

Comment on “Trends in Regional Cooperation,” by Ricardo Ffrench-Davis

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Ricardo’s contribution is an overview paper; it covers many points and indeed raises most of the issues I would have raised myself if I had been writing the paper. I usually agree with Ricardo and once again that is the case. So really my comments will be basically reinforcing some points and emphasising some areas more than he did.

I have divided my comments into two parts, one on historical developments, an area extensively covered in the paper, and the other on the contemporary situation. The history refers to the 1960s and the 1970s, and includes the 1980s as well.

History

In the case of obstacles, Ricardo mentions a number of them regarding what happened to the historical process of integration before this transformation that was experienced in the 1980s. I would stress a couple of points here.

One point is that the integration process during the 1960s and 1970s confronted a hard reality: that there was little commercial tradition in Latin America. I was always struck by the fact that Argentina did more trade with Holland than it did with Brazil. So I think this was one major obstacle that should be brought out.

Another problem was that the motivation for integration wasn’t really international competitiveness and the promotion of exports per se; it was rather an extension of the existing import-substitution policy which was based on physical expansion of the national industrial plant rather than to compete internationally. This had two consequences. One was that this integration effort was not able to resolve the problems of the import-substitution strategy because it ran up against the same barriers: high levels of national protection and the inherent inefficiencies associated with that. So the solution was overcome by the problem itself. And two, Ricardo points out that one of the results of this integration process _ which of course was not entirely negative by any means – was that there was an increase in intra-regional manufactured exports. But I think precisely because of the strategy – the extension of the

national market via import-substitution – that it is questionable whether these manufactured exports were, strictly speaking, internationally tradeable goods. This is reflected in the automobile industry where there was tremendous physical development, but where it is doubtful that many of the models could be sold or traded internationally. Brazil itself was, to some extent, a victim of this approach (partly because of the strategies of the multinationals). When Brazil finally started to try to export its cars to Europe and the United States it ran into big problems with quality, not to mention the obsolescence of the models themselves.

There are other obstacles that were very important. One was that the integration process was rather shallow and so, after trade was liberated among partners, one still had to confront a lot of non-tariff barriers. Moreover, there were no extensive agreements in some of the areas that support trade and services and that reduce risks on private investment. The old LAFTA framework also suffered from a degree of inflexibility; it was bound by MFN considerations that were resolved only later in the Treaty of Montevideo II, when countries could sign “partial agreements” and not necessarily extend the benefits to everybody within the region.

Finally, there was historically the question of the symmetry of benefits between the more developed and less developed countries in the region. There was much tension in that period because the smaller countries essentially had deficits with the larger countries and they had to finance these deficits by selling their primary commodities overseas. There is actually an excellent article by Germanico Salgado in the *Revista de la CEPAL*¹ where he examines this tension; if that is an accurate reflection of what was going on during the period, asymmetric benefits were a major issue.

Contemporary Situation

In the contemporary experience up into the 1990s, one would draw out more the effect of unilateral liberalisation on intra-regional export growth. What happened here is that with the reduction of tariffs around the countries, there was a spontaneous development of natural trading areas and this explains to an important degree the growth of intra-regional exports. This of course has been reinforced by formal agreements such as Mercosur and Colombia-Venezuela, but the unilateral reduction of tariffs has something to do with the booming of intra-regional exports during the early 1990s.

1 Germanico Salgado, “El Mercado Regional Latinoamericano: el Proyecto y la Realidad”, *Revista de la CEPAL*, No 7, April 1979.

Likewise, because there was a lowering of tariffs in the late 1980s and early 1990s, one would think that the intra-regional trade that is going on now – which is also heavily oriented towards manufactured goods – is effectively producing goods that are internationally tradeable and in this sense it does probably serve better than in the past as a platform for international competitiveness. This is a point that could be brought out to contrast with the earlier period.

Ricardo makes an interesting point, one of the many interesting points in the paper, when he stresses that during the 1980s intra-regional exports suffered in part because of the simultaneous devaluations in the region. There was a collapse of foreign capital flows and with that real devaluations; the simultaneous change in relative prices gave an impulse to extra-regional exports as opposed to intra-regional exports. Well, one could use the same logic for the boom in the 1990s. Because what happens is that there is a sharp increase in capital flows, appreciation of exchange rates and therefore, using the same logic, a bias towards intra-regional exports. I think that this is important because it suggests that a little caution may be merited about the success of intra-regional exports; it moreover leads to a question: are our intra-regional export substituting for a lack of international competitiveness? Yes, I think that may be happening to some extent. It is very evident in the Andean Group where there is practically no growth of extra-regional exports, while intra-regional exports are growing very strongly.

Now, the paper also stresses five points concerning why countries are considering intra-regional accords and they are all oriented around market failure. They are five very important points I fully agree with. I think they are all reasons to consider intra-regional accords and in fact reinforce the whole point of integration: to overcome some obstacles of a “Second Best World”. However, I am not sure that they are the main driving forces. Indeed, I think there is also a strong political motivation behind what is happening.

One is that countries were trying to “lock in” their policy reforms and also were trying to provide signals of commitment to the international financial markets, especially in the case of North-South type integration agreements. This political economy component is clearly driving integration. And second, there is a defensive reaction which I think is very important. Governments are signing agreements just because they see their neighbours signing; they don’t want to be left out in the cold without a preferential partner.

This leads me to another point. Today it is really hard to discuss regional integration without talking about hemispheric integration and the global economy, which is also consistent with the whole issue of open regionalism. I say this because if you just focus on Latin American integration, or Latin American-Caribbean integration, you miss a lot of points. There is the question of defensive reactions. It is a real issue – when a country joins a new

accord, what are the effects that it has on existing accords? The most notable case would be the effects of NAFTA accession on the Central American Common Market and the Caribbean Common Market, etc. It could lead to trade and investment diversion and a weakening of sub-regional accords, even though many people feel existing sub-regional accords are “building blocks” for hemispheric integration. There is also the question of compatibility of accords; the question of the development of poles – the Mercosur-NAFTA dynamic is an interesting one – and, of course, the North-South adjustment issues. These considerations can’t be very well developed in a paper that focuses exclusively on regional issues, although this problem is more due to the structure of the conference than anything else.

The other point is what I mentioned yesterday: that one must look at regional integration in the light of multilateral trends and the WTO, above all the Article 24, which in principle now, due to the new Understanding that came out of the Uruguay Round, could in fact become an effective instrument for surveillance and evaluation of intra-regional accords.

To end, just some other contemporary issues could be developed. The question of institutional barriers: integration is taking place with, in many cases, an institutional structure that was set up in the old framework of import substitution; there are many commercial mechanisms and instruments which really are not up to date for an internationally competitive type of open regionalism. So this is an area where there is probably need for reform and modernisation of institutions, for instance in dispute settlement.

There is also the issue of asymmetric benefits. While not fashionable today, I think it is still a problem that must be addressed.

There is the question of macroeconomic frameworks in the context of convergence: this is an issue where there are more questions than answers; somebody like Ricardo, who has a very strong macro-background, could fill this out very well.

There is the private sector dynamic which was mentioned yesterday: the private sector is a very important actor; indeed there is much spontaneous development of integration trends in the region.

And of course, the last thing is information. I am working on the question of hemispheric convergence and we are trying to gather data on the different accords and their norms and regulations. It is not easy. A private sector actor who wants to identify the rules of origins for products X, Y, Z at eight digits might have a difficult time. In effect, the system isn’t set up to provide easily accessible information for the private sector, which in the end is the leading protagonist in this whole recent explosion of intra-regional trade.