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Analyses on trade and integration in the Americas

The FTAA and Development Strategies in Latin America and the Caribbean

José M. Salazar-Xirinachs

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INTRODUCTION

Latin American and Caribbean (LAC) countries are interested in the Free Trade Area of the Americas (FTAA) and other free trade agreements (FTAs) because they see in it the promise of obtaining major benefits in terms of growth, development and poverty reduction. In fact, the FTAA will only be a reality if each government can argue with credibility that the FTAA is beneficial as an ingredient to restore growth, increase employment, and reduce poverty.

However, the connection between free trade, new trade rules, and development is a complex and multifaceted question. Despite much discussion about the FTAA, there is a surprisingly limited amount of literature analyzing its developmental impacts in LAC countries. This paper tries to fill this lacunae by providing a selective, although fairly comprehensive, discussion of some of the main developmental issues posed by the FTAA and FTAs. This is an issues paper. Its main objective is to raise relevant questions and review different academic and expert positions as well as existing empirical research results surrounding them. In light of the complexity of the subject matter, it would be over-ambitious to provide definite answers to these issues. Thus the spirit of this paper is more analytical and positive than normative or prescriptive.

The paper considers the developmental benefits and issues posed by the FTAA and FTAs in general, for LAC countries grouping them under six issue areas:

(i) market access issues in industrial goods and agriculture;
(ii) market access and rules issues in services and investment;
(iii) other rules related issues in areas such as intellectual property, subsidies and industrial policy;
(iv) the question of treatment of differences in size and levels of development,
(v) technical assistance and capacity building issues, and finally,
(vi) governance issues and the relationship between open markets and political institutions.

In terms of trade rules in a number of areas, World Trade Organization (WTO) agreements provide – if not the floor – at least a very important reference point for the FTAA. Given this fact, this paper makes frequent reference to WTO rules and their developmental implications.

I. DEVELOPMENTAL BENEFITS OF ENHANCED MARKET ACCESS IN GOODS

Enhanced and more secure market access for industrial goods and agricultural products is arguably one of the major, if not the major, benefit for LAC countries in terms of growth and development. Reciprocal trade liberalization produces of course both benefits as well as costs.

A. Building on Existing Economic Interdependence

As a first approximation, some basic orders of magnitude suggest the potential for gains. The U.S. market represents 78 percent of the aggregate GDP of the Western Hemisphere. This figure alone underlines the importance for LAC countries of achieving increased and more secure access to the U.S. market. Between 40 percent and 50 percent of the total exports of Central American, Caribbean and Andean countries are destined to the United States and Canada. These economies enjoy quite extensive access to these markets via the Generalized System of Preferences, the Caribbean Basin Initiative, and the Andean Trade Preferences Act. However, these are unilateral preferences, and as such present several drawbacks: they are more uncertain than a reciprocal arrangement, they do not have a dispute resolution mechanism, and key products are excluded. Therefore, in terms of market access these countries still have an important margin of benefit to gain from the FTAA.

In the case of the Common Market of the South (MERCOSUR), 20 percent of its total exports are destined to the United States and Canada, 26 percent to Europe, 31 percent to the rest of LAC, and 16 percent to the rest of the world. While, as often pointed out, the share of exports going to the United States is less important for MERCOSUR than for the other LAC countries, the fact remains that more than 50 percent of total MERCOSUR exports go to other countries in the Americas, and this makes the FTAA project potentially very significant for the economic dynamics of MERCOSUR.[1]

It is not only better access to the United States and Canadian markets that makes the FTAA an attractive proposition for all countries, but also reciprocal access between the LAC group of countries themselves. For instance, from 1990 to 1999 the growth rates of exports to other LAC countries as a group were higher for all sub-regions of LAC than the growth rates of exports to other regions in the world. This suggests an important benefit from the FTAA that would be foregone under a scenario of continued proliferation of bilateral agreements under a hub-and-spoke model.

B. Evidence from Computable General Equilibrium Models

A more direct estimate of the potential gains from the FTAA is derived from the various integration and trade liberalization scenarios in Latin America using multi-country Computable General Equilibrium (CGE) models. Such studies have tried to assess not only the effects of multilateral trade liberalization, but also the impact of regional initiatives, most notably the creation of a FTAA.

[1] For Brazilian positions on the FTAA see Lafer (2001), Barbosa (2001) and Soares de Lima (1999).

According to Roland-Holst and van der Mensbrugghe (2001), for the countries of the Americas the multilateral removal of tariffs would translate into a $605 billion increase in their total trade, while the removal of tariffs under an FTAA would expand the region's total trade by $125 billion. Diao, Díaz-Bonilla and Robinson (2001) estimate that the change in real GDP associated with the FTAA would be positive for all its members, and would range from less than 1 percent for the larger economies (United States and Canada) to over 5 percent for Argentina, Central America, and Colombia.

Empirical assessments of the effects of trade liberalization on the countries of the Americas not only underscore the key importance of market access in their liberalization strategies, but also raise questions as to the priority that countries should assign to different liberalization initiatives at the multilateral, regional or unilateral levels. In this context, several studies have sought to estimate the benefits of particular trade liberalization scenarios for particular countries in the Hemisphere. One such study by Roland-Holst and van der Mensbrugghe (2001) did not find evidence in support of the widely held view that unilateral liberalization is welfare superior to regional arrangements. To the contrary, for each of the six countries considered by the authors,[2] and for Latin America and the Caribbean as a whole, the FTAA is more beneficial in the aggregate than unilateral trade liberalization.

Monteagudo and Watanuki (2001) also estimate gains under different trade integration scenarios and find that for hemispheric partners, the FTAA is the best option, generating the largest economic gains and export growth. The exception is MERCOSUR, for which the FTAA is the second-best option after integration with the European Union when tariff-only liberalization is considered. However, the FTAA is the best option also for MERCOSUR when both tariff and non-tariff barriers are considered. The FTAA increases Latin America's exports by 11 percent in the entire hemispheric market and generates the strongest export growth of light manufactures in all Latin American members except Mexico. Another interesting finding is that, in general, the FTAA boosts the region's manufactured exports through intra-industrial trade, while integration with the European Union (EU) expands mainly agriculture-related exports.

The authors estimate that the elimination of tariffs under the FTAA would lead to a 6.5 percent increase in MERCOSUR's total exports. In the case of a free trade agreement with the European Union, MERCOSUR's total exports would increase by almost 8 percent. Expressed in terms of income growth, the EU option would be superior for MERCOSUR, as it would result in a 3.21 percent increase in its real GDP—0.37 percentage points more than the FTAA option. These results are broadly consistent with those of Decreux and Guérin (2001), who found that the growth of total MERCOSUR exports under a EU-MERCOSUR free trade area (12.7 percent) would exceed the growth of the region's exports under the FTAA (11.3 percent).

However, once the models are expanded to take into account the welfare effects resulting from the elimination of both tariff and non-tariff barriers (NTBs), the FTAA appears as the welfare superior option for the MERCOSUR countries. Specifically, Monteagudo and Watanuki (2001) estimate that the elimination of all tariffs and NTBs under the FTAA would result in a

[2] Argentina, Brazil, Chile, Colombia, Mexico, and Venezuela.

6.27 increase in real GDP for MERCOSUR, compared with a 6.1 percent increase in the case of a free trade area with the European Union.

Interestingly, these results are magnified significantly under a "combined" scenario involving the completion of an FTAA and a free trade area between MERCOSUR and the European Union. Under such a scenario, MERCOSUR's exports increase by over 30 percent and its real GDP by almost 12 percent.

In addition, a general conclusion of these estimates is that regional trade agreements (RTAs), such as the FTAA or the potential agreement between MERCOSUR and the European Union, are good for the participants and have little impact on the non-participants. Trade creation greatly exceeds trade diversion in most cases and, in general, the gains are found to be larger for the Latin American participants than for their large potential partners, the United States and European Union. These results are consistent with earlier studies of the North American Free Trade Agreement (NAFTA), which also predicted small positive gains for the United States and large gains for Mexico.

It should be noted that the positive impacts of full market access from trade agreements such as the FTAA tend to be underestimated in these CGE exercises due to the imperfect treatment of non-tariff barriers and of dynamic gains from trade in these models.

C. Agriculture

Agricultural trade liberalization has always been surrounded by special sensitivities due to certain intrinsic characteristics of agricultural activities and their unique role in the economies of both developed and developing countries:

- its importance in rural employment and standards of living;
- the potential impact of agricultural liberalization in rural-urban migration, particularly in developing countries where 20, 30 or even higher percent of the population make a living in rural areas;
- food security arguments; the complex systems of domestic support/subsidy in place, particularly in developed countries;
- the traditionally high degree of organization and political influence of agriculture and agribusiness interests; and, more recently,
- the different cultures and attitudes among the public and consumers over food safety and quality standards.

As Table 1 shows, agricultural production, employment, and trade are very important for most countries of the Americas. For instance, agricultural production is more than 15 percent of GDP for Paraguay, Guatemala, Honduras and Nicaragua. In terms of employment it accounts for 46 percent in Guatemala, 34 percent in Paraguay, 32 percent in Honduras, 21 percent in Mexico and Colombia, and 16 percent in Brazil, Chile and Dominican Republic. In addition, trade in agricultural products represents more than 19 percent of total trade for Paraguay, Guatemala, Honduras, Nicaragua, Argentina, Barbados and Chile, despite the fact that their trade potential is dampened by agricultural protectionism in major markets.

Table 1 SHARE OF AGRICULTURE IN SELECTED COUNTRIES IN THE WESTERN HEMISPHERE

Countries	GDP (percent)			Employment (percent)	Intra-FTAA Trade (percent)
	1975	1985	1999	2000	
Argentina	11.9	7.7	4.6	9.8	19.6
Barbados	13.3	6.4	6.0	4.0	19.0
Brazil	8.3	7.1	8.5	16.7	12.8
Mexico	9.6	8.6	5.0	21.0	5.8
Chile	9.8	8.0	10.3	15.7	20.7
Colombia	25.2	16.5	12.8	20.4	18.5
Dominican Republic	17.5	17.8	11.3	16.7	16.8
Guatemala	28.0	25.9	23.0	46.1	28.0
Honduras	29.3	19.6	16.2	31.7	25.3
Nicaragua	23.4	30.2	31.6	20.0	27.9
Paraguay	34.7	26.9	29.2	34.4	36.0
United States	3.3	2.0	1.2	2.1	6.2
Venezuela	6.7	5.7	5.0	8.0	13.0

Source: Adapted from Berrios, Granados, Jank, Monteagudo and Watanuki (2002).

FTAA countries present a very diverse set of negotiating priorities in agriculture due to their diversity in composition of agricultural exports, net trade position (net importers versus net exporters), level of development, and agricultural export potential. However, a number of evaluations of the impacts of FTAA agricultural liberalization on LAC economies using multi-region, multi-sector CGE models conclude that their benefits can be very significant for all LAC countries.

Burfisher, Robinson and Thierfelder (2002) find that despite the trade liberalization that has already occurred through MERCOSUR, NAFTA, and bilateral trade pacts, the FTAA can still lead to significant, additional expansion in the region's agricultural trade: "If the full elimination of all tariffs (agricultural and manufacturing) is accomplished in an FTAA, annual agricultural trade within the Hemisphere will increase by nearly $4 billion, or about 7 percent. Agriculture will account for about 20 percent of the expansion in Hemispheric trade due to an FTAA" (Burfisher, Robinson and Thierfelder, 2002, 5).

U.S. participation in FTAA agricultural liberalization is key to enable all countries, including the United States, to achieve the potential benefits of the FTAA. It is estimated that annual U.S. agricultural exports to the Hemisphere will increase by $1.3 billion (about 7 percent) and imports by $1.1 billion (about 5 percent) due to an FTAA.

The estimates also suggest that the concerns by some countries that they may be hurt by an FTAA because their margin of preference, particularly in the U.S. market, will be eroded, is misplaced. Model estimates suggest that all countries are expected to increase their agricultural exports to the region under an FTAA, with the Andean region and the Central American/Caribbean region presenting the highest rates of growth of their agricultural exports (6 percent and 4 percent, respectively), with most exports destined for the U.S. market, due largely to the fact that they face relatively high U.S. trade barriers on some of their agricultural products, particularly on processed foods. The Andean and Central American/Caribbean regions will also have relatively large increases in agricultural imports under an FTAA (13 percent and 14 percent, respectively), reflecting their relatively high tariffs on imports.

Monteagudo and Watanuki (2002) develop several scenarios of agricultural reform in the Americas under the FTAA by estimating the impacts of eliminating three main policy instruments: tariffs, domestic support and export subsidies. They estimate that tariff elimination would increase LAC's agricultural exports to the hemispheric market by 14 percent and that all countries in the hemisphere would benefit from tariff elimination. Exports to the United States account for 40 percent of LAC countries increased exports to hemispheric markets. Brazil and Chile benefit the most (their exports expanding by 26 percent and 28 percent respectively); by product, they enjoy relatively faster export growth, as processed food sectors are more protected than primary goods. Latin America expands exports of dairy products, beverage/tobaccos and poultry meat by more than 25 percent, while exports of sugar are estimated to increase by 23 percent and of oilseeds/soybeans by 19 percent. In contrast to these impacts of tariff elimination, the removal of domestic support has only a modest positive effect on LAC agricultural exports of 0.5 percent.[3] The elimination of export subsidies has negligible to negative impact on LAC exports. One of the most important conclusions that can be drawn from these estimates, with potential relevance for the FTAA negotiations, is that tariff reduction is by far the policy that would have the largest positive agricultural export growth impacts on LAC as a result of the FTAA, even if domestic support and export subsidies issues remain to be negotiated in the Doha Round.

Jank, Fuchsloch and Kutas (2002) develop and estimate an innovative index called the Regional Export Sensitive Tariff index (REST), which allows a comparison between a country's "faced tariffs" from its trading partners with that country's "imposed tariffs." More specifically, the REST index aggregates all tariffs faced and imposed by each country at the regional level into a single indicator, representing a ratio of the weighted value of those tariffs.[4] The analysis of agricultural trade in the Americas using the REST index shows that "NAFTA, Caribbean and most Andean countries impose higher weighted MFN tariffs than they face in the Western Hemisphere (REST below 1). The biggest face-off is Mexico and Canada, where high tariffs imposed on a very small group of key products are significant to potential FTAA partners. In other words, these countries are net liberalizers within the integration process in terms of agricultural tariff protection. On the other hand, most Mercosur members, Chile, and most

[3] However, non-FTAA countries would benefit from the non-discriminatory effects of this measure: the United States expands imports of all grains, oilseeds and bovine meat by more than 15 percent from the rest of the world.

[4] The index measures each country's *faced tariffs* from it partners weighted by its *total exports* in the numerator, and each country's *imposed tariffs* weighted by the *total exports* of all its partners in the denominator, calculated one by one based on a potential regional integration agreement. The index can be used to gauge concessions that each country makes relative to those it receives.

Central American countries would have net gains in terms of agricultural market access. Brazil would rank first in this process above Uruguay, Chile and Argentina, as a result of the very high tariffs faced by Brazil's sensitive products such as sugar, orange juice and tobacco, especially in the United States" (Jank, Fuchsloch and Kutas, 2002, 37).

In conclusion, empirical scenarios estimated by economists show that there would be major benefits for LAC countries if the FTAA negotiations manage to achieve a significant reduction of barriers to agricultural trade in the Western Hemisphere. According to some estimates, these benefits are significant even if the distorting effects of producer subsidies remain to be negotiated in the WTO during the Doha Round.

In most LAC countries reciprocal agricultural liberalization would have impacts in expanding both imports and exports of agricultural products. On the export side many LAC countries will find ample opportunities from increased market access given their comparative advantages in agricultural exports. On the import side, increased imports could produce serious dislocations, including potentially significant rural-urban migration, particularly in countries where agricultural employment is a high percentage of the labor force. Therefore, even in those countries where the net effect is expansionary, the agricultural sectors would experience a significant process of transformation. This poses important transitional issues related to the role of agriculture and the peasantry in LAC countries.

D. Rural Development in an Open Economy

Agricultural activities and rural livelihoods have been subject to great stress in most LAC countries by the processes of economic openness and modernization. As one analyst observes in the case of Mexico, over decades "peasants have been semiproletarized, subsumed, modernized, subsidized, made migrants and poverty-ridden, excluded, and included in the sweep of national development projects" (Appendini, 2003, 270).

As development proceeds, the long-term trend in rural change is clearly one in which part of the rural population is increasingly engaged in non-farm activities. International experience shows that the process of economic development involves a structural change toward manufacturing and tertiary activities as the demand for food grows at a slower rate than the demand for non-food foods and services, and as economies diversify away from natural resource-based activities and into higher productivity, knowledge and skill-intensive activities. It is in the interest of countries to promote this process also since the long run trend in agricultural commodity prices is downward.

However, this process is not painless and it is one that has taken decades for many now developed countries. One of the most difficult policy challenges is then how to influence and manage this transformation. Naturally, governments and civil societies want to avoid employment-reducing/poverty-increasing paths and aim instead for employment-creating poverty-reducing growth paths. That is, they aim to have a high quality insertion into world markets.

Policies in two fronts will influence the speed, costs, and benefits of the agricultural adjustment process: on the external front, the FTAA-negotiated transition periods by specific sector and product and the treatment given to the agricultural sensitivities of different countries; on the internal front, the process of agricultural transformation induced by the FTAA needs to be carefully managed, which includes making the necessary investments in rural development, education, communications, transportation infrastructure, export diversification, sanitary and phitosanitary and food safety capacities.[5] The FTAA Hemispheric Cooperation Program could usefully develop hemispheric-wide cooperation initiatives in agriculture to facilitate these transformation, diversification and agricultural capacity building processes. But ultimately, each country must find the right balance and pace for its rural transformation process, including the challenge of increasing modernization via new investments and large, highly integrated agribusiness, while preserving a space for the small and medium-sized producers, including family farms, engaged in production for both export and the domestic food market.

E. Safeguard Protection and Contingent Protection

Market access benefits from the FTAA would also flow from the reduced trade and investment uncertainty associated with disciplining safeguard and contingent protection.

Broadly defined the term safeguard protection refers to a provision in a trade agreement permitting governments under specified circumstances to withdraw –or cease to apply- their normal obligations in order to protect (safeguard) certain overriding interests (Hoekman and Kostecki, 2001, 303). There are several economic and political rationales for safeguard protection measures. They provide a safety valve to protect local producers from import surges that may cause serious market disruption and play a political role in the sense that without them governments and business would not be willing to sign agreements that reduce protection substantially. Thus, safeguard protection mechanisms are critical to the existence and operation of trade liberalizing agreements. However, the recent proliferation in the use of some of these mechanisms has raised the concern that they provide excessive opportunities to reimpose protection and negatively affect market access opportunities for all countries, particularly developing countries.

Safeguard protection provisions can be separated in two categories. First, those that allow for the *temporary suspension* of obligations, also called contingent protection provisions. In the GATT/WTO system these include antidumping (AD), countervailing duties (CVDs), balance of payments provisions, infant industry provisions, emergency protection, special safeguards, and general waivers. Second, those that allow for *permanent exceptions* from the general obligations. In the GATT/WTO system these include general exceptions to safeguard public morals, health and the environment (Article XX GATT and XIV GATS), national security provisions, and provisions that allow the renegotiation or modification of schedules.

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[5] For an analysis of the implications for agriculture of NAFTA and the adjustment challenges particularly as regards Mexico, see Veeman, Veeman and Hoskins (2002), Yunes-Naude (2002), Appendini (2003) and Lustig (2001).

One of the key developmental challenges of the FTAA is to design an appropriate safeguard protection system that limits the opportunities for protectionist abuse of these measures. Particularly sensitive is the issue of antidumping, in light of the recent drastic increase in the use of this instrument. Consider the following facts:

- During the 1980s, the global use of antidumping measures intensified but was limited mostly to a relatively small club of traditional developed country users; in the Americas, very few countries actually had AD laws.
- During the 1990s the demand for AD protection continued to grow and a new trend appeared: developing countries became major users of AD. Non-traditional users of AD involved mainly Argentina, Brazil, India, Korea, Mexico and South Africa, but the list keeps growing (Miranda, Torres and Ruiz, 1998). [6]

A disaggregated analysis done by Tavares, Macario and Steinfatt (2001) shows the relevance of AD for countries in the Americas:

- From 1987 to 2000 the United States and Brazil were the leading targets of AD investigations in the region representing 63 percent of the cases initiated against FTAA countries. A second group was involved in around 30 percent of the investigations and includes Argentina, Canada, Mexico and Venezuela, while 12 countries received the remaining 7 percent. Sixteen FTAA countries were not affected by AD measures during this period.
- The distribution by users of AD has a similar profile. Argentina, Brazil, Canada, Mexico and the United States were responsible for 93 percent of total investigations initiated in the FTAA area, while ten countries accounted for the remaining 7 percent. Nineteen FTAA countries have never used AD.
- One of the most revealing facts is that 485 of the 638 cases affecting FTAA economies, that is three of every four cases, originated in the region. There is therefore more density in the use of these measures between FTAA countries than between the rest of the world and the FTAA group.
- However, the main users of AD in the Americas direct their actions mostly against the rest of the world; of 1744 investigations initiated by FTAA countries, 485 (38 percent) were against other FTAA countries and 1259 against the rest of the world.

The increased use of AD in the Americas is part of a global trend. As Thomas Prusa puts it "The AD genie is out of the bottle. A multitude of countries have only recently enacted AD statutes and these new users are now filing a larger and larger number of cases" (Prusa, 1999, 8).

What is the developmental impact of this trend? AD actions have at least four types of negative effects: a) on exports and imports; b) distortion of competitive conditions; c) costs imposed on consumers due to price increases, and d) in encouraging rent-seeking behavior by import competing firms.

[6] For analysis of the spread and impacts of what some call "the antidumping epidemic" see: Prusa (1999) Lindsey and Ikenson (2001), Finger and Schuknecht (2001), Neufeld (2001), Finger (2002).

There is clear evidence of a decline in exports following the opening of an investigation, regardless of whether a duty is finally imposed. Prusa (1999) found that import quantities in the United States fell by 50-70 percent on average over the first three years following the imposition of a measure, while import prices rose by more than 30 percent during the same period. Even rejected petitions caused damage by reducing import volumes on average by 15-20 percent. Similar results are found by Messerlin (1988) for the European Union and in numerous comparisons of import levels before and after the initiation of an AD investigation (Neufeld, 2001). Some of these studies also argue that the disruption of AD is even worse than that of normal trade protection given the element of uncertainty about where and when it is going to hit.

In the Western Hemisphere, as for most of the rest of the world, the aggregate amounts of trade directly affected by AD tend to be very small. However, from 1987 to 2000 about 80 percent of the cases initiated by, and targeted at countries in the region, were concentrated in six industries: base metals (mostly steel products), machinery and electrical equipment, chemicals, plastics, pulp and paper and textiles. This concentration of investigations in very specific products and the importance of these products in the total exports of some countries such as Brazil, Mexico and the United States, means that for these countries more than 50 percent of their exports to other countries in the Western Hemisphere are hampered by AD-induced uncertainty and instability (Tavares, Macario and Steinfatt, 2001).

Developing countries are particularly hurt by these trade remedy measures. Besides being frequent targets of AD measures, their enterprises are particularly vulnerable to the extent that they are infant entrants in the international market or are typically in an economically weaker competitive situation or context. Under these circumstances developing country industries find it more difficult to face the uncertainty and unpredictability that AD rules produce in international trading relations than is the case with well-established exporters. And despite the fact that Article 15 of the WTO AD Agreement states that "*…special regard must be given by developed country Members to the special situation of developing country Members when considering the application of anti-dumping measures…*", and directs members to "*explore… constructive remedies before applying antidumping duties where they would affect the essential interests of developing country Members*" these have remained as best endeavor clauses not accompanied by concrete criteria and have therefore found no concrete expression (Neufeld, 2001).

In conclusion, improving the current system by designing an appropriate AD and safeguard protection system that limits the opportunities of protectionist abuse of these measures can have significant market access and developmental impacts for LAC countries. This is indeed one of the most difficult and complex issues in both the FTAA and WTO negotiations. In Doha, Ministers agreed to negotiations aimed at "*clarifying and improving disciplines… while preserving the basic concepts, principles and effectiveness of these Agreements and their instruments and objectives, and taking into account the needs of developing countries and least-developed participants*" (Doha Development Agenda, 2001, paragraph 28).

In addition, the Doha Decision on Implementation-related Issues and Concerns expanded this Ministerial mandate by, among other aspects, directing the Council to make specific recommendations on how to operationalize Article 15 cited above by November 2002. Numerous countries have presented proposals in the WTO that reflect a great divergence of views.

Much will depend on the politics of AD reform in the United States. During the last weeks of the discussion of the Trade Promotion Authority Bill in 2002, the U.S. Congress had before it a proposed amendment, the so-called Dayton-Craig Amendment, that called for a commitment on the part of U.S. negotiators to ensure that the negotiations in the WTO did not diminish the ability of the United States to vigorously apply its trade remedy laws. The amendment in its original form was dropped in conference but is indicative of the prevailing sentiment on the issue. In its final form, the U.S. Trade Act of 2002 states that "*The principal negotiating objectives of the United States with respect to trade remedy laws are: (A) to preserve the ability of the United States to enforce rigorously its trade laws, including the antidumping, countervailing duty, and safeguard laws, and avoid agreements that lessen the effectiveness of domestic and international disciplines on unfair trade, especially antidumping and subsidies…*". This language tends to reduce the room for maneuver of U.S. negotiators. On the other hand, there are several potential constituencies for AD reform in the United States: the increasing number of U.S. exporters hurt by the proliferation of foreign AD actions, as well as the downstream U.S. import-using industries and consumers, who are harmed by the price increases and supply disruptions caused by AD protection. Their influence could change the politics of AD reform in the next few years as the U.S. public debate and policy-makers widen their view to include the victims and costs of U.S. AD law, in addition to its beneficiaries. There is also a growing recognition of the specific and systemic dangers posed by the spread of AD in other countries.[7]

[7] The stakes for beneficiaries increased in 2000 with the enactment of an obscure new law that is transferring lots of money to certain U.S. manufacturers. Under the Continued Dumping Offset Act (CDO) of 2000, also known as the Byrd Amendment, an account is set up into which duties liquidated by the Customs Service from each AD and subsidy case are placed. Those funds are then transferred to domestic producers that were the petitioners to cases at the end of the year. The Byrd Amendment was found by the WTO Appellate Body to violate WTO rules on January 16, 2003. At present the U.S. Congress and executive are considering options to bring the Byrd law into conformity with WTO obligations (Inside US Trade, January 17, 2003).

II. DEVELOPMENTAL ISSUES RELATED TO INVESTMENT AND SERVICES

A. Investment

Increased investment is also one of the major benefits expected from the FTAA for LAC countries. International experience offers at least three important lessons as regards the impact of foreign direct investment (FDI) in host countries:

- that the benefits of FDI tend to exceed its costs,
- that policies can make a very important difference to maximize benefits, minimize costs and promote the shift from low skills/low wage to increasingly higher skills/higher wage foreign investor operations ("climbing the ladder"), and
- that most of this policy responsibility lies with the host country including areas such as macroeconomic stability, infrastructure, human capital, as well as regulatory, environmental and competition issues.

While maximizing the developmental benefits of FDI is first and foremost a domestic challenge, there is also an important role for international rules and collective action. Indeed, internationally negotiated investment rules, such as those under the Doha Development Agenda or the FTAA, pose abundant development related issues.

Following Sauve (2002), investment rule making and their developmental impacts can be usefully discussed in terms of four sub-agendas: a) investment protection; b) investment distortions; c) investment liberalization; and d) international cooperation to enhance investment climates and promote good governance.

Investment Protection

Investment protection encompasses obligations to provide foreign investment and investors protection and specific procedures with respect to issues such as expropriation and compensation, transfer of funds, protection and compensation in case of civil strife, fair and equitable treatment, and other standards of protection.

In recent years, there has been a dramatic increase in rule making for investment protection on two tracks: negotiation of bilateral investment treaties (BITs) and negotiation of bilateral and regional trade agreements, such as NAFTA, a model that has been extended quite widely to Western Hemisphere countries. So rather than starting from scratch, an FTAA investment chapter will actually build on these existing agreements.

The developmental argument for the protection dimension of investment agreements is that by reducing uncertainty and providing signals that the host country is committed to abide by international laws, they are an important additional factor in an attractive investment climate. It is important to note that investment agreements by themselves do not attract FDI. Available evidence strongly suggests that FDI flows respond to more fundamental determinants such as economic stability, quality of infrastructure and skills and other institutional factors. However, by reducing uncertainty, increasing policy credibility and positive signaling, investment agreements could make a difference at the margins of the companies' decision to invest. To the extent that investment agreements include a significant market access component, they may, however, have a large impact in FDI flows and associated benefits.

Some key concepts and standards of traditional investment protection and treatment law have caused difficulties of interpretation and raised public concern, particularly with respect to the ability of countries to regulate in the public interest. This is particularly the case of NAFTA Chapter 11 provisions on investor-state arbitration procedures. It is beyond the scope of this paper to enter into the fine and complex legal aspects of this debate. Suffice it to say that despite much recent concern on this issue, the argument in favor of investor-state arbitration procedures is that, when properly designed and circumscribed, they can be a good way of taking intergovernmental and foreign policy considerations out of investment disputes.

Investment Distortions

The investment distortion trade and development agenda includes the following important questions: What policy instruments can host countries put in place to maximize the flows and benefits of FDI? Which specific instruments will be disciplined away by international investment rules and is this good or bad for development policy? Table 2 contains examples of FDI policy instruments distinguishing between positive and negative incentives:

Table 2 EXAMPLES OF FDI POLICIES

Positive Incentives	Negative Incentives
• Tax holidays • Tax treaties to avoid double taxation • Exemptions on import duties on capital goods and raw materials • Other exemptions or relaxation of rules in priority sectors • Land grants • Training grants • Establishment grants	• Nationalization or expropriation • Double taxation • Domestic content requirements for intermediate inputs • Domestic employment restrictions • Export requirements • Screening • General foreign equity limits • Sectoral foreign equity limits • Landownership restrictions • Joint-venture requirements • Restrictions on remittance of profits • Limitations on transfer of shares or liquidation of the company

Source: Adapted from Hoekman and Saggi (2002)

<ins>Positive investment incentives,</ins> including fiscal incentives, have proliferated as part of the increased international competition to attract investment both between and within countries. And yet there has been no significant effort either at the multilateral or regional levels to bring them under discipline. Properly defined rules in the context of the FTAA can help not only to maximize the benefits from FDI, but also to minimize the dangers and costs of locational incentive competition among countries --and within them--, to attract the externality-rich

sourcing patterns of international investors (Moran, 1999).[8] However, there is very limited interest, particularly in federal states (where investment incentives programs are actively used as instruments of industrial or regional development policy) to address the issue of distortions associated with locational competition, either at the global or regional levels. And yet, arguably, it may be in the interest of smaller economies to discipline locational competition, given their more limited fiscal capacities to significantly engage in such competition.

While there has been practically no movement on positive investment incentives, negative incentives and other distorting effects of TRIMs have been subject to negotiated disciplines at the regional and multilateral levels. Many developing countries have used a number of performance requirements, including domestic content provisions, technology sharing arrangements, or export/import balancing requirements as instruments to maximize or capture the benefits of FDI for their local economies. However, the WTO Trade Related Investment Measures (TRIMs) agreement and a number of RTAs, request countries to phase out these instruments.

The key developmental question is how development friendly is the TRIMs agreement or RTAs that prohibit the use of these instruments? More research is needed to assess the developmental effects of various types of performance requirements. With the present state of knowledge there are two positions on this subject.

In the past, conventional wisdom has held that domestic content, joint-venture and other technology sharing requirements might be an effective means of harnessing FDI for the development goals of the host country. A number of empirical studies reveal that some performance requirements, particularly those related to export performance or local training requirements can have positive developmental effects.

However, Moran (2001, 2002), based on a number of case studies, argues in favor of a "new paradigm" that suggests that a much more effective means of capturing the benefits of FDI is to minimize distortionary interventions and allow foreign subsidiaries to be integrated as tightly as possible into the regional or global sourcing networks of their parent firms. Using evidence from the automotive, computer and electronics industries, where the globalization of the higher-skill investor operations has been most far-reaching, Moran compares the operations of foreign subsidiaries –and the backward linkages and spillovers to the host economy– under these two alternative approaches, and finds that the conventional approach is not only less successful but is in many cases actually harmful to the growth and development of the host country. The best policies that host countries can implement to develop dynamic backward linkages are found to be a combination of a performance requirement-free environment, coupled with vendor development programs, including upgrading support to local suppliers and nurturing of local

[8] Some degree of discipline on investment incentives is contained in the WTO Agreement of Subsidies and Countervailing Measures (ASCM). However, such disciplines are largely indirect when applied to investment, apply only to goods-related transactions (no equivalent disciplines exist for services under GATS); and can be invoked only in rather restrictive circumstances.

supplier relationships with foreign investors and operations, like those used by Singapore and Malaysia.

As suggested, the jury is still out on these very important issues, and more research on the economics of performance requirements is necessary to settle these issues in a satisfactory manner. Moran's arguments and case studies are quite persuasive. However, this is an area plagued by intellectual uncertainty, and caution should probably be exercised in excessively restricting the range of instruments that might have positive effects from a development point of view. On the other hand, disciplining the use of investment incentives is an area where smaller and developing countries stand to gain quite substantially.

Investment Liberalization

The FTAA offers participating countries important win-win opportunities based on achieving investment regime liberalization beyond the important unilateral efforts that LAC countries have undertaken in the last decade. The first win is because increased liberalization and competition may be beneficial per se for their growth and development prospects. The second win is associated with the fact that this liberalization might be in exchange for increased market access in the United States and other trading partners in agriculture and other key sectors, as well as in exchange for other important trade objectives.

Much of this win-win potential in investment liberalization lies in the services sector for a number of reasons: services account for the majority of discriminatory measures maintained by LAC countries precluding commercial presence of foreign investors; services sectors receive on average two thirds of global FDI flows; and services sectors are crucial for the international competitiveness of countries. Thus, most of the investment liberalization game in the Americas, as well as globally, is services-centric.[9]

Reasons why some LAC countries have resisted a more open FDI policy include, first, the presumed market power effect of multinational corporations. An open FDI policy, however, should aim at inviting not just one but many investors and should be accompanied by appropriate pro-competitive regulations. Secondly, concerns have been expressed about crowding out or scaling down of domestic entrepreneurship. A number of studies have indeed shown a significant change in ownership patterns associated with investment liberalization. However, it can be argued that downsizing of inefficient domestic firms is positive for development to the extent that it contributes to increase productivity, expand consumer choice and reduce prices. In addition, through mergers and acquisitions, and by transferring new technology, FDI can prevent some domestic industries from being wiped out.[10] The potential of FDI to develop local suppliers and transfer technology is also well documented. Ultimately, FDI is an instrument for growth and development, and since growth strategies vary from country to country, FDI policy should allow some flexibility to accommodate country specific conditions and strategies.

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[9] For multilateral negotiations this argument is made by Sauve (2002).

[10] Hoekman and Saggi (2002).

Negotiation modalities for investment and services (positive versus negative list approach) and architectural issues such as where to negotiate and place commercial presence (GATS mode 3) in the FTAA –whether as part of a services chapter or as part of an investment framework that applies to both goods and services— also have a number of implications in terms of transparency, user-friendliness for the private sector, flexibility and other developmental dimensions. However, it is beyond the scope of this paper to discuss these issues.

Good Governance

Although not part of a trade negotiations agenda, for the sake of completeness, it is important to emphasize that there is a wide range of complementary international cooperation initiatives that could enhance investment climates and good governance and thus promote development. Some of these initiatives can be legally binding while others could be more hortatory in nature. These initiatives involve issues such as bribery, corruption and money laundering, developing codes of corporate conduct for multinational investors, promoting corporate social responsibility, strengthening standards of corporate governance, exchanging information on best practices in investment, and export promotion activities, etc. All these are areas where international co-operation has produced important results in recent years and where continuing efforts could complement trade agreement-based attempts at addressing the trade-investment interface. In addition to global efforts such as the Organization for Economic Cooperation and Development (OECD) and others, the Inter-American System and Summit of the Americas process has initiatives on bribery and corruption (the Inter-American Convention against Corruption), money-laundering, and corporate social responsibility.[11]

B. Services

There is increasing recognition that services activities are critical for the economic dynamism and competitiveness of the economies of the Americas. Services represent on average 60 percent of the hemispheric GDP. In trade terms, services are even more important to the smaller economies of the Caribbean and Central America. The importance of policy in the service sector goes beyond the sector itself. Services are essential inputs into the production of virtually all other goods and services. Several studies show that on average, 60 percent of manufacturing value added is represented by services inputs, which means that competitiveness in manufacturing products is strongly dependent on competitiveness in services activities. Highly priced and inefficient services raise costs for all users, imposing a "tax" on the whole economy. Thus, service sector policy can have a major influence on economic performance. As a recent report by the World Bank argues, services is one of the most important areas to liberalize for developing country competitiveness.[12]

All this makes the FTAA services negotiations, and the liberalization and competitiveness that they might induce, one of the principal benefits for the FTAA for the

[11] For further information on these initiatives see the OAS website www.oas.org.

[12] World Bank (2002).

participating countries.[13] Moreover, as explained above, given that services account for the majority of discriminatory measures maintained by LAC countries --precluding commercial presence of foreign investors-- most of the investment liberalization game in the Americas, as well as globally, gravitates around services sectors and issues.

Service sector reform is a complex task. Service sector policies need to balance efficiency and competition objectives with the legitimate role for governments to intervene to offset market failures and achieve national development objectives such as the universal provision of education or health care services. As the OECD argues: "For service sector policies – and national commitments on trade and investment in services in the WTO or in regional trade agreements- to contribute to development, liberalization will need in many instances to be accompanied by *strengthened* regulation.(…) regulation and competition policy may need to be in place to complement trade and investment liberalization" (OECD, 2001, 4).

A number of developmental concerns have been expressed in relation to services sector liberalization:

(i) that services negotiations and the General Agreement on Trade in Services (GATS) pose a threat to the countries' right to regulate the production, sale, distribution or import of service activities;
(ii) that the GATS and a regional services agreement may restrict the room for development policy in sensitive sectors such as education, health, water supply, electricity distribution, and other utilities with strong public goods connotations;
(iii) that services or investment agreements are designed to promote the interests of large multinationals and preclude developing countries from applying developmental industrial policies;
(iv) that due to the asymmetric power relations and information asymmetries, most action at the multilateral level has been in sectors of interest to developed countries while there has been little progress in sectors of interest to developing countries such as mode 4, movement of natural persons.

Some of these arguments are based on misunderstandings of how the GATS and services agreements operate. Others are genuine and need to be addressed. Analyses and answers to these and other concerns about the GATS have been provided by OECD (2001). The main points are as follows.

Right to regulate

In the GATS context, a number of sovereign rights are recognized as fundamental and preserved. Under the GATS, governments retain the right to:

a) regulate in order to pursue national policy objectives;
b) modify/or withdraw commitments undertaken (subject to compensation);
c) designate or maintain monopolies, public or private;
d) choose which service sectors and modes of supply they wish to grant market access to

[13] For a collection of analyses on the role of services in hemispheric integration see Stephenson (2000).

foreign suppliers, and the conditions of such market access; and
e) make no GATS commitments on any particular sector.

In short, the GATS explicitly allows member countries to advance at their own pace and in accordance with their national priorities and objectives. It is also important to point out that the objective of GATS is the progressive liberalization of services trade, not deregulation. In fact, as pointed out above, to contribute to development, liberalization has to be accompanied in most instances by more (but different), not less regulation. In light of its flexibility, and its emphasis on the progressive, voluntary nature of liberalization, it is possible to argue that in fact, the GATS is the most “development friendly” of all Uruguay Round Agreements.

Services liberalization, development policy and public services

As the previous paragraph suggested, GATS rules do not dictate any specific role for the public and private sectors. Governments are free to decide what sectors will be reserved for the state or state-owned enterprises. Countries are free to decide whether or not to open sensitive public services to outside competition. Of course in practice, countries will be under pressure to liberalize or provide access in certain public services sectors. However, it is up to them to decide what is best according to their own growth, social and development policies.

Benefiting multinationals or host countries

Whether liberalizing trade in services benefits multinationals or host countries is a false dilemma. Many benefits can accrue to both international investors and national economies provided there is appropriate regulation and an open, competitive environment. The potential benefits of FDI for the host economy are well documented. FDI may have multiple benefits well beyond the traditionally recognized benefits of job creation and the provision of capital. Contingent upon the pursuit of appropriate host country policies, the main potential contribution of FDI is a bundle of intangible assets including technologies, best management practices, marketing capabilities, human relations policies, labor force skills, and other potential spillovers and externalities that are highly beneficial for host-country economic growth and poverty alleviation. In addition, FDI may exert a positive influence on environmental performance and social conditions, for instance by transferring “cleaner” technologies, or promoting more socially responsible corporate policies. As explained in Section II, trade agreements pose the issue of what policy instruments host countries can put in place to maximize the flows and the benefits from FDI. However, the instruments that are most relevant in this debate, such as investment incentives and performance requirements, are covered under investment and subsidies disciplines, not in the services area.

Balanced outcomes

Services negotiations are not a major arena for North-South tensions, or industrial versus developing country divides. In fact, many developing countries are deliberately, and often autonomously, inviting FDI in key services sectors to upgrade their domestic infrastructures in financial services, telecommunications, transportation, etc. From this point of view services liberalization should not be viewed as a “concession” to other countries, but as a self-interested national policy for enhancing domestic economic performance. This having been said, there are a number of issues as regards services negotiations that are of particular interest to developing countries, including more progress in movement of natural persons, improving their access to distribution channels and information networks, and the liberalization of market access in sectors of particular export interest.

III. OTHER RULES-RELATED DEVELOPMENTAL ISSUES

Two additional rules-related developmental issues are analyzed in this section: intellectual property and industrial policy, or as called in "new paradigm" language, promotion of competitiveness.

A. Intellectual property

Intellectual property protection is arguably the area where there has been the most heated controversy in terms of its implications for development. In fact, WTO Director General Supachai Panitchpakdi has identified the debate on how the Agreement on Trade related Aspects of Intellectual Property Rights (TRIPS) can be best applied by developing countries to their own development needs and how the TRIPS Agreement and the international framework can be improved as one of the areas of focus of the WTO in light of the Doha Development Agenda (Supachai, 2002).

Critics of the TRIPS Agreement and the intellectual property system in general, with special emphasis in patent protection, allege that the existing regime of intellectual property rights (IPR) does not serve the development concerns and interests of developing countries (particularly less developed countries). There are three main areas where the TRIPS agreement has been criticized as being an obstacle to development:

(i) It is claimed that intellectual property protection, as codified in the TRIPS Agreement, has increased the costs of technology transfer, widening the technology gap, and income inequalities, in the process. Some consider that it prevents developing countries from catching-up and climbing the technological ladder (Chang, 2001; Correa, 2000).

(ii) In the area of public health, the main critique is that it allows the price of basic medicines to be unduly high, thus posing a direct threat to public health.

(iii) Controversy also surrounds its application to agriculture, where the concern is that it may damage food security for the poor, and threatens the right of poor farmers to save, sell, and exchange seeds.

Defenders of intellectual property protection, on the other hand, while not disputing the reality of the increased short-term financial burden of importing new technologies, claim that IPR protection generates three types of long-term benefits: it encourages domestic innovation, provides incentives for multinational corporations (MNCs) to invest in developing countries, and provides incentives for faster diffusion of new technologies into developing countries (Maskus, 2000).

Additionally, given the private, territorial, and exclusive nature of IPRs, it may be unrealistic to expect that a regulatory system such as the TRIPS Agreement (or any national IPR legislation) will address and provide the solution to public policy issues as complex as access to essential medicines, high cost and lack of technology transfer, and the application of IPR protection to agriculture in developing countries. IPR is regarded as an important factor among the several determinants that play a role in each of these issues. Moreover, the TRIPS Agreement can be an effective influence not only to improve IPR protection but also to address developing country concerns. However, the WTO cannot constitute the only forum for discussion and TRIPS the only instrument for solutions. Effective responses require a broader agenda and serious cooperation from public and private sectors in developed and developing countries.

Patents, Technology Transfer and Incentives to Innovation

This is a very complex debate. Perhaps the most incontrovertible evidence relates to the fact that patent protection has indeed increased the financial burden for developing countries of importing new technology. The World Bank estimates that the six major industrial countries with significant surpluses on intellectual property trade will see their revenue increase by approximately $ 40 billion as a results of TRIPS (WB, 2002). At the same time, overall transfers from developing countries in the form of license payments to patent holders, which are mostly Northern transnational corporations (TNCs), will rise almost fourfold from their current levels of $15 billion.[14]

However, in order to determine whether these increased costs prevent developing countries from catching up and closing the "technology gap", these costs would have to be weighted against the benefits in terms of increased availability and diffusion of technology (for instance, information technology), increased innovation and technological variety induced by patent protection, positive impacts on developing country productivity associated with importation of capital goods and other technologies.

As with international trade, the relationships between IPR and FDI are subtle and complex. While the weight of theory seems to suggest a positive impact on FDI, overall it is inconclusive. Decisions on FDI depend on a host of complex factors regarding local markets and regulations. IPR clearly play an important role in these processes, though its importance varies by industry and market structure. Thus, IPR protection is more likely to be important for investment decisions of those industries in which intangible, knowledge-based assets specific to each firm are significant, such as pharmaceuticals, chemicals, food additives and software, as well as firms considering investing in local research & development (R&D) facilities (Maskus, 2000).

[14] According to different experts these figures should be treated with caution. According to the UK Commission on IPR's report, these figures depend on a number of debatable assumptions (Commission on IPR 2002); Maskus points out that there are several reasons why published data on royalties and licensing fees (RLF) may not capture adequately the amount of technology being traded. Licensing fees are determined through complex contracting procedures, which attempt to price the implicit value of information. Further, fees paid may be influenced by tax laws, accounting rules, and management decisions regarding the extent and form of income repatriation. Finally joint ventures, business alliances, and cross-licensing agreements may encompass different volumes of licensing than would be suggested by straightforward licensing fees (Maskus 2000). Additionally, the importance of IPR for trade has gained more significance as the share of knowledge –intensive or high technology products in total trade has doubled between 1980 and 1994 from 12 percent to 24 percent (Primo Braga & Fink, 1999). With respect to the US for example, an estimate indicates that the percentage of the country's exports with a high intellectual property content rose from 9.9 per cent in 1947 to 27.4 per cent in 1986 (Gadbaw and Richards). Ryan (1988) states that exports, as measured by RLF, amounted to about $27 billion in 1995, while imports amounted to only $6.3 billion. At least $20 billion of the exports are transactions between US firms and their foreign affiliates.

Another significant factor is the key role of the private sector in technology transfer. Technology, whether patented or in the form of know-how, is primarily in the possession of industrial companies. To such companies, their technology is a valuable commodity which they have paid for by their investment in research and development, and which they cannot simply afford to give away without receiving a reasonable return on that investment (Grubb 1999). Even if required to implement international agreements, governments cannot issue a decree or force the transfer of those technologies.

As suggested by the recently issued report *Integrating Intellectual Property Rights and Development Policy* published by the UK Commission on IPR, "Technology transfer and the development of a sustainable indigenous technological capability are determined by many factors, including but by no means limited to IPR. Therefore it may be unwise to focus on TRIPS as a principal means of facilitating technology transfer." The Report highlights that the crucial issue in respect of IP is perhaps not whether it promotes trade or foreign investment but how it helps or hinders developing countries to gain access to the sophisticated technologies that are required for their development. They recommend a wider agenda, including serious consideration by developed countries of their policies for encouraging technology transfer and more effective research and cooperation with and among developing countries to strengthen their scientific and technological capabilities (Commission of IPR, 2002).

Access to Medicines and IPR

The high profile cases of South Africa (1997) and Brazil (2001) in their efforts to ensure availability of affordable medicines to treat HIV/AIDS illustrated for many around the world the impacts of patent protection on the price of medicines as well as the vulnerability of the public health safeguards of the TRIPS agreement to being trumped by irresponsible pressures based on commercial interest (OXFAM, 2002). These cases, and the contrasting United States and Canadian responses to the anthrax spores crisis in 2001, giving immediate priority to the public health interest over the private interest of patent holders, provided important long-term lessons for the world –for both developed and developing countries alike- about the importance of flexibility, appropriate safeguards, and the need for intellectual property protection agreements, both in multilateral and regional settings, to give precedence to public health priorities over patent claims. The importance of this flexibility was indeed recognized in the Doha Declaration on Public Health. In Doha Ministers addressed most of the issues and concerns raised by developing countries at the TRIPS Council during the years following the entry into force of the WTO Agreement. In general, the Declaration sought to highlight the need for balance between protection of intellectual property and flexibility for developing countries while applying and implementing TRIPS.

The end result was a very carefully drafted document that balances the interest and concerns of developed and developing countries. On the one hand, the separate Declaration highlights provisions in the TRIPS Agreement that provide Members with the flexibility to address public health emergencies such as HIV/AIDS, tuberculosis, malaria and other epidemics. Thus, each Member has the right to grant compulsory licences and to determine the grounds upon which such licences are granted, moreover, the freedom to establish a national regime to deal with parallel imports.[15] On the other hand, through the Declaration, Members expressed their support for the TRIPS agreement and the importance of Intellectual Property Protection for the research and development of new medicines.

Pursuant to an outstanding mandate in paragraph 6 of the Doha Declaration, WTO Members will attempt to find a solution and report before the end of 2002 for the case of countries with insufficient or no manufacturing capacities in the pharmaceutical sector that could face difficulties in making effective use of compulsory licensing under the TRIPS Agreement.

The impact of patent protection on the price of medicines is a real issue, particularly for developing countries. But this concern must be balanced against the recognition that some degree of protection is necessary to provide incentives to the industry to invest in R&D and develop new drugs. However, stronger patent protection will not solve a very important issue, and this is the fact that the large asymmetries in market size between rich and poor drug consumer markets produce a disincentive to invest in R&D on drugs to combat the diseases of "the poor" (pneumonia, malaria, typhoid, cholera, tuberculosis, etc) as opposed to those of "the rich". As the World Health Organization (WHO) Commission on Macroeconomics and Health concluded, this can only be solved by a major international effort that is backed by increased aid and facilitated by public-private partnerships.

IPR and Agriculture

In Doha, Ministers restated the mandate to review TRIPs article 27.3b, which allows countries to exclude plants, animals and certain other biological processes from patentability. If countries decide to use this exclusion, they must provide for a *sui generis* system of protection, this may be an UPOV-type Plant Breeder's Right system[16], another *sui generis* alternative, or some combination of systems.

Assertions have been made that there is a link between the availability and adoption of patent or plant breeders' right protection, and the replacement in many areas of the world of complex, diverse agro-ecosystems containing a wide range of traditional crop varieties with monocultures of single agrochemical-dependent varieties (Dutfield, 2000). Some critics maintain

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[15] Compulsory licensing refers to a permission to use intellectual property, compelled by the government in order to accomplish some political or social objective. Compulsory licensing forces an IPR owner to allow others to use that property at a fee set by the government.

Parallel imports (grey market goods) refers to a foreign manufactured genuine product that is imported by a third party without the consent of the right holder. The legal status of parallel imports is a matter of national decision and is related to the issue of the exhaustion of rights.

[16] The International Convention for the Protection of New Varieties of Plants (UPOV convention) was signed in Paris in 1961 and entered into force in 1968. It was revised in Geneva in 1972, 1978 and 1991. The 1991 Act entered into force in April 1998. UPOV provides a framework for intellectual property protection of plant varieties. These rights are most often referred to as plant variety rights or plants breeder's rights. 14 FTAA countries have joined UPOV. Most of them adhered to the 1978 Act. The US ratified the 1991 Act. New members can only sign on to the 1991 Act.

that IPR provide perverse incentives which encourage activities that are prejudicial to biodiversity, cause the erosion of indigenous methods for using agrodiversity and of soil diversity (Reyes, 1996). Others have also raised concerns regarding the impact of seed patenting on the rights of farmers and plant breeders to save seeds from cultivation and replant, sell, or exchange them in subsequent seasons.

Even among developed countries, there are different views with respect to the patentability of inventions in areas of innovation at the forefront of scientific endeavour (e.g., life sciences) or where the pace of technological change is very fast. Some variations occur, for example, in the patentability of biological materials, with some countries allowing organisms of all kinds (humans excepted) to be patented, others excluding patents on plant and animal varieties, and some rejecting all patents on biological materials.

Experts agree that this is a highly complex issue and that an objective evaluation frequently made pro and contra IPR is hard to achieve when there is such a dearth of reliable empirical evidence (as opposed to anecdotal evidence and pure speculation).

It is a fact that IPR enhance incentives to develop seeds that will have a large potential demand. The commercial breeders chain respond to the demands of farmers, market signals from consumers, food retailers, or other purchasers or users of their crops. What can be presumed with some certainty is that it is almost unlikely that the erosion of agro-biodiversity can be attributed to a single cause such as IPR (Dutfield, 2000). Other factors commonly cited are: government farms credits and subsidies, policies and programs of international agencies and donor institutions, demographic changes, marketing, research and development programs of TNCs, concentration of pesticide and agro-biotechnology research and distribution, and certification requirements in many countries (Dutfield, 2000). A consequence of this trend is that research priorities overall will be increasingly less relevant to the needs of poor farmers in developing countries (Commission on IPR, 2002).

On the application of plant breeder's rights according to UPOV, the privilege of breeders both to use protected varieties as an initial source of variation for the creation of new varieties and to market these varieties without authorization from the original breeder (the breeder's exemption) is upheld in both versions (1978-1991). Regarding the farmers privilege, that allows a farmer to re-sow seed harvested from protected varieties for his or her own use, such right is not included in the 1978 Convention. Nevertheless members of such version of UPOV do indeed uphold it. The 1991 version is more specific about this matter and pursuant to Article 15 governments can use their discretion in deciding whether or not to uphold the farmers' privilege.

A very controversial element in this debate has to do with genetically modified crops -- creating transgenic plants with built-in resistance either to herbicides or to insect pests. Even more the so called "terminator technology" that prevents a variety from being propagated by farmers and makes it impossible to save, replant or sell seed. Allegations are that the widespread application of such technologies would threaten the customary seed saving and exchanging practices of traditional farming communities throughout the world. Corporations in these technological fields claim that without IPR protection they would have no incentive to invent or innovate. As explained by Dutfield, in this case it is not so much the patent or plant breeders' right that has been criticized but the technology claimed in it. "The award of a patent is not itself an authorization to commercialize the technology, product or process….Indeed patent offices are not the right places for such evaluations to be made since decisions on allowing or banning technologies should ideally be made in open and democratic fora" (Dutfield, 2000).

B. Other Issues Advanced by Developing Countries

Biotecnology, Biodiversity and the Protection of Traditional Knowledge

Related to the patentability of plants or the protection of plant varieties through a *sui generis* system, is the nexus of issues relating to biotechnological inventions, biodiversity and traditional knowledge with IPR. The discussion of this issue was included in the WTO agenda in Doha with the support of developing countries, and it is among the pending work of the TRIPS Council to report by the end of 2002. A central part of the debate covers the relationship between the TRIPS Agreement and the Convention on Biological Diversity (CBD).[17]

Increasing commercial interest in plant and animal species in industrializing countries, and in traditional cultural expressions and medicinal remedies, have raised questions of ownership of such resources, previously assumed to be in the public domain. Driven by the advent of tools and innovations, research-based corporations in developed countries' pharmaceutical and agricultural sectors have recognized the value of biodiversity and the indigenous knowledge of local communities regarding traditional plants and medicines. In some cases, researchers from the developed world, have invented novel, patentable products, based on starting biological materials from the developing world. However, there is a concern that developing countries are not adequately compensated when foreign researchers develop products that are based on existing material or knowledge once taken out of the public domain of developing countries. This has led to a debate in international fora on the rights of developing nations and local communities to biological resources and traditional knowledge.

Basic questions in this controversy are: Are corporations to be allowed to patent genetic resources from any country irrespective of origin? How can community rights and local knowledge be respected or benefits shared and is the TRIPS Agreement the right instrument to ensure this? Should a framework to respect and reward local or community knowledge and folklore be created inside or outside of TRIPS? Since developing countries account for around 90 percent of the world's biological resources these are very important developmental issues.

Views on the relationship between the patent system and the CBD's objectives vary widely. The pro-patent view is that they are compatible with each other, and neither is to be

[17] The 1992 Convention on Biological Diversity (CBD) is an international agreement which has as its objectives the conservation of biological diversity, the sustainable use of its components, and the fair and equitable sharing of the benefits arising out of the utilization of genetic resources, including by appropriate access to genetic resources and by appropriate transfer of relevant technologies. Pursuant to article 15 of the CBD nation states have sovereign rights over their own biological resources. This principle gives each country the right to control access to genetic resources within its territory, and to determine the conditions under which this will be allowed.

applied in such a way as to undermine the objectives of the other (Grubb 1999). Moreover, defenders of IPR indicate that in principle, the IPR system can play an important role in stimulating the development of new plant varieties and pharmaceutical products in this context to the benefit of both developed and developing countries. Specifically, IPR could foster local research or the formation of research joint-ventures with foreign companies, e.g., in the initial screening process of biological material and in the early research stages. On the other hand, concerns have been expressed regarding the extension of IPR to cover life forms or traditional knowledge. Critics in principle oppose the patenting of inventions based closely on genetic resources or traditional knowledge even if the patent holders have undertaken to share benefits with the communities concerned (Reyes, 1996).

A more pragmatic view establishes that IPR should not be the only means of protecting traditional knowledge and genetic resources. According to this view, rights of indigenous people and genetic resources can be protected through non-IPR instrument(s) that is part of a broader arrangement allowing a pharmaceutical company to patent inventions related to the know-how of this indigenous group or from genetic resources, but with certain agreed upon restrictions attached to the right to patent or commercially exploit the invention. Others have suggested that trademarks and geographical indications may also be appropriate forms of protection for some products based on traditional knowledge even if they cannot protect the knowledge per se (Dutfield, 2000).

As part of the preliminary work in the TRIPS Council on this issue, a group of developing countries introduced a proposal to amend TRIPS seeking to require that entities applying for patents disclose the country of origin of the biological resource and the traditional knowledge used in the invention, provide evidence that the national authorities in the country of origin consented to the extraction of the resource, and give evidence of "fair and equitable benefit" sharing (*Inside U.S. Trade*, August 30, 2002). These amendments seek to address what some perceive as the increasing risk of "bio-piracy" (unauthorized commercial exploitation of the knowledge and biological resources of indigenous peoples and/or developing countries). Other countries oppose this amendment, arguing that the TRIPS agreement governs intellectual property rights only and not access to genetic resources, which would be better regulated through contracts between national authorities and entities seeking access to those resources.

Other Issues

There are other issues supported by developing countries in the WTO and other international and regional fora. Among them, for example, the extension of the protection provided by geographical indications to products other than wines and spirits, protection of expressions of folklore and the incorporation of utility models.

C. Industrial Policy and Competitiveness Promotion

Although most LAC countries have unified, floating foreign exchange regimes, and have simplified and liberalized their foreign trade regimes by, for instance, eliminating most export and import quotas and substantially reducing tariffs, there are many industrial and competitiveness policy instruments that are widely used. These include:

- export subsidies (both in agriculture and in industrial goods)
- government procurement policies that give preference to local suppliers
- Export Processing Zones with regimes that include tariff exemptions but also a host of tax concessions and other incentives,
- national and sub-national investment incentives and regional assistance,
- domestic-content, joint-venture, majority ownership and other technology-sharing requirements for foreign direct investment, pricing and marketing arrangements
- and others

Some of these subsidies and instruments have been used in a targeted, sector-specific fashion, which goes against the principles of non-discrimination and national treatment at the basis of the multilateral trading system.

In the past, conventional wisdom has held that many of these policy instruments were important for promoting competitiveness, productivity, growth, and development. In fact, many of these instruments were widely used by the Asian high performing countries during their transition to the status of world-class competitors. However, economic research and experience has shown that some of these instruments are highly inefficient, that they may stifle innovation, discourage state of the art foreign direct investment and associated productivity and technology transfer benefits, as well as being highly vulnerable to protectionist abuse, rent-seeking behavior and corruption. Many are also self-defeating when considered from a general equilibrium and global level, leading to "subsidy wars", high fiscal costs and global welfare reductions.

This is why the use of a number of these instruments is disciplined, and in some cases prohibited, by multilateral trade rules (GATT/WTO) and are being gradually phased out. However, there is still an ongoing concern about whether deepening trade agreements to behind-the-border areas will reduce the "policy space" to use certain instruments of industrial policies or competitiveness promotion. Some analysts, such as Noland and Pack (2003) have argued that at present the WTO exceptions for R&D, special and differential treatment and others are such that they create fairly large loopholes for governments committed to selective intervention. The concern is however about further reducing the "policy space" by stricter rules in existing areas or by introducing new areas in the WTO such as the Singapore Issues. Others analysts, such as Theodore Moran, have insisted that the use of many traditional interventionist instruments such as performance requirements is anyway counterproductive in the new paradigm to attract and benefit of FDI. This debate is far from settled, and many respected economists hold different views about the microeconomics of some of the instruments and the institutions to promote competitiveness. Discussions of these issues are important to allow developing countries to make informed choices about policies and institutions that are appropriate for them. Some of these issues were discussed in the previous sections of this paper.

Trade agreement flexibility to use a number of industrial policy instruments, or as called in more modern language, instruments to promote competitiveness, also fall under the rubric of special & differential treatment.

IV. Special and Differential Treatment

Much of the discussion about the trade and development relationship in trade negotiations and agreements has been organized around the concept of "special and differential treatment" (S&D) in the GATT/WTO and around the heading of "treatment of differences in size and levels of development" in the FTAA.

A. S&D Treatment in the GATT/WTO [18]

Since the early days of the GATT, both developed and developing countries accepted the concept of S&D treatment for developing countries, but its justification, form, and content have evolved over time. Before the Uruguay Round this concept was used to give developing countries special rights and privileges based on three major justifications: the infant industry argument, the importance for the growth and diversification of their exports of preferential access to developed-country markets, and several asymmetry rationales to justify non-reciprocity in trade negotiations.[19]

The S&D treatment provisions reached their peak during the Tokyo Round with the 1979 decision known as the "Framework Agreement on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries". Also known as the Enabling Clause, this framework offers a comprehensive statement and legal cover on core S&D treatment issues in four major areas:

a) Enhanced market access via preferential tariff treatment for developing countries in accordance with the Generalized System of Preferences (GSP) and similar non-reciprocal schemes;
b) Exemption or possibility of opting-out from the Tokyo Round codes (technical barriers to trade, government procurement, subsidies and countervailing duties, customs valuation, import licensing and anti-dumping actions);
c) A waiver to developing countries to engage in RTAs among themselves; and
d) Special treatment or flexibility to least developed countries identified as a distinct group as defined by the UN classification, in making concessions and contributions in view of their special development, financial and trade needs.

In addition, the 1979 Enabling Clause codified a graduation principle by which developing countries would be expected to take on more obligations as their economies grow

[18] This section draws heavily from Oyejide (2002) and Fukasaku (2000).

[19] A recent paper by the WTO Secretariat contains an inventory of S&D provisions introduced in the GATT and then WTO agreements since the 1950s grouping them in three categories: a) those allowing fewer obligations or the easing of rules for developing countries (right to protect infant industries, right to use trade measures to address balance of payments difficulties, right to establish RTAs among developing countries, principle of non-reciprocity); b) those requiring positive actions in favor of developing countries (preferential access to developed country markets under the legal cover of the 1979 Enabling Clause such as GSP and other non-reciprocal trade preferences); and c) those meeting the special needs of the LDCs.

stronger. However, this concept of S&D treatment received a number of strong criticisms as a way to promote trade and development before and during the Uruguay Round:

a) First, the infant industry argument for protection of domestic industries was substantially discredited. In practice, during the 1980s and 1990s many developing countries around the world pursued aggressive liberalization above and beyond multilateral commitments.
b) Second, non-reciprocity has a serious disadvantage; it means that developing countries cannot participate fully on a reciprocal basis in market access negotiations, which in practice means reduced leverage and missed opportunities to gain effective market access in developed country markets.
c) Non-reciprocal arrangements have two additional disadvantages: they limit the potential use of the GATT/WTO framework as a mechanism to restrain unilateral actions by developed countries; and they also have limited value in providing a stable and reliable framework for investment.
d) The other main component of S&D treatment, derogation or exemptions from full discipline, has also been criticized as counterproductive to the extent that the market distorting measures so allowed would impose a self-inflicted cost on developing economies.

These and other assessments led to quite a drastic change in the form and content of S&D provisions that resulted from the Uruguay Round. The adoption of the principle of "single undertaking", that required all members to adhere to the full family of WTO agreements, significantly reduced flexibility for exemptions and derogations. And many S&D provisions were reformulated in terms of longer transition periods and differences in threshold levels. Thus, the general orientation of the Uruguay Round outcome was that developing countries should eventually meet virtually the same set of standards as developed countries on a broad range of both market access and rules issues, implying an eventual convergence in standards of behavior between developing and developed countries. However, there is still a variety of S&D provisions incorporated in the WTO agreements.

The difficulties of implementation of Uruguay Round commitments and new evidence about the costs of adjustment as well as the costs of institutional capacity building, led to deep dissatisfaction by many countries and experts with what were perceived as deficiencies with post Uruguay Round S&D treatment provisions. These issues were subject to heated debates in the preparation of the Doha Ministerial Meeting. Many developing countries insisted on the need for more flexibility, longer transition periods than those agreed in the Uruguay Round, more technical assistance for capacity building, a revisit of the issue of full or partial derogation from certain disciplines, and a revisit of the issue of classification of WTO member countries. In short, many developing countries insisted on the need for a careful rethinking of the concept of S&D treatment- of its justification, form, and content.

Some of these issues were subject to specific mandates in the Doha Development Agenda, in particular those related to capacity building, implementation and S&D provisions. [20] However, a month before the Cancún Ministerial (September 2003) most of these issues remain unresolved.

B. Treatment of the Differences in Size and Levels of Development in the FTAA

The issue of treatment of the differences in size and levels of development was present from the start in the FTAA process. It was highlighted as a special concern when the FTAA project was launched in the Summit of the Americas in December 1994 and then again when formal negotiations were launched in the next Summit in April, 1998. There are also a number of instructions on this issue in successive ministerial declarations. However, the concept of S&D treatment has not entered the language of the FTAA talks.

The San Jose Declaration of March 1998, which provides the blueprint for the negotiations, states the following principles in this area:

- Special attention should be given to the needs, economic conditions (including transition costs and possible internal dislocations) and opportunities of smaller economies, to ensure their full participation in the FTAA process.
- The rights and obligations of the FTAA will be shared by all countries. In the negotiation of the various thematic areas, measures such as technical assistance in specific areas and longer periods for implementing the obligations could be included on a case by case basis, in order to facilitate the adjustment of smaller economies and the full participation of all countries in the FTAA.
- The measures agreed upon to facilitate the integration of smaller economies in the FTAA process shall be transparent, simple and easily applicable, recognizing the degree of heterogeneity among them.
- In order to ensure the full participation of all countries in the FTAA, the differences in their level of development should be taken into account.

There are several reasons why S&D language never entered the FTAA talks:

- First, this is clearly a reciprocal arrangement, thus a non-reciprocity rationale for S&D will have no place in the architecture of the FTAA.
- Second, since the objective is to create a free trade area, an infant industry argument rationale for S&D will also have no place in this framework. Besides, LAC countries already tried to promote infant industries for several decades under the import substitution strategy of industrialization.
- Third, the FTAA talks were launched in the post Uruguay Round environment where, as stated above, the general orientation was towards an eventual

[20] As regards the latter, in DDA paragraph 44 Ministers "agreed to examine all provisions on special and differential treatment with a view to reinforce them and making them more precise, effective and operative. In this respect, we support the work program on special and differential treatment established on the Decision on issues and concerns relative to implementation".

convergence in standards of behavior between developing and developed countries.

Given the simultaneous nature of multilateral and regional negotiations, including target completion date, it would not be surprising if some developments in the Doha Development Agenda negotiations influence the FTAA content in this area.

However, these are two different processes. The FTAA objective is quite clear; it is to create a free trade area where tariffs will go down to zero and all the tariff universe is under negotiation, without exceptions. In practice, the degree of market access that will be achieved in agriculture, services, investment and government procurement as an end result, what the path will be to get there and what differentiated treatment some countries will receive during the transition, are open questions that will be defined by the negotiations. In the rules area, it will also be up to the negotiating process to define how the principles stated above regarding the treatment of the differences in size and level of development will materialize and receive legal expression.

V. TRADE-RELATED CAPACITY BUILDING

A. Lessons from Experience

Another set of very important developmental issues posed by trade negotiations and agreements relates to trade-related capacity building (TRCB). During the last seven to eight years there has been a significant amount of learning from experience in the multilateral system and in regional and bilateral practice on TRCB.

One field of learning has been the multilateral system. There have been two waves of responses to the need for TRCB of the least developed and developing countries in the multilateral system. The "first-wave" response occurred in the second half of the 1990s and focused on three initiatives: (a) the Joint Integrated Technical Assistance Programme (JITAP) for selected least developed and other African countries launched in May 1996 at the IX United Nations Conference on Trade and Development (UNCTAD IX); (b) the Integrated Framework for Technical-Related Assistance, including Human and Institutional Capacity Building to Support Least Developed Countries in their Trade and Trade-Related Activities (the Integrated Framework or IF), launched as a result of decisions taken at the Singapore WTO Ministerial Meeting; and (c) the "positive agenda" program of UNCTAD. The "second-wave" response dates from around mid-2000, following reviews from JITAP and the IF, and is concerned with "mainstreaming trade" as an integral part of the overall development and poverty reduction effort by countries.[21] This latter response is particularly focused on assisting countries in analyzing the impacts of trade policy reforms of poverty reduction.[22]

A second field of learning has been the rich experience by various donors, both bilateral and multilateral. Many lessons from this experience are reviewed and articulated by an exercise undertaken by the OECD Development Assistance Committee on best practices for donors.[23]

A third field of learning for the countries of the Americas has been the FTAA. The FTAA process has already contributed to a significant additional mobilization of resources for TRCB, and in and of itself it has been a tremendous learning exercise for many countries.[24] However, much more needs to be done. At the Quito Ministerial, on November 1, 2002 countries adopted a framework for a Hemispheric Cooperation Program (HCP) as part of the FTAA. Putting trade-and-aid together is a step in the right direction and the HCP has a number of valuable mechanisms, notably: the elaboration by countries of National Strategies for Trade Capacity Building, donor-country meetings to coordinate donors' responses to the needs identified and prioritized in the strategies. However, it is too early to assess whether this program will be able to mobilize sufficient resources to meet the needs identified.

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[21] For a description and assessment of experience with these initiatives see Luke (2002).

[22] See Hoekman, Michalopoulos, Schiff and Tarr (2002).

[23] OECD, 2001b.

[24] See Sydney Weintraub (2000)

Drawing from these different experiences of TRCB a number of points need to be stressed:

First, when discussing the rationale for the priority of trade capacity, one the first issues that stands out is what could be called the **paradigm issue.** This refers to the key question of what is the role of trade in achieving the objectives of growth, development and poverty reduction. This discussion is important because different answers to the fundamental issues of the links between trade and growth, growth and poverty and growth and income distribution will give different answers to the priority and modalities of trade-related technical assistance (TRTA) and TRCB in the development programs of countries and in the cooperation program of donors. Most developing countries are generally convinced of the importance of trade and trade-related capacities for wealth creation and poverty reduction. The Doha Development Agenda has clearly been a turning point and a victory for this view and for a reassertion of the role of trade in development.

A second key question is how to define, articulate and prioritize TRCB needs into national development strategies and in international cooperation programs. This has been called "mainstreaming trade" in the context of the WTO. To do this, there has to be a minimum amount of agreement among governments and donors about the scope of TRCB. Is TRCB to include only issues close to trade negotiations and trade agreement implementation? Or should it also include assistance to strengthen supply-side response capacities, such as export promotion, investment attraction and policies to promote competitiveness (particularly of small and medium-sized enterprises), or even issues of basic infrastructure development, macroeconomic stability and financial issues? One of the lessons from the first five years of the Integrated Framework is that lack of agreement on the definition of TRCB can affect policy coherence, coordination among donor agencies, and delivery of technical assistance. The FTAA-HCP has adopted a broad definition of TRCB that includes three major areas: preparing for negotiations, implementation of the agreement, and transition to free trade including the challenge of international competitiveness.

Different definitions of TRTA are also at the heart of differences between the development community and the trade community. What these two communities have traditionally understood by cooperation is very different. Trade negotiators are typically accustomed to delivering courses and training on trade rules, agreements and other issues close to negotiations. More recently their agenda has expanded with a concern for trade agreement implementation particularly in behind the border issues. The development community is accustomed to a much broader spectrum of policy areas where in many cases trade, market institutions, or private sector development might not even appear or have only secondary importance.

One of the major challenges is then to bridge these differences between the development community and institutions and the trade community and institutions, a difference that is sometimes expressed not only at the international level but also between different national agencies and institutions.

B. Towards a Trade-Related Capacity Building Framework for the Americas

The establishment of a sound trade related capacity building framework has to be based, first and foremost, on a solid understanding of the different types of costs involved in trade and of the different capacities countries must develop to engage significantly and beneficially in the global and regional trading systems. It is possible to distinguish between trade policy-making and negotiation costs, implementation costs, adjustment costs, and costs of developing international competitiveness.

Trade Policy-Making and Trade Negotiation Costs

Trade policy-making and trade negotiation costs involve aspects such as training a world class trade negotiating team, investment in internal consultation mechanisms with the private sector and other civil society sectors, general economic and sectoral impact studies, trade education and outreach, and of course, the costs of appropriate expert participation and follow up in the numerous meetings that the different negotiating processes entail.

The costs of a bad negotiation resulting from incapacity to invest in these items could be very high indeed to any national economy in terms of development and business interests. Limited capacity to participate in any specific trade negotiation for a particular country or group of countries can also have serious costs for the rest of participating countries. The post Uruguay Round problems with implementation of obligations were related in part to the fact that many developing countries did not engage significantly, and this led to insufficient sense of ownership, perceptions that a number of obligations were imposed on them, and lack of political will to implement. In summary, trade negotiations require significant investment. Only if each one of the participating countries makes the required investment can they maximize the benefits of a good negotiation and generate the "ownership" by all relevant stakeholders and the appropriate political conditions to implement obligations.

Implementation Costs

Implementation costs break down into costs of complying with the obligations and costs of administering the agreements to the benefit of the country. The former could be relatively low in some cases (tariff reduction, putting in place some new procedures). However, in most areas of behind-the-border or domestic regulation they can be very substantial and imply major investment decisions. This is the case in areas such as technical standards, sanitary and phytosanitary standards (SPS), competition policy, customs valuation, and intellectual property among others.

Michael Finger and Philip Schuler (2001) estimated the costs of implementation in three areas covered by WTO agreements (customs valuation, SPS and intellectual property) using World Bank project data. They showed that these investments require purchasing of equipment and software, hiring and training of specialized personnel, systems development, and other items to upgrade developing country institutions and systems to the level of industrial country standards, which means that, depending on each country's existing capacities, the required investment may be of the order of dozens of millions of dollars.

The development dimension of the behind-the-border issues negotiated in trade agreements needs more research and increased understanding in order to avoid in the FTAA the type of frustrations and implementation problems that arose after the Uruguay Round.

Adjustment Costs

Adjustment costs are those associated with the productive reestructuring, job dislocations and fiscal impacts of the transition to freer trade. Some of these dislocations are a necessary part of adjusting the economy to higher levels of productivity and competitiveness. The economic and social costs of these dislocations can be minimized with appropriately designed and financed adjustment programs and social safety nets. Even a developed country such as the United States has implemented Trade Adjustment Assistance (TAA) programs. TAA in the United States was significantly strengthened as part of the Trade Act of 2002 that also included Trade Promotion Authority.

Costs of Developing International Competitiveness

While adjustment costs and the required investments can be seen as defensive, investments to develop international competitiveness can be seen as proactive or offensive in a pro-growth and developmental sense. These may involve a wide variety of policies in areas such as support for small and medium-sized enterprises, policies to develop competitive advantages in specific clusters a la Michael Porter, credit policies, infrastructure development and upgrading, technical and vocational training, and general education policy. Even some aspects of health and housing policies are key to have the type of work force that can make a real contribution to global value added and further help in making the country attractive as a production and sourcing base to international investors.

It is important to note that multilateral rules, and most likely regional rules in the context of the FTAA, imply that, increasingly, member countries will have to shift the focus of their export and investment promotion policies, as well as industrial transformation and competitiveness policies away from discriminatory, sector-specific policies to a comprehensive, non-distorting, non-discriminatory approach. In this sense, the effect of the new WTO and FTAA rules is not to eliminate the role of government but to transform it. The emphasis of policies to promote competitiveness under the "new paradigm" is shifted toward enhancing the efficiency of infrastructure, regulatory reform, and liberalization of services sectors, including business services, improving human capital formation, trade and business facilitation, promoting internet readiness and information technology services, and creating an environment conducive to investment and innovation.

VI. POSITIVE IMPACTS ON INSTITUTIONS AND THE POLITICAL PROCESS

The final set of developmental issues posed by the FTAA selected for this paper has to do with national and international governance and it is this: as a comprehensive agreement, the FTAA will have a major impact in influencing the economic policies, institutions, regulatory frameworks, and traditional market governance practices of LAC countries. The FTAA will be a major force to promote transparency, predictability, competition, non-discrimination, and rule-bound behavior in many areas of the economic systems of Latin America, reducing the scope for discretion, corruption, collusion, rent-seeking and arbitrariness. It is not just that markets will be more open, but that their institutional and legal fundamentals will also be stronger as a result of FTAA rules and commitments.

For instance, the impact of NAFTA in locking-in not only a broad range of economic reforms, but also democracy has been widely recognized. NAFTA was instrumental in determining the policy response of both the Mexican and the U.S. governments to the 1995 peso crisis. Mexico maintained the reforms and increased its credibility as a location for international investment, and the U.S. response demonstrated that NAFTA meant more than just trade policy.

Precisely how the FTAA would help the members integrate to the world economy and benefit in terms of growth and development, will of course depend on how the agreement is designed, and on the availability of additional development assistance induced by the agreement, by mechanisms internal or external to the agreement.

VII. TOWARDS AN FTAA DEVELOPMENT AGENDA

The WTO Doha Ministerial Meeting produced a Doha Development Agenda, characterized by an unprecedented mix of trade and development priorities. In order to maximize the benefits for the participants, induce higher standards of living in Latin America and the Caribbean and accelerate economic convergence, the FTAA also faces the challenge of blending trade and development issues. There is a unique opportunity in the Inter-American system to do this given the smaller number of countries, their geographical proximity and the existence of important Inter-American and regional institutions. Parallel TRCB efforts can facilitate the transition to freer trade and upgrade the countries' public sector and market institutions to meet the development challenge.

The initiation of a HCP as part of the FTAA process is a major positive step in this direction. However, important questions remain unanswered. A number of distinguished economists think that for economic convergence to happen in integration arrangements, these arrangements themselves, or parallel efforts have to incorporate substantial transfers of resources from the richer countries and regions to the poorer ones in order to close gaps in infrastructure, education, institutional and other areas.[25] This raises a number of important issues for the FTAA:

- Will the trade-cooperation nexus established in the FTAA be sufficient to mobilize the necessary resource transfer, particularly to the smaller economies, to finance the trade and development challenges outlined in Section V?
- What will be the proportion of resources mobilized by the United States, as a partner in this agreement, versus the resources mobilized by other bilateral donors and multilateral agencies?
- What kinds of institutions should be created, or how should existing institutions be strengthened, to sustain aid, resource transfers and capacity building efforts to the smaller economies?
- Are the smaller economies themselves underestimating the challenge of financing the domestic tasks required by hemispheric free trade or a bilateral agreement with the United States?

Given the asymmetries in size and level of economic development, the foundations for a win-win outcome from hemispheric free trade must include both a world-class trade agreement and a no less impressive capacity building and resource transfer component.

[25] See Lopez-Calva and Lustig (2002), Bustillo and Ocampo (2004) and literature therein. Of course, aid and international resource transfers will not do much good if the internal redistributive mechanisms (tax policy, social policy) are not working, and no social safety nets are in place.

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