Western Hemisphere Integration: The Role of the Private Sector

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The answer to the question of the private sector's commitment to economic integration in the Western Hemisphere seems to differ by type of investor, country size, and according to the geographical scope of this participation. Since the late 1980s, portfolio investors (equities and bonds) have been the most high-profile private participants in the developing world, accounting for US$265 billion in net capital flows from 1990-1996.[1] In Latin America, they have also been the most volatile. In the aftermath of the 1994 Mexican peso crisis, the Asian shocks of 1997-1998, and Brazil's 1999 devaluation, portfolio investors were inevitably the first ones out the door. The swiftness with which portfolio flows have fled from troubled emerging markets in the 1990s has prompted Latin American governments to renew their efforts at attracting higher levels of foreign direct investment (FDI). Under the thrust of liberalized investment regimes that grant national treatment to foreigners, FDI inflows to the region hit a record level of US$76.7 billion by 1998.[2] While certainly a major advance over the net negative outflows of capital that plagued Latin America in the 1980s, today's revival is tempered by the extent to which just three countries (Argentina, Brazil, and Mexico) dominate as FDI destinations, and by the way that massive privatization programs have served as a the main lure for this recent boom in FDI.

[1] Sebastian Edwards and Moises Naim, "Introduction: Anatomy and Lessons of Mexico 1994," in *Mexico 1994: Anatomy of an Emerging Market Crash*, edited by Sebastian Edwards and Moises Naim (Washington, DC: Carnegie Endowment for International Peace, 1997).

[2] Economic Commission for Latin America and the Caribbean (ECLAC), *Foreign Investment in Latin America and the Caribbean, 1999* (Santiago, ECLAC, 1999).

Apart from the large emerging market economies being the dominant force for private investment in the hemisphere, the increasing trend toward sub-regional integration has also served as a magnet for investment. Within the North American Free Trade Agreement (NAFTA) and the Southern Cone Common Market (MERCOSUR), private sector activities have concentrated on trade-related investment in cross-border production. Here, investors from capital and technology-rich countries like the U.S., Canada, Germany, and Japan have joined with Latin American counterparts that bring an abundance of resource inputs (rubber, oil, copper) and cheap semi-skilled labor to the negotiating table. The result has been greater specialization and increasing economies of scale in such sectors as transportation equipment, auto parts and electronics. Manufacturing activities like these now account for more than a third of all FDI inflows to Latin America, with the services and raw material sectors each capturing roughly a third. Again, in all three sectors, the bulk of investment dynamism is concentrated in one of the three emerging market countries mentioned above; however, in the case of MERCOSUR, the multiplier effects are increasingly evident in member countries (Bolivia, Chile, Paraguay, Uruguay) that have strengthened their trade and investment ties with Brazil and Argentina through participation in this sub-regional scheme.

When the U.S. proposed in 1994 to negotiate a Free Trade Area of the Americas (FTAA) agreement that would include all thirty-four democratically elected governments in the hemisphere, the commitment by private sector actors to reach beyond their own narrow sectoral and sub-regional interests in bringing the FTAA to fruition was implicitly assumed. After all, the North American private sector had played a critical role in securing the passage of the NAFTA bill by legislatures in all three participating countries;[3] similarly, government-business coalitions in Argentina and Brazil were instrumental in the creation of MERCOSUR.[4] Yet, six years into the FTAA endeavor, with numerous ministerial summits and negotiating sessions behind them, it is still not entirely clear whether the private sector is on board. To some extent the numbers, in terms of the sheer magnitude of FDI and portfolio flows over the past decade, speak for themselves. But the question remains as to whether existing patterns of private sector participation can be transformed into a hemispheric whole that would be greater than the sum of its sub-regional parts.

The track record thus far has been ambivalent. In the case of the U.S. over the past decade, foreign trade and investment initiatives have succeeded only when assertive executive leadership and strong support from the business community are both present. At the same time, government-business coalitions have effectively willed their way in the foreign economic policy process only when they have made important concessions to labor and other peak social organizations. This was the coalitional dynamic on Capitol Hill that underpinned the passage of the NAFTA agreement, the Uruguay Round agreement, and the treaty to normalize U.S. trade relations with China. Conversely, the executive's efforts at securing fast-track negotiating authority from the

3 Sylvia Maxfield and Adam Shapiro, "Assessing the NAFTA Negotiations," in *The Post-NAFTA Political Economy*, edited by Carol Wise (University Park, PA: Pennsylvania State University Press, 1998), pp. 82-118.

4 Lia Valls Pereira, "Toward the Common Market of the South: MERCOSUR's Origins, Evolution, and Challenges," in *MERCOSUR: Regional Integration, World Markets*, edited by Riordan Roett (Boulder, CO: Lynne Rienner, 1999), pp. 7-23.

U.S. congress---which would be a necessary precondition for the U.S. to officially sign on to the FTAA---have been continually thwarted since 1994 because the nexus of relevant business, government, and labor/social interests has simply failed to come together and reach a compromise. Other examples of U.S. policy failure in the absence of a cohesive multisectoral coalition would include the sinking of the Multilateral Agreement on Investment (MAI) and the collapse of the World Trade Organization's (WTO) ministerial meeting in Seattle late last year.

While key groups have divided over foreign economic policy issues in the U.S. and Canada for numerous reasons (environmental concerns, human rights, worker adjustment assistance), in Latin American most of the opposition to the FTAA stems from traditional distributional fears over the adverse effect that increased competition could have on labor markets and on smaller producers. Recent findings by Latinobarometro, a regionwide opinion survey funded by the Inter-American Development Bank which draws on the expertise of Latin America's top polling firms, show that across countries citizens' top three priorities are salaries, educational opportunity, and job creation.[5] To the extent that a decade of market reform in the region has failed to deliver the same dynamic returns at the microeconomic level as it has at the macro-level in terms of global growth and investment rates, those who are still struggling to find their economic niche in this more competitive context are understandably wary of what the FTAA represents. This caution includes the bulk of small and medium-sized producers operating in a newly restructured Latin American

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5 See the essays in Nancy Birdsall and Carol Graham, eds., *New Markets, New Opportunities?* (Washington,

private sector, but without sufficient access to affordable credit, market information, and updated technology. The reluctance of Latin producers and workers alike to forge ahead with further liberalization in the absence of concrete progress within the "real economy" was perhaps the strongest theme surrounding opposition victories in recent presidential elections in Argentina, Chile, and Mexico.[6]

To summarize, to speak of the private sector's commitment to hemispheric integration is to speak from two distinct viewpoints: a more developed North American one and the Latin American emerging market perspective. Whereas the former's participation depends strongly on assertive executive leadership and coalition politics, the latter's potential support for the FTAA will hinge on the extent to which newly elected civilian leaders will be able to effectively address pragmatic distributional concerns. Because large firms in Latin America are increasingly tied into intra-industry trade and global production networks, and hence have ready access to cheaper international credit and sophisticated technology and management practices, it is the majority population of more vulnerable small and medium-sized producers whose participation is most in question. Given the lack of effective executive leadership on the part of the U.S. since the expiration of fast-track negotiating authority since 1994, and the continued economic volatility that all of Latin America has been subjected to since undertaking market reforms, the very most that could be expected from private actors in the hemisphere is a pace of integration that will be much more

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DC: The Brookings Institution, 2000).

[6] Peter Smith, "Whither Hemispheric Integration?" *Business Economics*, July 1999.

gradual than the "early harvest" and "WTO-plus" outcomes originally articulated by U.S. trade policy makers.

Having said this, the remainder of this essay reviews the kinds of activities that private sector actors have engaged in vis-a-vis the FTAA negotiations since their launching in 1999. The main organization that unites private interests in the FTAA process is the Caribbean/Latin American Action group (C/LAA), which serves as an institutional counterpart to the FTAA's own Business Forum. The C/LAA is organized into sectoral teams composed of diverse private sector interests from all 34 countries involved in the FTAA negotiations. Each team advises the FTAA negotiators on the stance that private actors have taken on a given issue. Private sector interests are defined and aggregated through C/LAA's ongoing outreach and polling of companies across the hemisphere. The outcome of this effort over the past four years has resulted in C/LAA's definition of four main criteria which frame the FTAA negotiations from the standpoint of the private sector, and it has enabled the private sector to advance crucial technical and business issues at an FTAA negotiating table that has otherwise remained bogged down by apathy on the part of the U.S. and Brazil.

C/LAA's Four Participatory Principles[7]

1) To define minimum benchmarks for the participation of the private sector in all aspects of the FTAA negotiations.

[7] C/LAA, "Position Paper to the Fourth Americas Business Forum," Costa Rica, 1998.

2) To promote the standardization of negotiating mechanisms and business practices via the FTAA, with the ultimate goal of producing a hemispheric agreement that goes beyond the business facilitation framework now in place at the WTO.

3) To solicit complete private sector support for issues (civil society input, sustainable development, education initiatives) surrounding the Summit of the Americas process, even if they are not part of the actual FTAA negotiating agenda.

4) To insist that the U.S. executive has secured fast-track negotiating authority prior to signing the FTAA agreement.

Laying the Technical Groundwork for the FTAA

Thus far, C/LAA and the FTAA Business Forum have spent most of their energy on the construction of a business facilitation framework to better guide and rationalize the integration process. Despite criticism from various NGO's concerning the authenticity of private sector attempts at inclusiveness, C/LAA has worked actively to accommodate the adjustment needs of small firms and smaller economies participating in the FTAA negotiations. Explicit consultation procedures were established for private sector input from smaller economies, which has resulted in the establishment of a Small Economies Working Committee which represents small countries on all of the FTAA's negotiating committees. While the stated timeline for completing the FTAA negotiations is 2005, the C/LAA has clearly stated its intention to advance more quickly in the following technical areas:

a. The creation of a common hemispheric customs code;

b. Adherence to mutual recognition arrangements and conformity agreements;

c. Harmonization of agricultural sanitary, phytosanitary (SPS), and industrial standards;

d. Universal rules governing the supply of services;

e. Hemispherically accepted documentation for business travelers;

f. Governments must consult with FTAA members prior to raising levels of protection;

g. Complete elimination of nuisance duties, i.e., duties below 1.0 percent.

Additional efforts at the simplification and streamlining of business procedures include the implementation of more transparent legal systems and procurement regulations. Applications for work visas to encourage greater labor mobility are also under discussion. New areas like electronic commerce have been addressed by C/LAA, with an eye toward harmonizing the legal framework for e-commerce contracts, guaranteeing the ease of transborder data flows, and the facilitation of cross-border trade in services through electronic means. The progress made in the four sectors (agribusiness, energy, financial services, telecommunications/information technology) considered most important to C/LAA members is summarized below.

Agribusiness: The private sector has worked to improve market access and to reduce price distortions that encourage the flow of contraband in foodstuffs. Proposals for reform have been advanced to eliminate burdensome internal taxes, to harmonize tariffs, and to eliminate protection for goods stiff covered under the Uruguay Round (sugar, dairy products). The use of state monopolies in agro-production has been discouraged by this sectoral team, as has the use of direct and indirect subsidies. Procedures have also been developed to address food safety issues and the use of genetically modified products.

Energy: Transparency and competition in the energy sector are encouraged to reduce corruption, promote FDI, and to provide cost-efficient energy to citizens within nations and to non-oil producing consumer countries in the region.

Financial Services: This team is studying the requirements for more modern and integrated banking and securities regulatory guidelines, as well as the structural changes required to revitalize the financial sector in Latin America and to generate greater investor confidence.

Telecommunications/Information Technology: This team has been working on the regulatory framework and infrastructure requirements that would provide much improved region-wide telecommunications services to citizens and businesses. Numerous efficiency-producing measures are being examined and selectively encouraged. The team advocates the creation of national regulatory agencies to oversee competition in the telecommunications sector, and to construct and supervise the generation of more wireless communications options. The promising potential of electronic commerce via the internet is also being studied by this team, as well as the way to best harmonize regulations to promote cross-border trade and service transactions.

Reasons for Caution

This year marks the point at which private sector leaders within the FTAA business Forum and the C/LAA have agreed to make concrete progress toward the negotiation of the FTAA, and to draw up a schedule for advancing in each of the above-mentioned sectors. Unfortunately, the earnest pursuit of these goals has become intricately tied with two key matters, over which most of the region has little control: the granting of fast-track negotiating authority by the U.S. Congress, and a clear sense of the scope and depth of the trade and investment issues that will be taken up by the next WTO trade round. While these wild cards have infused the FTAA process with an unexpected degree of uncertainty, they should not preclude advancement on two main fronts.

First, at the domestic level, more must be done to ameliorate the distributional strains that have come to constitute another main bottleneck for the FTAA; and second, as the sub-regional level, politicians, economic policy makers, and private sector interests must reconfirm that there is, indeed, a sound political economic rationale for the FTAA. From the evidence that I have briefly reviewed here, it appears that on balance the integration process has fostered a pattern of trade and investment dynamism in the western hemisphere, and that private actors have much to gain by advancing on the streamlining and harmonization of everyday business practices. Nevertheless, if all parties involved are not able to drum up the same degree of political will that underpinned the creation of NAFTA and MERCOSUR, then the FTAA may readily prove to have been an idea that emerged before its proper time.