

de Paiva Abreu, Marcelo

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THE POLITICAL ECONOMY OF ECONOMIC INTEGRATION IN THE AMERICAS:
LATIN AMERICAN INTERESTS

MARCELO DE PAIVA ABREU

DEZEMBRO 2002

The political economy of economic integration in the Americas: Latin American interests

Marcelo de Paiva Abreu ¹

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¹ Department of Economics, Pontifical Catholic University of Rio de Janeiro, Brazil. Paper as presented at the IDB-INTAL/Harvard University Regional Conference on the Free Trade in the Americas that will take place in Punta del Este (Uruguay), December 15-16, 2002 under the sponsorship of IDB-INTAL (Institute for the Integration of Latin America and the Caribbean of the Inter-American Development Bank. The author thanks comments on a draft of this paper by participants in the pre-conference 'FTAA and Beyond: Prospects for Integration in the Americas', sponsored by the Integration and Regional Programs Department, Institute for the Integration of Latin America and the Caribbean (*IDB/INTAL*), Inter-American Development Bank, the Center for International Development (*CID*), Harvard University and the David Rockefeller Center for Latin American Studies (*DRCLAS*), Harvard University, held at Cambridge (Mass.), May 31-June 1, 2002, especially those of Andrés Velasco. He also thanks the help of Marcos Jank, Honório Kume, Josefina Monteagudo, Guida Piani and Sandra Rios.

1. Introduction

Trade negotiations are generally conducted on the basis of the exchange of “concessions” in the form of reciprocal reduction of protection (tariffs and non-tariff barriers). It is somewhat disturbing that “concessions” offered by a given country, if adopted unilaterally, would in fact normally enhance its net welfare position. Existing levels of protection correspond to an equilibrium of national political economy processes involving the distributive impact of the costs and benefits entailed by protection. Protection subsists everywhere mostly because of the lack of balance between the capacity to lobby effectively of inefficient or high-profit domestic producers favoured by protection and that of consumers of expensive or lower quality domestic substitutes of imports, who bear most of the cost of protection.

To create the Free Trade Area of the Americas, then, is to find ways of disturbing the present perverse equilibrium, where protectionism thrives in practically every economy of the hemisphere, in the direction of an alternative zero protection equilibrium to be reached after a reasonable transition period. The reciprocal dismantlement of protection in the economies involved in the trade negotiations depends crucially on the mobilization of political support from groups which are likely to benefit from hemispheric integration to counter the political weight of those groups favoured by protection and that will be hurt by trade liberalization.

Commitments to liberalize can of course be ineffectual if it remains feasible to adopt unilateral discretionary policies based on actions intending to counter the effects of dumping or of subsidies, or simply to safeguard domestic producers from injury due to import surges. The issue of how binding are commitments concerning reduction of protection, even after the FTAA is completed, is thus crucial.

Each possible FTAA member is likely to favour a strategy which will minimize offers of improved access to its own market upfront and assure prompt access to export markets of other members. The political economy of the FTAA for each possible future member

boils down to finding an acceptable balance during the transition period between benefits for exporters and dislocation of domestic producers whose output is displaced by imports, plus the effects of trade diversion. But increased exports due to improved market access for each FTAA member correspond to inefficient output which is displaced by trade creation in other FTAA markets. Thus the political economy of the FTAA is mostly related to the political economy of protectionism in its members and, probably to a lesser extent, also to the consequences of trade diversion on pre-FTAA trade.

FTAA negotiations will not, of course, be restricted to market access and will certainly include many other issues. There is uncertainty about exactly which issues are going to be included in a final package. There is, to a certain extent, a trade-off between concessions concerning access and comprehensiveness of agreements covering other issues. Latin American countries, for instance, are certainly less than enthusiastic about agreements on environment and labour standards, issues which are deemed as crucial by some interests in the United States.

The next section of this paper centers on the reasons for the marked heterogeneity of interest concerning an FTAA in different Latin American economies. Different groups of economies are considered with an emphasis on their size, the present trade structure and trade orientation. Section 3 analyses the political economy of protection in different LA economies, underlines the important contrasts between past experiences of different LA economies in the transition from high protection to more liberal trade regimes, and considers possible economic reasons for such contrasts. To the extent that dismantlement of protection is bound to be, even if to a limited extent, reciprocal, reference must be made, in section 4, to the political economy of protection in the US, even if in a summary way as it is a theme to be treated by another paper to be presented at the conference. This is both because of the weight of the US economy in an eventual FTAA and because of the terms of the Trade Promotion Authority recently approved as well as of other recent decisions concerning steel imports and a new Farm Bill. Several aspects of the process of formation of the FTAA are considered in Section 5. These relate to liberalization schedules, comprehensiveness of offers and reciprocal gains. Estimates of the FTAA's

effects are reported and considered. Its comprehensiveness, in terms of the spectre of issues which it will embrace, will be analysed. Finally, the interaction, in terms of substance and timing, between the FTAA negotiating process and other negotiations, especially in the World Trade Organization, is considered. Section 6 concludes.

2. Contrasts in the hemisphere: size and trade

Once the structural characteristics of the 34 FTAA possible members are duly taken into account it does not seem implausible that national interests on a future FTAA should vary considerably. There are two striking features concerning composition of the FTAA as an integration initiative if it is compared to most other integration initiatives. The first is that, in common with NAFTA, the size of its most important member is overwhelming. The US answers for more than two thirds of the total GNI-PPP, almost eight times the size of Brazil, the second largest economy in a future FTAA. US, Brazil, Mexico and Canada answer for almost 90% of total FTAA GNI-PPP (see Table 1). The second important feature is a consequence of the first. The average size of the other FTAA members is extremely small (0.5% of GDI-PPP for 31 members). Any measure of concentration of GNI-PPP within the FTAA underlines this fact, in contrast with other integration initiatives which do not include the US. The ratio between the share of the US in FTAA's GNI-PPP and the average share of the other members is 76.3 compared to numbers in the 2.0-7.4 range for the CACM., Andean Community, European Union, Caricom and Mercosur. Bargaining power of members of other initiatives such as the European Union tends to be less concentrated both because there is a group of "big" economies more or less of the same size at the core of the decision-making process, and not just a single dominant big economy, and because of the average size of the other members is bigger.

The larger an economy is, the more likely is that political economy processes related to integration include, rightly or wrongly, the perception that the country does have the bargaining power to influence the stance of bigger partners and the outcome of negotiations. The smaller is an economy, the more likely is that the traditional small country status is generally accepted. Coalition-building may qualify this assertion, but if

small economies are really small, as is the often the case in the FTAA, even perfect coalitions would yield blocs with very limited bargaining power.

Mercosur economies constitute by far the most significant share of FTAA trade and GNI-PPP, in both cases excluding NAFTA economies. They answer for about half FTAA's non-NAFTA trade and almost two thirds of FTAA's non-NAFTA GNI-PPP (see Table 2). Since many of the issues under discussion in the FTAA are related to the size of markets rather than directly to trade, perhaps the GNI-PPP share is a better indication of national relevance in the FTAA. But still it is important to stress the wide contrasts in the relative importance of trade for different Latin American economies. The share of total trade in GNI-PPP is less than 10% in Mercosur, explained by a combination of a long tradition of inwardness, the continental features of the Brazilian economy and, especially in the case of Argentina, obstacles to the expansion of agricultural exports due to protection in developed markets. It is also very low in Colombia (10%) and Peru (11.6%). The more open economies in the hemisphere are those more dependent on the US market: Canada (almost 70% ratio of total trade to GNI-PPP), Mexico (about 40%), Caricom economies (44.7%) and Venezuela (36%). Chile (25.2%) and the US (20.7%) are in the intermediate range.

Another important source of contrasts between Latin American economies is the relative importance of intra-FTA trade, trade with the United States, trade with the hemisphere and trade outside the hemisphere (see Table 3). Some of the economies in the Southern Cone, especially those of Mercosur, which are more closed, have a geographically more diversified trade than those economies which are more open and nearer to the US. This reflects the similar natural resource endowments of US and Mercosur if compared to those of most other Latin American economies.

Canada and Mexico concentrate about 80% of their trade in the US, CACM economies about 50%, and Caricom and the Andean Community around 40%. This falls to around 20% in Mercosur and Chile. Economies such as Canada and Mexico have a very small share of their trade with the hemisphere excluding NAFTA, and also outside the

hemisphere. With the exception of Chile and Venezuela, the share of trade of all hemispheric economies with the hemisphere, excluding the relevant FTA and the United States, is rather small. Similarly, with the exception of Canada and Mexico, and to a lesser extent, the US in relation to NAFTA, as well as Argentina in relation to Mercosur, intra FTA-trade tends to be no more than around 10% of total trade in most other economies.

Although the importance of trade diversion generated by preferential trade agreements is often exaggerated, it is the more significant for a specific economy, the higher is the share of non-FTAA imports in its total imports. Similarly, the more geographically diversified is the trade of a given economy, the more likely is that multilateral concerns prevail over the regional perspective.

Contrasts between the levels of protection in different hemispheric economies are less marked than generally taken for granted. Progress towards lower protection since the mid-1980s in Latin America has been substantial. In the late 1980s, in the more extreme cases average tariffs considerably exceeded 50% and imports of many products were prohibited. Trade liberalization proceeded very fast in the early 1990s, but became somewhat bogged down after the middle of the decade, especially in Southern South America. Based on simple average tariffs and not taking non-tariff barriers into account (see Table 4) there is a small group of economies with a low average tariff level: Canada and the US in the 4-5% range, CACM and Chile in the 5-8% range. Most other average tariffs are in the 11-14% range.² The highest average tariffs are in the 16-21% range for

² It should be kept in mind that reference here is always to applied tariff rates. In most Latin America economies tariff lines have been bound in the WTO at 35% for industrial products. For some agricultural products bound levels are higher. Applied rates are thus much below bound rates. For the US and Canada applied rates are generally those bound in the WTO. The adoption of bound rates as a basis to start tariff reduction in the FTAA framework would only be feasible if the US strategy included acceptance of a grace period before trade liberalization started to be effective in Latin America.

Table 1

Selected FTA initiatives: data on the relative size of participants %¹

Initiative	Date of creation	Effective or proposed number of members	Relative size of total GNI-PPP in 2000 (EU=100)	GNI-PPP share of largest member in initiative's total GNI-PPP (A)	GNI-PPP share of second largest member in initiative's total GNI-PPP (B)	GNI-PPP share of third largest member in initiative's total GNI-PPP (C)	Average GNI-PPP share of other members excluding the three largest (D)	Average GNI-PPP share of all Members excluding the largest (E)	(F)= (A)/(E)
European Union	1957	15	100.0	23.2 (Germany)	16.2 (France)	15.9 (UK)	3.7	5.5	4.2
Andean Community	1969	5	6.4	44.0 (Colombia)	24.6 (Venezuela)	21.4 (Peru)	5.0	14.0	3.1
Caricom	1973	13	0.4	28.2 (Trinidad and Tobago)	23.1 (Jamaica)	12.8 (Bahamas)	3.6	6.0	4.7
CACM	1960	5	1.4	33.6 (Guatemala)	23.4 (Costa Rica)	21.9 (El Salvador)	10.6	16.6	2.0
Mercosul	1991	4	19.7	71.3 (Brazil)	25.6 (Argentina)	1.7 (Uruguay)	1.4	9.6	7.4
NAFTA	1993	3	128.0	85.0 (USA)	7.6 (Mexico)	7.4 (Canada)	0	7.5	11.3
FTAA	?	34	158.4	68.7 (USA)	8.9 (Brazil)	6.1 (Mexico)	0.5	0.9	76.3

*All gross national income estimates are PPP adjusted.

Source: World Bank, *World Development Report* 2001/2002.

Table 2
Western Hemisphere: Gross National Income-PPP and total
trade in goods, main FTAs and main economies, 2000

	GNI-PPP in US\$ billion ¹ (A)	Total trade in goods US\$ billion ² (B)	(A)/(B)
Nafta	11350	2869	.253
Canada	840	529	.628
Mexico	864	341	.395
United States	9646	1999	.207
Andean Community ³	566	99	.175
Colombia	249	25	.100
Peru	121	14	.116
Venezuela	139	50	.360
Caricom ⁴	38	17	.447
CACM ⁵	128	35	.273
Mercosur ⁶	1747	171	.098
Argentina	448	49	.109
Brazil	1245	111	.089
Other	216	64	.296
Chile	139	35	.252
Other ⁷	77	29	.377
Total	14045	3225	.230

¹ GNI-PPP in 2000 from World Bank, *World Development Report* 2001/2002.

² Trade data for 2000 from International Monetary Fund, *Direction of Trade Statistics Yearbook* 2000. Trade data for Costa Rica are for 1999 and for Haiti are for 1998. For most Caricom economies trade data are for years before 2000 as available in the IMF data.

³ Other members: Bolivia and Ecuador.

⁴ Members: Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, St Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago.

⁵ Members: Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.

⁶ Other Members: Paraguay and Uruguay.

⁷ Dominican Republic, Haiti and Panama.

Mexico and Caricom. It is, of course, important to qualify any statement based on high simple average tariff levels by the fact that a trade-weighted tariff taking into account preferential arrangements could generate quite different numbers. Especially in the case of Mexico, given the importance of intra-NAFTA trade, the relevant weighted average tariff is much lower than the simple average tariff. Trade creation following the FTAA would tend to be more important in those economies with a higher simple average tariff and lower shares of their trade with preferential trade partners.

Table 3

Western Hemisphere: Shares of intra-FTA trade, trade with the rest of the hemisphere, trade outside the hemisphere and trade with the United States for selected economies and FTAs, 2000, %

	Share of intra-FTA trade in total trade ¹	Share of trade with the US in total trade ¹	Share of trade with rest of hemisphere in total trade ¹	Share of trade outside hemisphere in total trade ¹
Nafta	46.5	---	5.3	48.2
Canada	78.5	76.7	1.3	20.2
Mexico	82.9	80.7	3.3	13.8
United States	32.2	0	6.7	61.1
Andean Community	10.0	41.3	21.6	27.1
Colombia	15.3	42.7	15.0	27.0
Peru	9.3	28.2	19.3	53.2
Venezuela	5.9	45.0	27.6	21.5
Caricom ²	11.2	38.2	12.3	49.5
CACM	11.4	47.5	13.3	27.8
Mercosur	20.9	20.4	11.0	47.7
Argentina	30.9	15.7	11.6	41.8
Brazil	13.9	23.5	10.8	51.8
Chile	---	18.4	30.6	51.0

Source: International Monetary Fund, *Direction of Trade Statistics Quarterly* December 2001 and International Monetary Fund, *Direction of Trade Statistics Yearbook* 2000.

¹Total trade includes FTA-trade (exports and imports of all partners).

² Excludes Antigua. Data for 1999.

Dispersion of the Mexican, Caricom and US tariff is rather high if compared to that of Mercosur and several of the Andean economies, and as the US average tariff is low, the US tariff coefficient of variation is the highest in the hemisphere. The proportion of ad valorem tariff lines above 15% – tariff peaks – in the hemisphere varies between 3.54% of all ad valorem tariff lines in the US to a range between 40 and 50% in Mercosur. Data presented in Table 4, however, only include tariff lines for which there is an ad valorem tariff. Since, especially in the case of the United States, specific duties are frequent, this omission significantly affects any assessment of protection. For 2000 there is information on ad valorem equivalents of specific duties imposed in the US. Data indicate that the number of total US tariff lines exceeding 15% would be almost doubled, if account is taken of the ad valorem equivalent of specific duties, to reach a total of about 500. The

number of tariff lines above 35% would be affected even more significantly, rising from 30 (ad valorem) to a total 107 (ad valorem and ad valorem equivalents of specific tariffs).³ In most Latin American economies, on the other hand, the role of specific duties is insignificant. In some Latin American economies agricultural products are significantly protected. Most of them, but not all, are net importers of agricultural products: Mexico, Venezuela, Peru and most of Central America and the Caribbean. In Chile, Colombia and Peru there are price bands in operation which dampen the effect of world price fluctuations on domestic prices through the use of variable duties. The mean tariff on agricultural products in Canada and Mexico is around 22-23% and there are also many tariff peaks, specific duties and tariff quotas. In the Caribbean such means are even higher.⁴

Table 4

Western Hemisphere: Simple average tariffs, standard deviations, coefficients of variation and tariff peaks, main FTAs and main economies, 2001¹

	Simple average tariff	Standard deviation	Coefficient of variation	% of tariff lines above 15%	% tariff lines above 35%
Nafta					
Canada	4.2	7.2	1.71	11.63	0.09
Mexico	16.7	14.1	0.84	47.90	0.63
United States	4.5	11.5	2.56	3.54	0.37
Andean Community					
Colombia	11.6	6.3	0.54	23.86	0.19
Peru	13.5	3.7	0.27	16.05	0.00
Venezuela	12.0	6.0	0.50	24.26	0.00
Caricom ²	17.7-20.9	11.1-15.3	0.58-0.84	35.74-71.06	8.21-25.17
CACM	5.1-7.6	6.9-9.2	1.04-1.77	0.43-24.73	0.15-1.12
Mercosur					
Argentina	13.4	6.6	0.49	49.98	0.40
Brazil	13.2	6.8	0.52	41.18	0.04
Other					
Chile	8.0	0.0	0.00	0.00	0.00

Source: Hemispheric Trade and Tariff Database.

¹For some of the smaller economies information is for 1999 or 2000.

²Excluding the Bahamas, whose simple average tariff is 0.6%, with a standard deviation of 6.7% and a variation coefficient of 11.17, and whose percentage of tariff lines above both 15% and 35% is 0.27%.

³ Ad valorem equivalents provide lower bound estimates for the protective effect as they are lowered by tariff reductions enjoyed in the US by preferential trade partners.

⁴ Data supplied by Marcos Jank: IDN-INT calculations based on data from the 2001 Hemispheric Database of the Americas and AMAD.

Tariff peaks in the US are concentrated in a relatively small number of chapters. Table 5 below shows the data for those tariff chapters where the average ad valorem tariff is more than double the average tariff: tobacco products, footwear, textiles and clothing, dairy products, agricultural products such as nuts, vegetables and fruit juices. There is also a concentration of specific duties with high ad valorem equivalents in some of these chapters.⁵

Another source of distortion in the evaluation of protection in hemispheric markets refers to non-tariff barriers or tariff quotas. These are more significant in the US than in other economies in the hemisphere affecting, for instance, trade in textiles, clothing, sugar and tobacco. There are also contingency measures such as safeguards and anti-dumping and countervailing duties which the US can use more effectively than its partners in the hemisphere due to its bargaining power. The same applies to Section 301 and related measures.⁶ These issues are likely to be of paramount importance in the formation of the FTAA as will be seen in section 5.

It is rather more difficult to single out peaks in Latin America markets as tariff dispersion is much lower and average tariffs much higher. In Mercosur, for instance, there are no less than 35 HS chapters with average tariffs between 16% and 23%.⁷ From the more disaggregated perspective: tariff peaks are concentrated most of all in transport equipment (31-36% range)⁸ as well as in dairy products, capital goods (chapters 84 and 85) and footwear (26-31% range). There is also a high incidence of tariff peaks in the 21-

⁵ It has been suggested that the abolition of tariff peaks in the US on Brazilian exports of 'other agricultural products and food industry' products, that is their reduction to 15% ad valorem, would halve the average tariff rate from 18.2% to 9.1% See Bouët, Fontagné, Mimouni and Pichot (2001). Quite often US extremely high peaks on agricultural products are hidden by disaggregation. The 8-digit tariff on line 24011065 "Tobacco, not stemmed or stripped, not or not over 35% wrapper tobacco, flue-cured burley, etc" is 350%, but at the 6-digit level the internationally comparable tariff on line 240110, "Wrapper tobacco", is a much more innocent looking average of 42.5%, see Marcos Jank, 'A complexidade das negociações internacionais', *O Estado de São Paulo*, 16.4.2002.

⁶ See US Trade Policy Review 2001 in www.wto.org.

⁷ These are the values for Brazil.

⁸ This is the most extreme case of protectionist inertia in Mercosur. It is of interest to note, in the context of the political economy of protection, that demandeurs of a high common Mercosur external tariff traditionally includes in a prominent position multinationals producing motor cars and capital goods which fear to lose their cosy protected markets. See, for perhaps an extreme view, Yeats (1999).

26% range in many other chapters which cover food residues, leather goods, textiles and clothing, and capital goods (other than chapters 84 and 85).⁹

Table 5

United States: : Simple average tariffs, standard deviations, coefficients of variation and tariff peaks, 2001

Chapters of the Harmonized System	Simple average tariff	Standard deviation	Coefficient of variation	Share of specific duties in tariff peaks	Share of specific duties in tariff peaks above 35%
04 Dairy products	12.4	5.0	0.40	69.7	100
07 Edible vegetables	9.0	7.6	0.84	12.5	---
19 Preparations of cereals	9.1	5.8	0.63	58.3	100
20 Preparations of vegetables	11.3	21.9	1.94	18.2	25
24 Tobacco and manuf. tobacco	90.7	156.3	1.72	40.0	33.3
52 Cotton	9.2	3.9	0.42	28.6	100
54 Man-made filaments	10.9	3.9	0.36	0	0
55 Man-made fibres	11.4	4.0	0.35	100	---
60 Knitted or crocheted fabrics	10.9	3.9	0.36	0	0
61 Apparel and clothing, k. & c.	12.7	8.4	0.66	21.7	0
62 Apparel and clothing, n.k.& n.c.	10.7	7.4	0.69	37.8	---
64 Footwear	14.1	14.2	1.00	35.1	24

Source: Hemispheric Trade and Tariff Database.

Jank, Fuchsloch and Kutas (2002) have used a “relative tariff ratio” (RTR) index¹⁰ as a synthetic indication of the imbalances among different prospective FTAA members on the relative importance of protection affecting their agricultural and non-agricultural exports and imports. The index is a ratio between tariffs faced by country A in country B and tariffs imposed by country A on imports from country B. Tariffs in each country are weighted by the other country’s exports. In the case of RTRs for the United States, Brazil is the extreme case of divergence between for agricultural products (very low RTR) and non-agricultural products (very high RTR) among western hemisphere economies, reflecting the protectionist stances of the US for agricultural goods and of Mercosur for industrial goods.¹¹

⁹ Hemispheric Trade and Tariff Database. See Jank, Fuchsloch and Kutas (2002) for a comprehensive analysis of protection in the FTAA with emphasis on agricultural products.

¹⁰ As proposed by Sandrey (2000).

¹¹ Divergences for other Mercosur economies, Venezuela and Caricom are also substantial.

Most antidumping activity in the Americas involves either as origin or destination the five largest economies: the US, Brazil, Mexico, Canada and Argentina.¹² The US and Brazil initiated about 60% of all FTAA actions. Actions by the US are heavily concentrated in base metals, while AD actions by other countries are more evenly distributed between sectors.

Other issues such as services also involve access. But the definition of levels of protection are considerably more complex than in the case of goods. Main gaps to bridge between the position of the US and that of at least some of the Latin American economies involve coverage criteria and modes of delivery. Services and investment issues are closely related, especially in a context such as that of recent years, when most of the FDI flows into Latin America was directed to the provision of public services. Other controversial FDI issues include those related to compulsory local content, technology transfer and also to chapter 11 NAFTA-like rules involving dispute settlement between foreign investors and host governments.

3. The political economy of protection in Latin America: the inertia of history

Lack of a sufficiently long stable democratic tradition is an obstacle to the consolidation of transparency in electoral processes and adequate analysis of the political economy of protection using standard models. Lobby for protection without a fully working democratic regime is bound to be even less transparent than under the usually established checks and balances. It thus affects any credible estimate of mobilization of lobbying resources and its possible links to tariff-formation. Political instability is bound to affect the stability of political-support functions since losses to the general population are not constrained by the usual electoral requirements which apply under democratic rules. Lack

¹² These economies have initiated 410 out of the total 485 actions initiated by prospective FTAA members in 1987-2000. See Tavares (2002). In Brazil, there is a concentration of actions involving chemical products see www.mdic.gov.br/comext/decom/decom.html.

of transparency also affects any attempt to explain protection by a campaign contributions approach or by a political contributions approach.¹³

As the position stands, at least in some of the big Latin American economies there is a very limited tradition of open discussion of the consequences of protection in terms of costs and benefits for different sections of the society. The links between the credibility of pledges by politicians and voting patterns are extremely fuzzy. This helps to explain why there is a patent lack of consciousness by different segments of the society about the distributive impact of protection.

To a large extent what appears simply as a myopic behavior is due to history. Inertial elements are of paramount importance in the political economy of protectionism in economies such as Brazil. There has been a tradition of high protection since the mid-19th century. More recently, in the 1947-1990 period, there was absolute protection against imports of many products. But at the same time high growth was achieved in the 20th century, at least until the 1970s. The Brazilian experience stands as the most successful among developing economies. Growth was faster only in Japan and Finland.¹⁴ It has been suggested that it was possible to maintain a high tariff in Brazil because higher production costs affecting exports could be significantly transferred to coffee consumers.¹⁵ This was due to the combination of a dominant position in the world coffee market, the importance of the coffee export economy in the Brazilian economy as a whole, and the low price elasticity of coffee demand. Attempts to raise protection in other commodity exporters raised the opposition of exporters who were price takers, rather than price makers, in their main commodity markets, and increased input prices resulted either in reduced mark ups or reduced market shares in the world markets. It was not that Brazil was able to avoid the costs entailed by a high tariff. It was a rather a question of at least

¹³ See Rodrik (1995) for the standard review of alternative political-economy models. See also Helpman (2002). Much of the political economy literature requires substantial adjustment to be applied to the formulation and implementation of commercial policy in economies with institutional characteristics rather different from those in the US.

¹⁴ See Maddison (1995).

¹⁵ See Abreu and Bevilaqua (2000).

partly compensating such costs at the expense of world coffee consumers.¹⁶ As coffee lost importance in the economy as whole such effects tended to become weaker over time.

After the 1929-1933 recession in Latin America, protection became widespread in many cases in the form of quantitative restrictions implicit in exchange controls. The strategy of import substitution by means of high protection was adopted by many smaller Latin American economies which had small shares in world commodity markets and whose market size only allowed extremely inefficient domestic production.. Foreign exchange regimes adopted after World War II entailed severe anti-export bias. But it is important to recognize that to some extent such policies were the result of the contraction of traditional export markets rather than just the result of primitive reasoning by populist politicians.¹⁷

The attraction of direct foreign investment even in the larger economies starting in the 1950s included policies that assured that competition would be limited to few entrants protected by very high tariff walls. This has created a strange Latin American phenomenon: multinationals which played, and continue to play, a crucial role in trying to delay trade liberalization because they have a long-established vested interest in protection. From the mid-1960s, the more extreme version of the autarchical model started to be abandoned in many Latin American economies as there was growing concern about the sustained anti-export bias of many of the previous international economic policies. But it is wrong to say that policies became outward-looking as domestic markets were opened slowly and, indeed, as a reaction to oil shocks and the following debt crisis, trade liberalization was reversed. In the mid-1970s nominal tariffs could be typically very high or protection could even be absolute due to import controls, but this was coupled with the discretionary distribution of tariff exemptions and

¹⁶ This resulted, of course, in important income transfers from consumers of imports to coffee growers.

¹⁷ See Fodor (1975) for a persuasive analysis of the policy choices available for Argentina in the immediate post-World War II period and the conclusion that not all of the Argentinian anti-export bias was due to either Perón's stupidity or wickedness, as suggested by many analysts, but to the recognition that it was preferable to increase real wages and let the masses eat more beef than accumulate idle unconvertible assets in European central banks.

reductions so that the collection of import duties was not very significant. Exports, on the other hand, were heavily subsidized, especially, but not exclusively, in the context of attracting foreign direct capital using fiscal rebates linked to future export performance. The spectacular increase in the share of industrial products in the total exports of economies such as Brazil from the mid-1960s to the end of the 1980s was a direct result of such subsidies. In a way, it is possible to say that foreign economic policy-making remained very much based on pick-the-winner strategies. The differences were that there was a relay of pickers, with the military in full control for a long period, and that instead of picking winners in connection with import substitution, as until the 1960s, the scope was widened to include those who were thought to be promising future exporters. So rent-seeking, after being concentrated for a long period in import substitution projects, and the consequent demands for protection, came to play a crucial also in the distribution of export subsidies. Conventional wisdom on the links between outwardness and growth only took account of such distortions quite late in the day.¹⁸

Since the late 1970s, but more markedly from the mid-1980s, trade liberalization came to be adopted as a pillar of comprehensive economic reform in most Latin American economies, even in those economies which were more reluctant to change traditionally protectionist policies. There was substantial unilateral trade liberalization, with sharp reductions in average tariffs and dismantlement of non-tariff barriers. Recourse to quantitative restrictions under article XVIII:B of the General Agreement on Tariffs and Trade, once frequent, almost disappeared. In the Uruguay Round, most Latin American countries bound 100% of their tariff lines on industrial products which converged to a maximum of 35% in five years. But in most cases applied tariffs are much below bound levels.

This shift in policies was due to the recognition that import substitution had failed to provide the incentives for high growth even in the economies where the strategy had been more successful in the past. Imports had been reduced so much that even a further

¹⁸ World Bank (1987). The relatively low shift towards trade liberalization was also related to the high priority in most Latin American economies of generating trade surpluses to service the significant foreign debt.

spectacular surge of import substitution (much more difficult to attain) had no significant overall impact. Moreover, long-term costs of protection became explicit, as exports faced increasing problems due to their lack of competitiveness aggravated by inefficient investment outlays in high-cost domestically produced capital goods. Exports subsidies also became an excessive fiscal burden in a context where there was much more competition for scarce public funding.

While commitment to trade liberalization is probably high in most of Latin America there are important actual or potential sources of resistance to its deepening, especially in the Mercosur. As the Argentinian economy faces its most dramatic crisis in independent history, it is open to question whether commitment to more open markets in the future is feasible independently of what is exactly going to be the mid-term outlook from a political point of view. The present crisis tends to undermine commitment to reform and it is not uncommon to hear comments suggesting that Argentina's collapse was due to the reforms undertaken since the beginning of the 1990's.

Similarly in Brazil, cavalier comments on the shortcomings of trade liberalization of the "too-fast and too-deep" kind are mingled with criticisms of the excessively long period during which the exchange rate was allowed to remain overvalued in the expectation of the beneficial consequences of a comprehensive reform program that in the end was only partly implemented. Consistently with the country's position as a laggard liberalizer in the Latin American context, the domestic debate on "industrial policy" shows a widespread reluctance to engage in further liberalization, especially in the FTAA context. The political element is perhaps paramount as there is much suspicion surrounding the decision to have closer ties with the US. But, in addition, the lack of economic sophistication of stances adopted by the average politician on trade matters may come as a surprise to newcomers. Mercantilist ways of thinking are pervasive, with frequent arguments on the need to redress sectoral balance of payments imbalances through more interventionist policies seeking import substitution and "increasing the value added" of exports. The protectionist, or latently protectionist, coalition is extremely wide and includes domestic entrepreneurs, unions and, frequently in a prominent position,

multinationals seeking to protect their *chasse gardée* recovering typical past stances adopted in the golden age of import substitution industrialization. All candidates during the recent presidential campaign emphasized how desirable was a return of more interventionist “industrial” policies. Victory of the opposition in October, 2002, shall mean, in principle, that the future stance on foreign economic policy is likely to be significantly less liberal than that adopted since the late 1980s and that a revival of protectionism is not unlikely. It is true that the victorious opposition seems to have reversed rather sharply its long-standing sweeping condemnation of orthodox macroeconomic economic policies. But it is unlikely that this volte-face spreads to trade policies.

The stance of multinationals concerning the political economy of protection in Latin America tends to be much more diversified nowadays than it was in the high tariff period. There was a spectacular increase of FDI in Latin America in non-tradable sectors such as banking and public services. These firms have a vested interest in the opening up of the Latin American economies and particularly in the stability of the macroeconomic environment. Most of the FDI in other sectors than services was directed to plants which were not necessarily geared exclusively to the domestic markets even in the larger economies. But it is still true that many multinational firms, especially when supplying large domestic markets, are crucial *demandeurs* of sustained protection and export subsidies and still enjoy effective protection well above 35% in the more protected economies.

4. The political economy of protection in the United States: ominous developments

Some of the features of protection in the United States which constitute important obstacles to a successful FTAA negotiation have already been indicated in section 2. In spite of the low average tariff, the US tariff schedule includes a relative large number of tariff peaks (above 15%) and of very high tariffs (above 35%), in the form of ad valorem and specific tariffs, in contrast with most other hemispheric economies. These sectors – textile and apparel, agricultural products – as well as steel products, which answer for

most antidumping actions, are the more sensitive products from the US viewpoint and are also the most important for its FTAA partners.

The analytical framework of many analyses of FTAA takes at least implicitly as a matter of course that the FTAA should be an extension of the NAFTA, or at least that the question can be treated as if the US occupied a *de facto* hub position, with all the Latin American and Caribbean non-NAFTA economies anxious to qualify for entry. The economic policies of Latin American countries are assessed for “readiness” to enter the FTAA, as if the whole exercise could be reduced to a club formation activity under the supervision of NAFTA members.¹⁹ There is less symmetrical effort to consider readiness from the point of view of the political economy of protection in the NAFTA members, and especially of the United States, a determinant factor for the success of the preferential trade arrangement as a result of negotiations based on mutual concessions.

In spite of incitations, cogently expressed already in the mid-1930's by internal critics of protectionism, that US policy should seek to manage political pressures by protection-seeking lobbies rather than letting them “run wild”²⁰, more recent US trade negotiating strategy has traditionally reflected the strength of those sectors more “sensitive” to the competition of imports. A direct result has been the US emphasis on a pick and choose approach to dismantlement of tariff, and, more rarely, non-tariff barriers, to the detriment of a comprehensive dismantlement of protection based on reduction formulae applied without exceptions. This emphasis on selectivity has converged with a similar outlook in the European Union, with its long standing strategy of placing high priority to resisting liberalization of trade in agricultural products. Combined with the pressure since the 1980s to continuous widening of the multilateral trade negotiations agenda through the inclusion of new issues, this has resulted in a significant backlog of unfinished business, mostly affecting traditional issues in relation to which developing economies, that is most of prospective FTAA members, are *demandeurs*. US expressed wishes to take into account “product sensitivities”-- in USTR lingo²¹ -- points out to a likely reincidence into

¹⁹ See Hufbauer and Schott (1994) and successive revisions.

²⁰ See the concluding paragraph of Schattschneider (1935).

²¹ FTAA Negotiating Group on Market Access. Public Summary of the US Position (www.ustr.gov)

a negotiation strategy that will leave a backlog constituted of products or issues which are sensitive for the US but also an essential part of the agenda for most of the other FTAA members .

The second feature of US trade policy which raises difficulties for a successful conclusion of the FTAA negotiation is related to uncertainty about how binding are US commitments concerning market access. What is at stake is whether, even if mutually advantageous reciprocal tariff concessions can be made during the transition period towards a preferential trade area, the US can assure its future partners that market access in the US will not be prevented by anti-dumping or safeguard actions or similar discretionary instruments.

Recent decisions on US trade policy such as the Trade Promotion Authority signed in August, 2002, together with the safeguards affecting US steel imports and the new Farm Bill, give an indication of the obstacles which will have to be surmounted for the successful conclusion of an FTAA. Such a radical shrinking of the “win-set”, that is of the set of possible outcomes of international negotiations given the restrictions imposed by the domestic political economy of protection, enhances significantly the already immense bargaining power of the bigger player. But such a development may simply be an overkill and thus reduce radically the likelihood of the other parties in the international negotiation accepting the signalled terms.²²

The approved TPA removes some of the provisions of former drafts which in the words of USTR Zoellick would "cripple America's (sic) ability to open markets around the world." The Dayton-Craig Senate amendment which would have allowed Congress to veto specific provisions of trade pacts if they changed US anti-dumping and other so-called “trade remedy” laws has gone. So has a previous clause on remedies to counter the allegedly unfair competition of goods produced in economies which resort to foreign exchange devaluation. But by creating a more elaborate compulsory consultation process

²² See Putnam (1988).

between USTR and Congress it continues to make difficult US commitments to improved access for a significant list of “import-sensitive” products, particularly agricultural goods.

The US decision on steel safeguards does not create a concrete obstacle to negotiations. It is also true that the decision has been followed by many exclusions which have reduced its initial distortions. But the move underlines the vulnerability of any negotiation on access based exclusively on tariff and NTBs bargaining. Perhaps more seriously, it underlines the US administrations’ inability to live up to its alleged commitment to free trade. It is of course true that NAFTA members have been excluded from the list of countries affected by the steel safeguards. But, besides doubts about the WTO-legality of such exclusions, it is not entirely clear whether the US would be willing to make such exclusion clauses a feature of the FTAA.

The Farm Bill has dramatically increased US agricultural subsidies. While the total amounts to be spent are still within the caps set in the Uruguay Round there are doubts whether the administration will indeed have the political clout to make use of the trigger mechanism which allows the reduction in subsidies in case world agricultural prices fall further and the WTO subsidy caps are exceeded. In any case it is difficult not to see the decision as a further surrender to protectionist pressures by the US administration. These US decisions boil down to “padding”, that is, increase of protection within the maximum levels multilaterally agreed so as to cut water in a prospective negotiation. Some comments on this decision are candid: “the 2002 farm bill and the steel relief measures gave [Latin America] additional incentives to enter a regional trade pact whose rules and understandings might roll back such protectionist policies and make them less likely in the future”.²³ This is to be deplored, especially when the Latin American economies agreed in the context of the FTAA negotiations to consider applied tariff rates as the initial tariff levels to be considered in the tariff reduction schedules rather than those, much higher, rates bound in the Uruguay Round.

²³ See Richard Feinberg, *Financial Times*, August 7, 2002.

5. The FTAA negotiation process

There are several alternative estimates of the impact of the FTAA on particular economies and specific sectors from the point of view of trade and welfare based both in the general equilibrium and partial equilibrium frameworks. For instance, Monteagudo and Watanuki (2002) estimated recently the impact of FTAA trade liberalization (excluding non-tariff barriers) using a CGE model incorporating trade-related externalities and economies of scale. They suggest that hemispheric real GDP would increase 0.55%, ranging from 0.33% for NAFTA and 2.23% for Mercosur with Chile, Central America and the Andean Community roughly between 1.4 and 1.8%.²⁴ There would be an expansion of exports substantially higher than imports in most FTAA economies. Only Canada, Mexico and Venezuela would be exceptions. Exports would expand 1.7% in NAFTA members, 4.7% in Mercosur, 5.2% in Chile, 4.4% in the Andean Community and 6.7% in Central America and the Caribbean. These aggregate data, however, may hide important inter-country contrasts: for instance, Brazilian exports to the US would increase 9% while Brazilian imports from the US would increase around 25%.²⁵ In a preliminary version of the paper only when non-tariff barriers were considered the impact on bilateral imports and exports became of the same magnitude.²⁶

But all these estimates consider instantaneous trade liberalization and do not take into account of exclusions. US strategy in the FTAA negotiations is unlikely to contrast sharply with that adopted in the NAFTA negotiations. Kowalczyk and Davis (1998) have shown that the tariff phase out in the NAFTA process took longer for high duty products and that liberalization in Mexico was correlated to US liberalization for the same products, suggesting an attempt to establish narrow reciprocity at the 8-digit level. Panagaryia (1998) suggests that this may be an indication that US export interests in

²⁴ Results obtained by Dsiao, Díaz-Bonilla and Robinson (2002), based on IRTS and considering only the elimination of tariffs, generate similar rates of GDP increase for most economies. But for NAFTA their estimates are higher and for Central America and the Caribbean and the Andean Community much higher than those of Monteagudo and Watanuki (2002).

²⁵ These are in line with the partial equilibrium estimates of Abreu (1995) and Carvalho and Parente (1999).

²⁶ Monteagudo and Watanuki (2001).

Mexico were concentrated in those sectors also enjoying high protection in the US and that the likelihood of trade diversion in the Mexican market is high.

Recent research on reciprocal Brazil-US market access for goods and revealed comparative advantage²⁷ has shown that, at the 6-digit level, to a certain extent, the relatively more competitive are Brazilian goods, the higher tends to be protection in the US market. In the Brazilian market, however, this relation is reversed, as the relatively more competitive US goods tend to face lower tariffs than the less competitive products. This is an indication that Brazilian exports to the US tend to be more adversely affected by protection than US exports to Brazil.

The FTAA negotiation as any other trade negotiation involves countries endeavouring to maximize, or expedite, access to export markets of their partners and minimize, or delay, access to its own market given an implementation time span. As pointed out by Panagaryia, every country would offer liberalization which entails trade diversion first, leaving trade creation liberalization to the later stages of implementation. While reciprocity is an important essential feature of multilateral trade negotiations involving mostly big economies of not very dissimilar size, it is unlikely to have the same importance in the regional or subregional context since there are so sharp differences in the size of the different economies involved in the negotiations.²⁸

The stance adopted by each country in international negotiation results from an internal negotiation involving interests which have may have gains or losses with the implementation of the initiative.²⁹ This complex domestic negotiation involves many relevant players: government, consumers, taxpayers, multinationals, trade unions, exporters, purchasers of inputs and capital goods, domestic producers of products likely to face increased competition from imports.

²⁷ By Honório Kume and Guida Piani.

²⁸ See Staiger (1998).

²⁹ See Putnam (1988).

Are there good reasons to postpone liberalization of sensitive products or, in a more extreme scenario, to exclude certain sensitive products in an overelastic interpretation of the hazy “substantially all trade” provision for FTAs under multilateral rules?³⁰ US reliance on a trade negotiating strategy which postpones more relevant liberalization – that is liberalization that affects inefficient domestic producers – notwithstanding, a “first things last” strategy from a strict efficient viewpoint may be justifiable under certain conditions. Grossman and Helpman (1994) have suggested that exclusions would reduce the government political costs in facing either the impact of trade diversion on the average voter, or the opposition of coordinated import-competing sectors, that is, loss of lobby income.³¹ Bargaining over the ranking of sectors exempted would reflect bargain weights of different governments.

Even supposing that an analysis emphasizing the role of contributions by affected sectors is relevant to all relevant governments in the FTAA context, more optimistic views, which would not put interpretations of what really is “substantially all trade” under undue stress, could result, for example, from substantially higher sensitivity by governments to the average-voter. This would contribute to make more likely liberalization over the board, or at least would moderate the incentives to delay liberalization which entails trade creation.

The universal application of a formula or formulae to eliminate tariffs (or tariff-equivalent) levels of protection would have been an efficient instrument to assure that different governments do not feet drag and try to delay the impact of liberalization on their most protected producers. The impact of formulae as tariff-cutting criteria on tariff dispersion, an usual indicator of sensitivity, is even more rapid than on tariff levels. But the opportunity to adopt such formulae is past as the FTAA tariff negotiations are to be

³⁰ See, for instance, World Trade Organization (1995), pp. 824-827, for the intricacies surrounding what is “substantially all trade” in the context of article XXIV of GATT 1994.

³¹ They also suggest that that successful negotiations between “politically minded governments” – that is, governments that take into account political contributions by interest groups, both against and in favour of the FTA, as well as the average voter’s well-being – are more likely the more balanced is trade between two economies. And also that success in the negotiation is more likely when the FTA results in enhanced protection – that is when there is significant trade diversion – rather than reduced protection in most sectors. Enhanced viability of the FTA is thus related to enhanced likelihood of a loss in aggregate welfare.

conducted based on lists of products classified in different categories according the liberalization horizon: instantaneous, five years, ten years and a residual of sensitive products. The United States would wish to negotiate bilaterally different lists of products in each category with different FTAA partners. The negotiation would then tend to be of a “hub and spoke” character, the main differences being that there would be some possible economies of scale in the negotiating process and that trade liberalization would be simultaneous even if affecting different products in the case of each pair of countries. Other countries would prefer an approach regional MFN-based approach couples with provisions to take into account different levels of development among prospective members.

In the negotiation on services, the US would prefer excluded sectors to constitute a negative list. Many Latin American countries would prefer a GATS-like positive list as this would cope more adequately with the lack of detailed knowledge on the impact of liberalization on national providers of many services. In any case there is greater Latin American reluctance to liberalize services than goods: some countries wish to consider WTO-bound commitments as an initial basis for negotiation rather than actual access conditions. Other important differences to bridge in services are the divergent views on local presence requirements and the flexibility of arrangements to accommodate movements of top managerial personnel.

In the grey area between services and investment lie many of the thornier problems to cope with in the negotiations, especially those concerning the provision of public services, such as transparency requirements or dispute settlement between foreign investors and host economies. While most of the issues involving trade-related investment measures seem non-controversial, attempts by Latin American economies to reopen some of the provisions of the agreements on TRIPS and subsidies reached in the Uruguay Round may be the origin of much heat. This is the case of banned performance requirements, particularly those which are export-related. Substantially more complex to

See also Helpman (1997).

solve are the problems connected to different views on issues such as compulsory transfer of technology and other possible requirements related to treatment of FDI.

Agricultural export subsidies are one of the main stumbling blocks faced by the negotiations as many of their adverse effects are on markets outside the FTAA. While the dismantlement of such subsidies affecting intra-FTAA markets is feasible it is much harder to think of substantive remedies which would counter their impact in other markets. This is typically an issue which would be more adequately dealt with in multilateral negotiations rather than at the regional level. Similarly, antidumping and safeguards measures, which are a crucial part of the US protectionist armor, and increasingly so also of other big economies in the continent, if left as they stand could seriously undermine results of access negotiations. Tit for tat bilateral use of AD is likely to put smaller economies at a disadvantage in relation to the US.

While the US stance on some of the “new” issues has proved to be until now less sanguine than it was initially feared it is not impossible that such stance will harden during the negotiations as and if the pressure for complementary agreements à la NAFTA gains strength.

6. Conclusions

The importance of obstacles in the path of successful FTAA negotiations should not be underestimated. Protectionist lobbies in the US and in Latin America, especially in the big and more protected economies, are stronger now than they were, say, a couple of years ago, and have been more successful in their bid to delay trade liberalization .

US strategy based in delaying trade liberalization of sensitive products to the last possible moment, or to exclude such trade from the FTA agreement, is likely to be taken as an example by other countries. Trade creation liberalization is to be delayed and trade diversion to prevail in the shorter term. The negotiation of specific lists of products to be

included in four categories, defined according liberalization schedule and sensitiveness on a bilateral basis, is a return to the hub and spoke model.

A not always explicit difficulty faced in the FTAA negotiations is that there are many existing preferences which would be adversely affected by the implementation of comprehensive trade liberalization. The erosion of subregional preferences, especially those related to the US market, in the NAFTA context and also in Central America and the Caribbean, may act as a deterrent for a more active approach by economies likely to be affected by a reversal of trade diversion in the US market.

The collapse of Argentina and macroeconomic instability in Brazil placed the eventual macroeconomic advantages of an FTA including the United States in a relatively secondary position in the list of possible benefits of such an integration at least in a mid-term perspective. To the extent, however, that binding trade liberalization commitments are made, there is a powerful implied macroeconomic discipline imposed by the sheer size of the main economy involved in the initiative. The scope for the adoption of unsustainable policies is significantly curtailed by the likely consequences on trade and FDI flows. Potential gains entailed by a convergence of interest rates in the direction of US levels are substantially higher than those related to trade. Curiously enough the impact of these imported macro-economic virtues has tended to play a rather secondary role in the Latin American public debate on the FTAA.

What can the US offer to Latin America which may clinch the deal? To a large extent what can be offered by the US that could ease the political pain of concessions by Latin America is concentrated in its list of sensitive products. This is why recent moves in the political economy of protection of the US tend to jeopardize successful FTAA negotiations.

The bigger Latin America economies outside NAFTA are demandeurs of both a reduction of national discretion in the use of antidumping and safeguard measures as well as of further disciplines and scheduled elimination of agricultural export subsidies or of

policies producing equivalent results. The US resistance to the overhaul of such policies is substantial. The US could always surmount such difficulties by offering a more attractive access package but it is unclear whether this would make sense if these issues are to be discussed multilaterally in Geneva.

It must be kept constantly in mind that the FTAA and the WTO negotiations are closely intertwined. This is specially relevant in connection with issues such as antidumping and agricultural exports subsidies but also to a certain extent in relation to access, as MFN improved access is bound to have important consequences on FTAA trade, especially on those all-important exporters seeking to exploit opportunities created by FTAA-induced trade diversion. Countries negotiating the FTAA will keep a very attentive eye on Geneva and be, perhaps, reluctant to clinch an hemispheric deal without a full picture of multilateral developments. This could be an additional source of pressure to delay the FTAA negotiations if the Doha Round proves to be as protracted as its predecessors and the deadline of 2005 is not binding. Most observers believe that an inevitable consequence of the European Union move to delay any decision to cut support under the Common Agricultural Policy until 2007 will be a postponement of the date scheduled for the end of the Doha Round. It is likely that this will also be relevant for the FTAA timetable of negotiations.

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Departamento de Economia PUC-Rio
Pontificia Universidade Católica do Rio de Janeiro
Rua Marques de São Vicente 225 - Rio de Janeiro 22453-900, RJ
Tel.(21) 31141078 Fax (21) 31141084
www.econ.puc-rio.br
flavia@econ.puc-rio.br