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The Four Amigos and Beyond: Towards the Free Trade Area of the Americas

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THE FOUR AMIGOS AND BEYOND: TOWARDS THE FREE TRADE AREA OF THE AMERICAS

Executive Summary

Canada's commitment to the open, multilateral trading system necessarily remains strong, the result of our considerable reliance on trade and investment flows and the lasting benefits achieved under the aegis of the GATT through the several multilateral negotiations since the late 1940s. By way of context, this Paper briefly outlines the more important multilateral initiatives now underway, including the push to complete the Uruguay Round's unfinished business on trade in services and government procurement, WTO accession negotiations with China and others, and a recent OECD decision to begin negotiations to develop a Multilateral Agreement on Investment. Preparations are now also underway for the first WTO ministerial meeting scheduled for December 1996, a meeting that could identify an agenda and set in train a process that lead to the launch of the next comprehensive trade "Round" by the end of the decade. Evidently, creative trade policy is alive and reasonably well multilaterally.

Much of the dynamism driving economic integration, however, originates at the regional or sub-regional level. Strong growth in regional trade and investment creates the conditions for and is further fuelled by formal, treaty-based commitments. Within the western hemisphere, two agreements stood out during the first half of the 1990s: NAFTA and MERCOSUR (comprising Argentina, Brazil, Paraguay and Uruguay). Although different in their comprehensiveness (NAFTA encompasses a wider range of rights and obligations than MERCOSUR in its current form), both agreements represent ambitious efforts to deepen formal economic integration.

Moreover, the search for freer trade and investment on a regional basis remains active. With an increasing number of policy issues in play, and more countries prepared to engage, the multilateral game has become more difficult to sustain without creative regional efforts that seek to go further faster, thereby goading the global system as a whole into action. In this regard, the Paper briefly outlines the scope of three regional initiatives that have recently captured much attention: trans Pacific, western hemisphere and trans Atlantic free trade.

The final sections of the Paper then focus in greater detail on efforts in the western hemisphere to expand the scope of economic interdependence through free trade negotiations. In this regard, the Paper includes a Canadian perspective on the rationale underpinning Chile's hoped-for accession to the NAFTA. The Paper puts particular emphasis on the negotiation with Chile as a test case of the capacity of the NAFTA, through its accession clause, to re-invent itself into a dynamically outward-looking instrument with a central (perhaps <u>the</u> central) rôle in achieving free trade in

the Americas by 2005, the target set by hemispheric Leaders in their December 1994 Summit in Miami. The Chilean accession negotiation will take the true measure of the credibility of North American and particularly U.S. trade policy vis-à-vis Latin America. Whether the negotiations conclude in 1995 or 1997 (after the next U.S. presidential election), the Chilean case remains central to Canada's expanding hemispheric foreign policy.

Finally, the Paper looks beyond Chilean accession toward the next steps that should be taken along the road to the 2005 target date. In particular, the issue of how to create sufficient momentum is addressed. Part of the solution lies in further accessions to the NAFTA (with Colombia a possible next candidate on economic grounds). But the central relationship that will make or break the hemisphere-wide goal is that between NAFTA and the MERCOSUR countries, taken collectively or individually. In this regard, the substantive and technical pros and cons of four options are explored: the negotiation of an entirely new agreement that would replace the NAFTA and MERCOSUR; the negotiation of a separate bilateral free trade agreement by each NAFTA member with MERCOSUR; MERCOSUR accession to the NAFTA; or accession to the NAFTA by individual MERCOSUR countries (with Argentina the most obvious candidate, given Brazil's continuing hesitation about free trade negotiations with North America).

The Paper concludes that, while neither automatic nor problem-free, the successful construction of a hemispheric free trade area in the Americas is achievable and makes sense. Moreover, the task ahead would finally cement Latin America considerably nearer the centre of Canada's economic diplomacy.

Résumé

Forcément, l'attachement du Canada à un système commercial multilatéral ouvert reste fort, étant donné notre dépendance considérable à l'égard des mouvements commerciaux et d'investissement et les avantages durables obtenus sous l'égide du GATT grâce à plusieurs négociations multilatérales menées depuis la fin des années 1940. En guise de contexte, le présent document décrit brièvement les initiatives multilatérales les plus importantes actuellement en voie de réalisation, notamment les efforts pour terminer les travaux inachevés de l'Uruguay Round sur le commerce des services et les marchés publics, les pourparlers avec la Chine et d'autres pays au sujet de leur accession à l'OMC et une décision récente de l'OCDE d'entamer des négociations en vue de conclure un Accord multilatéral sur l'investissement. Des préparatifs sont aussi en cours maintenant pour organiser la

première réunion ministérielle de l'OMC, prévue pour décembre 1996, qui pourrait établir un programme et mettre en marche un processus qui conduirait au lancement du prochain « round » commercial global d'ici la fin de la décennie. Manifestement, il existe une politique commerciale créatrice sur le plan multilatéral et elle se porte relativement bien.

Toutefois, une grande partie de l'impulsion qui engendre l'intégration économique trouve sa source au niveau régional ou infrarégional. Une forte croissance du commerce et des investissements régionaux, encore renforcée par des engagements officiels fondés sur des traités, crée les conditions propices. Dans l'hémisphère occidental, deux accords ont fait date au cours de la première moitié des années 1990 : l'ALENA et le MERCOSUR (comprenant l'Argentine, le Brésil, le Paraguay et l'Uruguay). Bien qu'ils ne soient pas aussi complets l'un que l'autre (l'ALENA comprend une gamme de droits et d'obligations plus large que le MERCOSUR sous sa forme actuelle), les deux accords représentent des efforts ambitieux pour approfondir l'intégration économique officielle.

En outre, on continue de chercher activement à libéraliser le commerce et les investissements sur une base régionale. Étant donné le nombre croissant de questions de principe en jeu et de pays prêts à s'y engager, la politique multilatérale est devenue plus difficile à mener sans des efforts régionaux d'un genre nouveau qui cherchent à aller plus loin plus rapidement, mettant ainsi en marche le système mondial dans son ensemble. À cet égard, le présent document expose brièvement la portée de trois initiatives régionales qui ont attiré récemment beaucoup d'attention : le libre-échange transpacifique, de l'hémisphère occidental et transatlantique.

Les derniers paragraphes du document portent ensuite plus en détail sur les efforts déployés dans l'hémisphère occidental pour accroître l'interdépendance économique au moyen des négociations sur le libre-échange. À cet égard, le document expose la position canadienne sur les raisons pour lesquelles on souhaite l'accession du Chili à l'ALENA. Il met particulièrement l'accent sur le fait que les négociations avec ce pays sont considérées comme une mise à l'épreuve de la capacité de cet accord, par sa clause d'accession, de se transformer en un instrument dynamique ouvert sur l'extérieur qui joue un rôle (peut-être <u>le</u> rôle) central dans la réalisation du libre-échange dans les Amériques d'ici 2005, comme il a été décidé au sommet des dirigeants de l'hémisphère, qui a eu lieu à Miami en décembre 1994. Les négociations sur l'accession du Chili montreront dans quelle mesure la politique commerciale nord-américaine, et particulièrement celle des États-Unis, est crédible pour l'Amérique latine. Que les négociations aboutissent en 1995 ou en 1997 (après les prochaines élections présidentielles américaines), la question chilienne reste essentielle pour la politique étrangère canadienne d'expansion dans l'hémisphère.

Enfin, le document va au-delà de l'accession du Chili pour parler des prochaines mesures qui devraient être prises en cours de route pour respecter l'échéance de 2005. En particulier, il aborde la question de savoir comment créer une impulsion suffisante. La solution réside en partie dans d'autres accessions à l'ALENA (celle de la Colombie, qui est une prochaine candidate possible pour des raisons économiques). Mais les relations cruciales qui permettront d'atteindre ou non l'objectif de libre-échange dans tout l'hémisphère sont celles des pays de l'ALENA et du MERCOSUR, prises collectivement ou individuellement. À cet égard, il passe en revue les avantages et les inconvénients techniques et économiques de quatre options possibles : la négociation d'un accord complètement différent qui remplacerait l'ALENA et le MERCOSUR, la négociation d'un accord de libre-échange bilatéral distinct que chaque pays membre de l'ALENA conclurait avec le MERCOSUR, l'accession du MERCOSUR à l'ALENA ou l'accession individuelle à l'ALENA de chaque pays membre du MERCOSUR (l'Argentine étant la candidate la plus probable, étant donné que le Brésil continue d'hésiter à entreprendre des négociations de libre-échange avec l'Amérique du Nord).

Le document conclut que, bien que ce ne soit ni automatique ni une panacée, l'établissement d'une zone de libre-échange hémisphérique dans les Amériques est une chose sensée et réalisable. En outre, la tâche en perspective rapprocherait en fin de compte considérablement l'Amérique latine du centre de la diplomatie économique canadienne.

Let's just do it!

Canadian official on Chile's accession to the NAFTA
(Santiago, October 1994)

For me, election day represents the end of the coup d'état and our entry into a state of law.

Biron Odige, deputy chief, communal election board (St.-Marc, Haiti - June 1995)

1. Introduction[1]

Canada's trade policy has taken on a certain Latin American colouring. This shift, although inevitably partial, is likely permanent. In light of the negotiation and implementation of the North American Free Trade Agreement (NAFTA), Mexico City has become as central as London or Paris to how we manage our trade policy relations with the United States. In the Asia Pacific Economic Cooperation (APEC) forum, Chile, more consistently than most Asians, pushes toward greater trans Pacific economic integration in close concert with Canada. The Latin Americans tend to share Canadian views on the management of numerous trade policy issues, including the increasingly important trade and environment file, further reform of agricultural subsidy practices and the necessity of considerably tightening the international disciplines on, if not the outright dismantlement of, anti-dumping law. In these matters, we often occupy more common ground with Mexico, Chile, Argentina or Colombia than with the United States or the European Union. On the other hand, the Latin Americans are much closer than most Asians to the developed countries, including Canada, with regard to the importance of negotiating an international framework of binding rights and obligations on investment.

A sea change in Latin American economic policy, albeit still incomplete and tentative in some countries, has finally combined with geographic proximity to ensure that a vigorous hemispheric dimension to Canada's economic diplomacy is no longer primarily the stuff of after-dinner toasts and public posturing.

On the one hand, Canada's commitment to the open, multilateral trade and investment system necessarily remains strong, as evidenced by the policy resources dedicated by the federal government to ensuring an effective launch of the work of the new World Trade Organization (WTO). Canada is a major world trader and will continue to play a very active rôle in key policy development and management fora such as the WTO, the Organization for Economic Cooperation and Development (OECD) and the periodic meetings of the Quadrilateral trade ministers (i.e., from Canada, the European Union, Japan and the U.S.). Moreover, the successful management of our economic relations with the U.S. requires creativity, adroitness and a cool head to a degree unparalleled vis-à-vis any other single partner. These institutions and relationships collectively represent the major league of our global trade and investment policy where the level of Canada's "game" must be and is recognizably of the first order (e.g., the WTO with its over-arching dispute settlement

[1] The author is Canada's Chief Negotiator for Chile's accession to the NAFTA.

mechanism was a Canadian idea launched in 1990).

On the other hand, this "big league" approach, while central, is no longer sufficient. Additional active countries have come forward, while since the mid 1980s the dynamism of international trade and investment rule-making has flowed as much from regional reform efforts toward the WTO/OECD/Quadrilateral world as the reverse. Trade and investment opportunities are emerging in the Americas that appeared to be pipe-dreams just ten years ago. Moreover, and just as importantly, several Latin American countries seek further clear, balanced and enforceable rules of the game that often coincide with Canadian views and will help to enhance and secure our access in the other Quadrilateral markets. In this regard, for example, the management of economic relations with the U.S. is no longer solely a matter for intense bilateral efforts underpinned by hard work multilaterally in the WTO in Geneva. The broader hemispheric neighbourhood, that ten years ago was frustrating as an export market and irrelevant to managing our relations with the U.S., has now unmistakeably "arrived".

This Paper will: (a) review how the international trade policy context has changed in recent years; (b) discuss the continuing vitality of regional initiatives; (c) outline the possible direction of Canada's new hemispheric trade policy; and (d) identify and review a number of techniques for achieving a freer trade and investment system in the Americas.

2. Backdrop

Over the past ten years, the world has undergone stunning, fundamental change. Perhaps most spectacularly, the end of the Cold War has forced a radical reinterpretation of the meaning of security, while also removing a major ideological barrier to the further integration of the world trade and payments system. The stark demythologizing of central planning and the so-called workers' state has combined with the at best mediocre gains generated by import substitution policies in many countries compared to the relative success of those régimes that wagered heavily on export growth and the careful management of domestic fiscal and monetary fundamentals. The balance sheet - while inevitably replete with nuances - indicates more clearly than ever before the substantial merits of the competitive market-place for sustaining growth.

Persistent economic and social failure in some countries, especially in sub Saharan Africa and in Haiti in the western hemisphere, and the deterioration of income distribution in several developing countries that are adapting through the market-place serve as salutory reminders that success overall can still carry within it important challenges of addressing marginalization and adjustment costs.[2] But few analysts believe that command economies can provide lasting solutions to such challenges, or that countries can successfully achieve sustainable growth through persistent and large deficit financing. Rather, the debate now centres on the detail of government involvement <u>within</u> the context of solid domestic economic fundamentals and <u>in light of</u> the critical importance of competing in regional and world markets.

Moreover, the growing acceptance of market forces[3] has strengthened an underlying trend toward deepening cross-border economic integration reflected in flows of goods, services, investment and technology that have increased at rates that have consistently outpaced growth in domestic economies over the past generation. In turn, increasing cross-border competition and integration continue to create further pressure for minimizing substantive differences between jurisdictions in many areas that policy-makers had considered quintessentially domestic and local in the past.[4] The reality and ideology of growth have thus converged to a considerable degree and on a more global scale than ever before.

Although much work remains, the recent results of this search for convergence and the resulting benefits are impressive. For example, the international trading community, and in particular the U.S. and the European Union, finally found the political will in 1994 to conclude the almost eight-year saga of the Uruguay Round of multilateral trade negotiations. The newly adopted WTO and its constituent agreements on goods, services, intellectual property, certain investment obligations,

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[2] On recent income distribution trends, see the draft paper by Albert Berry and Frances Stewart, "Market Liberalisation and Income Distribution: The Experience of the 1980s" (Ottawa: The North-South Institute, June 1994), as well as Albert Berry, "The Social Challenge of the New Economic Era in Latin America", Centre for International Studies (University of Toronto) and the Canadian Foundation for the Americas (FOCAL) Discussion Paper 1995-8 (Toronto, 1995).

[3] With governments debating how best to address "imperfect" markets and market "failures" where these occur and have an anti-competitive impact.

[4] For further background, see Keith H. Christie, "Globalization and Public Policy in Canada: In Search of a Paradigm", Foreign Affairs and International Trade Canada, Policy Staff Paper No.93/01 (January 1993).

dispute settlement and other trade rules took effect in January 1995.[5]

The OECD has estimated that the reductions in tariff and non-tariff barriers negotiated in the Round will increase world gross domestic product (GDP) by at least US$270 billion annually by the year 2002, with the non OECD countries receiving approximately $86 billion of these benefits.[6] This developing country share is half again as large in value terms as the annual Official Development Assistance they received in the early 1990s from the OECD countries. In fact, the gains overall will be considerably larger, as the modelling used to derive these results inadequately captures the dynamic growth effects achieved through specialization, scale economies and the confidence-building impact within the business community that a more secure trading framework invariably creates. In addition, the OECD estimate does not include the economic benefits that will flow from the liberalization of trade in services, the establishment of what should be a considerably strengthened dispute settlement mechanism and additional important aspects of the final package.

More recently on the multilateral front, the final Uruguay Round package included understandings to pursue and complete the negotiations on several specific files that participants could not conclude in 1994. This unfinished business covers several areas of trade in services as well as government procurement, with deadlines ranging from mid 1995 to mid 1996.[7] Moreover, the OECD has been pursuing its traditional and very useful "pathfinder" rôle since the early 1990s by pushing forward pre-negotiation analysis and discussions on newer issues such as the relationship between trade and the environment, and the linkages between trade, competition (anti-trust) law and the cross-border, predatory dumping of products by firms that

[5] Some of the new obligations will be phased-in over varying lengths of time during the next several years. For an accessible summary of the Ururguay Round results, see Jeffrey J. Schott, with Johanna W. Buurman, **The Uruguay Round: An Assessment** (Washington, D.C.: Institute for International Economics, 1994).

[6] OECD, **Assessing the Effects of the Uruguay Round** (Paris, 1993), pp.7, 20-1.

[7] More specifically, financial services and the freer movement of business-people and professionals by mid 1995; access commitments related to procurement of goods and services by governments for their own use - by the end of 1995; basic telecommunications services by April 1996; and maritime services by mid 1996. "Basic" telecommunications comprises widely available, public tele-communications transport networks (e.g., primary phone lines, as distinct from value-added services that use these lines, including fax, voice mail, Internet, data processing transmissions, etc. that have already been the subject of negotiations in the Uruguay Round and the NAFTA).

anti-dumping law is allegedly designed to discipline.[8] In the May 1995 OECD ministerial meeting, the decision was also taken to launch negotiations to move beyond the modest Uruguay Round harvest on investment by establishing a comprehensive Multilateral Agreement on Investment (MAI). While initially envisaged as an exercise among OECD members, the door is left open for the MAI's extension to non OECD countries once negotiations conclude, perhaps as early as June 1997. In addition, negotiations are underway that should lead to the accession of several more countries to the WTO, most importantly China and, over the longer term, Russia.

Evidently, further creative trade policy activity is underway multilaterally. Much of the dynamism driving economic integration has originated, however, at a regional or sub-regional level. This phenomenon is entirely natural. Much of the growth in world merchandise trade over the past generation has occurred on a regional basis. In 1993, over 65 percent of OECD European imports came from other OECD European countries, in comparison to 1960 when this ratio was 52 percent. With regard to North America, the share of intra-regional imports to total imports fell from its peak of 43 percent in 1969 to a trough of 32 percent in 1987. Since then, however, the intra-regional import ratio has climbed slowly but steadily. With regard to Asia, the share of intra-regional imports also increased, almost doubling from 18 percent in 1960 to over 30 percent in 1992. In recent years, growth in intra-regional trade in Latin America (followed by growth of its trade with North America) has also been considerably more robust than its trade with the rest of the world.[9]

Regional trade creates the conditions for and is further fuelled by formal, treaty-based commitments. From a results-based vantage point, regionalism is neither better than, nor dangerous for multilateralism. It is neither a predestined building block nor an inevitable stumbling block to more globalized liberalization. Despite sometimes well-founded fears about the trade-diverting impact of regional trading blocs, in

[8] Since 1992, Policy Staff of Foreign Affairs and International Trade has undertaken research on several of the "frontier" issues, both to highlight the nature of the policy questions raised by prospective negotiations in these areas and to make a start on collecting the information needed to negotiate. The results of this work are available in the form of Policy Staff Papers and Commentaries on issues such as trade and competition policy. A collection of Papers on trade and environmental and labour standards and their enforcement recently appeared in Keith H. Christie, ed., **New Directions: Environment, Labour and the International Trade Agenda** (Ottawa: Carleton University Press, 1995).

[9] Julie K. Fujimura, "Towards Regional Economic Blocs: Are We There Yet?", Foreign Affairs and International Trade Canada, Policy Staff Paper No.95/01 (February 1995), pp.33-9. See also GATT, **International Trade: Trends and Statistics** (Geneva, 1994), pp.6, 15-6, 24, 32, 35, 52.

practice regionalism can be a tool to achieve a positive end: growth and job creation.

The two processes, the multilateral and the regional, have often interacted, sometimes easily, sometimes with a certain creative tension, to improve overall access to markets. For example, the establishment and increasing scope of western European integration is the most ambitious and comprehensive example of the regional process at work. But the challenge of a more dynamic Europe has also encouraged others to deepen international trade and investment rule-making. To take another example, the agenda established at the launch of the Uruguay Round in September 1986 helped to shape the Canada-U.S. Free Trade Agreement (FTA) which in turn had a positive demonstration effect on the Round. This creative tension extended to the NAFTA and the final Uruguay Round package.

These mutually reinforcing efforts are salutory. They strengthen the pace of reform internationally. They lock-in domestic reforms that might otherwise suffer backsliding under pressure from local special interest groups unless underpinned by enforceable treaty obligations. And, consequently, they help to contain the unilateral impulses of the larger economies. Regional as well as multilateral efforts help to maintain the momentum for strengthening the rules-based trade and investment system.

The past ten years have witnessed other important efforts to build on regional strengths and opportunities in search of improved and more secure access in neighbouring markets. For example, proposals for enhanced regional integration in south-east Asia and recent efforts to deepen trans Pacific trade relations are important signposts.

Since the late 1980s, free trade activity in the western hemisphere has also sharply increased. For Canada, the first major step towards playing the regional trade and investment card came with the negotiation of the Canada-U.S. FTA, which entered into force in January 1989. There have also been important efforts to revitalize the Andean Pact, the Central American Common Market and the Caribbean Community. Mexico and Chile negotiated a free trade agreement that entered into effect in 1992 (the focus is primarily on the phase-out of import duties on bilateral commerce), while Mexico, Colombia and Venezuela have done the same (with their agreement becoming operative in January 1995). Other such agreements have also been completed or are under consideration. Amid this activity, two agreements in particular stand out, because each contains the promise of a much more ambitious hemispheric project: the North American Free Trade Agreement (NAFTA) and MERCOSUR.

The NAFTA took effect in January 1994. This agreement was the result of intensive negotiations that began formally in June 1991 and really only ended in late 1993 with the decision of the new Liberal government to proclaim the implementing legislation in Canada. In between came a tortuous path that included agreement on the negotiators' text in August 1992, the legal rectification or fine-tuning of the text that autumn, the negotiation of the side agreements on environmental and labour cooperation during the spring and summer of 1993 and the sometimes difficult process later that year of monitoring the drafting and Congressional approval of the U.S. implementing legislation.[10] The NAFTA drew its inspiration from diverse sources, including the FTA and key draft agreements that countries were labouring on multilaterally in the Uruguay Round (path-breaking work on intellectual property rights is perhaps the clearest example of the influence of the Round on the NAFTA negotiations).

The NAFTA is central to any discussion of western hemisphere economic integration for several reasons. First, it is the most comprehensive economic agreement in force in the Americas. It covers not only traditional tariff and non-tariff issues, but also important obligations on other matters related to trade in goods (e.g., detailed customs procedures; government procurement practices). Moreover, the NAFTA contains extensive provisions on trade in services (using the principle that everything is covered unless explicitly exempted) and intellectual property rights (that go beyond the Uruguay Round results in certain respects), as well as path-breaking provisions on investment and high quality dispute settlement procedures, including a unique binational panel system that replaces domestic courts in the review of national anti-dumping and countervailing duty determinations.

Second, the NAFTA package includes the two side agreements on environmental and labour cooperation, which contain provisions aimed at strengthening the enforcement of domestic standards in areas that are as close (if not closer) to social policy as they are to trade policy. Third, the NAFTA is evidence of the ability of countries at different levels of development but with the same underlying policy commitment to craft an ambitious, legally binding framework that promotes very close economic relations. The NAFTA provides for limited exceptions for each

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[10] The new Canadian government accepted proclamation only when its NAFTA partners agreed to establish two working groups (on dumping and anti-dumping duties, and on subsidies and countervailing duties) with a mandate to seek solutions that reduce the possibility of disputes on these matters. This arrangement commits the Parties to develop concrete recommendations by the end of 1995. Underlying this process is a long-standing Canadian interest in achieving agreement on reciprocal exemption from trade remedy law within the free trade area.

of the member countries and for phase-in periods in areas requiring additional time for adjustment, but there are no second class members and no special treatment for any given member when the package is viewed as a whole.[11]

Finally, negotiators consciously designed the NAFTA as an outward-looking agreement, with the potential to expand to include new members on a fully reciprocal basis. Specifically, Article 2204 (originally a Canadian proposal subsequently adopted by Mexico and the U.S.) reads:

> Any country or group of countries may accede to this Agreement subject to such terms and conditions as may be agreed between such country or countries and the Commission [comprising, in practice, the trade ministers of member countries] and following approval in accordance with the applicable legal procedures of each country.

This accession clause contains no geographic limitation and provides the NAFTA with the mechanism required to play a central rôle in the broader, hemispheric free trade debate.

For its part, MERCOSUR represents an important achievement for Argentina, Brazil, Paraguay and Uruguay. At the broadest level, MERCOSUR is a landmark agreement that expresses the political determination of Argentina and Brazil in particular to put their on-again, off-again geo-strategic rivalry behind them in favour of intensified cooperation. This agreement is also reasonably comprehensive in its economic intent, although rather less so in practice to date.

MERCOSUR was created in March 1991 with the signing of the Treaty of Asunción. The Treaty was further fleshed out in a series of subsidiary documents, including the Protocol of Ouro Prêto (Brazil) agreed to in December 1994. The concept is bold enough: the establishment of a common market involving the "free movement of goods, services and factors of production" among member states, the establishment of a common external tariff (CET), the adoption of a common trade policy and the coordination of macroeconomic and sectoral policies.[12] The reality to

[11] The economic crisis that began in Mexico in December 1994, the effects of which are still being felt, in no way modifies the judgement that the NAFTA represents a remarkable bridging of the North-South thinking that distorted so much economic policy-making until the past ten years or so. The root cause of the crisis was the domestic political decision in Mexico to keep the peso over-valued during most of 1993-4, despite a large and deteriorating current account deficit.

[12] See Article 1 of the Treaty of Asunción.

date is less sweeping (in several ways, considerably less so than the NAFTA), although still significant. In practice, the member states have focused on trade in goods and, in this regard, especially on the harmonization of import duties and the elimination of non-tariff border measures (NTBs).

The initial intent was a zero tariff and a full prohibition of NTBs for intra-regional trade by January 1995, with Paraguay and Uruguay enjoying an additional year to reach full phase-out. There has been slippage, however, with national exceptions extended for a further four years with regard to the intra-regional tariff, and some 200 identified NTBs still in place.

Moreover, and after considerable additional negotiation, the CET for most imports from non MERCOSUR sources took effect in January 1995.[13] Exceptions remain in this area as well. The current intent is to phase-in the CET for these extra-regional exceptions over either six or eleven years. Nonetheless, pressures to back-slide persist. Since early 1995, Brazil unilaterally (although on a "temporary" basis) increased its tariff on more than 100 classes of goods of non MERCOSUR origin and imposed import quotas on motor vehicles, the four member states agreed that Brazil could increase the number of its national exceptions subject to the longer phase-in, and Argentina reintroduced a so-called "statistics tax" (at three percent) on imports of most goods, thereby also violating the CET.

In addition to these problems with the CET, the common market does not yet include cross-border trade in services, intellectual property rights, product standards and regulations or government procurement, which are important features of the NAFTA. Nonetheless, there are positive achievements apart from the work on harmonizing import duties. A special MERCOSUR protocol covers many NAFTA-like rules and procedures on foreign investment. In addition, reasonably complete dispute settlement procedures are in place (including provision for binding rulings by panels of experts).[14]

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[13] As of January 1995, the CET covered about 85 percent of tariff lines, with duty rates ranging from zero to 20 percent.

[14] C. William Robinson, "MERCOSUL: What It Is, What It Does" (Brasilia, April 1995) is a competent and readable survey of evolving MERCOSUR rights and obligations. See also the January 1994 Colônia Protocol and the August 1994 Buenos Aires Protocol on investment and the December 1991 Brasilia Protocol on dispute settlement.

Thus, MERCOSUR's track record is mixed so far. On balance, however, it is the most ambitious attempt yet to deepen formal economic integration among selected Latin American states. Moreover, the Treaty of Asunción (Article 20) provides for accession by certain other countries.[15] Despite its limitations, MERCOSUR represents the most important, treaty-based trading area among developing countries, with a population of almost 200 million and a joint GDP of US$750 billion, approximating the combined GDP of China, Hong Kong, Malaysia and Thailand. MERCOSUR countries, whether collectively or individually, are well positioned to play a major rôle in the coming debate on hemispheric free trade.

3. And Promises to Keep

The recent past has witnessed important, concrete changes in the way the international community, including in the western hemisphere, views trade and investment interdependence. Real gains have been made. And despite a certain negotiations fatigue following the conclusion of the NAFTA and the Uruguay Round, further path-breaking proposals are now in play.

An important part of the action remains multilateral, or at least plurilateral among developed countries. In this regard, the push to complete the Uruguay Round's unfinished business on trade in services and government procurement, the WTO accession negotiations with China and others, and the recent OECD decision to begin negotiations to establish a Multilateral Agreement on Investment were mentioned above. Preparations are now also underway for the first WTO ministerial meeting scheduled for December 1996 in Singapore, a meeting that could identify an agenda and put in train a process that will lead to the launch of the next comprehensive trade "Round" by the end of the decade. Interestingly enough, however, most of the headlines and a significant share of the available negotiating resources and creative energy is focused on regional initiatives.

Without question, regionalism weighs much more importantly today than was the case following the conclusion of the penultimate great multilateral negotiations - the Tokyo Round that ended in 1979. The evolving negotiating agenda is now very complex and increasingly expansive. More players everywhere are prepared to engage more substantively than before, although some newly industrializing economies more clearly than others depending on the issue. In addition, several developing countries

[15] But only other members of the Latin American Integration Association (most commonly known by its Spanish acronym ALADI) - Bolivia, Chile, Colombia, Ecuador, Mexico, Peru and Venezuela are the ALADI members apart from the MERCOSUR partners.

are more concretely committed than some industrialized nations to specific trade reforms (the willingness of certain Latin American and Asian countries to push much harder than the European Union for far greater cuts in agricultural subsidies during the Uruguay Round is a case in point). With an increasing number of issues in play, and more players prepared to engage actively but often at cross-purposes, the multilateral game has become more difficult to sustain without creative regional efforts that seek to go farther faster, thereby goading the global system as a whole into action. In this regard, three regional initiatives have recently captured much attention: trans Pacific, western hemisphere and trans Atlantic free trade.

The first push has focused on trans Pacific trade and investment relations. At the heart of this approach, we find the Asia Pacific Economic Cooperation (APEC) forum established in 1989.[16] The APEC has been helpful in encouraging greater dialogue on economic matters across the Pacific. An impressive network of private sector and government level institutions has emerged, topped off by the annual meeting of government Leaders initiated in 1993. In their first meeting, Leaders committed themselves in general terms "to continue to reduce barriers to trade and investment to enable goods, services and capital to flow freely among our economies". A year later at their meeting in Indonesia, APEC Leaders reiterated the importance of the multilateral system by agreeing to accelerate the implementation of their governments' Uruguay Round commitments (without specifying which commitments nor how), to pursue further liberalization multilaterally and to work for the successful launch of the WTO.

Nevertheless, the most innovative and concrete new element emerging from the Indonesia meeting had a distinctly regional flavour. The Leaders adopted "the long-term goal of free and open trade and investment in Asia Pacific". Furthemore, they agreed:

> to announce...[their] commitment to complete the achievement of...[their] goal of free and open trade and investment in Asia Pacific no later than the year 2020. The pace of implementation will take into account the differing levels of economic development among APEC economies, with the industrialized economies achieving the goal of free and open trade and investment no later than the year 2010 and developing economies no later than the year 2020.[17]

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[16] APEC brings together Canada, Chile, Mexico and the U.S. on this side of the Pacific with Australia, Brunei, China, Hong Kong, Indonesia, Japan, Malaysia, New Zealand, Papua New Guinea, Philippines, Singapore, South Korea, Taiwan and Thailand.

[17] See the "APEC Leaders' Statement of Common Resolve", Bogor, Indonesia (15 November 1994), paragraphs 2, 5 and 6.

Given the diversity of the economies in APEC and the continuing hesitancy of several key members to engage in substantive negotiations leading to binding commitments that go much beyond the Uruguay Round results, the challenges that must be overcome to meet this pledge are considerable. Forward movement to date has been modest. By the time of the 1997 APEC Leaders' Summit that Canada will host, a significant down payment of specific actions and agreement on a negotiating agenda will be necessary if this pledge is to retain credibility. For the time being, however, APEC members have at least agreed on a relatively ambitious "mission statement" and have thrown down a gauntlet of sorts, helping thereby to sustain the momentum of the international liberalization message during the period of immediate post Uruguay Round fatigue.

The gauntlet was next taken up just four weeks later in the western hemisphere. In December 1994, the 34 democratically elected Heads of Government of the Americas met in Miami in their first Summit in 30 years. The Leaders declared "a partnership for development and prosperity" and focused on three broad principles - democracy, free trade and sustainable development - as the underpinnings of the emerging hemispheric community.

With regard to the trade and economic integration component, the Leaders of the western hemisphere trumped their Asian colleagues by declaring:

> We, therefore, resolve to begin immediately to construct the "Free Trade Area of the Americas" (FTAA), in which barriers to trade and investment will be progressively eliminated. We further resolve to conclude the negotiation [of the FTAA] no later than 2005 and agree that concrete progress toward the attainment of this objective will be made by the end of this century.[18]

Not only is the formal end-point for completing the process considerably more immediate than that contained in the Bogor Declaration, but the rest of the language also reflects a greater sense of commitment to get on with the job soon and a greater sense of self-confidence among the developing countries in the hemisphere, as evidenced by their acceptance of the common end-date (2005 versus the 2010/2020 split in Bogor).

Moreover, the Leaders approved a more detailed plan of action that unabashedly outlined a comprehensive negotiating agenda and a shorter term preparatory phase aimed at developing the information base required to negotiate. Ministers responsible for trade were instructed to meet in Denver in June 1995 to review the work in

[18] See Summit of the Americas, "Declaration of Principles", Miami, December 9-11, 1994. Emphasis added.

progress.[19]

Finally, the Miami Summit was significant as it served as the occasion for the Prime Minister of Canada and the Presidents of Chile, Mexico and the United States to announce their decision to begin the process by which Chile would accede to the NAFTA, thereby providing a concrete regional example of the will to move forward.[20]

The impact of the APEC and western hemisphere initiatives was soon felt in another direction - across the Atlantic. In late 1994, Canadians first launched the idea of a trans Atlantic free trade arrangement - potentially going much beyond current multilateral commitments in the WTO toward a special European Union-NAFTA link. Both Prime Minister Chrétien and Minister for International Trade MacLaren spoke early and clearly - and initially to skeptical audiences.

Recognizing the reality that north Atlantic security ties had fallen away to a considerable degree with the end of the Cold War, the Canadians focused more sharply on the economics of the relationship. In this regard, important changes have occurred over the past 30 years. Through all the shifts, however, the trade, investment and technology links have remained strong and fundamental to prosperity on both sides of the Atlantic.[21] Moreover, both North America and Europe retain their basic commitment to open markets and to the rule of law, which must exist if countries are to formalize their rights and obligations internationally. Yet both Europe and North America have traditionally focused their treaty-based economic relations through the WTO and its predecessor the General Agreement on Tariffs and Trade (GATT), while pursuing greater integration closer to home. This has led to a perception of drift in the formal economic relationship between the two continents in

[19] See section 9 of the Summit of the Americas, "Plan of Action", Miami, December 9-11, 1994.

[20] See the "Four Leaders' Statement on Chile", Miami, December 11, 1994. The next section will return to the case of Chile and its importance for the broader FTAA initiative.

[21] In the case of Canada, the changes include, for example, the significant decline in the relative importance of Europe as an export market, but its strengthened rôle both as a source of investment in Canada and as a host for Canadian investment abroad. Proportionally, U.S.-EU economic links remain markedly greater. See Stephen Wilson, "Changing Partners: Trends in Canada's Regional Economic Relations", Foreign Affairs and International Trade Canada, Policy Staff Paper No.95/02 (March 1995) and Stephen Lavergne and I. Prakash Sharma, "Renaissance: Re-engineering the Trans Atlantic Economic Relationship", Foreign Affairs and International Trade Canada, Policy Staff Paper No.95/13 (forthcoming 1995).

the 1990s. Canadian leaders believe that this drift is not healthy, and have identified a much more deeply integrated trans Atlantic market as having the potential to create a "North Atlantic renaissance".[22]

The concept subsequently gathered momentum. During 1995, EU, British, German and U.S. leaders and commentators were particularly open about recognizing the drift. Many, but not all, have joined the Canadians in proposing a number of concrete building blocks that could bring closer term benefits, while also providing momentum that could eventually lead to a more comprehensive negotiations phase.[23] The intellectual debate is reasonably well engaged - and certainly more positively than seemed possible when the concept was first broached in 1994. The challenge now is to focus realistically on concrete next steps.

There should be no doubt about the importance of these regional initiatives, although they enjoy differing degrees of precision and different senses of timing. They comprise key tracks along which the trading community will pursue better market access through further rule-making, whether on a building block, step-by-step basis that remains largely regional, or by folding some or all of these processes into a more comprehensive, global negotiation sooner rather than later - that is, through the launch of a new multilateral trade Round. There are many good ideas and surprisingly broad interest in seeking further economic integration - from this perspective, we live in stimulating times. The real question, nonetheless, is how to move toward the concrete negotiations stage; that is, how do we get from here to there? In this regard, the regional initiative that has so far generated the most concrete, albeit still fragile, momentum lies in Canada's immediate backyard - the western hemisphere. Consequently, the next two sections will focus on a fuller discussion of what this phenomenon is and where it might lead us.

4. The Hemispheric Road-Map: The Case of Chile

Chile's accession to the NAFTA is important for several quite different reasons. Accession will bring Chile improved and more secure access in the North American

[22] See "The Occident Express: Toward Transatlantic Free Trade", Notes for an Address by the Honourable Roy MacLaren, Minister for International Trade, to the Royal Institute of International Affairs, London, England, May 22, 1995, p.4.

[23] Examples of such building blocks include an agreement on the mutual recognition of information technology and telecommunications standards, as well as greater cooperation in the area of anti-trust investigations.

market-place. Accession also provides a high profile, high quality endorsement of the trade and economic policies in place in Chile, thus increasing the likelihood that the international community will continue to view Chile as a good site for investment. Accession will help to lock-in reform efforts in Chile by linking these policies to mutually binding obligations enforced through an international treaty.

For Canada as well, there are benefits. With only 14 million people, Chile is not likely to become more than a modest, although increasingly interesting, niche market for Canadian traders (exports topped just $300 million in 1994). Nonetheless, the elimination of Chile's 11 percent import duty on, and certain non-tariff barriers affecting, North American products will open up new opportunities. In addition, Canadian firms have invested heavily in Chile since the mid 1980s, with a stake of approximately $2 billion to date and another $3-4 billion in various stages of planning. This presence makes Canada the largest source of foreign investment in the Chilean mining sector and the second most important foreign investor overall after the U.S., with interests also established in banking, communications and the energy sector. Although Chile's investment regime in practice is transparent and non-discriminatory, accession to the NAFTA will provide Canadian share-holders with additional formal guarantees against any future back-sliding toward discriminatory practices - a kind of insurance policy.

Reflecting its solid domestic economic record, moreover, Chile has also established a well-deserved reputation for having a creative, market-based trade policy that in many ways parallels policies promoted by Canada. Consequently, Chile will be a welcome addition to the NAFTA. Chile and Canada should be able to work closely in further deepening the rule-making within the free trade area to achieve even more secure access to the U.S. and Mexican markets (further discipline on the misuse of anti-dumping law is a prime example).

But the seminal importance of the negotiation with Chile lies with none of these reasons. More critically, Chile is the test case of the capacity of the NAFTA, through its accession clause, to re-invent itself into a dynamically outward-looking instrument with a central (perhaps <u>the</u> central) rôle in achieving hemispheric free trade by 2005. Put another way, Chile is the test case that will take the true measure of the credibility of North American and particularly U.S. trade policy vis-à-vis Latin America.

In this regard, the next critical step is the ability of the U.S. Administration and the Congress to craft and implement a broadly non partisan bill providing the former with appropriate negotiating authority. Such "fast-track" authority will permit the relatively clean, expedited approval of the implementing legislation that will eventually be required to adapt U.S. law to the new obligations flowing from Chile's accession to the NAFTA. Without "fast-track" in place, Chile has made it clear publicly that it will not agree to conclude the negotiations that were formally initiated by the NAFTA trade ministers and Chile's Finance Minister at their meeting in Toronto on June 7, 1995.[24]

The underlying stakes have been well understood by all parties to the negotiation: get Chilean accession "right", and North America's credibility with regard to achieving hemispheric free trade is considerably strengthened; get Chile "wrong" - that is, no accession because of a failure in the U.S. system - and the most dynamic force behind the 2005 project would be lost.

At the time of writing, the Chilean accession process is moving slowly. The U.S. Administration and the Republican leadership in Congress are still struggling toward agreement on appropriate terms for "fast-track".[25] Failure to achieve "fast-track" in 1995 will effectively postpone Chilean accession negotiations until 1997, after the conclusion of what likely will be a very partisan and not very policy-creative election year in the U.S.. Despite this short-term uncertainty, Chilean accession to the NAFTA remains a priority for Canada, as well as for the U.S. Administration and Mexico. Moreover, attention is also beginning to shift beyond the Chilean prelude to the management of the next stage in the hemispheric integration process, for which the preparatory phase is necessarily somewhat longer.

5. The Hemispheric Road-Map: Beyond Chile

Parallel to the Chilean accession negotiation, the preparatory work continued on the December 1994 Summit goal of a Free Trade Area of the Americas (FTAA).

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[24] Under "fast-track", U.S. implementing legislation must be either approved or rejected in its entirety, with no amendments allowed once formally tabled, in either the House of Representatives or the Senate. To enter this stage without "fast-track" means that amendments that undermine the negotiated package would not only be entertained but might also be approved, given the relative lack of party discipline in the U.S. system. The foreign country, in this context, would in effect be obliged to negotiate twice - once with the Administration and a second time with shifting Congressional coalitions. Understandably, foreign governments are loathe to do so. The FTA, the NAFTA and the Uruguay Round package were all approved under previous "fast-track" authorities.

[25] Including an understanding that should allow Chile to accede to the two NAFTA side agreements on environmental and labour cooperation.

The next step was taken at a hemispheric trade ministers' meeting held in Denver, USA in late June 1995.

The ministerial declaration issued in Denver moved the preparatory work forward. It is in the nature of such complex, multi-nation exercises that participants begin to position themselves on substantive matters once the focus shifts away from the "big picture" objectives toward the detail of what might be negotiated in practice. The Denver declaration is no exception. It staggers the preparatory activities, with some beginning immediately and other aspects starting only at a later date. Moreover, the link between the preparatory work and a subsequent negotiations phase is more explicit in some areas (e.g., the elimination of import duties) and less clear in others (e.g., investment-related obligations), reflecting a combination of policy differences among the participants and (more optimistically) pre-negotiation posturing.

This is natural enough. The mere fact that senior representatives of most countries in the hemisphere are regularly sitting around the same table exploring how to achieve a comprehensive free trade area is nothing short of revolutionary - an indication of how far economic policy in the region has shifted. It is natural that certain smaller economies want the discussions to reflect their "special" transitional needs and that certain larger economies (especially Brazil) want to mould the agenda and the rhythm of this process to underscore their "central" rôle. It is also true that the degree of economic policy coherence varies within the region. This fact also reflects itself in the language adopted in public statements.

Nonetheless, the Denver declaration did clearly take a further step forward towards the free trade area objective. It established a preparatory work programme explicitly linked to the eventual initiation of negotiations. Ministers confirmed that the FTAA should be very comprehensive in scope (covering, inter alia, goods, services, investment and intellectual property) and that the final package would represent a "single undertaking".[26] Seven working groups were established, with four more to follow in early 1996, covering most major issues and charged with developing the information base and recommendations aimed at facilitating the initiation of "active negotiations". Ministers also approved a reasonably detailed work plan for each

[26] This is "code" language borrowed from the Uruguay Round. It is an important statement to the effect that the rights and obligations in each specific policy area are considered as part of a larger whole and not as individual stand-alone commitments from which a country can pick and choose. The single undertaking principle also implies that the various policy areas will be governed by a single over-arching institutional framework, including common dispute settlement procedures.

group.[27] The next ministerial session will occur in March 1996 to "determine... the next steps", including timetables for further work. It is agreed that a third ministerial meeting will follow, likely in early 1997.

The next challenge is to build on the positive but still tentative Denver results and the subsequent preparatory work by developing a concrete timetable leading to the launch of formal negotiations with a view to achieving a credible mid term harvest of binding commitments by the year 2000. In their next meeting in Cartagena, Colombia in March 1996 and in the third session that will follow, participants will have to focus more sharply on the how and when of initiating negotiations, if they are to maintain current momentum and expectations.

What might provide such momentum? First, the detailed work programme launched in Denver should help to keep all regional players focused on the free trade objective. A different country chairs each of the seven working groups created in Denver and the venue of the ministerial meetings will also likely vary. This is positive, as it reinforces the process among the more than 30 countries of "buying" into the 2005 vision. Nonetheless, participants with the resources to help drive the preparatory activity, and this includes Canada in the first ranks, will have to work hard to ensure that the momentum in the current preparatory phase does not become beached on the twin shoals of technical minutia and the lesser commitment of some countries to a comprehensive 2005 package. The Denver/Cartagena work programme is, therefore, necessary to achieve the FTAA, but not likely close to being sufficient to provide adequate momentum.

Second, countries that are in a position to negotiate must move forward forcefully over the next two or three years in order to create a concrete free trade dynamic that will echo back positively into the broader FTAA process. For Canada and the U.S., this includes working for deeper economic relations with countries that are solid candidates for NAFTA accession over the medium term (i.e., before the year 2000). North America must position itself to begin substantive negotiations sooner rather than later. For its part, the Canadian government is a strong, public advocate

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[27] The working groups include: market access (tariffs and non-tariff barriers on goods); customs procedures and rules of origin; investment; standards and technical barriers to trade; sanitary and phytosanitary measures; subsidies, antidumping and countervailing duties; and the factors affecting smaller economies. The four groups that will begin work in March 1996 cover: government procurement; intellectual property rights; services; and competition policy. See "Joint Declaration", Summit of the Americas Trade Ministerial, Denver, Colorado, June 30, 1995. Conspicuously absent is a group on dispute settlement, an issue central to an effective FTAA.

of further NAFTA accessions and the wider FTAA process. Moreover, once the 1996 presidential election process has run its course, that is by 1997, the U.S. should be in a technical and political position to engage seriously. In trade policy terms, 1997 is just around the corner.

In all likelihood, this date will be too soon for several of the smaller economies in the region as well as for some of the bigger players including Venezuela, where economic difficulties over the past few years have strengthened the preference for a slower, less comprehensive process.

On the other hand, Colombia should be a prime candidate for NAFTA accession on economic grounds. This country enjoys a solid and sustained economic track record and the most balanced and dynamic export sector in northern South America.[28] Its entry into the NAFTA would represent another clear, concrete step toward strengthening the Agreement, while helping to create the momentum needed to kick-start real FTAA negotiations as other countries begin to feel left behind.

More ambitiously, the central relationship that will make or break the broader FTAA initiative is that between the NAFTA countries and their MERCOSUR counterparts, collectively or individually. The fact is that these countries comprise the bulk of the hemisphere's production, trade, investment and population. How might these two groups converge?

One option is for the two blocs to negotiate an entirely new agreement that would replace the NAFTA and MERCOSUR (other countries in the region presumably could also participate). In effect, this approach would become a bottom-up construction of the FTAA, although the work of negotiators would be facilitated by having provisions found in existing agreements as technical guideposts. This option, nonetheless, has at least three defects. First, it would be very time-consuming and labour-intensive. Second, the end result would likely be less comprehensive than the NAFTA, as it would have to accommodate smaller economies and some major participants (including Brazil) which are uncomfortable with the scope of the NAFTA's

[28] Despite resilient inflation in the 20%-30% range and a less than stellar performance with regard to the current account of the balance of payments in 1993-94, most economic indicators for Colombia are solid: a combined public sector fiscal deficit averaging only 0.6% in 1990-94; an average annual real GDP growth rate of 4.5% since 1970 (an estimated 5.3% in 1994); a lowering of external public indebtedness from 37% of GDP in 1990 to 20% in 1994; goods other than coffee and petroleum products accounting for about 60% of exports; and effective, market-sensitive exchange rate management. See International Monetary Fund, Colombia: Recent Economic Develoments (Washington, December 1994).

coverage (e.g., with regard to intellectual property rights and trade in services). Third, a new agreement started from scratch would engage us for the third time within a decade in a fairly detailed negotiation with the U.S., thereby potentially reopening the balance reached in the FTA and the NAFTA that safeguards Canadian sensitivities.[29]

A second option would be for each NAFTA country to negotiate a separate bilateral free trade agreement with the MERCOSUR, recognizing that the latter is a customs union that would hope to negotiate as a unit. This approach could be seen as a parallel to the pattern developed in Europe whereby individual members of the European Free Trade Association (EFTA) established separate arrangements focused primarily on tariff preferences with the European Union - the more comprehensive, ambitious regional agreement in that instance. The possible defects of this approach in the Americas are several.

First, the U.S., given its economic weight in the hemisphere, would likely negotiate a better result than Canada could acting on its own. An asymmetrical result favouring U.S. access to the MERCOSUR market would not serve Canadian interests in the region. Second, it is not at all clear that the EFTA example is germane. In the European case, the EU was not only a customs union, but also a much more comprehensive association than EFTA and by far the biggest market and source of investment. In the western hemisphere, the NAFTA countries are the "jewel in the crown" - comprising the most prosperous and dynamic sub-regional unit and the group most committed to comprehensive economic integration and cooperation. From this perspective, it is the MERCOSUR countries that should logically seek association with the NAFTA and not the reverse.

Finally, Brazil laboured hard for higher CET rates when these were being negotiated with its MERCOSUR partners and has subsequently violated even these levels with higher tariffs and, with regard to motor vehicles, quotas because of concerns over imports from North America and Europe in particular.[30] It has also been reluctant to engage internationally on deep liberalization with regard to investment,

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[29] The U.S. propensity to seek further concessions in areas such as intellectual property rights was revealed yet again in a proposal made in the late July 1995 negotiating session on Chilean accession to the NAFTA. The Canadian and Mexican delegations rejected the U.S. proposals. See **Inside NAFTA**, Vol.2, No.17 (Washington: August 23, 1995), pp.1, 15-8. Such prodding is manageable in a NAFTA accession process, but would be considerably more difficult to contain in a multi-party, *ab initio* negotiation in which the FTAA is constructed from scratch.

[30] See section 2 above.

trade in services and govenrment procurement. It is, therefore, unlikely that Brazil would want to negotiate a comprehensive bilateral agreement between MERCOSUR and a competitive developed country such as the U.S. or Canada - at least into the foreseeable future.

MERCOSUR accession to the NAFTA represents a third option. This approach would make the most substantive sense in terms of trade policy principles and market realities, given the more comprehensive nature of the NAFTA and its market size. From an economics point of view, this marriage would represent the first-best solution. MERCOSUR's accession to the NAFTA would also ensure a better result overall for Canada than attempting to negotiate a bilateral agreement, and would avoid the complications always posed by a root-and-branch reconstruction exercise involving Canada-U.S. economic relations, such as that envisaged in the first option outlined above.[31]

The central difficulty with this approach, however, is Brazil's continuing lack of readiness and/or willingness to engage. Two concerns seem to underpin this hesitation. First, Brazil does not yet enjoy the kind of domestic economic policy coherence indirectly required for a country to be comfortable with adhering to a high quality agreement such as the NAFTA. Brazil's fiscal and monetary track record, despite recent valuable efforts by President Cardoso and his Administration, remains spotty and the direction of its trade policy, while more liberal than previously, is still uncertain. The lack of a straight-forward majority in Congress to support Cordoso's reform efforts and constitutional barriers to coherent economic policy complicate matters.[32]

Second, and in keeping with its long-standing self-image as an emerging global power (especially now that "power" is increasingly understood in economic terms), Brazil is also pursuing a vision of MERCOSUR as the hub of a South American free trade agreement (SAFTA) of which it, given market size and population, would be the

[31] NAFTA's current rules of origin for determining whether a product qualifies for duty-free, preferential movement within such an expanded NAFTA would likely suffice to prevent circumvention of member country A's tariff on imports from non-member countries that enter member country B (with a relatively low external tariff) to be reworked somewhat before shipment to country A (with a higher external tariff in place to protect domestic production).

[32] For a description of the tensions underlying Brazilian economic policy-making, see Stephen Wilson, "With or Without You: Argentina, Brazil and NAFTA", Policy Staff Paper No.95/09, Department of Foreign Affairs and International Trade (August 1995).

"natural" leader. At the very least, this vision translates into a desire to consolidate and widen the reach of MERCOSUR among neighbouring countries before engaging with North America in substantive negotiations. The free trade area of the Americas would eventually be determined by the U.S. and Brazil, the "natural" leaders of the two blocs in this Brazilian view of the new hemispheric order. At its most ambitious, however, a Brazil-led SAFTA would avoid real commitment to the FTAA process altogether, serving as a trampoline for Brazil's leadership rôle in the global economic arena, with Brazil as one of a handful of key players internationally.

Variations on these themes exist. There is no single driving view in Brazil. There are also voices calling for greater pragmatism and a direct relationship with the NAFTA sooner rather than later. But the upshot of these divergent strands is the unlikelihood of early Brazilian agreement to negotiate comprehensive trade liberalization with North America if this can be avoided, at least over the medium term.

This reality leaves a fourth and final option: accession to the NAFTA by individual MERCOSUR countries, joining Chile and potentially Colombia. The obvious candidate is Argentina, with its impressive macro-economic and trade policy track record of recent years. Growing interest in this approach exists, especially in light of Chile's accession if not this year then in 1997, and troubling policy gyrations in Brazil. Technically, accession would require careful management, but it is broadly feasible with regard to most issues even though Argentina is a member of an aspiring customs union.[33] The main difficulty with this option is one of political will. As mentioned in section 2 above, MERCOSUR is most obviously about integrating regional markets. But it is equally about turning the page on a rather barren Argentina-Brazil geo-strategic rivalry with occasional military overtones. Despite the clear economic merit of Argentina joining the NAFTA (while retaining its MERCOSUR membership), Argentines may well hesitate until Brazil's probable reaction is better understood.

[33] The two areas that would require the particular attention of negotiators if a member of a customs union were also to seek membership in a separate free trade agreement are rules of origin for goods traded under preferential import duties and any internal requirement that benefits granted to a non-member of the customs union - e.g., to members of a separate free trade agreement such as the NAFTA - be extended automatically and on a non reciprocal basis to the other members of the customs union. The latter requirement exists with regard to MERCOSUR provisions on trade in goods and investment. These are not simple issues. Recent Policy Staff work on MERCOSUR's obligations, however, concludes that, while these technical issues are difficult, they are not as insurmountable in nature as initially feared. See Wilson, "With or Without You", pp.29-37.

This Paper, therefore, comes to no easy conclusion on how Canada should proceed toward the hemispheric free trade objective. To remain a central player capable of shaping results in the national interest, we must be active. Engaging resources to move forward the FTAA work programme must be part of our hemispheric commitment. So must the successful conclusion of the Chilean accession negotiations and the prompt initiation of a NAFTA accession dialogue with Colombia. But perhaps the most challenging issue facing Canada is how to work creatively toward a NAFTA-MERCOSUR, or at least a NAFTA-Argentina, understanding. From these strands, the fabric of hemispheric integration will be fashioned.

6. Postscript

Two final thoughts. First, the underlying thesis of this Paper is the importance of rules and rule-making in international economic relations: thus the attention given in this document to formal trading arrangements. Rules bound in treaty form with a strong dispure settlement feature help to open markets and to keep them open for Canadian traders and investors. Rules, of course, have an impact in both directions - Canada also has adopted a much more comprehensive range of international obligations and will further deepen that commitment regionally and multilaterally in the years to come. Why?

For a relatively small, necessarily trade dependent economy that has traditionally relied on foreign investment, the answer is straight-forward. The rule of law is critical to ensuring civilized behaviour both within and among nations. Clearly defined law, or "rules", allow individuals as well as firms to plan their commitments ahead in time with reasonable certainty. This certainty encourages growth and job creation. Just as importantly, carefully crafted rules help to redress power imbalances at the state-to-state level that otherwise can and do distort market results unfairly. That is, from a trade policy perspective, economic benefits should flow from the market-place to those countries, firms and workers who can best deliver a quality product or service on time at a competitive price, not to those countries or industries that rely on sheer market power and ill-defined rules of the road to sustain special "fixes".

Second, proposals to extend free trade through the Americas comprise yet another initiative attempting to define and extend the rules more clearly. It is, perhaps, the regional initiative most likely to achieve substantial concrete results by the year 2000. But nothing is assured. The preparatory phase and the negotiations themselves, whatever the specific technique used, will be very labour intensive, especially as the likelihood of real progress increases. This focus will place heavy demands of scarce trade policy human resources now stretched quite thinly over a number of fronts. My view is that the goal of hemispheric free trade is worth the concentration of resources. As with the negotiation of the NAFTA and its side agreements and the Chilean accession process, Canadians can continue to be key shapers of the results if we wish, both through actively seeking further accessions to the NAFTA and encouraging progress on the Denver FTAA work programme.

Most strategically, NAFTA accessions and a solid FTAA mid term harvest will help to provide trade liberalization momentum across both the Pacific and the Atlantic, while making the launch of further multilateral negotiations more rather than less likely, and sooner rather than later. The probability of success with hemispheric free trade will have an important demonstration impact elsewhere.

More immediately, success will improve market access in the hemisphere for Canadian traders and will remove distortions in investment patterns. Moreover, success can also assist us in managing our always special economic relationship with the U.S.. And success will finally cement Latin America considerably nearer the centre of Canada's economic diplomacy. The extension of free trade in the Americas makes sense and is achievable.

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