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**Chapter IX: Latin American South-South
Integration and Cooperation: From a Regional
Public Goods Perspective**



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Chapter IX

LATIN AMERICAN SOUTH-SOUTH INTEGRATION AND COOPERATION: FROM A REGIONAL PUBLIC GOODS PERSPECTIVE

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Introduction

South-South trade of Latin America and the Caribbean (LAC) countries, composed both by intraregional and inter-regional trade with other developing regions, expanded at a rate similar to that of North-South trade between 1990-2000, thereby constituting a very significant trade component for the countries of the region. After the downturn experienced between 1998-2002, a strong recovery of intraregional trade observed in 2003, and the first half of 2004 and a big surge of inter-regional trade with other developing regions registered in the same period seem to be confirming once again the great potential that South-South trade holds for LAC.¹¹⁰

The main trait of LAC trade performance in the 1990s, especially up to 1997, was an impressive expansion in trade both within and among the four customs unions (Andean Community, MERCOSUR, CACM and CARICOM). However, until the year 2002, the economic problems plaguing most of the members of subregional integration arrangements forced the countries to suspend or postpone some of the commitments that had been undertaken to strengthen free trade among the partners and form customs unions in the respective sub-regions. In this sense, the four customs unions within and among themselves still have a long way to go in order to reach a more enhanced stage of “deep integration”. To advance towards this goal, LAC countries should keep perfecting the integration process by deepening trade-related commitments and strengthening the provision of regional public goods (RPG). With respect to the latter, as Devlin, Esdevadeordal and Krivonos (2003) argue, a formal regional integration agreement such as a free trade area or a customs union should be considered as a type of RPG.¹¹¹

¹⁰⁹ The author is Officer-in-Charge of the International Trade and Integration Division of the Economic Commission for Latin America and the Caribbean (ECLAC). The views expressed herein are those of the author and do not necessarily reflect the views of the United Nations. Special thanks go to Mr. José Durán for statistical assistance.

¹¹⁰ Preliminary data for the first half of 2004 show that the growth rate of merchandise exports of the region has doubled compared to the same period in 2003 and both intra- and extra-regional trade have seen strong increases. Therefore, the region seems to be experiencing a strong export boom during the biennium 2003-2004, in the aftermath of a two-year long stagnation (2001-2002). This robust performance has been influenced by the following three factors: i) demand expansion in almost all export markets, including not only the countries of the North (Canada, USA, EU and Japan principally), but also developing countries, especially China, India, Africa and Middle East; ii) increases in commodity prices; and iii) recovery of intra-regional trade, which forms part of the South-South trade circuits.

¹¹¹ Devlin and Estevadeordal (2002) define RPG as “transnational public goods whose non-rivalry and non-exclusive properties extend beyond national borders, but are contained in a well-defined set of states or a geographic region.” As examples, they cite: cleaning up a lake; a transnational park; preserving a rain forest; airport hub-spoke networks; transportation infrastructure; transnational diseases; agricultural and other research; and policy standards (financial; labor, etc.).

Subregional integration schemes are, by definition, integration arrangements with a broader scope than regional trade agreements (RTAs) or free trade agreements (FTAs), regardless of whether these agreements are bilateral or plurilateral. The integration agreements, which are often non-reciprocal in terms of preference provisions, have a clear nexus between “trade” and “cooperation” built explicitly into their original framework. The EU-bilateral Association Agreements systematically integrate several initiatives through political dialogue, cooperation and reciprocal trade under a single umbrella agreement. The recent FTA signed between Japan and Singapore, as well as those FTAs currently being negotiated with other countries of the South, also incorporate elements of cooperation in their official framework (Aoki 2004). These orientations on North-South trade are in strong contrast to that of more mercantilist, “business-like”, reciprocal FTAs such as NAFTA, the new bilateral trade agreements in the region existing or being signed with the United States, and the Latin American Free Trade Association (LAFTA) of the 1960s (Devlin and Estevadeordal 2002). From this perspective, in order to re-activate the regional integration process, it is vital for LAC to revisit the issue of the nexus between trade and cooperation in trade agreements from the perspective of RPG as a vehicle for further regional integration.

South-South trade

A. Overall picture

Trade among developing countries (South-South trade) increased rapidly in recent years, at an annual average rate of 8.0 per cent between 1990 and 2002, raising its share in world trade from 9.4 to 12.5 per cent — in nominal terms, from \$ 318 billion in 1990 to more than \$ 800 billion in 2002 (Table 1). Accordingly, the growth rate of South-South trade was 2.2 times greater than that for North-North trade during the same period. As a result, during 2000-2002, South-South trade (SST) came to represent 37 per cent of total global trade of developing countries. It is important to note that about two-thirds of South-South trade has Developing Asia (DA) either as origin or destination (\$ 466 billion), followed in importance by Middle East (\$ 103 billion), LAC (\$ 84 billion) and the Central and Eastern European countries (CEE) (\$ 79 billion). During the period, the growth rate of SST for CEE was negative while the other regions, especially DA, reported a high rate.

Among the various South-South intraregional trade flows, intra-DA trade (excluding Japan) was by far the most important, with an intra-regional trade share of 34.6 per cent, followed by the intra-CEE trade of 22.6 per cent, much higher than the level registered for LAC of 16.6 per cent. In general terms, these coefficients point to the increasing importance of intra-regional trade, with a possible exception of Africa and Middle East, which maintain stronger trade links with Developing Asia than with the proper region (Table 2).

Table 1
Size of South-South trade: Average of 2000-2002
(Billion US dollars and per cent)

2000-2002	LAC	CEE	Africa	ME	DA	SST	Growth 1990-2002
Latin America and the Caribbean (LAC)	58.5	3.0	3.6	3.8	14.8	83.8	7.5
Central and Eastern Europe ^a (CEE)	4.8	53.3	2.3	4.4	14.4	79.2	-1.2
Africa	4.7	0.8	11.2	3.3	18.3	38.3	9.4
Middle East (ME)	3.2	1.9	9.8	15.8	72.0	102.7	7.7
Developing Asia (DA)	27.5	14.7	18.4	30.9	374.0	465.5	11.9
South-South Trade (SST)	98.8	73.7	45.3	58.2	493.5	769.5	8.0
Share of region in total world exports							
In 1990	1.3	2.9	0.6	0.7	3.9	9.4	
In 2002	1.5	1.2	0.7	1.0	8.0	12.5	

Source: ECLAC, International Trade and Integration Division, based on WTO data.

^a Includes Russia

By disaggregating SST by region, one can observe that at the beginning of the present decade, Developing Asia represented 60.5 per cent of total global South-South exports, 49 per cent of which was accounted for by its own intra-regional trade. On the side of imports, the importance of DA was even more marked, with 64 per cent of total South-South imports. In the cases of LAC and CEE, only 1.9 per cent of total South-South trade was accounted for by DA, although the coefficient for other regions (Middle East, Africa and CEE) were even smaller (see Table 3). The upsurge in 2003 of certain SST including intra-DA and the LAC-DA bi-regional flows might have modified the relative importance of each SST circuit flow.

Table 2
South-South Trade: Shares of SST in the trade of regions of the South, 2000-2002
(Per cent)

2000-2002	LAC	CEE	Africa	ME	DA	SST
Latin America and the Caribbean (LAC)	16.6	0.9	1.0	1.1	4.2	23.7
Central and Eastern Europe (CEE)	2.0	22.6	1.0	1.9	6.1	33.5
Africa	3.4	0.6	7.9	2.3	12.9	27.1
Middle East (ME)	1.3	0.7	3.9	6.3	28.6	40.7
Developing Asia (DA)	2.5	1.4	1.7	2.9	34.6	43.1
South-South Trade (SST)	4.8	3.6	2.2	2.8	23.9	37.3

Source: ECLAC, International Trade and Integration Division, based on data of WTO.

Table 3
South-South Trade: Shares in Total SST, 2000-2002
(In per cent of total SST)

2000-2002	LAC	CEE	Africa	ME	DA	SST
Latin America and the Caribbean (LAC)	7.6	0.4	0.5	0.5	1.9	10.9
Central and Eastern Europe (CEE)	0.6	6.9	0.3	0.6	1.9	10.3
Africa	0.6	0.1	1.5	0.4	2.4	5.0
Middle East (ME)	0.4	0.2	1.3	2.1	9.4	13.3
Developing Asia (DA)	3.6	1.9	2.4	4.0	48.6	60.5
South-South Trade (SST)	12.8	9.6	5.9	7.6	64.1	100.0

Source: ECLAC, International Trade and Integration Division, based on WTO data.

LAC South-South trade

Despite great heterogeneity among countries, LAC as a region already shows a high dependence on SST. In 2003, close to 74 per cent of the region's exports were directed to the North (USA, Canada, EU and Japan), the rest being accounted for by the South. This overall regional picture changes dramatically when Mexico is excluded: Mexico accounted for close to 45 per cent of total regional merchandise exports, and more than 93 per cent of Mexican exports were destined to the North markets, with only 6 per cent towards South markets. When Mexico is excluded, in the same year, close to 49 per cent of total regional exports found their markets in the South (see Table 4). The importance of the South as an export market has increased over the years, when compared, for example, to 1990 when the South's share was a little over 35 per cent. Generally, MERCOSUR and Andean Community countries depend less on the northern markets, whereas Central American countries show a greater dependence on northern markets, especially the United States (see Table 5).

Therefore, if we exclude Mexico, almost half of region's exports are South-South exports. The South-South trade was split almost evenly between intra- and inter-regional trade, the former representing more than 27 per cent while the latter, 21 per cent of region's total trade. These figures confirm that South-South trade is already significant for the region as a whole, and that this trade holds a high potential for future growth.

Table 4
LAC (including Mexico): Export structure by major destinations, 1980-2003
(In per cent of total exports)

Regions / World	LAC (including Mexico)				LAC (excluding Mexico)			
	1980	1990	2000	2003	1980	1990	2000	2003
LAC – North	63.3	70.9	78.0	74.1	56.8	63.8	57.8	51.5
North America	36.2	40.9	64.4	56.8	30.3	33.1	36.6	30.8
European Union	22.9	24.0	11.4	11.1	25.7	29.2	20.6	20.4
Japan	4.2	5.9	2.3	6.2	0.9	1.6	0.6	0.3
LAC – South	36.7	29.1	22.0	25.9	43.2	36.2	42.2	48.5
Intraregional	22.0	14.6	16.3	14.3	26.4	18.2	31.0	27.3
inter-regional	14.7	14.5	5.7	11.6	16.7	18.0	11.2	21.2
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: ECLAC, International Trade and Integration Division, based on WTO data.

As pointed out earlier, the relative importance of the North for LAC (including Mexico) as an export destination in the present decade has been in a range of 70 per cent with a share of 74.1 per cent in 2003, 56.8 per cent of which was accounted for by North America, and 11.1 per cent by EU and 6.2 per cent by Japan (Table 4). The United States' share has been on a discernible rise while the EU's has been steadily declining. If we exclude Mexico — and despite rebounds in recent years — the relative importance of Japan as an export destination for the region is insignificant. The impacts of FTAs that LAC countries have signed, or are in process of signing, with countries of the North are yet to be substantiated, but it is likely that they divert LAC South-South trade, this is especially the case for the more developed countries in the region, at least in the short-run, for a number of manufactures (Nogués 2004).¹¹²

Admittedly, the degree of intraregional trade share is not the best measure to gauge the success of regional integration efforts. It depends on a variety of variables, ranging from market size, existing production and trade complementarities to trade infrastructure that exist in the region. As argued in this paper, the relatively low degree of intra-regional LAC relates to the existing significant trade barriers to regional trade, including residual duties, quantitative restrictions, other non-tariff measures such as rules of origin, and other market entry barriers like technical, sanitary and environmental standards, as well as the lack of infrastructure networks, trade facilitation and macroeconomic policy coordination measures. The provision of some of these RPGs is crucial for LAC to reach a more complex stage of regional integration, which will facilitate not only intra- but also inter-regional SST for LAC.

¹¹² Examining four RTAs involving LAC: (i) a South American Free Trade Area encompassing MERCOSUR, Chile, and the Andean Community countries; ii) an FTA between the Andean Community and the United States; iii) an FTA between the EU and MERCOSUR; and iv) the FTAA. Monteagudo and Watanuki (2003) argue that although North-South agreements are in general better options than South-South agreements, the latter are — from the perspective of productive specialization in value-added goods — the latter are preferable to North-South agreements for the more advanced developing countries of the region.

Table 5

Latin America (16 countries): Evolution of Exports by Major Destinations, 1990, 2000 and 2003
(In per cent of total in each year)

	1990			2000			2003		
	North ^a	South ^b	Total	North ^a	South ^b	Total	North ^a	South ^b	Total
MERCOSUR	59.5	40.5	100.0	45.2	54.8	100.0	46.1	53.9	100.0
Argentina	48.2	51.8	100.0	31.0	69.0	100.0	32.6	67.4	100.0
Brazil	65.7	34.3	100.0	53.2	46.8	100.0	52.4	47.6	100.0
Paraguay	37.3	62.7	100.0	17.6	82.4	100.0	11.2	88.8	100.0
Uruguay	36.7	63.3	100.0	27.3	72.7	100.0	38.5	61.5	100.0
Chile	70.8	29.2	100.0	56.6	43.4	100.0	53.8	46.2	100.0
Andean Community	71.7	28.3	100.0	63.5	36.5	100.0	61.3	38.7	100.0
Bolivia	49.4	50.6	100.0	36.1	63.9	100.0	24.3	75.7	100.0
Colombia	76.4	23.6	100.0	65.3	34.7	100.0	60.8	39.2	100.0
Ecuador	65.9	34.1	100.0	51.8	48.2	100.0	59.1	40.9	100.0
Peru	69.7	30.3	100.0	54.9	45.1	100.0	59.5	40.5	100.0
Venezuela	72.3	27.7	100.0	67.3	32.7	100.0	64.8	35.2	100.0
Mexico	90.8	9.2	100.0	92.5	7.5	100.0	93.9	6.1	100.0
CACM	68.4	31.6	100.0	63.4	36.6	100.0	67.9	32.1	100.0
Costa Rica	76.0	24.0	100.0	75.2	24.8	100.0	68.0	32.0	100.0
El Salvador	64.0	36.0	100.0	71.1	28.9	100.0	65.0	35.0	100.0
Guatemala	57.3	42.7	100.0	50.2	49.8	100.0	64.2	35.8	100.0
Honduras	85.3	14.7	100.0	68.0	32.0	100.0	73.7	26.3	100.0
Nicaragua	50.6	49.4	100.0	64.2	35.8	100.0	67.1	32.9	100.0

Source: ECLAC, International Trade and Integration Division, based on official data of countries.

^a Include region's exports to the United States, Canada, European Union and Japan.

^b In addition to intraregional exports, include exports to Developing Asia, Africa and Middle East.

*Intra-regional integration schemes*¹¹³

The hallmark of the region's trade performance in the 1990s, especially up to 1997, was an impressive expansion both in trade within each of the four customs unions (Andean Community, MERCOSUR, CACM and CARICOM) and in imports from the rest of the world. During this period, government authorities frequently resorted to regional integration to signal their continued commitment to liberalization, even when economic conditions for further unilateral opening were difficult, or when reciprocal multilateral initiatives were in a transition phase, as was the case since the end of the Uruguay Round.

Nonetheless, as can be seen from Figure 1-A and Table 6, despite a rebound in 2003, intraregional trade in LAC has experienced significant setbacks in recent years, and still

¹¹³ LAC countries have a long history of regional integration. First in the 1950s, there was much discussion of a Latin American Common Market. After a decade of negotiations, the Latin American Free Trade Association (LAFTA) was launched in 1960. The Central American Common Market was created in the same year, followed by the Andean Group in 1969. By the second half of the 1970s, all of these initiatives were in great difficulties and most of them became policy instruments of reduced relevance for the countries when the debt crisis of the early 1980s induced a deep recession in Latin America and a severe contraction of intraregional trade. These integration regimes were characterized by: i) a state-led import substitution industrialization development model; ii) an inward-looking orientation; iii) a high level of selectivity with the application of multiple positive lists; and iv) skepticism regarding private markets and great concern about the presence of, and dependence on, foreign firms (IDB 2002). The approach was to eliminate internal barriers while maintaining high external protection and expanding industrial planning.

remained at a relatively low level when compared with the levels of a decade ago; the level of intraregional trade (Mexico included), which accounted for 14.4 per cent of total regional trade in 2003, was still low compared to the peak of 21.1 per cent registered in 1997 or the 16.4 per cent level of 1980. Furthermore, these trade flows tend to follow a pro-cyclical trend whereby intra-group trade expanded and contracted in line with third-party trade.

This unsatisfactory performance, in large part, reflects the economic instability experienced by the majority of countries in the region as well as the limited progress made in strengthening ties, fulfilling objectives and improving compliance with the rules adopted. Other hurdles on this front have been the incompleteness of, and weakness in, the design of the original agreements themselves and difficulties in securing a consensus to remedy these constraints, economic and partisan-politics crises, and asymmetries in the benefits and costs accruing to the partner countries (IDB, 2003). In sum, although the four customs unions have been progressively deepened since the 1990s with the inclusion of non-border issues, there is much to be done to reach a higher stage of “deep integration.”

The contraction pattern of MERCOSUR is even more severe; the degree of intra-MERCOSUR trade was less than 12 per cent in 2003, this stands in contrast with the 25 per cent level registered in 1998 (Figure 2-A). Trade integration of the Andean Community member countries is even lower; at the peak of 1998, the degree of intra-group trade reached almost 13 per cent and continued to decline to 9 per cent in 2003 (Figure 2-B). The CACM and CARICOM show a relatively brighter situation because the share of all manufactures¹¹⁴ exported within each sub-region is larger than the share exported to industrialized countries with a sustained growth in terms of volume, but a standstill from the viewpoint of the degree of intra-group trade in recent years (Figures 2-C and 2-D). A common problem among the four groups is the uneven shares of participation of member countries in each group, which point to the issues of asymmetry and special and differential treatment (SDT) for less favoured member countries. In sum, no integration agreement of the region seems to come close to reaching the long-run impact of the EU (Figure 2-B), and the sub-regional agreements, which sparked intra-regional trade for some time, has important challenges ahead in order to foster trade and growth of each member country. Interestingly, ASEAN figures much more favourably than MERCOSUR, though the two regions are similar in terms of trade volume (Table 6).

¹¹⁴ In 2002, of the 20 major export products within CACM, 17 were manufactures, representing 36% of total intra-CACM exports (ECLAC, 2003c, Table 29). In the case of CARICOM, the top 15 intra-CARICOM exports in 1998 were manufactures representing 72 per cent of total exports. It is notable that primary agricultural products do not feature among the list in the case of CARICOM (see CARICOM, 2000, pp. 58-60). The relatively sophisticated manufactures that are important in both sub regions include chemical and pharmaceutical products, mineral fuels, lubricants and related materials, soaps, pigments, paints, building cement; iron and steel, paper and paper board, water and organic surface active agents, non alcoholic beverages and miscellaneous and edible products and preparations.

Table 6
 Intraregional Trade: LAC, NAFTA, FTAA, ASEAN(10), EU (15):
 1980, 1985, 1990, 1995, 2003
 (In per cent)

Regions /Sub-regions	Intraregional Trade (A) = $(X_{intra}/X_{Tot_i}) * 100$					Export Share in World Exports (B) = $(X_{Tot_i}/X_{world}) * 100$				
	1980	1985	1990	1997	2003	1980	1985	1990	1997	2003
LAC	16.4	10.6	14.4	21.1	16.0	5.1	5.0	3.8	5.1	5.2
Andean Community	3.7	3.2	4.1	12.1	9.0	1.6	1.2	0.9	0.8	0.8
MERCOSUR	11.6	5.5	8.9	24.9	11.9	1.6	1.8	1.3	1.5	1.5
CACM	23.1	14.4	14.1	13.3	20.7	0.3	0.2	0.1	0.2	0.2
CARICOM	8.3	11.3	12.4	16.7	21.3	0.3	0.2	0.1	0.1	0.1
NAFTA	33.6	43.9	41.4	49.1	55.0	16.3	16.7	15.9	18.1	15.6
FTAA (34)	33.6	43.9	41.4	49.1	60.1	20.5	20.6	18.9	21.2	18.7
ASEAN (10)	17.4	18.6	19.0	24.0	22.7 ^a	3.8	3.7	4.2	6.4	6.3 ^a
EU (15)	55.6	59.9	64.9	62.9	62.7	37.0	36.3	43.9	38.4	38.7

Source: ECLAC, International Trade and Integration Division, based on official data of the respective secretariats of the integration schemes and the IMF's Direction of Trade Statistics, May 2003.

^a Co-efficient corresponds to the year 2002.

The trade structure of each subregional integration scheme also suffers from a heavy trade concentration by member countries. In the case of MERCOSUR, for example, in 2003, Brazil represented more than 45 per cent of total intra-MERCOSUR trade, while this market accounted for only 8 per cent of Brazil's total exports. In the same year, Argentina accounted for 44 per cent of total MERCOSUR exports, while MERCOSUR partner countries absorbed only 19 per cent of total Argentinean exports. The remaining 10 per cent of intra-MERCOSUR trade was accounted for by Paraguay and Uruguay, whose dependence on this sub-regional markets was much higher, with 36 and 30 per cent, respectively.

A comparable phenomenon occurred in intra-Andean Community trade. In 2003, Colombia (38 per cent), Venezuela (22 per cent) and Ecuador (21 per cent) together represented more than 80 per cent of total intra-subregional trade, the rest being accounted for by Bolivia (8 per cent) and Peru (11 per cent). However, the highest subregional dependence was observed in Bolivia, which exported 27 per cent of its total exports to this integration scheme. A similar case can be made for CACM as well: while the share of intra-CACM trade for Costa Rica, the largest exporter in this sub-regional group, was substantially lower (13 per cent) than that corresponding to the other four countries, over 31 per cent of Nicaraguan exports were absorbed by this group while representing only 8 per cent of intra-CACM trade. In the case of CARICOM, over 76 per cent of intra-subregional trade was accounted for by Trinidad and Tobago, but less than 10 per cent of its exports were directed to its own sub-region. The level of reliance on the subregional market is strongly correlated with the level of GDP per capita of the country in question, pointing to the very important question of asymmetry and the distribution of benefits and costs of regional integration.

It is also disquieting that for the four customs unions, the relative importance of intra-regional trade in the overall trade that takes place at the regional level has been declining over the

years. Trade among LAC countries may be divided into two categories: i) trade between members of sub-regional groupings (intra-group trade); and ii) trade between countries that are parties to the economic complementarity agreements of the Latin American Integration Association (LAIA) or free trade agreements (inter-group trade). Whereas inter-group trade accounted for less than half the exports absorbed by the region in 1998, the proportion rose to 57 per cent in 2000 and 63 per cent in 2003 (ECLAC 2004b). In short, within the declining intra-LAC trade, the combined shares of intra-group trade of the four customs unions have been declining.

B. Impediments to intraregional trade

In light of the above, much remains to be done if LAC is to more fully exploit the potential benefits of regional integration. The countries in the region should continue to work on the continuing constraints facing its regional integration process, namely: i) the persistence of non-tariff barriers; ii) perforations of common external tariffs (CET) and failure to complete customs unions¹¹⁵; iii) inadequate regional infrastructure; iv) weakness in the national and regional institutional apparatus; v) limited coordination of macroeconomic and sector policies, as well as tax systems that do no work for integrated markets and fail to stimulate external trade and investment; and vi) few mechanisms to promote a socioeconomic development that would compensate for asymmetries in the distribution of the benefits of integration (IDB 2003). The modernization and simplification of customs procedures, the strengthening of sub-regional dispute settlement mechanisms, and the building of institutional and human capacities in matters related to certification/verification of technical barriers and sanitary and phyto-sanitary measures would also be important elements of such RPG (ECLAC 2002).

¹¹⁵ In the case that the FTAA ends up being a shallow, much less ambitious agreement, subregional agreements should play a larger role in raising the economic and social welfare of the countries in the region. This is especially so when the goal of LAC integration schemes to establish customs unions and common markets are fully met. Moreover, within the context of a complete customs union project, once agreement has been reached on the implementation of the CET, individual members of the union should not enter into bilateral deals with third parties. Regardless of the success and scope of the FTAA, subregions with common market tariffs should continue to reduce external tariffs, which can benefit all members, but especially smaller ones that are more prone to being affected by unwanted trade diversion (IDB, 2002, p.16).

Figure 1
Evolution of LAC vs. EU Intra-Regional Trade: 1960-2003
A. Latin American and Caribbean

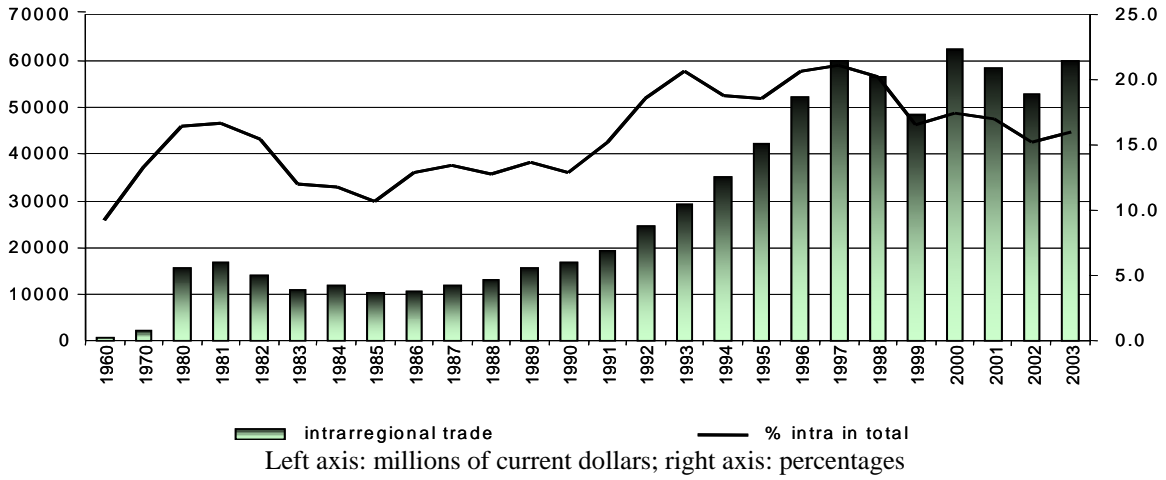
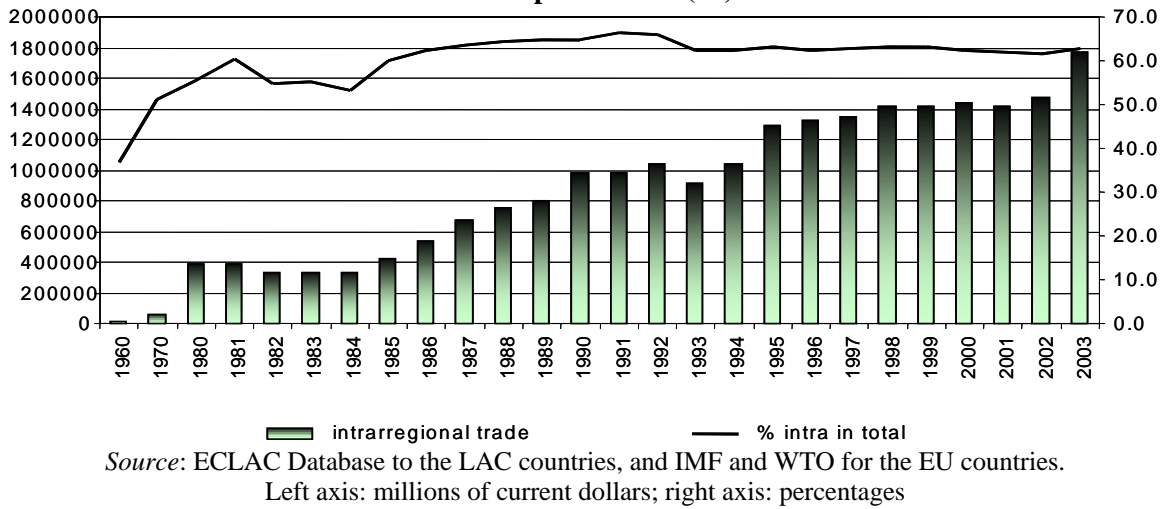
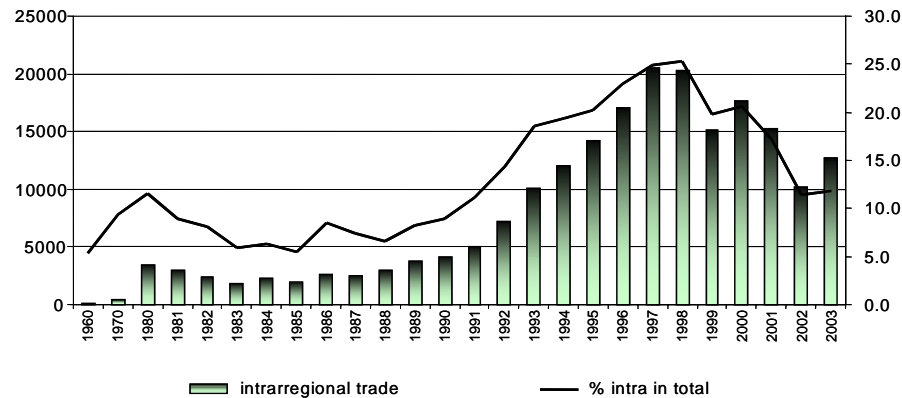


Figure 2
Latin America and the Caribbean: Intra-subregional Trade Evolution in Subregional Schemes: 1990-2003
B. European Union (15)

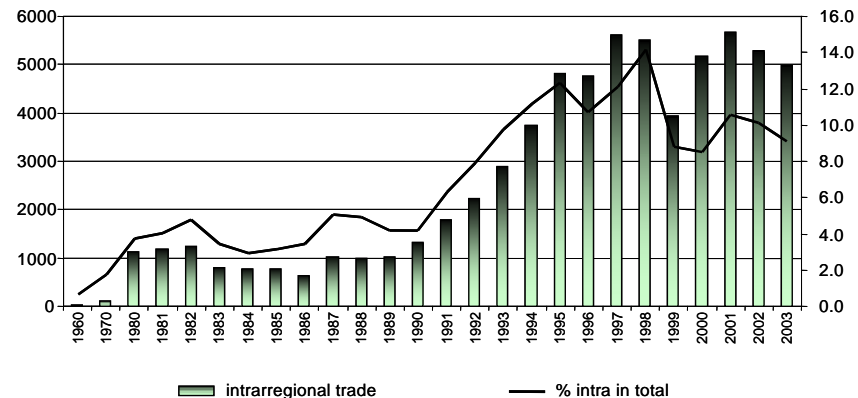


Source: ECLAC Database to the LAC countries, and IMF and WTO for the EU countries.
Left axis: millions of current dollars; right axis: percentages

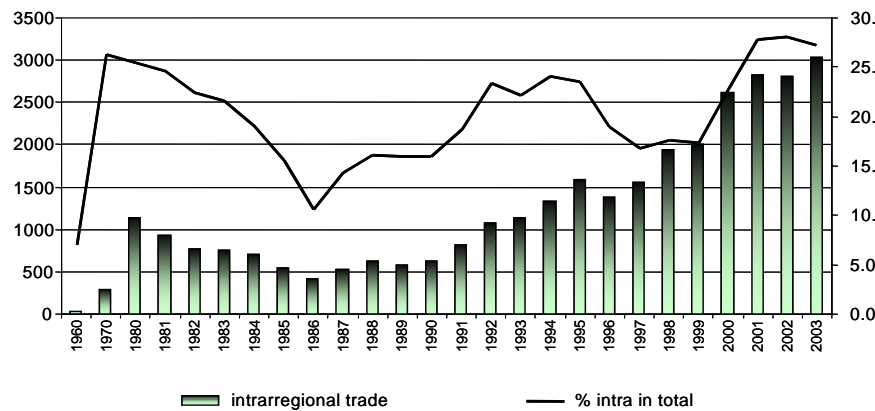
A. MERCOSUR



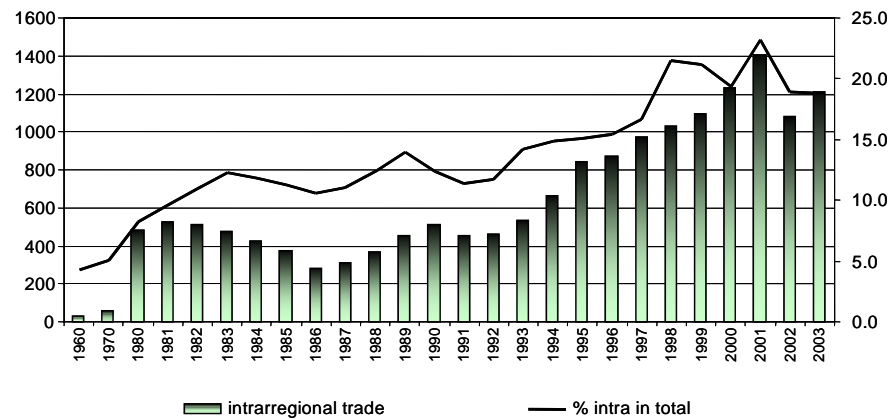
B. Andean Community



C. CACM^a



D. CARICOM



Source: ECLAC, Division of International Trade and Integration, on the basis of official data
^a In the case of CACM, intraregional exports excludes maquila whereas total exports include it.

The new MERCOSUR and Andean Community agenda (e.g., the 2006 Objectives and the Quirama Declaration of 2003, the CACM Action Plan, and CARICOM's Single Market Initiative, respectively) take into account the majority of the above-mentioned RPG matters and aim to remove the existing obstacles to sub-regional trade and investment flows. Though the four customs unions have been progressively deepened since the 1990s with the inclusion of non-border measures, they still have a long way to go in order to reach a next stage of “deep integration”, which, in part, involves the provision of RPG (see Boxes 1, 2 and 3).

Box 1

Summary of the MERCOSUR proposal “Target 2006”

Political, social and cultural programme

- Increasing participation of civil society
- MERCOSUR Parliament, which could be elected by direct voting by 2006
- Boosting cultural cooperation
- Setting up a social institute
- Enhancing “MERCOSUR Ciudadano” (civil society)

Customs Union Programme

- Dealing with development asymmetries
- Common external tariff (perforations eliminated by 2006)
- Special common regimes (negotiated until 2006)
- Free trade zones
- Common external negotiations
- Common commercial defence, including safeguards for extra-zone trade (regimes negotiated until 2004 and adopted in 2006)
- Definition of instruments for the gradual elimination of anti-dumping measures and countervailing measures for intra-group trade (negotiated until 2004, entry into force in 2006)
- Policy on common defence of competition (entry into force in 2006)
- Productive integration with promotion of competitiveness forums; definition of financing instruments; training programmes; and mutual recognition of conformity assessment systems
- Discipline on incentives (negotiated until 2004, entry into force in 2006)
- Macroeconomic coordination
- Reinforcement of institutions

Bases for a Common Market

- Liberalization of services
- Regional capital market
- Promoting regional investment
- Bases for a common currency
- Government procurement (agreement scheduled for conclusion in 2003)
- Circulation of labour force and promotion of workers' rights

Programme on new integration

- Education for MERCOSUR
- Cooperation programmes in science and technology
- Advanced productive integration
- Physical integration

Source: MERCOSUR Administrative Secretariat, MERCOSUR/XXIV CMC/DI N° 01/03.

Box 2
Summary of Quirama Declaration
(Andean Community)

The aim of this general programme is to enhance the process of embarking on a second generation of policies and to establish the following lines of strategic action and guidelines:

Political dimension

- Construction of a governance agenda
- Preparation of a set of guidelines on the Andean common security policy
- Launch of the Andean plan for the prevention, combating and eradication of small, light weapons
- Adoption of a programme to disseminate and implement the Andean charter for the promotion and protection of human rights
- Implementation of the operational plan for the control of illegal drugs and related offences
- Preparation of guidelines for an Andean plan to fight corruption
- Adoption of an Andean plan to fight corruption
- Laying down the guidelines for a subregional food security policy and action plans against poverty and marginalization
- Holding the first Andean Community-MERCOSUR and Chile political dialogue and cooperation meeting; Conclusion of the free trade agreement by the end of 2003; Continuation of negotiations for a political dialogue and cooperation agreement with the European Union and continuing negotiations with other countries and groups of countries.

Social and cultural dimension

- Formulation of the integrated social development plan
- Establishment of regulations for the decisions on labour migrations, social security and safety and health at work. The adoption of the necessary legal provisions for mutual recognition of professional licenses, degrees and accreditations
- Ensuring social participation in the integration process and defence of consumer and indigenous rights
- Preparation of policy guidelines to improve the quality, cover and relevance of education
- Promoting the creation of an Andean commission on investment in health.

Economic dimension

- Fostering a process of reflection on the Free Trade Area of the Americas (FTAA) and the Andean Community's international positioning
- Analysis of the causes and proposal of solutions for non-compliance with Andean Community regulatory provisions
- Assessment of the integration process for each country
- Formulation of a common agricultural policy
- Formulation of programmes for the liberalization of subregional trade in services and implementation of actions for linking customs.

Border integration and development

- Establishment of a comprehensive plan for border integration and development
- Support for implementation of South American Regional Infrastructure Integration Initiative (IIRSA)
- Promotion of border integration zones.

Sustainable development

- Design and execution of programmes on the environment, energy development and disaster prevention and assistance
- Design an Andean Plan to follow up on the World Summit on Sustainable Development (WSSD) held in Johannesburg and WSSD's Plan of Implementation.

Institutions

- Supporting and strengthening the Andean integration system
- Preparing proposals for extrajudicial conflict settlement
- Acceleration of the direct election of an Andean Parliament.

Source: Andean Community, *Quirama Declaration* [online], General Secretariat, 28 June 2003 (<http://www.comunidadandina.org/ingles/document/Quirama.htm>).

Box 3

**Summary of Central American Common Market Action Plan and
CARICOM Single Market initiative**

Central American Common Market Action Plan, 2002 (ADVANCES)

The action plan on Central American economic integration was adopted on 24 March 2002. The plan seeks to achieve deeper integration in the following dimensions:

Political, Institutional and Law dimensions

- Work in a comprehensive agenda to achieve the goals of the Action Plan
- CET tariff harmonization (tariff changes by consensus)
- Adoption of Treaty on Investment and Trade in Services (actually in force)
- The Central American Uniform Customs Code (CAUCA) has been approved
- Approve Dispute Settlement Mechanism
- Integration of the Executive Committee of the Central American Integration System (SIECA)

Economic dimension

- Macroeconomic convergence, specially in the achievement of:
 - a) reciprocal financing supervision;
 - b) harmonization of Central American public debt markets to eliminate barriers to capital flows

Border integration and development

- Support for implementation of the Puebla-Panama Plan to improve infrastructure of the region to achieve and promote regional development and integration of Central American countries with Mexico in energy, infrastructure, telecommunication, and trade facilitation.

Sustainable development

- Support for implementation of the Puebla-Panama Plan to strengthen the Meso-American initiative for sustainable development, human development and the prevention and mitigation of natural disasters.

CARICOM Single Market Initiative (ADVANCES)

The region has pursued and intensified its efforts to consolidate the Caribbean integration and has established the CARICOM Single Market and Economy (CSME).

Political, Institutional and Law dimensions

- CARICOM authorities decided to establish a work unit within the CARICOM Secretariat
- Joint action to maintain a single voice in international and hemispheric bodies (Regional Negotiating Machinery)
- Harmonization of customs legislation, regulations and forms
- Establishment of the Caribbean Court of Justice
- Establishment of the CARICOM Regional Organisation for Standards and Quality
- Approval of measures to avoid double taxation

Economic dimension

- Macroeconomic convergence, specially in the achievement of:
 - a) External reserves requirement (three month's import coverage of 80% of foreign currency bank deposits in central banks for a 12-month period);
 - b) Exchange rate requirement (stable against dollar with 1.5% band for 36-month period); and
 - c) External debt-servicing ratio (no more than 15%).

Source: SIECA home page (<http://www.sieca.org.gt/SIECA.htm>) and ECLAC (2003), Latin America and the Caribbean in the World Economy 2002-2003.

Impediments to Interregional South-South Trade

Two interrelated problems provide possible explanations for the level and moderate growth of trade flows for LAC's inter-regional South trade: country composition and product composition. Trade flows between LAC and Developing Asia (DA) and Central and European countries (CEE), for example, are concentrated in a few countries (Kuwayama, Mattos and Contador 2000, and Maldonado and Durán 2004), although import and export markets for both regions have become more diversified, and this process is expected to continue in the future. Regarding product composition, trade flows are remarkably different according to the direction of trade: imports from DA and CEE are composed of manufactured goods, whereas LAIA exports are mainly primary commodities. The nature of those flows is almost purely *inter-industrial*. This problem has been compounded by geographical distance, in general, and the lack of direct transport and irregularity of services offered across the Pacific, in particular, which have rendered trade exchanges between the two regions difficult, negatively affecting the competitiveness of export products.

Given the divergent pattern of international specialization between LAC, DA and CEE, LAC's future trade expansion to these two regions will most likely involve mainly traditional product areas, rather than those of an intra-industry nature, which theoretically possess high value-added and technology contents. However, as has been demonstrated in several LAC countries (Kuwayama and Durán 2003), it is quite possible to increase value-added and technology and knowledge contents in traditional export products by incorporating high quality services and other production methods such as information technologies.

On the other hand, a better intra-industry articulation between regions in the South is especially promising in cases where countries are less asymmetric in terms of development levels and industrial capabilities, and promoted by a *de facto* productive and financial integration by way of investment or joint ventures. This process is expected to provide another means for LAC countries to integrate themselves more effectively, especially in DA. It should also promote investment and the incorporation of technology and management skills, which will be facilitated by involving countries that have rapidly closed the "technology gap" with the developed world.

Moreover, given the present low level of economic interchange, discussions of trade accords or agreements should incorporate, from the outset, economic cooperation schemes for deeper interregional interaction. Cooperation could incorporate instruments such as trade and investment promotion schemes, training programmes for managers, scientific and technical cooperation and energy cooperation. "Business facilitation" should be encouraged, and special emphasis needs to be given to customs rules and procedures and technical standards and related testing and certification. Programmes on small- and medium-sized enterprises (SMEs) should also be encouraged, including human resources development, access to information and technology and sharing of technology, financing and joint-ventures.¹¹⁶ It is also important to

¹¹⁶ APEC has traditionally been in 13 areas of economic and technical cooperation and these could be major component of these efforts, the areas are: human resources development; industrial science and technology; small- and medium-sized enterprises; economic infrastructure; energy; transportation; telecommunications and information; tourism; trade and investment data; trade promotion; marine resource conservation; fisheries, and agricultural technology. Environmental protection does not appear in this list, but is mentioned in the context of some of the other areas.

resolve problems related to cargo systems and passenger transportation, identify areas of bottlenecks and formulate proposals to improve transportation and promote cooperation agreements. With respect to the enhancement of interregional trade for LAC, the provision of several RPG is also essential.

Proliferation of PTAs and South-South trade

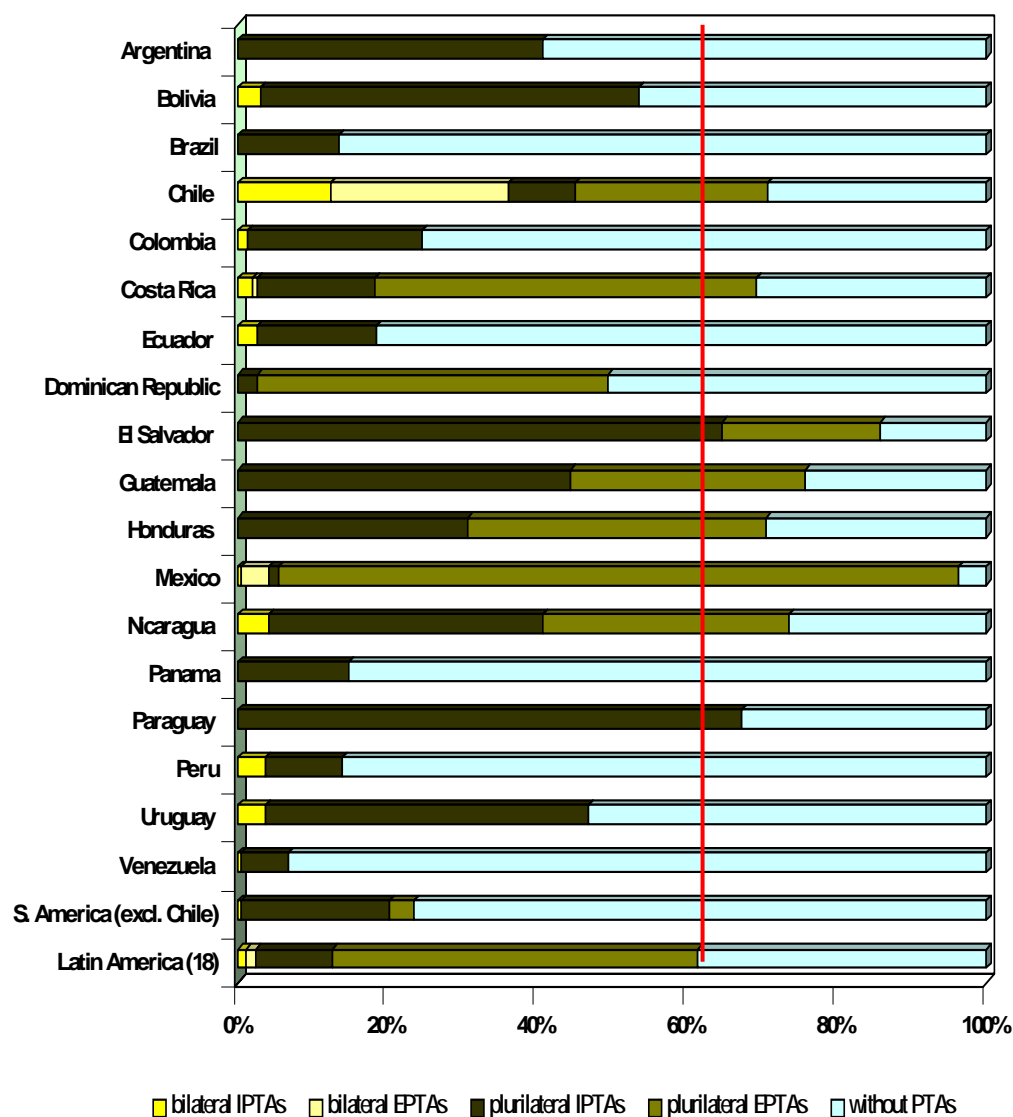
A. *Introductory remarks*

Among the various routes towards trade liberalization (i.e., unilateral, subregional, multilateral and hemispheric) that have been applied in the region, bilateral and plurilateral FTAs have predominated over customs unions since the mid-1990s. Moreover, LAC governments have been working actively to establish a network of arrangements with countries both within and outside the region, while proceeding with the negotiations on the creation of Free Trade Area of the Americas (FTAA). Mexico and Chile have concluded FTAs with a number of countries and regions that are not geographically contiguous, such as the European Union, as well as with the European Free Trade Association (EFTA). Chile has signed an FTA with the United States, and other FTAs have been implemented with Canada, the European Union, EFTA and several other parties. Central American countries have negotiated an FTA with the United States. MERCOSUR is building up an inter-regional association with the European Union, and there are initiatives to cover India and China, among others.

Using the PTAs in existence as of 31 of March 2004, including those PTAs that have been signed but not yet ratified,¹¹⁷ ECLAC estimates suggest that approximately 61 per cent of LAC exports in the first quarter of 2004 were covered by PTAs (i.e., bilaterals as well as plurilaterals) in one way or another, and that the increase in this coefficient has been especially sharp since the mid-1990s and continuing on into the present decade. It is important to point out that during this period, the most marked progress has been seen in the conclusion of FTAs with countries outside the LAC region proper (Figure 3), especially with the North countries such as the United States, Canada, the EU and EFTA countries. In the course of this process, Chile and Mexico have become true “semi-hubs” for FTAs in the hemisphere. Of the 61 per cent of LAC exports mentioned above, 49.5 per cent corresponds to extra-regional markets, in contrast to a small portion (11.6 per cent) for intraregional markets. In the former category, the North-South type predominates.

¹¹⁷ This includes the Central America Free Trade Agreement (CAFTA), which has already been signed, and the FTA between the Republic of Korea and Chile, which has already entered into force.

Figure 3
LATIN AMERICA (18 COUNTRIES): EXPORT FLOWS,
BY PREFERENTIAL TRADE AGREEMENT, 2004
(Per cent of total trade)



SOURCE: ECLAC, DIVISION OF INTERNATIONAL TRADE AND INTEGRATION, ON THE BASIS OF TRADE INFORMATION FROM THE UNITED NATIONS COMTRADE DATABASE.

^a For the 2004 estimate, the two-year average of exports for each country was used to determine the trade structure, and the PTAs in existence as of 31 March (including those for which negotiations have been concluded) were taken into account.

B. “Deep” integration in North-South and South-South agreements

Perhaps the most dramatic change in the LAC integration process has been the shift from an intraregional focus (South-South) to a growing interest in interregional agreements (North-South). This change has meant that LAC is now trying to link up with North countries via reciprocal FTAs, in contrast to the traditional non-reciprocal approach that these countries were more accustomed to. This increased tendency to pursue bilateral trade agreements (BTAs) parallel to the FTAA negotiations, especially the recent interest by the United States in initiating and/or concluding bilateral FTAs with Chile, Central America, the Andean Community and others, poses potential risks for a comprehensive and balanced WTO agreement and FTAA. In addition, there has been a proliferation of South-South FTAs in the region, led principally by Chile and Mexico as regional hubs. The progress of hub-and-spoke regionalism in the Western Hemisphere has been rapid despite the recognition that preferences obtained by BTAs would be gradually perforated and diluted by other PTAs over time. These strategies could stifle the formation of a balanced FTAA and could have a negative effect on economic and social welfare.¹¹⁸

It is important to note that, with regard to aspects of these BTAs as they relate to the North, that they tend to establish and consolidate the access already enjoyed by LAC countries through the Generalized System of Preferences (GSP). Secondly, those FTAs include provisions on investment, competition policy, government procurement and trade facilitation that are of special interest to the North with “WTO-plus” disciplines for which there are no multilateral rules currently in place. Thirdly, issues that affect Latin American signatories, such as internal support measures in agriculture or anti-dumping legislation, are remitted to the multilateral negotiating forum.

Therefore, LAC countries pursue North-South FTAs to secure more stable and greater market access, to attract foreign direct investment and to “lock-in” and add credibility to the often “WTO-plus” trade-related disciplines contained in FTAs. However, trade liberalization commitments contained in these FTAs with the North tend to reinforce comparative advantages of the countries of the South either in primary commodity sectors (e.g., South American countries), or in unskilled labour-intensive manufacturing sectors (e.g., Mexico and Central American and several Caribbean countries). At the same time, these FTAs are likely to divert intra-LAC trade in several important manufacturing sectors. Likewise, South-South FTAs with other developing countries outside the region (e.g., Chile-Korea FTA) would also reinforce comparative advantages of LAC countries in traditional sectors, while they increase complementarities in inter-industrial rather than intra-industrial trade relations.

Another important characteristic of North-South FTAs involving the United States is that these FTAs generally do not include a “cooperation” component, and are therefore not mercantilist or business-oriented in their initial intent, though this orientation might change in the near future (Devlin and Estevadelordal 2002). From the perspective of exclusion of cooperation aspects from their commitments, NAFTA, the new BTAs and the LAFTA of the 1960s can still be considered “shallow”, despite their broad coverage of disciplines and comprehensive nature of commitments.

¹¹⁸ The Santiago Declaration repeats the Declaration of the IV Ministerial Meeting on Trade in San José, Costa Rica stipulating that the FTAA can co-exist with bilateral and subregional agreements to the extent that the rights and obligations under these agreements are not covered by, or go beyond, the rights and obligations of the FTAA (building blocks approach); and that the FTAA should be constructed based on commitments that are balanced, equitable and advantageous for each of the members.

In contrast, the old LAC subregional integration schemes contemplate cooperation schemes in their initial commitments. Meanwhile, Western Europe is a good example of where deepening trade interdependence through trade has evolved into comprehensive mix of trade and cooperation. NAFTA partners seem to be moving §from a pure trade orientation to a mix of trade and cooperation. APEC is rather unique with its strong emphasis on cooperation *and* voluntary commitments on trade liberalization. ASEAN may be a unique case where the focus shifted from cooperation to a combination of trade and cooperation. The Western Hemispheric Summit process, which involves a free trade negotiation coupled with a confederation of somewhat autonomous non-trade cooperation initiatives involving more than twenty areas, might be considered as another type.¹¹⁹ On the other hand, Japan is beginning to apply the already established pattern of the Agreement between Singapore and Japan for a New Age Economic Partnership, which has a strong focus on economic cooperation, to other FTA negotiations with the countries of the South (Aoki 2004), including Mexico.¹²⁰ From the perspective of LAC South-South trade, several cooperation schemes are contemplated within the framework of an India-MERCOSUR Agreement.¹²¹ An inter-regional South-South FTA, the Chile-Korea FTA, contemplates in its official text a series of initiatives on bi-national cooperation in areas such as, amongst others, phyto-sanitary and sanitary measures, conformance and standards, information technology.

It should be stressed that in addition to the mercantilist approach, most of the FTAs signed in the 1990s and during the present decade that include developing countries in the Americas, follow the NAFTA model in terms of thematic coverage, with a possible exception for competition policy. South-South FTAs existing in the region are no exception to this rule. These second-generation FTAs are more comprehensive in scope, not only because they are “broad” in terms of the number of sectors negotiated and incorporated, but also because of the “depth” of the commitments they bring to bear in those sectors that are “WTO-plus” disciplines. This is especially true for services,¹²² investment and intellectual property (Blanco and Zabludovsky 2003). These FTAs are, of course, not identical to NAFTA, and take into consideration the specific interests of the relevant trading partner(s), thereby establishing a realistic agenda for the parties involved. However, not only do all these FTAs share the philosophy and format of NAFTA but that some texts in certain disciplines are almost identical to those of NAFTA (Blanco and Zabludovsky 2003). These FTAs also introduce new approaches to older issues such as rules of origin, contingent measures for imports and dispute settlement.

In sum, BTAs, especially those with North-South dimension, improve market access, consolidate and expand trade preferences, establish mutual rights and obligations (dispute settlement mechanisms), lock-in liberalization efforts, and may favour institutional modernization. Nevertheless, multiple BTAs do have some costs: intraregional trade diversion,

¹¹⁹ As outlined in the Hemispheric Cooperation Programme, endorsed by trade ministers attending the meeting held in Quito, Ecuador on 1 November 2002,¹¹⁹ the technical cooperation available will be fundamental to ensure that the FTAA brings benefits to its members. This should not be limited to providing technical assistance, but should also include strengthening productive capacity and stimulating competitiveness, innovation and technological transfers.

¹²⁰ In the case of the Japan-Mexico FTA, the Mexican government sources state that this agreement will have a strong emphasis on economic cooperation especially in the area of enhancement of Mexican SMEs.

¹²¹ For instance, India and Brazil signed five agreements that include bilateral cooperation in the peaceful use of outer space, tourism, culture and other areas.

¹²² In the case of services, for example, the scope of BTAs tend to be similar to that of NAFTA, and a fundamentally compatible relationship thus exists between this agreement and those signed by the countries in the region (Kuwayama 2003).

administrative costs (“spaghetti bowl”), reduced bargaining power for smaller countries, some countries agreeing to certain demands in areas that go beyond commonly accepted trade issues, etc. They also reduce the incentives to push the regional envelope and the willingness of the developed world to push multilateral negotiations. Besides, it should be kept in mind that FTAs (and FTAA) are an opportunity, and not a “panacea” — much in the same way that the structural reforms of the 1990s were not a “panacea” either.

In the same context, ECLAC (2004a) has argued that to ensure their development, countries generally must hold onto some flexibility to stimulate productive development, boost competitiveness and manage the capital account as a tool in macroeconomic regulation. Moreover, to ensure the eventual convergence of the level of development of participating countries, new initiatives are vital, among them the creation of cohesion or integration funds¹²³ and increasing international labour mobility (Assael 2004, Bustillo and Ocampo 2003). The countries of the region should maintain a certain degree of flexibility within the subregional, WTO and FTAA disciplines in order to adopt active policies for productive development and thus increase their systemic competitiveness.

Deep integration agenda and South-South agreements

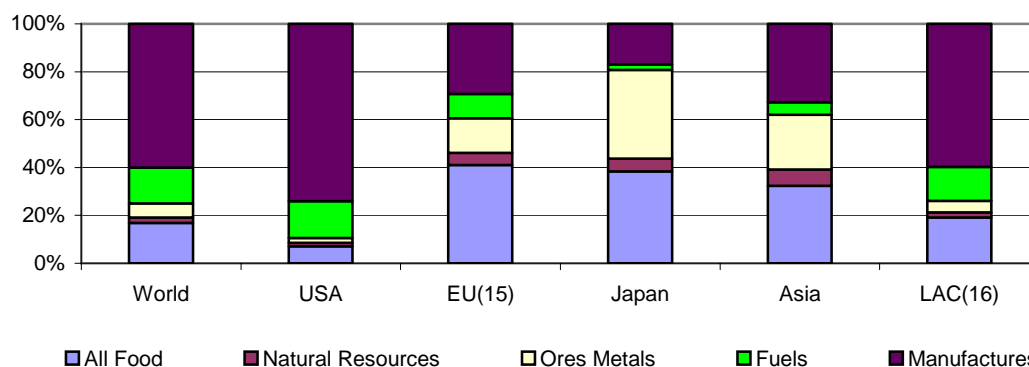
A. *South-South agreements as solutions for supply-side constraints*

It is often pointed out that the product composition of intra-regional trade differs substantially from that of inter-regional trade with the rest of the world, and that intra-regional trade is mainly composed of manufactured goods with higher value added, in contrast to trade with the rest of the world.

This is precisely the case for LAC: almost 60 per cent of intra-regional trade consists of manufactures, 20 per cent of food products, 2 per cent of agricultural raw materials, 5 per cent of ores and metals, and 14 per cent of fuels. In contrast, the production composition of LAC exports to the US market is skewed toward manufactures (74 per cent) when Mexico is included, while the share of manufactures for the EU market is quite small (29 per cent) and even smaller for Japan (17 per cent). LAC exports to EU (15) and Japan consist mainly of foods, and ores and metals. Interestingly, the share of manufactures with DA is substantially higher (33 per cent), highlighting once again the importance of South-South trade as a potential source of technological learning for LAC countries (see Figure 4).

¹²³ With respect to the FTAA on this issue, in the Third Summit of the Americas, (April 2001, Canada) various leaders called for the creation of a fund for social cohesion or integration that would allow a greater support to the hemispheric agreement. In that meeting, the President of Mexico referred to a cohesion fund, while various Caribbean prime ministers highlighted the importance of integration funds. The Government of Ecuador, which was in charge of coordinating negotiations until November 2002, later proposed the creation of a fund to promote competitiveness (Assael 2004). Venezuela has put forward a number of proposals regarding the issue of structural convergence funds (see: FTAA.TNC/w/242, Feb.16, 2004 in the FTAA website).

Figure 4
LAC's Exports Structure by Destination and Major Commodity Group, 2002
(per cent)



Source: ECLAC, International Trade and Integration Division, based on official data. Major product classifications are those of the UNCTAD.

The product composition of LAC exports by destination (intra-regional markets vs. North markets) and by technology intensity has experienced a substantial change over the years. Between the period 1990-1992 and 2000-2002, the share of manufactures in LAC-North trade increased from 56 to 74 per cent, due mainly to the impressive expansion of Mexican exports to the US market. This maquiladora-type trade for Mexico and several Central American and Caribbean countries with the United States translates into a relatively high ratio of 20.5 per cent registered for high technological intensity (HTI) products (see Table 7.A). It is noteworthy that the share of manufactures in intraregional trade increased to 75 per cent for the 2000-2002 period from an already high level of 71 per cent of the earlier period.

The breakdown of intra-regional trade in manufactures in 2000-2002 was as follows: natural resource-based manufactures (NRBM) products (29 per cent) and intermediate technological intensity (ITI) category products (14 per cent) were dominant, while the share of HTI remained at a low level (7 per cent), but was rising. The picture gets more clear-cut when Mexico is excluded (Table 7.B): the share of manufactures in LAC-North trade was around 50 per cent, and NRBM products accounted for another 25 per cent. In contrast, intra-regional trade showed a high manufactures share, composed primarily of NRBM (27 per cent) and ITI products (28 per cent). Meanwhile, the difference in HTI products between North-South and South-South trade almost disappeared due to the exclusion of Mexico.

Looking at the export structure of each sub-region by technology intensity, in South America, the trend towards diversification of the products that make up the export basket was particularly strong in the 1980s, but then stabilized in the early 1990s. The sub-region continues to be heavily dependent on commodities (see Figure 5.d). Although the share of ITI- and HTI manufactures has increased, it still falls far short of the increases observed in Central America and Mexico. This positive trend is largely due to the expansion of trade in consumer durables and manufactures in MERCOSUR and the Andean Community.

Table 7
LAC : Export Structure by North/South and Technology Intensity,
1990-1992 and 2000-2002
(In percentages of total exports)

A. LAC (including Mexico)

Destinations Sectors	1990-1992			2000-2002		
	LAC- North ^a	LAC – South		LAC- North ^a	ALC – South	
		ALC	Rest ^b		ALC	Rest ^b
Primary products	43.6	29.3	28.9	26.0	24.8	43.8
Manufactures	56.4	70.7	71.1	74.0	75.2	56.2
Manufactures based on NR.	21.4	25.5	23.1	13.0	26.2	29.3
Low technology	9.4	14.3	10.9	12.7	13.7	5.9
Intermediate technology	20.3	26.2	27.7	27.8	28.3	13.9
High technology	5.3	4.7	9.4	20.5	7.0	7.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

B. LAC (excluding Mexico)

Destinations Sectors	1990-1992			2000-2002		
	LAC- North ^a	LAC - South		LAC- North ^a	LAC– South	
		ALC	Rest ^b		LAC	Rest ^b
Primary products	51.6	28.2	44.0	50.6	26.2	46.2
Manufactures	48.4	71.8	56.0	49.4	73.8	53.8
Manufactures based on NR.	27.3	25.5	29.5	25.4	27.2	32.0
Low technology	9.8	15.6	11.6	7.9	13.2	6.2
Intermediate technology	9.3	26.8	14.1	9.9	27.6	10.1
High technology	2.0	3.9	0.8	6.2	5.9	5.5
Total	100.0	100.0	100.0	100.0	100.0	100.0

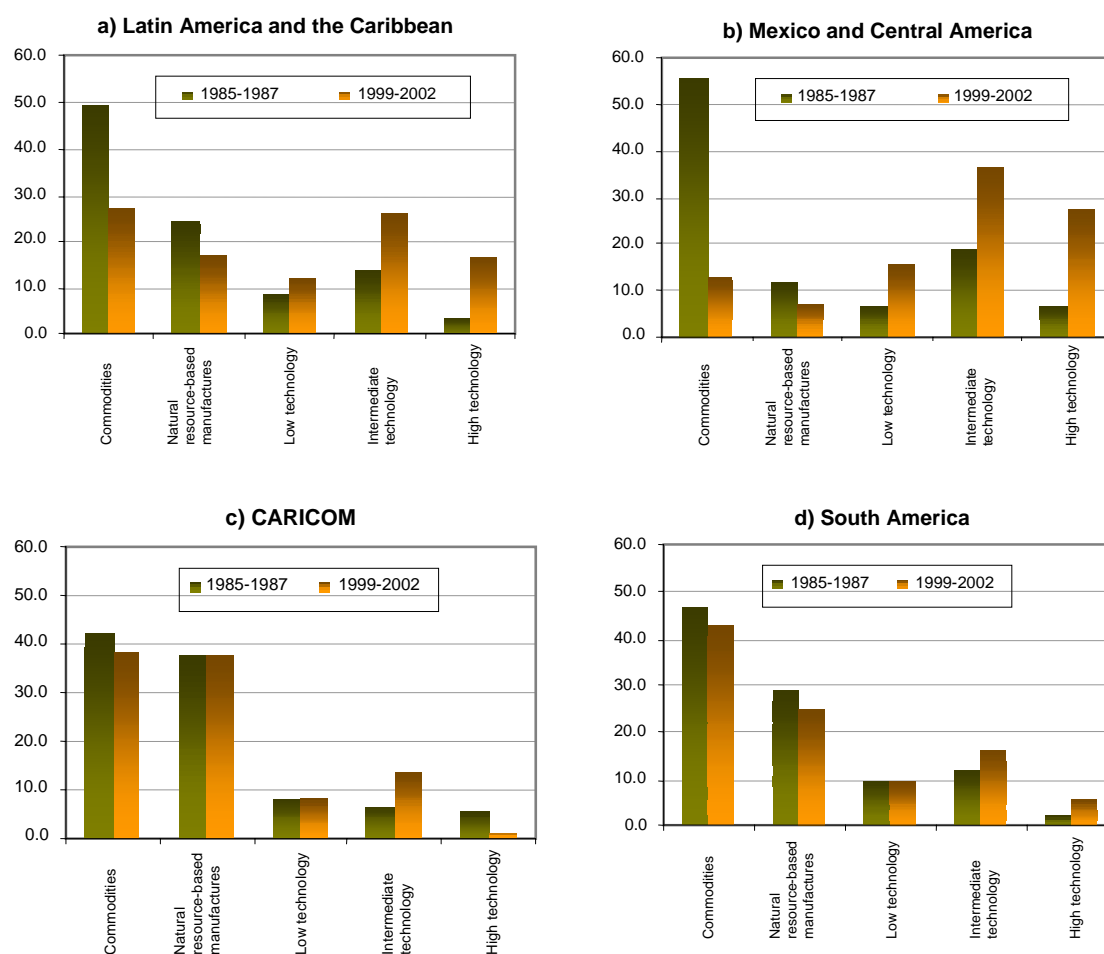
Source: ECLAC International Trade and Integration Division, based on Comtrade data.

^a Include trade with the United States, Canada and the EU and Japan.

^b Include the trade with Developing Asia, Africa and Middle East.

Central America and Mexico have made much more progress in reducing their dependence on commodities. As shown in Figure 5.b, they have completely changed their export pattern, moving from a basket in which commodities accounted for approximately 56 per cent to one in which manufactures, including technology-intensive products, account for 87 per cent. A similar, albeit much more limited, process has been observed in the Caribbean countries (see Figure 5.c). But a more detailed look at LAC intraregional trade by subregional groupings suggests that the importance of manufactures, and of ITI products in particular, applies to each of the four integration schemes (MERCOSUR, Andean Community, CACM, and CARICOM) (see Table 8).

Figure 5
Export structure by degree of technology-intensity,
1985-1987 and 1999-2002
(Per cent of total)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

In 2000, for example, ITI and HTI products accounted for more than 34 and 7 per cent, respectively, of total intra-MERCOSUR trade. Similarly, CACM showed remarkably high ratios of intra-zone trade in each of the three technological intensity categories (i.e., low, intermediate and high). An interesting case is Chile, which showed relatively high ratios for manufactures goods including ITI products for its intraregional trade; this stands in strong contrast with this country's export basket to the North, in which primary commodities occupy a preponderant place. The above observations seem to support the thesis that at least for LAC, regional integration has been, and can be, a device that fosters a diversification of exports towards non-traditional exports, diversified products and even products of more value-added and intensity in knowledge. In fact, the learning curve associated with experience in regional markets can serve as a platform for new international markets (Devlin and Ffrench-Davis 1998). This idea has been a major force of the concept "Open Regionalism" which ECLAC has been advocating since the mid-1990s (ECLAC 1994).

Table 8
LAC Intraregional trade exports by technological Intensity, 2000

	LACs	MERCOSUR	Andean Community	CACM	CARICOM	Mexico	Chile
A.- Primary Products	25.0	26.5	37.2	12.3	21.0	7.4	24.8
B.- Manufactures	75.0	73.5	62.8	87.7	79.0	92.6	75.2
Manufactures based on NR	26.4	19.8	32.4	30.5	52.1	16.5	46.8
Low technology	13.3	12.3	12.1	23.4	12.5	14.7	9.7
Intermediate technology	26.9	34.2	15.0	23.0	12.6	36.1	16.0
High technology	8.3	7.3	3.3	10.7	1.8	25.3	2.7
Total (A+B)	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: ECLAC International Trade and Integration Division, based on Comtrade data.

North-South FTAs tend to reinforce comparative advantages of the South, as in the case of South America, whose major exports are based on NRBM goods, or Mexico, Central American and some Caribbean countries whose comparative advantage is based mostly on price differentials, especially low-wage labour. Though Mexico and some Central American and Caribbean countries have increased their exports in fast-growing high-tech sectors, the maquila manufacturing contributes little value added to the economy; imported inputs represent between 70 and 80 per cent of the gross value of maquila activities (Kuwayama and Duran 2003). While it is true that free trade zones make contribution in terms of job creation and the generation of foreign exchange, these zones should play a more dynamic role in the development process.

As pointed out earlier, in many LAC countries, natural resources can be an important source to increase value-added and knowledge content in exports, emphasizing natural resource endowments such as landscape, climate and biodiversity as an element of international competitiveness. To foster this process further, it is desirable to: i) create networks and clusters in natural resources areas; ii) encourage the emergence and incorporation of technology intensive services to support the production process and tourism; iii) promote SMEs and their involvement in export activities; and iv) encourage the use of information and communication technologies as a tool for export promotion. In sum, the role of natural resources has to be re-addressed and re-examined as a potential promoter of technology transfer from a viewpoint of advantages of FTAs, North-South and South-South alike.

B. South-South RTAs/FTAs as Support for “Systemic Competitiveness” of LAC as a Region

Regional integration should tackle several dimensions of “deep integration” in a context of “open regionalism” by way of enhancing the provision of regional public goods (RPG). This involves reducing tariff dispersions and non-tariff barriers, and addressing “behind-the-border” measures, while harmonizing regulatory regimes, improving infrastructure (e.g., transport, communications, cooperation in energy via regional interconnection, and ports), and strengthening dispute settlement mechanisms. Harmonization of rules among the member countries on areas such as services, investment, intellectual property rights, rules of origin, anti-dumping, safeguards, sanitary and phyto-sanitary norms, customs procedures, and factor mobility should enhance the systemic competitiveness of each country and the region as a whole. In addition, this approach to integration requires the adoption of agreements that will contribute to macroeconomic stability and productive development in each country. In sum,

government provision of many of these public goods is a key determinant of the enhancement of regional competitiveness.

In the area of trade in services which already represents close to 20 per cent of total exports of the region and which is particularly important for the Caribbean countries because of tourism and financial services, it is desirable to explicitly incorporate services exports into the trade promotion strategy of each country, which will result in establishment and/or harmonization of rules related to trade in services at the regional level. It is also important to adopt measures to expand services exports involving: i) mutual recognition of academic degrees, records and technical standards; ii) agreements on double taxation and double social security contributions; iii) protection and promotion of investments; and iv) facilitation of the temporary movements of individuals, especially business people and their representatives, through initiatives such as the issuance of a regional business visa. (Prieto 2003).

a) *Macroeconomic coordination in sub-regional integration schemes*

Financial instability and market inefficiency are an important “global public bad” for developing countries and efforts at the regional level to construct regional institutions and mechanisms for macroeconomic coordination can be perceptibly considered as a RPG.

Since the early 1990s, the idea of complementing the trade-related aspects of regional integration processes through the coordination of macroeconomic policy has been gaining force. The renewed interest in this area has been promoted by: i) the recognition that the incorporation of macroeconomic variables into trade integration schemes has come to be a key factor in deepening and ensuring the continuity of sub-regional agreements; and ii) the acknowledgment that growth impulses are increasingly being transmitted through financial variables rather than being confined to commercial conditions as in the past.

In the LAC region, macroeconomic policy coordination efforts have intensified in all integration schemes, but have stopped short of original expectations. Nonetheless, the European solution clarified three important empirical points with respect to a number of diverging theoretical positions; i) macroeconomic convergence is feasible even among countries with significant asymmetries in development levels and vulnerability to external disturbances; ii) macroeconomic stability is essential in order to deepen trade integration, and conversely, dynamic trade is a prerequisite for macroeconomic convergence; and iii) individual solutions, especially competitive devaluations, are suboptimal from both the domestic and regional points of views. The European experience has shown that it is not necessary to wait for the achievement of theoretically-optimal conditions before coordinating policies. As the European case seems to suggest, the prerequisites for successful cooperation in this area include a minimum level of intraregional trade and mobility in labour and capital, and price flexibility in goods, services and factors of production, and the political will to carry out such cooperation over time.

b) *Competition regulation*

Until recently, most LAC countries operated without a formal competition policy. If a government perceived uncompetitive behaviour, it often intervened directly. However, the latest wave of deregulation, privatization and liberalization has changed the situation. It is increasingly recognized that domestically, without appropriate national competition policies, privatization can reduce social welfare, especially in public services, while from an

international perspective the boom in cross-border mergers poses a potential threat to competition in the region. Likewise, along with the potential benefits of inward foreign direct investment come potential risks; in the absence of an appropriate and effective domestic competition policy, foreign firms can crowd out domestic investment, stifle domestic competition, and reduce domestic productivity growth. Stronger trade flows propelled by the integration process and potential conflicts are challenging trade policies and demanding more attention on the issue of contestability of markets. With this question upper most in their minds, many Latin American countries in the 1990s created or reinforced their competition institutions and began coordinating and sharing information, and even began to include an element of competition in the subregional integration agreements (e.g., MERCOSUR, Andean Community, CARICOM), or with dispositions on competition in those agreements (NAFTA) and bilateral agreements. But some countries lack such regulations, while others are still at an incipient stage of their implementation. There is a wide scope for regional cooperation in this area (Silva, 2004).

c) Social Cohesion and structural funds

Despite their importance, social dimensions have not been adequately dealt with in Latin American regional integration schemes. The implementation of the social agenda is usually slow or postponed, while the concern for distributive effects has only been sporadically taken up. Regional and subregional agreement mechanisms only provide small financial resources aimed at improving the cohesion among social groups and supporting regions. Therefore, one of the major challenges in Latin American regional integration has been the adoption of effective, sustainable economic development policies and social integration policies for all social sectors that have suffered cumulative marginalization in the past 20 years.

In effect, integration processes have been significantly influenced by the fact that: i) disparities among the States and regions pose a risk for the integration process itself; ii) markets cannot, by themselves, promote economic integration when the states and regions are responsible for such disparities; iii) growth, competitiveness and employment are the principal instruments to achieve social cohesion; iv) there is a strong need to integrate economic and social policies in order to guarantee the citizenry an universal social protection system; v) the reduction of disparities by way of better access to training, education, employment (of women, the youth, and the unemployed for an extended duration), as well as of closing income and wealth gaps is an important base for social cohesion; and vi) a strong political will to provide support to States and less developed regions is necessary in order to achieve the conditions of convergence.

d) Inclusion of Border-region Migration Issues in the Regional Agenda

Though rather insufficiently, regional schemes (e.g. MERCOSUR, Andean Community, CACM, CARICOM) have already made some progress toward extending their fields of operation beyond the area of trade and are beginning to advance on issues related to their social agenda, which must include a specific recognition of the importance of migration. In this sense, the subregional integration agreements offer opportunities, as they represent especially suitable spaces for dealing with migration as a vital component of partnerships between members whose asymmetries are smaller than in the case of developed countries. Matters of mutual interests for countries, such as cross-border transit, mobility of the workforce, social security, return of migrants and the mutual recognition of diplomas and courses of study can be more effectively addressed in subregional or bilateral agreements.

There are important precedents in various integration components, the examination and renovation of which is pending: this is the case of the Andean Instrument of Migratory Labour, in the framework of the Simón Rodríguez Convention, which promises to provide the basis for an equalitarian treatment of working migrants.

e) *Trade Facilitation*

The LAC region as a whole has a clear and urgent need for additional measures to facilitate trade and business activity. Most importantly, special emphasis should be placed on standards and regulations relating to the modernization of customs systems. However, reforming the customs of countries at a low level of development requires complex and significant institutional changes in the public sector, and then are generally systemic in nature and very costly. As a result, coordinated and efficient international technical and financial cooperation is required in order to enable these countries to create the necessary capacities to achieve an appropriate degree of modernization. This is also relevant at the interregional and subregional, as well as bilateral and national levels, but is particularly important for the facilitation of international transactions by small and medium-sized enterprises (Izam 2003).

f) *Sanitary and phyto-sanitary measures and technical barriers to trade*

In order to ensure that negotiations on enforcing sanitary and phyto-sanitary measures and technical regulations achieve their goal and make it possible for the region to reap the benefits of integration, it is essential for countries to have suitable domestic institutional structures in place to administer the agreements and enforce the commitments that have been made. Most Latin American countries need to strengthen and modernize their institutional structures, to enable them to maintain a suitable and flexible system for the timely diffusion of national, regional and international data, thereby making it possible to fully exploit economic advantages. The countries of the region could therefore be well advised to make progress in harmonizing sanitary and technical rules and regulations, first in the regional domain and then internationally. The establishment of equivalence between measures adopted by the signatories of regional or subregional agreements is advantageous, partly because it reduces the potential for product discrimination among them and streamlines the import process (Larach 2003). As this is likely to benefit national consumers in addition to regional or subregional importers, such measures should be viewed as public policies that are highly beneficial for production, consumption and trade.¹²⁴

g) *Physical infrastructure and sustainable development*

In LAC, there are many issues and major challenges in the field of infrastructure and sustainable development that have motivated regional cooperation. Transport and tourism are representative examples. The issue of transport has gained importance in the debate on instruments to promote trade and investment in a world of low tariffs and progressive elimination or harmonization of non-tariff barriers, since lower transport costs directly encourage exports and imports and are equivalent in effect to a tariff reduction. At the same

¹²⁴ For example, Andean Community countries have agreed to implement the Andean System of Standardization, Accreditation, Testing, Certification, Technical Regulations and Metrology (Decision 376). An earlier resolution (Decision 238) defined the equivalence of national sanitary and phyto-sanitary regulations between member countries. This type of agreement, in which the Andean countries signed a pact on trans-border movements of genetically modified organisms, is an example of the harmonization of national regulations on biotechnological safety. MERCOSUR has a commitment to harmonize sanitary and phyto-sanitary measures, and maintains a technical standardization committee whose mission is to deepen regional cooperation on this issue.

time, market failures and imperfections that raise transport costs tend to concentrate industrial and economic activity in areas that are already endowed with suitable human and physical infrastructure (Venables and Gasiorek, 1998). Some major initiatives include the South American Regional Infrastructure Integration Initiative (IIRSA) and the Puebla-Panama Plan (PPP). The Association of Eastern Caribbean States has also set up a programme entitled “Unifying the Caribbean by Air and Sea”, which aims to harness public and private efforts among member countries and stimulate regional cooperation mechanisms. Caribbean countries will also cooperate in implementing air transport training programmes.

In terms of sustainable development, the LAC region has a characteristic that distinguishes it from all others: the wealth and importance of its natural resources and the global risks inherent in the rapid process of environmental degradation (ECLAC, 2002a). In recent years, several major regional proposals have emerged in this domain. The eight signatory countries of the Puebla-Panama Plan adopted the Meso-American Sustainable Development Initiative as a strategic and crosscutting framework to ensure that all relevant projects, programmes and measures contain appropriate environmental management practices and promote conservation and sustainable management of natural resources. Another important example is the Regional Biodiversity Strategy for the Tropical Andean Countries —a wide-ranging initiative for this sub-region that represents one of the world’s richest zones in terms of natural resources, containing about 25 per cent of the biological diversity of the entire planet. The strategy is one of the first attempts by the sub-region to develop a comprehensive platform of community action, promoting cooperation between member countries and projecting them with a new and unique identity to the international community. It is also one of the first community strategies adopted on this issue by a group of signatory countries of the Convention on Biological Diversity, and makes a specific contribution towards fulfilling its objectives (Andean Community 2003)

Conclusion

South-South trade already constitutes an important segment of LAC trade, especially when Mexico is excluded from the picture; almost half of region’s exports are of a South-South nature. The region’s South-South trade is split almost evenly between intra- and inter-regional trade, the former representing more than 27 per cent while the latter, 21 per cent of region’s total trade. It should be noted, however, that the present level of intra-regional trade is still low when compared to the peak of 21.1 per cent registered in 1997, despite its rebound in 2003 and continued recovery into 2004. While this trade holds a high potential for future growth, there are a series of problems to be addressed in order for regional integration to continue on the paths of recovery and “deep” integration.

By their nature, regional trade agreements (RTAs) divert trade by creating preferential treatment for member countries vis-à-vis non-members. However, regional integration can foster economies of scale: in the presence of economies of scale, what would otherwise be a costly trade diversion could be transformed into a cost-reducing and welfare-enhancing trade creation. At the same time, regional integration can be a device that fosters a diversification of exports towards output that is more connected to the overall competitiveness of the economies concerned, creating dynamic comparative advantages. It serves to “lock-in” improved access to regional markets, thereby fostering economies of scale. It can enhance non-traditional exports, differentiated products and products of more value added and intensity in knowledge.

The concurrent existence of an FTAA and subregional and bilateral FTAs with countries in and outside the region will surely increase the complexity and reduce the transparency of the multilateral trading system. Ensuring that rules across subregional agreements and between these agreements and the WTO are more compatible might lessen the negative effects that arise from the myriad of FTAs with their own distinct "depths" and scope. However, in some cases, coordination among the FTAs facilitates the convergence and compatibility process with regional and multilateral agreements. It may be possible to pursue a multi-track strategy of multilateral, regional and bilateral aspects that might lead to free and fair trade quicker than relying on just one track.

RTAs should tackle several dimensions of "deep integration" in a context of "open regionalism" by intensifying efforts on the provision of RPG: i) addressing "behind-the-border" measures, while harmonizing regulatory regimes in areas such as services, investment, intellectual property rights, rules of origin, anti-dumping, safeguards, sanitary and phytosanitary norms, customs procedures, and factor mobility; ii) advancing the efforts on the coordination of macroeconomic policy; and iii) improving various kinds of infrastructure and providing crucial public goods. These efforts will enhance systemic competitiveness of each country and the region as a whole.

These initiatives, which would result in the reduction of production and transaction costs inside the region and the avoidance of unnecessary competition among the countries, will likely facilitate inter-regional South-South trade as well. Given LAC's relatively low level of economic interaction with other developing regions, there is a need to institutionalize the mechanism of consultation and implement joint actions. In this perspective, future RTAs/FTAs between LAC countries and other developing regions should incorporate from the outset economic and technical cooperation as an integral part of the trade and investment liberalization effort. Some possible areas are: i) human resource development; ii) science and technology; iii) promotion of SMEs; iv) information technology (IT) and E-commerce; v) tourism; vi) food security; vii) transport infrastructure; and viii) environmental protection.

As for other regions of the South, Developing Asia is still an under-exploited export market for LAC. But as the experiences of some LAC countries in the 1990s and recent years demonstrate, there seems to be a good potential for expanding natural resource-based exports from the region. However, LAC's trade with Developing Asia exhibits the same limitations that the region has in international trade in general: its exports are mostly primary and semi-manufactured goods. LAC needs to find ways to increase the degree of processing of these natural resource-based export products and seek new outlets in Asia for more value-added differentiated products. The present product composition is extremely sensitive to economic cycles of importing countries and does not help to stabilize export earnings, as evidenced in drastic drops in export earnings in the Asian markets during the financial crisis. What is important in these product areas, however, is to find strategic alliances to augment value-added across the production chain and to increase market access.

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