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WORKING PAPERS
ON TRADE IN THE
WESTERN HEMISPHERE

WP-TWH-13
November 1992

**Western Hemisphere Free Trade:
Getting from Here to There**

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INTER-AMERICAN DEVELOPMENT BANK

UNITED NATIONS ECONOMIC COMMISSION FOR LATIN AMERICA
AND THE CARIBBEAN

Western Hemisphere Free Trade: Getting from Here to There

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Introduction

President George Bush set forth his Enterprise for the Americas Initiative (EAI) in June 1990. The centerpiece of this Initiative is free trade from Alaska to Tierra del Fuego. Progress toward free trade on a Hemisphere-wide basis is likely to be slow for reasons centered in the political-economic situations both in the United States and Latin America and the Caribbean (LAC). The United States is not ready to negotiate for Western Hemisphere free trade, at least not until the results of the North America free-trade negotiations are accepted and implemented by the Congress. When Chile proposed to start the time-consuming negotiating process toward free trade under what in the United States is called "fast track," this suggestion was rejected on the ground that one such negotiation at a time was all that the U.S. Congress wished to handle for now. Other than Mexico and Chile, no other LAC country is ready and economically able to open its market to free trade with the United States.

Any achievement of a Western Hemisphere Free Trade Area (WHFTA) would be the result of a process that already has begun. The U.S. part in this process includes entering into a free-trade agreement (FTA) with Canada, negotiating a North American Free Trade Agreement (NAFTA), and entering into framework agreements with all LAC countries other than Haiti, Suriname, and Cuba, either individually or by groups. The LAC countries are playing their part. Their actions include drastic changes in development policy, particularly opening their markets to imports, and seeking to revitalize subregional economic arrangements. Without these steps on both sides, the U.S. proposal for Western Hemisphere free trade would have had little resonance. In fact, however, it was greeted with great initial enthusiasm by most LAC countries as being appropriate to the times.¹

What is uncertain are its path and the end accomplishment. There are many paths and there are many potential final outcomes. Getting from here to there — and there must be some kind of there, possibly a WHFTA or perhaps something short of that — is the theme of this paper.

The organization of this paper is as follows. The next section will summarize the state of play in the Hemisphere with respect to economic integration. This need not occupy much space, but is necessary to set the stage for the subsequent sections. There will then be a discussion of what's in it for the parties. In addition to providing the input to understand the reasoning of subsequent arguments, these sections can serve as background for readers unfamiliar with recent developments in the Hemisphere.

This paper is not intended to provide either elaborate economic or political analysis of the benefits and costs of free trade. It is, rather, directed at process and institutions. However, getting "there," wherever that may be, is not done in a substantive vacuum. There is no sense in getting anywhere unless all the parties see some benefit from this. The two subsequent sections will contain the central core of the discussion. These are, first, the sequencing of getting to free trade, whether by subregions or individual nations, of using NAFTA as the core of a WHFTA, and how to overcome problems of costs to specific nations and subregions; and, second, the institutional framework that may be required as the process unfolds. The paper will conclude with suggestions on the options on the two central themes of sequencing and institutions.

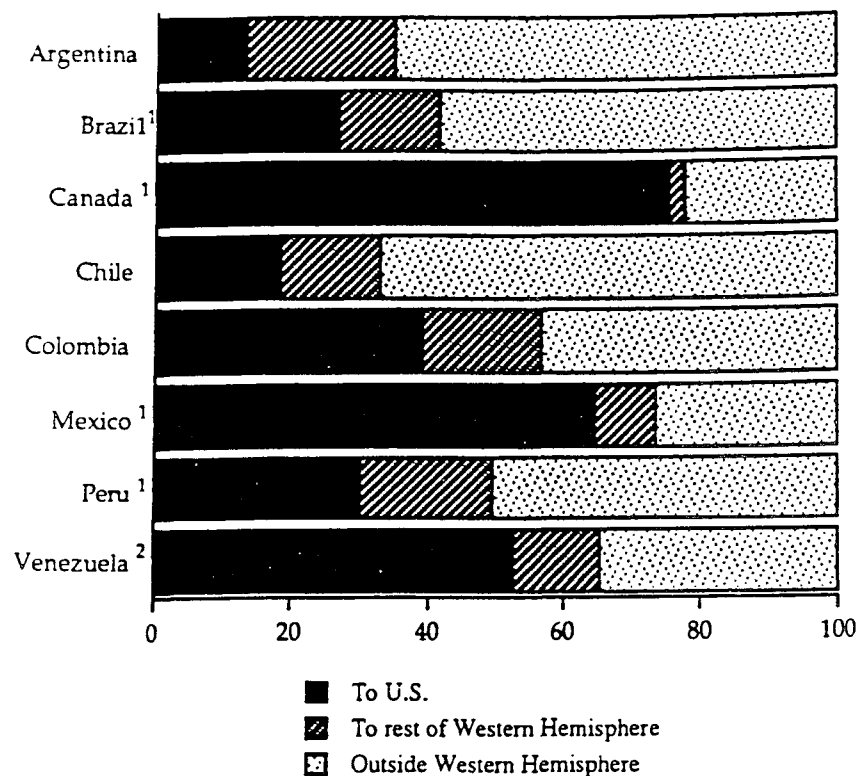
The Economic Integration Scene in the Americas

While the interest in economic integration is hardly new in the Americas, its renewed vigor during recent years is a consequence of developments both internal to the region and those occurring in other continents. Free trade between the United States and LAC countries as proposed in the EAI is an outgrowth of a shift in U.S. policy toward bilateralism and regionalism. This shift can be explained by the growth of regionalism in Europe (if regionalism has a beneficial economic outcome there, then why not in the U.S. backyard?), the emergence of persistent U.S. trade deficits reflecting the increasingly competitive nature of the world economy, and frustration with the workings of the General Agreement on Tariffs and Trade (GATT).² The change in policy is evident in the two free-trade agreements (FTAs) that the United States has since entered into, first with Israel and then with Canada. It is now conventional, even if not unanimous, wisdom, that regionalism and globalism in trade can be pursued simultaneously.³ I would argue somewhat differently, that regionalism is here to stay, at least for the indefinite future, so it is essential to make this compatible with globalism if the *latter* is not to disappear.

U.S. economic regionalism found its main outlet for more than a century in establishing a large national market. Regionalism has a longer history among LAC countries, going back to the Bolivarian dream and then emerging again, this time in its economic manifestation, after World War II as a way to widen the scope for

import substitution. What is new for the LAC countries is the acceptance of regional trade and economic arrangements with the United States. This is not the first time the United States has made a proposal for Western Hemisphere free trade, but it is the first time such an initiative has been taken seriously.⁴ The main reason for the change is the transformation in development policy from looking inward to seeking extra-regional markets for LAC exports; and what better market than the United States, by far the region's largest export destination? The importance of the United States as a market for the major LAC exporters can be seen in figure 1. This dominance in the exports of Canada and Mexico helps explain why these two countries were the first to seek FTAs with the United States.

Figure 1: Share of Exports to the United States of Selected Western Hemisphere Countries, 1988 (percent of total exports)



Source: Erzan and Yeats, p. 7.

1. Data are from 1987.

2. Data are from 1986.

The tragic decade of the 1980s for the LAC countries was the stimulus for substantial changes in economic policy — from closed to more open economies, from state-dominated planning to greater scope for private enterprise, and from what one commentator called "defensive nationalism," which consisted of a third approach to economic policy, that is, neither capitalism nor socialism, to greater reliance on markets.⁵ According primacy to economics as the centerpiece of international policy in the LAC countries is similar to what happened in the United States as its competitive position weakened.

The intensity of the shift from ultra-protectionism to open markets has not been uniform among all LAC countries, but the articulation of the new philosophy of greater import openness and export promotion has been near ubiquitous. Nine LAC countries now have tariffs that average below 20 percent, compared with levels as much as five times greater a decade ago. In the case of Mexico, the trade-weighted average tariff is about 10 percent. These tariff levels are still higher than those of the industrial countries, but they are no longer intended to generally exclude imports. Their further reduction over an extended transition period would no longer be traumatic. Nontariff barriers, such as prior import licensing, have also been dramatically reduced.⁶ It was these changes, taken unilaterally by the LAC countries, that made possible the free-trade initiative by Mexico, the request for free-trade negotiations with the United States by Chile, and the contemplation of hemispheric free trade on the part of LAC countries generally.

This is an important point, one to which I will revert throughout. Contemplation of free trade must come *after* much internal restructuring has occurred in order for a country to adapt to an open economy and for the transition to free trade to be accomplished in a reasonable number of years once an agreement is concluded

In addition, this shift in mentality from protectionism, from safeguarding generally small markets and small production runs, to playing a larger role on the world economic scene has served to reinvigorate the regional integration arrangements among LAC countries. This can be seen in table 1. However, the integration arrangements in the Western Hemisphere are a crazy-quilt pattern of cross memberships and nests of small integration arrangements within larger ones. The membership of Andean Common Market (ANCOM) overlaps that of the Latin American Integration Association (ALADI). So does the membership of the Southern Cone Common Market (MERCOSUR) and ALADI. Mexico is a member of ALADI, has a free-trade agreement with Chile, has negotiated to become a member of NAFTA, and is conducting integration talks with Venezuela and Colombia on the one hand, and the Central American Economic Community (CACM) on the other. Venezuela and Colombia have approached the United States about possible free-trade talks even as they retain membership in ALADI and ANCOM and are negotiating separately with Mexico.

This proliferation of economic integration schemes and the multiple membership phenomenon will have to be sorted out one day. Each arrangement has its own rules, and the rules are not always consistent with each other. This complex structure will presumably give way to something more coherent if the process of hemispheric free trade advances further. I will return to this theme when discussing sequencing of free trade and possible institutional arrangements as the process plays itself out.

Table 1: Integration Movements in the Western Hemisphere

<u>Movement</u>	<u>Established</u>	<u>Timetable</u>
ALADI	1980	Ultimate goal is Latin American common market
ANCOM	1969	Common external tariff 5 to 20% in 1992
MERCOSUR	1991	CET BY 1995
CACM	1960	Free trade zone and common trade policy, 1992
CARICOM	1973	Tariffs range 5 to 45%; CET by 1994
US-Canada FTA	1989	Transition to free trade by 1992
Chile-Mexico	1991	Remove all tariffs and many NTBs by 1998
Being considered:		
NAFTA		10-15 year transition to free trade starting 1994
Mexico-Venezuela		Transition to free trade starting 1994
Colombia		

Source: Council of the Americas, *Washington Report*, winter 1992; and de la Torre and Kelly

ALADI - Latin American Integration Association: Argentina, Bolivia, Brazil, Colombia, Chile, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela.

ANCOM - Andean Common Market: Bolivia, Colombia, Ecuador, Peru, and Venezuela

MERCOSUR - Southern Cone Common Market: Argentina, Brazil, Paraguay, and Uruguay.

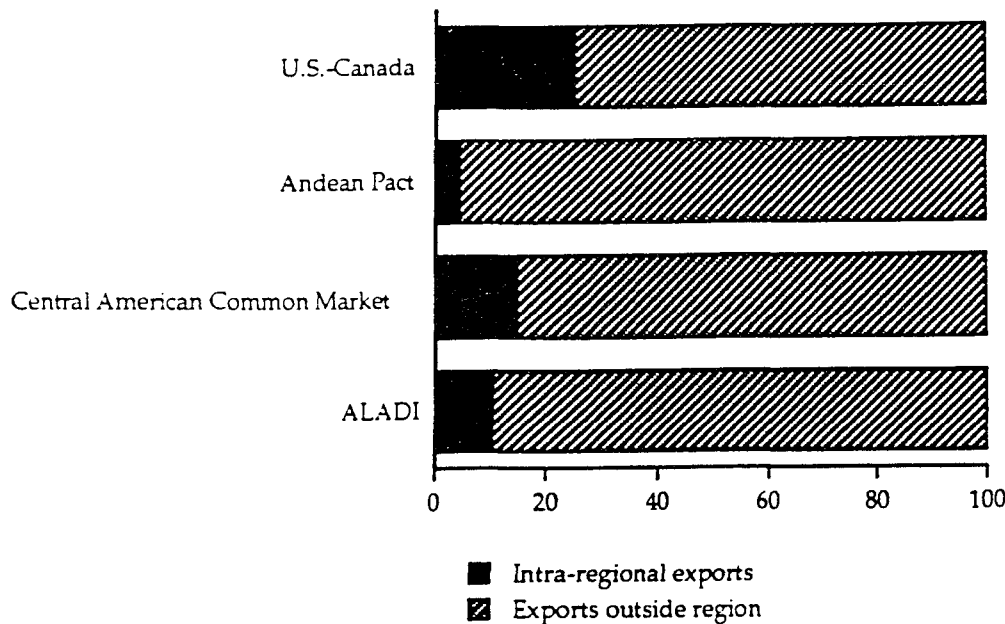
CACM - Central American Economic Community: Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.

CARICOM - Caribbean Community: Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago.

NAFTA - North American Free Trade Area: Canada, Mexico, and the United States.

Despite the invigoration and proliferation of economic integration schemes, intra-regional trade among LAC countries is not extensive. This is evident from figure 1, which shows how much more important the U.S. market is to LAC countries than are their markets in the rest of the Hemisphere. There are some exceptions to this; smaller countries in South America, namely, Bolivia, Paraguay, and Uruguay, send a larger proportion of their exports to other South American countries than to the United States.⁷ Figure 2 shows the relatively small proportion of intra-trade of Western Hemisphere groupings.

Figure 2: Intra-Regional Exports of Western Hemisphere Groupings, 1990
(percent of grouping's total exports)



Source: de la Torre and Kelly, pp. 20 and 30

The LAC countries still take a relatively modest proportion of total U.S. exports. This can be seen in table 2. U.S. exports to Canada, which has 27 million inhabitants, are greater in value than to the rest of the Western Hemisphere together, whose combined population is 450 million. U.S. exports to Mexico (population about 85 million), while only about 40 percent as great as those to Canada, are more than to all other LAC countries combined. The question asked by Erzan and Yeats is what's in it for the LAC countries in having free trade with the United States.⁸ There is obviously a reverse question: What's in it for the United States other than the potential for significant exports to a few countries in the Hemisphere? And there is a final question: What's in it for Canada? These are issues for the next section.

Table 2: U.S. Exports to Western Hemisphere Countries, 1991
(Millions of U.S. dollars)

Canada	85,103
Mexico	33,276
Caribbean	6,189
Central America	4,273
South America	19,227
Other	506
Total to world	421,614

Source: U.S. Department of Commerce, *U.S. Foreign Trade Highlights 1991*.

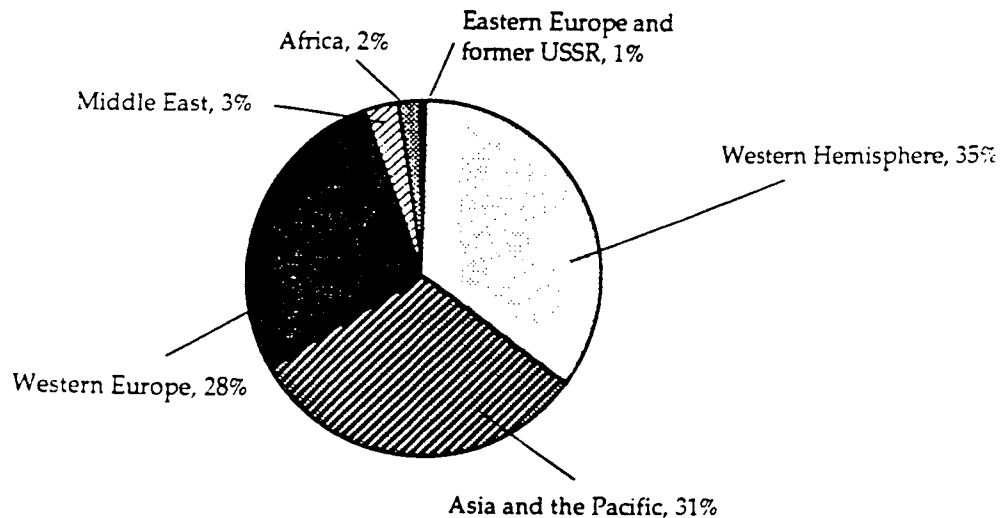
What's In It for the Parties to Hemispheric Free Trade?

Since the EAI proposal was made by the United States, its interest in hemispheric free trade will be discussed first, and then be followed by a discussion of the Canadian and LAC interests. None of the discussions need be lengthy because the theme is being taken up in other studies.⁹

The U.S. Interest

U.S. merchandise exports are geographically dispersed. This can be seen in figure 3. Western Hemisphere countries in 1991 took 35 percent of worldwide U.S. merchandise exports. Most of these were within North America; Canada and Mexico together took 28 percent of U.S. worldwide merchandise exports in 1991. Put differently, of all U.S. merchandise exports to Western Hemisphere countries in 1991, 80 percent were within North America. Canada and Mexico that year received \$118 billion of U.S. exports and the rest of the Western Hemisphere only \$30 billion. The static picture, therefore, does not demonstrate that the United States should have a great interest in expanding NAFTA to the rest of the Western Hemisphere. If anything, a snapshot of U.S. exports in 1991 would imply that the U.S. free-trade interest after North America should focus on Asia and the Pacific, which was the destination of 31 percent of U.S. exports.¹⁰

Figure 3: U.S. Exports by Geographic Regions, 1991
(percent of total U.S. exports)



Source: U.S. Department of Commerce, *U.S. Foreign Trade Highlights, 1991*.

Yet there is a dynamic picture that is more edifying. U.S. exports worldwide grew, in current dollars, by 7.1 percent in 1991 over 1990. Those to developing countries in the Western Hemisphere grew by 17.7 percent.¹¹ This was more substantial than U.S. export growth either to Asia and the Pacific or Western Europe,

the two other important export destinations shown in figure 3. This more substantial growth to LAC countries than to other destinations continued into 1992. Some of the growth in U.S. exports may have been due to the unilateral liberalization of import restrictions undertaken in recent years by LAC countries. A much more significant explanation, however, has been the overall economic recovery of LAC countries.¹²

U.S. merchandise exports to LAC countries grew fivefold during the 1970s when the region's GDP grew at an annual rate of about 4.5 percent. By contrast, U.S. exports to the region grew by less than 50 percent during the 1980s, when GDP growth averaged about 1.5 percent a year — or actually declined on a per capita basis. Discounting for inflation, U.S. exports to the LAC countries were stagnant during the 1980s, reflecting the economic stagnation in the countries themselves. A large proportion of LAC hard-currency earnings and capital inflows had to be dedicated to debt servicing, which both limited resources available for internal economic development and imports.¹³ U.S. producers paid a heavy price in order to sustain the viability of U.S. financial institutions. What is now happening is that the LAC economies are recovering and their imports from the United States are recovering as well.

A greater proportion of the imports of LAC countries and Canada comes from the United States than from any other source. This proportion varies by country, from 60 to 70 percent for Canada and Mexico, 40 to 60 percent for Venezuela and much of Central America, 30 to 40 percent for Colombia and Ecuador, 20 to 30 percent for Brazil, Chile, and Peru, and less than 20 percent only for Argentina among the more important economies. For the LAC region as a whole, the share of imports coming from the United States, which was 57 percent in 1989, is at least double the proportion for either Western Europe or Asia and the Pacific. Thus, as these countries are able to afford more imports, the main export beneficiary is the United States. This is not true of other regions with which the United States carries out substantial trade. U.S. imports from Western Hemisphere countries are reflected in large U.S. exports to them in return. U.S. imports from Asia and the Pacific, including Japan, have a far lower reflection ratio in exports back to the countries in those regions. The United States has a major trade stake in the economic health of the LAC region. The economic dynamics of U.S.-LAC relations, in other words, provide the main explanation for the U.S. interest in a WHFTA.

Moreover, the interest goes beyond trade as such. The United States is the leading foreign investor in the Western Hemisphere. This is particularly true in Canada and Mexico, but prevails as well in the rest of the Hemisphere. Trade has followed investment. Earlier, during the import-substitution period in the Hemisphere, U.S. investment in manufacturing was designed largely to serve the protected domestic market in the host country. This was attractive in the countries with the larger economies, such as Canada, Mexico, and Brazil, but less so in the smaller economies.

Today, as trade barriers are coming down, U.S. multinational corporations have a substantial interest in co-production arrangements in the Western Hemisphere. The very basis for the export processing zones that have proliferated in the LAC countries, especially in Mexico, the Caribbean, and Central America, is to exploit factor advantages — primarily low labor costs for labor-intensive operations — available in these countries. Their proximity minimizes transportation costs. These arrangements involving the shipment of intermediate goods across national boundaries require low trade barriers. U.S. law already partially provides this in that U.S. tariffs are levied on products imported under subheadings 9802.00.60 and 9802.00.80 of the harmonized tariff schedule only on the value added outside the United States. Free trade would lead to the elimination of these and other tariffs and also to the easing of nontariff barriers, such as quotas under the multifiber arrangement.

The United States thus has a combined trade and production interest in a WHFTA. This interest cannot be based on giving up markets in other regions because, as figure 3 shows, U.S. merchandise exports are broadly equally divided among three regions — the Western Hemisphere, Asia and the Pacific, and Western Europe. This division of U.S. exports provides an incentive to keep import barriers against third countries relatively low in any WHFTA.

The Canadian Interest

The Canadian interest in Western Hemisphere free trade is less evident. Only about 5 percent of Canada's trade is with LAC countries (see figure 1) and one-third of this is with Mexico. The Canadian case has been referred to as "reluctant regionalism."¹⁴ Canada joined the NAFTA negotiations to protect its interests in the U.S. market, but did so with considerable misgiving.¹⁵ Canada is being drawn into the broader regional free-trade process for much the same reason, to protect its trade interests in the United States and its potential interests more broadly in LAC countries, plus the desire to prevent a hub-and-spoke outcome. This issue, the way free-trade should be approached in the Hemisphere, will be taken up later. It is quite revealing, however, that the phrase hub-and-spoke as it refers to hemispheric free trade originated in Canada and is heard more from Canadian sources — governmental, academic, and business — than from elsewhere in the Hemisphere. Indeed, as table 1 shows, LAC countries are quite prepared to move ahead on a hub-and-spoke basis when they are the hubs — the Mexico-Chile free trade agreement is an example of this. The Canadian position against a hub-and-spoke outcome for a WHFTA is the correct one, in my view, but the issue is not pressing if hemispheric integration continues the follow the path on which it now seems to be embarked. The United States, the country Canada had in mind, has not suggested a series of FTAs in the Hemisphere with it alone, but has left open accession to NAFTA.

However reluctant its regionalism may be, if the process prospers, this will have repercussions on Canada's future trade and investment policy in the Hemisphere. Western Europe was not seen as a natural trading area before the establishment of the European Community, but the EC is seen now as being a quite natural trading bloc. This "natural" trading area is growing throughout Europe by grafting of additional countries on to the EC. The preferential opportunities that a WHFTA can provide should serve as a stimulus to Canadian businesses to invest more in LAC countries and to exploit export opportunities. It would be a mistake to assume that past Canadian lack of interest in most of the LAC region would prevail in the future if circumstances changed.

The LAC Interest

Defining the LAC interest is more complex than for either Canada or the United States because of the differences among LAC countries. Mexico has what can be called a natural market in the United States, one that has been nurtured over the years by U.S. investment and co-production and regional marketing alliances. This interest is reflected in free trade with the United States — in the creation of NAFTA — and not in a WHFTA, at least not yet. The more countries in the Hemisphere that have free access to the U.S. market, the more Mexican preferences will be diluted. Yet, for political and cultural reasons, Mexico has muted any misgivings about being joined in free trade by other LAC countries. Indeed, Mexico has embraced the idea by its own free-trade negotiations with them.

The first approach to the LAC interest in a WHFTA is to examine the current destination of exports — how much goes to the United States and how much to other LAC countries? Figure 1 does this for the main LAC exporters. This implies that the countries which should have the greatest interest in hemispheric free trade, that is, free entry into the U.S. market and not just into subregional LAC markets, are Mexico, Venezuela, Colombia, and to some extent Brazil. The Central American and Caribbean countries should be added to this list. The Venezuelan case is tenuous, however, because most of its exports to the United States are petroleum, for which an FTA is not particularly relevant. Less than 20 percent of Colombia's exports to the United States are manufactured goods, and it is for these products that free trade is most important.

Yet, both Colombia and Venezuela have indicated much interest in free trade with the United States. The proportion of Chile's exports to the United States is still relatively low, but it was the first country after Mexico to propose an FTA with the United States. In other words, the response of LAC countries to free trade with the United States is based on much more than the current destination of their exports. It is based as well on how they would like to see their economies develop in the future.

A second approach is to examine the extent of tariff and nontariff barriers which their exports face in the U.S. market. Erzan and Yeats make this examination and conclude that the countries which export a wide range of manufactures, such as Mexico and Brazil, should have the greatest interest in removing U.S. tariffs, whereas those countries which export raw materials, which face relatively few tariff barriers, are likely to have only a modest interest in free trade with the United States. They also conclude that the benefits of free trade with the United States would be constrained unless hard-core nontariff barriers, such as for textiles, clothing, and sugar, are eased or removed as well.¹⁶

These approaches — of looking at current trade patterns or levels of U.S. protection against current LAC exports — while valid, do not tell the full story. The levels of cross-national protection between Canada and the United States were quite low before they entered into free trade. The Canada-U.S. FTA would not have been necessary if the purpose were simply to reduce trade barriers. The composition of Mexico's exports changed radically from the early 1980s, when petroleum dominated, to what now exists, when manufactures dominate. The change in domestic development policy in Mexico made the past a poor predictor of the future. In both cases, the initiatives for free trade with the United States were taken on much broader grounds than the current trade and protective situation — to assure continuity of U.S. policy, to provide a psychological incentive for foreign investment, and to link production and marketing between Canada and Mexico respectively and the United States, and now among all three in a NAFTA.

It is not an overstatement to state that North American *free trade* is a simplification that borders on being misleading; North American *free investment* and trade might better describe the intent of the proposal. And not just investment from within North America itself, but from all sources to combine production and marketing in the large North American market. One of the weaknesses of many partial and general equilibrium models projecting the outcomes of free trade either in North America or the Western Hemisphere generally, particularly the static models, is that investment is either omitted or is not endogenous.

I would answer the question of what's in it for the LAC countries to have free trade with the United States — and with their neighbors in their own subregions as well — by approaching the issue from the viewpoint of their domestic development strategies. Country after country in the Hemisphere has concluded that its development requires substantial structural adjustment. This obviously involves many aspects of macro- and microeconomic policies. What these entail will differ country by country, but their general objectives are thoroughly discussed in the literature and need no elaboration here. One aspect of these new development policies is to induce greater competition through more open markets. It is these policies that are driving external trade and investment measures.

Mexico was able to seek free trade with the United States because it first decided to restructure its domestic economy and to open its market to imports. Chile has done the same. Both these countries have made substantial progress in their internal restructuring. Because relative prices in these two countries have been and are being altered for internal development reasons, and because markets have been largely opened unilaterally in order to stimulate competition, then seeking reciprocal opening in the U.S. market is almost certain to be a net plus for them. Their sequence was internal restructuring, then seeking free trade with the United States.

Most other LAC countries are not yet ready to seek free trade with the United States because their domestic adjustments, including the reduction of barriers against imports, are still in midstream. They still have a number of years of restructuring to reach the stage of either Mexico or Chile. These further changes, in my view, must come before they seek free trade with the United States.

I would argue that analysis of what's in it for the LAC countries should not be approached the way governments traditionally look at trade negotiations, where every reduction of one's own import barriers is seen as a "concession" to some foreign interest, but rather on broader development grounds. Is it in the national interest of an LAC country to open its market, to restructure its economy? If so, then free trade is a further step that permits obtaining reciprocity.

The Central American and Caribbean countries represent a special case. They enjoy preferential treatment for their exports to the United States, their main market, under the Caribbean Basin Initiative (CBI). Under a NAFTA, these preferences would have to be shared with Mexico, and under a WHFTA with other countries in South America. Many of the manufactured products they now export come from export-processing zones and pay duty only on the in-country value added when imported by the United States. This benefit would be diluted as other countries obtained duty-free entry for their products entering the United States; or, perhaps more significantly, as the United States gradually eliminates textile and clothing quotas for other free-trade partners, as is contemplated in NAFTA. The proposed NAFTA agreement calls for a phased easing of the U.S. sugar quota as it applies to Mexico and this too could disadvantage Central American and Caribbean exporters unless and until they obtain comparable treatment.

One expert from the English-speaking Caribbean posed a number of questions pertaining to that region arising from the EAI. Because of their small size, how many Caribbean countries can meet the criteria (especially markets open to free imports from non-CARICOM countries) that would make them ready to enter into free-trade negotiations with the United States? Should they try to meet these criteria? Even if they can, what will happen during the transition when Mexico enjoys preferential treatment in the U.S. market? If they negotiate for free trade with the

United States, should they do so individually or as a group? Would the necessary investment come to these countries under free trade? What will happen to the trade preferences these countries receive from the EC under the Lomé convention if they enter into an FTA with the United States? Or the reverse, must any preferences granted to the United States in agreements under the EAI be granted as well to EC countries?¹⁷

The Central American and Caribbean countries represent a special case because of their dependence on the U.S. market. Yet, I do not believe the resolution of their problem should be accession to NAFTA if they are not ready to undertake its obligations. An alternative solution is to augment the one-way preferences they now receive under the CBI to avoid disadvantaging them with respect to Mexico.

Concluding Comment on the Varying Interests

What emerges even in this cursory discussion of different national interests in a WHFTA is how hard it is to generalize for all countries. For the United States, if one takes a static view, free trade is of interest only with a few countries. The markets of many LAC countries and subregions are relatively tiny and the pursuit of free trade with them would require some U.S. political interest beyond expanded exports.

Looked at in reverse, some countries in the Hemisphere rely primarily on the United States for their export earnings, but many do not. Based on static analysis, free trade with the United States would not appear to offer much to those countries whose main markets are elsewhere, such as within the LAC region itself, or whose raw material exports do not face significant trade barriers in the United States. Indeed, some countries could be hurt, such as those in Central America and the Caribbean, if their present preferences in the U.S. market are diluted.

The longer-term view, not of current trade patterns but of desired ones, may change this outlook. The LAC market is of minor current interest to Canada, but Canada may be forced to become regional in spite of itself. Canada and Mexico now dominate U.S. exports to the Hemisphere, but the United States sees a natural trade advantage for itself if hemispheric incomes and imports grow. Chile, Colombia, and Venezuela all contemplate changing the composition and augmenting their exports to the United States. Chile is ready to move now and the other two expect they will be ready in the not too distant future. The MERCOSUR countries are not now ready for free trade with the United States, but Brazil and Argentina could be major beneficiaries as the process unfolds.

What is now driving the process — what did not exist during the import-substitution period in the LAC region — is the dramatic change in development thinking, from largely closed to open markets, from looking within to looking outward. The analysis of country interests, therefore, must derive from this philosophic change. Countries or groups of countries will be ready to consider a WHFTA for themselves only as their internal restructuring moves far enough to make this possible. This has happened thus far only in Mexico and Chile. It will have to take place in other LAC countries for the process of hemispheric free trade to progress.

The Process of Getting to Free Trade

Two issues must be considered in answering the question of how to get from here to there. First, is it in the interest of the countries of the Western Hemisphere, the two developed countries (Canada and the United States) and the more numerous developing countries in the LAC region, to get there, to get to hemispheric free trade? Second, if the answer is yes — yes to hemispheric free trade or yes to the process even if full hemispheric free trade is not achieved — then how should the process be managed? These issues will be discussed in turn.

The Compatibility of Regionalism and Globalism

The growth of regionalism, both formally and in informal trade and investment arrangements, is disquieting to many trade economists because it must diminish the authority of the more global structure as represented in the GATT or in a potential more comprehensive organization.¹⁸ Even though regional trade arrangements are authorized in Article XXIV, the GATT and the economist's ideal is still the unconditional most-favored-nation (MFN) rule for the conduct of international trade. Bhagwati has noted that regional integration, even while it can be consistent with the letter of the GATT, does threaten the basic conception of the world trading system as envisioned in the GATT.¹⁹ The very purpose of bilateralism and regionalism in the sense discussed here — an FTA or customs union — is to favor some countries over others. Whether the result of any regional preferential arrangement achieves the test set forth by Viner, that trade-creation should exceed trade-diversion — and despite all our sophisticated modeling, we do not always know exactly how much trade is created and how much diverted away from third countries, particularly over time — being on the outside of a preferential area arouses resentment. It is no accident that the formation of the European Economic Community spawned the creation of the European Free Trade Association. Preference begets counter-preference. Nor is it

any accident that the creation of the EEC led to a clamor for the entry of new countries, or that the Canada-U.S. FTA stimulated Mexico to act and that the prospect of NAFTA has aroused interest in other LAC countries for free trade with the United States.

Preferential regional arrangements also arouse political hostility. The United States from the time of its creation as a country until 1923 practiced conditional MFN, that is, it discriminated against countries unless they gave trade concessions in return for nondiscriminatory treatment. The main reason for the shift was that as the United States became a major trading nation, the discrimination inherent in this policy generated substantial political conflict.²⁰ Viner noted that this conditional application of the MFN clause has probably been the cause in the last century of more diplomatic controversy, more variations in construction, more international ill-feeling, more conflict between international obligations and municipal law and between judicial interpretation and executive practice, more confusion and uncertainty of operation, than have developed under all the unconditional most-favored-nations pledges of all other countries combined.²¹

The United States discriminated in its policy of conditional MFN in order to extract the most favorable trade openings by other countries. Regionalism is practiced in order to provide concessions to some countries but not to all countries. The contexts are different and the instruments are not the same, but the issue of resentment aroused by discrimination is identical.²²

Yet, to use two common metaphors, the horse is out and there is no use locking the barn door against regionalism; or if ever a task was Sisyphean, seeking to roll back the regionalism that already exists is of that nature. The major regional groupings that now exist in Western Europe (the EC and EFTA), and North America (the Canada-U.S. FTA), each account for about 30 percent of world GDP and together they generate some 65 percent of world trade and nearly 50 percent of developing country exports.²³ And these are not the only regional arrangements in existence. Japan does not have preferential trade arrangements with other countries in Asia, but is dominant in this trade nevertheless, in large part because of its investment and co-production arrangements. There is little prospect of rolling back the EC; the tendency is for both its deepening and widening.

Countries enter into preferential regional arrangements precisely because they are preferential. That is, they are willing to open their markets regionally more thoroughly than they are universally. The conflict that is taking place within the EC about completing the common market there and expanding to economic and monetary union, on the one hand, or widening the Community to include other aspirants, brings out this issue with great clarity. The issue there is whether to have sub-arrangements within a broad preferential arrangement, to have what has been referred to as

concentric circles in which an inner group takes on deeper obligations and has greater privileges, and simultaneously provides lesser preferential benefits to other groups of countries which also have a smaller say in the evolution of the Community.²⁴

Michel Rocard, the former French Prime Minister, made this point quite explicitly: "European integration is necessary, but it cannot be achieved in every field with the same partner or with the same intensity."²⁵

I raise this theme because precisely the same issue will arise in the Western Hemisphere. NAFTA, if it comes into existence, is apt to deepen over time, much more than can a free-trade arrangement between the NAFTA countries and those in Central America or the Caribbean, or most other LAC countries. I will return to this theme because I believe it is important for the path of hemispheric free trade.

Regionalism is thus certain to stay with us for the indefinite future. If anything, it is likely to take on greater weight in world trade. It will be a complex regionalism, of sub-regions within regions — in the LAC area, in Asia, and in Europe — and the relevant issue to be sorted out is the kind of order that can be constructed within this complexity. In addition to this awkwardness within regions, there are definite conflicts between regionalism and globalism centering primarily around the issue of who gets hurt when the sway of unconditional MFN is weakened. However, the world trading order that must be worked out will require minimizing this conflict because there is little to no prospect of eliminating it. If either element of this dyad is under threat today — if optimum coexistence is not achieved — the more vulnerable structure is the global one, the GATT, and not the regional structures.

Bhagwati, despite his misgivings about the growth of regionalism, concedes that its current rise will endure.²⁶ His recommendations to avoid undermining the GATT are to insist on strict interpretation of Article XXIV, granting permission only for customs unions with a bound common external tariff (CET) on the ground that this would probably result in a downward tendency in tariffs, and assuring that any arrangement will be open to new members.²⁷ Bhagwati suggests that in order to ensure that a CET leads to lower tariffs, GATT Article XXIV be changed to require all members of a customs union to adopt the lowest tariff on any item rather than to construct an average of the member countries tariffs, as is now the practice. The objective of these suggestions is quite straightforward — that regional integration arrangements should be constructed to minimize margins of preference in order to impose the fewest possible distortions on the system. Few economists would quarrel with the intent of these suggestions.

However, the double suggestion to tighten the provisions of Article XXIV and then to interpret these more strictly has elements of locking the barn door late. Schott has pointed out that GATT examined 69 preferential agreements between 1948 and

1988 (this includes the Canada-U.S. FTA) and only four minor agreements were deemed compatible with Article XXIV. No agreement was censured as being incompatible with GATT provisions; the Contracting Parties merely submitted reports with no formal conclusions on the other 65.²⁸ It is by no means assured that a CET will lower tariffs, as Bhagwati implicitly admits in his suggestion to eliminate averaging and to set the CET on particular items at the level of the lowest member. The requirement for a CET has served in some cases to keep tariffs high, for example in CARICOM today and earlier in the CACM. The Canadians preferred the use of an FTA over a customs union because of the belief that the former carried less political baggage. My own view is that if an FTA functions successfully, the pressure will be for tariffs on particular production inputs, that is, raw materials, intermediate products, and capital goods, to equalize at the lowest rate of any of the members. This is because that member would otherwise have a cost advantage in production. This tendency for tariff rates to converge downward in an FTA may not be as strong for finished consumer goods that are not used as inputs for further production.

One theoretical advantage of a CET is that this would eliminate the technical basis for rules of origin in an integration agreement. There would be no need to define products originating in the member countries if the tariff on any given item were the same in all. As we have seen in the NAFTA negotiations, the technical basis for a rule of origin has been transformed into a buy-North-American provision for many items, particularly automobiles and textiles and apparel. However, the EC has not found it difficult to devise other rationales for limiting foreign competition in these and other sectors.

Dornbusch does not agree that bilateralism is necessarily inferior to multilateralism. He has argued that bilateralism got a bad name when it was used to restrict trade, but it can also be used to liberalize trade, as NAFTA and the proposed WHFTA would probably accomplish.²⁹ The conclusion coming from this line of reasoning is that regional integration can serve a trade-creating purpose if it lowers barriers more than would otherwise be the case. Put differently, this is an argument that a low margin of discrimination in favor of member countries inherent in bilateralism and regionalism may be less onerous than high nondiscriminatory barriers.

My main conclusion is that a theoretical argument about the compatibility of regionalism and bilateralism is futile. The two will coexist; and if they do not, the multilateral structure is the one in greater danger of disintegrating. What remains, therefore, are two requirements: These are to strengthen the multilateral structure, such as by a successful completion of the Uruguay Round, and then making the GATT a more substantively comprehensive organization; and to minimize the effects of regionalism on third countries by reducing protection against them. This protection

deals not just with tariffs, but with a whole range of preferences in favor of insiders relating to differences in nontariff protection, trade in services, limits on foreign direct investment, entitlements to bid on government procurement, and many other facets of modern integration arrangements.

Managing the Process in the Western Hemisphere

The discussion thus far lays out many of the considerations that must be taken into account in structuring the process toward hemispheric free trade. The constraints on the process include the following:

- Determining the desired structure of free trade, whether hub-and-spoke, a single FTA, or a series of FTAs among the various subregional groupings;
- Setting priorities between subregional integration and hemispheric free trade;
- Taking into account the different objective circumstances of countries, or groups of countries, but without slowing progress toward free trade to the speed of the countries least able to act;
- Sorting out the labyrinth of integration arrangements that now exist in the Hemisphere;
- Minimizing barriers against nonmember countries;
- Maintaining the ability for new countries to join;
- But not thereby thwarting the ability of particular groups of countries that are willing and able to do so to deepen their integration arrangement.

These constraints raise some related questions. One of the more complex of these is whether the requirement that any hemispheric agreement be kept open to new members means that non-hemispheric countries should also be permitted to join. The proposed NAFTA agreement contains no geographic limit on accession of new members. The possibility exists that Australia and New Zealand in particular, but potentially other countries in Asia and the Pacific as well, might wish to become members. The lower the barriers against third countries, the less pressing it is to answer this question, but the issue may arise in any event. My view is that nonregional countries should not be excluded in principle, but that the decision can be deferred until the process in the Hemisphere has progressed much further than it has to date. Deferral of the decision is possible because the transition to free trade in

NAFTA will take 10 to 15 years; and the process of integration in the Western Hemisphere will take even longer.

A second set of questions relates to the undertakings of member countries of ALADI to each other and of the Caribbean countries that benefit from preferences in the EC under the Lomé convention. In the case of ALADI, the letter of the agreement requires that any concessions granted to nonmember countries be extended as well to other members of ALADI. Can Mexico join NAFTA and discriminate against other ALADI countries? In theory no, unless Mexico withdraws from ALADI; in the real world, my assumption is that some solution to this apparent inconsistency will be found for Mexico and then for other countries that wish to remain in ALADI and join in a WHFTA. In the case of Caribbean countries receiving preferences in the EC, the Lomé convention requires them to grant MFN trade treatment to EC countries. Thus, in theory, CARICOM could not join into free trade with the United States without giving free entry to EC countries as well. It is not clear what this will mean in practice. The EC might insist that beneficiaries of Lomé preferences give these up if these countries become part of a WHFTA.

The most important constraints deal with the issue of how countries enter into free trade within their subregions and with the United States. The initial Canadian concern was that the United States would sign a series of FTAs, country-by-country, first Canada, then Mexico, then a third country, and thus only the United States would enjoy free trade generally. This concern over a hub-and-spoke outcome was one of the reasons why Canada joined in the negotiations with Mexico, in order to have a single NAFTA rather than two separate bilaterals. According to Ronald Wonnacott, the main disadvantages of a hub-and-spoke pattern are that it would add to discrimination against spoke countries in each other's markets as compared with the hub country, which would be the only country to enjoy barrier-free entry into all markets; this, in turn, would erode the benefits derived from an FTA with the United States; and, perhaps most crucial, the advantage in attracting investment would be with the hub country.³⁰ Technically, devising rules of origin in an elaborate array of hub-and-spoke FTAs would be horribly complex. The end result of a hub-and-spoke pattern, Wonnacott argues, would be to lower collective incomes as compared with a single, large WHFTA.

The current fact is that the United States is not now a hub country in the sense that Canadians originally feared. Mexico is. The trade consequences are not significant because Mexico's trade with Chile, and potentially Colombia, Venezuela, and several Central American countries, is not substantial. NAFTA as a unit may be a hub, however, if it comes into existence.³¹ The starting point of the United States as a hub, the concern that led to Canadian analysis of hub-and-spoke arrangements, is not now the major problem. The issue, rather, is how the separate hubs, the subregional arrangements that exist plus Mexico's multiple agreements, are best melded into hemispheric free trade.

The second constraint listed above, that of the relative priority of subregional integration as compared with hemispheric integration, is now more relevant than a simple hub-and-spoke scenario. The most important of the subregional agreements is NAFTA. It has the largest combined GDP and conducts more trade than all the other arrangements in the Hemisphere combined. Most importantly, if the process is intended to lead to a single free-trade area in the Hemisphere, NAFTA is the only feasible nucleus around which this could come together. Nevertheless, for many LAC countries, the focus of attention is on subregional arrangements. Now, really for the first time in their modern history, LAC countries are approaching regional and subregional integration by confronting the constraint of minimizing barriers against nonmember countries. For the first time, there is an effort to use subregional integration as a device to expand trade and not just to augment the scope for import substitution.

Each subregion must decide its priorities: whether subregional integration should come first, or whether accession to NAFTA is more important. My own judgment is that subregional integration will be more important in the long term. If all LAC countries join in a WHFTA, the trade preferences of all of them will be diluted. One big FTA in the Hemisphere will almost certainly deal primarily, perhaps exclusively, with trade. It will be more like the EFTA, a preferential trading arrangement, and less like NAFTA, which involves many other rights and obligations of its members.

Over the long term, subregional agreements other than NAFTA can also deepen well beyond trade matters — into other economic areas, transportation, and policy consultation. Effective subregionalism does not preclude preferential trade with the countries of North America. If anything, subregional integration will enhance the bargaining power of the subregions.

The EAI as set forth by President Bush preferred FTAs between the United States and groupings of LAC countries, but the issue of individual LAC country adherence to NAFTA was left open. Chile, which is not a member of a subregional grouping other than ALADI, was the first to respond by requesting adherence to NAFTA. Venezuela and Colombia, despite their membership in ANCOM, are discussing free trade with North America separately from the remainder of ANCOM members. There have been suggestions that Jamaica and Trinidad and Tobago might seek entry into NAFTA separately from their CARICOM partners.³² In all these cases, the potential applicant countries feel they are more ready for free trade with North America than the other countries in their respective subregions. Venezuela and Colombia have, by action, placed higher priority on free trade with the United States and Mexico than on subregional integration. Chile argues that if it were to seek to enter MERCOSUR, it would be forced to raise duties to comply with that grouping's proposed CET, whereas its objective is to move in the opposite direction.

A good case can be made that NAFTA should not accept individual country applications for free trade. Indeed, I argued this way at one point.³³ My reasoning was that accepting country-by-country applications would only complicate the maze of integration agreements that already exists, in addition to pulling apart the promising movement toward subregional integration in the Hemisphere. Implicitly, this meant that Chile should be forced to join a subregional grouping, presumably MERCOSUR (but potentially ANCOM, of which it was once a member) before NAFTA should accept a Chilean petition to open FTA negotiations. This position may be too harsh. Chile is a unique case in that it is not now a member of any subregional integration arrangement other than ALADI and, moreover, is the only LAC country other than Mexico actually ready to enter into negotiations with NAFTA.³⁴ This is not an ideal solution, however.

Other countries, in addition to Chile, are not now members of subregional groupings. These include Panama, Haiti, the Dominican Republic, and Suriname. If Chile is accepted into NAFTA on an individual basis, then why not the others? On a practical basis, the answer is that Chile is ready for free trade with NAFTA because of its internal restructuring; the others are not. On a broader basis, NAFTA loses its *raison d'être* if every "orphan" country is admitted regardless of its potential economic contribution. My view is that these orphans should first seek subregional integration partners before seeking entry into NAFTA. They should not be penalized as the process plays itself out. Most will enjoy trade preferences in the U.S. market under the CBI.

There is an inconsistency here — Chile by itself, yes; the others by themselves, no — but practicality may be more important than symmetry. In the best of all worlds, Chile should come to NAFTA as part of a subregional integration group. However, it would be unwise to punish Chile because it preceded its neighbors in its economic restructuring.

It is clear that the LAC countries have not yet sorted out their priorities between subregional integration and accession to NAFTA. This is so despite the fact that other than Chile and Mexico, no other LAC country is ready for accession to NAFTA. The process cannot be for countries to open reciprocal negotiations to obtain free access to the United States in the context of an FTA before they are ready to open their own markets. One-way preferences into the U.S. market already exist for Andean and CBI countries. Countries, in my view, should first demonstrate that they are able to open markets within their own subregions. This would strengthen subregional economic and political solidarity in the Hemisphere, and this would be lost if each country chose to act separately to negotiate for accession to NAFTA.

The negotiating group on the North American side presumably would not be the United States acting alone, but NAFTA. The individual countries of NAFTA would have to agree to such a negotiation, just as the individual countries of other subregional groups would have to consent. This assumption raises a number of issues. It is not difficult to state, in principle, that NAFTA is open to accession by new countries. This has been done in the agreement. In practice, however, a number of problems arise. Each country of NAFTA, as the accession clause states, must go through its constitutional and legislative procedures for accepting a new member, whether an individual country or a group of countries. Because the new members would be joining NAFTA, the provisions of that agreement would set the parameters for membership.³⁵ The negotiation, in other words, would not be to alter the basic agreement for the benefit of the applicant country, but rather to discuss the transition to membership. Some applicants would need a long transition, with many exceptions during the phase-in period; others would need less.

However, the widening of NAFTA would almost surely limit its deepening among core countries ready and able to augment what now exists in the agreement. This is the last point mentioned under the constraints that must be dealt with in the hemispheric integration process. Deepening of integration in North America would not have the same content as it does in the EC. The three countries in North America do not aspire to economic and monetary union, let alone political union. However, they may wish to limit the volatility in their exchange-rate relationships as trade increases. They may at some point be prepared to consult more frequently on prospective changes in economic policy or in their regulatory framework. It is possible that they can make their dispute-settlement arrangements more comprehensive and more binding than is now the case. This is possible not just in the pure trade area, but in trade-related environmental issues and in complaints about labor standards. This type of deepening among the generality of LAC and North American countries is far more problematic.

Other subregional groupings of LAC countries may wish to pursue their own versions of deepening. This, too, would be lost if entry into NAFTA took place country by country. There would be no possibility for subregional deepening unless subregional integration were given top priority. Even if the NAFTA countries showed little interest in widening their preferential area — something that is clearly possible with changes in the political situations in all three NAFTA countries — subregional integration would have its own rewards.

There is another option to a single WHFTA that could lead to hemispheric free trade without compromising the potential for deepening within subregions. This would be a series of free-trade agreements between NAFTA and other subregional groupings. Under this choice, the NAFTA itself need not be the basis for the negotiation. Instead, two subregional groupings with different obligations among their

member countries would seek to reach free trade. This would not obligate either grouping to accept the other's internal arrangements. This is the concentric-circle approach to hemispheric free trade. It is, in rough form, the model that was followed in Europe between the EC and EFTA. The groupings could eventually come together if developments led in that direction, but this would not be necessary.

If the FTAs between the separate subregional groups were only with NAFTA, this would create another form of hub-and-spoke, with the three countries of NAFTA as the hub. To avoid this, it may be necessary for the various sub-regional groupings to reach free-trade agreements among themselves. The disadvantage of this approach is that it would create a new labyrinth of FTAs, but the structure would be much more straightforward than what now exists. After all, the EC and EFTA have separate provisions, but free trade between them.

These two ways of approaching hemispheric free trade would almost certainly lead to different outcomes. The first approach, looking toward a single hemispheric FTA, would subordinate other subregional arrangements in the sense that they would have to abide by NAFTA provisions. Under this scenario, they would become redundant and probably would wither away. The second approach would allow each subregion to develop according to its own idiosyncrasies, but still lead to free trade between it and NAFTA, and between it and other subregions. Other subregional groupings could seek accession to NAFTA as a group if they preferred this path rather than a separate FTA with NAFTA, but the ultimate decision in this case would rest with NAFTA. A series of concentric circles — a series of FTAs among regional groupings would simplify the labyrinth of integration arrangements that now exist if it was made clear that individual countries could join only one subregional arrangement. If individual countries continued to have multiple subregional memberships, this would complicate the current complexity of trade relationships.

Summary of Approaches to Hemispheric Free Trade

The danger of the hub-and-spoke option, with the United States as the hub country, has been diminished by the trilateral participation in NAFTA. This concern would be eliminated completely if NAFTA were to negotiate as a group with applicant countries or groups of countries.

Still, NAFTA could be the hub, particularly over an indefinite transition period as new countries or groups of countries joined and others remained on the outside. This is one option for reaching hemispheric free trade — using NAFTA as the center which receives accession applications from other countries or subregional groupings. This would lead to growing discrimination against countries outside of NAFTA until there was one grand WHFTA.

The advantage of this approach is that eventually it is possible there may be a single WHFTA in which all countries are treated equally. Its main disadvantage, other than the inherent growing discrimination over the transition period, is that it would not permit deepening either of NAFTA or other subregional arrangements.

Another approach is based on encouraging the strengthening of subregional groupings of LAC countries. These subregional groups could then seek accession to NAFTA, in which case they would still have to use the provisions of NAFTA as the basis of negotiation; or instead they could seek separate FTAs with NAFTA and with each other.

The advantage of the approach involving a series of FTAs is that it permits deepening of economic integration among like-minded countries without prejudice to the free-trade objective. Its disadvantage is that it maintains a large number of subregional groupings, perhaps indefinitely.

Institutional Arrangements

Two rules of institution building should be kept in mind. First, do not create institutions in the simple hope that a new body will lead to creative thinking. It is better when uncertain to just sit there. Second, which is a corollary of the first, do not create an institution until it is clear what it will be administering. The hemispheric scene is already replete with institutions and yet another, without a clear objective, would most likely intensify turf battles.

There are other viewpoints. One suggestion is that while existing institutions may be able to carry out many research and planning functions for now, consideration should be given to new architecture required to guide an economically integrated Hemisphere.³⁶ The underlying argument of this position is that a new mechanism will be needed to make pre-negotiation studies, check new FTAs for cross-consistency, help to settle disputes, and perhaps help in negotiations a developing WHFTA will have to carry out.³⁷

Following the second rule — do not create a new institution until it is clear what is being administered — calls for delay of institutional decisions until the sequencing option toward hemispheric free trade is chosen. More precisely, it means using existing hemispheric and subregional institutions for the time being. These include the IDB, ECLAC, the Organization of American States, and the various secretariats of the subregional integration arrangements.

If the architecture chosen for hemispheric free trade is the option of seeking a single WHFTA by building on the core of NAFTA, this would require its own type

of institutional structure. If, instead, the path chosen is that of reaching free trade by a series of FTAs, then quite different kinds of institutions are needed. In the first case, the organization needed would be similar to those of other large integration arrangements, a secretariat for monitoring the daily operations of the WHFTA and for carrying out studies and making proposals, a policy- and rule-making body, panels for dispute resolution, and preparing positions for negotiating purposes within the WHFTA and with other countries and groupings; this is the kind of mechanism suggested by Feinberg and Hakim. Implicitly, they assume option one. The arrangement would be something between that of the EC Commission and the EFTA secretariat — its powers would be less than that of the EC Commission because the WHFTA would have a less ambitious mandate than the EC, but more than those of the EFTA secretariat, because EFTA itself has a less comprehensive agenda than a WHFTA built on the core of NAFTA would have.

If the choice is option two — based on FTAs among subregional groupings — a large, unified secretariat would not be called for. Instead, each subregional grouping would function with its own secretariat, but with coordinating functions among the various groupings for cross consistency of the FTAs. Existing institutions like the OAS, the IDB, and ECLAC could be drawn on for more comprehensive studies, if so desired.

If priority is given to building subregional integration arrangements, then the choice of the ultimate institution can clearly be delayed until the overall architecture is determined. This is because subregional integration arrangements can be the prelude to either option, each of which has different institutional implications.

One other institutional feature should be mentioned. NAFTA, unlike the EC, does not call for financial transfers from the two wealthy countries to Mexico. The financial transfers that do take place come from outside the NAFTA structure, such as from the IDB. A suggestion has been made to establish a North American regional development bank to help Mexico meet its infrastructure and adjustment problems in the transition to free trade.³⁸ Regardless of whether this proposal prospers, similar suggestions have been made about the need for assistance to help the least developed countries of the Hemisphere prepare for free trade.³⁹ Should there be a special bank for hemispheric economic integration, similar to that which exists in the EC and in some subregions in the LAC area? Or, can this function be assumed by the IDB, augmented by the subregional development banks already in existence? The EAI as proposed by President Bush chose free trade as its centerpiece. The Initiative quite deliberately, based on U.S. budgetary considerations, did not choose foreign assistance. The main financial component of the EAI was relief from some official debt owed to U.S. institutions. In addition, the resources of the IDB have been augmented in recent years. It is most unlikely, therefore, that the United States would consent to still another development bank for the Hemisphere. The strength of

the free-trade proposal is that it provides permanent opportunities, not foreign assistance dependent on the whim of the U.S. executive and Congress.

Concluding Comments

The main purpose of this paper is to examine the path to hemispheric free trade and to explore the institutional implications of the path chosen. This required analysis of the objective situation in the Hemisphere: Why is hemispheric free trade now an option when just a few years ago the idea would have been dismissed out of hand? The answer is in the nature of the development philosophy that has emerged in the LAC region. Countries are opening their markets and seeking to promote exports, with or without free trade. The process of getting to free trade also requires that the countries of the Hemisphere make value judgments of what they would like to reject or include in the final arrangements that emerge. My judgments on these matters were given as the constraints that must shape the process toward free trade. What follows are my opinions on the main sequencing and institutional choices that must be made.

1. Priority should be given to strengthening subregional arrangements. These can and should be the building blocks of hemispheric free trade. This priority does not require that every LAC country be part of a subregional grouping — several countries are now outside the main subregional economic integration arrangements and should not be forced against their perceived interests to enter into one of them — but the main thrust should be toward inclusion. However, with the tenuous exception of Chile, countries that choose to remain outside of groupings in their own subregions should not have the option of joining NAFTA on an individual basis. Because most LAC countries, to one degree or another, are now opening their markets, the prospects for trade-expanding subregional integration are more promising than at any time since World War II.

2. Of the two major paths to free trade — that of building on NAFTA and enlarging it as other subregional groupings (or in the case of Chile, that country alone) are ready to seek accession, or concluding a series of FTAs among subregional groupings, including NAFTA — I prefer the second. My reason is that this will not preclude deepening of each subregional grouping beyond what now exists, whereas building on NAFTA alone would slow the progress of all groupings to the ability of the countries least able to take on greater obligations. Hybrids of these two options are sure to emerge, such as a mixture of some subregional groupings seeking entry into NAFTA and others more content to maintain their own structures but still wanting free trade with the NAFTA countries.

3. Decisions on the architectural structure are best delayed until the path to free trade is more clearly defined. The two sequencing options have quite different institutional implications.

I would like to conclude on an optimistic note. It is unclear where the free-trade proposal will take the countries of the Hemisphere. There will be many intervening circumstances that will shape the thinking of countries. Yet, a process has started. Negotiations for reducing subregional trade and related barriers are taking place throughout the Hemisphere. Unlike the past, these are intended to be trade-expanding. The very idea of hemispheric free trade, which would have been anathema as recently as a decade ago, is being given serious attention. The process in place is one of opening markets, not of closing them. This is new in the Hemisphere and should be encouraged.

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Notes

1. Peter Hakim, "President Bush's Southern Strategy: The Enterprise for the Americas Initiative," *Washington Quarterly*, vol. 15, no. 2 (Spring 1992), notes (p. 93) that Enrique Iglesias, President of the Inter-American Development Bank, referred to the EAI as perhaps the most ambitious proposal in the LAC region's relations with the United States.
2. Sidney Weintraub, "Regionalism and the GATT: The North American Initiative," *SAIS Review*, vol. 11, no. 1 (Winter-Spring 1991), p. 46.
3. For example, see the explicit statement to this effect in Richard Feinberg, "Economic Themes for the 1990s," in Henry Hamman, ed., *Setting the North-South Agenda: United States-Latin American Relations in the 1990s*, proceedings of conference plenary sessions (University of Miami: North-South Center, 1991, p. 34.
4. U.S. Secretary of State James G. Blaine proposed the formation of a hemispheric free-trade area at the Washington Conference of American States in 1889-90. The suggestion was peremptorily dismissed by the Latin American representatives.
5. Isaac Cohen, "Economic Questions," in G. Pope Atkins, ed., *The United States and Latin America: Redefining U.S. Purposes in the Post-Cold War Era* (Austin, Texas: Lyndon B. Johnson School of Public Affairs, 1992), p. 28.
6. These figures come from David R. Malpass, Deputy Assistant Secretary of State for Inter-American Affairs, testimony on U.S.-Latin American relations before the Joint Economic Committee, U.S. Congress, April 2, 1992.
7. Refik Erzan and Alexander Yeats, "Free Trade Agreements with the United States: What's In It for Latin America?" World Bank policy research paper WPS 827, January 1992, p. 7.
8. Ibid.
9. For example, see Hakim, "President Bush's Southern Strategy"; Siegfried Marks, *Free Trade With Mexico and the Hemisphere: Obstacles and Limitations* (University of Miami: North-South Center, 1991); Sidney Weintraub, "The New U.S. Initiative Toward Latin America," *Journal of Interamerican Studies and World Affairs*, vol. 33, no. 1 (Spring 1991), pp. 1-18; a special issue of the *ANNALS of the American Academy of Political and Social Science*, scheduled for the spring of 1993; and many of the papers in this project undertaken jointly by the Economic Commission for Latin America and the Caribbean and the Inter-American Development Bank.

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10. This may have been the indirect message of Robert Zoellick, U.S. Under Secretary of State for Economic Affairs, in an address on July 24, 1992, during post-ministerial meetings in Manila of the Association of Southeast Asian Nations. Zoellick said that free trade in North America and in Asia should complement each other and help create stronger pan-Pacific ties.
 11. U.S. Department of Commerce, *U.S. Foreign Trade Highlights 1991* (Washington, D.C.: International Trade Administration, 1992), p. 11.
 12. I base this statement on econometric analysis.
 13. Comisión Económica para América Latina y El Caribe (CEPAL), "Preliminary Overview of the Latin American and Caribbean Economy, 1991", information note no. 519/520, December 1991, Santiago, Chile, estimates that LAC debt service as a percentage of exports of goods and services was 22 percent in 1991 compared with proportions in the mid-30 percent range during most of the 1980s. This same source estimates that there were resource inflows into LAC countries of \$6.7 billion in 1991, the first time this figure was positive since 1981. LAC's debt problem is by no means resolved, but it does not now have the same devastating effect it did during the 1980s.
 14. Al Berry, Leonard Waverman, and Ann Weston, "Canada and the Enterprise for the Americas Initiative: A Case of Reluctant Regionalism," *Business Economics*, vol. 27, no. 2 (April 1992), pp. 31-38.
 15. Bob Rae, the premier of Ontario, has noted his concern about Canadian vulnerability "on cars, on culture and on two or three other issues." See Karsten Prager and George Russell interview with Premier Rae in *Time*, November 11, 1991, p. 39.
 16. Erzan and Yeats, "Free Trade Agreements with the United States," pp. 18-24.
 17. Richard L. Bernal, "A Caribbean Perspective of the Enterprise for the Americas Initiative," paper presented at a seminar on the Caribbean and the Enterprise for the Americas Initiative, Kingston, Jamaica, September 26-27, 1991
 18. What I have in mind by a more comprehensive organization is the proposal made in the context of the Uruguay Round negotiations to broaden the charter of the GATT to make it reflect what is actually covered in trade negotiations, such as trade in services, trade-related investment matters, environmental issues related to trade, intellectual property, and many other matters. GATT has never been universal, particularly because of the absence of most countries with centrally-planned economies, but, as we know, this situation is changing.
 19. Jagdish Bhagwati, *The World Trading System* (Princeton University Press, 1991), p. 58.
 20. This is discussed in Sidney Weintraub, *Trade Preferences for Less-Developed Countries: An Analysis of United States Policy* (New York: Praeger Publishers, 1966), pp. 1-22.

21. Jacob Viner, "The Most-Favored-Nation Clause in American Commercial Treaties," *Journal of Political Economy*, vol. xxxii, no. 1 (February 1924), p. 111.
22. See C. Michael Aho, "A Recipe for RIBS — Resentment, Inefficiency, Bureaucracy, and Stupid Signals," in Richard S. Belous and Rebecca S. Hartley, eds., *The Growth of Regional Trading Blocs in the Global Economy* (Washington, D.C.: National Planning Association, 1990), pp. 22-29, for a presentation of this point of view about the current trend toward regionalism.
23. Augusto de la Torre and Margaret R. Kelly, *Regional Trade Arrangements*, occasional paper 93 (Washington, D.C.: International Monetary Fund, 1992), p. 1
24. See *The Economist*, "European Community: Deepeners versus Wideners," February 3, 1990, p. 50.
25. Michel Rocard, *Europe and the United States* (New York: Council on Foreign Relations Press, 1992), p. 11.
26. Bhagwati, *The World Trading System*, p. 71.
27. Ibid, pp. 76-77.
28. Jeffrey J. Schott, *More Free Trade Areas?* (Washington, D.C.: Institute for International Economics, 1989), p. 27.
29. Rudiger Dornbusch, "U.S.-Latin American Trade Relations," testimony before the Joint Economic Committee, U.S. Congress, April 2, 1992.
30. Ronald J. Wonnacott, *The Economics of Overlapping Free Trade Areas and the Mexican Challenge* (Toronto: C.D. Howe Institute; Washington, D.C.: National Planning Association, 1991).
31. The discussion that follows assumes that NAFTA will come into existence.
32. Richard L. Bernal, "Trade Links to the U.S. — Before and NAFTA," *Hemisfile of the Institute of the Americas*, La Jolla, California, vol. 3, no. 3 (May 1992), pp. 10-11.
33. See Sidney Weintraub, "The New U.S. Initiative Toward Latin America."

34. Dornbusch, in his testimony of April 2, 1992, before the Joint Economic Committee of the U.S. Congress, argued that Chile should first reach agreement with its regional neighbors even if this slowed the process of its free trade with the United States.
35. This was the preferred choice set forth in Peter Hakim and Nora Lustig, "Western Hemisphere Free Trade: Issues and Prospects: Notes of a Policy Discussion," issued by the Inter-American Dialogue and the Brookings Institution, September 16, 1991.
36. Richard E. Feinberg and Peter Hakim, "The Americas Commission: A Proposal," in Feinberg and Hakim, *New Directions in U.S.-Latin American Relations* (Washington, D.C.: Overseas Development Council and Inter-American Dialogue, 1991), pp. 23-28.
37. The series of studies of which this paper is a part being carried out cooperatively by the IDB and ECLAC is presumably an example of what this suggestion has in mind.
38. Albert Fishlow, Sherman Robinson, and Raul Hinojosa-Ojeda, "Proposal for a North American Regional Development Bank and Adjustment Fund," processed, May 1991.
39. See Bernal, "A Caribbean Perspective...."

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