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IMPLICATIONS OF PROLIFERATING SUB-REGIONAL TRADE AGREEMENTS: Lessons from the Latin American Experience

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INTRODUCTION

Latin America has been one of the most proactive regions in the world in the recent proliferation of regional trade agreements (RTAs) among members of the WTO. Given its long experience with old type RTAs and the reactivation of regionalism under new principles in the 1990s, Latin America is a source of important evidence and lessons. This article provides an overview of the realities and reasons for proliferation of RTAs in Latin America and the Caribbean, and then proceeds to assess the evidence from the region as regards the following key analytical and policy issues raised by proliferation: Has trade diversion been a serious problem in the RTAs and Free Trade Agreements (FTAs) engaged by Latin American and Caribbean countries? Have RTAs been able to make more progress in liberalization than multilateral negotiations, or allowed member countries to integrate more deeply? Has proliferation in Latin America diverted attention away from multilateral negotiations? What problems have been created by overlaps between RTAs and how significant these problems have been? Have RTAs contributed to domestic policy reform and, if so, how? Finally, the paper draws some conclusions and lessons from Latin America and the Caribbean for proliferation in the Asia Pacific Region.

Proliferation and Diversity of RTAs in the Western Hemisphere[2]

As Table 1 shows, there has been a dramatic increase in the number of trade agreements negotiated by Latin American and Caribbean (LAC) countries in the last ten years with other countries in the Western Hemisphere as well as with countries outside the Hemisphere.

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[2] Throughout this paper the term Regional Trade Agreements (RTAs) is used to include bilateral, plurilateral and regional agreements, including customs unions (CUs) and free trade agreements (FTAs). Where necessary, the relevant distinctions are made in the text.

The Table classifies agreements into Customs Unions and Free Trade Agreements.[3] There are four Customs Unions in the Americas: the Central American Common Market (CACM) created in 1961, the Andean Community created in 1969, the Caribbean Community and Common Market (CARICOM) created in 1973 and the Common Market of the South (MERCOSUR) created in 1991. The former three, originally created under the old inward-looking strategy of industrialization, were significantly restructured and re-launched in the 1990s with a much lower Common External Tariff and new and deeper disciplines, while MERCOSUR was conceived under principles of "open regionalism" since its inception.

As regards FTAs, starting with Mexico's participation in NAFTA, created in 1994, there was an explosion in the negotiation of FTAs by LAC countries following more or less closely the NAFTA model. These so-called "new generation" agreements include, besides liberalization of trade in goods, new sectors such as services and agriculture, and new areas of discipline such as investment, competition policy, Intellectual Property Rights, and dispute settlement mechanisms. LAC countries have negotiated 12 FTAs among themselves since 1990 and are in the process of negotiating 7 more. One of the most notable developments in this new picture is the fact that since 1998 the 34 countries of the Western Hemisphere (with the exception of Cuba) have been formally negotiating the Free Trade Area of the Americas (FTAA).

Countries in the Western Hemisphere also have been negotiating new generation agreements also with other countries outside the hemisphere. Five of these agreements were completed in the last 3 years: Canada-Israel, Mexico-European Union, Mexico-Israel, USA-Jordan and Mexico-EFTA. And other six are under negotiation: Canada-EFTA, Chile-European Union, Chile-South Korea, Mercosur-EU, Mercosur-South Africa and Mexico-Singapore.

The new agreements in the Americas embody much more than trade barrier reduction at the border for goods. There is an important diversity in terms of the additional disciplines included as well as in institutional arrangements. The main distinction to be made is between Customs Unions, on the one hand and FTAs, on the other. As mentioned, customs unions have been progressively deepened during the 1990s by the inclusion of disciplines in services, investment, intellectual property and technical standards. Each custom union has specific characteristics and a history, which is beyond the scope of this paper to analyze.[4]

The Free Trade Agreements negotiated in the 1990s present important similarities, partly due to the fact that most of them have been modeled on the NAFTA in terms of their structure, scope and coverage. Table 2 presents an overview of the main chapters

[3] Note that the table does not include non-reciprocal trade agreements of which there are five in the Americas: the Caribbean Basin Initiative, the Andean Trade Preferences Act, CARIBCAN and the agreements between CARICOM and Venezuela and CARICOM and Colombia. It also does not include the "partial scope" agreements negotiated under the Latin American Integration Association (ALADI). For an analysis of the non-reciprocal agreements in the Western Hemisphere see Steinfatt (2001).

[4] For a history, characteristics and recent evolution of these agreements see Salazar-Xirinachs, Wetter, Steinfatt and Ivascanu (2001).

and disciplines in nine of these agreements. However, even among these agreements there are important differences. For instance, only some of them include significant disciplines in financial services, government procurement, competition policy and air transportation. While most included the telecommunication sector, this is not the case in Costa Rica-Mexico and Central America-Dominican Republic.

Table 1. ***Customs Unions and Free Trade Agreements in the Western Hemisphere***

Agreement	*Signed*	*Entered into force*
CUSTOMS UNIONS		
1. CACM (Central American Common Market)	1960	1961[c]
2. Andean Community	1969[a]	1969
3. CARICOM (Caribbean Community and Common Market)[b]	1973	1973
4. MERCOSUR (Common Market of the South)[d]	1991	1995
Free Trade Agreements		
1. NAFTA (North American Free Trade Agreement)[e]	1992	1994
2. Costa Rica-Mexico	1994	1995
3. Group of Three (Colombia, Mexico, Venezuela)	1994[f]	1995
4. Bolivia-Mexico	1994	1995
5. Canada-Chile	1996	1997
6. Mexico-Nicaragua	1997	1998
7. Central America-Dominican Republic	1998[g]	
8. Chile-Mexico	1998[h]	1999
9. CARICOM-Dominican Republic	1998[i]	
10 Central America-Chile	1999[j]	
11. Mexico-Northern Triangle (El Salvador, Guatemala, Honduras)	2000	2001
12. Costa Rica-Canada	2001	
13. Andean Community-MERCOSUR	In negotiation	
14. Central America - Panama	In negotiation	
15. Chile-United States	In negotiation	
16. Mexico-Ecuador	In negotiation	
17. Mexico-Panama	In negotiation	
18. Mexico-Peru	In negotiation	
19. Mexico-Trinidad and Tobago	In negotiation	
Agreements with Countries Outside the Hemisphere		
1. USA-Israel	….	1985
2. Canada-Israel	….	1997
3. Mexico-European Union	2000	2000
4. Mexico-Israel	2000	2000
5. USA-Jordan	2000	
6. Mexico-EFTA	2000[k]	
7. Canada-EFTA	In negotiation	
8. Chile-European Union	In negotiation	

9. Chile-South Korea	In negotiation
10. MERCOSUR-European Union	In negotiation
11. MERCOSUR-South Africa	In negotiation
12. Mexico-Singapore	In negotiation

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a. With the signing of the Trujillo Protocol in 1996 and the Sucre Protocol in 1997, the five Andean countries—Bolivia, Colombia, Ecuador, Peru, and Venezuela—restructured and revitalized their regional integration efforts under the name Andean Community.
b. The members of the Caribbean Community are: Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago, and Montserrat (an overseas territory of the United Kingdom). The Bahamas is an associate member but not a full member of the Common Market. Haiti will become the fifteenth member of CARICOM once its deposits its instruments of accession with the group's secretary general. The British Virgin Islands and the Turks and Caicos Islands count as associate members of CARICOM.
c. The agreement entered into force on this date for El Salvador, Guatemala, and Nicaragua; on April 27, 1962, for Honduras; and on September 23, 1963, for Costa Rica. With the signing of the Tegucigalpa Protocol in 1991 and the Guatemala Protocol in 1996, the countries of the Central American Common Market—El Salvador, Costa Rica, Guatemala, Honduras, and Nicaragua— restructured and revitalized their regional integration efforts.
d. The members are Argentina, Brazil, Paraguay, and Uruguay.
e. Before signing NAFTA, Canada and the United States had concluded the Canada-U.S. Free Trade Agreement, which entered into force on January 1, 1989.
f. Chapters III (national treatment and market access for goods), IV (automotive sector), V (Sec. A) (agricultural sector), VI (rules of origin), VIII (safeguards), IX (unfair practices in international trade), XVI (state enterprises), and XVIII (intellectual property) do not apply between Colombia and Venezuela. See Article 103 (1) of the agreement.
g. This agreement applies bilaterally between each Central American country and the Dominican Republic.
h. On September 22, 1991, Chile and Mexico had signed a free trade agreement within the framework of the Latin American Integration Association (ALADI).
i. A protocol to implement the agreement was signed on April 28, 2000.
j. This agreement applies bilaterally between each Central American country and Chile.
k. It will enter into force in July 2001.

FTAs in LAC have also been a fertile ground for experimentation both in traditional disciplines and in linking trade and non-trade objectives. For instance, the Canada-Chile agreement eliminates the use of anti-Dumping among the parties. Several agreements have moved beyond the GATT/WTO into such areas as environment and labor standards. NAFTA contains two side-agreements on labor and environmental cooperation that envisage the possibility of trade sanctions. The Canada-Chile FTA also includes side agreements in these areas, but eliminates the possibility of sanctions and instead introduces a system of monetary fines in case of violations. The recently concluded Canada-Costa Rica FTA also includes side agreements but does not include sanctions nor monetary fines, only transparency and a series of institutional instances for cooperative actions.

MERCOSUR incorporates a "democratic clause" that has at least once been used quite successfully to exercise pressure on Paraguay when the constitutional order was about

to be permanently broken in that country. There are ongoing discussions in the context of the Summit of the Americas process as to how to strengthen the democratic provisions in the Inter-American system, including possible cross-reference to the Free Trade Area of the Americas.

Table 2 Main Chapters in NAFTA-Type Agreements

	NAFTA	Costa Rica - Mexico	Mexico - Nicaragua	Mexico - Northern Triangle	Group of Three	Bolivia-Mexico	Canada-Chile	Chile-Mexico	Central America-Dominican Republic	Central America-Chile
Objectives,general definitions[a]	x	x	x	x	x	x	x	x	x	x
National treatment, market access for goods	x	x	x	x	x[b]	x	x	x	x	x
Rules of origin	x	x	x	x	x	x	x	x	x	x
Customs procedures	x	x	x	x	x	x	x	x	x	x
Energy[c]	x	...	...	...	...	...	...	...	...	...
Agriculture, sanitary, and phytosanitary measures	x	x	x[d]	x[d]	x	x	...	x[e]	x[e]	x[e]
Standards	x	x	x	x	x	x	...	x	x	x
Government procurement[f]	x	x	x	...	x	x	...	...	x	x
Investment	x	x	x	x	x	x	x	x	x	x[g]
Cross-border trade in services	x	x	x	x	x	x	x	x	x	x
Temporary entry for business persons	x	x	x	x	x	x	x	x	x	x
Financial services[h]	x	...	x	x	x	x	...	...	...	...
Air transportation	...	...	...	...	...	...	...	x	...	x
Telecom	x	...	x	x	x	x	x	x	...	x
Safeguards	x	x	x	x	x	x	x	x	x	x
Competition policy	x	...	...	...	x	...	x	...	x	x
Unfair trade practices/antidumping. And countervailing duty matters[1]	...	x	x	x	x	x	x[j]	...	x	x
Review and dispute settlement in antidumping and countervailing duty matters	x	...	...	...	...	...	...	...	...	...
Intellectual property	x	x	x	x	x	x	...	x	x	...
Publications, notification and administration of laws	...	x	x	x	x	x	x	x	x	x
Administration of the agreement[k]	x	x	x	x	x	x	...	x	x	x
Dispute settlement	x	x	x	x	x	x	x	x	x	x
Exceptions	x	x	x	x	x	x	x	x	x	x
Final provisions	x	x	x	x	x	x	x	x	x	x

a. Most agreements also include a preamble.
b. There is a chapter on automobiles in this agreement.

c. Energy is covered under market access in most free trade agreements.
d. Agriculture and sanitary and phytosanitary measures are in two separate chapters.
e. The chapter covers sanitary and phytosanitary measures. Agriculture is covered under market access.
f. Eighteen months after the entry into force of the Mexico-Northern Triangle free trade agreement, parties must start negotiating an agreement on government procurement. In the case of the Chile-Mexico, parties must do so one year after the entry into force.
g. The investment rules are those of the bilateral investment treaties signed by each Central American country with Chile. Article 10.02 states that Parties may at any time decide –but must within two years of the entry into force of the agreement analyze the possibility- to broaden the coverage of these rules.
h. Chile and Mexico agree to start negotiations on financial services no later than June 30, 1999.
i. Chile and Mexico agree to start negotiations on the elimination of antidumping one year after the entry into force of their free trade agreement.
j. Parties exempt each other from the application of antidumping duties when a tariff on a good reaches zero or on January 1, 2003, whichever comes first.
k. The issue of the administration of the agreement is addressed in the section on dispute settlement in NAFTA and in the Canada-Chile Free Trade Agreement.

Source: Robert, Maryse. 2001. "Free Trade Agreements," in *Toward Free Trade in the Americas*, edited by Jose M. Salazar-Xirinachs and Maryse Robert. Brookings Institution Press / General Secretariat of the Organization of American States.

Why Have RTAs Proliferated in Latin America?

Wilfred Ethier has correctly pointed out that there is a notable absence of research on the fundamental question of why the new regionalism has emerged.[5] As a practical matter a wide range of considerations enter when countries seek to negotiate RTAs. In LAC countries, as in countries around the world, objectives include: market access; investment attraction; strengthening domestic policy reform and positive signaling to investors; increased bargaining power vis-à-vis third countries (a particularly strong motivation in the case of MERCOSUR); political, security or strategic linkage objectives (an important motivation from the US perspective in the negotiation of the FTAA); and the actual or potential use of regional agreements for tactical purposes by countries seeking to achieve multilateral objectives.

[5] Ethier, 1998, p 1149. Important discussions of country objectives in pursuing RTA are Perroni and Whalley (1994) and Whalley (1996).

A brief historical perspective might contribute to understand the specificities, significance and nature of modern regionalism for Latin America. The idea of integration has deep roots in the region's political, economic and intellectual culture. Dreams and projects of economic and political integration have been a constant in Latin American history since colonial times. In fact, right at the birth of the new Latin American republics and their independence from Spain and Portugal in the early 1800s, the leader of the Andean Countries' independence, Simon Bolivar, had the most ambitious of these dreams: to create a Pan-American Union based on democracy and the rule of law. Even though Bolivar saw his dream collapse during his own lifetime by the assertion of local interests and nationalistic forces, ideas of political integration and common destiny continue to appeal to Latin Americans and to reappear intermittently in different contexts up to the present. A tradition of political thinking favorable to integration interacts in complex ways with the new regionalism in Latin America, however, today there are more basic economic and strategic rationales guiding the process.[6]

Perhaps the most fundamental reason for the new regionalism in Latin America is that it is consistent and helps to consolidate the market-oriented policy reforms and the countries' participation in the world economy. Again, it helps to place the policy reform process in historical perspective. During the 19th century Latin America developed strong economic links with Europe and the United States based mostly on the export of primary commodities in agriculture and mining. National systems of infrastructure were built to serve the needs of this export-import trade, which meant railways and roads from main cities to ports, and little physical integration between countries.

During the first half of the 20th century the medium sized Latin American countries began experiencing a significant degree of industrialization. But it was after the Second World War that Latin American governments adopted a more proactive developmental approach and set out to pursue policies of industrialization behind high tariffs and inspired by faith in the ability of government policies to secure growth and improve social conditions. Economic and physical integration was seen as an essential ingredient of this strategy in order to expand the limited size of the national markets, and this led to the creation of the Central American Common Market, the Caribbean Community and the Andean Community in the 1960s and early 70s.

The pursuit of industrialization and economic integration policies was provided a strong rationale by a number of young economists led by Raul Prebisch and linked to the Economic Commission for Latin America and the Caribbean (ECLAC).[7] During the three decades following its creation in 1948 ECLAC provided conceptual and institutional support to the growing consensus in Latin America about the importance of industrialization and economic integration. Latin America entered the post-World War II era with great optimism. Foreign Direct Investment in import substitution and

[6] An original analysis of the role of culture in shaping Latin American policies and institutions and its relationships with the United States is Harrison (1997).
[7] For a brief history of the role of ECLAC see Rosemary Thorp (1998).

basic industries was assigned, and in fact played, a major role as a source of growth for most Latin American economies during this period.

However, after the first oil shock of 1973 the development model followed by Latin America became increasingly unsustainable, as the growth dynamics came up against the limited size of the domestic markets, a growing percentage of capital accumulation was financed with foreign borrowing, the state enterprise sector grew disproportionately, and a maze of distortions and regulations stifled private initiatives.

The 1982 debt crisis and its impacts and the contrast with the policies and performance by East Asian economies, played an important role in reshaping policy views in Latin America. As the 1980s unfolded, country after country, often under pressure from International Financial Institutions, but also actively led by a new generation of local political leaders, adopted a new vision of economic policy based on market forces, international competition and a more limited role for the state in economic affairs. [8]

In the 1990s, the reform process intensified and generalized. In the trade front most countries not only deepened their unilateral liberalization measures, but also engaged in a three tiered trade strategy: those that were not already members joined the GATT-WTO and participated actively in the Uruguay Round (1986-94), they revitalized sub-regional agreements under new principles and also proactively engaged in bilateral Free Trade Agreements.

The shift by the US towards regionalism and the initiative by Mexico to join the US and Canada in the NAFTA posed a major challenge to Latin American countries. The rationale for old-type integration envisaged benefits of trade liberalization with countries in similar levels of development, but high costs for the relatively less developed partners when they joined with larger, more competitive economies. Mexico's move turned this view on its head. A new cost-benefit logic of linking up with the largest and most competitive markets in the world emerged. In fact, one of the defining characteristics of the new regionalism is that it typically involves small countries linking up with larger countries. (Ethier, 1998).

Despite the fact that unilateral liberalization and successive rounds of multilateral tariff-reduction have reduced global and regional tariffs substantially, the proliferation of RTAs in Latin America suggests that countries see significant advantages in them. What are these? The new logic for regionalism in Latin America is based on a number of interrelated factors.

First and foremost, it is related with the new global production paradigm where reduced transport and communications costs have made global coordination possible for multinational companies, and has opened new opportunities for comparative advantage by developing countries. As Wilfred Ethier (1998), Robert Lawrence (1997) and others have argued, the instrumental role of the new regional integration is

[8] For a history of Latin America's experience with adjustment and market-oriented reforms during 1982-93 see Sebastian Edwards (1995).

dramatically different from that of the old schemes. Agreement design and rules are more focused on being functional for attracting investment, rather than on the traditional export expansion motive; on reforming domestic regulations and rules with a view to facilitate the participation of the sub-region in the global organization of production and to facilitate region-wide sourcing. [9] From this perspective RTAs are means by which countries, particularly small countries, try to develop a competitive edge over others to attract FDI. One of Mexico's objectives not just in joining NAFTA but also in being the hub of a complex tissue of bilateral agreements can be understood in term of this "investment logic". A very similar path of negotiating numerous bilateral agreements has been followed by Chile and can be explained in the same terms.

In some respects, the motivations of smaller economies and of larger emerging markets tend to differ. Several smaller economies tend to give priority to signaling and to ensure continuing market access to develop their role as export and services platforms for larger markets. For instance, Costa Rica was a pioneer in Central America and the Caribbean in negotiating with Mexico (1995), then with Chile (2000) and recently with Canada (2001), as well as having a proactive role in the FTAA negotiations. At the same time the country has had an aggressive investment attraction strategy. These and other fundamental factors of the investment climate explain its recent success in attracting major world-class investments from high technology companies.[10] In large emerging markets, such as MERCOSUR, the interest of investors is not mainly production for export, but the benefits and competitive advantages of domestic presence to increase market share. Thus, for different reasons large regional blocs allow member countries to increase their magnets for international investment.

The investment-driven logic of the new regionalism also helps to understand why the recent vintage of RTAs contemplate new disciplines and deeper integration in aspects such as investment, services, product and production process standards, competition policy and other disciplines. Agreement design takes into account the need to facilitate the development of regional production systems and international outsourcing. This is one of the reasons why Latin American and Caribbean countries have been deepening arrangements such as the CACM, CARICOM, the Andean Community and MERCOSUR, and why new bilateral agreements include disciplines in all these areas.

[9] The point is important because it has also been argued that to the extent that the New Regionalism in Latin America and elsewhere is significantly about these deeper aspects of integration, the traditional analysis of costs and benefits of RTAs, which focus mainly on barriers at the border, while ignoring differences in national institutions and domestic regulations, is seriously deficient.

[10] Perroni and Whalley (1996) observe that several of the recently negotiated RTAs contain significantly fewer concessions by the large countries to smaller countries than vice versa. Yet, it is small countries that have sought them and see themselves as the main beneficiaries. The authors explain this apparent paradox by interpreting such agreements as insurance arrangements for smaller economies, which partially protects them against uncertainty in market access. Some of these agreements appear to produce little or no benefit relative to the status quo for smaller countries, but if they are evaluated relative to a post-retaliation tariff equilibrium, the value of these agreements to small economies is large because they help preserve existing access to larger foreign markets. This logic helps to explain why, even though they enjoy a quite satisfactory degree of access to the US market based on GSP and the Caribbean Basin Initiatives, the Central American countries are interested and eager to negotiate a reciprocal FTA with the United States.

But the new regionalism does not have exclusively an economic rationale, it also has a political and strategic one. How this applies depends on the precise grouping of countries. MERCOSUR for instance, is based on much more than a desire to liberalize trade. It is part of a vision to assert the role of Brazil and the other partners in the Western Hemisphere and as global players.[11] In Central America, some intellectuals and political leaders have tried to steer the process beyond economic integration and towards a more political project. Although this has not happened, the force of this tradition is one of the reasons why the region has a relatively heavy infrastructure of integration institutions including a Parliament and a Central American Court of Justice.

The efforts to create a Free Trade Area of the Americas have strong political, strategic and security dimensions. The FTAA was conceived from the beginning as part of a broader effort of rapprochement and interdependence in the context of the Summit of the Americas process. The new agenda of hemispheric cooperation promoted by this process includes areas that go from the protection of democracy and human rights to the fight against corruption and drug trafficking, and from hemispheric infrastructure to sustainable development and labor issues. The future FTAA members are also already parties to the set of principles, rules and legal and diplomatic instruments of the Inter-American System and the Organization of American States.[12]

In short, the proliferation of bilateral and RTAs in Latin America, and its diversity in terms of coverage and institutional arrangements, is linked to a complex interaction of economic, political and security objectives. First, it is grounded in the decisive shift in development and trade policy towards outward looking, market friendly policies, where integration into larger markets and Foreign Direct Investment are seen as the keys to higher growth. Second, in terms of sequencing, the typical pattern has been for countries to first engage in unilateral liberalization and in joining the GATT/WTO as part of the process of economic reform. Unilateral liberalization was then taken further in the direction of deeper integration with the neighboring countries. From this perspective, as Ethier (1998) has argued, national liberalization (both unilateral and that generated by the multilateral system) has promoted the revitalization of regionalism in Latin America, although bilateral agreements and RTAs have also induced additional liberalization.

Third, the fact that national competitive strategies are based to an important degree on the attraction of FDI provides a new logic to sub-regional integration efforts and to the role of trade agreements in the global repositioning of countries. In a number of smaller economies in LAC, a strong motivation to engage in bilateral and other RTAs, particularly with larger and relatively more developed countries, has been to develop a

[11] For a recent statement of MERCOSUR's trade objectives see Rubens Barbosa (2001) and for an American perspective on Brazil's trade policy see Henry Kissinger (2001).

[12] Presidential Summits of the Americas have been held in Miami in 1994; Santiago, Chile in April, 1998 and Quebec, Canada in April 2001. For analyses of the political, strategic and security objectives of countries in the Americas and of the Summit process see: Gaviria (2001), Weintraub (2000), Franco (2000), Feinberg (1997) and The Leadership Council for Inter-American Leadership (2001).

competitive edge in attracting investment. Finally, there are also important political and strategic rationales for the LAC countries engagement in RTAs that depend on the specific groupings and level of aggregation of countries.

Analytical and Policy Issues Raised by Proliferation

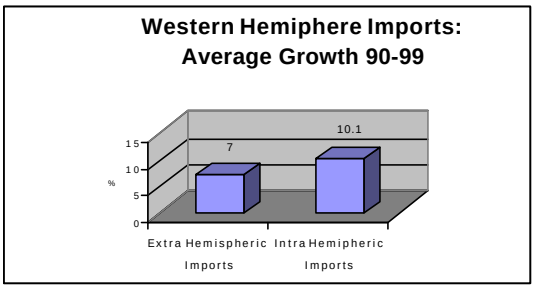
Proliferation of RTAs raise numerous analytical and policy issues. This section reviews some of the existing evidence from Latin America and the Caribbean (LAC) as regards the following key questions:

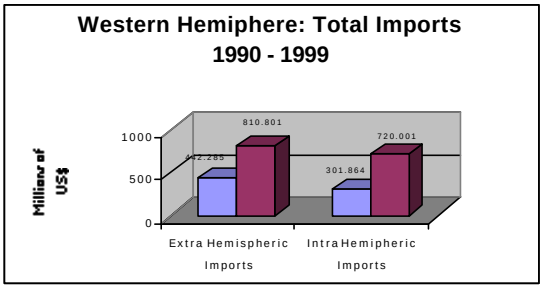
- Has trade diversion been a serious problem in the RTAs and FTAs engaged by Latin American and Caribbean countries?
- Have RTAs been able to make more progress in liberalization than multilateral negotiations, or allowed member countries to integrate more deeply?
- Has proliferation in Latin America diverted attention away from multilateral negotiations?
- What problems have been created by overlaps between RTAs and how significant these problems have been?
- Have RTAs contributed to domestic policy reform and, if so, how?
- Finally, how can proliferation be harnessed and oriented so that it maximizes its role as a building block for a more open trading system?

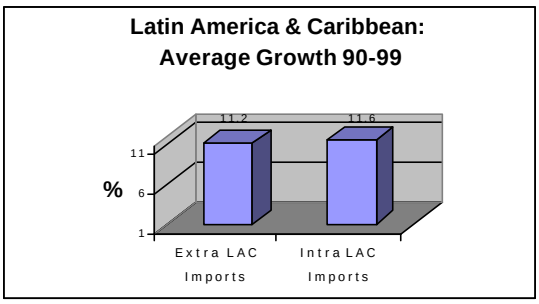
HAS TRADE DIVERSION BEEN A PROBLEM IN LATIN AMERICA?

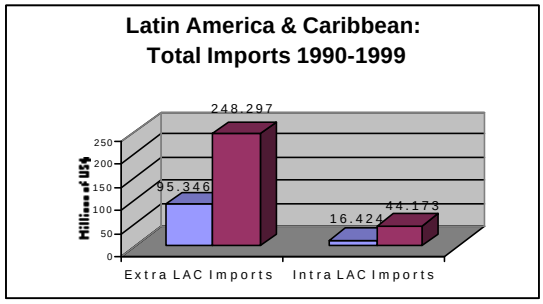
As regards trade-diversion or creation, let us look first at the rough orders of magnitude in the main RTAs in Latin America in the 1990s. Of course raw data is of limited value because it does not control for the impact on trade flows of other concurrent shocks and economic changes. But as a first approximation it is revealing of some important trends.

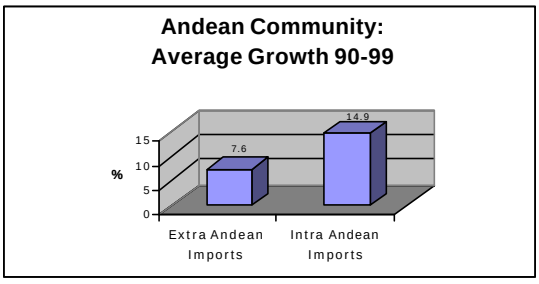
Figure 1. Rates of Growth Intra Regional and Extra Regional Imports: Western Hemisphere, Latin America and Sub Regions. 1990 – 1999

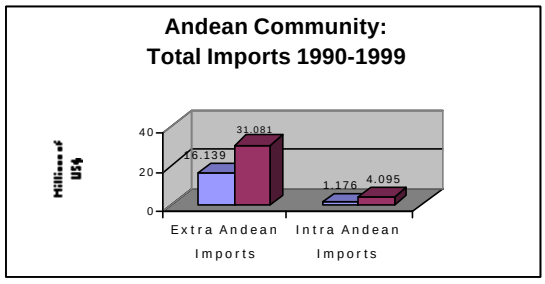


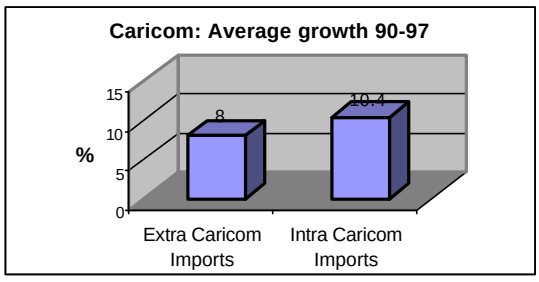


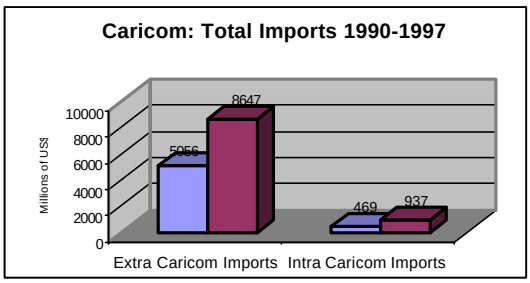


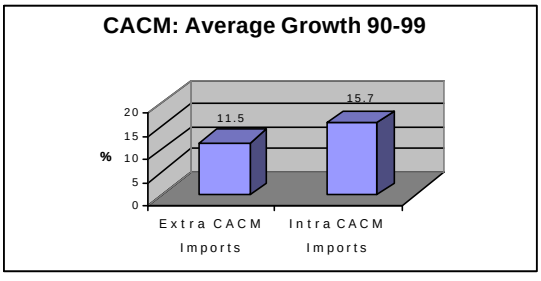


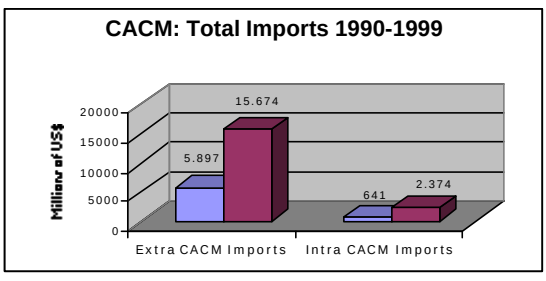












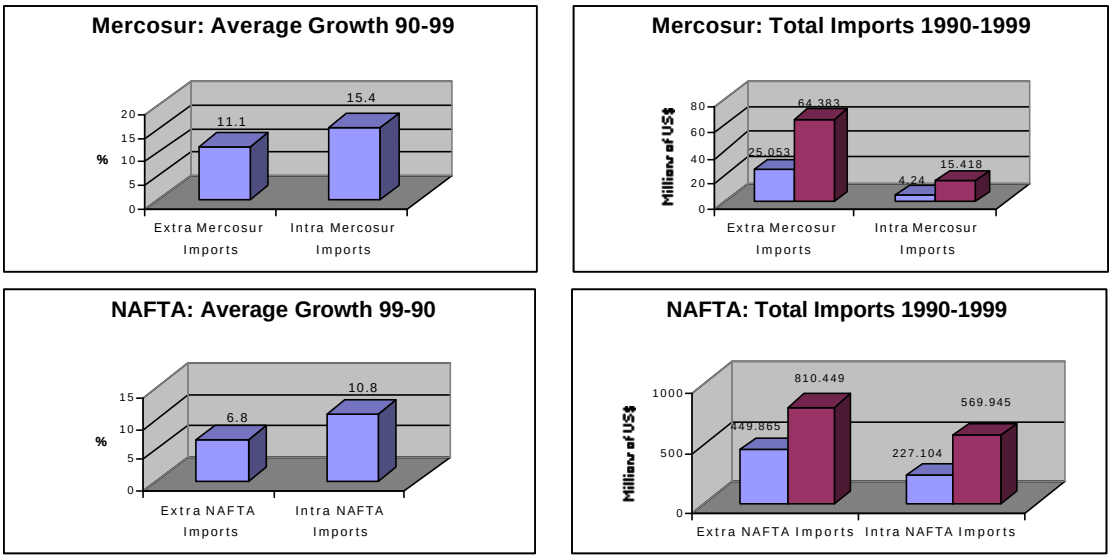


Figure 1 presents the absolute numbers and the rates of growth of intra-regional imports and extra-regional imports for the period 1990 to 1999, for the Western Hemisphere as a whole, for LAC as a group and for the four main RTAs: Andean Community, MERCOSUR, Central American Common Market and CARICOM. The typical behavior observed in this period is an impressive expansion in both trade within the group and also in imports from the rest of the world, suggesting that there is no evidence of trade diversion or that if any, trade diversion was overwhelmingly dominated by dynamic effects. Extra-regional imports in all cases increased by more than 7% annually in the Andean Community and CARICOM and by more than 11% annually in the case of the CACM and MERCOSUR during these ten years, and typically around much higher trade volumes than intra-regional flows. The following sections review the evidence emerging from studies in the different sub-regions.

Mercosur

In Mercosur, a study that attracted a great deal of attention was by Alexander Yeats in 1997. The study concluded that Mercosur had resulted in a significant amount of trade diversion and that much of the increase in trade between Mercosur countries was in the "wrong" products, that is, in capital-intensive products. However, these results were questioned by a number of other researchers. A paper by Nigel Nagarajan (1998) observes that in focusing on exports, Yeats's analysis failed to capture the importance of growing imports from third countries. Using the same Index of Regional Orientation, adapted to imports, Nagarajan finds that only in a few products there seems to be trade diversion, and that even for these products, there has been an impressive increase in imports from third countries. Given the upper-midddle income ranking of Mercosur countries, the notion that Mercosur countries should be exporting labour-intensive products, rather than the mix of capital-intensive products found in reality, is also questioned. Nagarajan also notes that over the period 1988 and 1996, EU

exports to Argentina and Brazil grew by annual average rates of 19 per cent and 17 per cent, respectively, suggesting that the formation of Mercosur does not seem to have seriously constrained EU exports to the region.

A more recent study by Estevadeordal, Goto and Saez (2000) also finds no evidence of trade diversion and argues that Mercosur is not just a traditional RTA but a case in New Regionalism, where preferential liberalization is accompanied by aggressive unilateral trade reform by its members, leading to trade expansion and improved welfare for both members and non-members.

Thus, there is no clear evidence of trade diversion in MERCOSUR, and even for the few products where trade diversion has occurred, the increasing multilateral openness of MERCOSUR coupled with the dynamic effects greatly outweigh any static welfare losses. It is fair to say, however, that it is not appropriate to pass definite judgement on MERCOSUR, or on other agreements in Latin America, as the newer agreements have data for only a few years and they are still evolving or in transition towards freer trade.

Andean Community

Fewer studies are available in the case of the Andean Community. Miguel Rodriguez (1999) applies some simple tests to both the Andean Community and MERCOSUR and concludes that far from suffering as a consequence of these two SRTAs, the outside world has continued to enjoy increased market access to both the MERCOSUR and the Andean Community. This study also analyses the issue of how the formation of the Andean Community and MERCOSUR affected the height of the preexisting tariffs against third countries. It shows that the average level of the CET of both MERCOSUR and the Andean Community in 1998 was lower than the average level of the tariff schedules of each member country in the year preceding the implementation of the agreements. Juan Jose Echevarria (1998) focuses on the Colombia-Venezuela trade flows, which concentrate 70 percent of intra-Andean trade, and finds that trade creation dominated over trade diversion.

NAFTA

A recent survey of studies on NAFTA by Mary Burfisher, Sherman Robinson and Karen Thierfelder (2001) shows that virtually all the studies on NAFTA show trade creation greatly exceeding trade diversion. In her 1999 study Anne Krueger (Trade Creation and Trade Diversion under NAFTA) examined data at the three-digit SITC level, and finds few sectors in which imports of any NAFTA country from the rest of the world fell while rising within NAFTA. She concludes that "changes in trade flows to date do not give much support to the view that NAFTA might be seriously trade diverting".

While this might be said on the aggregate, this is not to say that NAFTA did not have impacts in trade and investment flows with non-members in specific sectors. For instance, the potential growth of investment and exports in the textile and apparel sector in Central American and Caribbean countries was negatively affected by

NAFTA. As Table 3 shows, after a period of rapid growth in market share in the US, in the early 1990s, this market share stabilized or diminished in some cases for Central American and Caribbean countries, while Mexico's market share increased drastically. This situation was recently put on a "NAFTA parity" basis with Mexico with the approval and enactment of the Caribbean Basin Trade Partnership Act of 2000.

Table 3. Selected Countries: Market Share on Apparel Imports in the Unites States.

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Costa Rica	2.1	2.6	2.9	3.2	3.2	3.2	2.8	2.7	2.4	2.5
El Salvador	0.5	0.6	0.8	1.3	1.9	2.6	3.0	3.8	3.7	4.3
Honduras	0.7	1.2	1.7	2.0	2.5	3.6	5.5	6.4	6.2	6.7
Guatemala	1.1	1.6	1.8	2.1	1.9	2.0	2.1	2.1	2.2	2.2
Nicaragua	0.0	0.0	0.0	0.0	0.1	0.2	0.4	0.4	0.4	0.5
República Dominicana	4.2	5.1	5.9	6.5	6.5	6.8	6.8	7.0	6.5	6.1
México	2.9	3.5	3.8	4.3	5.7	8.4	11.4	13.7	15.4	16.4

Source: Gitli and Arce (2000), based on data from the US Department of Commerce.

Box. Intra-regional and extra-regional trade flows in the 1990s

Intra-Mercosur imports increased fourfold from 4 billion in 1990 to 15.5 billion in 1999, an annual rate of growth of 15%. Imports from the rest of the world into Mercosur were multiplied by a factor of 2.5 from 25 billion in 1990 to 64 billion in 1999, an annual rate of growth of 11.1%.

Intra-Andean imports grew at a rate of 15% per annum between 1990 and 1999, in absolute terms a fourfold increase from 1.1 billion to 4.1 billion. But imports from the rest of the world into the Andean Community grew at a significant annual rate of 7.6%, and doubled in ten years from 16 billion to 31 billion.

Intra-regional imports in the CACM grew from 650 million dollars to 2.5 billion at the end of the decade, an annual growth of 16%, while imports from the rest of the world grew at an annual rate of 11.5% almost tripling from 5.8 billion to almost 16 billion.

Caricom's intra-regional imports grew from 469 million to 937 million, an annual rate of growth of 10.4%, while imports from the rest of the world grew at an annual rate of 8%.

Intra-NAFTA imports grew at an annual rate of 10.8% from 227 billion in 1990 to 569 billion in 1999, while imports from the rest of the world almost doubled from 450 billion to 810 billion, an annual rate of growth of 7%.

For the total Western Hemisphere the pattern of intra regional versus extra regional trade flows is similar. Intra-hemispheric imports grew at 10.1% (from 300 billion to 720 billion) while imports from the rest of the world into the Western Hemisphere grew at 7%, almost doubling from 442 billion to 810 billion.

For Latin America and the Caribbean as a group, both intra-LAC imports and imports from outside of LAC grew at a very similar rate of 11%, however, trade volumes for extra-regional trade were much higher. While intra-LAC imports were multiplied by a factor of three from 16 billion to 44 billion, imports from outside of LAC were multiplied by a factor of 2.5 and grew from 95 billion to 246 billion.

Source: Inter-American Development Bank, Integration and Trade in the Americas, Periodic Note, December 2000.

Have the RTAs Liberalized Faster or Deeper?

Does the evidence from LAC support the argument that regional agreements have a capacity to liberalize beyond what can be accomplished multilaterally and to achieve "deep" integration?

As regards trade in goods, one of the characteristics of most of the new RTAs in LAC is that, following in many respects the NAFTA model, they contain tariff phase-out programs based on preprogrammed schedules at the outset, which are relatively quick, automatic and nearly universal. This contrasts quite sharply with the laborious step-by-step development of positive lists that characterized most of the old style trade agreements in the region. In most agreements, the base rate for the liberalization program coincide with the MFN applied rates. (Devlin and Estevadeordal, 2000). It is estimated that more than 80 percent of all trade conducted in the hemisphere is now conducted under the framework of one liberalizing agreement or another. (Mackay, Robert and Plank-Brumback, 2001). Two recent studies show that most programs among LAC countries will eliminate tariffs for almost all products by 2006 and that most of the bilateral trade in these agreements becomes fully liberalized, in terms of tariffs, in a ten year period (Devlin and Estevadeordal 2000; Rodriguez Gigena 2000).

These studies also show that the list of exceptions has been significantly reduced and at present represents between 5% and 10% of bilateral trade. In the case of Mercosur, the main exceptions to the liberalization schedule are autos and sugar that are covered under special regimes. In Central America, the list of exceptions has been reduced to three products (roasted coffee, alcoholic beverages and petroleum products). In the Andean Community, trade has been totally liberalized among Bolivia, Colombia, Ecuador and Venezuela, and since 1997 Peru joined the FTA under a tariff reduction schedule that would lead to free trade in goods by 2005.

Thus the RTAs in LAC have indeed shown a capacity to liberalize faster than at the multilateral level and to include nearly universal coverage of trade liberalization in industrial goods. However, there are some areas of weakness in the market access picture under the new RTAs: first, they have also introduced selective procedures and discretionary application of rules of origin, an issue taken up in section D below. Second, nearly all the agreements fail to adequately cover the agricultural sector. Exceptions for agriculture reflect the particular sensitivities of each participating country.

"Deep integration" and positive rule making behind the border is a central defining feature of the New Regionalism in LAC. Deep integration involves aspects such as investment, services, product and production process standards, and mutual recognition issues. There is very scarce empirical research in Latin America on these questions. A recent paper by Sherry Stephenson examines what has been done by members of regional trading arrangements in the Western Hemisphere to promote stronger disciplines for domestic regulation and recognition agreements in the area of trade in services. The paper compares the disciplines on domestic regulation contained

in four sub-regional agreements in the Western Hemisphere –NAFTA, the Andean Community, MERCOSUR and CARICOM- to those contained in GATS Article VI on domestic regulation, and a similar comparison is done in the area of recognition of qualifications for foreign service providers with GATS Article VII.

The hypothesis addressed by the paper is that because members have similar preferences and face fewer costs when designing more detailed common rules on services trade than in the multilateral context, then one might expect to find more detailed disciplines on non-discriminatory regulatory measures affecting trade at the sub-regional than at the multilateral level. With respect to domestic regulation, the analysis provides mixed results, in the sense that while some RTAs adopt principles that have a higher degree of generality than those of the GATS, other RTAs, most notably NAFTA and MERCOSUR, apply more stringent disciplines than GATS. With respect to recognition the analysis shows that the sub-regional integration schemes examined do go beyond GATS in encouraging or requiring the formation of recognition agreements.

These conclusions, however, relate to the nature of the disciplines contained in the agreements, not to the actual progress in changing national legislation or enforcement. It can also be argued that it is too early to assess the impact of services disciplines in the RTAs in Latin American because the new commitments and disciplines in these areas entered into force only very recently.

As explained in section I, FTAs in LAC have also been a fertile ground for experimentation both in traditional disciplines and in linking trade and non-trade objectives. For instance, the Canada-Chile agreement substitutes safeguards for antidumping. In doing so, the agreement seeks to reduce the onerous economic costs associated with the use of antidumping as a policy instrument to address the market disruptions resulting from sudden import surges. Such costs result not only from the decline in imports that follows the imposition of antidumping duties (Messerlin 1989, Prusa 1999), but also from the threat that antidumping investigations pose to exporters (Finger 1993). Safeguards are generally considered to be a less costly import relief mechanism than antidumping duties, because they "force" governments to address the domestic factors that may be hindering the competitiveness of the industry affected by increased quantities of imported goods, rather than simply assigning the blame for an industry's hardships to the exporters from another country (Tavares, Macario, and Steinfatt 2001). Institutional experiments such as these might, over time, percolate through to multilateral trade negotiations, shifting the focus of the WTO agenda towards more cost-efficient mechanisms.

Trade negotiations in the Americas support the view that RTAs play a role in expanding the liberal trade order by allowing a smaller group of countries to reach agreement on a larger number of issues. The FTAA negotiations include three areas that are not fully integrated in multilateral negotiations: investment, competition policy and government procurement. Treatment of these issues in the FTAA might provide important lessons as to how these issues might play out in a new WTO Round.

Even more significant is the fact that as an objective for the FTAA negotiations countries agreed to eliminate agricultural export subsidies affecting trade in the hemisphere. And in the Toronto Ministerial Meeting held in November 1999, one month before the Seattle Ministerial, they further agreed to work toward reaching agreement in the WTO on eliminating agricultural exports subsidies.

Has Attention Been Diverted Away From Multilateral Negotiations?

Is there evidence in LAC countries for the argument that their proactive pursuit of regionalism in the 1990s has been to the detriment of their commitment or attention to multilateral negotiations? There seems to be no evidence of this, in fact the opposite seems to be the case. One piece of evidence is related to the increased participation of LAC countries in the GATS after the Uruguay Round. Twenty LAC countries participated and made specific commitments in the Agreement on Basic Telecommunications, and all of these but Brazil also committed to adopt in whole or in part the Reference Paper on Pro-Competitive Regulatory Principles.

Similarly, seventeen LAC countries submitted improved schedules in the Financial Services Agreement that entered into force in January 1999, although there is considerable regulatory caution by countries in the hemisphere indicated by the fact that most commitments in the financial sector refer to mode 3, commercial presence. LAC countries also made numerous submissions on services and other issues during the months preceding the Seattle WTO Ministerial Meeting, and they have continued to be quite engaged in the year 2000. Most important, no LAC country is on the record before Seattle or at present as being opposed to a new multilateral round.

Renewed doubts about a potential "distraction effect" have been raised in relation to the negotiations to create a Free Trade Area of the Americas (FTAA). However, it can be argued that rather than a diversion of attention and energy from the new round, regional negotiations by LAC countries, particularly the FTAA negotiations, have generated important positive externalities and learning effects that benefit engagement in the multilateral system. As a practical matter, concurrent WTO and FTAA negotiations can easily stretch the resources of even the largest countries. It is not difficult in a Small Economy to reach the level of "negotiation fatigue" or "overload." However, there is a positive angle to concurrent FTAA and WTO negotiations.

First, as an established practice, many bilateral and sub-regional meetings are organized on the margins of the FTAA meetings not only for consultations on the subject matter of the meeting itself, but for other bilateral consultations and negotiations. Consultations on a WTO Round could also be organized on the margins of FTAA meetings. For small economies this might be a cost-effective system of gathering information, pooling resources and developing their own positions.

Second, there is substantial overlap of issues between the WTO and the FTAA talks and this defines a complex interaction in substantive issues. But this also means that the FTAA exercise has already contributed with a lot of preparatory work, including

very complete and comprehensive hemispheric data bases, inventories of national legislation, as well as progress in understanding and negotiating substantive issues. Therefore, concurrent negotiations might not require too much additional preparatory work.

Third, the FTAA has also generated a significant amount of additional trade-related technical assistance from a variety of sources. Several international and hemispheric organizations have increased their trade related technical assistance activities, and the same is true of bilateral aid agencies. But perhaps the most important element is that, as Sydney Weintraub found out from a series of interviews: "participation in the FTAA negotiation process itself has been the most valuable teacher" (Weintraub, 1999, p 5). For a number of countries this is the first opportunity they have had to participate in the negotiation of a modern, state of the art, free trade agreement. Then, both because of its "learning-by-negotiating-effects", and because of the increased technical assistance it has generated, the FTAA has already strengthened and will continue to strengthen the readiness of countries in this Hemisphere to negotiate in the new Round.

Finally, an additional positive externality of the FTAA into the WTO is the fact that it has contributed to focus attention and to generate additional pressure towards timely implementation of WTO commitments. For many countries in the Hemisphere, the Uruguay Round commitments constitute the first set of demanding external trade obligations in their history. And it is now well understood that in many areas implementation is about creating infrastructure and institutional capacities. As a result of the FTAA experience and the associated technical assistance efforts, many countries will be better placed to implement their existing obligations. Participation in the FTAA could also increase the sense of ownership of the rules that is important for effective implementation.

Overlapping Agreements and Spaghetti Bowls

What problems have been created by overlaps between RTAs and SRTAs? How significant have these problems been? To what extent has there been a spaghetti bowl problem in Latin America? This section focuses on two areas: rules of origin and dispute resolution.

RULES OF ORIGIN

Preferential rules of origin are the *sine qua non* of SRTAs that do not involve the harmonization of tariffs among their members. Rules of origin ensure that third countries do not unduly benefit from the preferential treatment that members of a SRTA grant to one another. In the absence of rules of origin, third countries could act as free-riders by simply deflecting trade, that is, by exporting a particular product to the member of the SRTA with the lowest tariff and subsequently selling the product throughout the SRTA without facing the trade restrictions that would otherwise apply

to third countries trying to access these markets. Accordingly, the larger the tariff differential between members of a SRTA, the greater the incentives that third countries have to deflect trade, and therefore, the higher the degree of restrictiveness of the SRTA's rules of origin. In contrast, whenever the tariff differential between members of a SRTA is small, rules of origin will tend to be less stringent or even non-existent.

Besides being tools to avoid free-riding, rules of origin are also potent instruments to protect domestic producers from import competition and to attract foreign direct investment. Krishna and Krueger (1995) have shown how the existence of rules of origin could afford protection to suppliers of intermediate goods located within a SRTA, as producers faced with restrictive rules of origin and the prospect of benefiting from preferential tariffs turn away from low-cost, foreign suppliers of intermediate inputs and toward high-cost suppliers located within the SRTA. At the same time, a restrictive origin scheme might provide foreign suppliers of intermediate goods with an incentive to relocate their production facilities to the lower-cost country participating in a SRTA, even though the new location might result in higher production costs.

Protection afforded to domestic producers by rules of origin will usually come at a high cost, however. For one, the operation and administration of origin schemes requires significant resources, especially in light of the growing internationalization of production, which is making it increasingly difficult for customs authorities to determine the "nationality" of a good. Likewise, private economic actors will face higher costs as a result of seeking to comply with rules of origin. More importantly, certain rules of origin can cause trade and investment diversion and may, under certain circumstances, introduce monopoly or monopsony (James 1997).

From a theoretical perspective, then, two opposing forces, both driven by the progressive decline of most-favored-nation tariffs in the context of unilateral trade liberalization and successive rounds of multilateral trade negotiations, will determine the significance of rules of origin in the future. On the one hand, lower and more homogeneous tariffs among members of a SRTA will erode the scope for trade deflection and therefore, the significance of origin schemes as mechanisms to prevent free-riders from enjoying the benefits derived from membership in a SRTA. On the other hand, lower tariffs are likely to lead to increased calls for protection, which in turn might foster the formulation of increasingly complex and protective origin schemes, usually based on a value added approach.[13] Depending on which of these

[13] Rules of origin in the Americas are based on one of two approaches: value added and tariff shift. The implications of adopting each approach are highlighted in Mackay, Robert, and Plank-Brumback (2001):
"The value added approach generally defines a maximum percentage of third country processing or components that can be included for a good to qualify for preferential tariff treatment. This approach suffers from severe limitations because it is highly dependent on fluctuations in a wide range of factors that determine the prices and cost of a good. It is also administratively very burdensome for customs administrations that must audit the cost of these materials because accounting methods vary widely throughout the world. Moreover, low-wage countries are at a disadvantage when using this method because they must use a higher percentage of originating components to qualify for the preferences.

two forces predominates, rules of origin might well accelerate the transformation of the world trading system into a "spaghetti-bowl […] with a multitude of tariffs and quotas applying to particular products, all depending on administratively defined and inherently arbitrary definitions of the product's 'nationality'" (Bhagwati, 1997). "The systemic effect is to generate a world of preferences with all its well known consequences, which increases transactions costs and facilitates protectionism" (Bhagwati, 1998, p 1139).

Empirical evidence on the specific impact of rules of origin in Latin America and the Caribbean, while scarce and inconclusive, points to the use of rules of origin in the hemisphere not only as tools to prevent trade-deflection, but also as protectionist instruments that allow countries to pursue certain strategic objectives. In a recent attempt to explain the structure of NAFTA's origin scheme, for example, Estevadeordal (1999) found that sectors with more restrictive rules of origin were also those with longer phase-out periods for tariff liberalization. This result suggests that NAFTA's rules of origin are primarily used as policy instruments to afford protection. With respect to origin schemes in the rest of the hemisphere, Garay and Cornejo (1999) have pointed out that a majority of free trade areas "have not tended to use rules of origin to compensate for the differences in member countries' national tariffs vis-à-vis third countries in order to prevent trade deflection; instead their design appears to have been more in response to different strategic goals."

There exists also anecdotal evidence on the effects of rules of origin, particularly on investment patterns. Moran (1999), for example, notes that many of the domestic-content rules in NAFTA successfully diverted investment to North America. As specific examples, Moran cites the cases of AT&T, Fujitsu, and Ericsson in the field of telecommunication equipment, and Hitachi, Mitsubishi, Zenith, Sony, and Samsung in the area of consumer electronics as examples of companies that shifted part of their investments from Asia to North America following the entry into force of NAFTA.

A central, open question in the debate about the impact of rules of origin on multilateral trade liberalization is the possible role of regional trade agreements in reducing the spaghetti-bowl effect of different origin schemes embedded in SRTAs. The negotiations toward a Free Trade Area of the Americas (FTAA) open the possibility for designing a new institutional structure that reduces the costs associated with the web of rules of origin existing in the hemisphere. The construction of such an institutional structure, however, will have to overcome numerous hurdles, notably the large differences existing between the origin schemes in force in the hemisphere. Perhaps a first step in the direction of a new structure on rules of origin in the context of the FTAA could consist of agreeing on a set of principles aimed at enhancing the transparency and predictability of hemispheric origin regimes. For example, countries could agree to minimize the number of criteria for determining origin, or develop

The 'tariff shift' model requires a determination that a party has modified a good or product enough to change its classification in the [Harmonized System], thus making it eligible for preferential tariff treatment. This method is not without problems. It does not always ensure that there will be a substantial transformation in the production of a good."

specific disciplines to make the process of origin certification more transparent. Such measures could be complemented by voluntary efforts on the part of members of an SRTA to move towards more homogenous tariff structures vis-à-vis third countries, thus reducing the incentives for trade deflection. As shown above, rules of origin have the potential of turning world trade into a spaghetti bowl. At the same time, however, they are intrinsic parts of a majority of SRTAs and as such, they are here to stay. The relevant question, therefore, is how to minimize their trade- and investment-distorting effects. The current FTAA negotiations offer a unique opportunity to find innovative answers to this question.

DISPUTE RESOLUTION

In the area of dispute resolution, proliferation of bilateral and sub-regional agreements poses serious potential risks to judicial cohesion and judicial economy in the resolution of trade disputes. This is especially so when similar substantive provisions are replicated in the several agreements as in NAFTA and NAFTA-like agreements. The issue can best be illustrated with a hypothetical example. Take country A that has bilateral trade agreements with countries B and C, respectively. Countries B and C consider that country A is violating an obligation under their respective agreement, which reads the same in both, as a result of the same country A measure. Each agreement contains dispute settlement provisions to deal with disputes that arise under that agreement. Each agreement is discrete, as is its dispute settlement mechanism. Under most systems, the decision to pursue recourse to a neutral body to resolve a legal dispute lies with the complaining party that chooses its defendant and defines the scope of the legal inquiry. Assume that countries B and C both decide to seek the establishment of a panel, which is provided under their respective agreements. Already there is a loss of judicial economy as lawyers would call it, or efficiency, as economists might label it, since overlapping agreements have generated two separate processes with ensuing costs for all concerned because not everyone involved in the dispute is together to resolve it.

This situation might turn worse if it is assumed that the panel in the A-B dispute concludes that there is a violation and that the panel in the A-C concludes there is not. This would be a worst-case scenario of lack of judicial cohesion, however, honest jurists may disagree. It is not altogether implausible, since some agreements provide for rosters composed exclusively of nationals of the parties while others provide for non-nationals, and perhaps this different composition may affect how panels view the matter.

If the A-B agreement is NAFTA or Canada-Chile, and if the parties cannot agree on how to resolve the dispute within thirty days, country B may automatically retaliate against A. Country A can only dispute whether the level of B's retaliation is "manifestly excessive" but the retaliatory measure may continue while its amount is litigated. Country C of course has no right to retaliate and continues to feel the adverse effect of the country A measure. Assume the A-C agreement has a choice of forum

provision as do NAFTA and NAFTA-like agreements, whereby a complaining party may choose whether to pursue a claim either under the agreement or the WTO, and C's decision on forum, once initiated, is exclusive to the other. C is thus barred from requesting a panel under the DSU. Assume, however, that C decides to bring the dispute to the DSU anyway. Can A refuse dispute settlement under the DSU on the grounds that the matter was litigated already under A-C agreement? It would not appear that A could do so without violating its obligations under the DSU. One could imagine a WTO panel on the A-C dispute going on while A sues C under the A-C agreement for breach of the choice of forum provisions. But what if C argues that its case under the WTO is based on a different cause of action or different grounds than available under A-C?

As this example illustrates, proliferation of bilateral and SRTAs pose systemic risks and rather than facilitating the resolution of disputes, might make dispute resolution more complex and costly. How to reduce these risks and costs is an open question and one of the major challenges posed by proliferation. Most of the NAFTA-like agreements in LAC are very new and even those that are older have not had much activity in terms of dispute settlement. So the complications suggested by the example are more theoretical possibilities than a matter of historical record.

Have RTAs Contributed to Domestic Policy Reforms and How?

As suggested in section I, LAC countries have engaged in the new RTAs to pursue a number of different objectives and see these agreements as an important instrument for development. RTAs contribute with domestic policy reform in a number of ways.

Commitment mechanisms. First, as frequently pointed out in the literature, RTAs allow countries to "lock-in" reforms, both in trade and non-trade areas, and therefore function as good commitment mechanisms enhancing the credibility of policy reform and sending positive signals to global markets. This issue was recently reviewed by the World Bank report on Trade Blocks (2000) that concludes that in the trade area, RTAs have indeed worked well as commitment mechanisms in practice.[14] The impact of NAFTA in locking-in not only a broad range of economic reforms but democracy has been widely recognized. NAFTA was instrumental in determining the policy response of both the Mexican and the US governments to the 1995 peso crisis. Mexico maintained the reforms and increased its credibility as a location for international investment, and the US response demonstrated that NAFTA meant more than just trade policy. MERCOSUR has been instrumental in creating interdependencies that reduce historical rivalries and promote cooperation. It also helped to discipline the economic response of its members to the 1998-99 financial instability. The democratic clause of MERCOSUR was effectively and successfully used at least once during the Paraguayan political crisis.

[14] Fernandez (1997) contains a useful analysis of the conditions under which a regional agreement will enhance the credibility of policy reform.

Of course, how effective RTAs can be as commitment mechanisms depends on the value of belonging to the group and on the credibility of the threat of action if rules are broken. So not all RTAs are equally effective in this sense. From this perspective, the FTAA, by allowing Latin America to link up with the US and other industrialized nations, will probably be a particularly effective commitment mechanism for most countries in Latin America both for a broad range of economic policies and in other non-trade but related areas, and this provides the FTAA with a strategic value that has been widely recognized.

Price effects. A second type of positive link between RTAs and domestic reforms occurs to the extent that RTAs accelerate domestic reforms that reduce price distortions because countries can no longer maintain substantial price differentials when they open up their economies. In other words, RTAs put pressure on countries to eliminate domestic distortions that are incompatible with free trade, and in this sense they serve as building blocks towards multilateral liberalization. A clear example of this in Latin America is the impact of the FTA between Central America and the Dominican Republic in the latter. Free trade with Central America has forced a national debate in the Dominican Republic about the need to rationalize the whole tariff structure. Producer lobbies in the Dominican Republic successfully pressed the government to reduce tariffs on intermediate goods, so that local firms can compete with Central American imports.

Political economy effects. A third type of positive influence of RTAs on domestic policy reform, for which there is a fair amount of anecdotal evidence, is that these agreements have induced positive behavioral changes in the traditionally rent-seeking behavior by the business communities. In many countries, the prospect and the reality of increased import competition has led the local business communities to be more interested in reducing domestic distortions in transportation costs, the costs of telephone calls, electricity rates, and interest rates that hinder their ability to compete with firms from countries with which FTAs have been entered. Again, these are pressures to eliminate domestic distortions that are incompatible with free trade, whether regional or global. Of course, the interaction of RTAs with local interest groups is complex. There are also instances where negotiation of RTAs in LAC has been resisted and used by some political leaders and/or NGOs as part of a more general anti-globalization, anti-American or anti-"Washington consensus" discourse.

Multilateralism vs Regionalism: A False Dilemma?

From a pragmatic point of view the regionalism versus multilateralism controversy is, to a certain point, built on a false dilemma. Not because RTAs cannot create trade diversion, they clearly can do this; not because one would neglect that RTAs can create a "spaghetti bowl" phenomenon that could hinder rather than facilitate business, they can clearly also do this; and not because in the limit one could not imagine scenarios of the world going down a path of RTAs while neglecting or diverting resources and

political capital away from the multilateral system, which could be a very negative path and welfare reducing indeed.

It is a false dilemma for three fundamental reasons. First, because there are many plausible trajectories where pursuing a two track strategy, both multilateral and regional, might get you to free trade quicker than relying just on one track. In what is called in the literature the "dynamic time-path" question, there is evidence of patterns of mutually reinforcing interdependence where the pursuit of regionalism, triggers or induces the pursuit of multilateralism.[15] In addition, the multilateral system is far from being as quick and efficient as is sometimes portrayed. It is slow to achieve results, and it is weak in a number of fundamental areas. Still, it is the major achievement in the area of global governance of the 20th century and must be protected and strengthened.

Second, the evidence from Latin America shows that these countries did not adopt the new regionalism instead of or as an alternative to multilateralism. The typical sequence was that countries first engaged in unilateral liberalization as part of the process of economic reform in the 1980s and early 1990s. The new regionalism was a consequence of this process of reform. Countries also participated actively in the Uruguay Round, and it was in the climate of protracted negotiations and uncertainty about the results of the round that they simultaneously engaged in the revitalization of their customs unions and in the negotiation of FTAs. Also, the evidence reviewed in this paper from LAC does not support the view that the new bilateral and SRTAs negotiated in the region have been seriously trade diverting.

Finally, it can be argued that it might even be counterproductive to portray regionalism and multilateralism as mutually exclusive alternatives, because in practice governments will most likely continue to pursue both simultaneously. So if RTAs are here to stay, the useful questions for research are for instance: How regionalism can be harnessed and oriented so that it maximizes its role as a building block for a more open world trading system? How Regional Integration Agreements can achieve faster and deeper results in areas where the multilateral system is slow, frustrating or shallow? Given the failure of the GATT/WTO mechanisms for examining consistency of PTAs with the conditions of Article XXIV of GATT and Article V of GATS, how to strengthen or reform these articles and these mechanisms to bring more discipline and more WTO consistency in PTAs? Dealing with these question is however beyond the scope of this paper.

[15] Many trade experts have argued that the creation of the EEC led directly to the Dillon and Kennedy Rounds. Others point out to the 1982 shift to regionalism by the US as having been instrumental in persuading the EU and developing countries to launch a new Round. The WTO (1995) argues that the failed Brussels Ministerial in December 1990 and the spread of regional integration agreements after 1990 were major factors in eliciting the concessions needed to conclude the Uruguay Round. At present many seem concerned that the new Bush Administration will give priority to the FTAA and not to the new round, and this seems to be acting as an additional incentive for the recent European and Japanese call in Davos for a new round.

CONCLUSIONS AND LESSONS FROM THE AMERICAS FOR PROLIFERATION IN THE ASIA PACIFIC REGION

Since 1998, there has been an explosion of new proposals for bilateral or plurilateral SRTAs in the Asia Pacific region (Scollay and Gilbert, 2001). This section summarizes the main conclusions drawn from the Latin American experience on the analytical and policy issues explored in this paper that might have important lessons for proliferation in the Asia Pacific region. As stressed in different sections, however, given the recent nature of the Latin American experience and the fact that many agreements are still evolving, there is a relative scarcity of empirical studies and any conclusion should be treated cautiously.

Explaining Proliferation. LAC countries have pursued a multiplicity of objectives in negotiating RTAs: market access; investment attraction; strengthening domestic policy reform; positive signaling to investors; increased bargaining power vis-à-vis third countries; political, security or strategic linkage objectives; and the use of regional agreements for tactical purposes in seeking to achieve multilateral objectives. The hallmark of the new regionalism in the region is, however, the interest to link up with the United States and Canada, the larger and most developed economies in the hemisphere. From this perspective, RTAs are an instrument by which economies, particularly smaller ones, compete to improve their investment climate and attracting FDI. Political and strategic rationales have also guided the LAC countries' engagement in RTAs, with variations depending on the specific groupings and level of aggregation of countries.

Trade diversion/creation. A review of the existing empirical evidence and studies on trade creation and diversion in the different agreements in LAC suggests that there is no evidence of trade diversion or that if any, trade diversion was overwhelmingly dominated by dynamic effects. The typical behavior observed in this period is an impressive expansion in both trade within the group and in imports from the rest of the world. This is to an important extent due to the fact that RTAs have occurred simultaneously with very significant unilateral trade liberalization.

Similarity and diversity in agreements. There is important diversity in the agreements in LAC in terms of disciplines and institutional arrangements. There are four customs unions and almost 20 Free Trade Agreements in force or under negotiation between countries in the Americas, plus twelve negotiated or under negotiation with countries outside the hemisphere. The FTAs negotiated in the 1990s present important similarities associated with the fact that most of them were modeled on the NAFTA in terms of their structure, scope and coverage. However, even among there are some significant differences. The combination of different strategic and economic rationales in each case has ensured that not all agreements are created equal, and that pragmatism has been a key component of the LAC experience.

Extent of liberalization. The evidence from RTAs in LAC suggests that these agreements have indeed shown a capacity to liberalize faster than at the multilateral level and to include nearly universal coverage of trade liberalization in industrial goods. Most programs among LAC countries will eliminate tariffs for almost all products by 2006 and most of the bilateral trade in these agreements becomes fully liberalized in terms of tariffs, in a ten-year period. One weakness in this market access picture is that nearly all the agreements fail to adequately cover the agricultural sector. Exceptions for agriculture reflect the particular sensitivities of each participating country.

The Latin American Spaghetti Bowl: Rules of Origin. Another weakness of the new RTAs is that they have introduced selective procedures and discretionary application of rules of origin. Several studies suggest an important degree of use of rules of origin not just to avoid trade deflection, but for protectionist and strategic goals. There is also evidence of use of rules of origin to influence investment patterns. One lesson to draw in this area seems to be that as an intrinsic part of most RTAs, rules of origin are here to stay and that the relevant question is how to minimize their trade and investment-distorting effect. A useful hypothesis is that a broader plurilateral agreement such as the FTAA offers an opportunity to "clean up" to some extent the spaghetti bowl effect of different origin schemes in the Americas.

The Latin American Spaghetti Bowl: Dispute Resolution. In the area of dispute resolution, proliferation of bilateral and sub-regional agreements poses serious potential risks to judicial cohesion and judicial economy in the resolution of trade disputes. Dispute resolution could become more complex and costly. How to reduce these risks and costs is one of the major challenges posed by proliferation.

Extent of deep integration. There is very scarce empirical research in Latin America on the question of the extent that RTAs have promoted deep integration beyond what has been achieved at the multilateral level. In the area of domestic regulation in services sectors one study provides mixed results: while some RTAs adopt more general principles than GATS, other RTAs, most notably NAFTA and MERCOSUR, apply more stringent disciples than GATS. With respect to mutual recognition a number of RTAs do go beyond GATS in encouraging the formation of recognition agreements. These conclusions relate to the nature of the disciplines in the agreements, not to the actual progress in changing national legislation or enforcement. Most of the new RTAs in LAC do expand the liberal trade order in that they include areas that are not fully integrated in multilateral negotiations: investment, competition policy and government procurement.

Innovation, experimentation and non-trade concerns in RTAs. FTAs in the Western Hemisphere have been a fertile ground for innovation and experimentation, both in traditional disciplines and in linking trade and non-trade objectives. For instance, the Canada-Chile agreement eliminates the use of anti-Dumping among the parties. Several agreements have moved beyond the GATT/WTO into such areas as environment and labor standards, some using a sanctions approach, others monetary fines to punish violators, others based strictly on cooperation in these areas. LAC

countries almost unanimously reject a trade sanctions-approach to labor and environmental concerns. As regards the trade-democracy nexus, MERCOSUR incorporates a "democratic clause", and there are ongoing discussions as to how to strengthen the democratic provisions in the Inter-American system, including possible cross-reference to the Free Trade Area of the Americas. There seems to be a growing consensus in the Americas to strengthen the trade-democracy nexus.

Distraction from multilateral negotiations. This paper argued and that there is no evidence in LAC that the proactive pursuit of regionalism in the 1990s has been to the detriment of the countries' commitment or attention to multilateral negotiations. In fact, the opposite seems to be the case. Concrete evidence of increased participation in the WTO process by LAC countries in the 1990s was presented. An attempt was made to explain this apparent paradox by arguing that regional engagement has generated positive externalities and learning effects that benefit engagement in the multilateral system.

RTA contribution to domestic policy reform. RTAs contribute with domestic policy reform in a number of ways: by acting as commitment mechanisms enhancing the credibility of policy reform and sending positive signals to global markets, particularly when the agreement includes a larger, relatively more developed country that acts as enforcer; by putting pressure on countries to eliminate domestic price distortions that are incompatible with free trade; and by inducing positive behavioral changes in the traditionally rent-seeking behavior of business communities.

What to do about proliferation? Although the academic controversy on multilateralism versus regionalism has provided many academic insights, an understanding of the economic, political and historic contexts of trade policy strongly suggests that governments will most likely continue to pursue both simultaneously, and that RTAs are here to stay. The appropriate pragmatic response to the revitalization of regional initiatives would then be to deepen the empirical study of the nature and implications of the proliferating agreements, with a view to orient it and to discipline it, through reinforced multilateral procedures, so that it maximizes its role as a building block for a more open trading system.

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