

4. THE UNITED STATES AND THE ANDEAN COMMUNITY: PROSPECTS AND PROBLEMS AT THE END OF THE TWENTIETH CENTURY

*Gary Hufbauer and Barbara Kotschwar**

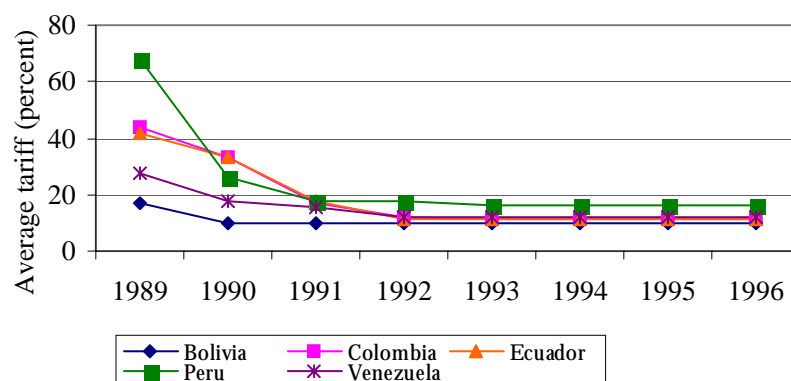
In this paper we assess the evolution of and future prospects for trade and investment relations between the United States and the countries of the Andean Community. The paper examines the patterns and composition of trade and investment flows between the United States and the Andean countries. The political economy aspects of the relationship are evaluated, and matters on the bilateral agenda, including conflicts that have marked the U.S.-Andean trade and investment relationship, are analyzed. Finally, we set out some thoughts on the future of the U.S.-Andean relationship.

THE ANDEAN COMMUNITY

The Andean Community is a trade and integration arrangement that links the economies of Bolivia, Colombia, Ecuador, Peru and Venezuela. This long-standing subregional trade arrangement – until recently known as the Andean Group -- has undergone several shifts in membership and a more profound shift in attitude since its inception in 1969, when Bolivia, Chile, Colombia, Ecuador, and Peru signed the Cartagena Agreement. Venezuela joined the Group in 1973, and Chile dropped out in 1976, leaving the current membership composition. Originally structured around the prevailing national policies of import-substitution industrialization, the Andean Group was formed to foster regional industrial development, and it did so by erecting high tariff walls against outside producers. The Andean Group also implemented one of the most restrictive investment regimes in the Latin American region. In recent years, the Andean Group has taken many steps to reform its formerly-protectionist structure and to implement a number of trade liberalizing measures, building upon the unilateral economic reforms undertaken by its member countries in the late 1980s and early 1990s.

Over the past decade, the individual Andean countries have substantially liberalized their respective economies, with large strides taken towards trade regime reform, effected through unilateral and subregional initiatives. In the late 1980s (Bolivia was the earliest reformer, beginning in late 1985), and into the 1990s, each of the Andean countries implemented an economic liberalization program, with a view to reigning in inflation and decreasing the debt burden, opening their trade regimes, deregulating exchange rates, and removing capital controls. All have undertaken some measure of privatization, and each country has taken unilateral steps to significantly decrease their barriers to international trade by simplifying tariff schedules, reducing border duties and lowering or eliminating nontariff barriers. Figure 4.1 shows the extent of tariff liberalization that has taken place in the Andean countries over the past few years.

* Gary Hufbauer is the Director of Studies and holds the Maurice R. Greenberg Chair at the Council on Foreign Relations. Barbara Kotschwar is a Senior Trade Specialist in the Trade Unit of the Organization of American States. The opinions expressed in this paper are solely those of the authors and do not reflect those of their respective organizations or the members thereof. The authors would like to thank Stephen Anthony for his invaluable assistance in the numerical analysis contained in the paper. They would also like to thank Patricia Correa, Donald Mackay, Miguel Rodriguez Mendoza and Jeffrey Schott for their helpful comments.

FIGURE 4.1. TARIFF REDUCTION IN THE ANDEAN COUNTRIES: 1989 TO 1996

Source: ALADI (1997)

The most dramatic example is Peru, which reduced its average unweighted tariff from a 1989 level of 67.8 percent to 16.3 percent in 1996. While quantification is impossible, parallel liberalization starting at a later date and continuing until 1993 or 1994 succeeded in lowering nontariff barriers.

While Figure 4.1 illustrates the point that tariff barriers have been effectively lowered in all of the Andean countries, and that the average tariffs of the individual countries are now much more alike than before, this figure also points to another, less encouraging trend. Since 1993 or 1994, the reform agenda has effectively slowed or stalled in most Andean countries. As pointed out by Sebastian Edwards in Chapter 2, while initial tariff reduction was indeed dramatic, little has happened since, and average tariff levels have languished between 8 and 16 percent. This is symptomatic of the reform slowdown, also apparent in other dimensions of external and internal policy.

The unilateral liberalization impetus was paralleled at the subregional level, with significant, although incomplete, measures toward regional integration. In the 1990s, the Andean Community has worked to consolidate its regional trade and integration arrangement. Tariffs and nontariff barriers have been eliminated among Bolivia, Colombia, Ecuador and Venezuela. Three members – Colombia, Ecuador and Venezuela -- have implemented, to a large extent, the common external tariff. Bolivia maintains its own two-tiered tariff, as does Peru. The Andean Community has a set of well-developed institutions, common policies in important areas such as investment and intellectual property rights, and is negotiating as a bloc with the Mercosur (to which Bolivia has already become an associate member). The Andean Community has also signaled its intention to negotiate jointly in the talks leading to Free Trade Area of the Americas (FTAA). However, continuing questions remain regarding the on-again-off-again membership status of Peru, and uncertainties linger about the larger role of the Andean Community as a unit. These cast doubt on the likelihood that the Andean Community will come to be viewed as a unit by U.S. policymakers.

Even when aggregated into a single unit, the Andean Community is a relatively small player on the international economic stage. With a combined GDP of \$222 billion or about 3 percent of the U.S. economy – the Andean Community's economic size is about that of the state of New Jersey. With a market of close to 100 million Andean consumers, the combined Andean Community population is one third that of the United States. Key figures are summarized in Table 4.1.

TABLE 4.1. SIZE OF THE ANDEAN COUNTRIES, 1995

	GDP (millions of dollars)	Population (millions)	GDP per capita (dollars)
Andean Community	222,245	99	2,057
Bolivia	7,574	7	1,022
Colombia	65,738	35	1,873
Ecuador	17,644	11	1,537
Peru	55,523	24	2,328
Venezuela	75,767	21	3,526

Source: IDB and IMF

U.S. ANDEAN POLICY

The United States is, and has historically been, of great economic importance to the Andean Community. It is the main export market for four of the Andean countries – Bolivia, Colombia, Ecuador and Venezuela – and is the second largest market for Peru, whose main trading partner is the European Union. Trade with the United States comprises 40 percent of the Andean Community's trade activity.

The Andean Community is less important economically to the United States than vice versa. In a ranking of U.S. export partners, the Andean Community as a whole falls behind Belgium-Luxembourg and Mexico. However, this regional grouping exceeds two continents --- Australia and Africa -- as a U.S. trading partner. Moreover, the Andean countries are important suppliers of two "strategic" commodities --- petroleum and narcotics. This gives the area a salience to the United States well beyond the magnitude of bilateral trade flows. As part of U.S. policy towards the region, Andean trade with the United States has been encouraged through the U.S. Andean Trade Preference Act (ATPA), a unilateral preference program that allows four of the five Andean Community countries preferential access to the U.S. market for a number of goods.

At this time, it would be incorrect to write of a U.S. trade policy vis-à-vis the Andean Community. While similar issues guide U.S. relations with each of the Andean countries an overarching U.S. Andean policy does not exist. Rather, U.S. policymakers deal with the countries on a bilateral, issue-by-issue, basis as dictated by the particular interests of the United States. This is demonstrated by the fact that not all of the Andean countries are able to tap into the benefits of the Andean Trade Preference Act.

U.S.-ANDEAN MERCHANDISE TRADE

Although not a particularly large market for U.S. goods, the Andean region is not insignificant to the U.S. economy. Venezuela, the largest economy of the group, is now the single largest supplier of petroleum to the United States, providing 17 percent of U.S. petroleum imports in 1996 (Table 4.2). Three of the five Andean Community countries are counted in the top fifteen suppliers of oil to the United States, contributing over 20 percent of U.S. oil needs in recent years. In 1996, Colombia was ahead of France, Chile and Argentina, as the seventh largest supplier of agricultural goods to the United States, and Ecuador was the 19th largest supplier, ahead of Spain and India.

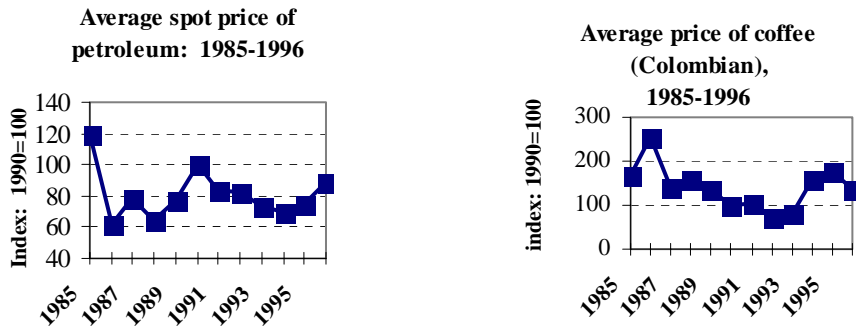
TABLE 4.2. TOP SUPPLIERS OF OIL TO THE UNITED STATES
(millions of dollars and percent of total)

	1990	1995	1996	% of World in 1996
WORLD	60,549	52,569	65,242	100.0
1 <i>Venezuela</i>	8,372	8,121	11,103	17.0
2 Canada	6,599	8,007	10,070	15.4
3 Saudi Arabia	9,822	7,686	8,169	12.5
4 Mexico	5,129	5,714	6,726	10.3
5 Nigeria	5,932	4,709	5,798	8.9
6 United Kingdom	2,071	2,764	2,815	4.3
7 Angola	194	2,226	2,678	4.1
8 Norway	840	1,654	2,214	3.4
9 <i>Colombia</i>	167	1,416	1,947	3.0
10 Gabon	691	1,426	1,916	2.9
11 Algeria	2356	1,544	1,826	2.8
12 Kuwait	545	1,284	1,611	2.5
13 Argentina	345	362	804	1.2
14 <i>Ecuador</i>	502	725	756	1.2
15 Aruba	0	407	549	0.8
TOP 20 SUPPLIERS	49,986	49,781	61,158	93.7

Source: U.S. Department of Commerce, *Foreign Trade Highlights 1997*.

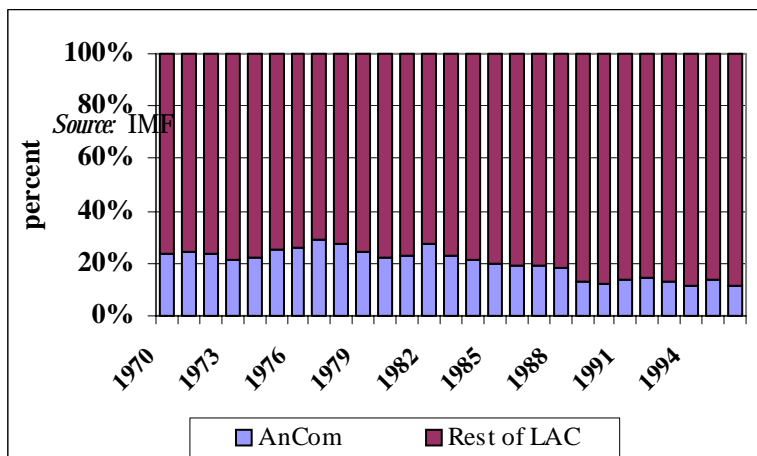
While U.S. imports of Andean goods show relatively robust trade growth over the past few years in certain commodities, it should be noted that the increase in the value of Andean exports to the United States in the first half of the 1990s was heavily influenced by the rising prices of petroleum and coffee (Figure 4.2), two important commodities for the Andean countries.

FIGURE 4.2. THE PRICE OF TRADE WITH THE ANDEAN COUNTRIES



Rising prices of these two commodities may not be an enduring feature over the next five years (though in ten years, oil prices could be significantly higher). In fact, Andean imports have declined in importance compared to other Latin American countries, as illustrated in Figure 4.3.

FIGURE 4.3. U.S. IMPORTS FROM LATIN AMERICA (percentage)



Source: IMF, *Direction of Trade Statistics*, 1997.

In the 1970s the United States purchased 31 percent of its Latin American/Caribbean goods from the Andean countries; by 1996 this proportion fell to 17 percent. During the 1990s, U.S. imports of Andean goods have grown by an average of only 6 percent, outperforming the Mercosur and South America as a whole, but underperforming Europe, Canada, Asia, Chile and Mexico (Table 4.3). In this case, it is clearly Mexico which is crowding out Andean suppliers (in share, if not in absolute terms): Mexico's share in U.S. imports from Latin America and the Caribbean rose from 47 percent to 60 percent in the six years since 1990.

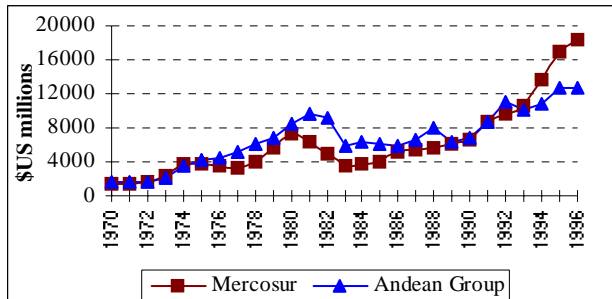
TABLE 4.3. U.S. IMPORTS FROM INDIVIDUAL COUNTRIES, 1990-96
(millions of dollars)

Country/Region	1990	1995	1996	average annual growth 1990 - 1996
WORLD	495,301	743,445	795,289	8%
<i>Andean Community</i>	15,029	15,046	21,091	6%
Mercosur	9,666	10,816	11,355	3%
Chile	1,313	1,931	2,262	9%
Mexico	30,157	62,101	74,297	16%
Canada	91,380	144,370	155,893	9%
WESTERN HEMISPHERE	155,250	248,930	279,721	10%
EUROPE	111,221	152,376	164,587	7%
ASIA	207,304	321,647	326,611	8%

Source: U.S. Department of Commerce, *Foreign Trade Highlights 1997*.

The Andean Community also figures as an export outlet for the United States. In 1996, Venezuela and Colombia were the 24th and 25th largest purchasers of U.S. manufactures, buying almost \$4 million each, and Colombia, Venezuela and Peru were the 20th, 26th and 29th largest purchasers of U.S. agricultural products, consuming a total of \$1.4 billion in U.S. agricultural goods.

FIGURE 4.4. U.S. EXPORTS TO THE ANDEAN COMMUNITY AND TO THE MERCOSUR, 1970-1996 (millions of dollars)



Source: IMF, *Direction of Trade Statistics*, 1997.

As shown in Figure 4.4, the pattern of U.S. exports to the Andean countries has been erratic. While there have been spurts of growth, especially in recent years, there have also been large lags, indicating that a sustained positive market opportunity has yet to be attained.

Exports from the United States to the Andean Community have expanded at an average rate of 11 percent per year between 1990 and 1996, a substantially higher rate of growth than U.S. exports to the world, which grew by 8 percent per year during the same time period (Table 4.4). However, the Andean Community has also declined in relative importance as a market for U.S. exports. In Figure 4.5, U.S. exports to the Andean Group are pitted against exports to the Mercosur, with the latter overtaking the former at a rapid pace in the mid-1990s. The export growth rate to the Andean Community was higher than to Europe, to Asia with the exception of China, and to Canada, but was lower than the growth rate to Mercosur, Chile or Mexico. In 1970 this group comprised 24 percent of total U.S. exports to the Latin American/Caribbean region, while in 1996 they accounted for only 12 percent, losing share to Mexico, Chile and the Mercosur.

TABLE 4.4. U.S. EXPORTS TO INDIVIDUAL COUNTRIES, 1990-96
(millions of dollars)

Country/Region	1990	1995	1996	average annual growth 1990 - 1996
World	393,592	584,742	625,075	8%
<i>Andean Community</i>	6,725	12,791	12,766	11%
Mercosur	6,678	17,016	18,616	19%
Chile	1,664	3,615	4,140	16%
Mexico	28,279	46,292	56,792	12%
Canada	83,674	127,226	134,210	8%
WESTERN HEMISPHERE	137,605	223,470	243,568	10%
EUROPE	117,271	140,564	148,810	4%
ASIA	120,270	197,402	207,328	10%

Source: U.S. Department of Commerce, *Foreign Trade Highlights 1997*.

Although the Andean share of U.S. trade has been declining, on both the import and the export side, there is no evidence that trade between the two regions is abnormally low. On the contrary, preliminary gravity model calculations indicate that U.S. trade with each of the Andean countries is larger than might be predicted on the basis of distance, GDP, population and other familiar variables (Table 4.5). Gravity models compare actual U.S. imports and exports from and to the countries with a 'natural' level of trade, according to factors including geography, distance and GNP levels. The table supports the notion that the United States is not "understating" trade with the Andean region.

TABLE 4.5. CGE ESTIMATES OF U.S.-ANDEAN TRADE: U.S.-ANDEAN TRADE, ACTUAL VS PREDICTED, 1995 (millions of dollars)

	Total U.S. trade			U.S. exports*			U.S. imports*		
	actual	predicted	difference	actual	predicted	difference	actual	predicted	difference
Bolivia	463	377	23%	213	235	-9%	249	131	90%
Colombia	8,620	4,333	99%	4,628	2,268	104%	3,992	1,528	161%
Ecuador	3,696	932	296%	1,538	563	173%	2,158	339	536%
Peru	2,867	2,214	30%	1,775	1,248	42%	1,092	833	31%
Venezuela	15,069	4,538	232%	4,641	2,343	98%	10,428	1,615	546%
Argentina	6,071	6,980	-13%	4,190	3,427	22%	1,881	2,662	-29%
Brazil	20,872	12,985	61%	11,444	6,267	83%	9,428	4,825	95%
Chile	5,810	2,226	161%	3,616	1,188	204%	2,197	830	165%
Mexico	108,157	35,244	207%	45,401	18,752	142%	62,756	13,547	363%

* using separate GNPs

Several factors could be at play that would explain this larger than 'natural' level of trade. Other Latin American countries listed in the table trade more heavily with the United States than the gravity model would predict, suggesting that the model may not entirely capture the "Western Hemisphere" effect (e.g. common second culture, common second language, etc.). Moreover, the results could be complicated by the Andean Trade Preference program, which allows preferential access to four of the Andean countries, and by the importance of oil in the Andean Community's export bundle.

Composition of merchandise trade

As seen in Tables 4.6 and 4.7, the U.S.-Andean trade picture is nearly a textbook illustration of comparative advantage. The Andean countries mainly ship primary products to the United States, from which they buy high value-added goods. U.S. imports from the Andean countries are concentrated in oil, mining, and agricultural products.

TABLE 4.6. ANDEAN EXPORTS TO THE UNITED STATES 1986 AND 1994
(as a percent of total exports to the United States)

Commodity Classification	(as percent of total)	
	1986	1994
(Harmonized tariff system)		
Live Animals & Animal Products	10	4
Vegetable Products	11	6
Coffee, Tea Mate' & Spices	25	4
Food, Fat, Beverages & Tobacco	6	2
Mineral Products	4	1
Coal & Oils	23	65
Chemicals	1	3
Plastics & Rubber	0	0
Hides & Skins	1	0
Wood, Pulp & Paper	2	1
Textiles, Clothing & Footwear	3	4
Stone, Cement, Asbestos, Glass, Ceramics	1	1
Precious Metals, Stones, Jewelry & Coins	2	3
Base Metals	10	5
Machinery & Mechanical Appliances	1	0
Planes, Ships, Trains & Parts	0	0
Motor Vehicles., Buses, Trucks & Parts	0	1
Precision Instruments	0	0
Arms & Ammunition	0	0
Miscellaneous	0	0

Source: Author's calculations based on IDB DATAINTAL data

TABLE 4.7. ANDEAN IMPORTS FROM THE UNITED STATES, 1986 AND 1994
(as a percent of total imports from the United States)

Commodity Classification (Harmonized tariff system)	(as percent of total)	
	1986	1994
Live Animals	1	1
Vegetable Products	8	1
Coffee, Tea Mate' & Spices	0	6
Food, Fat, Beverages & Tobacco	5	2
Mineral	1	1
Coal & Oils	2	2
Chemicals	16	14
Plastics & Rubber	5	6
Hides & Skins	0	0
Wood, Pulp & Paper	4	4
Textiles, Clothing & Footwear	3	3
Stone, Cement, Asbestos, Glass,	1	1
Precious Metals, Stones, Jewelry &	0	0
Base Metals	5	6
Machinery & Mechanical Appliances	33	36
Planes, Ships, Trains & Parts	2	4
Motor Vehicles, Buses, Trucks &	9	10
Precision Instruments	4	9
Arms & Ammunition	0	0
Miscellaneous	0	1

Source: Author's calculations based on IDB DATAINTAL data

In fact, the relationship between the Andean Community countries and the United States can be grouped into three major categories: the oil-exporting countries – mainly Venezuela and Colombia, but also Ecuador and Peru; metal producers - Bolivia and Peru, and to a lesser extent Ecuador and Colombia; and the coffee and food-supplying countries – Colombia, Peru, Ecuador and Bolivia. In exchange, the United States sells a basket of goods to the Andean countries which is concentrated in the manufacturing sector, mostly machinery, chemicals, and telecommunications equipment (Table 4.7).

A summary of the direction and composition of trade between the United States and the Andean region yields the following picture: First, while the trade relationship is not of an immense magnitude, the Andean countries are important suppliers of certain products, i.e. petroleum, to the United States. This gives the Andean region strategic importance as a commodity supplier. Second, the Andean region commands a declining share of U.S. trade with the Latin American and Caribbean region. However, the volume of trade is not understated – the countries are not trading at an unnaturally low level. Third, despite the economic reorientation away from the anti-exports policies of the 1960s and 1970s, the Andean countries have not successfully implemented the famous “export-led growth” model followed by many East Asian countries. This leads to the conclusion that, if their goal is to enhance the dynamism of this relationship, there are two shortfalls in Andean trade with their largest partner. First, there are not enough exports of manufactures and services. Second, exports are not growing enough.

TRADE DISPUTES

As in any continuing trade relationship, the United States and the Andean countries have had their share of trade irritants. Disputes have generally been conducted in a bilateral mode, but have recently moved into the multilateral arena. One Andean country, Venezuela, challenged the United States, in the first case heard by the World Trade Organization (WTO) dispute settlement body -- and won. Disputes between the individual Andean countries and the United States will not be examined in detail here, as they are covered in other chapters in this volume. Instead, we focus in this section on the issues that have caused the most friction in the Andean countries' bilateral trade relationship with the United States. These issues are largely shared by all

of the members of the Andean Community. We can generalize that the topics that clearly stand out are drugs and intellectual property protection.

Topping the list of U.S. concerns with regard to the Andean countries is, of course, the narcotics trade. Although not a part of the formal trade relationship, the flow of illegal drugs between the two regions is a prominent political and security issue that often lurks behind the scenes in the U.S. trade relationship with the Andean countries. The United States has implemented a policy of reviewing countries that are seen as drug producing and transshipment countries, and applying trade conditions to their performance in countering the narcotics trade. U.S. authorities have twice decertified Colombia, and Bolivia and Peru have been threatened with decertification. Venezuela, although not considered a dangerous drug territory, is increasingly recognized by the United States as a transshipment point, and has come under review in the past few years. Also high on the list of trade disputes is the issue of intellectual property rights. While intellectual property legislation is governed by the Andean regime on intellectual property rights (Decisions 344 and 351), the United States addresses this issue bilaterally, by including the issue in its bilateral investment negotiations with these countries and through the use of the "Special 301" tool.

As already indicated, no overarching policy exists to guide U.S. relations with the Andean countries. However, a general Andean policy can be extrapolated from the issues that are common to all, or to the majority, of the Andean countries. From these cases, an approach to the Andean community emerges: in its commercial relations with the Andean countries, the United States adopts an ad hoc policy comprised of one trade carrot and two sticks.

The trade carrot...

The Andean Trade Preference Act is a unilateral preferential trade program granted by the United States to Bolivia, Colombia, Ecuador and Peru. The ATPA allows expanded duty-free access to the U.S. market for goods from these countries for a period of ten years, beginning December 4, 1991, and lasting, under present law, until December 4, 2001. The stated goals of the program are to encourage alternatives to coca cultivation in these countries and to stimulate investment in nontraditional sectors to diversify the Andean countries' export base. The ATPA gives the beneficiary countries preferential rates of duty by eliminating the tariff on certain items, or by reducing the tariff below MFN rates. As seen in Table 4.8, the recipient countries vary as to their reliance on this program.

In 1995, the first year in which full use was made of the ATPA, 33 percent of Bolivia's exports to the United States were covered by the ATPA, while 22 percent of Peru's goods sold to the U.S. market were ATPA products. For Colombia and Ecuador, the program was less prominent: only 13 percent of Colombia's and 8 percent of Ecuador's goods entered under ATPA tariff lines. When these figures are calculated for non-oil imports from the Andean countries, the percentages rise somewhat: for Colombia, non-oil ATPA imports are now 20 percent of Colombian goods imported by the United States and for Ecuador the figure rises to 12 percent.

This carrot is, however, not very filling. First, not all Andean Community members are party to this program. Venezuela has been left out. Second, not all goods that are sold to the United States are covered. In fact, many of the excluded items are the Andean countries' top exports. Items which are not eligible for ATPA treatment include most textile and apparel items, certain categories of footwear, canned tuna, certain petroleum categories and products, certain watches and watch parts, certain sugar products, and rum (U.S.ITC, 1994).

TABLE 4.8. 1995 U.S. IMPORTS AND ATPA ITEMS AS PERCENT OF TOTAL IMPORTS

	HTS code	Description	millions of dollars and %
Bolivia	7113.19.10	Rope and chain for jewellery	
	7113.19.50	Jewelry and parts of precious metals (except silver)	
	7113.19.29	Gold necklaces and neck chains	
		Total of above products	74.8
		Total ATPA items	84.1
		ATPA as percent of total U.S. imports from Bolivia	33%
Colombia	0603.10.70	crysanthemums, carnations, anthuriums, orchids	
	0603.10.60	Roses, fresh	
	0603.10.80	Cut flowers and flower buds	
	0603.10.30	Miniature carnations, fresh	
	3921.12.12	Cellular plastic plates and sheets	
	1701.11.20	Raw sugar for production of polyhydric alcohols	
	4202.11.00	Leather trunks, suitcases, vanity cases, briefcases	
		Total of above products	381.0
		Total ATPA items	499.4
		ATPA as percent of total U.S. imports from Colombia	13%
		ATPA as percent of total U.S. non-oil imports	20%
Ecuador	1604.14.40	Tuna and skipjack, not in airtight containers	
	0603.10.60	Roses, fresh	
	0603.10.80	Cut flowers and flower buds	
	0302.69.40	Fresh or chilled fish	
	4421.90.98	Articles of wood, incl. pencil slats and others	
	2009.80.60	Fruit juices, incl. cherry, berry etc.	
		Total of above products	112.6
		Total ATPA items	148.0
		ATPA as percent of total U.S. imports from Ecuador	8%
		ATPA as percent of total U.S. non-oil imports	12%
Peru	7113.19.10	Rope and chain for jewelry, of precious metal	
	1701.11.10	Raw sugar not containing added flavoring or color	
	7113.19.21	Gold rope necklaces and chains	
	7402.00.00	Unrefined copper, copper anodes	
	7801.00.00	Refined lead, unwrought	
	7403.11.00	Cathodes and sections of cathodes of refined copper	
	7113.19.50	Jewelry and parts of precious metals (not silver)	
	0709.20.90	Asparagus, fresh or chilled, not entered Sept. 15 - Nov. 15	
		Total of above products	160.8
		Total ATPA items	207.7
		ATPA as percent of total U.S. imports from Peru	22%
		ATPA as percent of total U.S. non-oil imports	23%

Source: U.S. ITC and U.S. Department of Commerce data

The carrot is also not free. In keeping with the current trend in the U.S. Generalized System of Preferences (GSP) program, the ATPA is not an unconditional arrangement. In order to receive trade benefits, the countries must comply with certain requirements. ATPA countries are required, *inter alia*, to implement internationally recognized workers rights standards (as defined under the GSP conditions) and to provide effective protection of intellectual property rights, including effective copyrights for film and television material.

...and two sticks.

On certain issues the United States has employed persuasive measures, what we here call "trade sticks," to influence the Andean countries' policies. These sticks have been employed in rather varied issues: to bring Andean countries' national legislation on intellectual property regime into line with U.S. thinking, and to punish the countries which are seen as not doing enough on the drug front.

Stick 1: The issue of intellectual property rights enforcement is a matter of long-standing trade friction between the United States and its Andean trading partners. All five Andean Community members have been subject to review under the "Special 301" provisions of the Omnibus Trade and Competitiveness Act of 1988. Special 301 requires the USTR to review countries that are seen to have a history of violating existing laws and agreements governing intellectual property rights. If these countries are not found to improve their treatment of IPR, they are subject to mandated retaliation under Section 301 of the Trade Act

of 1974. Table 4.9 shows that all of the Andean countries have been placed on the watch list at least once, with Colombia and Venezuela occupying a place on this list since its inception in 1989.

TABLE 4.9. U.S. SPECIAL 301 ON INTELLECTUAL PROPERTY RIGHTS PROVISIONS

	Watch List	Priority Watch List
Bolivia	1996. Placed on watch in out-of season review.	
Colombia	1989-1997	
Ecuador	1992, 1993, 1996	1997
Peru	1992-1997	
Venezuela	1989-1997	

Source: USTR

Stick 2: The most contentious cause of friction between the United States and the Andean countries is the issue of narcotics trafficking. There are strong indications that narcotics exports may be a very large category of trade between these markets, but of course reliable statistics do not exist. U.S. policy is to carry out a yearly review of efforts to combat the drug trade in each producer country, with the threat of “decertification” if the country does not meet the standards of compliance set forth by the United States.

Within this process, the President of the United States has several possible courses of action. These are set out in Section 4.9 (b) (1) (A) of the Foreign Assistance Act of 1961 (as amended). One course is for the President to certify the country. Certification indicates that, in the eyes of the United States, that country is doing all it can do to counter narcotics trade. A certified country has cooperated fully with the U.S. agencies, or has taken adequate unilateral steps, to “achieve full compliance with the goals and objectives of the 1988 United Nations Convention Against Illicit Traffic in Narcotics Drugs and Psychotropic Substances.” A middle course is for the President to issue a certification with a national security waiver. This indicates that the country may not have fully cooperated, but it is deemed to be in the *vital national interest* of the United States to certify that country. This course carries a psychological threat, a warning signal to the country to step up its counternarcotics activities, but waives any retaliatory measures. The last course of action is to deny certification.

Decertification without a waiver has several implications. First, it carries a mandatory negative U.S. vote against lending to the target country by the multilateral development banks. It requires that 50 percent of certain kinds of U.S. assistance be withheld to the rejected country. The mandate also carries sanctions on other forms of U.S. foreign assistance, such as non-food assistance under Public Law 480, U.S. Export-Import Bank financing, as well as most other foreign assistance with the exception of certain humanitarian and counter-narcotics assistance. U.S. companies seeking to do business in a country that has been decertified are denied access to Overseas Private Investment Corporation (OPIC) programs. The President also has the option of imposing trade sanctions on the country in question.

In the 1990s, all of the members of the Andean Community have been classified by the United States as “major drug producing and/or major drug transit countries” and accordingly have been subject to this review process. As shown in Table 4.10, Bolivia and Peru have both been twice granted a national security waiver. The most serious case is that of Colombia, which was once granted a national security waiver and has twice been decertified by the United States.

TABLE 4.10. RECORD OF U.S. CERTIFICATION OF THE ANDEAN COUNTRIES, 1987-97

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Bolivia	C	C	CE	CE	CE	CE	CE	NIC	NIC	CE	CE
Colombia	C	CE	CE	CE	CE	CE	CE	CE	NIC	D	D
Ecuador	C	C	CE	CE	CE	CE	CE	CE	CE	CE	CE
Peru	C	C	CE	CE	CE	CE	CE	NIC	NIC	CE	CE
Venezuela						CE	CE	CE	CE	CE	CE

C = Certify; CE = Certify with Explanation (replaces C as of 1989) NIC = Certify due to National Interest; D = Deny certification
 Source: U.S. Department of State

U.S. FDI IN THE ANDEAN COUNTRIES

The United States is an important source of direct investment capital for the Andean countries. As seen in Table 4.12, the United States is the largest source of foreign direct investment (FDI) for four of the five Andean countries, supplying over fifty percent of Bolivia, Colombia, and Ecuador's foreign capital stock. In Peru, the European Union remains the largest investor, with U.S. investment comprising only 17 percent of Peru's FDI stock.

TABLE 4.11. DISTRIBUTION OF FDI STOCK IN THE ANDEAN COUNTRIES, 1994.

	USA	Canada	Japan	EU	LAC	Other
Bolivia	66%	5%	1%	10%	12%	7%
Colombia	58%	2%	2%	14%	7%	18%
Ecuador	63%	0%	1%	15%	5%	16%
Peru	17%	2%	1%	63%	6%	12%
Venezuela	49%	2%	3%	24%	1%	21%

Source: IDB/IRELA.

As was the case in merchandise trade, the Andean Group has declined, in relative terms, as a recipient of U.S. foreign direct investment in Latin America and the Caribbean. While the U.S. stock of FDI in the Andean region has grown, on average, by almost 20 percent per year, the stock of U.S. FDI in the Andean region as a proportion of total U.S. investment in the region has declined, falling from 20 percent in 1985 to only 8 percent in 1995, as U.S. firms began to divest themselves of many assets in the Andean region (Table 4.12). In fact, South America as a whole has declined in importance for U.S. foreign direct investment, as many multinational firms have shifted their emphasis to Asia. Portfolio investment (bank loans, bonds, publicly traded shares, privately placed equity), may give a different picture, but we could not assemble reliable data for the Andean countries.

TABLE 4.12. U.S. DIRECT INVESTMENT IN THE ANDEAN COUNTRIES, 1985-95 (millions of dollars and percent)

	1985	1990	1995
Total U.S. FDI	230250	430521	711621
Latin America/Caribbean as a percent of total U.S. FDI	28,261 12%	71,413 17%	122,765 17%
Mexico as a percent of U.S. FDI in LA/C	5,088 18%	10,313 14%	14,037 11%
South America as a percent of U.S. FDI in LA/C	17,623 62%	22,933 32%	46,970 38%
<i>Andean Community</i> as a percent of U.S. FDI in LA/C	<i>5,556</i> <i>20%</i>	<i>3,839</i> <i>5%</i>	<i>9,211</i> <i>8%</i>
Mercosur as a percent of U.S. FDI in LA/C	11,723 41%	17,054 24%	31,990 26%
Chile as a percent of U.S. FDI in LA/C	88 0%	1,896 3%	5,510 4%

Source: U.S. Department of Commerce, *Survey of Current Business*, various issues.

U.S. investment in the Andean region is concentrated in the petroleum and manufacturing sectors, as shown in Table 4.13. The two largest recipients of U.S. investment are Colombia and Venezuela. In Colombia, investment was concentrated in the manufacturing sector until the early 1990s, when investment started to shift to mining (especially coal, which is not separately shown in this table) and petroleum sectors. In Venezuela, FDI flows rose markedly in 1991 due to the substantial participation by a consortium of U.S. companies in the privatization program --- mostly concentrated in the telecom, transportation and energy sectors. After 1991, inflows have been lower.

Please insert Table 4.13 from file p2c4a.doc here.

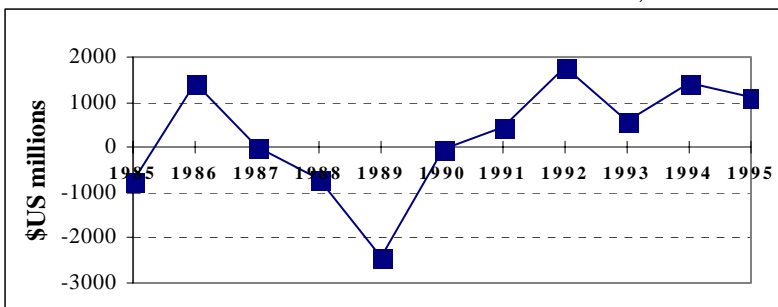
In the Andean region, the small “c” investment climate – which is determined by the policies towards foreign investment -- is generally good, if not outstanding. In the 1990s, the Andean investment regime became much friendlier towards foreign investors: Andean Group Decision 291, which repealed Decision 24, greatly improved the formerly restrictive investment climate. The new investment regime, for the Community as a whole, is oriented toward investment promotion, granting national treatment, removing most restrictions on capital and profit remittances and eliminating reservations in many sectors. National measures have also been undertaken to enhance the profile of individual countries vis-à-vis foreign investors. For example, Colombia recently significantly reformed its investment conditions in the financial sector, granting greater flexibility in operational terms, strengthening oversight and control mechanisms, and allowing foreigners to hold any portion of financial institution capital. The current regime virtually ensures national

treatment for foreign investors. Bolivia’s capitalization plan offers greatly increased participation for outside investors, and Venezuela is taking major steps to increase foreign participation in the powerful oil sector.

U.S. FDI flows to the Andean Community are shown in Figure 4.5. The recovery in investment in the 1990s reflects the economic recovery and liberalization efforts within these countries, as the somewhat sluggish conditions in most of the industrialized countries during the early 1990s which led firms to look to Latin America for more profitable returns, and the privatization opportunities which arose in the 1990s, as the Andean countries furthered their economic liberalization policies.

While many Latin American assets had already been privatized by the early 1990s, a few large transactions in the Andean countries sparked the jumps in investment flows seen in Figure 4.5. The Venezuelan privatization program, initiated in 1990, saw its greatest activity in 1991, when U.S. GTE Corporation led a consortium which purchased a large tranche of Venezuela’s CANTV, for approximately \$1.9 billion. The following year, a major government-owned airline, VIASA, was sold for \$145 million. Venezuela’s privatization program stalled after 1992 until the opening of the petroleum sector in late 1995. In Colombia, where the state role has traditionally been more modest, revenues from privatization have been small and do not account for the majority of the FDI flows. Peru’s privatization efforts picked up in 1994, with the sale in that year of shares of two telecommunications companies, CPT and Endelperu– along with the divestiture of assets in the energy and mining sector. In the smaller countries, privatization has come later. However, investment in Bolivia has picked up since President Sanchez de Losada’s capitalization program was implemented in 1994, capitalizing first the power sector then the telecommunications, airline and railway industries.

FIGURE 4.5. U.S. FDI FLOWS TO THE ANDEAN COMMUNITY, 1985-1995



Source: U.S. Department of Commerce, *Survey of Current Business*, various issues.

While the investment climate in the Andean region has improved in the 1990s – due to measures taken domestically in each of the member countries to attract foreign investment and as a result of the repeal of Andean Decision 24, investors continue to face many difficulties investing in the Andean countries. Reports of kidnappings, destruction of assets by guerrilla groups, and reports of corruption inspired both by political forces and the narcotics trade, may dissuade long-term investors from setting up shop. Infrastructure problems remain, especially in the smaller countries.

However, the big “C” climate --- the aggregate infrastructure, access to resources, risk factors, and institutional environment in which investors must operate -- still requires a lot of work. Work remains to be done in terms of both “soft” and “hard” infrastructure. Soft infrastructure refers to the institutional reforms

necessary to gain and maintain investor confidence. Legal reforms and reform of the judicial system, with a view to creating a fair and transparent environment are key. Hard infrastructure is the roads, electricity, communications equipment that enables companies to function efficiently.

CONCLUSIONS

While the Andean market is, in number terms, of little consequence to the United States, the Andean countries have a compelling economic incentive to maintain – indeed to expand – their access to the U.S. market. In order to bolster their exports --- especially of higher-value-added goods -- to the United States and to attract more U.S. investment, countries should resume their unilateral liberalization activities, and not languish in the hope that enough reform has been done. The Andean countries should focus on improving their infrastructure – both hard and soft – and continue to make their investment climates more user-friendly. If the FTAA really rises to the top of the agenda in the next few years, the Andean countries should use these negotiations as a means to enhance their liberalization efforts, to consolidate the Andean Community regime in relevant areas, and to engage in constructive dialogue with their large partner, in a forum where trade issues are the focus. The Andean countries should take the lead and push hard for the FTAA --- and try to beat the 2005 deadline.

The United States also has compelling reasons to maintain a constructive relationship with the Andean Community: oil and the real need to address the issue of drugs, whose sinister consequences profoundly affect the economies of both regions. Thus, Andean Community and U.S. policymakers share compelling objectives in the Andean region. These include the elimination of narcotics trade, a cessation of the guerrilla activities that threaten both domestic stability and impair investment opportunities, as well as the development of more constructive relations in areas such as intellectual property rights.

At the moment, there is no reason to predict a change in U.S. policy towards the region. U.S. policies towards the region and towards each country in the region will likely continue to be determined more by politics than economics. Given this assumption, three scenarios are possible. We recommend the third, but as a forecasting matter we see the second as the most likely.

The first scenario – which we will call the passive approach --- sees the United States turning even further away from the Andean countries, indeed from Latin America in general, as a matter of policy importance. Given the difficulties of passing fast track, and the unpopularity of any foreign trade initiatives in the U.S. Congress at this time, coupled with the elections that will take place in several of the larger Andean countries in the next year or two, the United States could adopt a wait-and-see attitude with respect to the Andean countries. This track would follow the prescriptions of those who advocate abandoning or diminishing the use of decertification as a tool for obtaining compliance with U.S. antinarcotics efforts, leaving the drugs issue in the hands of the DEA. In this scenario, the sticks are used less frequently – but it is not expected that any additional carrots would be forthcoming. While this track would moderate the possibility of triggering internal crises, it may also serve to further distance U.S. policymakers – and, in turn, U.S. business interests --- from the Andean region.

The second scenario, which we will call the “tough love” track, envisages a hardening of the U.S. stance toward the region. The United States would increase its strong-handed approach and bold rhetoric in dealing with the targeted problem areas in the relationship. U.S. agencies active in the area – particularly the Department of Justice and the USTR – would step up their efforts to force countries to comply with their demands. The United States will continue to push on the drug issues, using the decertification tool to further pressure governments. USTR would continue to push for individual countries to reform their intellectual property rights legislation, and would pressure for further opening of the Andean markets. All these measures would be taken to trigger “constructive crises” in the target countries. This pressure could lead to internal pressure in terms of narco/guerrilla/political internecine warfare, backlash from IPR profiteers, uprising of unions and other beneficiaries of closed markets. The strong use of sticks could be countered by some additional ATPA rewards for complying countries.

A third and more constructive scenario for the United States would involve a “double track” strategy. The areas in which the Andean Community has jurisdiction – areas such as market access, investment, and intellectual property rights – should be addressed on a regional, as well as a national basis, much as was done

with regard to the European Community in the early days of its formation. This would allow for a coordinated approach to a variety of economic issues, and would avoid the problem of double competence. For drug issues, the “tough love” approach could be applied to individual countries --- in moderation. In our view, the better U.S. diplomacy would carefully ration doses of toughness, and build constructive economic relations with the Andean countries in economic areas.

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