5. THE SALIENCE OF THE VARIOUS EXTERNAL MARKETS FOR THE ANDEAN COUNTRIES

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The most important market for merchandise exports from Andean Community countries, both overall and for manufactured goods, is NAFTA, particularly the United States. However, there is no uniformity of trade interests among the individual Andean Community countries. The northernmost countries, Colombia and Venezuela, rely more heavily on the U.S. market, as does Ecuador, than do Peru and Bolivia. For this reason, Andean Community countries have a big stake in bringing the Free Trade Area of the Americas to fruition. In addition, if the countries wish to negotiate as a bloc, the FTAA offers the best prospects for doing this because it permits each of the member countries to improve access to its main hemispheric markets.

The Andean Community was one of the early economic integration efforts in the Western Hemisphere. Following many lean years after its formation as the Andean Pact in 1969, it has demonstrated considerable effervescence in the 1990s. However, the Community as a whole and its individual members are still groping about next steps, particularly about expansion of free trade with other integration groupings. Bolivia already has thrown its lot in with Mercosur; Peru is weighing the wisdom of free trade with both Mercosur and eventually NAFTA; Colombia and Venezuela, unable to arouse much interest for some arrangement with the United States, are considering what their links should be with Mercosur.

The most expansive arrangement for widening the Community's free trade access in the hemisphere is the proposed Free Trade Area of the Americas (FTAA). This would not necessarily be exclusive of entry into other subregional groupings, but would be the most comprehensive. It is not surprising, therefore, that each of the five countries of the Andean Community is an active participant in the FTAA process.

The purpose of this essay is to analyze the trade interests of each of the countries to facilitate the necessary decision-making. The impulse for seeking economic integration with other countries comes from more than trade, but the main motive surely is to increase the trade flows of each member of the Andean Community. The desire to attract productive investment, foreign and domestic, is to a great extent, part and parcel of the trade motive. There are also foreign policy considerations for the choice of integration partners, but these will not be taken up in this discussion. One of the remarkable aspects of the durability of the Andean Community, and of its recent progress, is that this has been accomplished despite political antagonisms that have arisen between some of its members -- Peru and Ecuador, and Colombia and Venezuela, to name two such instances. The impulse for economic integration is clearly strong enough to overcome political impediments.

The following sections will provide trade data for each of the Andean Community countries in order to set the stage for the policy discussion that follows and the conclusions that will be presented in the final section.

OVERVIEW OF TRADE RELATIONS

The tables that follow show the destination of exports of each of the countries of the Andean Community. Total exports to all destinations had stagnated during the early 1990s --- and started to rise significantly only in 1994. Intra-Andean exports started to rise earlier and grew considerably more in percentage terms than extra-Andean exports

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every year from 1991 through 1995. Indeed, this intra-Andean trade was the success story of the Andean Community integration process during the first half of the 1990s, at least until 1996, when it stagnated (Iglesias, 1997).

Table 5.1 shows the total exports of each of the countries of the Andean Community as well as the Andean Community as a whole for 1994. The year 1994 was chosen because it permitted setting forth a detailed breakdown of exports under the Harmonized Tariff System. Data for 1995 were also examined to determine if the picture presented in 1994 continued -- and it did.

TABLE 5.1. ANDEAN COMMUNITY EXPORTS TO VARIOUS REGIONS, 1994
(millions of dollars)

	Bolivia	**Colombia**	**Ecuador**	**Peru**	**Venezuela**	**Total**
Andean Community	*195*	*1,110*	*386*	*310*	*1,426*	*3,427*
NAFTA	315	3,092	1,641	978	8,668	14,694
Mexico	13	108	76	151	249	598
Mercosur	184	131	77	209	614	1,214
Other Latin America	19	715	343	149	3,718	4,944
European Union	289	2,367	661	1,383	1,448	6,148
Japan	2	357	69	383	284	1,095
Other Asia	8	139	332	673	79	1,232
Rest of World	19	493	216	276	492	1,496
World Total	1,031	8,403	3,725	4,361	16,730	34,250

Source: DATAINTAL, with calculations by the Trade Unit of the Organization of American States and the author.

Two other features of Andean Community exports shown in Table 5.2 which merit emphasis are the importance of the NAFTA market -really the U.S. market- as an export destination; and the different market emphases of the northern tier countries, particularly Colombia and Venezuela but also including Ecuador, from those further south, namely Peru and Bolivia.

For the Andean Community as a whole, NAFTA was the destination for 43 percent of exports; for Bolivia and Peru, NAFTA took only 24 percent of exports (31 percent for Bolivia and 22 percent for Peru). Geography does make a major difference. So, of course, does the nature of the exports, as will be brought out when discussing the subsequent tables. Table 5.2 shows the destination of merchandise exports of the different Andean Community countries in percentage terms. This brings out the point made above about the different direction of exports of countries that are further north and those more to the south.

TABLE 5.2. ANDEAN COMMUNITY EXPORTS TO VARIOUS REGIONS, 1994 (percent)

	Bolivia	**Colombia**	**Ecuador**	**Peru**	**Venezuela**	**Total**
Andean Community	*19*	*13*	*10*	*7*	*9*	*10*
NAFTA	31	37	44	22	52	43
Mexico	1	1	2	3	1	2
Mercosur	18	2	2	5	4	4
Other Latin America	2	9	9	3	22	14
European Union	28	28	18	32	9	18
Japan	0	4	2	9	2	3
Other Asia	1	2	9	15	0	4
Rest of World	2	6	6	6	3	4
World Total	100	100	100	100	100	100

Source: DATAINTAL, with calculations by the Trade Unit of the Organization of American States and the author.

Table 5.3 shows the trade data in a different format, namely, how much each of the Andean Community countries constitutes of the total exports to each destination. The two large Andean Community exporting countries are Venezuela and Colombia, and the exports of the other three tail off after that. The dominance of NAFTA is largely the consequence of the large Venezuelan and Colombian exports to that market. Even though less than four percent of Venezuela's exports went to Mercosur countries in 1994, this constituted 51 percent of the entire Andean Community exports to that destination.

TABLE 5.3. CONTRIBUTION OF EACH COUNTRY TO ANDEAN COMMUNITY'S REGIONAL EXPORTS, 1994 (percent)

	Bolivia	**Colombia**	**Ecuador**	**Peru**	**Venezuela**	**Total**
Andean Community	*6*	*32*	*11*	*9*	*6*	*10*
NAFTA	2	21	11	7	59	43
Mexico	2	18	13	25	42	2
Mercosur	15	11	6	17	51	4
Other Latin America	0	14	7	3	75	14
European Union	5	38	11	22	24	18
Japan	0	33	6	35	26	3
Other Asia	1	11	27	55	6	4
Rest of World	1	33	14	18	33	4
World Total	3	25	11	13	49	100

Source: DATAINTAL, with calculations by the Trade Unit of the Organization of American States and the author.

TABLE 5.4. MERCHANDISE EXPORTS OF ANDEAN COMMUNITY BY RAW MATERIALS AND MANUFACTURES, 1994 (millions of dollars)

	Bolivia		Colombia		Ecuador		Peru		Venezuela		Total	
	MF	**Raw**	**MF**	**Raw**	**MF**	**Raw**	**MF**	**Raw**	**MF**	**Raw**	**MF**	**Raw**
Andean	87	108	849	261	225	161	247	63	1,032	394	2,440	988
NAFTA	101	214	725	2,367	118	1,523	485	493	1,073	7,596	2,501	12,193
Mexico	0	12	81	27	9	68	60	91	200	50	350	248
Mercosur	22	162	73	58	26	51	110	100	63	550	294	921
Other LAC	8	11	343	371	33	310	90	59	325	3,393	800	4,144
EU	14	275	354	2,012	84	577	709	674	196	1,252	1,357	4,791
Japan	0	1	36	321	14	55	206	177	250	33	507	588
Other Asia	0	8	36	103	3	329	496	177	38	42	573	658
ROW	2	17	58	435	57	159	128	149	55	437	300	1,196
World Total	235	796	2,474	5,930	560	3,165	2,470	1,891	3,034	13,697	8,772	25,479

MF=Manufactures; Raw = Raw materials

Source: DATAINTAL, with calculations by the Trade Unit of the Organization of American States and the author.

Table 5.4 shows the breakdown of each Andean Community country's exports by manufactures and raw materials for each destination. For the Community as a whole, manufactured goods made up a little more than 25 percent of the total in 1994. Three countries --Venezuela, Peru, and Colombia-- in that order, contributed 91 percent of the total.[1] Bolivia and Ecuador export mostly raw materials; this shows up particularly clearly for each country's exports to the EU and to a great extent for Bolivia's exports to Mercosur. The data on Peru deserve special comment. Table 5.4 shows that 57 percent of Peru's exports are manufactured products, a particularly high figure. However, this includes section XV of the harmonized system, or mining products, and these are included as manufactures when processed beyond the ore stage. Section XV exports from Peru made up 40 percent of the country's manufactured exports ($990 million out of $2,470 million). In other words, the proportion of manufactured exports from Peru is overstated when one thinks in terms of high value-added merchandise.

Finally, Table 5.5 pulls out in percentage terms the destination of each Andean Community country's manufactured exports. This is done in order to highlight the relative order of markets for higher value-added products. What comes through clearly in this table is the dominance of the Andean and the NAFTA markets -- of the United States -- for manufactured exports from the Andean Community. Peru is the exception in that the EU market is more important for its manufactured exports than either the Andean or NAFTA destinations. Copper explains much of this anomaly. Peru may be the least integrated of the five Andean Community countries in high value-added intra-Andean Community trade.

[1]These percentages were derived from data presented in the Harmonized System format. They are consistent with data in the Inter-American Development Bank (1997, p. 7) calculated using the Standard International Trade Classification.

TABLE 5.5. DESTINATION OF MANUFACTURED EXPORTS, 1994 (percent)

	Bolivia	Colombia	Ecuador	Peru	Venezuela	Total
Andean Community	37	34	40	10	34	28
NAFTA	43	29	21	20	35	29
Mexico	0	3	2	2	5	7
Mercosur	9	3	5	4	2	3
Other Latin	3	14	6	4	11	9
EU	6	14	15	29	6	15
Japan	0	1	3	8	8	6
Other Asia	0	1	1	20	1	7
Rest of World	1	2	10	5	2	3
World Total	100	100	100	100	100	100

Source: DATAINTAL, with calculations by the Trade Unit of the Organization of American States and the author. Note: Table may not be exact because of rounding.

SOME IMPLICATIONS OF THE TRADE FACTS

The most important issue that arises for the Andean Community as a whole, and for the individual member countries, is the choice or choices that must be made for further economic integration. This issue is complicated by the different interests of the member countries; and this, in turn, raises the question of whether the Andean Community should necessarily negotiate as a bloc.

Integration Widening

The only option now on the table that satisfies all these considerations is the FTAA because it would lead to free trade with all the countries of the Hemisphere and obviate the need for the individual Andean Community countries to choose between different partners. While Bolivia already has cast its lot with Mercosur, even as it pursues the wider option of FTAA membership, the other Andean Community countries are still pondering their action. Mercosur is not Bolivia's most important market - NAFTA and the European Union were more important in 1994 - but the potential for future Bolivian exports to Mercosur is promising.

This is not so for Venezuela and Colombia. The idea of a South American Free Trade Area (SAFTA) that is raised from time to time is at best a way station for these two countries -- and at worst a diversion from their main trade interests. Peru and Ecuador are in much the same position. For none of them did exports to Mercosur reach four percent of total exports in 1994. The picture is much the same if one looks only at manufactured exports. As can be seen in Table 5.5, for the four countries other than Bolivia, manufactured exports to Mercosur did not exceed five percent in any case, whereas in every case they exceeded 20 percent to NAFTA. Even in the case of Bolivia, whose manufactured exports to Mercosur reached nine percent of such exports in 1994, the proportion sent to NAFTA was 43 percent.

These considerations relate only to the expansion of free trade beyond the free-trade agreements that individual Andean Community countries have on a bilateral or plurilateral basis with Mexico, Chile, and Caricom. In every case, intra-Andean Community trade has grown considerably during the 1990s, and this includes manufactured products. However, even here the data should be kept in perspective. Of the absolute growth in intra-Andean trade, which was slightly more than $2 billion between 1990 and 1995, 96 percent was accounted for by just two countries, Colombia and Venezuela (calculated from data presented in Rodríguez-Mendoza, 1997, p. 17). A reality check requires keeping in mind that these are precisely the two countries that rely most heavily on the U.S. market both for total and for manufactured exports in their trade in this Hemisphere.

A conclusion identical to that reached here is contained in Cárdenas and Crane (1997, p.42), in discussing Colombia's future options: "It is probably better, for the time being, to strengthen the existing agreements while working multilaterally towards free trade in the Americas." With variations based on particular trading relations, much the same can be said for most of the other Andean Community countries.

Negotiating Process

The current hemispheric plan growing out of the process set in motion by the Summit of the Americas in Miami in December 1994 is to embark on hemispheric free-trade negotiations after the second summit in Santiago, Chile, in April 1998. The procedures for that negotiation are not yet fully in place, but presumably will be decided in time to get the effort under way. A number of important obstacles remain, at least as this is written. These are the ambivalence of Brazil about moving steadfastly forward toward concluding the negotiations by the year 2005 as agreed to in Miami (Motta Veiga, 1997) and the uncertainty about the ability of the United States to negotiate without fast-track authority in hand. These are not trivial concerns in that they affect the leading countries in South and North America. However, the assumption that is made here is that Brazil will try to shape the negotiating process so as not to disrupt its own internal priorities or the further advancement of Mercosur, but will not seek to prevent the FTAA negotiations from moving forward

The trade interests of the Andean countries would seem to be clear, that delay and possible death of the drive for hemispheric free trade would deprive them of the favorable access to the U.S. market that the FTAA offers. Some countries might wish to delay the onset of substantive negotiations until fast-track authority is obtained -- this was Chile's position for opening negotiations for access to NAFTA and may well turn out to be Brazil's preference as well. The trade logic of the Andean countries should move them in the opposite direction, to proceed as long as there is a U.S. commitment to seek fast-track authority later. There is precedent for this in the U.S. negotiation in the Uruguay Round.

At any rate, the Andean countries must prepare for participation in the negotiations. They must demonstrate their willingness to begin a process of moving to zero tariffs for trade within the Hemisphere, of reduction of non-tariff measures, willingness to open government procurement more thoroughly than in the past, and provide more solid protection of intellectual property than has been the case thus far for many of them. In order not to disadvantage the less developed among them, some of the Andean Community countries must lower their most-favored-nation (MFN) import tariffs even more than they have already.

These are not simple decisions for any of the countries. The Peruvian business sector, for example, has argued against a uniform tariff even for operating within the Andean Community on the grounds that this makes imported inputs more expensive than in other Andean Community countries (Vega, 1997). An alternative way to deal with this, of course, is to lower the uniform rate, which Peru is actually doing. Ecuador continues to take arbitrary measures that disadvantage foreign investors.

The model that hemispheric countries now accept for their trade policy, at least in principle, is open integration, to use the term first popularized by the Economic Commission for Latin America and the Caribbean. This is based on the earlier integration experience of the 1960s and 1970s when high tariffs against nonmember countries of the integration arrangements benefited mainly the more industrially advanced member countries and raised the import costs of the less developed. This is a variant of the Peruvian argument to this date, that if it enters into free trade with high MFN tariffs, it will be disadvantaged. Open integration, therefore, is based on low MFN rates. While the Andean countries have lowered their tariffs unilaterally in recent years, they are by no means low by international standards.

Bloc or Individual Negotiation

The Andean Community has not been successful thus far in converting itself from a free-trade area (FTA) into a customs union (CU). Only three of the five countries have accepted the common external tariff (CET) and even then there are numerous exceptions (Rodríguez-Mendoza, 1997). Individual countries have chosen to associate themselves (Bolivia) or are considering doing so with Mercosur in FTAs. Individual defections from the CET are not consistent with a customs union.

What we have had thus far, therefore, is a group of countries seeking deep integration in the form of a CU while other countries are prepared to negotiate on their own outside the grouping. Even those countries that favor moving to a CU have separate FTAs outside the Andean Community that are inconsistent with a CU.

One merit of the FTAA option is that it permits the five countries to act as a bloc, if they so wish. Most other options, such as entry into NAFTA if that were acceptable to the United States and other members, or the bilateral and plurilateral agreements that individual Andean Community countries have within the Hemisphere, may require forsaking the bloc negotiation process. Is this important? Yes, if the Andean Community truly wishes to expand its integration arrangements beyond the current membership and still maintain internal cohesion, particularly as a CU. No, if the CU turns out to be a chimera.

UNDERLYING ISSUES

It is useful to review briefly the key objectives that motivate the economic integration drive in the hemisphere, including that of the Andean Community. Under open integration, simply expanding the scope for import substitution cannot be an important objective, as it was in earlier integration efforts. The previous effort, including that of the Andean Community at the time, was to expand the integrated internal market and largely ignore the export possibilities outside the grouping of integration countries. This inward-oriented view of trade and industrial policy, predicated to a great extent on export pessimism, turned out be less successful than the outward-oriented trade practices of the newly emerging Asian nations (Krueger, 1997). Not only did exports not grow substantially outside the integration grouping except as raw material prices changed from time to time -- the effort to expand nontraditional exports was not even attempted seriously by most Andean Community countries -- but the industrial bases established within most countries were weak. We now know, also, that the benefits of integration were highly unequal, leading to the obsolescence or abandonment of the integration effort.

Today's integration paradigm is to seek the same objective of industrialization, but by looking outward in trade matters. Where once foreign direct investment was treated with suspicion -- and nowhere more than in the Andean countries under the famous Decision 24 -- it is now actively courted by most countries. The philosophic shift came after the lost decade of the 1980s when it became clear that the old model was not viable in most countries.

The purpose of economic integration is not to join countries that trade non-competitive products with each other because there is no purpose in protecting these products in the first instance, other than to generate revenue. The purpose, rather, is to increase trade in competitive products by intra-industrial specialization and the development of economies of scale. This reality was recognized in the earlier integration efforts by seeking to mandate intra-industry specialization through complementation agreements. This command type of industrial policy never had much chance to succeed when practiced across national boundaries. The current effort is to secure complementation by creating the conditions for investors to seize opportunities rather than insist that they do so.

Economists in the Andean Community countries generally accept these conclusions on what Krueger has referred to as the learning process relating trade and economic development. They are not necessarily always practiced by governments, however. Nor are they fully accepted by business groups who enjoy protection in internal markets. It was relatively simple to reduce tariffs from extraordinarily high rates full of water, overlaid with import quotas, to much lower rates that are often still largely prohibitive. It will be much harder to go the rest of the way to secure open integration and optimize the ability to secure outside markets by not prejudicing domestic producers with high import barriers on industrial inputs. It will be harder to reduce non-tariff barriers that now exist than it was to eliminate high tariff rates that were redundant. It is these actions -further reduction of border barriers- that will be the main challenge of the FTAA process.

The Andean Community countries today receive a number of trade preferences, particularly from the United States under the Andean Preference Act and the General System of Preferences. These preferences surely provide a benefit, but they also serve as a deterrent to moving ahead on the more comprehensive policy of fashioning an FTAA (Vega, 1997). The current preferences are non-reciprocal, whereas the phasing out of duties under the FTAA would demand reciprocity. The current preferences are granted as a matter of grace by the United States, whereas the FTAA would be in the form of a multilateral contract under which the member countries would have rights to free access.

Two important issues that deserve further analysis are the realism of Andean Community movement toward a customs union rather than a free-trade area and the nature of the collective arrangement with Mercosur. Both issues are discussed in Rodríguez-Mendoza (1997). The main arguments he makes in favor of a CU are that it is a higher form of integration because it requires not only a CET and a common commercial policy, but also a more comprehensive degree of policy coordination. But these are the very reasons why the decision to move to a CU has not taken hold. One must therefore question whether the logic of achieving the theoretical best, a CU, is preferable in current circumstances to further strengthening the FTA.

The discussion here will not be extensive, but a few points can be made. The underlying differences among the countries of the Andean Community, in size, trade levels and composition, and destination of exports, make it complicated to reach a common commercial policy or to coordinate economic policy. This is evident from the fact that not all the countries have accepted the CU. It does not necessarily follow, either, that a CU must be a deeper form of economic integration than a FTA. The obligations of the member countries in NAFTA are considerably greater than in any of the customs unions in Latin America, from Mercosur in the south to Caricom and the Central American Common Market in the north.

A number of arguments are made for supporting the integration of the Andean Community countries, acting as a group, into Mercosur. These are that this would reinforce cohesion and bloc negotiation among the Andean Community countries and would lead to the further liberalization of trade in the hemisphere. There is also a quasi-political argument, that the stronger the South American integration movement is, the more effective would be its bargaining leverage vis-à-vis NAFTA and the United States.

Perhaps, but these are not self-evident conclusions. The reason that the Andean Community countries have trouble in concluding an association agreement with Mercosur as a group is that they have different trade interests. This point already has been discussed. If the association with Mercosur did not substantially lower tariffs to outside countries, as it might not, this is hardly a positive step toward hemispheric trade liberalization. All this would accomplish would be to widen the area of preferences. On the last point, U.S. authorities are well aware that the main interest of the two largest trading countries in the Andean Community, Colombia and Venezuela, is better and more assured access to the U.S. market and this reality will not change if there is something approaching a Safta in South America.

The assumption inherent in the discussion throughout this chapter is that there is merit in deeper but realistic integration among the Andean countries. A CU in name but not in fact is not realistic deepening. The basis for the assessment that cohesion among the Andean Community countries is desirable is that their economic links have led to an intensification of intra-Andean Community trade without any evident serious offsetting trade diversion. This point should not be pushed too far because much of the intra-trade increase results from the separate free-trade arrangement between Colombia and Venezuela. In addition, the desire to maintain intra-Andean Community trade relations has survived despite tense political relations between some of the countries. The existence of these trade benefits may even have prevented the political strains from getting worse, especially between Colombia and Venezuela.

CONCLUSIONS

The starting point of the analysis undertaken here is that the Andean Community has shown more vigor in recent years than one might have expected given many of the setbacks during the 1980s. Internal problems have not been completely resolved, but the progress in addressing these has been substantial.

The task chosen in this essay was to examine the options for further expansion of free trade as this affects the Andean Community countries. The starting assumption is that countries should be most interested in such agreements with their most important trading partners -- with their most important markets. Those markets which offer best access for higher value-added exports are, all other considerations equal, more interesting than those which are more closed to these products. Looking at the trade of the five countries, this leads to the conclusion that priority should be placed on improving access to the NAFTA market, to the United States. The Andean Community should secure its base, its best market, and this then permits moving beyond that. The best practical way to accomplish this is through participation in the FTAA. This path permits pursuit of the most important objective even as it enables the Andean Community countries to do this as a cohesive group while simultaneously improving trading relationships with Mercosur countries and other nations in the hemisphere.

It is hard to overstate the critical importance of the U.S. market for the Andean Community countries, especially the two most important trading nations in the group -- Colombia and Venezuela. This conclusion leads to a related recommendation, namely, that the Andean Community countries should not allow the opportunity to move ahead in the FTAA process be sidetracked lest the opportunity be lost. This issue may be tested at the summit meeting of the leaders of the hemisphere in Santiago, Chile, in April 1998, should the United States arrive prepared to begin negotiations but without fast-track authority in hand. Some countries of the hemisphere have argued, in that case, that the negotiations should be delayed. The delay could be protracted or, more seriously, could stop the FTAA momentum dead in its tracks. The position taken here is that the Andean countries should vigorously favor moving ahead as long as the U.S. government commits itself to exert all its efforts to secure fast-track authority before the conclusion of the negotiations. For those not steeped in U.S. legislative practice, it is useful to point out that fast-track authority is not needed for the executive branch to open negotiations, but rather to assure that any agreement reached is voted up or down, without amendments, by the congress.

If the decision is taken to move ahead toward the FTAA, the Andean Community countries must put themselves in condition to negotiate. There are still many non-tariff measures impeding trade among Andean Community countries (Iglesias, 1997), and these will have to be addressed in the FTAA process. Tariff levels against outside countries remain higher than they should be if the Andean Community countries are to maximize their trade competitiveness, and these will have to be rectified. The smaller countries may need technical assistance for the negotiations, and ways of securing this must be considered.

There is still discussion in Andean Community circles as to how vigorously to pursue the movement toward a customs union. This debate need not be resolved in advance of FTAA negotiations because these presumably will leave the sub-regional groupings intact while superimposing hemispheric free trade. If the Andean Community countries wish to impose a discipline on themselves to go beyond free trade in their own grouping, this can be pursued. It is not essential to impose this discipline right now, especially in light of the internal disagreements among the countries. The argument made here is that the immediate focus of attention should be on those necessary steps that will permit negotiation for achieving the objective of hemispheric free trade.

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