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Integration *and trade* diversion

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Regional integration has once again become an important issue for Latin America and the Caribbean. Compared with previous experiences, however, recent integration commitments have a number of new aspects in such areas as negotiating procedures, the issues involved in the various agreements –some of which are as unprecedented as the adoption of common currencies, the creation of binational companies, common labour laws, etc.– and the actual timing of these steps. Among the various integration initiatives now being pursued, four are particularly important by virtue of the relative weight of the economies involved: MERCOSUR, the Andean Pact, the Central American Common Market (CACM) and the Caribbean Community (CARICOM). This article presents estimates for one of the possible outcomes of these four integration processes in terms of the resulting trade flows –within each country group and between each country and the rest of the world– on the basis of an arbitrarily defined criterion for estimating trade diversion, and goes on to discuss some of the resulting implications for integration policies and negotiating procedures.

I
Introduction

Regional integration is a long-standing issue in Latin America and the Caribbean, with early efforts in this area dating back to the late 1950s. The prospect of what was to become the Treaty of Rome (signed in 1957) led to a number of studies at the regional level to evaluate the possibility of fashioning a local replica of the then prospective effort to form a European Union.

A number of now well-documented problems (the practice of undertaking integration initiatives in parallel with efforts to deepen the industrial production structure, misconceived negotiating formulas, etc.) led to no more than piecemeal achievements in the following two decades, notwithstanding the strong official emphasis placed on the issue.

The situation changed somewhat in the late 1980s, when a number of commitments were made among groups of neighbouring countries which resulted in the formation of several subregional custom unions within a relatively short time span.

These commitments cover several new areas, including such topics as negotiating procedures, inherent problems associated with the various agreements –including some issues never tackled before, such as the adoption of common currencies, the creation of binational companies, common labour laws, etc.– and the actual timing of these steps.

Another feature common to a number of these initiatives is that they all look to the mid-1990s as a target date for the consolidation of integrated international structures.

Among the various integration initiatives now being consolidated, four are particularly important by virtue of the relative weight of the economies involved: (i) the Common Market of the South (MERCOSUR), formed by Argentina, Brazil, Paraguay and Uruguay; (ii) the Andean Pact, composed of Bolivia, Colombia, Ecuador, Peru and Venezuela; (iii) the Central American Common Market (CACM), comprised of Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua; and (iv) the Caribbean Community (CARICOM), made up of Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago (Bahamas does not participate in the Caribbean Common Market).

Successful integration efforts on the part of these four groups of countries may, of course, be expected to lead to larger intrazonal trade flows and to increased production within each group of goods designed to take the place of imports from third countries. The scale of such import substitution and its probable sectoral concentration are seldom examined in the related literature, however.

This article presents estimates of one of the possible effects of these four integration processes on the resulting trade flows, on the basis of an arbitrarily defined criterion for estimating trade diversion which makes it possible to analyse the probable changes in the trade flows within each country group and between each country and the rest of the world.

Section II gives a brief description of each of these four integration processes and presents basic data on pre-integration trade flows. Section III describes the basic assumptions made, and the methodology and data used. Section IV discusses the main findings, and section V speculates about these results and some of their possible policy implications.

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II

Four country groups in pursuit of integration

In recent years we have witnessed renewed efforts on the part of the Latin American and Caribbean countries to intensify their integration processes.

On the political front, one feature which sets these movements apart from previous integration initiatives is that those sponsoring them are democratically elected governments. On the economic plane, their simultaneous adoption of uniform liberalization policies has no precedent in the region and probably accounts for the novel aspects of these commitments to integration, which is no longer seen as a way of replacing imports from third countries, but rather as a means of enhancing the competitiveness of the member countries' exports and establishing fuller and closer links with the international economy. It is also the main reason why these integration initiatives' objectives and timing are so similar.

MERCOSUR was born in March 1991, when previous commitments between Brazil and Argentina to establish a common market were extended to include Paraguay and Uruguay. The target date for MERCOSUR's entry into operation was set at January 1995, and a similar time horizon was adopted by the countries of the Andean Group (under the Act of La Paz, signed in November 1990) and by the Caribbean countries, under an agreement signed in August of that same year. The year 1995 has also been chosen as the target date for the creation of an economic community among the Central American countries, in line with the Central American Economic Action Plan.

For the purposes of this analysis, the most important aspects to be explored here have to do with the (pre-integration) trade structure of the countries which are to make up these four free trade areas. The following paragraphs will provide an overview of the basic features of the intrazonal trade flows for these four country groupings in 1991. Detailed analysis at the product level could only be carried out on the basis of the most recent information available for this level of disaggregation, corresponding to 1989 in the cases of MERCOSUR and the Andean Pact and 1988 in those of CACM and CARICOM.

1. The Common Market of the South (MERCOSUR)

This is the largest of the four country groupings, with intrazonal exports in 1989 totalling US$4 billion, as compared to nearly US$1 billion for the Andean Pact and (in 1988) a little over US$600 million for CACM and less than US$200 million for CARICOM.

In all four country groupings, trade flows are quite concentrated, with the three main bilateral export flows accounting for well over half the total value of intrazonal exports. In MERCOSUR, bilateral trade between Brazil and Argentina and Brazilian exports to Uruguay represented 57% of total intrazonal trade in 1989.

Given the differences in the degree of openness and size of the economies involved, the relative importance of the intrazonal market varies sharply from country to country, although in all of them there are at least some sectors where that market accounts for more than half of the total value of sectoral exports (see table 1).

Clearly, the relative importance of the zonal market for, say, Paraguay and Uruguay is far greater than it is for Brazil. This is true not only in broad terms, but also for a number of specific industries: when the various industries were considered individually, it was found that the exporting sectors accounting for over one-third of the total value of Paraguay's exports sell more than half of their exports within MERCOSUR.

In view of the zonal market's limited importance for the main exporters, there would seem to be quite a significant margin for trade diversion, and the contribution made by intrazonal trade flows to the overall trade balance will obviously vary from one country to the next. Although all four countries participating in MERCOSUR had trade surpluses with the rest of the world, in 1989 Brazil and Uruguay were net importers in their intrazonal trade. (Trade balance figures are discussed in section IV, where a comparison is made between pre- and post-integration trade flows.)

TABLE 1

MERCOSUR: Some basic indicators

Country	Relative weight of zonal market in 1991 (%)		Sectors deriving over 50% of the total value of their exports from sales to MERCOSUR, 1989	
	Exports	Imports	Number of sectors[a]	Share of exports to MERCOSUR in total exports of the sector (%)
Argentina	16.06	12.75	44	3.1
Brazil	4.04	10.80	10	0.2
Paraguay	35.19	36.00	42	36.0
Uruguay	35.14	30.26	105	20.6

Source: International Monetary Fund (IMF), *Direction of Trade Statistics, Yearbook, 1992*, Washington, D.C., 1992, and estimates based on primary data from the ECLAC External Trade Data Bank for Latin America and the Caribbean (BADECEL).

[a] Out of the 237 three-digit product groups contained in the Standard International Trade Classification (SITC).

If we look at the most important trade flows, we find that in 1989 Argentina's main exports within MERCOSUR consisted of wheat, dairy products, fruits and nuts, petroleum products and motor vehicle parts. Brazil exported coffee, iron ore and concentrates, petroleum products, steel products and automobiles. Uruguay mainly exported meat, rice, processed cereals and some chemical products such as pigments and paints, while the principal Paraguayan exports were cotton, meat, coffee and essential oils.

2. The Andean Pact

The Andean Pact, which is the second-largest of the four groups, has a long history of integration initiatives involving such issues as common industrial policies and other measures that go beyond the idea of simply granting trade concessions. Recent efforts have been much less ambitious, and have focused mainly on trade policies with a view to the overall goal of forming a common market.

Here, too, intrazonal trade flows are fairly concentrated, with bilateral trade between Colombia and Venezuela, along with Ecuador's exports to Peru, accounting for 58% of total trade within this group in 1989.

The degree of integration –as measured by the proportion of total trade represented by intrazonal trade– is quite limited for all the countries involved, with intrazonal trade accounting for around 10% or less of total exports and imports, except in the case of Peruvian imports. Unlike MERCOSUR, the Andean Pact's indicators of zonal dependence for the exports of individual sectors are also very low (see table 2).

In 1989, the main exports to other countries in the zone were copper, zinc, synthetic fibres and petroleum products from Peru; crude petroleum, petroleum products and prepared fish, crustaceans and molluscs from Ecuador; petroleum products, various chemical products, steel products and aluminium from Venezuela; meat, cotton, some chemical products and light manufactures such as outerwear and travel goods from Colombia; and sugar, wood, some chemical products and non-ferrous metals from Bolivia.

3. The Central American Common Market (CACM)

Central American could perhaps be said to have the most ambitious of the recent integration initiatives, since the aim of the participating economies is not only to create a free trade area with common import barriers –as in most other subregions– but also to go a step further and form an economic community equipped with common institutions.

In 1988, however, intrazonal trade was highly concentrated (56%) in bilateral trade between Guatemala and El Salvador and Guatemalan exports to Costa Rica.

The figures given in table 3 attest to the fact that quite a significant percentage (over 20%) of El Salvador's and Guatemala's exports, and a somewhat smaller proportion of Costa Rica's exports, are sold on the intrazonal market.

In 1988 the main products exported by Costa Rica to the zonal market were rubber tyres, medicinal and pharmaceutical products and steel products.

TABLE 2

Andean Pact: Some basic indicators

Country	Relative weight of zonal market in 1991 (%)		Sectors deriving over 50% of the total value of their exports from sales to the Andean Pact countries, 1989	
	Exports	Imports	Number of sectors[a]	Share of exports to Andean Pact in total exports of the sector (%)
Bolivia	10.32	3.74	6	4.2
Colombia	7.54	8.53	54	1.6
Ecuador	4.97	7.55	32	0.9
Peru	7.73	17.15	48	1.7
Venezuela	3.21	2.49	17	0.3

Source: International Monetary Fund (IMF), *Direction of Trade Statistics, Yearbook, 1992*, Washington, D.C., 1992, and estimates based on primary data from the ECLAC External Trade Data Bank for Latin America and the Caribbean (BADECEL).

[a] Out of the 237 three-digit product groups contained in the Standard International Trade Classification (SITC).

TABLE 3

Central American Common Market (CACM): Some basic indicators

Country	Relative weight of zonal market in 1991 (%)		Sectors deriving over 50% of the total value of their exports from sales to the CACM, 1989	
	Exports	Imports	Number of sectors[a]	Share of exports to CACM in total exports of the sector (%)
Costa Rica	10.42	8.05	71	6.3
El Salvador	21.33	16.29	115	22.9
Guatemala	26.96	8.54	135	21.1
Honduras	3.59	7.95	59	1.6
Nicaragua	9.64	15.68	69	6.3

Source: International Monetary Fund (IMF), *Direction of Trade Statistics, Yearbook, 1992*, Washington, D.C., 1992, and estimates based on primary data from the ECLAC External Trade Data Bank for Latin America and the Caribbean (BADECEL).

[a] Out of the 237 three-digit product groups contained in the Standard International Trade Classification (SITC).

Exports from El Salvador consisted mainly of paper and paperboard, medicinal and pharmaceutical products and footwear. Guatemala's chief exports were medicinal and pharmaceutical products, food products, and perfumery and cleansing preparations. Honduras' share of zonal exports was primarily composed of fixed vegetable oils, fruits and nuts, and wood, while Nicaragua mainly exported iron and steel bars, some chemicals and wire products.

4. The Caribbean Community (CARICOM)

CARICOM is the smallest of the four groups considered here and also has the lowest integration coefficients.

According to the 1988 figures and to data available at the product level for only some of the countries participating in this integration process, CARICOM's intrazonal trade was concentrated

TABLE 4

Caribbean Community (CARICOM): Some basic indicators

Country	Relative weight of zonal market in 1991 (%)		Sectors deriving over 50% of the total value of their exports from sales to CARICOM, 1989	
	Exports	Imports	Number of sectors[a]	Share of exports to CARICOM in total exports of the sector (%)
Bahamas	1.05	1.10	...	...
Barbados	19.13	21.58	4	0.1
Belize	8.61	3.26	...	...
Dominica	12.96	4.96	...	...
Grenada	9.21	21.59	...	...
Guyana	4.35	16.83	...	...
Jamaica	5.08	4.94	11	-
St. Kitts and Nevis (1988)	2.06	5.40	2	-
St. Vincent and the Grenadines	6.68	2.88	...	...
Trinidad and Tobago	16.17	4.83	1	-

Source: International Monetary Fund (IMF), *Direction of Trade Statistics, Yearbook, 1992*, Washington, D.C., 1992, and estimates based on primary data from the ECLAC External Trade Data Bank for Latin America and the Caribbean (BADECEL).

[a] Out of the 237 three-digit product groups contained in the Standard International Trade Classification (SITC).

(64%) in bilateral trade between Jamaica and Trinidad and Tobago and in the latter country's exports to Barbados.

The zonal market is of some importance only for the exports of Barbados, Dominica and Trinidad and Tobago, although it accounts for less than 20% even in these cases (see table 4). For the rest of the CARICOM countries, the relative share of total exports accounted for by this integration grouping generally ranged from less than 1% to around 9%, and 1988 data indicate that the percentages were small even at the level of individual sectors

shortening were the principal exports from St. Kitts and Nevis.

This is the basic framework of trade relations which forms the setting for efforts to promote integration in these four groups of countries. The relatively low level of dependence on zonal markets (which is very low indeed when compared, for instance, with that of the European Community) would suggest that –so long as the overall composition of commodity trade is compatible with the excess demand met by imports from third countries– a significant margin exists for trade diversion.[1] The following