

16. A CONFERENCE ON U.S.-ANDEAN TRADE AND INVESTMENT RELATIONS: POLICY ISSUES AND CHOICES

AN OVERVIEW OF THE DISCUSSIONS^r

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The five countries of the Andean Community (Bolivia, Colombia, Ecuador, Peru, and Venezuela) have made important progress toward promoting liberalization and expansion of trade and investment. Since 1990, intra-Andean trade has grown by 29 percent annually, and the Andean Community now has some of the lowest tariffs in Latin America. Similarly, under the thrust of widespread privatizations, gross domestic investment has expanded considerably in the 1990s. On the macroeconomic front, the countries have reduced annual inflation to 11 percent (on par with the rest of Latin America), and per capita growth for the first half of this decade has markedly improved over the 1980s.

Still, as Sebastian Edwards, professor at UCLA, pointed out in his lead presentation, "these countries are only halfway there" in their efforts to construct a viable development model that can sustain growth and income gains over the long run. Edwards noted that overall growth and savings rates in the 1990s were "modest to mediocre," and that the Andean countries have not moved quickly enough to deregulate their economies, protect property rights, and carry out needed institutional reforms.

Edwards argued that, with low savings rates, the impetus for future growth in the Andean Community rests mainly with efficiency gains. Investment in education and training, as well as a more effective use of labor, are necessary for productivity gains. Yet, the evidence suggests that the upgrading of human capital stock is not enough to trigger higher productivity. Other crucial variables include: policy makers' commitment to markets; a credible legal framework that guarantees property rights; economic deregulation; and the quality of the judicial system and the state bureaucracy. Like the rest of Latin America, the Andean Community made major strides on most of these fronts in the early 1990s. However, the so-called "consolidation phase" has turned out to be more of a "standstill." In some instances, such as property rights in Ecuador and Peru, the current pattern is one of backtracking. In the end, Edwards cautioned that "only increased efficiency, along with higher savings rates and essential institutional renovations, will save these countries."

The commentators agreed that the reform process within the Andean Community is incomplete. The consensus was that Bolivia and Peru have advanced furthest to date. Guillermo Perry, Chief Economist at the World Bank, emphasized the need for more rigorous fiscal strengthening and for the deepening of financial reforms. Perry, along with Juan Cariaga, Executive Director for Argentina, Bolivia, Chile, Paraguay, Peru and Uruguay at the World Bank, and Ricardo Hausmann, Chief Economist at the Inter-American Development Bank, also pointed to the poor progress made in the areas of poverty reduction and income redistribution. Cariaga attributed Bolivia's continued distributional inequities to the fact that "key institutional reforms have not been implemented." Outdated social codes there protect a minority of organized workers at the expense of the mass of unrepresented laborers who have yet to find employment in the new market economy. Along with labor market regulation, Hausmann added that adverse income distribution is linked to the poor quality of education, and to the channeling of most new foreign investment to natural resource sectors which contribute little to employment and income gains. There was general recognition that, to achieve higher growth, productivity, and income gains the Andean country policy makers must address the reform agenda much more aggressively.

TRADE AND INVESTMENT POLICIES

In his inaugural remarks, OAS Secretary General César Gaviria applauded the Andean Community for having renovated itself into a sub-regional bloc based on the free flow of trade and investment. He stated that these advances are notable given the Andean Community's location between the two main poles of

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hemispheric integration, NAFTA and MERCOSUR. Gaviria warned that the Andean Community must overcome two important obstacles to deepen integration efforts. First, because it is organized partly as a customs union and partly as a free trade area (FTA), the Andean Community could see its institutional stability jeopardized over the longer term. Second, unless subregional trading groups work to "multilateralize" their trade and investment relations --at the hemispheric and international level-- they run the risk of becoming discriminatory arrangements. For Gaviria, a main challenge for the Andean countries is to foster a more cohesive sense of political and economic unity, while at the same time ensuring that their integration scheme is compatible with the multilateral rules of the World Trade Organization (WTO).

Colombian Trade Minister Carlos Ronderos identified three issues for today's policy agenda: 1) how the Andean countries can adapt national production practices to the heightened competition from integration; 2) what strategies will enable domestic firms to better cope with market pressures; and, 3) how the Andean countries can maintain their market share as their trading partners proceed with further liberalization. William E. Simon Chair in Political Economy at the Center for Strategic and International Studies Sidney Weintraub pointed to the continued importance of the U.S. market for the Andean Community as a whole. (As of 1994, 43 percent of all Andean trade was with the U.S., compared to just 4 percent with the MERCOSUR countries.) According to OAS consultant Juan Jose Echavarría, unilateral trade liberalization within the Andean Community was conducted with an eye toward increasing manufactured exports and, hence, the competitive position of these countries in international markets. Yet, despite impressive advances by industrial restructuring, the bulk of this trade has been conducted within the Andean market. Weintraub, Echavarría, and U.N. Economic Commission for Latin America and the Caribbean Washington Office Director Isaac Cohen agreed that the expansion of U.S.-Andean trade would best be pursued through the Andean Community's participation in the pending Free Trade Area of the Americas (FTAA).

In the case of Colombia, both Ronderos and CAF consultant Patricia Correa emphasized Colombia's status as the second or third (alternating with Venezuela) most important export market for the U.S. in South America. At the same time, Colombia has managed to reduce its trade dependence on the U.S. market, from 80 percent in the 1950s to 30 to 50 percent by the 1980s. Although 80 percent of Colombian exports to the U.S. are still dominated by primary products, Colombia's trade balance with the U.S. has stabilized over the past decade. Colombia's unilateral trade liberalization has contributed to this stability, as a high demand for Colombian exports in the U.S. now correlates closely with a strong demand for U.S. imports in Colombia. Turning to investment, although foreign direct investment (FDI) in Colombia has hit an all-time high in the 1990s, flows of U.S. FDI to Colombia have slowed, especially in the manufacturing sector. Correa attributes this to Colombia's weak intellectual property rights (IPR) regime, to the urgent need to "denarcotize" U.S.-Colombian relations, and to the negative effects that non-tariff barriers in the U.S. have had on FDI decisions that hinge on exporting back to the U.S. market. Ronderos emphasized the importance of designing a competition policy that more explicitly promotes productivity, technology transfer, and an efficient public sector.

The trade and investment concerns of the four remaining countries in the Andean Community represent variations on this theme. Like its neighbors, Venezuela has a strong trade tie with the U.S. Contrary to the Colombian pattern, Venezuela's trade dependence on the U.S. is on the rise. With oil as its predominant export, 56 percent of Venezuela's exports went to the U.S. market in 1996, compared to 48 percent ten years earlier. He also indicated that 18 percent of all U.S. oil imports come from Venezuela, and Venezuelan oil investments in the U.S. now make it the seventh largest foreign investor in the U.S. market. Miguel Rodriguez, OAS Chief Trade Advisor, pointed out that U.S. trade with other parts of Latin America, Brazil and Mexico, is growing more quickly than with Venezuela. While U.S.-Venezuelan trade is based primarily on the WTO legal framework, there are some pending irritants such as the U.S. tuna embargo and Venezuela's stance on IPR, on the bilateral trade and investment agenda.

The Peruvian case reflects the government's accomplishments in macroeconomic stabilization and trade adjustment, and progress in diversifying investment from its traditional dependence on the U.S. According to Javier Illescas, Economic Advisor for the Ministry of Trade of Peru, U.S. FDI has accounted for 32 percent of Peru's privatization proceeds since 1991, while U.S. portfolio investment represents 74 percent of the country's total. But overall, U.S. FDI now accounts for 16 percent of Peru's total, compared to some 66 percent in 1980. Jorge Daly, a financial policy advisor with Chemonics International, underlined that increased FDI in services

from Europe, mainly Spain, was responsible for this change in the sources of FDI in Peru. Similar to Colombia and Venezuela, Peruvian exports to the U.S. are heavily concentrated in the primary sectors.

Bolivian Minister of Trade Jorge Crespo and CIRESE consultant Gonzalo Bernal noted that, like Colombia and Peru, Bolivia mainly exports mineral products to the U.S. and the U.S. invests mostly in the hydrocarbons sector. Both analysts consider U.S.-Bolivian trade and investment ties weak, given the country's implementation of sweeping market reforms since 1985. The main explanation is "the tendency of the U.S. to condition everything on Bolivia's progress in fighting the war on drugs." This is evident in the failure of the U.S. to grant trade preferences to Bolivia under the Andean Trade Preference Act (ATPA). Crespo suggested that the image of widespread corruption, and weaknesses within the judicial system and national security apparatus are also deterrents to attracting higher levels of FDI from the U.S.

Ecuador is another case where U.S. influence is strong, although less so than in the 1980s. Since 1992, Ecuador has experienced an export boom in minerals and in nontraditional products (e.g., cut flowers, processed foods, wooden goods) to other countries of the Andean Community. Robin Newberger, a consultant with MULTIPLICA, highlighted two points with regard to Ecuador's trade and investment patterns. First, the country's recent trade boom has been underpinned by a more competitive exchange rate, and by an assertive effort to promote non-traditional exports. Second, Newberger noted that Ecuador's legal framework for investment, which has been relatively protectionist until this year, seems to have had little impact on actual investment trends. The U.S. is by far the largest investor in Ecuador, 50 percent of which is concentrated in the oil sector.

The final panel on trade and investment policy in the Andean Community touched on crucial sectorial issues. The discussion was focused on how Latin America could increase its competitive position, with an in-depth examination of some themes---dispute settlement, IPR, FDI, and competition policy--- that had been addressed earlier in the conference. Ana Julia Jatar, Senior Fellow at the Inter-American Dialogue, argued that the challenge is to enforce long-standing policies to promote competition. Colombia, Peru, and Venezuela have updated their competition laws along the lines of the European Union's. Bolivia and Ecuador continue to rely on market forces as the main impetus for increased efficiency and competition.

According to Jatar, despite the advances toward liberalization, privatization, and deregulation, the problems of collusive price setting and abuse of market power are still prevalent, particularly within nontradeable sectors. Competition policy has an essential role to play in promoting greater efficiency and rivalry between economic agents, and in guaranteeing broader market access. Jatar advocates a supranational competition policy, which would encompass all of the Andean countries, if not the entire Western Hemisphere. Apart from deterring restrictive business practices, this would facilitate the formation of firms based on economies of scale that are more appropriate for competing in a sub-regional, hemispheric or global market.

With regard to the remaining issues addressed on this panel (dispute settlement, IPR, and FDI), all five speakers focused on ways to strengthen the approaches of the Andean Community, and how to render regional strategies as compatible as possible with the WTO's multilateral rules. On dispute settlement, Peggy Clarke, an associate with O'Melveny & Myers, LLP, noted that with the lowering of tariff barriers in Latin America, anti-dumping complaints have been on the rise. This is most evident in the NAFTA countries, where the U.S. has brought 16 cases against the Andean countries, compared to just four cases which originated within the Andean Community against the U.S. Continued conflicts with the U.S. over dumping charges are considered by many to be the unfinished business of the NAFTA negotiations. But Clarke suggests that disagreements between the U.S. and Andean countries over dumping could be better handled through a "review mechanism," whereby a designated panel adjudicates the case in question and then generates standards of universal applicability.

In reference to how such an approach would fit in with dispute settlement procedures under the broader FTAA scheme, Craig VanGrasstek, Professorial Lecturer at American University's School of International Service, added that "the FTAA will need its own dispute resolution mechanism, but disputes arising from the FTAA should be adjudicated in the WTO to the greatest extent possible." According to Roberto Salazar, a member of the Andean Court of Justice, this proposed FTAA-WTO dispute resolution mechanism would also be the "natural forum" for resolving IPR-related conflicts which have arisen, for example, in biotechnology and other high tech sectors. As it now stands, 80 percent of the cases before the Andean Court of Justice stem from IPR disputes, which have not been handled effectively.

Carlos Primo Braga, Principal Economist at the World Bank, presented a case study of the telecommunications sector in the Andean Community. To date, the telecommunications sector has been privatized in Venezuela (1991), Peru (1994), and Bolivia (1995), while Colombia and Ecuador are now in the midst of privatizing this sector. These privatizations, along with the relaxation on institutional constraints for investors in these countries, have triggered a flood of FDI and technology transfer into the Andean telecommunications sector. Primo Braga cautions that the Andean countries must still establish the proper regulatory framework and create agencies with sufficient capacity to enforce competition laws. Increasingly, Primo Braga expects that the Andean countries' negotiation agenda with the U.S. over telecommunications will be dominated by the WTO's government procurement rules and its new Information Technology Agreement.

PERSPECTIVES FROM THE UNITED STATES

From the U.S. perspective, Gary Hufbauer, Director of Studies at the Council on Foreign Relations, and Jeffrey Schott, Senior Fellow at the Institute for International Economics, argued that the Andean region currently ranks third or fourth in terms of U.S. trade and investment priorities in the Western Hemisphere. U.S. exports to the Andean Community are not growing as fast as U.S. exports to the rest of Latin America. The U.S. sends manufactured goods to the Andean Community, and imports mainly primary products -- of which oil accounts for some two-thirds of all U.S. imports. U.S. FDI in the Andean countries, which amounts to less than 10 percent of total U.S. FDI in Latin America, is also concentrated in the primary sectors. Trade and investment in these countries is now quite open, and deterrents to increased U.S. FDI in manufacturing and services lie in the continued weakness of infrastructure in the Andean countries, both hard (e.g., transportation, communications) and soft (e.g., copyright protection, judicial systems).

Schott offers three reasons for the U.S. to pursue stronger ties with the Andean Community within the context of the FTAA: 1) to promote economic development and sustain market reforms; 2) to bolster the Andean Community's commitment to liberal democracy; and, 3) to expand political ties and improve cooperation. According to Hufbauer, the U.S. stance toward the Andean Community in the 1990s has been a "carrot and sticks" approach. The carrot has been the granting of preferential access to the U.S. market under the Andean Trade Preference Act. The sticks have centered on the threat of eliminating trade preferences or suspending trade, through the "decertification" of a country for failing to cooperate fully with the U.S. war on drugs, and the placement of a country on the U.S. "watch list" for IPR infringements.

Three private sector analysts commented on the Hufbauer-Schott presentation and all agreed, first, that the corporate viewpoint had been overlooked and second, that the private sector has shown a tremendous interest in the subregion, mainly because of the impressive scope of economic reforms implemented in these countries. As a sign of the extent to which things have changed, Roberto Dañino, a partner at Wilmer, Cutler & Pickering, pointed out that there are now 300 Latin American companies listed on the New York Stock Exchange, compared to just one company five years ago. In the past few years, the creation of private equity funds and the deepening of stock and bond markets in Latin America has produced new pools of financial resources. This economic dynamism has not been lost on U.S. companies, and the U.S. business sector can definitely play a strong role in bringing the FTAA to fruition.

But Dañino, along with David Rothkopf, Managing Director at Kissinger Associates, Inc., and Bowman Cutter, Managing Director at E.M. Warburg, Pincus & Co., Inc., was also realistic about the challenges that the Andean Community faces. At the present time just one country, Colombia, has obtained an investment grade rating for its banks. While the local private sector's access to credit in domestic capital markets has improved, credit is still limited and there is a shortage of investment grade projects that are eligible for financing. The U.S. private sector is also concerned about the "soft" infrastructure problems identified by Hufbauer and Schott, particularly the lack of a credible judicial system. Rothkopf emphasized the need for Andean governments to give more careful thought and concrete action to social policy, which potential investors are coming to realize is essential for the long-term sustainability of today's market reforms. For Cutter, the single largest challenge for the Andean Community is "the accumulated difficulties of creating businesses which work." In other words, without a bigger push toward deeper integration, i.e., the creation of Andean institutions which foster cross-border cooperation, Andean trade and investment trends may stagnate.

Bernard Aronson, Managing Partner at Acon Investments, LLC, concluded this session by adding that, although financial markets will indeed be important in the launching of the FTAA, it is important not to underestimate the important role that U.S. leadership plays in sending positive signals to these markets.

THE FREE TRADE AREA OF THE AMERICAS (FTAA)

As the April 1998 target date for officially launching the FTAA negotiations was approaching, this panel assessed the status and prospects of the FTAA from the standpoint of all the key actors in the upcoming negotiations. After reviewing the substantial progress that has been made since the 1994 Miami Summit in laying the groundwork for the FTAA negotiations, Costa Rican Trade Minister Jose Manuel Salazar identified the main issues still under consideration. Foremost, is the question of how to structure the negotiations. For example, the twelve hemispheric working groups that were created from the 1994 Summit must be transformed into a formal negotiating process. At the same time, a decision must be made as to whether the FTAA negotiations will simultaneously address all of the sectors and issues at hand, or if this will be done in a more sequenced manner. Second, is the question of how to deal with smaller economies. There seems to be a broad consensus that the smaller economies will need longer phase-out periods, and higher levels of technical and financial assistance to facilitate the adjustment process. But the specifics surrounding these measures, as well as the future role of the Working Group on Smaller Economies, still must be worked out.

Third, while there appears to be the political will to comply with the commitment made at the 1994 Summit to achieve "concrete progress by the year 2000," there is a miscellaneous list of tasks to be tackled. At the top of the list are the questions of whether the FTAA should have its own technical secretariat, and how to assure participation from the private sector, labor representatives, and civil society. Salazar concluded by stepping back from these details, and stating what he sees as the important conditions for the success of the FTAA negotiations: 1) the granting of fast track negotiating authority to President Clinton by the U.S. Congress prior to April 1998; 2) the forging of a strong regional consensus on the speed at which everyone is willing to proceed with the FTAA; and, 3) hard work by governments to convey the benefits of the FTAA to their respective constituencies.

Kathryn McCallion, Assistant Deputy Minister at the Ministry of Foreign Affairs, who emphasized Canada's strong commitment to the completion of the FTAA, stated the Canadian viewpoint on the upcoming FTAA negotiations. Whereas an arrangement such as the FTAA was just a distant goal back in 1994, McCallion says that the planning stage has fostered stronger hemispheric ties and much better understanding between countries. In turn, this has rendered the establishment of the FTAA a concrete reality. As she sees it, the gains from economic integration are now becoming apparent, and helping to assuage fears over the risks. Although the Canadian political economy has certainly registered its own share of trade adjustment stress and accompanying domestic conflicts, Canada's overall economic performance under NAFTA has outweighed these problems. The U.S.-Canadian trade relationship is now the largest in the world, representing \$1 billion per day, and total NAFTA trade grew by 26 percent in 1996. Canadian FDI in Mexico has increased fivefold since 1990, and Canada has been active in pursuing stronger economic ties with a number of other Latin countries. According to McCallion, any of the potential obstacles to negotiating the FTAA are "completely manageable." For her, the three main challenges are: 1) to sustain the political will for the creation of the FTAA as each participating country moves through its different political/electoral cycle; 2) to solicit the support of the private sector without opening up every detail to heated debate; and, 3) to deal constructively with the disparities between the large and small economies. The U.S. stance toward the FTAA negotiations was summarized by Peter Allgeier from the Office of the U.S. Trade Representative. Despite the difficulties in securing fast track negotiating authority from the U.S. Congress, and the continued domestic conflict in the U.S. over the proper role of labor and environmental side accords in any future U.S. trade agreements, Allgeier insists that the FTAA will be completed on time. The main issues now for the U.S. are how the FTAA negotiations will be organized, how concrete progress will be measured, and how to involve the private sector to the fullest extent possible in the FTAA process. On the organization of the negotiations, Allgeier says that rather than transform each Summit working group into a negotiating team, the U.S. envisions an "all nations negotiation" similar to the GATT/WTO approach. Within this framework, existing sub-regional arrangements would be free to continue, just as long as they push the FTAA liberalization agenda beyond that of the WTO. As for content, the U.S. does expect that

everything on the Miami Summit agenda will be subject to negotiation. As for how to measure the FTAA's progress, Allgeier sees interim agreements as the most effective way to track the gains that are being made. Finally, Allgeier sees the need for the extension of the business forum under the FTAA, which will offer useful information for the private sector and allow policy makers regular access to the business community.

Robert Devlin, head of the Division of Integration, Trade, and Hemispheric Issues at the Inter-American Development Bank, stated that "the progress achieved over the past two years is extraordinary, but we can't be complacent." He stressed the crucial role of the FTAA as a tool for furthering the consolidation of market reforms in Latin America. But he also called for a more systematic approach in monitoring where countries now stand in complying with their commitments under the WTO and the Miami agenda. On this point, Devlin agreed with Salazar's view that there is a definite need for stronger technical assistance to facilitate the FTAA process in Latin America (e.g., impact studies, trade education). Second, Devlin acknowledged that "good trade agreements can make for bad politics," and thus emphasized that governments in the region must work harder to forge better links between the private sector and civil society around the FTAA negotiations. For example, the fact that there is no labor equivalent of the business forum has been a source of conflict, given that Latin American labor representatives have not been regularly consulted. Devlin warns that, if not adequately addressed, domestic cleavages can clog the FTAA process. The Brazilian representative, Regis Arslanian, Minister Counselor at the Brazilian Embassy, validated this point on domestic obstacles, as this has been a main challenge that Brazilian policy makers have worked to overcome. While Arslanian says that the Belo Horizonte and San Jose summit meetings in 1997 seemed to be a catalyst for triggering greater internal consensus in Brazil over the FTAA negotiations, he is still uncertain about Brazil's ability to accomplish the full scope of the FTAA's goals by 2005.

The concluding discussion on the status and prospects for the FTAA was optimistic, on balance. Political leaders throughout the hemisphere must work overtime to sustain the momentum for the FTAA negotiations. Julius Katz, President of Hills & Company, had the last word on how to proceed with the FTAA: "There is no easy answer to these questions, and I'm not sure we'll help the process by teaching governments how to do it....the point now is to just get on with it!"