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**IDB**

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Institute for the Integration of Latin America and the Caribbean



# Integration & Trade

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# INTEGRATION & TRADE: A New Chapter

Today we open a new chapter in the *Integration & Trade Journal*, one characterized by important changes from past issues. Even so, we do not see this course adjustment as a relaunch of the Journal. Rather, we are revisiting the principles that have guided its development over the last 33 years, first as *Integración Latinoamericana (Latin American Integration)* (1976) and then under its current title (1996). The basic objective is to define renewed, fine tuned approaches to such principles to meet today's needs, and at the same time, recognize the capabilities that have been developing in the region.

We feel proud of the Journal's history and its pioneering role in the discussion of various issues related to the two pillars which stand together under its current name. It is worth recalling a few of these subjects: multilateral negotiations and their applications; the evolution of ideas on regionalism; the dynamics of subregional blocs; hemispheric and extraregional initiatives; and links between trade policy and economic development. In all these areas, a variety of different experts from the region and elsewhere have provided analytical foundations and empirical evidence through their research work. Our acknowledgement and gratitude goes out to all the many contributors. Looking back, the Journal clearly also sought to connect issues and research agendas developing around the world, thus contributing to the debate in Latin America and the Caribbean over concerns and question marks from elsewhere that may be relevant to the region's reality.

Although today we have greater capability in this respect, we also have new needs. Throughout its long history, the Journal chose to target an academic audience. However, the installed capacities have increased in this area, and there are now several specialized channels and journals in the region to

provide continuity and support for these initiatives. Conversely, we are now seeing new gaps appearing. For instance, a better balance of technical analysis and public policy conclusions should be struck, thus avoiding such conclusions playing a merely secondary role in research. In turn, today's realities and perceptions are more varied and controversial than before, and it is consequently preferable to come to grips with the actual terms of the debate rather than just the prevailing conclusions. Likewise, the clear recognition of the many actors partaking in public policies (policy-makers, civil society organizations, private sector representatives, and citizens at large) calls for an analysis of their most real and immediate dimensions, and of the consequences for the various actors involved. These are a few of the gaps that have been identified by IDB and that it wishes to address in this new phase of the Journal.

We will be guided in this initiative by **three main directions**. The first, conceptual in nature, will enable us to define the range of issues to be addressed. The Journal will therefore continue to prioritize the economic aspects of integration and trade, but will broaden the variety of issues addressed. On the one hand, it will focus on trade, but will also venture into subjects relating to sustainable development and the insertion of the region's countries in the global economy. On the other hand, it will address integration in a broad sense, encompassing *de jure* schemes and *de facto* developments. While concentrating on Latin America and the Caribbean, relevant developments and lessons learnt from the European and Asian integration processes will also be considered. Every issue will cover one main issue, and will provide complementary approaches and views.

The **second principle** aims to consider the kind of proposal oriented contributions to be prioritized.

Indeed, we feel it is necessary to promote well-founded, responsible, but also challenging, debate and to include opinions supporting public policy making and implementation in these areas. In other words, beyond the necessary analytical and empirical fundamentals of the statements and proposals, we would like to highlight the assertive content in order to explore options, contrast experiences, and move forward in addressing disputes. In short, essays allowing for debate over the most controversial issue aspects will take priority over traditional articles.

The **third communicational direction** will target public, in both profile and number, and mode of

interaction. Without losing sight of its academic audience, the Journal will aim at all participants or direct actors in the integration and trade processes, in the public and private sectors. This calls for a mass communication mode. We have therefore chosen to adopt an electronic format and to make use of multimedia when the content calls for it.

On the basis of these conceptual, proposal oriented, and communicational directions in the Journal's contents, we hope to reinforce our commitment to promoting the regional debate on integration and trade issues, thus complying with one of Inter-American Development Bank's founding mandates.

## New Areas of Interest

Articles on regional integration and trade; negotiations; global economy

Articles on environmental issues; financial integration; regional infrastructure cooperation; migration, and regional public goods

Articles on integration processes in LAC and its insertion in the global context. Integration in other regions: Asia, Europe

Interviews to key specialists from the public and private sectors on the areas of regional trade and finance; infrastructure; environmental, and energy

Panels - Discussion fora

Updated data on regional statistics - Institutional data bases

Comments - Bibliographic reviews

Dissemination of IDB integration activities



# CONTENTS

<b>I</b> NTRODUCTION	1
<b>I</b> TEGRATION & TRADE: AN EDITORIAL REJUVENATION TO HELP IDB'S EFFORTS <i>Luis Alberto Moreno</i>	7
<b>A</b> RTICLES	
<i>The IDB and Half a Century of Regional Integration in Latin America and the Caribbean</i> <i>Roberto Bouzas and Peter Knaack</i>	15
<i>Fostering Cross-Border Commerce and Market Integration: Lessons from European Experience</i> <i>Simon J. Evenett</i>	27
<i>Global and Regional Economic Integration: a View from Asia</i> <i>Masahiro Kawai and Ganeshan Wignaraja</i>	35
<b>I</b> NTERVIEWS	
<i>A Dialogue on the Future of Regional Integration in the Americas</i> <i>Grant Aldonas</i>	49 53
<i>José Botafogo Gonçalves</i>	61
<i>Guillermo Fernández de Soto</i>	69
<i>Félix Peña</i>	79
<i>Carlos Pérez del Castillo</i>	85
<b>S</b> TATISTICS	93
<b>R</b> EADERS' CONTRIBUTIONS	97



# INTRODUCTION

In keeping with the guidelines outlined in the section “Integration & Trade: A New Chapter”, we have chosen to tackle the issue of regional integration in this first issue of the editorial relaunch. The selection was made not just because of the controversies raised by the assessment of the regional integration process in Latin America and the Caribbean or its future prospects, but because the issue is inseparable from the Journal itself.

The fact that this new stage in the Journal’s development coincides precisely with the 50th anniversary of the Bank’s birth prompted us to ask President Moreno to write an introduction outlining his own vision of how IDB intends to confront the challenges to Latin America and the Caribbean where regional integration and insertion in the global economy are concerned. Based on an affirmation of goals that identifies competitive integration at regional and global level as one of the Bank’s five priority areas, President Moreno emphasizes the four chapters informing the institution’s work in this area: trade, investment and the integration of capital markets, physical integration, and the promotion of regional public goods. The attached box outlines the main institutional undertakings in all these areas in greater detail. In closing, President Moreno recalls that the Bank’s institutional focus expresses a genuine commitment for cooperation and that, therefore, the effectiveness of its task ultimately depends on the Member States. In this sense IDB, and other institutions, play a decisive role as catalysts in the wide-ranging agenda of regional integration and global governance.

Next, we asked three eminent specialists for individual essays on the subject in Latin America and the Caribbean, Europe and Asia. The first essay, by Roberto Bouzas & Peter Knaack, summarizes and illustrates a wide variety of regional integration cycles in Latin America and the Caribbean, as well as the role of integration in the Bank’s thinking. The second and third essays, by Simon J. Evenett and Masahiro Kawai & Ganeshan Wignaraja, aim to draw historical lessons and delineate current potentially important orientations for the region.

The paper, by Bouzas & Knaack, identifies three distinct cycles in the history of regional integration in Latin America and the Caribbean: in the first cycle -“old regionalism”- integration is conceived as an instrument of development policy and, in the last, “open regionalism”, it becomes one of the components of economic reform policy. Between these two cycles comes another, described as a “response to the crisis” of the 1980s. After analyzing the salient characteristics of each cycle, the authors examine the evolution of the IDB’s ideas on regional integration as expressed in the speeches, articles, and reports by its first three presidents.

In the authors’ opinion, they each, over their long terms of office, embodied and reflected the common core of the partners’ convictions and interests in the respective cycle. The arguments are illustrated with some of the main institutional initiatives in each period. Finally, Bouzas & Knaack conclude that, over the last half century, the IDB has been a permanent actor in the experience of regional



integration and that its contribution was manifested both on the level of ideas and through material support.

Evenett, for his part, holds that the European Union represents perhaps the most far-reaching international cooperation undertaking in the modern era and delineates three governing principles in this experience which, though not to be considered universal, may yet be useful for other regions: (1) it has not been enough to eliminate trade barriers; (2) integration initiatives have required institutions to run the process; and (3) concessions have been made between different policy areas and financial transfers between Member States.

Then, he looks at the relationship between the proposal, *Global Europe*, and trends in world trade, multilateral negotiations and the proliferation of free trade agreements recorded over the last 15 years, as well as the state of negotiations with Latin America and the Caribbean. Last, Evenett posits that Europe's contribution to market integration may well be to have shown that free trade agreements are suitable vehicles for creating and maintaining intergovernmental cooperation via institutional mechanisms in a broad spectrum of state policies of mutual interest.

Lastly, Kawai & Wignaraja analyze sequential integration in East Asia: shallow globalization followed by deeper regionalization. They also look at the ties with Latin American and Caribbean countries, summarize the evolution of emerging regionalism in East Asia, and highlight the strengthening of economic ties between East Asia and Latin America and the Caribbean arising from free and bilateral trade agreements. Looking to the future, they hold that East Asian regionalism can have favorable consequences for Latin America and the Caribbean if the region adopts coherent criteria to gain maximum benefit from deep integration. They also present six policy lessons based on the East Asian experience: developing manufacturing sectors capable of competing internationally; strengthening national structural reforms and market orientation in regional strategy; adapting the combination of policies to national circumstances; deepening interregional ties with East Asia; committing the private sector to developing a regional strategy; and, last, reducing internal gaps in development.

The controversial nature of regional integration processes and the need to explore them by comparing opinions had prompted President Moreno to call for a dialogue between recognized experts late in 2008. The richness of these reflections prompted us to draw up a questionnaire and ask for the reactions of the experts in question. Taking as its basis the answers of those who decided to take part in the survey -Grant Aldonas, José Botafogo Gonçalves, Guillermo Fernández de Soto, Félix Peña, and Carlos Pérez del Castillo- the third section sets out the experts positions on several questions. These are grouped into three main areas: the goals and motivations behind regional integration, its new profile, and the opportunities and constraints given by the global climate. In our opinion, each of the experts has managed not just to inform their answers with their academic training and knowledge, but also with the policy wisdom granted by their official duties. We believe that the variety of answers to the questions formulated in the three areas helps to grasp the terms in which the regional integration debate is currently couched, embracing its achievements, its frustrations, and, in particular, its prospects in the world of tomorrow.



This first issue is rounded off with a section presenting salient aspects of regional trade and integration in figures. On this occasion, the most important empirical evidence from the study, *Unclogging the Arteries: the Impact of Transport Costs on Latin American and Caribbean Trade* is also included. ♦

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**INTEGRATION & TRADE:  
AN EDITORIAL  
REJUVENATION TO HELP  
IDB'S EFFORTS**



**LUIS ALBERTO MORENO**  
President of the  
Inter-American Development Bank



## INTEGRATION & TRADE: AN EDITORIAL REJUVENATION TO HELP IDB'S EFFORTS

*LUIS ALBERTO MORENO*

*President of the Inter-American Development Bank (IDB)*

Last year, when the *Integration & Trade* Steering Committee set about the task of relaunching the publication, the reasons were exclusively editorial: the conviction that it had come full-cycle and that this was the time for a salutary makeover. But it is now several months since that decision and there are new factors today that call for a different angle on this editorial redesign.

The global economy and society will emerge with a different shape as we near the end of this first decade of the new century. Although we do not as yet know what the new features will look like, we do know that this transition stage is a watershed in recent history, that the societies of Latin America and the Caribbean, their mutual economic ties, and their links with the rest of the world will have to be reworked in a variety of hues and shades.

This is more than enough grounds for wanting to breathe fresh life into an IDB publication that, as has always been this Journal's tradition, sets about forging a vigilant, up-to-date, analytical approach to the reality of our countries' regional integration and international insertion. As I see it, this is true due to chief attributes that will mark the new times and our institution as well: on one side, the need to understand the phenomena that fuel everyday reality and, on the other, the responsibility we all have to produce responses that contribute to global governance, modest but timely.

This task involves a dual dimension: first, the intellectual challenge of analysis that endeavors to clear a way through the complexity and, at the same time, the call for action. This counterpoint between knowledge and proposals is, strictly, the essence of the Bank's mission, and I hope that *Integration & Trade* will be a useful tool in carrying out this work, enriching our vision, sparking debate, and, ultimately, providing food for thought for our responses.

The articles presented in this issue cover the phenomenon of integration from different perspectives, both within and outside the region. The panel of experts answering the Journal's questions met in Washington in October 2008 at the Bank's invitation to exchange views and provide us with the raw materials for our own work.

The Bank has a long standing working history with the countries of the region in the tightening of trade, economic and cooperation relations among themselves and outside regional borders. The starting point sets forth an affirmation of goals: one of the five pillars of the Bank is competitive integration at regional and global levels.

The first of the elements, an essential pillar of the whole integration process, is trade. The region has made significant progress, both in the framework of multilateral negotiations and process-compatible preferential agreements. This has been an effort of enormous significance, long years, and great effort. The benefits are palpable: the modernization of production, gains in market access, and the general security of being involved in processes where the rule of law provides protection against what would, in another context, be an exercise in the pure relationship of economic forces.

Naturally, much remains to be done. While progress has been made in trade in goods, trade in services in its various forms is moving at a painfully slow pace. The Bank has worked closely with the region's countries on the ample negotiating agenda, and continues to do so: training, experience exchange, information, research geared to improving policy quality, to name but a few, are frequent elements in the support provided by the institution.

The Doha Round has not concluded, but, today more than ever, it is up to all of us to maintain the results the world has achieved under the rules mutually agreed in the World Trade Organization (WTO). The picture is far from satisfactory, but it is the best that the global community has been able to achieve collectively. The agreements need to be applied and it is necessary to make regulatory and institutional adjustments consistent with the new environment. On another side, in the field of production development policy, complementary progress is also needed to assist the modernization of sectors and enterprises. Designed in isolation and operating statically, purely trade measures are limited in scope.

The second chapter complements the first, taking in investments and the integration of capital markets. The region has increasingly been witnessing the reception of investments and transnationalizations of companies originating in the region itself. We are seeing that the breakthroughs in the private sector needs to be accompanied by similar progress in regulations and the modernization of institutions so as to apply the same rules to local and foreign companies alike. In spite of everything, results have been achieved in terms of investment flow, and there is a general outline of the way ahead. Unfortunately, the same cannot be said of migration and the growing movement of people beyond national borders. This is a permanent issue in the region and is a challenge which the Bank, joining forces with other strategic organizations and actors, can meet with contributions.

The third of the elements is a territory that IDB has made major contributions to throughout its history, namely, physical integration. Our institution has always been

there to encourage physical connectivity in the region, whether in the field of road, rail, or sea transport, or with works that have enabled energy exchanges. Numerous lending projects and operations, some of them highly ambitious, punctuate IDB's history in this area of integration infrastructure. We will be pursuing this direction, encouraging works that cross borders and bridge distances. A recent telling example is IDB's participation in the expansion of the Panama Canal, as well as other initiatives of a regional scope such as the Mesoamerica Project and the Initiative for the Integration of Regional Infrastructure in South America (IIRSA), to stimulate environmentally sustainable investment that encourages production modernization, employment, and welfare of postponed communities.

There is a fourth chapter on regional action, whose limits are by definition less precise, but no less important for all that. The coordination of tasks for the prevention of and response to natural disasters, information systems, and weather data surveillance for use in agriculture, fighting endemic diseases and regional epidemics, or challenges at regional level associated with climate change, are examples of a more general category. This involves regional public goods where the Bank may be a major catalyst for action, as it has been in the past through innovative programs such as the Regional Public Goods Initiative. Our institution is in an advantageous position to contribute and support intergovernmental cooperation mechanisms in the management of these public goods and, ultimately, to contribute resources to their production.

The elements I have presented above encapsulate how I view IDB's task where these issues are concerned. It goes without saying that the development of each of these aspects requires an intense analysis and exploration, and specific practices. The Bank is actively working on these various levels. By way of illustration and for further information for the reader, the synopsis below describes several of the activities carried out by our institution in greater detail.

However, this brief overview of how IDB identifies and prepares to act in our countries' various regional and global integration issues would be incomplete if we were to leave out the institution itself. IDB participates, alongside the other organizations, in one essential attribute: its operational design and mechanics is an expression of a genuine vocation for cooperation. And, as such, its effectiveness is directly proportional to its real actors: the countries themselves. If we agree that the integration agenda is broad and that there is a need to contribute to the governance of the global system, IDB, acting together with other similar bodies, can help in the task. A concrete example here is this new phase of the *Integration & Trade Journal*, a joint collaboration between IDB's Integration and Trade Sector (INT) and the Institute for the Integration of Latin America and the Caribbean (INTAL).

One final reflection by way of conclusion. I began these paragraphs by stressing the importance of the current international economic and financial climate, aware of the fact that this will have to impart new features to global trade and regional integration processes. However, the reader will note that, by identifying our work agenda, the various different issues have dimensions and consequences that require a long breathing space. It is not about marginalizing current data. It is about defining our work while incorporating the reality we know today, but in the clear knowledge that we are seeking results that challenge our imagination and also our ability to conceive of the future. ♦



## IDB: Promoting Regional Integration

The countries of Latin America and the Caribbean (LAC) have long pursued trade and regional and global economic integration as a centerpiece in their economic development strategies. The IDB has been a partner with the member economies since its foundation. The Bank has provided loans, grants, technical assistance, training and policy advice for the regional economies to integrate and cooperate both with each other and with other regions in the world. We have been a central and strategic partner for the region both in the hard and soft sides of integration -the physical integration involving roads and other infrastructure networks connecting nations and reducing trade costs, and lowering of trade policy barriers and furthering the development of regulations conducive to trading across borders. The support is increasingly multi-sectoral, spanning trade promotion and facilitation, integration and improvement of regional infrastructure, communications, and energy networks, and cooperation in such areas as health and the environment. There are numerous flagship programs:

The Bank has long provided technical and financial support to the **Plan Mesoamérica (former Plan Puebla Panama) and the Initiative for the Integration of Regional Infrastructure in South America (IIRSA)**, whose main objective is to develop the regional infrastructure. Some notable examples of this commitment are multimillion dollar loans for the expansion of the Panama Canal -the largest infrastructure project underway in LAC- for building the Florianopolis-Osorio highway in the MERCOSUR corridor, for enhancing the efficiency of the Port of Montevideo. In 2008, the IDB also pioneered a pilot program for international transit in Mesoamerica that reduced transit times from an hour to 8 minutes. There were also efforts to facilitate regional trade through policy convergence, including operations to fund the convergence of the three free trade agreements signed among Mexico and the five Central American countries, to promote trade facilitation and to foster regional competitiveness.

In 2004, the Bank set out to promote the production of **regional public goods (RPGs)** by supporting the collective action of countries that address transnational challenges with coordinated public policy solutions. In 2008, all the regional member countries participated in RPG projects that included a regional framework for immigrant workers among 16 countries and an energy information system for national and regional energy planning.

The Bank has long supported the consolidation and institutionalization of the various integration schemes in the Americas -Caribbean Community, Andean Community, Southern Common Market, and Central American Common Market. Since 2007, the IDB has accompanied the **integration efforts of the Pacific-11 Group of Pacific Rim Latin American countries (Arco del Pacífico Latinoamericano)**, which is aimed at connecting the regional countries' various common trade agreements, facilitating trade, promoting investments, and solidifying the region's economic ties with the emerging markets of Asia-Pacific. In 2008, the IDB provided technical assistance for the five main working groups, including developing a web page for investment attraction to the region and a software for analyzing convergence of rules of origin regimes among the member countries' common free trade agreements; preparing a list of infrastructure projects for facilitating intra-regional trade; and providing technical assistance in the group's various meetings.

## IDB: Promoting Regional Integration

The Bank has an increasingly active work agenda to promote economic integration beyond the hemisphere, especially with the Asian economic powerhouses. The support is multifaceted, consisting of funding trans-pacific trade policy research, cooperation with the Asian Development Bank (ADB) on inter-regional integration, and support of the Asia-Pacific Economic Cooperation (APEC) forum meetings, in 2008 chaired by the Government of Peru, through technical studies, presentations, and private sector fora. The Bank also has a matchmaking initiative that brings Latin American businessmen and women together with their Asian counterparts. In October 2008, the Bank organized, in collaboration with the government of Japan, the *Japan-Latin America Trade and Investment Forum* in Tokyo to foster trade and investment between Japan and the Latin American and Caribbean countries. More than 400 private sector representatives from Japan and numerous LAC export and investment promotion agencies attended. The next forum will be held in 2010 in China, which acceded in the IDB last year.

IDB has created an **Aid for Trade Strategic Thematic Fund to help LAC public and private sectors to integrate into the global economy**. The fund seeks to help countries benefit from liberalized trade and increased market access by channeling grant resources to overcome these supply-side constraints. The IDB has played a central role in the global *Aid for Trade* initiative spearheaded by the WTO that is aimed at expanding the trade capacity of developing countries. The Bank has organized high-level dialogues and participated in the global reviews of *Aid for Trade* practices aimed at taking stock of aid for trade around the world and at honing the delivery, monitoring and evaluation aid for trade projects and programs. In 2008, the IDB provided support to member countries for seeing through the roadmap for implementation set out at the multilateral level. In particular, the Bank worked with the Caribbean countries to organize the *Second Regional Review* held in the Caribbean in the first semester of 2009 and will participate in the 2009 WTO Global review in Geneva (July 2009).

**Trade facilitation** has become a key issue for governments and companies in Latin America and the Caribbean. An IDB study entitled *Unclogging the Arteries: the Impact of Transport Costs on Latin American and Caribbean Trade*, published in 2008, found that the region spends more on transportation costs than most other regions of the world. A successful example on trade facilitation is the implementation of the "International Goods Transit" project in the Mesoamerican region. The World Customs Organization (WCO) and IDB are working together to facilitate trade in the Americas. They have worked jointly to implement capacity-building programs, evaluated customs agencies and their systems throughout the Region, and developed other common initiatives, including an Action Plan for the Canadian International Development Agency-funded *Customs Reform Program for Haiti*.





# Articles



# THE IDB AND HALF A CENTURY OF REGIONAL INTEGRATION IN LATIN AMERICA AND THE CARIBBEAN

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## INTRODUCTION

The creation of the Inter-American Development Bank (IDB) in 1959 coincided with two simultaneous events in the regional and hemispheric scenario: the growing influence of integrationist ideas and practices in Latin America and the Caribbean (LAC), and the shift in the US Government's stance toward the region, as shown by its endorsement to the creation of a regional financial institution. This convergence of factors anticipated two permanent features of the bank's history: its close connection with the ebbs and flows of the integration process and with the state of hemispheric relations. This article briefly reviews IDB's history through the lens of the first of these issues, taking the hemispheric context as a backdrop. Apart from this introduction, the paper is organized in three sections. The first takes stock of five decades of regional integration in LAC. The second assesses the

role of regional integration in the ideas prevalent in the IDB.<sup>1</sup> The third draws some conclusions.

## A HALF CENTURY OF INTEGRATION IN LATIN AMERICA AND THE CARIBBEAN

The history of regional integration over the last half century is inseparable from the broader debate on alternative development strategies and paths of integration of LAC countries into the global economy. Its contrasts have been typically encapsulated in the dichotomy between "old" and "new" regionalism.

<sup>1</sup> The paper deals with IDB's first three administrations up to 2005. The vision of the present administration is included in another article published in this same issue.

\* The authors wish to thank the *Integration & Trade* Steering Committee for their valuable comments on a first draft of this paper. Any remaining errors are our own exclusive responsibility.

According to IDB [2002], a key difference between the two was the policy environment in which each model was implemented. While “old” regionalism was part of a development program based on import substitution, “new” regionalism was “an extension of the same structural reform process that had begun in the mid-1980s” (IDB [2002] p. 37). The distinction between “old” and “new” regionalism is conceptually useful, but fails to fully capture the ebbs and flows of the integration process in the region, especially the long period of transition that separates the two stylized models. In this article we thus identify three cycles in the history of regional integration in LAC, distinguishing the role of regional integration as: (a) an instrument of development policy (“old regionalism”), (b) a defensive response to the crisis, and (c) a component of structural reform (or “open regionalism” proper).

#### THE “GRAND DESIGN”: INTEGRATION AS DEVELOPMENT POLICY

The first cycle corresponds to what might be christened as the “grand design”. During this period regional integration was conceived as a key component of the prevailing development strategy (import substitution industrialization) and a fundamental ingredient of a new paradigm of integration into the world economy. The role of regional integration was to expand markets and thus enable a more efficient industrialization process in the context of relatively closed economies. If industrialization was desirable and its stimulus required the protection of “infant industries”, the small size of most national markets limited the ability to achieving economies of scale and imposed high efficiency costs. Regional integration could help to bring these costs down.<sup>2</sup>

This first cycle had its golden age in the first half of the 1960s, when the Latin American Free Trade Association (LAFTA) (1960) and the Central American Common Market (CACM) (1960) were created.<sup>3</sup> It was a period fertile in initiatives but relatively poor in

its practical results.<sup>4</sup> LAFTA rapidly came up against barriers to further liberalize trade, arbitrage differences in national interests, and manage asymmetries in the distribution of costs and benefits. Initially the CACM recorded more substantial progress, but by the late 1960s it was also dominated by widespread dissatisfaction with the distribution of costs and benefits and the effective contribution of regional integration to the process of industrialization.<sup>5</sup> The Caribbean Free Trade Association (CARIFTA) also delivered modest results and was replaced in 1973 by the Caribbean Community (CARICOM).

The reaction to LAFTA's early difficulties was not long in coming. In 1965 the Chilean president, Eduardo Frei, asked four Latin American economists to prepare a document containing their views and recommendations to speed up the integration process.<sup>6</sup> The result was the *Document of the Four*, published that same year, proposing a “leap forward” through the creation of a Latin American common market (merging the experiences of LAFTA and CACM), the adoption of new instruments (such as automatic tariff phase-out calendars and regional investment programs), and the strengthening of the institutions of regional integration.<sup>7</sup>

#### TRANSITION: REGIONAL INTEGRATION IN TIMES OF CRISIS

After this cycle of activism and disenchantment, the LAC countries entered into a transition period triggered by the world economic crisis and internal turmoil. During the 1970s, LAFTA entered a state of lethargy that led to a renegotiation of the *Montevideo Treaty* in 1980 and the creation

<sup>2</sup> The basic document setting out this strategy was prepared by Raúl Prebisch and published in 1950 by the United Nations (UN) under the title *The Economic Development of Latin America and Its Problems*. This original manifesto was followed by several studies published in the 1950s with similar recommendations, e.g. Prebisch [1959].

<sup>3</sup> In 1968 the Caribbean countries created the Caribbean Free Trade Association (CARIFTA).

<sup>4</sup> For an analysis, see Fuentes & Villanueva [1989].

<sup>5</sup> The rapid headway of the CACM in its early years can be attributed to the fact that, in the Central American countries, import substitution and regional integration emerged together, stimulated by the small size of domestic markets. In the largest South American economies, however, regional integration became fashionable well after the process of import substitution began.

<sup>6</sup> The authors were IDB President Felipe Herrera, ECLAC Executive Secretary Jose Antonio Mayobre, ILPES Director Raúl Prebisch, and CIAP President Carlos Sanz de Santamaría.

<sup>7</sup> A year earlier, the countries signatory of the Cartagena Agreement had created the Andean Development Corporation (*Corporación Andina de Fomento* - CAF) as a multiple bank and agency to promote Andean development and integration. Both the creation of CAF and that of the Andean Group drew on a “deeper” integration proposal than that implicit in LAFTA.



of the Latin American Integration Association (LAIA). LAIA formally acknowledged the inviability of the free trade area approach and adopted a flexible and bilateral approach void of specific targets.

The Andean Group also experienced mounting difficulties shortly after getting off the ground. After an initial phase of rapid intra-regional trade growth, it suffered the effects of political cleavages (symbolized in Chile's abandonment of the group in 1973) and the failure to meet targets and implement common policies. Like the members of LAFTA in 1980, the Andean countries signed an *Additional Protocol to the Cartagena Agreement* in 1987, easing their commitments, opening the door to bilateralism, and ending the common foreign investment policy.

In CACM's case, open political and military conflict was even more visible. Although the CACM had implemented a free trade area for industrial goods in a relatively short period of time, it had harmonized the tariff schedule, and it had invested heavily in both physical and institutional regional infrastructure, by 1969 it also floundered in a deep crisis that included open military conflict between two member states (El Salvador and Honduras).<sup>8</sup> After a decade of paralysis, political and military conflict worsened during the 1980s further dragging the process of regional integration. CARICOM too faced serious obstacles shortly after getting off ground. As its secretary general noted in 1979, "the ink on the [Chaguaramas] Treaty had not yet dried when the full force of the international economic crisis destroyed the basis of everything we hoped to accomplish".<sup>9</sup>

Over and above endogenous difficulties, the international crisis of the mid-1970s and the debt crisis of the early 1980s gave a *coup de grâce* to the original regional integration projects and their subsequent adjustments. In particular, the debt crisis led to an across the board increase in protection and shrank intra-regional trade flows. Shortly after, the reform policies that followed opened the door to an approach incompatible with the basic assumptions of the "grand design".

In short, the main objective of Latin American integration initiatives during this transition period was

to adapt old instruments to the constraints imposed by the external and domestic contexts. This adaptation included the easing of existing commitments as well as new initiatives aimed to provide a defensive response to the international crisis and to Latin American longstanding problems to integrate into the world economy.<sup>10</sup> LAIA and the *Additional Protocol to the Cartagena Agreement* were paradigmatic examples of the former policy response, while the Argentina-Brazil *Economic Trade and Cooperation Program*, launched in 1986 under the umbrella of LAIA, illustrates the latter.

#### REGIONAL INTEGRATION AS A VEHICLE FOR ECONOMIC REFORM

The third cycle began in the late 1980s and coincides with the phase of "new" regionalism.<sup>11</sup> Its main feature was the turning of regional integration programs into vehicles for structural reform, in line with the new policy paradigm that John Williamson (1990) dubbed as the "*Washington Consensus*". Its ingredients included trade liberalization and a deeper integration of the Latin American countries into the world economy. Its widespread adoption throughout the region led to pre-existing integration processes and institutions developing in a policy framework radically different from its predecessor.

The new integration initiatives, such as the Southern Common Market (MERCOSUR), were part of ambitious structural reform programs. The role of the *Buenos Aires Agreement* (1990) and the *Treaty of Asunción* (1991) as instruments of liberalization was clear in the case of Brazil, one of the last Latin American countries to reluctantly adopt the liberalization agenda. This functional role for reform policies was even more visible in the case of the free trade agreements signed between Latin American and developed countries. This modality of integration was inaugurated by the North America Free Trade Agreement (NAFTA) between Mexico, the United States, and Canada, and was followed by free trade agreements (FTAs) between Mexico and the European Union, the

<sup>8</sup> Two years later Honduras dropped intra-regional free trade regime.

<sup>9</sup> Kurleigh King, "Statement by the Secretary General of the Caribbean Community", cited by Payne [1981].

<sup>10</sup> CARICOM's experience is slightly out of step with the rest of the region, since CARICOM was launched precisely at a time when other regional integration schemes were showing growing signs of strain.

<sup>11</sup> An early analysis of the "new regionalism" can be found in Bouzas & Ros [1994]. A couple of years earlier, Bhagwati [1992] had christened this second wave of discrimination "the second regionalism". ECLAC referred to it as "open regionalism".

European Free Trade Association (EFTA) countries, and Japan. As soon as the US Administration obtained a renewal of the Congressional authority to negotiate under the “fast track” mechanism, it also signed new FTAs with Chile, the Central American countries and the Dominican Republic, and Peru.<sup>12</sup>

This new generation of preferential agreements liberalized trade virtually without exceptions (something that Latin American governments had, in general, resisted in South-South agreements) and incorporated WTO-plus disciplines in areas of US offensive interests, such as “trade” in services, foreign investment policy, intellectual property protection, and government procurement. The disciplines included in these new agreements made them powerful vehicles of regulatory reform.<sup>13</sup> In some cases, like CACM, the signing of a free trade agreement with the United States served to broaden the subregional agenda; in others, such as the Andean Community (CAN), it was a factor encouraging its disintegration. There is no doubt that the demise of customs union projects in LAC is bound up with the endogenous fragilities of the original projects. However, in the last fifteen years new international circumstances have drastically altered the profile, objectives, and instruments of regional integration.<sup>14</sup> As a result, the current path combines institutional fragmentation with, at least in some countries, closer economic ties.

### THE ROLE OF REGIONAL INTEGRATION IN IDB'S IDEAS

In its first 45 years, IDB had three presidents, each of whom held the post for over a decade. In a relatively small institution this is enough time to

influence its activities. Their extensive terms of office also suggest that they effectively represented the lowest common denominator of the partners' beliefs and interests. This section briefly reviews the evolution of IDB's ideas on regional integration as expressed in the speeches, articles, or reports made by its first three presidents. The arguments are illustrated with some of the Bank's major initiatives in each period.<sup>15</sup>

#### FELIPE HERRERA: IDB AS THE “INTEGRATION BANK”

In keeping with his times, the first IDB president, Felipe Herrera, was a promoter of the “grand design” version of integration. The early years of his administration, covering the 1960s, coincided with the cycle of integrationist enthusiasm inspired by the European experience. Under his presidency, IDB took up the moniker, “Integration Bank”, and engaged in activities to support integration through the promotion of trade, investment in infrastructure, and technical assistance (IDB [1960]). The issues relating to monetary and financial integration also attracted the attention of Herrera, who saw a prominent role for IDB in this area (Herrera [1961]).

Herrera's integrationist convictions rested on two pillars. The first was a structuralist vision shared by many of his contemporaries. To the traditional argument to improve efficiency in a protected environment, Herrera added the benefit of distributing the burden of the high fixed costs necessary to undertake research and development (Herrera [1965]). The creation of a regional market would thus contribute to production and trade diversification and, indirectly, to a better integration of Latin American countries into the world economy. The second pillar was political. The frequent appeal to Bolivarian ideas revealed an idealistic mindset: “Latin America is not a group of nations: it is a great nation unmade”. (Herrera [1967] p. 354). Herrera never wasted an opportunity to describe regional integration as cooperation based on solidarity between States. He did not see differences in levels of development as a hindrance, but as a catalyst for integration: therefore, he supported technical studies to examine the possibility of LAFTA less developed countries improving their competitive conditions (Herrera [1960]). Diversity

<sup>12</sup> This network of bilateral agreements, dubbed a “competitive liberalization” strategy by the US Trade Representative (USTR [2005]), paralleled the failure to negotiate a Free Trade Agreement of the Americas (FTAA) (Bouzas [2007]). The United States also negotiated free trade agreements with Colombia and Panama, but both are pending parliamentary ratification.

<sup>13</sup> The template of North-South FTAs spread rapidly to new agreements associating other Latin American countries with the leaders (mainly Mexico and Chile).

<sup>14</sup> For a more detailed analysis of Latin American custom unions' endogenous fragilities, the limits to Latin American integration in the new century, and the prevailing tendency to fragmentation, see Bouzas, Motta Veiga, and Ríos [2008].

<sup>15</sup> The paper deals with IDB's three first administrations. The vision of the present administration is included in an article by the current president published in this same issue.

meant potential complementation and an opportunity for the more developed countries to put their progress at their poorer neighbors' disposal (Herrera [1977]).

Despite his political motivation, Herrera ascribed an instrumental purpose to integration: a region united by the "mystical" could change the world's game rules, especially in trade, through action in international fora such as UNCTAD (Herrera [1965]). His vision was heavily influenced by the institutionalist slant of the European experience, which persuaded him of the fundamental role of regional institutions as promoters of integration in the long-term: "The Inter-American Development Bank makes it possible to turn an old Latin American aspiration into institutional reality: having a technical and financial instrument of its own to support the action of governments and the private sector, and, above all, one capable of promoting a process of economic and trade approximation among our nations". (Herrera [1975] p. 100).

For Herrera, the contemporary example of rapid and successful integration was CACM, which he enthusiastically supported and which was the subject of his admiration. In his view, this process would enable the incorporation of new social groups in political life, strengthening the democratic system and weakening "totalitarian formulas". Herrera extended the cooperation of IDB to the Central American Bank for Economic Integration (BCIE), created in 1961, through the provision of technical assistance and a global credit line (through which BCIE channeled loans to the private sector). The two institutions' presidents also signed an agreement through which BCIE acted as an agent of IDB in Central America, while IDB represented BCIE in the United States and the rest of the world.

While being highly enthusiastic about the Central American integration process, Herrera also looked positively on the experience of LAFTA. But in his view the objective of creating a free trade area was inadequate. In 1967, Herrera compared LAC to an archipelago of isolated economies: "We have, in recent years in the case of LAFTA, built trade bridges connecting these economic islands; but we already see that in order to create dynamic intra-regional trade flows we need more advanced integration policies, ones that encourage and steer large investments towards regional infrastructure and industries designed to supply expanded markets. The positive experience of CACM fuels belief in the achievement of this aim". (Herrera [1967] p. 218).

Herrera's convictions were reflected in the recommendations of the *Document of the Four* in which he took part. The document was a demonstration of disagreement with the results of LAFTA. It called for a deepening of the integration process and proposed the creation of a Latin American Common Market to integrate the member states of LAFTA, CACM, and the other Latin American countries in a single process of deep integration.<sup>16</sup> For Herrera, conflicts between member states that, even during his term of office, checked or reversed the integration process in Central America and the rest of the region could be solved through dialogue in the framework of strong, stable regional institutions, among which the IDB outstated.

One of his first projects was to do with the promotion of intra-regional trade through an *Intra-regional Capital Good Exports Financing program* set up in 1963. This program had a marked structuralist rationale, its aim being to drive import substitution through the long-term financing of intra-regional trade in capital goods. In its first year of operations, IDB granted loans to finance capital goods exports from Argentina, Brazil, Chile, and Mexico to other countries in the region for a total of US\$11 million, but, by the mid-1970s, the program was contributing almost two percentage points of total loans approved by the Bank.

During its first decade, IDB also developed a "regional" loans portfolio (except export financing) that reached a total of US\$340 million (current US\$).<sup>17</sup> Most of these resources were for infrastructure works with cross-border spillovers. One of the first loans was granted in 1964, when IDB loaned US\$3.2 million to finance an electricity interconnection system in the border area between Colombia and Venezuela. Regional transport infrastructure also received support from the Bank, which, in 1965, awarded a first loan for US\$20 million to build a road between the Paraguayan-Brazilian border and the port of Paranaguá, where

<sup>16</sup> As late as 1983, in the middle of the debt crisis, Herrera continued to refer to this proposal as the desirable path (Herrera [1983]).

<sup>17</sup> The "regional loans" referred to in IDB's reports are not loans made to groups of countries. Typically, each country has been an individual borrower, even when the loan was aimed at integration projects. A frequent modality was to lend to one of the members, which, in turn, would relend to a binational entity. In spite of its "integrationist ideology", until the approval of the Regional Public Goods program at the start of the new century IDB had not developed a credit instrument designed specifically to promote regional integration.

Brazil had granted a free zone for its neighbor. These loans grew significantly in the 1970s.

Finally, the Bank also launched technical assistance and coordination activities to assist regional integration. In 1961, it supported the newly created BCIE in its installation process and granted funds for the preliminary analysis of integration projects in the region. Two years later, it launched the *Integration Technical Assistance Program*, which made a great leap forward in 1966 with the creation of the *Latin American Integration Preinvestment Fund*, endowed with US\$15 million from the Special Operations Fund and an additional US\$1.5 million from the Social Progress Trust Fund. The Preinvestment Fund was intended to finance feasibility studies for regional integration projects, especially those related to basic industries and joint exploitation of natural resources, sectors seen as having a high potential for integration (IDB [1966]).

One aspect that illustrates the importance attached to the technical assistance and coordination activities was the creation, in 1965, of the Institute for the Integration of Latin America and the Caribbean (INTAL), established by recommendation of a commission created during the Fifth Board of Governors meeting in 1964 (Lagos [1990]). Although the idea of INTAL becoming a “university for integration” did not materialize, the Institute played a role as a center for technical studies, training and dissemination following the ebbs and flows of the regional integration process.

#### ANTONIO ORTIZ MENA: THE CRISIS OF REGIONAL INTEGRATION AND IDB IN TRANSITION

Elife Herrera stepped down as IDB president in 1971, shortly before the full impact of the international crisis was felt in LAC. His successor was the Mexican, Antonio Ortiz Mena, who ushered in a period of transition and adjustment in the Bank's activities. During his mandate, which ran from 1971 to 1988, the new president faced profound changes in the international and regional context. One result was that the bank lost of its leading role in multilateral financing, first because of the abundant liquidity available in the private international capital market, and later because of the debt crisis. In a context where the region's economies were suffering the consequences of the exhaustion of the import substitution industrialization model and of the integration strategies that accompanied it, Ortiz

Mena embraced a more pragmatic and skeptical view of regional integration, pointing out that “the illusion of being able to deliver immediate results has been abandoned”. (Ortiz Mena [1985a] p. 4).

This conclusion was based on two lessons. The first was that integration could have vitality only insofar as it was the byproduct of active national leadership: the formulas coming out of multilateral institutions could not thrive if they were not suited to the interests or potential of the participating nations. Thus, Ortiz Mena stressed the need to strengthen national integration-related organizations and, above all, national commitments to the process (Ortiz Mena [1985b]). The second lesson was that the integration process required active participation from the business sector, which led him to look sympathetically to the business rounds that LAIA and CAN started to organize by that time (Ortiz Mena [1985a], [1985b]).

During Ortiz Mena's administration, IDB's approach and its contribution to regional integration shifted from the “ideological” promotion of grand integration schemes to bilateral cooperation over specific projects. During the 1970s, the Bank found its “niche” in loans for mega-infrastructure projects (such as hydroelectric power stations) in a context in which the region had abundant private financing available to it (Tussie [1997] p. 85). In 1972, the Bank made what was then “the biggest loan in IDB's history”, when it granted Argentina and Uruguay a total of US\$80 million to build a hydroelectric plant in Salto Grande. This level of financing was easily surpassed three years later when IDB supported the construction of the Paraguayan-Brazilian Itaipú dam, the largest hydroelectric power plant in the world at the time. Between 1975 and 1989, the construction of the Yaciretá dam on the Paraguayan-Argentine border also received over US\$500 million in funding (IDB [1975], [1988]).

Other infrastructure works included road integration projects like the trans-Andean road between Chile and Argentina and the Andean Trunk Road System. IDB also provided US\$15 million to prepare for the construction of the Pan-American Highway through the Darien Gap in 1973, in an effort to complete the Panamerican Highway System that never materialized. Another area that gained in importance since the late 1970s was telecommunications infrastructure, which the Bank supported with a series of loans to carry out feasibility studies and establish land and satellite connections (IDB [1971], [1975]).



In the mid-1970s, the resources allocated to regional technical assistance also increased in absolute and relative terms.<sup>18</sup> During that period, IDB provided assistance to subregional integration schemes in two ways. First, through technical cooperation programs for the institutional strengthening of CACM, LAFTA, the Andean Pact, and CARIFTA (later CARICOM). Second, through special credit lines so that subregional financial institutions (BCIE, CAF, *Fondo Financiero para la Cuenca del Plata* - FONPLATA, and the Caribbean Development Bank - CDB) developed technical cooperation projects. The Bank also financed regional studies, like the one on Central American electrical interconnection in 1977 and the Cooperative Program for Agriculture Technology Development in the Southern Cone (PROCISUR) in the 1980s and 1990s. IDB also authorized operations for the creation of two Regional Advisory Groups on Integration, one for Central America and another for CAN.

In contrast to his predecessor, Ortiz Mena argued that integration took place not thanks to, but in spite of the institutions created in the 1960s: "The reality of the integration process transcends the vicissitudes of the institutions set up to carry it out" (Ortiz Mena [1980] p. 118). Regional integration moves forward "because, beyond institutional constraints and policies, the reality is that our trade is growing, our production activities complement each other, and vast investments that would be impossible in national isolation are being carried out in common even through bilateral agreements" (Ortiz Mena [1980] p. 118). Given this background, it comes as no surprise that the IDB president did not include regional integration among the Bank's priorities for the 1980s (Ortiz Mena [1980], [1984], [1986]). During this period, Bank's actions contracted sharply due to the decline in the demand for credit for infrastructure investment due to the fiscal crisis and the constraints on the Bank's lending capacity. Regional "loans" were down by half on the previous decade as a result. In a context of the strong need to finance the balance of payments and contain public spending, the type of operations IDB was used

to (project loans) lost relevance.<sup>19</sup> During this period, the main challenge for LAC was to cope with the lack of external finance and the macroeconomic adjustment processes that this entailed, rather than to promote regional integration. The adaptation to the world economy and its constraints had replaced its reform as the most immediate concern.

#### ENRIQUE IGLESIAS: IDB IN THE AGE OF "OPEN REGIONALISM"

IDB's policies and programs in regional integration acquired fresh momentum and adopted a new approach from the late 1980s. With a new president and a significant increase in resources subject to temporary monitoring by the World Bank (Tussie [1997] p. 66), IDB refloated its activities to foster integration with three priorities: (a) assisting governments in the implementation of adjustment programs geared to liberalize trade, in their participation in the Uruguay Round negotiations, and in their efforts to actively engage in the globalization process; (b) stimulating intra-regional cooperation in trade and business, with particular emphasis on the private sector; and (c) promoting physical integration (IDB [1989]).<sup>20</sup> In the new framework, some of the existing programs were discontinued (such as the financing of intra-regional capital goods exports) and, as explained below, IDB rethought its activities and operational units linked to work in this area.

After leading the Economic Commission for Latin America and the Caribbean (ECLAC) for over a decade, Enrique Iglesias was president of IDB between 1988 and 2005. His positive view of regional integration was undoubtedly influenced by his passage through ECLAC, but was also qualified by a critical evaluation of its results.<sup>21</sup> Like his predecessor, Iglesias stepped back from what he characterized as a "romantic phase" in

<sup>18</sup> Funds classified as "regional technical assistance" are not exclusively aimed at promoting regional integration: the label corresponds to an operational classification (the existence of beneficiaries in more than one country) rather than to the content of the action.

<sup>19</sup> This problem was not exclusive to IDB, but also extended to the World Bank. It was at the base of the reform in the operational modality of these institutions, as reflected in the development of "policy loans".

<sup>20</sup> The agreement approving the eighth capital replenishment involved the adoption of "policy loans" and made IDB another actor in the reform process spearheaded by other multilateral institutions like the IMF and the World Bank. To meet its aim the Bank reorganized its operating structure through subregional offices, thus increasing the focus on countries and subregions.

<sup>21</sup> Iglesias liked to associate his analytical approach with that of Raúl Prebisch. See Iglesias [2006].

which prointegrationist rhetoric was dissociated from the real experience or opportunities for progress. Paraphrasing Albert Hirschmann, Iglesias ([2005] p. 12) argued: "There is in the region a tendency to overcome obstacles with the announcement of new ambitious objectives, which may contribute to worsening the climate of unfulfilled expectations in the field of integration". Looking back to previous diagnoses, Iglesias pointed to low levels of trade interdependence and lack of leadership as obstacles to progress towards integration. He also became a vocal critic of the relationship between protectionist policies typical of import substitution industrialization and the "old regionalism". In an implicit reference to the institutionalism of Herrera and his contemporaries, Iglesias said "From its inception, the old regionalism was characterized by an outsized institutional structure in relation to existing commitments, costly to run and underfunded". (Iglesias [2000] p. 143).

Based on this diagnosis, IDB stuck to the counterpoint between "old" and "new" regionalism. Iglesias described the "new regionalism" as a rejection of the "absolutely anachronistic" aspiration of economic autarky and as a proposal for "competitive, efficient, and equitable integration" into the world economy compatible with multidimensional liberalization initiatives. In addition to the historical goal of structural transformation and export diversification, the "new" regionalism should serve to attract foreign direct investment and open the door to business partnerships, technology transfer, and financial market development (Iglesias [2000]). At the start of the period, when the "new regionalism" seemed to be leading to a revitalization of subregional integration processes in a context of greater openness, Iglesias enthusiastically supported the agreements between Latin American countries (such as MERCOSUR), differentiating IDB from the open criticism raised by other multilateral institutions.<sup>22</sup> In his vision it was fully consistent to support "subregional integration initiatives in order to bring about hemispheric trade integration" (IDB [1994] p. 10). However, the stagnation and decline of subregional agreements on entering the new century strengthened a critical assessment: "None of the integration groups has managed to reach the

intermediate stage of a true customs union with established parameters" (Iglesias [2005] p. 14).

From 1991, IDB became a key "facilitator" for the Initiative for the Americas and, after 1994, for the monitoring and implementation of the Miami Summit resolutions that launched negotiations for a Free Trade Agreement of the Americas (FTAA).<sup>23</sup> Throughout this process, IDB provided technical support for preparatory activities and, with the Organization of American States (OAS) and the Economic Commission for Latin America and the Caribbean (ECLAC), joined a tripartite commission to support negotiations as of 1998. It also supported the Administrative Secretariat created to accompany the process with resources and technical assistance. Iglesias held a positive view of this process: "A hemispheric free trade area will offer a wide range of new business and investment opportunities. [...] Experience has shown that formal regional agreements incorporating a wide-ranging set of rights and mutual obligations can lead to dynamic trade and investment creation. Moreover, some of these forces can be amplified when they are consolidated in an industrialized market, thus having powerful effects on the economic and social transformation and modernization of its members" (Iglesias [2001] p. 5).

The failure of the FTAA negotiations in 2003 paved the road for a series of asymmetrical bilateral agreements between several countries in the region and the United States (then followed by the European Union). Iglesias, who appreciated the modernizing impetus of an FTA with a developed country, also expressed concern about the vulnerability of family farming and rural employment, the fragility of intra-regional trade in manufacturing against competition from producers in developed countries, and the possibility of bilateral negotiations soaking up human and financial resources once available for Latin American integration (Iglesias [2005]).

During this period, two new institutions, independent but associated with IDB, also gained in importance. On one hand, the Inter-American Investment Corporation

<sup>22</sup> In the mid-1990s, economists from IDB and the World Bank participated in an active debate on the importance of trade diversion in MERCOSUR. See Devlin [1997] and Yeats [1988].

<sup>23</sup> Against this background, the Integration, Trade, and Hemispheric Issues Division was strengthened as part of a process of internal reorganization. Jointly with INTAL, this Division developed and promoted a large number of works and technical studies on trade, integration and development policy, published in institutional reports and in this journal.

(IIC), created in 1986 to promote the development of the private sector in a context of a capital shortfall, launched several projects of regional scope. On the other, the Multilateral Investment Fund (MIF), also created in 1993 to promote the development of the private sector (especially SMEs), financed non-refundable technical cooperation operations and offered various human resources training programs. The projects of both IIC and MIF did not have the exclusive objective of strengthening intra-regional trade, but of increasing SMEs' capacity to integrate successfully in foreign trade, both with the region and the rest of the world. While IIC projects boomed in the 1990s, MIF gained in importance in the new century and is currently responsible for a high proportion of regional projects.

Faced with compelling evidence that the obstacles to successful regional integration remained dominant, IDB again emphasized infrastructure and intra-regional connectivity, which led regional "loans" to record levels in the 1990s. Support materialized through the backing of the Puebla Panama Plan (PPP), now the Meso-American Integration and Development Project, and the Initiative for the Integration of Regional Infrastructure in South America (IIRSA).<sup>24</sup> In the PPP's case, IDB granted resources for the modernization of customs institutions, border crossings, and harmonization of phytosanitary measures. In the framework of the IIRSA, it supported the construction of roads, pipelines, bridges, and other projects in border areas. With the CAF and the FONPLATA, IDB joined the IIRSA Technical Coordination Committee, whose secretariat was established at INTAL headquarters in Buenos Aires (IDB [2001]). The Bank also channeled its efforts into easing the regulatory, institutional, and operational obstacles in the field of infrastructure and established a US\$20 million technical cooperation fund to design integration projects (IDB [2005]).

The increase in resources for regional technical cooperation was aimed both at promoting the institutional strengthening of subregional integration processes (mainly in the 1990s) and at supporting North-South free trade initiatives. In fact, in addition to the training of public officials responsible for

negotiating FTAs in Peru, Colombia, and the Central American countries (CAFTA-DR) with the United States, IDB provided technical support in the agreements' implementation phase. The Bank also provided assistance to organize interaction between Andean Community and MERCOSUR officials and those of the European Commission. Support operations went to the public and private sector, including the academic community through the financing of the Latin American and Caribbean Research Network since 1991.<sup>25</sup> Technical assistance activities were not confined to regional integration processes: in 1999, as part of the revitalization of its training tasks, INTAL was appointed by the World Trade Organization (WTO) as a regional training center in trade, coparticipating in the organization of regular workshops for public officials on different topics of the multilateral agenda. In recent years, IDB also collaborated with the WTO in the organization's Aid-for-Trade Program. In 2004, in one of its latest initiatives, before Iglesias left his post, the Bank launched the Regional Public Goods Promotion Initiative, through which it finances projects up to US\$10 million a year for the promotion of public goods in the various subregional integration schemes, including the North American Free Trade Agreement (NAFTA).

### *IDB AND A HALF CENTURY OF REGIONAL INTEGRATION IN LATIN AMERICA AND THE CARIBBEAN*

This essay has shown that, over the past half century, IDB was a permanent actor in LAC countries' experience of regional integration. Their contribution has been manifested on both the level of ideas and material support.

In the 1960s, IDB was the vehicle for the dissemination of the ideas predominant in LAC regarding regional

<sup>24</sup> The three financial institutions have thus been supporting the South American countries' intergovernmental cooperation in their physical integration agenda. For a discussion of the IIRSA rationale, see Carciofi [2008].

<sup>25</sup> The program served to spotlight certain issues that IDB deemed relevant for the region's policy agenda, including aspects related to regional integration processes. 1999 also saw the creation of the INTAL Integration Research Centers Network (RedINT), which brought together centers in several Latin American countries. As a complement, the Euro-Latin Study Network on Integration and Trade (ELSNIT) was founded in 2002, including three European research centers. IDB also organized and financed the Trade and Integration Network, which brings together the vice-ministers of various different countries, responsible for stimulating dialogue and driving cooperation.



integration. During Felipe Herrera's presidency, the Bank embraced the rhetoric and ideology of integration, strove to play a leading role, and viewed itself as a catalyst for the prointegrationist initiatives of the Latin American political and intellectual elites, looked on, sure enough, with tolerance or sympathy from Washington. After the interregnum of the 1970s and 1980s, when IDB's operations were dominated by a climate of crisis that eventually forced it into a secondary role, IDB made a comeback during the presidency of Enrique Iglesias with a proactive agenda grounded in the idea of "open regionalism" and the promotion of liberalization and integration as part of reform policies across the region.

It was not only ideas that changed between the stages of the "grand design" and "open regionalism", but the focus of policies and, to some extent, the instruments used. The two main channels through which the bank supported regional integration were the financing of regional infrastructure and the provision of technical and financial assistance to the various integration schemes. The first of these two fields was given constant attention. The second, however, evolved at

the pace of the predominant conceptions and the ebbs and flows of real integration processes.

After a half century of regional integration in LAC, results can only be described as modest. The grand design presided over by integrationists in the 1960s buckled under the weight of low interdependence, differences of national interests, and structural and policy asymmetries. As a result, at the start of the new century, the main subregional agreements are either at a standstill or in open retreat. Neither have the promises of "open regionalism" been strictly kept either. Even though several countries in the region have formalized free trade agreements with the United States and other developed countries, the objective of achieving a hemispheric free-trade area has given its place to a network of overlapping and asymmetric bilateral agreements. These results cannot be attributed to the Bank's action or inaction; rather, they reflect the practical limitations that the undertaking of regional integration has faced in Latin America. In this context, IDB'S main inheritance from five decades of action has been an important stock of regional infrastructure investments in both physical and human capital. ♦

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# FOSTERING CROSS-BORDER COMMERCE AND MARKET INTEGRATION: LESSONS FROM EUROPEAN EXPERIENCE

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*The European Union represents perhaps the most extensive international collaborative venture in modern times. In this paper three principles are distilled from European experience that may be of use to policymakers seeking to promote cross-border commerce and market integration in the 21st century.*

## INTRODUCTION

Western Europe has been at peace for over sixty years. The standard of living enjoyed by people living in that part of Europe is among the highest in the world. Many observers attribute part of the peace and prosperity in Europe to the sustained impulse towards regional integration and the willingness of nations there to forge common solutions and, where necessary, pool sovereignty. Whatever disagreements there exist from time to time between European governments, they have not discouraged twenty-one nations from joining the original six parties to form a European Union (EU) that now has a total population of over 450 million people and is the world's largest international trader and donor. Moreover, other nations seek to join this club or to foster closer relations with the European Union.

With this enviable track record, it is not surprising that policymakers and analysts want to distill transferable lessons from the European experience in promoting cross-border commerce and market integration. The purpose of this paper is to articulate three principles that may be of relevance to other regions of the world economy. Particular attention is given to Latin America and the Caribbean (LAC), bearing in mind ongoing global economic processes, the recent wave of signing free trade agreements around the globe, and the fact that the European Commission (EC) is seeking to negotiate Association Agreements (AA) with several groups of Latin American nations.

The remainder of this paper is organized as follows. In the next section three principles or lessons from the European experience with integrating markets are enunciated. Each principle has implications for the

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content and conduct of regional integration initiatives, highlighting often the importance of complementary institutional and non-commercial factors. The various aspects of the EC's current common external commercial policy are summarized in the third section, and LAC's place in that policy is described. In this section some aspects of the relationship between that policy and global commercial trends, multilateral trade negotiations, and the proliferation of regional trade agreements in the past 15 years is explored. The fourth and final section looks forward and reflects on the potentially enduring lessons from European experience.<sup>1</sup>

### THREE PRINCIPLES TO GUIDE REGIONAL ECONOMIC INTEGRATION BASED ON EU EXPERIENCE

The process of integrating Europe's markets, of eliminating overt and subtle barriers to the flow of goods, services, persons, and capital within the EU, started over 50 years ago and is by no means complete. Goods markets are relatively well integrated but much remains to be done to assure the other three "freedoms" of movement. Still, functional supranational institutions -in the form of the EC, European Court of Justice (ECJ), European Parliament, and associated agencies- have been created and several attempts made to refine the allocation of so-called competences between the Member States and these supranational bodies. It is important to appreciate that the momentum behind furthering the four freedoms has embedded and flowed, and that from time-to-time more of the impetus behind integrating Europe's markets has come from the EC and the ECJ than from the Member States themselves.

At the risk of over-simplification and without any claims of particular originality, the following three principles characterizing the European approach to integrating markets can be discerned:

<sup>1</sup> With the constraints on this paper's length it is impossible to do justice to the multi-faceted literature in economics, political science, international relations, and history on European economic integration. Moreover, the focus here will be principally, but not exclusively, on commercial relations and regional market integration, ignoring the many other policy domains where the EU has become such an important force, such as climate change.

### ELIMINATING BORDER BARRIERS TO TRADE IS NOT ENOUGH

European experience bears out that abolishing intra-regional tariffs, quotas, and other forms of blatant discrimination against foreign goods at the customs house is a necessary but not sufficient condition for the regional integration of markets. Time and again European governments have resorted to discriminatory state measures not related to the customs house to keep out imports and to frustrate previous trade reforms. Product and health and safety standards, policies towards state aids and financial support for firms, and the enforcement of competition law have all been applied by European governments in a discriminatory fashion to keep out imports.

The pressures on political leaders to protect jobs and to shelter locally-based firms is not unique to Europe, however. This first principle implies that serious attempts to integrate markets need to address a wide range of government policies and it should not be surprising that this realization has led to free trade agreements (FTAs) covering a wide range of state policies that, whether intended or not, can have discriminatory effects. Moreover, as subtle trade barriers replace a previously banned discriminatory instrument it should not be surprising that there has had to be a sequence of initiatives to integrate European markets, leading neatly to the second principle.

VIEW CROSS-BORDER INTEGRATION INITIATIVES AS INCOMPLETE CONTRACTS, SO PUT THE INSTITUTIONAL MACHINERY IN PLACE TO COPE

European experience suggests it is best to think of initiatives to integrate markets, including regional trade agreements,<sup>2</sup> as incomplete contracts. In fact one might go so far as to argue that in practice it is impossible at any one point in time to foresee all of the possible ways in which cross-border movement of goods (let alone services, investments, and people) can be frustrated by government measures or decisions

<sup>2</sup> Throughout this paper regional trade agreements, free trade agreements, and bilateral trade agreements are used synonymously. Of course, the former is the term employed in discussions of these matters at many international organisations, even in the somewhat confusing case when the parties to any such agreement are not located in the same continent.



by governments not to take certain measures.<sup>3</sup> This realization has led to the appreciation that no set of regional agreements in Europe is regarded as the last word. Future revisions are not only likely, but expected. Regional integration in Europe, then, has been an evolving process, for sure with fits and starts, and not a one-off event.

Regarding the cross-border integration of markets as a sequential process raises practical challenges as to where realistic proposals for reform are to come from and on what basis and in what fora a sequence of decisions among Member States are to be made.<sup>4</sup> Entrenching a body, comprised of experts that collectively have the power of initiative (that is, to propose new measures), independent of the Member States' governments, into a regional integration schema helps overcome the first practical challenge, and provides one rationale for the EC.<sup>5</sup> The creation of the European Council of Ministers, its rotating presidency, and complicated voting rules sought to address the second challenge. This is not to say that these two practical challenges must be addressed *à la EU*, but it does suggest any sustained attempt to integrate cross-border markets requires alternative means to the same ends.

COMMERCIAL GAIN, EVEN MERCANTILISM, NEED NOT SOLELY DETERMINE THE MOMENTUM FOR CROSS-BORDER INTEGRATION AND CO-OPERATION

So much of the language of many trade negotiations centers on "concessions," "reciprocity," and the like. While commercial considerations, both Member States jockeying with one another within

Europe and concerns about European competitiveness compared to other parts of the world, have played their part in shaping European cross-border integration initiatives, it would be misleading not to point out the key role that historical legacies (three wars between European nations between 1870 and 1945), geopolitics (the Cold War), and social considerations have played in advancing and, in some cases (see next paragraph for an example), holding back the pace of cross-border integration of markets in Europe. These factors simply could not be ignored and in other regions they should be identified and harnessed if possible, certainly taken into account, and possibly all three.

Concerns about the distributional and social consequences of regional integration have played a greater role in recent years in Europe. An initiative to liberalize service sector markets was effectively blocked in the European Parliament by a constituency concerned about the effects on wages of service sector employees and on the quality and affordability of public sector services of possible cross-border competition in these activities. More generally, the impression has arisen in some Member States (most notably France) that EC economic initiatives are principally about maximizing corporate opportunities and systematically overlook the wellbeing of others, such as employees. And, of course the relative importance that a Member State gives to commercial *versus* other considerations may vary over time, evolving perhaps as the parties in government change.

Learning how to accommodate disparate motives for cross-border co-operation is essential. In Europe this has involved "grand bargains" across seemingly-unrelated policy domains and financial transfers between Member States. Therefore, analysts should not be surprised if regional trade agreements grow in scope over time, often including policies and measures that many may view as having nothing to do with commercial policy.

In sum, these three principles characterize (in reverse order) the motives for, the mechanisms to channel the impetus for, and the scope of the cross-border co-operation and integration of markets observed in Europe over the past decades. These principles may be of interest, even relevance, to governments in other regions seeking to sustain regional co-operation and integration over many years. None of the above discussion is meant to suggest that others must follow the tenets of the European approach. Indeed, others may have different combinations of means and ends

<sup>3</sup> Such as declining to apply a national competition law to investigate allegations that domestic firms have blocked distribution channels to foreign rivals.

<sup>4</sup> In the European case the need for such institutional arrangements was heightened by the fact that the Member States decided to form a customs union and so needed a mechanism to determine what their external commercial policy would be, including the negotiating mandates for any negotiation with trade partners, and who would negotiate on their behalf of the Member States. Over time the set of government policies that have become the "sole competence" of the European Commission and upon which the EC negotiates alone with a foreign trading partner has expanded.

<sup>5</sup> In some accounts of European integration experience, some have argued that when the momentum behind integration slowed (as was the case in the 1970s) some of the decisions taken by the ECJ opened the door for future regional initiatives and integration of markets.

that are both feasible and desirable. Nor is there a suggestion that these three principles cover every factor that was important at some point in time in European experience, but then such are the perils of trying to draw first-order lessons from an integration trajectory that has lasted more than 50 years.

### CURRENT EC EXTERNAL COMMERCIAL POLICY

The current common external commercial policy of the European Union is described in the EC's Communication titled *Global Europe*, issued in October 2006 and approved soon after by the Member States. The EC reiterated its continued support for this policy in 2008 arguing that the strategy was an "important step forward in European trade policy" (EC [2008], p. 5). By adopting *Global Europe*, the EC characterized both the principal change involved and motivation for its commercial policy as follows:

"Its main focus was on the wider picture beyond current World Trade Organization (WTO) negotiations, with trade policy being seen as part of the wider globalisation agenda. The aim was to make sure that the most important challenges and pressures of the global age were addressed, and that EU trade instruments were fit for that purpose. This Communication set out an agenda for opening the most important markets, and for keeping the EU's markets open, competitive and protected from unfair trade. It represented an agenda based on positive reciprocity-reciprocal opening, not closing, of markets" (EC [2008], p. 5).

Several comments about this statement are in order, especially in the light of the scope of this paper.<sup>6</sup> The first observation is that the EC has sought to align its external commercial policy with the objectives and initiatives undertaken in respect to the internal integration of European markets, that was the subject of the last section. The *Renewed*

*Lisbon Strategy*, adopted in 2005, that places great store on revitalizing the productivity and employment growth as well as the commercial viability of the EU economy, provides the overarching objectives of internal and external EC commercial policies. Interestingly, the EC has often argued that support for its open markets at home is dependent on being able to open markets abroad and demonstrate that foreign trading partners are providing European firms with a chance to compete for business. Moreover, the EC has argued that European firms are more likely to compete effectively on world markets if they face tough competition at home. Now, stating objectives and identifying policy complementarities (such as these) is one thing, capitalizing on the latter to meet the former is another. Still governments, in particular developing country governments, are often advised to align their strategy towards openness with their broader development strategies and arguably *Global Europe* represents a coherent attempt to do just that.

Second, in articulating its three internal policy priorities the EC argued that globalization has accelerated structural change in the European economy and that "we must recognise the potentially disruptive impacts of market opening for some regions and workers, particularly the less qualified" (EC [2006], p. 5). The EC noted that failure to address such matters jeopardizes social justice, intra-EU cohesion, and ultimately support for openness and global economic engagement. That the structural change was associated with the rise of East Asia is the first of several indications that the EC's external commercial policy has been shaped by recent global trends and developments abroad.

Third, the *Global Europe* strategy effectively terminated the moratorium that the EC and the Member States had adopted in the late 1990s on launching new negotiations towards FTAs, or AAs as EC FTAs signed in the 1990s were often called. This moratorium took on particular significance once the Doha Round was launched in November 2001 because the EC encouraged European exporters to channel all their demands for overseas market opening into support for ongoing multilateral trade talks. This turned out to be a risky strategy for as those talks dragged on, and the perception gained ground that the ultimate Doha Round outcome would involve little additional commercial opportunities in the large emerging markets for European manufacturers and

<sup>6</sup> One initiative hinted at in the quoted text and that was aborted by the EC was the reform of its anti-dumping, countervailing duty, and safeguards provisions (the "trade defense instruments" in EC parlance). These reforms were abandoned in the face of strong Member State opposition and are not discussed here.



service sector firms, dissatisfaction grew in certain powerful Member States with the self-imposed moratorium.<sup>7</sup>

Moreover, the aggressive pursuit by the United States government of a policy of *Competitive Liberalization*, that included as an objective the opening of markets for American firms through signing FTAs with as many trading partners that were prepared to accept a demanding “gold standard” agreement, also fed the impression that European business was falling behind.<sup>8</sup> The moratorium’s demise, therefore, was influenced heavily by developments in multilateral trade fora and a leading rival’s FTA strategy.

In the *Global Europe* Communication, after affirming the EU’s commitment to the WTO and to completing the Doha Round, the EC argued that FTAs:

“if approached with care, can build on WTO and other international rules by going further and faster in promoting openness and integration, by tackling issues which are not ready for multilateral discussion, and by preparing the ground for the next level of multilateral liberalisation. Many key issues, including investment, public procurement, competition, other regulatory issues and intellectual property rights (IPR) enforcement, which remain outside the WTO at this time can be addressed through FTAs” (EC [2006], p. 10).

The policy issues emphasized in the above quotation, in particular reform of service sector and investment policies, are precisely those that the EC has argued repeatedly were critical for maintaining and extending European commercial success in world markets, in particular in high value-added manufacturing and

services.<sup>9</sup> The EC also noted that it had a high level of commercial ambition for its FTAs and that “broader political considerations” would influence the decision to launch FTA negotiations with a trading partner and that any FTA provisions would be part of a “wider institutional architecture (EC [2006], p. 12)” between the EC and the trading partner concerned, implying that the ultimate agreement would likely include provisions on non-commercial policy matters, such as scientific co-operation and exchanges, just like the AAs signed in the 1990s.

In its preparations for the launch of the *Global Europe* strategy the EC took into account the following economic factors when identifying its next set of FTA partners: potential market size and growth of the trading partner, level of protection (including non-tariff barriers) in place against EU export interests, the FTA negotiations that a potential partner has concluded or are under way with other countries, the possible effects of the FTA on EU markets and employment,<sup>10</sup> and the potential negative impact on the EU’s preferential market access schemes that tend to benefit developing countries and countries close to the EU. On the basis of these criteria the EC identified the South East Asian Nations (ASEAN), Korea, and MERCOSUR as priority countries for completing FTAs with (although in the case of MERCOSUR this would entail concluding an existing FTA negotiation that was started before the moratorium came into effect.) Potential FTAs with India, Russia, and the six Gulf Co-operation Council countries were mentioned by the EC. Interestingly China, although meeting several of the above criteria, was singled out for differential treatment, it being felt that an FTA would not find favor with some EU Member States. In addition to these negotiating plans, the EC was committed to concluding Economic Partnership Agreements (EPA) with the African, Caribbean, and Pacific countries (ACP).

<sup>7</sup> German manufacturing firms, it was said, were particularly unhappy with the moratorium.

<sup>8</sup> The fact that the USA share of world exports fell more than twice as fast as that for the 25 original members of the EU during the years 1995-2005 belied the fear of European exporters. There again, fears don’t have to be true to be effective arguments in policy arenas. Perhaps the greater irony is that the incoming Bush Administration in 2001 used the EU’s signing of FTAs in the 1990s, that is before the self-imposed moratorium, as its justification for launching new negotiations towards free trade agreements. By the end of the Bush Administration in 2008 it was difficult to find independent analysts prepared to argue that the strategy of *Competitive Liberalization* had delivered the gains to USA business that the Administration had originally claimed.

<sup>9</sup> See, for example, the statements made on page 6 of EC [2006] and throughout EC [2008].

<sup>10</sup> This includes sectors that are particularly sensitive in the EU such as agriculture. Indeed, so sensitive is the latter sector that European proponents of the new FTA negotiations were, it was reported in the specialist press, forced by certain Member States to accept that agricultural trade and support policies would not be on the negotiating table. Given that many developing countries, including those in Latin America, have a comparative advantage in the agricultural production this limits the benefits of an FTA with the EU to such trading partners.

What has the EC achieved with its new FTA strategy? Perhaps it is too soon to come to any definitive judgment, however, at best the picture is mixed. No FTA negotiation has been concluded, although the negotiations with Korea are said to have considerably advanced. Having said that, the sticking points in the latter negotiation (treatment of automobile imports and rules of origin) have remained unresolved for over half a year and official estimates of the conclusion of these negotiations keep being moved back. Moreover, there are indications from informed parties that the negotiated text (still secret) goes little beyond the FTA text agreed between Korea and the United States. Still, the Korean economy is a sizeable one and trade with the EU exceeded €3 billion in 2005.

As far as Latin America and the Caribbean are concerned, the FTA negotiations with MERCOSUR have been put on hold until after the conclusion of the Doha Round (putting to one side a very difficult negotiation over agricultural trade and support policies). Broader partnership negotiations with the Andean Community (CAN) were launched by the EC, but divisions among the former's governments over the desirability of an FTA with the EU have stalled negotiations. EC negotiations with the Central American countries, motivated in part by the USA conclusion of its FTA negotiations with these countries, are said to be well advanced. The EC's EPA negotiations with the Caribbean countries were concluded but the

agreement has not come into effect because of second thoughts on the part of certain developing countries. In sum, no Latin American or Caribbean country has gained improved preferential market access to EU markets since Chile concluded its AA in 2002.<sup>11</sup>

This section has described the shift in the EC's external commercial policy from an almost exclusive focus on negotiating the Doha Round and the EPAs, with their emphasis on developing global rules and governance and by promoting development, to a more competitiveness-driven agenda that involved the launching of a new wave of FTA negotiations. In many respects this evolution in EC external commercial policy was shaped by the implications of ongoing global economic integration, differential negotiating success in various trade policy fora, and a renewed priority given by the current EC to promoting European competitiveness with all available means. With respect to the latter, the alignment of current EC external commercial policy with its internal economic priorities is noteworthy and may well be of interest to governments in other regions.

<sup>11</sup> FTA negotiations are, of course, not the only vehicle through which the EU and LAC engage in dialogue and potential collaboration. The European Union-Latin America and Caribbean Partnership was launched in 1999 at a summit in Rio de Janeiro, Brazil, and a similar summit has followed every two years.

### LOOKING FORWARD AND CONCLUDING REMARKS

The EC's approach to integrating its own region's markets and to negotiating FTAs with its trading partners is multi-faceted and reflects a broad set of commercial and non-commercial goals that mirror the diversity of values among governments representing 450 million people, the wide range of European economic interests, and the recognition that many state measures affect the commercial opportunities of firms. These underlying causes are not unique to the European continent and counterparts can be found in the other jurisdictions. Looking forward, it is difficult to see these underlying causes becoming less important. Consequently, free trade agreements are likely to grow in scope, implicating more levels of government and areas of policymaking. Moreover, these accords are likely to include more provisions to review, renegotiate, and extend co-operation. Ultimately, then, the European contribution to integrating markets may well be to have demonstrated that FTAs need not be one-off deals whose disciplines are confined to border barriers, but as vehicles for creating and then sustaining through institutional mechanisms inter-governmental co-operation across a wide range of state policies of mutual interest to the parties concerned. ♦

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# GLOBAL AND REGIONAL ECONOMIC INTEGRATION: A VIEW FROM ASIA

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*This paper analyzes the East Asian case of sequenced integration, that is, shallow globalization followed by deeper regionalization. It also assesses links with and offers lessons for Latin American and Caribbean countries. It examines recent developments in emerging East Asian regionalism (including the development of ASEAN as a production and free trade agreement - FTA hub), and highlights growing economic links between East Asia and Latin America through FTAs and bilateral trade. Looking forward, the paper argues that East Asian regionalism can fully benefit Latin American economies, if coherent approaches to maximize the benefits of deep integration are put in place in Latin America. Six policy lessons from East Asia's experience are offered: (i) develop internationally competitive manufacturing sectors; (ii) emphasize domestic structural reforms and market orientation in a regional strategy; (iii) adapt policy mix to national circumstances; (iv) emphasize cross-regional linkages with East Asia; (v) involve the private sector in developing a regional strategy, and (vi) narrow development gaps.*

## INTRODUCTION

The onset of the global economic crisis has fuelled renewed interest in the links between the processes of global and regional economic integration in the developing world particularly, Latin America and the Caribbean (hereafter, "Latin America"). This paper analyzes East Asia's<sup>1</sup> integration experience with a

view to offering some policy lessons for Latin American economies. It (i) provides an overview of processes of global and regional integration in East Asia, focusing on the emergence of the global factory and the spread of free trade agreements (FTAs) in the region; (ii) charts some spillovers from these processes for Latin American economies in terms of increasing trade links between East Asia and Latin America and assesses the impact of East Asian regionalism on Latin American economies using the results of a recent computable general equilibrium model (CGE) exercise; and (iii) draws on East Asia's experience of global and regional integration, offering policy lessons for Latin America. The paper finally provides conclusions.

<sup>1</sup> East Asia includes the Association of Southeast Asian Nations - ASEAN (Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam), People's Republic of China (PRC), Japan, Republic of Korea, Hong Kong, China, and Taipei, China.

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## AN OVERVIEW OF EAST ASIA'S GLOBAL AND REGIONAL INTEGRATION

### EMERGENCE OF THE GLOBAL FACTORY

The story of East Asia's spectacular rise over fifty years or so from a poor underdeveloped agricultural backwater to become the global factory is regarded as an economic miracle (Stiglitz [1996]). Particularly remarkable is the emergence of several newly industrialized economies (NIEs) within a relatively short historic time span (Amsden [2001]). The Republic of Korea (hereafter, "Korea") and Taipei, China were the earliest NIEs in the 1960s and 1970s while the People's Republic of China (PRC) and Viet Nam are more recent.

A long period of market-driven expansion of trade and foreign direct investment (FDI) followed, during

which East Asia increasingly became the global factory. *Table 1* shows the share of world exports for various groupings in the world during the years 1980–2007 and charts East Asia's rise in world trade. East Asia's share of world exports nearly doubled from 14% to 27% between 1980 and 2007 driven particularly by Northeast Asian economies of the PRC, Japan and Korea. By comparison, North America Free Trade Area's (NAFTA) exports fell from 17% to 13% from 1980 to 2007 while South American countries' exports stagnated at around 3%. FDI inflows into East Asia (including Japan) rose from 7% of the world total in 1980 to 13% in 2007, while East Asian FDI outflows increased from 5% to 11% over the same period.

Through strategies of innovation and learning, East Asian firms acquired technological capabilities to compete internationally or become suppliers to multinational corporations (MNCs) (Hobday [1995]; Lall [2001]; Kimura [2006]; Wignaraja

**Table 1**

### WORLD AND INTRA-REGIONAL TRADE SHARE OF EAST ASIA (1980, 1990, 2000, and 2007)

Region	Total World Export Share <sup>a</sup> (%)				Intra-regional Trade Share <sup>b</sup>			
	1980	1990	2000	2007	1980	1990	2000	2007
ASEAN (10) <sup>c</sup>	3.9	4.3	6.7	6.2	17.9	18.8	24.7	27.0
ASEAN+3 + Hong Kong, China + Taipei, China (15) <sup>d</sup>	14.0	20.6	25.9	26.7	36.8	43.1	52.1	53.5
ASEAN+6 (16) <sup>e</sup>	14.9	18.6	22.6	25.2	34.6	33.7	40.5	42.4
NAFTA (3)	16.6	16.2	19.0	13.4	33.8	37.9	48.8	43.8
South American Countries <sup>f</sup>	3.5	2.6	2.6	3.2	11.1	10.9	20.3	21.9
New EU (27) <sup>g</sup>	39.6	41.5	38.0	38.6	61.5	66.8	66.3	67.1

**Notes:**

<sup>a</sup> Share of world export is computed as the value of total exports of the region to the world as share of total world exports.

<sup>b</sup> Intra-regional trade share is computed as  $X_{ii} / [(X_{ii} + X_{iw}) / 2]$ , where  $X_{ii}$  is the value of intraregional exports,  $X_{iw}$  is the value of total exports of the region to the world, and  $X_{wi}$  is the value of total exports of the world to the region.

<sup>c</sup> ASEAN=Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam.

<sup>d</sup> ASEAN+3= ASEAN countries, PRC, Japan, and Republic of Korea.

<sup>e</sup> ASEAN+6=13 ASEAN+3 countries, Australia, New Zealand, and India.

<sup>f</sup> South American countries except Guyana and Suriname.

<sup>g</sup> New EU=Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom.

Source: IMF [2008]; Taipei, China data is from the CEIC Database [2008].



[2008]). This involved developing production engineering skills to use imported technologies efficiently and successfully plugging into advanced global production networks formed by MNCs and local suppliers. Over time, as systematic innovation and learning took place at firm-level, a shift from labor-intensive exports (e.g., textiles, garments, and footwear) to more technology-intensive exports (e.g., chemicals, ship building, electronics, and automobiles) occurred in Asia.

Furthermore, intraregional concentration of trade and FDI activities rose as production networks involving Asian firms deepened regionally (Hiratsuka eds. [2006]; ADB [2008]). Falling regional trade barriers and logistics costs as well as technological progress spurred decentralization and dispersed production networks to the most cost-effective locations. Accordingly, intraregional trade shares in Asia have increased significantly, particularly in parts and components. Essentially market-driven regional trade integration has occurred as part of the globalization process.

#### SPREAD OF FTAs

Alongside multilateralism, East Asia, in the late 1990s, began emphasizing FTAs as trade policy instruments, and is today at the forefront of world FTA activity (Gilbert, Scollay, and Bora [2004]; Fiorentino, Verdeja, and Toqueboeuf [2007]). There are presently 46 FTAs in effect in East Asia, up from 3 FTAs in 2000. Four main factors underlie the recent spread of FTA initiatives in Asia (see Kawai [2005], [2007]) and the formation of East Asian production networks and supply chains. These factors are: (i) market-driven economic integration has begun to require further liberalization of trade and FDI; (ii) European and North American economic regionalism led Asian economies to focus on the importance of regional integration; (iii) the 1997-1998 Asian financial crisis made it clear that East Asian economies needed to work together in the area of trade and investment in order to sustain growth and stability; and (iv) slow progress in the WTO Doha negotiations encouraged countries to consider FTAs as alternative options.

Several key groupings have developed in Asia over the last two decades, including ASEAN, ASEAN+3, East Asia Summit, Asia-Pacific Economic Cooperation (APEC), and Asia-Europe Meeting (ASEM) (Hew ed. [2007]; Kawai

and Wignaraja [2008]; Petri [2008]).<sup>2</sup> In these groupings, ASEAN plays a central role by forging, or negotiating to forge, FTAs with major East Asian economies -the PRC, Japan, and Korea- and India, Australia, and New Zealand. Clearly, this regionalization process is deeper than globalization as it involves not only tariff reductions and services liberalization but also many WTO-plus elements, such as Singapore issues (trade facilitation, investment, government procurement, and competition policy), intellectual property rights, labor mobility and standards, and dispute settlement.

Although FTAs are a relatively new phenomenon in East Asia, East Asian exporting firms tend to utilize FTA preferences more intensively than conventionally thought<sup>3</sup> and may even increase the utilization rate. Some interesting new evidence is provided by surveys conducted by ADB and its partners in Japan, Singapore, Korea, Thailand, and the Philippines (for an overview, see Kawai and Wignaraja [2009b]). The surveys found that most firms see more benefits than costs from the agreements. But of the 609 East Asian sample firms, only 22% use FTA preferences. The main impediments to FTA use include a lack of information on FTAs, low margins of preference, use of other schemes -such as export processing zones and the Information Technology Agreement (ITA) for exporters- and non-tariff measures in partner countries. When plans for using FTA preferences are also factored in, 44% of all East Asian firms use or plan to use FTA preferences, which is double the figure for FTA use.

#### SPILLOVERS ON LATIN AMERICA AND THE CARIBBEAN

There is little doubt that the process of East Asian global and regional integration is beginning to have a variety of spillover effects on other

<sup>2</sup> The definitions of these key groupings are: ASEAN (Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam), ASEAN+3 (ASEAN countries, PRC, Japan, and Republic of Korea), ASEAN+6=13 (ASEAN+3 countries, Australia, New Zealand, and India), APEC and ASEM.

<sup>3</sup> Previous studies of the ASEAN Free Trade Agreement (AFTA), for instance, suggested that FTA utilization rates were low. Baldwin [2006] reports an overall AFTA utilization rate of under 3% for the late 1990s. He suggests a small increase of 4% for Malaysia and 11% for Thailand by 2002.

developing regions including Latin America. The few available studies on the subject, however, do not clearly show the size of spillover effects from East Asian integration on Latin American economies, both present and future.<sup>4</sup> It has been observed that East Asian economies such as the PRC offer huge potential markets but also act as potent new competitors in markets for Latin American goods and services (Devlin, Estevadeordal, and Rodriguez-Clare [2005]). Some empirical light can be shed to highlight spillover patterns and assist in the identification of policy lessons for Latin American economies. In this vein, three issues are briefly discussed below –(i) economic effects of FTA consolidation in East Asia on Latin America, (ii) an increasing number of East Asian FTAs with Latin America, and (iii) growth of East Asian trade with Latin America. The first issue deals with indirect effects of East Asian integration, while the second and third issues consider more direct effects.

#### NEGLECTIBLE LOSSES FOR LATIN AMERICA

A process of FTA consolidation has been taking place in East Asia, with ASEAN emerging as the regional FTA hub. FTAs between ASEAN and the three major Northeast Asian economies are in effect and two large region-wide FTAs (the East Asian Free Trade Agreement - EAFTA and the Comprehensive Economic Partnership in East Asia - CEPEA) have been proposed. The income effects for various regions from a recent CGE exercise are shown in [Table 2](#).<sup>5</sup> The results are reported relative to a 2017 baseline simulation (in US\$ million and as a % change) to reflect the presumption that the formation of a region-wide FTA is likely to take time. Scenarios 1-3 are concluded FTAs between ASEAN and each of the major Northeast Asian economies (the PRC, Japan, and Korea). Scenarios 4 and 5 represent

likely regional FTA scenarios to be considered by the region's policymakers. Based on bridging ASEAN and the region's Northeast Asian neighbors, scenario 4 (EAFTA) was an early attempt by the PRC at an East Asia-wide FTA. Scenario 5 (CEPEA) spearheaded by Japan has emerged with the realization that synergies could be gained by linking Australia, New Zealand, and India with ASEAN+3 economies.

The two East Asia-wide FTA scenarios -CEPEA and EAFTA- offer larger gains to world income than the three scenarios involving ASEAN and any of the major Northeast Asian economies. Typically, the gains to members of these five FTAs (e.g. Northeast Asian and ASEAN countries) are significant while the losses to non-members are relatively small.

Latin America as a whole -which is outside these FTA scenarios- will experience negligible losses of less than US\$3 billion under CEPEA or EAFTA and a few hundred million dollars at most under the ASEAN-Korea FTA or the ASEAN-Japan FTA.<sup>6</sup> Unexpectedly, Latin America sees gains of US\$2.7 billion under the ASEAN-PRC FTA. Furthermore, Mexico (a NAFTA member) sees notable gains under four of the East Asian FTA scenarios. Thus, simulation analysis suggests early fears about the negative impact of East Asian integration on other regions may be misplaced.

#### AN INCREASING NUMBER OF EAST ASIAN FTAs WITH LATIN AMERICA

Alongside the rapid spread of cross-regional FTAs, East Asia's FTA activity with Latin American economies began in the early 2000s. The Chile-Korea FTA and the Taipei, China and Panama FTA were the earliest East Asia-Latin America FTAs to take effect in 2004. This was closely followed in 2005 by the Japan-Mexico FTA and in 2006 by the PRC-Chile FTA. As [Table 3](#) shows, the number of East Asian FTAs in effect with Latin American countries doubled from four to nine between 2005 and 2009.

These FTAs have typically resulted in increased market access in goods and improved bilateral trade

<sup>4</sup> Insightful studies include Devlin, Estevadeordal, and Rodriguez-Clare [2005] and IDB [2006].

<sup>5</sup> These estimates are from a CGE model developed in Francois and Wignaraja [2008] with the following features: (i) strong micro-foundations and detailed interactions among industries, consumers and governments, across the global economy; (ii) medium to long run investment effects by allowing for trade to affect capital stocks through investment activities; (iii) projection of the GTAP dataset (version 6.3) through to 2017 trade and production patterns to represent a post-Uruguay Round world by including the phase out of the Agreement of Textiles and Clothing, the remaining WTO commitments under the Doha Round and EU enlargement to 27 members; and (iv) a stylized FTA that includes goods, services, and some aspects of trade cost reduction.

<sup>6</sup> The direction of our CGE estimates confirm those of previous studies which looked at the economic effects of tariff reduction in alternative FTA scenarios in East Asia (see, for instance, Gilbert, Scollay and Bora [2004]).

**Table 2**

**INCOME EFFECTS OF ALTERNATIVE SCENARIOS: COMPARED TO A 2017 BASELINE**  
(At constant 2001 US\$)

Region	ASEAN+PRC FTA (Scenario 1)		ASEAN+Japan FTA (Scenario 2)		ASEAN+Korea FTA (Scenario 3)		EAFTA (ASEAN+3) <sup>a</sup> (Scenario 4)		CEPEA (ASEAN+6) <sup>b</sup> (Scenario 5)	
	Value (US\$ Mn)	% change	Value (US\$ Mn)	% change	Value (US\$ Mn)	% change	Value (US\$ Mn)	% change	Value (US\$ Mn)	% change
Northeast Asia <sup>c</sup>	9,756	0.11	18,624	0.21	7,256	0.08	165,720	1.85	172,087	1.93
ASEAN	44,211	3.72	28,831	2.43	8,088	0.68	62,186	5.23	67,206	5.66
NAFTA	9,985	0.06	-214	0.00	273	0.00	-235	0.00	-4,474	-0.03
USA	7,713	0.05	-782	-0.01	287	0.00	-4,966	-0.03	-8,917	-0.06
Canada	1,211	0.12	363	0.04	155	0.02	1,796	0.18	1,546	0.15
Mexico	1,062	0.11	205	0.02	-169	-0.02	2,935	0.31	2,897	0.30
Latin America	2,667	0.13	-109	-0.01	-303	-0.01	-2,082	-0.10	-2,958	-0.14
EU-27	12,921	0.11	867	0.01	253	0.00	6,786	0.06	1,806	0.02
World	81,998	0.17	45,134	0.09	14,173	0.03	213,919	0.45	259,837	0.54

Notes: <sup>a</sup> ASEAN+3 includes the 10 ASEAN members (Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam) and PRC, Japan, and Republic of Korea.  
<sup>b</sup> ASEAN+6 includes the ASEAN+3 countries, Australia, India, and New Zealand.  
<sup>c</sup> Northeast Asia includes Japan, Republic of Korea, and People's Republic of China.

Source: ADB estimates. For details of the CGE model used, see Francois and Wignaraja [2008].

flows. The Korea-Chile FTA is a case in point. Under this FTA, Korea undertook to eliminate tariffs on 96.3% of its tariff lines (HS 96), equivalent to 99% of its imports from Chile in 2003, within ten years (WTO [2005] and [2008]). Korea's tariff elimination schedule saw the immediate liberalization of virtually all industrial products. This contributed to a 220% increase in Korea's imports from Chile. Similarly, upon entry into force of the Japan-Mexico FTA around 3,367 tariff lines (37% of Japan's tariff lines) became duty-free for imports from Mexico (WTO [2009]). Remaining tariffs are progressively eliminated and by 2015, 87% of Japan's tariff lines (86.1% in terms of import value) for Mexican exports will be duty-free. In 2007 alone, exports from Japan to Mexico increased by 10.5%, while Japan's imports from Mexico increased by 11.8%.

Most East Asia-Latin America FTAs appear to have reasonable coverage beyond goods including, services, the four Singapore issues, and other cooperation

**Table 3**

**GROWTH OF EAST ASIAN FTAs WITH LATIN AMERICA,  
1980–2009**  
(Cumulative number of FTAs)

Year	East Asian FTAs with Latin America			All East Asian FTAs		
	Total	FTAs in Effect	Future FTAs <sup>a</sup>	Total	FTAs in Effect	Future FTAs <sup>a</sup>
1980	0	0	0	1	1	0
1990	0	0	0	1	1	0
2000	2	0	2	7	3	4
2005	17	4	13	67	21	46
2009 <sup>b</sup>	24	9	15	109	46	63

Note: <sup>a</sup> Future FTAs include those signed but not yet in effect; FTAs under negotiation or proposed FTAs.

<sup>b</sup> Data as of 1 April 2009.

Source: ADB [2009].

**Table 4****COVERAGE OF SELECTED EAST ASIAN FTAs**

Chapters / Provisions	With Latin America							With Rest of the World						
	Japan-Mexico EPA (2005)	PRC-Chile FTA (2006)	Japan-Chile FTA (2007)	Korea-Chile FTA (2004)	Singapore-Panama FTA (2006)	Transpacific Strategic EPA (2006)	Singapore-Peru FTA (2008)	ASEAN FTA (1992)	ASEAN-Japan CEPA (2008)	Japan-Singapore EPA (2002)	Japan-Thailand EPA (2007)	Korea-Singapore FTA (2006)	PRC-New Zealand FTA (2008)	New Zealand-Singapore CEP (2001)
<b>A. GOODS</b>														
Tariff Elimination														
ROO														
Trade Remedies - Anti Dumping														
Trade Remedies - Subsidies & Countervailing														
Trade Remedies - Bilateral Safeguards														
Agriculture														
Textiles and Apparel														
Quarantine and SPS Measures														
Other Non-Tariff Measures														
Technical Barriers to Trade														
Standards and Conformance, MRAs														
Customs Administration and Procedures														
<b>B. SERVICES</b>														
Telecommunications														
Financial Services														
Professional Services														
Labor Mobility/Entry of Business Persons														

enhancement provisions (Table 4). Strikingly, six agreements have provisions on most of the Singapore issues as well as some coverage of cooperation enhancement provisions. This underlines the point that the main motivation behind East Asia-Latin America

FTAs is deep integration, i.e., ensuring market access in distant markets in areas beyond goods.<sup>7</sup>

<sup>7</sup> See Plummer [2007] for review of provisions in East Asian FTAs and suggestions for best practices.

## COVERAGE OF SELECTED EAST ASIAN FTAs

Table 4

Chapters / Provisions	With Latin America							With Rest of the World						
	Japan-Mexico EPA (2005)	PRC-Chile FTA (2006)	Japan-Chile FTA (2007)	Korea-Chile FTA (2004)	Singapore-Panama FTA (2006)	Transpacific Strategic EPA (2006)	Singapore-Peru FTA (2008)	ASEAN FTA (1992)	ASEAN-Japan CEPA (2008)	Japan-Singapore EPA (2002)	Japan-Thailand EPA (2007)	Korea-Singapore FTA (2006)	PRC-New Zealand FTA (2008)	New Zealand-Singapore CEP (2001)
C. SINGAPORE ISSUES														
Trade Facilitation (Paperless Trading/Transit)														
Investment														
Government Procurement														
Competition Policy														
D. COOPERATION ENHANCEMENT														
Intellectual Property														
ICT and E-Commerce														
Labor Standards/Movement of Natural Persons														
Environment														
Economic & Technical Cooperation														
Information Exchange														
Energy														
Transport and Communications														
SME														
Trade and Investment Promotion														
Transparency														
Dispute Settlement														

Source: Compiled from ADB FTA database and official documents (data as of 1 April 2009).

## RAPID TRADE GROWTH FROM A LOW BASE

Over the last two decades there has been rapid growth in trade between East Asian and Latin American economies, albeit from a relatively low base (see [Table 5](#)). The value of East Asia's total

trade with Latin America increased eleven-fold from US\$20.5 billion to US\$234.5 billion between 1987 and 2007 (from 2.3% to 3.3% of East Asia's total trade). By 2007, East Asia's imports from Latin America amounted to US\$101.9 billion while its exports to Latin America reached US\$132.6 billion indicating that the trade

Table 5

### EAST ASIA'S TRADE WITH LATIN AMERICA (1987, 1997 and 2007)

Exports to Latin America	Value (US\$ Mn)			Growth Rate <sup>a</sup>		Share of Total Exports (%) <sup>b</sup>		
	1987	1997	2007	1987-1997	1997-2007	1987	1997	2007
East Asia (15)	10,776	45,585	13,2641	15.5	11.3	2.1	3.2	3.5
China, People's Republic of	394	4,425	49,325	27.4	27.3	1.0	2.4	4.0
Japan	7,861	19,655	32,669	9.6	5.2	3.4	4.7	4.6
Korea, Republic of	1,148	8,238	23,768	21.8	11.2	2.4	5.7	6.4
Singapore	428	2,096	7,273	17.2	13.3	1.5	1.7	2.4
Taipei, China	0	2,999	5,439	--	6.1	0	2.5	2.2
Hong Kong, China	635	5,135	5,176	23.3	0.08	1.3	2.7	1.5
Thailand	79	651	3,846	23.5	19.4	0.7	1.1	2.5
Malaysia	137	1,258	2,648	24.8	7.7	0.8	1.6	1.5
Indonesia	52	888	1,913	32.8	8.0	0.3	1.7	1.7
Philippines	41	174	378	15.6	8.1	0.7	0.7	0.7
Imports from Latin America	Value (US\$ Mn)			Growth Rate <sup>a</sup>		Share of Total Imports (%) <sup>b</sup>		
	1987	1997	2007	1987-1997	1997-2007	1987	1997	2007
East Asia (15)	9,689	27,667	101,857	11.1	13.9	2.4	2.1	3.1
China, People's Republic of	1,158	3,654	49,732	12.2	29.8	2.7	2.6	5.2
Japan	6,076	11,090	22,437	6.2	7.3	4.0	3.3	3.6
Korea, Republic of	1,181	3,940	11,142	12.8	11.0	2.9	2.7	3.1
Singapore	193	1,368	2,687	21.6	21.6	0.6	1.0	1.0
Taipei, China	0	2,325	4,807	--	7.5	0	2.0	1.9
Hong Kong, China	376	1,636	3,020	15.8	6.3	0.8	0.8	0.8
Thailand	211	1,150	2,359	18.5	7.5	1.6	1.8	1.7
Malaysia	168	1,141	2,612	21.1	8.6	1.3	1.4	1.8
Indonesia	214	883	1,543	15.2	5.7	1.7	2.1	2.1
Philippines	111	464	870	15.4	6.5	1.6	1.2	1.6

Notes: East Asia (15) includes ASEAN, PRC, Hong Kong, Taipei, China, Japan, and Republic of Korea; Latin America refers to all Organization of American States (OAS) members except the US and Canada.

<sup>a</sup> Growth rate is computed using annual growth rate =  $(FV/PV)^{1/n} - 1$ .

<sup>b</sup> Shares of total exports or imports is computed as the value of total exports to Latin America as a share of total world exports from the East Asia (15) economy or region

Source: IMF [2008]; Taipei, China data is from the CEIC database [2008].



balance is still somewhat in favor of East Asia. Studies suggest that the bilateral trade balance may be related to weak industrial efficiency and competitiveness in Latin America relative to East Asia.<sup>8</sup>

Kawai and Zhai [2009] argue that the PRC (and more generally economies in East Asia) and Latin American countries need to move beyond their traditional focus on resource complementarity to more dynamic, FDI-based intra-industry trade. Policies that encourage deeper economic integration between the two regions would help Latin American firms integrate into the value chains of global production, and enable East Asian firms to have greater and more stable access to markets, in addition to resources. Further liberalization of trade, FDI regimes, and regulatory policies should be of high priority for most Latin American countries, while the East Asian economies could make a great contribution to trade ties by investing in manufacturing sectors and infrastructure in Latin America.

### LESSONS FOR LATIN AMERICA

There are six lessons from East Asia's experience of sequenced economic integration - a strong initial focus on shallow global integration since the 1960s, followed by a greater and more recent emphasis on deeper regional integration- for Latin American economies.

1) *Develop internationally competitive manufacturing sectors.* Historically, a shift from subsistence agriculture to export-oriented manufacturing has been associated with rising economic prosperity and a flexible skill base. This shift requires significant investment in innovation and learning activities by individual firms, as well as the development of geographically dispersed production

networks driven by MNCs. Over time, production networks can acquire regional roots with the emergence of regional suppliers able to produce goods to world class delivery and quality standards.

2) *Emphasize domestic structural reforms and market-orientation in regional strategy.* A general emphasis on markets for resource allocation and promotion of greater competition in domestic markets encourages efficiency. Where market imperfections arise, however, intervention may be required. Improvement in business climates is essential.

3) *Adapt policy mix to national circumstances.* There is no one-size-fits-all strategy. Key ingredients of regional strategy - investment in infrastructure, improvement of logistics, open trade and investment policies, measures to improve export competitiveness, and public-private sector partnerships- need to be modified and sequenced to suit individual country needs and priorities.

4) *Emphasize cross-regional linkages with East Asia.* Not all trading partners are equal. Integration into dynamic production networks of economies such as those in East Asia can bring numerous externalities to Latin American economies and their enterprises (e.g., capital, marketing linkages, scale economies and technology transfer).

5) *Involve the private sector in developing a regional strategy.* The behavior of foreign and domestic firms influences the formation and deepening of regional production networks in different industries. Accordingly, close involvement of the private sector in discussions of regional strategy and FTA negotiations is critical.

6) *Narrow development gaps.* To sustain the consensus for greater integration in formal regional arrangements, it is imperative to accelerate economic development in smaller, low income countries which may be at risk from short-term adjustments within regional arrangements.

### CONCLUSION

East Asia is internationally reputed for having successfully integrated into the global economy over the last five decades through sustained outward-oriented development strategies. One

<sup>8</sup> A detailed study by Weiss and Jalilian [2003] on industrialization in East Asia and Latin America concludes that "there is little evidence of LA catch-up with ESEA in efficiency terms once Mexico is treated as a special case and the improvement in export performance in the 1990s for LA appears much less impressive", (Weiss and Jalilian [2003], p. 36). Weiss and Jalilian suggest that the gap in Latin America's performance may be related to the investment climate, weak educational and technical base and weak and unreformed institutions. Similar conclusions are reached by Wignaraja and Taylor [2003] who benchmark manufacturing export competitiveness across a sample of 80 developing countries. Seven East Asian economies are present in the top ten list and only one in Latin America.

highlight was the evolution of East Asia as the global factory through the engineering of a series of industrial advancements in several economies. The most recent of these are the PRC and Viet Nam. In addition, the East Asian economies began to create FTAs among themselves in the late 1990s. While the initial globalization process was a shallow type of integration, the new trend of regionalization is a deeper one.

East Asia's emergence in the world economy has begun to impact other regions and economies within them. There are also growing economic links between East Asia and Latin America through rising trade flows and cross-regional FTAs. CGE results presented in the paper suggest that the two region-wide FTA scenarios (EAFTA and CEPEA) offer large gains to world income and limited losses to Latin American economies and others outside these arrangements. Hence, early worries about the global impact of East Asian regionalism seem misplaced.

However, benefits from deep economic integration with East Asia may not automatically trickle down to Latin American economies. Latin American economies

and the region as a whole may need to develop coherent approaches to maximize the benefits of deep economic integration with East Asia while minimizing costs.

The global economic crisis is likely to exert a dampening effect on the pace of East Asian-Latin American economic relations in the short-term. In the medium-term, however, there are grounds for optimism and a return to pre-2008 levels of integration activities across East Asia and Latin America. These include: (i) a global recovery which is expected to start sometime in 2010; (ii) growing regional markets in East Asia, led by the PRC, which offer opportunities to take up low demand and slack capacity; and (iii) more intense diplomatic activity on the APEC front,<sup>9</sup> which is expected to lead to more liberalization between East Asia and Latin America. ♦

<sup>9</sup> As agreed by APEC Leaders in Bogor, Indonesia, in 1994, the Bogor Goals set the target of free and open trade and investment in the Asia-Pacific region to be achieved by 2010 for industrialized economies and 2020 for developing economies.

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# **I N T E R V I E W S**







# PANEL INTERVIEWS

## A DIALOGUE ON THE FUTURE OF REGIONAL INTEGRATION IN THE AMERICAS

*Both the evaluation of the achievements and frustrations on the now long road of integration processes in Latin America and the Caribbean, and the region's immediate prospects are today a matter for controversy in the region. The IDB President therefore decided to call a dialogue in October 2008\* between recognized experts to contrast views and experiences. Insofar as the general thinking is conditioned by the logic of each subregional bloc, it was sought to maximize representation at the meeting, including personalities with experience in each of the schemes in force in the region.*

*The positive results of the dialogue pointed to the advisability of moving forward in the debate, and participants were therefore invited to answer a questionnaire covering the most salient aspects of the discussion. Below are the questions put to the experts who decided to cooperate in the effort, and the answers they gave. These were, in alphabetical order, Grant Aldonas (USA); José Botafogo Gonçalves (Brazil); Guillermo Fernández de Soto (Colombia); Félix Peña (Argentina), and Carlos Pérez del Castillo (Uruguay).*

### 1. Objectives and motivations of the integration process

- a) *There is no doubt that integration processes in the region have taught us several lessons, some positive, some negative. Which ones would you highlight as the main lessons learned in either sense?*
- b) *In your opinion, what new drivers of the integration process in Latin America and the Caribbean ought there to be over the next few years? How do they differ from the drivers that have traditionally shaped the processes of regional integration?*
- c) *There is frustration and disenchantment in various circles with the regional integration process. This is grounded in the considerable gap between expectations and achievements. What factors would you highlight to explain this distance? Are these views shared by broad sectors of government or are they merely concerns of very small elites that take an interest in this area?*
- d) *The experiences of the European Union and Asia indicate that integration processes have brought about per capita income convergence among member states. Could this be a new driver for a region that has the unfortunate privilege of being one of the most inequitable regions in the world, both among countries and within them? What prerequisites and commitments would it involve?*

\* Meeting called by President Moreno and organized by the Integration and Trade Sector (INT): "A Dialogue on the Future of Regional Integration in the Americas". Washington D.C.: October 21, 2008.

- e) *Some feel that a new rationale for integration in Latin America and the Caribbean is to lean toward greater individual and collective competitiveness in the global economy. Through which mechanisms and in which areas do you feel this would be possible and most profitable? How do you assess the predisposition of the business and political elites in this sense?*
- f) *Others suggest that the new driver is political (practical, rather than ideological) and that it consists in founding integration processes on greater convergence of values, the deepening of democracy, the opening-up of opportunities for those in greatest need, and the progressive effective operation of citizenship. How do you feel this type of ideology can be reconciled with material progress for the very sectors that support, reinforce and make it credible?*

## 2. The new integration profile

- a) *Notwithstanding the region's sound performance over the last six years, no significant changes in the countries' modalities of integration in the global economy have yet been seen. Which sectors or activities look more promising as platforms for integration in the global economy? What are the most significant current and potential differences between subregions?*
- b) *The capacity to produce food, generate energy, and have abundant water are, in practical terms, absolute advantages for Latin America and the Caribbean in global terms. How might the regional integration process contribute to focusing these resources, to inducing innovations in process, product, and administration, and appropriating the maximum possible benefit from their exploitation? How to avoid competition between countries and lean toward greater cooperation?*

## 3. The current international climate: opportunity or restriction?

- a) *The financial crisis is gradually spreading across the globe and a recessive process is setting in, which will last throughout 2009 at least. How will this impact the integration process in Latin America and the Caribbean? Will it be a question of every country for itself or will there be possibilities of joint efforts to meet the current climate head on? Might it be an opportunity to position the region differently and dynamically in its external relations?*
- b) *Another of the dilemmas that will face the integration process in Latin America and the Caribbean is whether its scope will be restricted to the region or aimed at hemispheric integration. Do you think the tripolar structure being consolidated in the global economy will be enough incentive to make headway on the obstacles to hemispheric integration? Do you feel the change of administration in the United States and the reordering subsequent to the present crisis may provide a favorable opportunity for a regearing of the FTAA toward the drivers mentioned above, thus correcting the failure of the previous negotiations?*
- c) *The current crisis is leading to a rethink of the role of international organizations on various fronts. What do you feel the role of international organizations (and of IDB specifically) ought to be in the countries' processes of regional integration and global economic integration.*

GRANT ALDONAS

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## INTERVIEW TO GRANT ALDONAS

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### 1. Objectives and motivations of the integration process

- a) *There is no doubt that integration processes in the region have taught us several lessons, some positive, some negative. Which ones would you highlight as the main lessons learned in either sense?*

The positive lessons are economic. Even taking into account the significant economic adjustments faced by a number of countries in the region during the 1990s, the reduction in trade barriers within the hemisphere resulting from initiatives like The Southern Common Market (Mercado Común del Sur - MERCOSUR), the North American Free Trade Agreement (NAFTA), Chile's free trade agreements with Canada and the United States, and the more recent Central American and Dominican agreements with the United States, corresponded to a period of strong economic growth throughout the hemisphere. While it would not be fair to attribute that growth exclusively to the reduction in trade barriers, it does suggest that further trade and investment liberalization would complement domestic economic reforms designed to improve the prospects for development, raise productivity, and lift living standards throughout the hemisphere.

The negative lessons are largely political: overselling the benefits of trade, underinvesting in the infrastructure needed to ensure that the economies of the hemisphere derived the full benefit of the agreements they reached, and the need to have adequate adjustment policies in place to ensure that the changes wrought by trade liberalization are complemented by an effort to help those most affected.

That said, it is not clear that the lessons of the past two decades are apposite to the challenge ahead. The challenge we face lies in developing the economic rationale and the political support for further regional integration in the context of a globalized, knowledge-driven economy. This represents a very different challenge than that presented by earlier efforts at trade and investment liberalization -one that starts from the perspective of what drives economic development in a

globalized economy and then reasons to a conclusion about the external policies that countries of the region might adopt to foster our collective progress toward that goal.

- b) *In your opinion, what new drivers of the integration process in Latin America and the Caribbean ought there to be over the next few years? How do they differ from the drivers that have traditionally shaped the processes of regional integration?*

The single most important driver of the integration process is likely to be the ongoing revolution in computing, communications and transportation. The reality is that technology will continue to drive the integration process even in the absence of further government efforts to reduce barriers to trade and investment. Economic borders are now incredibly porous. New technologies are rapidly diffused. That alters the economic equation fundamentally.

What once involved arm's length transactions between independent buyers and sellers in different countries is now more likely to take place within the affiliates of a single regional or global enterprise or within the extended reach of their global supply chains. That alters the way firms compete. What was once a competition for markets which lent itself to a mercantilist approach to trade negotiations is rapidly giving way to a global competition for capital, talent, and ideas.

In that world, border measures of the sort that we bargained about in past efforts toward integration mean less. What matters more is an economy's openness, the quality of its institutions, and the skills and adaptability of its workforce. The reason lies in the fact that those are the features of economies that are attractive to globally-engaged firms and such firms are the primary mobilizers of capital, talent, and ideas in today's economy.

As we think about the future of hemispheric integration, we should both design the effort with that in mind and measure the success of the effort in those terms.

- c) *There is frustration and disenchantment in various circles with the regional integration process. This is grounded in the considerable gap between expectations and achievements. What factors would you highlight to explain this distance? Are these views shared by broad sectors of government or are they merely concerns of very small elites that take an interest in this area?*

In my own view, the frustration and disenchantment with hemispheric integration cannot be separated from the broader anxiety about globalization. There, the concerns of workers are legitimate. It is not simply that a knowledge-driven, globalized economy presents significant new challenges. It also drives changes that affect individuals' perceptions of their own value and role in society.

This is why developing a rationale for regional integration that is firmly grounded in the reality of the global economy is so important. Unless the effort is backed by an economic and political narrative that explains how it will contribute to the future of individuals and help them address the adjustment challenges they face, it is likely to prove unavailing.

In addition, any new effort will have to confront the fact that previous efforts did not deliver all that their advocates promised. The gap between promises and economic reality has contributed to a broader loss of trust and confidence in both public and private institutions that are the foundation of each country's economy and society. The advent of a more populist turn in politics throughout the hemisphere from north to south is a direct result of that growing loss of faith in existing institutions and existing explanations for the current organization of the economy domestically, regionally and globally.



- d) *The experiences of the European Union and Asia indicate that integration processes have brought about per capita income convergence among member states. Could this be a new driver for a region that has the unfortunate privilege of being one of the most inequitable regions in the world, both among countries and within them? What prerequisites and commitments would it involve?*

It is important, first, to understand that Europe and Asia represent very different models of integration. While the European Union (EU) is the result of a conscious effort driven by the political imperative of ending disputes that plunged the world into two global conflicts (arguably three, if one includes the Cold War), the process in Asia has been one in which the actions of government have largely followed what had already become an economic reality. What that means is that the two regions present very different lessons - lessons that may be ahistorical when applied to this hemisphere (i.e., they ignore the hemisphere's own history which necessarily shapes the possible routes forward).

If we take the European model, for instance, it is hard to see where the political imperative would come from to adopt a common understanding about the premises underlying a common market and, equally important, a common society (i.e., the requirement that each EU member country adopt a common code of human rights as well as the various economic arrangements). This is not because the countries of the hemisphere do not share a common vision of human rights or of the underlying premises of a market-oriented economy. While that may not be true in every instance, there is broad support for democracy and for greater economic freedom as the organizing principles of political and economic life.

The problem lies in the lack of a force, either economic or political, that is sufficiently compelling to force entrenched economic and political interests to accept the loss of sovereignty, whether political or personal, that such a new arrangement would imply.

If, on the other hand, we take the example of Asia, it is not at all clear that the lessons apply with any greater comfort to the circumstances we face. Asia has long been dominated by governments that were more authoritarian, economies that were far more open for those who could pay to play, and societies that are far more homogenous than those of this hemisphere. It would be difficult to duplicate that model even if we desired to give up that measure of political and economic freedom that we would need to sacrifice in order to achieve a similar approach to economic development.

In my view, we are far more likely to succeed with integration if it is geared to the needs and the historical reality of this hemisphere. What that does suggest, however, is that we should look to the broader premises on which we agree as a starting point for the effort. Those points of agreement do not start with agreement on trade theory and the importance of the principle of comparative advantage. Rather, they involve far more fundamental and political choices about building a stronger and more equitable society, from which a stronger rationale for economic integration can be built.

- e) *Some feel that a new rationale for integration in Latin America and the Caribbean is to lean toward greater individual and collective competitiveness in the global economy. Through which mechanisms and in which areas do you feel this would be possible and most profitable? How do you assess the predisposition of the business and political elites in this sense?*

The anxiety that drives the individual's response to globalization finds its counterpart in the focus of politicians and policymakers on the issue of competitiveness. The term is more often conflated with more mercantilist notions of how a country or a region like the hemisphere

improves its export competitiveness. The benefit of that approach is that it allows a broad appeal to economic nationalism. The danger, of course, lies in the fact that it will not work and that will only lead to greater cynicism about the idea of integration.

Far better that we focus on something that will make a real difference in an individual's life and in the future they can provide for their families. That involves a concerted effort to raise individual productivity, which is the only basis for further economic development and the only route to a more equitable society and economy. That naturally compels the question of what drives productivity gains and how integration can contribute.

The answer lies in the basic principle that has animated economic theory since Adam Smith. To raise productivity, an individual needs the freedom to specialize in what they do best and the capacity to exercise that freedom. The freedom to specialize depends on the availability of markets that will offer a mechanism by which the individual can gain his or her freedom to specialize economically. The capacity to exercise that freedom depends heavily on education and an economic environment that rewards the skills acquired (as opposed, for example, to the skills that spell success in an environment when all economic opportunity flows from government control and individuals must devote enormous resources to effecting their economic demands through the political process).

In the context of today's global economy, that simple stylized example nonetheless offers a more coherent rationale for hemispheric integration than a focus on competitiveness. Arranging the incentives within the hemisphere so they systematically favor the exercise of individual economic freedom is essential to allow individuals to raise their own productivity and contribute to the process of economic development. Seen in that light, trade and investment liberalization has an incredibly important role to play not just in terms of the economic outcomes it fosters, but because it is a powerfully liberating force.

- f) *Others suggest that the new driver is political (practical, rather than ideological) and that it consists in founding integration processes on greater convergence of values, the deepening of democracy, the opening-up of opportunities for those in greatest need, and the progressive effective operation of citizenship. How do you feel this type of ideology can be reconciled with material progress for the very sectors that support, reinforce and make it credible?*

Properly understood, trade liberalization should serve the same ends - a greater convergence of values, a deepening of democracy, the opening-up of opportunities for those in greatest need, and the progressive effective operation of citizenship. The reason lies in the fact that societies and economies prove to be incredibly path-dependent. In the absence of some reason to realign the incentives within a society, there is little reason for entrenched economic and political interests to give up the power they exercise in their respective spheres.

One need not adopt the conventional Marxist analysis at the core of dependency theory (or the predicted revolutionary outcomes) to recognize that this path dependence represents the "dead hand" that so many have spoken of in the context of the hemisphere's development. Economic liberalization lifts this dead hand precisely because it encourages market-driven outcomes, rather than outcomes driven by the exercise of political power. It offers opportunities to those at the bottom to escape the path dependence of their own circumstance.

That is a liberation from which all good things flow, both in terms of economic outcomes and in terms of political freedom. For any serious student of history, it is axiomatic that political freedoms are not effective in the absence of the economic wherewithal to exercise those

freedoms. To gain one's economic freedom is to gain one's political freedom and that, in the end, requires access to markets.

## 2. The new integration profile

- a) *Notwithstanding the region's sound performance over the last six years, no significant changes in the countries' modalities of integration in the global economy have yet been seen. Which sectors or activities look more promising as platforms for integration in the global economy? What are the most significant current and potential differences between subregions?*

Ironically, the sector that would benefit most from full integration into the global economy is the one that represents the single greatest stumbling block to a global trade deal. From north to south, the hemisphere is extraordinarily competitive in agriculture. Even in the United States, where crops like cotton and sugar benefit from enormous protection and subsidies, the broader interests of agricultural producers lie in global trade liberalization.

Indeed, the most globally competitive U.S. crops are those that receive no government subsidies.

Greater integration within the region would only enhance the competitiveness of the hemisphere's producers in a global economy precisely because those producers capable of taking maximum advantage of the scale economies offered by regional free trade in agricultural goods would prove to be the strongest competitors when those skills could be applied across a broader plain in a world economy free of barriers to farm exports.

What is more, the United States would gain significantly from the allocative efficiencies that would flow from eliminating distortions in our own agricultural sector. The reality is that American farmers respond to the subsidies as any farmers would - they plant the commodities that offer the best return, which are those most heavily subsidized. Removal of the subsidies would undoubtedly alter what American farmers produce, but it is unlikely to be the deciding factor in whether they survive in a business that is now capital-intensive and geared to global markets even in spite of the significant subsidies.

Brokering a hemispheric deal on agricultural trade would add weight to our efforts multilaterally. We would, in effect, be untying our hands with respect to multilateral trade negotiations.

- b) *The capacity to produce food, generate energy, and have abundant water are, in practical terms, absolute advantages for Latin America and the Caribbean in global terms. How might the regional integration process contribute to focusing these resources, to inducing innovations in process, product, and administration, and appropriating the maximum possible benefit from their exploitation? How to avoid competition between countries and lean toward greater cooperation?*

Even with the revolution in transportation and logistics that has dramatically dropped the cost of shipping, weight-to-value ratios still matter. In any rational economic world, more of the processing of agricultural products would take place in the hemisphere because it yields a higher value added product - one in which the cost of shipping represents a far smaller share of the total cost of the product. What that suggests is that the incentive to invest in higher value-added production closer to the source of the commodity is being offset by trade distortions or other barriers in various consuming country markets.

Our goals should be twofold. First, to secure a regional arrangement on agriculture that encourages this economic dynamic with the hemisphere as a platform for overcoming the

distortions of agriculture and food trade that inhibits the ability of investment to respond to the cost savings associated with doing more of the intermediate and final processing closer to the source of the commodity's production in order to take advantage of the cost savings that flow from the improved weight-to-value ratios. Second, to negotiate a global reduction in the distortions that inhibit the natural flow of investment in higher valued-added production toward the hemisphere.

In that context, we should, however, be mindful of the commercial reality that shapes this market. In many instances, the tariffs, quotas, and sanitary and phytosanitary rules that govern access to a particular market are only part of the story. Increasingly, the real obstacle is putting producers in the hemisphere in a position to satisfy the commercial standards applied by global firms, which are necessarily concerned about the reputational effect of any failure to supply high quality, safe products to consumers in global markets.

This is not something that is susceptible to direct government-to-government negotiation like border measures on agricultural subsidies, but it is susceptible to domestic economic reforms and assistance that provide an infrastructure capable of ensuring that producers in the region can satisfy those standards. Any hemispheric approach to these issues should think in terms that reach beyond the conventional trade arrangements precisely because it is often those features of commercial markets that lie beyond government regulation that really shape the economic opportunities available to the region's producers.

### 3. The current international climate: opportunity or restriction?

- a) *The financial crisis is gradually spreading across the globe and a recessive process is setting in, which will last throughout 2009 at least. How will this impact the integration process in Latin America and the Caribbean? Will it be a question of every country for itself or will there be possibilities of joint efforts to meet the current climate head on? Might it be an opportunity to position the region differently and dynamically in its external relations?*

We should not sugarcoat the pill. The financial crisis will make progress on trade liberalization incredibly hard in the short run. We will, in fact, be fortunate to prevent a significant rollback in previous liberalizations in the face of rising protectionist pressures.

Having said that, it is also true that times of crisis provide extraordinary opportunities for institutional change that would not be possible under normal circumstances. The real issue is political - where might we look for the political leadership that would underscore the importance of continuing openness to any economic recovery in the short run and to greater prosperity in the longer run?

Increasingly, that leadership has to come from the south. The political dynamic in the United States works against its leadership in any new effort toward integration. Any such effort is, moreover, far more likely to succeed if it is grounded in what it can contribute to economic development and is led by one of the countries of the hemisphere with the greatest stake in that result. That strongly suggests that the pace of progress on any new initiative will depend heavily on the extent to which one of the leading economies of Latin America steps forward to drive the process.

- b) *Another of the dilemmas that will face the integration process in Latin America and the Caribbean is whether its scope will be restricted to the region or aimed at hemispheric integration. Do you think the tripolar structure being consolidated in the global economy*

*will be enough incentive to make headway on the obstacles to hemispheric integration? Do you feel the change of administration in the United States and the reordering subsequent to the present crisis may provide a favorable opportunity for a regearing of the FTAA toward the drivers mentioned above, thus correcting the failure of the previous negotiations?*

It is worth emphasizing that the tripolar structure is more apparent than real. The current economic crisis highlights that fact. While one might argue that the effort of the Association of Southeast Asian Nations (ASEAN) countries to develop a network of “free trade” arrangements with other Asian countries represents the consolidation of a Pan-Asian trading bloc, the reality is quite different. The trade arrangements are neither broad in terms of their coverage nor particularly deep in terms of their commitments. As I noted above, they more often follow economic reality than create it.

More profoundly, what the current crisis underscores is the extent to which the Asian economies, by adopting a more mercantilist, export-driven economic model, are far more heavily dependent on the fortunes of their external markets than the budding regional trade arrangements would suggest. That could change, but in the current context it is difficult to suggest that Asia is quite the coherent bloc that the theorists of a tripolar world suggest. It simply does not function independently of the rest of the world.

The same, of course, could and should be said of our hemisphere. Plainly, Brazil, Chile and other commodity exporters benefitted greatly in recent years from strong growth and infrastructure investment in China and the rest of Asia. Significantly, so did the United States. In other words, our fortunes are more closely linked to the success of our Asian trading partners than many would like to admit.

That is why we must develop a rationale for regional integration in the context of a global economy, rather than a tripolar one. A strategy that was based on the notion of a tripolar world is likely to fail because the tripolar model offers an inaccurate picture of the global economy in which we find ourselves and the quite different challenges that presents to domestic policy-makers as well as trade negotiators and development institutions.

- c) *The current crisis is leading to a rethink of the role of international organizations on various fronts. What do you feel the role of international organizations (and of IDB specifically) ought to be in the countries' processes of regional integration and global economic integration.*

This is actually the easiest of the questions to answer. The truth is that we are fortunate to have the IDB. It is the only institution in the region that is capable of providing a forum for the discussions that have to take place, not so much between governments at this stage, but among politicians, economists, academics, journalists and civil society over the point of integration within the hemisphere. That points toward the role that the Bank should play in this context - providing the thought leadership that must begin before the politics can follow.

More broadly, the Bank's leadership has begun the process of reshaping the IDB in ways that make it more capable of rising to that challenge. The next step is to integrate the actual financial commitments of the Bank with an approach to integration that is driven by the members and perceived by their public to be profoundly in their interest. That is a step I am certain the Bank's leadership will take and I am convinced that political leaders within the region will, in fact, come around to the need for a strong foundation within the region in order to accomplish the goals they seek within the framework of the global trading system. But, that process has to start with the conversation the Bank has thankfully started.





## INTERVIEW TO JOSÉ BOTAFOGO GONÇALVES

*Currently President of the Board of Trustees to the Brazilian Center for International Relations (CEBRI). A retired diplomat formerly assigned to Moscow, the Vatican, Rome, Santiago, Paris, Bonn and Milan. He was Vice-President of External Relations to the World Bank in Washington (1985-1987). Along his career he has also been appointed to several governmental positions in his home country, Brazil. He's also been Special Ambassador to MERCOSUR Issues (2001) and Ambassador to Brazil in Buenos Aires (2002-2004).*



### 1. Objectives and motivations of the integration process

- a) *There is no doubt that integration processes in the region have taught us several lessons, some positive, some negative. Which ones would you highlight as the main lessons learned in either sense?*

What can we say about the experiences of regional integration at the dawn of the 21st century? Let's start with its more negative aspects.

*The absence of operational pragmatism:* the regional institutions' constitutive texts set generous political objectives, but pay little attention to the pragmatic aspects of integration. Everybody thought they knew where they wanted to get to, but few knew how to explain how to do so.

*Unrealistic political ambitions:* In the eagerness to stimulate Latin American union as a defense mechanism against the actions of developed countries, mandatory rules were adopted over the years against the grain of existing historical and geographical differences between member countries.

*Abstract rhetoric:* The inability of the Southern Common Market (MERCOSUR) and the Andean Community (CAN)-type regional institutions to meet the objectives outlined came to be thought of as proof of a lack of seriousness of purpose, cultural underdevelopment, or secular rhetorical verbiage so typical of the Iberian legal tradition.

*The absence of adaptation mechanisms:* The academic world, international institutions, and even governments have paid little attention to the deep causes of contractual non-compliance.



Rather than becoming important pragmatic lessons indicative of changes of tactics, they are thought of as expressions of a lack of "political will."

*The abuse of delaying tactics:* As a result of this, critics are split into two groups: those who propose a rollback or outright dropping of integrationist schemes and those who propose "deepening" them, reiterating now discredited objectives or creating new auxiliary mechanisms (parliaments, banks, or superimposed regional forums).

*Excessive importance given to tariff protection:* The debate over the fate of the MERCOSUR Common External Tariff (CET) is paradigmatic of the situation described above. Instead of examining with technical rigor the causes of the proliferation of CET perforations (practiced by all members of the Group), which in all probability would lead one to conclude that it is necessary to gradually reduce MERCOSUR's average level of tariff protection, the government and private sector prefer to speculate about the demise of the CET, and the resumption of bilateral agreements signed separately by every member of the group. Any averagely educated observer knows that the pressure on the members of MERCOSUR to reduce customs tariffs in individual negotiations, either with the United States or the European Union (EU), will be a great deal stronger than if the four associates negotiate jointly.

*Nationalistic or heterodox macroeconomic policies:* The current crises affecting the countries of Latin America in recent decades, associated with wrong-minded macroeconomic policies and within a framework of productive restrictions generated by a deficient investment program in transport and energy infrastructure contributed greatly to widening the gap between the ultimate objectives of regional integration agreements and their effective instrumentation.

Nevertheless, the balance of the results achieved by the innumerable regional integration agreements in force in Latin America and the Caribbean also includes several positives.

*Popular enthusiasm for integrationist rhetoric:* Ever since the second half of the 1980s, the ideals of integration have become political flags, with major popular repercussions and practically unanimous support from civil society, leaders, and, with a degree of reticence, rural and industrial business.

*First-time acceptance of the distribution of responsibilities:* MERCOSUR on the Atlantic side of South America and the Andean Community on the Pacific side continue to be powerful drivers of regional integration.

*Persistent confidence in deepening mechanisms:* Leaders and parliamentarians have heard from their respective electorates that the problems facing MERCOSUR and CAN will only be solved with more MERCOSUR and more CAN, not less.

*The recovery of regional self-esteem:* This defense by civil society of integrationist assets already accumulated cannot be underestimated by international credit organizations, nor can it be seen as mere rhetorical and academic adherence to the old Pan-American ideal.

*The networked development of political, trade, and economic interests:* There are very sound concrete reasons to explain a sustained adherence to the ideals of integration. Among them, the reestablishment of democracy in Brazil and Argentina acted as a trigger for a series of bilateral agreements culminating in the negotiation of the 1991 *Treaty of Asunción*, which created MERCOSUR. The bloc's adherence to the so-called "democratic clause" consolidated its legitimacy in the eyes of the public, as, for the first time, this involved adopting a self-applicable antidote to any poison that breaks with democratic legality. The spectacular expansion of regional trade as a

result of generalized tariff elimination: It matters little whether part of this expansion was due to a favorable international climate, for, once the new trade networks are created, they take on a life of their own and develop resistance mechanisms to unfavorable climates. The gradual abandoning of heterodox macroeconomic policies with immediate high-impact, but unsustainable in the medium- to long-term: In particular, the growing perception among politicians and leaders that inflation in a political context of democratic freedom is the staunchest enemy of electoral victories. Control of inflation enabled policies to combat poverty and social difference to be defined more clearly. Finally, press freedom increased popular sensitivity to transverse issues that forced regional development organizations to pay attention to the environment, corruption, food security, energy sustainability, and climate change, among others.

- b) *In your opinion, what new drivers of the integration process in Latin America and the Caribbean ought there to be over the next few years? How do they differ from the drivers that have traditionally shaped the processes of regional integration?*

For several centuries, and despite the economic and physical distance from the major consumer markets, the region based its prosperity on exports of the riches of the soil or subsoil. Some countries were unable or unwilling to ensure the benefits of exports of raw materials for future generations, but others did better. Two examples, Argentina and Brazil, are enough. Argentina was able to combine beef and cereal exports with a domestic policy of support for a well-educated and well-fed urban middle class, which made it one of the more developed countries in the world in the early decades of last century. Unfortunately, until the late 1800s the Brazilian economy depended on slave labor. If, Brazil's industrialization was a success, it nevertheless accumulated a gigantic social debt with a majority of the poor black or mixed-race population poorly fed and poorly educated.

Today there is sufficient reasonable evidence to believe that the most powerful driver in the next phases of regional integration will be the definition and implementation of a firm program of infrastructure investment (intermodal transport, renewable and non-renewable energy, communications), with two objectives in sight: the first is to promote national integration alongside with regional integration; the second is to radically alter transport logistics to enable South American production to reach distant markets with increasing competitive advantages. Fortunately, IDB is a pioneer in this area through its support to the Initiative for the Integration of Regional Infrastructure in South America (IIRSA). Regrettably, IIRSA has not received the priority it warrants from its own member countries. The acronym itself is still unknown to the South American public. IIRSA ought to receive greater media exposure through seminars held in cities around South America, organized by IDB together with *Corporación Andina de Fomento* (CAF), *Banco de Desarrollo de Brasil* (BNDES), *Fondo Financiero para la Cuenca del Plata* (FONPLATA), and even other extraregional funding organizations.

- c) *There is frustration and disenchantment in various circles with the regional integration process. This is grounded in the considerable gap between expectations and achievements. What factors would you highlight to explain this distance? Are these views shared by broad sectors of government or are they merely concerns of very small elites that take an interest in this area?*

The balance of the results achieved by the countless agreements in force in the field of regional integration in Latin America and the Caribbean is based on a comparison of the final objectives expressed in such agreements and the degree of implementation to date. The results vary between the modest scope of the targets pursued and failure plain and simple.

In my opinion, historical and geographical circumstances have not favored integration. However, and despite their modesty in certain cases, the objectives already achieved suggest

that the region's civil societies ardently wish to achieve the regional integration targets and overcome the historical and geographical obstacles.

In conclusion, we believe that the new political and economic circumstances arising from the consolidation of democracy, the globalization of trade, the evolution of technology and communications, and the appreciation of natural resources of the soil and subsoil have to become a powerful stimulus for integration in the years to come.

- d) *The experiences of the European Union and Asia indicate that integration processes have brought about per capita income convergence among member states. Could this be a new driver for a region that has the unfortunate privilege of being one of the most inequitable regions in the world, both among countries and within them? What prerequisites and commitments would it involve?*

The closeness of the Latin American countries, from Mexico to Argentina, leads outside observers to look at this vast region as if the similarities between the countries were much more pronounced than the differences. Unfortunately, the reality is very different, as there are major asymmetries between the countries. To this are added the problems of major heterogeneities within countries. For example, Brazil's evolution does not encourage the integration of the various natural regions into which the country is divided. The North, after a brief natural rubber boom, has remained isolated and impoverished. The Northeast suffered an economic slump sugar cane production due to its semi-arid climate and became a vast stain of human destitution and hunger. The Southeast prospered with foreign sales of coffee and, more recently, of soya, meat, and sugar. The Center-West, before Brasília, was an isolated region that made a living from cattle farming and some mining. The agricultural South has declined, but has kept up a reasonable level of agriculture inspired by the European model.

Moreover, poor road and energy infrastructure across the various regions of Brazil led to the populations of the backward or most isolated regions of the North and Northeast viewing the real benefits of MERCOSUR with skepticism. The agreement is seen as a scheme of benefits operating between São Paulo and Buenos Aires. Businessmen and politicians often say that MERCOSUR is not enough and that their regions need a MERCONORTE. In other words, Brazil is not yet reasonably integrated within its own borders. It is no surprise then that it adapts to ambiguous stances on regional integration, which can be seen as a policy that deepens asymmetries between the country's Northeast and Southeast. We can assume that these perceptions, technically inadequate but politically strong, also occur elsewhere in the region.

- e) *Some feel that a new rationale for integration in Latin America and the Caribbean is to lean toward greater individual and collective competitiveness in the global economy. Through which mechanisms and in which areas do you feel this would be possible and most profitable? How do you assess the predisposition of the business and political elites in this sense?*

It is one thing to criticize the economic and social policies of most countries in the region, which, over the centuries, led them to build up intolerable inequalities; it is quite another to try to ignore the fact that the riches of the soil and subsoil, especially from 21st century, would become the main factor of their progress and development.

The acceleration of the globalization process, the denationalization of production chains, the growing and intensive use of sophisticated technologies in agricultural or industrial production, the added value in production chains through the incorporation of intangibles like intellectual property, trademarks, and patents, and marketing strategies are all factors that currently invalidate the "ECLAC" axiom that the international raw materials market tends to

suffer the negative effects of the slump in the terms of trade, as opposed to what happens in international trade in industrial products. In this context, we can identify another powerful driver of regional integration in the years to come.

For both MERCOSUR and CAN, the abundant availability of goods that are increasingly scarce in the developed world (land, sun, and water) will be a certain factor in social and economic prosperity, if those resources are properly exploited and supported through environmentally sustainable policies.

South America has the chance to play a leading role in the world in implementing food and energy security policies. The definition of a continent-wide production matrix combining non-predatory agriculture, rational water use, sustainable management of forest resources, renewable energy resources, including biofuels, is no pushover and cannot be undertaken by environmental organizations or national governments in isolation.

- f) *Others suggest that the new driver is political (practical, rather than ideological) and that it consists in founding integration processes on greater convergence of values, the deepening of democracy, the opening-up of opportunities for those in greatest need, and the progressive effective operation of citizenship. How do you feel this type of ideology can be reconciled with material progress for the very sectors that support, reinforce and make it credible?*

The region has, since the late 1800s, been endeavoring to create institutions that promote integration among its countries. The history of the successive failures -or extremely modest success, at best, in terms of the objectives- seems to suggest that it is not worth persisting with the integrationist effort. As a result, either one backs out of this ideal of integration or one seeks partnerships, especially trade partnerships, with countries outside the region as a means of compensating for the frustration of regional integration.

Today we can say that both the skeptics and the defenders of integration tend to use economist arguments on the one hand and politico-ideological ones on the other in order to substantiate their points of view: those opposed to integration argue that economic regionalism creates trade diversions that do not guarantee increased international competitiveness for products in the region; defenders of integration often see in regionalism a defense mechanism against the industrial or agricultural imperialism of the great world centers of economic power.

In both cases, one is working with half-truths or false perceptions. There is no doubt that more trade is better than less, and that free trade is better than regulated trade. On the other hand, the granting of regional preferences, the resultant changes in scale of production, and the modification of regulatory frameworks lead to regional production gaining in strength, reinforcing its competitiveness, and boosting participation in international trade.

## 2. The new integration profile

- a) *Notwithstanding the region's sound performance over the last six years, no significant changes in the countries' modalities of integration in the global economy have yet been seen. Which sectors or activities look more promising as platforms for integration in the global economy? What are the most significant current and potential differences between subregions?*

To examine the possibility of designing a new integration profile we need to separate North America, Central America and the Caribbean from South America. If we look at what happened in the last six years, we might come to the conclusion that some countries underwent more

significant change than others in their integration into the global economy. Mexico undoubtedly deepened its integration in the global economy through the free trade agreement with Canada and the United States (NAFTA). The Central American and Caribbean countries consolidated their integration mechanisms with an eye on the US market. The picture in South America is more varied. In the case of Brazil, foreign trade today accounts for over 20% of GDP, while 20 years ago this ratio did not reach 10%. Chile strengthened its ties with Asia and North America through a unilateral trade liberalization policy. Thus, to answer the question of which sectors and activities appear most promising as a platform for global economic insertion, it would be necessary to conduct disaggregated studies, almost country by country.

- b) *The capacity to produce food, generate energy, and have abundant water are, in practical terms, absolute advantages for Latin America and the Caribbean in global terms. How might the regional integration process contribute to focusing these resources, to inducing innovations in process, product, and administration, and appropriating the maximum possible benefit from their exploitation? How to avoid competition between countries and lean toward greater cooperation?*

Without a shadow of a doubt, the South American integration model will, over the next few decades, be strongly influenced by the excellent availability of water, land, sun, potential energy, and agriculture. The subregion has the chance to build a regional energy matrix and to produce food in an environmentally sustainable way, in other words, the increased use of renewable energy sources and agricultural production, without affecting tropical forests, in particular, the Amazon. IDB can play a leading role in technical assistance, in the field of productive investment and infrastructure for the construction of this regional platform.

### 3. The current international climate: opportunity or restriction?

- a) *The financial crisis is gradually spreading across the globe and a recessive process is setting in, which will last throughout 2009 at least. How will this impact the integration process in Latin America and the Caribbean? Will it be a question of every country for itself or will there be possibilities of joint efforts to meet the current climate head on? Might it be an opportunity to position the region differently and dynamically in its external relations?*

The financial crisis global may lead the South American countries to give in to the temptation of "every man for himself" or to adopt extreme protectionist policies. South American culture is still highly nationalistic and protected in its sovereignty. However, the current crisis provides an excellent opportunity to try and define a joint work program to confront the current climate and to, in turn, create new forms of regional cooperation that will enable countries to obtain greater benefit when the crisis reaches an end, and the global economy regains its dynamism.

- b) *Another of the dilemmas that will face the integration process in Latin America and the Caribbean is whether its scope will be restricted to the region or aimed at hemispheric integration. Do you think the tripolar structure being consolidated in the global economy will be enough incentive to make headway on the obstacles to hemispheric integration? Do you feel the change of administration in the United States and the reordering subsequent to the present crisis may provide a favorable opportunity for a regearing of the FTAA toward the drivers mentioned above, thus correcting the failure of the previous negotiations?*

The scope of the future integration process of Latin America and the Caribbean should not be restricted exclusively to the region. In today's globalized world, the integration process must recognize the region's position in the world as one of its essential components. But this must

be done while respecting the determining historical and geographical factors still impacting on each country, recognizing that subregional schemes (MERCOSUR, CAN, Central American Common Market - CACM, Caribbean Community - CARICOM, and NAFTA) remain valid and should be deepened, and concluding that investment in infrastructure and connectivity are the most rapid and effective means to make it possible for member countries to increasingly participate in the global economy.

- c) *The current crisis is leading to a rethink of the role of international organizations on various fronts. What do you feel the role of international organizations (and of IDB specifically) ought to be in the countries' processes of regional integration and global economic integration.*

The Bretton Woods institutions can no longer perform their functions as they originally thought because the world changed. In 1944, the United States and the United Kingdom accounted for the bulk of trade and international finance. Today, however, Brazil, Russia, India, China (BRIC) tend to take up a greater share of trade and international financial transactions.

The World Bank and the International Monetary Fund (IMF) need not only to review their procedures, but also to increase the financial resources in order for their assistance to have appreciable effects on countries' economies. So, for example, the total volume of loans currently being offered by the World Bank to its customers is less and less relevant.

In the case of Latin America and the Caribbean, IDB's role tends to be more important than in the past and is in no way in competition with the other multilateral credit organizations. IDB's role in the development of Latin American and Caribbean countries and the promotion of better insertion in the global economy is irreplaceable.









## INTERVIEW TO GUILLERMO FERNÁNDEZ DE SOTO\*

*Currently an Inter-American Development Bank (IDB) Consultant and Legal Advisor on trade and international issues. Former Minister of Foreign Relations of Colombia. He was also appointed Andean Community Secretary General (CAN) and President to Bogotá Trade Chamber and to the Iberoamerican Association of Trade Chambers. Former Colombian Ambassador to the Netherlands.*



### 1. Objectives and motivations of the integration process

- a) *There is no doubt that integration processes in the region have taught us several lessons, some positive, some negative. Which ones would you highlight as the main lessons learned in either sense?*

Among the positive aspects of regional integration are the favorable effects of trade in goods, especially those with higher industrial added value. There is evidence that the quality of this trade has had a significant impact on employment for small and medium enterprises in the member countries of each subregional economic bloc.

We should also remember the role played by integration (economic and trade aspects aside) in defense of democratic principles at times when it has been threatened by de facto regimes or periods of political instability that have put our countries' institutions to the test. The existence of a Democratic Clause in the Andean Community (CAN) was at the time decisive in confronting this type of situation in an integrationist framework.

Similarly, the existence of common institutional frameworks, albeit with differences in the depth of commitments, made possible the deepening of the process in economic and trade terms for a significant length of time, and in terms of political cooperation and relations with third parties, at least until countries' will to move forward together in a multilateral direction became sustainable.

\* Further to the submission of these notes, the IDB Board of Governors approved the resolution to review the need for an increase in the Bank's ordinary capital. This increase would provide resources for more projects in the integration area.

Despite these achievements and after five decades of breakthroughs and setbacks, regional integration processes in Latin America are facing several difficulties. First, the concentration of the process in recent years in an ambitious trade agenda that has not had sufficient “critical mass” (in terms of its volume as a percentage of world trade) and has not achieved the expected results. This has undermined the credibility of the subregional blocs and has expressed itself in the resurgence of bilateralism in relations with other countries in the region and more developed third parties to establish free trade agreements, more ambitious in some cases and with greater certainty in the game rules.

Secondly, the appearance of more serious complexities in political relations between the member countries of the subregional agreements, especially in South America, and the manifestation of different foci in development and international relations models, have put the concepts and practices of traditional regionalism to the test, and demand new approaches to regional integration based on a multidimensional agenda that has to go beyond trade dimensions.

Last, as a combination of the above reasons, integration is now facing less political will from countries to move forward on the preservation or deepening of institutional agreements. In some cases, because they find them incompatible with their development expectations and, in others, because they consider them rigid in the perspective of a more agile insertion in world trade and investment flows.

The lessons to be learnt from the achievements and frustrations of the regional integration process therefore point in three directions:

The new regional integration must make compatible the efforts to stimulate trade flows within the various blocs, which still display high growth potential, with the action aimed at building a common platform through integration to contribute to relevant and effective global insertion. In the framework of the proposed new concept of “interdependent regionalism” there can be no exclusionary insertion platforms for our countries.

It is also an integration that, consulting the new realities of the regional political scene and the challenges of globalization, has to build basic consensus over the role of collective agreements in promoting competitive development and social inclusion. The consideration of asymmetries between the countries and the consolidation of the region as a differentiated political and economic actor in globalization -in a context of respect for diversity and the construction of common minima around a new consensus over development in the region and the hemisphere- are basic to the legitimacy of the concept and practice of interdependent regionalism.

It is, in a word, an integration that must today be guided by criteria of flexibility in institutional agreements, which make convergence possible in a multidimensional agenda, with different speeds in practices and disciplines most difficult to reach consensus over, and binding commitments in areas where countries’ interests coincide. Interdependent regionalism must rely on realism and variable geometry in order to avoid unattainable goals in political, economic, and trade dimensions that could lead to the kind of dilemmas MERCOSUR and CAN have had to face in the past and in the present.

- b) *In your opinion, what new drivers of the integration process in Latin America and the Caribbean ought there to be over the next few years? How do they differ from the drivers that have traditionally shaped the processes of regional integration?*

The changes in recent decades in the field of integration and trade, as well as the new factors arising from globalization, have gained relevance and will have a decisive impact on the region's development and integration in the global economy. These momentous changes make it essential to define a strategic medium- and long-term vision in order to successfully move forward in integration processes, the strengthening of democracy, and the generation of dynamics of economic, social, and cultural inclusion. Similarly, the region faces a variety of challenges that make any future agenda complex and that go beyond the straightforwardly economic. The main axes that should steer new integration in the framework of a multidimensional agenda and under the principle of interdependent regionalism include:

- The common minima of a regional prosperity and security strategy on the basis of which it is possible to strengthen hemispheric dialogue through the decisive integration of the war against terrorism with an agenda to overcome poverty, exclusion, and inequality, and a new treatment for migration.
  - The remaining tasks of regional market access (which must be compatible with various hemispheric and global insertion platforms) in a framework of the convergence of existing agreements and the recognition of asymmetries between countries that includes cooperation with the less developed nations in the promotion of production standards and the assimilation of trade disciplines for market access.
  - Action necessary to facilitate trade, improve infrastructure, and optimize the logistics of exchange, as additional conditions of regional, hemispheric, and global market access.
  - The promotion of public-private partnerships to obtain more promising results in the development of innovation, the adaptation of infrastructure, and the strengthening of regional educational systems in order to prepare national production structures to deal with the opportunities and threats of global integration.
  - The construction of a joint production transformation agenda that emphasizes cooperation strategies around such issues as science, technology, and innovation, and that enables active involvement of small and medium enterprises in regional trade flows and investment.
  - The strengthening of collective action for the production of regional public goods such as, for example, in support areas to enhance the investment climate in the region's formal sector from the base of the pyramid, or to expand the cover and improve the quality of secondary education.
  - The consolidation of regional partnerships to oversee global coresponsibility regarding climate change, to defend Amazon biodiversity and water sources, to promote energy integration as the hard core of regional integration and as a privileged space for hemispheric dialogue on energy security; and to strengthen democratic governance and social inclusion.
- c) *There is frustration and disenchantment in various circles with the regional integration process. This is grounded in the considerable gap between expectations and achievements. What factors would you highlight to explain this distance? Are these views shared by broad sectors of government or are they merely concerns of very small elites that take an interest in this area?*

Regional integration is currently undergoing a deep crisis. Skepticism is being seen among the countries' political, economic, and social agents as a result of the gap between expectations and achievements. In the case of CAN, the weakening of the process originated in the slight progress in achieving balanced and harmonious development between member countries, which had been the objective set out in the 1st Article of the Agreement.

In the case of the private sector, it is common knowledge that, for reasons associated with privileged positions obtained in its own market, there were always reservations about integration. However, it should be noted that, today, large business groups are ready to forge ahead in integrationist plans on the basis of precise game rules and stable relations between countries. These rules must be the basis of transparent, sustainable decisions regarding transport infrastructures, the proper functioning of customs, and the removal of barriers at border crossings, and reduce their emphasis on tariff regulations, which have already shown sufficient progress.

Although the State's regulatory and facilitating role continues to be of great significance, we must not forget that the context in which integration emerged in the 1960s is very different from current scenario, with the private sector consolidated as a decisive actor. The importance of companies in economic and social worldwide development is apparent in the fact that, of the 100 largest economies in the world, 51 are corporations and just 49 are countries, and that the sales of the top 200 corporations are 18 times the total income of 24% of the world population (those living in extreme poverty). It is also important to mention that many developing countries receive more foreign private investment than external financial aid. This confirms the importance of being able to channel it in the interests of economic growth to improve the conditions of their inhabitants' lives. The approach of an interdependent regionalism seeks for a central role for the private sector in economic development, creative public sector partnerships, and the business agreements for sustainable development.

Perhaps the widespread perception that integration only responds to the interest of the political and business elites is based, on the one hand, on the preponderance economic and commercial agents have had in implementing it. Consequently, greater legitimacy for any integration process over a period when the presence of civil society in defining of the national agendas has been strengthened requires more expeditious mechanisms for the consultation and participation of the social agents. On the other hand, this disenchantment also originates in the common citizen's perception that integration has little or nothing to do with aspects of immediate interest to them in areas of highest impact, such as quality of life and human development, or more elementary areas, such as free movement in the region to promote cultural exchange, the mutual provision of services and the development of tourism, among others.

- d) *The experiences of the European Union and Asia indicate that integration processes have brought about per capita income convergence among member states. Could this be a new driver for a region that has the unfortunate privilege of being one of the most inequitable regions in the world, both among countries and within them? What prerequisites and commitments would it involve?*

This became one of the main difficulties I had to face as Secretary General of CAN. Effectively, after 35 years of Andean integration, we could see that major disparities between the member countries of the *Cartagena Agreement* persisted. So, for example, Ecuador and Bolivia together accounted for just 14% the member countries' GDP, while their *per capita* GDP, as measured in terms of purchasing power parity, remained well below the Andean average (50% in Bolivia's case and 69% in Ecuador's). For this reason, there were frequent claims by these two countries' delegations, which insisted, with a good degree of justification,

that the major asymmetries existing at the start of the process had not been compensated for with the traditional mechanisms of special and differential treatment, or with the effort of financial cooperation existing within the community.

European integration was achieved with enormous support for cohesion and convergence in the *per capita* GDP of countries and especially their internal regions. Our integration has been performed without anesthesia. We now have huge disparities between countries, but also there are only a few subnational regions that export and are connected to the outside world.

This puts the role of a treatment of asymmetries squarely on the table of the new integration. Accordingly, it is essential to find novel solidarity mechanisms to finance national and territorial cohesion and make integration to globalization based on greater equity and social inclusion more feasible.

In any event, this is matter is of great significance because the well-founded perception in some countries regarding the unequal distribution of the benefits of integration could become a major obstacle for convergence in any fresh integrationist effort. It is increasingly widely recognized that the criterion of increased participation in member countries' markets by the less developed countries through traditional actions of special and differential treatment in matters of tariffs and trade rules would be inadequate if it is not combined with solidarity strategies to contribute to the development of production capacity and to convergent growth. The above touches more directly on the issue of asymmetries and even the business of the multidimensional integration agenda, which have an essentially political dimension.

- e) *Some feel that a new rationale for integration in Latin America and the Caribbean is to lean toward greater individual and collective competitiveness in the global economy. Through which mechanisms and in which areas do you feel this would be possible and most profitable? How do you assess the predisposition of the business and political elites in this sense?*

I am convinced that free trade agreements constitute an opportunity to improve access conditions to new markets for the countries of Latin America and the Caribbean. However, it is becoming increasingly clear that the signing of free trade agreements does not in itself contribute to the economic growth or sustained development of nations.

Consequently, I feel that, through interdependent regionalism, there is a favorable space for the construction of an agenda to transform production that will help to generate competitive capabilities in the region's countries, especially in the sectors of small and medium urban and rural industries, in areas like export promotion, the incorporation of science, technology, and innovation, and in the creation of conditions conducive to private investment in key areas like infrastructure provision and ICT access. Education, which is the master key to competitiveness, has not substantially improved in recent decades. On these fronts, certain countries in the region have made progress in rich experiences that could be exchanged in an integrationist framework.

There is also a great will in political and business sectors to move in this direction. IDB should therefore continue to promote the exchange of best practices and, at the same time, support the collective construction of regional public goods in structuring areas of competitiveness and sustainable development.

- f) *Others suggest that the new driver is political (practical, rather than ideological) and that it consists in founding integration processes on greater convergence of values, the deepening of*

*democracy, the opening-up of opportunities for those in greatest need, and the progressive effective operation of citizenship. How do you feel this type of ideology can be reconciled with material progress for the very sectors that support, reinforce and make it credible?*

Under the present circumstances, it is vital we understand hemispheric integration as a political project that transcends the field of trade. We have made progress on several fronts. Today, it is more imperative than ever to start from a multidimensional approach to integration. To this end, countries must adopt a flexible structure to enable them to resolve dilemmas about the difficulties preventing us from meeting our own objectives and to extend that agenda to the new issues of interdependent regionalism. That said, we must not forget the importance of building common minima regarding the role of the State, the market economy, the private sector, and NGOs, as well as the authentic values that inspire democracy in our continent.

We cannot hide the fact that regional integration is at a crossroads, among other reasons, due to disagreements in the approaches to development, which have had an impact on the glaring differences visible today over the best alternatives for international insertion and in the different ideological approaches affecting our political and economic model. However, this diversity of approaches has not been an insurmountable obstacle to the continent becoming a highly differentiated economic and political actor in international relations, as emerges from its nations' concern to strengthen genuinely regional cooperation scenarios in order to solve their own problems and differences.

## 2. The new integration profile

- a) *Notwithstanding the region's sound performance over the last six years, no significant changes in the countries' modalities of integration in the global economy have yet been seen. Which sectors or activities look more promising as platforms for integration in the global economy? What are the most significant current and potential differences between subregions?*

Indeed, the most recent boom in the economy and world demand had a visible impact on the dynamism of exports and, thus, on the higher rates of growth of the 'region's economies. In fact, total exports from Latin America and the Caribbean between 2002 and 2007 grew at an annual average rate of 14%, higher than the expansion in world trade, but this was not enough to introduce substantive changes in their international integration patterns, or in the quality of their growth and productive employment. Furthermore, there was scant diversification in markets of destination, with the notable exception of Brazil and Chile, and a predominance of commodity exports to the United States and, more recently, China.

The task ahead of the region is the exploitation of opportunities offered by the global knowledge economy for emerging countries and regions as a result of the redefinition of products, services, and markets. This requires creating conditions through public policies and public-private partnerships to promote the training of qualified human resources and innovation in sectors of the new technoeconomic paradigms, such as ICTs, nanotechnology, and biotechnology.

In any case, I believe that, more important than offering recipes or recommendations for a list of sectors, which are ultimately the responsibility of national strategies, is to make this new stage of integration a common platform to build up the required road infrastructure and connectivity, the necessary technical and technological capabilities, and the institutions vital for accessing sources of productivity and competitiveness. It is precisely in this field that the



most noticeable differences between the subregions and countries of Latin America and the Caribbean for their successful insertion in the global economy are to be seen.

- b) *The capacity to produce food, generate energy, and have abundant water are, in practical terms, absolute advantages for Latin America and the Caribbean in global terms. How might the regional integration process contribute to focusing these resources, to inducing innovations in process, product, and administration, and appropriating the maximum possible benefit from their exploitation? How to avoid competition between countries and lean toward greater cooperation?*

This question leads me to a strategic reflection. CAN and MERCOSUR, together with Chile, Guyana, and Suriname, represent US\$2.3 billion of GDP (in current 2008 dollars) and a market of close to 400 million people. Also, South America has almost a third of the planet's biodiversity; a little less than a quarter of the world's freshwater, a wide variety of energy sources for the next 100 years, and is a traditional exporter of foods that, elsewhere in today's world, are subject to visible restrictions on supply. We are, therefore, one of the major platforms in the multipolar scenario of the 21st century. The challenge is to jointly make the most of the opportunities presented by the exploitation of this enormous potential. UNASUR's efforts in this direction are encouraging.

On the environmental front, the region's countries have been obliged to rethink isolated efforts to move forward with associative intervention and coordination schemes in international forums, giving priority to the environmental agenda in their development strategies. This is, without doubt, an area where integration has ample room for action to identify joint initiatives in order to stop the decline in biological diversity, protect freshwater sources and negotiate en bloc with interest groups and developed countries that have shown little commitment to improving the quality of the environment.

The status of megadiverse countries, which the Andean countries share with Brazil, must be seen as an opportunity to build solid partnerships that require global coresponsibility in the defense of their biodiversity and, particularly, their freshwater sources, an issue of the greatest relevance for sustainable development over the next 50 years.

Integration can and must play a strategic role too in the construction of a sustained development partnership based on the subregion's immense energy potential. This is a fundamental in our countries' rapprochement because of the risk of shortage in some of them and is a key element in negotiation with third countries, which clearly recognize South America as a global actor on this front. The achievements in the framework of the Union of South American Nations (UNASUR) should, notwithstanding breakthroughs and setbacks, be more far-reaching in order to enhance the reasons for and potential of the new integration.

Multilateral organizations and, in particular, IDB have a crucial role to play in strengthening cooperation between countries in order to highlight existing resources, both in terms of sustainable development and their relevant presence on the global stage.

### 3. The current international climate: opportunity or restriction?

- a) *The financial crisis is gradually spreading across the globe and a recessive process is setting in, which will last throughout 2009 at least. How will this impact the integration process in Latin America and the Caribbean? Will it be a question of every country for itself or will there be*



*possibilities of joint efforts to meet the current climate head on? Might it be an opportunity to position the region differently and dynamically in its external relations?*

The full-blown recession that the developed economies have entered, as well as the sharp slowing of the global economy, will contribute to the end of a boom in world demand. This will necessitate adjustment programs in all countries to face this contingency. The close links Latin American and Caribbean countries have today with the US economy, may result in lower growth in the region of around 4.5% for 2008 and 2.5% for 2009, according to preliminary estimates by the International Monetary Fund at the end of 2008. These estimates are constantly being adjusted downward because of the growing magnitude of a crisis whose full scope has still not been estimated.

The global uncertainty could become a source of pressure for protectionist practices and trade defense measures that would work against efforts to revive a process of economic integration in the region. However, I believe that the current global climate provides an opportunity to reevaluate the role of integration in the search for common minima regarding certain key aspects for the future of the region. These include countries' alternatives to jointly address the complex picture forecast for the world economy in 2009, as well as the scenarios of global geopolitics that have been outlined over the past two decades.

Integration plays a major role when it comes to meeting these challenges because the big problems of the future cannot be faced by each country individually. They are realities that perforate borders, that migrate and, consequently, require a common institutional platform within the flexibility required by interdependent regionalism.

- b) *Another of the dilemmas that will face the integration process in Latin America and the Caribbean is whether its scope will be restricted to the region or aimed at hemispheric integration. Do you think the tripolar structure being consolidated in the global economy will be enough incentive to make headway on the obstacles to hemispheric integration? Do you feel the change of administration in the United States and the reordering subsequent to the present crisis may provide a favorable opportunity for a regearing of the FTAA toward the drivers mentioned above, thus correcting the failure of the previous negotiations?*

There are no exclusive platforms. Latin America's global insertion does not occur on the basis of a tripolar structure but on the basis of a multipolar dynamic as a result of the emergence of new economic and geopolitical actors that are not exclusively regional blocs.

The 21st century world will be a scenario with no real center and one with no boundaries. This may seem naive, but that power will wane over time, become more relative, more spread across a complex network of partnerships, agreements, and potential conflicts. New powers will rise up. Some of them, like China, India, Russia, and Brazil, are already doing so. In so diverse a world, Latin America and the Caribbean has to play on many boards at a time. National interests and their resultant strategies will contribute to specifying the axes, as well as the scope of the partnerships in various different scenarios of regional, hemispheric, and global integration.

One of the most important boards on which the future of the region will be played out is its relationship with the United States. Indeed, the arrival of the new administration and the statements made by President Obama and his Secretary of State could signal a more hopeful path for hemispheric integration in a context of cooperation, and respect for diversity and interdependent autonomy. Hence the significance of the conclusion of the Americas Summit (April 2009), at which we are confident the foundations of a new partnership between the

United States, Canada, and Latin America and the Caribbean will be laid, founded on genuine democratic values and the principles of common prosperity.

- c) *The current crisis is leading to a rethink of the role of international organizations on various fronts. What do you feel the role of international organizations (and of IDB specifically) ought to be in the countries' processes of regional integration and global economic integration.*

IDB could use its authority and credibility to play a major role in the debate over a new development consensus in Latin America and the Caribbean. This has gone from being necessary to being urgent due to the wide variety of approaches existing today among the countries and the challenges posed by globalization trends.

This debate should facilitate the construction of common minima regarding the role of the State, the business sector, and public-private partnerships, as well as the tasks of the new integration, to make the productive transformation of the countries possible in a context of growth, equity, and social inclusion.

The particulars obtained from this debate, which should lead to the consolidation of IDB as the Development and Integration Bank on the continent, would reaffirm, and in some cases redirect, support programs emphasizing strategies of collective action for the construction of regional public goods or the strengthening of countries' integration scenarios to move forward with flexibility in areas such as:

- the achievement of common goals in terms of quality of life and human development, which are key elements for the legitimacy of the new integration;
- the construction of competitive capabilities to stimulate the individual and collective insertion of countries in the global economy, with an emphasis on the treatment of asymmetries in the less developed countries;
- and the creation of conditions conducive to the flow of trade and private investment, which require specific action by countries in areas such as regulatory frameworks, the modernization of infrastructure, transport, and customs procedures, and policies of free circulation of citizens.





## INTERVIEW TO FÉLIX PEÑA

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### 1. Objectives and motivations of the integration process

- a) *There is no doubt that integration processes in the region have taught us several lessons, some positive, some negative. Which ones would you highlight as the main lessons learned in either sense?*

Perhaps the main lesson of 50 years' experience in regional integration is precisely that, when one-dimensional and partial views have predominated at the level of action and public policy, (for example, placing the emphasis just on trade or politics) they have led to deadlock or decline and eventually the failure of an integration process. Sometimes such partial views have reflected those that have dominated at the academic level too.

Understanding the phenomenon of integration in Latin America and the Caribbean in all its profundity, particularly in its differing expressions, requires it to be placed in the historical perspective of the countries and region as a whole, as well as systematically combining the political, economic, social, and even cultural factors that explain the tendencies of countries that share a regional geographical space either for working together (including the hypothesis of a formal process of voluntary integration) or tending toward conflict- and, potentially, confrontation-dominated competition.<sup>1</sup> Any attempt to tackle the phenomenon from the perspective of just one of the factors that explain it can lead to a distortion of reality or to the failure to understand it in all its richness. At the level of strategies and public policy, this opens the door to loss of efficiency and, finally, to the decline and irrelevance of the integration process in question.

<sup>1</sup> The need for a historical perspective and multidisciplinary approaches to the phenomenon of the integration of a regional geographical space also prevails today when it comes to understanding the evolution of international economic relations and world trade. Ronald Findlay & Kevin H. O'Rourke, *Power and Plenty: Trade, War, and World Economy in the Second Millennium*, Princeton and Oxford: Princeton University Press, 2007).

Here are some other important lessons learnt. The construction of a space for regional integration is a task that is unending and non-linear. There will always be breakthroughs and setbacks. But the negative side of the regional experience is that this twisting and irregular trajectory has been translated, on various occasions, into losses of the assets accumulated, even with a tendency to begin again from scratch, with consequent erosion of the image of the very idea of integration.

- The mobilization of countries toward the development of integration processes is in response to fluctuating incentives. Its intensity determines the concern to promote or check an actual regional integration process. These can also be predominantly political or economic, but are in general combined, albeit with different emphases.
- Consensual integration between adjacent sovereign nations requires collective leadership in which at least a hard core of countries takes part with sufficient incentives to steer and drive the respective process. An approach based on the notion of a country acting as the anchor or axis for the integration of regional markets seems neither realistic nor feasible in a regional geographical space of growing diversity and multipolarity. But a picture similar to the one that, in Europe, led to a pattern of collective leadership institutionalized in the current European Union has not been observed in the region
- To be sustainable over time and raise the costs of its reversibility, an integration process has to come from a combination of top-down and bottom-up methodologies. Three typical products of an integration process combining both methodologies have generally been absent from the processes developed in the region. These are: formal and informal game rules that are effective, efficient, and possess social legitimacy; networks of interests and solidarities to do with economic and social events; and symbols that enable citizens to identify with the respective regional space. At least, this is one of the main lessons that can be drawn from 50 years' experience of European integration.

Regional integration can produce economic, social, and political benefits, provided that each country has a clear strategy that indicates why it is participating in a given process, how to exploit it in terms of its interests and what place on the broader stage of its insertion in the global scene. The lesson could be summarized as follows: the regional is built on the basis of the national, and integration will be as solid as the national interests of the countries taking part in it are well-defined.

The predominance of defensive interests in the business sectors and the inadequacy of offensive interests reflecting internationalization strategies in the region has translated into the emphasis on exceptions and sensitive issues. The selective and precarious liberalization of the respective markets has been a keynote of regional integration. At the trade level, at least, exception lists and the interests behind them go a long way to explaining the history of integration processes.

The quality of the game rules and consequently the processes that create them are key variables in an integration process being sustainable over time, as it contributes to the predictability required by those who eventually invest on the basis of the expanded markets. The lesson could be summarized as follows: to have the desired effect, an integration process has to be "rule-oriented" and this requires effective coordination mechanisms for national interests that take into account all kinds of asymmetries between the countries participating.

The integration dynamics and the working methods used must continually adapt to changes in the countries themselves, and in the regional and global environment. The lesson could be summarized as follows: there are no fixed formulas to develop an integration process and this

is reflected in the need to continually adapt objectives and working methods to internal and external realities without the resulting flexibility affecting overall reasonable predictability.

- b) *In your opinion, what new drivers of the integration process in Latin America and the Caribbean ought there to be over the next few years? How do they differ from the drivers that have traditionally shaped the processes of regional integration?*

First, ensuring reasonable conditions of governance of the regional or subregional geographical space; in other words, the predominance of factors that make for peace and political stability. Historical experience shows that this predominance is essential for the expansion of trade and economic integration between countries sharing a geographical space.

Second, facilitating the collective tackling of various political and economic challenges at regional and global levels. In other words, the challenges that cannot be addressed individually by each country. Security and access to sources of energy, water, food, technological innovation, are some of the main areas where forward-looking collective challenges can be discerned. They will condition the respective regional integration agendas with obvious differences according to subregion.

Third, boosting national capacity to develop systemic competitiveness strategies, securing social cohesion, and negotiating with third countries. This will remain a strong incentive for each country to seek to influence the organization of a favorable regional environment.

Finally, economic asymmetries between the region's countries render fundamental policies and instruments that contribute to less developed countries also having access to the potential benefits of integration. The European experience in the field of assisted transition with countries joining in recent years is also of value to the region, especially when linked to international cooperation with LAC.

- c) *There is frustration and disenchantment in various circles with the regional integration process. This is grounded in the considerable gap between expectations and achievements. What factors would you highlight to explain this distance? Are these views shared by broad sectors of government or are they merely concerns of very small elites that take an interest in this area?*

Accumulated experience indicates that, to avoid large gaps between expectations and the results of the integration process, it is a necessary condition to provide the public with extensive and reliable explanations about the costs and benefits for each country. This requires political leadership, but also technical reliability. The potentially negative reactions to an integration process come from perceptions of inequality in the distribution of benefits, be they economic, social or political. It is often difficult to distinguish what the result of the respective integration process in such perceptions is (for example, in terms of effects on employment and levels of social inequality) from what is a result of national policy.

Another condition is resisting the frequent temptation to overestimate the results that can be expected from an integration process due to a tendency to produce facts with a short-term media effects. Summit diplomacy has sometimes contributed to the kind of decision-making that does not filter through to the real world. There is a trend here to qualify certain results as historical which later turn out to be ephemeral.

Ensuring the participation of all social sectors in defining national integration strategies would be a third condition to avoid the above gap. More active participation in their respective national parliaments by civil society and their representatives, as provided by greater transparency in the decision-making processes, may contribute to an integration process's greater social

legitimacy. But, to achieve this, it is vital for the respective sectors also to have their interests and strategies clearly defined.

- d) *The experiences of the European Union and Asia indicate that integration processes have brought about per capita income convergence among member states. Could this be a new driver for a region that has the unfortunate privilege of being one of the most inequitable regions in the world, both among countries and within them? What prerequisites and commitments would it involve?*

Such convergence is largely the result of the respective national development strategies and policies. Integration should enhance such strategies, but cannot replace them. However, active policies are needed to enable smaller, less developed countries to share in the benefits supposedly resulting from integration and, in particular, expanded markets. Assisted transition mechanisms and policies can help to mitigate and eventually eliminate the effects of income gaps generated opened up by the liberalization of the respective markets, especially when economic asymmetries between the participating countries are pronounced.

- e) *Some feel that a new rationale for integration in Latin America and the Caribbean is to lean toward greater individual and collective competitiveness in the global economy. Through which mechanisms and in which areas do you feel this would be possible and most profitable? How do you assess the predisposition of the business and political elites in this sense?*

The experiences accumulated in the region itself seem to point to there being three necessary conditions to increase individual and collective competitiveness in the global economy.

First, any factors of precariousness in access conditions to the respective markets need to be eliminated and the insurance effect installed against protectionism in integration agreements. Currently, save in the case of natural resources, precariousness in the game rules generally favors the concentration of production investments in the economically larger countries, generates more inequalities in the distribution of benefits from integration, increases the risk of the growing social illegitimacy of the integrationist process in countries that feel they are losing more than they are gaining, and stimulates the search for alternatives to the respective integration scheme, causing a draining that has been seen in several cases in the region.

Second, with the support of international cooperation, active policies in favor of the less developed countries need to be developed, with the aforementioned scope of assisted transition.

Finally, the development of offensive strategies in the respective business sectors must be stimulated in order to intensify transnational production and distribution networks within the integration space and depending on its importance to global markets.

- f) *Others suggest that the new driver is political (practical, rather than ideological) and that it consists in founding integration processes on greater convergence of values, the deepening of democracy, the opening-up of opportunities for those in greatest need, and the progressive effective operation of citizenship. How do you feel this type of ideology can be reconciled with material progress for the very sectors that support, reinforce and make it credible?*

A realistic integration ideology can only come from the quality of the respective national strategies and a recognition of the multidimensional nature of the entire consensual process between sovereign nations. Divorcing the political from the economic and social can only lead to integration processes that are not sustainable over time and that therefore generate frustration and, ultimately, the social illegitimacy of the joint enterprise.



## 2. The new integration profile

- a) *Notwithstanding the region's sound performance over the last six years, no significant changes in the countries' modalities of integration in the global economy have yet been seen. Which sectors or activities look more promising as platforms for integration in the global economy? What are the most significant current and potential differences between subregions?*

In an international context of uncertainty and profound changes in the distribution of power among nations, it is difficult to forecast what activities and sectors are most promising. Such an exercise can only be performed via the respective national strategies and proper assessment of which collective challenges also require collective approaches. This makes the quality of the consultation mechanisms for national interests even more important, as well as the updated diagnosis of the changes taking place beyond each country's borders.

- b) *The capacity to produce food, generate energy, and have abundant water are, in practical terms, absolute advantages for Latin America and the Caribbean in global terms. How might the regional integration process contribute to focusing these resources, to inducing innovations in process, product, and administration, and appropriating the maximum possible benefit from their exploitation? How to avoid competition between countries and lean toward greater cooperation?*

Recognizing that competition between countries is natural and inevitable is a necessary condition for coordinating joint working mechanisms, for example in the field of energy or food. These will very likely have to be variable geometry working mechanisms in order to deal with the very different situations that are met in the real world, especially in the field of resource endowment. In the long term, cooperation between sovereign nations can only be based on the perception of mutual gains and on game rules that are both flexible and predictable.

## 3. The current international climate: opportunity or restriction?

- a) *The financial crisis is gradually spreading across the globe and a recessive process is setting in, which will last throughout 2009 at least. How will this impact the integration process in Latin America and the Caribbean? Will it be a question of every country for itself or will there be possibilities of joint efforts to meet the current climate head on? Might it be an opportunity to position the region differently and dynamically in its external relations?*

An accurate and permanently updated diagnosis of the effects of changes in the global context in each of the region's countries is a vital condition to aspire to joint approaches to any challenges that might arise. The other condition is the effectiveness of any consultation mechanisms for national interests used, as well as their adaptation to the diversity of situations. Shunning the temptation of one-off formulas is also vital, given the great diversity that characterizes the region as a whole, and even its subregions.

- b) *Another of the dilemmas that will face the integration process in Latin America and the Caribbean is whether its scope will be restricted to the region or aimed at hemispheric integration. Do you think the tripolar structure being consolidated in the global economy will be enough incentive to make headway on the obstacles to hemispheric integration? Do you feel the change of administration in the United States and the reordering subsequent to the present crisis may provide a favorable opportunity for a regearing of the FTAA toward the drivers mentioned above, thus correcting the failure of the previous negotiations?*

The global context tends to be multipolar or decentered, not tripolar.<sup>2</sup> The region's countries are accordingly faced with multiple options for their international insertion. Regional integration is one such option. However, it should not be conceived as the only one and, sometimes, not even the main one. The others arise at the hemispheric level and on different interregional axes. The possibilities of joint work at the hemispheric level are enormous. But these cannot be to the detriment of the variety of current and future external options for each country in the region. It seems vital to avoid the mistake of slotting any joint work, either at the hemispheric level or on the individual interregional axes, into rigid formulas as may be the case with the proposed Free Trade Area of the Americas (FTAA) or some of the proposals linked to the Latin American, Caribbean and European Union (LAC-EU) strategic partnership. In this respect, it is worth valuing non-preferential mechanisms in relations with third countries as a complement or potential substitute for preferential trade agreements. The existing work agenda is extremely broad in terms of cooperation with a non-preferential scope (in the sense of GATT-WTO rules), especially in the field of energy, climate change, food security, production chains, technological innovation, physical market connectivity, and trade facilitation.

- c) *The current crisis is leading to a rethink of the role of international organizations on various fronts. What do you feel the role of international organizations (and of IDB specifically) ought to be in the countries' processes of regional integration and global economic integration.*

IDB could contribute to the process of regional integration and global insertion of the region's countries in various ways. Perhaps the main contribution would be to maintain and strengthen the idea of an Integration Bank, with an emphasis on the development of an effective, flexible, multidimensional regionalism that is open to the world.

In its multiple financing and technical cooperation mechanisms, it could also privilege those projects that contribute to the development of: the physical connectivity of each country's markets with those of the region and the world; transnational production, distribution, and technological innovation networks; the institutional quality of integration mechanisms, in particular, the quality of public and private organizations that have a bearing on the preparation and application of national policies for economic insertion in the region and the world.

It should pay particular attention to the question of asymmetries in regional integration, and to support programs and mechanisms for smaller, less developed countries by working toward active participation in actions developed in the countries in the region that are better equipped to cooperate (for example, through trilateral cooperation mechanisms that facilitate access by these countries to the opportunities opened up, in turn, by regional and global markets).

It could also support the development of regional or subregional networks of social and academic institutions in order to encourage interdisciplinary debate and multi-stakeholders of best practices, which contribute in the region and in the world to an effective regionalism that will translate, at the economic level, into greater connectivity and interaction between countries and their social actors.

Last, it should encourage the spread of best practices based on effective integration methods, i.e. those that can produce sustainable effects of regionalization over time.

<sup>2</sup> On the characteristics of the current picture of the distribution of world power and its impact on the redefinition of the international order, see among other recent books, Fareed Zakarias, *The Post-American World*, New York-London: W.W. Norton and Company, 2008, and Jean-Claude Guillebaud, *Le Commencement d'un Monde. Vers une modernité métisse*, Paris: Éditions du Seuil, 2008.

## INTERVIEW TO CARLOS PÉREZ DEL CASTILLO

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### 1. Objectives and motivations of the integration process

- a) *There is no doubt that integration processes in the region have taught us several lessons, some positive, some negative. Which ones would you highlight as the main lessons learned in either sense?*

Among the positive lessons for the Southern Common Market (MERCOSUR), are the expansion of trade in the subregion, support for democratic institutions and political stability, and convergence in certain areas. The negatives include the fact that, among its members, there has never been a shared vision or strategy of the integration process's objectives; that there has been resistance from the larger countries to reducing their autonomy or discretionality in the handling of their national policies; that there have been huge gaps between declarations and agreements; and that the bloc was incapable of coordinating more efficient external insertion in international trade.

- b) *In your opinion, what new drivers of the integration process in Latin America and the Caribbean ought there to be over the next few years? How do they differ from the drivers that have traditionally shaped the processes of regional integration?*

The new drivers of the integration process will have to be preceded by a process of self evaluation among Members regarding the extreme weakness, paralysis, and deep crisis the integration processes currently find themselves in. It is absolutely necessary to find a new configuration of commitments and obligations based on national political realities, that take into account the flexibilities required by each member and make use of the lessons of the past.

Without ditching the goals initially agreed, which may be reactivated in due time, a realistic timeline in integration needs to be formulated to enable us to gradually move forward on the

basis of commitments with real chances of compliance to restore credibility to the process. These drivers include: returning to collective treatment of issues; promoting institutional strengthening; bringing in any obligations undertaken by members flexibly and at different speeds, and giving priority to renewed regional cooperation in strategic areas like energy infrastructure and food security.

- c) *There is frustration and disenchantment in various circles with the regional integration process. This is grounded in the considerable gap between expectations and achievements. What factors would you highlight to explain this distance? Are these views shared by broad sectors of government or are they merely concerns of very small elites that take an interest in this area?*

As mentioned earlier, one of the most serious problems is non-compliance. All sorts of provisions are agreed that are never complied with, nor even integrated into each country's legal system. This has been eroding the credibility of integration. Another important factor is that, for an integration process to succeed, leadership, altruism, and sacrifice is needed from the larger countries for their positions to take in the interests of the smaller ones. (The European Union would not be what it is without the leadership of France and Germany looking to the other members' needs). This never existed in MERCOSUR. What is good for Brazil is not necessarily good for the other members. Leadership is earned, not imposed while ignoring the interests and needs of the smallest. This view of the gap between expectations and achievements, and its main causes are shared by large swathes of the leadership both at the governmental and private sector, union, and academic levels.

- d) *The experiences of the European Union and Asia indicate that integration processes have brought about per capita income convergence among member states. Could this be a new driver for a region that has the unfortunate privilege of being one of the most inequitable regions in the world, both among countries and within them? What prerequisites and commitments would it involve?*

I can see no indicator or concrete signal (other than certain rhetoric) that income convergence is a driver of integration in the region. Development and income convergence among the various members of the integration process in the European Union came about through massive transfers of financial resources to the poorest regions or through the implementation of support measures and sectoral subsidies for all members, on an equal footing (like the Common Agricultural Policy). No regional integration process in Latin America and the Caribbean enjoys such financial wherewithal, or the community institutions needed to address the issue of income convergence.

- e) *Some feel that a new rationale for integration in Latin America and the Caribbean is to lean toward greater individual and collective competitiveness in the global economy. Through which mechanisms and in which areas do you feel this would be possible and most profitable? How do you assess the predisposition of the business and political elites in this sense?*

The achievement of greater competitiveness is a prerequisite for better integration of the region in the global economy. I believe the area of trade, investment and technology attraction, and joint negotiations with third countries are ideal opportunities to achieve greater rationality in regional integration processes with a view to an enhanced international competitiveness. However, at present, I see no predisposition among governments or business and political elites to move forward together in that direction. As an example in MERCOSUR, we need only cite Argentina's attitude regarding its current import substitution

policy, which erodes any possibility of joint negotiations by the bloc, on either the multilateral or the bilateral level.

- f) *Others suggest that the new driver is political (practical, rather than ideological) and that it consists in founding integration processes on greater convergence of values, the deepening of democracy, the opening-up of opportunities for those in greatest need, and the progressive effective operation of citizenship. How do you feel this type of ideology can be reconciled with material progress for the very sectors that support, reinforce and make it credible?*

The real question here is how to get fruits of integration to those most in need of them. How to make them feel they are part of this integration so that they can keep up the process. The answer is not easy. The European Union has, to at extent, as already mentioned, made breakthroughs in this field that are difficult to replicate in the region. Perhaps more of a priority on infrastructure works (roads, ports, all kinds of transport and energy) that make a serious impact on regional development and mobilization may be an indirect path to reinforcing this objective. I am not convinced by the concepts of social integration as advocated by the *Alternativa Bolivariana para los Pueblos de Nuestra América* (ALBA) as the new paradigm of regional integration. Without criticizing the reasons and potentially beneficial outcomes for citizens most in need, the actions foreseen are social projects financed basically by one of the Members (Venezuela), rather than true integration activities. They could be implemented bilaterally without the need for a regional integration framework.

## 2. The new integration profile

- a) *Notwithstanding the region's sound performance over the last six years, no significant changes in the countries' modalities of integration in the global economy have yet been seen. Which sectors or activities look more promising as platforms for integration in the global economy? What are the most significant current and potential differences between subregions?*

Logically enough, no significant changes are seen in the pattern of external insertion, as the region's countries continue to depend largely on exports of natural resources and energy. It is also highly likely that several of these products, especially those with greater added value, will continue to be important in the region's future export basket. However, many of these have been losing share in the world trade in goods and services. Yet certain mid and high technology services and products are behaving more dynamically as platforms for insertion in the global economy. Accordingly, a diversification of our exportable supply in that direction would be highly desirable.

- b) *The capacity to produce food, generate energy, and have abundant water are, in practical terms, absolute advantages for Latin America and the Caribbean in global terms. How might the regional integration process contribute to focusing these resources, to inducing innovations in process, product, and administration, and appropriating the maximum possible benefit from their exploitation? How to avoid competition between countries and lean toward greater cooperation?*

Food and energy have become subjects of great significance on the international agenda, both at the level of governments and of international organizations and the mass media. In turn, medium-term global forecasts regarding the availability of water all point to a great shortage at several critical points on our planet, a fact that gives this resource a strategic



dimension for the world economy. Latin America and the Caribbean has a privileged position in these three fields: it is a net exporter of food and energy and has the largest freshwater reserves at the global level.

The best we could do to highlight these resources and, at the same time, strengthen the process of regional integration is to jointly define both inward and outward regional policies regarding these issues. An important first step would be give priority to the regional food and energy supply, ensuring the interests of the net importers. To this end, a plan of action could be agreed that would contemplate aspects of supply and cooperation activities aimed at upgrading or constructing infrastructure to facilitate its instrumentation. Second, policies and actions should be defined regarding the production, distribution and transport of these products. A third step would be to actively participate as a region in all international cooperation forums dealing with food and energy security at a global level. Given the abundance of these resources, its production capacity, and its competitive advantages over other regions in the world, our region must necessarily be part of the solution to these problems. A fourth step would be the promotion of joint investment at regional level for a more rational and efficient exploitation of these resources, the convergence of production chains between countries in order to give products added value, and avoiding sterile competition.

Where our abundant water resources are concerned, it is imperative to analyze the situation together in order to define a strategy and a set of rules at regional level to ensure rational exploitation and use amid growing demands of a different nature (urban, rural, irrigation, and other). Actions of this type could contribute significantly to strengthening the regional integration process. For example, this could be the case with the Guaraní aquifer for MERCOSUR.

### 3. The current international climate: opportunity or restriction?

- a) *The financial crisis is gradually spreading across the globe and a recessive process is setting in, which will last throughout 2009 at least. How will this impact the integration process in Latin America and the Caribbean? Will it be a question of every country for itself or will there be possibilities of joint efforts to meet the current climate head on? Might it be an opportunity to position the region differently and dynamically in its external relations?*

I agree with the concept that the global recession should be an opportunity to work together in the regional integration process to tackle the situation and position ourselves better in our external relations. However, the reality we are seeing in MERCOSUR tends instead to be "every man for himself," with everybody applying their own measures or trying to prove to the international community they are different from the rest and should be regarded as such.

- b) *Another of the dilemmas that will face the integration process in Latin America and the Caribbean is whether its scope will be restricted to the region or aimed at hemispheric integration. Do you think the tripolar structure being consolidated in the global economy will be enough incentive to make headway on the obstacles to hemispheric integration? Do you feel the change of administration in the United States and the reordering subsequent to the present crisis may provide a favorable opportunity for a regearing of the FTAA toward the drivers mentioned above, thus correcting the failure of the previous negotiations?*

The failure of the Free Trade Area of the Americas (FTAA) led to the United States forging hemispheric integration its own way, through bilateral preferential agreements with countries or groups of countries in the region on the basis of an agenda that mainly considered its interests. MERCOSUR bears much of the responsibility for hemispheric integration not being carried out



in a more balanced way where the region's interests are concerned. History will be the judge. As a result, the United States currently has preferential agreements with all countries in the region, except MERCOSUR and Cuba. This looms not just over access conditions to the northern market, but also over investment attraction. I do not see the possibility of a reformulation of the FTAA at this stage. It is feasible, however, that, once Brazil and the United States agree over the content of a preferential trade agreement that provides mutual benefits, the agreement will be extended to other members of MERCOSUR through the negotiation of a 4+1.

- c) *The current crisis is leading to a rethink of the role of international organizations on various fronts. What do you feel the role of international organizations (and of IDB specifically) ought to be in the countries' processes of regional integration and global economic integration.*

If it is to go on contributing to the consolidation of integration processes in Latin America and the Caribbean, the IDB must recognize and adapt its action to the current realities of these processes. To ignore them and carry on acting on the basis of their potential virtues and benefits is not an adequate solution, to my mind.

The financing of plainly regional or subregional projects that take in the interests of all and distribute the benefits among them (infrastructure, waterways, transport, energy, R&D, technology transfer, and support for the establishment of regional institutions acting in the interests of all members, among other initiatives) is, to my mind, an ideal path that has a great deal to contribute to the consolidation and credibility of integration processes.





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9	9	2	+	1	0	β	1	6	1	3
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# TRADE AND REGIONAL INTEGRATION: SELECTED INDICATORS

*This section will regularly review data measuring trade and integration dimensions in the region. The purpose is to provide a brief regional overview every six months.*

## NEWLY RELEASED DATA

**Table 1**

### EXPORTS BY INTEGRATION GROUP, 2008 (Provisional Data, % change from 2007 to 2008)

Exporting Region	Destination								
	MERCOSUR	MERCOSUR + Chile + Bolivia	Andean Community	ALADI <sup>1</sup>	CACM	Latin America <sup>2</sup>	NAFTA	Hemisphere	Total World
MERCOSUR	29	26	26	22	3	21	7	19	25
Andean Community	40	46	16	27	23	25	27	25	23
ALADI <sup>1</sup>	31	30	26	24	17	23	9	13	17
CACM	34	64	31	24	14	17	6	11	9
Latin America <sup>2</sup>	31	30	26	24	16	22	9	13	17
NAFTA	36	37	31	19	15	19	6	9	10
Total Hemisphere	33	33	29	21	16	20	8	11	13

 Table 1

### EXPORTS BY INTEGRATION GROUP, 2008 (Provisional Data, US\$ millions)

Exporting Region	Destination								
	MERCOSUR	MERCOSUR + Chile + Bolivia	Andean Community	ALADI <sup>1</sup>	CACM	Latin America <sup>2</sup>	NAFTA	Hemisphere	Total World
MERCOSUR	41,683	53,514	10,188	74,791	1,619	77,516	41,676	118,523	278,914
Andean Community	5,559	10,300	7,000	25,995	1,548	28,910	32,321	61,846	94,115
ALADI <sup>1</sup>	59,205	78,407	29,588	133,528	8,505	146,771	380,131	524,993	827,473
CACM	79	222	211	1,585	6,391	9,137	11,739	20,210	25,927
Latin America <sup>2</sup>	59,287	78,637	29,818	135,149	15,008	156,073	392,331	545,836	854,544
NAFTA	50,810	65,696	27,727	265,674	23,159	302,384	1,011,938	1,169,646	2,045,709
Total Hemisphere	105,131	137,678	52,585	386,998	34,222	438,969	1,163,012	1,454,213	2,608,447

### STRUCTURE OF EXPORTS BY INTEGRATION GROUP, 2008 (Provisional Data, % Distribution)

Exporting Region	Destination								
	MERCOSUR	MERCOSUR + Chile + Bolivia	Andean Community	ALADI <sup>1</sup>	CACM	Latin America <sup>2</sup>	NAFTA	Hemisphere	Total World
MERCOSUR	15	19	4	27	1	28	15	42	100
Andean Community	6	11	7	28	2	31	34	66	100
ALADI <sup>1</sup>	7	9	4	16	1	18	46	63	100
CACM	0	1	1	6	25	35	45	78	100
Latin America <sup>2</sup>	7	9	3	16	2	18	46	64	100
NAFTA	2	3	1	13	1	15	49	57	100
Total Hemisphere	4	5	2	15	1	17	45	56	100

## Notes:

Estimates of Venezuela's exports use partner country import data

<sup>1</sup> Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela. Cuba is not included.<sup>2</sup> Includes Panama and the countries of ALADI and the CACM.

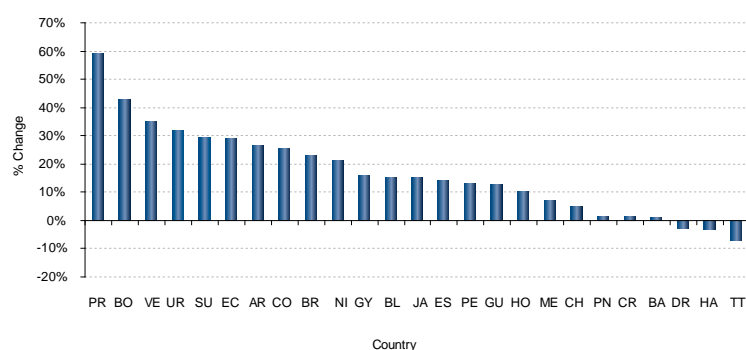
Source: IDB, Integration and Trade Sector, based on ALADI, SIECA, and official country data.



## REGIONAL TRENDS

**Figure 1**

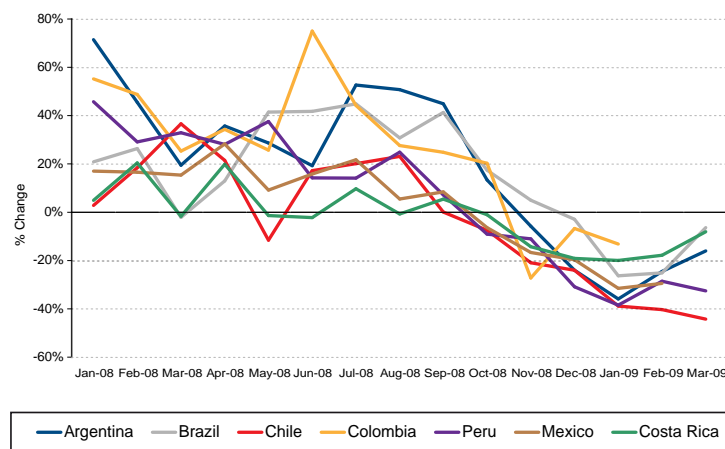
**ANNUAL EXPORT GROWTH WAS STRONGEST IN SOUTH AMERICA:  
CHANGE IN EXPORTS 2007-2008  
(Provisional data)**



Source: IDB, Integration and Trade Sector, based on ALADI, SIECA, and official country data.

**Figure 2**

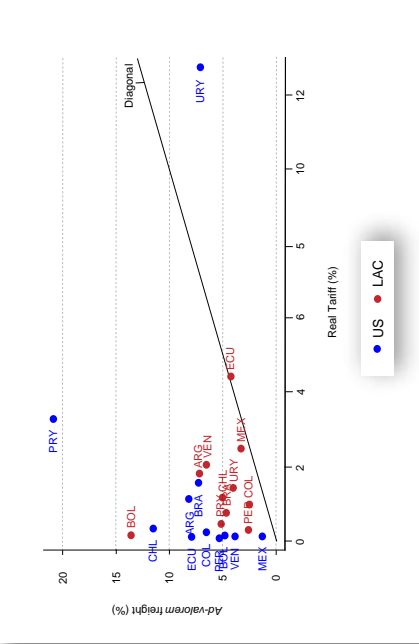
**EXPORT PERFORMANCE DETERIORATED SHARPLY STARTING IN 4TH QUARTER 2008  
CHANGE IN TOTAL EXPORTS FROM SAME MONTH IN PREVIOUS YEAR**



Source: IDB, Integration and Trade Sector, based on ALADI, SIECA, and official country data.

FEATURED PUBLICATION

AD-VALOREM FREIGHT AND REAL TARIFFS  
FOR INTRAREGIONAL EXPORTS  
AND EXPORTS TO THE U.S.  
SELECTED LAC COUNTRIES, 2005





## READERS' CONTRIBUTIONS AND PRESENCE IN THE NEW STAGE OF THE INTEGRATION & TRADE JOURNAL

**A**s we pointed out at the beginning of this new edition, *Integration & Trade* sets out to lay down communication mechanisms with its readers, who are also potential contributors. The Journal will progressively apply four editorial modalities.



The first, through calls for papers, is somewhat like the dynamics applied in the past, but will now be restricted to specific issues. These will then be the topics according to which respective issues are organized. To this effect, any announcements and invitations to submit articles will be issued at the relevant time. Any articles received will be assessed and those selected will be published.



The second modality aims to gather feedback from readers on issues and matters dealt with in previous issues of the Journal. It consists of a Comments Section comprising opinions on published articles, panels, or interviews.



Third, the Journal will promote more open modalities of interaction: on the one hand, a standing invitation to submit reviews of books and publications related to the disciplines and focus of the Journal and its readers.



On the other, and as the fourth modality, a section of readers' letters dealing with information or facts pertaining to the Journal's main issues.

In all cases, rules and guidelines on focus, length, and format will be provided for submitting works in all four of the above modalities. ◆



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