



# Open regionalism in Asia-Pacific and Latin America: a survey of the literature

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# Open regionalism in Asia Pacific and Latin America: a survey of the literature

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This document was prepared by Mikio Kuwayama, a staff member of the International Trade and Development Finance Division.

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## Summary

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Both in Asia Pacific and Latin America, considerable confusion and ambiguity surround the notion of “Open Regionalism” that question its relevance for practical purposes. Chapter I will examine various interpretations and applications of the concept and study under what circumstances the two elements “open” and “regionalism” come into contradiction. The chapter first put to provide some precision on the relationship that may exist between Open Regionalism and regional integration, and then it inquires of under what conditions regionalism can be a “stepping stone” or “building block” towards the improvement of multilateralism.

The rapid economic growth in Asia provided a solid foundation for inter-firm networks and intra-regional trade and investment flows, with few institutional or government-led schemes. In the 1990s, Latin America, whose integration has often been characterized as “policy driven”, has also experienced a deepening of *de facto* integration, resulting in stronger intra-regional trade and investment linkages. Chapter II reviews briefly the impact of the recent economic crisis on production, trade and investment patterns for each region and identifies integration instruments that might be compatible with and conducive to policies to enhance the synergistic effects of *de facto* and policy-driven integration.

“Deep” integration usually refers to an integration that deals with “behind the border” issues, going further than “shallow” integration that involves mainly the reduction of measures applied at the border. Chapter III analyzes the appropriate scope and nature of “new” trade issues to be included in “deep” integration of developing

countries and assess whether the initiatives through regional agreements can be more effective than those undertaken at the multilateral level. The chapter elaborates on arguments, in favor of or against, potential dynamic benefits and costs that might be involved with regional cooperation, in areas such as, services, investment, infrastructure, trade finance, social and equity problems, small- and medium-size enterprises.

Chapter IV analyzes the implication of the Uruguay Round commitments on the development process and major problems faced in their implementation. Based on this review, the chapter identifies the major areas of interests of developing countries for a new “Millennium Round”. In doing so, some new “conditionalities” and opportunities that the new round might introduce on regional agreements are considered.

## I. Conceptualization and implementation of “Open Regionalism”.

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### A. Introduction

Despite many attempts by trade economists, government officials and regional institutions to define open regionalism, there remain considerable confusion and ambiguity, that leads to questioning its relevance. The concept is imbedded in and was originated from economic cooperation efforts in Asia-Pacific.<sup>1</sup> More recently, the concept became of common use by trade officials en Latin America, although with even less precision on its use and meaning.

A trivial definition differentiates “open” regionalism from a “closed” one. The usual criterion for such distinction is a clear shift from an inward-looking, import substituting focus that was prevalent in the regional integration movement of earlier decades, to a greater emphasis on outward-oriented and internationally competitive strategies.<sup>2</sup> Also, open regionalism is sometimes interchangeably used to refer to the “new”

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<sup>1</sup> For details on how the concept was conceived and developed in Asia Pacific, see Okita (1992).

<sup>2</sup> Langhammer (1999) argues that the European Union’s way to regional integration is not “closed” *per se*, except for the agricultural sector. He maintains that since 1957 trade barriers with the rest of the world in the industrial sector have been dismantled rapidly in parallel to the dismantling of barriers within the Community. This dual process of dismantling has taken place without a fixed program of reduction between internal and external trade barriers.

regionalism, whose main features is the liberalization not only of goods but of services, movements of capital and labor, the harmonization of regulatory regimes, and the emergence of North-South regional agreements. The term “new” also underlines inclusivity of membership, as opposed to a regionalism based on exclusivity (Primo Braga, 1994, Mistry 1995). An important criterion is open membership in the regional arrangement: any country with credible willingness to accept the rule of the regional arrangement would be welcome to join. Another version of the new, open regionalism refers to a multidimensional process of regional integration that includes economic, political, social and cultural aspects (Hettone and Inotai, 1994).

Probably the first attempt in applying any notion of open regionalism specifically to Latin America was made by Reynolds, Thoumi and Wettmann (1993). In examining the possibility of employing such concept to the Andean integration, the authors defined it as a comprehensive strategy to create “a set of dynamic markets fully integrated to the international economy through the progressive removal of barriers to economic exchange plus proactive measures to increase social access to the modern market”(p.175). Shortly after, in 1994, ECLAC put forward the open regionalism as an effective “process of growing economic interdependence at the regional level, promoted both by preferential integration agreements and by other policies in a context of liberalization and deregulation, geared towards enhancing the competitiveness of the countries of the region and, in so far as possible, constituting the building blocks for a more open and transparent international economy” (ECLAC, 1994, p.8).

Focusing on Latin America, Lizano (1998), Kuwayama (1993) and Bulmer-Thomas (1998) similarly conceptualize open regionalism as series of joint actions at the regional levels to acquire and enhance international competitiveness. Regional trade agreements (RTAs) can serve a useful economic purpose beyond the direct gains from trade liberalization, by reducing uncertainties and improving credibility and thus making it easier for the private sector to plan and invest regionally and globally. Grinspan (1995) perceives open regionalism as a regional integration scheme which would incorporate the issues of sustainability, equity and solidarity. In addition, referring to the term open regionalism, Van Klaveren (1997) and Palacios (1995) identify a new regionalism in Latin America that involves a significant process of convergence between diverse initiatives at the subregional, regional and even hemispheric levels, and a new orientation towards the rest of the world based on much less rigid and non-exclusive alliances and groupings. This is also accompanied by increasing political cooperation in a wide set of issues range of issues (human rights, disarmament, etc.).

Various understandings of open regionalism by ECLAC and other sources are “systemic” in nature and go much further than traditional trade liberalization. An “open regionalism” that is appropriate for the foregoing objectives should allow an extensive liberalization of intraregional markets in terms not only of countries but also of sectors, with few exceptions. In addition, this approach to integration requires the adoption of agreements that will contribute to macroeconomic stability in each country, to a suitable technological infrastructure, to the modernization of basic production support services such as transport, communications, ports and trade, to the establishment of suitable payment and trade-promotion mechanisms, to the building of the infrastructure, and to the harmonization or non-discriminatory application of trade rules, domestic regulations and standards. Moreover, the reduction of transaction costs and of discrimination within the region could be reinforced by sectoral arrangements or policies to take advantage, in turn, of the synergetic effects of integration. Such rules should be adopted so that reciprocal integration agreements can serve as an unequivocal guarantees against all possible risk or uncertainty about access to the expanded market.

This way of conceptualizing open regionalism from the systemic viewpoint accommodates well the more recent efforts on the part of trade economists to define open regionalism as a strategy of international economic opening which stresses regional cooperation with an emphasis on the reduction of intra-regional transaction costs, broadly defined (Reynolds, 1997, Fernandez 1997). Open regionalism is to facilitate international economic transactions in a region without seeking to divert trade or investment from the rest of the world. From this optic, although it may divert trade towards less efficient regional sources in the short-run, regional integration decreases transaction costs and enlarges the market in the medium- and long-term.

## 1. Asia Pacific

In broad economic terms, the concept of open regionalism portrays a general strategy to enhance the benefits of regional liberalization without jeopardizing the continued vitality of the multilateral system. Frankel and Wei (1998) define open regionalism to be external liberalization by trade blocs. In more precise terms, Bergsten (1997) suggests that the concept of open regionalism involves at least five possible definitions: i) open membership; ii) unconditional MFN; iii) conditional MFN; iv) global liberalization; and v) trade facilitation. The first four definitions focus on tariff and other traditional border barriers. The inclusion of the last, facilitating trade through non-tariff and non-border reforms is a new focus of the concept and constitutes one of the major pillars of APEC's open regionalism. Such initiatives and measures of trade facilitation can be narrowly focused, such as customs harmonization and mutual recognition of product standards, or could be quite far-reaching, as with cooperation in enforcing national competition policies and deregulation of key domestic markets (deep integration). Initiatives of both types are being contemplated within APEC.

A strict interpretation of open regionalism would require open membership and even extension of concessions and privileges under MFN conditions to non-members. For instance, Garnuat (1996, p.7) defines the open regionalism of APEC as "concerted unilateral MFN liberalization of trade by a number of states".<sup>3</sup> In view of some analysts (e.g., Ariff 1998), the APEC forum is perceived as the only regional grouping that is completely WTO-consistent in both letter and spirit, despite its loosely structure that serves as a consultative, non-negotiating body whose decisions are not legally binding.<sup>4</sup> It has been argued that from its inception, one of the underlying principles behind APEC has been to exert a strong, positive influence on the future evolution of the global trading system, by pursuing liberalization within APEC on a General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) and not to the detriment of others. Furthermore, APEC should offer to multilateralize, in future negotiations, all proposals which had been considered in the GATT (e.g., during the Uruguay Round) but could not yet be adopted there, but were taken at the regional level. Therefore, the APEC community should seek to 'ratchet up' the process of global trade liberalization (APEC 1997b).

In addition, APEC seems to have a "systemic" focus. Economic and technology cooperation is built in as one of the three pillars of APEC cooperation, along with liberalization and facilitation of trade

<sup>3</sup> In contrast, Langhammer (1999, p.1) labels the EU way to integration "concerted plurilateral non-MFN(discriminatory) liberalization by a specified number of club members".

<sup>4</sup> As is well known, in 1994 APEC Leaders delivered the ambitious Bogor Declaration of "achieving free trade in the region by 2010 and 2020", the former for the developed countries and the latter for other members. Next year in Osaka, they agreed on the Action Agenda for achieving the targets and in 1996 in Manila they adopted Manila Action Plan for APEC. The ASEAN Economic Ministers Meeting in October 1999 has reportedly decided to accelerate the member countries' commitments in APEC, bringing forward the Bogor process by two years. For Indonesia, Thailand, Malaysia, Singapore, the Philippines and Brunei, the period is now fixed for the year 2015.

and investment.<sup>5</sup> APEC has adopted a unique modality of trade and investment liberalization and facilitation (TILF) in 13 different areas.<sup>6</sup> The potential importance of these initiatives can be appreciated by the fact that the impact of trade facilitation exceeds that of trade liberalization: the former creates a gain of about 0.26% of APEC GDP whereas the gain from the latter is estimated to be 0.14% of GDP (APEC 1997a).

Some analysts (Ariff, 1998, Garnaut 1998) of Asia-Pacific regional trade agreements similarly maintain that the Association of Southeast Asian Nations (ASEAN) has enabled its member countries to multilateralize regional tariff reductions under the ASEAN Free Trade Area (AFTA). Thus, in their view, ASEAN comes fairly close to what may be termed open regionalism. Of course, being full members, ASEAN's integration with the global economy has also been in many ways conditioned by its participation in APEC and WTO. Besides, ASEAN's outward-looking orientation is evident from its new initiatives to establish links with other regional groupings.<sup>7</sup> Very recently the ASEAN countries have decided to accelerate the liberalization process.<sup>8</sup> Even more, the ASEAN experience might suggest that trade discrimination within a customs union or free trade area is not necessary for powerful increases in intra-regional trade, while multilateral liberalization can be also associated with rapid increases in extra-regional trade.

Also, in ASEAN, trade liberalization efforts in goods has been supported by cooperation in such areas as industrial complementation and joint ventures, agriculture and forestry, customs, mechanisms for dispute settlement, finance and banking, intellectual property rights, investment,<sup>9</sup> minerals and energy, services<sup>10</sup> standards and conformance, tourism, transport and communications. The global complement to these regional arrangements was the inclusion of services in the mandate of the Uruguay Round and the consequent negotiation of the GATS. In the case of services, for example, a very distinct feature of the Framework Agreement that differs from the GATS and CER is the stress placed on cooperation between member economies for the development of service industries (Article II). Members are urged to cooperate in areas such as

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<sup>5</sup> The Manila Declaration identified the following six areas as important for giving greater coherence and direction to sustainable development: i) development of human capital; ii) development of stable and efficient capital markets; iii) strengthening economic infrastructure; iv) facilitation of technology flows and harnessing technologies for the future; v) safeguarding the quality of life through environmentally sound growth; and vi) developing and strengthening the dynamism of small and medium enterprises.

<sup>6</sup> The TILF in the 13 areas include tariffs, non-tariff measures, services, investment, standard and conformance, customs procedure, intellectual property rights, competition policy, government procurement, deregulation, rules of origin, dispute mediation, and mobility of business people.

<sup>7</sup> Efforts are underway to link AFTA with CER (Closer Economic Relations) of Australasia, Mercosur, and South African Development Coordination Conference. Such links will eventually turn regional blocs into building blocks of global free trade.

<sup>8</sup> On the border measures, the Twelfth Meeting of the ASEAN AFTA Council, held in October, 1998, in Manila, the Philippines, decided to accelerate its implementation ahead of the original timetable of 0-5% tariff rates by the year 2003 (2006 for Vietnam and 2008 for Laos and Myanmar). The ASEAN summit, December 1998, decided to accelerate the implementation of the reducing Common Effective Preferential Tariff (CEPT) products from 2003 to 2002, and to expand them. As a result, this summit decided to bring forward one year the day for an end of implementation of AFTA, so that AFTA will be completed by 2000. However, it might be difficult for the less developed countries, such as Vietnam, to comply fully with the obligations (Tongzon 1999).

<sup>9</sup> In October 1998, AFTA decided to establish a framework agreement on the ASEAN Investment Area to create a favorable investment climate for foreign direct investment through the business opportunities accorded from an enlarged regional market.

<sup>10</sup> At the end of 1997, the Governments of ASEAN members signed the "Protocol to Implement the Initial Package of Commitments under the ASEAN Framework Agreement on Services". This contains schedules of specific commitments and the list of MFN exemptions, which go beyond those inscribed in each Member State's schedule of specific commitments under the General Agreement on Trade in Services (GATS).

establishment or improvement of infrastructure facilities, joint production, marketing and purchasing arrangements, R&D and exchange of information (Findlay and Warren 1997).

## 2. Latin America

In Latin America as well, traditional integration arrangements have adjusted themselves to new realities. Instead of serving as instruments for the limited expansion of protected markets, they are now often referred to as a strategic weapon for export expansion and a potential testing ground for access to developed countries' markets for new manufactures from the region. Among the 12 countries of the Latin American Integration Association (LAIA), 41 Economic Complementation Agreements (ECAs) have been signed, majority of which are bilateral.

The major pending issues are the completion of Mercosur negotiations with Mexico and with the Andean Community countries. For the latter, the two integration schemes are negotiating to establish multilateral preferences over existing bilateral agreements signed between the countries concerned.<sup>11</sup> The Summit Meeting between the European Union and Mercosur, August 1999 in Rio de Janeiro, decided to initiate negotiations to liberalize, gradually but progressively, the totality of trade, without excluding any sector and in conformity with the norms of the WTO, with a view to establishing a free trade area early in the next century. Towards a similar goal, Canada has recently started official discussions with Mercosur, while the latter has begun contacts with Australia, China, Japan, New Zealand, Panama and others. Chile and Mexico individually have signed a similar agreement with the European Union. Canada and Chile have signed a free trade agreement.

Public declarations by officials of Mercosur countries suggest that its regulatory process has been underpinned by a vision and a set of values that have been rationalized through the concept of open regionalism (Sanchez 1999). The framework and rationale behind its membership enlargement and coverage deepening are the pursuit of strengthened regional integration without jeopardizing the relationships with the rest of the world. This general orientation is forged with the following four aims, all of which should lead to competitive insertion of Mercosur in the world economy: macroeconomic policies of adjustment in terms of stabilization, microeconomic policies in terms of deregulation, trade policies in terms of liberalization, and the private sector as an engine of capital accumulation. A document of Ministry of Foreign Relations of Argentina states: “[Mercosur is]...open regionalism, in the framework of market oriented national policies and adhesion to multilateralism...In case of success, Mercosur constitutes a tool intended to improve business profitability and the expected returns from investment projects” (cited in Sanchez 1999).<sup>12</sup>

Most significantly, the majority of the governments of Latin America and the Caribbean are committed to creating the hemispheric-wide Free Trade Area of the Americas (FTAA) beginning in the year 2005. The Declaration of IV Ministerial Meeting on Trade in San José, Costa Rica stipulates that the terms agreed should be compatible with the rules and regulation of the WTO,

<sup>11</sup> The partial Scope Agreement on Economic Complementarity between Brazil and the Andean Community was formalized in August, 1999, in which the Community negotiated as a bloc. This agreement on tariff preferences grew out of the Framework Agreement for the creation of a free trade area between the Andean Community and Mercosur, signed April of 1998. To encompass the other Mercosur countries, the free trade area can be negotiated under the 5+4 format. At present, the Andean Community is negotiating a FTA with Panama and a tariff preferences agreement with Guatemala, El Salvador and Honduras (see the website of the Andean Community).

<sup>12</sup> In this connection, it is interesting to note that in July of 1997, in response to the question raised by the Trade Policy Review Body (TPRB) of WTO regarding Paraguay's compliance with the provisions of Article XXIV and its participation in other free trade agreements, the country's representative noted that Mercosur's philosophy was based on the practice of OR and that regional agreements were compatible with the multilateral trading system (WTO 1997b). Also, in September of the same year, in examining the balance in Chile's trade policies between multilateral and regional agreements, the TPRB asked the country to clarify its understanding and definition of the concept OR (WTO 1997a).

especially Article XXIV of the GATT and Article V of the GATS. Into this declaration several points stressed by Mercosur were incorporated. They included that: i) the FTAA can co-exist with bilateral and sub-regional 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); ii) the FTAA should be constructed based on commitments that are balanced, equitable and advantageous for each of the members and should be assumed completely and simultaneously by the 34 countries; and iii) the different negotiation areas should move forward at the same time and no agreement should come into effect separately (single undertaking). Thus, it might be said that the nature of FTAA fits the open regionalism focus. The countries in the region are expected first to implement RTAs and second to make different provisions across various sectors of these schemes converge and/or be harmonized, in a reasonable time framework, in conformity with the present or future WTO commitments.

It should be noted that the creation of FTAA forms part of the wider initiatives contemplated in the area of “Economic Integration and Free Trade”, of the Plan of Action signed by the Heads of State in the Second Summit of the Americas, held in Santiago, Chile, in April of 1998. This way, the Plan incorporates actions to advance the modernization of financial markets, programs of science and technology, energy cooperation, and hemispheric infrastructure, in particular in the fields of transportation and telecommunications. Also, the Plan constitutes a body of concrete initiatives intended to promote the overall development of the countries of the Hemisphere in the areas of education, democracy, human rights, and poverty eradication and discrimination.

Since the most important element of open regionalism is the question of whether RTAs contribute to perfecting the multilateral process, it is interesting to know the position of WTO on the concept. Mr. Renato Rugggerio, former Director General of WTO, earlier accepted the concept of open regionalism, as long as: i) any RTA be consistent with Article XXIV of the 1994 of GATT and the understanding on its interpretation incorporated in the Uruguay Round agreements on trade in goods; and ii) the gradual reduction of internal barriers to trade within a regional grouping will be implemented at more or less the same rate and on the same timetable as the lowering of barriers towards non-members (WTO 1996). However, Srinivasan (1998) questions that if regional liberalization were to be executed on the same timetable to non-member countries on an MFN basis, it would be multilateral and not regional. There is no official definition of open regionalism by WTO, while the foregoing understanding by the former Director General remains still vague and confusing.

## B. Problematic areas of the concept open regionalism of APEC

However, a more critical reading on open regionalism suggests that the two elements of “open” and “regionalism” might come into contradiction (Saburi 1997, Srinivasan 1998, Woo 1999). As Woo (1999) asserts, open regionalism was not a contentious notion until the second report of the Eminent Persons Group published in 1994, which claimed that all liberalization agreed by APEC must proceed in a manner consistent with the principle of open regionalism. The liberalization process was to be implemented by a non-mutually exclusive four-part formula consisting of: i) the maximum possible extent of unilateral liberalization; ii) commitment to continue reducing its barriers to non-member countries; iii) willingness to extend its regional liberalization to non-members on a mutually reciprocal basis, while it liberalizes internally on an MFN basis; and iv) recognition that any individual APEC member can unilaterally extend its APEC liberalization to non-members on a conditional or unconditional basis.

With respect to the last, Article I on MFN treatment of GATT requires the extension of liberalization benefits to non-members on an unconditional basis, rather than on a conditional

MFN. If the liberalization of trade by some APEC member, that is also a GATT member, is extended to a non-APEC but GATT member, it is un conformity with the GATT rule, even if it is applied on a voluntary basis. Therefore, open regionalism conceived in this way, includes an element of contradiction to the GATT rules. Saburi (1997) argues that the more trade is liberalized, the more it becomes difficult to coordinate both elements of “open” and “regional”. In short, the application of APEC liberalization on a conditional MFN basis contradicts GATT Article I and would require these members to form an FTA to be consistent with GATT Article XXIV.

Yamazawa (1994) also mentions that there is ambiguity in the definition of open regionalism and its consistency with GATT. In his view, the Asian conception of open regionalism that emerges from APEC is that trade and investment liberalization is based on an unconditional MFN basis. On the other hand, the American viewpoint is that APEC liberalization should be extended to non-members only on a conditional MFN basis, in fear of free rider concerns. The latter is more consistent with a Free Trade Area, permitted under GATT Article XXIV, and bodes well with the American concept of open regionalism (i.e., openness through reciprocity by non-members). He maintains that the application of unconditional MFN in APEC in every area is improbable, while the extension of conditional MFN in many areas is equally unlikely.

What Yamazawa considers the most important is that late-starters in industrialization are not yet prepared for quick liberalization and that developed country producers in such areas as agriculture and textiles keep being protected. It is unlikely that those sensitive areas will be liberalized rapidly, even though the combined APEC shares are predominant in world trade. A more practical approach to the APEC liberalization would be to select some sectors (e.g., TRIMs, TRIPs, some service sectors) where a majority of APEC members are interested in further liberalization and willing to apply the outcomes to non-members on an unconditional MFN basis. “Successful liberalization in such areas will increase the momentum for further liberalization, which will eventually lead to a new WTO round.” (1994, pp.41-42).

An important feature of open regionalism in APEC is that governments would act in a unilateral and voluntary way to reduce barriers, but in concert, approach which can be summarized as “concurrent unilateral voluntary trade liberalization (cuvtl)”. In this regard, the Asian conceptualization is that negotiations would take place only among the “likely-minded”, and not in all sectors, with the result that APEC would tolerate very different speeds of liberalization and reform. Therefore, there would appear to be little need for negotiating concessions on a reciprocal basis: decisions would be left to national governments about the depth and speed of liberalization, under the assumption that their national interest and peer pressure would gradually push them in the direction of multilateral liberalization.<sup>13</sup> The idea of the United States is, on the other hand, that APEC must be built on “comprehensive action” across all sectors, that “concerted unilateral action” has to be implemented with some guarantee of compatibility of members’ liberalization efforts (Haggard 1997).

Comparing with the case of European Union, Langhammer (1999) thinks that reliance on peer pressure as the only mechanism to commit members to liberalization of APEC lacks “teeth” to insure a successful multilateral liberalization process. He argues that instead of unilateral trade facilitation and liberalization, APEC should adopt a common policy towards non-members, as done in the EU. The approach based on peer pressure should be replaced by the rule of laws.

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<sup>13</sup> Besides, the voluntary, non-binding character of APEC could have a potential advantage in that it enables countries to risk offers that they would not commit in WTO’s formal framework. Besides, the WTO involves lengthy, lumpy negotiations, because participants tend to hoard concessions until the final agreement is imminent. In contrast, APEC strategy looks for modest progress in the context of broad long-term goals. This strategy might encourage participants to follow a more cooperative approach.

Differentiated liberalization by sectors, which is a focus of APEC, should be changed to an “across the board” liberalization to the style of EU. Also, APEC’s tacit understanding of non-intervention into domestic policies can be improved towards the EU’s approach on common foreign and security policy by way of commercial policies.

In the view of Woo (1999), APEC members have worked from different interpretations of open regionalism, some of which are not comparable. The difficulties in the early stages of APEC development in carrying forward the Early Voluntary Sectoral Liberalization (EVSL) initiatives in APEC, can be, therefore, recognized not as an aberration in APEC’s institutional development, but a logical outcome of the ambiguity of the open regionalism concept itself.<sup>14</sup> The compromise on EVSL in Vancouver in November 1997 was achieved by giving up the full consensus model that APEC had previously thought sacred. APEC members instead agreed on a new “18 minus X” formula by which sectoral liberalization could proceed via plurilateral agreements among a group of APEC countries. He states that the most unfortunate result of the open regionalism debate based on the unconditional and conditional MFN aspects was that it diverted attention from other accepted, though more obscure meanings of open regionalism, that are more pertinent to the APEC project. One of those “neglected open regionalism definitions” includes trade facilitation. Interestingly, the summary report of the 25<sup>th</sup> Pacific Trade and Development Conference (PAFTAD), held in Osaka, June 1999, admits that “the experience of negotiating EVSL has brought home the reality that the structure of APEC is not suited to promoting traditional trade negotiations, which are best concluded through WTO” (PAFTAD 1999, p.4).

Similarly, Srinivaran (1998) points out that open regionalism is nothing but an oxymoron, and is not a fruitful new concept in the area of trade liberalization. If the smaller developing countries of APEC, instead of pursuing their unilateral liberalization on an MFN basis, succumb to the open regionalism, they will be subjecting themselves to a process by which a hegemonic power often manages to satisfy its multiple trade-unrelated demands on other weaker trading nations more easily than through multilateralism.

In the view of some analysts (e.g., Oxley, 1996, 1999a, 199b; Woo 1999), the APEC approach lacks the rigor and institutional strength which is needed for an effective process of plurilateral trade liberalization. Therefore, “any broad targets to be met by 2010, such as the Bogor target for industrialized economies, will need to be mirrored in WTO programs of liberalization agreed in the next round” (Oxley, 1999b, p.2). To put it differently, “if commitments are not made in the WTO to reduce accordingly to a timetable which would achieve the Bogor targets for APEC members, there is every reason to assume that it will not be achieved. APEC members have already demonstrated that they are incapable of developing effective programs for voluntary liberalization.” Securing the Bogor targets as negotiating objectives for the forthcoming WTO round makes far more sense than trying to have the EVSL objectives adopted by the WTO” because the EVSL were compromises for partial liberalization, non-binding, for APEC member countries, and are therefore unsuitable for the WTO (Oxley, 1999a, p.4). In the similar vein, Woo (1999, p.12) states: “The

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<sup>14</sup> The Fifth APEC Leaders’ Meeting, held in Vancouver, Canada, in November 1997, approved the goals previously agreed to fully liberalize trade and investment within APEC, based on a voluntary process of early sector liberalization. For that purpose, nine sectors were identified for accelerated tariff elimination starting in 1999, and six others for an immediately subsequent stage. Subsequently, at the APEC Trade Ministerial Meeting in June 1998, the Government of Japan specifically opposed liberalizing the fisheries and forestry sectors according to the accelerated plan. The view of Japan and several other countries was that given the voluntary nature of APEC, any economy had the right to exclude any sector it did not wish to participate. At the Trade Ministerial Meeting in June 1999, the Accelerated Tariff Liberalization (ATL) initiative was emphasized to provide impetus to the wider negotiation on industrial (non-agricultural) tariffs which they agreed should be launched at Seattle. Thereby, APEC has passed on to the WTO the liberalization of the EVSL initiative.

risk is that by continuing to insist on a specific APEC trade liberalisation agenda through revival of EVSL and other accelerated liberalisation initiatives, the regional forum is setting itself up for more near-term failure." Being critical of APEC, Langhammer (1999, p.12) states that its members "can be tempted to see the grouping only as a long-winded way to a Millennium Round in Geneva and to ask how large the value added is not to go this way directly but to pass via APEC".

## C. Building blocks and stumbling blocks

A question often posed on the relationship between regionalism and multilateralism is whether the former is a "stepping stone" or a "stumbling block" towards the achievement of the latter. A central concern surrounding regional integration schemes, therefore, has been not only the consistency of RTAs with the GATT/WTO commitments to global trade liberalization, but also the broadening and deepening of RTA concessions which go further than those made in the GATT/WTO.

First of all, there is a definitional problem regarding the terms "regionalism" and "multilateralism". The former, for example, as done by Bhagwati (1993) and Winters (1996), is understood as preferential reduction of trade barriers among a subset of countries that might, but not necessarily, be geographically contiguous. Preferences are therefore restricted to a subset, and not extended to the whole set of countries of the world trading system. Thus, *discrimination* is the essential feature of regionalism. If this definition is accepted, multilateralism contains a *nondiscriminatory* reduction of trade barriers. But then unilateral reduction of such barriers will be also deemed multilateralism (Srinivasan 1998). In this sense, as Bhagwati stresses (1993, 1998, p.16), it is necessary to distinguish between multilateralism as a "process" (i.e., multilateral trade negotiations) for liberalization and multilateralism (i.e., MFN) as an "outcome".

Mistry (1995) claims that it is wrong to perceive "regionalism" or "regionalization" are antithetical, second-best, inferior or sub-optimal option, if not pejorative, while "multilateralism or "global liberalization" as something positive, first-best, superior or optimal. He maintains that the "new" regionalism will likely lead to a "new multilateralism" because new RTAs have built-in features, which make them multilaterally friendly rather than multilaterally resistant. The new regionalism is driven by market forces rather than fiat, the forces of globalization, corporatization and global competition, by the globalization of financial markets, capital flows, consumer demand, and by the global ease with which technology and innovation can now cross national frontiers. Thus, the very forces that are driving regionalism are compelling it be multilaterally friendly.

### 1. Static and dynamic effects

Those who advocate total reliance on the multilateral process argue that RTAs divert trade by creating preferential treatment for member countries vis-à-vis non members. They maintain that trade diversion is still substantial, as found in the case of the European Union (Frankel and Wei 1998) and Mercosur (Yeats 1997), and, as Bhagwati (1998) asserts, in NAFTA as well. Despite of 50 years of efforts in tariff reduction, there still remain serious discrimination and trade diversion (Bhagwati, 1998, Hoekman, Schiff and Winters, 1998, pp.13-14).

The proponents of regionalism, on the other hand, claim that trade diversion is negligible or not completely negative, while creation may not always positive. Trade creation may have negative effects in the transition, if it is abrupt, and diversion can be positive under cost-reducing economies of scale and learning-by-doing (Ffrench-Davis, 1998, Mistry 1995, Reynolds 1995). Total trade

creation will outweigh trade diversion in most cases, and the regional process is faster to produce substantial progress toward further trade liberalization.<sup>15</sup> On this regard, ECLAC (1994) has maintained that the potential benefits of integration should be assessed in the light of the dynamic advantages of reciprocal trade and not on the basis of a rigid calculation of its static effects.

In a framework of open regionalism, which applies moderate external barriers, RTAs are thought to provide substantial benefits to member countries. First, regional integration can be a device to foster a diversification of exports, towards output more connected to overall competitiveness of the economies concerned. Second, it serves to “lock-in” improved access to regional markets, fostering economies of scale: in the presence of economies of scale, what otherwise would be a costly trade diversion, can become a cost-reducing and welfare-enhancing trade diversion (Freund 1998b). Third, it can enhance nontraditional exports, differentiated products and products of more value added and intensive in knowledge, because the typical export basket to regional markets consists of these goods and services, which is distinct from that to developed economies with a much larger share of primary products. 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).

Thus, regional integration builds on strategic considerations arising from imperfect and incomplete markets at home and abroad, which handicap the spread of efficiency gains in certain sectors and the development of new productive patterns with progressively higher value added (Iglesias 1998, p. 25; Ffrench-Davis, 1998, p.73). These authors caution, however, that all these aspects are potential benefits rather than guaranteed outcomes, and that the latter depends on the nature of policy implementation.

The advocates of regionalism also argue that RTAs may facilitate liberalization in areas that are too complex to be negotiated successfully in the WTO or too difficult to enforce in that setting (Krugman, 1993). For instance, for activities that are at present highly protected (e.g., government procurement, anti-dumping measures, some services), liberalization in a regional context may be more feasible than through global liberalization. The same observation might apply to highly technical areas, such as industrial standards, where intensive negotiations are required. Once formed and implemented, regional arrangements in these areas might also serve as blueprints for future multilateral liberalization (Hoekman, Schiff, Winters, pp.11-12).

There are also counter arguments. Baldwin (1997) and Pizarro (1999) caution that regional liberalization undertaken in the 1990s did not occur because regionalism was easier. Resurgent of regionalism in the decade was not caused by either frustrations with the GATT negotiation processes, or the complexity of modern trade barrier, or even by the United States’ conversion from devoted multilateralist to ardent regionalist. Instead, resurgent regionalism was caused by idiosyncratic events that were multiplied by a domino effect. The best example has been that announcement of the free trade area between US and Mexico created powerful forces for inclusion that led to NAFTA and a sequence of NAFTA membership requests. When requests did not materialize, the forces vented in a series of overlapping bilateral and plurilateral agreements in the Americas. Mercosur is one of the outcomes of this domino effect. Baldwin (1997) argues that this type of domino effect involving North-South preferential arrangements can be an excellent way of promoting liberalization in developing countries.

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<sup>15</sup> There are counter arguments to Yeats’ proposition on Mercosur. Nagarajan (1998), for instance, concludes that dynamic intra-Mercosur trade has been accompanied by a strong growth in imports from third countries. High growth in extra-regional trade is also evident in products which have shown a shift towards Mercosur suppliers in these countries’ imports.

The proponents of regionalism also argue that RTAs adopt a “WTO-Plus” approach by accepting higher levels of obligation than in multilateral agreements in certain areas, thereby laying the foundations for progress multilaterally in those areas as in the Uruguay Round (Sampson, 1996, Blandford 1995). Countries in a regional agreement tend to have a strong incentive to widen the initial coverage of the agreement in order to increase the gains of cooperation. Participants may be better off by introducing new targets and issues in the agreement (Hughs Hallett and Primo Braga 1994, 18; López and Matutes 1998). This might occur in such areas as in trade in services, investment, intellectual property rights, factor mobility, rules of origin, competition policy, antidumping and safeguards, sanitary and phyto-sanitary regulations, etc. As discussed later, purely economic factors can be combined with political or security issues, as it is in the European Union; the most important achievement of the European Single Market Program has been to reduce barriers in trade in services among European countries. Advance towards broadening and deepening of commitments is likely to proceed faster at the regional level, thanks to the smaller number of participants and their closer common interests.

Some examples of the “WTO-Plus” include, among others, that though less ambitious than the case of European Union, NAFTA removes regulatory barriers to services and investment. Closer Economic Relations Protocol between Australia and New Zealand (CER) has opened services markets with an WTO-plus focus (Findlay and Warren 1997)<sup>16</sup> and includes a common competition policy. Mercosur, the Andean Community, the Central American Common Market, and the Caribbean Community aim at a common market and the establishment of a dispute settlement mechanism. The stated objectives of APEC and of the FTAA, as well as other smaller sub-regional integration arrangements such as ASEAN and Mercosur are known to be much more ambitious in the areas of standards and conformity assessment than is the WTO Trade Barrier Trade (TBT) Agreement (Stephenson 1997).

As one of the dynamic effects, by way of economies of scale and competitive gains under imperfect competitive and market structures and the elimination of contingent protection, membership in a preferential arrangement is more likely to promote industrialization than unilateral liberalization (Puga and Venables 1998). The flow of FDI to some or all of the RTA member countries is also likely to increase.<sup>17</sup> Besides, a reduction in uncertainty about policy reform associated with the “locking-in” or “anchoring” of policy reforms through the RTA may increase investment from all sources and change other behaviors as well. Moreover, the location of industry among member countries will be likely to be affected in a manner that enhances growth potential. Ethier (1998) argues that incentives for small countries to go into RTAs with larger countries can be substantial because a reform-minded small country can more easily achieve reform after linking up with a large country, since the regional agreements gives the small country a significant advantage over other small countries in attracting FDI. When tariffs are low, the value of FDI is greater, making developing countries more eager to sign RTAs, even if they are required to make most of the concessions.

There may be also permanent effects on the rate of economic growth through higher rates of transfer of technology and greater investment in R&D. They may be due to demonstration effects or competitive pressure to adjust. They may reflect forward linkages (other firms using better

<sup>16</sup> For instance, the CER adopts a negative list approach and includes important commitments on the movement of people. The agreement contains provisions for periodic review of the relationship with the aim of bringing excluded services within the purview of the Protocol.

<sup>17</sup> To foreign companies, the single, unified market that regional integration creates is also an attractive investment market, and the larger the integrated market, the greater the scale merits and therefore the attraction of locating there. Their objectives may be to exploit investment opportunities in individual markets and/or to use one member as a platform for serving the whole bloc.

inputs from the multinational company) or backward linkages (the multinational company's requiring and helping local small suppliers to produce better inputs for all their customers). They may also arise from the mobility of labor as the multinational corporation trains labor and manages who then move on to other parts of the economy.

The critics of regionalism, on the other hand, state that what these dynamic effects constitute and how they come about are rather vague, and that the evidence linking dynamic benefits to particular instances of integration is very difficult to pin down (Winters, 1998, p.58). The relation between RTAs and growth is ambiguous if not weak, except the case of the European case (Vamvakidis 1998; Winters, 1998, pp.58-59).<sup>18</sup> In their view, few of the more recent arguments in favor of RTAs have been satisfactorily formalized or tested. For example, such argument that regionalism simulates investment,<sup>19</sup> that it confers credibility on reform programs (locking in) or that it leads automatically to multilateral liberalization, has not been rigorously tested for developing countries.

## 2. Political economy considerations

It is often argued that a policy “package” that contains both unilateral liberalization and RTAs is likely to receive greater political support than one that is limited to unilateral liberalization. A partial opening in a subregional arrangement is likely to meet less political resistance: member countries of a RTA can overcome industry resistance to trade liberalization because reductions of intra-regional tariff and non-tariff barriers are seen as trade-offs within the framework of reciprocal arrangements. Politically, it is much easier and acceptable for governments to first reduce these barriers within the region and then subsequently extend the reduction to others than to do it unilaterally at once (Winters 1998, p.57).

RTAs are frequently said to provide an important element of diplomacy. States might pool sovereignty in a RTA to achieve sufficient leverage to manage global concerns. RTAs are thought to enhance the capacity of developing countries to influence worldwide outcomes; a strong Mercosur may have changed the landscape for negotiations of FTAA. Also when there is a possibility that trading partners may revert to protection, RTAs can “lock in” access to export markets by imposing costs to their “exiting” those agreements. “Entry costs” also enhance credibility, because the negotiations leading to RTAs and their implementation require public resources and political will, that in turn assures that the government is likely to continue its course of liberalization and sound economic policies (Rajan 1995). In many instances, smaller countries approach large countries, with whom they already extensively trade, for insurance-based, access-preserving trade agreements. Typically, in these agreements, little new liberalization is undertaken by the large country, while the smaller country liberalizes, and an insurance premium (or side payment), the nature of which will be defined later, is paid benefiting the large country (Perroni and Whalley 1998). In short, a RTA may raise the cost of eventual macroeconomic laxity and political reversals.

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<sup>18</sup> Though the literature on spillovers from FDI is ambiguous, there is some evidence in favor of their existence. FDI appears in many cases to stimulate productivity in local firms. Blomstrom and Kokko (1997) suggest that while the US-Canada had little investment effect, Mercosur and NAFTA both stimulated FDI inflows. Intraregional FDI flows may be also stimulated.

<sup>19</sup> On the effects of RTAs on investment, the critics may argue that a simple RTA may reduce FDI flows between member countries because they make trade a more attractive option than investment. Also, in as much as investment resources are limited, this has the effect of diverting investment away from other countries. Furthermore, if regional integration brings with it trade policies that discriminate against products from outside the region, then it may distort the investment pattern between regions. For instance, if regional integration results in stricter rules of origin, for non-regional products, then it will encourage direct investment in the region rather than export to it. Therefore, the principal requirement for attracting FDI is sound policies at home –including macroeconomic stability, good labor relations and open borders.

It is also likely that RTAs contribute to democratic consolidation if maintaining a democratic regime is a prerequisite for continued membership, as in the case of the Central European countries joining the European Union, or Paraguay in Mercosur. There are also “peace lock-in” effects in the sense that RTAs, by strengthening business ties across countries, reduce the likelihood of border disputes (Burki and Perry 1998, pp.6-7, Iglesias 1998, p.25). These reciprocal “lock-in” effects tend to reduce uncertainty and risks and thus increase trade and especially investment in a more stable and lasting environment by raising the “costs” of policy reversals. Winters (1998 p.63) questions, however, whether RTAs are the best means of such signaling, and there may be other means of winning credibility, for instance, binding trade and other policies under the WTO. Similarly, Fernandez (1997) asks whether signaling is sufficient to justify RTAs.

### 3. Conclusions

The difficulties in evaluating regional integration processes and their costs and benefits are multi-fold. First, the process involves distinct issues that link growth to technology, learning, externalities, political economy and politics, all of which are difficult to assess, not only at a national level, but also among several countries simultaneously or historically. Also, as in the case of Latin America and Asia, the integration processes have been an integral part of profound structural reforms, making it difficult to isolate the effect of the former from the overall consequences of reforms. Second, major costs are usually concentrated up front (such as costs of trade diversion) while many benefits of RTAs are likely to play out over a longer period of time. And third, regional integration is often evaluated in light of what would have happened in its absence (Devlin, 1998, pp.69-70; Iglesias 1998, p.25). On the other hand, the models that intend to measure dynamic effects are also deficient. Given the complicated nature of how dynamic variables interact and ultimately affect policy reform, being able to add this dimension in specific modeling endeavors in the near future is unlikely (Plummer, 1997, p.207).

The difficulties in evaluating various effects might lead to the opinion that it is more important to examine the different objectives of a specific integration scheme, assess if and how these objectives are being realized, and analyze the causal factors contributing to development, instead of being overly concerned about the counterfactuals. For instance, one frequently stated objective of regional integration is to enhance competition; it might be useful to examine whether: i) the integration agreement is stimulating investment, domestic and international alike; ii) sectoral markets are adapting to competitive pressure; iii) firms’ technological capacity and cost structure are being transformed to gain international competitiveness; iv) new international exports and competitive advantages are realized in the process of learning by doing in the regional market; and v) intra-industry specialization is increasing in the regional market (Devlin 1998, p.70). Therefore, assessment on regional integration has to go far beyond trade itself and should be based on economic welfare. A major criterion for evaluating an integration scheme is whether it can help to build mechanisms to correct “market failures” or even create “markets” in different spheres such as technology, information, capital, labor (French-Davis, 1998, p.72), that are superior to those offered by unilateral and multilateral liberalization (Ffrench-Davis, 1998, p.73; Gana 1995).

It is not straightforward whether there are complementarities between regionalism and multilateralism, in a dynamic context. Much depends on the design and content of the RTAs that are negotiated, as well as the characteristics of the member countries. As a minimum criterion, in the view of the World Bank experts (Hoekman, Schiff, and Winters, 1998, p.13), RTAs should go beyond the existing coverage of the WTO, and have a “GATT/WTO plus” focus in areas that are already subject to the WTO disciplines. What matters is that over time the dynamics move the RTA towards a reduction in the external barriers against non-members. This in turn calls for careful scrutiny of the incentives that are being built in a RIA to achieve this objective.



## **II. Dynamics of regionalism in times of boom and crisis**

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### **A. Introduction**

The rapid economic growth of the last two decades of East Asia has strengthened Asia-Pacific economic networks and constructed a solid foundation of APEC. However, APEC activities, which were likely to be backed by ever expanding regional economies now face the first challenge and must look to reconstruct the damaged market system (Omura, 1998). A series of surveys conducted on the Asian Crisis have found that the countries and regions experienced reduced production, reorganization of the dysfunctional financial systems, and rising corporate bankruptcies, unemployment and other social disorders (World Bank 1998; Cheng and Leung 1999).<sup>20</sup>

On the one hand, some analysts maintain that since the summer of 1998, improved economic conditions suggest that situation has settled and may have taken a turn for the better. There has been a substantial recovery not only in balances of payment (through most of the adjustments have come from reduced imports), but also in local

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<sup>20</sup> One of the major woes of the Asian financial crisis is mounting unemployment. The collapse of businesses, the retreat of foreign investment, and the fall in demand of foreign and domestic goods and services all contributed to the surge in unemployment. As local workers lose their jobs, foreign workers, who had increased rapidly in the years leading to the summer of 1997, have become an easy scapegoat; while governments in some APEC countries have placed various restrictions on imported labor (Cheng and Leung 1999).

currencies, in foreign currency reserves, and interest rates, which in some cases are below those prevailing before the crisis. Fiscal policies have been adjusted to allow increased spending to support demand and employment. The initial acceleration in inflation that accompanied devaluation has been contained to moderate levels and the rate of inflation is now decelerating across the region. Others still view that the worsening condition of the local economies is behind this apparent calm (Kado 1999).

The international financial crisis that began in Asia in mid 1997 hit the economies of Latin America much more severely than originally imagined. Following the growth rate of 5.4% in 1997, growth in 1998 fell to 2.3%, owing in part to the international financial crisis and a series of natural disasters. For the first half of 1999, almost all countries in the region either reported a sharp decline in economic growth, or else were in full recession. While the value of exports by the region fell in 1998 for the first time in over 10 years, imports lost momentum but still continued to expand (ECLAC 1999b); as a result, the region's current account deficit grew from an average of 3.4% of GDP in 1997 to 4.5% in 1998. As the trade gap widened, foreign capital became scarcer and more expensive (ECLAC 1999a). Despite a possible recovery in the second half, regional GDP in 1999 will shrink slightly for the first time in the decade, and will only start to grow again in the following year.

## B. Effects of the Crisis on Trade and Investment

### 1. Asia-Pacific

In contrast to the case of the European Union or NAFTA, economic linkage between the countries in the Asia-Pacific had grown with few institutional or government-led regional integration schemes. Rather, the feature of regional integration in Asia can be expressed as "market-led integration", which means that economic interdependence in the region had been proceeding naturally in the process of rapid economic growth. As a result, both intra- and extra-regional trade had increased rapidly (Ohno and Okamoto 1994; Langhammer 1995).

The impact of the Asian currency and economic crises spread in 1998, and imports and exports of the East Asian countries plunged in dollar terms, the first year fall in the region's exports in dollar terms since 1985 and the first in imports since 1982. The severe drop in exports took place despite an expected increase resulting from weaker currencies. A substantial drop in East Asian trade in 1998 was recorded in Singapore and the Chinese Province of Taiwan, where exports fell by 12.1% and 8.9% respectively from the previous year. Imports of the Republic of Korea, Indonesia, and Thailand fell by 35.5%, 34.4% and 31.6%, respectively. In the first quarter of 1999 with the corresponding period in the previous year, both Taiwan and Malaysia recovered to register positive growth in exports, while the majority of the countries which recorded a large decline in imports in 1998 narrowed the decrease or even registered an increase (JETRO 1999a).

The reasons which explain such sluggish performance in 1998 were due to several factors: first, East Asian market, which account for some 40% of exports, were in the midst of an economic crisis, and demand in these markets fell sharply. Second, exporters found it difficult to procure required parts and other inputs because of the lack of funds (credit crunch as well as the reduced issues of letter of credit). Third, the weakening of local currencies in the countries intensified price competition. Finally, a severe drop in production of automobiles and other heavy equipment lowered the quantity of components being imported, which in turn reduced the availability of containers coming into these countries, resulting in a shortage of containers for exports (Kado, 1999).

It is noteworthy that in terms of other export destinations, however, shipments to the United States and Europe in particular have decreased by an insignificant rate or even increased (JETRO 1999a), leading to a higher interregional trade with these areas. In 1998, roughly 22% and 15% respectively of the ANIES4 (Republic of Korea, Chinese Province of Taiwan, Hong Kong and Singapore) were destined to the United States and Europe. A similar percentage of ASEAN 4 (Malaysia, Thailand, the Philippines, and Indonesia) exports went to these blocs, which served to cushion the adverse effect of reduced intraregional trade.

It is also interesting to note that FDI inflows to Developing Asia, where the impact of the currency and economic crises was greatest, fell to US\$85 billion in 1998 from US\$ 95 billion of the previous year. Roughly half this overall total went to China. As expected, there was a net withdrawal of investment and in securities and other portfolio investment. Against the backdrop of the crisis, the Republic of Korea received its largest ever volume of FDI inflows at US\$ 5 billion, transforming itself as a net recipient after having been a net FDI exporting country since the beginning of the decade. While the FDI flows to Malaysia, Singapore went down by roughly 26% in comparison to 1997, Thailand and the Philippines registered an increase. It can be said in general that despite the crisis, Asia, except Indonesia, has held up relatively well during the crisis, as foreign firms have responded to new opportunities to acquire companies and gain access to local markets (UNCTAD 1999a, Thomsen 1999). This relatively healthy behavior of FDI in Asian developing countries reflects a heightened awareness of the importance of FDI to economic growth among the countries affected by the crises (JETRO 1999b, Chapter II).

The effect of the crisis has not been uniform across countries and sectors. In the case of Japanese FDI, deteriorated sales and profits in Japanese affiliates in Asia may be accelerating the diversification of Japan's FDI from Asia to other regions (Tejima 1999). Japanese firms' success in the most important sectors in the region of automobile and electric and electronic industries will highly depend on whether they can reconstruct their advantageous position by establishing good relations with parts suppliers or investing in them themselves. On the other hand, the crisis has been a blessing in disguise for certain TNCs from the United States: US TNCs have reported substantive declines in local profits and sales but steady increase in exports in this region. Cheaper and more widely available local assets, increasingly liberal host-government policies, greater export competitiveness via currency depreciation, the decline of foreign competition, especially from European competitors, and other factors all contribute to the renewed interests of the US TNCs in this region. Those US firms that are involved in export-oriented sectors such as electronics will likely to increase their FDI in the region than the firms whose principle aim of FDI is to serve local markets (Mason 1999).

The process of regional integration in East Asia is often characterized by the so-called "flying geese pattern" of development. This process is said to have been spearheaded by Japan, while the newly industrialized countries have acted as an intermediate link. The influence of this phenomenon on the members of ASEAN is similar to that exerted by Japan on the newly industrialized countries two decades ago. Since those countries have reached an advanced stage of development by accumulating skilled manpower and modern technology, in some markets their exports have displaced those from Japan. However, higher labor costs, the appreciation of their currencies and the growing trade barriers they face left the newly industrialized Asian countries out of the main markets for labor intensive products; this, in turn, has helped the ASEAN countries and China to gain access to those markets.

As a result, there has been the interaction between trade and FDI as a process of relocating production across national boundaries, which creates a two-way or triangular trade flow among participating countries. According to the flying geese pattern of development, new trade flows originate in changes in relative factor prices that generate new inflows of FDI. Initially, FDI creates

a flow of capital goods from the investing country and to the host country. Parent companies then provide affiliated companies with parts and components for assembly or intermediate goods for further processing. Affiliated companies sometimes send unfinished goods to a third country or back to the home country for final assembly. In some cases, final goods products are sent back home or to a third country. As liberalization of trade and investment has become a global trend, many TNCs look upon ASEAN as a whole and practice a division of labor, by taking advantage of the differences in the stage of development and factor endowments in each country. There is a growing tendency to support such an activity institutionally, namely AFTA (ASEAN Free Trade Area) and AICO (ASEAN Industrial Cooperation).<sup>21</sup> ASEAN countries now realize that it may not be always beneficial to have an industrial structure with a complete set of industries in every member country and that specialization should be encouraged (Karikomi 1998).

On the other hand, the “flying geese” paradigm was questioned even before the outbreak of the crisis (e.g., Rowthorn 1996, Ravenhill and Mitchell 1995) and its validity may be addressed even more critically now after the crisis. Questions are frequently asked whether the East Asian geese continue to fly in formation, whether the lead goose (i.e., Japan) is able to continue to lead effectively or its presumed leadership will be challenged in the future. International competitiveness is increasingly determined by the rate of generation and disappearance of new knowledge and innovation, the predominance of the quality of the product over cost competitiveness, and shorter process and product life cycles, while labor costs *per se* cease to be the most determinant factor. Besides, recent events, such as contraction of aggregate demand for goods and services, including through lower production and reduced public sector demand, costlier finance for investment, higher import prices due to steep currency devaluation, and realignments of exchange rates among the East Asian countries, may be changing significantly the development pattern, from one based on dynamic intra-regional trade and FDI to another focused more on inter-regional dynamism.

Admittedly, FDI has been a key factor driving export-led growth in ASEAN especially in those sectors with the fastest export growth such as the electric and electronics sectors. It was also at the heart of the decision to accelerate the process of regional integration through AFTA and the ASEAN Investment Area. However, the perceived threat of investment diversion away from ASEAN and towards China had begun to push ASEAN4 policies towards FDI in a more liberal direction even before the crisis. While among political circles in Asian countries, voices opposing liberalization have been strengthened, the IMF relief packages brought about substantial commitments to further trade and investment liberalization (JETRO 1999a). With lower growth rates, investors would be less tolerant of the controls on foreign investment than before the currency crisis. To encourage investors back, regional economies are liberalizing further, improving regulation on the financial sector, improving the framework of law in which business has to operate, and allowing greater access to the domestic market for foreign investors, including through the acquisition of local firms.

Also, questions are also raised regarding whether FDI inflows were contributing sufficiently to technology transfer and industrial upgrading. In many cases, endogenous capabilities have not been developed in those export sectors dominated by TNCs (Thomsen 1999, Mahani, 1998). There is a wide recognition that liberalization on FDI, now in process, should be welcome if it fosters

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<sup>21</sup> The AICO scheme, which took effect in November 1996 under the ASEAN framework, allows two or more countries approving items for AICO to give preferential 0-5% tariffs on AICO-designated items to applying companies. These companies are to be founded in the ASEAN countries, and to have at least 30% local capitalization, and at least 40% local content in their products. The 1998 ASEAN summit decided to remove the 30% local capitalization requirement only to two years, 1999 and 2000. Because it might raise barriers to imports, it is necessary to monitor AICO administration closely (MITI 1999, p.18).

future development on a more sustainable basis. Such development depends, in turn, on the overall policy environment to enhance transfer of technology and other know-how to the local economy.

## 2. Latin America

In contrast to the market-led, *de facto* integration of East Asia, where a high level of productive interdependence has not necessarily called for policies on deeper integration, economic integration in Latin America is said to have been more policy-driven. This region has witnessed a proliferation of different kinds of arrangements that vary widely with respect to their modalities and geographical configuration. A shared tendency towards a similar macroeconomic framework, unilateral and plurilateral trade liberalization, non-discriminatory promotion of exports, deregulation and elimination of obstacles to foreign investment, privatization and the lifting of payment restrictions, have impelled the policy-driven integration to be accompanied by a parallel process of *de facto* integration (ECLAC 1994, Chapter II). In like fashion, Haggard (1997) and Pizarro (1999) posit that while formal economic integration agreements were viewed with skepticism in the 1980s, the high degree of institutionalization observed in most Latin American countries has to do with the severe domestic economies crises of the 1980s, which led them to prefer “deeper” economic integration.

On the other hand, it should be pointed out that without much institutionality for and sectoral programs on industrial restructuring (Sanchez 1999), in the 1990s Mercosur was able to invigorate intra-zonal trade: it increased by almost five times between 1990 and 1998, reaching more than 25% of total exports. The larger more integrated market attracted FDI, allowed economies of scale larger than what the limited national markets would offer, and at the same time exposed national firms to regional competition. This intraregional dynamism was accompanied by a strong intra-industrial push between Argentina and Brazil, especially in the chemical and transport sectors (Chudnovsky and López 1997): in 1996 intra-industrial trade accounted for roughly 30% of total bilateral trade (Machado and Markwald 1997, 1999).

It is also noteworthy that the share of intraregional trade of Andean Community has increased substantially from a 5% in 1990 to 12% in 1998, the most important component being manufactures. The participation of these products in the intra-zonal trade increased from an already high level of 80% in 1990 to 90% in 1998 (Andean Community website). Greater intra-community trade flows in general, and a high manufacture component in particular, imply that unequilibrium of one country can more easily transmit to other countries, by way of demand contraction.<sup>22</sup>

Given these observations, it might be asked whether the present economic turbulence has interrupted or put brakes on the trade-cum-investment process of deeper integration among the countries in the region. The economic slowdown of 1998 and 1999 has resulted in the shrinking of total exports from the region, and in a slowdown of the most dynamic component, intra-regional trade. In 1998, the value of trade between the countries of the Latin American Integration Association (LAIA) broke a 12 year rising trend to fall by 5.5%, although trade within Mercosur and the Andean community declined by 0.5% and 5.9% respectively (LAIA 1999). In contrast, intra-zonal exports in the Central American Common Market increased by 9% (ECLAC 1999a).

In most of the region’s larger economies, the slowdown in exports noted in the second half of 1998 intensified in the first quarter of 1999, and merchandise export values in Argentina, Brazil,

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<sup>22</sup> Though intra-community FDI represents a very small portion of total investment, with a sum of around US\$ 700 million up to 1996, they are known to have been directed to sectors different from those chosen by investors from outside the Community (ECLAC 1999b).

Ecuador, Paraguay and Uruguay plunged by between 15% and 25% from the still high levels of the same period of a year earlier. Paraguay and Uruguay also suffered the full impact of the sharp devaluation of the Brazilian *Real* in early 1999. Bilateral trade between Argentina and Brazil during the first 8 months of 1999 is reported to have experienced a 27% decline, in comparison with the same period of 1998 (ECLAC 1999a). Looking at the trade figures only, however, it is difficult to conclude how the economic crisis that the countries in Latin America face today is affecting this parallel process of de facto and policy driven integration.

With respect to FDI, however, the data available up to the end of 1998 seem to reject the hypothesis that the macroeconomic difficulties have severely affected the inflows to and outflows from the region. In fact, FDI flows to Latin America and the Caribbean increased by 5% in 1998 to reach a record US\$ 72 billion. This increase is explained mostly by Brazil whose inflows increased from US\$ 19 billion in 1997 to US\$ 29 billion in 1998, and roughly 25% of which corresponded to privatization. Other major recipient countries (Argentina, Chile, Colombia, Mexico and Venezuela) experienced a decline, while Peru and Ecuador recorded a slight increase. UNCTAD's *World Investment Report 1999* states that the outflows from Latin American and Caribbean countries continued to be strong in 1998 and that the trend of TNCs from the proper region investing in neighboring countries, particularly marked among the Mercosur countries, is likely to be maintained. The wave of intra Latin American FDI has been led by firms mainly from Argentina, Chile, Mexico and to a lesser extent Brazil. Assets abroad by firms whose headquarters are located in these countries are estimated between US\$ 40 and US\$50 billion (UNCTAD 1999b).

Misalignments of the exchange rates among the countries caused by a balance-of-payments problem in major partner countries of an integration are a source of great concern, due to potentially large changes in trade flows, market disruptions, unemployment and even transmission of balance-of-payment problems. In effect, the cooperative arrangements that are inherent in an integration scheme are now put to a test in a difficult environment, such as one observed in Mercosur and the Andean Community.

Referring to the recent occurrence in Mercosur, the Interamerican Development Bank states (IDB 1999, p.56) that “national political commitment to the Mercosur project, coupled with the timely development of imaginative consensual responses that share the burden of adjustments, and possibly further public collective commitments to deepen integration, are elements that would strengthen Mercosur and actually contribute to it being an active agent for resolving current difficulties.” Although anti-dumping and countervailing duties are typically allowed for regulating intra-regional trade, they are warranted only for counteracting “unfair” trade practices and therefore should not be applied to deal with shifts in price competitiveness caused by devaluations. Though most RTAs contain safeguard clauses that can be applied when imports from a partner are causing adjustment difficulties in a domestic industry, an exchange rate devaluation in a trading partner or an import surge does not automatically allow for the application of safeguards.

## C. Coordination of macroeconomic policy

The impact on trade of macroeconomic policy is one of the most contested areas in the literature of international trade and finance. However, there is consensus that there exists a negative relationship between exchange rate variability and trade, and that long-term real exchange rate variability is affected by the variability of the terms of trade and the average level of inflation. There is also evidence that both fiscal and monetary policies are used less effectively in more open economies: in these economies, the relatively active use of monetary policy runs the risk of destabilizing the terms of trade, while a large leakage leads to these economies to undertake less automatic fiscal stabilization (Eichengreen 1998a). There is also a growing awareness that the

ongoing process of globalization, the financial opening and the volatile nature of capital, and the incipient intraregional articulation of the capital markets and the deepening of the regional and subregional process push member countries to coordinate or bring macroeconomic policies into lines. The lack of such policies may threaten integration itself. Nonetheless, there is no precise definition of what should be done with respect to coordination or standardization of the macroeconomic policies within an integration scheme.

There are basically three theoretical levels for coordinating the macroeconomic policies of the members of an integration agreement, which go from the simple exchange of information and consultation between the monetary and financial authorities, via coordination and cooperation between these authorities, to culminate in a standardization of policy instruments based on institutionalized mechanisms, including supranational institutions. At the first level, as in the case of the Group of Seven, the main concern seems to be how to organize coordinated management of each country's policy instruments so as to internalize the effects transmitted by each economy to others. In such cases, the demand for coordination tends to arise sporadically: coordination of macroeconomic matters is circumstantial, lacks permanent mechanisms and is not a result of an economic opening. At subsequent, higher levels, the demand for coordination reflects not the desire to correct a temporarily adverse situation, but the need to provide integration with a macroeconomic framework by means of relatively permanent agreements or even institutional commitments on the joint administration of certain economic policy instruments. The best example of this type of coordination is provided by the European Union.

Within the integrating block, the types of coordination should also differ where macroeconomic interdependence is asymmetrical; smaller countries can opt to harmonize their policies with large economies, but the small countries are not in position to demand that the large ones do likewise (ECLAC 1994, p.86). Therefore, "unified policy management through joint decision-making systems must be based on converging views of the measures that should be adopted in each case, and on a sufficient level of confidence that costs and benefits will be distributed fairly." (p.87). Unless considerable progress has been made towards establishing solid links among the economies of member countries for a substantial period of time with favorable results, macro policy coordination will be difficult. Whether the distinct integration schemes both in Asia and Latin America satisfy these conditions remains moot.

## 1. Asia

The financial crisis in Asia has posed severe challenges for APEC. This forum has found it difficult to come up with a credible and relevant response. Immediately after the outbreak of the crisis in mid 1997, APEC governments contributed to IMF 'rescue package' to support the foreign exchange reserves of economies whose currencies had come under great pressure. While many APEC governments stressed the need to adhere to the IMF programs, they were not able to act collectively to try to ensure that those programs were relevant to the economic conditions in East Asia. In fact, before the 1998 meetings APEC was not able to take active steps on economic and technical cooperation to help member countries strengthen the management and structure of their financial sectors. In the lead up to these meetings, there was evidence of disagreement among member countries and observers on the relevance of APEC major agenda so far –trade and investment liberalization— to the requirements of the financial crisis. The Leaders' Declaration issued in mid November failed to set precise goals and a detailed strategy on how goals such as reduction of debt on companies and banks, strengthening of financial systems, recovery of investment and growth, and social safety nets on the poor, might be achieved and funded (Frost 1998).

Since the outbreak of the crisis, ASEAN countries are reported to have made considerable progress on financial cooperation. The recently created “ASEAN Surveillance Process” is developing an early warning system to keep track of macroeconomic trends and provide early detection of any adverse development. In its peer review system, ASEAN countries exchange views on economic developments and measures being undertaken to address the crisis as well as jointly formulate responses to pending problems. It also promotes closer coordination of macroeconomic policies.

As integral part of such cooperation, ASEAN plans to adopt and implement sound international financial practices and standards by 2003. Capital markets will be deepened, particularly the bond market, to provide a wider variety of instruments, with longer maturity and ample liquidity. ASEAN will be working closely together to harmonize data collection and reporting systems on a wide range of statistics. There will be cooperation in money, tax and insurance. A greater use of ASEAN currencies in intraregional trade and services will be encouraged, while a study shall be conducted on the possibility of an ASEAN exchange rate system including a common ASEAN currency (Hanoi Plan of Action 1998, ASEAN website). Mr. Rodolfo Severino (1999), Secretary General of ASEAN, recognizes, however, that less demanding forms of economic integration (e.g., AFTA, investment, industrial cooperation, customs procedures, facilitation of goods in transit, mutual recognition agreements, etc.) must be achieved before the establishment of a common currency.

## 2. Latin America

Eichengreen (1998a) states that the need for macroeconomic policy coordination in Mercosur, at least in the short run, is limited.<sup>23</sup> “As long as Mercosur remains just an FTA and is not accompanied by measures abolishing restrictions on factor flows, subsidies for domestic industry and preferential public procurement like those features in the Single European Act, the impact of currency swings on the profitability of competing national industries will not be as pronounced as in Europe’s Single Market ”(p.241). On the other hand, as Latin America financial markets become more open and integrated, and as competition between the manufacturing and services sectors of the Mercosur countries grows even more intense, the potential for a protectionist backlash due to currency fluctuation will mount. This will promote efforts to coordinate exchange-rate and macroeconomic policies within Mercosur.

Eichengreen (1998b) and Lavagna and Giambiagi (1998) argue that the options for more closely harmonizing the macroeconomic policies, such as monetary unification, intraregional currency band, and a common currency board peg, are limited. Feasible policy coordination is likely to be focused on harmonization of policy rules and guidelines (e.g., the adoption of common inflation targets). Lack of consensus on the best exchange rate regime and difficulties in achieving a convergence of fiscal and monetary policies also suggest that the coordination of exchange rate policy, in a narrow context, is not a practical option at the current early stage of Latin American and Caribbean integration processes. The progress of such a regime will require not only the use of monetary and fiscal policies to reconcile, within certain limits, the internal imbalances of the participating countries, but also the taking of similar steps with respect to external imbalances.

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<sup>23</sup> The Asunción Treaty which established the Mercosur in 1991 refers to the “consolidation of macroeconomic policies” in its Preamble, in Art.1 and Annex V which create the sub-working group No.10 with a specific mandate in this area. Sub-groups No.4 on Trade-related Fiscal and Monetary Policy and No.7 on Industrial and Technological Policy, among others, are linked to this area as well.

In a similar fashion, the Andean Community has discussed the issue of macroeconomic policy coordination.<sup>24</sup> The Advisory Council of Treasury or Finance Ministers, Central Banks and Economic Planning Authorities, at its III Meeting on May 1999, recognized that “the economic stability of the member countries is a matter of collective interest and is essential for maintaining the unity and coherence of Andean integration”. The participants in this meeting agreed to work toward inflation targets of less than 10 per cent a year and to continue with their efforts to define criteria for aligning macroeconomic policies, especially monetary, exchange-rate, tax and fiscal deficit policy. They additionally agreed to support the improvement and further development of financial supervision and control instruments so that they are able to progressively attain adequate Community supervision (Andean Community website). There is a wide recognition within the Community members that the exchange rate volatility and inflation rates affect negatively the intra-community trade, which has been the most dynamic in recent years, and which has a high component of manufactures exports. But at present, when some of the Community countries face enormous difficulties, it is not clear what a viable program of macroeconomic policy coordination would consist of and how it can be carried out.

For the countries of CACM, the Guatemala Protocol to the 1991 General Treaty stipulates that “the economic integration process will be promoted through the coordination, standardization and convergence of economic policies, extraregional trade negotiations, infrastructure and services” (Article 1c) and that the States will seek “consistently the macroeconomic balance and internal and external stability of their economies, through the application of congruent and converging macroeconomic policies” (Art. 4). Similarly, for CARICOM, Chapter 6 on “The Coordination of Economic and Development Planning Policies” of the 1973 Chaguaramas Treaty which establishes the Caribbean Community provides for consultation on economic policies in accordance with the objectives of the common market and the standardization of fiscal measures. It is not clear, however, what concrete actions were derived from these general policy guidelines and have been implemented if any, and how effective they have been.

In sum, integration via trade and investment is increasing the need to coordinate macroeconomic policies, and the countries in Asia and Latin America are paying much greater attention to the topic. Nonetheless, such coordination has been limited, particularly where conditions of instability weaken a country’s effective control over its own policy instruments. Current situations might call for the definition of a coordination procedure that would involve an exchange of information and an examination of the potential impacts of some economies on others, in order to reduce the risks of actions and reactions that could create conflicts.

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<sup>24</sup> In the Cartagena Agreement, the provisions relating to macroeconomic issues acquired relevance in 1989, when the meetings of the Monetary and Exchange Council and the Economic, Planning and Finance Ministers and Central Bank Presidents were held. These have dealt mainly with foreign exchange and monetary matters, incentives for exports, and the standardization of economic policies. The Sucre Act of the Andean Community signed by the Presidents in April of 1997 created the Advisory council of Finance Ministers, Central Banks and those responsible for economic planning.



### **III. Systemic competitiveness and regional integration**

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#### **A. Systemic regional competitiveness**

As pointed out at the outset, ECLAC (1992, Chapter V; 1994) has argued that open regionalism should lead to growing economic interdependence at the regional level and more enhanced global competitiveness. Enhancing competitiveness and improving the countries' insertion in the international economy call for enhancement in entrepreneurial capacity and above all, in the education and training of the labor force, a better organization of production and marketing on the part of enterprises, be they leading corporations or small- or medium-sized enterprises.

From this optic of open regionalism, the productive system can be viewed as a series of national networks of inter-firm, intra-industry and inter-industry linkages: the nature of these relations among the longer production chain –based on efficient firms and a competitive network of R&D units, suppliers, producers, distributors, wholesalers, retailers and service centers— is what determines competitiveness. These national networks are in turn sustained by a favorable macro-economic environment, adequate physical infrastructure, a literate skilled workforce and adequate institutional infrastructure for the legal system, the financial system, export promotion and technological support.

The same argument applies to the regional market. The systemic competitiveness in trade and investment is likely to be enhanced by eliminating other obstacles (e.g., political, legal, institutional, physical and social) than those normally considered in trade liberalization. Lower regional costs that result from a removal of regional barriers to exchange enhance and shift economic activity to the region in an efficient manner. It seems likely, for instance, that articulation, harmonization and coordination of national policies among member countries of regional integration, in areas that affect the regional systemic competitiveness, such as the transport, telecommunications, energy, water and other infrastructural capabilities, will promote increased international competitiveness of the member countries individually and collectively. Today, trade and FDI tend to look beyond the national borders for regional comparative advantages. The elements that establish these regional advantages include market size, natural-resource endowment, cost structure of production and pattern of specialization by country, availability of skilled and unskilled labor, R&D capabilities and infrastructure (e.g., UNCTAD 1996, Part II: Kagami 1995).

## B. “Deep integration”

In pursuit of dynamic benefits of integration, most new RTAs extend beyond conventional arrangements addressing trade in goods and involve attempts at “deep integration” in envisaging liberalization of trade in services, factor movements, harmonization of regulatory regimes, environmental and labor standards and in fact all domestic policies perceived as affecting international competitiveness. There has been an important shift of emphasis in both South-South and North-South agreements whereby free trade areas and customs unions seek to build on national trade liberalization efforts and deepen their outward-oriented trade strategies.

In literature, dealing with the “behind the border” issues has been termed “deeper integration”, in contrast to “shallow” integration that had been the central piece of the GATT, and that revolved around reducing measures applied “at the border” (tariffs, quotas, etc.).<sup>25</sup> In shallow integration, different national regulatory policies are still determined and administered at the national level. In deep integration, common rules and policies and/or supra-national implementation are adopted, and international negotiations have increasingly centered on domestic regulatory policies that are alleged to impede the ability of foreign firms and products to contest a market.<sup>26</sup>

One can also think of the economic integration processes as travelling on three distinct, but not necessarily exclusive, tracks. Increases in the volume of goods and services traded are the first track, while increases in the flows of factors such as capital and labor are the second track. There is also a third track, which is sometimes referred to as “institutional integration” that encompasses the harmonization and convergence of domestic policies (ESCAP, 1997, p.48). The nature and scope of impediments to integration in each track are different. There are border impediments, or what Lawrence (1993) calls impediments to “shallow integration” (e.g., differences in languages and culture as well as border barriers to international movements of products and factors of production). There are also impediments to “deeper” integration that are caused by divergences in domestic policy (standards, administrative procedures, commercial legislation and regulation).

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<sup>25</sup> The terms “shallow” and “deep” integration were coined by Robert Lawrence (see for instance, 1993)

<sup>26</sup> UNCTAD (1993, p.113) has suggested that regional integration can assume two main forms. “Shallow” integration occurs largely through trade in goods and services and international movements of capital. “Deep” integration extends to the level of the production of goods and services and besides, increases visible and invisible trade. Under the latter, linkages between national economies are increasingly influenced by the cross-border value adding activities within TNCs and networks established by TNCs.

Instead of using the term “deep integration”, the World Bank experts (Hoekman, Schiff and Winters, 1998) refer to “policy integration”, which they define it as actions by governments to reduce the market effect of differences in national regulatory regimes through either coordination, harmonization, or mutual recognition of national laws, regulations, and enforcement mechanisms. For instance, all exporters of a RTA may benefit if members adopt common administrative procedures or unify the standards of products, or competition rules for producers operating in the RTA. This way, not only that a “level playing field” is more likely to be ensured among member countries, but also there is a higher likelihood to internalize externalities, reduce waste and redundancy, realize economies of scale and increase competition on domestic markets.

Rather than using the border versus non-border distinction, Hoekman (1998, pp.4-8) views shallow integration as actions to eliminate discrimination between foreign and domestic firms (i.e., the application of the national treatment principle). This implies not only zero tariffs and quotas, but also the abolition of contingent protection. Therefore, many RTAs are only about a shallow type of shallow integration because it seeks only to eliminate measures that discriminate against foreigners by granting national treatment to products originating in the preferred partner country. He also visualizes another level of shallow integration in which non-discrimination is also applied to factors of production such as labor and capital. In these cases of shallow integration, there is no harmonization /recognition of the regulatory regimes on labor markets or investment in each of the participating countries. Instead, governments remain sovereign and unconstrained in this regard, though the economic impact of shallow integration may far exceed that of deep integration.

In the view of Hoekman (1998), deep integration, on the other hand, “consists of explicit actions by governments to reduce the market segmenting effect of differences in national regulatory policies that pertain to products, production processes, producers and natural persons. In practice, this requires decisions not only that a partner’s policies are equivalent (mutual recognition) but also to adopt a common regulatory stance in specific areas (harmonization). The latter approach may be complemented by decisions to cede enforcement authority to a supra-national entity” (p.4).<sup>27</sup>

“Deep integration” has a variety of implications for the new dimensions of market access: the issue of market access has now to be approached in a broader manner than that which prevailed earlier. It is necessary to embrace the continuum of trade, investment and competition policies that impede the international contestability of markets. The totality of potential barriers includes not only traditional border measures, but also investment conditions, domestic regulatory conduct, structural impediments as well as private anti-competitive practices. That is, there is greater emphasis on an integrated approach to relationships between goods, services, investments/investors and business people who are main forces for deeper integration. As a consequence, removal of impediments in one policy area should be coordinated with and/or complemented by efforts in other areas (Sauvé 1996). Therefore, whether the economies benefit from a particular RTA depends on the scope and coverage of its provisions and the nature of the enforcement mechanism.

Regardless of how deep integration is defined, reducing transaction costs at the regional level should be an important policy objective, because they not only segment markets and reduce competition but also typically waste real resources in doing so. Systemic competitiveness of individual countries will be likely to be promoted by way of harmonizing domestic policies,

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<sup>27</sup> In his view, competition disciplines may be an apt area for deep integration, because antitrust laws generally prohibit anti-competitive practices such as price fixing, collusion between firms to restrict output, or the abuse of a dominant position. At the same time, competition policy spans the broader set of measures and instruments that may be pursued by governments to enhance the contestability of markets (e.g., privatization, deregulation, reduction of firm-specific subsidy programs, liberalization of trade and investment) (1998, p.5).

including even industrial policies (Bekerman and Sirlin 1997) and improving infrastructure, trade financing and knowledge of markets (marketing channels, organized transportation, standards, etc.), jointly among member countries. Nonexistence or rudimentary stages of complementarities in these areas has been a significant factor in explaining why intra-regional trade has been lower than in Latin America than what the gravity of geography suggests (French Davis 1998, p.74). In this sense, RIAs can help to remove these unnatural, artificial obstacles to reciprocal trade, and as a consequence of this enhanced systemic competitiveness, extra-regional trade might be fostered as well.

## C. Problems in executing “Deep integration”

### 1. Convergence or divergence?

Literature on the relationship between shallow and deep integration raises the issue of convergence. In general terms, convergence can be defined as the gradual confluence of non-uniform elements towards a more harmonious whole. Within the context of regional integration, a distinction can be drawn between convergence within integration schemes and convergence between integration schemes. The type of convergence process within a given integration may relate to different dimensions of that scheme, depending mostly on the degree to which the participating member countries are committed to policy harmonization. At each stage of the integration process (e.g., from a free trade area to customs union, common market, economic union, and economic, monetary and policy union) increasing degrees of policy harmonization and, ultimately, convergence, is required.

Regarding convergence within an integration scheme, there is also a problem of asymmetry and solidarity; special preferential treatment allowed for the adjustment process in the more backward countries that liberalize trade and investment with other, more advanced economies in the region and to supplement this process with additional measures. One mechanism to ease the adjustment of trade and production facilities is the implementation of the tariff reduction processes that result from integration agreements gradually and progressively. Another way is to adopt agreements on S&D treatment that would generate benefits both for countries with less capacity to take advantage of the potential of integration and for the other countries. In fact, despite the increasing application of the reciprocity principle and the relative decline of the preferential treatment granted to developing countries, S&D treatment has been the means of tackling the problem of asymmetries in Latin America and the Caribbean (SELA 1997).

In order to incorporate the issue of asymmetry, it might be useful to distinguish between conditions of eligibility and performance conditions. The former would be determined by objective criteria of a country's level of development, which can be possibly accompanied by a graduation policy. The latter, on the other hand, should be linked to the compliance of certain objective norms to efficient use of resources. Most importantly they should not be linked to negotiating power or unilateral decisions.

The type of convergence that may occur between integration schemes also depends on the depth of the scheme involved: the convergence of different trade instruments, by way of tariff reductions, rules of origin, safeguards, customs valuation and technical standards, for example, is a rudimentary type of convergence. The ongoing negotiations between Mercosur and the Andean Community correspond to this stage. As the trade relations intensify, however, it will become increasingly necessary to coordinate other policy instruments, such as exchange rate policy, some types of monetary and fiscal policies, policies dealing with competition, the attraction of foreign investment, and the unification of relevant economic legislation and administrative regulations.

Examples of these processes might include the efforts currently undertaken by the Andean Community, Mercosur, CACM and Caricom (ECLAC, 1999b).

The convergence process for the countries in Asia and the Western Hemisphere is complex since some countries are constituents of free trade accords in both sides of the Pacific Rim. The NAFTA member countries, together with Chile and Peru, are the participants in both APEC and FTAA initiatives. The presence of the NAFTA countries is overwhelmingly important in both APEC and the Western Hemisphere. The NAFTA measures are being widely referred to and taken into consideration in the regional processes of APEC and FTAA. From this perspective, the principal features of APEC must be compared with those of NAFTA and the forthcoming provisions of FTAA (Hosono 1998). The future course of trade and investment liberalization, trade facilitation and economic and technical cooperation in the Pacific Rim will influence, and at the same time will be determined to a large extent by, the parallel processes in the Western Hemisphere. Depending on future negotiations, the world economy might see the construction of three major economic blocs consisted of two mega FTAs (the APEC-FTA and FTAA) and the EU. If this were to take place, NAFTA would be a subregional FTA in both of these two mega FTAs.

It is certain that the multiplicity of current agreements, whose coverage differs widely is not only an obstacle to their implementation in a single country but also a factor in raising transaction costs. Indeed, what most affects the integrity of the regional market is a proliferation of partial accords, which in some cases overlap or even counteract one another. In theory, it would be possible to harmonize this plethora of agreements if they were based on a common set of standards and regulations and similar tariff-reduction time frames. But if these conditions are not met, numerous and crisscrossing RTAs with distinct level of commitments, can produce what Bhagwati (Bhagwati and Panagariya 1996) calls a “spaghetti bowl” phenomenon. This, in turn, results in increases in transaction costs and levels of protection.

## 2. Other difficulties

There is no consensus as to what the scope of “new” trade issues should be and what their relation might be with other trade-linked agenda. Soon after its creation in 1995, the WTO formally established a committee on Trade and the Environment, and at its Singapore Ministerial Conference in 1996, it agreed to create Working Groups on the relationship between trade and investment, and trade and competition policy. The WTO Council has also begun its work on “trade facilitation”, in areas such as information collection, documentation requirements, policy dialogue, and the harmonization or mutual recognition of official processes, such as streamlining of customs procedures.

It is often mentioned that deep integration might result difficult because it requires mutual trust and confidence between partners as well as the perception that their interests in various issues are compatible. For instance, harmonization of standards can entail agreeing about the trade-offs, say, between costs of production and safety, and tends to favor the partner whose standard is adopted by the group (Winters 1998, p.57). Moreover, if policy integration that reduces regulatory costs can be and is applied to nonmembers as well as members of a RTA, the greater the attractiveness of regionalism as an instrument of trade and investment policy reform (Hoekman, Schiff and Winters, 1998, p.7). Therefore, whenever possible, the benefits of policy integration should be extended to all countries.

Furthermore, in some instances, much can be done *unilaterally* to integrate domestic policies. In others, the optimal domain for a new area can be *regional*, whereas in others, it is

*global.* Formal agreements may be required between governments in some areas in order to reduce frictional costs and facilitate entry, but these do not have to be associated with trade discrimination against non-members.<sup>28</sup> In many cases, such agreements can stand-alone; they do not have to include the preferential trade dimensions of the RTA. Whether trade preferences are necessary to achieve deep integration is not always clear since countries already share some standards (e.g., electrical power, compatible railway gauges) but nonetheless impose tariffs on each other's goods (Winters, 1998, p.57).

There is also great scope for developing standards and regulatory norms in the international forums that have been created over time for this purpose (e.g., International Organization for Standardization, the Basle Committee on Banking Supervision, and the International Telecommunication's Union). Regional standards that diverge from global norms will not necessarily be first best, unless there are region-specific characteristics that justify diverging from global standards (Hoekman, Schiff and Winters, pp. 8-9). Therefore, in *ex-ante* assessments, it is necessary to address the question of whether such regional integration is desirable and how and in what areas deep integration will be achieved.

There is also a dilemma of whether it is advisable to deepen, before widening the agreements to other trading partners in the region, in contrast to moving simultaneously on both fronts. Conceptually, within the framework of open regionalism, a group of countries could in fact move to deepen their mutual commitments and at the same time open up membership to other countries, although at different speeds and in different ways. Indeed, some recent examples in Latin America and Asia show that it is feasible in practice. Nonetheless, there are counter arguments worth considering in favor of strengthening the ties between countries with stronger affinities before they proceed to broaden the geographical scope of reciprocal preferences.

## D. Systemic competitiveness in some specific sectors

### 1. Trade in services

Latest estimates from the WTO indicate that close to US\$ 1.3 trillion worth of services were traded in 1998 (WTO 1999). The service sector has grown very rapidly in recent decades and accounts for roughly two-thirds of total economic output (61% and 64% of the regional GDP in the Western Hemisphere and the Asia Pacific, respectively in 1995). This trend has translated into substantial flows of trade in services as well as substantial amounts of service-related investment. For both regions, trade in services now represents approximately 20% of total trade.

Liberalization and deregulation of trade in services has a strong implication for systemic competitiveness. Supply of competitive, high quality services is crucial to dynamic growth of the domestic economy. Also, given the paramount importance of services in the production chains of goods, effective rates of protection on goods would vary significantly depending on the level of protection levied on the services required for producing such goods. For instance, even if a country

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<sup>28</sup> In this connection, Bhagwati argues that the best strategy for the United States and Latin America is the exclusive focus on multilateralism and MFN-based trade liberalization. This can be complemented by a series of initiatives through non-PTA means. “[W]e should renounce the FTAA gracefully, easing into an Americas Initiative that focuses, like APEC, on issues like security, democracy, human rights, drug trafficking, customs procedures and a whole host of issues of hemispheric interest, while becoming a regional platform for launching multilateral trade liberalization initiatives.”(1998, p.18). Such was a case in the Alliance for Progress in which two (trade and non-trade) objectives were achieved best with two distinct policy instruments.

were to engage in a trade reform to reduce tariffs or non-tariff barriers on goods substantially, if this reform did not include the service sector, effective rates of protection may change for the goods sector: as they lose protection on their goods but continue to be confronted with input prices that are higher than they would if services markets were contestable. Liberalization and deregulation of services has emerged as a negotiation issue of high priority because industries need to have access to low cost, excellent quality service inputs in order to be competitive on both the domestic and international markets (Hoekman and Primo Braga 1997; Laird 1999b).

In APEC, the focus of service liberalization, like other areas of in the trade and investment liberalization, is the concerted unilateral liberalization (IAPs), combined with concerted collective action (CAPs). This uniqueness of the liberalization process, however, raises several important questions such as: i) insurance of the comparability of market-opening measures included in the IAPs; ii) relationship between IAPs and CAPs; iii) guarantee of non-reversals of non-binding measures; iv); criteria to be used for S&D treatment for developing and developed economies (Stephenson 1997).

Besides, liberalization of services has to take place in conformity with other sub-regional agreements with provisions on trade in services: in the Asia-Pacific, namely, CER and AFTA; and in the Western Hemisphere, NAFTA, Mercosur, Andean Community, Group of Three, and the bilateral free trade agreements signed by Mexico, and between Chile and Canada. The major concern of the FTAA process will be the coverage and scope of services, the disciplines to be included in a horizontal agreement, the time framework for implementation, and importantly, the type of liberalizing modality to follow, as between the two poles of the “negative list approach (adopted by NAFTA and other sub-regional agreements) and the “positive list approach” (by the GATS). Therefore, it is important to ensure: i) the political momentum behind negotiations in the context of “competing” sub-regional initiatives; and ii) the compatibility of such a preferential arrangement with the Article V of the GATS (Prieto and Stephenson 1998, Stephenson 1997).<sup>29</sup>

One of the future challenges is therefore how to enlist and sustain the continued will and political support to move forward along the lines of the chosen integration modality (IAPs and CAPs in APEC) and negotiations on FTAA. A second challenge is how the overlapping members both of APEC and FTAA can reconcile between the obligations which will be granted on a preferential basis between the members of FTAA and the commitment by APEC members to grant market-opening measures on a MFN basis to all members of the world trading community.

The Group on Services (GOS) of APEC so far concentrated in gathering and disseminating results of research and analysis on trade liberalization and those measures affecting various service sectors. They have offered training seminars, with private sector representations, to promote understanding the complexity of the said sector. Proposed future work plans include the elaboration of an APEC Directory of Professional Services, commencing with architecture, engineering and accounting, the implementation of ongoing/outstanding actions in its CAPs, and the formulation of CAPs to address major issues concerning trade in services that apply across all service industries.

During its existence up to early 1998, the Working Group on Services of FTAA carried out preparatory work along the following lines; i) enhancement of the understanding of the concepts involved in trade in services and its relationship to other negotiation areas; ii) creation of a comprehensive data base of measures affecting trade in services; iii) preparation of two compendiums containing information on the treatment of services within existing sub-regional

<sup>29</sup> For an evaluation of the significance of Article V of the GATS for the sub-regional agreements both in Asia-Pacific and the Western Hemisphere, see Stephenson (1999).

trade and integration schemes and on sectoral agreements on services in the Western Hemisphere; iv) creation of a statistical database of trade flows on services; v) assistance with the understanding and implementation of the GATS, including through technical assistance; and vi) identification of areas of commonality and divergence in the approaches to liberalization of trade in services in the hemisphere.

The negotiations in the Negotiation Group of FTAA, which succeeded the Working Group, so far have been focused on issues such as the scope and coverage (e.g., universal sectoral coverage, with certain very limited exceptions under a negative list approach), standard of treatment (application of national treatment, MFN, at the national and local government levels), modes of supply (e.g., right of establishment), treatment of non-conforming measures (no reversal of measures by a subsequent amendment), and denial of benefits (withdrawal of benefits of the agreements from companies that have no substantial business activity in any country that is a party to the agreement). The coming meetings of the Negotiation Group would try to establish some consensus on these sometimes-conflicting elements of negotiation.

## **2. Transport, infrastructure, energy and environment**

Given the vast distances which separate the Asia-Pacific, the efficiency and safety of the regional transportation system has been of great concern to the APEC countries. Priority areas of APEC in the area of transport are diverse and include safe and environment-friendly transportation systems (urban transportation, aviation safety, satellite navigation and communications, maritime safety, road safety, Y2K problem), trade facilitation, promotion of a more competitive industry including infrastructure (intermodal transportation, port efficiency regional transportation planning), human resources development (virtual centers of technology transfer and of R&D and education, seafarers training, Standards of Training, Certification and Watchkeeping for Seafarers (STCW), database of transportation technology research, women), and new transportation technologies.<sup>30</sup>

Because of the recent economic crisis, among the countries of ASEAN, there is greater urgency to enhance the region's economic competitiveness through closer cooperation in transportation. At present the Ministers of Transport of these countries are exploring various areas in which member countries could harness their relative strengths in transport infrastructure and facilities and complement each other in order to make maximum use of each country's strengths and resources and reap maximum benefits.

The major areas of cooperation in ASEAN include the Y2K problem in air traffic control and airport systems, study on the liberalization of air freight services in ASEAN, study on maritime training, the development of the cruise industry, strengthening of port cooperation, and sustainable urban transport development and road safety. The Fourth ASEAN Transport Ministers meeting, held in September 1998, signed the Agreement on the Recognition of Commercial Vehicle Inspection Certificates of Goods Vehicles and Public Service Vehicles. This agreement will facilitate cross-border movements of goods vehicles and public service vehicles. With this agreement, ASEAN member countries will now recognize one another's commercial vehicle

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<sup>30</sup> At present, the APEC Working Group executes a series of action programs. For instance, under the Trade and Investment Liberalization and Facilitation (TILF) Collective Actions, they try to enhance road transport harmonization by way of mutual recognition of arrangements for automotive products between APEC members and a global agreement on road vehicle regulations. This sub-group examines also the possibility of taking appropriate steps to facilitate privatization or corporatization of transportation infrastructure projects. It also has initiated a pilot Electronic Data Interchange trial program. Under the framework of TILF/ECOTECH, the issues of air and maritime services are being discussed.

inspection certificates. Public service and goods vehicle operators from ASEAN countries will no longer require to send their vehicle for inspection checks before they enter another AEAN country. The Ministers also endorsed the ASEAN Framework Agreement on the Facilitation of Goods in Transit, which will includes the simplification of all transit transport procedures and requirements, and minimizing of unnecessary delays or restrictions.

In APEC, the work on The Impact of Expanding Population and Economic Growth on Food, Energy and the Environment (FEEEP) has progressed, and active and comprehensive work programs have already been established on energy and the environment. The major challenges in this area are the need to: i) sustain and expand investment in agricultural R&D, including the question of the respective contributions of private and public sources of investment; ii) ensure investment flows to rural infrastructure, particularly for irrigation and transport; iii) assure a stable food supply; iv) assess the impact of environmental change on agriculture; and v) assess the impact of agriculture on the environment and impact of economic growth on rural communities. A series of joint actions were suggested for review and discussion by APEC Leaders in November 1998 (APEC 1998a).

In recent years Latin America has witnessed a rebirth of initiatives on regional integrated transport systems. In Central America, for example, a multimodal transport project is already underway, while a new master plan by the Central American Economic System (SIECA) is being prepared. In South America, the Latin American Integration System (LAIA) and Latin American Railways Association (ALAF) have launched a prefeasibility study on a plan for the sustainable development of transport. Within the Andean Community, there exist a series of provisions whose aims are to facilitate and liberalize the different modes of transportation services, with a view to spurring its intra-zonal trade (Andean Community website). Also, in April of 1998, the Second Summit of the Americas adopted a plan of action that now takes in the work of the Executive Committee of the Western Hemisphere Transport Initiative. In the same month, Intermodal 98, the fourth in a series, was held in Sao Paulo, Brazil (ECLAC, FAL Bulletin, no.143).

These initiatives are based primarily on the observation that after several years of economic growth, transport infrastructure, equipment and services appear inadequate to respond to the growing demand of international trade in the region.<sup>31</sup> In order to bring about more efficient regional, subregional and hemispheric transport systems, which would lead to increases both in inter- and intra-regional trade, several obstacles have to be solved. Efforts in this area include, among others, facilitation of transport (e.g., customs procedures, sanitary and phytosanitary controls at border crossings). Solutions to the problems on technical standards of transport equipment (e.g., loading and unloading operations and the inter-connectivity and inter-operability of the different transport modes) should be provided. Safety standards, in compliance with ruling international standards on environmental protection and public safety should be ensured (Andean Community website, ECLAC, FAL Bulletin No.148). There is wide recognition that successful execution of new infrastructure projects depends on the capacity of national governments to establish regulatory apparatus capable of making compatible the quality and price of services with sufficient profitability to mobilize private-sector capital (INTAL, Informe Mercosur, 1998 No.4).

More specifically, a concern in the LAIA forums is the need to ensure greater fluidity of the growing volumes of intraregional trade and to reconsider the today's strong bias in favor of road transportation in merchandize and passenger flows. Therefore, their initiatives seek to harness the advantages of each mode of transport as well as the development of integrated regional transport

<sup>31</sup> For instance, between 1993 and 1994 railway traffic between Argentina and Brazil rose over 60%. All of this traffic was through the Paso de los Libres/Uruguiana border crossing, where trans-shipment was necessary between cars of different gauges.

networks (Sgut 1997, Thomson 1997). Emphasis is placed on the renewed vigor of rail and shipping transport which have suffered from poor management of railway companies and high port costs. Though projects on railway integration in the subregion have a long history, there is now renewed interest in reconsidering the economic feasibility of certain investment projects relating to trade between countries of the Southern Cone, and between one or other of such countries and the overseas export market, through the territory of other countries of the subregion (Thomson 1997).<sup>32</sup>

The major objectives of the Western Hemisphere Initiative are to integrate air, land, and sea transport policies and practices both across modes and between countries through improved planning in the development and maintenance of transportation infrastructure, by: i) linking regional and subregional transportation institutions and systems; ii) sharing information on “best practices” in utilizing traditional and innovative financing mechanisms; iii) improving transportation safety and security; and iv) establishing better information networks and mechanisms of capacity-building (ECLAC, FAL Bulletin, No.149).

With respect to the energy sector, there are enormous potentials for complementarity and integration among the countries in the region, especially in the areas of hydroelectric resources and natural gas (Wiegert 1996). Those integration projects in this sector that are considered feasible among the Southern Cone countries for the period of 1996-2010 might require more than US\$ 20 billion of investment. While the major part of this capital would be forthcoming from the private sector, active participation of the governments, regional energy organizations and the multilateral financial institutions as well as other financial institutions in charge of export finance is required as credit guarantors. Though these projects are binational or plurilateral in nature, it is not clear whether integration organizations themselves should get involved as their major promoter.

### **3. Small - and Medium-sized Enterprises**

The nurturing of small and medium-sized enterprises (SMEs) has received a high priority of the APEC agenda, and at the Leaders Meeting in Manila in 1996, the issue was identified as one of the identified six priority areas for economic and technical cooperation (ECOTECH). There is consensus that SMEs are critical for all APEC members' economies as they attempt to achieve the goals of increasing investment, creating employment opportunities and managing sustainable development. SMEs are known to play a key role not only in the economic development of individual APEC countries, but they are also instrumental in promoting trade and investment activities among different economies, including the facilitation of a more open environment for investment in the APEC region.

Under the recognition of the role played by SMEs in economic development and intraregional trade and investment, governments of ASEAN are also eager to raise the performance of their SMEs.<sup>33</sup> Yet, the rapid growth of industrialization has exposed a fundamental weakness arising from an acute lack of supporting industries to provide parts and components for assembly and processing-type industries, such as the automobile and electrical/electronics industries. The small size of the domestic market, complemented by local content regulation and high tariffs on parts, components and other inputs had hindered the development of SMEs in the ASEAN region.

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<sup>32</sup> Grain production in the center of the South American continent has been soaring but it is not clear what proportion of this production will be channeled through Pacific ports. The feasibility of certain projects, such as the proposed link between the two Bolivian rail network, will be determined to some extent by projected production increases of grain (ECLAC, 1996, FAL Bulletin No.127).

<sup>33</sup> ASEAN's programs on SMEs under consideration include a match-making workshop involving ASEAN SMEs and those of other countries, attraction of investments specifically in SMEs, a regional export financing and credit guarantee scheme and an investment fund.

In order to overcome this weakness, the development of strong and competitive SMEs is thought as a prerequisite for continued development and increased competitiveness of the manufacturing sector in ASEAN (Karikomi 1998).

In Latin America, globalization, the competitive pressure coming from trade liberalization and the amplified market size resulting from RTAs are now forcing SMEs in the region to adjust their organization towards of lesser verticalization of and greater intra-SME cooperation and more enhanced inter-firm relations with large enterprises (see various articles in SOCMA 1998). Contrary to what might be expected, SMEs in Latin America play a greater role in the industrial structure of larger economies than in small countries, especially with respect to value added and sales. Regardless of the size of the economy, SMEs are most concentrated in the chemical and food industries, though in the large ones, their presence is also significant in activities linked to metal products and machinery (Peres and Stumpo 1999). Although their importance in the overall economies is overwhelming (in the economies of the four Mercosur countries, SMEs account for over 90% of establishments and over 50% of jobs), their participation in foreign trade is insignificant, accounting for less than 3% of total exports. Due to their role in overall economy, SMEs have had a special place in discourse on economic policy in Latin America and all the countries in the region have policies to support them.

The support programs include those undertaken not only by the national and subregional entities, but also by international financial institutions. In the case of Mercosur, for instance, the Common Market Group (GMC) has promoted a number of projects on SMEs, whose objectives are two-fold: one is to incorporate SMEs within a framework of integration efforts and regional development, and the other to strengthen the competitiveness of these entities congruent with the policies of the individual countries. One of the most significant efforts has been the harmonization of the conceptual elements and the statistical indicators. In addition, several mechanisms and instrumentation of support have been implemented to develop management and technological capacity, to eliminate excessive restrictions and limitations related to the market structure, to facilitate and simplify tax treatment, to lesson the problems associated with credit, finance and capitalization, and to articulate and coordinate export-related activities of the public and private sectors. However, while lacking sufficient funds or concrete projects, such regional efforts seem neither to have been implemented effectively nor coordinated well among the countries.

The Plan of Action adopted at the Second Summit of the Americas in April 1998 earmarks also the importance of SMEs. In this declaration, the governments pledge to establish access to financial services to especially to those in low-income countries by the year 2000. They urge to support private-sector providers of non-financial services to enable these firms to expand access to new technologies and training. They also think it necessary to promote partnerships of SMEs to allow them to take advantage of cooperative assistance in doing business and in modernizing business management. In addition, they request to convoke a regional meeting of ministers or senior officials responsible for public policies to support SMEs. Finally, the governments request regional organizations, government, multilateral and bilateral development agencies to assist in policy formulation and invest between US\$ 400 and 500 million over the next three years in SME-related programs, including training and technical assistance.

#### **4. Trade and Development Finance**

Stability in payment systems can play a vital role in the management of OR. In theory, the main function of clearing houses is to reduce the number of bilateral transactions, thereby saving time and resources, and is to reduce the uncertainty inherent in trade. Also, they tend to serve to reduce risks for new intraregional exports, unlike traditional exports that are usually conducted through middlemen operating on a large scale.

The Multilateral Compensation and Reciprocal Credit Mechanism of the Latin American Integration Association (LAIA), in existence since 1966 but adjusted in 1982, provides several important services, namely: i) bilateral lines of credit denominated in US dollars between each pair of central banks; ii) four-month paid multilateral compensation of balances accumulated in the bilateral accounts and the outstanding balances paid in US dollars usually through the Federal Reserve Bank of New York; and iii) channeling of payments through voluntary in principle, if convenient or necessary, member Central Banks may make them compulsory.

In addition, since May 1991, a transitory financing mechanism of the credits due to the multilateral compensation balances (Automatic Payment Program) has been incorporated in the agreement. This mechanism foresees occasional liquidity difficulties that the Central Bank of member countries might face at the closing of the multilateral compensation periods. This mechanism is multilateral and automatic and consists in postponing the payment obligations for a period of four months. There is also the Santo Domingo Agreement, another credit mechanism designed to help alleviate temporary illiquidity experienced by member countries.

The size of operation under the payment scheme can be appreciated by the fact that the volume of payments handled through this clearing mechanism during 1966 and 1998 amounted to approximately US\$ 203 billion, which represent a 55.8% of imports registered among member countries. In general, the utilization rate of the system has been higher in the 1990s, but since 1997 there has been a significant relative decline in its use (LAIA 1998, IMF 1999, Otero 1995). Not clear are the reasons for the decline, nor it is straightforward whether such decline is good or bad for intraregional trade. The importance of reciprocal payment systems will decline as the convertibility of currencies is provided for, private foreign-exchange markets are well established and national currencies become more attractive as means of payment. However, as long as these conditions are not met, instruments for creating regional liquidity are welcome and desirable.

The Andean Community has its own system, whose operation is known to be quite successful. The Latin American Reserve Fund (FLAR), established in March 1991 as the successor to the Andean Reserve Fund, is a regional financial institution whose principle aim is to assist in correcting payments imbalances through loans with terms up to four years and guarantees extended to the five Andean Community members. Subscribed capital of the FLAR is US\$1 billion, to which Bolivia and Ecuador each contribute US\$125 million, while Colombia, Peru and Venezuela each contribute US\$ 250 million. The paid-up capital as of the end of 1998 was US\$940 million.

In addition to financial cooperation in supporting balances of payments, other kinds of financing can be broadened and strengthened, such as those provided by regional export financing channeled through the Andean Development Corporation (CAF)<sup>34</sup> and the Latin American Export Bank (BLADEX).<sup>35</sup> At present, commercial banks finance the bulk of the exports of countries in

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<sup>34</sup> CAF, main promotional and financial institution of the Andean sugregional integration process, has been able to efficiently attract capital resources for the provision of multiple financial services to the public and private sectors of shareholder countries. For the year 1998, in which the organization attained the highest level of net profits in its history, it, together with cofinancing and local contributions, funded investment approximately US\$ 8.0 billion for the shareholder countries. Almost two-thirds of investment loans and operations were destined to finance physical infrastructure and projects with a high regional integration and strategic content. Its operations were also diversified geographically to include Paraguay, Jamaica and Panama. It also approved an Emergency Program to finance preventive measures, and reconstruction projects as a result of disasters caused by the El Niño phenomenon. Thanks to its efficiency, Moody's upgraded its investment grade rating from Baa2 to A3, the highest for any issuer in Latin America and was able to place the most competitive issue in respect to spreads and terms in the United States market achieved by any regional issuer (website CAF).

<sup>35</sup> BLADEX, a specialized multinational bank, promotes and finances trade of 23 Latin American and Caribbean member countries. They provide short-term financing at market rates to banks (mostly shareholders) for use in on-lending to exporters and importers, as well as directly to selected regional exporting institutions. It also provides, on a limited basis, medium-term loans to serve the demand

Latin America, but access to export financing is limited. SMEs, which could be among the main beneficiaries of easier access to neighboring markets, are usually hindered by the lack of real guarantees. Banks tend to give financing preference to final and direct exporters. The supply of short-term credit that is characteristic of commercial banks also limits the amount of funds available after the shipment of capital goods and that available for investments in fixed assets for export activities. All these factors make a case for supplementing the export financing by commercial banks. The creation of comprehensive, agile systems for financing non-traditional exports, that are one of the most important components of intraregional trade, is desirable (ECLAC, 1994, Chapter III).

Central American Bank for Economic Integration (CABEI), one of the largest and best capitalized financial institutions in this region, also assists the public and private sectors in attaining external resources to promote regional development. It attends mostly infrastructure programs with emphasis on telecommunications, energy and transport and social development. The bank's membership has grown to include extra-regional members of Mexico, Taiwan Province of China, Argentina, and most recently Colombia. By December 1998, CABEI sustained capital reserves of US\$502million, generated US\$81.0 million in net income, and managed a loan portfolio of US\$2.1billion. Also 100 intermediary financial institutions and 14 non-governmental organizations had been declared eligible for loans (website CABEI).

## 5. Social, labor and political dimensions

Integration schemes are increasingly addressing the more complicated questions related to social integration, though such efforts to incorporate social aspects into regional integration are neither new nor uncommon. The European Union has extensive and numerous formal instruments, with a long list of vulnerable economic and social sectors and geographic regions that require special policies with the aim of generating greater equity. NAFTA has complementary agreements on labor and environmental norms to which respective national legislation should conform.

In view of some analysts (Gonzalez 1997,Grandi 1998), one of the major challenges in Latin American regional integration has to do with the adoption of effective and sustainable economic development policies and social integration policies for all social sectors that have suffered cumulative marginalization during the lost decade and the severe effects of adjustment policies in the 1990s.<sup>36</sup> Though regional integration generates considerable benefits, it also entails high costs, of which the social costs are very significant. Among the many "deficits" that the states in Latin America suffer, the social deficits are the most prominent.<sup>37</sup> It is often argued that regional

for medium-term trade financing. In December 1998, capital funds amounted to US\$607 million and total assets reached US\$5,6 billion.

<sup>36</sup> Berry (1997) asks whether there is a causal relation between economic reforms adopted and an abrupt and important deterioration of income distribution observable for most countries in Latin America and the Caribbean. He maintains that though economic downturns contributed to some extent to the increases in inequality, there were other major factors, namely ongoing technological change, more open trade regimes, the dismantling of labor institutions, and the "socialization of debts in which the State became responsible for certain private debts. The scaling-down of the public sector via privatization, increasing foreign investment might also have contributed to the worsening of income distribution. In the case of trade, for example, it appears that the comparative advantage of the region does not lie in unskilled labor-intensive products. Trade opening has not necessarily led to increases in incomes of agricultural workers; instead it has led to a widening gap in income between urban and rural areas. Import liberalization appears to have favored better-off families. Based on these observations, he suggests that priority policy areas include, among others, education/training to bring in low skilled workers to the dynamics of trade opening, SME policy, better targeted policies to poverty.

<sup>37</sup> Grandi (1998) argues that despite the region's significant progress, the current integration of Latin America faces several "deficits" in distinct areas: the leadership deficit; the management and governability deficits; the democratic and social deficits; the deficit of judicial-institutional capacity; the deficit of follow-up, monitoring and evaluation; and the deficit of information and training. In his view, any successful integration scheme should provide institutionality to address these deficits systematically.

integration without social programs will not produce opportune reconversion of the productive system, while it is likely to have an increase in disparities and marginalization of certain regions, economic sectors, thus threatening the integration process itself (Gonzalez 1997, p.52). Policies that governments often adopt to attenuate undesired social effects that might stem from the rapid dismantling of trade barriers are based primarily on exceptions or temporary protection. These policies usually have a short life, and integration can be seen not only as an opportunity but also threat.<sup>38</sup>

When viewed from this perspective, a viable and durable regional integration needs to avoid serious imbalances and to offer responses for reducing them. The social polices on equity and solidarity with growth, competitiveness and employment have to be included in economic reforms (Gonzalez 1997). There is the need to develop policies to transform production, to lesson the impact of the geographical concentration and relocation of production, to regenerate the social fabric in the countryside and to reconvert the primary and industrial sectors that perpetuate old means of production or limited productive supply. These goals should be achieved without sacrificing equity, income distribution and real wage (Di Filippo and Franco 1997).

Even more, regional integration is expected to restore to the community a sense of belonging and solidarity, to solve the cultural issues brought about by resurgent and constant migration and labor mobility and to resolve the issues concerning mega-cities and their neighborhood countries, etc. In short, the reformation and strengthening of current civil society has to accompany, and at the same time to be accompanied by, the emergence of a new multi-dimensional citizenry that complements the national one (Tirado 1997). This implies that from the economic point of view, the issues such as specialization, reconversion and adaptation become vital, while in the social field, planning and capacity to respond to social needs are prominent. Education, health, and the training of human resources are thought be areas of high priority.

Another justification for regional joint or common actions to tackle social issues is that the power and identify of the State is being diluted and national governments are losing maneuvering room to take decisions and implement policies. The borders of policy between the three levels (i.e., international/intergovernmental, national and subnational) compete and at the same time are weakened, while the means to resolve problems are diversifying.<sup>39</sup> But the present nation State appears to be too large to deal with some issues, whereas too small to deal with others. Cross border issues such as drug trafficking, environmental pollution, immigration, terrorism, urban or rural conflicts, as well as corruption are part of the same logic of globalization whose effects transcend states and which are multiplying on a global scale. Similarly, joint actions at the regional level tend to allow new actors in integration (e.g., trade unions, industrial and commercial bodies, sectoral and consumer organizations, service industries, universities, NGOs and even networks of political parties and other social organizations) to participate more actively in the integration process.

Despite the recognized importance, specialists in Latin America argue that social dimensions have not been adequately treated in the regional integration schemes. In the case of Mercosur, for instance, in spite of recent recognition, the labor issue has been taken up only sporadically and substantive labor rights of Mercosur circumscribe to the 12 agreements of the ILO, which have

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<sup>39</sup> On the one hand, there is a tendency towards a transnationalization of political power in its various forms: to the supranational, the intergovernmental or the international. On the other, there is also a tendency toward decentralization or the transfer of power over essential services to the provinces or municipalities (fiscal, educational, health). This latter trend is expanding to other areas such as industrial, commercial and investment promotion. These two forces tend to perforate the power of the nation State.

been ratified by the four countries of the group (Ermida 1997). Mercosur is not equipped with adequate institutionality to address the social issues and implement policies on them (González 1997).

Similarly, in order to reactivate the Simón Rodríguez Convention, the members of the Andean Community decided in May 1999 to establish the three working groups to come up with an Action Plan on social and labor integration. The principle tasks entrusted to these groups range from the guarantee of the basic rights and free circulation of workers, productive employment and professional education and training, to social security and workplace health and safety. The Community is promoting other initiatives in the other areas of social dimensions, including the cultural and educational aspects of integration (Andean Community website).

The major issues in the area of human resource development in the Asia-Pacific region are basically labor flows and skill development. With respect to the first, international labor migration within the region is playing a key role in correcting labor market imbalances from labor surplus economies to those affected by sector-specific labor shortages.<sup>40</sup> PECC (1999) argues that GATS and host economy policies address the needs of only highly skilled workforce, without giving adequate attention to the ability of the majority of low- and medium-skilled workers who comprise over 90% of migrants in the Asia Pacific region. PECC considers it unlikely for the WTO to formally address the issue of migrant protection, in the foreseeable future, and as a result, it is appropriate for forums such as APEC to take measures to regularize and facilitate it, and to provide an institutional structure that would ensure the protection of migrant workers. In addition, shortages of skills in areas vital to economic development must be assessed through research and addressed through various cross-country arrangements, including “twinning” of enterprises and educational institutions. In these initiatives domestic and foreign educational and training institutions join forces, allowing each to access the specialist skills of the other. Thanks to the impressive growth of telecommunications, distance learning arrangements may also be considered.

Despite enormous efforts made, it is frequently stressed that APEC should also be prepared to broaden its scope to include consideration of social issues that are related to the capacity to achieve market reform. These issues that are outside the competence of trade officials, have to be addressed in a forum where consideration can be given to the social policies, such as employment safety nets, health and safety standards and others, which is the most pressing need across developing APEC countries (Oxley 1999a, p.4).<sup>41</sup>

Though some of these concerns have been present in the development of international trade policy institutions since Bretton Woods, the debate as to whether it is desirable to put the issue of social justice and labor on the international agenda is far from over. To deal with social issues within a regional integration in an effective and practical manner, as Harcourt (1997) suggests, there is a series of questions to be addressed. The list of questions includes: i) what is the best means of improving living standards in the member countries of an integration scheme? ; ii) what are the mechanisms by which freer trade and investment lead to improved real wages? Is it desirable to integrate different national labor systems at the same time as capital becomes more

<sup>40</sup> This migration is encouraged by various “push” factors in the laborer’s home economy, such as population growth, political instability and fewer barriers to emigration, and by a series of “pull” factors in the host country economy such as labor shortages and the existence of home economy immigrant communities. Direct investment also encourages the flow of skilled and professional workers in the host country and a transfer of skills to the domestic workforce as a result of localization programs.

<sup>41</sup> In this regard, ASEAN are now executing several projects that are financed by UNDP. The project to establish an ASEAN Occupational Safety and Health Network has resulted in a four-year plan of action on these aspects. Another project, the ASEAN Regional Project on Informal Sector Development, also funded by UNDP, has produced a plan of action, which is now being finalized (ASEAN website).

mobile and integrated and competition policy becomes international?; iii) should integration be harnessed to improve living standards and social conditions as well as improving business opportunities and economic expansion?; iv) can nations no longer affect their own income distribution by domestic economic policy alone so that it necessary to look for some sort of distributive mechanism for workers internationally? Or policy solutions to these issues lie mainly in the labor market itself rather than in trade policy? In effect, it is neither true that all the social issues are related to integration, nor that all the aspects of regional integration affect the social issues.

## 6. Conclusions

As briefly reviewed, the existing integration schemes both in Asia-Pacific and Latin America already address some of the crucial aspects of deeper integration. However, It is often pointed out that in APEC there are a large number of programs which repeat work done elsewhere; are not coordinated with related work in other APEC working groups and other organizations; and have nebulous purposes (Oxley 1999a.). A quick review of the work programs endorsed by Ministers in the Transport, Small and Medium-sized Enterprises, Human Resource Development, Science, Sustainable Development, Telecommunications, Energy and Tourism working groups, for example, reveals that the desire to do something is stronger than the capacity of officials to identify concrete work targets.

The same observations might apply to Latin America. In the case of Mercosur, for instance, while the main objectives of creating a customs union is well underway, most of the other objectives such as services and foreign investment, labor, R&D, social and regional development, and industrial policies, have only begun to be addressed.<sup>42</sup> The recently approved Montevideo Protocol on the Trade in Services in Mercosur defines the intra-subregional framework that will permit the countries to present specific offers, through successive annual negotiation rounds so that a complete liberalization of services between the countries will be achieved within a maximum of ten years. The agreements on foreign investment are of a general nature which establish limits on allowable actions and whose definitions do not seem to be very precise.<sup>43</sup>

Also lacking are provisions on public investment and those investments directed to infrastructure, transport and telecommunications, determinants which are conducive to a better functioning of more ample regional markets. Neither, Mercosur defines any financing mechanism for regional development, industrial restructuring or reconversion initiatives, or joint research and development projects (Machado and Markwald 1999). Though full labor mobility is a long-term objective, Mercosur does not have a general provision on it. Although the Preamble sets out a generic objective of accelerating development processes with social justice, the Treaty of Asunción does not contain any explicit mention of labor, employment and social security matters. A working group deals with environmental issues but there are not specific provisions (Leipziger et. al.1997, Sanchez 1999). Despite its publicized determination, whether Mercosur is capable of “deepening” its commitments remains to be seen.

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<sup>42</sup> Mercosur have established 11 working groups and they have been covering various fields such as communications (No.1), mining (No.2), technical norms and regulation (No.3), finance (No.4), transport and infrastructure (No.5), environment (No.6), industry (No.7), agriculture (No.8) energy (No.9), labor (No.10) and health (No.11). Their major task is to harmonize the national norms to create a “level playing field”.

<sup>43</sup> They do not contain clauses to promote jointly Mercosur as an attractive investment area.

## **IV. Possible contents and focuses of a WTO millennium round**

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### **A. The “Positive” Agenda**

The period since the mid-1980s has witnessed widespread and rapid trade liberalization in developing countries, undertaken not only in the context of unilateral, bilateral and multilateral trade negotiations, but as part of conditionality attached to structural adjustment and stabilization programs. The short-term impact of the Uruguay Round, therefore, has been obscured, to some extent, by the structural adjustment processes that took place before the launching of the Round (UNCTAD 1999c; Laird 1999b, Kuwayama 1998). Such processes resulted in, among others: retrenchment in public expenditures which led to the reduction of fiscal and credit instruments to promote local industries; privatization of industrial, infrastructure, and service enterprises; reorientation in trade relations, with the abandonment of import-substituting strategies and sectoral targeting in favor of unilateral trade liberalization and relaxation of foreign investment regimes; and the pursuit of regional trade initiatives in parallel to multilateral negotiations. Most of these processes took place before the end of the Uruguay Round and the negotiations *per se* did not affect the policy choices of many developing countries.

Rather, the negotiations and eventual adoption of the Uruguay Round agreements constituted one more element of the international environment to which these countries were already adjusting themselves (UNCTAD 1999 c).<sup>44</sup>

The initial perception of the governments on the strengthened disciplines by the RTAs and the Uruguay Round was that the room for manoeuvre for trade policy formulation and particularly for protection has been reduced.<sup>45</sup> Besides, developing countries believe that the Uruguay Round and its implementation process did too little to improve market access for their exports: the results of these extensive policy efforts and structural reforms are that for many developing countries average trade deficits in the 1990s have been higher than in the 1970s by almost 3% of GDP, while the average growth rate has been lower by 2% annually (Ricupero 1999a). In short, for most developing countries, the expansion of imports has not been matched by a satisfactory increase in exports.

These countries also feel that the new WTO rules have been imbalanced in several important development-related areas such as the requirements on intellectual property rights (IPRs) and the suppression of industrial subsidies, while the issue of special and differential (S&D) treatment for them in the WTO agreements has been inadequately addressed and needs revision. In addition, these countries are concerned of their weak human and institutional capacities to use the WTO system to pursue their trade interests, particularly in making use of its dispute settlement mechanism,<sup>46</sup> and also to comply fully with their multilateral obligations (Ricupero 1999a, Stiglitz 1999). Finger and Schuler (1999) also remind that the implementation of the Uruguay Round commitments requires a huge amount of financial resources, that can be easily equivalent to one year's development budget for the least developing countries. Their frustration also relates to the question of "credit" that developing countries should get as a consequence of their own autonomous (though quite often under strong pressure) liberalization in trade in goods and services (Stiglitz 1999).<sup>47</sup>

There is also recognition that the outcomes of the UR have stopped short of what was expected by many developing countries. After the conclusion of the UR, because of competitive pressure, developed and developing countries, though less frequently than before, resort to anti-dumping and other contingency actions. Also, there has been another setback since the UR; the comeback of the so-called "voluntary export restraints" agreements, and the return of "managed

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<sup>44</sup> The direct impact in terms of domestic tariff reduction was minimal, since the UR liberalization initiatives bound tariffs at ceiling levels above applied tariffs. Still, some countries introduced legislative and institutional changes, such as the Agreement on Subsidies; the Anti-dumping Agreement; and TRIPs. The traditionally export-oriented agricultural sector has benefited in market access, to some extent, from the first steps of the worldwide agricultural reforms. On the other hand, there are other sectors for which the implementation of and compliance with the URAs has brought significant costs. This has been the case of the sectors that are heavily dependent on intellectual property rights (e.g., pharmaceutical and software industries), and the automotive industry, for which export subsidies and TRIMs are still in place. It has been also necessary for some countries (e.g., Chile) to adjust the drawback schemes.

<sup>45</sup> On the other hand, there is also a strong perception that there still exist a number of policy instruments, which are in conformity with the new multilateral framework, which developing countries can take advantage of in order to deal with structural deficiencies, and market failures, and to accelerate growth, promote investment, increase systemic competitiveness and assure a better income distribution. These measures might include, among others: i) broad pro-competitive measures; ii) R&D enhancement; iii) human resource development; iv) encouragement of SMEs; v) promotion of FDI; and vi) information diffusion.

<sup>46</sup> Hoekman and Mavroidis (1999) state that in order to use the dispute settlement mechanisms embodied in the WTO effectively, there must be domestic "upstream" mechanisms through which national interests can channel information to the government. What is important is the feasibility and effectiveness of using national legal mechanisms to enforce commitments made by the governments. The efficiency of the "downstream" WTO panel process is only a part of the complex process.

<sup>47</sup> This issue was present in advance of the Uruguay Round, and was subsequently taken up in the Functioning of the GATT System (FOGS) group. For this issue to be considered as a principle in a new Round of negotiations it is necessary that further autonomous liberalization is accompanied by more liberalization commitments and bindings (Krueger 1999, pp.11-12; Michalopoulos 1999, p.31).

trade” in some developed countries, as in steel products, automobiles and aluminum (Laird 1999a). There is a protectionist wave of a new variety (“grandfather” protectionism) that legitimates environment and labor standards as protectionist tools. All this contributes to that many developing countries do not see promising prospects of correcting past imbalances in a new round, maintaining the view that a new Round should not be launched unless and until the Uruguay Round agreements are fully implemented.

These observations lead to the conclusion that further liberalization alone might not automatically help to improve the export structure of developing countries, or to ensure stability of the prices for commodities, nor will induce or promote investments. Therefore, future negotiations should focus on the following two dimensions: one is to seek liberalization conducive to increases in the traditional trade flows of developing countries, and the other is to incorporate a “development dimension” that would help these countries strengthen the technological capacities and to enhance the structural competitiveness of their productive sectors. The development dimension can be implemented by combining the Special and Differential (S&D) Treatment provisions and legitimizing the “space for development policies” within agreements. In reviewing the implementation of existing agreements, as well as in the negotiations scheduled under the built-in agenda, it is thought desirable to identify and recognize those development-oriented policies that are already existing in the agreements or that could be introduced, in conformity with the WTO rules. This proposal has been termed as a “pro-active” or “positive” agenda.

In view of Stigliz (1999), to assure the development dimension, the future negotiations should be guided by two interrelated principles, comprehensiveness and fairness. The former includes not only sectoral comprehensiveness (agriculture, services, industrial products, etc.) but also comprehensiveness across factors of production as well as comprehensiveness of instruments (antidumping, countervailing duties, and their onerous implementation process and competition policy, trade facilitation). The comprehensiveness, which goes much further than trade liberalization, would likely to be perceived as fairer, because it will enhance the chances of trade liberalization within developing countries and increase the number of potential winners across sectors. Fairness, in turn, means not only that developed countries should recognize the higher costs of liberalization in developing countries, but that the developed countries should consider establishing formal programs of trade adjustment assistance. In considering also the concept of fairness, special attention should be paid to the long-term growth aspirations of the less developed countries, including promotion of the national banking sector, SMEs, less strict IPRs (especially in such sectors as pharmaceuticals where human needs, like health, can be affected), and technology development. There should be some way of accommodating the concept of infant industry promotion, as well.

However, there is little consensus as to which sectors are convenient for developing countries to include in the negotiation agenda and how to go about it. Panagariya (1999) thinks it convenient for developing countries to concentrate on the built-in agenda plus and industrial tariffs. To engage in wider negotiations risks spreading their scarce negotiating resources. He considers it premature to bring in a multilateral investment agreement, while the issues of labor and environment standards should not be dealt with in the WTO. Michalopoulos (1999) suggests that developing countries should focus future negotiations on the already agreed agriculture and services, two other topics, TRIPs and industrial tariffs, which can be in interest to developing countries; and potentially two others, trade and environment and government procurement, to be included as part of future negotiations. In his view, several other areas, such as trade facilitation<sup>48</sup>

<sup>48</sup> For a series of suggestions as to how to go about negotiating the trade facilitation issues, see Messerlin and Zarrouk (1999).

and electronic commerce, are still premature, while labor standards, competition and investment are counterproductive.

Laird (1999a) adds to the built-in agenda, the topics of dispute settlement, textiles and clothing, anti-dumping, government procurement, regional trade agreements and technical barriers to trade, as possible areas for negotiations from the viewpoint of developing countries. The issue of competition does not seem ripe yet for negotiation. He thinks it likely that the investment issue be taken up within the negotiations on trade in services, rather than as a separate agreement. Issues such as environment and labor should not be brought within the WTO framework at present. Krueger (1999) similarly maintains that agriculture and movement of natural persons should be actively negotiated, while the implementation of Multi-Fibre Agreement of the Uruguay Round should be carried out in its entirety.<sup>49</sup> In addition, stricter regulations on the use of Anti-dumping and Countervailing Duties (ACD) measures and revision on the rules of origin (RO) can be addressed.<sup>50</sup> In her view, however, the issues of labor and environmental standards should be avoided since they might transform themselves into new protectionist measures. Rollo and Winters (1999) also maintain that the issues of labor and environment should be dealt with somewhere else than the WTO.

Developing countries might be advised to consider a range of new issues, in return for support of the areas in which developing countries have strong interests (Anderson 1998). Issues on which these countries would be asked to liberalize more than some of them would like (e.g., services, TRIPs, investment) be counter-balanced with issues of direct interest to their exporters (particularly agriculture and textiles). Both Michalopoulos and Krueger agree, however, that what is necessary to open up the heavily protected markets of developed economies, such as agriculture, some specific sectors and modes of supply of services and, textiles, is precisely additional commitments on the part of developing countries in the form of more binding and reductions in the bound and applied rates of industrial products, in addition to some additional commitments in service sectors. Their focus on S&D treatment should be on the establishment of realistic transition periods and technical assistance to lesson institutional capacity constraints.

In any case, if the new draft Ministerial Declaration released on early October is any guide to future context of the next round, the negotiations should be done as a single undertaking, which permits trade-offs across these distinct topics, with a three year period. According to the draft Declaration, agriculture and services are the only agreed-upon sectors under “New Negotiations” so far. There is an emerging consensus on reducing industrial tariffs under “Future Work Programme”, while the draft makes weak references to transparency and environment; and a more substantial “Implementation” section reflecting the proposals of the eight “like-minded” countries (i.e., Cuba, the Dominican Republic, Egypt, Honduras, Indonesia, Malaysia, Pakistan, and India). Prospects for including investment and competition, both areas strongly supported by the European Union and Japan to be included as sectors for negotiations, are reported to be reducing due to the opposition of the United States. At any rate, a relatively small number of topics would not excessively tax the negotiating or institutional capacity of developing countries and can be concluded in reasonable time framework. Below several specific sectors that are interest to developing countries are examined in some details.

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<sup>49</sup> The MFA is written in such a way that the developed countries will be able to legally put off elimination of MFA restrictions until 2005. While the provision of the “four stages” suggests that 33% of the agreed liberalization should have taken place by the end of 1997, the United States has eliminated only 1% of its MFA quotas, the EU 7% (Finger and Schuknecht 1999).

<sup>50</sup> Krueger (1999) recommends that all ROs be based on a value added criterion, and that the value added be the same across all activities.

## B. Some specific sectors

### 1. Agriculture

Agriculture is accepted as one of the most challenging elements in the WTO's built-in agenda.<sup>51</sup> Agricultural exporters, such as the developing and developed countries of the Cairns Group, will seek significant liberalization of markets, building on the reforms already agreed in the UR. Their position is to look to early total elimination and prohibition of export subsidies, regulation of export credits, deep cuts in tariffs and non-tariff barriers, increase in trade volume under tariff-quotas, and elimination of trade distorting domestic support measures.<sup>52</sup> On the other extreme, there are a large number of net-import developing countries that express the concern that these reforms may lead to increase food costs.<sup>53</sup>

As in the UR, the United States will push for further liberalization, and to take up specific aspects of the arrangements established by the Agreement which it believes have not worked as they should, such as application of tariff quotas and some activities of state-trading companies. The countries of Mercosur also share the concerns on tariff quotas and state-trading companies (WTO 1999a, 1999b). The European Union, on the other hand, has been again engaged in reforming the CAP, this time under the combined pressure to reduce the budgetary costs of the CAP and to meet the needs of accessing Eastern European countries that are highly dependent on agriculture than its present members (Croome 1998).

More specifically, a number of issues that has been put forward by some WTO members for consideration in future negotiations include: i) ways and means to reduce existing tariff peaks (arising from the tariffication process) and tariff escalation;<sup>54</sup> ii) modifications to the tariff rate quota system as well as possible disciplines on harmonization of tariff quota administration; iii) elimination of "Blue Box" measures (direct payments under production-limiting program, which should not be based on the production quantity, and are exempt from the reduction commitments regardless of their possible trade-distorting effects) and revision of "Green Box" criteria; iv) complete elimination of export subsidies;<sup>55</sup> v) the future shape of S&D treatment for developing

<sup>51</sup> According to Article XX of the Agreement on Agriculture, new negotiations are to be initiated by 1 January 2000.

<sup>52</sup> According to Finger and Schuknecht (1999), the implementation of UR commitments in this sector has been far from successful and "the public relations dimensions of the agriculture agreement may have outpaced the substance of liberalization" (p.62). They argue that the often cited 36% cut by developed countries and 24% cut by developing economies were guidelines, not legal obligations, and that these guidelines could be meaningless for tariffed products by the possibility of setting inflated equivalents (e.g., Japan's specific tariff on rice, which amounts to 1,000% *ad valorem*). Their calculations suggest that the post UR tariff rates are lower than the tariff equivalent of pre-UR protection for only 14% of products that underwent tariffication.

<sup>53</sup> In recognition of the concerns of food importing countries, the Agreement contains several provisions that imply differentiating the rights and obligations of smaller, low-income developing countries from those of large, middle income ones. The Agreement also established a committee to monitor progress with regard to the Ministerial Decision on "Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries". Certain commitments to maintain adequate levels of food aid and agricultural export credits were also established (Laird 1999a). Admittedly, all these commitments are vague. With respect to food aid, the Mercosur countries have recently postulated that it is necessary to establish appropriate disciplines for the trade-related aspects of food aid under the WTO (WTO 1999c).

<sup>54</sup> Regarding the issue of market access in agriculture, Michalopoulos (1999) suggests that under the present circumstance that the variance of tariffs in agriculture is higher than for manufactures, it is convenient for developing countries to seek formulas which would result in proportionally greater reductions in peak tariffs. Panagariya (1999) considers it convenient to adopt a formula similar to the one adopted in the Tokyo Round for industrial goods, where the higher tariffs will be reduced more and lower tariffs reduced less. Also, given the amount of escalation in many tariffs levied by developed countries, developing countries should seek formulas that would lead to greater reduction in processed food products.

<sup>55</sup> Panagariya (1999) reports that export subsidies by six developed countries in 1995 accounted for more than 75% of the global value of export subsidies subject to reduction commitments. Approximately 100 developing countries combined, on the other hand, accounted for just over 20% of the global subsidies.

countries in the sector; vi) incorporation of the special needs and conditions of developing countries in market access commitments, including fullest liberalization of trade in tropical agricultural products; vii) concrete follow-up actions to the Ministerial Decision on Measures Concerning the Possible Negative Effects of the Reform Program on Least-Developed and Net-Food Importing Developing Countries (NFIDCs); and viii) other issues, such as disciplines concerning the role of State trading companies and the treatment of biotechnology in the agricultural trade (UNCTAD 1998, 1999c, 1999d).

Several ASEAN countries (WTO 1999f) and Colombia (WTO 1999e) have recently claimed that though being an essential feature of S&D in this sector, flexibility of low rates of reduction commitments and longer timeframe for implementation would not be adequate to address the development needs of developing countries. These countries should be given flexibility to pursue WTO-consistent policies and strategies to develop the potential in agriculture and address their non-trade concerns, including food security, rural development and poverty alleviation. The position of these countries is that market access commitments in this sector by developing countries should be directly related to the outcome of reform commitments by developed countries on domestic support and export subsidies.

The first clearest priority for the next WTO agricultural negotiations, of course, is to deepen the Uruguay Round commitments whose have progressed very little in terms of protection and insulation. As Anderson, Erwidodo and Ingco argue (1999, p. 10), “Nothing less than a ban on farm export subsidies is needed to bring agriculture into line with non-farm products under the GATT”. However, in their view, it is also necessary to combine this traditional focus of liberalization with another approach by incorporating this sector in the mainstream of WTO. Since the WTO negotiations focus on reciprocal exchange of market access across sectors, export-oriented farmers have a negotiating interest not only in better access to food markets but in more competition from abroad in their own economies’ markets for non-agricultural products. This approach allows “give-and-take” negotiations among sectors, cheaper prices for inputs necessary for farm production, including factors of production like capital and labor.

## **2. Trade in services**

From the viewpoint of developing countries, the GATS is considered to be a relatively balanced agreement whose principle merit is to establish a flexible basis for future negotiations. The Agreement involves the whole voluntary commitments of liberalization via a combination of positive and negative lists that have excluded some modes of supply or sectors. Recently, however, a large number of developing countries have also recognized the adverse effects that protection of inefficient service sector can produce on the rest of the economy, in particular the competitiveness of the export sector. For these reasons, many participated actively in the successful conclusion of two additional sectoral negotiations (financial services and telecommunications).<sup>56</sup> The structure of the GATS could be a framework for the negotiation of commitments on investment as well.

On the one hand, there is a view that developing countries should adopt a much more positive and active role in a new round, in contrast to their reluctant and defensive participation of in the previous GATS negotiations. As Mattoo (1999) states, they are encouraged to liberalize domestic services markets, with emphasis on competition rather than ownership, to improve rules

<sup>56</sup> As provided for in Article XIX of GATS, future negotiations should start before the year 2000. The objective is to achieve progressively higher level of liberalization. The negotiations are to be directed to “the reduction or elimination of the adverse effects on trade in services of measures as a means of providing effective market access.”

for remedies for market failures in domestic regulation, to pursue social goals, and to liberalize effectively foreign services markets by eliminating both explicit restrictions and implicit regulatory barriers. On the other hand, the following statement by Brazil might convey the prevailing posture of developing countries: “[M]andated services negotiations [are envisaged] with the objective of completing gaps in the agreement’s regulatory framework proceeding with the progressive liberalization of trade in services, a commitment that must permeate the entire negotiating process and share its results” (WTO 1999d, p.1).

One of the challenges faced by developing countries in the future multilateral negotiation in this sector is, thus, to identify barriers to their current or potential trade that should be removed, and to ensure a coherence between their national development objectives and further commitments on market access and national treatment. As in other sectors, there is a large range of countries from Least Developed Countries, with scarcely any modern domestic service suppliers, to middle income countries with advanced service sectors that face market access problems in developed economies (e.g., construction), and many countries in between. As the recent events in Asia and Latin America demonstrate, liberalization of financial services requires strong prudential and regulatory frameworks. Therefore, as the Government of Colombia has insisted to the WTO (WTO 1999h) that developing countries should have flexibility for opening fewer sectors, liberalizing fewer types of transactions, and progressively extending market access in line with their development level. And market access to foreign service suppliers should be subject to conditions aimed at some broad objectives set out in Article IV (Croome 1998).

Now special attention needs to be paid to identifying sectors of export interest to developing countries, as well as ways of facilitating further commitments on services through the movement of natural persons, without a commercial presence. “[I]t might be possible to adopt imaginative approaches to commitments relating to movement of persons at the level of service sub-sectors or categories of professions. The reference paper approach used in the basic telecommunication protocol could be adopted to the situation of other sectors, such as tourism, for example.” (Gibbs, 1998, p.4). A possible elimination of economic needs tests (ENTs) would introduce greater predictability of a country’s service trade through this mode of supply.<sup>57</sup>

The GATS contemplates further negotiations on specific sectors. The United States has shown interest in the following sectors: courier services; tourism, engineering; wholesale distribution; legal services; advertising; environmental services; management consulting; construction services and engineering; and other professional services. The United States is not enthusiastic about maritime services, where there exists a powerful domestic lobby (VanGrasstek, 1998). However, this should be a major area of interest for developing countries in the negotiations on trade in services. Liberalization in this sector would lead not only to increased competition and reduced margins may be of great importance to many of the small economies, but also to increases in the provision of shipping services by some developing countries themselves (Michalopoulos 1999, Stiglitz 1999).

Other pending issues on GATS legal framework that have made little progress so far and may well be taken up in the new round includes, among others: safeguards (GATS Article X); government procurement (Article XIII); and subsidies (Article XV). Developing countries are generally in favor of creating an emergency safeguard provision, arguing that its inclusion might make them more willing to take on liberalization commitments in the services sector (Croome

<sup>57</sup> Article XVI of GATS, which deals with market access commitments, stipulates that Members should not limit service operations by requiring an ENT, unless specified in their Schedules. However, only 12 countries indicated in their schedules of commitments that an ENT does not apply to certain categories of service suppliers, while at least 34 Members do require an ENT, or refer to legislation that may contain ENTs.

1998, Michalopoulos 1999). While Article X of GATS requires negotiations whose result should enter into effect no later than three years after the entry into force of the WTO agreement (i.e., 1998), these have not taken place yet. However, developing countries would not only be users but also targets or victims of such a safeguard mechanism (UNCTAD 1999c). The government of Brazil proposes (WTO 1999c) that services negotiations should be conducted in two well-defined and consecutive phases. In the first stage, the Member countries complete the drafting of disciplines for GATS rules, emergency safeguards, subsidies, government procurement and domestic regulation, followed by the second stage where the negotiations for progressive liberalization and new specific commitments begin.

### **3. Electronic commerce**

Given its special cross-border nature of the transactions, in the context of trade negotiations, e-commerce would appear to be primarily an issue of trade in services. But since the Internet allows the transport of all goods and services that can be digitized, it blurs the distinction between goods and services and thus calls for effective cross-border regulation and monitoring (Mattoo 1999). There seems to a consensus that trade via electronic media, particularly Internet, should be classified as trade in services with GATS discipline applied to it (Panagariya 1999). This special mode of supply also raises the question of whether the electronic mode of service supply should be given preferential status over other modes that are subject to regulation.

A number of governments and intergovernmental organizations of developed countries put forward proposals to create a global framework for e-commerce, based primarily on private sector initiatives. In particular, self-regulation by the private sector is being encouraged in areas such as standard setting, information security and content management. However, from the perspective of developing countries, a proposal as the one made by the United States to permanently exempt electronic transmissions from customs duties would greatly reduce customs revenues. Also, it will be important to incorporate the development dimension such as the potential benefits of such commerce (via a wider availability of professional and business services, health and education, tourism, software, entertainment, and financial services etc.), infrastructural aspects and connectivity, human resources needs, and financial aspects. Especially for SMEs the advent of e-commerce provides new opportunities to tap into global market suppliers and customers with relatively small investment in marketing and distribution.

Trade negotiation on e-commerce interrelates to many areas of GATS; its links with the Telecommunication Agreement, Article I (scope, including modes of supply), Article II (transparency), MFN (Article III), Article IV (increasing participation of developing countries), Articles VI and VII (domestic regulation, standards, and recognition), Article VIII and IX (competition), Article XIV (protection of privacy and fraud practices), etc. There are also some aspects on TRIPs as well (copyrights, trade marks, new technology and access to technology).

At this time, most developing countries do not have the technical capacity to negotiate meaningfully a multilateral agreement in this area. “To do so in most cases may result in assuming commitments which they have either the capacity to understand or implement. Thus, it may well be that at present, developing countries agree simply to continue the standstill on protection, and defer multilateral negotiations on this issue to a later date.” (Michalopoulos 1999, p.21).

### **4. Market access, rules, and standards**

The major issues of concern to developing countries on market access that have arisen from the implementation of the multilateral trade agreements relate to industrial tariffs, the rules applicable to contingency measures (anti-dumping, subsidies and safeguards), and technical regulations.

Though further negotiations to reduce industrial tariffs are not part of the built-in agenda, there have been proposals for its inclusion in the future negotiation agenda. For instance, the recent APEC Meeting in Auckland, New Zealand, in September 1999 (APEC 1999a) concluded that comprehensive market access negotiations covering industrial tariffs should be included in the new round. The term, "industrial" includes all tariff lines but those classified as "agriculture" (HS categories 1-24 and a few additional HS lines). This is an area in which developing countries have had some negotiating experience (Panagriya 1999). The view of the United States is that future negotiations on industrial tariffs should build on agreements to be reached at Seattle that include the Accelerated Tariff Liberalization (ATL) initiative, which is supported by a large number of WTO members (WTO 1999g).

Developing countries participated actively in the market access negotiations in the UR. Their tariff reductions were as broad and at the same time deeper than those conceded by the developing countries (Finger and Schuknecht 1999). Notwithstanding, developing country exports of manufactures keep facing much higher trade barriers than exports from developed countries. The average trade weighted MFN applied tariffs facing developing countries exports of manufactures in OECD markets, though low in absolute terms, tend to be almost four times as high as those faced by other OECD countries (Hertel and Martin 1999, Anderson 1998). The barriers that developing countries face in other developing countries are even higher. The major issues here are tariff peaks<sup>58</sup> and tariff escalation in sectors of interest to developing countries. It is clear from these data that these countries will gain substantially from the inclusion of manufactures in a new round of negotiations. Hertel and Martin (1999) estimate that as much as 95% of the gains from liberalization of trade in manufactures would accrue to the developing countries from global liberalization in this sector.

Such negotiations might take place through sectoral negotiations, building on the example of the Information Technology Agreement (there are 15 goods and services sectors for which liberalization has been proposed by the APEC member countries), and or via "across the border" tariff negotiations. In any case, obtaining substantial reductions in industrial tariffs would require that developing countries open their own markets for such products. Their applied tariffs are usually higher than in developed economies and have a greater dispersion. Besides, the major markets for developing countries are often other developing countries. However, a significant proportion of industrial tariffs of many countries, except for Latin America, have not been bound (Michalopoulos 1999, p.16, Krueger 1999). For this reason, it would be wise to adopt a formula approach that would result in greater proportional reduction of high bound tariff rates in both developed and developing countries (Laird 1999b). Other approaches would place developing countries at a disadvantaged position since few of their markets are individually large enough to be of "interest" to developed countries.

The Agreement on anti-dumping does not include provisions for any substantive review nor foresee the specific possibility of amendments, though it includes a sunset review process to cut down on the "life expectancy" of such measures<sup>59</sup> (UNCTAD 1999c, p.71). Nonetheless, given that

<sup>58</sup> It should be noted, however, that tariff peaks (defined here as products whose tariffs are at least 12% or roughly three times their average MFN tariff on manufactures) in developed countries are present in major agricultural staples such as meat, sugar, milk and cereals, cotton and tobacco, fruit and vegetables, processed food products such as canned meat and fruit juices, etc., apart from textiles and clothing, footwear and leather goods, selected automotive and transport equipment products. If the mentioned agricultural products would be the subject of the agriculture negotiations, it would be difficult to entice developed countries to negotiate tariff rates on textiles and clothing. For this sector, the Agreement on Textiles and Clothing would be the only mechanism of protection after 2005.

<sup>59</sup> The sunset clause in the ADM Code may be used to legitimize anti-dumping duties for five years even though the industry has recovered from the injury, which led to the duties. The number of anti-dumping measures introduced by the traditional users such as

anti-dumping rules and procedures are among the most pressing areas for reform, the impact of contingency protection measures on trade of developing countries and on costs to consumers should be analyzed. Also, it might be necessary to study the relationship between the principles and rules of the anti-dumping and those used in competition legislation. The WTO Ministerial Meeting in Singapore set no work program for anti-dumping apart from an effort to improve notifications and give more technical assistance to developing countries.<sup>60</sup>

WTO Members resort to countervailing measures more often than safeguard actions but less than anti-dumping measures to protect local producers. During 1992 and 1998, some 2000 antidumping cases were initiated while 200 cases of countervailing duty investigations were held. For the period of 1995-98, there were roughly 900 anti-dumping cases, while only 19 safeguard investigations took place. The United States is by far the most frequent user of countervailing duty investigations accounting for more than 40% of initiations undertaken in the 1990s. Developing countries such as Brazil, Chile and Mexico are reported to be other, but less, frequent users (Finger and Schuknecht 1999). Laird (1999a, p.4) claims that any examination of anti-dumping by itself could well be a sterile replay of the UR negotiations, and suggests for a re-examination, as a single package, of anti-dumping, countervailing and safeguards, including special safeguards under the Agreement on Textiles and Clothing and the Agreement on Agriculture.

The subsidy agreement figures in the WTO built-in agenda. Two important rules in the agreement apply only provisionally, and must be reviewed during 1999. One establishes a presumption that certain subsidies, such as those which amount to more than 5% of the value of a product or are given to cover an industry's operating losses, give rise to adverse trade effects. A second review is to decide whether permitted category of subsidies should continue to exist. There are two further reviews, also during the course of 1999. They involve respectively an issue linked with the permitted category of subsidies and experience gained of the export competitiveness rule (Article 27.6) which makes the right of developing countries to give export subsidies to the product which does not gain more than 3.25% of the world market. Nonetheless, Croome (1999) states that today's concern is more about the implementation of the agreement than its rules, since many WTO members have provided little or none of the information they should have supplied more than three years ago about how they are meeting their obligations to bring their subsidy regimes into line with the rules.

Consideration should be given also to ways of strengthening WTO disciplines to prevent abuses of standards, environmental, health, safety and social concerns, which are in some cases disguised non-tariff protection. The Agreement on Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary Measures (SPS) are designed to reduce the risk of standards and regulations becoming protectionist devices. Developing countries find the notification requirements under the agreements particularly burdensome. Under these Agreements, provisions contrary to MFN or national treatment obligations can be readily challenged; a successful appeal must demonstrate that the regulations create an unnecessary obstacle to trade, which in turn requires the preparation of arguments based on detailed technical criteria. For these reasons, several proposed elements of the work program concern technical assistance to developing countries, and the application of S&D

Australia, Canada, EU and the US has been less since 1995, while a large number of developing countries become major users (over 30 WTO members have notified anti-dumping actions since the initiation of the UR). Argentina, Mexico, Brazil and India are the major users. Anti-dumping duties of 30-50% are common and many are higher (Finger and Schulnecht 1999).

<sup>60</sup> One issue unsolved in the Uruguay Round concerns what constitutes "circumvention": The European Union and the United States unsuccessfully sought explicit authority to act against efforts by producers to circumvent anti-dumping decisions by such means as carrying out final assembly of a product held to dumped in a "screwdriver plant" in the importing country, or in a third country. So far, WTO member countries have not even reached a conclusion on the definition of circumvention. Opponents of anti-circumvention measures consider that this problem can be addressed as an issue of rules of origin and/or customs classification (UNCTAD 1999c).

treatment to them, including measures to help them develop their own capacity to prepare and adopt technical regulations and standards (Croome 1999, Payagariya 1999). Though of great importance, it is recognized that technical assistance would not replace trade barriers. Developing countries are encouraged to formulate their position by the following two ways. One is to seek substantive modifications in the rules by, for instance, participating more effectively in formation of international standards and by gaining access to mutual recognition agreements. The other would be to list up specific concerns about standards, administrative procedures, conformity assessment etc. (UNCTAD 1999c).

## 5. Trade-Related Aspects of Intellectual Property Rights

Some developing countries have introduced changes in their legislation to comply with all the obligations contained in the TRIPs Agreement, while most of them are still far from finalizing this process. The Agreement requires a considerable amount of investment and time related to the design and drafting of the new legislation and the establishment of the institutional infrastructure, and many adjustments in administrative, juridical, police and customs personnel (Primo Braga, et. al. 1999).

It is expected that several developing countries will fail to comply with Article 71.1 of the Agreement which calls for a review of the implementation of the Agreement after the expiration of the transitional period by December 31, 1999. This review may consider any relevant new developments that might warrant modification or amendment of the TRIPs Agreement. Additionally, the following issues have been examined during the course of 1999: i) certain exceptions to patentability and protection of plant varieties; ii) the development of a multilateral system of registration of geographical indicators of wines; and, eventually spirits; and iii) the use of the Dispute Settlement Mechanism (DSM) to prevent violations of IPRs. The links between IPRs protection and other policy areas, such as investment and competition, are also issues under consideration.<sup>61</sup>

Policy implications of IPRs protection for developing countries are increasing because of international policy shifts towards greater protection through bilateral, regional and multilateral actions, and because of the emergence of new technologies (biotechnology, genetics, computer software in a digital environment such as the Internet). Many of these technologies promise substantial social and economic benefits to developing countries (Primo Braga, et. al. 1999). Notwithstanding, in the view of UNCTAD (1999c,p.96), the best possible scenario, from the viewpoint of developing countries, would be that the Agreement is not reopened for negotiations and discussions remain limited to the built-in agenda. This would permit these countries to put their legislation in conformity with the TRIPs obligations without having to address new facets of IPR protection. Instead of seeking a comprehensive revision, a second strategy might be a modest approach, where renegotiations would be opened for only a few items. Another approach would be to seek revisions in the Agreement based on specific objectives such as the transfer of technology, biodiversity, environment, health and competition (Panagariya 1999).

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<sup>61</sup> Lahouel and Maskus (1999) argue that if TRIPs is to be revisited in the next round of negotiations, its broad limitations on IPRs exploitation in the name of competition regulation could come up for review. Competition regulation aims at curbing the unwarranted exercise of an intellectual asset beyond the boundaries provided by IPRs (patents, trademarks, trade secrets, etc.). They suggest that developing countries should consider carefully the extent to which these countries wish to retain these limitations.

## 6. Trade-Related Investment Measures

WTO investment disciplines are found in the TRIMs Agreement and the GATS, but both of these deal with particular areas or particular aspects of investment. The Agreement simply identifies several types of measures, notably the imposition of requirements on local-content, trade balancing, foreign-exchange restrictions and export restrictions. WTO members are required to eliminate its TRIMs that have been notified by 1 January 2000, by which date the review on the TRIMs agreement is to be completed.

The major difficulties encountered by developing countries in the implementation of TRIMs included, among others: i) the identification of TRIMs and the timely notification to WTO; ii) the importance of local content requirements in development policies of several countries, in particular in the automotive sector; iii) the shortness of a transitional period (5 years for developing countries) for phasing out TRIMs; and iv) the need to reexamine the approach taken in the TRIMs Agreement by concentrating on adverse effects on trade, rather than outright prohibition of certain measures (UNCTAD 1999c, p.110). With respect to i), UNCTAD (1999c, pp.109-110) states that “the TRIMs Agreement does not give a definition of a TRIM or an objective test for identifying such measures. It is therefore up to the notifying country to judge which of its TRIMs are illegal under the Agreement”. “[F]urther challenges will no doubt be made to establish the exact “frontier” of the prohibition beyond the scope of the “illustrative list” (p.112).

Article IX of the Agreement requests the Council for Trade in Goods to review the Agreement no later than 31 December 1999 and consider whether the Agreement should be complemented with provisions on investment policy and competition policy.<sup>62</sup> In the past two years the Working Group analyzed and reviewed four items on a “checklist of issues”: implications of the relationship between trade and investment for development and economic growth, the economic relationship between trade and investment, stock-taking and analysis of existing international instruments, and an assessment of the need for possible future initiatives taking into account commonalities and differences in existing international instruments dealing with investment and obligations between and home and host countries and between investors and host countries. Whether negotiations on comprehensive rules on investment will take place still remains open. Nonetheless, UNCTAD (1999c) and Hoekman and Saggi (1999) consider it convenient for developing countries to continue the education process in the WTO Working Group and to negotiate investment in the framework of TRIMs and GATS, which provide the basic principles such as national treatment and right of establishment or the asymmetries in the development levels between countries, with a positive list approach.

In parallel, the OECD was negotiating a comprehensive, legally binding Multilateral Agreement on Investment (MAI) that would liberalize investment and provide protection for foreign investments. Some OECD members were reluctant to accept further commitments to liberalize restrictions on foreign investment that would go beyond what had been already accepted in the WTO or in RTAs (Hoekman and Saggi 1999). The level of commitments to be included in the agreement was said to be too exigent for developing countries and there were doubts about how many developing countries could join. Moreover, the MAI, which drew heavily on the investment provisions of NAFTA, seemed less ambitious than envisaged by the main proponents of such an agreement, and thus was not acceptable to them. Many non-governmental organizations (NGOs) also opposed the agreement, arguing that it gave excessive powers to TNCs. At the same time, the

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<sup>62</sup> The Singapore Ministerial Meeting in 1996 decided to establish a Working Group on the Relationship between Trade and Investment with the understanding that the work undertaken shall not prejudge whether negotiations will be initiated in the future. This reflected the opposition of some developing countries to future negotiations on this issue.

proposals by the United States to include labor and environment standards, the insistence by France and Canada on cultural exception, and the request by the European Union for regional integration agreements made the negotiation process of the MAI difficult. In addition, the draft MAI did not contain a proper balance between the rights and responsibilities of TNCs, nor between the rights and responsibilities of the TNCs on the one hand and those of the host governments.<sup>63</sup>

From a developing country's perspective, what is at stake is, therefore, how to combine their economic and development objectives (which often imply a conditioned application of the principles of market access and national treatment) with policies that promote their international competitiveness based on more liberal FDI policies. First of all, developing countries must make sure that any investment agreement is confined to FDI. Second, no negotiations proceed until China has been admitted to the WTO (Panagariya 1999). Other interests and concerns of developing countries in the sphere of investment and competition include, among others: i) allowing small economies to control horizontal and vertical restraints and abuses by TNCs; ii) the ability of developing host countries to remedy their major FDI concerns when they adopt a liberal FDI regime; iii) allowance for time-limited exceptions to certain dynamic and growth-oriented sectors that might need temporary protection from full-fledged competition in order to realize learning-by doing benefits and promotion of SMEs (UNCTAD 1999c).

At this moment, however, attaining a formal agreement which strikes a balance between the interests of foreign private investors and developing countries seems unlikely. Recent macroeconomic problems created by inflows of short volatile capital, in both Asia and Latin America, would put a further brake on such development. The Government of Colombia, for instance, proposes to other WTO members that "the five years provided for as a transition period are insufficient for restructuring the industrial base of developing countries", so that "bearing in mind the present circumstances of developing countries in terms of unemployment and competitiveness, it is necessary for them to be able to maintain TRIMs indefinitely" (WTO 1999h, p.1).

## 7. Special and differential treatment

In WTO, apart from a few cases where S&D is linked to quantitative criteria, it takes the form of transitional periods, differences in threshold levels and technical assistance. The length of transitional periods and the level at which thresholds are set have been chosen haphazardly without any linkage to specific criteria based on the level of development. An area for future discussion will be on the adequacy of current approaches to S&D treatment, namely the "Reduced commitments" method, as in the Agreement on Agriculture, and the "transitional period" method, present in many WTO agreements. In view of the significant and growing divergence in the economic situation and capabilities of developing countries, S&D treatment based on objective economic criteria may be necessary for application as well as for graduation.

On the other hand, Laird (1999a) cautions that S&D treatment has brought limited benefits in the past and in some ways, longer transition periods may also seem as postponing the implementation of practices that are beneficial to a country's own trade regime. He admits,

<sup>63</sup> It should be noted that the definition of foreign investment in the MAI includes not only FDI but also portfolio investment, IPRs, licenses, franchises, etc. UNCTAD (1999c) argues that compared to the range of policy instruments at a government disposal, the TRIMs Agreement does not heavily constrain the ability of any government to regulate FDI. However, attempts to define investment broadly to include portfolio raises a number of issues, particularly in view of the recent financial crisis resulting from the volatility of short-term capital.

however, that there is a need to provide developing countries with technical assistance for the negotiations themselves.

## **8. GATT/WTO Provisions on regional trade agreements (RTAs)**

Almost all WTO members, both developed and developing countries, are already parties to some RTAs. Japan and Hong Kong are among the few exceptions. Although the countries belonging to RTAs in general endorse the central WTO principle of non-discrimination, and may even express concerns on the impact of RTAs on the integrity of the multilateral trading system, in practice they appear rather reluctant to tighten the relevant WTO disciplines. Strengthened multilateral rules mean that the degree of flexibility now they enjoy in negotiating new agreements might be reduced, or that they are forced to adjust significantly the disciplines and provision of RTAs in force. In turn, requests for tighter rules come mainly from four members: Australia, Hong Kong, Japan and South Korea.

The final outcome on this issue heavily depends on the posture of the United States and the European Union, however; “So far, they [United States] do not appear to have decided what they want. If they were to decide in favour of strengthened rules, an eventual negotiation would be likely, but its value could well depend on whether they sought to have their own existing agreements “grandfathered” (i.e., exempted from the additional disciplines). A few years ago, the United States could have been expected to favour stricter rules –but that was before it developed its present enthusiasm for establishing free trade areas with other countries in the Americas and beyond. Meanwhile, the EU has become the centre of a network of free trade agreements linking other European countries, with it, and among themselves” (Croome, 1999, p.35). A way to break the present impasse might be a shift in the emphasis towards periodic examinations to monitor developments in RTAs, similar to the Trade Policy Review Mechanism of WTO (Laird 1999a).

So far, the question of whether most customs unions or FTAs conform to GATT Article XXIV has been examined by working parties established separately for each RTA for which notification has been provided. However, no consensus, or agreement exists over how to interpret this article since the wording is vague: “substantially all the trade between the constituent territories”, “other restrictive regulations of commerce (ORRCs)”, and “on the whole....shall not be higher or more restrictive”. Although the review process has been streamlined since the creation of WTO, in the whole history of the GATT and WTO only one agreement, that between the Czech and Slovak Republics, has ever been approved (Laird 1999a, p.5).

The original objective of the phrase “substantially all the trade” was to avoid a mass of protectionist measures oriented to a broad range of sensitive sectors. Today, nonetheless, there remain a series of interpretative problems. For instance, if the expression is judged on the basis of both quantitative and qualitative criteria, the listing of agricultural products or other important sectors as “exceptions” may not be necessarily justified. Put in other terms, the questions are whether the word “substantially” should be interpreted qualitatively (i.e., no major sectors are excluded) or quantitatively (i.e., share of trade of the members covered).<sup>64</sup>

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<sup>64</sup> During the UR, a minor interpretative understanding was reached on Article XXIV and helped to clear up a number of technical points. This understanding clarified that “the general incidence of the duties and other regulations of commerce applicable before and after the formation of a customs union be based upon an overall assessment of weighted average tariffs and of customs duties collected”, rather than the arithmetical average used by the European Union. However, neither a rationale for the proposed action was offered, nor it was established that one can infer how the welfare of non-members is affected by the formation of customs unions by using the suggested comparison (Srinivasan 1998). This understanding also established that the “reasonable length of time” referred to

Another problem is when a regional integration is enlarged, whether anti-dumping and the safeguards should not be automatically extended without fresh investigations to establish injury to the domestic industry. When they are applied only to outsiders and not to members, it would contradict Article XXIV.<sup>65</sup> According to the new Anti-dumping Agreement, when two or more countries have reached under the provisions of Article XXIV:8(a) of the GATT 1994 (customs unions) that they have the characteristics of a single, unified market, the industry in the entire area of integration shall be taken to be the domestic industry for purposes of the application of anti-dumping measures. With respect to the new Subsidies Agreement, the same provisions as in the new Anti-Dumping Agreement apply. On the Agreement on Safeguards, nothing in this agreement prejudges interpretation of the relationship between Article XIX and Article XXIV:8 of GATT 1994.

There is also a problem that when the establishment of a RTA results in rules of origin (RO) being used to substantially increase the barriers to trade on outsiders, then it is in contravention to the requirement in Article XXIV:5 that restrictions on commerce not be any higher than prior to formation of the customs union or the FTA.<sup>66</sup> Another source of interpretative problems of Article XXIV arises with respect to the requirement that the common external tariff and other restrictive regulations imposed at the time of the formation of a customs union not be "on the whole higher or more restrictive" than those imposed by its members prior to its formation.<sup>67</sup> On 13 November 1997, Brazil and Argentina imposed a 3% across-the-board rise in the tariffs on most of the common tariff goods and exceptions.<sup>68</sup> Mercosur members have also agreed to raise common tariffs by a flat 3% by 31 December 2000. The Japanese government (MITI 1999, p.17) considers that such hikes in common tariffs would seem to go against Article XXIV:4, and is also likely to be a violation of GATT Article II.

Another complex area is the relation of Article XXIV with the Enabling Clause. The latter allows RTAs signed among developing countries for the mutual reduction or elimination of tariffs and non-tariff measures to be exempted from the MFN principle under Article I.<sup>69</sup> This clause and its relationship with Article XXIV can be viewed in different ways. One extreme way of interpreting the relation is that RTAs among developing countries should be looked at only under the terms of the Enabling Clause, whose objective is to increase exports of developing countries and promote their economic development.

in Article XXIV: 5(c) should generally not exceed 10 years. It also stipulated that when a Member forming a customs union proposes to increase a bound rate of duty, the procedure set fourth in GATT XXVIII must be commenced before tariff concessions are modified or withdrawn.

<sup>65</sup> Mercosur's common safeguard rules are not clear on whether other members of the region will be exempted. However, when Brazil enacted safeguards for toys in January 1997 and Argentina for footwear in September 1997, other Mercosur member countries were exempted. Exempting members and applying safeguards selectively to third countries is in violation to the non-discrimination rule in the Safeguards Agreement, and is also in violation of GATT Article XXIV:8(b). The footwear safeguards case is still pending in the panel requested by the European Union.

<sup>66</sup> A WTO member must ensure to satisfy the requirements for the preferential RO and publish all laws, regulations and provisions relating to preferential RO for transparency purposes. Also, in introducing changes to the preferential RO or new preferential origin, they shall not apply retroactively. For trade in services, countries agreed to add wording similar to GATT Article XXIV to Article V of the GATS.

<sup>67</sup> From this perspective, it will be necessary to watch closely the convergence process of Mercosur's common external tariffs to ensure that the agreement meets the condition in GATT Article XXIV:8 (a)(ii) for "substantially the same duties" (MITI 1999, 17). Mercosur common tariffs have resulted in the tariff rates on some items exceeding the bound rates. Mercosur ought to have followed GATT Article XXIV:6, initiated the concession amendment procedures found in Article XXVIII, and negotiated adjustments with interested parties before the common tariffs were imposed. It did not do so. Some countries, including Japan, European Union, and Canada, have reserved the right to negotiate with Mercosur under Article XXIV:6.

<sup>68</sup> The tariff rate on most common tariff goods went from 14% to 17%, the maximum tariff rate from 20% to 23%, the rate on excepted capital goods from 17% to 20%, and the rate on automobiles was held at the current level of 63%.

<sup>69</sup> This clause originated from the decision of the contracting parties on 28 November 1979 ("Differential and More Favorable Treatment Reciprocity and Fuller Participation of Developing Countries").

The other extreme is that the Enabling Clause only imposes certain requirements on contracting parties to notify and consult countries that are entering into RTAs or taking measures that are only by nature partial and non-inclusive. Being partial and incomplete, dealing with RTAs should be done under Article XXIV. An intermediate position is that judgements concerning RTAs among developing countries should take into consideration both Article XXIV and the Enabling Clause.

How to deal with such RTAs first became a focus of discussion when the Mercosur was formed and notified formally to the GATT. Some contracting parties called on the GATT to form a working party under the Council to examine the agreement under the terms of XXIV, but a consensus was reached to have the Committee on Trade and Development (CTD) review Mercosur in light of both the Enabling Clause and Article XXIV. Since the establishment of the new Committee on Regional Trade Agreements (CRTA) in February 1996, this Committee perform examinations. A similar issue regarding the AFTA has been debated, though there has been no consensus. So far only the CTD has been informed by the AFTA that it would form the area.<sup>70</sup> In fact, the ongoing examinations in the CRTA has been delayed and not single examination report has been adopted since the establishment of the WTO (1999,WT/GC/W214).

As integral part of preparations for the 1999 Ministerial Meeting, several countries put forward several proposals.<sup>71</sup> The Government of Japan (WTO 1999j), for example, proposed to work on the interpretation of certain elements of the provisions related to RTAs, first, by clarifying the meaning of the provisions such as: “Other regulations of commerce”(Article XXIV:5 of the GATT); “Other restrictive regulations of commerce” (Article XXIV:8 of the GATT); “Substantially all the trade” (Article XXIV:8 of the GATT); “Substantial sectoral coverage” (Article V:1 of the GATS) and “Absence or elimination of substantially all discrimination”(Article V:1 of the GATS). Secondly, they propose to strengthen the examination of process from a systemic point of view in the course of the next negotiations. This includes not only the establishing of a review process but also of ensuring the enforcement of the results of the examination and of establishing the obligation for the notification of economic integration in the area of liberalization of trade in services.

The Government of Australia goes a bit further on the systemic issues in their proposals. Regarding the clarification of rights and obligations, they urge, among others, to clarify thresholds for meeting basic requirement that RTAs cover “substantially all the trade” in the case of GATT Article XXIV or have “substantial sectoral coverage” in the case of GATS Article V, including the latter’s requirement that “agreements should not provide for a priori exclusion of any mode of supply”. They also recommend that the coming round negotiations should decide “whether the various WTO rules on RTAs should be integrated into a single framework, including whether “substantially all the trade” should be measured in terms of goods and services together” (WTO 1999k, p.2). They also call for disciplines on preferential rules of origin, and precision on whether agreements covered by the Enabling Clause should be subject to the disciplines of Article XXIV. They also think it convenient to clarify whether other thresholds for RTAs need to be introduced; for instance, linking the extension of preferences under a proposed RTA to a reduction in trade barrier on an MFN basis.

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<sup>70</sup> AFTA provided notification to the CTD, as mandated by the Enabling Clause, but there is still no consensus regarding whether it should be reviewed for conformity to GATT Article XXIV. In February of 1993, the United States, European Union and other member countries argued before the GATT General Council that the CEPT, the core of AFTA, required detailed review since it sought to create an integrated market. In the view of AFTA, CEPT was an agreement on comprehensive tariff reductions and therefore, not only was it important from a GATT perspective, it also went beyond the size and scope of the regional agreements intended by the Enabling Clause. Developing countries argued that CEPT was a RTA between developing countries as defined in Paragraph 2(c) of the Enabling Clause, and that having being notified to the CTD, subsequent handling of the issue was up to the developing countries themselves. A solution to the impasse has yet to be found (MITI 1999, p.18).<sup>70</sup> For some ideas to improve Article XXIV, see Srinivasan (1998).

<sup>71</sup> For some ideas to improve Article XXIV, see Srinivasan (1998).

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## Open regionalism in Asia-Pacific and Latin America: a survey of literature

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