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Regional Integration in Latin America: Experience and Outlook

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The attmept to reach formal and informal agreements among groups of countries encouraging economic cooperation and establishing tariff and other trade-related preferences for the members of the group is not a new phenomenon. The most notorious historical example of a customs union is the Zollverein, formed in 1834, and which led to the eventual political unification of Germany. In our days, particularly in the postwar period, many attmepts of economic integration took place in different areas of the world and, among them, the best known and probably the most successful case is that of the European Economic Community.

Since many of the earlier and better-known cases of integration took place between countries which had reached a relatively high level of economic development, most of the attention of policymakers and theoreticians was primarily directed to the analysis of these cases without considering the particular circumstances and interests of less developed economies. The advocacy of economic integration between developing countries became a very topical issue in the 1960s, particularly after the establishment of the Latin American Free Trade Area (LAFTA), and, motivated by the growing number of integration attmepts in different areas of the world, the interest of the economic profession started to shift toward the specific aspects concerning developing countries.

In this light, the first section of the paper very briefly surveys the main elements of the traditional approach to economic integration with its standard extensions, and then turns to the modifications introduced to deal with developing economies. The second section is the core of the paper and focuses on the Latin American experience. The last section reviews the implications of recent development regarding the prospects

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for regional cooperation.[1]

Ⅰ. The Theoretical Framework

1. The Traditional Approach

The traditional approach to economic integration is based on the pure theory of customs unions. It is a "trade" approach in the sense of dealing with the liberalization of the current account and neglects other aspects of international economic relationships such as tax agreements, the harmonization of fiscal and monetary policies, liberalization of capital flows, the free movement of labor, and many other forms of international cooperation. The traditional approach is largely based on the evaluation of the static welfare implications of altering the existing patterns of production and trade following the formation of a customs union. Jacob Viner (1950) showed that the welfare effects of a customs union are ambiguous, since its establishment gives rise to two opposite effects : trade creation and trade diversion. Clearly, welfare increases if trade creation effects dominate trade diversion.

This traditional view regrading the welfare effects of customs unions is based on a large number of stylized assumptions which raised questions about the appropriateness of this model for the case of developing countries. The central assumptions include perfect competition in factor and goods markets, fixed terms of trade, full employment, constant returns to scale, no externalities, no transport costs, identical production functions, constant technology, constant tastes, and constant quality and quantity of factors of production. Despite the restrictive nature of these assumptions, they helped to establish a taxonomical approach for the characterization of those potential partners which are more likely to benefit and those which are more likely to reduce their welfare as the consequence of a customs union. In addition, a rationale for the theory of the "second best" was presented, a theory later elaborated by Meade (1955) and Lipsey and Lancaster (1956), and which expanded to many other fields of economic theory. The central tenet of this theory is that, in the presence of many distortions, the addition of others or the elimination of some do not affect welfare in an a priori known direction. The message within the context of economic integration was that, although the establishment of a customs union is a step in the direction of free trade, a firstbest in this neoclassical

1.For a more extensive discussion of these topics, see Blejer (1984). The 1984 Annual Report of the Inter-American Development Bank was devoted to the issue of economic integration in Latin America and is an extensive source of historical, statistical, and analytical information on the subject.

paradigm, its ultimate effect on the economic welfare of the participants could not be evaluated ex ante.

The theoretical conception regarding economic integration was therefore set on the premise of the superiority of free trade and the negation of protectionism as a channel eventually conducive to first best solutions. In the best of cases, integration could improve welfare above autarky levels but, generally, the gains were lower than those attainable through nonpreferential commercial liberalization.

This type of argumentation, however, was not well received in political and economic circles of many developing countries where integration was seen as a step to counterbalance the economic weight of the industrial world and as a way to solve some of the structural problems affecting the developing countries, such as a very narrow market size and the secular deterioration of the terms of trade. The desirability of the idea, however, had to be sustained by a set of economic arguments in order to provide a rationale for the implementation of integration policies.

2. The Development Approach

The analytical framework supporting economic integration among developing countries is based on various departures from the original theoretical framework. Those departures are of three main types: (a) extensions to the basic model, especially changing the assumptions but without altering the general analytical structure: (b) the elaboration of arguments rationalizing economic integration in terms of alternative objectives and social welfare functions; and (c) the consideration of the effects of distortions and the introduction of dynamic elements to the cost-benefit evaluation.

(a) Two sets of departures from the assumptions of the basic model provide some theoretical arguments relevant for supporting economic integration in developing countries. The first relates to changes in the terms of trade, and the second to the presence of economies of scale.

The consequences of allowing for terms-of-trade effects are related to the proposition that a country with monopsonistic power in world markets improves its terms of trade by imposing tariffs. But it is only when each individual member is small but the combined union has market power that a terms-of-trade argument for small countries may be made. However, the attainment of terms-of-trade improvements may require a very high common external tariff with the consequent high probability that negative welfare effects will arise from trade diversion. Moreover, the argument seems to apply more to the formation of consumer cartels than to favoring economic integration.

A second set of modifications refers to the achievement of economies of scale following the formation of a union. The central idea is that, following the enlargement of the market for some commodities being produced at high costs by members of the union before its formation, what, on the surface, appears to be trade diversion will ultimately be beneficial to all the members since the average cost of production will fall as production expands. However, in order to raise welfare, the economies-of-scale effect should lead to a final price lower than the world price, which implies that the country could, in principle, have become an exporter to world markets even without the union. The point in question is then one of achieving market access and not of granting discriminatory protection. In addition, the argument about economies of scale applies only at the level of the production unit and is not relevant for the combination of total production of multiple individual units. This carries the implication that, in order to attain economies of scale, single members of the union may have to capture the entire market of specific products with others totally abandoning its production. This, of course, raises the critical issue of the distribution of gains and location of industries within the union.

(b) In the attempt to support the push for economic integration among developing countries, a new approach emerged. This new approach accepts protection and trade restrictions as tools of economic policy which is not necessarily inferior to the free-trade system. Such advocacy of tariff protection is viewed as justified when the social welfare function is redefined to include future as well as current consumption and other noneconomic objectives, and when there are imperfections, externalities, and distortions in commodity and factor markets. In all those cases, an optimal trade policy seeks the attainment of dynamic transformations in the economic structure, which would lead to a different pattern of specialization reflecting the concept of dynamic comparative advantage.

The "development approach" to economic intergration is, therefore, theoretically grounded on the nonsuperiority of free trade over protection when nonstandard economic objectives are considered or when commodity, factor, and foreign-exchange markets are distorted. Accepting this idea, the "development approach" does not view customs union formations as a second-best policy.

When considering nonstandard welfare functions, the attainment of industrialization plays a central role in the design of the alternative social objectives. The structuralist approach to development has been based on this type of reasoning. Because of specific rigidities, lags in technological transfers, and the pricing mechanism predominant in the world economic system, structuralists view industrialization as the core of economic development. Given the perceived superiority of the industrial strategy, the conservation of the domestic market together with the enlargement of other marketing horizons becomes the centerpiece of this development approach. But why is economic integration the most appropriate trade policy to reach this objective? The answer appears to lie on the belief that some members of a customs union have an advantage within the union but suffer a definitive comparative disadvantage with respect to the rest of the world. In addition, the potential optimality of integration policies to attain industrialization is supported by the view that customs unions tend to enhance the bargaining power of the participants. In this context, some authors (e,g., Meade, 1955) have stressed the increased bargaining power of the uion as a whole when negotiating with third parties. The threat of the union to increase the common external tariff, unless some advantages in third markets are granted, may be more credible and effective than the possibility of individual retaliatory actions. Although it may indeed be factual that unions carry more weight than individual participants, it is not obvious that setting up common barriers is a precondition for expanding the bargaining power of the countries of a region. It is certainly conceivable to work out ad hoc regional arrangements with the specific purpose of improving the negotiating stance of the group which do not necessarily require trade integration.

(c) The advocacy of economic integration in developing countries, however, rests mainly on arguments based on the achievement of dynamic effects in the presence of distortions and market imperfections. The introduction of nonstatic cost-benefit analysis into the context of economic integration is an extension of the concepts of the infant industry and of a dynamic comparative advantage. However, when these notions have been elaborated in connection with economic integration, they have been largely linked to the issues of market constraints and to an extended variant of the economies-of-scale argument.

A common version of the traditional infant-industry claim asserts that the observed patterns of international trade only reflect the structure of comparative advantage at a given point in time. However, this structure is not static and developing countries may emerge, after a learning process, with a comparative advantage in many industrial sectors which, at present, show a negative relative cost ratio. The unfolding of such a comparative advantage requires the preservation of the domestic market for those industries indentified as likely to benefit from increases in the volume of production. This is therefore an argument for temporary protection, leading first to import substitution and, potentially, to exports and competitiveness in world markts.

The economic rationale of the infant-industry argument is based on a dynamic variant of the economies-of-scale notion. It claims that the complete structure of average and marginal costs, even if increasing in a static sense, falls as production proceeds. The downward displacement of the cost structure is caused by technological gains, productivity rises, and human capital improvements, which can be achieved only through learning by doing and cannot be disembodied from the production process itself.

When utilizing the infant-industry argument in the context of economic integration, an additional element plays an important role : the indivisibility of plant size. Individual country markets may be large enough to suffice for efficient primary import substitution, but further import substitution involving intermediate imports, consumer durables, and capital goods requires an even larger market size to attain a dynamic comparative advantage. This is so because in many of those sectors there are minimum plant sizes which are a pre-requisite to even start the process of production at reasonable costs, and production at those levels of plant sizes requires more than individual national markets. Therefore, in their quest for enlarging the scale of import substitution, developing countries are constrained by limited national markets which do not allow the establishment of efficient size plants that will be conducive to subsequent improvements in productivity and competitive production costs.[2] In this light, economic integration is viewed as a way to overcome the limitations of the national market by allowing the establishment of economically efficient plants designed to produce for larger union markets.

The standard criticism to the infant industry argument can, however, be applied to its extension to the customs union context. In the first place, we confront the empirical issue about eventual cost reductions following increases in the levels of production. But even if initial costs decrease as the volume produced rises, the case for protection can be made only if the total discounted welfare costs arising from protection are lower than the present value of the social benefits which will accrue to the country as the industry becomes efficient and competitive in world markets. But even granting that the dynamic cost-benefit ratio clearly shows a positive balance, the question is why private initiative, without protection, would not exploit a profit opportunity expected to yield net benefits over time.

There are a number of answers to this type of criticism. In the first place, social and private costs and benefits probably differ due to externalities and to the inability

2.On the issue of plant size and its impact on developing countries, see Teitel (1975).

of private firms to fully capture the returns from accumulation of human capital, which tends to be nonfirm and even nonindustry-specific. In addition, the horizon over which benefits are discounted as well as the rate of discount may differ when social, rather than private, considerations are taken into account. Moreover, distortions and imperfections in financial markets may limit the access of private enterprises to the capital resources needed to finance projects even if they are indeed profitable in the long run.

However, as most of these factors arise from market-specific distortions and imperfections, direct intervention in those markets may have a lower social cost than the roundabout method of protecting the product markets.

Apart from the analytical issues mentioned above there may be some practical considerations related to the infant industry argument which are of special relevance in the context of customs unions. Since the degree of protection needed to attain dynamic benefits may differ widely across members, depending on their level of technological development and industrialization, this would give rise to a conflict about both the level and the time profile of reductions in the common external tariff. Furthermore, since the argument is based on the need to expand the market due to the indivisibility of plant size, it has implications for the issue of the location of new industry together with the dismantling of some already existing industry in other members. This is a central matter regarding the distribution of gains from a union and may become a stumbling block in many integration schemes.

II. The Patterns of Economic Integration in Latin America

The first steps toward Latin American integration were taken in the decade of the 1950s but no concrete framework emerged until 1960. Since then, three different models of integration have been implemented with different degrees of success. The first model is represented by the Latin American Free Trade Area (LAFTA), which was an attempt to gradually eliminate barriers to intra-regional trade without establishing a common external tariff of designing any other substantial measure of domestic or external policy coordination. The second type is the creation of subregional common markets, like the Andean Group, the Caribbean Community (CARICOM) and the Central American Common Market (CACM). These are devised as true customs unions which have also attempted to implement a larger degree of homogeneity in internal policies. The third model is that embodied in the more recently established Latin American

Integration Association (LAIA),[3] which sets up a framework for negotiations with the objective of achieving multilateral trade agreements based on initial bilateral negotiations. The operational structure of this framework could, therefore, be characterized as a regional GATT.

Some of the attributes of these three models of integration, as well as the problems that they encountered, are analyzed in this section.

1. The Free Trade Area Model (LAFTA)

In the late 1950s, many of the leading economic and political forces in Latin American arrived at the conclusion that the deterioration in their terms of trade, which was a central problem during the decade, was a very long-run phenomenon of the world economy. At the same time, the larger countries in the area started to realize that the strategy followed in the post-war period, basing economic development on import-substitution industrialization, was facing some constraints due, among other factors, to severe domestic-market limitations and to the significant magnitude of the investments needed to deepen the process of import substitution beyond the stage of consumer goods into the intermediate and capital goods levels. At the same time, the degree of competitiveness in foreign markets of most of the Latin American countries remained low, making more dfficult the transition from an inward-looking to an export-led development strategy.

In these circumstances, regional economic integration appeared to be the most promising alternative which would, at the same time, break the domestic market limitations and avoid the need to penetrate the industrialized countries markets. Therefore, economic integration was basically regarded as a channel for the continuation of the process of import substitution. The opening of a larger market, which would remain highly protected from the rest of the world, would enable the deepening of the import-substitution process, now at the regional rather than at the national level. In this conception it is already possible to discern, to some extent, the seeds of the problems which later plagued the first formal attempt of integration, since a scheme based on these grounds was bound to result in a very unequal distribution of benefits, following the different levels of progress of the various members in the process of import substitution.

The widespread acceptance of economic integration as the proper channel to continue the process of economic development led to the signature, in 1960, of the Montevideo

3.Asociación Latinoamericana de Integración (ALADI).

Treaty which established LAFTA.[4] Operationally, the agreement envisaged only the multilateral negotiation of regional tariff reductions and the elimination of other barriers limiting the volume of intra-trade. There were no provisions for the coordination of external commercial policy, and no rules were set up for the harmonization of internal policies.

LAFTA established a transition period of 12 years during which the member countries would gradually eliminate most of their mutual trade barriers following product-by-product negotiations. Two principles were supposed to serve as guidelines for the implementation of the agreement: the principle of reciprocity and the "most favored nation" clause. The reciprocity principle was a procedure designed to allow those members for which trade flows with the rest of the area did not increase or become largely unbalanced, to request compensation. The "most favored nation" clause is similar to the GATT principle, by which each member country should generalize to all the other members any tariff advantage granted to third countries (whether the third country is or is not a party to the agreement). However, in order to be consistent with the principle of reciprocity, member countries could grant to some other members tariff reductions not extensive to the rest, provided that the beneficiary was a country of a relatively lower level of economic development. This discriminatory rule could have avoided extensive trade diversion, but it was never clearly established which ones where the relatively less developed countries.[5]

The instrumentation of the Agreement was based on three mechanisms of negotiation: the national lists, the common lists, and the agreements for industrial cooperation. The national lists contained those products for which an individual member country agreed to reduce its tariff level by at least 8 percent after each round of negotiations. The common lists were to be negotiated every three years in a mutilateral forum and would include those commodities for which all the members collectively agree to fully eliminate all internal trade restrictions over the formative period of 12 years. The agreements for industrial cooperation were conceived as bilateral understandings between members of the region, leading to the coordination of their industrial policies with the objective to incentivate, in an ordered fashion, the production of commodities not yet subject

4.The Montevideo Treaty was signed by Argentina, Brazil, Chile, Mexico, Paraguay, Peru, and Uruguay. In 1961, Ecuador and Colombia added their signature. Venezuela joined LAFTA in 1966 and Bolivia in 1967.

5.In practice, however, Bolivia, Ecuador, Paraguay, and Uruguay were considered to belong to that group.

to intra-regional trade. These agreements would be mainly bilateral but any member could join through negotiations.

The expectation that LAFTA would lead toward the elimination of trade barriers in the region never actually materialized. It did not achieve even the short-term goal of establishing a free trade area by fully eliminating the tariffs on the common lists. The national lists were of little practical importance and their enactment all but stopped with the creation of the Andean Group in 1969. Only one single common list was approved in 1964 and it never became effective. After 1969, the focus of negotiations in LAFTA shifted from trade issues to the agreements for industrial cooperation. However, these agreements inculuded very few sectors, generally dominated by multinational corporations and mostly located in the three larger countries–Argentina, Brazil, and Mexico.

The standstill reached by LAFTA in 1969 and its decline thereafter are reflected in the percentage of negotiated commodity trade from total intra-regional trade. This percentage reaches a peak of 88.7 percent in 1964/66 and falls to 40 percent by the end of the 1970s.[6] This means that intra-regional imports not subject to LAFTA agreements grew faster than, and currently exceed, those which were negotiated, and some type of tariff reducton was reached. In addition, an even more striking fact is that imports subject to LAFTA agreement were no more than 6 percent of the total imports of the region from the rest of the world in 1979.

What are the main underlying reasons for the weaknesses of LAFTA ? The vulnerability of LAFTA could be traced to the very nature of the agreement which took a pure trade approach to integration. It did not include any concrete mechanism to guarantee the even distribution of the costs and benefits from the potential increase in trade flows, and there were no instruments for the planning of multilateral industrial investments adopting a regional rather than national scope. In addition, there were no provisions for the harmonizaiton of domestic monetary, fiscal, and exchange rate policies. Confronted with this situation, the smaller countries in LAFTA, which were interested in advancing beyond the pure trade approach, sponsored the creation of instruments which would use the integration process as a framework for the implementation of collective development initiatives. Thus, in 1964 a resolution was approved establishing formal mechanisms for the programming of regional investments. This decision was, however, never implemented.

This very partial approach to integration, an approach based on the expansion of the national markets in order to increase the flows of trade, directly reflects the

6.Trade is measured by imports.

predominant conception that regarded the process of integration simply as the continuation of the process of import substitution and not as a tool to further collective regional growth. But even within this narrow scope, LAFTA had quite a short and limited success. Tariff reductions applied mainly to commodities which were already subject to regional trade and, consequently, LAFTA only helped to consolidate traditional trade.

In practice, particularly after 1964, most of the attempts to further reduce or eliminate tariffs were frustrated by sectorial opposition. Progress took place only when the interests of one member country to capture the market of another did not affect any particular sector in that country. Although it is reasonable to anticipate that those industries which are losing protection would react negatively to any sort of trade liberalization, the nature of the integration process as envisaged in LAFTA did not necessarily have to lead to this type of confrontations. A negotiated mutual liberalization of trade could avoid the total elimination of the industries with higher costs if some sort of intra-industry specialization could be assured. This requires that each country should specialize, within each industry, in those varieties and qualities in which it has, or is likely to attain, a comparative advantage. Although a strong case for such specialization could be made, it is not simple to determine in isolation in which products each industry would have a comparative advantage in a regional context. In those circumstances, some degree of centralization in the establishment of the patterns of industrial specialization may be more conducive to the attainment of an efficient structure. As mentioned above, no mechanism for such centralization was created within the LAFTA framework.

Moreover, the Agreement did not provide for mechanisms designed specifically to deal with the issues arising from the creation of new industries as a response to the enlargement of the market. The geographical placement of new industries is a crucial factor for the determination of the trade effects of a union. To the extent that new regional industries produce commodities previously originating outside the union, there will be export gains for the new producers but a trade-diversion effect for the rest of the members, giving rise to opposite welfare costs. In those cases where LAFTA provided incentives to the creation of new industries, the location and structure of those industries were left to be determined by market forces, without any concrete attempt to overview the process. Since Argentina, Brazil, and Mexico were at a significantly higher degree of industrial development, free market forces would have led to a concentration of new industries in those countries. The deepening of the integration process within a scheme like LAFTA would have resulted in the reproduction, at the Latin American level, of the world pattern of trade, with the more advanced countries reaping most of the benefits of industrial development, and the rest of the members concentrating in the production and export of primary commodities. Such a model of integration was rejected by the smaller countries and was a central reason for the stalling of the process.

An additional major limitation of LAFTA was the total lack of harmonization of the members' domestic economic policies. Thus, exchange rate, fiscal, and monetary policies continued to be designed in each country without any coordination with the other members and without regard for the stated objective of increasing cooperation within the region. In addition, there were no attempts to collectively exploit possible externalities in the process of export promotion (like developing common marketing strategies, or exploiting common lines of credit). Moreover, since there was no agreement about a common policy regarding the treatment of foreign investment, LAFTA offered, in a number of areas, large profit opportunities for some foreign-owned firms which could take advantage of the larger market size by locating their operations in the countries with a more favorable treatment. This type of situation may result in distortions and trade diversion due to the relocation of industries from one country member to another for reasons which have little to do with underlying comparative advantages but, rather, with the different financial treatment of foreign investment.

2. The Common Market Model (The Andean Group)

The limitations and contradiction of interests within LAFTA paralyzed the process and convinced many members that a different type of integration model was required if, indeed, integration was going to play a pivotal role in achieving sustained development through trade. For that reason, the countries in the Andean region which felt a stronger need to expand their markets than the larger countries in the region, decided to follow a different, much more ambitious patten of integration. This led to the signature in 1969 of the Cartagena Accord which formally created the Andean Group.[7] With the intention of correcting the shortcomings of LAFTA, the Andean Group established the following mechanisms of operation :

(i) mutual trade liberalization within the subregion would be carefully planned at a global level ;

(ii) a common external tariff would be gradually established ;

7.The original signatories of the Accord were Bolivia, Chile, Colombia, Ecuador, and Peru. In 1973, Venezuela joined the agreement while in 1976 Chile decided to separate from the Group.

(iii) the problem of distribution of costs and benefits would be attended mainly by the implementation of regional investment programs;

(iv) there would be concrete attempts to harmonize domestic economic policies, starting with the treatment of foreign investment; and

(v) special treatment would be given to the two relatively less developed countries in the area, Bolivia and Ecuador, which would be allowed to implement the agreements at a slower pace.

In principle, the Andean Group looked much more promising than LAFTA since it was apparent that the members had less structural dissimilarities and less conflicts of interest. Moreover, in order to minimize frictions, the process of negotiation would be more global and automatic instead of item by item as in LAFTA. The project envisaged a specific horizon for the adoption of a common external tariff and faced immediately the task of planning the pattern of subregional industrial development. This two instruments proved, however, to be much more difficult to implement than originally thought, and soon became important stumbling blocks in the advancement of the Andean Group. In addition, other factors precluding sustained progress included the lack of compatibility of exchange rate policies of individual countries with the subregional liberalization policies and the absence of coordination of their export promotion strategies. Also, the issue of intra-region factor mobility was almost totally disregarded in the Cartagena Agreement.

Since the establishment of a common external tariff and the adoption of a subregional program of industrial planning were recognized as two of the basic innovative tools of the Andean Group, some detailed analysis of the problems involved in their implementation is in order. A central conclusion which can be reached is that, although both instruments are indeed appropriate means to deal with the issues of policy harmonization and distribution of costs and benefits, their actual implementation is a strenuous endeavor inasmuch as significant conflicts of interests remain between the accepted common objectives of the group and the basic development strategies of the individual countries. A corollary of the above is that a successful integration process requires not just an understanding regarding the harmonization of policies but also the elimination of major discrepancies among the members about their long-term development strategies. A compromise about this last issue seems to be a more important ingredient in the process than the actual implementation of specific policies.

As a case in point, the complications arising from the process of designing the common external tariff could be mentioned. The countries of the Andean Group agreed to establish a common external tariff by 1980 and, by the same time, the level of intra-regional tariffs should have been reduced to zero for a large number of commodities. This was not fully implemented, reflecting the basic conflicts of interest between members. A genuine adoption of the type of commercial policy envisaged by the Accord requires that countries surrender their autonomy regarding a number of policies, since the objective of increasing intra-regional trade would not be reached if exchange rate policies, indirect taxation, and nontariff barriers are not subject to coordination. This type of coordination is not easy to achieve.

The acceptance of a common trade policy carries, therfore, political and economic costs. The economic cost may be substantial if the volume of intra-regional trade was very low prior to establishing the tariff, since the common external tariff would certainly lead to significant trade diversion.[8] To be acceptable, this cost should be compensated for by the gaining of access to an enlarged export market. Since, within the Andean Group, the potential for expanding industrial exports was extremely different across countries, a serious distributive problem was bound to arise. Thus, the adoption of a common external tariff, together with the elimination of the internal barriers, may result in an intra-regional transfer of income of a magnitude which would depend on the level and the dispersion of the common tariff. The higher the common tariff, the higher the potential internal redistribution if the assumption is that the level of the tariff reflects the cost differential between the world price and the most efficient regional producer. Therefore, in the absence of a comprehensive compensation policy, the level and coverage of the common tariff would become a matter of serious contention. But the evaluation of the compensation size and the mechanism for its implementation are indeed a very difficult issue.

An additional source of difficulty regarding the common external tariff is the lack of consideration given within the Andean Group to the interrelationship between commercial and exchange rate policies. Clearly, the degrees of intra- and extra-regional competitiveness are jointly determined by the tariff and the exchange rate levels. When a country devalues its currency, it increases the level of protection granted by a given common tariff and the magnitude of its incentives for intra-regional exports. On the other hand, countries with an overvalued currency will need a higher common external tariff in order to preserve its internal market and to restrict external competition for its exports to other countries of the region. This source of conflict is exacerbated when countries in the

8.Assuming that there was some trade with the rest of the world in the commodities in question before the formation of the union.

region do not share the same outlook about the role of the external sector in the development process. Thus, in the discussions with in the Andean Group there were two opposite positions : Colombia (joined later by Bolivia and Peru) favored a lower external tariff, mainly for efficiency reasons and following its more export-oriented strategy and its policy of maintaining a realistic exchange rate for its manfacturing sector. Chile actually broke from the Group over its insistence, basically guided by free-trade ideology, that external barriers should be uniform and minimal. On the other hand, Venezuela insisted in a high common tariff in order to compensate for the large productivity gap between its petroleum sector, which determines its exchange rate, and the other sectors of the economy.

The second innovative element incorporated within the Andean Group is the important role given to industrial planning. The priority given to this elelment arises from the need to solve the location problem, one of the sources of inequity in the distribution of costs and benefits, and from the emphasis given within the Andean Group to the protectionist approach geared to the continuation of the import substitution process at a regional level. The purpose of industrial planning is to obviate the market process and directly determine the location of new industries. The objective is to maximize the benefits, for the Group as a whole, of the establishment of new industries aiming, at the same time, to achieve an equitable distribution of these benefits. It is clear that the two objectives may not be consistent since maximization of benefits should follow the pattern of intra-regional comparative advantage which may not satisfy regional equity considerations. In addition, the implementation of industrial planning is largely biased in favor of the producers and disregards the implied costs for the consumers and the distribution of these costs. If these costs are unevenly distributed, pressures to stall the plans are certain to mount.

The potential conflict between efficiency and distributive equity may certainly threaten the viability of industrial planning. A popular proposal to solve this problem has been the separation of location from ownership. New industries could be owned by multinational corporations formed by all the member countries, with the distribution of dividends linked to the level of benefits and to some agreed criteria for distributional equity.[9]

Two additional difficulties related to regional industrial planning are the delegation of authority to a multinational entity and the issue of labor mobility. Regarding the first porblem, the conflict is similar to the one arising in relation to the common external tariff. If the long-term development approaches of the member countries do not coincide,

9.See Schydlowsky (1978).

the sectorial priorities arising from the national development strategy may clash with those established by regional industrial planning. With respect to factor mobility, the issues of labor migrations and capital flows were never settled within the Andean Group. The presence of different levels of labor utilization and wages have some implications for the intergration process. One practical consequence is the fact that, without labor mobility, the divergence between the social and the private costs of labor tends to be different in each member country if employment levels are different and, as a consequence, the social costs of producing the same commodity differ, even if the private costs are equalized across countries. This creates additional tensions in the design of common policies since, for example, the equalization of social costs would require different external tariffs,[10] which is incompatible with the principles of a common market.

3. A Loose Arrangement Model (LAIA)

With the stagnation of LAFTA and with the complications faced by the more comprehensive arrangements established within the Andean Group, there was a feeling in Latin America that the formal framework of integration should be reshaped. Against this background, a new organizational structure, the Latin Integration American Association (LAIA), was created in 1980 to replace LAFTA. The new organization is a much looser framework, with a smaller scope than LAFTA. The two basic instruments of LAIA are negotiated partial agreements and regional tariff preferences. The partial agreements are bilateral tariff reductions containing a "convergency" clause which allows other members to negotiate their inclusion. The regional tariff preferences are limited reductions in the external tariff of each member, which apply to all the members of the Association. This is not a common lower tariff among all the member countries since each country maintains the level of its tariff with third countries but grants a specific preference to the other countries of the region. Therefore, members have preferential access, relative to the rest of the world, to other member markets, but intra-regional tariffs countinue to differ for the same commodities.

Thus, with the establishment of LAIA, the global program of regional liberalization which characterized LAFTA is substituted by a formal framework aimed at setting up an area of mostly *partial* economic preferences. Although it is apparent that this shift indicates a weaker commitment, especially of the non-Andean countries, to the idea of economic integration, in fact, it is a reflection of a more realistic and pragmatic

10. Because the equalization of social costs requires a differential between the private costs (and prices) of the various countries.

Table 1. Intra-Regional Exports as a Percentage of Total Exports, Latin America, 1962-1979/82

	1962	1965	1970	1975	1979	Most Recent Year
LAIA						
Argentina	13.0	16.8	21.0	25.9	26.3	20.3 1/
Brazil	6.4	12.8	11.6	15.6	17.1	15.0 1/
Chile	8.5	8.3	11.2	23.8	.....	24.7 2/
Mexico	5.0	8.2	10.4	12.6	6.7	.....
Paraguay	32.6	30.7	38.5	36.0	34.4	.....
Uruguay	.....	.....	12.6	28.8	40.2	28.7 3/
Andean Group						
Bolivia	4.1	2.7	8.5	35.0	31.5	.....
Colombia	5.5	11.1	13.5	20.8	17.9	20.7 1/
Ecuador	6.0	10.6	11.1	37.8	24.1	.....
Peru	9.6	9.4	6.4	16.9	21.3	15.6 1/
Venezuela	10.1	12.6	12.5	12.3	11.7	16.9 3/

Source: United Nations international trade tapes.
1/ 1982.
2/ 1980.
3/ 1981.

attitude. The trade negotiation process in LAIA takes a distinctive bilateral nature, particularly since the abandonment of the most-favored-nation clause, which was a centerpiece in LAFTA, makes the issue of generalizing preferences a nonbinding but a negotiated process. This facilitates the reaching of agreement between countries with some commonality of interests, which may not be shared by the rest of the countries of the area. This approach may have higher potential for increasing intra-regional trade flows, resulting in an environment more conducive to regional cooperation in other areas. Also, it is more likely that bilateral agreements will be reached by countries which already have trade relationships, increasing the potential for trade creation and reducing the risk of trade diversion.

Regarding the regional tariff preferences, they may be a source of contention. The reason is that by not adopting a unified tariff for intra-trade, the degree of access that each country is granting to the other members may very dramatically. If, for example, there is water in the tariff of country A while the tariff of country B is very low, the same margin of preference may still deny regional access to the market of A, while entry into B may be free for member countries. This is bound to create friction, which will limit the number of agreed tariff preferences.[11]

So far the actual performance of LAIA has not been better than that of its predecessors. In general terms, LAIA currently sells to countries within the region no more than 20 percent of its total exports, buying within the region a similar percentage of its total imports. Individual countries show quite a different picture as can be seen from Table 1. The table also shows that, following a substantial increase in the volume of intra-trade until the mid-1970s, there has been a reversal, with a particular downturn in the early 1980s. To stop this trend, the 1985 Annual Meeting of LAIA decided to adopt some new measures intended to increase the volume of trade within the region. The new measures are based on multilateral mechanisms for the reduction of nontariff barriers and a request to the public sector of each country to channel its own foreign trade toward the Latin American region. There is also an intention to intensify counter-trade and barter mechanisms which would reduce the need for the use of foreign exchange. The perspectives for success are, however, not better with the adoption of those mechanisms because the basic barriers to the integration effort have not been removed.

11.In addition, LAIA requests all members to eliminate nontariff restrictions for intra-regional trade. This has been implemented to a very limited extent.

Ⅲ. Recent Developments and the Outlook for Further Regional Cooperation

This section discusses the impact that recent global and regional developments may have on the process of intergration, and considers a number of options for intensifying other forms of regional cooperation.

A number of significant developments have taken place over the past decade and have affected the conditions, as well as the socio-political milieu, within which the process of integration evolved in Latin America. Among the most consequential are: (a) the differential impact on the region of the oil shocks and countershocks; (b) the adoption, in some of the countries of the region, of comprehensive trade liberalization programs; and (c) the eruption of the world financial crisis, centered on the very high volume of the Latin American foreign debt.

1. The Oil Shocks and Countershocks

The oil shocks of the 1970s as well as the sharp fall in oil prices after 1985 had a global effect on the Latin American economies, but it also had a marked differential impact in the various countries of the region. It is quite evident that the major global effects arise from the consequences on the industrial countries of the violent changes in the relative price of oil and the nature of the links that those countries maintain with the developing world. Following the oil shocks, many industrial countries experienced serious economic recessions which were propagated to the periphery, among other channels, through the downturn in the growth of international trade, with the consequent shrinkage in the export markets for LDCs, and the deterioration in the price of primary commodities. It is apparent that, in those circumstances, a deepening of the integration process could have served as a palliative and the process could have been strengthened from this development. On the other hand, the current renewal of the growth of industrial countries and the reduction in the oil-induced balance of payments burden of these countries could be seen as leading toward the weakening of the integration efforts, given the higher potential for extra-regional exports.

That these worldwide fluctuations in economic conditions have not had a clear impact on the integration efforts in Latin America could be, at least partially, explained by the differential incidence that the oil price changes had on the various countries of the area, depending on their relative position in the world oil market. Clearly, in the 1970s, oil exporters, particularly Venezuela and later Ecuador and Mexico, largely strengthened their external payment position while oil importers, like Brazil and most of the Central American countries, suffered a dramatic deterioration of their external balance. This change in internal distribution and in the value of the countries' endowments was instrumental in making less operative the set of common goals established by the standing integration frameworks. A clear expression of this new reality was the changing priorities of the members, evidenced by development strategies which became increasingly more divergent. A practical consequence of this situation was the adoption of domestic incentives and of exchange rate and fiscal policies geared toward the achievement of a new set of priorities, even if the characteristics of these policies were detrimental and inconsistent with the attainment of regional objectives and with the aims of the integration process.[12]

The substantial change in the relative price of energy had very serious consequences for the viability of some operational aspects of the integration agreements already established. The energy shock changed the pattern of internal comparative advantage, altering the considerations, particularly within the Andean Group, which were guiding the establishment of new industries. Furthermore, the changes in regional income distribution was bound to affect the distribution of gains and losses from the process, in general, and from industrial planning, in particular. Therefore, the need to reassess the criteria for reallocation of resources and for subregional specialization slowed down the process of integration in the late 1970s.

An additional negative impact on inter-regional trade relationships has arisen from the oil countershocks, that is, the sharp reductions in the nominal and relative prices of oil. The reason for this development is that some of the countries in the region, mainly Mexico and Venezuela, which largely expanded their trade following their terms of trade gains, are faced with strict external limitations which caused them to drastically reduce their imports, including those from the other countries of the region. From the ideological point of view, however, the oil countershocks may be seen as providing further support to the industrialization-cum-protection approach, since they prove that even countries with large supplies of what is considered a valuable natural resource are not immune to world fluctuations, which could be extremely damaging for their stability if they rely heavily on primary commodity exports.

12.It should be remembered that the first oil shock coincided with a commodity boom which improved the terms or trade of some other countries of the region reducing their perceived need for integration as a central piece of their development strategy.

2. Liberalization Policies

A second salient event taking place during the past decade was the adoption of comprehensive trade-liberalization programs in Latin America, particularly in the Southern Cone countries of the region (Argentina, Chile, and Uruguay). In general, the late 1970s witnessed a growing disposition in the region to turn away from protectionism and to allow free-trade mechanisms to play a more prevailing role. The stated purpose of the new trade policy was to open the economy to foreign competition by reducing and standardizing tariffs and other foreign-trade restrictions, and by relaxing the limitations to foreign investments and foreign credit. This policy marked the abandonment of import substitution, at least at the ideological level, and the adoption of a development strategy based on the gains from free trade.

The implementation of these policies had a number of consequences for the integration process. At the operational level, contradictions arose between the liberalization policies and the contractual obligations undertaken by some of the countries in the framework of the existing integration schemes. The most dramatic event in this context was the conflict between Chile and the Andean Group. In October 1976, tariff reforms, as well as a new liberal treatment of direct foreign investment, led Chile to abandon the Andean Group and to pursue independent trade and investment policies.[13]

In addition, the liberalization attempts coincided with a period of innovation, on the one hand, and of turbulence, on the other, in the foreign exchange market of many countries. Some of the adopted policies, like using the exchange rate as a counter-inflationary mechanism and preannouncing and lagging the rate of nominal devaluations, resulted in broad fluctuations in the value of the real exchange rate and in dramatic swings in the direction of intra-regional trade. This was motivated by profit opportunities constantly shifting across the borders. In addition to payment imbalances, such a situation created confusion and turmoil in the trade relations of the countries involved, disrupting regular commercial ties, and disturbing the conventional mechanisms which affect the nature of trade flows. This turn of events certainly had upsetting effects on the evolution of the integration process by weakening the concept of unified regional markets and by lowering the likelihood of attaining any sort of exchange rate policy coordination.

The most important manner by which the advent of liberalism to the region hindered the process of integration was at the doctrinally level, since it gave renewed impetus to the debate about the adequacy of the development model upon which integration

13.The source of the conflicts were both the opposition of Chile to the common external tariff and to the Andean Code regulating foreign investments.

was founded. The process of integration in Latin America was conceived as an essentially inward-looking process, an extension, within an enlarged setting, of the post-war pattern of development based on import substitution intended to preserve the domestic market for local producers.[14] The liberal approach was directed against the continuation of import substitution which was regarded as a source of distortions, inefficiencies, and misallocations. Liberalization, on the other hand, was promoted as an outward-looking approach designed to incentivate competition, efficiency, and modernization. As such, it was, in some sense, the antithesis of the view upon which integration was established since it advocates low and nondiscriminatory tariffs and more reliance on the free market mechanism for the allocation of resources.

The conflicting ideologies had a detrimental effect on the integration process by promoting, even in those quarters rejecting liberalization, a re-assessment of the integration policies. Here, once again, we can point to the same source of tension that was mentioned before : the main stumbling blocks to the process of integration are not the result of antagonistic interests about rather limited specific issues, but reflect fundamental divergencies of views regarding long-terms development strategies.

Despite these divisive events, the process itself did not suffer a fatal blow, largely due to the apparent failure of the liberalization attempt. For a diversity of largely country-specific reason, most of the countries were forced to abandon the reform packages which included commercial opening-up as a centerpiece. Although it can be argued that the type of free trade policies adopted were not the reason for the collapse of the programs (Blejer, 1983), it is evident that the demise of liberalization in the early 1980s reversed the trend against economic integration which was growing in the previous decade. The emerging negative attitude regarding liberalization was strengthened by the bad timing of the Southern Cone experience, which coincided with the intensification of protectionist tendencies in industrial countries. These tendencies reinforced parallel trends in the developing world and restored respectability to protectionist policies as a desirable option, thus re-establishing the ideological basis upon which the Latin American integration movement was established.

14.It could be mentioned in this context that this approach is not very different from the view taken by the European Common Market with respect to the agricultural sector. In fact, it could be argued that there is more merit to protecting industry in developing countries than to protecting agriculture in Europe, which could only look to a declining future. There is, therefore, no normative implication in the assertion here about the protectionist characteristics of the integration process in Latin America.

Table 2. Trade Balances, Selected Latin American Countries, 1980-1985(Cumulative, in billions of dollars)

	1980-82	1983-85
Argentina	2.1	12.5
Bolivia	0.9	0.6
Brazil	−0.8	32.0
Chile	−3.4	2.0
Colombia	−4.1	−2.3
Ecuador	0.6	3.0
Mexico	−1.4	34.3
Peru	−0.1	2.3
Uruguay	−1.0	0.6
Venezuela	18.8	24.4
10 major Latin American countries	11.5	109.3

Source: Morgan Guaranty Trust Company of New York, *World Financial Markets*, February 1986.

Table 3. Imports and Nontraditional Exports, Selected Latin American Countries, 1981-1985

	Nontraditional Exports (As a percent of total exports)		Imports in 1985 (Percent change from 1981-82 average)	
	1981–82	1985	Value	Volume
Argentina	30.0	37.0	–45.4	–43.4
Bolivia	5.0	–	–11.7	–8.5
Brazil	51.0	54.0	–36.4	–26.4
Chile	55.0	55.0	–42.1	–34.8
Colombia	52.0	53.0	–20.7	–22.6
Ecuador	6.0	5.0	–26.9	–26.1
Mexico	27.0	31.0	–29.1	–28.9
Peru	22.0	27.0	–46.8	–45.5
Uruguay	55.0	65.0	–41.1	–46.1
Venezuela	4.0	10.0	–48.7	–28.1
10 major Latin American countries	30.0	35.0	–36.9	–29.8

Source: See Table 2.

3. The Financial Crisis

The third global development which is affecting the integration process is the Four-year old financial crisis arising from the large foreign debt of the Latin American nations. The common economic denonimator acorss the region in the 1980s is the unprecedented stocks of foreign liabilities which have caused a drastic reduction in available foreign financing, and the need to curtail domestic expenditures in order to generate the trade surpluses which would allow to service the foreign debt. Although very impressive balance-of-trade surpluses have been registered since 1981 (see Table 2), a large portion of the surpluses are generated by import cuts and there are only few signs that nontraditional exports are expanding enough to play a significant role (Table 3). It is quite clear, therefore, that the adjustments have been trade-depressing, which can have a number of repercussions for intra-regional commercial relations.

In the first place, there is evidence that the contraction of intra-regional trade has been proportionally larger than the overall trade reductions. If this only represents reciprocal cuts on imports, it will certainly not result in foreign exchange savings for the region as a whole. On the other hand, the simple promotion of growth of intra-regional exports will also not, per se, generate additional hard currency to service the foreign debt. The claim that economic integration should be intensified as a response and as a solution to the foreign debt problem may be justified only if intra-regional exports substitute imports from outside the region. In such a case, foreign exchange is regionally saved, but this, by definition, implies trade diversion. Moreover, it is important to establish the source of those additional intra-regional exports. If there is a simple redirection of exports away from extra-regional destinations, no additional foreign exchange is gained. If, on the other hand, exports are produced drawing resources from the nontraded sector or, more important, if idle resources are utilized, there is a net gain of foreign exchange for the region as a whole. In the case of intersectoral factor mobility, the welfare cost of trade diversion still persists, but if intra-regional export growth generates employment, trade diversion has a very low social cost and there is a genuine gain for the region as a whole. In sum, the intensification of integration may play a role in the overall solution of the debt quagmire and help to activate the economy, only if it is export oriented and if it can mobilize unemployed capacity and resources without diverting those already engaged in extra-regional exports.

4. Options and the Outlook for Further Cooperation

It is possible to think about additional mechanisms which could promote regional cooperation in areas beyond the already established formal frameworks.

An area which deserves attention refers to intra-regional capital flows and to the integration of financial-markets. Intra-regional capital flows have been, in general, very unstable, reflecting the lack of well-organized capital markets.[15] Capital movements often represented trade credit or the financing of specific projects rather than the free flow of financial capital. The obstacles to the growth of regional capital flows have been of a different nature. In the first place. in Latin American countries as a whole, capital is a scarce resource and, therefore, the financial systems in these countries are designed to attract funding from outside the region rather than to facilitate the flow of capital within it. More important has been the widespread use of an exchange control system designed to alleviate balance of payments difficulties. This type of currency controls has tended to impede the internal flow of capital.

The actual volume of capital flows have been, however, infuenced by the development of intra-regional trade, given that it requires suppliers' credit and the strengthening of ties between the banking and the financial systms. Also, some of the formal integration framework, which resulted in the organization of subregional financial institutions functioning as clearing houses or as financial corporations, had some influence in increasing intra-regional capital flows.

Table 4 shows the total of intra-regional loans included in the external public debt of Latin American countries for the period 1970-82. The table shows an increase in the loans approved during the period, but the fluctuations are erratic and there is no clear trend. Clearly, the most important type of loans are official bilateral loans, followed by loans from financial institutions, and then by suppliers' credits. The official bilateral loans have been used merely to finance the export of basic commodities from some countries of the region, largely oil from Venezuela and Mexico.

It is important to stress, however, that the ratio of intra-regional debt to total external public debt is extremely low (never exceeding 6 percent), as can be seen from the figures in parentheses in Table 4. It is clear therefore that there is ample room for developing mechanisms to incentivate the intra-regional mobility of capital and, in the light of the current financial crisis, this could contribute to greater and more effective regional cooperation.

To attain this objective, it will be necessary to reach some degree of financial market integration. This is, however, one of the most advanced stages of cooperation, which usually takes the form of a monetary union involving the establishment of fixed

15.See IDB, 1984, Chapter Ⅲ.

Table 4. Intra-regional Loans Included in the External Public Debt, Latin America, 1970-82[1] (In millions of 1980 dollars)[2]

	Intra-regional Total	Supplier Credit	Loans by Financial Institutions [3]/	Official Bilateral Loans
1970	104.3	44.1	–	60.2
	(1.7)	(2.3)	(–)	(4.6)
1971	127.0	64.1	12.5	50.4
	(1.8)	(4.0)	(0.3)	(3.2)
1972	290.9	77.3	56.2	157.4
	(3.0)	(4.5)	(1.0)	(6.4)
1973	397.8	45.2	58.3	294.3
	(2.9)	(2.8)	(0.6)	(9.5)
1974	816.7	283.5	37.9	495.3
	(4.5)	(11.8)	(0.3)	(12.3)
1975	575.1	24.5	98.2	452.4
	(3.4)	(1.0)	(0.8)	(18.7)
1976	1,153.2	141.3	398.3	613.6
	(4.8)	(6.8)	(2.3)	(13.5)
1977	464.2	65.1	22.7	376.4
	(1.9)	(3.6)	(0.1)	(17.3)
1978	672.7	108.4	185.1	379.2
	(1.9)	(5.5)	(0.7)	(6.6)
1979	823.9	68.5	401.5	353.9
	(2.1)	(1.9)	(1.2)	(14.7)
1980	1,443.1	42.5	699.8	700.8
	(5.7)	(3.3)	(3.5)	(18.0)
1981	791.7	31.8	256.8	503.1
	(2.5)	(1.4)	(1.0)	(14.3)
1982	557.2	51.2	75.1	430.9
	(2.2)	(4.1)	(0.4)	(10.7)

(In parentheses: ratio of intra-regional loans to total external public debt.)

Source: IDB (1984).

1/ External public debt includes all debts guaranteed by the government of debtor countries with maturities of more than one year.

2/ The U.S. GDP deflator was used to convert original data into 1980 dollars.

3/ Except those financial institutions located in the Bahamas and in Panama.

exchange rates along with the harmonization of monetary and fiscal policies. This requires a high degree of policy synchronization and, in general, requires that a customs union be in place before a monetary union could be established. Moreover, it can be argued that the free movement of goods, services, and factors of production is a necessary pre-requisite for a successful monetary union.

Under these circumstances, it would be hard to foresee any type of monetary integration in the Latin American context, given the slow progress of the integration movement. This, however, should not preclude the pursuit of some type of coordination in the management of exchange rates and the promotion of cooperation agreements in the financial area.

It is perhaps interesting to mention in this context that, unlike in the commercial area, not too much effort has been devoted to the promotion of mutual understandings in the area of invisibles trade, in general, and of financial services, in particular. To some extent, goods entering world trade could be regarded as composite commodities, comprising the good itself and the variety of financial, informational, communications, and other types of services which took part in the process of transferring them from the producers to the foreign consumer. Many of these services, particularly in the financial area (such as insurance, banking, credit information, etc.), are increasingly becoming subject to international trade. For this reason, the determination of the pattern of comparative advantage may not be solely dependent on the relative costs of producing the commodities themselves but on the composite cost of bringing them to the world market.

Although it would be difficult to argue that developing countries have any type of obvious competitive hedge in the provision of financial and other trade-related services, it is likely that there are economies of scale in providing these services and, therefore, regional sharing and other cooperative agreements on this field may result in lower financial and other service costs throughout the region. This could lead to both an intensification of existing trade flows and a re-direction of trade from outside the region, arising from a more competitive position of member countries when a whole-inclusive measure of the cost of trading is considered. In other words, imports from inside the region may be cheaper than those from outside when financial and other service costs are included, if agreements reducing those costs for intra-regional trade are reached. Specific mechanisms of cooperation, which could lead to such a reduction in trade-related service costs, include the collective provision of insurance services, nondiscriminatory practices regarding commercial banks of other countries in the region, incentives for the operation of regional banks geared to the provision of trade services, the promotion of specialized credit lines, the pooling of marketing and advertising information, etc. Another potential area for increased cooperation in this context relates to financial market taxation. Differential taxation gives rise to abnormal patterns of capital flows which may distort trade patterns, particularly if they generate under–and over–invoice practices to avoid exchange controls.

Ⅳ. Some Concluding Remarks

The process of economic integration in Latin America was largely based on the "development approach" which relies on protection in order to enlarge the size of the market to attain economies of scale and gain dynamic benefits arising from increased productivity. In fact, most countries viewed the integration schemes merely as a channel for the continuation of the import-substitution process. They looked at the potential larger market as the way to overcome the limitations imposed by technology and by indivisibilities in plant size when import substitution is deepened beyond the final and the intermediate goods level.

It would be quite accurate to state that the main objectives of economic integration in Latin America have not been achieved. Although it is possible to point out a number of sources of the complications, it is the lack of convergency of the conceptions of the various countries regarding their long-term development strategies which have been indeed the most important stumbling block for the process. Countries find it difficult to relinquish, even partially, their national autonomy in favor of global considerations when there are very large discrepancies regarding the desired long-run path for the economy. It is, therefore, difficult to envisage a very successful integration process between countries with conflicting views about the social, political, and economic characteristics of economic growth. Moreover, even if the importance of policy harmonization within any integration framework cannot be overemphasized, from past experience it is possible to claim that the harmonization of policies is in fact a precondition for success and not an additional stage in the process. A feasible course of action is the encouragement of cooperation in many areas outside the formal frameworks of integration. Regional trade would tend to prosper if countries could provide a stable environment conducive to an intensification of mutual relations. The search for stability includes the affirmation and clarification of the rules to be observed in policies governing all types of regional relations. This is necessary if there is to be a reduction in the degree of uncertainty inhibiting those transactions and preventing related cross-country investments. A clarification of the rules that apply and a realistic appraisal of the costs and benefits are crucial elements to assure the progress in the process of regional cooperation.

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