreements are fulfilled or not: the dummy values which take values of 0 or 1, express the idea that there are two corner situations, while in reality there are many intermediate forms of regional trade liberalization. For example, the EU, nearly 48 years after its creation, is still not yet a fully integrated market in services as the political resistance against the Bolkestein directive on service[2] shows. So there are many problems in comparing different regional liberalization agreements.

Furthermore, what the authors repeat at several occasions, is that there is a risk of endogeneity: countries choose to join FTA to compensate for their own shortcomings. Therefore, they will have difficulties to fulfill their commitment. Once again the EU experience is enlightening: some country members are always very late in translating EU regulations into their national regulations.

Third, the measures of intra-regional trade are not clear (see Iapadre [2004]).

Fourth, the size of intra-regional trade is always very low between the different agreements under review (10% to 20%) compared to extra-regional trade. Therefore, the impacts of RTAs are necessarily relatively weak and difficult to measure; this is probably the reason why the authors do not succeed in obtaining clean-cut results. These methods applied to NAFTA or the EU would probably give better results.

Overall, the results are often ambiguous and therefore can be easily misleading while it is tempting to conclude that regional agreements are not growth-conducive, this would be a conclusion that is not necessarily supported by evidence.

[2] One of the major points of disagreement is the status of workers supplying services by working outside their country of origin: would they be subject to their country of origin regulations including social taxes or would the regulations of the country of service consumption apply?

III. REGIONAL TRADE, BUSINESS CYCLES AND MONETARY INTEGRATION

A. Trade Specialization and Business Cycles Synchronization in EU- and non-EU-Europe

It is a well-founded empirical phenomenon that with rising income, the exploitation of economies of scale, imperfect competition and diversified consumer preferences, trade becomes increasingly based on cross-country exchange of similar but differentiated goods within a sector –so-called intra-industry trade– relative to the exchange of goods which originate from different sectors –so-called inter-industry trade being influenced by the Heckscher-Ohlin factor endowment model.

Yet, to the same extent, that rising intra-industry trade (IIT) indices based on the catalyst work of Grubel and Lloyd [1975] and subsequent refinements were witnessed at all levels of income even including poor countries, scepticism arose that the rise of IIT was not founded on economic grounds but was a statistical artifact (Finger [1975], Pomfret [1979]). Slicing up the value-added chain across countries simply meant that the number of "sectors" increased and that two-way exchange of goods at a constant level of sector disaggregation was simply due to trade classification. The higher the aggregation level, the higher are IIT indices and the higher the disaggregation level the more inter-industry trade seems to dominate. Hence, any measurement is highly sensitive to the level of disaggregation and any technological improvement in terms of broadening the processing chain internationally requires a cautious approach in arguing whether this trade is driven by relative factor endowment criteria or by market imperfections and varying preferences. Notwithstanding the driving forces behind intra-industry trade, empirically this segment of trade has been found increasing relative to inter-industry trade at all stages of income, with the highest initial level in the industrialized countries.

Concerning the link between trade and business cycles, trade is the most traditional transmission channel of shocks and cycles from one country to the other. In contrast to the two other channels, international finance and asset markets, the trade channel is also the least volatile one and much more influenced by fundamental factors such as sectoral structural change, technological change and globalization. Hence, it is the channel, which appears most suitable to investigate both regarding the speed and the level of market integration within a regional integration scheme over a longer period.

One way to empirically measure market integration is the validity of the law of one price. Once the segmentation of markets either through policy measures or through "natural" barriers such as distance costs is vanishing, prices in different market are expected to converge by means of arbitrage activities. The other way is to identify the degree of harmonization of national business cycles and the role, which trade plays in harmonization trends. Growing inter-industry trade would lead to more specialization so that national shocks could be idiosyncratic and driven by the peculiarities of the specific sectors in which a country specializes. As a result, countries would not share common shocks. In contrast, more intra-industry trade is expected to expose countries to the same industry-specific shocks and thus push business cycle harmonization and the exposure of the trading partners to common shocks.

Recent studies suggest that the euro area economies shared a similar output dynamic during the main recessionary periods with some differences still remaining in the size and timing of business

cycles features. In general, growth cycles were found reasonably similar across European countries in both their duration and amplitude (Altavilla [2004] p. 894). Furthermore, the formation of the European Economic and Monetary Union (EMU) and the tightening of monetary and fiscal discipline in the pre-1999 period among the EMU candidates led to an increase in the business cycle affiliation of the countries. Far less well established, however, than the observation of similarities in growth cycles is the link between the emergence of intra-(or inter-)industry trade and business cycles.

The phenomenon of business cycles comovements in regional trade integration schemes has been the subject of two papers in the empirical part of the Florence conference (Garnier [2004]; Fanelli and Gonzáles-Rozada [2004]). While Garnier focuses on the European experiences, Fanelli and Gonzáles-Rozada concentrate on the MERCOSUR region.

The paper presented by Garnier departs from the hypothesis that rising similarity in the sectoral structure of (industrial) trade between two trading partners exposes them to a number of common shocks arising for instance from technology changes, changes in demand patterns or changes in the competitive pressure from third countries. That should lead to the harmonization of business cycles. More specifically, the paper is concerned with the comovements of (industrial) output cycles and their correlation with the IIT indices. The analysis differentiates between the questions:

- to what extent two business cycles are dominated by the same frequencies (comovement of cycles); and
- to what extent the elements with the same frequency lead or lag one another (synchronization of cycles).

Econometrically, Garnier applies a Two Stage Least Square (TSLS) regression between IIT indices in the Grubel-Lloyd tradition as independent variables (alternatively, an index for trade intensity is used to account for high IIT in bilateral trade but little bilateral relative to trade with third countries) and two measures for business cycles similarity as dependent variables. One is the so-called spectral coherence displaying the intensity with which the two series commove at a given frequency. This variable stands for the comovement element. The series are the monthly indices of industrial output of two countries. As a proxy for synchronization, the second dependent variable is the phase lag, more specifically the average phase lag statistic that is the time delay between two series. The situation in which two cycles share a high coherence and a large phase lag between them is referred to as transmission business cycles relations, while a high coherence and a small phase lag is referred to as common business cycles relations. To take account of different definitions of cycles, the dependent variables appear as levels, first differences and filtered using the Baxter-King's (BK) band pass filter.

As concerns the trade data side, Garnier uses bilateral two-digit trade data for 16 countries for four periods of equal length. The country sample contains both EU and non-EU countries in order to capture the effect of EU integration. Instrument variables explaining intra-industry trade are the usual gravity model variables: that geographical distance between countries, common borders and cultural proximity approximated by a dummy variable for countries sharing the same language. The model includes the independent variable IIT, the independent variable instrumentalized and the independent variable plus the instrument variables.

The hypothesis derived from theory and supported by empirical studies of Frankel and Rose [1998] is that IIT impacts positively on coherence and negatively on the phase lag. The latter would mean that with rising IIT phase lags decline and national output cycles become more synchronized.

The first result suggests that the gravity model variables distance and neighborhood (adjacency) explain intra-industry and trade intensity for the entire sample as well as for the EU countries but not for the non-EU countries. Language barriers within the EU do not influence the two trade variables in a negative way as one would expect. Probably, internal market conditions for trade and the harmonization of major technical standards in intra-EU trade are so advanced that they compensate for language barriers which themselves are eroded because of the rising dominance of English as the major commercial language. The fact that distance does not have a negative effect on intensity of trade of non-EU countries may be due to the larger importance of inter-industry trade in trade outside Europe and to the lower sensitivity of inter-industry trade to distance. With rising specialization (rising inter-industry trade), dependency on foreign exchange of goods, which are locally not available, rises regardless of the distance between the trading partners.

The second result supports findings by Frankel and Rose that in general IIT promotes the comovement of cycles except for the EU. Hence by controlling for the integration process, the result turns out to be inconclusive. Results also differ between filtered and non-filtered dependent variables.

The third result focuses on the synchronization of business cycles. Here, the hypothesis of a negative relationship between IIT and phase lags is not generally supported. The relationship is not stable over the three samples (total sample, EU countries, non-EU countries) and differs by variations of the synchronization variable).[3] It is again puzzling that the hypothesis finds more support in the non-EU sample than in the EU sample.

Further variations such as using ordinary least squares (OLS) instead of TSLS estimation do not change the results significantly. They underline that splitting the sample into two sub-samples (EU countries and non-EU countries) leads to even more inconclusive results with many coefficients not significantly different from zero. Results are generally more conclusive for the comovement than for the synchronization hypothesis.

In his comments, Correa [2004] points to the econometric pitfalls of Garnier's analysis. One is the weakening of statistical significance once the sample is split in two sub-samples. Another one is the omitted variable problem as IIT is the only independent variable, and most likely if is not a catchall variable for demand shocks, productivity spillovers and policy factors. Third, instrument variables are not highly correlated to the independent variable but more correlated to the dependent variable thus weakening the explanatory power of the estimates. Fourth, the methodology of testing for cycle transmission warrants improvement since, as mentioned by Correa, lack of synchronization of cycles may be due to different country-specific responses to the same shocks,

[3] For the first variant, the absolute value of phase lags, results are mostly inconclusive. For two other variants (absolute value of phase lags computed on differenced series and absolute value of phase lags computed on BK-filtered series), coefficients are generally negative as theoretically expected.

for instance, different labor market conditions in the countries concerned or because, more generally, of differences in the endowment with immobile factors, including the institutional setting. Finally, there is the general issue of whether IIT in the industrial sector (even if it is not seen as a statistical artifact and even if it is measured correctly at the two-digit level) really pushes cycle transmission in advanced economies with a rising importance of non-industrial activities, such as services. It is known that services disembodied from goods display less cyclical volatility in output than manufactured goods and thus can smoothen cycles. So do service-intensive industrial activities. It might be possible that the growing importance of non-industrial cross-border activities in the EU in recent years has contributed to the often-inconclusive results for trade of EU countries.

A side aspect in the Garnier analysis is devoted to the important question of whether a monetary union is instrumental in promoting intra-industry trade, thereby contributing to the harmonization of business cycles and thus bringing a union closer to the optimum-currency-area (OCA) state. This would be the sophisticated variant of the endogeneity hypothesis of the OCA introduced inter alia by Frankel and Rose. They straightforwardly argue that a monetary union promotes trade and ex post creates OCA conditions in the union. Garnier shows that between the mid-sixties and the year 2000 IIT indices in EU trade were increasing (as in all countries) and that the rise of the Grubel-Lloyd index departs from higher levels in the EU than in non-EU countries probably due to the homogeneity of the production structures of the core EU countries. This was the record of the pre-EMU era and therefore cannot be linked to monetary and real convergence, which became effective after the mid-eighties in particular. Therefore, Garnier concludes that jointly with the relatively weak link between IIT and business cycles synchronization in the EU, the long-term development of IIT in the EU does not support the endogeneity hypothesis.

In conclusion, it is still more challenging to theory to explain how a monetary union influences trade and trade patterns other than the well-established reverse causality of trade intensification through free trade areas or customs unions which create OCA conditions and thus facilitate monetary integration. One reason why positive effects from monetary integration in Europe may provide a lower benchmark for the effect generally to be expected becomes evident if one looks at the underlying transmission mechanism (Gern *et al.* [2004]). The trade gains expected from a monetary union are assumed to be related to the trading costs, which, in turn, are imposed by real exchange rate instability. As pointed out by Baldwin and Taglioni [2004], gains from lower real exchange rate volatility in a monetary union should be reaped at the micro level with relatively large gains for already highly integrated areas like Europe with a high extent of intra-industry trade. However, looking at the real effective exchange rate changes in Europe reveals that they have been rather small in old member states and have become rather more synchronized between EMU and non-EMU after 1999. The changes for the new member states are clearly larger and dominated by an increasing trend, related to the long-run catch-up process and by the recovery from their substantial entry devaluations in the early 1990s. Hence, real exchange rate changes were significant but rather predictable.

The standard deviation of the real exchange rates as a measure of uncertainty also shows no significant differences between EMU and non-EMU. The volatility observed among the new member states is still somewhat above the one observed for EMU but has already fallen to values quite similar to those observed among the non-EMU countries. Taking this eclectic evidence together implies that real exchange rate variability is either low or predictable due to the adjustment, which

already took place because former transition countries were eager to join the EU as soon as possible. It is therefore difficult to single out the effects of monetary integration although due to the Copenhagen-criteria for entry into EU monetary integration had to be a central element of convergence (Foders *et al.* [2002]).

If the trade channel is not promising - what about business cycles. In a recent study, Darvas and Szapáry [2004] investigated the business cycle synchronization in the enlarged EU. To check the robustness of their findings they applied five measures of synchronization, two filtering techniques and two measures of euro area economic activity against which to measure the co-movements on individual countries' business cycles. They find some indications for OCA endogeneity. First, the extent of synchronization is very high within the EMU core countries and the peripheric EMU countries have been moving towards that level. Second, synchronization has become high even for the traditionally less synchronized components of GDP, private consumption and services. Third, synchronization has significantly increased between 1993-97 and 1998-2002, i.e. in the run-up to EMU. However, the synchronization of business cycles seem also to be a general phenomenon because non-EMU European countries and even the United States (US) and to some extent Japan and Russia revealed greater co-movements with the euro cycle. A reason not mentioned by the authors may be that the emergence of the euro changed the rule of the game with the G3 countries moving closer together. It would be interesting to observe whether this trend also holds after 2002 with the strong depreciation of the dollar against the euro.

B. Value-Added Based Economic Integration and Monetary Integration in MERCOSUR

Members of free trade areas or customs unions who decide on whether or not they should enter into a process of monetary integration leading to a single currency area usually considered the intensity of intra-regional trade as an important criterion in their cost-benefit analysis. The higher this trade relative to trade with the rest of the world is and the higher the share of the region in world trade the more it is likely that monetary integration is a natural and relatively easy follow up to deep real sector integration (the non-endogeneity hypothesis). Yet, as Wang [2004] argues in his analysis, disregarding the production chain and thus the importance of imported intermediates and their origin (intra-regional or extra-regional) yields a misleading foundation for assessing the income generation effect of trade,[4] which is based on value-added figures and not on gross output.

It is evident that the difference between gross economic integration (GEI) and the value-added economic integration (VEI) concept has important implications for the net benefits to be drawn from regional integration and depends on a number of structural and policy-determined factors. To mention just two of these factors, integration schemes between low-income countries, for instance, whose production structures rely on assembly activities in downstream industries with a high extra-area import content (primarily to be found in African integration schemes) overrate the benefits from integration if they neglect the value-added concept. Yet, enlarging the market by removing barriers to trade towards neighboring countries might change the production structure

[4] Trade in intermediates can both be subsumed under inter-industry or intra-industry trade depending on how accurately vertical processing stages are mirrored in the level of disaggregation of trade. The higher this level is the more likely it is that vertical processing chains are translated into rising intra-industry trade indices.

toward upstream industries on one hand and change the proportion between intra-regional and extra-regional import content to the favor of the former on the other hand. Following the VEI concept, benefits from integration would increase (provided that changes in the proportion are not due to trade diversion). Second, effective rates of protection in developing countries are usually higher than nominal rates because downstream stages of production are more protected than production of intermediates. The higher this so-called escalation effect is, the lower the benefits from integration following the VEI concept. Yet, the formation of a free trade area might contribute to lowering tariff escalation and thus increase the benefits again according to the VEI concept.

Wang departs from the observation that openness of selected members of integration schemes in Latin America, North America and Europe measured in terms of export/GDP ratios has generally increased since 1960, with the two MERCOSUR countries Argentina and Brazil at the lowest level relative to Spain (EU) and Mexico (NAFTA). Wang focuses the openness concept on the GEI model by calculating first a regional export ratio (RER) that is the value of goods and services sold by the country intra-regionally in relation to all products the economy produces for final demand. Second, a regional import ratio (RIR) is calculated which measures the value of the economy's intra-regional imports as a share of country's GDP. Intra-regional imports consist of imports of intermediates of the country and of imports of goods and services for final demand.

Following the two ratios, the MERCOSUR countries are much less integrated with each other than the EU countries and NAFTA countries except for the US, whose major trading partners are outside the NAFTA region.

Wang argues that such significant differences in the degree of regional integration (based on intra-regional trade) will have implications on the decision of countries to enter into a process of monetary integration with the same partner countries by fixing exchange rates. Net benefits of monetary integration (net of costs) increase with the rising degree of trade integration following the traditional (non-endogeneity) concept of the OCA: real sector integration precedes and facilitates monetary integration. Theoretically, there is a minimum degree of trade integration beyond which monetary integration yields positive net benefits but that degree - as Wang correctly points out - cannot be derived from the two ratios.

The second essential step of Wang is to use regionalized input-output tables by calculating so-called regional value-added based export ratios (RVER) and regional value-added based import ratios (RVIR), respectively. RVER comprise the domestic value-added generated by regional exports of the home country while RVIR relate regional value-added generated by regional imports to the GDP. These regional imports are not only direct imports from partner countries but also indirect imports, which are contained in imports from non-member countries because the non-member countries imported intermediates from member countries.

In short, intra-regional exports and imports do not only create income locally or in the country of origin but - through the production of intermediate goods needed for exports and imports - also income beyond borders. Income is thus generated either locally, inside the region or outside the region, depending on the origin of the intermediate goods.

The value-added based economic integration concept is empirically applied to the three integration schemes using 1997 regionalized trade input coefficient figures and GDP data. To the extent that

intra-regional exports require inputs from non-member countries, income is created abroad and thus yields lower net regional export ratios than at a gross base (Table 4). In the case of imports, these imports are made partly from intermediates, which the importing country sold to the exporting country. Imports thus raise income in the importing country.

TABLE 4
DEGREES OF ECONOMIC INTEGRATION IN MERCOSUR, NAFTA AND EU, 1997

Percent of GDP	Export side		Import side	
1997	RVER	RER	RVIR	RIR
MERCOSUR				
Argentina	2.40	2.70	2.00	2.20
Brazil	0.80	0.90	1.10	1.20
Paraguay	–	–	–	–
Uruguay	5.70	7.10	8.30	9.00
NAFTA				
Canada	19.2	27.1	20.0	22.5
Mexico	17.7	23.2	16.3	18.2
United States	2.20	2.60	2.40	3.30
EU				
Austria	14.8	21.1	23.4	26.8
Belgium	24.8	48.4	42.3	48.6
Denmark	16.1	21.7	18.0	20.7
Finland	15.0	20.7	16.7	18.9
France	11.8	14.5	12.1	14.3
Germany	11.3	14.1	11.4	13.6
Greece	6.70	7.80	14.4	16.3
Ireland	29.3	49.8	37.2	41.9
Italy	9.90	12.9	11.3	13.0
Luxembourg	25.9	50.6	47.3	54.1
Netherlands	25.7	42.1	27.4	31.0
Portugal	16.1	21.7	26.1	30.3
Spain	12.4	16.4	15.1	17.5
Sweden	15.7	22.1	19.5	22.3
United Kingdom	10.5	13.2	12.3	14.2

Notes: RVER = Regional value-added export ratio.
RVIR = Regional value-added import ratio.
RER = Regional export ratio.
RIR = Regional import ratio.

Source: Wang [2004].

As a rule of thumb, the ratios based on the net concept (RVER and RVIR) reveal that the downward adjustment of the trade ratios compared to the gross concept is larger the smaller a country is and the more it is integrated into world trade.

Thus, relatively closed economies such as the two large MERCOSUR countries reveal small differences between the net and the gross concept at a low level whereas for the relatively small open economy of Uruguay ratios are higher and differences are larger. The smallest economy relative to the RoW trading partners is Luxembourg, which shows the highest level of trade ratios of all countries but also the largest differences likely due to the country's full integration into international trade.

Wang's point is that the GEI model overvalues regional integration as it includes extra-regionally originating intermediates and thus misleadingly relates parts of trade to income generated by regional integration. Replacing the GEI model by the VEI model might lead to a higher minimum degree of economic integration needed to achieve a positive net effect from fixing exchange rates. Consequently, his policy recipe would be to consider only the intra-regionally originating trade flows (including intermediates) as a measure for the "true" degree of regional integration and as a criterion for entering monetary integration. Either less members of an integration scheme might then qualify for monetary integration under the VEI than the GEI concept or the starting point of monetary integration might be postponed for all member countries until real sector integration has been deepened by trade. For MERCOSUR, his results suggest a skeptical conclusion whether the scheme has already reached a minimum level of real sector integration to make the entry into monetary integration beneficial for member states. Yet, this assessment is based on the low levels of RVER and RVIR (in absolute terms) relative to NAFTA and EU and not on the estimate of "minimum" degrees. Therefore, the question remains ultimately open.

The basic message of the Wang paper is not to follow the simple idea that intra-regional exports are a reasonable yardstick for a country's gain from regional integration and thus for the gains to be collected from monetary integration. To the extent that countries are strongly integrated into extra-regional trade and import intermediates from outside the region for export production, such input-output relationships have to be taken into account and income generation from exports must be calculated on a net basis leaving income generation outside the region aside. Such strong integration into international production chains can be due to two factors, first structural ones and second policy-determined ones. Concerning the structural ones, very poor countries lack depth of their local production chain and thus assembly goods imported from outside the region. Here, the high foreign import content reflects the income level and the state of development. Very rich small open economies such as Luxembourg and Singapore, however, also show high foreign import contents because of their high specialization profile. For these economies as well as the gains from regional integration must be discounted somewhat following the VEI concept. As concerns policy-determined factors, any erosion of preference margins of intra-regional trade either by lowering external tariffs in general or by eroding the difference between tariffs on downstream and upstream industries provides incentives to shift intermediates production from outside the region into the region and thus improves income generation derived from net intra-regional trade following the VEI concept.

In her discussion of the paper, Taglione [2004] addresses three major points of criticism.

First, without a deeper view on the sectoral structure of trade, the interpretation of RVER and RVIR remains difficult. This is particularly important as the depth of the processing stages both intra-regionally and extra-regionally is at the core of the Wang analysis.

Second, the model departs from shallow integration (free trade areas and customs unions). Deep integration schemes, which include agreements on free capital mobility and labor migration such as a common market are not taken into account. This is important as factor mobility could trigger factor flows from outside the region into the region, deepen the production structure toward intermediate products and thus increase the share of regional value added in total output. As a result, Taglione sees deep integration as a means to increase the benefits of individual countries from regional integration. This is important as the advancement of integration stages from shallow to deep integration would eventually lead to a revision of Wang's skeptical assessment of monetary integration in MERCOSUR. As all recent integration agreements, MERCOSUR includes provisions on capital mobility and rights of establishment and thus may already be more advanced than assumed by Wang in his analysis.

Third, and most important, is Taglione's remark that Wang excludes any endogeneity of monetary integration. In his analysis, trade integration determines the benefits of monetary integration and not vice versa. Following McKinnon [2004], Wang argues along "Mundell 1" (Mundell [1961]) stressing the importance of asymmetric shocks in the face of internal price and wage rigidities and the flexibility of exchange rates as the best adjusting variable in such a case of a non-optimum currency area. Real sector integration and openness would contribute to the removal of stickiness of domestic prices and wages. A one-size-fits-all monetary policy would therefore be ill-fated in the light of a low level of real sector integration as Wang shows for MERCOSUR. Yet, as McKinnon puts it, there is also Mundell II (Mundell [1973]). Twelve years after his seminal AER paper, Mundell argues that under a common currency a country suffering from an adverse shock can better share the loss with a trading partner because both countries hold claims on each others output (McKinnon [2004]: 695). Later on, Mundell substantiates this argument for a European currency. Better reserve pooling and portfolio diversification would mitigate a country-specific shock if a common currency would be in place. Such loss sharing with trading partners might also ensure the further advancement of trade integration, for instance, meeting deadlines for dismantling intra-regional barriers to trade.

C. Common vs. Country Specific Business Cycles in MERCOSUR

The main purpose of the paper presented by Fanelli and González-Rozada (FG [2004]) is to analyze aggregate fluctuations and cyclical comovements in the MERCOSUR area, as well as to draw conclusions on macroeconomic policy coordination. The authors depart from the literature on optimum currency areas and exchange rate choice because of special features of the MERCOSUR area which have to be incorporated into the analysis: a low degree of economic and trade integration, high dollarization with a high degree of financial instability, and the experience of sizable shocks in recent years which have been detrimental to the integration process. The key questions raised by the authors in the introduction are whether regional actions can be taken to reduce the volatility of some variables -the real bilateral exchange rate in the first place- thereby facilitating the integration process, and what institutional framework at the regional level and what domestic policy regimes can be introduced to support the coordination efforts.

Notwithstanding the specific features of MERCOSUR mentioned above, there are some studies, which come to the conclusion that regional monetary integration would be a plausible strategy for the MERCOSUR countries. Eichengreen [1998] and Eichengreen and Taylor [2003] use cross country data and panel data techniques to address the question of whether MERCOSUR needs a single currency. To answer that question these authors build on the OCA theory and derive a model of the determinants of exchange rate outcomes. This is the approach pioneered by Eichengreen and Bayoumi [1996] when assessing the optimality of European monetary integration. It is traditional in the sense that neglects the potential endogeneity of the OCA criteria and it is debatable because it explains actually observed instead of optimal exchange rate variability (Schweickert [2001]).

The main conclusion of the Eichengreen and Taylor papers is that no important economic impediments exist for monetary cooperation and that the lack of political will may be the most important obstacle. "The failure to engage in monetary cooperation in MERCOSUR is not obviously a function of economic variables. The countries do not have unusual size, trade, composition, or other economic characteristics that militate against monetary cooperation; in this respect they are reasonably similar to the EU. Rather, the sources of the cooperation deficit lie elsewhere" (Eichengreen and Taylor [2003] p. 25).

With respect to business cycles, these authors provide evidence that higher synchronicity of the business cycle is associated with lower volatility of the bilateral rate. They also consider financial characteristics and external vulnerabilities in order to account for the importance of the external balance for emerging markets. Nevertheless, FG point at serious drawbacks in the treatment of business cycles. Because of the cross-country comparison the measures for the synchronicity of cycles and financial sector variables have to be very rough proxies. Another weakness is that propagation mechanisms are not analyzed.

Therefore, FG concentrates on analyzing the relationship between idiosyncratic and common cycles by applying time series methods. As argued by Belke [2004] in his comments, this allows to apply a range of sophisticated measures to determine the nature of cycles. The authors expect the correlation of cycles to be rather low because of the low degree of integration achieved by MERCOSUR so far but they claim that a low correlation of cyclical movements does not mean that there are no coordination opportunities to be exploited. Designing such mechanisms needs to understand the relationship between different types of shocks and to identify regional propagation mechanisms within a unified methodological framework.

It is therefore surprising that FG implement various approaches in a rather eclectic way. First, they have a section which reveals the following stylized facts about output fluctuations in MERCOSUR:

- Contemporaneous correlations between Argentina and Brazil are low, while Uruguay experiences a larger degree of comovement with the other members (Paraguay is not considered in the paper).
- Both the Argentine and the Brazilian cycle lead the Uruguayan cycle and the values of lead coefficients are rather stable. Cross-correlations show that Argentina’s output response to an impulse originating in Brazil and vice versa are low and decline quickly.

- The output response to price changes is inverse in the short run in the three countries, a result consistent with the assumptions of contractionary devaluations and the dominance of supply shocks originating from external relations. Looking at cross-correlations linking real exchange rate variations with output residuals shows that in the case of Uruguay and Argentina the correlation remains negative for several quarters. In the case of Brazil, to the contrary, the correlation coefficient soon becomes positive, indicating that real depreciation is less contractionary which, according to FG, may be explained by the lower degree of dollarization in this country. A lower level of dollarization reduces the currency mismatches due to real exchange rate changes and reduces negative effects on output.

The authors also apply a VAR model for identifying supply and demand shocks based on the Blanchard and Quah methodology and, finally, the unobserved component methodology developed by Watson [1986] and Kouparitsas [2002] to identify the common and idiosyncratic components of cyclical fluctuations as well as to analyze the relationship between the estimated common cycle and changes in financial conditions. The main result is that the common factors originating in impulses stemming from changes in investor's sentiment are relevant for explaining regional output comovements and that spillover effects between neighbors are significant. However, the country-specific cycle accounts for a large part of total output variance (see Table 5; for a detailed discussing of methodological issues see the comments by Belke [2004].

TABLE 5
COMMON VS. COUNTRY-SPECIFIC BUSINESS CYCLES IN MERCOSUR
(% of total variability)

	Argentina	Brazil	Uruguay
Common component	12.4	15.5	13.0
Country-specific component	87.6	84.5	87.0

Source: Fanelli and González-Rozada [2004].

Based on these results, FG draw rather far-reaching conclusions. "(…) while it seems sensible that the IMF helps these countries to manage the effects of common shocks that cannot be diversified away within the region, the members of the region could take some steps to diversify the idiosyncratic risks asssociated with the country-specific cycle. More simply, there could be a division of labor in risk management. The International Monetary Fund (IMF) would help countries to hedge 'systematic' risk and the countries would develop an institutional framework to manage those risks that could be diversified away within the regional agreement, for example, via reserve funds or new fiscal instruments developed at the regional level" (Fanelli and Gonzáles-Rozada [2004] p. 24).

Because the authors restrict themselves to pure time series analysis, these conclusions do not seem supported by the paper. This points to a general critique of the FG approach (Belke [2004]). Interesting issues like propagation mechanisms are not analyzed. As mentioned in the abstract, propagation mechanisms are important because a shock that was initially country-specific might spillover to others. As pointed out by Belke, also the reverse may be

the case, i.e., that a common shock transforms into a country-specific shock because of different adjustment mechanisms. This would require to have a closer look into the role of exchange rate mechanisms, market structures, and institutions. Especially the role of real exchange rate variations in the propagation of shocks is not analyzed although this is the central question for monetary integration strategies. As mentioned by the authors, Argentina and Brazil for more than four years implemented a fixed exchange rate against the dollar implying that for this time period the variability of the exchange rate was considerably lower that in the other years. Large swings in the bilateral real exchange rates were experienced before Brazil started to fix its exchange rate in 1994 and after Brazil and Argentina ended the fixing in 1999 and 2002 respectively. The information of the effect of exchange rate policies on the business cycles in MERCOSUR countries should be exploited in order to be able to draw any conclusions with respect to macroeconomic coordination and, mores specifically, with respect to monetary integration.

A paper which explicitly focuses on the link between exchange rate variability and economic performance in the case of MERCOSUR is provided by Gros and Belke [2002]. Their results suggest that exchange rate variability (whether extra- or intra-MERCOSUR) and interest rate variability had a statistically significant negative impact on employment and investment for countries like Argentina, Brazil, and Uruguay. Based on a model of the ‘option value of waiting’ it can be argued that these results make sense even in the case of a low degree of economic integration (both extra- and intra-regional). The impact of exchange rate variability on investment and employment is stronger than on current production and exports because the latter can be adjusted with the existing labor through variations in utilization rates. Irreversibility of set-up costs is thus not an important consideration for production that can be sold within weeks or days, whereas it is crucial for long-run decisions, such as decisions to invest or to hire additional workers. In this sense, the results for MERCOSUR are comparable to the results for other regions as, e.g., reported by Belke and Setzer [2003] on the first ELSNIT Conference in Barcelona for the case of the new EU member countries.

Generally, the results from the papers discussed in this chapter imply that monetary integration is a reasonable option for the MERCOSUR countries, although economic integration in MERCOSUR is rather low as reported by FG and the paper by Wang. The evidence reported by Eichengreen and Taylor [2003] indicates that even taking OCA criteria as exogenous leads to net benefits of monetary integration in MERCOSUR while the evidence reported by Gros and Belke [2002] implies that monetary integration would even improve OCA criteria but, arguably, not by affecting short-run decisions on production and exports in the first place. However, as was also shown by the Garnier paper on the European case and the literature discussed in Section III.A. above, the "endogeneity" vs. "non-endogeneity" debate is still open.

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Contents

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SECOND SESSION: MACROECONOMIC DIMENSIONS OF INTEGRATION AND TRADE

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MACROECONOMIC DIMENSIONS OF INTEGRATION AND TRADE[*]

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I. INTRODUCTION

The Second Annual Conference of the Euro-Latin Study Network on Integration and Trade (ELSNIT) took place at the European University Institute in Florence, on October 29-30, 2004. The conference contained three parallel sessions. The first of them was entitled "Macroeconomic Dimensions of Integration and Trade," and analyzed the role of institutions and the external environment on economic performance. The goal of this paper is to provide a structured overview of the main issues that were raised in this session, and also some others that were not discussed for a lack of time.[1]

We have organized the overview of the papers around two recurring themes: (i) integration and the role of (economic) institutions; and (ii) the growth of world trade and the emergence of China. In some way or another, all the papers presented in the Florence conference touched upon these two issues. In the presentation that follows, we summarize the key contributions of these papers and make an effort to place them in the wider context of the relevant literature. We conclude our overview of the issues by extracting some lessons for Latin America.

A. Integration and the Role of (Economic) Institutions

The key role of institutions on economic integration and growth has been emphasized by the economics profession during the last decade. Many authors have highlighted the existence of a positive, strong relation between the quality of institutions and the degree of integration on one side, and economic development on the other side.[2]

From the point of view of economic theory, an economy is characterized by an environment and institutions. The economic environment is described basically by a technology depicting how goods are produced from production factors, and preferences telling how individuals value outcomes. Institutions represent a general framework under which the property of factors is

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[*] We would like to acknowledge the participants to the Second Annual Conference of the Euro-Latin Study Network on Integration and Trade (ELSNIT) for their comments. In particular, the speakers Alejandro Cuñat, Ester Faia, Hugo Hopenhayn, Francesc Ortega, Giovanni Pica, and Paul Segerstrom; and the discussants Tito Boeri, Renato Flores, Alicia García-Herrero, Pablo Sanguinetti, Morten Ravn and Thierry Verdier.

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[1] The Appendix contains the agenda with the program of this session. This presentation has been prepared for the ELSNIT conference in Santiago on May 6-7, 2005.

[2] Rodrik *et al.* [2004] find evidence on the primacy of institutions in economic development.

established, and production and trade take place. Among other things, the institutional framework of a society includes markets and all sorts of rules regulating economic activities. In perfectly competitive economies, markets are the basic institution. As established by the First Welfare Theorem, perfectly competitive markets grant efficient allocations. However, real economies are far from perfect competition, making it less obvious the design of efficient institutions. In a general sense, we say that high-quality institutions are those that deliver high economic performance, by favoring market activities and correcting market failures.

A common topic of most of the papers presented in this session is the understanding of the economic role of institutions, their optimal design from a normative perspective and their political feasibility. Based on a growth accounting exercise, Hopenhayn and Neumeyer [2004] stress the negative role of Import Substitution Industrialization (ISI) polices in the behavior of Latin American economies until the middle eighties. Dinopoulos and Segerstrom [2004] study the growth weakening effect of intellectual property rights (IPR) protection in developing countries. Pica and Rodriguez-Mora [2004] analyze the impact on (bilateral) foreign direct investment (FDI) of differences in regulations between countries, as well as the political economy of harmonization of regulations. Ortega [2004] looks at the political economy of immigration policies and the welfare state. Finally, Faia and Monacelli [2004] are concerned with the optimal design of monetary policy cooperation.

B. Import Substitution Industrialization

Hopenhayn and Neumeyer [2004] perform a growth accounting exercise for Latin American countries between 1960 and 1985. They stress the puzzling finding that physical capital accumulation accounts for 75% of per-capita GDP growth in Latin America with an almost zero contribution of the Solow residual. They claim that the ISI policy implemented in Latin America during this period is responsible for the simultaneous observation of high investment rates and low growth rates of total factor productivity. As stressed by Renato Flores in his discussion of Hopenhayn and Neumeyer, "the merit of the paper is to propose this research agenda", suggesting the need for "modeling of some of their assertions, or rather new insights."

The general agreement about the responsibility of ISI policies on the poor performance of Latin America from the sixties to the eighties has moved Latin American policymakers towards more orthodox policies. However, the return to orthodoxy observed in the last two decades has not helped Latin America, as pointed out by Rodrik [2003], to converge to the life standards of developed countries.

The "carrot-and-stick strategy" proposed by Hausmann and Rodrik [2003] may help to understand the bad performance of both ISI and orthodox policies. In a world where production costs on innovative activities are uncertain and there are public returns to information, i.e. a small number of adopters is enough to reveal it, orthodox policies may be suboptimal since they do not provide enough incentives to innovate. This is a handicap for developing countries, since local firms may not have enough incentives to approach the frontier technology. In this context, a second-best policy would involve subsidizing local firms to help them moving to the frontier. This is one of the arguments in favor of ISI policies. By introducing trade barriers to foreign products, and subsidizing investment, local firms would adopt the foreign technology and produce those goods

that were previously imported. However, trade barriers introduce other distortions in a world of moral hazard, since removing foreign competition destroys market discipline. As pointed out by Hopenhayn and Neumeyer, ISI has not worked in practice.

A better understanding of Latin American specificities is still missing. It would help to formulate growth strategies that, taking into account local idiosyncrasies, implement primary economic principles. Economic policies implemented in East Asia during the last decades have combined both incentives and discipline, and have shown to be growth enhancing. Despite the fact that successful policies do not move well from one region to another, the recent example of these countries may help Latin America in the search of imaginative solutions.

C. The Protection of Intellectual Property Rights

Dinopoulos and Segerstrom [2004] have two main objectives. Firstly, they would like to understand the effects of China joining the world trading system. We comment on it in the section "The emergence of China and its impact in the world economy" below.

Secondly, and more important for our analyses of the role of institutions, Dinopoulos and Segerstrom find that protecting intellectual property rights (IPR) moderates the positive effects of economic integration. In their framework, technological progress adopts the form of innovation in the North and imitation in the South. By lowering the extent of imitation activities, IPR protection weakens competition from the South and raises wages in the North, reducing the incentives to innovate and increasing North-South wage inequality. For this reason, the authors join the allegations of developing countries against stronger IPR protection in the framework of the Trade-Related Aspects of Intellectual Property Rights agreements ("TRIPs" agreements), claming that it would not stimulate faster technological progress, but generate substantial rents to the North at the expenses of Southern consumers.

Pablo Sanguinetti in his comments stressed that the key mechanism in Dinopoulos and Segerstrom depends crucially on the assumption of a homogeneous labor supply. He suggested extending the model to include skilled and unskilled labor, in order to analyze how globalization affects the joint evolution of the skill premium in both Northern and Southern countries. He also pointed out that welfare analysis is missing. Finally, it was mentioned that the long term neutrality of IPR protection predicted by the Dinopoulos-Segerstrom model depends crucially on the particular assumption introduced to deal with scale effects.

Dinopoulos and Segerstrom assume that the degree of IPR protection is measured by the productivity of the imitator sector in the Southern country. Under low IPR protection, imitators are highly productive and imitate with high probability. Successful imitators produce for both the local and foreign markets. This assumption is consistent with protection of IPR being low in the South. However, patent laws in the North would preclude South imitators to export, restricting their activities to the Southern market only. In a model allowing for an asymmetric treatment of IPR protection, the negative effect on innovation of low protection in the South might be partially mitigated by high protection in the North reinforcing the positive effect of low protection predicted by Dinopoulos and Segerstrom.

The paper does not analyze the likely situation in which Southern firms eventually become innovators. In this case, protecting IPR may play the opposite role, by improving conditions for the development of an innovative sector in the South. Let us restate this point in another way. Rodrik [2003] claims growth promoting policies tend to be context specific, since first-order economic principles do not map into unique policy packages. The relevance of this claim may be clearly understood by comparing Dinopoulos and Segerstrom [2004] with Gancia [2003].[3] These two papers reach opposite conclusions concerning the protection of IPR, because they refer to different economic environments. Dinopoulos and Segerstrom study a North-South endogenous growth model, where Southern countries basically grow through imitation of technologies developed by the North. In this framework, protecting IPR is not growth enhancing, since it renders imitation more difficult. Under low protection of IPR, opening to trade makes imitation more profitable, raises growth and reduces wage inequality between the North and the South. The authors claim that this is the Chinese experience. However, Gancia studies the same problem in a similar framework, but under the alternative assumption that the main engine of growth in Southern countries is innovation. In this framework, protection of IPR plays the opposite role. An improvement in IPR protection would benefit local innovation and promote the adoption of new technologies. For a similar argument, openness needs to go hand by hand with IPR protection to be growth promoting. This would be the case of Ireland and Southern European countries joining the European Union. Consequently, a correct understanding of the local environment is of a fundamental importance for the design of an IPR policy addressed to promote growth.

As a general statement, high-quality institutions are expected to be growth enhancing. In this sense, a well-designed IPR protection legislation may be considered as a good example of high-quality institutions. However, the previous discussion makes it clear that the relation between the quality of institutions and growth is highly nonlinear. If in the initial stages of development, technical progress is mainly guided by imitation, protecting IPR is not growth enhancing. However, a growth strategy may not be based in a long-term policy disregarding the protection of IPR, since the final stages of development cannot be reached without a highly developed R&D sector. At some point in the development process, protection of IPR eventually becomes a requirement for further growth.

D. Immigration Policy and the Welfare State

In a dynamic political equilibrium framework, where immigrants may affect domestic politics, Ortega [2004] analyzes the factors determining migration policies, in particular those directed to control the level and the skills of immigrants. The positive implications of endogenous migration, with immigrants acquiring voting rights in the future, and welfare state policies are studied under social mobility. A welfare state policy is designed to redistribute from skilled to unskilled workers in a world of skill-complementarities. In this framework, a majority of unskilled workers may or may not support a policy favoring unskilled migration since they face a trade-off between reducing their current wages and maintaining political control, due to the future voting rights of migrants. This is an issue of particular relevance for developed countries facing high unskilled migration pressures within a democratic system providing migrants with political rights.

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[3] Gancia [2003] was presented at the first ELSNIT conference. See Licandro [2004].

Ortega’s paper is a dynastic model: Altruistic agents live one period and then are replaced by their descendants. Individuals may be skilled or unskilled, and the probability of having a skilled or an unskilled child follows a Markov chain with persistence. Social mobility is a function of the degree of persistence of the Markov chain. The main results depend on the cost of losing political control, which is related to social mobility. In one extreme, when social mobility is very high, the cost of losing political control is very low since descendants will not belong to the same social group with high probability. In this case, policy cycles characterize the political equilibrium. Under high prospects of social mobility, if the unskilled workers were the majority group, they would promote migration of skilled workers to enjoy high wages. They would not care about losing political control, because their offspring would be skilled with high probability. In the opposite case, when the cost of losing political control is high, the decisive voter remains constant over time as well as do migration and welfare state policies. The author refers to this type of equilibrium as immigration quotas, since the majority will allow migration of its own type up to the point in which they insure future political control to their own social group, to which their offspring will belong with high probability.

Finally, Ortega performs a quantitative exercise and finds that the United States (US) economy is close to an unskilled-majority equilibrium where the social policy requires high-income distribution and migration of unskilled workers is allowed up to a quota.

In his comments, Tito Boeri pointed out that there are other theories of migration restrictions related to the labor market (partially captured in Ortega's paper), linked to the issues of crime and xenophobia; he questions the relevance of migration policies by skill, which exist only in a few countries; voting rights of migrants are seriously limited, notably on social security issues. He also claimed that the issue of economic sustainability is as important as the issue of political sustainability, since high skill workers may "vote with their feet." Finally, Boeri pointed out some unexplored dimensions, such as the effect of the age of immigrants on intergenerational distribution; the segregation problem resulting from the fact that mobility is much lower for low skill immigrants; education policies, at the bases of social mobility, are also part of the political game.

What do we learn for regional integration? In particular, what do we learn for North-South integration agreements? Is Southern country accession to the European Union (EU) designed to reduce migration pressures? May the Free Trade Area of the Americas (FTAA) play a similar role? Ortega’s paper is suggestive at this respect, but further research is needed to give a serious answer to these questions.

The EU faces migration coming from different regions. A large flow of low skilled migrants, coming mainly from Southern Mediterranean countries and Near Asia, has largely contributed to maintain the weight of unskilled workers in the labor force and may be explained in a similar way as unskilled migration in the US. However, a different strategy has been developed to deal with the potentially large migration movements from Eastern European countries following their entry in the EU. The prospect of rapid development and convergence is meant to contribute to mitigating the massive migration that would have surpassed any acceptable quota for the European median voter. European Union redistributive policies, as the so-called structural funds, are designed to improve the local conditions in poorer regions and prevent large migration. Rich regions are ready to make transfers to poorer regions in order to avoid workers moving from poor to rich

regions negatively affecting local salaries and protecting them from a radical change in the political equilibrium. It is difficult to believe that the FTAA may play a similar role; the problem has another dimension in the Americas and the cost to be paid by the US may be too large.

E. Differences in Regulation

Pica and Rodriguez-Mora [2004] analyze the effects on foreign direct investment (FDI) flows of the harmonization of regulations across countries. By exploiting the OECD International Direct Investment Statistics, they find evidence showing that bilateral flows of FDI are larger for pairs of countries with similar regulations, in the context of a gravity model. This is clearly the case of the EU.

In a two-country framework, Pica and Rodriguez-Mora assume that creating and operating a firm is more costly for foreigners, since among other things they need to learn local regulations. The extent and scope of these regulations are decided by the political system, allowing locals to introduce barriers to the entry of foreign firms. The authors stress the following results. Firstly, from the normative point of view, similar regulations are efficient since they encourage highly productive local entrepreneurs to become multinationals. Harmonization improves the allocation of talents, raising productivity, output and wages. Secondly, Pica and Rodriguez-Mora find that locals negatively affected by harmonization, i.e. the less efficient local entrepreneurs, would oppose it. On the other side, workers and potential investors are the political supporters of harmonization. It implies that, under some conditions, barriers to multinationals may exist in equilibrium as a result of the political process. Thirdly, they conclude that the support of harmonization is history dependent: multinationals, already installed abroad, are reluctant to support additional convergence in regulations that would benefit new competitors.

An important issue in the recent growth literature is the role of institutions in growth. High-quality institutions are a necessary condition for good economic performance. In this sense, we should expect that highly performing economies implicitly converge to similar institutions. Good institutions tend to be imitated, since copying from neighbors is a simple way of improvement. This is the case of the EU, where a long process of negotiation has built up a complex set of highly harmonized regulations. More striking, acceding countries voluntarily accept to adopt the institutions previously agreed by the existing members. As a general rule, regional integration agreements may be seen as the result of a step-by-step harmonization of regulations.

If harmonization is of a fundamental importance, conditions for any harmonization agreement to be stable are of importance as well. As stressed by Venables and Winters [2003], the existence of common political institutions, playing the role of the guardians of integration, and the so-called aquis communautaire, the result of a long process of harmonization of policies, are two of the pillars of the EU. Because of them, the European Union offers to investors a highly stable, harmonized framework to invest in other countries in the EU.

Is harmonization of regulations universally good? The answer is no, since it cannot be excluded that countries harmonize on the basis of bad regulations. Trade diversion in the framework of regional integration agreements is an example. The Chinese experience discussed in one of the previous sections is another. At the initial levels of development, China is not interested in

protecting IPR, implying that it has opposed interests than the developed countries. Consequently, harmonization may not be growth enhancing, at least at the beginning of the development process. Notice that developed countries have no incentive to converge to Chinese low levels of protection and enforcement of IPR. Both expect that at some point China will eventually be more interested in developing its own technology and then decide to move towards some level of protection of IPR rendering harmonization possible. In other terms, it may be that differences in regulations do not have symmetric effects: protecting IPR may be good for an innovator North but not necessarily for an imitating South.

In his comments to Pica and Rodriguez-Mora's paper, Thierry Verdier suggested that harmonization of regulations between countries should be studied in the framework of coordination games. This is particularly important if learning costs are country specific, implying that harmonization may have larger effects in one country than in the other. In this sense, Pica and Rodriguez-Mora may be understood as a framework where the quality of institutions is similar across countries, but regulations are different. It would be adapted to understand the long process of institutional building in the EU, where countries at a similar level of institutional quality have agreed on harmonizing their national regulations. Harmonization is the result of agreeing on common institutional standards. In North-South relations, however, the fundamental difference is the degree of quality of institutions. For this reason, the cost of differences in regulations may be country specific and harmonization should take the form of Southern countries adopting the high-quality regulations of Northern countries. This is the way in which acceding countries harmonize regulations when they enter the EU.

The fundamental problem faced by underdeveloped economies is how to convince entrepreneurs, national and multinational firms, that the time is arrived to start investing in the country. Promoting FDI is an important part of the story. A lesson from Pica and Rodriguez-Mora is that improvements in regulations in the direction of reducing the cost faced by multinationals to locate in the country are from a normative point of view of a fundamental importance. However, the issue of harmonization is much more complex in a multinational framework. Should Paraguay and Uruguay harmonize their legislation with Argentina and Brazil, instead of the US or the EU? Finally, from the positive point of view, it is still unclear who are the political players interested in moving in this direction. If Pica and Rodriguez-Mora predictions are accurate, left wing parties in power in the Southern Cone and representing working groups should promote harmonization, which would help to improve working conditions and welfare of the working class.

F. Monetary Policy Coordination

Faia and Monacelli [2004] have two main objectives. The first is methodological and consists of proposing a framework for the design of optimal policies in open economies evolving around non-efficient steady state equilibrium. The second objective, the most important for our aims, is the study of optimal monetary policy cooperation in a two-country dynamic general equilibrium framework with price stickiness and monopolistic competition. They formulate and solve the Ramsey problem faced by both public authorities engaged in a Nash game. National central banks act under commitment as Ramsey planners by taking into account the reaction of economic agents to changes in policy, and compete with each other as Nash players. In this framework, stability dominates in the case of closed economies. However, under Nash competition some

price instability may appear at equilibrium when countries are open to free trade. Openness adds a further inefficiency associated to the possibility countries have, under nominal price rigidities, of manipulating the terms of trade in their favor, the so-called terms of trade externality. Finally, monetary policy cooperation may reestablish price stability under free trade.

As pointed out by Alicia Garcia-Herrero in her comments, the main results are reassuring since they are consistent with the theory of Optimal Currency Areas, but the computed positive welfare gains of monetary policy cooperation are very small. She also questions whether monetary policy is the appropriate instrument to address market imperfections, since a single policy cannot deal with market imperfections at the sector level. In particular, Ramsey taxes should be a more appropriate instrument to deal with idiosyncratic productivity shocks in a multi-sector economy. Finally, she claims that some extensions as well as alternative assumptions may be studied, and suggests adding capital accumulation, since most of the analyses focused in the long run, compare menus costs vs. quadratic price adjustment costs, discuss the home bias assumption, and extend the analysis to the role of fiscal policy.

The call for monetary policy cooperation under free trade is of a fundamental importance for deeply established Regional Integration Agreements. The European Monetary System and the European Monetary Union are good examples. Monetary policy coordination would avoid the use by local authorities of monetary policy as an instrument to move the terms of trade in their favor. Finally, a desirable extension would be the simultaneous analysis of a common monetary policy and independent fiscal policies, which would allow for a discussion of the optimality of the Stability Pact in the European Monetary Union.

II. THE GROWTH OF WORLD TRADE AND THE EMERGENCE OF CHINA

Understanding the external environment in which economies operate is crucial to design a successful development strategy. And this is more difficult today than ever, since the world economy is changing continuously bringing new opportunities and challenges to developing countries. The trend is certainly towards more economic integration, as world trade grew more than three times faster than world income in the second half of the XX century. And it is also clear to most observers that there are some broad developments, such as advances in technology or changes in political climate that are pushing the world economy towards this unprecedented degree of economic integration. But it has been quite difficult to identify the relative importance of each of these developments or to pin down the exact mechanisms through which they have led to such a massive increase in trade.

All of the papers in the conference recognized the importance of the external environment and the ongoing process of economic integration. For instance, Hopenhayn and Neumeyer [2004] study the effects of the ISI strategy in Latin America, Ortega [2004] analyzes the effects of immigration on the welfare state, Pica and Rodríguez-Mora study the effects of regulations on foreign direct investment, and Faia and Monacelli [2004] analyze the conduct of monetary policy in an open economy. In all of these papers the external environment plays a crucial role, but it is not the main objective of the study. There were two papers however that directly analyzed the causes and effects of changes in the world economy. Cuñat and Maffezzoli [2004] examined the underlying forces behind the growth of world trade, while Dinopoulos and Segerstrom [2004] studied the effect of the emergence of China in the world economy. The goal of this section is to place the contributions of these two papers in a broader perspective.

A. What Explains the Growth of World Trade?

It is commonplace to attribute the spectacular growth of world trade in the second half of the XX Century to a reduction in trade costs and therefore import prices. Advances in transportation and telecommunications technology, the appearance of the Internet, and the development of new and standardized software have all opened up the possibility of trading a wider range of goods. Recurring rounds of multilateral trade negotiation and the creation of custom unions and free-trade areas have also led to the dismantling of tariff and non-tariff barriers to trade. It seems just a small step to conclude that technology and politics have combined to reduce trade costs and triple the trade to income ratio.

Although this seems a very plausible hypothesis, it has been really difficult to build more than circumstantial evidence in its support. Economists that have tried to measure the actual reductions in trade costs find that these are not large enough to explain the magnitude of the observed increase in world trade. Somewhat surprisingly, improvements in transportation technology have led to, at most, a very modest decline in transport costs (see Hummels [1999]). Observed reductions in tariff and non-tariff barriers to trade also seem too small to explain the growth in world trade, given existing econometric estimates of import elasticities (see Yi [2003] and Cuñat and Maffezzoli [2004]). Unless we are willing to assume that imports are much more sensitive to changes in prices than these estimates indicate, the growth in world trade constitutes a quantitative puzzle from the vantage point of conventional trade models.

Given this state of affairs, the research agenda has gone in either one of two directions or lines of research. The first one consists of using conventional models but starting to look elsewhere for the determinants of the growth in world trade. In a nutshell, if our models tell us that the observed reduction of trade costs has been too modest to explain the growth of world trade, there must be some other (possibly complementary) explanation for this growth. The second line of research consists of keeping the assumption that a reduction in trade costs is the main determinant of the growth of world trade but then modify conventional models in such a way that they can account simultaneously for the growth in world trade and existing estimates of import elasticities. In other words, a reduction in trade costs is what has caused the growth of world trade, but this has worked through mechanisms that are not well captured by conventional models.

Interestingly, the first systematic study of the growth in world trade falls squarely into the first line of research. Helpman [1987] argued that the growth of trade among industrial countries was not due to a reduction in trade costs but instead to the natural outgrowth of a process of income convergence. Helpman used a standard model of increasing returns and imperfect competition to derive the popular gravity equation of international trade. This equation predicts that the volume of trade between any two countries is proportional to the product of their incomes. An implication of this observation is that world trade is maximized when all countries have the same size. More generally, convergence (divergence) in economic size leads to increases (decreases) in world trade as a share of world income. Helpman then noted that there was a strong process of income convergence among industrial countries and argued that this was the reason why trade among these countries had grown so much. He provided some empirical evidence that was consistent with this hypothesis.

Helpman’s result has been challenged from many quarters. To start with, there has not been any convergence in incomes between industrial and developing countries (if anything, the opposite). And yet growth of North-South trade has been as vigorous as the growth of North-North trade. It is therefore not surprising that empirical work that includes the set of developing countries, such as that performed by Hummels and Levinsohn [1995] and Baier and Bergstrand [2001], finds scant evidence supporting Helpman’s hypothesis. Moreover, Bergoeing and Kehoe [2001] have recently challenged even the claim that convergence in incomes can explain the increase in trade between industrial countries. These authors calibrate a trade model similar to Helpman’s, and find that the model is unable to predict the increase in intra-OECD (Organisation for Economic Co-operation and Development) trade unless we assume implausible large reductions in trade costs.

There has been surprisingly little work beyond Helpman’s study trying to find other culprits for the growth of world trade. This omission reflects in part a deep felt belief that the growth of world trade is due to a fall in trade costs, and that this reduction in trade costs is in turn due to a decline in both transport costs and policy-induced barriers trade. As explained before, this belief clashes with the observation that measured reductions in trade costs are far too small to explain the increase in world trade. A second line of research has therefore tried to explain the growth of world trade by identifying mechanisms that magnify the effects of a given reduction of trade costs on the volume of trade.

An interesting study in this line of research is Yi [2003], who modifies a conventional trade model to introduce vertical specialization. By vertical specialization, it is meant that the production

process is broken into many intermediate steps that occur in different locations. In Yi's model, the most efficient production process requires shipping intermediate inputs many times between different locations. This means that trade costs are also paid many times, one for each shipment of intermediates. In this situation, a small reduction in trade costs can generate a substantial reduction in production costs and therefore import prices. Through this mechanism, Yi's model shows how the small observed reduction in trade costs is enough to explain the growth in world trade, even if we use existing econometric estimates of import elasticities. According to this view, the missing element in conventional models is vertical specialization.

Another study in this line of research is Cuñat and Maffezzoli [2004], presented in the first session of the Florence conference. These authors also modify a conventional trade model to introduce a dynamic response of comparative advantage. In particular, they recognize that factor endowments are endogenous and reductions in trade costs affect the incentives to accumulate different factors in different countries. Cuñat and Maffezzoli use their model to analyze the effects of a reduction in trade costs (mostly due to a reduction in tariffs) on the growth of US trade with non-OECD countries. They find that a fall in trade costs has two effects on the volume of trade. The first one simply consists of the fact that, for given factor endowments, import prices fall and countries specialize further on those industries in which they have comparative advantage. This is the conventional or static effect, and they confirm that in their model this effect alone cannot explain the growth of US trade with developing countries.

But the Cuñat-Maffezzoli model incorporates a second dynamic effect, and this is the key contribution of their paper. The reduction in trade costs raises the price of each country's abundant factor and therefore inducing countries to accumulate more of this factor. This leads to a divergence in factor endowments that deepens comparative advantage and further reduces import prices. Cuñat and Maffezzoli show that this effect is quantitatively strong enough to explain the growth of US trade with developing countries.

It is still too early to determine whether the non-conventional modifications introduced by Yi [2003] and Cuñat and Maffezzoli [2004] are enough to reconcile our models with the view that a decline in trade costs is the culprit of the growth in world trade. Surely other papers will be written trying to build evidence for and against these models. But there is little doubt that these papers constitute the frontier of our knowledge in trying to explain the causes of the spectacular growth of world trade during the second half of the XX Century.

B. The Emergence of China and its Impact in the World Economy

China contains more than one fifth of the world's population. From 1948 until 1978, this large fraction of the world population lived in almost complete isolation from the rest of the world. Largely, this was the result of a deliberate policy choice. After its arrival to power, the communist regime prohibited internal market activities and, except for a small amount of government trade, it completely closed the economy to the outside world. Starting in 1978, and to the surprise of the rest of the world (ROW), the communist regime decided to shift its policy stance by opening internal markets and allowing international trade. This policy decision initiated an unprecedented period of economic growth in China, averaging about percent annually since then. The emergence

of China has also been felt in international markets and this has led to a lot of discussion, both in academic and policy circles.[4]

As a matter of theory, the entrance of China into the world economy has both static and dynamic effects on the incomes of the rest of the world. The static effects take factor endowments and technology as given, and consider how the emergence of China affects the incentives for specialization, raising the efficiency of the world economy and moving it closer to the current world production frontier. The dynamic effects consider how the emergence of China alters the incentives to accumulate factors and technology worldwide and therefore push the world production frontier outward.[5]

The static effects of trade in conventional models are well known and typically positive. New trade between China and the rest of the world allows countries to exploit their comparative advantage, creating gains from trade. The entry of China in the world economy also increases the size of the market and this allows the world to sustain a larger variety of inputs and final goods, creating additional gains from trade. Exploitation of comparative advantages and increases in market size constitute the classical benefits from trade and are often linked to the names of David Ricardo and Adam Smith. Modern economic theory shows that these gains are always positive for the rest of the world, although they might be unevenly distributed. To see this, note that the entry of China into the world economy implies that prices fall (increase) in industries in which China has comparative advantage (disadvantage). Since, by definition, the rest of the world as a whole has comparative advantage in those products where China has comparative disadvantage, the overall gains are positive. But the rest of the world is not a homogenous entity. Countries and/or social groups with comparative advantages in the same industries as China might find themselves worse off after the entry of China and this might lead to some unrest. Theory tells us that there always exists a transfer scheme that would make everyone better off after trade. Practice tells us that this scheme hardly ever is implemented.

There are some cases though in which trade can have negative effects. The movement of industries towards China might have a negative impact on the rest of the world if agglomeration effects are important quantitatively.[6] Also trade with China can lead to a "race to the bottom" in institutional quality. As pointed out by some observers, increased trade leads to increased spillovers and this eliminates the incentives to adopt good but costly policies and regulations. Moreover, trade also "bails out" countries with bad institutions since they can spare some of their costs by specializing in industries where bad policies have little effects.[7]

Despite these caveats, there is a strong presumption that the static effects (i.e. taking factor endowments and technology as given) of the emergence of China are positive for the Rest of

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4 Including a report from the IADB entitled "The Emergence of China: Opportunities and Challenges for Latin America and the Caribbean" (IADB [2005]).

5 See Ventura [2005] for an overview of the effects of trade on income and growth.

6 This effect has been emphasized by the new literature on economic geography. See Fujita *et al.* [1999] and Baldwin *et al.* [2003].

7 See Levchenko [2004] for an opposite view in which increased trade leads to a "race to the top" in institutions.

World (RoW) as a whole. However, as already mentioned, it might hurt some countries and social groups that have similar comparative advantages. The discussion in the Florence Conference focused, however, on the dynamic effects of the entry of China and, in particular, on its effects on factor accumulation and the rate of innovation.

Although not specifically designed for this purpose, the Cuñat-Maffezzoli model can be used to analyze how China's entry into the world economy affects the factor endowments of ROW. In particular, this model predicts that the entry of a labor-abundant country into the world economy should raise the return to capital in ROW and this should foster capital accumulation. This is an added dynamic benefit for the rest of the world. Moreover, this effect is likely to be large quantitatively. This seems a reasonable inference taking into consideration their quantitative results and the substantial difference in capital-labor ratios between China and ROW.

Dinopoulos and Segerstrom [2004] analyze the effects of the entry of China on the rates of innovation and imitation. In their model, the North innovates and the South imitates. The relative incomes of the North and South depend on the rate of innovation relative to the rate of imitation. The reason is simple, the higher is innovation relative to imitation, the larger is the pool of "monopoly" goods, i.e., goods that can only be produced by the North. The size of this pool determines the extent of international differences in technology and their effects on relative incomes. Since the North has a fixed number of workers, the larger is this pool of "monopoly" goods, the smaller is the quantity produced of each of them, and the higher are the terms of trade, wages and income of the North. Therefore, we must determine the impact of China on the rates of innovation and imitation in order to establish its effect on the relative incomes of North and South.

In the Dinopoulos-Segerstrom model, the entry of China into the world economy is modeled as an increase in the size of the South. This naturally leads to an increase in the rate of imitation since, by assumption, the South can only imitate. They also show that the rate of innovation initially increases due to the decline in the wage rate of the North, although it eventually returns to its previous and unique steady-state level.[8] Therefore, Dinopoulos and Segrestrom conclude that the entry of China should lead to a permanent improvement in world technology (remember that there is a permanent increase in the growth rate) and a reduction in the technological advantage of the North (remember that the pool of "monopoly" goods shrinks).

As mentioned already in section A, the results of Dinopoulos and Segerstrom depend crucially on the assumption that the South can only imitate, but not innovate. As the pool of "monopoly" goods shrinks one would expect that the South starts innovating. This has two implications. First, the rate of innovation is likely to increase and therefore the Dinopoulos-Segerstrom model underestimates the effect of the entry of China on world technology. Second, the rate of imitation increases less and the world economy stops spending resources on the useless task of copying already available technology. For both of these reasons, it is likely that the effects of China's entry into the world economy are more positive than suggested by Dinopoulos and Segesrstrom.

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[8] As pointed out in the discussion of the paper, this result is due to a specific assumption about scale effects. In general, the effects on the rate of innovation are likely to be ambiguous.

III. LESSONS FOR LATIN AMERICA

A fundamental issue for the future of Latin America is the design of a development strategy in a global world. As pointed out by Hopenhayn and Neumeyer, ISI policies largely implemented in the period after the Second World War have not helped Latin America to increase productivity steadily, despite investing an important fraction of national resources in the development of local technologies. Closing national borders has been an incentive to local entrepreneurs to undertake investment projects, but they have missed the discipline provided by international competition, and consequently they have not had the good stimulus to adopt the most efficient technologies diverging more and more from the permanently improving frontier technology. As a consequence, Latin America has become a world of rent seekers. Some degree of protection may help the development of a local industrial sector, but protection cannot be growth enhancing if local firms do not face the discipline of international markets. This is the fundamental principle of the export-oriented trade policies promoted by Far East countries, as pointed out by Baldwin [2003].

Economic policy in most of the recent economic miracles is impregnated of heterodoxy. China and the low protection of IPR are not an exception. Dinopoulos and Segerstrom claim that the protection of IPR may not be growth enhancing in developing countries if technological progress is basically the result of imitation activities. However, it would be dangerous to conclude from the observation that low protection of IPR has been growth enhancing in Southern East Asia that it would help Latin America to develop a modern sector through imitation. As Rodrik [2003] claims, "institutional innovations do not travel well". Further research is needed to better understand the conditions under which an imitation sector may develop under free trade, facing international competition. Low protection of IPR in a global world also opens local markets to countries with relative advantages in imitation activities. Latin America has been inundated with Chinese products in the last decade. It may be welfare enhancing, since consumers buy goods at lower prices. But, there is no guaranty that it would help the development of a local imitation sector.

Another related issue is how Latin America would react in a global world by building dynamic comparative advantages. It is not clear that the prediction in Cuñat and Maffezzoli foreseeing dynamic comparative advantages moving Latin America towards more labor intensive technologies would be highly beneficial in the long term. Less clear is that this trend is irreversible. Far East countries have shown that well designed export-oriented policies may help the development of capital-intensive sectors in economies that initially were labor abundant.

The design of a common migration policy between the United States and Latin America is an issue of mayor relevance. As described by Ortega, the permanent, but highly controlled flow of low skill migrants from Latin America to the United States may be understood as the result of the equilibrium in the American political system. However, the disparities in per capita income make it difficult to believe that migration pressures may reduce in the near future. Interregional distribution policies, as those implemented in the European Union, may not be feasible in the medium term, making it difficult to believe that the FTAA may in a near future play this role.

As pointed out by Pica and Rodriguez-Mora, harmonizing regulations should help efficient local entrepreneurs to invest in partner countries, raising productivity. Regional integration agreements are a natural vehicle to harmonization. The European Union has been moving in this direction

during the last decades, generating large flows of bilateral FDI. This has been of a great importance for acceding countries, showing that the adoption of North high-quality institutions by Southern countries, a particular form of harmonization, may be growth enhancing. There would be similar gains for most Latin American countries if the FTAA would move in this direction. Further research is required to understand if harmonization may be growth promoting in the framework of South-South regional integration agreements, as the MERCOSUR.

The recent experience of the European Monetary Union has shown the great advantages of monetary policy coordination. This has been confirmed by the recent empirical literature showing clear evidence of a positive effect on growth of currency union membership (see Frankel and Rose [2002] and Micco *et al.* [2003]). In the same direction, Faia and Monacelli theoretically stress the importance of monetary policy cooperation for price stability and economic performance. Latin America has suffered repeated episodes of high instability in the past decades and searches for the "Holy Grail" of monetary policy stability. The resurgence of regional integration agreements in Latin America, and the consequently increase on market integration, raises the problem of the cross effects of national price instability calling for new forms of monetary cooperation. Further research is needed.

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Contents

MACROECONOMIC DIMENSIONS OF INTEGRATION AND TRADE: A COMMENT

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I wish to begin these comments by stating that -given the broad coverage of unrelated topics- it is not easy to summarize the outcome of the conference. With this in mind I must say that the authors have succeeded in writing an articulated piece of work. Hopefully the comments presented at the Santiago conference will enrich the discussion on such topics.

The paper starts by highlighting the importance of institutions in trade reforms. Recently, Chang, Kaltani and Loayza [2005] looked into the relationship between economic growth and institutions. The results suggest that institutions that help to rearrange the allocation of productive factors have a positive impact on the process of opening and growth.

The debate on institutions and development was recently revitalized by Acemoglu *et al* [2001]. In their influential paper, the authors try to address the essential question on the fundamental causes for the large differences in per capita income across countries. They relate current institutions to European settlers' mortality rates in their colonies so as to estimate the effect of institutions on economic performance. The underlying rationale is that in colonies where Europeans faced higher mortality rates, they had disincentives to settle down permanently and thus were more likely to set up extractive economic activities accompanied by political institutions prone to exclusion.

Following Acemoglu *et al.* [2001] there has been an abundance of studies that analyze the role of institutions along several dimensions of the development process. But how can we characterize the appropriate institutions needed for development? Ventura and Licandro present the following definition: "high quality institutions are those that deliver high economic performance by favoring market activities and correcting market failures".

Therefore the fundamental question of the papers presented at the conference is about the optimal design of institutions.

The paper is divided into two parts. The first includes:

- Role of ISIs in LAC.
- Growth and IPR’s.
- Differences in Regulation.
- The political economy of immigration.

- Monetary policy cooperation.

The second part is devoted to the analysis of:

- The growth of world trade.
- The emergence of China.

Role of Import Substitution Industrialization (ISI) in LAC

Ventura and Licandro start by pointing out that Hopenhayn and Neumeyer [2004] present the Solow zero-residual puzzle for Latin America. This puzzle states that most of the economic growth in Latin America during the last decades was due to factor accumulation rather than to technical progress. Hopenhayn *et al*. [2004] argue that the ISI policies implemented for decades in Latin America are responsible for this result. But I wonder why ISI is the answer? What is the underlying mechanism? -Neither the original paper or the summary paper outline this argument.

It seems that the authors forget that the most serious problem of ISI is political economy in its nature. ISI policies shift incentives away from efficiency and introduce "rent-seeking", which in turn could bring about serious institutional problems such as corruption (Ades and Di Tella [1999] Wei [2000]). Thus, given the institutional setting, ISI policies do not seem to be the answer for Latin America.

Intellectual Property Rights

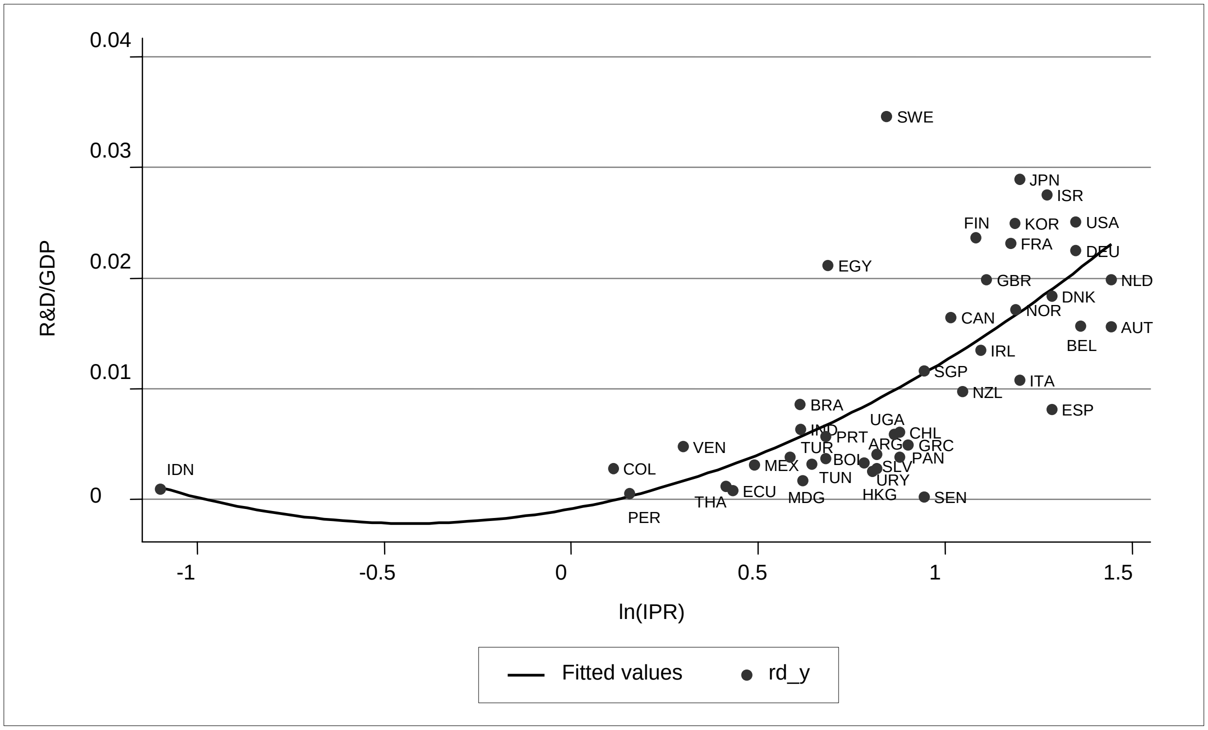
Since the nineties there have been several theoretical attempts to explain the links between investment in R&D and the intellectual property rights (IPR) regime. This literature has mainly focused on the North-South patterns of trade related to different regimes and the welfare gains/losses linked to each one of the regions, once IPR enforcement is tightened in the South (see Helpman [1993]). Most of the literature shows that stricter IPRs in the South benefit the North and that, therefore, loss of IPRs in the South would be the appropriate response to the higher R&D capabilities of the North. However, in Zigic's [1998] opinion there is divergence from this general outcome.

Dinopoulus and Segerstrom's [2004] paper is no different from mainstream literature. They find that stronger IPRs in the South benefit the North. Unfortunately, the result of Dinopoulos and Segerstrom [2004] relies -in my understanding- on the assumption that the South can only imitate the North. Indeed, Gancia [2003] reaches opposite conclusions by accepting that growth in the Southern countries can be driven by innovation. Unfortunately, the literature on the latter is not very conclusive and its results are very sensitive to assumptions.

In ongoing research with Daniel Lederman, we have empirically found that there is some evidence that good IPRs and institutions promote R&D. Graph 1 shows a positive relationship between Ginarte and Park's index of IPR and R&D. This index takes into account the following

elements: coverage (patentability of seven different item groups), membership in international agreements, provisions for loss of protection, enforcement mechanisms, and duration of protection.

FIGURE 1
R&D AND INTELLECTUAL PROPERTY REGIME
(1995; quadratic fit)

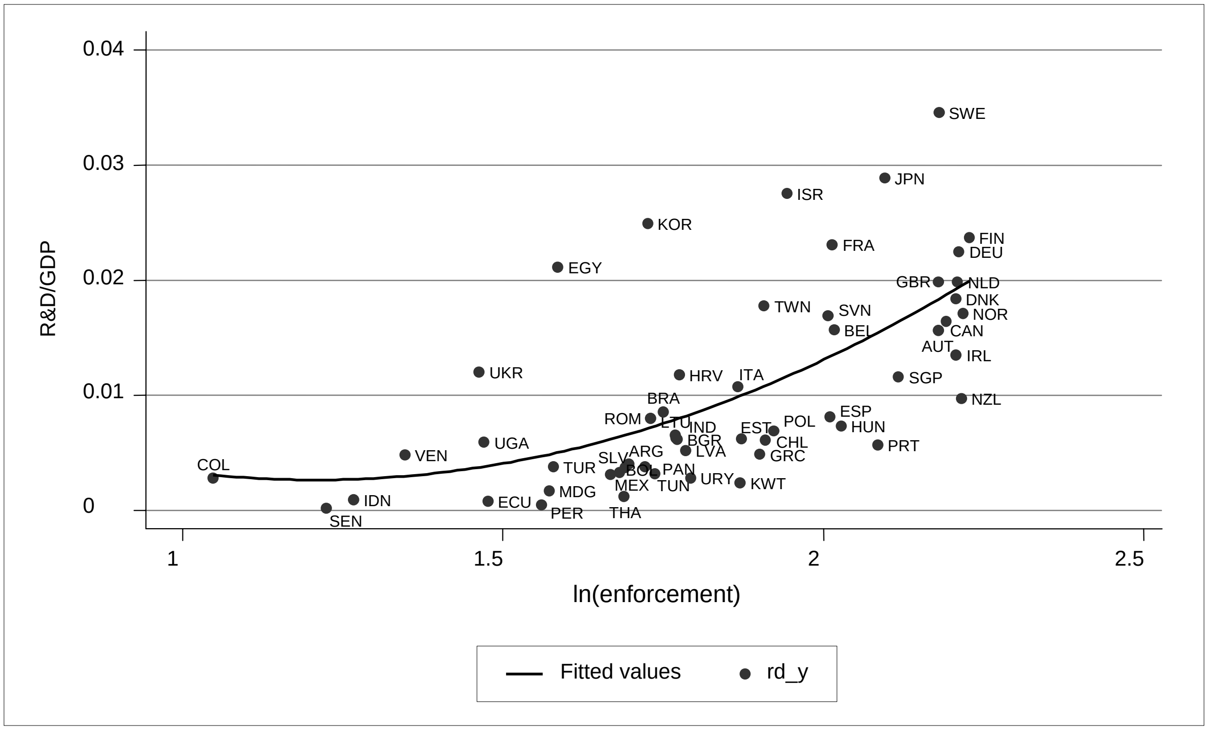


Source: Lederman and Saez [2003].

In general there has been a lack of theoretical models addressing the role of institutions in shaping the appropriate response of IPR regimes in Southern countries. Are lost IPRs a result of higher levels of R&D in the North? Or are the low levels of R&D in the South a consequence of lost IPRs? The relationship between the quality of institutions and IPR regimes and R&D levels is a question that may be addressed in certain empirical literature (See for example Ginarte and Park [1997]), although the mechanisms through which this relationship operates have not been clearly examined. In Figure 2, we focus on the impact that the Gwartney and Law [2004] law enforcement index has on R&D levels. There appears a non-linear, close to quadratic, positive relationship.

In short, there is preliminary evidence that institutions matter for R&D activities.

FIGURE 2
R&D AND LAW ENFORCEMENT
(1995; quadratic fit)



Source: Lederman and Saez [(2003] and Gwartney and Lawson [2004].

Immigration

Ortega [2004] studies the policies directed to control the level and skills of immigrants. It is a very technical paper and its results are not easy to summarize so Ventura and Licandro do a pretty good job here.

Ortega [2004] considers endogenous migration, with immigrants having voting rights and a chance for social mobility. He defines the welfare state as a function of redistributive taxes. Overall, it seems to be an excellent paper given that there are non-trivial, although intuitive equilibriums in the model. The model presents a trade-off between reducing their current wages and loosing political power for the unskilled sector of the population.

In any case it seems to me that the problems depicted in the model are not that relevant in LAC given the small income gap in the region, compared with the one between LDC and developed countries.

Differences in regulation

The paper starts by discussing the evidence that shows that FDI is larger in pairs of countries with similar regulations. The main hypothesis that accounts for this behavior would be that the cost of creating and operating a firm is higher for foreigners due to the fact that they must

learn about regulations. As a uninformed reader, one wonders whether this cost is that relevant. Has anybody tried to quantify it? Why can't firms hire management with deep knowledge of regulations in the host country? All these questions are unanswered in the review of the Pica and Rodriguez-Mora [2004] paper. We must note that having the same regulation in many cases would allow the export of technology and management techniques bringing about the same results as the hypothesis of learning the regulations. How can we distinguish between these hypotheses?

Ventura and Licandro state that "highly performing economies implicitly converge towards similar institutions"; in my opinion, however, they do not make a convincing case. Indeed, I am reluctant to believe it. It is easy to imagine that different factor endowments will generate different regulations in the case of electricity generation or in the privatization of public roads. I would rather think that different institutions might be optimal at different stages of development (given factor endowments). This implies that optimal institutions are related to income levels and not to growth rates, e.g. environment regulation.

Monetary Policy

Ventura and Licandro state that the Faria and Monacelly [2004] publication is consistent with optimal currency predictions. Given that these are well-known results, I am not going to discuss them in further detail. Nonetheless, there are some topics I think are relevant and might be considered at future meetings of the network, among them: economic integration and business cycle synchronization, and trade and real exchange rate (RER) volatility.

The Growth of World Trade

The "trade growth puzzle" is a very relevant question from the policymaker's standpoint. There is some convincing evidence that openness, measured as trade over GDP, is positively correlated to economic growth. Therefore, it is important to know what can boost trade.

Ventura and Licandro review several papers. Among them Yi's [2003] paper which addresses vertical integration and "redundancy" of trade costs. After reading the paper one wonders whether there is any supporting evidence for this hypothesis. However, I tend to think that Cuñat and Maffezzoli [2004] present a more relevant assumption. They argue that due to the drop in trade costs there is a deepening of comparative advantages which, in turn, induces factor accumulation and a further fall in import prices that significantly increases trade.

The Emergence of China

Cuñat and Maffezzoli [2004] make reference to an interesting dynamic response to the emergence of China. This paper gives one more twist to the idea of factor accumulation and trade. However, from the point of view of Latin America there does not seem to be a clear-cut prediction. Indeed, the emergence of China should favor capital accumulation in the rest of the world given the abundance of labor in China. Let's consider three factors of production: labor, capital and natural resources. Under this assumption it seems that Latin America would be natural resource abundant. Would this mean that Latin America would keep exporting primary products?

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THIRD SESSION: A RESEARCH AGENDA FOR INSTITUTIONAL DIMENSIONS OF INTEGRATION AND TRADE IN LATIN AMERICA

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A RESEARCH AGENDA FOR INSTITUTIONAL DIMENSIONS OF INTEGRATION AND TRADE IN LATIN AMERICA

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I. INTRODUCTION

This paper has been prepared at the request of the IDB on the basis of the six papers[1] presented at the Second Conference of the Euro-Latin Study Network on Integration and Trade (ELSNIT - Florence, October 29-30 [2004]) within the session on "Institutional Dimensions of Integration and Trade", as well as on the basis of the discussants' comments and the general discussion that took place during the session. It has been presented at the "Seminar Regional Integration And Trade: Issues For Latin America - Discussion on Second Cycle of Euro-Latin Study Network on Integration And Trade (ELSNIT)" at Santiago de Chile, 6-7 May 2005, and consequently revised, taking into account the discussions at the Seminar. Unlike the other papers on "Economic Policy Dimensions of Integration and Trade" and "Macroeconomic Dimensions of Integration and Trade", this paper does not endeavor to be a survey of the papers presented in Florence; it represents the views of the authors on the issues that emerged out of those papers and the subsequent discussions. Unlike the majority of the economic policy and macroeconomic papers, those dealing with the institutional dimensions of integration and trade were aiming far more at surveying the empirical and practical options than at developing models and theories or applying them to available data. Furthermore, the institutional dimension has only been recently integrated in the work of ELSNIT, and its research agenda needs therefore to be further developed and consolidated.

The authors of the paper have long been involved in academic as well as policy oriented research and training on regional integration in Europe, but they are not specialists in Latin America. This paper is therefore an outsider's view about the issues that have emerged out of academic discussions. It includes reflections on the policy implications of the identified issues, which are mainly intended as inputs for discussion at the follow-up seminar of ELSNIT, (Santiago de Chile, May 5-6, 2005).

Those reflections are not intended as having immediate prescriptive value, for which a good knowledge of both the different countries of Latin America and the ongoing and former experiences of regional integration in the Americas would be indispensable. They are mainly presented in order to stress the need for policy-relevant research to be further developed in the framework of ELSNIT on the basis of the issues identified in the field of Institutional Dimensions of Integration and Trade in Latin America. Section II discusses a set of eight institutional and legal issues of integration and trade, which emerged out of the second ELSNIT Conference and assesses their policy relevance. Section III proposes some ideas for establishing a research agenda on Latin America to address in more detail the institutional and legal dimensions of integration and trade.

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[1] The Appendix contains the agenda with the program of this session. This presentation has been prepared for the Euro-Latin Study Network on Integration and Trade (ELSNIT) conference in Florence, October 29-30, 2004. The papers are published on-line on *http://www.iadb.org/europe/ELSNIT_CONF_2004/ELSNIT_Papers_2004.htm*

II. INSTITUTIONAL AND LEGAL ISSUES OF INTEGRATION AND TRADE: IDENTIFICATION AND POLICY RELEVANCE

A. Merits of Regional Integration as a Tool for Development: Institutional Dimensions

The merits of regional integration as a tool for economic development are the subject of debates and indeed disagreements among economists on the basis of competing analyses of statistical data and of a comparison of different models of evolution. We do not go into these debates in this paper. Our focus is on the institutional dimensions, where we identify two main questions which were only rapidly touched upon at the second ELSNIT Conference but merit further research: first, what are the links between the institutional settings for peaceful settlement of disputes and, second, what are the conditions for the effectiveness of the institutional setting for economic integration and their links with economic development or the intensification of the integration process?

Links between Peaceful Settlement of Regional Disputes, Institutional Setting and Development

A major requirement for institutions to provide a solid base for regional development is that they are supposed to provide tools for the peaceful settlement of disputes in the region. The first link with development seems quite obvious, although there are risks that this may be forgotten when assessing the contribution of regional integration to the development of a specific country or the region as a whole: the absence of interstate armed conflicts has positive consequences upon economic development in the relevant states and region, even in the absence of a development in trade relations. Persistent political frictions or ideological tensions generate serious obstacles to harmonious relations between neighboring states and thus discourage attempts to develop trade. Furthermore, a robust and efficient system for the peaceful settlement of disputes provides not only for security but also for the stability and predictability of the business environment, which is an obvious precondition for the development of trade. Such a system for the peaceful settlement of interstate disputes must aim at resolving not only political disputes, but also disputes of an economic nature, whether they relate directly to trade or only to its policy environment. Even if there are discussions in economic literature about the direct links between economic development on one side, interstate trade and regional integration on the other, the development of regional integration has merits of its own as a means of reducing tensions in the relevant region, which may spillover upon economic and social development in the relevant countries.

The mechanism of "diplomatic protection" (as it is called in public international law) allows governments to take up cases in international negotiations or to an international court of justice or arbitration mechanism in the names of private persons - individuals as well as businesses and non-governmental organizations NGOs. A solid and transparent system of interstate dispute resolution may therefore also serve in solving transnational disputes of a private nature. Identifying the most appropriate mechanisms and procedures for dispute settlement at regional level and the ways of access to government in this framework is a largely underdeveloped field of research and political thinking. A discussion of the possibilities of Section 301 of the 1974 U.S. Trade Act and the EU Trade Barriers Regulation N° 3286/94 of 22 December 1994 in a Latin American context could provide some ideas in this direction (see Ziller [2003a and 2003b]).

Effectiveness of Institutional Settings for Economic Integration and Asymmetries between Countries

Comparing the conditions under which regional integration is taking place in different parts of the world, and especially comparing the European experience on one side, the different experiences in Latin America on the other side, as was done repeatedly during the second ELSNIT Conference, points to the centrality of the issues of asymmetries between participating countries: this is especially striking in the framework of MERCOSUR. The same is true for the influence of third countries or groupings which have a much bigger role in trade than any of the relevant Latin American countries, especially the US and the EU in the past, but maybe also China and India in the years to come. Attention to these types of internal and external asymmetries in institutional design has always been highly developed in the framework of the European Communities (starting with the European Coal and Steel Community in the 1950s) and later the EU, and of the special agreements with Africa, Caribbean and Pacific (ACP) countries. Asymmetries are of course also highly relevant as well in classical intergovernmental settings as in integrated systems like the European Communities They have been less extensively studied, and they are harder to offset in a context where the key operating principle is the formal equality between sovereign states, whatever their size and resources.

Finding the right combination between respecting the equal rights of states of different size and acknowledging differences in economic and political size and weight of countries is one of the central issues in the design of regional institutions for trade and economic integration. Ways and means to take into account especially powerful partners should receive more attention. Even in Europe, experience in this field is limited, and attention mainly focuses on voting mechanisms in the EU Council of Ministers,[2] although there is a history of the German economy and currency playing especially important parts in the EU integration story. Whether the case of the EU Common Security and Foreign Policy might have relevance for trade issues remains unexplored both in the EU context and in terms of relevant comparisons.

B. Sustainability of Regional Integration and Institutional Development

Recent historical experience in Latin America demonstrates how central the issue of sustainability of regional integration is. Institutional design at regional level needs not only legal expertise and diplomatic skills in drafting treaties; it also needs to address a series of macro-management issues in a professional way. Three of these issues have emerged during the second ELSNIT Conference (see especially Pena and Rozemberg [2005]), which lend them to more detailed methodological illustration.

Ask the Right Questions To Be Decided before Choosing to Set Up Institutions

Only too often, the questions of institutional setting seem to be resolved in terms of choosing in a toolbox of already existing systems (be it in the Latin American experiences, the EU experience or

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[2] Even here it should be noted that explicit voting is not so common in the EU Council, where norms of consensus-building are deeply embedded. The relative weight of individual countries/governments is exercised rather by implicit leverage.

other experiences of regional integration) (see especially Bilal [2004]) or experimenting with new possibilities. The first step, i.e. identifying what are the functions to be exercised before deciding upon the institutions to be set up, is not given enough attention by policy makers and too often ignored by academic writings.

One example could be the institutional setting, which is needed for a well functioning customs union.[3] A formal approach to institutional design would be to present to decision makers the different models of available or imaginable institutions - a political or technical Secretariat, a Commission more or less inspired from the European experience, a more or less institutionalized Council of Ministers, a Court of Justice or an Arbitration mechanism - and let them decide upon the question of their composition, degree of independence, decision making powers and resources. The step preceding this type of decisions should however be a thorough examination of objectives which are being pursued and a realistic assessment of available resources which condition the sustainability of the institution as well as their adaptation to the tasks they will have to fulfill.

The use of a simple grid demonstrates that there are far more options to be explored than might appear at first sight, and that the characteristics of the institutions should differ according to their functions. A first step for a customs Union is to agree upon the objectives to be pursued, for which some kind of institutionalization is indispensable, *i.e.*:

- Enforcing prohibitions of tariff (and possibly non tariff) barriers;
- Interpreting principles and rules of the customs union treaty;
- Establishing the common tariff levels on every single good (and service);
- Negotiating trade agreements with third countries or regions, or within the plurilateral framework.

For each of these objectives, an assessment of available resources has to be undertaken, not only in quantitative terms (human resources, financial endowment) but also in terms of:

- Technical competence, especially in terms of economists and lawyers, but also of specialists of other technical issues linked to the functioning of customs services;
- Political authority (capacity of being heard by public institutions and bureaucracies);
- Independence (towards the businesses for which trade, is relevant, governments which need to defend national interests and economic stakeholders, third parties such as trade unions and NGOs);
- Political legitimacy (accountability towards the citizens).

Needless to say, the relative importance of these different elements may vary according to the objective pursued, as well as the technical skills, expertise and financial resources necessary for a well functioning institution.

[3] This example is not based upon the ELSNIT Conference, but upon a presentation by J. Ziller for IDB (Ziller [2005]).

Objectives / Resources	Enforcing prohibitions of tariff (and possibly non tariff) barriers	Interpreting principles and rules of the customs union treaty	Establishing the common tariff levels on every single good (and service)	Negotiating trade agreements with third countries or regions
Technical competence				
Political authority (towards public institutions)				
Independence (towards businesses, governments, third parties)				
Political legitimacy (towards the citizens)				

Only by answering those questions can realistic choices be made about the kind, range, structure, endowment and location of the institutions. Experience shows that anyway far more attention is given by politicians to the geographical location of institutions and to the national origin of their top officials, as these are the issues relevant to sovereignty.

Further research on existing institutional settings as well as on the functions to be fulfilled in the framework of regional integration would probably help asking the right questions when it comes to set up or reform regional institutions for trade and integration.

Think Ahead about Implementation before Setting Goals and Thresholds

A major feature of policy planning, which has an important impact upon institutional design, is the question of setting goals and thresholds at a high enough level to produce incentives that foster a dynamic process, but which remain in the realm of realistic options. Setting too high levels (i.e. not taking into account available resources and a realistic time-span) is a major source of disillusion in the system or even of breakdown. But setting levels too low does not provide for the impetus, which is needed in launching integration and making it keep its pace.

One of the major elements in this respect is time: the European experience with the completion of the customs union. The Rome Treaty foresaw a transitional period of a maximum of twelve years, with three intermediate stages to be respected, and this proved a big success: the completion of the customs union was foreseen on 1 January 1970 according to the initial plan in the EEC treaty, but was achieved on 1 July 1968 in reality although France and Italy had experienced economic difficulties linked to the student uprising of May 1968. The program for the completion of the internal market, which was launched in 1985 with 1 January 1993 as a deadline, and with the adoption and ratification of the Single European Act as a major milestone, or the establishment of the Economic and Monetary Union by the Treaty of Maastricht (signed in 1992), with three phases that were foreseen in detail by the Treaty before the Euro would be launched, are two other examples. All of them show how important it has been at different moments to set up timetables in order to trigger interest and activity and to ratchet commitments not only in the institutions devoted to regional integration but also amongst the interested actors: public administration, businesses, local government, and civil society.

The appropriateness of goals and thresholds not only depends upon a good economic analysis and a strong political commitment, it also needs to design appropriate procedures and, if needed, institutions, a requirement which is very often underestimated. Solid research on past and ongoing experiences in Latin America and in Europe could generate many useful proposals in order to set up realistic and effective schemes, especially if they are based upon interdisciplinary cooperation.

Compatibility of Different Regional Integration Processes and Cross-Regional Partnerships

One of the striking features of trade and regional integration in Latin America is the overlap between efforts to create more integrated regional areas and the series of free trade agreements, which include powerful third parties, especially the US and the EU. Overlaps between different integration areas are not as such specific to Latin America: within the EC/EU there has always been an overlap with the Benelux economic union the members[4] of which have also always been members of the EEC. The European Economic Area (EEA) includes all EU member states and three member states[5] of the European Free Trade Area (EFTA). The EEA is more than a free trade area, as it includes a series of common policies, but it is not a customs union. A number of EFTA members have gradually become members of the EC/EU.[6] The UK is both a member of the EU and of the Commonwealth, which includes a big number of non European countries; Belgium, France, and Luxembourg are members of the "Francophonie" which also includes a number of other European and non-European countries. What is unique in the Latin-American case however are the asymmetries between the non-Latin-American partner (US or EU) and the Latin-American ones, which very often result in hub and spoke patterns of trade, and which are further increased by the asymmetries in Latin-America especially when Brazil is involved. The experience of European countries with the North Atlantic Treaty Organization (NATO), which includes the US and Canada, has only a limited relevance for comparative purposes, as NATO is a military and political alliance which is not involved in trade and economic questions.

The overlap between different trade areas creates at least two series of institutional problems which need to be addressed with care: at the regional level, mechanisms have to be designed, which both allow for the participation of third countries- with some kind of observer status - in the decision-making mechanisms, and maintain the autonomy of each regional arrangement. At the national level customs services, for example - and more broadly all government agencies, which are involved in the administration of border crossing - might face extremely complex situations, and their resources might not be adapted to face an increase in transnational factor movements.

C. The Coordination Deficits in Latin America

During the second ELSNIT conference, the issue of coordination deficits in Latin America emerged in a recurrent way. No reference to a specific definition of coordination has been made, and it might be useful to apply more precise analytical instruments in order to set a diagnosis of these deficits and to come up with proposals to address them.

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4 Belgium, the Netherlands and Luxembourg.

5 Iceland, Liechtenstein and Norway.

6 To start with Denmark, Ireland and the UK in 1973.

The coordination scale developed by Les Metcalfe [1994] in the framework of European integration, and which has been used in other parts of the world as an analytical tool to understand and overcome coordination problems,[7] could be considered for further research on Latin America. According to this scale nine levels of coordination can be distinguished. Their achievement serves different purposes and needs different types of resources (Metcalfe [2000]). It is a "Gutman" type scale, which means that in order to achieve effectively a further level of coordination the institutions and procedures needed for the achievement of previous levels of coordination need to be available.

1. Clarifying competencies for independent decision-making (knowing and agreeing upon who does what).

2. Circulation of information among institutions/countries (simple communication of projects and actions taken).

3. Consultation among institutions/countries (possibility given to other institutions/countries to comment formally on projects and actions taken; the consulting institution/country is committed to take comments into consideration).

4. Prevention of contradictory policies (speaking with one voice).

5. Consensus of the other institutions/countries required to develop a policy (conflict management).

6. Central arbitration mechanism preventing the adoption of contradictory policies or ensuring the adoption of complementary policies (policy coordination tolerating parallel policies in the first case, by opposition to complementary policies in the second case).

7. Setting common limits on institutions/countries action (prohibition of a number of options; institutions/countries are free to develop policies as long as these don't follow prohibited options).

8. Setting common priorities (followed by every institution/country).

9. Unified strategy (central authority designs an elaborate and systematic plan of action, setting objectives and modes of intervention).

While being indispensable, coordination mechanisms and procedure can be very time consuming and costly in terms of resources, and therefore any recommendation in this sense needs to be based upon a careful cost-benefit analysis. Three aspects of coordination have received special attention during the ELSNIT Conference: coordination between countries, coordination within countries and conflict resolution in regional integration.

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[7] For an example of use of the coordination scale in empirical studies, see Landry Réjean "Coordination of Interactions in Innovative Environments", *http://139.124.177.94/proxim/viewabstract.php?id=201*. A recent internal note in the European Commission services shows that this analysis starts being known by practitioners- but probably not yet fully understood.

Coordination between Countries[8]

The issues of coordination between Latin American countries obviously cannot all be resolved within the same institutional settings. Issues of trade and economic development are to be addressed by the institutions of the relevant free trade agreements, customs unions or common markets, but they need also to be addressed in different fora, on a bilateral as well as multilateral basis.

While regional institutions may serve coordination up to levels 4 and 5 above (more rarely 6), broader coordination can only aim at setting up coordination mechanisms for levels 2 or 3 at best.

Coordination within Countries[9]

Analyses of international negotiations show that a number of problems are due to the lack of sufficient preparation and support within participating countries; this is even more the case of decision-making within the EC/EU. The need to centralize negotiations within a clearly defined administrative structure very often leads to insufficient coordination at the preparatory stage, and this inevitably back fires at the stage of implementation.

Analyses of the functioning of coordination mechanisms might be very useful in order to detect where the problems lie. Very often experience shows that they are due to an attempt to create strong arbitration mechanisms (level 6) when the procedures for levels 1, 2, and 3 above are not functioning: in such a case the conditions for a smooth implementation of arbitration decisions are not met, and the efforts undertaken in order to establish such an arbitration mechanisms are wasted, as well as the resources which are allocated to its functioning.

Conflict Resolution in Regional Integration[10]

The problem of conflict resolution in regional integration seems to be considered as particularly acute. Institutional solutions to conflict resolution are only part of the answer. Well designed institutions and procedures might help lowering tension by de-politicizing some technical/legal issues, but they are not sufficient to ensure smooth coordination in all cases. According to the type of tensions and conflicts, which arise in a given region, there might be a need for bilateral or multilateral confidence-building measures before trying to build up or strengthen arbitration mechanisms or even courts. International relations analyses provide with a number of cases and methods, which might well, be complementary to the institutional study of regional integration.

This being said, there is a need for an in-depth analysis of the existing arbitration or judicial resolution mechanisms, which are available in the Latin-American experience and in other relevant cases of trade and integration. A low number of cases brought to arbitration might be due to a low intensity of trade exchange, to:

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8 See especially Jordana Comments to Botto [2004].

9 See especially Jordana [2004] p. 8.

10 See especially Pena-Rozemberg [2004] p. 13-18.

a) a well functioning free trade or customs area;

b) lack of confidence in the arbitration mechanisms;

c) too scarce availability of remedies for individuals and businesses, and;

d) other.

Deeper analysis of the types of conflicts which are brought to arbitration, the parties involved and the solutions they get are indispensable in order to go beyond a mere quantitative analysis. This is mainly a work for lawyers, but would amply benefit from a collaboration between lawyers and trade economists.

D. The Role of Law in Regional Integration

As regional integration and especially free trade areas, customs unions and common markets are established on the basis of treaties or agreements amongst states, i.e. using tools of international public law, the legal dimension of regional integration is generally assigned a high importance both by academics and by politicians and practitioners. There is a rich literature on this subject in the context of the EU and other trade and integration agreements. To what extent do these authors go beyond a fact-finding analysis of the treaties? The perspective of public international law is indispensable, but it concentrates very much on the elaboration of treaties - i.e. on their negotiation, ratification and entry into force - and to some aspects of the institutional settings - the role of states in decision-making. This perspective takes much less account of the functioning of the system of regional integration: analyses usually focus mainly on the conflict solving mechanisms, and rarely take into account its day-to-day functioning.

The perspective of international public law is therefore insufficient. It needs to be complemented by analyses of the "case law’"- i.e. the succession of practices applied both in non-conflictual situations and in conflict solving. The relevant "case law" is that developed by the regional institutions in applying the treaties, but in order to become fruitful, such an analysis needs to be based upon a good number of decisions, which are not always published. The development of a genuine and specific law of regional integration needs time and stability in the institutions. Research and practice - linked to the education of students and training of practitioners – will then generate their own research agenda for regional law, as has happened for European Community law, for the law of the Council of Europe or the law of the Organization of American States.[11] There is, however, no need to wait for the establishment of a specific law of regional integration and trade in order to further develop research about the role of law in regional integration. Two aspects have been highlighted during the second ELSNIT conference, which merit special attention not only by lawyers and officials, but also by academics of other disciplines and decision makers.

[11] For the Council of Europe and the OAS, regional Human Rights Law is a major aspect of this development.

Mechanisms and Effectiveness of "Internalization" of Regional Agreements[12]

The treaties establishing free trade areas, customs union and common markets impose a certain number of obligations on the relevant states - usually complemented by decisions of the regional institutions - which need to be translated into the law of the member states in order to acquire the formal qualities which are indispensable to their effectiveness, though not necessarily sufficient. Laws need to be adopted by national parliaments, delegated legislation and regulations adopted by governments. They also need to be sufficiently publicized to be applied by the relevant administrative agencies and to be appealed to by the private parties whose interests they are supposed to foster.

The lack of specific decision-making procedures that enable quick and efficient translation into national law within a framework of legitimate democratic accountability is one of the major obstacles to the development of regional integration. Comparing these procedures from a formal perspective and especially with an analysis of practice is a particularly promising field of research, which should result in recommendations to regional and national institutions in order to come to a more efficient and accountable system.

It is especially important always to take into account both the specific regional institutions and decision making procedures as well as the national institutions and agencies which are involved in rule making, adjudication and conflict-solving for regional trade and integration. Only a comprehensive setting allows the overcoming of the institutional and bureaucratic bottlenecks, which at best delay the practical effects of common decisions, and at worst develop skepticism, encourage the bypassing of legal frameworks and sometimes lead to the collapse of regional integration mechanisms. Research by academics, taking into account the evolutions which take place within member states and in the transborder relations, should be fostered as a tool for regional trade and integration as important in practice as the formal decisions taken in the form of treaties or other instruments.

Law as Set of Constraints v. Law as Set of Tools

The role of lawyers, both practitioners and academics, is to support structural and operational changes, not to oppose them.

To cite a specialist in public management, "Where is the complementarity between public law and public management? Provided that lawyers are able to transcend their traditional role of establishing an authoritative hierarchical framework, law has a fundamental role in designing the accountability framework within the network, while public management has a fundamental role in the development of the network" (Metcalfe [2001]). This reflection is particularly important in the field of regional integration and trade, which rests upon the establishment of networks between the relevant institutions and government agencies of the member states and regional institutions and upon their effective functioning.

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[12] See especially Botto [2004] p. 10.

Establishing an authoritative hierarchical framework is admittedly not the only contribution that law can make to regional integration and trade. Law must make many other contributions, provided that lawyers - both academics and practitioners - are able to draw on all the technical and conceptual resources of international law as well as constitutional law and administrative law, but also of contract law and the law of liability (torts - responsibility). It would be a good thing if, in addition, the best practices of legislative science could be studied on a solid comparative basis, in order to improve legislative techniques. As far as everyday practice is concerned, the training of administrators is also needed in distinguishing between legal rules or principles and what is merely the bureaucratic translation of these principles in documents with no binding value.

In concrete terms this approach needs common research by specialists of different legal sub disciplines including international law, public law and private law, with a solid comparative methodology, and also by specialists of different social sciences disciplines especially through projects involving lawyers, economists and political scientists.

E. Role of Civil Society and Interests in Regional Integration

The issue of the role of civil society and economic and societal interests was addressed in some depth by one of the papers presented at the second ELSNIT conferences (see especially Grugel [2004]), and attracted further attention during the discussions, with some comparisons being made between Europe and Latin America.

One of the important features of EU experience has been that the integration process has involved increasingly stakeholders, interest groups and non-governmental organizations. On the one hand, the EU institutional framework has explicitly included mechanisms for engaging wider opinion and for building constituencies of support for specific integrative policies. On the other hand, certain kinds of interest and advocacy groups have learned to organize themselves on a transnational basis in order to develop opportunities to influence the development of EU policies. In some cases such transnational activities have had autonomy of their own, notably in the case of multinational corporations. In other cases the transnational policy-influencing mechanisms have been built from consortia of country-based groups and organizations. In addition national stakeholders and groups play a continuing and important role in setting the parameters of the policies of individual EU countries. Most political scientists close to this process would argue that the dynamics of the integration process in the EU have been developed through the interaction of governmental public policy processes and the recurrent interventions of private actors and special interests, and to some extent organizations representing broader society. In addition in the EU context there is a relevant parliamentary dimension, both through the European Parliament and through the nationally specific roles of national parliaments. As the European integration has evolved over time, so both the civil society dimension and the parliamentary dimension have gained in the volume of their activities and in their impact on policy outcomes.

In the context of Latin America such expressions of civil society are a more recent phenomenon, and one, which it is as yet hard to evaluate. There are some suggestions, for example, that there may be a tension between such activities in regional fora and those that remain focused in national for a (see especially Grugel [2004] and comments Trejos to Grugel [2004]) the EU experience suggests two apparently contradictory lessons. On the one hand, there is evidence of distinctly transnational groups pushing forward specific integration initiatives, of which there are two

striking examples: the big business push behind the development of the 1992 single market program; and the 'epistemic community' in banking sector which helped to develop a consensus around the goals of economic and monetary union. On the other hand, country-based groups and constituencies of stakeholders have also played important parts in promoting - and sometimes in blocking - integration initiatives. Beyond these mainly economic interests, we can also observe in the EU context that groups concerned with the non-economic dimensions of integration, such as environmental and social organizations, have also pushed for the extension of the scope of integration policies beyond the narrowly economic dimensions. These latter, however, came as part of a longer sequencing pattern of policy developments provoking responses that also fed into demands for 'flanking' policies.

To revert to our earlier point on institutional design, it is evident from EU experience that some institutional designs lend themselves more readily to the involvement of both stakeholders and civil society groups. Here too EU experience may be instructive - in the early years of the EC, rather formal mechanisms were established (such as, for example, the Economic and Social Committee,) which produced rather meager results. In contrast those mechanisms that were focused in a functionalist way on particular client groups proved more productive (although sometimes at the cost of biasing policy content).

F. Institutional Consequences of Multilevel Governance

Political science literature has for a number of years used the expressions "multilevel government" or "multilevel governance" in all possible ways, sometimes "ad nauseam", especially in the context of European integration; and this trend has been followed more recently by legal literature. There are disputes in academia both on definitions and concepts and on the weight of the evidence to support one or other proposition. What is of practical importance is that the expression "multilevel" relates to a very important phenomenon, well known not only to academics specialized in regional integration studies, but also to a most practitioners. Regional integration can develop only through a simultaneous and related functioning of at least two 'levels' of governance: the specific regional institutions and decision making procedures on one side, and the different institutions and procedures of governance of the states involved in trade and integration on the other side. If national institutions and public administrations are not fit for the coordination of policy making at regional level, and if they are not able to translate the decisions which are taken at regional level in street level practice, the integration process will remain extremely fragile if not totally hollow, and might collapse with the first crisis between the relevant t states. In addition and very importantly in the EU literature as well as EU practice, a third layer of government or governance is often involved at the sub-national level (i.e. local level or regional/provincial level). One of the key points here is that the penetration of integration policies deep inside participating countries may generate processes of support for - or resistance to - integration initiatives.

During the second ELSNIT conference in Florence, these issues have been examined especially through the analysis of the impact of different modes of regional integration on domestic policy making in the organization of national government and agencies, a venue, which should be explored further. More research would be needed on a complementary institutional aspect of the multi-level governance issue, i.e. the adaptation of national and sub-national institutions to newly created regional institutions.

The Impact of Different Modes of Regional Integration on Domestic Policy Making[13]

Empirical research is needed in order to understand how the current projects in regional trade and integration are impacting upon domestic policy making.

If regional trade is developing sufficiently, it contributes to change the distribution of power between the usual participants in policy making. This happens through the opening of new channels of participation, parallel or complementary to the usual formal and informal procedures for policymaking. Organized interests, important stakeholders in regional trade, and to some extent NGO's may gain a say on agenda setting, which they do not have in a strictly national polity. A promising field is therefore to explore the creation of new channels of participation of trade interests and more broadly stakeholders and to asses their functioning and consequences on policy-making and implementation.

A second aspect of the multi-level governance issue is the impact of regional trade and integration on public management within the relevant states. Taking integration seriously means allocating resources to both policy preparation and coordination within national and possibly sub-national administration (depending on the internal political organization of individual countries), and also to the monitoring of policy implementation.

Allocating resources heavily depends upon the availability of human resources (see especially Jordana [2004] p. 16-17), which are conditioned by the structure and functioning of civil service systems. Do they allow for enough flexibility in order to quickly integrate the necessary specialists in administrative structures? Do they give the necessary incentives for the civil servants in order to invest their time and energy in complicated and rather unknown fields of work? Are the training programs and institutions available, and if not, is it possible to create them? To what extent are training programs at regional level functioning? Are they effective? These issues are not new and have received quite some attention on the side of international and regional organizations which specialized in the study, practice and teaching of public administration.[14] ELSNIT should obviously try and find out to what extend it can complement the work of these organizations, especially with the possibility of multidisciplinary studies involving economists with specialists of public management.

The Adaptation of National and Sub-National Institutions to the New Regional Institutions

The existence of some forms of regional institutions - be it only institutionalization of more or less regular meetings at political level - create needs for adaptation of the political and administrative institutions at national and sub-national level. Often these needs are not taken into account when politicians and civil servants try and develop regional trade and integration. The European experience shows how different adaptation can be, from one country to another. This experience

[13] See especially Botto [2004].

[14] Especially the International Institute of Administrative Sciences (*http://www.iiasiisa.be/*), its specialised branch the International Association of Schools and Institutes of Administration (*http://www.iiasiisa.be/schools/aequestce/aequestc.htm*), and at regional level, *Centro Latinoamericano de Administración para el Desarrollo* (CLAD) (*http://www.clad.org.ve*).

has included a tendency - which lasted for quite some time, i.e. until the mid nineteen eighties - to underestimate the national and sub-national institutional dimensions of integration, in academia as well as in the practice of institution building and management. An easy test of this lack of interest was and still is that government reform is undertaken and often carried through without taking into account the changes, which are linked to regional integration. For instance, decentralization processes intend to carry over to sub national institutions powers, which are shared with other states at regional level, without setting up the necessary institutional mechanisms for policy coordination in the preparatory phase of regional policy-making and for the implementation of decisions that are taken at regional level.

If regional integration is a dynamic process, it means that institutional settings and procedures have constantly to adapt and are usually in danger of being one step behind the evolution. Research in this field, and especially comparative research, between the countries involved in the same regional trade or integration area, but also between countries pertaining to different groupings, may help in understanding the main requisites of adaptation to integration.

G. Relevance and Transferability of European Experience

During the second ELSNIT conference, quite some time was spent on the issues of relevance and transferability of the European experience to Latin America, both in the session, which was devoted to the institutional dimension of trade and integration, and in the general session (see the especially papers of Bilal [2004] and Ziller [2004]). A number of specific dimensions came out at the forefront of discussions, which should be pursued by further research and be taken into account more consciously by decision makers.

One important preliminary point needs to be made clear as regards whether and if so how far experiences from European integration can be helpful for understanding the potential for regional integration in the Americas. The European Union (EU) is an unusual example of "deep" integration among countries. Thus "deep" integration comprises several key elements:

a) an intensity of underlying interdependence (economic, social and political) among neighboring European countries;

b) an approach to integration that has wide scope, thus comprising not only political and social features, but also a wide range of economic activities that go far beyond classical trade integration; and

c) an institutional and legal design which ‘locks in’ the participating countries, both through anchoring political institutions and binding legal commitments within a supranational legal system.

Moreover the elements of formal integration are buttressed by many mechanisms and processes of informal integration, which engage people-to-people links both among individuals and in terms of civil society. This broader context and setting help to explain many of the features of EU integration, and these are hard to replicate in other regions of the world. Hence we need to be aware that the scope for lesson drawing between Europe and Latin America is constrained.

Questions are often raised in academia and practice about the risks involved in simply replicating in other regions the typical EU institutions - Commission, Council, Parliament, Court of Justice. It is nevertheless a fact that counsels and experts, or even representatives of donor organizations in international conferences, are too often recommending to developing countries that they follow the example of Europe in order to achieve development by means of regional integration.[15] Furthermore these recommendations occur without any specification about what has to be followed - the political requirements and commitments, the system of power sharing, or the procedures and institutions? This type of recommendation is counterproductive or even dangerous when it results into an exercise of institutional engineering, trying to transpose to Latin America the organizational and legal arrangements upon which the EC/EU is based. The possible relevance of EC/EU institutions and arrangements for other parts of the world can only be assessed by taking into account the specific European environment, in terms of economic, social and administrative development, the historical experiences upon which efforts in regional integration are based, and the culture of the different stakeholders in the process of integration.

Questioning the transferability of EC/EU institutions is not enough, as it may also result in a rejection of the European experience, which is also counterproductive in that it does not allow taking into account the lessons which can be drawn both from failures and successes elsewhere. Special attention should be given, in interdisciplinary research as well at the level of policy making, to the match between the goals of regional integration (macroeconomic objectives - technical harmonization - political cooperation etc.) on one side, and on the other hand the feasibility of accepting the necessary delegation of powers to regional institutions. This can only be done if sufficient attention is been given to the context in which the European institutional setting has been built and developed, as well as to the real practice of institutions. Simplistic views of the European decision making process may result in the transposition or on the contrary the rejection of formal mechanisms - e.g. qualified majority voting - without realizing that they are hardly being used in European practice. Furthermore the consequences, if any, of such formal mechanisms are far less linked to the details of institutions, rules and procedures, than to the possibility for different actors in the decision making process to refer to them as a possibility to get out of a deadlock in the process of bargaining.

Further attention should be given to the possibility of - and limits to - taking only some elements of the EU/EC institutional model as a source of inspiration for regional institutions in Latin America. Two of the questions to be further explored are:

- What is at the heart of the system from a European perspective, and does it mean that it would also have to be at the heart of a system in Latin America, if the goals were comparable? What on the contrary is rather marginal, and can be considered as a good technical solution in a specific policy field, which might be transposed even if the other elements of the institutional setting are not taken up?

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[15] The author is referring mainly to personal experience of his own, and of other specialists who have had the opportunity to work on regional integration. This type of experience is not easy to document with written evidence, as more care is usually given to reports, official or even unofficial documents and academic writings than to oral communication. Experience shows however that the latter is far more influential in practice, especially as decision makers have little time to consult long and precise documents.

- Which elements respond to structural, i.e. medium or long-term needs and strategies, and which ones are to be considered as a short-term response to an urgent need or to a crisis in conjuncture?

These issues are only quoted as examples and certainly have no exhaustive value.

Solid understanding of the European experience in Latin America is not a luxury and should not be considered as the result of a fashion. There is a need for decision-makers to be able to rely upon the necessary knowledge in order to resist proposals to take up the European model when it is not relevant, but also in order to ask for support when the European experience may be useful.

H. Nature and Quality of EU Support for Regional Integration in Latin America

The nature and quality of EU support for regional integration in Latin America has emerged from the Florence conference of ELSNIT as another issue, related to that of relevance and transferability of the European experience. Latin American governments may be mainly asking for political support to their projects, a request, which might seem easy to satisfy, but which may also result into mere lip service support. More attention could be given in research to the implications of this support in relation to third parties.

On the other hand, the EU is providing - or often rather financing - technical assistance -including "toolboxes (see especially Bilal [2004] p. 17) and minimal requirements"- to countries engaged in regional integration. More attention could be devoted to assessing the nature of the actors involved in technical assistance, their techniques and tools. Some solid case studies could be very useful in understanding the processes by which technical support is transformed into changes in institutional setting, in procedures and routines. This in turn could help both the recipient government and the services of the European Commission and agencies of EU member states to concentrate more on relevant technical assistance. One of the elements, which need most attention, is the match between knowledge of the European experience and the knowledge of the recipient region bythe actors or teams of actors involved in the further development of regional integration.

This match may result from specific programs developed both by the EU, regional institutions and governments in Latin America and by the IDB. It may also gain very much from appropriate empirical in social sciences and could therefore be accomplished amongst others in the framework of ELSNIT.

III. SOME IDEAS FOR A FUTURE LATIN AMERICAN RESEARCH AGENDA IN THE INSTITUTIONAL AND LEGAL DIMENSIONS OF INTEGRATION

In order to develop a Latin American Research Agenda on the Institutional and Legal Dimensions of Integration, the issues identified in this paper should serve as a way to identify topics for further research. In order not to come out with a mere list of possible topics, some thought needs to be given to methodological issues. The following short section of this paper was mainly intended as an agenda for discussion in the May 2005 meeting of ELSNIT. These topics might be further developed if there are sufficient reactions to these proposals in order to make them fit the real needs for a Latin American perspective on regional integration.

A. Methodological Issues for a Research Agenda

Pluri-Disciplinary Research and Mono-Disciplinary Research

Some of the topics listed in the following sub-section need to be addressed by lawyers, organizational theorists, political scientists or sociologists, who have the methodological skills in order to do the necessary empirical research. Some gaps in expertise are unavoidable, but ELSNIT could help in bridging them if it developed into a forum for research in regional trade and integration for a large number of disciplines of the social sciences, going thus beyond the economic focus of most of its past and present research.

A lot of value added would obviously result from pluri-disciplinary research. Experience shows that overcoming the barriers due to the differences in disciplinary languages and research methods is very difficult. It is nevertheless possible to set up multidisciplinary teams working on specific problems of regional integration, in order to examine together the different aspects and especially take into account the economic aspects of regional trade and the institutional aspects of the developing trade areas. A somewhat more manageable method is to try and identify a set of topics, which would gain from several studies, conducted separately in different disciplinary fields, but then confronted in their result.

Multi-country Research Teams

Regional trade and integration are by nature relevant to a number of countries. It would be naïve to think that the national origin of researchers, their geographical location as well as the origins of funding do not have an impact on their choice of research topic and their conclusions, but even on the methods they use. The costs involved in managing multi-country research teams are however high, even in the time of Internet and e-mail, and should be carefully assessed in a cost-benefit analysis by researchers themselves as well as by possible sponsors. The same is obviously true and even more difficult when it comes to transatlantic research partnerships between Europe and Latin America.

Policy Relevance of Research

The policy relevance of research is not easy to assess, neither on the side of politicians and civil servants - or even more broadly on the side of practitioners - nor on the side of academics and research institutions. On both sides there are other agendas, gaps in knowledge and methodological prejudices, which interfere with ex-ante priority setting for research. There is no easy solution to this issue, which should however be borne in mind by all relevant actors in deciding to undertake or to finance specific empirical studies.

B. Topics for Further Research

The following list is only a non-exhaustive draft list, derived from the considerations exposed under section one. More specific topics are indicated in section one, and the following list is being proposed only in order to help better classify them.

- Tools and procedures used in the institutional design of regional integration
- Studies in multi-level governance
- Studies in implementation
- Role of civil society
- Further study of elements of relevance of the EU experience

  - Context, especially asymmetries and role of elites

  - Relevance of specific institutions

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A RESEARCH AGENDA FOR INSTITUTIONAL DIMENSIONS OF INTEGRATION AND TRADE IN LATIN AMERICA: A COMMENT

ALICIA FROHMANN
CHIEF, FTAA AND NORTH AMERICA DEPARTMENT, MINISTRY OF FOREIGN AFFAIRS, CHILE AND PROFESSOR, UNIVERSITY OF CHILE

- Thank you for the invitation to comment on this very interesting paper on the institutional dimensions of integration and trade in LA
- I will address two issues:
    - My view on the problems facing regional institution building, in the light of the ideas presented in the paper,
    - Briefly present Chile's experience in establishing institutions at the national level for implementation of FTAs, under the umbrella of the concept of multilevel governance of regional integration;

A. Regional Institution Building

- When reading and reflecting on the issue of regional institution building, I was reminded of the poem *IF* by Rudyard Kipling. There are many ifs, many basic elements, which are necessary in order to build strong and relevant regional institutions. These are only feasible:
    - *If* there are strong political and economic institutions at the national level, and there is a legitimate democratic accountability (this is not the case in many LA countries).
    - *If* there is a dynamic development of regional trade (this is only the case in some subregional arrangements, often strong rivalry and real interest is to penetrate markets of industrialized economies).
    - *If* there is awareness of the importance of regional integration as a public good (rethoric but not in practice).
    - *If* there is acceptance of the necessary delegation of powers to regional institutions (this is a very alien concept in most LA countries).
- LA countries do not do very well on most of these counts. This does not mean that efforts towards regional institution building should not be attempted until we reach all these goals at the national level, and that we should only then continue on to the Nirvana of regional integration and institutions. However, the absence of these ifs, of these elements, often becomes a stumbling block and certainly helps to explain the difficulties the existing regional institutions undergo.

- I am rather skeptical about existing regional institutions and also about some of those which seem to be in the pipe-line. I will only mention a few of them:
    - The oldest institution, *Asociación Latinoamericana de Integración* (ALADI), has certainly served to advance economic integration goals since its creation in 1980; it has been resilient, surviving the ups and downs of the economic and political cycles in LA; but it has not been able to adapt to the challenges of globalization and to develop into a regional economic integration mechanism which goes further than tariff preferences.
    - More than developing and strengthening existing mechanisms, LA countries often prefer to further new initiatives, which overlap with previous ones. This is the case of the recently created South American Community of Nations, which seems to follow more a political than an economic rationale, and for the time being exists only on paper, even if their is a lot of lip-service to it in political spheres.
    - MERCOSUR is certainly the most interesting and ambitious subregional integration mechanism. It has evolved in time, becoming more and more comprehensive. However, the economic asymmetries, trade imbalances, and relative weakness of some national institutions result in a gap between objectives and practice. Thus, very often political momentum does not translate into institutional practice, eroding whatever institutional mechanisms have been or are in the process of being created.
- What has gone wrong? What needs to be addressed in order to improve? The paper deals with many of the issues which need to be kept in mind in order to attain sound regional integration institutions, and which have been often absent in the really existing regional initiatives:
    - There is a coordination deficit both at the national and the regional level
    - The sustainability of regional integration mechanisms is a serious problem
    - We have not found adequate ways to address asymmetries among countries
    - We lack strong regional dispute settlement mechanisms. Although often trade in the regions is less significant in commercial terms than trade with industrialized countries, there are many more disputes, and they are often impossible to solve.
    - We need to think ahead about implementation before setting goals and thresholds
    - We have a gap between objectives and practice, between political commitments and implementation
- There are some good news however:
    - Informal mechanisms of integration have often worked out better than formal ones: business community, unions, academics, legislators, NGOs, *Zona de Integración Centro y Oeste de América del Sur* (ZICOSUR).
    - Civil society groups interested in non-economic integration have pushed for a widening of the scope of the integration mechanism.

B. Institution-Building for Trade Integration at the National Level

- The case of Chile sheds light on some of the challenges we face at the regional level. Chile is a small and open economy; international trade is crucial for economic growth and development. Chile is not a member of formal regional of subregional integration mechanism, but has trade agreements with all countries in LA, as well as FTAs with Canada, the European Union, the US, South Korea, EFTA; and is currently negotiating with New Zealand and Singapore, China, India and possibly, Japan.

- Already almost 70% of trade is in the framework of existing agreements; by 2010, it will be more than 90%. The transaction costs of having and implementing so many different FTAs are high; hopefully regional and/or hemispheric integration mechanisms will develop and facilitate the convergence and joint implementation mechanism of trade commitments.

- Today the priorities of institution-building in Chile are clearly shifting from trade-negotiating institutions to trade-implementation institutions. Although most of these mechanisms do not go beyond trade issues, this is where the future challenges lie.

- What does implementation of trade agreements involve?

  - Implementation of commitments through legislation and administrative rules, not only at the beginning but as a permanent process.

  - Day to day administration of trade agreements together with partners.

  - Policies to translate new business opportunities opened by trade agreements into real benefits for the business community, especially SMEs; and also into benefits for the community as a whole. Here is the focus of public attention regarding the implementation of FTAs.

- What are the institutions for FTA implementation?

  - Light institutional framework, no specific new institution like e.g. the NAFTA Secretariat

  - Coordination of implementation process is responsibility of DIRECON, in the Ministry of Foreign Relations, the same institution which was responsible for trade negotiations.

  - The main task is effective coordination within the public sector and also with the private sector.

  - Effective coordination means (a) to check that obligations have been implemented and are being enforced, (b) to take into account and adapt specific sector policies and institutions to international commitments and opportunities.

  - Some examples of implementation through the coordination of specific institutions and public policies: SPS issues (Agriculture, Health), IPR issues (Health, Education, Economy, Patent Office), Transparency issues address the nature of the public sector itself and are closely related to state-reform.

- Coordination scale for trade agreement implementation[1] (each level builds on the previous one)
  - Clarifying competences for decision making
  - Circulation of information among agencies
  - Consultation among institutions
  - Prevention of contradictory policies
  - Consensus of other agencies required to develop a policy
  - Central arbitration mechanism (ministers, President) preventing the adoption of contradictory policies or ensuring complementary policies
  - Setting common limits on agencies' action
  - Setting common priorities
  - Unified strategy

- Problem: How do we develop incentives for effective coordination when intraburocratic rivalry is usually the default situation?

[1] Reference by Ziller to Les Metcalfe, "International Policy Coordination and Public Management Reform", *International Review of Administrative Sciences*, Vol. 60, London: Sage. 1994. This conceptual framework is excellent for defining coordination needs according to the Chilean experience.

II. FINAL COMMENTS

- Relevance and transferability of European experience:
  - Certainly crucial in the medium and long term.
  - Even if we are not quite there yet, it is definitely important to have a good understanding of the successful regional institution-building process in the European Union.
  - Awareness of the role in Europe of stakeholders and civil society in the development of regional institutions is of great relevance, in order to facilitate the creation of legitimate and accountable regional institutions in LA.
  - The comprehensive agreements the European Union has negotiated with countries in LA (political, cooperation and trade components) are serving as a model for deepening agreements among LA countries. E.g. negotiation for Strategic Association Agreement between Chile and Mexico is seeking a more comprehensive integration mechanism after a successful process of integration through a tariff agreement, first [1991] and an FTA, second [1999]. This agreement would closely follow the model of the Association Agreements both Chile and Mexico have with the European Union.
- Agenda for future research:
  - Topics proposed by authors are all very important.
  - Issue of policy relevance of research is especially important.
  - In LA (Chile) research agenda often lags behind the policies.
  - Research teams should include or have a close link to policy makers.

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APPENDIX

AGENDAS

Florence, October 29-30, 2004

Santiago de Chile, May 6-7, 2005

INTER-AMERICAN DEVELOPMENT BANK

SPECIAL OFFICE IN EUROPE (SOE)
INTEGRATION AND REGIONAL PROGRAMS DEPARTMENT (INT)
INSTITUTE FOR THE INTEGRATION OF LATIN AMERICA AND THE CARIBBEAN (IDB/INTAL)

SECOND ANNUAL CONFERENCE OF THE EURO-LATIN STUDY NETWORK ON INTEGRATION AND TRADE (ELSNIT) FLORENCE, OCTOBER 29-30, 2004

VILLA SCHIFANOIA - VIA BOCCACCIO 121 - 50133 FIRENZE, ITALY

CO-ORGANIZED WITH THE ROBERT SCHUMAN CENTRE FOR ADVANCED STUDIES (RSC)
AND IN COOPERATION WITH THE CENTER FOR RESEARCH IN INTERNATIONAL ECONOMICS (CREI),
THE CENTRE D'ETUDES PROSPECTIVES ET D'INFORMATIONS INTERNATIONALES (CEPII)
AND THE KIEL INSTITUTE FOR WORLD ECONOMICS (IFW)

Preliminary Agenda

Friday, October 29

8:30 – 9:00	**REGISTRATION**
9:00 – 9:30	**WELCOMING REMARKS** **Helen Wallace,** Director of the Robert Schuman Centre for Advanced Studies, European University Institute (EUI) **Carlo Binetti**, Special Representative in Europe, IDB
9:30 – 10: 45	**OPENING SESSION**
(9:30 – 10:15)	"Trade and Integration in Latin America: The State of Play" **José Luis Machinea**, Executive Secretary, UN Economic Commission for Latin America and the Caribbean (ECLAC), Santiago, Chile
(10:15 – 10:45)	**Open Discussion**
10:45 – 11:15	**Coffee Break**

Parallel Sessions

11:15 – 13:05	**Session I**: MACROECONOMIC DIMENSIONS OF INTEGRATION AND TRADE Coordinated by **Jaume Ventura**, CREI and **Omar Licandro**, EUI	**SESSION II:** EMPIRICAL DIMENSIONS OF INTEGRATION AND TRADE Coordinated by **Rolf J. Langhammer**, IfW and **Michel Fouquin**, CEPII	**SESSION III:** INSTITUTIONAL DIMENSIONS OF INTEGRATION AND TRADE Coordinated by Professor **Helen Wallace**, RSC
(11:15 -11:55)	**Elias Dinopoulos**, University of Florida, USA and **Paul Segerstrom**, Stockholm School of Economics, Sweden and CEPR "A Theory of North – South Trade and Globalization" *Comments: Pablo Sanguinetti, Universidad Torcuato Di Tella, Buenos Aires, Argentina*	**Julien Garnier**, European University Institute, Florence, Italy and THEMA, University of Paris, 10 – Nanterre, France "To What Extent Does Intra-Industry Trade Matter in Business Cycles Comovements? Distinguishing Common and Transmitted Cycles" *Comments: Rafael Correa, Universidad San Francisco de Quito, Ecuador*	**Sanoussi Bilal**, European Centre for Development Policy Management, Maastricht, Netherlands "Can the EU Be a Model and a Driving Force for Regional Integration in Developing Countries?" *Comments: Félix Peña, Universidad Nacional de Tres de Febrero, Argentina*
(11:55 -12:10)	**Open Discussion**	**Open Discussion**	**Open Discussion**
(12:10 -12:50)	**Ester Faia,** Universitat Pompeu Fabra and **Tommaso Monacelli,** IGIER, Universitá Bocconi and CEPR "Ramsey Monetary Policy and International Relative Prices" *Comments: Alicia García Herrero, Banco de España*	**Lelio Iapadre**, University of L'Aquila and CIDEI, University of Rome "La Sapienza", Italy "Regional Integration Agreements and the Geography of World Trade: Statistical Indicators and Empirical Evidence" *Comments: Maurice Kugler, Southampton University, UK*	**Mercedes Botto**, FLACSO, Buenos Aires Argentina "The Impact of Regionalism on Trade Policy Making: A Cross Study in South America" *Comments: Jacint Jordana, Universitat Pompeu Fabra, Barcelona, Spain*
(12:50 -13:05)	**Open Discussion**	**Open Discussion**	**Open Discussion**
13:05 – 14:45	**LUNCH**		

(14:45 -15:25)	**Giovanni Pica**, University of Southampton, UK and **J.V. Rodríguez Mora**, Universitat Pompeu Fabra, Barcelona, Spain "FDI, the Allocation of Talents and Differences in Regulation" *Comments: Thierry Verdier, Delta, Paris, France*	**Alessia Lo Turco**, Università Politecnica delle Marche, Ancona, Italy "South-South Trade Agreements and Growth. A Panel Data Aproach to the Evaluation of Three Latin American Agreements" *Comments: Simon Evenett, Oxford Business School, Oxford, UK*	**Celina Pena,** Dirección del Mercosur, MRE, Buenos Aires, Argentina and **Ricardo Rozemberg**, Centro de Estudios para la Producción, Buenos Aires, Argentina "MERCOSUR: An Experience in Sustainable Institutional Development?" *Comments: Helen Wallace, Robert Schuman Centre, EUI, Florence, Italy*
(15:25 -15:40)	**Open Discussion**	**Open Discussion**	**Open Discussion**
(15:40- 16:20)	**Francesc Ortega**, Universitat Pompeu Fabra, Barcelona, Spain "Immigration Policy and the Welfare State" *Comments: Tito Boeri, Bocconi University, Milan, Italy*	**Lars Wang**, University of Hohenheim, Germany "Economic Integration Models and Monetary Ingegration Analysis – A Reassessment of MERCOSUR" *Comments: Daria Taglioni, University of Geneva, Switzerland*	**Jean Grugel**, University of Sheffield, UK "Civil Society and Inclusion in New Regionalism: Can Civil Society Influence a Trade-led Agenda?" *Comments: Alberto Trejos, Senior Advisor, INCAE, Costa Rica and former Minster of Trade of Costa Rica*
(16:20- 16:35)	**Open Discussion**	**Open Discussion**	**Open Discussion**
16:35 – 16:55	**Coffee Break**	**Coffee Break**	**Coffee Break**
(16:55- 17:35)	**Alejandro Cuñat** University of Essex, LSE and CEPR, London, UK and **Marco Maffezzoli**, Università Bocconi and IGIER, Milan, Italy "Can Comparative Advantage Explain the Growth of US Trade?" *Comments: Morten O. Ravn, EUI, Florence, Italy*	**Thierry Mayer**, Université de Paris I and CEPII, Paris, France and **Soledad Zignago**, CEPII, Paris, France "Market Access in International Trade: The North-South Divide and Regional Agreements" *Comments: Riccardo Faini, University of Rome, Italy*	**Jacint Jordana** and **Carles Ramió**, Universitat Pompeu Fabra, Barcelona, Spain "Trade Policy Institutions: A Comparative Analysis" *Comments: Alberto Trejos, Senior Advisor, INCAE, Costa Rica and former Minster of Trade of Costa Rica*
(17:35- 17:50)	**Open Discussion**	**Open Discussion**	**Open Discussion**
17:50 – 18:10	Final Remarks by **Jaume Ventura** and **Omar Licandro**	Final Remarks by **Rolf Langhammer** and **Michel Fouquin**	Final Remarks by **Helen Wallace**
20:30	**DINNER**		

Saturday, October 30

09:00 –13:00	**PLENARY SESSION**
	SESSION I: MACROECONOMIC DIMENSIONS OF INTEGRATION AND TRADE
	Coordinated by **Jaume Ventura**, CREI and **Omar Licandro**, IUE
(09:00- 09:40)	Hugo A. Hopenhayn, University of California, Los Angeles, USA and Pablo A. Neumeyer, Universidad Torcuato Di Tella, Buenos Aires, Argentina "Latin America in the XXth Century: Stagnation, then Collapse" *Comments: Renato Flôres, Fundaçao Getulio Vargas, Rio de Janeiro, Brazil*
(09:40-09:55)	**Open Discussion**
	SESSION II: EMPIRICAL DIMENSIONS OF INTEGRATION AND TRADE
	Coordinated by Rolf J. Langhammer**, IfW and** Michel Fouquin**, CEPII**
(09:55- 10:35)	**José Maria Fanelli**, CEDES, Buenos Aires, Argentina and **Martín González Rozada**, Universidad Torcuato di Tella, Buenos Aires, Argentina "Business Cycles and Macroeconomic Policy Coordination in MERCOSUR" *Comments: Ansgar Belke, University of Hohenheim, Germany*
(10:35- 10:50)	**Open Discussion**
10:50 – 11:10	**Coffee Break**
	SESSION III: INSTITUTIONAL DIMENSIONS OF INTEGRATION AND TRADE
	Coordinated by Professor Helen Wallace**, RSC**
(11:10- 11:50)	**Jacques Ziller**, Department of Law, European University Institute, Florence, Italy "The Challenge of Governance in Regional Integration: Key Experiences from Europe in an Inter-American Perspective" *Comments: Alfredo Valladão, Chaire Mercosur, Fondation Nationale de Sciences Politiques, Paris, France*
(11:50- 12:05)	**Open Discussion**
12:05 – 12:45	**Final Remarks by Sessions Coordinators**
12:45 – 13:00	**CLOSING REMARKS: Robert Devlin, Deputy Manager,** Integration and Regional Programs Department, IDB
13:00 – 14:30	**LUNCH**
14:30 – 16:00	**Discussion On The Future Agenda For The Network**

SECOND ANNUAL CONFERENCE OF THE

EURO-LATIN STUDY NETWORK ON INTEGRATION AND TRADE (ELSNIT)

FLORENCE, OCTOBER 29-30, 2004

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INTER-AMERICAN DEVELOPMENT BANK

SPECIAL OFFICE IN EUROPE (SOE)
INTEGRATION AND REGIONAL PROGRAMS DEPARTMENT (INT)
INSTITUTE FOR THE INTEGRATION OF LATIN AMERICA AND THE CARIBBEAN (IDB/INTAL)

REGIONAL INTEGRATION AND TRADE: ISSUES FOR LATIN AMERICA - DISCUSSION ON SECOND CYCLE OF EURO-LATIN STUDY NETWORK ON INTEGRATION AND TRADE (ELSNIT) SANTIAGO DE CHILE, 6-7 MAY 2005

WITH THE COLLABORATION OF THE UNIVERSITY OF CHILE

AGENDA

FRIDAY, MAY 6

9:30 - 10:00 **OPENING REMARKS**
Ricardo R. Carciofi, Director IDB/INTAL
Julio Angel, IDB Representative, Chile
Joseph Ramos, Dean, Department of Economics and Administrative Sciences, University of Chile

10:00 - 11:00 **KEYNOTE LECTURE**
Moderator: *Robert Devlin*, Deputy Manager, IDB/INT

"REGIONAL DISPARITIES IN REGIONAL AGREEMENTS: THEORY AND POLICY"

Anthony Venables, Professor, London School of Economics, United Kingdom

11:00 - 11:15 COFFEE BREAK

11:15 - 17:45 **OVERVIEW OF DELIBERATIONS AT ELSNIT SECOND ANNUAL CONFERENCE (29-30 OCTOBER 2004, FLORENCE, ITALY)**
Moderator: *Antoni Estevadeordal*, Principal Trade Economist, IDB/INT

11:15 - 12:45 **ECONOMIC POLICY DIMENSIONS OF INTEGRATION AND TRADE**
Panelists:
Rolf J. Langhammer, Vice-President, Institute for World Economics, Kiel, Germany
Michel Fouquin, Deputy Director, CEPII, Paris, France

Discussant:
Patricio Meller, Professor, University of Chile

Open Discussion

12:45 - 14:30 LUNCH

14:30 - 16:00	**MACROECONOMIC DIMENSIONS OF INTEGRATION AND TRADE** Panelists: *Jaume Ventura*, Professor, CREI, Barcelona, Spain *Omar Licandro*, Professor, European University Institute, Florence, Italy Discussant: *Claudio Bravo-Ortega*, World Bank and Professor, University of Chile Open Discussion
16:00 - 16:15	COFFEE BREAK
16:15 - 17:45	**INSTITUTIONAL DIMENSIONS OF INTEGRATION AND TRADE** Panelist: *Jacques Ziller*, Professor, European University Institute, Florence, Italy Discussant: *Alicia Frohmann*, Chief, FTAA and North America Department, Ministry of Foreign Affairs, Chile and Professor, University of Chile Open Discussion
17:45 - 18:00	**CLOSING REMARKS** *Joseph Ramos*, Dean, Department of Economics and Administrative Sciences, University of Chile *Robert Devlin*, Deputy Manager, IDB/INT
18:00	COCKTAIL

SATURDAY, MAY 7

9:30 - 10:10	**OPENING PRESENTATION** Moderator: *Oscar Landerretche*, Professor, University of Chile "REVISITING THE CHILEAN TRADE LIBERALIZATION EXPERIENCE" *Osvaldo Rosales*, Director, Division of International Trade and Integration, Economic Commission for Latin America and the Caribbean (ECLAC), Santiago de Chile
10:10 - 11:10	**GROWTH EFFECTS OF REGIONAL INTEGRATION AGREEMENTS** *Matias Berthelon*, Pontificia Universidad Católica, Valparaiso, Chile Discussants: *Rolf J. Langhammer*, Vice-President, Institute for World Economics, Kiel, Germany *Omar Licandro*, Professor, European University Institute, Florence, Italy Open Discussion

11:10 - 11:30 COFFEE BREAK

11:30 - 12:30 **FIRM DYNAMICS AND REAL EXCHANGE RATE FLUCTUATIONS: DOES TRADE OPENNESS MATTER? EVIDENCE FROM MEXICO'S MANUFACTURING SECTOR**
Miguel Fuentes and Pablo Ibarrarán, Pontificia Universidad Católica, Santiago, Chile

Discussants:
Jaume Ventura, Professor, CREI, Barcelona, Spain
Michel Fouquin, Deputy Director, CEPII, Paris, France

Open Discussion

12:30 - 13:30 **FREE TRADE AGREEMENT BETWEEN CENTRAL AMERICA AND UNITED STATES: OPPORTUNITY AND CHALLENGES**
Manuel Agosín, Regional Economic Advisor, Regional Operations Department 2, IDB

Discussants:
Rolf J. Langhammer, Vice-President, Institute for World Economics, Kiel, Germany
Jacques Ziller, Professor, European University Institute, Florence, Italy

Open Discussion

13:30 **CLOSURE**
Joseph Ramos, Dean, Department of Economics and Administrative Sciences, University of Chile
Robert Devlin, Deputy Manager, IDB/INT

SECOND ANNUAL CONFERENCE OF THE

EURO-LATIN STUDY NETWORK ON INTEGRATION AND TRADE (ELSNIT)

SANTIAGO DE CHILE, MAY 6-7, 2005

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