

# MEETING ASIA AND LATIN AMERICA IN A NEW SETTING

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## 1. Introduction

The emerging economies in Asia and Latin America have become new centres of gravity in the world economy and have caused major shifts in world trade and investment flows. Particularly in the Pacific Rim, purchasing power, investment and trade have grown at extraordinary rates during several decades of export-orientated economic growth. This successful growth performance was interrupted in 1997 by the Asian crisis but by now many countries in the region are recovering.

In Latin America, the economic crisis of the early 1980s induced radical change in economic policies along the lines of the Washington agenda. The comprehensive and rapid opening towards international markets of manufactured goods and investment since the late 1980s has made these economies more accessible to foreign traders and investors and stimulated domestic industry to export. However, the region's growth performance in the 1990s was rather volatile and less impressive than in Asia and notwithstanding relatively high

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average levels of income the overall purchasing power in Latin America as a region is more limited than in East and South-East Asia.

In connection with the emergence of these economies, a range of policy initiatives has been taken at the multilateral and regional levels. Nearly all countries in these two regions have become members of the World Trade Organization (WTO). Their integration in the multilateral rule system has been one of the most significant achievements of the Uruguay Round and the deepening of their integration in the WTO will be among the major objectives of the Millennium Round, at least from the perspective of the European Union (EU).

Moreover, countries in both regions as well as outsiders have taken initiatives to co-operate and intensify their economic relations in many different ways, ranging from the creation of structures to facilitate exchange of information and co-ordination of policies to the establishment of preferential trade agreements (PTAs). A special case is the full integration of Hong Kong into China. An increasing number of countries participate in one or more PTAs with neighbouring countries or major trade partners outside the region. Particularly in Latin America, a complex cobweb of overlapping PTAs has been created in the 1990s to support the radical liberalization process. Partnerships among countries in the region and the Triad powers in PTAs may have significant trade-creation and diversion effects for participants as well as outsiders.

In this new setting the EU faces two challenges. First, to stimulate its own growth the EU needs to strengthen its position in Asia and Latin America. During the past decades, trade and investment between the EU and both regions have grown strongly and the share of these flows in the overall external economic relations of the EU has increased substantially. At the same time, however, the EU faces strong competition in these markets and its market shares in emerging markets have been declining. Strengthening the EU's position requires not only improved competitiveness and marketing

at the level of the firm, but also EU initiatives to improve market access by lowering barriers to entry. No matter whether this will be negotiated in a multilateral or regional framework, it will require trade concessions on the side of the EU.

Second, the EU must respond to the policy initiatives of its major competitors in global markets, the USA and Japan, and the new regional superpowers in order to reduce the risk of becoming an outsider in these markets and to avoid the costs of trade and investment diversion.

This paper analyses the new setting in which the EU has to design a new approach towards the Pacific Rim and Latin America, the policy choices that have been made to face the new challenges and the available options to intensify the relationships with these regions in the future. Sections 2 and 3 study the general characteristics of the new setting in which the EU has to make its strategic policy choices towards the two regions. Section 2 focuses particularly on the new multilateralism and Section 3 on the new regionalism. Section 4 presents the policy options available to the EU to intensify its relations with both areas. Sections 5 and 6 review the traditional and recent policy initiatives towards Asia and Latin America respectively. More specifically, the sections focus on the Asia-Europe Meetings (ASEM) and the PTAs between the EU and Mercosur, Chile and Mexico that are in the making. The final section presents concluding observations.

## **2. The new multilateralism**

The setting in which the EU and the newly emerging countries in Asia and America attempt to intensify their relations changed during the 1980s and 1990s in two respects. First, most emerging countries significantly reduced their most-favoured-nation (MFN) tariff rates and deepened their commitment to the multilateral trade regime by offering more significant concessions in the Uruguay Round than ever before. Second, many countries in both areas and

particularly in Latin America have been involved in the establishment of new PTAs among themselves as well as with their major trade partners among the Triad powers.

The growing commitment of emerging countries to a well-functioning multilateral trade regime reflects their higher dependence on trade for their growth and development. Since 1980 many countries in both regions acceded to the General Agreement on Tariffs and Trade (GATT) as was the case with Colombia (1981), Thailand (1982), Hong Kong (1986), Mexico (1986), Venezuela (1990), Bolivia (1990), Paraguay (1993) and several other countries. By now, nearly all countries in the two regions are members of the WTO, the major exceptions being China, Vietnam and Cuba.

Not only did the number of Contracting Parties (CPs) among developing countries increase but also their involvement in the process of trade liberalization through tariff binding has been intensified strongly. Traditionally, developing countries have enjoyed special and differential treatment in the GATT. Art XII on Restrictions to Safeguard the Balance of Payments, Art. XVIII on Government Assistance to Economic Development and Part IV on Trade and Development provide for a more flexible and less demanding participation in the GATT. Moreover, the so-called Enabling Clause of the GATT, on 'Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries' allows them to enjoy preferential access to the markets of developed countries under the Generalized Systems of Preferences (GSP) without offering concessions in return. Also, they may notify PTAs among themselves under the provisions of the Enabling Clause as has been the case with Mercosur, which was notified to the GATT in February 1992 by Brazil. The Enabling Clause is less specific regarding the acceptable degree of tariff liberalization and the abolishment of non-tariff barriers (NTBs) than Art. XXIV is.

These special and differential arrangements allowed countries in Asia and Latin America to maintain a comprehensive and complex system of barriers against imports for several decades and to establish

Table 1. Tariff protection in Asia and Latin America.

	<i>Imports with bound tariff rates (%)</i>		<i>Tariff rates (%)</i>	
	<i>Pre-Uruguay Round</i>	<i>Post-Uruguay Round</i>	<i>Applied</i>	<i>Bound</i>
<i>Latin America</i>				
Argentina	17.1	100.0	10.3	31.0
Brazil	16.0	100.0	11.7	29.0
Chile	100.0	100.0	11.0	25.0
Colombia	4.4	100.0	10.9	39.7
Mexico	100.0	100.0	10.4	34.1
Peru	17.1	100.0	14.6	33.7
Venezuela	100.0	100.0	12.4	31.6
<i>East Asia</i>				
Indonesia	29.7	93.4	10.7	38.4
South Korea	21.3	83.2	7.7	16.4
Malaysia	1.6	77.4	6.4	9.3
Thailand	7.5	64.3	26.1	27.5
Latin America	50	100	11.7	32.7
East Asia	16	77	11.9	21.0
European Union	98	100	2.8	3.2

*Notes:*<sup>1</sup> Latin America: Argentina, Brazil, Chile, Colombia, El Salvador, Jamaica, Mexico, Peru, Uruguay and Venezuela.

<sup>2</sup> East Asia: Indonesia, Macao, Malaysia, Philippines, South Korea and Thailand.

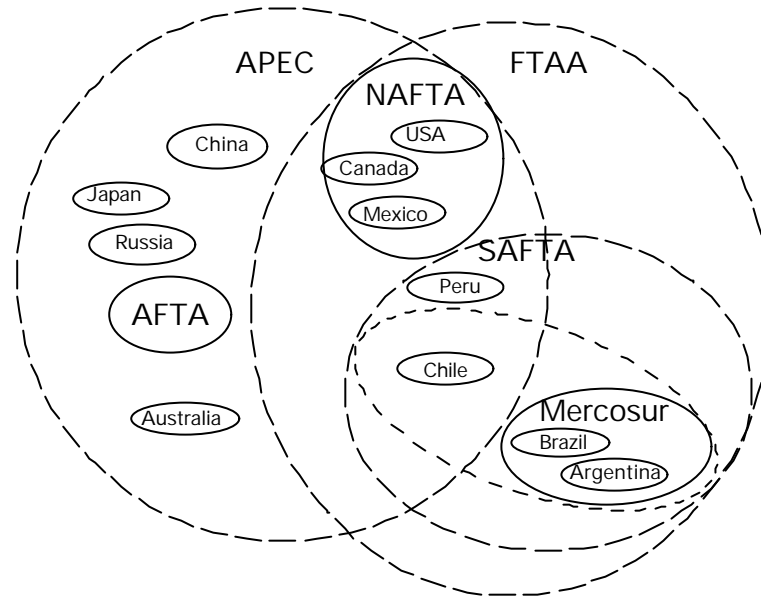
*Sources:* J. Finger, M. Ingo and U. Reincke, *The Uruguay Round: Statistics on Tariff Concessions Given and Received*, as reproduced in: J. Nogués, 'Comment: The Linkages of the World Bank with the GATT/WTO', in: A.O. Krueger (ed.), *The WTO as an International Organization*, The University of Chicago Press, Chicago, 1998, and J. Finger and L.A. Winters, 'What Can the WTO Do for Developing Countries?', in: A.O. Krueger (ed.), *op.cit.*

PTAs among them, which offered only little preferential margins to the partners. Strikingly, Brazil and India belonged to the founding fathers of the GATT in 1947 and were among the most protectionist countries in the world for many decades.

In several respects the Uruguay Round has changed in a significant way the position of developing countries and particularly newly emerging countries in the multilateral trade regime and contributed to their fuller integration in the world trade system. They accepted as a single undertaking the Multilateral Agreements on Trade in Goods, the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). Many provisions for special and differential treatment have been included in GATT 1994 and this holds also for the continued application of the Enabling Clause, but in several respects the degrees of freedom of developing countries have been reduced. Particularly the Understanding on the Balance-of-Payments Provisions of the GATT 1994, which relates to Art. XII and XVIII:B may increase discipline. Most significantly, all developing countries have schedules in the areas of goods with bound agricultural tariffs and many countries have bound a large part of their industrial tariffs as shown in Table 1.

In many cases, however, the actual tariff reductions and cuts in NTBs had taken place in the process of unilateral and autonomous structural adjustment, not so much as part of the multilateral negotiations in the GATT. Tariff ceilings in the GATT have been set at rates much higher than the rates actually applied. In Asia the percentage shares of imports with bound rates are smaller than in Latin America and the ranges of bound and applied Post-Uruguay Round rates are much wider. By comparison levels of applied tariff rates are low in South Korea and Malaysia and relatively high in Thailand. In most Latin American countries the use of NTBs has been restricted strongly and import tariff rates have been bound in the WTO for 100 per cent. The levels of bound tariff rates are rather high as compared to applied rates. As shown, post-Uruguay

Figure 1. The proliferation of preferential trade areas in Asia and America.



Round bound tariff rates in most of the large countries in Latin America are in the range of 29-34 per cent and applied rates are in the range of 10-15 per cent. This gives countries room to re-introduce barriers against imports to support their domestic industry or the balance of payments or, alternatively, to bargain for concessions in the WTO or PTAs.

### 3. The new regionalism in Asia and America

A second major element of the new setting in which future relations between the EU and emerging Asia and America will have to take shape, is the recent proliferation of PTAs in Latin America and to a lesser extent in East and South-East Asia. Figure 1 positions in a

schematic fashion emerging Asia and America, two Triad powers and some other trade partners in this new setting.

It is remarkable to witness the rise of regionalism at the time that unilateral and multilateral liberalization have reduced the room to offer meaningful trade preferences substantially. Gravity models of international trade show that the impact of PTAs is additional to basic factors determining the size of trade flows such as gross national product (GNP) and population size of the trade partners, the degree of similarity in the structure of import demand and export supply or comparative advantage of potential suppliers and access to markets. The trade history of both regions shows that trade may expand strongly outside the framework of a PTA and that, alternatively, trade may be insignificant and stagnant notwithstanding trade preferences.

#### *Regionalism in the Pacific Basin*

In the case of Asia, economic links among the countries in the region have intensified because of high overall economic growth during several decades and a process of relatively early and gradual trade liberalization. Intra-regional trade in the Pacific Basin has been stimulated particularly by the high degree of complementarity between natural-resource poor, densely populated and industrialized economies such as Japan, South Korea, Taiwan, Hong Kong and Singapore, and natural-resource rich countries such as Malaysia, Indonesia and the Philippines. Moreover, intra-industrial patterns of specialization have developed between the industrially more advanced countries in the region and countries with a comparative advantage in labour-intensive production and assembly activities. In this vast region growth triangles may be distinguished of countries combining intensively different sources of comparative advantages (Chia Siow Yue and Lee Tsao Yuan, 1993). Informal networks and family ties rather than formal PTAs have played a significant role in shaping these intra-regional economic linkages (Noland, 1990).



So far, PTAs have hardly played a role in stimulating trade among Asian countries, as well as trade between Asia and the rest of the world economy, with the exception of the GSPs. Even ASEAN, prior to the promulgation of the establishment of the ASEAN Free Trade Area (AFTA) in January 1992, hardly contributed to intra-regional trade in South-East Asia. Also, the Asia-Pacific Economic Cooperation (APEC), formed in 1989, was initiated primarily to exchange information and facilitate policy co-ordination and harmonization, not so much to liberalize trade in a co-ordinated fashion, left alone to create trade preferences.

Against this background, the announcement of the initiative in January 1992 to establish a PTA among ASEAN countries - AFTA - reflects a significant change in policy direction. The initiative aims at reducing intra-group tariffs to 5 per cent within a period of 15 years. The ambition is to include all 10 countries in South-East Asia and to liberalize markets for manufactures and agricultural products as well as financial services. In September 1994 it was agreed to shorten the timetable for cutting import tariffs above 20 per cent from 15 to 10 years with the deadline in 2003. Moreover, it was agreed to include agricultural products in the liberalization process. Also, ASEAN countries have aimed at the creation of an ASEAN Investment Area (AIA) to encourage foreign direct investment (FDI) by reducing barriers to the free movement of financial flows and by improving transparency.

More significant for the countries in the region as well as the rest of the world economy may be the future implications of unconditional or conditional free trade among APEC member countries as proposed at the APEC Summit in Bogor in November 1994. APEC has become an open economic association among an increasing number of countries and with a broadening agenda. Since its formation APEC-wide joint initiatives have been promoted to stimulate economic growth and improve the conditions for international trade and investment. Its creation has been prompted by the continuous integration process in Europe and the shift in

US trade policy reflected by the Canada-US Free Trade Agreement (CUSFTA) of 1989 and the steps towards the North American Free Trade Agreement (NAFTA) in 1993.

Open regionalism has been the predominant approach towards trade liberalization in the region and distinguishes APEC from trade agreements such as the EU, NAFTA and Mercosur. Open regionalism is characterized by concerted unilateral trade liberalization on an MFN basis (Drysdale et al., 1998, p.6). As the Eminent Persons Group of APEC puts it in its Second Report (1994, p. 2), open regionalism is

‘A process of regional co-operation whose outcome is not only the actual reduction of internal (intra-regional) barriers to economic interaction but also the actual reduction of external barriers to economies not part of the regional enterprise; ...’

In this perspective, open regionalism is, by definition, a building block for a liberalized global economy. Such a strategy has the advantages of avoiding the costs of trade diversion and the complications related to GATT Art. XXIV requiring that ‘substantially all the trade’ is liberalized in the region. More generally, open regionalism bypasses conflicts between multilateralism and regionalism at a large scale. At the same time, it opens the option of free-rider behaviour of non-members.

Three factors may complicate the realization of region-wide free trade or the establishment of a WTO-consistent PTA among APEC member countries. First, there are extremely wide differences among APEC countries in levels of economic development and degrees of competitiveness, economic organization and orientation. Apart from the USA and Japan, the group involves other high-income countries such as Canada, Australia and New Zealand, middle-income countries in Asia and Latin America such as South Korea, Malaysia, Thailand, Indonesia, Mexico, Chile and Peru, and countries in transition such as the Russian Federation, China and Vietnam. Consequently, countries differ widely in their capability to participate in a group-wise effort to liberalize trade. This is reflected

by the different timetables for liberalization that have been proposed and the different priorities to include liberalization of agriculture in the APEC agenda. The USA, Canada and Australia insist on a comprehensive liberalization package but Japan, China, Taiwan and South Korea prefer a more exceptional treatment of the agricultural sector.

Second, a number of the Asian APEC countries have indicated at several occasions to have a preference for an exclusive East Asian Economic Group or East Asian Economic Caucus (EAEC) as proposed by Malaysia rather than the more heterogeneous group of APEC members.

Third, countries differ in their appreciation of the implications of open regionalism for non-members, which reflect in part differences in trade interests and strategic objectives. Japan and the newly emerging countries in Asia, particularly Indonesia, take the view that unconditional and non-discriminatory treatment of outsiders is preferable and Asian countries have confirmed their preference for MFN-tariff liberalization during the APEC Osaka Summit in November 1995. However, the USA, Canada and Australia prefer extension of concessions to outsiders on a reciprocal basis, to avoid giving the Europeans a free ride in the region.

In case APEC members would offer extension of benefits to non-members on the basis of reciprocity in order to avoid free rides, Art. I of the GATT on the MFN principle is violated since such a measure discriminates among non-members.

The USA in particular pushed strongly for trade and investment liberalization in APEC economies and managed to get the objective of free trade by the year 2010 for industrialized countries and 2020 for the rest of APEC accepted and included in the Bogor Declaration of November 1994.

Thurow has questioned the relevance of the decision to transform APEC into an area of free trade by the year 2020 suggesting that by implication there is no consensus on free trade in the region at an earlier time (Thurow, 1996, pp. 124-25).

Although APEC is not meant to become a closed block, the process of regional harmonization of trade and investment-related rules and standards may have significant consequences for the capability of outsiders to compete in the APEC region, even if free trade would be extended unconditionally to non-members. In case conditionality is introduced, rules of origin may limit the option for outsiders to gain from trade liberalization. Hence, there are good reasons for the EU to take complementary initiatives towards the APEC region.

#### *Cobwebs of preferential linkages in Latin America*

In contrast to Asia, Latin American has had a long history of establishing PTAs, which goes back to the early 1960s. The first wave of PTAs in the 1960s aimed at supporting a process of inward-orientated industrial development by protecting regional industry against outside competition. This policy kept external trade barriers high for a long time and liberalized intra-regional trade only to a limited degree. Notwithstanding the existence of a number of overlapping PTAs in the region, intra-regional trade as a share of overall trade tended to decline, particularly so during the 1980s.

From the early 1990s onwards, a second wave of PTAs swept the region and within a fairly short period of time a region-wide cobweb of preferential linkages has been established. These PTAs aim at supporting the process of trade and investment liberalization, initiated in most countries only in the second half of the 1980s as part of structural reform programmes.

Renewed growth, overall liberalization and trade preferences have contributed to a strong increase in intra-regional trade in Latin America in the 1990s. It should be added, however, that there are also costs involved in this specific strategy. Although PTAs may have supported trade liberalization programmes, the emerging layers of preferential linkages with different rules of origins, preferential margins, exclusion lists and timetables contribute to the complexity of the liberalization process, may increase transaction costs and

ultimately inflict welfare costs upon the region, as compared to an ideal process of unilateral or multilateral trade liberalization.

In this context Mercosur plays a crucial role since it involves two regional economic superpowers with a combined production of over 40 per cent of region-wide GNP measured at PPP prices. To the extent that Mercosur contributes to growth in its member countries, it may stimulate trade with the rest of the region but trade diversion may inflict welfare losses to trade partners,

Moreover, Mercosur is actively involved in shaping the trade and investment relations in the region by establishing special and preferential linkages with many countries inside and outside the region. In doing so, Mercosur has started to become the centre of a more comprehensive trade regime that will integrate a large part of the Latin American market. The priorities in this regard have been laid down in the Mercosur 2000 Action programme approved by the four heads of state in December 1995. Chile and Bolivia have become associate members of Mercosur in 1996 and 1997 respectively and it is expected that a PTA with Mercosur will be established by 2006. Moreover, Mercosur and the Andean Community signed a framework agreement in April 1998 which aims at launching a PTA by 2000. Also, Brazil has supported Venezuela to join Mercosur, and Mexico as well declared its interests in a special linkage with Brazil and Mercosur. In 1998 Mercosur and the Central American Common Market (CACM) agreed to set in motion a programme of tariff reductions in order to start a PTA among them. Finally, trade and investment agreements were signed with Canada. The extension of Mercosur and its new linkages with the rest of the region may be considered essential elements for the realization of one of Brazil's foreign policy initiatives, the South American Free Trade Area (SAFTA). Brazil announced in 1993 that such a PTA was to be created in 10 years of time. SAFTA aims at liberalizing trade among all members, not a hub-and-spoke model with bilateral linkages.

The new initiatives to establish preferential linkages between the USA and Latin America mark a major change in policy for all partners concerned. Traditionally, the USA supported multilateralism and only recently it has broadened its policy options by getting involved in the establishment of PTAs. By doing so, the USA makes progress in its international economic agenda less dependent on multilateral co-operation and creates a mechanism that provides it with more leverage over its economic partners as well as over multilateral institutions. The initiation of negotiations on a NAFTA and the announcement in June 1990 to create a Western Hemisphere Free Trade Area (WHFTA) not only created a new framework for hemispheric relations but was also a signal to the EU not to put progress in the Uruguay Round at risk.

Within a relatively short time span the USA established CUSFTA and NAFTA, took the initiative to create an area of free trade in the Pacific Basin among the countries associated in APEC and is the driving force behind a Free Trade Area for the Americas (FTAA).

The initial plan to establish free trade from Alaska to Tierra del Fuego in a WHFTA envisaged bilateral negotiations between the USA and individual countries or members of an existing PTA that were considered by the USA to be ready for a NAFTA-like arrangement. Chile and Argentina in particular indicated at the time to be interested in such an agreement.

Although the average MFN tariff rates of the USA are relatively low except for sensitive sectors, and Mexico and other Latin American countries have reduced their tariff rates significantly, trade and investment-diversion effects of these PTAs may negatively affect other trade partners and stimulate them to seek similar arrangements or compensation. Trade and investment diversion and the implications of stringent rules of origin of NAFTA on outsiders are discussed by Mathieson (1993) for Japan, Paemen (1996) for the EU and Frankel and Wei (1997, p. 87) for the East Asian developing economies. To avoid such effects, Thailand, South Korea and Singapore indicated their interest in participating in a NAFTA-like arrangement.

According to the study by Hufbauer and Schott (1994, pp. 162 and 163) on the implications of a WHFTA for outsiders, trade-diversion effects for the EU will be concentrated particularly in the sectors of food, textiles, primary metals and chemicals.

In 1994, the USA initiated the plan for a FTAA during a hemispheric meeting of heads of states in Miami in 1994, aiming at hemispheric free trade by 2005. In the new approach all countries in the southern hemisphere will participate in negotiations on the comprehensive liberalization of trade among all of them. Such a strategy would deny the USA the potential advantages of the hub-and-spoke approach envisaged at an earlier stage. At the Trade Ministerial meeting in Belo Horizonte in May 1997 it was decided that the FTAA can co-exist with bilateral and sub-regional PTAs to the extent that the rights and obligations under these agreements are not covered by or go beyond the rights and obligations of the FTAA (Trade Ministerial Meeting, 1997).

The intensification of regional linkages between Mercosur and the rest of the region or the establishment of SAFTA will strengthen the position of the combined group of countries and particularly of Brazil in negotiations on the structure and the rules of a FTAA. Mercosur is at the heart of the Brazil's so-called building blocks approach of a FTAA to be built upon existing PTAs, not as an extension of NAFTA. In 1996, the USA proposed Brazil to form a strategic partnership to establish a hemispheric PTA by the year 2005.

Notwithstanding significant liberalization and structural reform in the countries in Latin America, only little progress has been made so far in establishing a hemispheric PTA. This has opened new opportunities for Brazil and the EU to establish preferential trade links with the countries in the region on terms that reflect more their own interests.

#### 4. Strategic options for the EU

Essentially, the EU has four options at its disposal to improve access to the emerging markets and reduce the advantages that its main competitors may have created or are in the process of creating in these markets through the establishment of PTAs.

First, by speeding up multilateral rounds of trade liberalization to reduce the significance of preferential margins and essentially to undercut the rationale of regional preferential areas.

Second, by joining preferential areas of its main competitors. Of course, European firms have the option of joining by investing directly in the PTAs.

Third, by establishing its own PTAs with the same groups of emerging markets.

The fourth option is a sort of in-between approach by using effectively the offer of an unconditional extension of benefits, which members of a free-trade association may offer to non-members, or, alternatively, to respond to the option of a conditional extension of benefits of a regional PTA to non-members. The case of a PTA offering non-members unconditional extension of benefits conforms to the trade strategy of so-called open regionalism as proposed by some APEC countries.

When reviewing the recent initiatives of the Union, it may be noted that combinations of these options are being used. The initiative of the Commission to launch a new round of negotiations in the WTO reflects the EU priority to improve access to markets worldwide and will, if realized, reduce preferential margins of PTAs. Also, the Commission has taken policy initiatives towards emerging Asia and Latin America, the most significant of which are ASEM and the announced PTAs with Mercosur, Chile and Mexico. In addition, the Commission has made a proposal to turn Lomé into several reciprocal PTAs, one of which involving the countries in the Caribbean.



## 5. Asia-Europe meeting

Europe and Asia have been too faraway for a long period of time, notwithstanding the special arrangements made in the past to stimulate trade and investment between the two regions. The establishment of special and informal relations between the European Community (EC) and ASEAN goes back to 1972. By 1980 the EC-ASEAN Co-operation Agreement was signed with an emphasis on economic co-operation. This agreement has long served as the cornerstone of the EU's Asia policy (Dent, 1997-98). In the context of the agreement ASEAN received financial and technical assistance to promote trade with the EC, support for industrial and technical development, and project support in the areas of agriculture and transportation. Also, ASEAN countries benefited from the EC GSP. Moreover, the European Investment Bank (EIB) has extended its lending operations since 1993 to countries in Asia in the context of co-operation agreements. Apart from co-operation at the level of governments, dialogues were initiated between the private sectors of both regions. For an overview of traditional economic relations between the EC and ASEAN see Akrasanee and Rieger (1982).

Special arrangements to support economic relations had also been made with many other countries in East and South-East Asia. In April 1978 a trade agreement between the EC and China was signed which was replaced by the trade and co-operation agreement of September 1985. Relations between the EC and Japan were intensified by the EC-Japan Joint Declaration of 1991, which deals with co-operation in the areas of technological and industrial development. Moreover, a trade and co-operation agreement between the EU and South Korea was signed in 1996 at the ASEM Summit in Bangkok in March 1996.

In 1994 the New Asia Strategy (NAS) was launched and endorsed by the European Council of Essen in December. The NAS was induced by several factors. To start with, changes in the economic setting as analyzed in the previous section, made a critical assessment

of the adequacy and effectiveness of the traditional relations with the Asian region urgent. Also, the EC 1992 programme resulted in a uniform trade policy for the Community and created a new internal setting to design an external economic policy. Moreover, in the context of the EU's special and differential relations with countries around the world, a lack of balance was noticeable between the economic importance of regions and the content and significance of the Union's formal relations with them (Pelkmans, 1997).

The initiative to establish non-formal 'Pacific-style' ties between Asia and Europe came from the side of the ASEAN countries by the end of 1994. From the perspective of the EU, a broad policy dialogue with the Asian members of APEC would facilitate the implementation of the NAS. ASEM is meant to function outside formal regional structures such as ASEAN and the EU, and is not only a meeting at the level of governments but involves the business communities as well. Meetings among members of the private sector have been organized to facilitate trade, investment, technical and economic co-operation between large and smaller firms in both regions.

Clearly, neither the EU nor ASEAN seek to establish a PTA, both confirm their commitment to the strengthening of the multilateral rule of law in the areas of trade and trade-related matters, and both consider consultations and co-operation in that framework the most effective way to intensify their relations. In that respect, the NAS differs significantly from nearly all other initiatives the EU has taken in other parts of the world.

Both sides have an interest in enjoying the gains from trade and avoiding the risks of trade and investment diversion. Studies of the effects of European integration on Asia in the 1990s indicate that additional economic growth will stimulate demand for commodities that are traditionally imported from developing countries and that little trade diversion will occur. However, Asian producers of labour-intensive manufactured goods may have suffered from substantial trade-diversion effects of previous enlargements of the EU with

Table 2. Final common external tariff (CET) of Mercosur, 2001/06.

	%
<i>Total</i>	11.2
Agriculture, hunting, forestry and fishing	7.0
Mining and quarrying	3.4
Manufacturing	11.5
Food, beverages and tobacco	11.6
Textile, wearing apparel and leather	17.1
Wood and wood products incl. furniture	10.5
Paper, paper products, printing and publishing	10.9
Chemicals	8.1
Non-metallic mineral products	10.9
Basic metal products	9.9
Fabricated metal products, machinery and equipment	13.3
Other manufacturing industries	16.6

*Source:* WTO Secretariat, as reproduced in: S. Laird, *Mercosur: Objectives and Achievements*, Staff Working Paper TPRD 9702, WTO, Geneva, 1997.

Spain, Portugal and Greece. Enlargement with Sweden, Finland and Austria may have caused trade diversion for Japanese export industries in relatively skill-intensive sectors. The future enlargement with countries in Eastern Europe such as the Czech and Slovak Republics, Poland and Hungary may cause additional trade diversion. However, the longer-term dynamic effects of integration in Europe are expected to stimulate exports from Asia at rates that exceed trade-diversion effects (Frankel and Shang-Jin Wei, 1997, pp. 89-91).

So far, PTAs in Asia had only a marginal impact on trade and investment flows and did not affect the positions of outsiders

negatively. However, the intensity of the trade links among the countries in East Asia and the APEC region exceed levels expected on the basis of gravity models, suggesting that an implicit Asian or Pacific trade bloc favours trade in a discriminatory fashion. Brown, Deardorff and Stern find that outsiders may gain from an East Asian PTA due to scale economies and increased product varieties, but the CGE model of Lewis, Robinson and Wang shows that the significant trade-creation effects of a potential APEC PTA is accompanied by trade diversion for the EU (Frankel and Shang-Jin Wei, 1997, pp. 94-104).

Rather than creating a 'Fortress Europe' and an inward-orientated Asian bloc, both sides strive for new openings and look for mechanisms to facilitate trade and investment through interregional consultations and initiatives, business exchanges and the creation of new private-sector partnerships. Hence, at the first ASEM Summit Asian participants have proposed trade liberalization in Europe parallel to that of APEC. Another form of co-operation may concentrate on the multilateral rule system. Less than two weeks after the first ASEM Summit, Sir Leon Brittan referred to the combined Europe-Asia effort to save the multilateral negotiations on financial services. In the same vein, the two regions could co-ordinate their efforts in future trade negotiations to liberalize trade in an wide array of services as well as agricultural products and to establish new rules and standards to facilitate trade, and to protect investments and intellectual property.

In view of the wide differences between the countries in both regions in a number of these policy areas - particularly non-discriminating rules for international investments and higher standards for internationally traded products - intensification of consultations may be helpful not only to strengthen interregional ties but also to support the multilateral system.

The Asia-Europe Vision Group (1999), which was established at the second ASEM Summit in London in April 1998, recommended that ASEM partners set the eventual goal of free trade

in goods and services by the year 2025 by adopting a strategic framework for progressive trade liberalization among themselves.

## **6. The EU-Latin America PTAs**

The special economic relationship between the EU and countries in Latin America has been based on special and differential trade arrangements, investment facilities and development aid. Countries in the Caribbean have participated in the Lomé Conventions and benefited from preferential access to the EU market and development aid. Some of them benefited particularly from the Sugar, Rum and Banana Protocols and subsequent arrangements that safeguarded their shares in the European market. However, after the ruling of the WTO panel in favour of Latin American countries that suffer from discrimination in the EU banana market, future arrangements with the Caribbean countries will in all likelihood be less WTO-inconsistent than the current arrangements are. In the first decade of the 21st century, the preferential relationship between the EU and the Caribbean countries may take the shape of a WTO-consistent Regional Economic Partnership Agreement (REPA). Also, Latin American countries have received trade preferences in the context of the GSP of the EU with special schemes for Central America and the Andean countries with so-called special drug regimes.

Moreover, the EIB has made loans available in the context of co-operation agreements of the EU with Latin American countries since 1993, particularly to finance infrastructural projects. From 1988 the European Community Investment Partners (ECIP) programme has supported investment and co-operation through the creation of joint ventures, and since 1994 the AL-INVEST programme has supported co-operation between small and medium-sized firms in the two regions through its Eurocentres in Latin America.

Finally, the EU is the largest donor of development assistance to countries in the region. Over 60 per cent of all bilateral official

development assistance (ODA) received by the region in the mid-1990s was donated by the member countries of the EU and the Commission through its co-operation funds. Particularly Central America and the Andean countries benefited from these aid flows. New forms of development co-operation have been introduced including external debt relief for countries in Central America. The Commission aims at concentrating ODA to the poorest countries in the region to enhance its effectiveness and efficiency (IRELA, 1999).

Apart from these initiatives in the economic sphere, the Union has intensified the political dialogue with Latin America under its Common Foreign and Security Policy (CFSP) and the framework agreements for co-operation with Mercosur, Chile and Mexico that have been signed in 1995, 1996 and 1997 respectively (IRELA, 1997).

The recent initiatives to establish PTAs between the EU and Mercosur, Chile and Mexico involve major policy changes but fit well with the overall long-term trade strategies of countries in both regions to organize trade and investment links in the context of PTAs.

Countries have different reasons to participate in PTAs. Economic objectives appear to be dominant not only in the smaller partner countries but also in the EU. From the perspective of the Latin American countries, such PTAs will improve their access to the large EU market and may reduce trade diversion of EU PTAs with Central and Eastern European countries (CEEC) and countries in the Mediterranean and North Africa (MENA) that have already or will receive preferential access to the EU market, and supply a similar range of primary products. In the case of Mexico, a PTA with the EU may reduce the overall dependence on the USA and more specifically the costs of trade diversion resulting from NAFTA.

From the perspective of the EU, the PTAs would provide producers of exportables with preferential access to over 70 per cent of the Latin American market and reduce actual discrimination and

trade diversion that they suffer in the markets of Mercosur and NAFTA, and potential diversion effects of SAFTA or FTAA.

A PTA with Mercosur is particularly significant in terms of potential flows of exports of goods, services and investment. However, even without preferential access, the Mercosur market has been gradually liberalized by the reduction of the common external tariffs (CET). As shown in Table 2, the average CET rate will be 11.2 per cent and 11.5 per cent for manufacturing at the end of the transition period which will be in January 2001 for Argentina and Brazil and January 2006 for Paraguay and Uruguay. Among the most important exceptions are metal products and transport equipment. As noted earlier, applied rates in the Mercosur member countries are significantly below the levels at which they are bound in the WTO, thus allowing for upward adjustments without violating WTO commitments. However, the effective rates of protection in manufacturing may be significantly higher than nominal rates and the highest effective CET rate in 2006 will be 53.1 per cent for cars, trucks and buses (Laird, 1997, p. 15).

Notwithstanding substantial reductions in external trade barriers there is concern about trade-diversion effects, particularly in some capital-intensive sectors such as capital goods and transport equipment (Yeats, 1997) which are of major importance from the perspective of EU exporters and investors. In itself this provides a rationale for the EU to negotiate for preferential access. It should be noted, however, that transport equipment has not yet been integrated fully in the Mercosur CET regime. According to schedule, Brazil and Argentina must establish a Common Automobile Regime by the year 2000. In the preliminary agreement the external tariff has been set at 35 per cent, the maximum allowed in WTO. At the same time, these high rates of protection have induced foreign firms to invest in production facilities in the region.

An additional consideration to opt for a PTA with Mercosur may be rooted in the instability of the Brazilian trade regime. In the recent past Brazil has adjusted frequently its tariff rates (Tavares

and Tineo, 1998). At the request of the WTO, the International Monetary Fund (IMF) investigated Brazil's import regime for the car industry in 1995. Measures to limit imports and control investment in the automotive sectors provoked complaints in the WTO by Japan and the USA in 1996 and the EU and USA in 1997, and more complaints were filed in other areas by the Philippines, Sri Lanka and Canada in 1996 (WTO, 1998).

Moreover, the EU has a large interest in the liberalization of services in Mercosur, particularly in the sectors of transportation, telecommunications, banking and insurance. The Mercosur Framework Agreement on Services follows the approach of the GATS. Mercosur aims at establishing free trade in services among its members that will continue to apply national regulation towards non-member countries. According to Art. V.1 of the GATS on economic integration, a special or preferential agreement must have 'substantial sectoral coverage' in terms of number of sectors, volume of trade affected and modes of supply and should not provide for the *a priori* exclusion of any mode of supply. Moreover, such an agreement must provide 'for the absence or elimination of substantially all discrimination' among the parties, including national treatment as stipulated in Art. XVII of the GATS. However, Art. V.3 provides flexibility regarding these conditions for developing countries that are members of such a PTA. This relatively unexplored and complicated domain of trade negotiations may be difficult to include in a comprehensive agreement particularly in view of the 'sensitive' character of specific services.

Mercosur member countries as well as Chile have strong comparative advantages in agriculture and cattle husbandry and their exports to the EU are concentrated in a limited range of product groups including soya and derivatives, livestock, meat and derivatives, fresh fruit, coffee and tobacco, and fish products. These agricultural imports are directly and indirectly affected by the complex set of measures and regulations of the Common Agricultural Policy (CAP). According to EU tabulations, 63 per cent of agricultural imports



enter the EU market freely: 52 per cent under a MFN zero tariff rate and 10.5 per cent under a GSP zero tariff rate. Only between 10 and 12 per cent of total EU imports from Mercosur are sensitive agricultural and fishery products and all together, 14 -16 per cent of all products imported from Mercosur are considered sensitive or potentially sensitive, including some industrial products. Among the most important of these sensitive products are beef products, selected cereals and sugar, and some fresh fruits. Calculations of the European Commission indicate that liberalization of imports from Mercosur and Chile would entail additional costs up to 14.3 billion ECU annually (IRELA, 1998, p. 1). According to the current interpretation of GATT/WTO Art. XXIV.8 'substantially all the trade' requires liberalization of 90 per cent of trade, implying that some import restrictions may be continued in a WTO-consistent PTA, but nevertheless a significant transformation of the CAP will be required to liberalize trade with Mercosur and Chile.

As compared to the market of Mercosur, the domestic markets of Mexico and especially Chile are much smaller and potential effects of liberalization of trade and investment will be less sizable. The integration of Mexico in NAFTA and its participation in APEC and several PTAs among countries in Latin America, as well as the association of Chile with Mercosur add to the economic significance of PTAs with these countries. It should be noted that even without tariff preferences, these markets are well accessible in view of the low average import tariffs applied as shown in Table 1. Chile intends to reduce its import tariffs further to 7 per cent in 2001.

The PTA in the making between the EU and Mexico aims at the liberalization of 'substantially all the trade' in goods, the progressive liberalization of trade in services, and the liberalization of capital movements and payments. Moreover, the agreement aims at the opening of government procurement, prevention of distortion or restriction of competition, and protection of intellectual property rights.

In the area of trade in services, the agreement must be in conformity with Art. V of the GATS. While the EU makes an exception for the audiovisual sector, it aims particularly at liberalization of professional services, basic telecommunications, financial services and transport services.

Contrary to the trade relationship with the countries in the Southern Cone, a PTA with Mexico does not require substantial adjustments in the agricultural sector of the EU, which has facilitated the rapid conclusion of the negotiations. In the case of Mexico however, differences between NAFTA's rules of origin that are very detailed and specific in some manufacturing sectors and the rules the EU prefers to apply, have been a complicating factor in the negotiations.

Negotiations resulted in an agreement on the reduction of EU tariffs on 82 per cent of goods imported from Mexico by July 2000 and elimination of tariffs on the remainder by 2007. Mexico will set a maximum tariff of 20 per cent on 60 per cent of industrial products imported from the EU until 2003, a reduction of the maximum tariff to 6 per cent on 70 per cent of industrial products imported from the EU in 2003. Remaining tariffs on sensitive products will be phased out by 2010.

## **7. Concluding observations**

The analysis has shown that the EU has been rather late and slow in designing new policies and taking new initiatives to facilitate and stimulate economic relations with emerging markets in Asia and Latin America. To exploit fully the new opportunities in international trade and investment and strengthen interregional relations, the EU has a large interest in improving the functioning of the multilateral trade system. This objective may be realized in the following ways.

Probably the most significant contribution the EU can make in this regard is the full integration of its regime for the agricultural

sector in a liberal multilateral trade regime as has been initiated in the WTO Agreement on Agriculture. Also, liberalization of its import regime for textiles and clothing according to the Agreement on Textiles and Clothing of the WTO may contribute significantly. CAP reform and abolishment of barriers against labour-intensive manufactured products would benefit particularly the emerging countries in Latin America and Asia, respectively.

Next, full compliance of PTAs in which the EU is involved with Art. XXIV and the Understanding on the Interpretation of Article XXIV of the GATT 1994, and with Art. V of the GATS may help to make regionalism and multilateralism mutually supportive.

Finally, by supporting and respecting the decisions of the Dispute Settlement Body (DSB) of the WTO the authority of the multilateral regime will increase. The complaints of Ecuador, Guatemala, Honduras, Mexico, the USA and Panama concerning the EU regime for the importation, sale and distribution of bananas are a case in point.

Comprehensive multilateral liberalization may deepen the relationship with emerging countries and provide an effective strategy to reduce the trade-diversion effects of PTAs for outsiders. The EU must be prepared to respond to the challenge of an APEC strategy of conditional open regionalism, as preferred by the USA, Canada and Australia, by liberalizing trade in industrial products in particular.

The worldwide proliferation of large PTAs underlines the urgency of scrutinizing the consistency of PTAs with WTO rules and more specifically to increase discipline in the application of rules of origin in PTAs beyond the requirements laid down in the Agreement on Rules of Origin in the WTO.

Apart from these initiatives at the multilateral level there is room for effective and efficient region-wise policy initiatives as well. The emergence of very large PTAs reflects intense competition among the Triad powers, particularly the EU and the USA. In case the USA would be successful in turning APEC into a preferential trade

zone in the Pacific Basin, and at the same time in creating a free trade and investment area from Anchorage to Tierra del Fuego, it would have managed to put itself into the position of a giant hub with preferential access to the markets of Japan, China, and all emerging economies in Asia and Latin America except India. The US hub position would become even more articulated with a Trans-Atlantic preferential linkage.

The recommendation of the Asia-Europe Vision Group to take the initiative for non-discriminatory trade liberalization is particularly relevant in this context. Finally, the regional initiatives towards emerging Asia and Latin America may be very effective and efficient in reducing non-border barriers to trade and investment, enhancing transparency, establishing trade channels and creating investment opportunities for small and medium-sized firms, as has been the experience of the Internal Market programme of the EU itself.

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