



# Le pouvoir des économies de petite taille en Amérique du sud à leur insertion internationale

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## THÈSE

Pour obtenir le grade de

## DOCTEUR DE L'UNIVERSITÉ DE GRENOBLE

Spécialité : **Sciences économiques**

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Présentée par

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Thèse dirigée par **Bernard / GERBIER**

Préparée au sein du **Laboratoire d'économie de la production  
et de l'intégration internationale**  
dans l'**École Doctorale Sciences économiques**

# Le Pouvoir des économies de petite taille en Amérique du Sud à leur insertion internationale

Thèse soutenue publiquement le **18 mars 2011**,  
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**Monsieur Joachim, BECKER**

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## Résumé

Depuis les années 60, l'Amérique Latine avait accueilli les suggestions des organismes économiques internationaux (OEIs) sur la façon de réussir le développement. Dans les années 70, les Nations Unies ont suggéré la politique où les pays pourraient définir indépendamment leur propre politique nationale et internationale pour atteindre leur développement. Cela n'a pas fonctionné en raison de l'interdépendance croissante (de quoi ?); donc, dans la deuxième moitié des années 80, le Consensus de Washington a remplacé cette politique. Le Consensus de Washington disait que, la globalisation favorise le multilatéralisme dans la mesure où un pays ne peut pas prendre unilatéralement des décisions qui affecteront d'autres pays. Et même que cela paraît-il vraisemblable, il signifierait que le libre-échange doit régner en maître et au-dessus des actions des Etats, éliminant tout entrave aux échanges et aux investissements à l'étranger. Selon la Commission des Nations Unies pour le Commerce et le Développement (CNUCED), « la production internationale est devenue la caractéristique structurale centrale de l'économie mondiale ». Une plus grande liberté de commerce et une large ouverture aux mouvements de capitaux, pourrai mener les nations sous-développés à la croissance économique comparable à celle des pays riches. En conséquence, beaucoup de pays latino-américains qui avaient rejoint entretemps le néolibéralisme proposé par le Consensus de Washington en 1989, ont ainsi mise en place des mesures visant à réduire les entraves au commerce : ils ont ouvert leurs marchés aux capitaux étrangers et suivi plusieurs des indications des OEIs ; le but étant le développement par l'internationalisation.

Des économies nationales rejoignent ainsi un réseau du commerce international, d'investissement et de crédit où le commerce devait apporter le développement. Les OEIs ont indiqué que la taille du marché national n'importe plus si un pays se focalise sur de plus grands marchés internationaux. L'internalisation des normes de Consensus de Washington était difficile pour les SSE parce que les règles de ce consensus les ont pris en tant que groupe « d'une taille unique, ouvert, juste, établie sur le terrain d'une régulation non discriminatoires » approchez pour la multilatéralisation du commerce et du développement. Cependant, les SSE n'ont pas tiré profit de ces mesures car ils ne faisaient pas le poids des puissances au point d'influencer les règlements du libre échange et de la libéralisation de l'investissement directe étrangère (ou IDE). Ils n'ont pas la capacité ni le pouvoir de changer la structure des normes à l'intérieur des OEIs, où les politiques et les lois internationales sont suggérées sans prendre en considération des privilèges particuliers ni les besoins propre à chacun. Cette marginalisation dans la scène internationale accentue les problèmes économiques et sociaux qui sont à l'origine de l'agitation sociale constante et mettent en péril la stabilité de leur gouvernement. Plusieurs chercheurs et gouvernements ne perçoivent pas ces vrais problèmes et ne peuvent pas ainsi prévoir des mesures proportionnées pendant les négociations internationales. Le pire est que, les EPT ne connaissent pas eux même leur faiblesses et comment les évaluez.

Avec cette thèse, nous voulons explorer la capacité d'insertion des EPT sur la scène internationale. De ce fait, la thèse est divisée en deux parties : dans la première partie, nous analyserons pourquoi après plusieurs années de multilatéralisme proposé par les OEIs, aucune amélioration en termes de l'internationalisation et du développement de certains pays sud-américains n'a été constaté ; mais au contraire, il y a eu un accroissement de la pauvreté. Nous pensons que c'est le fait que la scène internationale a été ordonnée seulement par les plus grandes économies laissant de côté la majorité des pays en voie de développement et leurs besoins. C'est pourquoi nous avons voulu explorer (objectif principal) les circonstances dans lesquelles ont été appliquées le multilatéralisme et le Consensus de Washington. Nous verrons

l'impact du multilatéralisme tel qu'elle a été proposé par les OEIs en termes d'internationalisation et de développement et les options pour améliorer la situation dans le multilatéralisme. Ainsi, dans le chapitre 1 nous fournirons une typologie des EPT pour montrer que les pays en voie de développement ne peuvent pas être dans un seul groupe d'analyse parce qu'il y a des différences fondamentales basées sur la taille de leurs économies. Cette typologie nous permettra d'analyser la participation des EPT dans le multilatéralisme et le régionalisme ; les difficultés dans les négociations internationales et comment ces difficultés pourraient être surmontées. Nous adopterons deux options différentes pour le multilatéralisme : celui proposé par le consensus de Washington et celui du Consensus de Pékin (chapitre 2).

Dans la deuxième partie, nous poserons la question si le régionalisme ne serait pas une meilleure option pour que les EPT s'internationalisent et se développe. Si oui, voir quel type de régionalisme serait le mieux pour eux. Ainsi, l'objectif principal de cette partie est d'analyser l'impact que la régionalisation aura dans l'internationalisation des EPT et le degré d'attraction pour les IDE et les courants commerciaux que les EPT ont avec le reste du monde (chapitre 4 et 5). Pour finir, nous ferons en quatre sous-parties, une étude de chaque bloc régional qui compose les EPT: l'intérêt géopolitique, performance économique, théorie des jeux sur la régionalisation et conclusions. Nous analysons d'une manière numérique la gravité commerciale relative et s'il y a des forces pour la formation des blocs régionaux et voir leurs impacts.

La méthodologie utilisée dans la recherche a traité la revue de littérature principalement, l'utilisation de l'analyse statistique (au moins de 15 ans), les études de cas comme référence et en tant qu'élément de la théorie des jeux, l'utilisation du modèle gravitationnel de Tinbergen pour analyser l'attractivité commerciale relative et pour voir s'il y a des forces qui effectuent les blocs régionaux et va comment cet impact.

La nouveauté de la thèse est comme suit : d'une analyse complexe des positions théoriques et d'une manière générale du comportement commune aux EPT dans les négociations internationales. Nous présentons la puissance de ces pays et leur influence dans l'ordre du jour international selon leurs besoins d'internationalisation et du développement et leurs difficultés des règlements de SPS/TBT. La valeur pour la science est multiple. D'abord, nous proposons une typologie pour les pays en voie de développement de petite taille de sorte que les nouvelles stratégies et politiques puissent être appliquées en parlant des EPT et d'un type d'intégration. En second lieu, nous proposons une approche étroite pour un type d'intégration d'un point de vue d'un EPT. Troisièmement, nous proposons l'utilisation de l'analyse gravitationnelle pour vérifier la pertinence de l'appartenance à un bloc régional. Et quatrièmement, nous proposons une analyse pertinente de la théorie des jeux pour chaque différend international que les EPT en ont. Il est important de prendre en considération tous ces mécanismes multidimensionnels des négociations pour arranger d'une manière potentielle le débrouillement de la faiblesse, le dessin des stratégies pour atteindre un modèle amélioré de négociation, et pour accorder une position politico-économique comme pays. Ceci évitera des différences élevées dans la négociation entre les économies de grande taille (EGT) et les EPT des pays en voie de développement dans la scène internationale. Ceci pourrait améliorer leur pouvoir d'internationalisation qui pourrait les mener au développement.

Les résultats scientifiques de la thèse sont :

La taille de l'économie est une conséquence des différentes causes économiques, politiques et sociales qui sont liées entre eux. Dans le côté économique, la raison pour laquelle les EPT

sont petits est fondée dans leur petite puissance de négociation aux relations internationales (côté politique). Leur faible poids et inexpérience dans les négociations est une entrave à l'amélioration de leur situation économique. Les EPT ont de différentes caractéristiques qui peuvent expliquer pourquoi elles acceptent des accords de négociations (FTA, régional ou multilatéral) internationaux sans les analyser sur la base de leurs propres besoins et sur la base d'une situation spécifique du pays. Quand les pays améliorent leur insertion internationale et améliorent leur situation économique, ils ont une confiance améliorée et une meilleure position aux négociations. En conséquence, les points spécifiques que nous pouvons tirer de cette thèse sont :

*Le poids dans les négociations au niveau international ne dépend pas toujours de la taille économique du pays.* Les EPT peuvent se servir d'autres facteurs pour le commerce et les négociations des l'IDE comme le gazoil, son endroit ou même la pauvreté pour compenser la manque de puissance économique.

*La qualité de la gouvernance est importante dans les négociations commerciales* parce que le gouvernement peut créer une équipe des négociateurs forts qui peuvent négocier au lieu de créer des rivalités politiques. Pour cela, la disponibilité d'information est un facteur critique pour les pays dans les négociations commerciales.

*La théorie gravitationnelle relative s'applique aux EPT si des facteurs spécifiques sont pris en considération* comme de petits coefficients correcteurs qualitatifs. Les différences observées pour les EPT sont des différences politiques, le TSD pour le commerce, l'accès vers la mer et les différences culturelles avec les plus grandes économies.

*L'IDE est affecté par les garanties à long terme et la stabilité sociale du gouvernement.* Un EPT dépend- en termes relatifs - davantage de l'IDE que les EGT dû au manque de capital.

Les blocs régionaux en Amérique Latine ne sont pas employés à pleine capacité pour créer intra-commerce ou pour avoir ensemble une position dans les négociations commerciales avec les EGT ou d'autres blocs-commerciaux.

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**Mots-clés :** Amérique du Sud, pays en développement, commerce international, multilatéralisme et régionalisme.

## Abstract

Since the 60s, Latin America has been hearing the suggestions of International Economic Organizations (IEOs) on how to reach development. In the 70s, the United Nations suggested the politics of development, where the countries could define independently their own national and international politics to reach development and be equally rich. This did not work due to the increasing interdependence; therefore, in the second half of the 80s, the Washington Consensus replaced this policy. The Washington Consensus claims that globalization promotes multilateralism and does not allow countries to take unilateral decisions because they affect others and are being affected by other countries' decisions as well. Although this made a lot of sense, it would mean that the free market prevailed over the actions of the government, eliminating all barriers to trade and to foreign investments. According to the United Nations Commission for Trade and Development (UNCTAD), "International production has become the central structural characteristic of the world economy". A greater freedom to trade, plus the opening of capital flows, could lead the underdeveloped nations to economic growth showing as a sample the rich countries. Therefore, many Latin American countries joined the neoliberalism that was proposed by the Washington Consensus in 1989, reduced trade barriers, opened up their markets to foreign capitals and followed many of the indications of the IEOs in order to find development through internationalization.

National economies are linked together by a network of trade, investment and credit and this link is supposed to bring development. The IEOs said that the national market size does not matter anymore if a country focuses on larger international markets. Internalizing the Washington Consensus norms was difficult for Small Size Economies (SSE) because the rules of this Consensus took all the countries as a group of a unique size and established on common and non discriminatory rules to approach multilateralization. However, the SSE had no part of the cake and no power to influence the regulations of free trade and foreign direct investment (FDI) liberalization. The same, they do not have the capacity or power to change the norm structure inside the IEOs (where policies and international laws are suggested) that could take them into account with particular privileges according to their specific needs. This marginalization in the international arena is believed to have accentuated economic and social problems that now keep them in constant social turmoil and put in risk their government's stability. Several researches and governments do not perceive this problem and cannot foresee adequate reactions in international negotiations. Worst, SSE do not know themselves what are their weakness and how to asses them.

With this thesis, we want to explore the power of SSE on international insertion. For this, the thesis is divided in two parts. The problem that we want to analyze in the first part is why after several years of multilateralism proposed by the IEOs, internationalization and development did not improve for some of the South American countries increasing poverty. It seem that the reason lies in the fact that the international arena was only ruled by the largest economies leaving aside to the majority of the developing countries and their needs. This is why we wanted to explore (main goal) under what circumstances multilateralism and the Washington Consensus was applied, which were the options to improve the situation within multilateralism and what was the impact of multilateralism as proposed by the IEOs in terms of internationalization and development. Then, chapter 1 intends to provide with a typology of SSE to show that developing countries cannot be analyzed as a whole group because there are fundamental differences based on the size of their economies (chapter 1), this typology will allow us to analyze the participation of SSE in multilateralism and regionalism, their

difficulties face to international negotiations and see how these difficulties could be overcome addressing the two different options for multilateralism, the one proposed by the Washington Consensus and the Beijing Consensus (chapter 2).

The problem that we want to analyze in the second part is if regionalism would be a better option for SSE to internationalize and develop and if so, what type of regionalism. Then, the main goal of this part is to analyze the impact that regionalization has in the internationalization of SSE and the degree of attraction for FDI and trade flows that SSE have with the rest of the world (chapter 4 and 5). To achieve this, the thesis does a study of every regional bloc that deals with SSE, each study containing four sub-parts: geopolitical interest, economic performance, game theory on regionalization and the conclusions. Economic performance is done in a numerical way and uses the relative gravity on trade, if there are gravity forces for the regional blocs and what their impacts are.

The methodology used in the research dealt with literature review mainly, use of statistic analysis (at least of 15 years), case studies for reference and as part of game theory, and the use of the gravity model from Tinbergen to analyze the relative trade gravity and what the regional impacts are.

The novelty of the thesis is as follows: from a complex analysis of theoretical positions and a common way of behaving that SSE have on international negotiations, we present the power that these countries have to influence the international agenda according to their needs of internationalization and development and their difficulties of SPS/TBT regulations. The value for science is a compound. First, we propose a typology for developing countries of small size so that new strategies and policies can be tested and applied when talking about SSE and a type of integration. Second, we propose a close approach for a type of integration from a point of view of a SSE. Third, we propose the use of gravity analysis to check the pertinence of belonging to a regional bloc. And fourth, we propose a previous game theory analysis for every international difference that the SSE have. It is important to take into account all these multidimensional negotiation mechanisms to set potential ways to fix the weakly designed strategies and to reach an improved model for negotiation, and granting a political-economic position to a country. Likewise this will avoid differences in negotiation between the large size economies (LSE) and the SSE of developing countries in the international arena and improve their power for internationalization that could lead them to development.

The scientific results of the thesis are:

The size of the economy is a consequence of different economic, political and social determinants that are related one to each other. In the economic side, the reason why SSE are small is based in their power of negotiation face to international relations (political side). The lack of power of negotiation hampers them and they cannot have a better economic situation. The SSE have different characteristics that can explain why they join international negotiations (FTAs, regional or multilateral agreements) without a previous analysis of their own needs and specific country situation. When countries improve their international insertion and improve their economic situation, they have an improved trust and a better position to negotiate.

Consequently, specific points that we can draw from this thesis are:

*The Power of negotiation at international level does not always depend on the economic size of the country; the SSE can use other factors for trade and FDI negotiations like gasoil, its location or even poverty to offset the lack of economic power.*

*Quality of governance is important in trade negotiations because it can create a strong negotiators' team that can negotiate instead of creating political rivalries. For this, the availability of information in the countries is critical for trade negotiations.*

*Relative gravity is applicable for SSE if specific factors are taken into account like small qualitative correcting factors. Differences observed for SSE are political differences, SDT for trade, access to the sea and cultural differences with larger economies.*

*FDI is affected by SSE government's long-term guarantees and social stability. A SSE depend – in relative terms - more on FDI than LSE due to the lack of capital.*

*Trade-blocs in Latin America are not used to full potential to create intra-trade or to stand up together in trade negotiations with LES or other trade-blocs.*

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**Keywords:** South America, developing countries, trade, multilateralism and regionalization.



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**Avertissement**

*L'université n'entend donner ni approbation, ni improbation aux opinions émises dans cette thèse.*



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*A mes parents,  
Freddy et Marina  
A mon mari,  
Arnold J.J. Hagens*



## Foreword

To be able to understand a problematic political situation in a country, one really needs to experience it firsthand to be able to grasp all the different points of view that can provide an objective diagnosis of the situation of a country. It would be impossible to achieve this without actually being in the country where one can actually feel the tenseness of the issues. However, being in a developing country does not make it easier when it comes to research, because information is distorted data is unavailable and libraries hardly ever have the latest books which can offer the most recent theories or concepts. So when I decided to start with my doctorate on political economics I knew that on one side I had to be in Bolivia to be able to see actual situations, but I was also aware that finding related scientific knowledge was going to be hard. I was fortunate to be able to spend a big part of my time in France where I found myself in a privileged position to be able to acquire knowledge in politics and economics and to be under the guidance of my supervisor Mr. Gerbier.

Everything changes all the time in Latin America. When I started my research Bolivia was just coming out of a big crisis, the so called gas-wars, and not a single President had managed to stay in office for more than a year. The population was a bit divided, but they all agreed that it was time to manage the natural resources in a way that would be more beneficial for Bolivia. Now we are about 6 years further and things have changed a lot. The country is more divided than ever, the rhetoric say that Bolivia turned for socialism although the mayor part of the economy is still fully moved by the market power. All these changes and events make it hard to be up to date on events which are needed to write for a dissertation.

During my research I have had the possibilities to travel around the globe and witness firsthand how other more developed countries manage their politics. In my opinion, the differences are, to be modest, immeasurable, which often made me think about handling the issue of development differently. Countries are sometimes compared to companies that just need to be managed. Who is doing that for the governments? Sure there are many consultants, but the risk is different. A company can go bankrupt or is being taken over but a country just muddles on and the loss is being offset to the



people who in most cases do not have any other option than to stay living in a conflicted and fragile country. Besides, in management it is sometimes said that small companies are flexible and therefore more innovative than big ones. What about small size countries? Are they flexible? Bolivia is certainly and is submitted to big players in the international arena. Thus, I always wondered how a small and poor country can stand up against the dominating behavior of large countries. Large rich countries decide often on trade barriers and other politics that influence the way our economy develops. International negotiations were in most cases just a show because large countries had already decided our fates before the meetings ever took place. Nowadays, small countries are trying to take their own decisions going under several structural changes and trying to get together into regional cooperation.

Following a political-economics related research in a country as Bolivia is not easy. Everything has a political touch and it is easy to get caught up in a complex discussion and change, from an observer to an active participant with a political preference. Nonetheless, it would be impossible to form a good view of the political situation of Bolivia without taking this risk. The emotions and the subtle information that a person receives when being here cannot be compared to just reading the news reports, seeing the protests on TV or even reading a scientific analysis. I noticed that development economics often tends to forget the importance of a good functioning government and that is why international political economics is so important. How often do we hear that development aid is for building a hospital, a school, a new road? and also how often do we hear that the money disappears because of corruption or the result does not meet the expectations? Living in Bolivia these facts were part of my every day experience not only with development aid but also with tax money or national income that was used inefficiently. On a higher level, where international negotiations take place, these failures can make a country overlook opportunities in international trade due to an inefficient functioning government on top of the fact of being a small size economy. Bolivia is a small developing country suffering from both little power of negotiation and from an inefficient government.

All these events lighted my curiosity on what is really happening to economies similar to the one of Bolivia and in what way my country could improve development and international integration over passing the issue of being also a small size economy in

the context of world trade. This thesis aims to analyze these aspects in order to enhance a view for development by increasing power in negotiations through international integration.

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## Acronyms

ACE = Economic Complementary Agreement, From Spanish Acronym  
 AEI = Shell and Ashmore Energy International  
 ALBA = Bolivarian Alliance for the Peoples of Our America  
 ANCOM = Andean Common Market  
 APEC = Asia-Pacific Economic Cooperation  
 ASEAN +3 = Association of Southeast Asian Nations + China, Japan and Korea  
 ASI = Andean System of Integration  
 ATPDA = Andean Trade Promotion and Drug Eradication Act  
 BITS = Bilateral Investment Treaties  
 CIF = Cost, Insurance and Freight  
 CSOs = Civil Society Organizations  
 CTD = Committee on Trade and Development  
 DCs = Developing Countries  
 DHT = Direct Hydrocarbons Tax  
 EAA = Economic Active Age  
 ECLAC = Economic Commission for the Latin America and the Caribbean  
 EDA = Economic Dependent Age  
 EIA= Economic Inactive Age  
 EU = European Union  
 FAO = Food and Agriculture Organization of the United Nations  
 FARC = Revolutionary Armed Forces of Colombia  
 FDI = Foreign Direct Investment  
 FTA = Free Trade Agreement  
 FTAA = Free Trade Area of the Americas  
 GATS = General Agreement on Trade in Services  
 GDP = Gross Domestic Product  
 GFCF = Gross Fixed Capital Formation  
 GM = Genetically Modified Product (crops)  
 GNP = Gross National Product  
 GSP = General and Special Preference  
 HDI = Human Development Index  
 HIPC = Heavily Indebted Poor Countries  
 IADB = Inter-American development Bank  
 ICSID = International Centre for Settlement of Investment Disputes  
 ICTSD = International Centre for Trade and Sustainable Development  
 IDP = Internationally Dominant Power  
 IEO = International Economic Organization  
 IMF = International Monetary Fund  
 IPE = International Political Economy  
 ITC = International Trade Centre, Centre du Commerce International (CCI)

LAIA = Latin American Integration Association; known as ALADI in Spanish  
LSE = Large Size Economies  
MAI = Multilateral Agreement on Investment  
MAS = Movement towards Socialism  
MERCOSUR = Common Market of the South or Mercado Comun del Sur  
MFN = Most Favored Nation  
NAFTA = North American Free Trade Agreement, USA+Canada+Mexico  
NPPC = Non-petrol Producing Countries  
OAS = Organization of the American States  
OEI = International Economic Organizations  
OPEC = Organization of the Petroleum Exporting Countries  
RTA = Regional Trade Agreement  
SCN = Southern American Community of Nations, UNASUR in Spanish  
SDI = Social Development Index  
SDT = Special and Differential Treatment  
SITC = Standard International Trade Classification  
SSE = Small Size Economies  
TCP = People's Treaty of Commerce, part of ALBA (Tratado de Comercio de los Pueblos in Spanish)  
TNC = Trade Negotiations Committee  
TNCs = Transnational Corporations  
UNCTAD = United Nations Conference on Trade and Development  
UNESCO = United Nations Educational, Scientific and Cultural Organization  
USA = United States of America  
WB = World Bank  
WHO = World Health Organization  
WTO = World Trade Organization

## General Introduction

Since the 60s, Latin America has been following the suggestions of International Economic Organizations (IEOs) on how to reach development. In the 70s, the United Nations suggested a set of politics for development, where the countries could independently define their own national and international rules and would consequently reach development. This did not work due to the increasing interdependence. Therefore, in the second half of the 80s, the Washington Consensus<sup>1</sup> replaced this policy. The Washington Consensus is under the opinion that globalization promotes multilateralism and does not allow countries to take unilateral decisions, because their decisions affect others and are being affected by other countries' decisions as well. Although this made a lot of sense, it would mean that the free market prevailed over the actions of the government, eliminating all barriers of trade and opening up to foreign investments. According to Margaret Thatcher, the British Prime Minister at that time, there was no alternative to the status quo of the economic system than neoliberalism, free markets, free trade, and capitalist globalization which were apparently the only way in which modern societies could go. She claimed that any deviation from their doctrine is certain to lead to disaster and that the nation would be blamed first by the world market and then by the society. Therefore, many Latin American countries joined the neoliberalism that was proposed by the Washington Consensus in 1989.

According to the United Nations Commission for Trade and Development (UNCTAD) "international production has become the central structural characteristic of the world economy", (Gallin D., 1998). In other words, the global economy is nothing but the internationalization of trade, investment and production as well as employment. And national economies are linked together by a network of trade, investment and credit. If this is so, the essence of international production should mean the development of all the countries, and the equitable distribution of world trade and in the process, giving developing countries the opportunity to gain access to resources, technology and markets through this so called "globalization". But

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<sup>1</sup> The Washington Consensus was promoted by the IMF and the World Bank.

experience shows that these objectives have not been achieved. Far from it, the opposite has resulted. Backward countries remain backward and continue to be deprived of their legitimate share of resources and world markets where small countries have practically no part of the cake in trade and foreign investment. Instead of the net inflow of resources, a net outflow has occurred with attendant accentuation of economic and social problems and SSE countries live in constant social turmoil putting in risk the stability for their governments.

Small Size Economies (SSE) got in debt in their effort to reach economic recovery. Developed countries, through the International Monetary Fund (IMF) and the World Bank (WB), advised these countries telling how important it was to pay the debt maybe even through disinvesting the shares of vital public services. Privatization was then proclaimed as the panacea for all the economic perils and shortcomings. The creditor soon became the owner through Transnational Companies (TNCs). The claim that there has been an internationalization of trade production and employment cannot hide the reality that the TNCs' objective is profit and not social or human development. With the Washington Consensus came another globalized idea for development based on the concept that international trade is important to reach development (Besley T. and Zaghera R., 2005, pp. 31-60). Industrialization for the larger countries and trade diversification for the smaller ones were once viewed as the main ingredients in the recipe for attaining growth in the case of developing countries. Then, globalization and interdependence came to constitute an important reason for joining a multilateralized world characterized by IEOs who claimed that the national market size does not matter anymore if a country focuses in larger international markets. SSE found themselves lucky whenever a country decided to buy anything even when the selling prices were very low, or worst, even when the product would not be longer available for their national market or they had to leave diversification in their agricultural production for being able to cover the engaged amounts of one product.

Internalizing the norm of the Washington Consensus was difficult for SSE because this Consensus viewed them as a group of a "unique size, open, fair, established on common and non discriminatory rules" approach for multilateralization (Halle M., 2010, pp. 3). No typology study was ever undertaken to try to adapt these norms

according to the specific needs of each country, so in some cases, international insertion and development was never reached. Therefore, this only contributed to an increase in the international debt, raised poverty and inequality which in turn increased dependency on trade. It is true though, that without these norms and the enforcement of the IEOs, SSE would not have global rules because they fulfill the role of norm-takers, while the LSE-developed countries are the norm-settlers and norm-enforcers. However, it is necessary a difference in treatment for developed and developing countries and for different sizes of developing countries that have itself a wide economic and political diversity. By putting together SSE within developing countries as one group, several researches and governments do not perceive diversion in the economic and political analysis for SSE and cannot foresee adequate reactions in time, particularly in international negotiations.

Rubens Ricupero, former Secretary General of the UNCTAD, made a reference in an article regarding small developing countries and stated that these nations take part in trade negotiations primarily afraid: a) not to seize the stakes well or not to have competences or of the necessary means to practice difficult art negotiation; b) to suffer from the quite real negative consequences of the negotiations: margin, job losses preferably or of food safety, degradation of the terms of trade for the net importers of food products and costs associated with the implementation of complex devices to ensure the compliance with the rules (protection of the intellectual property, for example); c) not to be rather competitive in terms of quality, of price and the offer of products. But this can be explained in the fact that SSE do not know themselves what is their weakness and how to asses them (Ricupero R., 2005). Chapters two and three will outline an important question; if opting for a multilateralisation of the SSE has led to development and international insertion and if so, what are the challenges that this change presents. Both chapters will show the advantages and disadvantages for an SSE country following the multilateral normative of free trade and free financial system. With this thesis, we intend to first elaborate a typology of SSE (chapter 1) and then provide an analysis of SSE and their tendency towards multilateralism and regionalism. The main objective is to expose the difficulties that these nations face in international negotiations and how these difficulties could be overcome (chapter 2). When countries improve their international insertion and improve their economic situation, they have an improved trust and a



better position to negotiate in the international arena. This creates a good context for trade and negotiations, so SSE can strive to reach development and represent them better in their needs.

Besides, it is important to address the two different options for multilateralism that are being proposed by several countries (chapter 2). One option lies within the frame of the Washington Consensus and the other one within the frame of the Beijing Consensus. The later is considered as an option for China to promote multi polar power and regional domination, instead of only one omnipotent source of power in the world. It also promotes independence for each country and the chance to define an own vision of development. The SSE in South America were always directed by the U.S. without a self-determination and sovereignty. Therefore, this new focus is believed to have a chain-reaction wherever it is copied, creating a complete revolution in these nations in several aspects, such as their view of multilateralism in regards to security, defense, social values, etc. The provision of common public goods that until now were defined by the U.S. (hegemony) could now be managed by different regional leaders (multipolarity), who would redistribute these goods and services them according to the needs of the region and particularities of the country. In fact, the SSE are willing to have and are working on a switch in the planning and organizing or their own regional security, monetary and fiscal plan, social and economic development. All this will be presented in detailed analysis in Part I, chapter 2.

In the second part, we will talk about the impact of regional integration for SSE. Regional agreements as the Andean Community of Nations (ANCOM), Mercosur, and others will be taken into account for our analysis. This part contains chapter 4 that describes the SSE between left and right options for integration at regional level. Chapter 5 describes the situation of SSE face to Free Trade Agreements (FTAs) that became so popular in the last ten years and did not bypass the small economies.

Thirteen economies will be used for our analysis including fifteen years of comparative analysis (1995-2009). This analysis includes South American countries, the United States, China and Cuba distinguished in small and large size economies as part of the methodology (read more Appendix 1).

## **PART ONE**

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### **SSE: IMPACT OF MULTILATERAL INTEGRATION**

## Introduction

Since the 60s, Latin America has been hearing the suggestions of IEOs on how to achieve development. In the 70s, the United Nations suggested some politics of development, where the countries could define their own national and international policies independently in order to reach development and economic equality. This did not work due to the increasing interdependence; therefore, in the second half of the 80s, the Washington Consensus<sup>2</sup> replaced this policy. The Washington Consensus claims that globalization promotes multilateralism and does not allow countries to take unilateral decisions because they affect others and are in turn affected by other nation's decisions as well. Although this made a lot of sense back then, it would mean that the free market prevailed over the actions of the government, eliminating all barriers of trade and of foreign investments. According to Margaret Thatcher, the British Prime Minister at that time, there was no alternative to the status quo of the economic system other than neoliberalism, free markets, free trade, and capitalist globalization, which was apparently the only way in which modern societies could maneuver. She claimed that any deviation from their doctrine is certain to lead to disaster and that the nation would be blamed first by the world market and then by the society. Therefore, many Latin American countries joined the neoliberalism that was proposed by the Washington Consensus in 1989.

IEOs like the International Monetary Fund (IMF) and the World Bank (WB) started to promote the Washington Consensus to the Latin American countries<sup>3</sup>. Since the economy in this region stagnated, their governments were constantly asking to borrow money. For this monetary boost to be granted, Latin American countries had to follow drastic conditions imposed by the IMF, whose main doctrine was the payment of the international debt above anything else. Moreover, when the WTO was created, it

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<sup>2</sup> The Washington Consensus was promoted by the IMF and the World Bank.

<sup>3</sup> The IEOs (not all) were established giving more financial commitment and votes to those countries which financial quota was higher (e.g. the six international financial institutions (IFIs): the International Monetary Fund (IMF), World Bank, Asian Development Bank (AsDB), African Development Bank (AfDB), European Bank for Reconstruction and Development (EBRD), and Inter-American Development Bank (IDB). Therefore, ideas and new regulations were promoted to be applied directly from the Large Size Economies (LSE) to the Small Size Economies (SSE).

demanded from each of the member countries, a detailed memorandum on its foreign trade regime, economic policies, domestic and international trade regulations, intellectual property policies, degree of privatization in the economy and the extent to which government regulations were transparent (Michalopoulos C., 2002). All based on the principles that the WTO has, regarding the reduction of obstacles for commerce and also to allow commercial flow with greater freedom between countries. A greater freedom to trade, plus the opening of capital flows, could lead the underdeveloped nations to economic growth emulating the rich countries (WTO, 2005). For that reason, all Latin American countries reduced their trade barriers, opened up their markets to foreign capitals and followed many of the indications of the WTO, IMF and the WB in order to find development through internationalization. All these institutions were and are aligned to a more liberalized world, regardless of the development of the countries and their particular difficulties.

In the 90s, during the move towards internationalization, Latin American countries opened their markets to free trade and FDI-inflows eliminating the program of Industrialization by Import Substitution (ISI program). Nevertheless, Latin American countries, especially those with Small Size Economies, underwent a type of domination imposed on them by the larger and more developed countries (U.S. for instance). The Internationally Dominant Power (hereafter IDP)<sup>4</sup> of the U.S. through all the IEOs+WTO, where U.S. has a majority membership, imposed not only the international trade policies towards openness and FDI liberalization with transparency to secure foreign investment but also imposed a common vision for development that was, not necessarily, adapted to the Latin American countries. Because of the domination effect in international relations, we understand a situation in which the IDP, that are normally LSE from developed countries, impose their national structure to the world in an asymmetric way, which can be understood and viewed in several dimensions. One of them is the way that international relations are done and the vision for development. In this case, the IDP imposes a system to trade where SSE increase its dependency and need to export or import products, especially for its

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<sup>4</sup> The Internationally Dominant Power or IDP is a term used by Bernard Gerbier to refer to the power of a dominant economy, the effects and transformations over the world structure. This term allows us to make a deep analysis on the reality and mechanism of an uneven world economy. Read more in : GERBIER Bernard. *"Pour une théorie de la dynamique du capitalisme"*, in G. RASSALET (ed.), 2007. Les transformations du capitalisme contemporain, Editions l'Harmattan, Paris.

national development. This need affects directly the level of dominance in the SSE that is directed to its markets of agriculture and hydrocarbons, sectors that are potentially for export.

The SSE did not have any national institutions that could doubt whichever of the IEOs suggestions or adapt them to their reality as it might have occurred in large economies. More than a decade after the application of those measures, there is a notorious difference of international integration and development between countries in Latin America. This difference can be observed by looking at the size of each economy, being the smallest ones the poorest and less developed. The SSE of Latin America has no power for negotiation inside these IEOs, where the policies and international laws are suggested by the United States or other developed nations. For that reason, the trade domination that the SSE possesses over Latin America is different to the trade domination that other economies of larger size have. SSE face difficulties in overcoming domination, because they have problems in their internal, political, and economic structure which negatively affects the expansion of trade (at national and international level). These problems of reduced economies lead to underdevelopment that in turn forces these nations to become heavily dependent on trade (both imports and exports). This domination only deepened social and economic problems in their respective societies and divided them in their Consensus to approve internationalization. On one side, some social movements and small producers think that trade domination is linked to imperialism and capitalism, after noticing the increase in the poverty gaps through several years of liberalization and international trade. On the other side, other social movements believe that trade is the only way to have access to a better market price, quality, and product differentiation, and therefore better welfare for the consumer. Trade then would be another pathway for promoting growth and development through international insertion. This last view goes in accordance to the policies promoted by the IEOs and the WTO. Consequently, both positions visibly divided South America and gave rise to a proposal that called for different types of regional integrations. Some of these integrations could be a solution for the SSE and some others could keep them in their vicious cycle of underdevelopment (part two).

The first part will concentrate on the economic and political trade domination within the SSE. The International trade dimension and international insertion will be analyzed in terms of how trade affects the development of SSE and if policies proposed by the IEOs or the WTO in the last years have been helping them or not. It contains three chapters. The first chapter will present a typology for the SSE in South America. This set of conditions and assumptions have the intent to shape a methodology that could be applied in other regions as well. The second chapter will deal with the multilateral options that the SSE have for a better internationalization of their economies. This chapter will examine the Washington Consensus applied in the SSE and its difficulties dealing with Structural Adjustment Programs<sup>5</sup> and the compatibility with the level of development of these countries. It will also present the Beijing Consensus and its potential applicability in the SSE, the self-determination programs and its compatibility with development. The third chapter will research the political trade domination. This chapter will contain two subparts, one dealing with economic and trade domination and the other one dealing with trade domination. These both will be analyzed with the objective to clarify if trade is leading SSE to welfare development or if it is jeopardizing it in terms of domination, dependency and world integration. It also will analyze the impact of Internationally Dominant Power and the polarization of trade negotiations as main concerns for the SSE. To achieve this, we will analyze thoroughly how the current position of the SSE is and what are the government activities to improve their international insertion and their negotiation power. We will also look at other dimensions like the economic policies and the politics that include foreign inflows, trade openness and growth, which theoretically lead to international insertion and welfare. The analysis will be made with an international political economic (IPE) perspective.

This first part concludes that multilateralism, as it was applied by the IEOs, the WTO and a dominant U.S. Government, damaged the SSE. This is because their suggestions did not take into account the real needs for small size economies. The Structural Adjustments Programs suggested by the Washington Consensus were not compatible with the need for development and governance that was lacking at a national level. On

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<sup>5</sup> Structural Adjustment Programs were mainly based in three pillars: privatization, trade openness and financial openness. It was said that following these three pillars together with a reduction of the role of the government in the economy, international insertion and development could be foreseen.

the contrary, those structural adjustments even increased poverty. This does not automatically mean that multilateralism is not convenient for the SSE because these countries actually were the ones which blindly applied the recommendations, since they had no capacity to create their own. However, since these nations carried out this advice, mainly due to a lack of a thorough assessment, disillusion was stronger. Trade openness and financial openness as strategies of domination from U.S. and the IEOs demotivated self-sufficient agriculture in the SSE that had terrible effects on food security. This together with the export bans (SPS/TBT barriers) from LSE were some of the causes for migration from the rural areas to the urban areas or to other countries. Ideas on trade and financial spread by the LSE and IEOs to promote free-trade and international insertion promoted the largest agro-businesses in the SSE focused on export production on the request of LSE rather than trying to expand their national market. This has led to a countrywide dis-integration, since some cities were more integrated to the world than others. At the same time it also increased the gap between rich and poor. Some were living with standards comparable to rich countries while another large number of people were living outside the active market and survived even without food security or food diversification. As a result this inequality created rivalries inside the country. All this created discomfort in the societies that had countless turmoil against multilateralism and the proposed neoliberal model. This reality ended when socialist governments promised them another path of development and another multilateral option appeared in the scene: The Beijing Consensus.

Some Latinamerican countries, particularly the SSE have chosen to abandon the neoliberal model and take economic and political measures far from the free-market economy. This motivated governments to retake most of the roles that were carried out by the market at the end of the 80s. Besides, SSE motivated by the spirit of the Beijing Consensus have decided to reduce the influence of multilateral organizations and create their own concept for international insertion and development, sometimes creating regional organizations to support their financial development. This has opened a new door to a potentially new type of investment and trade domination, which is different to what traditional investors and trade partners as the U.S. and EU had with SSE. Unfortunately so far, not much change can be observed in the sector of investment (monopolist and extractive sectors). The same happened with trade, since

it is mostly based on comparative advantages as the WTO suggests and in this context the SSE stand in a position of major disadvantage.

Improved FDI and trade conditions could be created at a multilateral level as a common engagement between SSE and LSE to reach development and basic welfare through free internationalization. This would be the only way to continue in a path of multilateralism for SSE. The other option is to regionalize the economy, imposing particular non-standard rules to small groups of countries which might not lead to global welfare or global peace and we will present in the second part of the thesis.

The methodology for this part one consists in two steps. The first one will be to draw a typology to define which countries can be called SSE, and if so, what are the challenges that these countries face in the search for a better integration. The second step is to explain the two viable options for SSE to reach multilateral integration. With this, we will find out the impact of multilateralism in the internationalization and development in the SSE (the main objective).



# Chapter 1

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## SSE: Typology

The definition of the size of an economy and its characteristics can be found in the economic literature. One of the first authors who referred to the size of the economy was Kuznets (1963) who proposed to establish a threshold for SSE at less than 10 million inhabitants. Others such as Marcy (1963) or Vakilé and Brahmananda (1963), added the concept of geographical size of the country to this first criterion, based on the surface of its territory to distinguish small from large. Evans and Hughes (2003) based their ideas more on international trade literature and proposed to improve the list with a twofold criterion: the economic proximity of the markets and the opening to trade. There are new studies on SSE, Lessard (2002 a); Escaith and Inoue (2001); Helleiner (2001) and present several analyses about the challenges that SSE face within the FTAA. The Latin American Integration Association (LAIA)<sup>6</sup> has also given a denomination and a concept for these types of countries focusing in the difficulties for development (ALALC, 1980); however, it remains vague. The importance of both resolutions can be seen when we focus on special and differentiated treatment (SDT) that LAIA and FTAA grant in trade relations to SSE.

The objective of this chapter is to create a typology for the developing countries with small size economies that differentiates them from large size economies. The methodology will be used to insert a sub-category in the category of Developing Countries. It takes into account the characteristics of the countries in relation with power for international negotiation. Besides, it refers to a quantitative analysis (statistics from 1970-2009) and qualitative interviews done to experts from South American organizations<sup>7</sup> and it will allow us to:

- Differentiate the SSE from the LSE within the current denomination of developing countries.

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<sup>6</sup> Also known as ALADI in Spanish (Asociación Latinoamericana de Integración)

<sup>7</sup> Interviews were done to people that work in: LAIA, MERCOSUR and ECLAC.

- Identify the problems of SSE in international negotiations (multilateral, regional and bilateral agreements) that prevent them from having a better international insertion.
- Describe how the size of the economy influences development and trade structure within different integration agreements (bilateral, regional and multilateral).
- A methodology that could be used for South America and other SSE.

## 1.1 SSE in South America

The framework of this typology is based on the main common features shared by these countries in their economic and political processes, vis-à-vis the social challenges they face according to the economical and political agenda. Despite the fact that South American countries share the same language, culture and similar history; they have different paths of development. This and the specific structural characteristics led each of them to a different level of development. Since all the criteria developed before this point seemed to fall short when defining the SSE, we propose the following factors to identify small from large size economies: population size and demographic density, GDP, trade participation and trade openness<sup>8</sup>, FDI inflows, geographical distance and governance index.

- **Population size and demographic density.** The size of the population is rather small in SSE. This fact turns more adverse when these inhabitants have little purchasing power. Often this is because the majority of the SSE have over 55% of its population under 24 years old, and less than 40% in working age. This means that less than 2/5 of the population has to be in charge of 3/5 and this does not leave much space for the population to save for future investments or for high

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<sup>8</sup> Trade openness or openness to trade index is a calculation done to see how oriented an economy is to trade (in trade volume rather than policy orientation sometimes). The calculation is done with the summation of imports and exports, dividing the total over the GDP. The higher the number, the more open is an economy. This is presented in typology, popularly measured as  $(X+M)/GDP$  in the hundreds of studies published to date. Since 2006, there are new methodological proposals for calculating trade openness to avoid having numbers that go higher than 100%. This calculation reflects better the reality by combining two dimensions of trade openness: trade intensity and the relative importance of a country's trade level to total world trade (Squalli and Wilson, 2006). However, at international level, trade openness did not change its methodology and keeps using the traditional one. This is why we will attach to the old methodology for this thesis.

consumption. The result is that people in average, demand mostly food and basic consumption and do not have the possibility of savings, long term investments or luxurious consumption. Since the government of SSE does not have social security programs, people cannot afford living without a job. The poorest families even have to go as far as sending their children to work making a negligible income. Most of them are inserted in the *informal sector*<sup>9</sup> which is around 40%-60% of the economy which is off-charts. Child labor, informal sector and agriculture of subsistence grant little purchasing power to the population and maintain the vicious poverty cycle for an SSE.

Another problem that SSE face is the scattered population around its territory. More than 50% of the population of a country lives in one or three cities, the rest of the population is scattered around the rest of the territory, making most of it look quite deserted or with small villages far from the *main cities*<sup>10</sup>. The cause of this is due to dictatorships in its history. These dictators preferred to have strict control over the economy and the population of these few key cities and to focus on providing and developing infrastructure only for this main metropolis and not for the rest of the country. The problem of having only a few developed cities with the required infrastructure<sup>11</sup> while other cities are underdeveloped is that the population with the purchasing capacity and the consumption possibilities is reduced. Thus, the national market remains small because far away cities that are not provided with national production have the possibility to import goods from the neighboring countries and others have their own production or self-sustainability.

In table 1-1, it can be noticed that the area in km<sup>2</sup> is not a determinant for the definition of an SSE or a LSE. One example is Bolivia, the fifth largest country in SA but is a SSE in our study. Thus, to determine the size of a developing country,

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<sup>9</sup> Informal sector are all the activities that are out of the regulation from government. Therefore, these activities are not taxed or controlled at economic or social level.

<sup>10</sup> Main cities are defined to contain all together more than 55% of the population. These cities are consequently the most developed regarding basic services, housing and roads. Nonetheless, large peripheral slum areas are and poverty (represented by high GINI coefficient) which prevents the population to participate of the economy and have an equal development within the country.

<sup>11</sup> Roads, basic services, education and health center, communications and roads for exporting goods are available in the main city (es). This is why a huge concentration of sectors, industries and business, that attracts labor that is obliged to migrate to these cities to find a job.

there are some demographic indicators that should be used to start differentiating the size of their economy. For instance, SSE have the smallest population in South America and more than 55% of this population<sup>12</sup> is concentrated in only 17% of the territory. Therefore, *density for square kilometer* fails to work as an indicator in developing countries, providing a misleading idea for the population as a market. Because of this, it is better to work with *concentration of the population* and *age-groups* as indicators. *Age-group* as an indicator shows what the structure of the population is and how this factor affects its economic development. For example, SSE have the lowest GDP and GDP-per capita in the region (with the exception of Uruguay) and this can be explained because of the *age-group structure*.

**Table 1-1. SSE and Brazil: Main economic and demographic indicators (2009).** To describe the size of a developing country, it is important to use different demographic indicators.

<b>Economic Indicators</b>	<b>Bolivia</b>	<b>Ecuador</b>	<b>Paraguay</b>	<b>Uruguay</b>	<b>Brazil</b>	<b>SA<sup>1</sup></b>
Area (km2)	1.098.581	283.561	406.750	176.220	8.511.965	17.715.341
Population (in thousands)	9.863	13.625	6.349	3.362	196.627	392.787
% of Population in South America	2,44	3,50	1,57	0,91	50	100
% of people under 24 years	60	56	58	40	49	21
% of people in working age	36	40	38	47	46	73
% of people over 65 years	4	5	5	13	5	7
% Population living in 2 or 3 cities	71	57	47	56	85	78
#cities englobing >55%population	3	3	2	2	5	-
total number of cities	9	22	18	19	27	-
GDP (million US\$, 2008)	17.387	50.970	15.691	30.637	1.552.656	1.913.633
GDP per capita (US\$, 2008)	1,763	3,741	2,471	9,113	7,896	4,872
GINI coefficient	60,6	42,0	56,8	45,2	56,7	-
Informal economy, % over GDP	67	34	n/a <sup>2</sup>	51	40	41
<b>Demographic indicators, 2009:</b>						
Crude birth rate per 1000 inhab	27,35	20,99	24,82	15,09	19,17	20,25
Crude death rate per 1000 inhab	7,59	5,13	5,54	9,25	6,33	6,28
Infant mortality rate per 1000 inhab	46,73	21,37	32,34	13,27	23,86	23,99
Emigration rate per 1000 inhab	2,08	5,22	1,29	2,99	0,24	0,89
Natural increase rate p/1000 inhab	19,76	15,86	19,28	5,84	12,84	14,72
Population growth rate	1,77	1,07	1,80	0,29	1,26	1,31

<sup>1</sup> SA stands for South America

<sup>2</sup> N/A stands for non available data

Source: Unctad Statistics 2010 (2010), for the GINI: Nation Master (2010), for Area and cities: CIA Factbook (2010)

Bolivia, Ecuador and Paraguay have around 38% of its population inside the working-age to sustain 62% of the population that does not work or does not have

<sup>12</sup> 55% or more of the population is reached by the aggregation of the population living in a city or more.

a pension<sup>13</sup>. On the other hand, the opposite occurs with Uruguay, as it has a universal pension which added to the working age population makes 60% of the population taking care of 40%. This ratio has a positive correlation at the end, with a higher GDP-per capita.

Table 1-1 contains main economic and development indicators of SSE that compared with Brazil (an LSE-developing country) and the average of South American (SA) countries can show that low rates and results may be impacting negatively on the international insertion (for trade or FDI attractiveness). Low rates of economic and demographic indicators impact on development and reduce the positive side of economic integration.

- **National disintegration.** The relative distance between cities gets larger when there are no paved roads to integrate the national market of a country. This is why some national products are only available for the *main cities* and not for the entire country. Thus, frontier cities have to consume products from neighboring countries being that this option is cheaper than buying national products. Even though South America has vast areas of land, it lacks the necessary road and ways infrastructure to integrate its cities. The problem deepens with SSE countries, which are the worst on the list, with little number of roads that are often unavailable during rainy seasons, and a noticeable lack of airports, navigable waters or usable railroads. This causes the number of urban cities to reduce in size and contain a large number of the countries' total population. As you can evidence in table 1-2, the SSE have a high percentage of the population living in a few cities (normally 2 or 3). The lack of infrastructure provokes a national disintegration while the motivation for world integration grows. Main cities are well connected with each other and have roads that go outside the country, not to connect other cities inside the country. Some cities are connected with bad roads or can be in the middle of being constructed, but very slowly (table 1-2). The lack of infrastructure inside the country causes high transport costs compared to the transport costs for export. This fact reduces the

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<sup>13</sup> Bolivia has a universal pension system since 1994 but had some changes and adjustments along time which makes it difficult to evaluate at present. The universal pension was first based on the income due to privatization of public companies but nowadays is based on the tax income generated by the gas exports.

attractiveness for commercialization inside the country, increasing the preference to produce for export despite the local demand for the product.

**Table 1-2. National number of routes per country, 2006 and 2009.** SSE have less km roads to integrate their country which is worsened by rainy periods or little amount of airports, navigable waters or railroads. This makes that few urban cities concentrate larger number of population. This reality barely changed in the last three years of economic boom within the SSE.

Country	Infrastructure until 2005			Roads by 2009
	Number of roads	Road details or Difficulties	Other ways of communication	Increase of roads infrastructure
Argentina	29.4% of roads are paved, connecting main cities	215,471 km, reach all corners of Argentina	133 airports, 11,000 kms navigable, 34572 Km railroads	231,374 km, 7.4% increase, country comparison No 22
Bolivia	5.5% of roads are paved, 1 highway connects 3 main cities	52,216 km, main road is impassable in rainy period	9 airports, 10,000 kms navigable, 3504 Km railroads	62,479 km, 19.7% increase, country comparison No 71
Brazil	10% of roads are paved, mostly South and southeast of the country	2 million Km, difficult to maintain and very expensive	436 airports, 50.000 kms navigable, 30618 Km railroads	1.751,868 km, 12% decrease, country comparison No 4
Chile	14% of roads are paved	79,800 km, capital best served. All can be used all year	45 airports, 725 kms navigable, 7766 Km railroads	80,505 km, 0.9% increase, country comparison No 57
Colombia	23.64% of roads are paved	112,998 km, main cities are well communicated	74 airports, 14,300 kms navigable, 3386 Km railroads	164,257 km, 45% increase, country comparison No 31
Ecuador	19% of roads are paved	43,709 km, main cities. Rainy periods are impassable	32 airports, 1500 kms navigable, 965 Km railroads	43,670 km, 0% increase, country comparison No 84
Paraguay	11.84% of roads are paved, 3 paved highways from the capital	25,901 km. Main city. Rainy periods make roads impassable	7 airports, 3100 kms navigable, 970 Km railroads	29,500 km, 14% increase, country comparison No 98
Peru	12% of roads are paved	72,900 km, well connected but a lot still to pave	38 airports, 8600 kms navigable, 1801 Km railroads	78,829 km, 8% increase, country comparison No 60
Uruguay	89% of roads are paved	77,732 km, well connected all the year	15 airports, 1600 kms navigable, 3000 Km railroads	77,732 km, 0% increase, country comparison No 62
Venezuela	33.6% of roads are paved	96155 km, northern part is well connected but llanos and south have few paved	114 airports, 7,100 kms navigable, 542 Km railroads	96,155 km, 0% increase, country comparison No 47
Cuba	49% of roads are paved	60,858 km, excellent roads	38 airports, 240 kms navigable, 12,623 Km railroads	60,858 km, 0% increase, country comparison No 73
United States	89.16% of roads are paved	6.430,366 km, well connected	4,190 airports, 41,009 kms navigable, 226,612 Km railroads	6.465,799 km, 0.6% increase, country comparison No 64
China	19.38% of roads are paved	1.400,000 km, well connected all cities with 200.000 hab or more	185 airports, 138,600 kms navigable, 65,780 Km railroads	3.583,715 km, 56% increase, country comparison No 2

- Airports are with paved runways, over 914 m

- Road details include the total km of road (paved and unpaved) but exclude the large parts of the countries which are not even communicated or have only walking paths from region to region

- Number of Larger urban cities include: Important urban cities and the percentage of total population.

Source: The World Fact book, 2010

The inexistence of an integrated national market complicates the possibility to have economies of scale, to learn, and to become internationally competitive. Production with economies of scale can reduce the costs of implementation of multilateral trade rules; however, a small and disintegrated market turns into a barrier to comply with the TBT and SPS requirements for export agreed at the WTO.

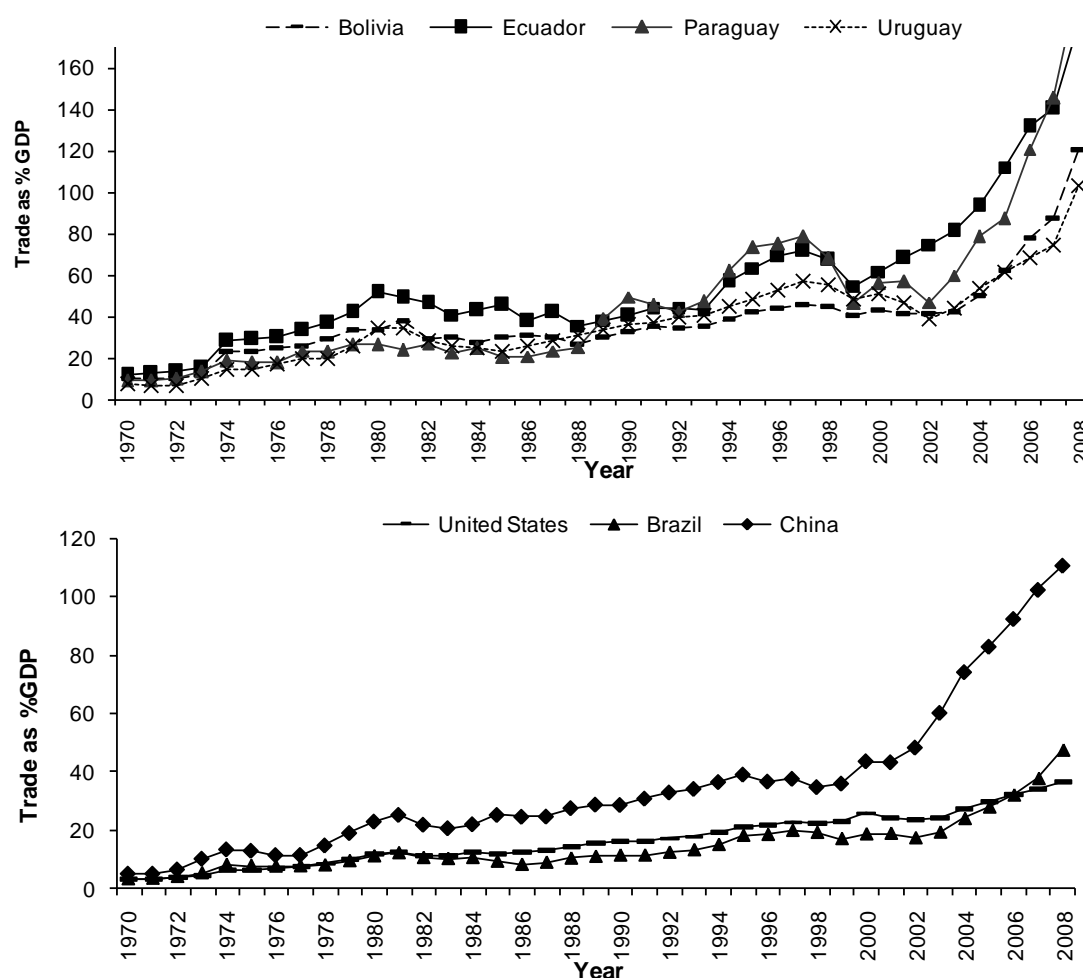
- **GDP.** GDP reflects the size of the economy and the development of each sector. According to Unctad (2009), SSE have a large part of the population (38%) working in the agricultural sector and yet, this only represents around 10% of the GDP. The GDP also reflects that a large source of income is based in one or two major natural resources (hydrocarbons, mining, etc.) which are exportable since the national market does not demand much. This increases the dependency of the economy towards trade, making the country susceptible to international prices and depending on international rules (such as SPS or TBT) to be able to export. Above, table 1-1 shows that the GDP and the GDP per capita in SSE are the lowest of the group and this will later be reflected in the public investment. Statistics are not available for these specific expenditures but information can be seen in different national journals<sup>14</sup> where demands for more budgets are voiced. The exception of the group concerning GDP is Uruguay, because it has one of the 4<sup>th</sup> highest GDP per capita of South America. Nonetheless, the Uruguayan GDP is very small compared to Brazil. The apparent breach in GDP may be the cause to have a differentiated weight in the international or regional arena. When GDP is so small, it reflects a small economy. Multilateral, regional or bilateral negotiations do not take into account the specific needs of SSE, these types of agreements are directed by large size economies looking for their needs of development, hegemony and power of influence. Thus, regional agendas do not include the SSE problems or needs.
- **Trade participation and trade openness.** Trade participation of SSE (in quantity and amount of money) is minor compared to other LSE. Nevertheless, LSE have less *trade openness* than the SSE. As figure 1-1 shows, the SSE are more

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<sup>14</sup> Hidrocarburos Bolivia, 2009. "Recorte de IDH afectará a proyectos de educación, salud e infraestructura", *El Mundo*, Wednesday, December 30 2009.

dependent on international insertion than LSE with rates over 50% of trade openness and increasing at a yearly rate. This indicator alone reflects the country's involvement in trade and it implies, at the same time, an inverse correlation between size of the economy (GDP) and the ratio of the indicator (trade dependence). This means that the smaller the country, in terms of its GDP, the larger the share of trade for its national economy, as measured by its indicator of trade dependence if all other factors are *ceteris paribus* (Mikic, 2005). Then, this indicator should not only be interpreted as degree of openness or dependency, but also as a degree of international insertion to the global economy<sup>15</sup>.

**Figure 1-1. Trade dependence or trade openness as a percentage of GDP (1970-2009).** SSE are more dependent to international trade than LSE due to the small size of their national economies. LSE are less dependent since they can count with a large national market.



Source: Own calculations based on UNCTAD Statistics 2010, Geneva, 2010.

<sup>15</sup> The results should be interpreted case by case, analyzing specifically and comparing the results with other indicators of trade dependency and trade performance to have a better interpretation.



Until the 70s, SSE were mostly self-sufficient on agriculture and basic products<sup>16</sup>, the degree of openness was not more than 10% but after this year, the slope increased greatly per year until reaching an average of 81% in the 2000s decade. This could be explained by several factors but the most important is the role of multilateral agencies at that time, the so called the Bretton Woods institutions<sup>17</sup>. These institutions tried to ensure economic stability and political peace through the U.S. vision of *free trade*. Several South American countries had dictatorships during this period which were friendly to American, European companies and governments and so these multilateral organizations granted large loans for controversial objectives. As a result, the domination of trade openness increased on the SSE turning them less self-sufficient and more dependent on international trade.

High dependence for SSE is due to the small size of its national economies which can, in turn, be proven by the small size of their GDP. On the other hand, LSE (Brazil, United States) are less dependent to international insertion since they have a large national market which is visible by their GDP<sup>18</sup>, their trade dependence rates are less than 25%. This percentage had increased in the last five years due to the insertion of China and its increased demand over the world economy. On the other hand, despite the size of the population of China, this country is an exception for large trade openness because it has more than 55% of trade openness. The explanation can be found in the fact that the GDP is still minor and could be compared to the ones of developing countries if we take into account the amount of people China has (GDP per capita). This makes the country dependent

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<sup>16</sup> In this time, industrialization was tried to be pushed protecting infant industries but did not have a good application in the region since SSE had to still import machinery to pursue industrialization and importing was extremely expensive at this time.

<sup>17</sup> The International Bank for Reconstruction and Development (IBRD) (now one of five institutions in the World Bank Group) and the International Monetary Fund (IMF) were created with the Bretton Woods system in 1944.

<sup>18</sup> Larger economies have a larger national market size; therefore, they can focus on national consumption for their own production rather than thinking in trading outside their borders. This disadvantage in the size of the economy of an SSE represents a constraint per se and this makes them more dependent on international economy and its international insertion. SSE have trade domination and for this reason, they are more susceptible to be directed with multilateral normative than LSE. SSE are willing to adapt multilateral legislation even when this goes beyond their national security because SSE would not have the possibility to determine this since they often lack personnel, infrastructure, etc. Besides, SSE are willing to adapt free-trade not only for their national consumption (import) but also for their national production (export).

to international insertion rather than in its own national economy<sup>19</sup>. China is also a main partner for LSE due to its demand of raw materials which increased trade rates in the last years. This indicator can change depending on the regulations for national markets, developments of national economy and several international events. Although, in the last year's trade openness has increased for all the countries in general, it remains quite low when looking at LSE (particularly U.S.) and remains high when analyzing the SSE.

SSE import a lot to satisfy the needs of the population since the country cannot provide all the products. Importing became more and more necessary in the last two decades due to loss of competitiveness. Exports are essentially done via Special and Differential Treatment (from now SDT) with LSE through bilateral agreements. Exports are based in few strategic products, mostly natural resources or agricultural products and often sold with little added value. Minimal diversification in SSE reduces their power for negotiation in price, SPS/TBT barriers, quantity and quality that will be offered to the buyer. Additionally, the governments of SSE are more susceptible to accept openness to trade in order to be able to export more, even if this trade openness prejudices their national economy with hazardous imports. Free market reduces or eliminates the income that SSE currently have from importing taxes which reduces their capacity for public expenditure and prejudices their little GDP. Nonetheless, governments are prompt to have open markets so they can avoid retaliation from LSE for their exports. This takes them to reduce SPS/TBT measures at the same time of a reduction on import tariffs. Besides, the government has not much power to negotiate on scientific instruments to prove a barrier for unsafe imports, prove of this fact is the reduced number of cases started at the WTO from SSE.

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<sup>19</sup> Empirical observation shows that when the people has less power of purchase (reduced GDP-per capita), the economy of the country does not move as fast as other economies where the rates of consumption are higher.

GDP per capita is an important and widely used indicator of countries' level of economic welfare which goes hand in hand with consumption. However, it should not be applied uncritically since it can be more fruitful to focus on consumption per capita or the actual individual consumption (AIC) rather than on GDP (Euro stat – European Commission, 2008). Due to lack of detailed information for SSE, we will just keep the GDP-per capita for our analysis.

Table 1-3 presents highlighted indicators that are common in SSE. Exports and import ciphers are by far small compared to an LSE. All SSE together do not have more than 6% as an export share in South America while Brazil makes 37%. Furthermore, trade openness that Brazil has between 1994 and 2008 is only 23% while there are SSE which depend for more than 80% on international trade rather than their national market as is the case of Paraguay and Ecuador. This could be a reason why LSE do not care for retaliation or the loss of an SSE partner when placing a SPS/TBT barrier. On the contrary, an SSE cannot have a retaliation action against an LSE since the possibility of losing it as a trade partner can cost the SSE more than the original cost. If we keep analyzing the reality of SSE, we can keep finding patterns of domination and dependency in trade. *Export domination* refers to the reduced number of trade partners to which the SSE export their production. This is institutionalized through a Generalized System of Preferences (GSP) for the SSE as beneficiaries with a number of developed countries. *Import dependency* comes from trade relations that SSE have with LSE; these LSE exercise domination so that SSE import from them instead of importing from neighboring countries. SSE keep importing from LSE to have potential benefits from an increase of trade relations or bilateral/regional agreements with LSE (i.e. more exports in the future).

**Table 1-3. SSE and Brazil: Main trade indicators (1995-2009).** SSE import a similar quantity as they export and sometimes more. Main trade partners are few from whom they have a great trade domination.

Indicators	Bolivia	Ecuador	Paraguay	Uruguay	Brazil	SA*
Export (US\$ million, 1994-2008)	2.115	7.402	1.474	2.918	83.240	223.917
Import (US\$ million, 1994-2008)	2.148	7.381	3.682	3.798	72.712	191.928
% share in SA for Export	1	3	1	1	37	100
% share in SA for Import	1	4	2	2	38	100
trade openness, in % (1994-2008)	55	89	84	57	23	27
Export domination: LSE <sup>1</sup> , in %	55	62	55	60	49	-
Import dependency: LSE <sup>2</sup> , in %	50	50	50	47	47	-
Average tax by sector, in %	37	25	10	30	34	-
Average import tariff, in %	10	12	8	11	13	-

\* SA stands for South America

<sup>1 2</sup> are calculated by the % that exports or import by region or country mean to the total of exports and imports. LSE here are the large economies of: US, EU and Brazil. The percentage is taken from the total trade (average 1995-2009)

Source: Unctad Statistics 2010, Geneva 2010.

SSE depend a big part of their national income in exports. Since SSE have little diversification, the products are primary products and practically without added

value; therefore, susceptible to bug price fluctuations and submitted to international demand directives<sup>20</sup>. Moreover, the applied import tariff rates on agricultural, fuel and manufactured products are an important source for national income. Still, these taxes are on average lower in SSE (9-10% for manufactures, 12% for agricultural products<sup>21</sup>) than the ones applied by Brazil (14-15% for manufactures, 13% for agricultural products<sup>22</sup>) that tends to protect its national market from competition. Brazil can afford to have protectionist import tariff rates because it is self sustainable on those products. SSE on the contrary cannot have high protectionist tariffs even when they depend on them for their national income since the need to belong to a regional group is also important to assure their exports. Thus, this is bit by bit reducing their import tariffs and the control that they have for their national security to keep their markets prompt for openness.

- **FDI inflows.** According to Heijs (2006), the Foreign Direct Investment (FDI) creates the possibility of numerous technological transfers; efficient management practices; competitive production and consequent growth in the host country. This assumption is based upon the classical economic theory that with technological transfer and innovation, these advances will filter into other areas of the economy, known as “spillover effects”. SSE have little capacity to attract FDI. When there is a possibility, SSE compete with the LSE in the region to attract foreign investors. The advantage that they use to attract FDI relies on their endowments in natural resources. Most of the time, SSE have no power of influence over the regulations and type of investments that foreign multinationals will have in the country. Then, if an SSE changes regulations to ones that are not profitable for FDI investors, foreign investors leave to search for more advantageous and larger markets. Currently, developing countries<sup>23</sup> are increasing their role for FDI-outflows that were only done before by developed countries. Since then, SSE are benefiting with better conditions for their national economy.

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<sup>20</sup> The directives indicate how to produce (conventional, biological), what types of products, the quantity, quality standards, etc. SSE like Bolivia and Ecuador have been receiving international organizations which install and invest in agriculture to control the production and the harvesting of the products for agriculture export to their countries and world for instance.

<sup>21</sup> Unctad Statistics 2010 for manufactured products and USDA 2008 for agricultural tariffs.

<sup>22</sup> Idem

<sup>23</sup> Brazil, Venezuela, Argentina, China and India are main leaders in the region for FDI-outflows.

**Table 1-4. SSE and Brazil: FDI facts and trade regulation.** SSEs are susceptible to weak property rights, intense regulation that is not well regulated due to corruption and law delays.

Country	For 2003			For 2010
	FDI regulation	FDI nationalization	Trade freedom	FDI regulation
Bolivia	Investment freedom, property rights, labor freedom, and freedom from corruption scores are low. Significant regulation for FDI. High corruption.	Possible nationalization. Rule of law is weak, and private property in risk of expropriation.	Average tariff is 5.5%, some non-tariff barriers. Monetary and financial freedom but control of prices in main services. Investment hindered by social unrest and restrictions.	* Lack of FDI in the mining and hydrocarbon sectors due to a poor infrastructure, risk for expropriation, hostile to FDI. * Shaky Bolivian politics and difficult climate for investment have caused companies to invest elsewhere.
Ecuador	Property rights, labor freedom are low. Heavy regulation (business/labor flexibility). Law is politically influenced and inefficient. High corruption.	Outright expropriation is a constant concern.	Average tariff rate is 8.7%, required licence from government to import and tariff quotas. Monetary and financial freedom with price bands in main sectors. Investment hindered by cumbersome labor laws, lack of contract enforcement, and government restrictions.	* CORREA announcement in 2009 terminating 13 bilateral investment treaties have generated economic uncertainty and discouraged investment. * Inconsistent application and interpretation of its existing investment laws complicates enforcement of contracts and increases the risks and costs of doing business. * Government use questionable legal maneuvers to affect operations with additional payments not negotiated originally,
Paraguay	Business freedom, labor freedom, property rights, are weak. High corruption.	Never a privatization due to opposition. Protection of property is extremely weak due to delays in the registration. Commercial and civil codes cover bankruptcy for claims to employees 1st. Acquiring title documents for land can take two years or more.	Piracy of goods. Average tariff rate is 5.8%, some barriers. Monetary and financial freedom with low controls, control in fuels and sector utilities. Investment hindered by shortage of skilled labor	* Several cases of expropriations of land and companies without prompt and fair compensation in recent years. * Many investors find it difficult to enforce contracts and get frustrated by lengthy bureaucratic procedures. * Regulations are enforced by a bureaucracy with limited transparency and accountability. Corruption and impunity are widespread and this hinders Paraguay's investment climate.
Uruguay	High levels of investment freedom, trade freedom, property rights, freedom from corruption, and fiscal freedom, no personal income tax, highest GDP per capita.	Never a nationalization. Private property is generally secure, and expropriation is unlikely.	Average tariff rate is fairly low 3.5%, though non-tariff barriers are extensive. Financial and investment freedom, government control on prices.	* Financial indicators are stable, sovereign bond rating investment-grade. * FDI is traditionally low (under 3% of GDP) because of the country's small market and the lack of major privatization initiatives.
Brazil	Weak financial freedom and a large central government. Regulatory inflexibility, significant restrictions on foreign capital in many areas, and the government remains heavily involved in banking and finance. High corruption.	Contracts are considered secure. Private property is generally secure, and expropriation is unlikely.	Piracy of goods. Average tariff rate is 7.1%, non-tariff barriers are extensive. Financial freedom but investment restrictions in some sectors.	* FDI is prevalent across Brazil's economy, although communications, aviation, transportation and mining, are subject to foreign ownership limitations. * Burdensome tax and regulatory requirements. The Government makes no distinction between foreign and national capital.

Source: Own elaboration based on The World Factbook, 2010.

As table 1-4 show above, other main determinants to attract FDI inflows are: FDI regulation, property rights, financial freedom and FDI history for nationalization and trade regulations. The risk of nationalization is present in SSE since the recent leftist governments have announced and applied different measures for foreign investments and new rates for taxes. Besides, SSEs are more susceptible to weak property rights, heavy regulation that is not well regulated due to corruption and law delays. SSE have several aspects that do not favor them to attract FDI-inflows in the short term. On the other hand, SSE have natural resources that are important products for the development of other nations, i.e. hydrocarbons, clean electricity, minerals, etc. This type of endowment has changed the FDI-inflows towards the SSE and made it interesting enough to not care much for the type of government, economic or social development. The high prices of natural resources and the push that China did to the world with a rapid increase on its demand pushed different investors towards the SSE in search of natural resources from 2006 to present. Besides, table 1-4 shows that nationalization is possible in 3 of the 4 SSE countries, except in Uruguay which has a stable regulation for FDI inflows. The instability of FDI regulation raises the uncertainty for foreign investors and reduces the degree of attractiveness of a country. A spokesman for the British oil company, BP, whose fields were taken over in 2006 by Bolivia, for instance says "... if we are going to invest in a foreign country, we want to see political and fiscal stability. An unsettling environment makes any investment decision harder for us." (Mitchell J., 2006).

- **Governance index.** Governance is important for the development of a country and for a good international insertion. SSE face difficulties to rule through laws, mainly due to long distances between populated areas, which makes it more difficult to manage the country, and also the issue of wide differences of development within the country. Table 1-5 shows six different indicators to measure governance done year by year by Kaufmann, Kraay and Mastruzzi (2009). If we take a look at the table 1-5 and we identify the lowest rates (between 0 and 33 which mean bad), most of them are localized in the SSE with the exception of Uruguay that does well in all the indicators. Low quality of governance in SSE leads to social and political conflicts that are difficult to solve in the short term: national disintegration, smuggling in the abandoned frontiers,

informal economies, small scale production, etc. All of these factors influence the size of the national market and make it difficult for SSE to have a common position for the international insertion. A low governance indicator influences negatively the international insertion because of a lack of control at national level.

**Table 1-5. SSE and South America: Governance indicators (2003, 2006 y 2008), by percentile Rank (0-100).** SSE have the lowest governance indicators (exception of Uruguay).

Country	Year	1	2	3	4	5	6
Argentina	2008	57,2	42,1	48,8	28	32,1	40,1
	2006	57,2	47,6	56,4	23,9	40	44,2
	2003	56,7	37	53,1	23,4	30,5	43,2
Bolivia	2008	48,1	14,8	19	15,9	12	38,2
	2006	52,4	17,3	26,1	18	18,1	36,4
	2003	47,1	27,2	40,8	51,7	40	22,3
Brazil	2008	61,1	38,3	54,5	58	46,4	58,5
	2006	62	41,3	51,7	53,7	45,2	53,4
	2003	62	49	61,1	62,9	45,2	59,7
Chile	2008	76,9	66	84,8	92,8	88	87
	2006	76	66,8	84,4	91,7	88,1	90
	2003	78,8	77,9	88,2	91,2	84,8	85,9
Colombia	2008	39,4	8,1	60,2	59,4	37,8	50,2
	2006	42,3	7,2	57,3	56,1	35,7	53,9
	2003	34,6	1,9	53,6	52,7	20	42,7
Ecuador	2008	40,9	20,1	15,2	14	9,1	22,7
	2006	38	19,2	14,2	15,1	13,8	20,4
	2003	43,8	20,2	24,2	30,7	31	25,2
Paraguay	2008	37	23,4	22,3	33,8	15,3	17,4
	2006	33,7	26,9	23,2	25,4	16,7	10,2
	2003	39,9	22,1	20,4	25,9	12,9	5,3
Peru	2008	49	19,1	46,4	62,3	25,8	49,3
	2006	50	20,2	35,1	55,6	26,2	50,5
	2003	49,5	19,7	40,3	56,1	33,8	55,3
Uruguay	2008	81,3	75,1	68,7	55,1	65,6	83,6
	2006	76,9	67,3	68,7	60	61	79,6
	2003	76,9	62,5	69,2	63,4	65,2	79,6
Venezuela	2008	30,3	12,4	17,1	4,8	2,9	9,2
	2006	34,1	14,9	22,7	9,8	4,8	14,6
	2003	34,1	13,5	18	14,1	9,5	9,7

0 to 33: bad 34 to 66: medium to good 67 to 100: very good

- 1: Voice and Accountability, Comparison across selected
- 2: Political Stability, Comparison across selected countries
- 3: countries Government Effectiveness
- 4: Regulatory Quality, Comparison across selected countries
- 5: Rule of Law, Comparison across selected countries
- 6: Control of Corruption, Comparison across selected countries

Source: Kaufmann D., Kraay A., and Mastruzzi M. (2009), Governance Matters VIII: Governance Indicators for 2003-2008. World Bank.

Note: The governance indicators presented here aggregate the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, and international organizations. The WGI do not reflect the official views of the World Bank, its Executive Directors, or the countries they represent. The WGI are not used by the World Bank Group to allocate resources.

The rates in table 1-5 show how to define SSE with the governance indicators. A country defined as SSE does not mean that it is destined to score bad in all dimensions. It rather means that in numerous dimensions a SSE fails to have a good score managing the country at national level. Thus, several questions arise to help find a solution that could lead to (welfare) development through a better international insertion. For instance, who would have thought that the number of cities would affect the power of negotiation or the degree of internationalization of a country? How can a low level of governance reduce internationalization? How could SPS/TBT barriers affect more the SSE than LSE countries? And how could a SSE reach development through international insertion?. Well, the answer is in this typology that we defined to be a main description of the SSE.

## **1.2 Challenges: orthodox and non-orthodox**

The changes to the economic modes of SSE have been rather cyclic in the past. Mixes of liberal and social models were used to find development and internationalization in the past eighty years. 1930 was a liberal period of outward-oriented growth with intensified changes that brought about new structural transformation. The complete reverse came in the 1950s and early 1960s when a social model in the region promoted agriculture for the domestic market; thus, endogenous development reigned in this phase. However, since the 1960s subsistence crops, which were mainly produced by the peasant sector, grew at a much lower rate than export crops<sup>24</sup>, produced largely by the medium and large commercial farm sector. Liberalization was promoted in the 60s with a petrodollar period that brought private capital and stimulated export. However, the liberalization period ended in the 70s when dictatorship governments in the region tried to implement the State-driven import-substitution-industrialization (ISI) development strategy. By then, Latin America was basically cut off from private international financial markets because of the dictatorships mentioned above. Hence, they relied on official capital flows for industrialization from World Bank, IADB and the IMF. These countries had soaring

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<sup>24</sup> Export crops such as soja started to gain space between other traditional crops that diversified and assured food sovereignty for the SSE. Since the 1960s, agriculture has aggravated social injustice and concentrated capital and land management in the hands of a few companies, supplanting traditional crops and changing the landscape to monocultures.



economies at the time (particularly with the high oil prices) so the creditors were happy to continue providing loans. These uncontrolled loans created a large fiscal deficit that resulted from three worrisome developments: a) real exchange rates were extremely appreciated, hurting export's competitiveness, b) domestic savings remained flat, at rates inconsistent with sustainable rapid growth, and c) a large proportion of the capital inflows were being used to finance consumption and investment projects of doubtful quality. These funds were intermediated by banks that were subject to little supervision and quickly became the Achilles heel of these economies.

The shift away from ISI towards a new outward-oriented development strategy in 1987 further integrated the Latin American agricultural sector into the world economy and has been accelerated by the process of globalization. Agriculture that provided a major share to Latin America declined substantially its contribution in the 1970s and 1980s towards the ISI program. Agricultural exports that accounted for 44% of the total exports in the 1970s declined to 24% until the 1990s (ECLAC 1993:81). In the 1990s a new phase of deregulation and market driven process started in order to solve the debt crisis and reduce the protectionism for imports installed during the ISI period. This phase introduced the Washington Consensus so that the SSE could adopt 'Structural Adjustment Programs' that stimulated agricultural and other exports in the hope that these would alleviate Latin America's foreign exchange and international debt problems. As a result of the export drive, agricultural exports as well as other traditional products have been increasing against a decrease in the supply for the domestic market causing a twofold problem.

The first one is that national market could not have access to products that were produced locally since it was more profitable to export rather than trying to reach different small local markets (costly to deliver). The second problem is that exporting products were directed to niche markets within a small number of partner countries, mainly U.S. This endorses dependency towards few trade partners that could define the quantity and quality of the products. Moreover, when exporting, SSE face several Sanitary and phytosanitary measures (SPS) and Technical Barriers to Trade (TBT) concerning the application of food safety and animal and plant health regulations which entered into force with the establishment of the WTO since 1995. The negative

side of this situation was that these measures were also used as a barrier for exports, since sometimes these measures were hidden in non-transparent norms or they were too difficult to internalize for SSE. It is for this reason that the UN Secretariat and The United Nations Conference on Trade and Development (Unctad) have commented on and acknowledged the difficulties faced by DCs in meeting their obligations under these agreements (WTO, 1998e, 1998f; Unctad, 1998) without any solution at present time. In the other aspect, Unctad XII in Accra (2008) explained how depending on a few primary products seals and perpetuates poverty on DCs drawing attention to three features of commodity markets that could keep nations in poverty forever. First one is the unpredictability of international prices. Second is the belief that over the long term period prices of primary commodities go down in comparison to prices of goods with added value. The third feature explains that there exists a tendency to concentrate industrialized products and its exports in developed countries submitting them to a higher dependency. These three features reduce the power of negotiation for SSE at the WTO or other IEOs. Unfortunately, this affects the SSE in negative ways because they depend on imports for their local consumption and they need partners for their exports (see typology). Then, an increase in the international prices provokes national inflation and reduces local consumption which leads to poverty. In addition, excessive SPS/TBT normative impedes SSE to keep exporting due to constraints in the supply side (production and financial). These two impediments impact negatively the power of negotiation and effective participation in the agreements.

Since SSE have a small scale production and have difficulties to internalize the SPS/TBT normative, several arguments were created to support the idea of exporting under Special and differential treatment (SDT) first, rather than for national markets, in order to have more income for the country; and other arguments were recently created to support the non-orthodox idea to supply the national market first and what is left for export. Within the first idea, the objective was to meet the orthodox framework that argues in favor of liberalization of trade to reach development. SSE countries have been trying to come across the best pathway to find international insertion that could lead to development. For this, the internationalization of U.S. throughout the neoliberalization of the economy was often recommended as part of “the American dream”. Then, an orthodox path was often followed signing different types of integration agreements with a SDT approach. Even when a socialist country

would come to power, trade agreements would still follow the orthodox path "Free trade is the best policy because, in part, the gains are larger than the losses" (Mankiw, 2004). According to the UN, multilateralism is marked by the universal tradition of idealism, liberalism and democracy as a range of factors that can motivate trade development, prosperity, and transfer democratic and neoliberal values considered as universal which could in the future help in the political negotiation between countries. Multilateralism was promoted as the most orthodox model for development. Regional and bilateral agreements would be another way to reach multilateralisation at a slow pace. Then, development would arrive to a SSE country if they would follow all the Structural Adjustment Programs promoted by the Washington Consensus. The application of free trade without development generated skepticism by saying that liberalization brought more losses and poverty than gains to SSE. Worst, trade agreements that are examined by the CRTA-WTO<sup>25</sup> keep benefiting interest groups of LSE to pursuit their own trade agendas. Even when the main objective of multilateralism is liberalization of trade for development, the WTO has failed to reduce the new protectionism of developed countries and has failed to increase the exercise of intellectual and political leadership of DCs or even a proper<sup>26</sup> participation of SSE in trade negotiations or lengthy stalemates as during the DOHA Round (2001-2008). Unctad XI in Sao Paulo knew about this and seemed to have focused in multilateralisation that includes the agenda of the South in matters of trade and development in 2004; however, by 2008, Unctad XII-Accra presented another position alleging that it would only assist in "research" and provision of "technical assistance" to DCs. Trade agreements managed by LSE from developed countries oriented the WTO and IEOs on global rules which failed to push development and international insertion for SSE. And this is what pushed SSE to explore other non-orthodox models.

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<sup>25</sup> CRTA stands for Committee on Regional Trade Agreements. In February 1996, the WTO General Council established the CRTA and its two principal duties are to examine individual regional agreements; and to consider the systemic implications of the agreements for the multilateral trading system and the relationship between them. The Committee agreed to deal with "systemic issues" (questions of cross-cutting concern) under a three-pronged approach, encompassing (i) legal analyses of relevant WTO provisions; (ii) horizontal comparisons of RTAs; and (iii) a debate on the context and economic aspects of Regional Trade Agreements (RTAs).

<sup>26</sup> By proper we mean not only signing a trade agreement but being able to influence its content and main agenda so that it can include the needs of SSE.

Since 2006, SSE experienced a government oriented to a socialist model. Consequently, a non-orthodox pathway is being created in order to find a better way to develop effectively and to have a solid international insertion. Multilateralisation with the U.S. as a leader is being rejected, leaving space for regional and bilateral agreements signed under a new system that may conflict with the WTO rules. The difference with the Regional Trade Agreements (RTAs) of today is that these are not based on an orthodox agenda that could push towards a multilateral world. It is held mostly by an endogenous development supported by LSE-from developing countries<sup>27</sup> that have a similar need; pushing up internationalization through strategic products that could bring high sources of income to the country. These agreements are settled on a socialist ideology that unifies the needs of the SSE with LSE-developing countries in order to cooperate with each other on the pursuit of similar objectives. This has motivated nationalization in some of the SSE (like Bolivia and Ecuador) with the belief that state-owned monopolies can assure welfare and a better income distribution. This new vision for internationalization gives priority to “*a development through a national integration*” instead of “*a development through exports*”. A national integration promises equal development rather than the orthodox path that was followed for several years. The non-orthodox path bases its strength on the common vision for cooperation between countries of the same level of development. Ideology plays an important role in the agreements, since ideology is pushing countries together towards a reduction of social unrest through the increased participation of the State in the main sovereign decisions of the country. Of course, this is a new trial of cooperation between SSE and neighboring countries and there are many challenges to face still, as we will present, in detail, in chapter 4 and 5. This fact shows how easily SSE can switch from one suggested model to another. Orthodox and non-orthodox models are very popular according to time cycle. The population agrees to swap from one model to another in the hope to reach development through a better international insertion.

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<sup>27</sup> LSE from developing countries would be Argentina, Brazil and Venezuela in South America; China and India in Asia.

## Chapter 2

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### SSE: Multilateral Options

SSE now have two options of multilateralism. The first one is to integrate the existing political and economic system under the Washington Consensus. The other option is to join the political system that China proposes with the Beijing Consensus. In this chapter we will analyze these two options paying special attention to the political capacity of negotiation of a SSE to include its needs and special requirements in the multilateral agenda. In this sense, we will be able to concentrate in weak and strong governments for negotiation at the multilateral arena.

Consensus regulations were implemented through the IMF to be able to receive a credit loan are also known as the stabilization policies and the structural policies. The first measures introduced the concepts of a reduction of the public investment, and on the other hand, an investment in infrastructure in order to be able to pay the international debt first. The other regulation consists on paying attention to measures that would ease FDI as the liberalization of capital flows and financial system. Both types of measures dealt with going back to the market laws to be able to have an internationalization of its economy and to reach development<sup>28</sup>. Hence, SSE had to adapt these and other structural policies that would adjust its supply conditions for an economic growth in the short and long term. These rules were followed blindly by the SSE of South America. Besides, the U.S. as the main leader of the region advised SSE to privatize only the most attractive companies since otherwise, the multinational companies would not be attracted to the privatization call. As a result, the decade of the 90s, public investment fell and privatizations occurred in the most attractive

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<sup>28</sup> Most of South American countries were coming out of dictatorship governments which took the country to hyperinflation and very negative payment balance. These countries were starting to have a democratic opening just after military dictatorships but most of them were not able to pay the international debt contracted by the precedent dictatorship government. The IMF and the World Bank are blamed for supporting military dictators with millions of dollars of loans and credit that were denied to previous democratically-elected governments (More information can be found at: "Dictators and debt". Jubilee 2000. <http://www.jubileeresearch.org/analysis/reports/dictatorsreport.htm>. Retrieved on 21 September 2007).

natural monopolist companies of the country (i.e. hydrocarbons, telecommunications, etc.). Therefore, countries like Bolivia offered their companies to the market at the lowest price possible. Bolivia also accepted to follow some political and economic structural reforms like long term investments, education and health. The idea behind this was to have a country better prepared to attract and receive FDI. Luring FDI into a SSE from a developed country was focused in the creation of numerous beneficial factors for the foreign companies so these could bring up investment flows. SSE were moved to increase productivity for a higher rate of exports and a better national consumption. However, after 15 years, SSE started to realize that they did not reach development or more international insertion. Worst yet, these actions of free market and structural reforms seemed to increase poverty. This is one of the main reasons why SSE decided to move towards a non-orthodox multilateralisation. As we will present in this chapter, the reality for SSE that have blindly applied the Consensus of Washington shows contradictory results when we take into consideration what was predicted at first. After more than a decade, the results were not encouraging and did not take to economic growth. Quite the opposite, all outcomes lead to a general feeling of disillusionment (Stiglitz, 2003) and towards the formulation of new economic and political options as we will also outline in this chapter.

The other option for multilateralisation is under the Beijing Consensus. It refutes Western notions of political liberalization or economic reforms as indispensable for long-term and for sustained development. It is also skeptical about the benefits of privatization and free trade. Multilateralism is promoted so that nations can fit into the global system choosing their own pathway according to their needs and own sovereignty. The Beijing Consensus is as much about social as economic and political change, using economics and governance to improve the society. With this, China seeks to promote multipolarity to restrict U.S. pre-eminence through the increasing participation in multilateral organizations including the UN, the World Bank, the IMF, but also with other regional organizations, such as the civil, security and military sectors. Its increased participation in existing global organizations constitutes a hope for DCs to have an equal say in determining the future of the world. This is what disturbs the traditional multilateralism that is not always happy with the influence that China and its Beijing Consensus is having between developing countries.

The first part will outline the application of the Washington Consensus in the SSE and will present the Structural Adjustment Programs that were needed from the SSE at an economic and political level. Next, an examination about the compatibility between development and the Washington Consensus will be explained and described. The idea is to present all the relations between the Washington Consensus and the neoliberal policies that were implemented in the SSE regarding a future multilateralism. The second half of this chapter will analyze the Beijing Consensus. This section will describe the self determination programs and their compatibility with development. The conclusions of this part show us that despite of the application of the Consensus, the SSE could not find economic growth and development through multilateralization because of the type of participation that small economies have at the heart of IEOs and the lack of power within the multilateral structure. With the creation of a new option for multilateralization, SSE are joining forces with relative larger economies from developing countries (Brazil, China) for a common voice and vision for international insertion and a more beneficial structure of trade. This part will mainly focus in the political capacity of governments for negotiation in both types of multilateral options and check the convinience of each of them to their international insertion.

## **2.1 The Washington Consensus**

In the 70s, the SSE joined a new orthodoxy with a new structural development oriented towards endogenous development and finding the necessary financing for this development. International debt service multiplied ten times between 1970 and 1980 and represented 40% of the exports of Latin America (Abbas, 2005). The 70-80s were very difficult for the SSE because of hyperinflation, high international debts, corruption, dictatorships and social unrest. SSE as well as the other countries in the region needed an economic and political reform to manage the internal and international debt crisis. The application of the Washington Consensus at that time seemed logical because it was based on the free market economy. It signified a switch to neoliberalism that promised a rapid growth through international insertion, export-orientation and other economic reforms. These reforms were based on three general axes: macroeconomic discipline, a market economy and openness and insertion to the

world (trade and FDI). This meant relying on an international integration as the only mean to improve the national economic system. The type of development that was followed by the SSE focused on an auto-centered development with industrialization by substitution of imports (ISI) and a protectionist state that looked towards an open-economy oriented to free-trade and based on comparative advantages and equal treatment for all partners. The Washington Consensus was a way to settle a hegemonic vision for development that the U.S. had within a multilateral agreement framework. This period ended the *industrial import substitution program* (ISI) that was effective in the 80s.

Over the 90s, all the Latin American countries had to apply the Structural Adjustment Programs. These prescriptions were initially coined in 1989 by John Williamson to describe a set of ten specific economic policy recommendations. Each prescription contained a detailed list of strategies that he considered to be a reform package, although the IMF and WB went further in pursuit of these principles than Williamson enounced (Abbas, 2005). The main idea in this Consensus was to eliminate debt crisis in the developing countries of Latin America; thus, it was widely promoted by the IMF and World Bank as part of a multilateral agreement. The SSE, more than any other country followed the directive lines blindly. The reasons for this blind chase are diverse. One of them could be attributed to the small size government SSE have regarding the number of personnel to apply the specific economic policies; or the capacity of the people to analyze or adapt them to the reality of the country (Council on Hemispheric Affairs, 2005).

This section will present the Structural Adjustment Programs that the SSE went through in order to internationalize their economies successfully and to find the development promised by multilateral economic organizations (IEOs). It will also make a comparative analysis between the structural programs and its compatibility with the development programs that the Beijing Consensus proposes. Finally, it will show the degree of attractiveness of an SSE towards trade and foreign direct investment.



## **A. Structural Adjustment Programs**

Structural Adjustment Programs were based on the liberalization of the financial system and trade alongside the idea of a reduction of the government intervention through privatization of the public companies and measures to reduce the hyperinflation. In 1990, SSE started with the application of economic and political reforms. SSE believed that with a better internationalization these economies could grow and reach development through internationalization. The idea was that export-orientation, a free financial system and a series of national structural adjustments would clear up all economic problems from the 70-80s. The IEOs claimed that an opening of the financial system in the country would attract and increase FDI-inflows and FDI-outflows. This would impact positively in the increase of the productivity of the domestic companies and would have a positive effect in the internationalization of the economy. This is why from early 90s all SSE began to liberalize their regimes for foreign investment. This reform motivated the government to redefine preferences, social urgencies and cut public expenditures to leave an open space for private and multinational companies through FDI. Therefore, privatization of public companies came to place together with the liberalization of the market and the financial system.

In Bolivia, with the help of Planning Minister and future President Gonzalo Sánchez de Lozada, the 78-year old Estenssoro (President at the time) implemented a harsh series of austerity measures drafted by students of Jeffrey Sachs, who at that time attended Harvard University. During this process, the power and profits of key resource industries were concentrated in the hands of an elite minority of owners in the eastern lowlands and abroad. Although the political left wing was against these actions, they were unable to present any sort of formidable resistance or alternative model. The result was the best and worst of free markets. Inflation rates dropped from a whopping 8,170 percent to a more manageable 9 percent within a year. Meanwhile 35,000 factory workers and 20,000 miners lost their jobs due to privatization. This, together with a downturn in global tin prices and soaring cost of commodities in Bolivia, caused the middle class to slip into poverty and thousands were forced to relocate in search of work. According to journalist Benjamin Dangle, the displacement of Bolivia's once-radical, now-unemployed working class served to "spread the embers of the fire around Bolivia". When the idea of privatization arrived

to this nation, it was said that it was going to get rid of inefficient public expenditures in companies that could be managed better by multinationals. However, the Washington Consensus did not consider that the power of negotiation of multinationals would be greater than the power of negotiation of SSE. Some multinationals that were attracted with privatizations were financially larger (in assets) than the entire SSE economy (in GDP) and the amount of money inflow had a great impact on the national economy<sup>29</sup>. The control over the media announced that SSE would go through different structural adjustments (Washington Consensus) to be able to attract FDI; the failure of this implementation would result in low prices offered in the bid for their public companies. SSE were afraid that their public companies could not attract big multinationals. This led the governments to ask for a low bid price underestimating their assets. Besides, the government enacted simple regulations without restrictions on FDI-inflows or FDI-outflows and with low exploitation taxes to not panic away multinationals.

Beginning of 2000, the SSE noticed that the measures of the Washington Consensus did not achieve its promises. National income was reduced due to the fact that the most attractive natural monopolist companies were privatized. This meant two things. On one side, the income that the best companies brought to the government in taxes was lost at privatization as well as the control of the extension of services to the population. On the other side, the less attractive public companies were kept by the government since they were neither profitable nor inviting for multinational investment (for instance: telecommunications<sup>30</sup>, road toll, etc.). Multinationals did not carry out their contracts in terms of socializing and enlarging the provision of services to the population. Moreover, multinationals negotiated a good taxing frame structure and with this measure these companies could exploit and produce the service under low taxes, leaving the SSE in the same situation as they were during times of colonization: *exploitation and extraction enclaves*<sup>31</sup>.

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<sup>29</sup> In Bolivia, the privatization capital that arrived in 1995 represented 10% of the national GDP. For instance, Suez France that acquired Aguas de Bolivia had 235 billion dollars in assets while Bolivia's GDP was 10301 million dollars, both by year 2006.

<sup>30</sup> Telecommunications in Ecuador (EMETEL) did not attract any FDI since it evaded taxes for about 70% of its assets. The same occurred with other companies that were not a natural monopoly for FDI-inflows.

<sup>31</sup> For instance, Petroecuador had a tax exemption for exploitation and profit. In Bolivia, until 2004, 11 out of 18 oil companies such as Bolivian Refinery, Bolivian Distribución SA, Dispetro, Copenac Ltda. and Sergas declared zero profit since they started work (from 2000 until 2004) to avoid paying taxes.

In terms of exports and welfare, SSE did not improve after privatization as much as these companies promised. With the exception of telecommunications, the other sectors did not invest as much as they promised. In the case of train stations, Bolivia for instance, kept the two train stations, the Oriental and the Andean lines that were created in times of colonization with the purpose of extracting minerals for Europe. These lines were constructed for mining extraction purposes to sustain the demands of Brazil or Chile and they went out from the mines to neighbor countries, without crossing Bolivian populations, one going to the border of Brazil and the other one going to the border of Argentina. There is no connection inside the country; lines only orientate the population to move to the outskirts of the country. Chile, the country that privatized the train lines in Bolivia maintained the disconnected nature of travel<sup>32</sup> without any reinvestment.

Another case privatization in Bolivia was that of the Bolivian Airline (LAB in Spanish). LAB was privatized by the Brazilian Viacao Aérea Sao Paulo (VASP). VASP took advantage of the lack of control from the Bolivian government, the free financial system and FDI regulations and dismantled the financial structure of the company. The multinational consulting companies Triade and Berthin Amengual held an external auditing but never revealed the anomalies that were carried out in the administration of LAB, fruit of its privatization in 1994 until 2001. This is why the Bolivian government took seven years to charge VASP for tax evasion and social security evasion. The decentralized government had no right to neither ask nor receive official information from the privatized company. VASP also avoided presenting reports to the Pension Fund Administration (AFP from Spanish), Superintendence of Transport and Pensions or the administrator of insurances. The President of the legislative commission, Jerjes Justiniano (2002), concluded that a real and thorough supervision never existed<sup>33</sup>. Currently Bolivia has no national airline and the only private airline that exists also abuses its monopoly position without paying taxes or fines to the government by threatening to close down their flights and services.

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<sup>32</sup> Lines in Railways with Argentina are different in the width and speed capacities (with 5 foot 6 inch gauge). This is problematic with Argentina to have a common and continuous connection. With Chile it is remaining the connection with Calama despite the geopolitical discontent.

<sup>33</sup> Bolivia Hoy Journal, 2002. "Ni las AFP sabían cómo manejaba Canhedo el LAB". Posted on Dec 17<sup>th</sup> 2002. URL: [www.boliviahoy.com/modules/news/article.php?storyid=2993](http://www.boliviahoy.com/modules/news/article.php?storyid=2993), accessed on Sept, 2008.

After a decade with multinationals and privatization in the SSE, corporations have gained a stronghold over the SSE economy, some taking huge advantages of negotiation. First, naturally monopolistic companies were granted privileges to keep their monopoly for numerous years. For example in Bolivia telecommunications ENTEL had 6 years of monopoly; LAB airlines had 7 years granted by law No 1632<sup>34</sup>. Similar case occurred in Ecuador: Petroecuador –oil company had first 99% of the profit for the company and 1% for the State, later it was changed to a 50-50 profit division; Water Guayaquil was granted to do half of its investments from what it could charge the consumers by water bills or from taxes that the government could charge on behalf of the company<sup>35</sup>). This mainly occurred because the Washington Consensus did not take into account that some SSE had no power to negotiate with larger companies that had bigger assets than their own economy (GDP). Besides, some elements were not clearly understood, like the fact that the number of personnel and their capacity for good governance, and control of the process of privatization without corruption and performance was not enough for an SSE. Worst yet, the reinvestments that had to be done had to be intoned with the income that the TNCs would acquire from the service that was offered, and this proved to be out of the hands of the government. In some sectors many multinationals did not reinvest after privatization. Moreover, the price of services increased becoming too expensive for the poor. It is true that in this period, FDI accounted for more than 80 per cent of the net private capital flows into the region (Levy Yegati et. al., 2007). This capital inflow boosted the amount of financial assets coming towards SSE, from European and U.S. investors especially as in Table 2-1.

**Table 2-1. FDI: Number of companies, price of acquisition and impact of privatization in Bolivia.** SSE are more dependent to international investment due to small ciphers they have as GDP. The amount of money that flew to Bolivia impacted with 26% over the GDP.

Company	Year	Price in million USD	Multinational Companies	% Privatization over the GDP
ENDE	1995	140	Dominion Energy; Energy Initiatives Inc.; Constellation Energy	
ENFE	1995	40	Cruz Blanca S.A.	
ENTEL	1995	610	STET Internationale, Italia	
LAB	1995	47.5	Viaçao Aerea Sao Paulo	
YPFB	1996	834.9	AMOCO; YPF, Pérez Compac; PLUSPETROL; Enron; Shell	
<b>Total FDI Bolivia</b>		<b>1,672</b>		<b>26%</b>

Source: Own calculations based on ECLAC, Santiago, 2000.

<sup>34</sup> Ministerio de Capitalización, 1997. Capitalización en Bolivia. Ministerio de Capitalización. La Paz.

<sup>35</sup> Journal: En Marcha, 2008. Interagua Guayaquil. Accessed on September 12<sup>th</sup>, 2008. URL: [www.pcmle.org/EM/article.php3?id\\_article=975](http://www.pcmle.org/EM/article.php3?id_article=975)

In the case of Bolivia, the privatization brought FDI from United States, Europe, Brazil and Chile as we can observe in the table above. This financial inflow represented 26% of the total GDP. It is true that it is difficult to say if privatization alone promoted growth or if there were different policies that played a hand in this process. The truth is that the GDP grew after this inflow going from -0.75% GDP year growth, in the decade 1980-1990 to an annual average growth of 3% (1995-2005). SSE countries were heavily influenced by privatization because the flow of money represented a high income compared to their GDP. And the fact of receiving a lot of FDI inflow might have been one of the reasons that led SSE to a reduction of negotiation power against TNCs and the lots of benefits the SSE granted them.

**Table 2-2. South America: Income due to Privatization and GDP growth (1990 - 2000).**

Bolivia is one of the countries who benefited the less of the period of privatizations. Other countries (Ecuador and Uruguay included) had a minor income representing around 5% of the total income in the region by privatizations. SSE had a greater impact over their GDP than a larger economy as Brazil.

*(in million dollars)*

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000e	Total
Argentina	7532	2841	5741	4670	894	1208	1033	969	598	4082	309	<b>29877</b>
Bolivia	-	-	9	13	-	789	874	...	...	137	27	<b>1849</b>
Brazil	44	1633	2401	2621	2104	992	3752	17400	36600	4440	12260	<b>84247</b>
Chile	98	364	8	106	128	13	579	12	186	1434	429	<b>3357</b>
Colombia	117	168	5	391	170	138	1476	3180	470	292	433	<b>6840</b>
Peru	-	3	212	127	2840	1276	2669	681	292	301	380	<b>8781</b>
Venezuela	10	2278	140	36	8	39	2090	1505	174	37	23	<b>6340</b>
Others	71	147	120	393	1289	132	68	837	3390	1291	305	<b>8043</b>
<b>Total</b>	<b>7872</b>	<b>7434</b>	<b>8636</b>	<b>8357</b>	<b>7433</b>	<b>4587</b>	<b>12541</b>	<b>24584</b>	<b>41710</b>	<b>12014</b>	<b>14166</b>	<b>149334</b>

*(in percentage compared to their GDP)*

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000e	Total
Argentina	5.33	1.50	2.51	1.97	0.35	0.47	0.38	0.33	0.20	1.44	0.11	<b>14.6</b>
Bolivia	-	-	0.16	0.23	-	11.75	11.82	-	-	1.65	0.32	<b>25.9</b>
Brazil	0.01	0.40	0.61	0.60	0.39	0.14	0.48	2.15	4.65	0.83	2.04	<b>12.3</b>
Chile	0.29	0.95	0.02	0.22	0.23	0.02	0.76	0.01	0.23	1.96	0.57	<b>5.3</b>
Colombia	0.25	0.34	0.01	0.65	0.21	0.15	1.52	2.98	0.48	0.34	0.52	<b>7.4</b>
Peru	-	0.01	0.59	0.36	6.32	2.38	4.78	1.15	0.51	0.58	0.71	<b>17.4</b>
Venezuela	0.02	4.40	0.24	0.06	0.01	0.05	3.06	1.75	0.19	0.04	0.02	<b>9.9</b>
Others	0.29	0.52	0.37	1.08	3.00	0.28	0.13	1.54	6.33	2.88	0.71	<b>17.1</b>
<b>Total</b>	<b>6.19</b>	<b>8.12</b>	<b>4.51</b>	<b>5.17</b>	<b>10.51</b>	<b>15.23</b>	<b>22.94</b>	<b>9.93</b>	<b>12.59</b>	<b>9.72</b>	<b>4.99</b>	<b>109.9</b>

Source: Own calculations based on World Bank, Global Development Finance, 1998, pp. 104 (for 1990-1995). ECLAC, 2000-2001, Santiago de Chile, 2002 (for 1996-2000). Unctad Statistics 2010 for the GDP.

Different countries in South America took the same measures for privatization in their search to attract FDI towards their economies (Table 2-2) but the SSE had the highest impact of financial inflow compared to the size of their economy. The exception to

this process of privatization was Paraguay, where privatization was not allowed by the congress, and also Ecuador, that had reduced privatizations due to the modest attraction of FDI in its sectors because of the quantity of shares (less than 35%) that the government wanted to offer for privatization (Eclac, 2000). Table 2-2 also allows us to compare the FDI over the GDP of each state, small or large. Clearly, it is visible that Brazil and Bolivia received practically the same FDI amount in 1994. But for Bolivia, this investment represented 26% of its GDP while for Brazil it only represented 0.14%. Some researchers (UNESCAP, 1985) think that the results of this privatization were to be applauded due to a greater efficiency and supply of services and products; others (Daniels, Krug and Trevino, 2007; IMF forum, 2002) think that the privatizations only brought higher social differences regarding the access to services and products being that the prizes were higher in companies that were privatized. Others claim that it has increased the lesser-developed nations' dependence on FDI. Both results could be true, services were improved but prices were increased as well. Still the impact on welfare and development is not that simple to evaluate for certain groups since there are two positions between the academics and the governments. In spite of that, the negative effects provoked social problems and conflicts at a national level against FDI and the corruption that spawned in the national government that was strictly looking for its own benefits and not the social and national wellbeing.

Rodrik and Rodriguez (2000) mention that FDI is not always good for developing countries being that these nations would first need to have a good level of governance to benefit from openness. Rodrik and Subramanian (2008) also mention that current events have showed that financial globalization has not generated increased investment or higher growth in developing markets. Financial globalization has not led to welfare or a reduced volatility of the economies. Rodrik suggested that a good governance environment was necessary to reach a well functioning market with a better application of the Consensus and more respect to the WTO's idea of free trade. This idea, at the time, did not question the Washington Consensus; it was more a supplement to all the existing rules that focused more on strengthening the public institutions. Nonetheless, few researchers could really see that SSE did not benefit from this Consensus in time, and after applying several imposed measures development was still slow, privatizations did not bring the expected results and fruits

of the labor were not visible: Globalization and its discontents, as the Nobel Prize Joseph Stiglitz mentioned in his book about the imposed policies of the Washington Consensus. Besides all, the negotiation power of the SSE was weak and some even lacked capacity to internalize which rules to apply and which not. Furthermore, the number of personnel from SSE staying in Geneva or New York (as both cities are headquarters of main IEOs) where multilateral negotiation take place, is not enough to manage the constant negotiations held daily by IEO. In addition, the initiatives of development from the SSE are submitted to the conditionality of the IMF that pushes the indebted countries to apply the structural political adjustment defined by IEOs. The dominance of the U.S. was fundamental in pushing the SSE to apply the suggestions of the IMF under a common order, which the U.S. wanted to achieve in the region. This was rather easy since all Latin countries wanted to achieve the same level of development that the U.S. maintained. So, based on this ideal, all countries followed the structural political adjustments beginning with the liberalization of national markets, liberalization of financial systems and the cutting of public investment in the long term: health, education and infrastructure. SSE began to liberalize their regimes for foreign investment. SSE then pursued unilaterally or through regional, bilateral trade or investment agreements, a typical set of reforms. These reforms included the elimination of performance requirements for export (i.e. to keep a percentage for its national market) restrictions on the ability to exclude certain sectors from FDI to "screen" foreign investment for development goals, limitations on the ability to require joint ventures or research and development facilities, and so forth. Moreover, the reforms altered the nature of settling disputes over the FDI, benefiting the foreign investor at all times by protecting them against a government that had the capability to protest or nationalize the companies that were performing poorly. This would not give any chance to a SSE to protest at an international level since multilateral agreements on FDI do not deal with these issues.

Whereas trade agreements have traditionally relied on States to settle disputes among themselves in international forums, newer trade and investor agreements have "investor-state" dispute systems where foreign firms can directly prosecute a national or local government without the need for a host government oversight. These policies were advocated by the U.S. government, the WB and the IMF and endorsed enthusiastically by many governments across the Americas. These new regulations

back up FDI regulations by the ICSID and other IEOs. FDI even became more protected in the 1994 with NAFTA, CAFTA, bilateral agreements with Peru and Chile and other Bilateral Investment Treaties (BITS) as was the case with Uruguay. The U.S. goal is to protect its national investors overseas as part of its hegemony plan over the continent.

But the notorious ultra-liberal conditionalities that marked the structural adjustment programmes of the 90s are still being practised. An example of this, gives testimony of the contradictions that the World Bank and the IMF have, and the social resistance that these oppositions have ensued. In Ecuador, a popular uprising that called for a resistance against the decrees of the IMF and WB was responsible for the fall of President Lucio Gutierrez in April 2005. The government of the new president, Alfredo Palacio, has proved to be touchier on the subject of economic sovereignty, much to the displeasure of these IEOs. It must be noted that in 2000, Ecuador abandoned its domestic currency and switched to the U.S. dollar, thus becoming totally dependent on Washington's monetary policy. In July 2005, the government decided to reform the use of oil resources and instead of being entirely earmarked for paying back the debt, part of those resources were put aside to fund social programmes, notably for the often under-privileged indigenous communities. To show its displeasure, the WB withheld a \$100 million loan to Ecuador. Rafael Correa, the popular finance minister who had initiated the reform, stated: "*It is an offence against Ecuador*", nothing that "*no one has the right to punish a country for changing its own laws*" (Le Potentiel, 2006). In response, Ecuador looked for funding elsewhere: in Venezuela first, where President Hugo Chavez was willing to support such measures so he granted a \$300 million loan; and in China second, whose flourishing economy constantly requires increasing amounts of raw materials.

## **B. Attractiveness at present**

Different papers on FDI tell that Latin America has increased FDI flows in the last years and South-South investments have come to benefit their economies. Despite of the increase of FDI and trade flows in developing countries as a whole, or even in Latin America, these numbers are still much lower for SSE. To reveal this reality and



assess difficulties and challenges, it is necessary to separate the SSE from the group of developing countries, or to view them as a region. SSE have not raised FDI inflows, all the contrary, South-South investments have only come for extracting sectors, leaving out service sector which could benefit the development. Even though FDI has proven not to be effective in the times of privatization (90s) for SSE countries, it is still of great importance to their economies, perhaps more than to any other country. Attractiveness for FDI is important since SSE lack enough capital to invest in their own projects for industrialization in key sectors that could boost development and international insertion improving welfare. Besides, key sectors<sup>36</sup> and their exploitation require geophysical studies, know-how and technology which require large and long term investments. The fulfillment of this aspect is impossible for SSE since they lack large budgets to do this and if they did have this amount, it would probably have to be invested in social development first (healthcare and education). This is why, despite the numerous protests from the population against neoliberal policies, privatization occurred in the 90s and despite the nationalization of the majority of these companies in 2006, leftist governments called again for responsible FDI under new regulations. The difference between these two phases is that before 2006, the investment provisions<sup>37</sup> were used to serve one or more of three purposes - investment promotion and cooperation, liberalization and market access, and investment protection even when the International Investment Agreements (IIAs) did not assure compatibility with domestic investment laws in differends or complaints and when these agreements promoted the importance for foreign investment rather than national ones. Besides, the IIAs resulted in the transfer of the national sovereignty jurisdiction over contractual or commercial disputes between the State and natural or juridical persons to international arbitration authorities. On the other hand, from 2006, Ecuador and Bolivia decided to change their Investment Policy based on justice, solidarity and complementary. Further, this investment system promotes sovereignty and national investment (public especially) over

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<sup>36</sup> Key sectors in SSE mean the sectors which can generate more income to the country as energy, mining sector, telecommunications, etc. To push these sectors it is required investment and new laws. SSE, especially, Bolivia and Ecuador nationalized FDI because the government has the intention to export value added products instead of just raw materials. This income would allow more income and better international insertion. Besides, Bolivia has in its priorities to have and increased production for both: national consumption and added value products for international markets.

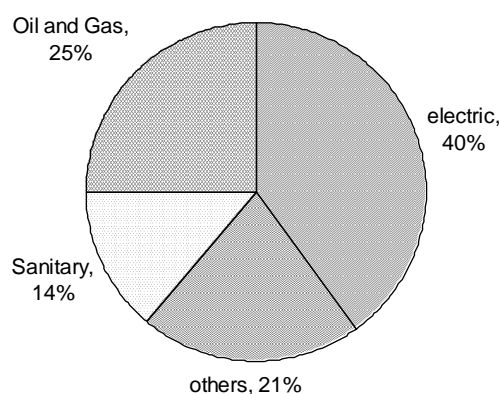
<sup>37</sup> According to the research of De Velde and Fahnbulleh (2003), there are three types of agreement that may relate specifically to investment or include provisions on investment: Bilateral investment treaties (BITs), Regional integration agreements (RIAs), multilateral treaties related to investment.

international investment, containing a better idea for exploitation/compensation and for income distribution/welfare policies for host countries. Despite this, SSE face the same challenges as right-wing governments in the past: *how to attract FDI for other sectors than energy and monopolist companies*.

Albeit, the regulation system was modified in two of the SSE, it seemed that this new regulation had a negative impact on the degree of attractiveness since traditional investors left the country. Regulatory changes and nationalization raised uncertainty among investors in the primary sector (hydrocarbons), potentially resulting in a further decrease in FDI inflows in 2007 and 2008<sup>38</sup>. Figure 2-1 (FDI-inflows with privatization) could be contrasted with table 2-3 (current FDI-inflows) in order to see how FDI reaches SSE for extractive natural resources or in monopoly companies.

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**Figure 2-1. South America: Privatizations by sector, 1999. (In percentage).** Three sectors were the ones that captured attention in the privatization period: electricity sector, oil and gas and sanitary sector with 79% of the total investments.



Source: ECLAC, Santiago, 2000.

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The current situation in SSE with FDI inflows in the last nine years (2000-2009) is presented in table 2-3. This table shows information on which sectors attract the most and who are the new players in the region and for the SSE. We can evidence in this table that SSE were not able to attract sufficient FDI inflows to boost their growth and international insertion. Consequently, SSE are now trying to associate with new types

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<sup>38</sup> Traditional investors (US, Spain, France) left Bolivia when it changed its regulation and are cautious in Ecuador. It is true that after these investors left, Venezuela and Brazil took these places but until now could not have the same level of investments yet.

of partners, leaving multilateral organizations and their legislation aside. Besides, up to now the sectors that bring FDI to SSE are just extractive.

**Table 2-3. SSE: FDI in million dollars, percentages of FDI performance and main sectors (2000-2009).** SSE have more FDI in primary sector, with the exception of Uruguay. The rest of the South American countries and partners have more varied FDI with especial growth in banking.

Country	Rank group	2000-2005		Main Sectors	2006-2009		Main Sectors
		Average in \$	Average in %GDP		Average in \$	Average in %GDP	
Argentina	5	57.693	32,88	food, beverages, tobacco, hydrocarbons, gas distribution, banks, telecommunications, electric power.	67.973	25,64	Industrial, banking
Bolivia	11	5.353	63,69	hydrocarbons, mining, gas distribution	5.534	40,33	hydrocarbons, mining, gas distribution
Brazil	3	136.747	21,63	telecommunications, chemicals, food, beverages, tobacco, electric power.	272.662	20,89	industrial, banking and financial
Chile	4	18.113	64,38	electricity, mining, banks, telecommunications, electric power, gas distribution.	93.591	58,36	electricity, mining, banks, telecommunications, electric power, gas distribution.
Colombia	6	21.132	22,57	mining, banks, electric power, gas distribution.	56.302	33,61	mining, banks, electric power, gas distribution.
Ecuador	9	8.105	31,32	hydrocarbons	10.586	23,30	hydrocarbons
Paraguay	12	1.148	17,89	agriculture	2.150	17,84	agriculture
Peru	8	12.920	20,81	mining, banks, telecommunications.	25.841	23,48	mining, banks, telecommunications.
Uruguay	10	2.108	13,99	retail, transport	6.348	25,47	retail, transport
Venezuela	7	40.302	36,98	telecommunications	43.592	18,55	oil
Cuba	13	80	0,21	--	151	0,17	--
United States	1	1.412.937	12,91	manufacture 35%, bank 18%, retail 16%, information 14%.	2.076.410	14,93	banking, retail, information
China	2	226.488	14,15	manufacture	332.576	9,62	manufacture and industrial

Main Sector: more detailed information was only available for the United States.

Source: Own calculations based on UNCTAD Statistics 2010, Geneva, 2010; main sectors from Eclac 2007 and Jackson 2005.

A number of studies have suggested that investment and growth in developing economies is positively associated with indicators of ‘openness’, export promotion and international insertion (Balasubramanyam et al., 1996). Such findings may suggest that investors prefer countries with relatively liberal trade regimes and few constraints on profit repatriation, possibly within regions with wider supra-national free trade arrangements. SSE have tried all these theoretical suggestions to improve their international insertion having a high degree of openness to trade and FDI protection, they comply with obligations required by the GATT/WTO and they

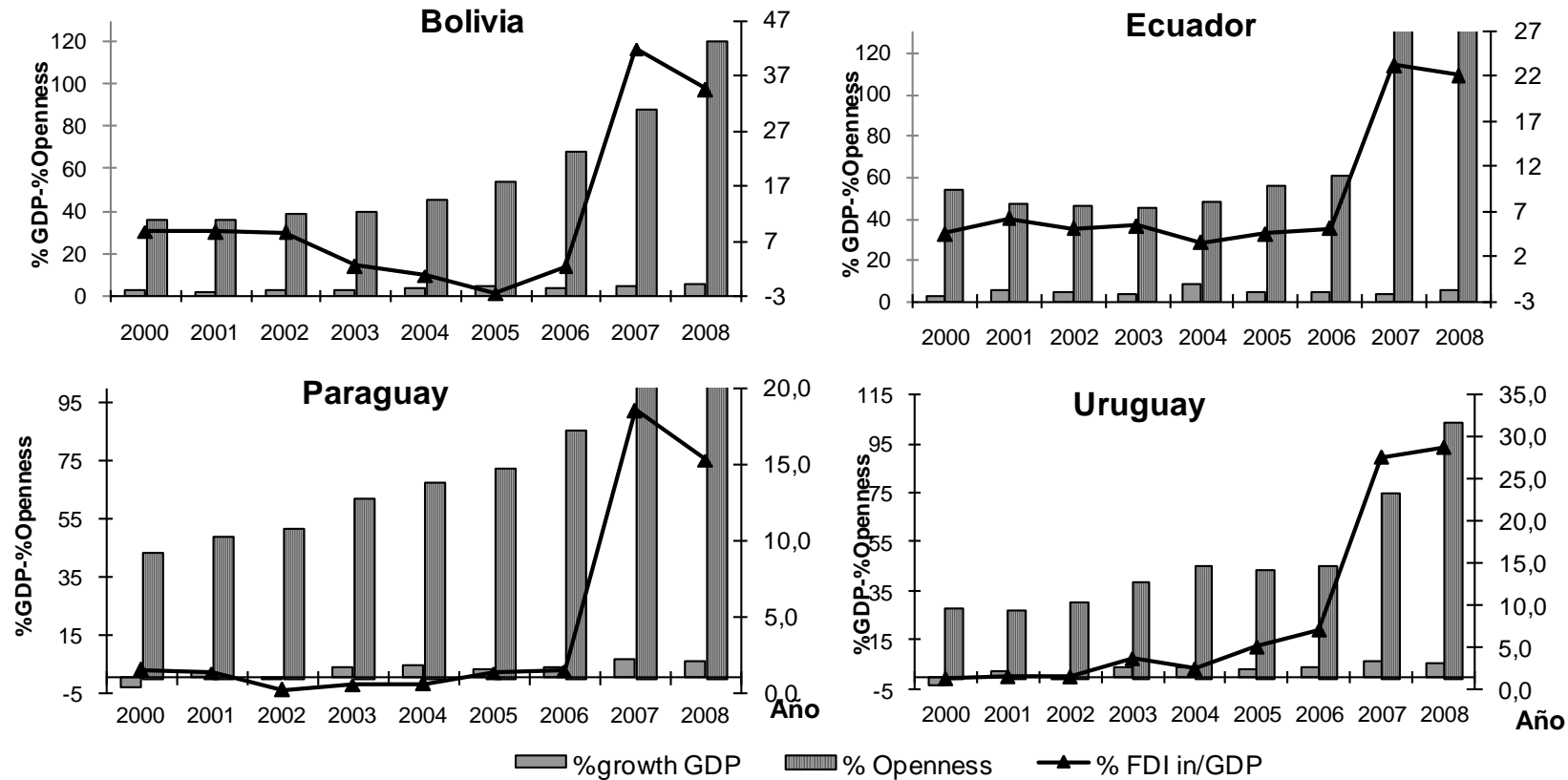
belong to International Centre for Settlement of Investment Disputes (ICSID)<sup>39</sup>. Some empirical investigations (Accolley, 2003) say that the effects of some macroeconomic variables such as economic growth, market size, degree of openness, real effective exchange rate, and labor cost have a positive influence and attract FDI flows towards a country. Other researchers suggest that the existence of local markets with business linkages may help (Bod, 1997). And another group claims that free trade policies can also affect flows (Barrell and Pain, 1998). In order to try to prove which could be the factors that attract or repel FDI in the SSE, we did an analysis on the following variables: economic growth, degree of openness and trade (see figure 2-2 and 2-3).

Unfortunately, available statistics do not differentiate exports and imports accounted with FDI. As we can observe in figure 2-2, FDI had a rise only during privatization. In the case of Bolivia, between 2005 and 2006, the FDI was high compared to other SSEs because it invited TNCs to exploit minerals (Jindal Steel from India) and extract gas (PDVSA from Venezuela and Petrobras from Brazil). Average growth rate of the GDP between 2000 and 2006 was 2.99% for Bolivia, 5.13% for Ecuador, 2.61% for Paraguay and 0.88% for Uruguay. If you compare the FDI-inflow and GDP growth is almost negligible compared to trade openness that the SSE gained during the same years: 45.70% for Bolivia, 51.19% for Ecuador, 61.75% for Paraguay and 37.34% for Uruguay. Figure 2-3 show the opposite in FDI inflows and GDP growth in LSE because it shows a constant flow. Besides, FDI-outwards over the GDP show an increase in the last 7 years: U.S. increased 0.55%, China 16.95% and Brazil 11.60%. It is important to mention that the role of Brazil and China on Africa and Latinamerican countries increased in their quest of raw materials for its economic growth.

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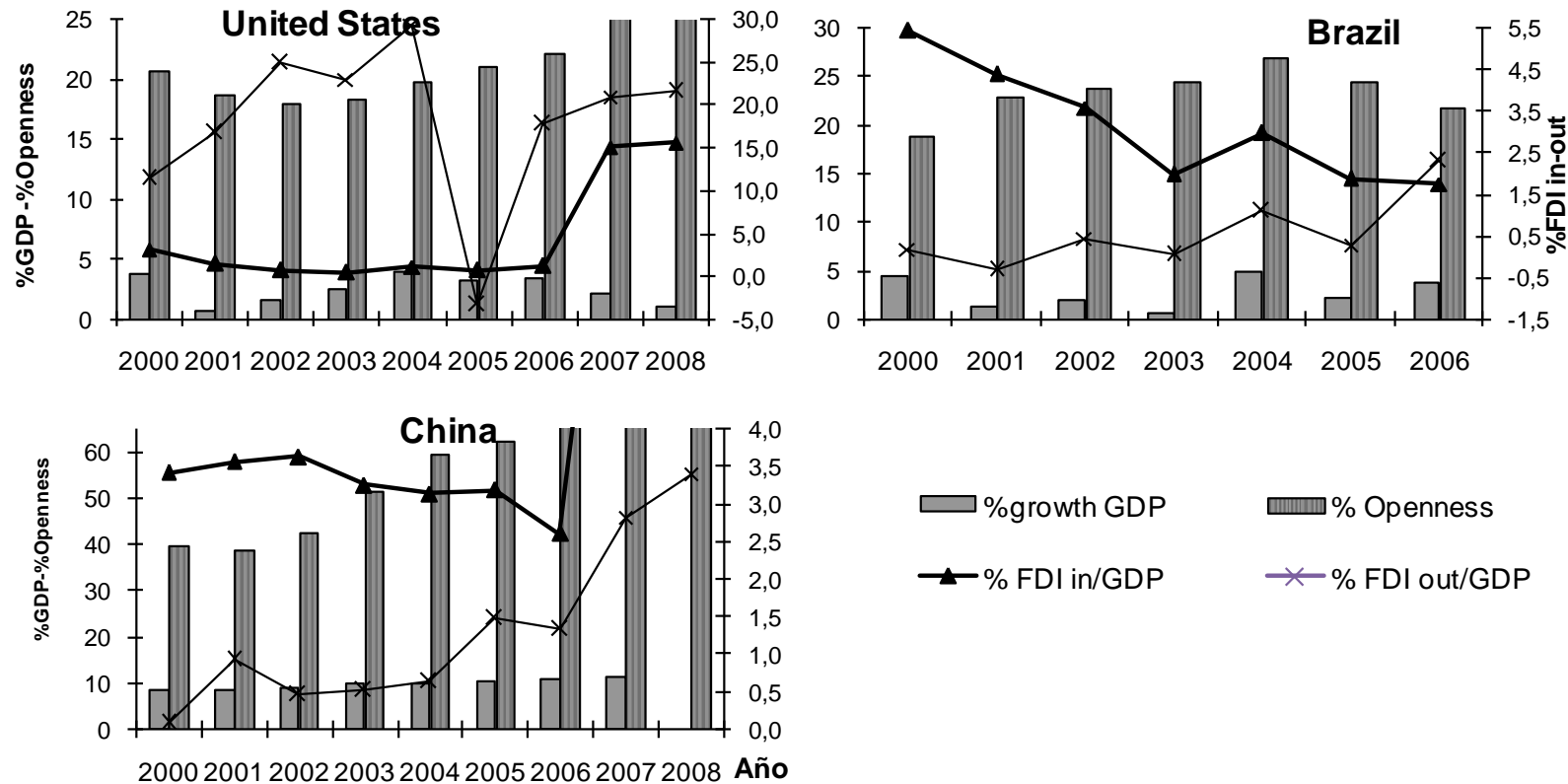
<sup>39</sup> All SSE belong to ICSD with the exception of Bolivia that decided to leave the ICSID Convention on May 2<sup>nd</sup> 2007 in order to get rid of the Italian company of telecommunications at the moment of its nationalization. Bolivia wanted to avoid paying any compensation for the nationalization of telecommunications since the company had avoided government taxes that were the same magnitude of its international investment. Nonetheless, there is a trial going on since Bolivia was a member until 2006 and the company got in Bolivia before then. This of course caused different problems for future foreign investments who were denying going to Bolivia due to instability and insecurity for investments. Or because currently it was a government willing to have more control on its national management.

**Figure 2-2. SSE: % of FDI-inward over the GDP, degree of openness and percentage growth of GDP (2000-2009).** All variables are expressed as a percentage of GDP. SSE show high rates of trade openness but very low rates of FDI inflows and GDP growth. Trade Openness is higher when the economy is small.



Source: Own calculations based on UNCTAD Statistics 2010, Geneva, 2010.

**Figure 2-3. LSE: % of FDI (inward and outward) over the GDP, degree of openness and percentage growth of GDP (2000-2006).** All variables are expressed as a percentage of GDP. LSE show high rates of FDI (outward and inward), a stable GDP growth during years and a low rate of trade openness. China has the biggest rates for GDP growth and trade flows (trade openness). A constant GDP growth can attract FDI-inflows. Trade Openness is lower when the economy is large.



Source: Own calculations based on UNCTAD Statistics 2010, Geneva, 2010.

Figure 2-3 shows that in average, the last 7 years FDI outward represented 17.17% of the GDP for U.S., 0.98% for China, 0.95% for Brazil and 4.49% for EU. Still, the greatest money flows are created by the United States towards international markets, as shows the increasing in last year's investment towards China and other European countries. On the other hand, FDI inward over the GDP decreased for all the LSE economies (as for the rest of the world). In average it accounted for 0.94% for U.S., 3.04% for China, 2.17% for Brazil and 2.78% for EU. The average growth of the GDP was 2.47% for U.S., 9.60% for China, 2.21% for Brazil and 1.58% for EU while by the size of their economies; the average degree of openness in the last 7 years was 19.92% for U.S., 51.55% for China, 23.41% for Brazil and 58.27% for EU. The degree of openness in LSE is smaller compared to SSE due to their national market that allows some degree of independence to international markets, except when the population does not have enough purchase power that allows them to participate in the economy, as is the case in China.

SSE only receive FDI flows with an interest for the short term profit. Hydrocarbons and mining are extractive sectors, known as technology intensive-use with low labor use. While in the rest of South America, FDI inflows came to the service sector (around 50%), manufactures (35%) and primary sector (15%) (Eclac, 2007). The reality for the SSE is the opposite as FDI is mainly for primary extractive sectors. For SSE, it would be interesting if FDI reaches other key sectors that promote development and if governments are not capable to do all the investments needed, for example services, agriculture, agro industry, or infrastructure which is intensive in labor use. The development of these sectors is important, not only for the development of the economy but also as an instrument for employing people, provide welfare, and with time promote a wider national market and international insertion. But no investment reaches these sectors due to size constraints and little profit perspectives; therefore, it might be useful that the government furthers private investments (local or international) with some benefits<sup>40</sup> without forgetting the obligations to the host country. Although promoting the investment strategies might

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<sup>40</sup> In this arena, it is important to regulate the money entrance conditions, the promotion policies to receive these investments, safeguards for risk protection (invasion, expropriation, fees, etc), environmental protection, regulation with human resources, research and development policies, financing and credit, links of foreign with local investment, policies regarding market access. These investment policies should go accordingly to the new vision of the SSE for their future.

seem more an internalization to an orthodox multilateral system for investments, it could be a good start for SSE towards a higher attractiveness under a better regulated investment market. Until present time, SSE have not played any role in the creation or modification of the multilateral investment law, and that is why TNCs currently have more rights than the host country. The power of TNCs is larger when the economy of the country is smaller<sup>41</sup>. Even so, SSE could increase their power of negotiation with a full awareness of the ownership of natural resources (degree of liberty) as a good measure to attract FDI inflows and the settlement of new investment conditions. *The challenge then is to include in the negotiations FDI with social engagements and try to use trade agreements for the coordination of common negotiations.* This should be done through a multilateral position that includes SSE and other countries in order to have influence and a possibility to switch the extractive type of FDI. Bolivia's experience in negotiating for natural resources in 2006 with 'nationalization'<sup>42</sup> can be analyzed with a twofold vision: economic and political. *Political insight*, made to improve the number of people that accepted the policy of Morales. Although later on, people realized that the lack of a business vision in Yacimientos Petroliferos Fiscales Bolivianos Company (YPFB)<sup>43</sup> provoked a continuous shortage of production for the local consumption and a decrease in exports towards other countries<sup>44</sup>. At the same time, this action gave Bolivia a new sovereign position façade towards other neighboring countries and to LSE. In search of this goal, the Bolivian government would increase its power in national investment and social projects by redistributing the hydrocarbon profits, but this vision was not handled with proficiency and as a result did not come to pass due to lack of governance. The *Economic insight* is that the State takes control and direction of production, transport, refining, storage, distribution, commercialization and industrialization of hydrocarbons in the country, gaining back the power in the exploitation and distribution in Bolivia. High oil prices during 2007 and 2008 would have provoked any government (leftist or right wing oriented) to nationalize the hydrocarbons that could grant some extra money for their

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<sup>41</sup> Size could be compared through the GDP and the Total Assets that a company has.

<sup>42</sup> Nationalization declared with the May 1<sup>st</sup> decree states that foreign companies must hand majority control over to state-owned YPFB.

<sup>43</sup> YPFB stands for Yacimientos Petroliferos Fiscales Bolivianos, the nationalized company in 2006.

<sup>44</sup> Due to lack of entrepreneurial vision (constant investment, good human resources, etc.) YPFB couldn't accomplish the quantities contracted with Brazil and Bolivia. A decrease in gas exports raised tensions between Brazil and Bolivia and between Bolivia and Argentina during 2006- 2008 when these countries needed gas for the development of their industry (Brazil) and to cover the local consumption in winter times (Argentina).



national budget. Oil companies were obliged to negotiate new contracts granting the State the right of ownership and control of hydrocarbon production and full control over its commercialization. The amounts received from the commercialization of the net hydrocarbons include royalties (of 18%) and direct tax on hydrocarbons (until 64% for large fields<sup>45</sup>) to the government<sup>46</sup> (Gaceta Oficial, 2006). The 82% state participation consists in 32% direct hydrocarbons tax (DHT), 32% participation of state oil company YPFB and 18% for royalties and participations. This whole process increases the profit for the government. However, affected countries, the IMF and WTO expressed their worries for SSE changing the rules on FDI warning to be more cautious and not scare FDI that is important for the SSE: *“The way in which the Bolivian government carries out the nationalization of its oil and natural gas industries will affect foreign investment and the health of the economy. In terms of how those aspects are handled, it could have an impact on continuing availability of domestic and foreign capital in the production of carbon-based energy, which as you know is an important part of the Bolivian economy”* the IMF Director of External Relations Masood Ahmed said in a regular briefing reported by Dow Jones<sup>47</sup>.

**Box 2-1. Bolivia: Nationalization and renegotiation of contracts in oil and gas.**

The measure of nationalization and the new tax system has hit the two largest gasfields, San Alberto and San Antonio that was formally owned and operated by Petrobras (Brazil), Repsol YPF (Spain), and, to a lesser degree, Total (France). The State is generating an additional \$320 million annually through this arrangement that grants the State with 82% of rent and the property to the government that will participate in the whole industrialization chain as well. The smaller camps continued with the former tax regime of 50% to the company, 50% to the state.

The gas refineries of Gualberto Villarroel in Cochabamba, and Guillermo Elder Bell in Santa Cruz, owned and operated by Petrobras since 1999, were brought under state control. The state bought 51% of shares. Petrobras (Brazil), Repsol (Spain), Total (France), and BG and BP (UK) were the major players until 2006 in the natural gas sector in Bolivia. Petrobras and Repsol were by far the leading actors, controlling almost 70 percent of the gas reserves in Bolivia. But, according to Jorge Alvarado, former president of YPFB, even when they receive only 18% of the value of the gas being produced, these companies are enjoying 20-25% profit rates. Therefore, after the renegotiations, the companies that stayed are Petrobras Bolivia, Petrobras Energía, Repsol YPF, Andina, British Gas, Chaco, Matpetrol y Pluspetrol that merged with Total y Vintage and accepted the new conditions of the government.

<sup>45</sup> Large fields are the ones that produced more than 100 million cubic feet a day (Mcf3/d) of gas during the precedent year.

<sup>46</sup> Law 3058 of May 17, 2005 Art. 52 and 55.

<sup>47</sup> WTO (2006), “IMF: Bolivia Must Consider Economic Impact Of Nationalization”, Joint WTO committee. Geneva.

Nonetheless, it is with nationalization that the government of Bolivia will have the chance to audit each of the companies' investments, amortizations, operating costs and profitability to determine "the retribution or participation" of companies. And any failure to comply with this requirement entitles YPFB to terminate the Operations Contract without having to pay any compensation which means a huge threat for multilateral agreements on FDI, particularly because nationalization signifies a revision of the contracts with TNCs that were signed under the support of the ICSID. To be able to do this and to initiate disputes at a national level, President Morales has changed the Operations Contracts to be governed not by the ICSID but only by the laws of the Republic of Bolivia, consequently expressing that disputes are settled by arbitration in La Paz, Bolivia, according to the procedures and the regulations of the International Chamber of Commerce. Technical disputes can be submitted to independent expert determination but the opinion of the independent expert is not binding for the parties. Bolivia started with this initiative and will probably be followed by Ecuador as President Rafael Correa announced this June 30<sup>th</sup> 2009. The fact is that ICSID has 140 country members promising to have an impartial arbitration tribunal but in this situation the TNCs have found a place to challenge States. Of 232 arbitration cases, 230 have been brought by TNCs against States seeking for damages of millions of dollars, not only for investments but loss of future profits, according to them. ICSID is known for being business-friendly, in 36% of the cases it has presided over, it has awarded in favor of TNCs demanding compensation be paid, 34% result in out of court settlements being paid, 30% have become paralyzed for various reasons<sup>48</sup>. In the few cases that have been won by States, these have not been compensated by TNCs. Regardless of how poorly a corporation has behaved, they are more important than the opinion of the population on the TNC. What's more, it is a very expensive tribunal for developing countries. A lawyer in Washington can earn \$800 per hour. A small case for a country including fees for lawyers, travel and experts can cost \$3 million. Above all, the ICSID convention was signed in violation of SSE constitutional laws which say that all companies in the country are "considered national companies and must be subject to the sovereignty, laws and authorities of the Republic and therefore foreign companies and citizens are subject to national laws and cannot invoke exceptional privileges or appeal to diplomatic

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<sup>48</sup> CADTM, CIADI/Telecom Italia, (2007), "hands off Bolivia", 7 December 2007, p.1.

channels"; instead, the State has submitted to a multilateral agreement and a BIT, leaving aside its national sovereignty for an unbalanced supranational justice system for SSE<sup>49</sup>.

Nationalization was then perceived as something good for Bolivians and a good precedent of sovereignty. However, to date, people are realizing that a lack of a business vision within the company was creating a shortage of production for the local consumption, a reduced number of working post or a decrease in exports towards Brazil and Argentina even when there was a higher demand. The YPFB shows a large reduction in the production of oil and gas for the local and international market, turning Bolivia into an unreliable provider<sup>50</sup>. Although the income of the country increased and filled national and international reserves, this was just sleeping money not used for re-investment. The government of Morales was not aware that the gas and oil sector needed great investments and capacity for expertise labor at all times, even when prices go down<sup>51</sup>: *"...with gas and oil prices going low... One of the weaknesses evidently is the nationalization of hydrocarbons, because of the need of investment (...) I am almost sure that with partners, credit and ...here is a central subject, I am not sure if there is the need to make a consultation via a referendum to see if we spend or not our international reserves for oil industrialization"* said the President Evo Morales through the official media —Canal 7 (TV) and Patria Nueva (radio) in January 2009. With this, President Morales wanted to delegate the responsibility of industrialization and internationalization to the population expands

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<sup>49</sup> Against the threats posed by BITS to Bolivia, lawyer and Congressman Wilson Magne have presented a legal challenge against Law 1593 which ratified Bolivia's adhesion to ICSID as well as 6 Bilateral Investment Treaties. According to the lawyers, Law 1593 as well as the clauses in each BIT which allow companies to seek arbitration in an international tribunal (ICSID) contravene key constitutional articles (Clauses 135 and 228) which says that foreign firms must be treated as national firms and are subject to national sovereignty and national laws. This means companies that want to initiate legal against the Bolivian State can not seek international arbitration and can only seek redress nationally.

<sup>50</sup> Diario Exterior (2007), "Bolivia incumple los contratos de gas con argentina", Friday, November, 16<sup>th</sup>, 2007, Buenos Aires.  
Page 12 (2008), "Promesas de más gas boliviano", Written by Cledis Candelaresi, Wednesday, September 10<sup>th</sup>, 2008, La Paz.

<sup>51</sup> La Razón (2009), "Evo propone referéndum para usar reservas internacionales", Monday, January 5<sup>th</sup>, 2009. Cochabamba  
Los Tiempos (2009), "Evo propone consulta para gastar reservas internacionales", Monday, January 5<sup>th</sup>, 2009, Cochabamba

due to a larger number of included populations<sup>52</sup>. For this, FDI is important to motivate real development, avoiding enclaves. To achieve this it is necessary to tackle and eradicate corruption. Eliminating corruption is essential for an effective FDI. Until now, SSE have tried two models for FDI and none of them seem to be getting positive results due to corruption and lack of governance. One of the models was privatization (90s) as part of the neoliberal model and the Washington Consensus; the other model was nationalization (2006-on) as part of socialist project to recover sovereignty. The first one, privatization, allowed: low taxes, long term monopolistic permission and recovery of invested capital before a new re-investment was done and allowed capital drain because the profit of the companies was overprotected by national laws and TNCs could do what they wanted without a major control of the host government (Mckenzie and Mookherjee, 2001; Chong and López-de-Silanes, 2003).

#### **Box 2-2: Bolivia's experience under ICSID**

- When U.S. multinational Bechtel sued Bolivia for between \$25 and \$100 million dollars after it was thrown out during the Cochabamba Water War. Bechtel sued under a Bilateral Investment Treaty (BIT) between Bolivia and The Netherlands by the mere fact of having a postal address in The Netherlands. Only a huge international activist campaign forced Bechtel to back down not the ICSID.
- In early 2005, Quiborax, a national mining company initiated legal actions under ICSID. The company was illegally given mining rights to a protected area in the south of Bolivia, Uyuni. Under mass mobilization, the concession was cancelled. Even though the company was national, the company got its Chilean shareholders to initiate legal action against Bolivia.
- ETI Telecom, an Italian multinational notified ICSID on 30 April 2007 that it was undertaking negotiations and then a legal procedure with the Bolivian Government over its decision to nationalize the former State telecommunications company, done under the Bolivia-Dutch BIT. Even when Bolivia decided to leave ICSID without fortune since the ICSID convention states that 6 month notice period applies to any withdrawal. So Bolivia has to pay ETI Telecom.

Source: Own elaboration based in different press releases from Bolivia, 2006-2009.

The second model, nationalization, takes care of taxes, re-investing controls and engagement for environment responsibility. However, both models have corruption which does not allow the entire population to benefit from the national resources, plus

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<sup>52</sup> By included population we mean the amount of people in a country that have access to basic services as water, electricity, housing, health, education, etc. As we presented in chapter one, SSE have a reduced number of included people which makes their national markets smaller.

it keeps the people excluded from welfare. For example, in June 2009, it came to light that the President of YPFB, Carlos Villegas Quiroga who was in charge of nationalization of Transredes, the largest oil and gas pipelines of Bolivia, now called YPFB Transporte S.A., had paid an overprice of 200 million dollars to purchase Shell's and Ashmore Energy International's (AEI, a UK investment fund) stake in TR Holdings but the official price that YPFB reported to pay Shell and AEI was \$241.155 million each, pointing a lack of transparency. Buying at this price, Carlos Villegas admitted a company with high debts of national taxes and huge operational debts.

### **C. Compatibility with development**

SSE cannot increase the national production or improve the quality of the services<sup>53</sup> if they do not count with FDI. This dependency is disturbing socialist governments that do not have entire sovereignty to fight against poverty<sup>54</sup> by themselves because they are unable to discard the U.S. from their economies in the short term. Besides, their dependency does not allow them to have a better control on the FDI operating in their countries. For instance, Bolivia wanted to cash the guarantee of the Jindal Company of 18 million dollars because they did not invest the quantity that was agreed due to contract, but the Bolivian government found that it is impossible since Jindal denounced the government for not complying with the counterpart of investment either<sup>55</sup>. This is just one aspect that keeps SSE from saying a definite good-bye to the U.S. as a main trade partner, FDI and financial aid. Financial assistance from the U.S. is a key for their development and improvement on international insertion in: multilateral trading and financial systems. This goes according to dependency and world system theorists who have argued that FDI from the advanced capitalist states

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<sup>53</sup> Services where huge investments are needed are by nature monopolies.

<sup>54</sup> Many speeches in the last two years mentioned by Hugo Chavez (President of Venezuela), Evo Morales (President of Bolivia), Rafael Correa (President of Ecuador) tell that Latin America is turning towards the "socialism for the 21<sup>st</sup> century, against imperialism and capitalism with more sovereignty and without the domination of the US. At the same time, all three continue to have large amounts of trade with the US. Moreover,, Bolivia and Ecuador have requested to continue with the US preferences for trade which shows how dependant these countries are in one of the largest FDI investor and financial donor as is the US.

<sup>55</sup> A guarantee worth 18 million dollars could benefit the Bolivian government but this will also mean a breaking up of the contract. The planned investment from Jindal included the construction of roads, a railway route, waterways, a harbor infrastructure, a concentration plant, and a pelletization to move the iron and steel. The counterpart (government) had to provide land but due to social instability and people 'without land' did not allow prejudicing the fulfillment of the contract.

promotes export and import dependent forms of development for the underdeveloped economies (Cardoso, 1977; Theotonio dos Santos, 1971). Some other researchers say that total FDI has a significant positive impact on the measures of export, import and hence, on the total international insertion. Nevertheless, in some studies, several researchers found that when the total FDI measure is disaggregated by sector destination (agriculture, manufacturing and petroleum) only investment in petroleum/extraction has the expected effect on trade dependence (Jaffee and Stokes, 1986). We can observe in the SSE that indeed, FDI in hydrocarbon and mining cause a greater dependence on trade since the country focuses its economy on this option. This result did not come as a surprise, because SSE that possess energy resources as the other countries (e.g. Chile, Venezuela) have oriented their economies to the increase of FDI with more government control and shares, so that the amount of exports increase taking advantage of the fact that prices are high enough to enlarge their national income, no matter if their political stand is leftist or right-wing. Accordingly, SSE have been competing for small FDI-inflows with their neighboring countries since FDI was seen as a main part for the trade development and international insertion. In consequence, FDI is important for a SSE, both for economic and political interest. A **political interest** because FDI is necessary to provide access to services for a larger number of the population, granting them with access to technology, receiving in exchange social acceptance which reduces social turmoils. An **economic interest** because SSE could negotiate better investment conditions to receive more taxes, technology, increase of employment and social inclusion that pushes development and welfare.

Multilateral agreements signed for an open financial system do not work for SSE. At the end, an open financial system grants an easy entrance of FDI to countries, protecting the investment in the host country but forgetting to protect the host country from speculative investments or the danger of a low degree of governance. None of the multilateral agreements take into account the difficulties that SSE face in front of TNCs. While tariff liberalization can be broadly beneficial for low-income countries, rapid capital liberalization can be a recipe, in the absence of prudential regulation and sound domestic capital markets, “for volatility, unpredictability and booms and busts in capital flows” (Held D., 2005). Countries that have rapidly opened their capital accounts have performed significantly less efficiently, in terms of economic growth

and income inequality, than countries that have maintained tight control of capital movements but cut tariffs (Held D., 2005). As a result of this multilateral agreement, the governing capacities of developing countries can be seriously eroded. This is not to say that developing countries do not need access to capital flows whether public or private. They certainly do – especially during trade liberalization when initially imports tend to rise faster than exports. But private market capital flows are both too low and too volatile to provide for such financial needs.

Joseph Stiglitz asserts that both the crises in East Asia, in the late 1990s, and the constant recessions in Latin America show that “premature capital market liberalization can result in economic volatility, increasing poverty, and the destruction of the middle classes” (Stiglitz, 2004). And a study carried out by IMF economists published in March 2003 exposes the fact that “there is no strong, robust and uniform support for the theoretical argument that financial globalization per se delivers a higher rate of economic growth” (PRASAD et. Al., 2003). Even more troubling, the IMF study concludes that “countries in the early stages of financial integration have been exposed to significant risks in terms of higher volatility of both output and consumption”<sup>56</sup> and some appear to accumulate unsustainably high levels of external debt. Yet, the IEOs still demand financial integration and capital liberalization through international financial institutions and bilateral trade agreements. However, if we compare the evolution of trade openness with the FDI-inflows, there is an inversely proportional relation between them (see figure 2-2 and 2-3). While trade openness has high growth rates, the FDI flows do not show the same characteristics, and have even evidenced a diversion towards other regions with better attractiveness. *SSE remain high in trade openness but are marginalized in terms of FDI flows.* This means that there is no relationship between the variables Openness and FDI. Perhaps, there exists a connection between the growth rates of GDP and the FDI flows that show a similar trend: *while growth rates of the GDP are small, FDI-inflows also remain small and while GDP growth rates increase, FDI-inflows also increase.* This shows that world growth (in trade and FDI) and development in the last ten years is still lead by developed countries that have a larger internal economy or as in the case

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<sup>56</sup> Idem

of the European Union, that managed to solve the problem of several small internal market size economies with an economic integration.

A new Consensus of multilateral financial system liberalization is needed. SSE and other developing countries may not be able to agree in standard regional regulations, since these countries have been taking the norms proposed by LSE-developed countries for their regional agreements. Nonetheless, new changes have to be made regarding these norms. For this purpose, it is necessary to take into account extreme liberalization and other problems (as the economic and financial crisis of 2008-2009) that SSE have confronted with the current Washington Consensus. Therefore, a better negotiation position is possible, but SSE have to know that their position is fragile and feeble when negotiating alone. This could be launched as a global initiative towards a more social development and concern for the SSE as part of a multilateral agenda.

The IEOs have spread around the idea that FDI would help to alleviate poverty and stimulate the economic growth in developing countries. Financial freedom and openness to FDI was necessary and became a part of the Washington Consensus. In order to reach development it was important to acknowledge these measures, the non-inference of the State, and a reform of the public institutions, so that private investments can step in. Therefore, two conditions were to be met (NUNNENKAMP P., 2004) in order to reach this expansion. First, developing countries needed to be attractive to foreign investors. Second, the environment of the host-country in which foreign investors would operate must be conducive to favorable FDI effects with regard to overall investment, economic spillovers and income growth. Nevertheless, empirical evidence in the SSE suggested that their conditions included weak institutions with corruption and insufficient endowment of complementary factors of production (for example human resources)<sup>57</sup>. In spite of that, the Washington Consensus was implemented and now some researchers try to justify its failure by clinging to the missing aspects in the SSE that constrained the growth, enhanced poverty and reduced the positive effects that FDI could have had. What's more, SSE

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<sup>57</sup> Empirical evidence was collected through different interviews held with people working in trade within the institutions of regional integration: MERCOSUR, ALADI, ECLAC, ANCOM. All persons interviewed between 2006-2007 coincide with the idea that the lack of government capacity influenced by the quality of human resources is the main cause so that the SSE do not have a good production infrastructure neither a good krvn international insertion.



apparently had not a strategic plan for national development through FDI. This fact impeded them to demand specific requests for foreign investors in the 90s. Thus, SSE were taken advantage of when it came to their natural resources and monopoly services by TNCs because they did not socialize its consumption due to high prices which, in turn, increased social differences and poverty. Lack of good governance in the SSE left the management of basic services to TNCs that took advantage of their monopoly status. In Bolivia, TNCs had monopoly grant, free-will to set the price of the service and tax revenues settled by the government so that TNCs can recover their investment. SSE tried to please the TNCs to have favorable effects and spillovers on the national income as the Washington Consensus suggested, but the effects of privatization were not as positive as expected. This situation deteriorated the relationship between social movements and the government, leading them to turmoil which still persists nowadays. Several social movements even questioned the real gain of the SSE by participating in the multilateral agreements. This dreadful experience also constitutes one of the main causes for a switch in the economic model.

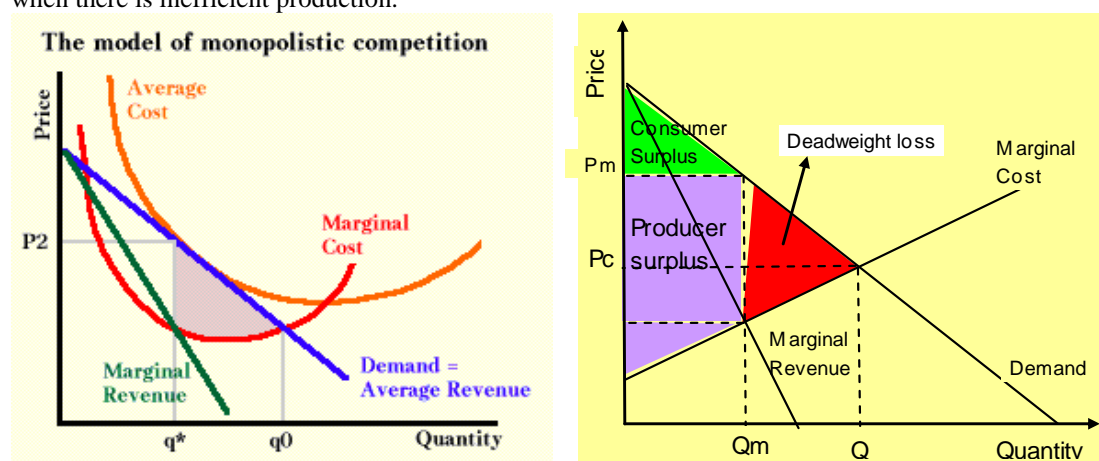
In the aspect of internationalization, the country did not improve either. Most of the privatized companies in the SSE focused to develop the national market with high prices rather than export. Economics theory says that monopolies can develop the infrastructure so that future companies could get attracted to penetrate the market, but this did not happen in the SSE. With the exception of telecommunications and airlines, there were no other companies that settled down to rupture the power of monopoly. SSE carried on structural changes<sup>58</sup>: financial liberalization, privatization, trade liberalization, health, education, water and hygiene, environment – rural and urban development, social protection, anticorruption / accountability, civil service reform, decentralization, public finance management, tax administration, legal and judicial reform, monitoring & evaluation civil society organizations. The Washington Consensus underlined the importance of following those structural changes closely, in order to develop their national economy and achieve international insertion in the world without taking into consideration specific needs or difficulties that certain SSE had. Subsequently, most of these conditions were carried on by the SSE in disadvantage of their own national priorities and needs leading to social gaps and

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<sup>58</sup> These structural changes were adopted but not achieved efficiently.

poverty. According to the Eurodad Report (2006), Bolivia had to follow 33 conditions when asking a loan in 2005. It is difficult to assess the type of conditions and amount of money that the SSE had to devote to be able to apply for the conditions that the IEOs demanded from them, after receiving a loan. The Washington Consensus is blamed now for social failure and unsustainable development. Hence, not only are these institutions imposing too many conditions on poor countries, but many of the conditions were very expensive to apply<sup>59</sup> and worst, it seems to have been harmful for the national management of its needs. This has led SSE to keep investing to comply with the conditions instead of a real “fight against poverty”. According to Rodrik (2001 b), global integration has become a substitute for particular development strategies and international insertion for SSE. Nonetheless, the mistakes were various because there was no technical support at the moment of implementing these changes. Sometimes, SSE wrongly applied financial freedom and could not foresee speculative investments, speculative real state, etc. that deteriorated the financial health in the SSE. For example, between the 1990s and 2000s, Bolivia for instance, suffered from different bankruptcies due to speculation and an excess of freedom on behalf of the financial system, to grant loans to people who could not pay back.

**Figure 2-4. SSE: Benefits of Monopolistic competition.** On the contrary to perfect competition where the price is equal to average cost and average revenue, SSEs are more susceptible to attract FDI that has a monopolistic competition which takes high producer surplus and marginal revenues even when there is inefficient production.



Source: Own elaboration based on The World Factbook, 2003 and [www.theodora.com](http://www.theodora.com), 2008

<sup>59</sup> The adoption of these structural changes not only demanded a special budget for this but also time and human resources. People that are currently in the government in Bolivia say that the budget that was spent in the adoption of the Washington Consensus could have been spent in health and education.

Despite the application of the Washington Consensus in the SSE, the share of FDI declined after the privatization period. Seemingly, FDI was only interested in the natural monopolistic companies because they could adjust the price and quantity of goods and services they offered within the small market. Otherwise, FDI seems to lack interest on very small market and a population that does not possess much purchase power. Thus, FDI would not even go to sectors for competition or where services are perfect substitutes where the market share is small. Graphically, we can observe the profit of FDI when it buys monopolistic companies that have a negative demand curve, equal to the market demand. The implications are deeper in price and profit that the TNCs obtain in the SSE in these sectors. Price of a monopoly is higher even when the quantity of supply is reduced; if the service is widened, profit and price would be reduced (figure 2-4).

With the inflows of FDI to privatized natural monopolies, the Washington Consensus proved to have different imperfections in the last decade and a half. SSE did not have the capacity to flawlessly implement the structural adjustments, due to different social, economic and political problems. Since orthodox reforms needed for development and a better international insertion were not impeccably implemented, it caused more negative results than good ones. At the end of 2003, Bolivia noticed its failure with neoliberal policies and liberalization of the market. Since then, constant turmoil put pressure on the government to back-away from the neoliberal model and an embracement of a more socialist model as a new path to find internationalization and development. Being that trade and investment are directly linked to development; it can jeopardize the national development of SSE and its international insertion. First, they depend on larger economies to define their main economic goals that come as conditions for their development together with targeted financial aid. Second, international insertion depends on negotiation but especially on the space that LSE grant to them in trade and FDI agendas at multilateral level. Therefore, they cannot foresee if what they planned as part of development will work or not.

SSE are main subscribers of the WTO, IMF or WB, major multilateral organizations that are under a political interference from LSE-developed countries, especially the United States. This fact does not leave room for SSE to insert their needs and problems in the multilateral agenda of these IEOs. Developed countries with larger

economies have a preference when setting the agenda of these multilateral organizations<sup>60</sup> and it seems that it will not change in the short term. The DOHA Round Negotiations results show the difficulty for LSE to change the paradigms that could benefit the SSE. Consequently, multilateralism has failed to meet expectations for SSE in both international insertion and development. Then, regionalism is the current hope for SSE to have a better international insertion and development through their needs at regional level.

## 2.2 The Beijing Consensus

The Beijing Consensus is the concept idea of Joshua Cooper Ramo (2004), who pointed out that China, has a new model of development. This model, named as the Beijing Consensus refutes Western notions of political liberalization or economic reforms as indispensable for long-term and for sustained development. It is also skeptical about the benefits of privatization and free trade. Other nations can, and should, fit into the global system ‘in a way that allows them to be truly independent, to protect their way of life’, argues Cooper Ramo. The Beijing Consensus is as much about social change as it is about economic and political transformation. It is about using economics and governance to improve the society, an original goal of development economics that somehow lost its way in the Washington Consensus, implemented in developing countries in 1990s.

Essentially, the Beijing Consensus was born to replace the Washington Consensus at national range (that is conceived only for China) and then it was promoted at international range. The Washington Consensus imposed its rules on many developing countries, that after many years of applications these principles realized that the results were only higher social discomfort and at the same time a shattering of the national economies by creating a larger gap between the rich and the poor. Besides, this imposition was a common measure for all the countries, without taking

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<sup>60</sup> At the occasion of an employment briefing at the UN on February 3<sup>rd</sup>, 2009, Ms. Gillian Sorensen, Senior Advisor for the UN Foundation and Former UN Assistant Secretary-General for External Relations admitted that the UN has political interference from the US especially and other large countries but said that the only way for small countries is to group together as the Small Island developing countries (SIDS) did. This would be the only way for small countries to make their voice prevail.

into account the reality of each of those nations, despite the clear fact that they were so different in every aspect. This is why; China ignored the World Bank and IMF that supported the application of the Washington Consensus as a standard measure for all developing countries. China developed its own model which is driven by a desire to have equitable, peaceful high-quality growth, including a pragmatic approach to international relations based on the principle of non-interference in domestic affairs from U.S. or other countries considered to be of large economy. The Beijing Consensus is flexible enough but makes it difficult to classify it as a doctrine as *it does not believe in uniform solutions for every situation*. This idea has been influencing other countries in the world that want their independence and own sovereignty to define their own path for development.

This sub-part will present the self determination programs that the Beijing Consensus proposes to developing countries. SSE could go through these programs in order to better internationalize their economies and to find development. Through this sub-part we will also analyze if these programs are compatible with multilateralism and the IEOs. This will also show if this path could be an option for SSE to reach development and have a voice in the multilateral agenda.

### **A. Self-determination Programs and multilateralism**

As mentioned before, China does not believe in uniform solutions for every country's situation, as the Washington Consensus dictated in the 90s. This idea had a major impact on several developing countries, including the SSE. With this idea in mind, SSE rigorously stressed the fact that every country has the right to choose the best option for its own development path. This left behind the U.S. and IEOs directives for development. In the last four to five years, this idea became popular because it granted the independence to define a particular and unique vision for development. The SSE in South America were more attracted to the Beijing Consensus since this helps them to protect their way of life and their political choices independently. SSE often were longing for sovereignty that was not possible since governments always relied on the U.S. word on politics and economics. For many years, U.S. had an important voice in the support of some political parties (Schmitz, 2006) or in the way

the development had to be achieved (NGA Best practices, 2006) particularly for those countries where U.S. military bases were installed (Ecuador, Bolivia).

On the contrary, China chose not to follow the Washington Consensus in the 90s and created the Beijing Consensus for its own economy. This action later was described by several researchers as the start up of new physics of power in the international system because China's result was observed and admired by many developing countries which later felt identified with the political and social change of this so called Beijing Consensus. Although there are many changes to be done in China, this country has questioned the Internationally Dominant Power (IDP) and its provision of common goods at multilateral level. And the proposal of the Beijing Consensus was mainly thought of to question sovereignty, dominance and multipolarity. Cheng Enfu, of the Chinese Academy of Social Sciences, defines the Consensus of Beijing as the promotion of an economy in which the *public property*<sup>61</sup> is dominant. This would change the idea of privatization of natural resources (hydrocarbons or water for example) to propose a public property of them and the possibility to make it accessible for the poor and rich segments of the population. It chooses a progressive change rather than a therapy of shock as the Washington Consensus proposed. And from our point of view we consider this to be the correct outcome, since the Consensus proposes the provision of security, trade and environment governance planned, defined and carried on by all the countries and not just by the U.S. It also opens the country to international trade while at the same time; it enables self-sufficiency at national level; proposing to reform the market as well as a political and cultural change. China has learned the lessons from the failure of globalization in other countries and the ideas proposed to solve the failure deal with politics, quality of life and a need to rebalance the global power which cannot remain in only one country. The 'go global' opening-up strategy is not only of significant economic implications but of significant political dimensions. Hegemony's and power politics remain in today's world. Developing nations are the main force to oppose the IDP and safeguarding world peace, changing the international order. It makes SSE dare to rethink their position at the international arena from passive to an active position to let

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<sup>61</sup> Public property is property which is jointly owned by a whole community of individuals and not like the private property, which is owned exclusively by an individual. Currently, SSE take "public property" as synonymous to state property, which is said to be owned by the people as a commons, e.g. natural resources such as water.

other countries know their needs and conflicts concerning the main issues of common goods, trade and FDI. For instance, Lula's frustration with U.S. and EU trade ideas of extreme liberalization when LSE have to export and extreme protectionism when they have to import -particularly in agriculture products, is leading inevitably to his hope of changing the *geografia comercial del mundo* for a more real base idea: "... either we believe in ourselves or we keep crying for the end of agricultural subsidies...", Lula says as a part of his reflection on the Beijing Consensus, fitting his worries about globalization with the offer of another pathway of development. It is necessary to have a proposal where integration of global ideas goes in harmony with the demands of local sustainability. In this sense, the Beijing Consensus has a positive impact between SSE because it is believed that China's economic rise is capable of changing the paradigm of development and the course of the dominated nations. With this Consensus, each country could have sovereignty and a power of its own, perhaps not powerful enough to dominate the world but enough for self-determination. The SSE in South America were always directed by the U.S. without self-determination and sovereignty. Therefore, this new focus is believed to have a chain-reaction wherever it is copied, creating in these nations a complete revolution in several aspects, such as their view of multilateralism in regards to security, defense, social values, etc. The provision of common public goods that until now was defined and ruled by the U.S. (hegemony), could instead be defined by different regional leaders (multipolarity) that rule them according to the needs of the region and particularities of the country. In fact, the SSE are currently working on a switch in the planning and organizing of their own regional security, monetary and fiscal plan, social and economic development.

Despite the fact that China is increasing its participation at multilateral level, the Beijing Consensus is leading countries towards a noticeable preference for regionalism rather than multilateralism. While in the past multilateralism was the solution for internationalization and development, nowadays, we can evidence that regionalism has strengthened the relations and negotiations at international arenas. The Beijing Consensus backs up a reaction against the idea of development and imposition of the Washington Consensus. Currently, the SSE are now reluctant to implement economic and political reforms considered necessary by Western Donor institutions and countries. This also responds to a need of having another geopolitical leader that can introduce new solutions to all the economic-social and political

problems that SSE face. These countries are trying to learn from China and its way of the development and this is impacting the international financial arena. This is the only way that multilateralism has a meaning, because China can sway the balance in negotiations and SSE can benefit from it. China intensified its role in the existing IEOs as part of the Beijing Consensus. For instance, in January 2009, China joined the inter-American development Bank (IADB) as an important donor. Besides, China is in talks with the IMF in connection with an increased decisional participation in exchange of more financial contributions. Recently, after a crisis that was blamed on the U.S. economy (real estate market) and the US dollar (global currency), the Chinese government has suggested the IMF and United Nations to adopt other international currency to replace the dollar as the world's reserve currency with a new, more multilateral system based on Special Drawing Rights<sup>62</sup>. The reason explained is that the dollar has taken the world to a financial crisis just because of a failure in U.S. economy. Claiming that developing countries (DCs) are paying for the financial mis-performance of the U.S., China has proposed to create another currency for international trade and exchange having wide supports between DCs and of course the SSE. Of course, this is just one component of a Chinese strategy for pursuing power shift in the international monetary order. Another is the increasingly emphatic Chinese tone on the need for IMF reform pushed by additional Chinese contributions to the IMF as a step towards more voice for developing countries. However, while China offers a higher contribution to the IMF it also pushes the independence of the IMF at regional level (ASEAN-3) by increasing the contribution to a regional bank (ASEAN+3). This idea is also stimulating a new base for a sovereign financial management in Latin America. This all is taking China to play in double ground: regional and multilateral. On one side, China is increasing its contribution to the IMF (\$40 billion) while at the same time announced an almost equivalent contribution (\$38.4 billion) to the Asian Monetary Fund and is participating as an observer in other regions to support the development of other financial axis for development. All this creates a useful independence from the IMF and an alternative to borrowing and being monitored from the IMF which is also seen as an American instrument for economic coordination. China certainly made transformations in trade and FDI concerning participation and voice of developing countries at multilateral level. This .have given

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<sup>62</sup> This proposal was initially made by Zhou Xiaochuan, the China's Central Bank governor. He questioned the agreement of the Bretton Woods signed in 1944 given the financial crisis of 2008-2009.



new players a new voice face to international negotiations and LSE-developing countries have polarized the world power which is creating negotiation conflicts in the forums where the largest economies were used to rule. A sample of this change is Doha Round where several conflicts were raised and finally ended without a Consensus because LSE-developed countries are not willing to let their privileges and power get reduced. Still, there is a lot to do at multilateral level and Venezuela tells that if there is no way for small economies to have a space to express their opinions and interest within free trade, multilateral negotiations will constantly fail.

The idea of a replacement for the dollar changes the idea of a hegemonic power that tells the rest of the countries which is the main design for development concerning FDI, trade and international relations as a unique idea for economic growth. Because China accepts FDI under strict government conditions and continues to sign bilateral and regional agreements under the surveillance of the government, DCs feel the urge to intervene more in the framework of the agreements, regardless the size or level of development of the partner. The BC has turned into a reference for multilateral participation and regional cooperation. Of course, there are also several negative aspects to the BC. One is that it does not implement a common governance framework on the management of common goods and the environment. It grants too much freedom to governments, even when the government is a dictatorship with high levels of corruption or no preparation for good planning and long term envisioning.

## **B. Compatibility with development**

Critics of the Washington Consensus contend that this set of politics could be found at the core of Latin America's economic problems, which included multiple currency crises, recession, and economic collapse in some countries. Currently, development and internationalization is not conceived anymore as privatization, extreme liberalization of the financial systems or a reduction of the role of the State. The Beijing Consensus encourages a development in which the government plays a more preponderant role, which centers on the idea of providing development and basic services to reach a minimum level of welfare. This idea seems to cope more closely with the needs of the SSE rather than with the Washington Consensus. An increased

participation of the government in solving the market failures is becoming necessary, particularly in times of crisis in which even the new government of Obama presented the urge to intervene with market failures, particularly in the financial system. Although some question the true utility of the Beijing Consensus as a “model” vis-à-vis the Washington Consensus, China’s specialists, such as Chan Lai-Ha and Pak Lee, generally agree “that the state should play a predominant role in reform and development” adding that the Beijing Consensus “enhances the voice of developing nations in global affairs”.

Beijing Consensus seems to be compatible with development and the expectations of SSE; however, there are also failures that can jeopardize its application. China as a country has several controversial topics that are not well solved inside the country. Matters like poverty, environment, energy use and human rights are questioned and this puts in doubt the real compatibility with development in the SSE, since these issues are also controversial and highly demanded in the SSE. Some worries raised in its partners worldwide concerning labor standards, pollution, management and exploitation of resources in their urgent quest for securing them for their national market. Besides, China does not seem to care about corruption, economic mismanagement, labor and environmental laws or political instability in the host countries. Western companies worry that the Chinese state-owned firms have an agenda beyond commercial gain. As the Economist magazine (2007) says, the Chinese government is willing to pay over the odds for mining or drilling rights to secure access to physical resources intervening unfairly on behalf of its companies, they claim, by offering big aid packages to countries that welcome Chinese investment. Concerning trade and financial system, the Beijing Consensus does not have a rule or suggestion for a better performance of the IEOs and for another type of multilateral organizations either. Therefore, it does not include any means to control or solve a problem that could emerge between SSE or between SSE-LSE when applying the Beijing Consensus. It is true that China is financing several regional banks of development to grant the region with more sovereignty in their development projects and is signing new types of FDI agreements to promote a new type of IEOs that surges from the regional needs. This action is intended to eliminate the Internationally Dominant Power (IDP) of the U.S. and open up the international arena to multipolar power. Yet, none of these initiatives have changed the multilateral ruling

and even some agreements that China is signing are in the same base as the ones of the U.S.. There is no acceptance of the idea for common governance between the countries in one region, moreover it is only supporting development with another point of view. And if this Consensus is good for the SSE, what could happen when more government control seats within a government that is not subscribed under accepted governance or is inserted in dictatorial governance?. In this case, who could fight for the rights of this country that in a “sovereign” way chose its type of government? And what about the common goods that China wants to preserve for the welfare of everybody in a multipolar world when there are no ruling institutions either in the current IEOs or the ones proposed by DCs or BRICs or SSE?. This all makes us rethink in the question: what about the correct path for development? Would it work an endogenous trade system and a controlled financial system? Controlled by whom? Would it be multilateral, regional or national sovereignty? These questions would have to be worked out by the Beijing Consensus as a response to the SSE needs.

## **2.3 Conclusions**

The structural programs imposed by the Washington Consensus on the region and applied particularly by the SSE brought poverty rather than international insertion and development as was promoted. Furthering the idea of international insertion was not present even when its main supporters (IMF, WB, U.S.) argued that its application would improve the situation of the region and lend money for its application. Unfortunately, this only contributed to the international debt and raised poverty and inequality. The World Bank estimates that the number of Latin Americans living with 1.25\$ per day increased from 99 million in 1981 to 128 million in 2001 and the gap between rich and poor has continued to grow having the most unequal wealth distribution of any region in the world (United Nations 2009). With this data in mind, SSE have proven that the Washington Consensus and directives sent by the IEOs do not work. This is why some of the SSE are opting to apply the Beijing Consensus in their economies. With China’s rise as the fastest growing economy of the last years, it became clear that development can be achieved following other paths, in other words, joining another option of multilateralism. SSE accept this option because they believe that the role of the government should have never been reduced in countries with

structural failures in the national economy. The neoliberal economic model that multilateralism imposed through the IDP, named the U.S. and the IEOs only increased poverty gaps in the society where governments felt less responsible for the population, leaving all to the market despite the market failures.

Beijing Consensus is an option for China to appear in the scene and promote multipolar power and regional domination instead of one power in the world that disseminates the use of one currency (US dollars) and one policy for development and governance for public goods. While multilateralism proposed by the IDP through the IEOs did not always seem to be beneficial for the SSE, it has provided a range for basic rules, a common order on financial and trade markets. SSE until now have followed the same regulations that multilateralism has provided and internalized, having the possibility to have a rather standard legal, trade and financial systems in the region and the world. Facing several structural difficulties, SSE would not have been able to create a particular framework by themselves. Until now, the Beijing Consensus only proposed freedom to decide on sovereign national decisions without considering the global issues. Besides, it is important to know that in order to have coherent national and sovereign regulation with multilateral framework is important to have a building-capacity in the SSE so that they can create new proposals that could be more suitable for them and for other developing countries.

## Chapter 3

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### **SSE: Trade domination**

International trade domination has become more notorious in different regions of the world, which depend more and more on international networks for exporting and importing. Thus, this interdependence has grown in importance in the last years. International trade, also known as integration into the world economy has become more significant for SSE than it is for any other country in the world. This is due to different reasons: one of them is the reduced size of its national market, the diversity of its own production, and the build-on capacity for diversification of the national production. International insertion is regarded by many researchers as another track for development, because this process can promote both growth and progress. However, after several years of liberalization of the SSE markets to international trade and the integration of SSE to the world economy through bilateral, regional and multilateral blocs of integration, growth and development are not evidenced for all the South American countries, especially for the SSE.

The analysis centers on trade domination from the LSE towards the SSE at multilateral system. At the same time, it links globalization and domination and its effect on national policy with a specific view for development and trade. Trade in the last twenty years has been moved by geopolitical interest of the LSE, promoting the creation of supranational regulations for market liberalization and non-tariff barriers (SPS/TBT) in order to reach a more open and operational market for its products, and the opportunity for its economy to grow. This chapter wants to interrogate *how trade domination can affect development and international insertion with a better bargaining for SSE within the multilateral frame*. This chapter will help to answer questions like; how could SSE influence the creation of norms in favor of them, and how could their power influence the agenda of WTO or IEOs to have a better international integration?. All these issues will be analyzed from the side of multilateralism. We will concentrate on the international trade dimension of multilateralism and how this type of integration affects trade and development of SSE.

To achieve this goal, this chapter will have two sub-parts: the first one will be on economic and trade domination and a second sub-part on political trade domination. To present these issues, we will show that trade relations are linked to domination of different nature like the number of partners and size of these partners, their influence in the WTO agenda. This all will be analyzed from the international political economics (IPE) point of view within a dual vision: economic and political. Both visions were chosen so we can have an integrated approach to the problems that SSE face in international insertion.

### **3.1 Economic and Trade Domination**

Internationally Dominant Power can impose its vision for trade at multilateral level and this trade domination can change the political values, the type of FDI, the plan for national development. The dominance level can be shown by the degree of openness implicated since this reflects to what degree a country is integrated to the global economy and how much the national wealth depends on international markets. This is also mentioned by the World Development Indicators of the World Bank (2010). But dominance on SSE should not only be understood by the degree of openness but also through a process of cross information with other factors. For instance, the loss of a market for a small number of partners would represent a risk to its national income and the national economy. Another risk lies on the fact that the reduced size of a national market and the capacity for diversification to satisfy the needs of its population obliges SSE to import. Both of these situations can be considered as other examples of trade domination. Therefore, trade domination has created two groups in a SSE, the small group that wants to have multilateral world integration and the larger group that wants to have a more sovereign country that can trade only what is left from the national economy. A precedent national disintegration attributable to lack of infrastructure has led to a menacing political disintegration. The soaring domination from IDE<sup>63</sup> regarding power and trade has created social unrest in SSE. These groups complain about their international economic subjugation and blame their underdevelopment and poverty on this hegemony that leaves no room for SSE to

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<sup>63</sup> The International domination economy is represented with the US economy.

suggest multilateral norms that could benefit SSE in trade and financial liberalization. Thus, SSE are submitted to internalize norms that sometimes prejudice their national budget to be able to adapt to them. This last aspect makes planning and negotiation for international insertion very difficult for SSE authorities due to the conflict between constant social needs and the international level priorities. Accordingly, the issue of international trade domination turns more significant for SSE than it is for any other country in the world as we will present in the following paragraphs<sup>64</sup>.

The fact that a dependency to international markets exists in the SSE provided a sort of tool that was used very well by the U.S. and other dominant countries to push multilateralism and supranationality. The idea was to implement free-trade and market liberalization through multilateralization and influence everybody into believing that free trade is the only way to reach development and welfare. This dominant idea together with the constraint of size of their national market, made SSE dependent to international trade. Since then, the goal to reach progress was not based on the national development anymore, leaving the floor open to liberalization of national market and a preference for internationalization. The WTO alleged that trade would diversify national production and allow the economy to get the cheapest products for the consumers. However, the Chinese competence is ruining the local artisanat. The Washington Consensus suggested liberalization to countries that could not manage economies of large enough scale to provide competitive international prices. Since this was not possible, it increased their dependency on imports, causing national companies to disappear. Actually, this happened within years, SSE turned dependant on imports, reducing the exports in non-traditional products except for the increase of energy resources. This means that the trade balance is mostly negative and they are kept dominated by the hegemon leader that strategically defines which products and services to trade and which not to trade with the SSE. Therefore, SSE are kept in the cycle of trade openness mostly to import even what they were used to produce before (agricultural products for instance<sup>65</sup>) but with free trade turned to be more expensive than the imported ones. The application of the Washington Consensus did not mean a complete opening to trade, since different trade barriers were created.

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<sup>64</sup> Although this does not mean that SSE countries put international trade under their priority agenda.

<sup>65</sup> Before the 80s, almost all SSE were self-sustainable on agricultural production. Bit by bit that has changed. In the case of Bolivia, 10% of its total exports are agricultural products and 10% of its total imports are agricultural products.

SPS and TBT barriers were settled for countries to take care of their national security at the time when each country was increasing trade dependency. SSE not only purchased tertiary products (machinery and others) but also basic goods (all food items for example) and processed oil and gas items.

SSE depend first in LSE from developed countries and then in the LSE from developing countries. Table 3-1 shows average trade flows during the last 33 years for SSE and shows export domination for about 48.4% in average towards developed economies, mostly the United States. The exports are directed to neighboring countries mostly to Brazil and Argentina. The exception to this is Paraguay since 56% of its trade is originated in a large economy from developing countries: Brazil mostly but also Argentina and Uruguay. For Uruguay and Paraguay, the majority of their exports go to the European Union rather than the United States as is the case of Bolivia and Ecuador. The reason might be the easiness for transporting<sup>66</sup>. Around 45.4% SSE are dependent on developing countries. Regional neighbors with large size economies such as Brazil (and Argentina afterwards) are the most important markets for SSE at regional level. Therefore, around 50% (in average for all the SSE) of their international trade towards developing countries is dependent on regional LSE partners. This is the case for the exports and imports as well.

**Table 3-1. SSE: Trade structure by main region of destination (1975-2009).** This trade structure shows an average of trade by country to every region of the world. It can be observed that SSE depend on developed economies and neighbors economies.

	Bolivia		Ecuador		Paraguay		Uruguay	
	X	M	X	M	X	M	X	M
Developed Economies	49,2	50,3	62,9	64,6	37,8	33,2	43,6	33,5
United States	22,6	23,0	46,0	33,1	5,1	9,9	12,3	10,1
Developing Economies	48,1	47,2	25,3	31,8	56,0	65,6	52,3	62,7
South America	46,7	42,1	15,5	22,5	49,8	46,4	36,9	41,8
Brazil	14,0	18,0	1,0	5,0	32,8	27,8	25,0	21,2
Economies in Transition	0,6	0,3	2,1	0,8	1,7	0,0	3,1	3,2

Source: Own calculations based on UNCTAD Statistics 2010, Geneva, 2010.

<sup>66</sup> Transport for Bolivia goes easily and cheaper via Iquique (Chile); Ecuador has a sea port, the same Uruguay. For Paraguay, they have a river that goes to Uruguay for exporting or through Buenos Aires (Argentina). Then, for Bolivia and Ecuador is easier to export to US than to the EU via the Pacific Ocean. For Paraguay and Uruguay is easier to export to the EU via the Atlantic Ocean.



International insertion has become a very important factor for advancement. Many of the strategies for development that have been proposed in the last years had to deal with a higher international insertion (Rodrik, 2000; Dollar, 2003). SSE are not the exception, because they are constantly trying to improve their insertion by improving their power of negotiation at an international level, so their products are not clogged up or denied in other markets. Multilateral organizations promoted free trade, but this type of trade, despite the TBT and SPS normative, increased gaps between countries and exalted the breach between poor and rich, and small and large economies. In the race for international integration, governments from SSE have focused more on the extractive sectors leaving behind fundamental areas like agriculture. Only oil/gas/mining sectors were taken into account for international trade, forgetting development through the national market. This was intensified by the Washington Consensus in the 90s. In the following sub-parts of this chapter all these issues will be presented in detail. In the first sub-part, we will analyze how national disintegration is an increasing threat in SSE while the richest parts of the country want to have world integration. We will evaluate how diversified the partners and the sectors of these SSE are. We will try to present the main reasons why a national domination and the need for trade openness exist in SSE. Accordingly, we will try to convey key ideas to profile trade impacts due to multilateralization and the participation of SSE in the WTO.

### **A. World integration and National disintegration**

The type of democracy that has been implemented by the dominant economy has led SSE to concentrate their development on the main cities and not in the entire country (read more in chapter 1: Typology). This has led to home conflicts in the absence of a common view for a national integration, which influences the international insertion. The eagerness of SSE to integrate at international level has left the great problems at national level unattended. The worst known case is in Bolivia, which is threatening towards political disintegration due to the fact that the richest cities based on agri-business would prefer to avoid government controls for providing the national economy first so that they can export without troubles. Whereas the richest cities would like to integrate more to the world economy exporting their products, the

poorer cities struggle with lack of food security and poverty. The view of development that U.S. and the IEOs implemented in the world towards free-trade and market liberalization does not fit with the reality of most SSE that have only 1 to 3 large cities prepared for internationalization while more than 60% of the country remains in poverty and displays a lack of proper food diversification and energy sources which are being exported by the main cities. As a result, political disintegration might take place as some cities wish to have more international insertion without minding the needs of the other less endowed. As Spolaore (2007) mentioned, civil conflicts takes place before borders are set, in order to determine whether there should be one country or two; and the stronger region takes decisions “democratically” about their preferred type of government to the citizens of the smaller regions, fact which later turns to be as "conflict inputs". Economic conflicts turn into political conflicts which could lead to political disintegration or higher social unrest. This is created by some contradictions in the economic and political management of the country.

*The first contradiction is that the main cities decide the destiny of all the country dealing with its international orientation.* Largest cities contain an internationalized nucleus of activities, regions and social institutions of varying degrees of importance in each country. These sectors share a common culture which expresses itself through the same books, texts, films, television programmes, similar fashions, similar groups of organization of family and social life, similar style of decoration of homes, similar orientations to housing, building, furniture and urban design that came through international companies installed in the main cities of the SSE. This way of life defines development through international insertion. However, this internationalization does not fit with the needs of the rest of the country being that they are not yet prepared for internationalization. These two points of view for reaching development is what creates internal conflicts, when powerful groups proper of the main cities decide to choose the international orientation and the development path without taking measures to increase the capacity of the rest of the country for adapting to it. Osvaldo Sunkel (1972) mentions that the intervention of TNCs creates modernization which implies the gradual replacement of the traditional productive structure by another of much higher capital intensiveness (...) and incorporates individuals and groups that are apt to fit into that kind of rationality; expelling the

individuals who lack the capacity to become adapted to it, preventing or limiting the formation of a national entrepreneurial class and even a national working class. The marginalized entrepreneur will probably be added to the ranks of small or artisanal manufacture, or will abandon independent activity and become middle class employees. The IDP managed to implement a vision of development and a way of life different to the population living in the country. This is one of the main reasons why the population is divided and as a consequence of this division the rise of social unrest and income inequality becomes evident. While there is a class with export driven agriculture without regards to the environment, there is agriculture of subsistence that has not enough income and pushes migration to constitute mega-cities with a high concentration of the total population and not many opportunities to improve their life.

*The second contradiction is the incapacity to change the production structure.* The SSE have a long time history for being suppliers of raw material: agriculture, mining, hydrocarbons, etc. This is why SSE are more sensible to international price changes, political conflicts or to SPS/TBT norms than any other country. Raw materials are submitted to different barriers to export (quantity, quality, sanitary measures and technical barriers) that do not allow SSE to export. LSE from developed countries have consumers that demand other quality standards and SPS measures that small producers would not be able to invest in. As a result, exports to LSE-developed countries remain in niche markets that require little and unfrequent quantities of the product. On the other hand, LSE-developing countries (for example Brazil) have the same patterns of consumption and similar quality and preference standards within its consumers. Therefore, LSE-developing countries share the same production structure which encourages the government to protect its producers, creating technical barriers that are impossible to comply for small scale producers. Worst, given the relative price inelasticity of demand for raw materials, SSE do not benefit with an increase of demand of their products. Hydrocarbons as raw materials do not have these type of trade barriers (SPS/TBT) due to the urgent demand for them in the market, but the government has no money to invest in industrialization.

The national level of integration is given by the level of the development that a national economy has. According to Maniruzzaman (1967) national cleavages can shatter development. Then, if the country invests on infrastructure to integrate internal

markets, the national market and productivity could grow larger as well as the possibilities to export. This type of infrastructure development is successful as it provides equal opportunities in all the regions of the country. Social conflicts as well as economic problems can rise if the government pays more attention to some regions and not to others. These two contradictions have a large impact on the national disintegration. Small production that is destined for foreign niche markets gives little negotiation power face to LSE. These types of conflicts of integration become visible with different levels of *power of negotiation that regional economies have*. What we just stated can be analyzed by historical facts of regional performance inside. Santa Cruz, the oriental part of Bolivia, had great opportunities for its development since they had a better capacity for negotiation and government interests<sup>67</sup>; hence, the government dedicated most of the national budget to Santa Cruz in the construction of roads, infrastructure and other projects forgetting the other regions of the country. In other SSE, the same happened and this is why only few cities are the ones that are developed and they can be compared to European or American cities while others are immersed in poverty and lack even basic services. *Asymmetric development* occurs often in SSE since there are regions that are developed, as any other developed country, together with regions that are very poor and underdeveloped. Consequently, some regions can produce to export and some others can only produce for their self-consumption. Asymmetries of information treated by Stiglitz, Akerlof, Spence (2001) do not take into account that main actors are conditioned by the size of the economy where they live and work in at the time of international negotiations. And this can be a main fact for international insertion and development.

National disintegration keeps SSE chained to international dependence. The fact that few cities decide the way to internationalize the economy leaves the rest of the country underdeveloped. National disintegration does not allow the increase of national production and the enlargement of the market because the industries prefer to

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<sup>67</sup> Santa Cruz had largely benefited from military governments (1964–1970) and dictatorship period (1970–1987), from the government of Hugo Banzer especially that was later democratically elected (1997–2002). Banzer was from Santa Cruz and in order to keep the power under control and benefit from its natural resources and keep the population concentrated, pushed its development using the government budget (from hydrocarbons and tin exports) to develop this city, potentially rich in natural resources as well. During his dictatorship and being part of the Operation Condor (a clandestine network supported by Washington), the international debt went from 782 million dollars (1971) to 3000 million dollars (1978). Although it is difficult to prove that international debt went only to the development of Santa Cruz, this city developed to become the second largest city in Bolivia.

export rather than facing high costs of distribution on the national market. In the last years, this has enabled larger and prosperous cities to seek for autonomy or a more decentralized government management, so that they can handle their income and regional taxes without sharing this growth with the rest of the country. The feeling for autonomy has raised in the people who live in the larger cities demanding their independence from national government and finances claiming that a centralized government only delays their growth because the money that they produce is spread all over the country. Several examples can be given in different SSE but the most recent is the case of Bolivia where we can see a demand for autonomy coming from the oriental part while the western part (poor in productive land and reduced population) is capable of giving their lives in the fight against autonomy (Box 3-1).

**Box 3-1. Autonomy demands in Bolivia: rich clashes with poor**

In Bolivia, Autonomy feelings started in 1985, but became more relevant in October 2003 when the population obliged the interim President to approve the law of referendum for autonomy. Autonomy here means not a geographical division but meaning a separated financial management per region. Elections were called in 2006 and four out of five departments voted for autonomy (Santa Cruz, Beni, Pando and Tarija). Later on, the city of Santa Cruz, a lowland state and the wealthiest, defined its statute for Autonomy and on May 4th 2008, called for a referendum which obtained more than 82% in favor.

The most important points of the Statute are: better distribution of resources per region that until now was asymmetric, greater citizen participation in the planning of the region; divide the political power by regions; improve management of resources to solve failures in infrastructure, health, roads, education, a police force and other priorities that until now were badly carried out by a centralized government. The implementation of this Autonomy is based in three big changes: a) eradicate the neoliberal model and modify it by a new Autonomic Productive Model (based in entrepreneurial initiative); b) management of resources to develop accordingly to sovereign plans and needs and not submitted to a centralized government, c) become trade independent and have no restrictions.

The problem with the autonomy is that one of the most productive region under which the state would hold on to nearly two-thirds of the tax revenues at national level wants to become financially independent and this could prejudice the most unproductive cities that had already major gaps of development of pre-existing differences in local management capabilities. So, they depend economically on the three major regions of the country. Then, the net effect of these two forces (centralization and decentralization) could be positive for rich regions and negative for less developed ones, which of course would imply an increase in regional disparities. This is why the international concern was greater for a SSE as Bolivia since it endangered the future of a common development in Bolivia.

Source: Own elaboration based in different press releases from Bolivia, March-May 2008.

National integration is important for the national development and welfare. SSE economies are not integrated and they cannot afford to have a product at a national level due to a lack of infrastructure and roads. The first step before aiming for a better

international insertion is to integrate at a national level; otherwise, the disintegration will lead to constant social unrest and could very well reduce the population's welfare due to regional differences and unequal opportunities.

## **B. Export domination**

Statistical analysis of eleven years was used to determine the export domination of SSE countries and their main trade partners. Export domination is based on the total exports of the country over the GDP expressed in dollars. This indicator reflects the country's involvement in exports and its international insertion in the world economy as an exporter. When this number is large, we can say that the country depends on exports (as we presented in trade openness in chapter 1). Exports mean a lot for an SSE in terms of its GDP, particularly in the last four years (2006-2009). For instance, if we compare total exports with the national GDP, for Bolivia it means 54.25% of its GDP, for Ecuador 76.19%, Paraguay 43.78% and Uruguay 35.72% of its GDP. This means that any reduction in exports would endanger their national economy. Unfortunately, for SSE, SPS/TBT barriers are a constant threat because the majority of its exports are primary commodities and are susceptible to these barriers. A second threat is the political conflicts with trade partners that can derivate in broken relations or the creation of SPS/TBT measures as a retaliation method which decreases trade between countries. The explanation for the name Export Domination is based in the fact that LSE are the main rule settlers at multilateral arena and the ones who can decide virtually everything, even what level of quality they require from products offered by the SSE. International insertion has gained importance with the application of the Washington Consensus in the 90s and SSE pushed industries and sectors to export<sup>68</sup>. This new view of development changed the complete set of priorities for the government since the "degree of development" started to be compared with "how much exports grew on a year basis" rather than seeing if all the population could afford having the same product that was exported. This contradiction can be observed

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<sup>68</sup> SSE promoted industries or agricultural business that could orient their production to export by reducing tax for activities related with exports.

in Bolivia who exported at cheaper prices to Argentina<sup>69</sup> (soybean-oil, maize, etc.) than to certain regions in Bolivia; and natural gas was available for export while it was only available to less than 1% of the population. This export domination created gaps between those agribusiness whose main objective was exporting and the rest of agriculture that was self-sustainable and without competitiveness within international markets.

**Table 3-2. Country Export structure by product group, in percentage. 1995-2009.** This export structure shows how dependent are SSE on primary commodities (more than 72%) and LSE on manufactured goods (more than 52%) less dependent on price elasticity of demand.

	Year	Primary commodities, including fuels <sup>1</sup>				Manufactured goods <sup>2</sup>				
		Food item	Agricultural r.	Ores/metal	Fuels	Chemical	Machinery	ε	Other mnf	
<b>Argentina</b>	1995-2005	<b>67,2</b>	47,9	2,3	2,7	14,3	<b>31,5</b>	7,2	11,7	12,6
	2006-2008	<b>66,8</b>	49,2	1,2	4,7	11,7	<b>31,1</b>	7,9	13,4	9,7
<b>Bolivia</b>	1995-2005	<b>74,5</b>	26,8	4,5	22,9	20,2	<b>19,7</b>	1,1	7,4	11,2
	2006-2008	<b>91,4</b>	14,4	1,4	26,3	49,3	<b>7,6</b>	1,2	1,0	5,3
<b>Brazil</b>	1995-2005	<b>44,5</b>	28,0	4,2	9,5	2,7	<b>53,2</b>	6,2	23,9	23,0
	2006-2008	<b>50,8</b>	26,2	3,7	12,4	8,5	<b>46,7</b>	6,6	22,7	17,5
<b>Chile</b>	1995-2005	<b>81,5</b>	25,2	10,0	45,3	1,0	<b>14,7</b>	5,2	2,4	7,1
	2006-2008	<b>86,4</b>	15,4	5,9	63,6	1,5	<b>10,8</b>	4,3	1,6	5,0
<b>Colombia</b>	1995-2005	<b>64,7</b>	22,9	5,2	0,8	35,8	<b>33,8</b>	9,6	4,3	19,9
	2006-2008	<b>63,7</b>	15,1	4,0	4,3	40,2	<b>35,1</b>	8,1	6,2	20,9
<b>Ecuador</b>	1995-2005	<b>90,6</b>	45,1	4,7	0,2	40,6	<b>8,7</b>	1,6	2,0	5,0
	2006-2008	<b>91,8</b>	26,2	3,8	1,0	60,8	<b>8,1</b>	1,2	3,3	3,6
<b>Paraguay</b>	1995-2005	<b>84,4</b>	68,4	15,4	0,5	0,1	<b>15,1</b>	2,7	0,6	11,9
	2006-2008	<b>88,4</b>	82,4	5,2	0,9	na	<b>11,6</b>	2,5	0,9	8,2
<b>Peru</b>	1995-2005	<b>67,4</b>	24,2	2,2	34,9	6,1	<b>16,3</b>	2,6	1,0	12,7
	2006-2008	<b>82,1</b>	14,7	1,3	57,5	8,6	<b>12,3</b>	2,4	0,6	9,3
<b>Uruguay</b>	1995-2005	<b>62,7</b>	49,2	11,3	0,5	1,7	<b>36,4</b>	5,8	5,4	25,2
	2006-2008	<b>71,3</b>	55,7	10,3	1,7	3,6	<b>28,3</b>	6,4	3,7	18,2
<b>Venezuela</b>	1995-2005	<b>87,6</b>	2,0	0,2	4,3	81,2	<b>12,1</b>	3,5	2,1	6,5
	2006-2008	<b>94,1</b>	0,3	0,0	2,4	91,4	<b>5,9</b>	1,4	0,9	3,6
<b>Cuba</b>	1995-2005	<b>85,5</b>	53,8	0,3	30,2	1,3	<b>12,4</b>	4,2	1,3	6,9
	2006-2008	<b>74,0</b>	34,6	1,3	36,9	1,2	<b>18,8</b>	6,8	6,2	5,8
<b>United States</b>	1995-2005	<b>14,5</b>	8,1	2,5	2,1	1,9	<b>81,6</b>	11,4	50,4	19,9
	2006-2008	<b>19,4</b>	7,6	2,2	5,2	4,3	<b>77,3</b>	13,4	45,6	18,3
<b>China</b>	1995-2005	<b>11,7</b>	5,7	1,1	1,8	3,0	<b>88,2</b>	5,2	33,5	49,6
	2006-2008	<b>7,0</b>	2,7	0,5	2,0	1,9	<b>92,8</b>	5,0	47,2	40,5

<sup>1</sup> Primary commodities include: All food items, Agricultural raw materials, Ores and metal, Fuels

<sup>2</sup> Manufactured goods include: Chemical products, Machinery and transport equipment and Other manufactured goods

Source: Own calculations based on UNCTAD Statistics, Geneva, 2010.

While export domination was growing, the number of buyers was not. Actually, due to a lack of competitiveness for international markets, SSE have settled their exports to those countries which had a SDT for SSE. LSE-developed countries such as the U.S., the European Union and Japan signed several bilateral and multilateral agreements

<sup>69</sup> Bolivia as well as other SSE or developing countries have “incentives to export”. One of them is that the Government pays-back the export taxes that the exporter had and some other measures for the promotion of exports. This is why, sometimes, products are cheaper to export than to sell at national level.

under the umbrella of the WTO to grant these countries with preferential treatment for their agricultural products to access their markets. This of course has worked but only created more dependence towards the dominant countries that maintained the agreement as long as the SSE would follow certain conditionalities in exchange<sup>70</sup>.

Due to different factors, SSE became primary commodity-export dependent. This increases their sensibility to external shocks: in price, demand drops, quality and of course SPS/TBT barriers. As table 3-2 shows above, almost all the South American countries have the same export structure as SSE which increases the competition in the region. South America in average has more than 78.7% belongs to export in primary commodities and fuels in the region, with the exception of Brazil which only depends in 50.8% because more than half of its export structure belongs to manufactured goods as well, being the most industrialized country of the region with 46.7%. With an increase of 140% in the last four years, Bolivia and an increase of 50% Ecuador, both base their economy in the export of fuels. Paraguay and Uruguay which do not have fuels or minerals depend more than 55.7% on food items with an average increase of 10% in the last four years. On the other hand, LSE (U.S.) depend for more than 77.3% on manufactured goods having faced a reduction of 10% in the last four years probably against China. Primary structure of products to export makes the SSE countries susceptible to inelasticity of their products and their target markets are sensitive to the amount of providers that could provide with the same products, especially with agricultural products. The problem here is that agriculture is a competitive business. Even worst, the chains for distribution and export at international level are centralized in international traders which display a control over production and quality through a high or low demand for the national products or from other countries. Chain coordination tends to be loose and indirect in the SSE. The main source of profitability is volume rather than margins for agriculture producers and for small scale producers, this is difficult. Only technical change can alter the chain dynamics and lead small producers to a better international insertion (Box 3-2).

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<sup>70</sup> Special and differential treatment demanded certain conditionalities dealing with economic restructuring and market liberalization was part of this, international debt management, anti-drug policies, etc.



### Box 3-2. Failed exports: rice from Uruguay

Rice imports from neighboring Mercosur countries have led to different scenarios of hostility from Brazilian producers (Rio Grande do Sul), who pushed their government to implement legal actions to stop imports and raise safeguards from 2000. Several demonstrations at border crossings have impeded imports from Argentina and Uruguay and the case even reached the WTO. The *Regional Law from Porto Alegre* decreed this interdiction to protect its national production but Mercosur and the Uruguayan government declared that it was forbidden to close frontiers but Brazil did not hear them and kept blocking frontiers.

Brazilian rice producers who saw themselves threatened by a reduction in their demand and prices have complained for the past years about supplies from neighboring countries flooding the market and depressing prices and they have impeded this since 2000, obliging their local government to implement safeguards against the rice of Uruguay, even when the central government of Brazil denied protective measures. Rice producers in Brazil have denounced the measure that the government of Brazil took to reduce inflation, high retail prices and lack of provision in the 90s already represented a big threaten to the national production by 2000. Besides, the new levels for the Common External Tariff under the Mercosur trade pact that were reduced to 4% for paddy, brown or milled rice originating from countries outside of Mercosur are also prejudicing their production.

Uruguayan government has publicly condemned the boarder protests and the "attitude of Brazilian producers" and these problems are worrisome to Uruguayan exporters who fear actions against imports because they cannot do anything against it. Uruguay sees Brazil as less of a partner and more a trade adversary who competes in the same markets as those from Uruguay or other partners of Mercosur. Current law demands the Uruguayan rice to be transported to Sao Paulo through sea. Despite this temporary solution, the veto to imports of rice together with the non-reaction of the government of Brazil towards the problem with the cellulose plants with Argentina is increasing the Uruguayan negative impression to Mercosur. Up to now (2009) this conflict keeps repeating without the government of Brazil at national level to stop the barriers, denying that they have any barriers to trade.

Source: Oryza Market Report, 2006 and Defesa @ net, 2006 and 2009.

SSE not only compete with neighbors with relatively larger economies on similar agricultural products and fuels for export, but also struggle with the similarity of trade partners where they export. Table 3-3 shows the importance of each region for the SSE and compares it to the relatively larger economies which have the same partners buying similar products from them and of course, competing with each other in price, quality and quantity exported. This situation confers little margin for improvement regarding negotiations at the multilateral arena: a) they compete with LSE that have a better scale production, b) they have to open up more their markets or accept more conditionalities to get SDT from LSE within niche markets to avoid competing with larger neighbors. In table 3-3, if we sum all SSE together and get an average of their exports per region, we can evidence that SSE depend for more than 45% in Latin America, 21% in the U.S., 19% in the European Union and only 5% in Asia particularly China.

**Table 3-3. SSE and Main Partners: Exports by main region of destination. Average in percentage, average of exports in million dollars, 1990-2009.** This trade structure shows SSE have a high rate of dependency in Southern American countries and U.S./ EU.

	EU	US	JP	LA	Asia	Others	average X in million \$
Argentina	23	12	2	39	12	11	29.201.866
Bolivia	22	19	1	54	2	2	1.781.028
Brazil	27	22	5	20	10	10	70.535.622
Chile	29	17	14	17	16	4	23.189.832
Colombia	19	46	2	27	3	3	13.966.374
Ecuador	15	46	2	22	4	5	6.156.017
Paraguay	18	4	1	61	5	4	1.177.634
Peru	28	27	7	18	12	6	9.406.954
Uruguay	21	14	1	43	9	10	2.577.577
Venezuela	9	51	1	22	2	2	30.251.637
Cuba	37	0	3	12	14	33	1.900.614
United States	25	..	9	19	17	31	746.161.857
China	16	17	14	2	41	10	372.058.117

Regions are: European Union (EU), United States, Japan and all Asia (mainly China), Latin America (LA) and others.

Source: Own calculations based on UNCTAD Statistics 2010, Geneva, 2010.

Although exports to China are small, the yearly growth rate in the last seven years was enormous and the potential for the future remains high. The exception of the SSE group here is Ecuador which depends in average 46% in the U.S. market and 22% in Latin America. The situation of the SSE is not the same with the rest of the South American countries which first partner is the United States with 29%, second are neighboring countries but with only 24%, EU with 22% and Asia with 9%. We can confirm that all South American countries mainly depend on exports towards the United States and Latin America (neighboring countries). The U.S. market is an unavoidable partner for both of these reasons, relative geographical proximity (comparable to EU or Asia) and its large market size which can be targeted for commodity-fuels or niche markets. U.S. market has a huge diversity of tastes and demands for consumption that has a more open market than Brazil in the region. Of course, depending on the U.S. market poses risks for the SSE as they count on exports with special and differential treatment (SDT). If this situation ends, the SSE could not be able to cope with a comparative advantage as it will be presented in detail in chapter 2. Table 3-3 also shows that larger economies as Brazil have equally divided their exports in different regions and countries. Around 25% of their exports depend in the United States or European Union and similar amount depend on Southern

American countries. This fact grants LSE with a reduced risk for market or partner loss. For SSE, this has advantages and disadvantages. For Uruguay, for instance, an average of 43% is destined to South America and more than 50% of this percentage is towards the Brazilian market. Then, every trade barrier from Brazilian to Uruguayan imports has a huge impact on Uruguay's possibilities to export. Even when all the countries under our analysis are signataires of the WTO and accept free trade and market liberalization, SSE have been facing several barriers for market access. The WTO has been trying to find ways to standardize the SPS/TBT barriers for example through common norms but still allowing countries to adopt their own measures to the extent that they do not represent a market protection. Even so, SSE have faced more difficulties than any other developing country, not being able to adapt to standard norms and thus affecting their international insertion to multilateral trading system. This is why, on March 2002, the General Council of the WTO agreed that the question of small economies would be a standing agenda item and that the Committee of Trade and Development (CTD) would hold dedicated sessions focused on this question and report regularly to the General Council on how the assistance is advancing without creating a separate category of WTO members<sup>71</sup>. In November 2005, the Ministerial Declaration held in Hong Kong contained several references to SSE and its monitored progress of proposals made by small economies in the WTO's negotiating groups and other bodies (Paragraph 41), also its will to establish ways to provide flexibilities for small, vulnerable economies without creating a sub-category of WTO Members (paragraph 26) to formalize the decision taken in 2002. Appart from these declarations, not many effective actions have been taken. In September 2006, the CTD adopted a report on measures to assist Small Economies in meeting their obligations under the agreements on SPS/TBT and TRIPS measures (WT/COMTD/SE/5). This document states in the 35<sup>th</sup> paragraph of the Doha Ministerial Declaration that the objective of framing answers to the trade-related issues identified for the fuller integration of small, vulnerable economies into the multilateral trading system, without creating a sub-category of the WTO members. They support their assistance in the fact that SSE have to go through different structural economic changes that advocated the application of the Washington Consensus in the 90s (WT/COMTD/SE/W/15, WT/COMTD/SE/W/16 and

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<sup>71</sup> WTO, 2002. Work programme on small economies – framework and procedures. WT/L/447. Geneva.

WT/COMTD/SE/W/18) but until now they did not implement the designation of regional bodies that could assist the SSE in the implementation of their obligations in the SPS/TBT and TRIPS Agreements since these underwent two revisions, in order to take the concerns raised by other Members into account. Even after long discussions, the final word of WTO is to accept that SSE use regional bodies to assist them but this cannot prejudice integration and the implementation of other measures. The problem that can be observed here is that the WTO demonstrates little effectiveness on the decision to assist the SSE in their difficulties of integration and adoption of SPS/TBT measures since all measures will keep being applicable and free trade cannot be stopped. The fact that WTO promotes free-market still poses limitations for the effective application of it, leaving sovereign decisions to adopt specific SPS or TBT barriers to protect the security of their national territories which is a big constraint for SSE and its products.

This is why export dependence on LSE from developed countries has advantages and disadvantages. The advantage is having the chance to export to a large country at better prices. The disadvantages are many. First of all, agricultural countries as the SSE lose to large scale agricultural production not only because the consumer shifts to cheaper markets (creating trade imbalances) but also because the consumption of agricultural products is inelastic and even when the price is low, the demand will not increase. Second, SSE compete with larger economies in the region that have the same trade partners which leads to permanent regional tensions and political conflicts that minate the multilateral harmony raising distrust in open trade and open competence. Finally, the last difficulty is to be confronted with more SPS barriers and trade disappearance if the SPS norm is not complied. SSE countries suffer from barriers of export towards developed countries (Kamplinski and Morris, 1999) due to quality, specifications of the product, etc. which represents a big disadvantage for international insertion.

Foreign markets are more difficult to penetrate since it is difficult to know the consumer and their specific preferences for SSE. Due to these problems; it is easier to think that exporting to neighboring countries should be easier (Cordova, 2001 and 2007). If SSE export to the region, they have a potential to sell the same quality and type of products abroad that they produce, since there is a larger possibility to have

similar demands with neighboring countries that have less income, quality demands and preference gap than with richer countries. Besides, private companies are often more profitable when they export to neighboring countries due to lower transport costs and frontier barriers, which gives them the possibility to expand their size. Preferential agreements with none or reduced taxes are widely common between South American countries<sup>72</sup>. Thus, exporting to neighboring countries is beneficial because SSE can take advantage of larger economies with similar patterns of consumption, quality demands, enchainment and industrialization in agriculture and hydrocarbon sectors that are mostly exported in the region. On the other hand, to export in the region is not easy and there are difficulties. One of them is that neighboring countries have similar products in the agricultural sector and they barely demand high quantities since they are sensitive to national competition. There is an import demand by a segment of the population but with high control from the government (local or regional) such as statistics on the evolution of the imports of this product and the creation and implementation of TBT barriers. As long as the SSE supplies cities that need the product there is no evident problems, but as soon as the products represent an endanger to their national production, they tend to create TBT barriers despite their common agreements and SDT, the imports from SSE are cancelled or reduced to a minimum that would not imperil their national production as we will present later on the chapters. Still, history has proven that these types of barriers apply only to agricultural products and not to hydrocarbons or mining.

Table 3-4 shows the index of diversification and concentration of exports. The index of export diversification or also called the Finger-Kreinin measure of similarity in trade (Finger and Kreinin, 1979) shows extensively how SSE's export depends on particular products relative to world exports. Diversification for SSE shows a number nearby 1 (average of 0.74 until 2005 that later on reduced to 0.50). This means that there is a great difference between the SSE trade structure and the world trade structure and that little number of persons who do almost all the exports. Different countries in South America have the same trade diversification as SSE. A great difference can be noted in Brazil that is considerable lower than the rest of the countries. The other LSE have lower index, 0.14 in the United States. SSE could still

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<sup>72</sup> Bolivia, Ecuador, Paraguay and Uruguay belong to different regional integration groups. The most important are: ANCOM, MERCOSUR, ALBA-TCP, LAIA, SCN.

have possibilities to increase market shares. Still, there are other aspects to take into consideration before: scale of production, trade barriers (SPS-TBT norms) that have a great influence on trade structure. Growth in trade for SSE also would depend on their diversification at a geographic level with trade partners and buyers (vertical diversification). This would reduce risks of quality demands from the buyer and market reduction, as a consequence of quality standards. Horizontal diversification is also important because it lessens the risk in market or economic changes (price fluctuation, over-supply of one product, etc.). Therefore, it is important to constantly have an analysis on what is the most convenient for the SSE.

**Table 3-4. Diversification and Concentration indices of exports, 1995-2009.** Diversification is higher in Latin American countries compared to the United States; while concentration of few products is more common in Southern American countries and this index remains low in larger economies.

Country	index 1995-2005			index 2006-2008		
	Number products	Diversification	Concentration	Number products	Diversification	Concentration
Argentina	252	0,57	0,14	254	0,28	0,43
Bolivia	125	0,76	0,24	120	0,55	0,56
Brazil	253	0,51	0,09	256	0,22	0,34
Chile	251	0,76	0,29	252	0,51	0,64
Colombia	220	0,63	0,24	235	0,34	0,45
Ecuador	160	0,77	0,41	187	0,61	0,67
Paraguay	108	0,78	0,38	128	0,51	0,63
Peru	197	0,78	0,23	219	0,43	0,60
Uruguay	170	0,67	0,18	187	0,35	0,52
Venezuela	212	0,80	0,65	195	0,88	0,85
Cuba	105	0,83	0,46	171	0,55	0,63
United States	258	0,26	0,08	258	0,14	0,20
China	255	0,46	0,09	256	0,22	0,34

Close to 1 = It indicates a bigger difference from the world average and the structure of trade of the country, or close to 1 = is little number of products that take all the biggest exports, or close to 1 = few producers or traders do almost all exports.

Source: Own calculations based on UNCTAD Statistics 2010. Geneva, 2010.

The index of trade concentration, also called Herfindahl-Hirschman index, shows the concentration of the trade structure on one or small a number of products within the exports of the country (close to one means a higher concentration). Concentration for the SSE was under 0.41 between 2000-2005 but in the last four years, all SSE increased their index of trade concentration into fewer products (e.g. fuels: petroleum or gas for Bolivia and Ecuador or soybean for Paraguay and Uruguay) ranging from 0.52 until 0.67. SSE countries increased their concentration of exports in one or few products and this increased the risk of dependency particularly in times of crisis, for

instance the financial crisis of 2008 that collapsed the price of fuels which affected very much the SSE and its social programs. In general, the region has a maximum concentration with Venezuela that bases its economy in petroleum (0.85). Ciphers are less when the economy is bigger; countries as Brazil, United States and China range between 0.20 to 0.34. In general, trade concentration for SSE has a lot to do with trade instability and continuous changes in price. A great supplier of only one product to the world means not only profits but also high risks of fluctuation of their income due to exports, since it can also be associated with a small number of partners and or buyers for that particular product. For example Venezuela, who depends mostly on the exports of oil, noticed that if the U.S. partner decides to change the policy of import or consumption it has a direct impact on the income flow from exports. The same happens with two of the SSE that have increased dependency on the export of hydrocarbons which at the moment benefit from high prices. This improved the income flow for every one of these national economies, still if any changes would occur at international level, their participation at international level would change as well. Worst, concentration in SSE has an influence in the production structure from high dependency on few partners.

### **C. Import dependency**

A statistical analysis of fourteen years was used to determine the import dependency of SSE and main trade partners. Import dependency is based on the total imports of the country over the GDP expressed in dollars. This indicator reflects the country's involvement in imports and its international insertion in the world economy as an importer. When this number is large, we can say that the country depends on imports (as we presented in trade openness in chapter 1). Imports mean a lot for SSE and their GDP, particularly in the last four years (2006-2009). For instance, for Bolivia it means 41.29% of its GDP, for Ecuador 76.19%, Paraguay 112.30% and Uruguay 46.52% of its GDP. This means that a sharp reduction in imports could have devastating effects on their national economy and national consumption. This is because SSE economies import technology equipment or manufactured goods so they can produce supplies for national consumption and exports. Besides, in the last years, and thanks to the increasing liberalization of markets and reduction of trade barriers,

SSE countries have increased the amount of imported food items, as table 3-5 shows it was in average 11.5% between 1995-2005 and in the last 4 years, Paraguay and Uruguay reduced considerably the import of food items (their own industries grew up a lot). Bolivia and Ecuador reduced a bit the imports but on the other hand a lot of food items were imported by the government and given to the population as a donation or subsidy to cover the times of food crisis and hyperinflation in certain food items. Moreover, the amount of Food Assistance Programs have developed in Bolivia and Ecuador which have negatively impacted on the motivation for agricultural self-provision of some products.

**Table 3-5. Country Import structure by product group, in percentage. 1995-2009.** This import structure shows that SSE import an average of 25% of primary commodities (especially fuels and food items) and in manufactured goods of more than 74% (especially on machinery and transport equipment). What is interesting is that the import structure is similar to LSE.

	Year	Primary commodities, including fuels <sup>1</sup>					Manufactured goods <sup>2</sup>			
		Food item	Agricultural r	Ores/metal	Fuels		Chemical	Machinery	Other mnf	
<b>Argentina</b>	1995-2005	<b>13,0</b>	4,7	1,8	2,9	3,7	<b>86,5</b>	20,6	43,6	22,3
	2006-2008	<b>14,5</b>	3,6	1,3	3,6	6,0	<b>84,9</b>	18,4	47,1	19,3
<b>Bolivia</b>	1995-2005	<b>19,4</b>	11,1	1,4	1,0	5,9	<b>79,5</b>	15,1	38,7	25,6
	2006-2008	<b>21,6</b>	9,7	1,1	1,2	9,6	<b>78,0</b>	17,4	34,7	25,9
<b>Brazil</b>	1995-2005	<b>26,6</b>	7,6	2,0	3,1	13,9	<b>73,4</b>	18,3	40,3	14,7
	2006-2008	<b>29,6</b>	4,5	1,4	4,7	19,0	<b>68,1</b>	18,9	34,6	14,7
<b>Chile</b>	1995-2005	<b>25,2</b>	7,4	1,2	1,6	15,0	<b>74,1</b>	12,6	37,9	23,6
	2006-2008	<b>37,8</b>	7,1	0,8	3,2	26,7	<b>62,0</b>	11,2	31,8	19,1
<b>Colombia</b>	1995-2005	<b>17,9</b>	11,2	2,2	2,3	2,2	<b>80,7</b>	20,9	37,2	22,6
	2006-2008	<b>17,2</b>	9,3	1,4	3,1	3,3	<b>81,9</b>	19,1	40,2	22,6
<b>Ecuador</b>	1995-2005	<b>20,5</b>	9,2	2,3	1,4	7,6	<b>78,5</b>	18,6	35,3	24,6
	2006-2008	<b>30,6</b>	8,0	1,1	1,3	20,2	<b>69,0</b>	15,5	31,4	22,1
<b>Paraguay</b>	1995-2005	<b>29,4</b>	15,3	0,7	1,0	12,4	<b>70,6</b>	13,8	33,9	22,9
	2006-2008	<b>21,7</b>	6,6	0,6	0,7	13,8	<b>78,2</b>	14,5	44,7	19,0
<b>Peru</b>	1995-2005	<b>29,4</b>	13,7	1,8	0,8	13,2	<b>70,5</b>	15,0	33,1	22,4
	2006-2008	<b>23,5</b>	8,5	3,0	0,6	11,4	<b>72,0</b>	16,0	26,6	29,3
<b>Uruguay</b>	1995-2005	<b>30,1</b>	10,9	3,4	1,3	14,5	<b>69,8</b>	18,5	27,7	23,6
	2006-2008	<b>38,5</b>	8,3	2,5	1,3	26,3	<b>61,5</b>	18,1	25,0	18,3
<b>Venezuela</b>	1995-2005	<b>19,5</b>	13,0	2,0	2,1	2,3	<b>80,5</b>	14,9	42,2	23,4
	2006-2008	<b>13,4</b>	10,3	1,0	1,5	0,6	<b>70,9</b>	11,1	39,6	20,2
<b>Cuba</b>	1995-2005	<b>41,3</b>	19,7	1,2	1,8	18,6	<b>58,4</b>	10,2	24,0	24,2
	2006-2008	<b>39,8</b>	15,1	0,8	3,3	20,6	<b>59,5</b>	8,0	27,9	23,6
<b>United States</b>	1995-2005	<b>19,0</b>	4,6	1,6	2,2	10,6	<b>77,1</b>	6,6	43,5	27,0
	2006-2008	<b>28,8</b>	4,3	1,1	3,6	19,9	<b>68,0</b>	8,0	36,4	23,7
<b>China</b>	1995-2005	<b>21,3</b>	4,4	4,4	5,7	6,8	<b>78,2</b>	13,1	42,3	22,8
	2006-2008	<b>30,3</b>	3,6	3,5	10,9	12,4	<b>69,4</b>	10,9	42,4	16,1

<sup>1</sup> Primary commodities include: All food items, Agricultural raw materials, Ores and metal, Fuels.

<sup>2</sup> Manufactured goods include: Chemical products, Machinery and transport equipment, Other manufactured goods.

Source: Own calculations based on UNCTAD Statistics 2010. Geneva, 2010.

Table 3-5 shows the detailed structure of imports by sectors and how the SSE depend more on manufactured good with more than 73.8% in average, being at least 35.1% of this sum based in machinery and transport equipment. This import structure is similar



to LSE that also depend on manufactured goods, despite the fact that their major exports are also based on machinery goods. What is interesting to see in table 3-5 is that SSE import a high percentage of food items, being themselves producers. Table 3-6 shows this last aspect again, similar products that are exported are also imported. This fact increases price sensitivity unnecessarily being that these nations could provide their local market first which is not possible due to lack of infrastructure. In fact, food crisis has been present in 2008 (Box 3-3) in these countries. This creates possibilities of import of products that come from neighboring countries at relatively shorter distance, and without mentioning, cheaper and faster than what national products would take to reach this far away city. Bolivia has food exports worth 26% of its structure and imports about half of it (11%). The same, it exports an average of 23% in fuels and imports an average of 6.21%. Ecuador exports average of 23% of fuels and imports an average of 9%. This is interesting because primary products do not much variation and it can somehow prove that national disintegration obliges to import from the relative close cities.

**Table 3-6. Bolivia and Ecuador: Main Imports and exports by sector: fuels and food items, in percentage and in million dollars, 2009.** This import structure shows that SSE imports similar products that were exported before.

<b>Bolivia - Fuels</b>	<b>Average Imports</b>	
	%	in million dollars
All the rest	91%	2,560,953
mineral oil and diesel	7.94%	223,967
fueloils	0.97%	27,399
other fuels and lubricants	0.30%	8,364
<b>Total fuels</b>	<b>9.21%</b>	<b>259,730</b>
	<b>Average Exports</b>	
	%	in million dollars
All the rest	51%	1,717,728
Natural Gas	42.10%	1,422,430
crude oil, bituminous mineral	6.20%	209,539
heavy oil, fueloils	0.43%	14,691
other fuels and lubricants	0.43%	14,479
<b>Total fuels</b>	<b>49.16%</b>	<b>1,661,139</b>

<b>Ecuador - Fuels</b>	<b>Average Imports</b>	
	%	in million dollars
All the rest	80%	9,705,582
Diesel 2	7.62%	919,400
Other oil and lubricants	6.66%	803,332
Disolving gasoline	4.33%	521,850
Oil manufactures to export oil & gas	0.95%	92,203
<b>Total fuels</b>	<b>19.56%</b>	<b>2,336,785</b>
	<b>Average Exports</b>	
	%	in million dollars
All the rest	41%	5,194,144
Crude oil and bituminous mineral	54.5%	6,934,010
Fueloils	3.84%	488,810
Disolving gasoline	0.87%	111,064
<b>Total fuels</b>	<b>59.19%</b>	<b>7,533,884</b>

	All Food items	Agricultural raw materials
	Average Exports, in %	
Bolivia	25.79	4.28
Ecuador	43.56	4.62
	Average Imports, in %	
Bolivia	10.96	1.38
Ecuador	9.06	2.21

Source: Own calculations based on LAIA, Montevideo, 2009.

The amount of food items and other goods (manufactured, chemical, others) that are smuggled from close cities of neighboring countries is immense<sup>73</sup>. Illegal imports are not well controlled at border limits and this is why the SSE markets' are full of these products. Food items are imported from neighboring countries and sometimes at cheaper prices than at national level due to the scale of production in larger economies and tax evasion at import. This price competition demotivates local producers from staying in the business. For instance, apple producers that cultivate in the valleys of Bolivia and that sell their product in the three main cities of the country; fearfully watch how the national market is flooded with Chilean apples and other Chilean fruits provided by legal and illegal imports. Another example is Paraguay, where the market is saturated with Chinese products legally or illegally imported and that compete directly with the national industry (in quality, novelty and price). This price competition and scale production is eliminating the chance for SSE to develop an industry at local level which at the same time increases the import dependency.

<sup>73</sup> Illegal imports or smuggled products are called to all the products that are imported to the country without paying the current taxes for importing products. Normally, these imports eschew all the controls and reach the market without any restriction for the sell at cheaper prices compared to the ones that are produced locally or to the ones imported legally.

Import dependency has disadvantages to the national economy. The first one is that SSE are susceptible to economic conditions coming from the rest of the world. National inflation has caused export restrictions and SSE could no longer import. The second is that economic crisis can increase import prices and this impacts negatively on food supply and food quality. Governments have a limited ability to influence domestic prices since a majority of the products consumed are imported. Thirdly, it also creates trade imbalances and limited import substitution possibilities. Any promotion for national production and national consumption would not be implemented fast enough because consumers are used to imported goods. In consequence, a change in consumption patterns can be evidenced when the country has *import dependency* that requires a process. And this process has a base in the size of the national market. Regardless of the reduction of food or other items' prices, open trade in SSE has several disadvantages at economic and political level. This can derivate in social conflicts due to the closing of national industry and higher unemployment rates. Economies of scale and comparative advantages of open trade only benefit the LSE. The theory of David Ricardo on comparative advantages pushed the idea of free-trade and it led all countries into liberalization<sup>74</sup> and to join multilateralisation. Nonetheless, the results have not been all positive for SSE. Moreover, excessive competition in local markets with cheaper imports has pushed small scale farmers to migrate to squatters in the larger urban cities. This migration not only affected the reduction of welfare for the farmers but also for citizens that became more dependent on international prices in their daily consumption, which in turn makes them sensitive to food crisis and food security as well. 2008 and 2009 were years in which this dependency for food imports showed its negative effects on welfare, particularly for the poor. *First*, comparative advantages discredit small producers that do not have any motivation from their governments to keep producing even for local consumption. Lack of success in agriculture pushes people to migrate. High migration rate flows from the rural to urban cities was the result of not having any promotion in the sector, not counting with better credits for production and investment, infrastructure, etc. Bolivia, Ecuador, Paraguay (again with the exception

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<sup>74</sup> Liberalization through the multilateral system (WTO) included different levels and tolerance to developing countries so they can still have tariff to compensate their market damage. Through the years, WTO pushed the countries to liberalize but could not influence in the reduction of trade barriers (as SPS/TBT) or agriculture subsidies to developed countries to have a more effective liberalization on both sides.

of Uruguay) are countries with the highest rates of migration in South America. Between 2005 and 2006, around 500 people per day migrated from Bolivia towards the EU and Argentina<sup>75</sup>. Nowadays people still migrate but the number reduced to 50 persons/ day due to all the restrictions as VISA or others<sup>76</sup>. Around 60 persons per day migrate from Paraguay and Ecuador to Spain and the United States as well. Unfortunately, the governments of the SSE cannot do much to stop the wave of migration because they know that within their countries it is difficult to create sufficient work sources. *Second*, when a great number of the population is recently included in the economy<sup>77</sup> and a great number of the population have changed patterns of consumption and started consuming things that they did not consume before<sup>78</sup>, it leads to food crisis if the country is not self-sufficient. Worst, if the country is import dependent, this increase of consumption leads to food inflation and food insecurity. In Bolivia, for example, 2004-2005 there was a lot of people from the agricultural sector that migrated internationally and 2006 was a year full of natural disasters (floodings, droughness, etc) which mostly affected rural areas. This period of disappointing years for agriculture had an effect at the end of 2007 and 2008 as the inflation for basic food items reached 16-20%<sup>79</sup> and many were not even available in the markets.

Trade concepts that have worked until now in different periods of time now show to dissociate theory with the new reality on food crisis, particularly for import dependent countries. As Dani Rodrik<sup>80</sup> (weblog, 2008) highlighted the argument of Cowen published in the New York Times, assuring that the idea of free trade of food commodities (such as rice) that would boost global supplies and help reduce prices, proved to be wrong. This could be attributed to the fact that Rodrik thinks that despite

<sup>75</sup> Agencia Bolivariana de Información ABI (2007), “Unas cien mil personas migran al interior de Bolivia y 180 mil salen del país cada año”, January, 15<sup>th</sup>, 2007. La Paz.

<sup>76</sup> La Razón (2008), “El éxodo boliviano inquieta, pero no moviliza al Estado”. June, 15<sup>th</sup>, 2008. La Paz.

<sup>77</sup> When talking about people that were included in the economy, we refer to the amount of people that were very poor before and that lived on their own agricultural production and that nowadays have access to different other products because they receive remittances from family that migrated.

<sup>78</sup> China, for example has started to consume cow meat in the last months and this has increased greatly the demand on cow meat. To produce meat, it is needed 8 Kg of grain to feed the cow so it can be produced 1 Kg of meat. This has lead some countries to increase agricultural imports in other countries.

<sup>79</sup> Basic food items that increased prices were products that Bolivia used to be self-sufficient due to its good land and climate conditions to produce them: maiz, wheat, soybean, flours of different grains to prepare bread, oil for consumption.

<sup>80</sup> Rodrik Dani (2008), “The free trade reduces prices fallacy, yet again”, Weblog of April, 2008. URL: [www.rodrik.typepad.com/dani\\_rodriks\\_weblog/2008/04/the-free-trade.html](http://www.rodrik.typepad.com/dani_rodriks_weblog/2008/04/the-free-trade.html)

free trade boost global supplies, it does not reduce prices since the effect of free trade on domestic food prices depends on whether a country is a food importer or exporter. Free trade would reduce prices of food (relative to other prices) if countries are food importers. Food exporters would experience a rise in the relative price of food. Another point that Dani Rodrik is not acquainted with is that countries are not only importers or exporters of food, they are both. In the case of SSE, the last three years have shown that SSE had food inflation (due to export of food) and a reduction of food availability at a national level, while exports kept existing. This is because agrobusiness with priorities set on profit kept exporting and at the same time high migrations from the rural sides (that normally provided with food at local and national level) caused a reduction of food supply at national level. Consequently, SSE were the most affected as it can be read in Box 3-3.

### **Box 3-3. Food crisis in SSE – inflation and reduced production**

#### **Bolivia**

Migrations of 2007 and natural disasters (rains and flooding) in 2008, Bolivia had suffered some scarcity of agriculture products. These problems, together with the inflationary trend in the world derived in two policies. The first policy is when the government of Evo Morales decided to forbid exports of oil for consumption (soybean and sunflower). This short-thought measure put the producer and the whole chain in danger. Bolivia would never be able to consume the full production. Therefore the processing industries reduced their production affecting many small farmers who could not sell anymore. The pressure from the population was high but prices kept increasing. Bread turned from 0.20 to 0.70 Bs. which is about three times increase. Also many other common food products increased. In a poor country like Bolivia a large amount of a person's income goes to food and an increase of the food prices is felt severely.

Politically the measures taken are not well thought and might even worsen the inflation. Forcing companies to keep prices low would prevent new production to come online. Nevertheless in a socialistic focused government it is seen as a victory to capitalism when big companies are being forced to do so. In short run it they might gain votes, lower prices and admiration from the regular man on the street. In the short-long run, production will be reduced; people loose jobs and prices will go up again.

The second policy adopted was to import commodity goods without import-tax. This would allow the population to have a basic consumption but would prejudice the local producer.

#### **Ecuador**

As an economy that depends a lot on agriculture also for the export, increasing food prices have motivated the export of food while at the same time the migration of farmers to the city have reduced the production. Attempts of the government to move those people back to the country side seem not to catch. Despite an increase of the food prices in the cities, people prefer to stay there because in their thinking, cities offer more possibilities for work, better education and more security. All this seems to be more important than obtaining cheap land and cheap credit to produce profitable crops. Nonetheless, they do not want to see that main cities are increasing its belts of poverty where the government has not been able yet to offer proper infrastructure not even for basic services and less for work opportunities.

### **Paraguay**

The rise of prices for basic products like maize, wheat, rice and oil surpasses in some cases the 100 percent and constitutes the worse nourishing crisis of the last years for Paraguay and the world has said the Worldwide Food Program (PMA).

### **Uruguay**

In the last 12 months, the values of foods in Uruguay grew at least 18%. "The government cannot stop the inflation and the prices (of food) continue rising", said the President of the National Party, Jorge Larrañaga. The growth of the inflation "is generating dissatisfaction" in the citizens "...because the same wages and retirements are buying less products for basic needs". Larrañaga indicated that if the government does not stop the raise of inflation "it is going to plunge Uruguayan people in poverty" and the country "will spend a very hard winter". Senator Ruperto Long (National Alliance) pointed out that "nowadays there are no reliable numbers on inflation". He does not know himself which is the real inflation since "the lack of trustworthiness in the numbers begins to settle in Uruguay", said. Some Latin American Presidents have presented the need for sovereignty in food production at national level. Still, all are just words and no plan will see an effect until next years. Meanwhile, the lack of food in different countries in Latin America will increase malnutrition in kids and pregnant women. This will have irreversible physical and intellectual consequences.

Politicians had power to put prices of food downwards but their answers were discouraging: Restrictions to exhaust and impoverish the neighbor. Neighbors have gone to ruin by the imposition of restrictions to the export of food by the governments so they could assure a low price at national level, forgetting with this that any country is self-sufficient and that still they needed the neighbor for buying some food items and agricultural products. This had consequently created a disfunction world-wide increasing international price and reducing the incentives to invest in the agricultural sector. In the summit of the FAO (Rome 2008) the Secretary General of United Nations, Ban Ki-moon, called to the countries "to not let themselves be tempted by policies that impoverish the neighbors and to increase the aid through bonds of food, the adjustment of trade policies in order to liberalize exports and diminish the restrictions to imports (protectionism) to not distort the markets and raise prices, rather to draw up long term policies to increase the amount of food.

Source: Own elaboration based in different press releases, Feb-Dec 2008.

Fuel imports are also interesting to highlight. As presented in tables 3-5 and 3-6, SSE import hydrocarbons for about half of their fuel exports. SSE export and import similar products, so maybe they import for internal consumption and as a base for exporting its raw material later. Some fuel products as gasoil have subsidy for the national market (for example in Bolivia), even if Bolivia imports gasoil, the government keeps subsidizing the price to final consumers. Naturally, this has created trouble with smuggling in the frontiers of Bolivia with Peru, Chile and Brazil (for re-exporting). The smuggling process is conducted through the frontier with Desaguadero, 83 Km by main road from La Paz-Bolivia, which was settled as a free

frontier to benefit trade with the Andean Community. Smugglers take advantage of the lack of control, their cleverness, or corruption in Bolivian customs<sup>81</sup> (Box 3-4).

**Box 3-4: Smuggle in Bolivia: huge losses against welfare**

Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) indicates that the gasoil or gas is taken in its majority to Peru and in less quantity to Argentina, Brazil and Chile. This causes shortage of supplies within the country. These fuels were reduced in price for Bolivia because the price was subsidized and frozen compared to the international price as it happened in other countries. Then, price outside frontiers is double or triple.

Modus operandi is varied. One is done by 'ant smuggle'. The other is done by international or public transport. All products are hidden under other products that passengers have. This makes all efforts to avoid smuggle difficult since smuggle evades control or try constantly new 'road' alternatives.

What is stranger, the imports of gasoil are increasing by month and year and the government keeps having a subsidy for it. Despite the government knows that there is constant scarcity of gasoil or gas at national level due to smuggle, they keep spending millionaire quantities of national budget for its import. Just two years ago, Bolivia consumed 180 thousand barrels per month but now, the government is buying 240 thousand barrels per month (133% more). Main partners for import are PDVSA-Venezuela (200 thousands barrels), Shell-Chile (200 thousand barrels), and Refinol-Argentina (10 thousand barrels).

Source: Own elaboration based in different press releases from Bolivia, 2008.

SSE in average are dependent on more than 47% of their imports for the region (mostly Brazil and Argentina). The second important region is the United States that alone represents more than 23% for Bolivia and Ecuador. For Uruguay and Paraguay the European Union represents around 15% but in the last years Asia (China and India especially) has increased its share with both SSE groups reducing the EU and the U.S. share. Paraguay for instance depends on 19% on imports from China practically being now the second largest provider for its imports. *Relative distance prevails for imports* (ports, shipment, roads), as presented in detail in table 3-7. On the contrary, for LSE, import partnership is different because they have equal dependency on different regions. Brazil for example, has EU, U.S. and Latin America with equal importance.

<sup>81</sup> Smuggle affects not only gasoil subsidy but also natural gas (hydrocarbons). Both sometimes lack at national market level because some people prefer to keep smuggling since they can win twice or more the price that is sold in Bolivia. More information can be read at: a) El Deber (2008), "Contrabando: Desaguadero es una vía de escape", Artículo de J.Carlos Salinas. Dec, 2, 2007. Santa Cruz de la Sierra. b) La Prensa (2003), "Ocho clanes mafiosos operan sin control en rutas del contrabando", March, 2<sup>nd</sup>, 2003. La Paz. c) Los Tiempos (2006), "Comprueban contrabando de gasoil boliviano a Brasil". August 26<sup>th</sup>, 2006. Cochabamba. d) La Prensa (2007), "Por tráfico de diésel, Bolivia casi pierde Bs 1.4 millones". November, 2<sup>nd</sup>, 2007. La Paz.

**Table 3-7. SSE and Main Partners: Imports by main region of destination, in percentage, average of imports in million dollars, 1990-2009.** This trade structure shows SSE have a high rate of dependency in Southern American countries and as second important partner is U.S. for some and EU for others.

	EU	US	JP	LA	Asia	Others	average X in million \$
Argentina	25	18	3	38	10	4	23.737.811
Bolivia	13	20	7	53	6	1	1.933.224
Brazil	27	20	6	18	12	17	60.239.853
Chile	20	17	5	31	11	10	19.441.452
Colombia	20	33	6	27	8	4	15.366.084
Ecuador	18	27	6	36	8	4	6.032.395
Paraguay	13	8	8	48	19	2	2.951.373
Peru	16	24	4	36	10	6	8.973.743
Uruguay	17	9	2	51	9	11	3.297.227
Venezuela	20	37	3	25	4	3	14.900.971
Cuba	38	3	3	33	12	12	4.698.879
United States	20	..	13	16	24	27	1.217.680.045
China	15	10	16	3	38	13	325.703.440

Source: Own calculations based on UNCTAD Statistics 2010. Geneva, 2010.

Importing structure is very important for SSE. Firstly because most of the importing products (manufactures principally) are a base for local industry and exports. Without them, it would not be possible to add value to the national production. Even so, importing barriers instaurated by the governments in the SSE do not distinguish the necessary products to import from the products that compete and anulate the national industry<sup>82</sup>. This prejudices the industry at the same time that is protecting the infant national industry<sup>83</sup>. This is a job for the government who should be called to plan and to control according to the needs of the economy but governments do not do so. Therefore, lack of control and rule of law for a policy for trade originates trouble at national economy and high importing taxes to expand national income. As we can confirm, in general, importing taxes are the highest in SSE (table 3-8) compared with

<sup>82</sup> Machinery, information technology, other industry materials that are not produced in the country but are needed to push industrialization have high import taxes (40-45% of the total value). The same happens with necessary items for the welfare of population as medicaments. Some medicaments for example are taxed with such high taxes at import despite national industry in SSE has not specialized in all the medicaments. This import tax makes some medications too expensive for the population which reduces the level of health since SSE do not have medical insurance and have to pay for their own medicaments.

<sup>83</sup> It is true that Infant industry Argument applied in 1960-1980s in South America did not work. This is because the terms which it was applied did not push the development of a better performing industry. Despite that capitalism informs the failures of developing countries is due to a "wrong" application of the theory, Sachs & Warner, 1995; Bhagwati, 1985 and 1998; Bhagwati & Hirsch (eds.), 1998 tell that this is not true because the theory was not applied according to the reality of each country due to lack of governance capacity.



other LSE. However, SSE face a lot of trouble to control their frontiers and this motivates smuggling. The exception is Brazil, a very protectionist country in almost all sectors, also containing non-tariff barriers (SPS/TBT) particularly for neighboring countries. This is the main reason why some SSE have to search for other markets to export their products being that Brazil closes its frontiers to potential competing products.

**Table 3-8. Average applied import tariff rates on non-agricultural and non-fuel products, 2000-2009, effectively applied rate.** This table shows that South America and SSE have high import taxes, especially in the machinery and transport sector, other manufactures and manufacturing goods. Brazil and China have high importing tariffs as well, contrary to the reduced rates of the EU and the United States.

	Year	Ores & Metal	Chemical	Machinery&T. <sup>1</sup>	Other manuf.	Manuf. Goods
Argentina	1995-2005	8,77	8,70	11,69	22,25	11,62
	2006-2008	6,50	6,45	8,56	11,73	8,55
Bolivia	1995-2005	9,42	9,56	8,01	9,62	9,00
	2006-2008	5,33	5,72	5,57	6,87	6,17
Brazil	1995-2005	8,58	8,91	19,68	22,84	12,86
	2006-2008	6,55	6,58	11,19	13,53	10,25
Chile	1995-2005	8,37	8,45	8,55	8,47	8,49
	2006-2008	1,29	1,59	1,94	2,23	2,00
Colombia	1995-2005	7,43	7,88	10,20	14,26	11,45
	2006-2008	6,05	6,75	8,96	12,72	10,16
Ecuador	1995-2005	6,61	7,68	9,19	14,35	11,02
	2006-2008	4,44	5,09	6,84	11,75	8,77
Paraguay	1995-2005	6,95	7,71	7,57	13,15	9,16
	2006-2008	3,53	5,16	4,39	9,19	6,03
Peru	1995-2005	11,21	11,04	11,17	16,02	12,14
	2006-2008	5,42	5,27	4,34	8,78	6,53
Uruguay	1995-2005	8,24	8,74	8,20	14,92	10,51
	2006-2008	4,68	5,93	5,87	11,21	7,71
Venezuela	1995-2005	7,43	8,48	11,09	14,68	12,19
	2006-2008	6,77	7,41	9,97	14,05	11,30
Cuba	1995-2005	6,84	10,10	10,20	13,35	11,82
	2006-2008	6,98	9,19	9,64	12,83	11,21
UnitedStates	1995-2005	1,36	3,18	1,23	5,61	4,13
	2006-2008	1,11	2,35	0,80	4,21	3,12
China	1995-2005	5,38	10,74	16,14	28,85	25,87
	2006-2008	3,33	6,75	7,61	9,90	8,62

<sup>1</sup> Full names of sectors are: ores and metal, chemical products, machinery and transport equipment, other manufactured goods, manufactured goods.

Source: Own calculations based on UNCTAD Statistics 2010, Geneva, 2010.

China is another country where import taxes are high. This is somehow expected since China just became member of the WTO in 2001 and China still wants to protect its most advantaged sectors (for instance manufactured goods). On the other hand, the United States and the European Union have reduced import tariffs, this poses as a great opportunity for the SSE to export their products. Unfortunately, the products

that SSE export are agricultural based products where there are high SPS barriers and other large scale agricultural competitors.

**Table 3-9. Diversification and Concentration indices of imports. 1995-2009.** Diversification in imports is higher in SSE compared to the United States or EU; while concentration of imports is similar to larger economies.

Country	index 1995-2005			index 2006-2008		
	Number products	Diversification	Concentration	Number products	Diversification	Concentration
Argentina	252	0,32	0,06	256	0,16	0,25
Bolivia	216	0,45	0,09	220	0,22	0,32
Brazil	252	0,30	0,08	256	0,15	0,22
Chile	255	0,29	0,09	250	0,19	0,25
Colombia	253	0,35	0,06	251	0,16	0,25
Ecuador	241	0,39	0,07	242	0,20	0,30
Paraguay	207	0,45	0,12	213	0,24	0,35
Peru	241	0,34	0,08	217	0,22	0,34
Uruguay	229	0,35	0,09	237	0,21	0,27
Venezuela	239	0,34	0,06	254	0,23	0,32
Cuba	234	0,43	0,12	243	0,27	0,31
United States	259	0,19	0,10	260	0,15	0,17
China	259	0,39	0,10	258	0,22	0,31

Close to 1 = It indicates a bigger difference from the world average and the structure of trade of the country, or close to 1 = is little number of products that take all the biggest imports, or close to 1 = few producers or traders do almost im ports.

Source: Own calculations based on UNCTAD Statistics 2010. Geneva, 2010.

Concerning diversification (table 3-9), SSE countries have a similar rate with other countries in the region (0.41) but differ with the United States (0.19). Still, both ciphers are very small. This means that SSE have similar structure of import with the average world structure. Imported manufacture goods are competing in *Price* and not in *Quality* anymore. People and industries in SSE are leaving *quality aside* for the *cheapest price* as the most important factor for consumption or business<sup>84</sup>. SSE are finding their national economies flooded with Chinese products in different sectors: machinery, equipment and transport, clothing, toys, etc. and in some cases as in Uruguay, even flooded with logistics from Asian companies (e.g. India). These Asian companies are fastly replacing American or Brazilian market shares which represent a threat for neighboring industry where its main scale production was destined. On the other hand, an increase of trade with Asia and Latin America has reduced trade

<sup>84</sup> As the Engel law (Ernst Engel 1857, 2. edition, 1896b, s.28-29) suggest, the population in SSE spend most of their income share in food; therefore, other products have less share or decline when food price increases. Consequently, when the market offers cheaper products, people would switch to those fitting better with their budget. Chinese products have less quality and are cheaper, generally, a good option for poor families and small companies that still need basic manufactures.

concentration of imports in the last three years. This index does not reflect the import of basic products and competing products which would be an important factor for decision making and planning of trade policies.

## 3.2 Political Trade Domination

### A. The impact of Internationally Dominant Power

Since the installation of an Internationally Dominant Power (IDP), multilateral institutions have been influenced by its political capacity of negotiation in the preparing of global rules for common goods and trade. Certainly these rules were adopted by the SSE. F. Perroux defines three principal dimensions of influence:<sup>85</sup>

- **Geographical dimension.** The United States is considered an IDP because it possesses the largest economy at national level (in terms of GDP) and at international level (in terms of its participation in the market share of imports, exports and investing capacities). Its political and economic power of negotiation at multilateral level has granted them the power to settle a multilateral framework. In this context, the U.S. can constantly take advantage of its relative superiority for future negotiations and general performance in the international arena. Nonetheless, it is not just a superpower pursuing its interest; the U.S. is a producer of world order. Over the decades, with more support than resistance from other nations, it has fashioned a distinctively open and rule-based international order. This order has not only been designed for one nation but for all nations without distinguishing the size (SSE or LSE) neither its different capacities to integrate to the world multilateral economy with the idea of not granting differential treatment to any nation. Its dynamic bundle of oversized capacities, interests, and ideals constitutes an "American Project" with unprecedented global reach. Moreover, many developing countries, particularly the SSE, see the U.S. as the "American Dream way of life"; thus, these countries want to follow its economic and political

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<sup>85</sup> PERROUX François (1949), "L'effet de domination dans les relations Internationales". Hommes et Techniques. January. After talking about national dominant economy, the article adopts the denomination of international dominant economy after a republication.

lines. This motivated an easier settlement of TNCs in the world with the idea of free trade and free move of capitals.

- **Contractual Force.** The IDP is also one of the most influential military strategic powers. U.S. interacted successively with the SSE and other developing countries in the world within the framework of several different programs on security and military matters. The struggle against drug trafficking, terrorism and the proliferation of weapons of mass destruction, the imperative to work for an alternative of development in these countries created several bilateral agreements so that the U.S. could install military bases in every region in the world. The U.S. global strategy to maintain peace became a key factor in the overall geopolitics. The U.S. ,in turn, became one of the largest military powers in the world and is the “Peace source equilibrium” for any world conflict. Of course, there are other non military instruments to push off, stop or undermine military politics that constitute a counterbalance of powers and are based on the same principles that the U.S. has. Nonetheless, face to a weak power unity as it is the European Union in matters of military, the U.S. tends to react unilaterally. Subsequently, the U.S. possesses a near-monopoly on the use of force internationally. Since September 11 (2001), the Bush administration's assertion of "contingent sovereignty" and the right of preemption have made this transformation abundantly clear. The rise of a strategic power capacity for choosing the political and economics framework for the world makes U.S. as the unipolarity dominant power. This can be evidenced in three key factors. First, the U.S. has provided public goods, particularly the extension of security and the support for an open trade regime, mostly in exchange for the cooperation of other states. Second, the power system is exercised through rules and institutions; power politics still exist, but arbitrary and indiscriminate power is reigned in as well. This is creating discomfort between SSE and other countries, particularly with the installation of military bases and the initiation of preventive war. Third, smaller states are given "voice opportunities" access to the policymaking negotiation processes (within the IEOs for example) but still, the most powerful states have the power to take the final decisions. The multilateral order that was installed by the U.S. is hierarchical and ultimately sustained by economic and military power, although it is still contained by a democratic and capitalistic system.

- **Role and responsibilities of the leader.** The U.S. is the producer of the world order. It has promoted multilateral rules for the difficult themes that were not only creating conflicts between nations but also depriving the people of well-being: drug and people trafficking, nuclear weapon development, etc. around which several multilateral organizations were created and U.S. is the main supporter. However, The U.S. has an economic and political dilemma. While it promotes free trade and common rules for the countries without taking into account if they have a different size or not, it also wants to be the unipolar power that rules and exerts leaderships over the world order and this is creating conflicts. In the area of trade, U.S. promoted the idea that free trade brings development and well-being in the population. This has increased the multilateral participation in trade of developing countries that were soon flooded with products from developed countries or countries where producing was more competitive than within small economies which were losing self-sufficiency in agricultural foods and escalating poverty since then. The importance of multilateralism is also questioned when topics out of the concern for the U.S. arise in the agenda like *the environment*. The Kyoto protocol was a failure whilst U.S. did not sign its ratification. According to John Ruggie, the American power is keen when creating an international order compatible with its own international objectives; therefore, the American practice of multilateralism is not conceived in terms of multilateral or unilateral strategy but according to the national interest of the U.S. This is what creates discordance between the world order and the national American order which materializes the problem of a unique IDP.

## **B. Asymmetry within trade negotiations**

The IEOs, conformed by governments in which the most powerful ones, particularly the U.S., have been deciding the agenda, the rules for trade and development benefiting only the LSE. A Millennium Declaration of 2000 signed by all member countries tells that trade should be free, open, fair, established on common and non discriminatory rules and with a unique size for all countries. This declaration contradicted a reality of vast differences between developed and developing countries and between developing countries as well due to their size of economy. Although

these common rules do not take into account the specific needs of SSE, it is true that without these IEOs, SSE would not have global rules because they are norm-takers, while the LSE-developed countries are the norm-settlers and norm-enforcers. This is why, SSE have internalized these rules anyway since the only other option would be to let every country define its own trade rules based on a sovereign power and as history shows us, these rules may be even more conflicting than the multilateral ones. And yes, multilateral agendas up to now could not include specific problems that SSE needed to address<sup>86</sup> but this also could be due to a reduced capacity of negotiation that they have as we presented in the typology of SSE (chapter 1). The UNCTAD has proposed several times the need to take into account the different size of the countries but the vision of the most powerful countries prevented the implementation of this proposal with the excuse of non-discrimination and equal treatment to all member countries. At the WTO<sup>87</sup>, delegations of countries always negotiated within the frameworks of their countries' instructions. For this reason, country instructions are essential for the success of multilateral negotiations that would allow a fairer multilateral trade system. When the IDP or the LSE is too ambitious or little flexible in their instructions, this fact forbids the conclusion of negotiations. The instructions are directly influenced by domestic pressure (electoral campaigns, national politics, government coalitions, lobby from different sectors, etc.) and sometimes this pressure does not allow taking into account revindications from SSE.

Few countries are industrialized, mostly the LSE. These countries do not allow SSE developing national industry due to high competitiveness and small national-import-competing industries that stand to lose with an increased provision of products from LSE in an already small national market. At the same time, free trade seems to exist unidirectionally from LSE towards the world that imposes non-tariff walls for their

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<sup>86</sup> For instance, the WTO is not able to address a solution to subsidies in agriculture and trade barriers that are avoiding SSE to export. Another problem is that the WTO has not been able to open barriers when trade conflicts emerge and puts in evidence the power of influence that LSE. Besides, the huge delays from the WTO in taking decisions to end trade conflicts of protectionist measures motivate the reduction of potential exporters from SSE.

<sup>87</sup> Traditionally, negotiations at the WTO are organized around two main actors: the United States and the European Union. Every agreement reached by these two actors is a systematic agreement taken later by the rest of the members. However, in the last negotiations, a major place for negotiations was granted to India, Brazil (until here G4), Japan and Australia (until here G6), and China. These countries have nowadays a major force for negotiation and gave convergence to several issues of developed countries and developing countries (creating different coalitions: G10, G20, G90, etc). This is giving a new configuration to the WTO's governance and its negotiations.

markets. SSE have no specific support from the WTO to back them up with research or technical support against unfair SPS/TBT measures, certain safeguards or retaliations that greatly prejudice the international insertion. What's more, SSE are primary material exporters which suffer constant demand and price fluctuations, erosion of preferential reimes and the increase of the import supply within these countries that cannot fairly comete due to a reduced capacity of production at large scale and a non-existant capacity for international competitiveness to negotiate the insertion of rules that fit their realities and difficulties. Thirteen years since its creation and six ministerial conferences<sup>88</sup> after, the WTO did not advance in its main issues and it could be called a “one lost decade for trade and multilateralisme”<sup>89</sup> as Abbas said (2005). There is a visible fracture between developed countries, developing countries and emerging countries which characterizes the WTO's meetings in the last years and which is leading to two visible crises: of results and legitimacy<sup>90</sup>. On one hand, the Doha Round had seven unsuccessful years of negotiations (results) and on the other hand two other problems sprouted (legitimacy): one is that developed countries sign bilateral agreements that grants them more concessions in multilateral negotiations, second is that developing countries believe that the WTO is bias and prefer to sign regional agreements on which they trust more. It was expected that LSE could reduce their subsidies to agriculture and open up their markets in the real sense of liberalization in the negotiations of the Doha Round, but did not happen. Contradicting this idea is the one of some researchers that assures that this reduction of subsidies and increased liberalization would have unequal gains between developing countries according to its economy size. For instance, it was said by the group of developing countries that Brazil, China, India and Australia would benefit significantly with free trade whereas SSE would not benefit that much because most of the preferences and special treatments would be removed. And this idea also goes along with our reasoning: too much liberalization of the economy is not good for SSE. There is also a political dimension that could be more symbolic than its

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<sup>88</sup> Singapur 1996; Geneva 1998; Seattle 1999; Doha 2001; Cancún 2003 and Hong Kong 2005.

<sup>89</sup> M. Abbas, « *De Doha à Cancún: éléments d'analyse de la crise du multilatéralisme commercial et de l'Organisation Mondiale du Commerce* ». Annuaire Français des Relations Internationales, Vol. 6, 2005, p. 880.

<sup>90</sup> This crisis of legitimacy can be understood as the set of multilateral institutions such as the World Bank (WB), International Monetary Fund (IMF). Read more on: Birdsall N. (2007), “The World Bank, Towards a Global Club”, *Centre for Global Development*, May 2007; and Woods N. (2006), “The Gobalizers in Search of a Future”, *CGD Brief*, Centre for Global Development, April 2006.

economic and trade side. For instance, it hides the political fallout of an agreement that sends a positive signal indicating a new dynamic of negotiation where LSE grant concessions that could contribute to improve the trade system that not only benefits rich and developed countries but all. The legitimacy of the WTO can be improved if the costs of transaction (e.g. SPS/TBT measures) reduce. On the issue of legitimacy of the WTO is worth to highlight the debate on the erosion of preferences for the developing countries against the implementation of the Generalized System of Preferences (GSP) that limits its application to a small number of countries, prejudizing the entire developing countries group. It is true that SSE belong to GSP groups but when they are out of one of these groups, they find themselves constrained in the limited number of products for export, facing more protection in the LSE countries that grant GSP or have to see price erosion due to the new internal market price assured to the GSP countries.

In all the negotiation of Doha Round, it seemed that LSE were not the only players in a field of multipolar power with stronger positions of the LSE-developing countries (Brazil, China and India) as the only way to agree certain negotiations. LSE-developing countries requested concrete support from LSE to assess social turnmoils due to underdevelopment, unemployment, migration and food security in developing countries. Nonetheless, the last meeting of Doha Round (in 2008) the LSE (U.S. and EU) showed unwillingness and difficult lobbies making the complete Round fail. This all has limited the appetite for liberalization and has encouraged other types of agreements (regional or bilateral) that could offer another option against the WTO and the domination of LSE in the IEOs. Even so, no country has suspended its membership, more, many want to join it. Still, there is an increasing criticism of the four basic rules<sup>91</sup> and questionable benefits for countries lacking power of negotiation. Faizel Ismail, chief of the South-African delegation to the WTO, insists on the need for granting special attention to the small member states. Sok Siphana, Secretary of State for trade of Cambodia, states that the solution lies in the concept of opening and not in isolation, also notes that Cambodia would require the WTO to create more favorable rules. Some complications of global norms proposed by the WTO were

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<sup>91</sup> The four basic rules of the WTO are: 1) Protection of domestic industry is through tariffs like a ban on quantitative restrictions on trade, 2) Caps or bindings on the level of tariffs, 3) Most favoured Nation (MFN) treatment that bans discrimination among foreign suppliers, 4) National Treatment that bans discrimination against foreign goods once they cross the border of a country.



evidenced and still there are no measures taken to solve them. Despite the disenchantment, free trade is still promoted and followed by all countries.

### 3.3 Conclusions

Larger economies have the advantage of a larger national market size; therefore, they can focus on national production destined for their own consumption rather than thinking about trading outside their borders. This fact dictates the size of the economy and represents a constraint *per se* for SSE. This condition makes them more dependent on international economy and international insertion, especially under the shadow of the idea that development is reached through free trade and liberalization. Thus, multilateralization has only meant until now: liberalization, even without taking into account the difficulties and constraints for small size economies. SSE are shackled by trade domination and are more susceptible to be directed through multilateral normatives. SSE are willing to adapt multilateral legislation even when this goes beyond its national security because SSE would not have the possibility to determine their own rules since they often lack personnel, infrastructure, capacity, etc. Besides, SSE are willing to adapt free-trade not only for their national consumption (import) but also to make more productive its national production (export). This is the main reason why international insertion has become so crucial for SSE. However, this dominating policy is creating greater conflicts that push towards national disintegration, given that only the main cities can be provided with local production and the rest of the country is abandoned. The reason may lie in the fact that large agro-businesses prefer to make more profit than to lose earnings by providing products to their local market at reduced prices. International insertion is more important for these agro-businesses than national needs. All this increased gaps of poverty and migration. Comparative advantages that are the base of the WTO got small producers out of business and SSE that were self-sustainable (with a agriculture population of 40%) passed to be more dependent of imports of food items, creating greater sensitivity to international prices and reducing the access to food for the poor.

Multilateralization had in some way opened a path towards a new hegemon power. Even when the U.S. is geographically so far; it possesses the majority of the trade

share from the SSE. This is why the impact of the SDP on the trade and development policies is enormous in the SSE countries. Bit by bit, the U.S. increased its financial assistance destined for development in these countries, which also increased the indoctrination for the use of certain development strategies. One of them is free-trade which was reinforced through the SDT. The size of its economy and its development programs has attracted all the SSE towards its market. This has increased domination in trade and financial assistance. Later, other LSE proceeded in the same way, granting programs of special treatment to SSE as the GSP (General and special preference) of the EU. Being LSE the ones that define the list of products and the quota that could fit within the GSP program. This is the case of the ATPDA for the ANCOM countries or the SDT with the EU or Japan. Trade dependency was enlarged without the SSE could even notice through the years and bit by bit, SSE could not keep being self-sufficient for its consumption products, including agriculture; therefore, they are obliged to import. All this created per se asymmetry in trade negotiations in the IEOs in front of LSE.

The import of products is also part of the dominant supremacy since SSE tend to import more from LSE partners than from neighboring countries that could offer the same products. This is because SSE want to have increased relations with the LSE rather than with the neighbor. Trade openness in SSE went from an average of 0.5% in 1975 to an average of 52% in 2008 for the exports and from an average of 11% in 1975 to an average of 86% in 2008 for the imports. This increase in imports shows how much dependent the SSE became from international economies to provide its national consumption through an open trade. In spite of the strong import restrictions in the SSE, the reality is that they need to import different goods to cover the needs of the population and industries and this need avoids regulation or even legal importing. This though impacts negatively the national industries that cannot have comparative advantages to large scale industries from LSE. This has raised much discomfort between the population of the SSE and New Leftist governments have raised polarization and conflicts in the region to reduce the dominating power of the U.S. and other IEOs to impose their regional type of integration as it is going to be presented in the second part.

## **Conclusion of the first part**

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### **SSE: Impact of multilateral integration**

Since the end of the 80s, SSE have joined neoliberalism and implicit in this system is comes the idea of promoting as the only way to reach development. The IEOs (not all) were established with the intent to give more financial commitment and votes to those countries which financial quota was higher (e.g. the six international financial institutions (IFIs): the International Monetary Fund (IMF), World Bank, Asian Development Bank (AsDB), African Development Bank (AfDB), European Bank for Reconstruction and Development (EBRD), and Inter-American Development Bank (IDB). This is why IEOs through the LSE have determined often the path for development and the degree of freedom in trade. Multilateralism had a position for trade and development and this had to be applied through the Washington Consensus. SSE have not participated much on these decisions since the majority lack the capacity for negotiating a position in their best interest. This is caused mostly by the size of their economy and the little or no influence that they have in the international arena (trade, financial flows, etc). SSE have applied the drastic conditions suggested by the Washington Consensus because their region was often stagnated or behind the standards of development and needed to borrow money for their social and growth projects. In exchange of several loans, the IMF and the World Bank asked that these Latinamerican countries reduce trade barriers, open up their markets to foreign capitals regardless their particular difficulties that were not taken into account based in the idea of “non-discrimination” and “equal treatment”.

The fact that SSE applied the vision of development meant a direct imposition of a national and multinational economic and political structure to the world implemented in an asymmetric way by LSE and SSE. The Internationally Dominant Power (IDP) imposed a system to trade, to invest and to rule through its power of decisions inside the IEOs. The SSE just increased its dependency and need to export or import products, especially for its national development. However, after several years of application of the Washington Consensus showed to be not efficient for reducing the

inequalities and the development gaps that existed between the different social groups and different size economies in the world.

As we will present in this part, trade domination for SSE is high. The larger the size of the country as measured by its GDP, the smaller the total share dedicated for export and import. Of course, the export quantity in dollars from SSE is negligible if we compare both groups (LSE with SSE). On the other hand, the real amount of trade seems to be defining the power for negotiations at the WTO and the IEOs where are defined the rules and trade barriers. This fact is reflected in the impossibility to improve international insertion with better conditions to SSE at multilateral level even with the SDT that some LSE have granted to these countries. The percentage of total trade has a great impact in the GDP of the country (more than 150%) for SSE while for LSE as the United States and Brazil, the impact of trade on the GDP is small (maximum at 30%) by 2008. Since trade is important to SSE, trade standards such as SPS/TBT are of vital importance for the continuity of trade. Trade statistics of SSE show that trade is very important for internal development and welfare because of several reasons. The *first reason* lies in the fact that, since national market is very small to keep a good ratio of production, exports turn into an important income for the company and for the income of a country. Alesina, Spolaore and Wacziarg (1997) mention that small economies have the tendency to open their markets drawing more advantages than larger economies. Exports, for example, do not contribute much to the national GDP of LSE while for SSE it means a great part of their GDP. This is the case of many of the food items and agricultural products that are exported from SSE to larger economies and LSE define how much they need or compete at national level by SPS/TBT norms. The *second reason* is that they decide the quality of the product which means that exported products have to be raw materials, selected only by size and quality since it is hard to export with SPS/TBT norms that obstruct trade.

International insertion depends on trade dimensions and FDI inflows. However, in order to have an impact on development and welfare, the importing and exporting structure must be taken into account as well as the type of FDI inflows SSE have. Unfortunately, SSE have a limited amount of partners to export one or many number of products, often under the GSP and this keeps the SSE dominated. On the side of imports, SSE have come under a state of dependency on food imports and

manufactured products due to their high degree of liberalization and loss of competitiveness. Worst, FDI inflows only are attracted to those SSE that possess natural resources because their economies are small and not propense to large scale production or sale. So, even when governments are interested in improving negotiation power and their position in the international arena there are still some challenges to overcome like those mentioned on export domination and import dependency. Within the IEOs, the negotiating position has a lot to do with the size of the economy and the attraction that these economies have for trade and foreign investment inflows. At the moment, hydrocarbons grant a higher degree of liberty to define new rules of investment and this opportunity should be used as an advantage for the SSE possessing these resources. To improve internationalization, it is very important to improve national integration in order to achieve national development and welfare. SSE economies are not integrated and they cannot afford to manufacture products at national level due to lack of infrastructure and roads. The first step before aiming for a better international insertion is to integrate at national level; otherwise, the disintegration will lead to constant social unrest and reduced welfare of the population due to regional differences and unequal opportunities.

Multilateralism under the principles of market power and extreme liberalization failed for SSE. However, this did not induce any SSE to abandon the IEOs (except the ICSID in the case of Bolivia). However, there is a strong move towards an unification of developing countries through larger economies (e.g. Brazil, China, India) that can stand for them in the negotiation meetings within the IEOs. Still, there is a lot to work here since LSE-developing countries not always stand for all the group of DCs.

The other option for multilateralization is the Beijing Consensus (BJC). The BJC is relevant to the world—not necessarily as a replicable model—but as a new lens through which to the world has an “alternative global order”. The Beijing Consensus constitutes the way for China to appear in the scene and promote multipolar power and regional domination instead of one power in the world that disseminates the use of one currency (US dollars) and one policy for development and governance for public goods. This is why some of the SSE would like to apply the principles of the Beijing Consensus in their economies. With China’s rise as the fastest growing economy of the last years, it became clear that development can be achieved

following other paths, in other words, joining another option of multilateralism. SSE have accepted this option because they believe that the role of the government should have never been reduced in countries with structural failures in the national economy. But there is a long path to walk in this multilateral option still. Meantime, China and other large developing countries are constantly trying to influence the regulations and new negotiations within the IEOs.

Finalizing this first part, we can conclude the following points:

**SSE are suffering from trade domination of IEOs.** Imposing certain policies through the Washington Consensus did not help at all in closing the development gaps in the SSE, but in fact worsened the situation. We can conclude that imposing detailed policies does not work if it does not take into account the particular problems that SSE have inside their economies (based on the typology).

**SSE need international insertion.** SSE, in most cases, need trade to be able to run an efficient economy. Nevertheless, this does not mean the implementation of liberalization without a previous analysis of national security, national integration and the promotion of equal development for their economies and the population's welfare. For this, it is important to take into account the support of the LSE and the creation of specific regulation and negotiation fields which take into account the size of the economy and the macroeconomic volatility this aspect has at national level and in their process of internationalization in order to change the type of participation they have at the heart of the IEOs. For this, it might be needed a new voting and participation system.

**Export or increasing trade should not be a goal by itself but a result of development and welfare in the country first.** Based in the experience of the SSE so far, it is vital to not focus only in exporting. . Washington Consensus had the principle of development based on internationalization through the liberalization of the market and increase in trade. So, since the 80s, SSE governments were only promoting exports, even subsidizing them in some ways. As a result, a large agro-business was created to take advantage of this promotion and kept exporting even when the product was not available at national level. Even the public companies were

exporting hydrocarbons, when at a national level people did not have access to it. Exporting should be a result of larger production and not the promotion of businesses think that think that it is more profitable to export than to provide to their own market.

**Multilateral integration is a good option if national situations are respected.** SSE need multilateral integration to have a multilateral frame for trade, investment and development. However, the way that this multilateralization has been handled is not good for the SSE. Multilateral integration should focus on giving tools and support so that SSE with less capacity are not subject to unfair trade barriers, unequal competition and asymmetric negotiations. To implement such policies and tools, a rigorous analysis of costs-benefits is required, identifying the winning and losing groups, with special attention to the most vulnerable actors. New multilateral options should discuss this and include them in their agendas. SSE are still different and demand specific detailed policies for development according to their needs and constraints. The typology presented in this part for SSE will serve for the construction of a specific assessment tool for multilateral participation. The same, governments and national politics should create awareness to be able to make people understand the values of real integration and the importance of its participation in the international arena.

## **PART TWO**

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### **SSE: IMPACT OF REGIONAL INTEGRATION**



## Introduction

The theory of comparative advantage from David Ricardo (1817) suggests that free trade is good for everybody. First, because goods are produced in contexts where production is the cheapest, and second, because consumers benefit from the lowest possible prices all over the world. However, this theory did not take the size of the countries into account, and as time went on, we could evidence that open trade was not necessarily beneficial for everybody. In fact, SSE were not benefiting from trade and parallel growth as the idea of open trade suggested in the economics literature. Literature from the World Bank (2010) and others pointed out that the relationship between trade and growth is strong and positive, meaning that trade is most definitely pro-poor. According to Dollar and Kraay (2001), increased trade usually generates a more rapid economic growth, while showing no systematic change in household income distribution, thus increased trade generally goes hand-in-hand with improvements in the well-being of the poor. Berg and Krueger (2003) point out that while the vast literature that exists regarding the effects of trade liberalization on income distribution reveals no systematic relationship between openness and the income of the poorest, evidence firmly supports a positive relationship. On the other hand, Rodriguez and Rodrik (2000) conclude that more work needs to be done to demonstrate conclusively that free trade brings all the benefits that are avidly promoted by its proponents. On the other hand, it is also important not to forget that the geographical size of the country matters, at the time of evaluating the impact of trade. As Alesina and Spolaore (1997) demonstrated, the size of countries was a decisive factor and was determined by geography and income, “...*the trade-off between the benefits of size, such as economies of scale, internalization of externalities, military strength, etc., versus the costs of heterogeneity of preferences of the population offers a useful prospective to think about political borders*” as an important factor in determining the size of the country. For Alesina (2003) the relationship between country size and market size depends on the trade regime. If a country works under a complete autarchy, then, political size and market size are the same. On the contrary, if the country is economically integrated, the market size of a country is larger, sometimes even larger than the political size of the country. When multilateral free trade exists, borders turn out to be totally irrelevant for economic interactions, and the market size of each country is the world. Since free trade is basically nonexistent because of trade barriers, natural borders, and political and economic conflicts within countries (heterogeneity, different income per capita,

etc.), the size of the economy becomes the main issue in the internal market. This is why SSE would benefit further from having a closer national market to make trade easier (Frankel and Romer 1999; and Rodriguez and Rodrik 2000).

It turns out that size, is a very important factor for a country and its international insertion. Regardless of this fact, during the past years, several clashes between countries have occurred due to an increased protectionism in the developed countries who at the same time promote liberalization of trade. Moreover, SSE have had a very difficult time protecting their frontiers from products that could be harmful to their national economy or population mainly because they create a state of extreme dependency towards certain partners, as we will present below. SSE might simply be unprepared to cope with the effects of free trade and hard competition. Nevertheless, SSE have certain strategies at hand that give them a larger degree of power. For example, the correct type of integration could create the possibility of negotiating as a group or increasing their negotiation position through the management of their natural resources. In all cases, participation of SSE in international trade is having a twofold transformation, both economic and political. The economic aspect is that being SSE agricultural based economies with little power of negotiation have switched in the last years to an energy resource base which not only increased their national income but also their power of negotiation. The political aspect of this situation has to do with the political power that some of the SSE are gaining at international arenas due to their endowment of energy resources.

South America is known for specializing in the agricultural and electrical energy sector. SSE export only a small part of their production to neighboring countries despite the geographical proximity, orienting a great part of their primary production to developed countries (DC)<sup>1</sup>. On the other hand, two of our SSE are specialized in energy<sup>2</sup> and have increased their trade with neighboring countries, avoiding the creation of barriers on exportations, due to the growing demand from neighbors. Moreover, these neighbors are willing to increase imports of energy granting SSE a better negotiation position.

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<sup>1</sup> SSE structure of exports towards the Developed countries show that, most of the agricultural exports represent a high quantity for the SSE's trade but it only represents a minor item for developed countries so they are not in competition. Thus, most of the products exported by the SSE fit within an exclusive target of consumers willing to pay for variety and exclusivity of traditional products.

<sup>2</sup> Energy as: oil, gas or minerals are part of the resources of the SSE.

In this section of the research paper we will analyze the size of a determined country in a more profound manner, adding other factors to the scope, like its role in specific regional or bilateral agreements and the extent of the power that they have to insert their primary and most relevant issues in the regional/bilateral agendas. To achieve this, the study of every regional bloc will contain four sub-parts: geopolitical interest, economic performance, game theory on regionalization and the conclusions that will observe the impact of each economic bloc on the internationalization and development of the SSE, both looking for negotiation capacities and difficulties in each type of integration. Finally, we will expose several points regarding the regional or bilateral agreements and the impact of the later on trade. We will also focus on determining which would be the most convenient type of agreement for SSE in terms of trade and development.

The main goal of this section (chapter four and five) is to analyze the impact that regionalization has on the internationalization of SSE and the degree of attraction for FDI and trade. To achieve this, the methodology used will contain an exhaustive study of each of the regional blocs that the SSE participates in: ANCOM, MERCOSUR, ALBA-TCP, FTAA and FTA with China.

## Chapter 4

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### **SSE between deep and hollow integrations**

During the course of the last years, SSE have been joining different initiatives to promote regional integration, such as: the Latin American Integration Association (LAIA), the Andean Community of Nations (ANCOM), Mercosur, the Bolivarian Alternative for the Americas (ALBA-TCP), are just some to name a few. Lately, these integration blocs have been switching from objectives focused on deep integration to political maneuvers. This created a sort of hollow integration process that does not actively engage in any determined actions, but is only looking to take advantage of being together for political representation in the international arena. Open trade and international insertion became the main priority for the development of the SSE, leaving behind endogenous development and structural changes in each member. This could explain why poverty and the high inequality between the countries in South America subsist. Contesting the IEOs influence in the types of integrations, ALBA-TCP oriented its discussions against neoliberal measures that were taken in the last twenty years which had the distinct effect of increasing the gap between poor and rich. On the other hand, other neighboring countries that belong to other types of integration, do not accept the extremist posture of ALBA-TCP, that is notoriously leaning towards socialism and governing policies that might be a threat to the region and the current regional agreements that contain neoliberal policies based on liberalization. This vision argues that either governance or the capacity of the government to rule proficiently, are to blame or congratulate for the gap between rich and poor and not the free-market model. Some countries like Brazil for example are in the socialistic wing but without leaving the free-market model. Deep and hollow integrations have been impacting in different ways the international insertion of SSE in the last years.

This chapter will analyze ANCOM, the Mercosur and the ALBA-TCP regional agreements. A marked differentiation will be established between these regional blocs, who either support the right wing or the left wing. All the three sub-parts of each of the regional agreements will

analyze the geo-political interest, the geo-economic interest and a small presentation of game theory on regionalization within the member countries in each of the regional blocs. Geo-political and geo-economic interest and performance will be analyzed in each of the SSE countries within the bloc. This analysis will take the past and present behavior that SSE and LSE had towards each other into account. This intent to review the type of participation of the small states within the bilateral agreements (FTA) or regional agreements and its position in the international political economy and how do SSE respond to the structural power of LSE with the continuing demand for trade openness and the ideological forces behind it. Finally, we will present and apply game theory on the different issues and problems that the SSE have within the region and with the main members of the later. Game theory will present lobby activity and the strategic pay-off within the trade bloc<sup>3</sup>. This will enable us to show how some interest groups hold great influence over the international economy, even when this policy is in direct conflict with the welfare of the rest of the population. It will also try to show how the country responds to the continuing pull of national interest of various sorts where states (and non-state actors) compete for a relative advantage in the Global Economy, either for a better international insertion at regional level or a better international insertion at multinational level. This analysis has the objective of determining all the opportunities and threats that SSE have face when dealing with international integration within bilateral or regional blocs.

## 4.1 ANCOM (Andean Community of Nations)

ANCOM is also known as Comunidad Andina (CAN for the acronym in Spanish) and was created in 1969. Currently it has four member countries: Bolivia, Ecuador, Colombia and Peru (figure 4-1). Chile left the group in 1973 under the government of Augusto Pinochet and requested its entrance again in 2006. Venezuela left ANCOM the second semester of 2006 because it wanted to become a full member of Mercosur. Venezuela was one of the main partners in this regional bloc. These are also candidate members for Mercosur. The integration process of ANCOM was first oriented towards trade and governed by market forces (as the majority of its legislation promotes). The integration process followed economic and political interest, in the search for a widespread development of its members,

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<sup>3</sup> Some authors claim that Nash equilibrium does not provide predictions but rather an explanation for why the population remains in that state.

taking advantage of the cultural, linguistic and historical similarities amongst the group. Nowadays, the political interest related to integration became stronger albeit the low intra-trade level to link up all South America with a common view of social development. The main objective of ANCOM is to move ahead in deepening a profound integration process that will contribute effectively to sustainable and equitable human development. This process will be enforced with the aim to live well, with respect for the diversity and asymmetries that agglutinate the different visions, models and approaches and that will converge in the formation of the Union of South American Nations (Unasur).

According to UNCTAD (2010) ANCOM has a GDP of 452.527 million dollars and a population of 122.894 million people living in an area of 3.806.272 km<sup>2</sup>. ANCOM's population has an average of 47% of productive population, 46% of young people between 0-19 years old and 7% of 60 or more years, which means that 53% of the population depends on the income that 47% produces, since there are only a handful of social programs or pension/retirement programs for the citizens who did not work in the formal sector. ANCOM has around 50% of its economy in the informal sector.

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**Figure 4-1. ANCOM member countries.**

■ ANCOM members  
 ■ ANCOM associates



Source: Adapted from Wikipedia (2010)

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Nowadays, two trends can be evidenced in ANCOM: a) one is the tendency to lean towards the left wing, as countries like Ecuador and Bolivia show; b) the other is primarily right wing, and includes Peru and Colombia. Bolivia is one of the smallest countries in the sense of population and GDP. The second smallest economy is Ecuador. At present, Colombia is relatively the largest in the bloc, though it is about 6.6 times smaller than Brazil in GDP. Then, almost all four country members are relatively similar in size and are denominated the Small Economies within LAIA. With this knowledge in mind, it can be said that the strategy

followed by ANCOM points towards the fusion of small economies that cannot compete or negotiate alone to form a pact for trade negotiations against larger countries, or to face an open world of free trade as in the WTO.

### **A) Geo-political interest**

**Geographical dimension.** The total GDP of ANCOM is by half as big as Brazil's; conversely, ANCOM is still an interesting negotiation partner for the EU or the US, who are not interested in spending much time negotiating issues with each country separately, due to their small size. The bloc is organized around a common interest for international negotiations and enlargement of national markets. The bloc has several objectives mentioned in the point above; however, the group is basically ruled by market power, orienting each member to individually improve their international insertion in order to reach development. All members of ANCOM have a common leader that dominates the organization of the supranational institutions, enforcing the idea of liberalization that would in turn lead to development. Their dominant leader is the US and even when it does not belong to the bloc it has a high influence on the construction of the WTO, World Bank and ECLAC rules that are used as a starting base in the majority of the ANCOM's supranational set of laws for integration. This created a stronger dependency on the IEOs, especially since 1990. This limited the creation of common policies for the group. In the last years, Venezuela has pushed forward with the dominant idea to gain national sovereignty in each of the ANCOM countries and in the region. This has caused a division within ANCOM into left and right wing advocates. These nations are constantly confronting each other, because Venezuela is imposing a new dominant position in Bolivia and Ecuador through its financial aid, thus reducing the dominant influence of the US and increasing political conflicts in the bloc.

**Contractual Force.** ANCOM as a trade-bloc is interesting for negotiations at a political level being that it can insist on the insertion of certain demands for small size economies. Seeing that most of the members are relatively small and have similar problems, the negotiation in bloc has shown to be fruitful. In the economic sense, ANCOM is not a bloc with a high intra-trade exchange. The countries have been concentrated on individual agendas and in the advantages of trading with larger economies rather than within the bloc. This is why, it is difficult for ANCOM to be able to reduce national sovereignty with the aim that all members

submit to the supranational sovereign institutions since the majority of these countries are a result of "traditional" military governments, characterized by clientelism, caudillismo and populism (Dabéne O., 1997) and are until now, seeking for economic power and autonomy at national and regional level. Politically, the bloc is interesting for the potential power on international negotiations. This orientation was often influenced by two economic and political models: left and right wing. Ecuador and Bolivia (SSE) gained significant influence in the bloc through this New Leftist orientation (since 2006) having a strong support from Venezuela and the oil power, common in the three countries.

**Role and responsibility of the leader.** Currently there is no proclaimed leader in the bloc and as we mentioned before, the dominant power of the US has an influence over the main activities performed that strive to reach the development of key sectors (agriculture, hydrocarbons or drug control programs) through a common conception of what is international insertion, free trade and development. Some rules for trade and liberalization are internalized from the US or the IEOs. The US is the largest trade partner (with almost 40% of the total share) and also the largest foreign investor. In spite of several democratic and participative intentions at each Summit of Heads of State, members could never manage to cooperate between them and become more independent of the US. Common problems like education, security, frontier control, drug trafficking, smuggling, etc. cannot be handled by the ANCOM, who lacks the capacity to create proper action programs by themselves, so the US continues to take charge of some of these issues through the signature of several bilateral negotiations and cooperation programs as the ATPDEA (Veillette Connie, Ribando Clare and Sullivan Mark, 2006).

In the case of Bolivia and Ecuador, both nations depend on ANCOM for common international negotiations with other regional blocs and larger economies like the US, who happens to be their main partner. Individually, it would be a difficult task, since they both lack the capacity and the human resources to analyze all the facts and matters for a specific negotiation. Despite the importance of ANCOM as a region, it still poses a twofold problem: economic and political. *First problem*, ANCOM has an **economic dilemma** because ANCOM is oriented towards trade with larger partners and not within the bloc. Members within the bloc prefer to import products from larger partners (US mainly) who can later import their production rather than buying from other SSE. In average, the bloc has intra-trade of 7,5% in 2009 (ALADI) while with US, the trade share reached 28.4% in that same



year. Until 1999, Bolivia exported more than 21% to the bloc but with all the barriers and political conflicts within the members, it reduced to 11.2% in 2009, having now a higher dependence on Mercosur. Slightly different, Ecuador passed from 7,4% to 11,8% in exports to ANCOM, having a higher dependence in the region for its imports that went from 10,5% (1995) to 14,3% (2009). Both SSE have the opportunity to sell their production (food, processed food and manufactures) to the bloc without too many SPS/TBT barriers as other LSE demand. Besides, having a similar level of development, income per-capita, the needs and demands are similar to each other and the SSE find in these markets an opportunity to sell value-added production and to push national industry.

*The Second problem* is the **political interest** that SSE have in the matter of reaching a common position on trade negotiation or development policies face to LSE but that the bloc members do not always respect it. The best example is the negotiation that ANCOM underwent for drug control with the assistance of the US for the Andean Trade Promotion and Drug Eradication Act<sup>4</sup> (ATPDEA from now on), and the SGP+ from the European Union and other projects for the development and improvement of trade with the US, Mercosur and the EU. Being in ANCOM means that you can fall back on political protection in the international negotiations with different back-up actions that the supranational institutions<sup>5</sup> plan to carry out. These programs might be for: trade of goods, services and investments, intellectual property, competitiveness for small size enterprises, sanitary and phytosanitary measures, rural development and food security and macroeconomics convergence. However, in practice SSE cannot take full advantage of the supranational institutions because there is no political cohesion between members, due to the fact that it is not possible to reduce the national sovereignty of each member in order to apply a set of common actions. Since ANCOM cannot have the initiative on common foreign policy, it neither can influence the trade policy that each member has. This represents a weakness particularly for SSE. For instance, there was a restriction on the signature of unilateral FTAs making it only possible to negotiate as a bloc and only in some cases, unilaterally (Decision 598<sup>6</sup>). This preserves the

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4 ATPDEA is a trade preference system by which the United States grants duty-free access to a wide range of exports from four Andean countries: Bolivia, Colombia, Ecuador, and Peru. It was enacted on October 31, 2002 as a replacement for the similar Andean Trade Preference Act (ATPA) enacted on December 4, 1991. The purpose of this preference system is to foster economic development in the Andean countries to provide alternatives of production to cocaine production.

5 Some supranational actions in ANCOM are: the Common Foreign policy (PEC, in Spanish) and a common financial system.

6 Decision 598 was signed by the Andean Council from ANCOM, signed in Quito-Ecuador the July 14th 2004.

legal arrangement of ANCOM and respects the trade sensibilities of each member against liberalization. In 2005 Peru avoided this decision in order to negotiate an FTA with the United States and adapt to the intellectual property of the US. Moreover, Peru demanded to change the Decision 486 that rules National Treatment and Most Favored Nation (MFN) from a compulsory compliance to a voluntarily compliance changing the Decision to a simple recommendation document where each member could decide when and what to accomplish independently, respecting its own sovereignty. This modification could alter the nature of the Andean decisions in its fundamentals to reach a base for a common policy, so that Peru can keep the cycle of national sovereignty voiding the possibility of developing a supranational independence. What is more, Decision 486 excludes the possibility of patenting living beings, biological processes or genetic material, therapeutic or surgical methods or those inventions that must be prevented in order to protect the public order, moral, health, life and the environment. Furthermore, it defines the necessary procedures to request patents and terms for its granting (between 15 days and two months). With the change in this Decision, the regulations of the US will prevail over each of the countries that sign an FTA with the later, reducing the institutional power of ANCOM. Peru insisted in the change of this Decision assuming new regulations that widen time for requesting patents, eliminating the obligation to register the use of brands, restraint the dissemination of inventions, protecting intellectual property rights and granting more priority to brands than to denominations of origin. The demand for changing Decision 486 was completely accepted by Colombia but caused conflicts with Ecuador and Bolivia because they did not want to accept any change.

Constant conflicts in the bloc prevent the convergence of the members, which in turn, makes it very difficult to reach a real integration. Problems between the smallest and largest representatives of the bloc are weakening the coalition, its common vision and objectives. This is why each member is motivated to sign bilateral agreements with other countries in a very individualistic sphere, for instance, the adhesion of Equator and Peru to APEC, the association of Bolivia to Mercosur, the Peru's FTA with the US and China, and the association of Bolivia to ALBA-TCP. Despite the dynamic effort from ANCOM to create norms towards a common economic policy for the bloc, the group has never managed to converge on a common view in practice. Nonetheless, in the last years, the higher interdependence of the international politics has originated some conflicts between its members (Peru and Bolivia on one hand, Colombia and Ecuador on the other) for decisions taken alone, without foreseen the impact or externalities to fellow members (see box 4-4).

Thus, political conflicts between members have a great influence on trade and have had a negative impact on deep integration and on the position of the smallest in the bloc.

In the last four years, conflicts of a different kind augmented between members who questioned two things. One aspect was the growing doubt that centered on the belief that If ANCOM could survive in the next years or would it be dissolved. The other question is if SSE benefit from international insertion by belonging to ANCOM. Political conflicts impact the level of cohesion of the bloc, even when conflicts are at bilateral level (e.g. Bolivia-Peru), it influences the performance of intra-trade within ANCOM and it endangers its future. Conflicts highlight the failures of ANCOM who was unable to bring into play the supranational institutions and for lacking rules to solve conflicts raised by sovereign political decision of a country that could be creating negative externalities to the other members, smaller economies of the bloc do not have special rules either.

#### **Box 4-1. Peru-Bolivia: Intervention Vs. Accusations Strategy of balance of Nash**

##### **Background**

One of the conflicts was initiated on June 2008. The conflict was between Bolivia and Peru and was based in the increasing relations between Peru and the dominant US. Evo Morales, the President of Bolivia denounced Peru for allowing the installation of military forces in Peru. As far as it is not allowed within ANCOM to interfere in sovereign decisions, Bolivia assured that it was not interference but an expression of concern for the region in matters of regional security and international interference by the US government. Bolivia highlighted that this was not only a national concern for Peru but a concern for the rest of the region. As the President Alan Garcia was elected in June 2006, he modified some articles in its national Law No 27856 (Law for requirements and authorization for the entrance of foreign troops in Peruvian territory) and created other Ministerial Resolutions (RM-Nº418-2008/DE/SG, RM-Nº 451-2008/DE/SG, Legislative Resolution Nº 29234) to authorize the entrance of US troops (marine, land, air) which have increased since 2006. Alan Garcia allows US troops to get in Peru as troops for instruction, training, social assistance in the poorest areas of Peru, etc. This unilateral decision of Peru goes contrary to the will of South American countries to initiate the liberalization of the domination and the neoliberal forces of US that were governing and deciding the turn of Latin America. Since ANCOM did not pronounce a decision to this, Bolivia denounced to several regional blocs. The congress of Brazil, the Mercosur and the Amazon Parliament expressed their concern for the reactivation of a US military base in Peru. While South America is trying to lessen the ties with US through different regional blocs in the region, Peru is serving still the interest of the US government. This conflict has threatened the economic relations between two great traders. Peru was forcing to break trade relations with Bolivia knowing the high dependence of Bolivia towards Peru. Political issues seem to have more weight in trade relations for ANCOM members than economic interests.

Although these are just speculations, it is not a secret that the US maintains a complex network of military installations in Latin America and the Caribbean as: Ecuador, Aruba, Curacao and El Salvador, known as "cooperative security locations," or CSLs. These CSLs are leased facilities established to conduct counter narcotics monitoring and interdiction operations with ten-year agreements with each country. US Southern Command (SouthCom) also operates some 17 radar sites, mostly in Peru, Colombia and Bolivia, each typically staffed by about 35 personnel. US military agreements have access to military presence in the region and this questions democracy, international cooperation and interaction of the sovereign Governments because US influences the development of the country.

Major U.S. Bases in Latin America of Caribbean	Number of military personnel
Guantánamo Bay, Cuba	8100
Soto Cano, Honduras	550
Manta, Ecuador*	475
Comalapa, El Salvador	100
Palanquero, Apiay and Malambo, in Colombia	1400

\* President Rafael Correa has refused to renew the lease U.S. operations were set to end in July 2009.

Colombia, 2 military bases in Peru, one in Guantánamo (Cuba) and another one in Grove (Honduras), 4 in Salvador, one in Ecuador. The figure above presents the number of U.S. military settled in these countries: Cuba 8100, Honduras 550, Ecuador 475, El Salvador 100. Several forums and consultations organized by Latin American countries are space of discussion on the military strategies that the United States is using for the submission of those less developed countries that cannot decide on the different problems they face: drug trafficking, poverty, immigration, development, health, natural resources, environmental and others. This is why, together Latin American countries are trying to promote joint operations to become more sovereign. However, the United States impose to smaller economies its military troops, military exercises, military training schools and even peace operations as part of the alternative development and fight against drug trafficking through bilateral agreements that cause restlessness in the neighboring countries. This is the case of Bolivia that accused the United States of political interference and expelled from Bolivia some U.S. institutions (USAID, DEA) because they were causing economic and social instability.

Once Bolivia has expelled the US military, its President asked Peru to do the same. This request has raised a conflict creating tensions that could be interpreted by a game theory that is lasting from 2008 until 2009 (Present) due to a political interference. Therefore, the strategies are as they follow:

- Bolivia accuses the government of Peru to have American military bases in its country and demands to remove them (A) or it does not accuse, leaving Peru in its own sovereignty to decide (NA).
- Peru on the other hand demands Bolivia breaking international relations (D) or does not demand (ND) Bolivia to international organizations for political interference keeping a continuous conflict between them but without destroying international relations.
- If Bolivia chooses (A), then Peru chooses (D) and demands Bolivia for political interference and breaks international relations. The cost-effectiveness for both will be low in (0,-3) since bilateral relations that have a socio-economic importance for both would be broken. However, Bolivia loses more because Peru is one of the most important recipients of the industrial exports of Bolivia.
- If Bolivia chooses (NA), then Peru chooses (ND) for political interference and the relations between both countries remain calm. Here the cost-effectiveness will be higher for both in (3,3).

Supposing that the accusations of Bolivia are confirmed, the strategies would be:

- If Bolivia chooses (A) and Peru chooses (ND), then Peru has a lower gain because at international level it would have a bad image and trade relations with other countries would be affected (-1,1).
- If Bolivia chooses NA knowing that it exists military bases and Peru chooses D to break up relations with Bolivia because of the initial intromissions and searches for new trade partners; then Bolivia has a loss (1,-1).

		Bolivia	
		A	NA
Perú	D	(0,-3)	(1,-1)
	ND	(-1,1)	( 3,3)

**Analysis:**

Here, the dominant strategy for Bolivia should be to avoid political interference in Peru respecting its sovereignty as it does with the rest of the countries. Consequently, Bolivia will not only maintain a political partner but also an important trade partner. It is expected then that less interference will reinforce the agreements subscribed with Peru and the region. On the other hand, the installation of U.S. military bases in the Latin American countries demonstrates that it exist a great economic-political and trade domination from U.S. Nevertheless, joint operations in several South American countries are taking place to promote sovereignty and independent governance through regional mechanisms of economic and political support.

Nonetheless, Bolivia has kept on air this conflict and has increased since 2008 because the President Evo Morales has been constantly criticizing President Alan Garcia's government in several aspects. President Morales says that President Garcia is a neoliberal and that the Peruvian population suffers due to that. In June 2009, President Morales denounced publicly that President Garcia has committed genocide against its indigenous people that were protesting against the exploitation of oil in the Amazons. President Garcia discovered that President Morales and other Bolivian members from the government had participated in an indigenous meeting in Peru suggesting the indigenous population to start a revolution to prevail their rights of territory. This had a result of 35 deaths and Morales denounced this action as genocide. The UN had to intervene after the accusation of genocide but determined that it was not genocide. Still, President Morales kept giving revolutionary speeches to the press so that Peruvian indigenous could revolt against its President. This has altered terribly international relations between Bolivia and Peru and seems to continue in the future because President Alan Garcia is one of the fewest Presidents in South America that is not currently with the leftist trend that the rest of the countries are following.

#### **Box 4-2. Colombia-Ecuador: Political Conflicts Vs War against terrorism**

Another conflict worth to highlight because of its political importance is the one between Colombia and Ecuador. This one started when Colombia did an attack against the terrorist group FARC in March, 24th (2008). With the help of the US army forces, Colombia discovered a group of FARC in its territory and attacked it. In the attack, there was a cross-border air strike with Ecuador against Colombian rebels and more than 20 dead were confirmed and among them was an Ecuadorian civilian. This action further strained the already tense relations between Colombia and Ecuador due to infringement of territory. Both countries mobilized troops along their borders with Colombia and broke diplomatic ties, even the President of Venezuela took part in the conflict declaring war to Colombia by sending armed forces and tanks to its frontiers. The first move towards the Colombian frontier included 6.000 armed men (February) and the second move (March) included 10.000 military troops. President Chavez sustains that US has armed Colombia and is transforming it to a conflictive country for the region as Israel is for the Middle East.

As a result, the conflict influenced trade relations in ANCOM, particularly Colombia-Ecuador and Colombia-Venezuela. The fight against terrorism left aside and more importance was granted to the infringement of territory and despite of the great trade relations between them, this conflict threatened to break up. To solve the problem, Mercosur and ANCOM intervened at a summit in Rio de Janeiro and also talks at the OAS in Washington. Here it can be seen that a SSE can have power of statement through the support of neighboring countries even when a relative larger economy as Colombia has the right to fight against terrorism and even when this security is a common good for the region.

Individual Politics are more important for ANCOM than regional economics and bloc cohesion. No country member seems to be willing to submit to regional sovereignty over their own ideology, which is usually separate from the common interest. Then, the effort to create regional blocs and keep signing agreements becomes questionable. This initiative may be explained by the particular position of each member. Each member is individually

motivated to reach international insertion and development for its own economy. Different regional agreements have proven to work well for political and economic negotiations rather than being alone; therefore, integrating is better. ANCOM knows this but faces difficulties in promoting cohesion, and the reduction of sovereign decisions to work with common negotiations that would surely benefit the group. Moreover, smaller economies seem to forget the goal for common welfare and public good because they insist on sovereignty.

In the last four years, the negotiations of SSE have dealt in the most part, with its government's ideology rather than common interests. It is said that the current ideology is part of the defense of "national interests" and when the topic of discussion tempts to damage these interests in any way, the debate leads to a political conflict. Even when the complete implications (economic or political) of the topic under discussion are unknown, more emphasis is put on ideology and sovereignty than on the economic impact of it. SSE often lack technical expertise, capacity and resources to analyze trade issues and economic implications on the topics discussed. There is no actions taken in the bloc to improve the situation and this fact makes SSE fail in their national and international decisions and potential negotiations. Accordingly, Luis Abugattas<sup>7</sup> said in a seminar of integration and convergence held in Buenos Aires in 2006 *"in effect, we are gambling with our country's future every day at the negotiating table"*. This is one of the challenges for the SSE (to improve negotiations) and for the neighboring countries to take national decisions thinking that these actions not only have an effect on their own economy but also on the neighboring countries with cross-border externalities. This understanding could also improve the creation and applicability of regional regulations for international public goods.

Political troubles seem to have a negative impact on the bloc which in turn tends to weaken the integration. A constant increase of the interdependence within its members and the mismanagement of cross-border externalities of public goods, originated by one member, could deteriorate the deepening of the integration. A common vision for an international common policy is not yet possible due to sovereign decisions on its policies. But ANCOM legally respects the sovereignty of each country allowing them to program their own international policies, leaving the bloc powerless to impose any regulations on the

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<sup>7</sup> Abugattas is the Executive Director of the Institute of Economic and Social Studies at the Sociedad Nacional de Industrias in Lima, Peru.

management of externalities. Despite all the supranational institutions<sup>8</sup> that ANCOM has to improve trade with, the current situation shows that trade is not the only concern for the member countries. For instance, there is an increasing need for a political position to face international relations with other countries outside the bloc and the vision for national development regarding left-right wing but common position towards a foreign policy which have to reduce the individuality and this is unlikely to happen. Colombia and Peru prefer to continue in the race of FTA with US and EU while Ecuador and Bolivia try to avoid future FTA preferring deep agreements that aim to assist in national development and internationalization rather than just simple signatures for an agreement that will only benefit the other nations that is ready to export its products.

Both the economic and political sides happen to be intertwined in ANCOM, and they both exert influence over the international insertion of the SSE. One of the main reasons which cause these phenomena is the fact that the four member countries are somehow similar in: production structure, trade partners, consumption patterns, etc. with their closest neighbors. The similarity in development and social difficulties are the main reasons why neighboring countries are constantly confronting each other with the SSE. Each relatively large economy wants to have leadership and power over the region to stop competing with similar trade partners and similar products that are manufactured by the SSE, and in the chase for this objective they sometimes sign unilateral agreements with other countries. Each member wants to have more chances for their own individual international insertion, even when this option is not a Pareto optimal. There is no leader in the group and never was. When Venezuela started to grow towards a relatively larger economy, it abandoned ANCOM to join the Mercosur in 2006. The lack of a dominant figure in the bloc (especially since the exit of Venezuela) creates constant conflicts between them. Trade interdependence keeps them together in the bloc even when they have a conflict (Bolivia-Peru; Colombia-Ecuador; Peru-Ecuador). This need is what grants each SSE a higher position and negotiation power. Still, as trade is seen as an intricate part to reach development, Colombia, Peru and even Ecuador decided to have individual negotiations with the EU, leaving Bolivia behind. Bolivia insists on not ever again signing a light FTA as it is a reproduction of neoliberal measures that only benefit large exporters, mostly from Europe or the United States. And in fact, FTA tend to

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<sup>8</sup> Supranational institutions in ANCOM are managing (after four decades) the creation of national laws that constitute nowadays the Andean Right applied by the Andean Court of Justice postulates the a.i. General Secretary, Alfredo Fuentes.

disregard small producers and small exporters, who prejudice their work because they are not capable to compete with large scale production and exports from larger countries. Besides, when export treaties are done, SSE can export (agricultural) products to these markets but in contrast, SSE start importing with predilection from LSE due to the lower prices and higher quality of its products. Following this assumption, the President of Peru, Alejandro Toledo stated in an ANCOM meeting, (2008) "... the bloc has to improve their social welfare first, because nobody wants to trade with the poor". This phrase expresses why ANCOM has no success for intra-trade. SSE does not attract LSE unless they have something of interest that would change this fact.

If ANCOM does not negotiate a position based in the *common interest*, trade negotiations would only keep the gap in production and trade. Politically, SSE thought they could find in ANCOM an entity that has supranational institutions to assist them with development, a common position for all SSE which would help them having a better international insertion. However, after several years, SSE that became larger decided to leave the bloc, as Venezuela did mainly because of two aspects: a) Venezuela wanted to impose a vision and a ideology to the bloc that did not agree with this and confronted with Colombia and Peru and a heavy influence from the US in their culture, media, type of economy, politics and military bases; b) Venezuela grew thanks to continue rise of oil prices with the raise up of oil prices and it assessed Mercosur as more important for potential trade and negotiation than ANCOM. Besides, Brazil and Argentina are the largest consumers of oil in the region and therefore, Venezuela can increase its negotiation power. To change this situation and impose its vision and ideology, Venezuela would have to increase its responsibilities towards the bloc reducing its own potential to grow, that is why Venezuela left ANCOM and decided to cooperate from outside. Chile joined the bloc as an associate member only to benefit from the tariff regulations that ANCOM has. Chile has a great percentage of its trade depending on ANCOM and is planning to increase. This is why associating to ANCOM is interesting to Chile, at the same time; Chile gains the opportunity to enlarge its international market where it can also export goods with added value without many SPS/TBT barriers. The new geopolitical vision for ANCOM changed with the entrance of Evo Morales to the Presidency of ANCOM in 2006. Morales gave a new vision for trade within ANCOM and another type of trade and development (Bilaterals, 2005). The main objective of this new vision was to promote trade for small producers and small potential exporters within the bloc. Taking advantage that everybody in the bloc has similar problems of productivity and large scale



production for trade, it is important to benefit the small producers from all the nations within the bloc promoting their trade. This new vision could have been a good potential solution for the bloc and could have helped to keep its existence, reducing the risk of disappearance of the bloc; however, this vision did not persist between members since there were many political confrontations between them and actually intra-trade reduced since 2006. What determines trade rates in SSE within ANCOM? Are they attracted to the relatively larger members in ANCOM or outside?. We will analyze these aspects in the following point with a Tinbergen approach to trade.

## **B) Geo-Economic performance**

**Nature and Empirical analysis of trade.** The Protocol of 1987 encourages the international insertion of ANCOM (through the reduction of the constraints on foreign assets, programs of customs office until the full opening of frontiers with zero tariffs in the future, multilateral negotiations) the creation of trade, economies of scale and improvement of comparative competition that could oblige the bloc companies to adapt and modernize or push them out of the market. ANCOM consists of four countries with a very similar culture and language, almost the same level of economic development, consumption, income and preference patterns. So ANCOM does not possess any natural trade barriers<sup>9</sup>; therefore, trade would not be hindered unless artificial political barriers are created. However, ANCOM has different barriers, both economic and political, which obstruct trade. In the last ten years ANCOM has reduced trade instead of increasing it, mainly due to several conflicts within the member countries.

The reasons for reducing trade are: political and economic. According to EEAS (2010) 33% of intra-Andean exports are represented by only 22 products whose majority are agricultural or hydrocarbon origin. Bolivia for instance has 88% of its exports represented by only 3 products as soybean cake, soybean grains and cotton. Nowadays, if we check the UNCTAD Statistics Report 2010, we can evidence that since 2004, the reality until now (2010) did not change much because intra-trade is still based on food items and fuels. For instance, by 2009 exports were represented by 23% primary food production and 25% fuels and imports are

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<sup>9</sup> Natural trade barriers could be defined as the ones that are raised by: language, culture, consumption patterns, income level and development level.

23% primary food and 22% in fuels. This specialization has been reinforced since 1995, because of the low capacity of investment in other sectors, the legal insecurity for private property, and the syndrome of the revenue (generation of fast capital with hydrocarbons) for the government. In consequence, ANCOM is a battle ground for competition between its members, since they have a similar productive structure for trade partners. In order to compare how SSE behave in trade within ANCOM and the world, we use the relative gravity constants and these are shown for ANCOM in table 4-1.

**Table 4-1. ANCOM Gravity model: Relative Gravity Constants of attraction.** The values give a theoretical percentage on what share of their total trade should be with a certain country or region.

Country	ANCOM	Bolivia	Colombia	Ecuador	Perú
<b>COMUNIDAD ANDINA</b>	<b>0,00%</b>	<b>2,68%</b>	<b>1,91%</b>	<b>2,53%</b>	<b>3,55%</b>
Bolivia	0,09%	0,00%	0,04%	0,05%	0,13%
Colombia	1,13%	0,72%	0,00%	1,10%	0,97%
Ecuador	0,43%	0,27%	0,31%	0,00%	0,43%
Perú	1,05%	1,19%	0,49%	0,76%	0,00%
<b>MERCOSUR</b>	<b>4,78%</b>	<b>8,88%</b>	<b>3,04%</b>	<b>3,48%</b>	<b>5,91%</b>
Brazil	3,69%	6,40%	2,50%	2,75%	4,31%
Argentina	0,75%	1,39%	0,47%	0,55%	0,96%
Paraguay	0,04%	0,09%	0,02%	0,03%	0,05%
Uruguay	0,06%	0,12%	0,04%	0,05%	0,08%
<b>EUROPEAN UNION</b>	<b>19,30%</b>	<b>21,16%</b>	<b>16,81%</b>	<b>18,42%</b>	<b>19,49%</b>
<b>NAFTA</b>	<b>44,26%</b>	<b>40,02%</b>	<b>46,49%</b>	<b>46,52%</b>	<b>43,79%</b>
United States	46,24%	38,99%	55,26%	51,08%	44,06%
México	2,67%	2,29%	2,68%	2,98%	2,76%
Canadá	3,17%	3,12%	3,18%	3,11%	3,11%
Chile	0,59%	1,10%	0,35%	0,43%	0,83%
China	2,07%	2,19%	1,80%	1,93%	2,23%
Venezuela	1,06%	0,86%	1,78%	1,14%	0,92%
<b>Rest of the World</b>	<b>17,64%</b>	<b>20,11%</b>	<b>14,26%</b>	<b>15,63%</b>	<b>19,66%</b>
Total	100,00%	100,00%	100,00%	100,00%	100,00%

Source: Own elaboration based on GDP and Distances (see appendix 2)

The table's values are used further on in this part for specific analyses of Bolivia and Ecuador, the two SSE in ANCOM.

- **Bolivia.** Bolivia's economy depends on total trade with an average 51.6% over the GDP (1995-2009). Bolivia's structure of exports towards ANCOM depends on 26% on agriculture, for 23% on fuels which is mostly due to natural gas and 23% on minerals (Unctad 2010). Table 4-2 shows the main trade partners of Bolivia. ANCOM (Comunidad Andina) has a share of only 11.1% (2000-2009) compared to US that alone has a 14.0% share or Mercosur that has 37.6% share. To better analyze the ANCOM bloc, we will take a closer look at its numbers, which clearly show that the relative exports have gone down

and imports have slightly increased. There is also a visible decrease in trade with Ecuador and Peru particularly for exports. This is because of different political barriers to increase preferences with other neighboring countries or with the US. Ecuador for instance, prefers to import soybean and its derivatives from the US rather than Bolivia with the possibility for an FTA that could grant Ecuador a wider market for its tropical fruits. Besides, subsidized US grains flood Ecuador at low prices, driving out Bolivian soy. The FTA is currently stand-still but the market of soybean for Bolivia did not open again. The same case happened with Colombia since it started negotiations with FTA US-Colombia. Despite the fact that US Congress froze the negotiations, Colombia had already stopped buying soybean from Bolivia to grant preference to the US soybean. The same can be said in the case of Peru, who has signed an FTA with the US and some products that were imported from Bolivia are now being imported from the US.

**Table 4-2. Bolivia: Relative trade shares with the world.**

	Exports		Imports		Average	
	1995-1999	2000-2009	1995-1999	2000-2009	1995-1999	2000-2009
<b>COMUNIDAD ANDINA</b>	21.0%	12.9%	7.1%	9.2%	14.0%	11.1%
Colombia	7.7%	7.4%	1.9%	2.5%	4.8%	4.9%
Ecuador	2.6%	0.4%	0.3%	0.4%	1.4%	0.4%
Perú	10.7%	5.1%	4.8%	6.4%	7.7%	5.7%
<b>MERCOSUR</b>	16.2%	38.1%	22.6%	37.0%	19.4%	37.6%
<b>EUROPEAN UNION</b>	23.6%	8.3%	15.1%	9.2%	19.3%	8.7%
<b>NAFTA</b>	26.6%	14.8%	29.5%	17.9%	28.0%	16.4%
United States	25.4%	13.0%	26.2%	15.1%	25.8%	14.0%
México	0.6%	0.8%	1.7%	2.0%	1.2%	1.4%
Canadá	0.6%	1.0%	1.6%	0.8%	1.1%	0.9%
Chile	3.1%	1.8%	6.5%	7.1%	4.8%	4.5%
China	0.1%	1.0%	0.9%	6.2%	0.5%	3.6%
Venezuela	0.6%	6.9%	1.0%	2.1%	0.8%	4.5%
<b>REST OF THE WORLD</b>	9.0%	16.2%	17.4%	11.2%	13.2%	13.7%

Source: Own elaboration based on Andean Community Statistics and ALADI, [www.aladi.org](http://www.aladi.org)

Moreover, different products that were legally exported from Peru before, now passed to be part of smuggling in the frontiers Peru-Bolivia. This became a difficult situation to control for Bolivian customs, mainly due to a lack of personnel along the frontier<sup>10</sup> and high levels of corruption. The reasons could be various, a general increase of the Bolivian prices obliged the legal exporters to quit while there is another part of the population that

<sup>10</sup> There is customs office in La Paz – frontier with Peru but smugglers can use several entrances created by them to avoid control. In this way, several trucks come in or go out of Bolivia not only avoiding control but also taxes and SPS/TBT measures.

started to dedicate to export in small quantities and to be profitable in their business, they avoid paying taxes doing their business in the illegal way (game theory).

To be able to take a closer look at the situation that Bolivia faces within ANCOM, table 4-2 presents also the detailed relative trade shares with other countries and regions in the world. Colombia increased its importance for Bolivian trade especially on the export side. Conversely, Peru lost some protagonism regarding exports but still remains the most important trade partner for Bolivia. This is not that surprising since it is the closest neighbor with a rather large production and consumption pattern compared to Bolivia. SSE are attracted to relatively LSE economies so is Bolivia to Peru. Since Ecuador prefers to import products that are primary items for exports in Bolivia, it lost a big or its share, leaving space to trade more with Colombia and Peru. Now, the question is if these relative trade shares make sense from a normative point of view. In order to verify this, we go back to Tinbergen's gravity constants. Since ANCOM have very similarities in culture, language, income and level of development not any additional parameters are used for the gravity model and we keep a clean look at it. Table 4-3.a. presents the relative trade shares within ANCOM (as if it was 100% within the members). Table 4-3.b will compare real trade shares with the gravity trade shares that should be according to the Tinbergen's model and which are a deduction of the gravity value presented in Table 4-1.

**Table 4-3.a Bolivia: Relative Trade shares compared to ANCOM countries.** Trade of Bolivia with ANCOM expressed over total trade with ANCOM.

Country	Exports		Imports		Average	
	1995-1999	2000-2009	1995-1999	2000-2009	1995-1999	2000-2009
Colombia	36.9%	57.5%	27.2%	26.8%	34.5%	44.7%
Ecuador	12.2%	3.1%	4.7%	4.5%	10.3%	3.7%
Perú	50.9%	39.3%	68.1%	68.7%	55.2%	51.6%

**b. Bolivia: Relative trade shares compared with gravity shares.** Gravity from table 4-1 compared to actual relative trade share.

Country	Gravity <sup>1</sup>	95-99 <sup>2</sup>	rat <sup>3</sup>	00-09 <sup>a</sup>	ratio <sup>*</sup>
Colombia	33.0%	34.5%	1.0	44.7%	1.4
Ecuador	12.5%	10.3%	0.8	3.7%	0.3
Perú	54.5%	55.2%	1.0	51.6%	0.9
<b>Standard deviation</b>			<b>0.1</b>		<b>0.5</b>

1 Tinbergen's gravity expressed in relativity to the chosen counters

2/3 Relative trade shares calculated as the average of imports and exports

a/\* Ratio between Tinbergen's gravity and real trade shares (1=optimum)

Source: a) deduction Table 4-1 b) Deduction Table 4-2

To facilitate the interpretation of the values in table 4-3, we will assume that all the gravity of Bolivia's trade goes only to ANCOM. Hence, the total gravity and trade value is over 100% in each column. Having the gravity value indexed in such a way gives us the advantage of comparing them directly with the relative trade shares as they were calculated in table 4-3.a. Then, according to Tinbergen's Gravity model, 33% of the total trade is destined towards Colombia and only 12.5% to Ecuador.

Comparing the gravities with the real trade share of Bolivia with the ANCOM countries, we can see that Tinbergen's Gravity trade shares fit very well between years 1995-1999, with ratios near to 1 and a standard deviation of 0.1. Between the time of 2000 to 2009 however, the differences increased to values between 0.3 and 1.4 and the standard deviation increased to 0.5. We can say that a higher standard deviation mean a lesser fit. In these years, Ecuador and Peru lost shares against an increase of Colombia. These differences might be caused by the economic growth that Colombia had in the recent years (measured with the GDP) with an increase of its demand in agricultural products that are not fully represented in the gravity model.

For Bolivia, ANCOM is more important than what gravity suggests, almost 4 times more relevant. Table 4-1 gives a relative world share according to gravity of 2,68% while in reality it was 11,1% in 2000-2008 according to table 4-2. This might be because ANCOM is organized with similar relative SSE economies. The attraction that the members have towards LSE from other regions is notorious, but ANCOM is also drawn towards trading with the relatively LSE inside the bloc, which could be seen as an advantage for Bolivia. Even so, the relative share of Bolivia with ANCOM is reducing as well as with NAFTA and the EU. On the other hand, Mercosur, China and Venezuela are increasing their

relative shares with Bolivia. This could be for two reasons: trade barriers are less with these three countries/regions or there are new items for trade that do not face trade barriers. In the case of Mercosur, Bolivia increased exports only with Brazil and Argentina by selling more fuels. In the case of China, Bolivia increased its imports in different sectors.

- **Ecuador.** The position of Ecuador as a SSE in ANCOM is good since it improved its trade share. As shown in table 4-4, ANCOM has increased the level of relative importance for Ecuador's trade from 10.7% to 14.7% during the past fourteen years. All three partner countries improved their relative trade position with Ecuador, particularly Peru. This relative share is quite impressive if we compare it to the gravity trade share of only 2.53% for ANCOM according to table 4-1. This means that for Ecuador, other countries have higher SPS/TBT or other barriers than ANCOM has; subsequently, Ecuador takes advantage of ANCOM and trades more within the bloc. Ecuador, as a SSE depends 62% over its GDP on trade within the world; however, ANCOM occupies a small percentage of its share (14.7%) while the US has alone 30.7% (table 4-4). This fact increases the dominance of the US over Ecuador based on the large size of the US to attract international insertion. Nevertheless according to table 4-1 the share with US should be even higher.

**Table 4-4. Ecuador: Relative trade shares with the world.**

Country	Exports		Imports		Average	
	1995-1999	2000-2009	1995-1999	2000-2009	1995-1999	2000-2009
<b>COMUNIDAD ANDINA</b>	<b>9.4%</b>	<b>13.8%</b>	<b>12.1%</b>	<b>15.7%</b>	<b>10.7%</b>	<b>14.7%</b>
Bolivia	0.1%	0.1%	0.2%	0.5%	0.1%	0.3%
Colombia	6.1%	5.5%	10.6%	12.6%	8.4%	9.1%
Perú	3.1%	8.2%	1.4%	2.6%	2.3%	5.4%
<b>MERCOSUR</b>	<b>2.9%</b>	<b>1.2%</b>	<b>6.2%</b>	<b>9.1%</b>	<b>4.5%</b>	<b>5.2%</b>
<b>EUROPEAN UNION</b>	<b>20.6%</b>	<b>13.9%</b>	<b>16.3%</b>	<b>11.6%</b>	<b>18.5%</b>	<b>12.7%</b>
<b>NAFTA</b>	<b>39.6%</b>	<b>43.1%</b>	<b>36.3%</b>	<b>25.2%</b>	<b>38.0%</b>	<b>34.2%</b>
United States	38.1%	42.1%	30.9%	19.4%	34.5%	30.7%
México	1.1%	0.7%	3.8%	4.1%	2.5%	2.4%
Canadá	0.5%	0.4%	1.9%	1.7%	1.2%	1.1%
Chile	4.2%	3.8%	3.5%	4.1%	3.9%	3.9%
China	1.6%	0.7%	0.9%	8.4%	1.2%	4.6%
Venezuela	1.2%	2.5%	5.8%	7.1%	3.5%	4.8%
<b>REST OF THE WORLD</b>	<b>20.5%</b>	<b>21.0%</b>	<b>18.8%</b>	<b>18.9%</b>	<b>19.7%</b>	<b>20.0%</b>

Source: ALADI, 2010 [www.aladi.org](http://www.aladi.org)

Looking at the more detailed situation (table 4-4) of Ecuador in ANCOM, we can confirm that indeed Peru is gaining importance for Ecuador. Not only exports but also imports

have shown a relative increase. Exports to Colombia have fallen, which is basically due to the fact that Colombia and Ecuador faced several tensions in areas of armed revolutionary groups, potential signature of a FTA with US and EU. Bolivia keeps playing a small role for Ecuador though it had a small increase.

In table 4-5 we perform a more detailed analysis of Ecuador inside the ANCOM. For this purpose, we have compared the real trade with the theoretical value, according to the gravity model between Ecuador and each member country. First, we can see that the trade is very much in line with the theory, which confirms that barriers between countries are similar, so Ecuador prefers to ship its products towards the countries that seem to be the most attractive. Next, we can observe that trade shares and gravity values converge, standard deviation in the 90s was 0.47 and for the 2000s 0.21. Peru's share is increasing towards the gravity value of 39.6%. From 1997-1999 to 2000-2006 Peru's share increased from 22.3% to 37%. Also, Bolivia's share went from 1.3% to 1.7% towards the gravity share of 2.8%. Colombia on the contrary, moved from 76.4% to 61.4% towards the gravity share of 57.6%.

**Table 4-5.a Ecuador: Relative Trade shares compared to ANCOM countries.** Trade of Ecuador with ANCOM expressed over total trade with ANCOM.

Country	Exports		Imports		Average	
	1995-1999	2000-2009	1995-1999	2000-2009	1995-1999	2000-2009
Bolivia	1.3%	0.7%	1.3%	2.9%	1.3%	1.8%
Colombia	65.2%	39.8%	87.5%	80.6%	76.3%	60.2%
Perú	33.6%	59.5%	11.2%	16.5%	22.4%	38.0%

**b. Ecuador: Relative trade shares compared with gravity shares.** Gravity from table 4-1 compared to actual relative trade share.

Country	Gravity <sup>1</sup>	95-99 <sup>2</sup>	rat <sup>3</sup>	00-09 <sup>a</sup>	ratio <sup>*</sup>
Bolivia	2.8%	1.3%	0.46	1.8%	0.65
Colombia	57.6%	76.3%	1.33	60.2%	1.05
Perú	39.6%	22.4%	0.57	38.0%	0.96
<b>Standard Deviation</b>			<b>0.47</b>		<b>0.21</b>

Source: a) deduction Table 4-1 b) Deduction Table 4-2

On one hand, the share of ANCOM in the total world trade of Ecuador is increasing more than the relative gravity share would suggest. On the other hand, on the level of ANCOM we see that relative values make a lot of sense. These points clearly point towards the evidence that SSE like Ecuador benefit a lot from regional integration (ANCOM). This is because trade turns to be more difficult and closed by increasing trade barriers with EU and US (more in game theory).

## C) Game theory on regionalization

In order to have a better idea of SPS/TBT or other barriers that SSE suffer from at the hands of LSE, we will present different case scenarios. Game theory will be applied to different problems of trade, to show the position of SSE and possible ways of reaction. This analysis is important in order to have a clear picture of how SSE could improve their trade position and international insertion. Therefore, this part could serve for decision makers in SSE for future negotiation patterns at international level.

### Bolivia

#### *Lobby Activity*

Interest groups sketch a part of the political landscape of Bolivia. Some of those groups have a lot of political power, which could be understood as client politics. The government is rather susceptible to these groups, so the groups get what they want, whether at national or international agenda, even if this decision damages the national economy.

#### **Box 4-3. Interest groups and their power on political decisions**

Blockades and other disturbances (like marches and strikes) are a common action to reach change or improvement. Blockades and disturbances are so frequent in Bolivia that in 2006 there were 3252 but in 2008 they almost duplicated to 5666. Blockades are seen as an emblematic action done by practically all interest groups in Bolivia and in other neighboring countries. These blockades occur when interest groups do not agree with certain policies, whether they might benefit the interest of the rest country. As a result, cities are disconnected and economic activities within cities stop during the time the government takes to solve the problem. The blockades generate an economic loss that is not compensated and demotivates entrepreneurship and exports since they cannot rely on clear roads for transportation. Worst, every blockade destroys public goods (roads or buildings) with fire and rocks that blockers use to put pressure on the government. Due to financial trouble within government, destroyed public goods are difficult to repair in the short term.

In Bolivia, social movements are valid for a modification in national policies or strategies. Meetings as ‘cabildos’ (ancient meetings of the community that agreed to vote for something in order to solve a problem) are generally accepted, even if they are only of a certain interest group and does not include the general view or welfare of the entire population. This has led to confrontations between two interests groups with opposite views. Even though, a group organizes ‘referendums’ to vote for the solution of a problem, the opposition avoids by any means people to vote so that democracy is doubted. ‘Democracy’ has been questioned a lot in Bolivia since in different occasions people buy votes or push votes to one direction. People vote for money, promises of jobs at government or by general pressure, ignoring that voting is secret.

Interest groups have several people participating in blockades or confrontations against other interest groups or the government with coercive instruments. People that would not like to risk their life in dangerous confrontations are still obliged to assist if they do not want that their syndicate leaders destroy their culture or houses. Other people prefer to go along the activities of their syndicate since they receive a good payment per day (100 Bs equivalents to 14 dollars) of blockade which turns out to be one fifth of their monthly salary (500 Bs equivalents to 70 dollars). Civil Society Organizations (CSOs) are so different from one to another that clashes are raised often between regions and their actions doubt the efficiency of democracy since people are moved more by specific temporal interest over the long term interest.



The actions of different interest groups can directly affect the decisions that each country takes, regarding exports and imports. Smuggling, for example, is widely supported by different communities who live and work thanks to smuggling near the frontiers with neighboring countries. For instance, Bolivia has different communities that were established on the borders with Chile (associate member in ANCOM), Peru and especially Argentina, where most of the agriculture, fuels and manufacture are exported or imported off-charts. Due to the collectivities' importance for the economy, actions taken by the government against smuggling can lead to long and violent confrontations between the government and the people.

Specific lobbying should not be necessary, since the agreement takes care of a common view and negotiation position for all members that face the same problems at a national and international level. In this way, the bloc possesses a stronger negotiation position face to engage in international negotiations, so that agreements deal with special and differential treatment. It is thanks to this situation that, members can export and improve their international insertion. Nonetheless, the position and interest of small producers who would like to insert themselves at an international level are being affected negatively because global agreements do not include them and only large agribusinesses are taken into account. Moreover, small producers are not the main focus in the ANCOM's agenda as well as in the other regional or multilateral agreements. Despite the fact that President Morales (Bolivia) wanted to include the needs of small producers in the agenda of ANCOM and their will towards FTA with other regions through a referendum, the idea found no support in the bloc. Another visible problem is that relatively larger economies in the group negotiate separately from the others when they feel benefited from a particular proposal for agreement.

#### **Box 4-4. Integration versus Disintegration: FTA EU-ANCOM Equilibrium Strategy**

##### **Background**

The ANCOM and the European Union (EU) have a common challenge: to negotiate and to subscribe to an Agreement of Association (AA, similar to a FTA) that allows them to reinforce its political dialogue, intensify the cooperation and increase trade. The ANCOM is having a deep internal crisis, especially **Peru and Colombia** who are constantly searching for a greater trade opening with the EU. On the other hand, Bolivia and Ecuador are against such subscription since it would disintegrate the bloc and it would go against the ANCOM treaty as well as the ideological principles of the new economic model adopted by these countries. In addition, the EU at first instance broke negotiations because it was notorious that the bloc did not have one voice and it had visible asymmetries that did not let them agree in terms of trade, sustainable development and intellectual property. The idea of the EU was not to sign an agreement if this does not imply the participation of the entire bloc (ANCOM-EU).

Nevertheless, Colombia and Peru requested a formal petition to the EU that due to asymmetries with the smaller partners (Bolivia and Ecuador) the larger ones should negotiate unilaterally based in the decision 598 (Trade Relations with third party countries) and the decision 667 that it establishes in its first article: "the existence of different levels of development and economic approaches between its member States, and this has to be taken into consideration in negotiations as a bloc between the ANCOM and the EU, and the right to express its differences at the moment of negotiations", so that this can reach a different speed, depth in the topics and engagements of the future agreement... assuring Special and Differentiated Treatment for Bolivia and Ecuador. This request was the origin of more conflicts inside the bloc, particularly with Bolivia that demanded the resignation of the Secretary General of the ANCOM at that time.

The EU requested to negotiate in a "bloc to bloc" fashion, but the indecision of Ecuador and Bolivia, reluctant to open its economies to the free market, led the Europeans to reconsider the possibility of making a specific trade agreement with Colombia and Peru. At the present time, the unique possible solution to such a great problem for the SSE was that the EU integrated Bolivia and Ecuador through differentiated agreement with different speed levels of integration but it was decided to leave them aside while the EU negotiated with Peru and Colombia. In the time that it was not sure that EU would accept to negotiate individually, the game was appearing to look like the following assumptions:

Peru and Colombia: both wish an FTA with the EU.

Bolivia and Ecuador: Countries do not want an FTA with the EU

- If Peru and Colombia sign the FTA with the EU as individual countries: then disintegration in ANCOM will exist and the gains will be greater for the signatories and low for Bolivia and Ecuador (3,0).
- If Peru and Colombia do not sign the FTA with the EU, there will be no disintegration. Gains will be intra-bloc but much smaller than with the EU (2,2).
- If Peru and Colombia sign the FTA as a bloc with the EU: then there will be disintegration because the SSE do not want to proceed with this. Gains will be even higher for Peru and Colombia (4,4)

A situation that is not feasible to happen is that Bolivia and Ecuador sign the FTA and Peru and Colombia will not. In this case, gains will be low for Colombia and Peru (0,3)

		Peru & Colombia	
		Yes FTA	No FTA
Bolivia & Ecuador	Yes FTA	(4,4)	(3,0)
	No FTA	(0,3)	(2,2)

Nevertheless, there are other factors to study. For instance, if FTA negotiations start without Bolivia and Ecuador, what will happen to its economies?

- If Colombia and Peru sign the FTA with the EU unilaterally, they will in turn increase trade with EU and internationalization; if this is so, then Bolivia and Ecuador will reduce internationalization. In this case gains will be higher for the signatories and will be lower for Bolivia and Ecuador because there might be less intra-bloc trade. (3,0).
- If all four continue the FTA agreement with SDT for Ecuador and Bolivia; then they will gain something in one way or another. This will reduce the internal conflicts because all four countries will speak with the same voice and both groups will increase intra-bloc trade. (4,4).
- Ecuador decided to join negotiations and Bolivia was left alone for another phase of negotiations in the future. This will provoke internal conflicts consequently, a reduction in intra-bloc trade. There will be higher gains for the 3 and none for Bolivia (1,0).

In this point the situation is very little probable that it happens: if Bolivia and Ecuador manage to improve the situation in ANCOM and they improve intra-trade bloc, the FTA that Peru and Colombia signed will be worthless (0,1).

	Bolivia-Ecuador	
	I-B trade	No I-B trade
Intra-bloc trade	( 4,4)	(3,0)
Perú y Colombia No intra-bloc trade	(1,3)	(3,0)

**Analysis:**

In this situation, the most feasible strategy for the continuity and development of the ANCOM is to negotiate as a bloc hoping that intra-trade will not reduce and will not disintegrate. Now that Ecuador is negotiating with the EU, it should strive for the interest of Ecuador and Bolivia as SSE with asymmetries in opening its national markets, production and trade. This agreement also has to foster unity and intra-trade bloc to increase trade and internationalization so that all members don't make the mistake of designating all its production to the EU market only. For all this it is needed political will and the will to leave the national sovereignty to adopt regional sovereignty.

*Strategic pay-off within trade-bloc*

Bolivia by itself has not much power to negotiate with big neighboring countries like Brazil or larger markets like the European Union or the US, who happen to be its main trade partners. By belonging to ANCOM, Bolivia has no need to negotiate anymore since ANCOM negotiates trade preferences, development projects, etc. as a bloc. Besides, the bloc can negotiate more proficiently against certain barriers for trade. Bolivia alone would not be able to pull off a good bilateral agreement of whatever sort, but being in ANCOM increases its power of negotiation through the collective strength of the bloc. More, Bolivia could be left alone in its trade difficulties if there was no rule for signing unilateral FTAs. On the economic side though, free trade within ANCOM is not directly a big opportunity for Bolivia. First, as shown in table 4-3, Peru, Colombia and Ecuador, barely account for 20% of the Bolivian exports and just 10% of the imports. Second, despite several years of effort, intra-trade has not increased significantly between the members and this is unlikely to change in the next years. Hence, the largest profit of participating in the trade-bloc comes from the extra political power in international negotiation.

**Ecuador***Lobby Activity*

The same as Bolivia, Ecuador's government is under a great deal of influence from society, specifically regarding government policies. Constant blockades and social unrest can push the government to change course on any policy and trade agreement. At ANCOM level, lobbying in the bloc is not necessary since the agreement itself takes care of a common view and negotiation position. ANCOM should maintain a common position in international

negotiations, and keep the common needs of the people in mind and demand that international agreements deal with special and differential treatment for the relatively small size nation. This bargain position helps every member to export and improve its international insertion. However, the same as in Bolivia, bloc agreements often take into account business agriculture or great manufacture industries, not the small producers which negatively affect their national position. Also, it is notorious that the voice of Ecuador in the bloc is reduced by the relatively larger economies that strive to sign agreements being that they are in a better position without noticing the SSE of the group.

**Box 4-5. Case: Ecuador-Bolivia safeguards  
Strategy of balance of Nash**

**Background**

Several ANCOM countries have been applying safeguards to several productive sectors. This provision is enforced under the idea that the import of certain products affects national production, which at the same time produces inadequate integration within ANCOM and the country that imposed this restriction. Ecuador applied safeguards measures (through quotas and tariffs) to refined vegetal oils from Bolivia. This has caused a reduction in the Bolivian exports as the aftermath of two reasons: one is that refined vegetal oils are considered fundamental for Bolivia's export structure, second because ANCOM is one of the main destinations for this product.

For Bolivia, Ecuador's measure does not have any base, since data shows that Bolivia generally exported less than 3% of the total oil products and that the negative effects on Ecuador were due to higher imports of oil products from countries outside the ANCOM (the United States for instance). Within the bloc, there is a quota of 9% to export to Ecuador but Bolivia does not cover this quota. Then, a demand against this safeguard was presented by Bolivia to the Committee of Safeguards of the WTO from which is expected a supervision of the agreement and the safeguard. Nevertheless, although it seems clear that Bolivia could raise a complaint to the WTO about similar issues or against barriers on trade, it does not pursue this measure for different reasons. First, Bolivia is a small country and its national and international committees of negotiation do not have the intention to initiate a formal complaint, because the exported amount of goods by small companies, does not justify the cost-benefit of the complaint. Second, the capacity or the reduced number of civil servants dedicated to negotiations that would allow the country to reach agreements and international relations, causes the difficulty of engaging in negotiation conflicts that last a long time and constitute a risk of aggravating the trade relations in other sectors. Finally, a complaint settled in the WTO lasts between 4-6 years. This time is taken to examine the information, circumstances of the safeguard, the decisions taken by both countries, etc. During that time all trade agreements of one company are lost already, often are ended definitively because within the region, almost all the countries can provide the same product that another country has stopped providing.

For the analysis of this situation, we will present Ecuador applying safeguards to oil products from Bolivia knowing that Bolivia could not cause any conflicts in ANCOM (S, NS). However, Bolivia could take retaliation measures (R, NR). What would be the gains?:

- If Ecuador applies safeguards on Bolivian oil products (S), and Bolivia does not counteract with a retaliation measurement (NR), then Bolivia will probably not gain a lot from this action (NR, S) with payments of (0,2).
- If Ecuador applies safeguards to Bolivian oil products (S) and Bolivia takes a retaliation measurement against Ecuador (R), both countries have low gains in (0,0) although they are in different sectors because total trade would fall.
- If Bolivia and the Committee of the WTO demonstrate that Ecuador did not import the established amount from Bolivia within ANCOM, then it will have to remove the safeguards, so that trade relations are restored. Here, the gain will be higher for Bolivia and Ecuador

(4,4).

- If Ecuador eliminates safeguard measures (NS) and Bolivia continues with its retaliation actions in other sectors (R), the gain would be better for Bolivia in (2,0), but only in the short term. This gain would be for the short term because Ecuador is a SSE market for Bolivia and Bolivia for Ecuador. This is why; retaliation methods would only damage the potential of integration within the ANCOM bringing a lost at their international insertion.

		Ecuador	
		S	NS
Bolivia	R	(0,0)	(2,0)
	NR	(0,2)	(4,4)

### Analysis

The best strategy for both countries is for Ecuador to remove the safeguard measures over oil products, so that both nations can obtain mutual benefits guaranteeing the commitment of free trade in ANCOM. If the Commission of Safeguards of the WTO determines that oil industries of Ecuador were not damaged as a result of the exports done from Bolivia and Ecuador would continue applying safeguards, then the trade relations would diminish in ANCOM affecting them both. But also deepening the economic and political conflicts existing in the bloc. Ecuador is not only losing a small trade partner but is also responsible for weakening the integration of the bloc, which is already in a fragile state and without political cohesion. This endangers even more future negotiations for Ecuador that benefit all the SSE of ANCOM.

### *Strategic pay-off within the trade-bloc*

The economic importance of ANCOM's free trade bloc could be doubted for Ecuador. This is because only Colombia has a relative importance to trade for Ecuador. Accordingly, Colombia accounts for just 5.5% of the exports and about 12.6% of the imports (table 4-2). Bolivia and Peru play hardly any role for Ecuador. For Ecuador, the most important partner is US and then EU. Nonetheless, ANCOM is an interesting bloc for its political importance at negotiation level to improve the Ecuadorian international insertion. ANCOM plays a role of negotiator with a common view and needs on the four partners in order to get more trade partners. Trade partners are mostly out of the bloc. This turns into a disadvantage for the bloc which does not have any economic interest but mostly political.

## D) ANCOM conclusion

### The impact of regionalization on the SSE is:

- ANCOM is more important for its members than theoretical trade gravity values suggest. However other regions are increasingly more important probably due to political conflicts inside the bloc.
- ANCOM is also more important for Ecuador than the theoretical trade gravity suggests. Its trade with the block 14% instead of the 2.5% according to the gravity values.

- ANCOM is interesting because it makes the members stronger in trade negotiations and trade performance due to preferences with other countries (mostly LSE). The intra-trade is rather small. Thus, ANCOM is a tool to increase the political power for negotiations then to increase the intra-trade.

The US exerts a dominant influence over ANCOM's vision of development and international insertion. There is no dominant player within ANCOM, and the explanation can be threefold. *First*, is the fact that the members have almost a similar size and equal level of development and possess structures of production that are very much alike. This means that all members have similar economic and political interests. None of the members take a leading position to enhance trade and cohesion within the bloc because these nations do not have enough power to take a leadership position. This is why the US has a dominant role and power to influence the development of key sectors as agriculture and hydrocarbons (convenient to the US and its national market) with basic or non added value. The US has the largest share of trade and cooperation in the region which increases its dominating position its influence on the economics and politics of the bloc.

Besides, all members prefer to trade outside the bloc individually without much economic or political interest in the bloc. During all the years of integration members did not show any wish to improve intra-trade with each other; it was more on improving the negotiation power for a better international insertion. This last fact leads us to the *second explanation*. Grouping is important because it gives the consortium a strong position for international negotiations which helps them to have preferential conditions for international insertion. A common agreement for ANCOM based in the smaller relative size and less development opens up international attractive markets for their niche products. All of these countries have small producers that can export their products to niche markets willing to buy little quantities, pay more for these products and for its natural quality. This is at the same time a reason why the four member countries are competitive to each other. Inside the bloc, they trade only some complementary products but most of them are competing with their national production so trade barriers as political preferences exist between them increasing the gap for a common cohesion.

The SSE benefit from common negotiations at intra-bloc level and international level. This way of negotiation does not grant a stronger position to any of them; accordingly, there is no dominant in the group. All members remain practically the same at any conflict resolution

and solution of differences. *The third reason* is that trade members are based on geographical distance and neighborhood for trade and they are not based on the regional agreement. This means that trade would exist even without the integration bloc. Of course, the countries that normally trade now can benefit from their exchange with 0% or very reduced tariffs. Still, a substantial amount of trade is smuggled and not counted in the intra-trade exchange. Intra-trade growth is beneath expected. Nonetheless, when separately analyzing two neighboring countries: Bolivia-Peru, Peru-Ecuador, Ecuador-Colombia; trade increase through time is important. This means that regional agreement *per se* would not be that important as it is with gravity. Trade in pairs reduces the emergence of a dominant in the bloc and prejudices a good open trade in the region. Dominant relationships can be observed at a bilateral level when the dominant imposes its rules and preferences for importing a certain type of product. Dominance lies predominantly in the side of the relatively larger country as it was presented in the statistics above that SSE have larger import shares with U.S. rather than from the bloc members.

The lack of a leader in the bloc (especially since the exit of Venezuela) causes constant conflict between them all the members. Conflicts can emerge easily from any topic. Each of the countries has trade interdependence only because they are neighboring countries; consequently, they need each other even when they have a disagreement between them (Bolivia-Peru; Colombia-Ecuador; Peru-Ecuador). The interdependence makes it necessary to have a common institution to control the behavior of each country and also to have common rules to play the role of solving problems. All the member countries delegate their power to the supranational institutions of ANCOM to solve the differences. Nonetheless, the effective action of the supranational institutions is questionable, due to the individual decisions that each member makes in light of own their interest. This is why; there is no contractual force that is really applicable to the bloc. Supranational institutions are not functioning as they would have to because they cannot influence the sovereign decision of each country that has an individual vision for their own development and international insertion. To keep this sovereign decision, members could find themselves in serious political conflicts without foreseeing the full implications for the bloc.

The main idea behind the creation of ANCOM was to enhance trade rates inside the bloc. In general, there appeared to be a steady increase in trade with LSE; intra-trade did not increase but conflicts between members did, and this prejudiced intra-trade even more. After many

years the bloc has proven to just benefit the member countries with stronger positions for international trade (trade preferences, lower tariffs, development projects, etc.) and international insertion, having a common position against larger economies or other regional blocs. An SSE does not want to trade with poor countries within the bloc, these SSE members prefer to trade with LSE. This is visible when they grant preferences to importing products from the U.S. or other countries rather than accepting from ANCOM members. The U.S. market is potentially more important to keep than to deny some ANCOM member products.

ANCOM members are oriented towards exporting, because the bloc still believes that exporting is a synonym of growth and development, and this can be reflected in the purpose of its integration. To have a better international insertion, there is an increasing need for a political position when facing international relations and national development. This vision is now in the paradox of turning left-wing as Ecuador and Bolivia, or staying in the right-wing as Colombia and Peru. The same occurs with the increasing need to define sovereignty in front of the dominant influence that the US has as a part of an hegemonic power. *Would it be possible to foresee a stronger neighboring cooperation in a status of win-win leaving aside national sovereignty? Or, is it easier to stay under the umbrella of the US?.* The lack of a leader in the region makes it politically easier to negotiate a common position for trade of SSE. On the other hand, the lack of a leader makes it difficult to have a common vision for improving intra-trade policy. Each of the countries proceeds independently from a common vision in ANCOM. Since all members do not want to cooperate with each other, they grant preferences to third countries outside the bloc, endangering their own future. Each of the countries competes between them since all have a similar productive structure. ANCOM respects the sovereignty of each country allowing them to program their own international policies and international relations without a proper coordination to make ANCOM work. Despite all the supranational institutions that ANCOM has to improve trade within its members, the current situations show that trade is not the only concern for the member countries anymore. They are also concerned in improving their economic situation and the political instability in each of these countries. ANCOM did not react effectively on any of these matters though.

One of the important characteristics of ANCOM as a whole is that all the member countries have a large percent of informal economy and a big part is traded by smuggling. The informal economy causes two effects which should be taken into account by the integration bloc. First,



smuggling creates illegal trade, which is difficult to control. Thus, tariff and non-tariff barriers are worthless between countries in the bloc. This common fault should have led to a joint effort from all member countries, but no action was taken until now. On the other hand, for traders, smuggling possibilities reduce the value of integration. The other problem is that a large informal sector does not pay taxes, which make it harder for the government to have available resources to invest in suitable intra-bloc or international negotiations. ANCOM is aware that the informal sector has a negative impact on the national economy and on its path for international insertion, but until now, no member country has ever addressed the problem individually or within the bloc.

Although ANCOM members have a lot in common, they certainly do not have a large intra-trade between them. In spite of the similarities in economy, consumption and income per-capita, ANCOM member countries trade an average of 10-20% within ANCOM, the rest is oriented outside the bloc. A quick browse through the national journals of any member country reveals that these nations prefer to trade with high income per-capita consumers, who are able to pay for its niche products. Thus, intra-trade is oriented to complete the modest production of a certain product that is more consumed at national level but giving the chance to export industrialized products with added value.

If we take aside the importance of ANCOM for international negotiation and an easier international insertion, ANCOM stays hollow for intra-trade and cohesion pushing towards a common development. Countries don't have much to win or lose in the economic sense from being an ANCOM member. This might lead to a rather casual behavior towards the trade-bloc, characterized for not giving a lot of effort to make it successful. Basically, this shows the vulnerability of the existence of the trade-bloc in the future. Irrespective of economic interest, ANCOM is certainly an interesting loadstone for political negotiations concerning trade outside the bloc and a better position for international insertion. At negotiation level there could be a lot to win with ANCOM since all the countries see it as a region with small size economies which helps in receiving special and preferential treatment at trade. This benefits Bolivia and Ecuador in a great way. ANCOM is taken seriously in trade negotiations and this can be proven by checking the rest of Latin American countries that became associate members of ANCOM. Moreover, members find themselves immerse in a multiple type of agreements that keep the preferential and special treatment status of ANCOM. According to the CEPAL (1991): "If countries which take part today in the various subgroups

and partial agreements decide to approach their relations in an individual way with the objective to liberalize trade between them, it could emerge some difficulties with the members that did not sign the bilateral agreement”.

Even if SSE like Bolivia and Ecuador strongly urge for the cohesion and strengthening of the group, it would seem that it would not only depend on them or on their common vision for trade and development. The strong right-wing positions of Colombia and Peru threaten to engage in independent negotiations aside from ANCOM and have seemed to have found support in the European Union. ANCOM forbids FTA negotiations outside the bloc (regional or bilateral negotiations) with individual members. However, this agreement has already been broken since Peru (already) and Colombia (with standstill negotiations) signed an FTA with the US; and now both are also going to negotiate independently from ANCOM with the EU. This possibility of negotiation directly with the interested countries leads to different behaviors: a) the increase of trade with the European Union as a political interest from the EU to gain influence in the region and counterbalance the economic and political influence of US; b) Put doubts on those countries that do not join the agreement, leading this to social unrest from the industrial and large corporations in agriculture that are prepared to export; c) push political disintegration of the bloc for disagreements at ideological level. This could step backwards the advancements in supranational institutions in matters of development and infrastructure. This all means then, that ANCOM has a new challenge for the future and is to counterbalance left and right wing to regain a common position for negotiations at international level. This challenge will be difficult to achieve because while right-wing promotes free-trade with protectionism in sensible areas, the left-wing promotes endogenous development and zero FTAs.

For the SSE there are not many options for trade empowerment, and could constantly face zero-sum games. Ecuador and Bolivia benefit within ANCOM because it helps them to reduce the neighboring frontiers and SPS/TBT barriers. Nonetheless, if they had not joined the bloc, they would have had to setup bilateral agreements without economic or political power, which would have led them under a disadvantaged position regarding international negotiations. Besides, since they would need to negotiate country by country, this would represent higher costs of transaction that SSE do not have. If the SSE take good advantage of ANCOM, they would automatically turn into a stronger partner for international negotiations against LSE as the US, the European Union or Brazil. Therefore, international insertion could

improve. This poses as a great challenge for the bloc since it is difficult to find partners willing to work for the benefit of the group without betraying the team. There is a great difficulty for the correct functioning of the bloc and enlargement of intra-trade since all members have frontiers to non-ANCOM members or have easy access to export to larger economies (the sea or roads for example). This results in a larger trade with non-ANCOM members or other LSE from developed countries.

## 4.2 MERCOSUR

Mercosur was created in an agreement signed in 1985 between Argentina and Brazil. Later Paraguay and Uruguay entered and participated in the creation of the Mercosur in March 26<sup>th</sup>, 1991. In 2004 (December 8<sup>th</sup>), the Declaration of Cuzco foresees a progressive integration into a political and economic union of all South America by merging ANCOM and the integration of Chile, Guyana and Suriname. Venezuela applied for full membership and was accepted by all four presidents in June 2006. The presidents who signed this decree—Chávez, Lula, Kirchner, Vázquez and Duarte who were all still in power until 2007, did not make Venezuela a member of Mercosur. This delay is technically due to ratification by all four legislatures. In 2007, Argentina and Uruguay ratified Venezuela's entry, Brazil and Paraguay, up to date, have not. Associate members are Bolivia, Chile, Colombia, Peru and Ecuador (Figure 4-2).

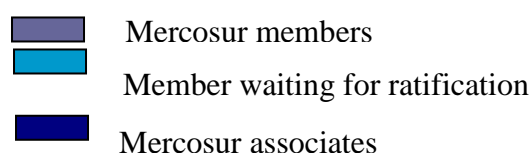
The main objective of the bloc is the integration of member states in a common vision of sustained economic development based on social justice, environmental protection, and the struggle against poverty. The bloc endeavors to become a tool for cooperation that goes beyond a free-trade agreement area. Mercosur wants to have proximity in the harmonization of the economic policy, the legislation, and a visible improvement of democracy and development for all the members, avoiding rivalries (within the larger members Argentina and Brazil) within the region. In the past, all South American countries suffered from a coup, poverty, small scale production and an ever present risk of continuous political rivalry. Mercosur wants to avoid any social crisis in the region again. Then, the political and social dimension is highlighted every time there is a Summit in Mercosur. All the main difficulties that are ambushing the region are treated in the Summit, especially by Brazil. For this reason, the need to have an integration in which the citizens can feel the advantages of the cohesion

directly is always present in the bloc. This of course, involves different aspects, like the difficulty to assure welfare for the entire population, especially when trade troubles the national market of Brazil and prejudices the trade potential of an SSE.

Mercosur is an international organization. Mercosur is the third largest integrated market in the world, just after the EU and the NAFTA and it is the most important working trade-bloc in Latin America. If we only take the four member countries into account, Mercosur has a market size of more than 243 million people, and an aggregate GDP of over USD 1312544 million (Unctad Statistics, 2010), and an area of 11.861.825 km<sup>2</sup>, where 71.76% belongs to the Brazilian territory. The population in Mercosur has an average of 49% for productive population, 39% of young people between 0-19 years old and 12% of 60 or more years which means that 51% of the population depends on the income that 49% produces. Social programs for education, health and food for social inclusion to the most poor in the largest members (Brazil and Argentina) help in whole, to construct a good social base with less poverty and potential to improve productivity and the size of the economy.

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**Figure 4-2. Mercosur member countries.**



Source: Adapted from Wikipedia, 2010

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Mercosur can be defined with a center-leftist wing vision. However, the governments of Brazil, Argentina, Uruguay and Paraguay are not as radical as their counterpart in Venezuela. Uruguay and Paraguay are the smallest members of the region, as is Bolivia who holds the spot of smallest associate member (measured by its GDP). The largest member country is Brazil, which is about 72% of the total area (in km<sup>2</sup>) and the 81% of the GDP in Mercosur, the next one is Argentina which represents 23% of area and 16.5% of the GDP in the bloc. The strategy followed by Mercosur is not only to have a larger market or better negotiation

against larger countries as the ANCOM countries do. The strategy is far more elaborated as we will present in the following point (geo-political interest).

### A) Geo-political interest

**Geographical dimension.** Mercosur was mainly created because of the increasing trade and need-dependence between Argentina and Brazil. The reason why Paraguay and Uruguay were added to the bloc lies in the fact that this constituted a good way to maintain peace between the four countries. There was always a risk for war between Brazil and Argentina<sup>11</sup>, and Argentina-Paraguay<sup>12</sup> (Gobierno Argentino, 1925). Argentina and Brazil nearly engaged in two wars since their independence. The need for hegemony over the Rio de La Plata profoundly marked the diplomatic and political relations between the countries of the region until nowadays (Valeriano, 2004). Of course, if we take size into account, LSE had more to win than SSE. Brazil and Argentina could win in the case of a war against Paraguay, but this the later could cause a lot of damage for Argentina and Brazil due to its Yacyretá dam. This dam is a large hydroelectric power plant on the Paraná River which in case of war, could be destroyed by Panama, possibly causing a devastating flood in a nearby Argentinean city. There is a second dam that is co-owned 50%-50% with Brazil, the dam is called Itaipu. This dam took about 80 years in the works before an agreement was reached between the four member countries that led to the construct of it. In a way, the dam is a symbol of peace and stability for the four member countries. The potentiality for political conflicts in South America remains a controversial topic. SSE like Paraguay is considered either a fearless struggle for the rights of an SSE against the aggressions of neighboring LSE. That is why; Mercosur could be seen as integration for maintaining peace.

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11 Argentinean –Brazilian War, it was in the decade of 1820 between the Unified Provinces of Rio de la Plata that recently were liberated from Spain. The Empire of Brazil possessed a large territory and the war was to emancipate what today is the Republic of Uruguay and part was still kept by Brazil (State Rio Grande do Sul). Hegemony often kept Argentina and Brazil tensed.

12 The War of the Triple Alliance (1864-1870), called by the Paraguayans Great War or War against the Triple Alliance (Brazil, Uruguay and Argentine) fought militarily against Paraguay. This war had its origins in the political interests of the British government to divide the monopoly of Brazil over the sea waters for transport in the area of Paraguay and Uruguay. The Empire of Brazil often was preparing and increasing the army of Paraguay and Uruguay (that before belonged to Brazil) to control the Rio de la Plata. Fearing excessive Argentine control, Brazil favored a balance of power in the region, helping Paraguay and Uruguay retain their sovereignty. Nonetheless, Brazil allied to the war against Paraguay because Paraguay asked too high taxes to Brazil for its ships that traded via there and this was reducing its productivity at international level. This is why, despite the armies of Brazil, Argentina, and Uruguay was a fraction of the total size of the Paraguayan army; they were supported by the British and won.

Mercosur is an interesting bloc because it is one of the largest in Latin America and in for the region it could be regarded as a example of a free-trade bloc agreement that can counterbalance the power of the United States in the region. The largest economy in the group is Brazil and the smallest economies are Paraguay and Uruguay. These last two, depend on their trade in Mercosur. Yet, Brazil makes it difficult for them to penetrate its national market, due to its protectionist national behavior. Brazil, being too protectionist, makes the smaller economies face different difficulties not only for trade but also for negotiation and growth inside the bloc. The main reason for the SSE to be in Mercosur happens to be also the main point for conflict. SSE have no power to negotiate inflexible decisions that Brazil sometimes takes to protect its national market. For this reason, the huge differences in the size of the economies becomes noticeable, Uruguay and Paraguay cannot make pairs against Brazil due to their small size; and this is why Brazil takes the major decisions for trade and the internationalization of trade rules. Brazil is not only the leader of the bloc but also the leader of South America with the power to influence main regional rules. Recently, its leadership power increased more since the proposal of the UNASUR bloc that includes all the South American countries. This bloc took a step forward in the unification of the region which is an enlargement of the original idea to merge ANCOM with Mercosur.

**Contractual Force.** Despite the fact that Brazil complains against subsidies and the protectionist posture taken by Europe and the US, they themselves protect their economy and limit the entrance of competitive products from neighboring countries into their market. Brazil is an LSE in the region and takes advantage of its size to define and influence main trade rules for the bloc. Brazil has the power of its market that enables it to exert dominance over the bloc and this fact keeps them from adopting certain rules of free trade for Mercosur, deciding first based on their own welfare rather than the bloc's wellbeing. Mercosur is characterized by strong asymmetries with two LSE (Brazil and Argentina) and two SSE (Paraguay and Uruguay) and the leadership was granted to Brazil for common negotiations at international level (e.g. DOHA round). Brazil alone represents 81% of the total GDP of Mercosur and still, Brazil is the one that trades the least with its neighbors because it prefers to equally spread its international partners around the world (around 20% for every region in the world). The main trade partners for Brazil are: The United States with 22%, Argentina follows with 8.2%, the European Union with 27% and then the rest of the South American countries which in sum only amount to 19% (Including Argentina ). None of the SSE figure

between the most important trade partners for Brazil, not even Bolivia with which it trades important quantities of gas. Trade partnership of Brazil appears evident within trade relations in Mercosur that has an average intra-trade of 13% (2000-2006) while trade with the rest of the region was 73%. More, according to Unctad Statistics (2010), between 1990-1999 and 2000-2006, Mercosur reduced intra-trade with 23% and increased with other partners in the region with 15%. This increase is due to trade of hydrocarbons but not in the other sectors. Mercosur has sufficient power for international negotiations due to the weight of Brazil in the region.

**Nature of the Activities.** Mercosur bases its main activities on the market and financial power. Nonetheless, agriculture is a key sector for all the members in the bloc, which sometimes makes free trade between LSE and SSE difficult. Even when Mercosur has adopted the SPS/TBT measures from the WTO, there are several conflicts that cannot be solved within Mercosur but in the WTO. Brazil has an important financial system that helps national development, and in the last years has also promoted an increased growth of the FDI-outward flows towards neighboring countries (road and hydrocarbon especially). Brazil seems to have more power to influence the norms adopted in Mercosur due to its size and research power which also influence asymmetries in the bloc. Mercosur does not exercise any supranational activities and the States Parties tend to stand behind the rule of unanimity that allows them to express a common will. This is the same as the national will, because the norms have to be introduced in the Member States by means of ratification and legislative approval, and hence their respective parliaments have the opportunity to declare themselves on behalf of the citizens they represent. The fact is that the existing disparities among the members do not permit the immediate adoption of a system of weighted voting, and some of the participants were bound to feel that they are in a position of disadvantage under either a weighted or an unequal voting system. Despite this system, when it comes to trade, the power of Brazil is notorious. For instance, if Brazil decides to protect its agricultural market, there is no rule in Mercosur that can obligate Brazil to open its national market, even when the justification of the TBT norm does not have a scientific base. This is what we could call the power to choose between the compliance of the law or not.

**Role and responsibility of the leader.** From the mid 90s, Brazil had begun to design a strategy towards South America with the purpose to integrate the whole region under its leadership. This strategy consisted on several plans for physical integration, economic,

political and security measures that could assure its regional role of leadership. Lula da Silva has dramatically increased his visits around the entire region, elevating its FDI-outflows and cooperation aid as well. Brazil decided to grant some concessions in terms of rules of origin<sup>13</sup>, initiate a program of customs duties harmonization<sup>14</sup> and a program of social investments<sup>15</sup> that would increase trade between the SSE within the bloc, and would reduce the discontent of them towards Brazil.

For example, Lula da Silva paid a visit to Colombia which was part of his campaign to recover the political initiative in South America and to differ from the line of Hugo Chavez. The agreement signed in the matter of defense subscribed by Alvaro Uribe, Alan Garcia and Lula contemplates the usual programs of exchange of personnel for classes and visits in the area of military formation, the Bi-national Work group for Cooperation in the matter of Defense that will be formed by its ministries of Defense and International Relations. This of course, includes something of great interest to Brazil, which is to expand its exports of war and defense equipment. Besides, the signed agreement instituted on the 20th of July in Leticia concerning military leaders in the 2005 between Colombia and Peru, was ratified in 2008 by them both, and Brazil who opened the space for trilateral actions and the fight against cross-border crimes, drug trafficking, the guerrilla and the need to restrain the trafficking of arms in the Amazon. Venezuela was against the treaty for its militarization but Brazil is also making an effort within UNASUR to agree on July 19<sup>th</sup> 2008 with Colombia and Michelle Bachelet (President of Chile) against the proposal of Chavez to grant LAS FARC with an international legal recognition. The three countries agreed with UNASUR in three aspects: the decisions of the South-American Council of Defense will be done by consensus, recognition will be granted only to the institutional army forces created by the Constitution of each country, and the emphatic rejection of violent groups.

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<sup>13</sup> Rules of origin that determine whether a product is eligible for the preferential Mercosur tariff rates, Paraguay and Uruguay were allowed to boost the proportion of value added overseas from 40 percent to 60 percent - thus expanding the pool of merchandise qualifying for the lower duties. In addition, the more flexible rules were extended from 2012 to 2020.

<sup>14</sup> Mercosur is currently working to build the infrastructure to create a common external tariff. But in order to do so, the bloc must first obtain a list from each member identifying all goods imported from elsewhere, as well as the duties currently levied on those products. To expedite the process, Mercosur had set an end-2007 deadline for countries to submit their lists. Paraguay and Uruguay had complained that that timeframe was too short, and have now been given an extra year.

<sup>15</sup> Brazil and Argentina agreed to boost spending under Mercosur's Structural Convergence Fund (FOCEM) - the bulk of which comes from Argentina and Brazil - to finance projects in Paraguay and Uruguay ranging from housing to transportation, biosafety, sanitation, and incentives for micro enterprises.



Hereafter, Brazil is increasing its weight in Mercosur and South America by increasing investments, offering credits; an increase of the role of its embassies; regional academic programs; etc. as a country. As a leader of the region, proposed to freeze negotiations with the US in the project of FTAA since all have more to lose than to win; Brazil also tried to integrate ANCOM with Mercosur proposing the creation of UNASUR to include the other countries in this that were often excluded from South America (Guyana and Suriname). In this way, Brazil not only tightened relations with left and right wing countries but also obtained a twofold advantage. The first one is to make a great attempt at reducing the increased role of Venezuela in the region. The second is to take advantage of the dominant power of the US which is reducing in the region and presents a good opportunity for Brazil to prevail as the country that assumes the leadership role. This all gives Brazil a good role for supporting a regional common development (as Brazil got the implicit role for the representation of developing countries at DOHA). However, the challenges are huge; one is to reduce the influence of Venezuela trying to keep the region (including Mercosur) out of free-trade tending more to an ideological integration rather than economic integration in the region; and second is to keep including more and more the SSE in this.

Other reasons that explain the geopolitical importance of the existence of Mercosur can be described as follows. The first one is to have a regional bloc in Latin America that can be a world reference of free-trade. Mercosur has some degree of conversion towards the WTO, especially in topics of SPS/TBT measures, foreign investments, all regulated under a multilateral regime in the WTO. Mercosur is one of the largest blocs in the world and with the adhesion of Venezuela would even grow bigger in importance with energetic resources. The second reason lies in the fact that Brazil wants to consolidate its large economy in the world. Brazil would not have managed alone as one country since some regional blocs want to sign with another regional bloc. Therefore, the only possibility to grow larger and put an end to the threat of war in the region was to sign an agreement with Argentina and later with other two neighboring countries more. With the establishment of Mercosur, the region gained more weight and influence at an international level. Of course, Brazil is the country of reference for the bloc and main ruler in the region. Brazil has a potential for leadership of the Mercosur and of South America. Its dominant position helps the countries in the region to achieve better negotiation positions at international level. At regional level, Brazil plays a leadership role in the creation of rules and regulation inside the bloc, but with time, this role diminished a bit in order to adopt the same rules from the WTO and other IEOs that prejudice

the SSE and other developing countries. For Brazil, it is important to comply with multilateral regulations dictated by the bloc, so Brazil can have an easier entrance to LSE from developed countries. Besides, this collaboration makes it easier to sign other regional blocs and to internalize multilateral regulations. Its national interest of specific lobby groups (especially agricultural and industrial lobby groups) scratched trade relations with the other members of the bloc. The SSE scratched trade relations with Mercosur because they were not happy with the protectionist behavior of other LSE markets where they could not export their agricultural products and they had hope in the large Brazilian market. Nonetheless, Brazil not often has positive externalities for the SSE. Cross-border negative externalities from the signature of multilateral agreements fostered by Brazil prejudice the international insertion and national development of the SSE. Brazil's will to grant advantages (to LSE) for increasing liberalization in agriculture and industry lead to regional conflicts because it did not take into account the negative impacts of liberalization towards the South American countries. (see box 4-6)

#### **Box 4-6. DOHA Brazil-Argentina Nash Equilibrium**

##### **Background:**

Argentina and India have been trade partners of Brazil in the G-20 (coordinate proposals from developing countries for agricultural trade) and in Nama-11 (11 developing countries with interest to protect its industrial sector). Argentina reached out for support from India, in order to restrain concessions of Brazil in the Doha Round. The government and entrepreneurs of Brazil decided to make major concessions in the reduction of tariffs for industrial products, although LSE did not accept the reduction of the agricultural tariff that limits exports. Argentina was not pleased with this offer because Brazil mentioned that it was just the base of negotiations.

The agreement seeks to link the opening of markets to sensible products. This means that there will be a reduction of import tariffs, which include the protection of sensible products against foreign competence. Argentina points out that these negotiations are not favorable for developing countries and that Brazil is straining further and further from the common interest and the defensive position of developing countries that would most likely face serious troubles if they eliminate import tariffs. Brazil on the other hand, is looking to construct an agreement in the Doha Round over the basis of larger import tariff reductions, an action that has been openly opposed by Argentina and India. The strategy is as follows:

- If Brazil concludes the agreement with major concessions, then Argentina and India can retaliate against it. Gains are smaller for Argentina and India in (1,0)
- If Brazil concludes the agreement without major concessions, then Argentina and India have a better chance to gain from this than Brazil. (0,1)

In the suppose case that its necessary to include major concessions of liberalization that include sensible products, the game is as it follows:

- If Brazil, Argentina, India sign the agreement including sensible products the gain will be high for all. (1,1)
- If Brazil, Argentina and India do not sign the agreement, they will trade less with LSE and have a lower gain in (0, 0).

		Argentina - India	
		NA	A
Brazil	MC	(1,0)	(1,1)
	SC	(0,0)	( 0,1)

MC=Major concessions  
 SC = without concessions  
 NA= Do not establish an Agreement  
 A = Establish the agreement

**Analysis:**

Brazil, as one of the largest countries in South America that is currently still under the category of developing countries, has a higher advantage in negotiations for the Doha Round. Argentina and India do not have this advantage since the smaller reduction in import tariffs would imply a greater competition for their internal production and market, having a larger number of sensible products. This would reduce the possible advantages for these two countries and consequently for all the SSE in the region.

For Argentina and India specifically, the best strategy is to pressure Brazil into discarding the idea of granting major import concessions, since this fact would be disadvantageous for its partners. The best strategy is a common dialogue with all developing countries and agrees demanding more flexible mechanisms of liberalization in the agreements.

From 2006, the role of Venezuela seemed to increase inside the region. Despite the fact that its adhesion to the Mercosur was not yet ratified, its participation increased in meetings and activities. Some of the reasons for the non-ratification by Brazil and Paraguay might have been due to the unwillingness of President Chavez to fully liberalize trade in accordance with Mercosur requirements' or to fully abide with Mercosur Democratic Clause where "functioning democratic systems" are "an essential precondition for the development of the integration process". Even so, the activities and government visits to neighboring countries in the region increased<sup>16</sup>, especially in activities with the SSE (FDI-outflows and financial assistance for social projects). This increased Brazil's concern for losing the leadership position within the region (see box 4-7). Brazil then retook the leading role in Mercosur, proposing meetings and leading the regional agenda with various essential topics as migration, food crisis, governance, etc. In the last years, the role of Venezuela grew in the region and this turned the basic support towards the smaller size economies, paying attention to its main problems and trying to solve them. This somehow, also had an impact on the role of Brazil, which until now has been geopolitically interested in LSE and the conquering of new and larger markets instead of focusing on the region. In the last meeting of Mercosur<sup>17</sup>, the President Lula da Silva addressed the continuous problems that the countries in the bloc

<sup>16</sup> Venezuela did more than 40 visits in the region while Brazil did 40. Detail

<sup>17</sup> Mercosur Summit 2008. XXXV Summit of Presidents of the Mercosur. Held in Tucuman –Argentina, 1 of July 2008. Main agenda was to try the type of cooperation between members.

face, especially the ones concerning trade. He referred to the misleading that every constituent of the bloc participated in against fellow members in order to get preferences with LSE where it could export its production. This action was often taken without thinking about the prejudice exerted on the other members of the region. Worst yet, individual actions taken by countries to find their own market spaces were prejudicing the regional integration, and promoting a direct price and quality competition between nations that produced the same product. The concepts considered and put forth in the that the President of Brazil made concerning trade and international insertion, promoted a new regional thought for trade and conversion that countries should have towards common policies for trade that benefit the entire group and the region. Only coordinated trade policies could improve the international insertion and that would mean the reduction of sovereignty. All SSE want to improve levels of trade and international insertion; nonetheless, reducing sovereignty is hard to accept nowadays. Especially when SSE are finally trying to have their own voice and thoughts on their own development without the interference of the US. For Brazil itself, it is difficult to reach a point of regional reduction of protectionism, due to its fear of opening up its agricultural markets to the neighboring countries. This is why probably, meetings in Mercosur remain quite rhetorical since it is difficult to create common policies at regional level. Leaving behind sovereignty is hard even though they look for common trade benefit.

#### **Box 4-7. War of Ideological influences (South America) Nash Equilibrium Strategy**

##### **Background**

In Latin America, Venezuela is undergoing a series of cooperation agreements with the objective of having a larger political influence in the region and implementing a Revolutionary Socialist alternative, different to the current neoliberal model. For such purpose the president of Venezuela, Hugo Chavez, is trying to gain further political support in each one of the countries that integrate the region. Currently, Venezuela has the support of the member countries that signed the ALBA-TCP, plus others like Iran, China and Russia. As the third producer of oil petrol, Venezuela is subscribing to a series of agreements based on economic cooperation in the region. This is the case of Argentina and Uruguay. Venezuela wants political support and be the leader of a new geopolitical region. Then, we can deduct the following:

- If Venezuela offers economic support (ES) through its petrodollars to one or more countries in the region, it is expected that it will have a larger political influence (PI).
- If Venezuela does not offer economic support to the countries of the region, then it will not have political influence.

It is believed that Venezuela will grant either more or less political interference in their sovereignty given the conditions and the amount of financial aid that they receive. Some other determining factors to consider are: Brazil is a country of great political and economic influence and can ask Venezuela to assist other countries financially with the objective of preserving governability, trade and infrastructure policies, and to not allow any political interference. With this in mind, the game will be:

- If Venezuela offers economic support, Brazil can also offer economic support since the country is economically stable. Venezuela is not likely to gain anything from this and Brazil might have a larger gain because the region will be better prepared for trade with the financial aid (0,3)
- If Venezuela offers economic support and Brazil offers political support as long as both types of cooperation have a common frame for development in the economic, political and social interests in the region, the gain will be high for both (3,3)
- If Venezuela offers political support and on the other hand Brazil offers economic support, due to the fact that the political, commercial and social objectives are different within the region, then the expansion of Venezuela will become less dramatic than the one of Brazil, because it will cost more to lead the countries in one single political direction (1,2).

Opposite to the previous case, Venezuela can give political support instead of economic support economic accedes to support political to Brazil for the purposes of which jointly they enter mutual agreement for the construction of economic and social policies for the benefit of both and the rest of the region. Then the serious strategy as it follows:

- Venezuela offers political support to Brazil with the intent of gaining political influence in the region for both countries since they both have the same ideology towards the region. In this strategy, both investments in the region can have a same objective. Gains are the (4,4).

		Venezuela	
		ES	PI
Brazil	ES	(0,3)	(1,2)
	PI	(3,3)	(4,4)

#### Analysis:

Venezuela's strategy is to acquire larger political influence in the region through economic power, particularly supporting small economies. Nevertheless, the strategy does not have the same impact on larger economies such as Brazil, because this nation is economically competitive and has a great influence in the region, not only because of its economic size but also because of its representativeness at international level. Therefore, the best strategy for Venezuela in relation to Brazil is to offer political support to it within the context of integration (probably within UNASUR) and both create a common view for the region. The advantages are then higher for Venezuela and Brazil.

Venezuela faces a disadvantage with the new scheme of integration. Although ALBA-TCP has the support of some countries (small size economies), this is not enough to assure regional leadership. Moreover, the economic support that is granted to these countries is strengthening the commercial strategy of Brazil in the region: increase neighboring trade openness.

Basing ourselves on the analysis above, we can say that Mercosur represents a dual problem for the SSE countries: economic and political. It stands as an **economic problem** because the LSE (Brazil and Argentina) only trade between themselves or with larger partners outside of the bloc rather than with the SSE belonging to the bloc, unless the relation is one that involves exports. Brazil prefers to mainly export products from the US. Brazil's second major partner is Argentina by far, and after them, there are other countries from the EU, Japan or China that trade mostly with Brazil. None of the SSE appear to be a regular and important partner for Brazil even though they often define the Brazilian negotiation position. A lot of

the times, Brazil takes an inflexible economic position. This action is meant to benefit their agricultural producers that account for a big part of their GDP and for their employment rates. Even though, Mercosur does not admit protectionist behavior without a valid reason (under the same SPS/TBT regulations of WTO), Brazil allows it, submitting to lobby groups. No member country would take retaliation measures because Brazil is an important partner for their national markets.

One of the principal **political problems**, is that Mercosur did not contemplate the uneven levels of development presented by small states. Brazil for example is a huge counterbalance against all other members. This strong disparity makes Brazil a strong ally for international negotiations and a strong enemy for regionalization, if Brazil negotiates on behalf of its own interests. This results in further polarized positions between groups and governments that favor to open-regionalism (market led and global-export driven sectors); and in the other hand, socioeconomic movements that have regained political power and influence within government to distance themselves from the neoliberal model and type of integration that prevailed since the 90s (just like a FTA). All this circumstances have taken Mercosur from an initial integration position to (prevailing idea in 1990s) a regionalist project that acts as a platform of political stability for all member countries. Nowadays, Mercosur through the role of Brazil is carefully focusing on an open integration, product of being oriented too much towards the market, but has managed to still create a bloc open to trade and ready to support democratic governments instead of dictatorships. For Mercosur and Brazil, who is leading the bloc, it is important that freedom and development prevails as part of the integration policy within the region. It is also time to start creating supranational institutions to keep and control democracy and trade policies for the members of the bloc to all benefit and reduce the losses of the SSE. The challenges to solve these problems are twofold: a) is to open up more the Brazilian market to have the SSE happier to belong to Mercosur within an open trade structure; b) the SSE have to be willing to reduce their national sovereignty in order to let supranational sovereignty interfere to solve national problems that cannot be solved within the country alone or when the solution of the problem would entitle too many problems or negative externalities for the neighboring countries as well. This is the case of Bolivia and its constant turmoil's that push the population to huge migration level that Argentina and Brazil are the most affected of this, especially in the health sector that grants free healthcare to its population without discriminating the nationality.

Regionalism in Mercosur was threatened many times by the same conflict type: protectionism and little integration. SSE have not found benefits joining the bloc because of the high SPS/TBT barriers that were not able to solve within the 15 years of the Mercosur existence. For the SSE regionalism has been marked by a particular set of uneven conditions on its international insertion due to their weak influence on the norms and regulations against protectionism of the LSE. Internal and external constraints limited their potential participation in their will to have a better international insertion. This will was not supported by Mercosur. Despite the common fund for adjustments to avoid trade barriers, TBT barriers were increased by the LSE continuously as trade barriers that could not be surmounted (see game theory).

Despite all the disadvantages, Mercosur is very important for the smaller members (Paraguay and Uruguay), both, economically and politically. From the economics point of view, Mercosur represents for the SSE more than 60% of their exports and imports. The political reason for integrating the Mercosur is that SSE can negotiate at international level better within their group than from outside. This negotiation though, is oriented more towards intra-trade negotiations that can ease the relationships with Brazil and Argentina. This political interest is different to the interest that ANCOM members have, who are focused more on trade outside the bloc.

Mercosur is also very important for Bolivia's trade. In the last years, Bolivia has increased its numbers in pricing and quantity exported towards Brazil and Argentina, which is higher than the quantity that Bolivia sold to ANCOM. Of course, this is due to exports of gas and not other agricultural products. Brazil, maintains a common position at an international (a leader position) in front of all developing countries in the region; therefore, it negotiates well for all the Mercosur members to have a better international insertion. First, Brazil has an invariable position against protectionism and high tariffs for products with aggregated value in front of international trade negotiations. Second, Brazil plays an important role for the members in the bloc to preserve and motivate governance, democracy, solutions to high migration and food crisis. Taking advantage of the fact that it has a good position in the international arenas; Brazil plays the role of a leader fighting for common problems knowing the needs of the SSE in its region. Brazil is only concerned with benefiting the neighboring countries offering them similar conditions regarding their international insertion. However, there are other occasions in which Brazil deals alone, and only negotiates in those sectors where they hold an

advantageous position, (industry) not taking into account the common situation of the SSE or the threat that this could represent for them. That is how Mercosur has supported and adopted most of the WTO, SPS/TBT rules even when the SSE face different difficulties for the internationalization of these rules. Brazil, knowing that SSE face difficulties to internalize them does not negotiate with all Mercosur members to adopt other rules that could make trade easy for the smaller economies. Mercosur does not take into account any differentiation for the smaller economies and Brazil does not negotiate in their favor inside Mercosur. This changing position of Brazil disturbs the SSE within Mercosur since every country has to look for themselves at their international negotiations except when there is a common interest for LSE. This makes Mercosur unstable and unsafe to improve international insertion for SSE in the long term. A conflict worth mentioning is the last one in the Doha Round (August 2008), where Brazil had the main role for negotiation for agriculture openness and a reduction of subsidies of developed countries. Instead, Brazil moved to the sidetrack of developed countries giving more than what developing countries were going to receive (see box 4-6). This then, is the main reason why new options for regionalization are rising all the time for SSE in the region as UNASUR, ALBA-TCP, etc. that reduces cohesion between countries in the region.

Geopolitically, the SSE greatly depend on Mercosur, not only benefiting from trade but also from the legislation that Mercosur has to offer. SSE gain advantage from the common legislation for trade, tariffs and the free-trade zone within their main partners. Being in Mercosur, SSE can take advantage of larger economies like Brazil or Argentina, which is the main destination for their trade. Still, not everything is well with SSE and nuisances, starting with the trade barriers to competitive products for Brazil or Argentina. The lack of possibilities for a better trade position makes the SSE feel like dwarfs between two gigantic economies that do not let them compete or participate in trade under equal conditions. Paraguay and Uruguay even asked for a FTA negotiation with the US independently in 2006 since after 15 years in Mercosur, they did not see their trade situation improving and due to constant uneven conditions to SSE. Brazil and Argentina trade so much between them that leave no space for the SSE. This is a main reason why most of the time; Paraguay and Uruguay team up for common trade between them (economic interest). In spite of this, the small size of each of these countries make it impossible to trade at the same level as with Brazil; therefore, they look forward to reach the LSE market of Brazil over the one of the neighbor. The dominating position of Brazil obliges the SSE to do all efforts to submit to the



SPS/TBT rules that Brazil creates and demands from the import of products. In addition, Mercosur is also important for SSE that have a potential for emigration (Paraguay and Bolivia) because they can benefit their population for moving freely between the bloc towards LSE (Brazil and Argentina). Nonetheless, Mercosur has decided to not have a common policy on migration, keeping the sovereign power on each country to decide its own laws and procedures on this. This has led to special bilateral agreements between SSE and larger economies for migration policies as for example, Argentina-Bolivia.

With all, Mercosur has showed to be the largest bloc in the region and the first best option for trade for the SSE. In order to reduce trade barriers, the SSE try to internalize as fast as possible and try to benefit from the common fund to promote trade so they can adjust their production to the demands of the LSE. With this, the SSE can reduce trade barriers as fast as possible. Still, there are many conflicts rising all the time with SPS/TBT trade barriers that cannot be solved when the lobby groups of Brazil do not want to let in any competitive product coming from the SSE. Examples are varied, the case of rice from Uruguay, the case of soybean from Paraguay, the case of heart palmitos from Bolivia. None of these products are been imported by Brazil since the lobby groups strongly demanded the government to stop all imports of those products.

As in ANCOM, in the last years, different conflicts rose between the member countries and this questioned if the Mercosur could survive the current and future challenges. Political conflicts have had an important weight in the cohesion of the regional bloc. The conflicts have emphasized the failures of the Mercosur concerning supranational institutions and regulations that could help to solve political controversies and sovereign decision of a country that could be generating negative externalities to the other member countries. The adoption of WTO regulations for trade keeps the cycle of difficulties for the SSE to improve international insertion.

The role of Brazil is crucial to keep an affordable regionalization with free-trade for the SSE. Despite the cooperation of Venezuela is strong to SSE as Bolivia, from an economic point of view, Argentina and Brazil are still the most important trade partners for the region. Politically, the role of Brazil is very important for the creation and modification of regional regulations could ease trade and development for the SSE. There is a true dynamics of integration whose engine is especially the Brazilian diplomacy. However, there are strong

asymmetries. The fact that Brazil represents 81% of the Mercosur GDP and 61% of its population is the only country that has reached a diversified industry and the development of diversified sectors. If Brazil keeps abusing its dominant position, difficulties will surmount with the Mercosur leaving space to other type of regional integration.

## **B) Geo-Economic performance**

**Nature and Empirical analysis of trade in the bloc.** Mercosur consists of four countries plus Venezuela. All of these nations have a similar cultures, language, consumption and preference patterns, but different levels of economic development and income per-capita. This difference does not only pertain to the members, but also within the countries (larger and smaller cities<sup>18</sup>). The population has similar consumption patterns which enlarges the potential of the market size for the SSE. This fact should reduce natural trade barriers<sup>19</sup> between members so that trade is not hindered. Even so, Mercosur has uncountable political and TBT barriers that damage economic relations. Most of trade barriers are due to the dominant economy of LSE Brazil that wants to impose trade in the region but does not want to open its national market for its associate members. Table 4-6 we show the relative gravity constants for Mercosur which are going to be used in this part to see how good this integration bloc is working. In the case of overlap, the gravity was corrected. For example, the gravity of Brazil with Mercosur has been corrected by reducing the internal gravity of Brazil inside Mercosur.

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<sup>18</sup> Montevideo is similar to any European country but the rest of the cities in Uruguay not. Buenos Aires is often called as “the Paris of South America” while the rest of Argentina has huge disparities in development and income. The same happens with Asuncion (Paraguay). Some cities in Brazil are even unequal inside the city sharing rich and extreme poor people within the same regions.

<sup>19</sup> Natural trade barriers could be defined as the ones that are raised by: language, culture, consumption patters, income level and development level.

**Table 4-6. Mercosur Gravity model: Relative Gravity Constants of attraction.** Tinbergen's relative gravity constants for Mercosur with the rest of the world.

Country	MERCOSUR	Brazil	Argentina	Paraguay	Uruguay
<b>COMUNIDAD ANDINA</b>	<b>1.10%</b>	<b>1.23%</b>	<b>1.19%</b>	<b>1.31%</b>	<b>0.99%</b>
Ecuador	0.15%	0.17%	0.16%	0.17%	0.13%
Bolivia	0.07%	0.08%	0.08%	0.10%	0.06%
Colombia	0.45%	0.53%	0.47%	0.51%	0.40%
Peru	0.43%	0.46%	0.48%	0.53%	0.40%
<b>MERCOSUR</b>	<b>0.00%</b>	<b>2.62%</b>	<b>12.35%</b>	<b>17.10%</b>	<b>24.76%</b>
Argentina	4.43%	2.27%	0.00%	3.07%	14.73%
Paraguay	0.17%	0.14%	0.15%	0.00%	0.12%
Uruguay	0.41%	0.22%	1.52%	0.26%	0.00%
Brazil	14.59%	0.00%	10.68%	13.77%	9.91%
<b>EUROPEAN UNION</b>	<b>20.60%</b>	<b>26.45%</b>	<b>21.79%</b>	<b>20.70%</b>	<b>19.06%</b>
<b>NAFTA</b>	<b>33.64%</b>	<b>40.61%</b>	<b>36.01%</b>	<b>36.08%</b>	<b>30.68%</b>
Canada	2.49%	3.08%	2.65%	2.61%	2.28%
United States	29.42%	35.54%	31.45%	31.63%	26.79%
Mexico	1.73%	1.98%	1.91%	1.84%	1.61%
Chile	1.32%	0.99%	2.15%	1.38%	1.57%
China	2.14%	2.66%	2.32%	2.14%	2.02%
Venezuela	0.58%	0.72%	0.60%	0.65%	0.51%
<b>Rest of the World</b>	<b>21.04%</b>	<b>24.72%</b>	<b>23.60%</b>	<b>20.65%</b>	<b>20.42%</b>
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

Source: Own elaboration based on GDP and Distances (see appendix)

- **Uruguay.** As an SSE, Uruguay highly depends on other countries when trade is concerned. This is also confirmed if we check the gravity constants in table 4-6. After NAFTA (30.68%), Mercosur has the highest gravity for Uruguay with a value of 24.76%. However, different trade barriers with NAFTA, including SPS/TBT make Uruguay more dependent of Mercosur with 37.8% (2000-2009) (table 4-7), Even though there was a visible reduction compared with 1997-1999, where it accounted for 46.6% of trade. This reduction is due to political conflicts within Mercosur (with LSE, Brazil particularly) that restrain trade. Other important markets are the EU who accounts for 19.8% and the US who is responsible for 13.0% alone. These markets have a higher gravity expectation within the Tinbergen model and in reality the trade shares are not as high. This is maybe caused by a general reduction of trade and some SPS/TBT but also because Brazil is more attractive for Uruguay, in the sense that Uruguay is more dependent on the Brazilian market for its agricultural products which are produced solely for this market. The share of Mercosur for Uruguay's trade is more than the 38% and this clearly shows that Brazil still has a relative preference for Uruguayan trade as a LSE over other countries and trade blocs, which could be explained by the high trade barriers with NAFTA and the EU

and/or the easiness of trade with Mercosur since it is a neighbor country and has the same culture, language and low transport costs.

**Table 4-7. Uruguay: Relative trade shares with the world.**

Country	Exports		Imports		Average	
	1995-1999	2000-2009	1995-1999	2000-2009	1995-1999	2000-2009
<b>COMUNIDAD ANDINA</b>	<b>2.2%</b>	<b>1.7%</b>	<b>1.0%</b>	<b>0.5%</b>	1.6%	1.1%
Ecuador	0.3%	0.2%	0.6%	0.1%	0.4%	0.1%
Bolivia	0.1%	0.2%	0.0%	0.0%	0.1%	0.1%
Colombia	0.6%	0.5%	0.2%	0.1%	0.4%	0.3%
Perú	1.3%	0.8%	0.1%	0.2%	0.7%	0.5%
<b>MERCOSUR</b>	<b>49.0%</b>	<b>30.4%</b>	<b>44.1%</b>	<b>45.1%</b>	<b>46.6%</b>	<b>37.8%</b>
Argentina	14.4%	9.4%	21.8%	23.7%	18.1%	16.6%
Paraguay	2.4%	2.3%	0.5%	0.6%	1.5%	1.4%
Brasil	32.2%	18.7%	21.7%	20.9%	27.0%	19.8%
<b>EUROPEAN UNION</b>	<b>20.0%</b>	<b>19.8%</b>	<b>20.3%</b>	<b>13.2%</b>	<b>20.1%</b>	<b>16.5%</b>
<b>NAFTA</b>	<b>8.4%</b>	<b>16.6%</b>	<b>13.5%</b>	<b>9.5%</b>	<b>10.9%</b>	<b>13.0%</b>
Canadá	1.1%	2.1%	0.8%	0.7%	1.0%	1.4%
Estados Unidos	6.1%	10.7%	11.3%	7.7%	8.7%	9.2%
México	1.2%	3.7%	1.3%	1.2%	1.3%	2.5%
Chile	2.1%	2.6%	1.7%	1.7%	1.9%	2.1%
China	4.2%	4.1%	1.8%	6.6%	3.0%	5.3%
Venezuela	0.8%	1.6%	2.0%	5.6%	1.4%	3.6%
<b>REST OF THE WORLD</b>	<b>13.3%</b>	<b>23.3%</b>	<b>15.6%</b>	<b>17.8%</b>	<b>14.5%</b>	<b>20.5%</b>
<b>TOTAL</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Source: Own elaboration based on ALADI, [www.aladi.org](http://www.aladi.org)

Now that we have evidenced the proficiency of Mercosur regarding Uruguay, it is time to see how this country is doing within Mercosur. In table 4-8 we have rearranged the relative trade shares. Without doubt it is obvious that Uruguay depends on Argentina and Brazil with a joint trade share of 96%, which hardly changed during the past years. Paraguay accounts for only 4% and shows that for Uruguay, Mercosur is practically only Argentina and Brazil. This confirms the attraction that a LSE has to a SSE.

These relative trade shares also coincide with the gravity value, as shown in table 4-6 but adjust them for only Mercosur. In table 4-8 we can see that Argentina and Brazil, considered to be the LSE of the bloc, are indeed the most important trade partners within Mercosur. But if we take a closer look we can see that the trade with Paraguay has increased and is still over performing with about seven times more trade than what the gravity model suggests. This implies that Uruguay and Paraguay still have a special trade relation.

**Table 4-8.a Uruguay: Relative Trade shares compared to Mercosur countries.** Trade of Uruguay with Mercosu expressed over total trade with Mercosur.

Country	Exports		Imports		Average	
	1995-1999	2000-2009	1995-1999	2000-2009	1995-1999	2000-2009
Argentina	29%	31%	49%	53%	39%	44%
Paraguay	5%	8%	1%	1%	3%	4%
Brazil	66%	61%	49%	46%	58%	52%

**b. Uruguay: Relative trade shares compared with gravity shares.** Gravity from table 4-6 compared to actual relative trade share.

Country	a	b	c	d	e
	Gravity	95-99	ratio	00-09	ratio
Argentina	59.5%	38.9%	0.7	43.8%	0.7
Paraguay	0.5%	3.2%	6.4	3.8%	7.6
Brazil	40.0%	57.9%	1.4	52.4%	1.3
<b>Standard deviation</b>			<b>3.1</b>		<b>3.8</b>

a Tinbergen's gravity expressed in relativity to the chosen countries

b/d Relative trade shares calculated as the average of imports and exports

c/e Ratio between Tinbergen's gravity and real trade shares (1=optimum)

Source: a) deduction from Table 4-1 b) Deduction from Table 4-2

Another interesting observation from table 4-8 is that Argentina has less trade than the expected share, according to the gravity, unlike Brazil who benefits more from commerce. Although the difference seems to be converging during the past years, the gap is still notorious. A logical explanation could reside in the fact that Uruguay has very similar products compared to Argentina and so, there is less need for trade between both of them. On the contrary, Uruguay knows that there are certain products that have a bigger demand in Brazil, due to this nation's high national and industrial consumption that opens up opportunities for providing the goods and services that are needed. These products are complementary and are not competing for its national market. (Observatorio del Mercosur, 2006)

- **Paraguay.** As a landlocked country, Paraguay has a harder time in trading with markets overseas than the other members in Mercosur. Besides that, it is the poorest country within Mercosur and one of the poorest in South America. One would expect that trading to USA, EU and other overseas regions is a hard task for Paraguay and this is the main reason why neighboring countries would play a more significant role for its trade. However, looking at table 4-6 we see that according to gravity Paraguay should trade even more with NAFTA and EU than with Mercosur or with Uruguay that have less gravity. Absolute distances are indeed shorter but relative distances are larger. Paraguay

has no decent road infrastructure, and trade barriers or preference differences are even larger for Paraguay than for Uruguay. (Observatorio del Mercosur, 2006)

If we compare the numbers in table 4-6 with the real trade shares in table 4-9, the most impressive difference is the trade share of 48.5% with Mercosur instead of only 17.10% as the gravity model would suggest. Besides, the share of the EU and the US is much lower than expected, especially for the US, only 4.4% instead of 31.63% according to the gravity model. These numbers suggest that Paraguay has real difficulty positioning themselves inside larger markets like the US and the EU, maybe due to the problems that it faces offering its products outside its regional leader, Brazil (read game theory below). On the other hand, Brazil, other LSE with a similar level of development and patterns of consumption accounts alone more than half of Paraguay's trade in Mercosur. That 24.8% is traded with Brazil could be due to the fact of shorter distances and SPS/TBT barriers only in competing products with the LSE. The Brazilian cities that neighbor with Paraguay show high amounts of trade and seem to have a similar type of population, income and needs. For Brazil is difficult to reach this national market and trade helps its own subsistence. This is one of the main reasons why Brazil allows trade from Paraguay to enter its borders without practically any barriers. On the other hand, for Paraguay it is easier to trade with Brazil than with a LSE from developed countries, since it demands a level of technology and development that Paraguay is not capable of providing. Moreover, the geographical location of Paraguay makes it not have any important port within its rivers and most goods have to go through another country to be exported or imported. This is why trade is harder for Paraguay. This fact though did not stop Paraguay from having smuggled merchandise towards Brazil and Argentina.

When we take a look at the restructured trade shares of Paraguay only with Mercosur (table 4-10), we can see a better detail on the performance of Paraguay in the bloc. For instance, Uruguay has increased its trade importance with Paraguay when comparing the two periods, primarily caused by increased exports from 5.3% to 20.9%. Brazil reduced its importance. This can be due to an increase of trade with other regions in the world as with China, going from 0 to 10.4% (table 4-9).

**Table 4-9. Paraguay: Relative trade shares with the world.**

Country	Exports		Imports		Average	
	1995-1999	2000-2009	1995-1999	2000-2009	1995-1999	2000-2009
<b>COMUNIDAD ANDINA</b>	<b>1.6%</b>	<b>4.0%</b>	<b>0.3%</b>	<b>0.5%</b>	<b>1.0%</b>	<b>2.2%</b>
Ecuador	0.1%	0.3%	0.0%	0.0%	0.1%	0.2%
Bolivia	0.7%	1.5%	0.0%	0.3%	0.3%	0.9%
Colombia	0.2%	0.3%	0.1%	0.1%	0.2%	0.2%
Peru	0.7%	1.8%	0.0%	0.0%	0.4%	0.9%
<b>MERCOSUR</b>	<b>53.2%</b>	<b>49.8%</b>	<b>48.9%</b>	<b>47.1%</b>	<b>51.0%</b>	<b>48.5%</b>
Argentina	9.9%	8.7%	18.2%	18.5%	14.0%	13.6%
Uruguay	3.1%	18.1%	2.4%	2.2%	2.7%	10.1%
Brasil	40.2%	23.1%	28.3%	26.4%	34.2%	24.8%
<b>EUROPEAN UNION</b>	<b>27.0%</b>	<b>8.1%</b>	<b>11.9%</b>	<b>7.4%</b>	<b>19.4%</b>	<b>7.7%</b>
<b>NAFTA</b>	<b>6.2%</b>	<b>3.2%</b>	<b>12.5%</b>	<b>6.1%</b>	<b>9.3%</b>	<b>4.6%</b>
Canada	0.0%	0.2%	0.3%	0.2%	0.2%	0.2%
United States	5.8%	2.8%	11.6%	5.2%	8.7%	4.0%
Mexico	0.3%	0.2%	0.7%	0.7%	0.5%	0.5%
Chile	3.2%	5.0%	1.6%	1.4%	2.4%	3.2%
China	0.0%	1.6%	0.0%	19.1%	0.0%	10.4%
Venezuela	1.2%	1.6%	0.2%	1.6%	0.7%	1.6%
<b>REST OF THE WORLD</b>	<b>7.7%</b>	<b>26.8%</b>	<b>24.7%</b>	<b>16.8%</b>	<b>16.2%</b>	<b>21.8%</b>
<b>TOTAL</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Source: Own elaboration based on ALADI, [www.aladi.org](http://www.aladi.org)

**Table 4-10.a Paraguay: Relative Trade shares compared to Mercosur countries.** Tinbergen's relative gravity constants for Mercosur with the rest of the world.

Country	Exports		Imports		Average	
	1995-1999	2000-2009	1995-1999	2000-2009	1995-1999	2000-2009
Argentina	19%	17%	37%	39%	28%	28%
Uruguay	6%	36%	5%	5%	5%	21%
Brazil	76%	46%	58%	56%	67%	51%

**b. Paraguay: Relative trade shares compared with gravity shares.** Gravity from table 4-6 compared to actual relative trade share.

Country	a	b		c		d		e
	Gravity	95-99	ratio	00-09	ratio	00-09	ratio	
Argentina	18.0%	27.5%	1.5	28.1%	1.6			
Uruguay	1.5%	5.3%	3.5	20.9%	13.6			
Brazil	80.5%	67.1%	0.8	51.1%	0.6			
<b>Standard deviation</b>			<b>1.4</b>		<b>7.2</b>			

- a Tinbergen's gravity expressed in relativity to the chosen countries  
b/d Relative trade shares calculated as the average of imports and exports  
c/e Ratio between Tinbergen's gravity and real trade shares (1=optimum)

Source: deduction from Table 4-6 b) Deduction from Table 4-9

If we compare the gravity constants of Paraguay with the real trade shares within Mercosur (table 4-10), we see that there is more trade with Argentina than expected but less trade with Brazil. But like in Uruguay there is much more trade with Uruguay than expected being another SSE. The last observation shows that Uruguay and Paraguay definitely team up for trade and keep a good trading relationship. Of course, trade is larger with Brazil but less than its gravity and is more with Uruguay though in small numbers.

- **Bolivia, associate member.** According to gravity, Mercosur should go for about 8.9%, but in reality it is 37.6% and it even grew in the past decade. Another one is US which should have a very high gravity of about 39%, but the real trade number is just 14.0% and it even went lower from 25.8% in the 90s. It seems that the well developed market of US is harder to reach than Mercosur. This can be explained through the idea that exports to the US are obstructed by political trade barriers and differences in the consumer preference either cultural or consumption patterns. Mercosur and Bolivia are nowadays more compatible on economic side since Bolivian gas is highly needed in Brazil and Argentina that there are no trade barriers for it. If trade increased within Mercosur is only due to natural gas and not for agricultural products as it is with the US (Observatorio del Mercosur, 2006).
- **Venezuela's membership.** The situation of Venezuela's membership at this time is stuck because neither Paraguay nor Brazil wanted to ratify its membership in 2006. Political quarrels between two of the largest powers, Brazil and Venezuela, have prevented the full membership of Venezuela. Brazil would also become one of the most important trade partners for Venezuela since it is a direct neighbor. At the same time, Venezuela could become one of the most important oil and gas providers for Brazil. This means that in the case that Bolivia cannot provide the necessary amount, or in the case that Brazil increases its industry potentiality, Venezuela could become an important player to satisfy the needs of the Brazilian production.



## C) Game theory on regionalization

In order to have a better idea on SPS/TBT or other barriers that SSE suffer from relative LSE, we will present different case scenarios. Game theory will be applied to different problems of trade to show the position of SSE and possible ways of reaction. This analysis is important in order to understand how the SSE could improve their trade position and international insertion. Therefore, this part could serve as a guide for decision makers in SSE for future negotiation patterns at international level.

### Paraguay

#### *Lobby Activity*

Landowners have vast lobbying power in Paraguay. The big landowners created the Committee for the Defense of Private Property ten years ago; and now, it is the government, that created the Citizen Security Councils to protect landowners. In the last decade, the area sown with genetically manipulated soja went from 800.000 hectares to 2 million hectares, taking up 64% of the country's agricultural area and communal lands, which forced large numbers of people to migrate. The second group that possesses considerable lobbying power, (though against government) is the rural workers movement, which gained strength around the idea of putting a stop to government and landowner's abuse. Marches, roadblocks, land occupations and sit-ins in public buildings turned the rural workers movement into the most important in the country. These movements hold up neoliberal privatization policies in 2002 and keep confronting the government abuse when they have anti-social measures. With all the power of lobby that agricultural sector has in the government, this, was not able to get out positively of trade problems with its larger partners in Mercosur.

#### **Box 4-8. Soybean Brazil - Paraguay Nash Equilibrium Strategy**

##### **Background**

In the frontier between Paraguay and Brazil there is an ominous presence of capitalism in agribusiness, particularly *Brasiguayos* (is to term referring to Brazilian migrants in Paraguay and to their descendants) that are dedicated to the production of transgenic soybean in the Paraguayan side. This has caused a serious problem of intoxication of the nearby communities due to the extensive use of poisons and fertilizers. This fact has caused an increase of violence between Paraguayan farmers and natives towards the Brasiguayos.

The oligarchy is constituted by 200 families which own around 70% of land and control the legal and illegal trade. On the other hand, 50% of Paraguayans are living in urban centers of Asuncion and have businesses that center around trade, the other half are farmers. Around

100 thousand of them are forced to go to the cities expelled by the transgenic soybean. Therefore, Paraguayan soybean is produced mainly for the foreign market (up to 75%), having the national market only 25% of which 25% goes to the industry and around 2% are for seeds. Without any doubt, Paraguay has grown due to these exports.

At present, farmers have made a request to President Fernando Lugo, to displace landowners and to institute a new distribution of land. This problem increased to a point where President Lula had to intervene with military force in the hydroelectric dam Itaipu, so that no more Brazilians were expelled. The governments of Lugo and Lula began a round of negotiations focused in two points: Paraguay wants to recover the free availability of its energy and power from Itaipu to sell its surplus to any country, and wants to receive something more than the price of cost that establishes the Treaty of Itaipu, five times smaller than the market price. Alternatively, Paraguay is in crossroads because farmers will not accept a new redistribution of land and on the other side, Brazil requests Paraguay to assure the safety of the Brasiguayos. But we also have to analyze other factors like the invasion and expel of landowners, as the armed intervention of Brazil in the border with the Itaipu dam.

- If the Government decrees redistribution of land, then farmers have a high percentage of benefit whereas Brazilian entrepreneurs face a low probability of seeing benefits. But this scenario will most likely create regional conflicts with Brazil, therefore Paraguay would not be able to trade normally losing (0) and Brazil would lose double, not trading and having Brazilians expelled from Paraguay (-1).
- If the government does not decree land distribution, then farmers have a low chance of gaining economic strength and the Brazilian people that live in Paraguay will surely have an advantageous position. Results in (0,1). This situation would increase Brazilian farmers' profit since they could keep exporting and there would be more profit for Paraguay. This measure can cause though that Paraguayan farmers invade or destroy their cultivations which can cause retaliation in trade from Brazil losing Brazil (0) and more loss to Paraguay that would not sell.
- If it is a recursive strategy of dominance, the Paraguayan farmers will continue with their retaliation, causing a serious deterioration of business relationships with Brazil. Gains would be 0 for Paraguay and -1 for Brazil.

		Paraguay	
		Yes	No
Brazil	No trade	(1,0)	(-1,0)
	Yes	(0,-1)	(0,1)

### Analysis

The government strategies are difficult. If it decides for a redistribution of the land it can cause regional conflicts with Brazil and a diminution in the production of soybean, as a result of the expulsion of landowners which mainly had the duty of exporting. Nonetheless, conflicts with the farmers could be solved reaching an advantage of 1. On the other hand, if it is possible to instate an agreement with Brazil that would grant security for the Brasiguayos and their permanence in the soybean production, trade would keep benefiting them. This would be a recursive strategy of dominance because the Paraguayan farmers could continue with retaliation causing tensions with Brazil.

### *Strategic pay-off within the trade-bloc*

Being a member of Mercosur is very important for Paraguay, both for economic and political reasons. On the economic side, Paraguay depends on Mercosur (2000) for 64% of its exports and 52% of its imports. In 2000, the major partner for Paraguay was Brazil (39% exports and 25% imports), followed by Argentina (11% exports, 23% imports). Correspondingly, in the economic sense, Paraguay has a good strategic pay-off within the trade bloc, except for the

trade barriers that have a positive impact on trade distortion. Paraguay has a high dependence on agricultural trade and Brazil disallows products when these come to endanger the competitiveness of its national production.

In the political sense, for Paraguay, it is beneficial to be in Mercosur because it is the third largest regional bloc in the world. Being in the same structure with Brazil brings advantages for trade and development. Still, Paraguay is not blind to the imperfect scheme of integration that Mercosur promotes, and this is a disadvantage for Paraguay and the other small members, concerning free-circulation of products and access to the large market it wished for when joining the Mercosur. Brazil and Argentina have different non-tariff barriers and public policies that distort competitiveness. Unfortunately, the trade policies that both countries have can even go beyond any common rule within Mercosur. For instance, the conflict of rice between Brazil and Uruguay had an effect over Mercosur, advising Brazil to open up its market, and still, Brazilian agriculture lobby was so strong that Brazil could not accomplish the resolution of Mercosur.

Mercosur has not yet provided smaller economies like Paraguay the real benefits that were foreseen when joining the bloc. High asymmetries within the bloc causes the smaller countries to benefit less than it was expected, despite the Fund of structural convergences (FOCEM) that assist the countries in arranging any problem that forbids trade (as SPS or TBT norms that could avoid national products to export). On the other hand, being in the Mercosur helps Paraguay's governance since, in the last years, Mercosur created a Social Institute and a Center for Promotion and Law where Democracy is monitored at national and Mercosur level. Hence, this institute has a certain influence on Paraguay, whereas it is constantly observed and compared with the other members in order to maintain democracy over dictatorship. In spite of that, Paraguay is known as a very corrupt economy (chapter 1) where law and property rights are vulnerable from corruption, and the new institutions in Mercosur are seen as entities that can help with the improvement of governance at a national and international level. Another example is the Permanent court of Arbitration with the main office in Asuncion who has been instituted as the maximum jurisdictional instance to settle controversy between different members.

## Uruguay

### *Lobby Activity*

Uruguay is shaped in a way where government or people that work in the government have more influence than others. The multinational companies also have influence but these two entities have shared power of influence for the politics. There are different interest groups sharing the power level of influence. In 2006, for instance, different social movements participated in marches worried by the contents and conditioning that the FTAA was offering to Uruguay and the way their government was negotiating the treaty with US. Social movements manifested that they are interested in participating to the government with a vote whether government should sign the treaty or not. Contrary to the mentioned above, at international level, the lobby of Uruguay is small, especially when dealing with a large partner as Brazil.

#### **Box 4-9. Trade barriers in Mercosur: the Rice Case between Uruguay & Brazil**

##### **Nash Equilibrium strategy.**

##### **Brazil**

Brazil is one of the main producers of rice in the region; nevertheless, its production does not cover the total demand of its internal market since a great amount of its production is destined for exporting purposes. For this reason, it imports rice from the region preferring always to first import from the partners of Mercosur, then the United States or Asia (mainly from Thailand). On the other hand, Brazil is a very protectionist country and rules for imports vary from national to State particular regulations. For instance, the exports from Uruguayan face technical barriers to trade (TBT) as well as social and tariff barriers in the State of Rio Grande do Sul (RGS), a border city with Uruguay. This city is also a producer of rice and does not want the competition of rice in its internal market. Several sectors try to impel a State law that would prevent the entrance of Uruguayan rice. This law is unacceptable within the Mercosur; however, this situation could not be arranged by the national government, neither by the institutions of Mercosur to respect the free circulation.

Another problem that prevents Uruguay from increasing export volumes to Brazil is the high amount of imports that Brazil has with the subsidized rice from the European Union (EU) because of its low price. For the importers of great volumes, this was a great opportunity but not so much for Uruguayan and Argentinean producers who could not compete with those prices. This reduced the motivation to keep investing in the production of rice in a small and medium scale. Uruguay was the SSE that suffered the most, since it is highly dependent on the Brazilian market. Moreover, the EU can sell its rice at any price because if the price lowers, it can internally compensate it with more subsidies. This is the main reason why Brazil benefits further from buying rice proceeding from the EU than buying it from its partners in Mercosur. The game for Uruguay is as follows:

- If Brazil applies technical barriers on trade (TBT), restricting imports from Uruguay in free trade (FT), Uruguay can take retaliations and intraregional conflicts in trade. Both countries will lose (0,0) reducing trade.
- If both fulfill the agreement dictated by Mercosur with free circulation (FT) and they give priority to buying products from the bloc, they will both be the recipient of winnings in the short and long term. (6,6)

Considering the fact that Brazil imports subsidized rice of the EU, the gains will be:

- If Brazil imports rice from the EU, Uruguay will have less gain because the subsidized prices

of the rice of EU make it impossible to compete for Uruguay. If EU would not have enough for its own internal market, Brazil can also import subsidized rice from the U.S. Here, the gains will be low for Uruguay (7,1)

- If Uruguay retaliates against Brazil in its key sectors, Brazil can lose in trade, resulting in a common loss for both, prejudicing a bit more to Uruguay (3,4).

		Uruguay	
		FT	TBT
Brazil	FT	(6,6)	(3,4)
	TBT	(7,1)	(0,0)

#### Analysis:

Here the strategy of Brazil is to restrain the imports from Uruguay with TBT. In this case, the gains for both will be low since intraregional trade will fall. If Brazil imports subsidized rice from the EU, this will only benefit the importers, since lower prices can prejudice both Uruguayan and Brazilian producers. For Uruguay the most feasible strategy is that Brazil does not import from the EU respecting the Mercosur agreement. Nevertheless, the lobby of importers of Brazil is stronger than the one of producers. Uruguay does not have any power to influence Brazil so that this complies with free trade and better integration in Mercosur.

Brazil is one of the largest economies in the region and it's the most attractive country for exporting purposes. However, Brazil represents an edifying example as regards the protectionism's traps. Brazil is one of the closest economies and has several TBT barriers settle at national level and besides, every State also has its own barriers that sometimes do not comply with the regional agreements done by the government. Brazil occupies the rank of 113 over 179 countries as the country with the most protectionist policies in the Index of Economic Freedom 2010 of the Heritage Foundation/Wall Street Journal. This fact is frustrating for several neighboring countries that hope to export their products to a similar population with analogous cultural and socio-economic patterns. Similar barriers such as the ones to import rice have been occurring inside the Mercosur. For instance, Bolivia had to stop exporting palm hearts to this market since 1999 because Brazil proposed a new disposition to concern palm hearts to its market with a series of technical regulations that made impossible for Bolivia to keep exporting. This norm was settled by Brazil when it had a fall of palm heart exports to Europe, U.S. and neighboring markets. For Bolivia this market loss has meant a great loss for the sector and for the total economy.

#### *Strategic pay-off within the trade-bloc*

For Uruguay, being a member of Mercosur is very important, for both economic and political reasons. For instance, in 2000, Uruguay depended on Mercosur for 41% of its exports and 43% of its imports. This is of great importance for the economic side. For Uruguay, the most important associates are Brazil (23% exports and 18% imports), followed by Argentina (19% exports, 24% imports). Both account for almost 50% of the Uruguayan trade. In the political sense, it is of outmost importance to be in Mercosur, because it is one of the third largest regional blocs in the world and has a great potential market for the Uruguayan production. However, Uruguay, the same as Paraguay, does not have an easy trade with Mercosur despite its membership. Several SPS or TBT barriers make it impossible sometimes to keep growing in trade. Trade barriers are a handicap for international insertion. Brazil and Argentina know

that Uruguay practically depends on its markets, and still, both of these nations take advantage of this situation and blockade the entrance of Uruguayan production to their markets as a way pressuring Uruguay to accept any policy that they want. Lobby groups are easily found out of Uruguay than inside the country itself. Argentina for example, takes actions and blockades the main connection Uruguay-Argentina to put pressure on Uruguayan laws.

In the last years, Uruguay was blocked several times in 2006 and 2009, because the government approved the construction and the installation of two large paper pulp mills in the eastern coast of the Uruguay River to produce paper. Being that Argentina is a huge paper producer, this was not convenient for them, risking the country to lose competitiveness in the region; therefore, several weeks, people blocked the bridge that connected Argentina with Uruguay. These actions caused an enormous damage to the Uruguayan economy, not only blocking trade but also movement of people and tourism in the most important seasons. The same, Brazil also blocks several products that are endangering competitiveness of national production. Protectionist measures are taken by the larger partners despite all the regulations and arbitrages that Mercosur has. The conflicts with its partners show that Mercosur has problems in its original design, which lacks supranational institutions and renders it unfit to solve conflicts.

Mercosur internalized the SPS/TBT norms from the WTO but did not adapt them to the particular reality of the members. It is true that it has a fund of compensation for the country that has to adapt to a new norm without stopping trade; nonetheless, the country stops trade during the time the differend persists because the process can take time and once the decision is made, the trade opportunity is gone or there is another competitor in the market.

### **Associate member Bolivia**

#### *Lobby Activity*

Bolivia does not have much power in the resolution of controversies within the Mercosur, nor does it have the chance to obtain the funding needed to improve trade and get rid of SPS/TBT barriers. The obstacle for Bolivia in winning these privileges is that it is not a full member of Mercosur, is just an associate of it. Similar barriers such as the ones to import rice have been occurring inside the Mercosur for Bolivia. For instance, in 2000, Bolivia had to stop exporting palm hearts to this market since 1999 because Brazil proposed a new disposition to

concern palm hearts to its market with a series of technical regulations that made impossible for Bolivia to keep exporting. This norm was settled by Brazil when it had a fall of palm heart exports to Europe, U.S. and neighboring markets. For Bolivia this market loss has meant a great loss for the sector and for the total economy.

*Strategic pay-off within the trade-bloc*

The reasons that push Bolivia towards becoming an integrated member of Mercosur include the same economic and political reasons of the other SSE countries. For Bolivia, the primary objective is to become a fundamental axis in the integration between ANCOM and Mercosur. This project is present between all South American countries and will constitute a good opportunity to open their markets to all neighboring countries. Brazil had this same intention trying to launch the SACN (Southern American Community of Nations) in 2004 with the assumption that Mercosur could not accommodate all nations due to different difficulties within its original members already. For Bolivia, it is of main importance to join both blocs as a full member due to trade relations; however, nor ANCOM neither Mercosur allows signatures of a country as a full member in more than one regional bloc. This is a problem for the members of ANCOM who would like to join Mercosur due to trade relations. Firstly, because a country that trades with Mercosur as much as with Ancom is not an easy decision if it is analyzed the trade structure. Within ANCOM for instance, Bolivia trades added value agriculture and basic manufacture, whereas with Mercosur, Bolivia only trades primary production: gas (hydrocarbons) and agriculture. Both trade structures at only one regional bloc are not possible due to historical demands that each regional bloc has. A similar situation happens to Ecuador or Venezuela that decided to quit ANCOM thinking that could benefit more in Mercosur.

On the economic side, Bolivia can gain an advantage from the associate membership with Mercosur and find a larger economy (Brazil and Argentina) for its exports. Nevertheless, the intentions of Bolivia to join Mercosur and gain access to a larger market is not always palpable, since Brazil often puts up different SPT and TBT barriers for Bolivian exports when the products represent an imperil to the national production. On several occasions, Brazil has closed its frontiers to previously imported goods from Bolivia, claiming that the products do not meet the different requirements that Brazil establishes from time to time. In consequence, Bolivia often had to stop exporting the products that could not meet the

requirements, due to the high costs for adaptation or to deficient technology. One very illustrative case is presented below.

Bolivia's trade with the Mercosur is only involves raw agriculture and hydrocarbons without added value. Within Mercosur, the productivity in agriculture and its small scale production turns into a major problem for Bolivia. This is because Bolivia has to compete with similar products from larger partners (Brazil and Argentina) that produce on a large scale and high productivity. The prosperity for agriculture with higher prices and demand in 2007 and 2008 could not benefit Bolivia as it did with neighboring larger countries because it was not prepared for exporting at higher scales. Worst, Bolivia suffered the food crisis in 2008 due to inflation and bans to export from the neighboring countries. Food crisis existed in 2008 in Bolivia because agriculture was only for sustenance, as was the case in many other small economies. This type of agriculture prevailed due to lower prices for imported agricultural goods. As a result of this action, neighboring countries, who had earlier sold to Bolivia, preferred to deal with other partners that were willing to pay more. Besides, the ban to export agricultural products on behalf of assuring fare prices for its national market, caused problems of food scarcity for neighboring countries. Or, the products that could be exported were previously controlled by its government to grant or not export permission which in whole increased the exporting price; thus the food price.

Concerning hydrocarbons, in 2005, Bolivia has turned into the largest reserve of natural gas in the Southern Cone. This fact has given Bolivia a better position in the international scene for both, negotiations and international insertion within the region. Main destination for gas is Mercosur because it is easier and cheaper to export gas to neighboring countries since Bolivia lacks infrastructure for exporting to other countries. An increase of hydrocarbon international prices and taxes for the exploitation of hydrocarbons in Bolivia gave the possibility to the government to invest in social programs and the strengthening of governance and national institutions. Still, Bolivia has a very weak position to decide for itself the industrialization of the hydrocarbons within its national market since it is dependant to outside markets who decide what level of industrialization to import. Another weakness for Bolivia is that industrialization requires high level of investment and Bolivia depends on international foreign investment for this. In 2008 and 2009, Bolivia was trying to negotiate the increase of FDI from Brazil to increase production and industrialization but the last option seems to take longer time than the first one. This shows that the need of gas provision for its market and the



Argentinean market moves faster the FDI from Brazil at previously agreed prices that are lower than current international prices (Bolpress, 2008). Garcia Linera, the Vice-president of Bolivia assured to Bolpress that new investments from Petrobras are based in the increase of exploration champs. This increases vulnerability in negotiation for Bolivia since there are not more trade partners. This means that if Bolivia does not sell or reduces the exported amount, socio-economic programs and political stability would be in danger.

## **D) Mercosur conclusion**

### **The impact of regionalization on the SSE is:**

- Uruguay depends more on trade with MERCOSUR than the theoretical trade gravity suggests, and less on U.S. and EU
- Also for Paraguay depends more on trade with MERCOSUR than the theoretical trade gravity suggests, and less on U.S. and EU
- The well performing intra-trade suggests that MERCOSUR works very well for its members, however, it could be also that other countries have higher trade barriers in relative terms

For SSE, Mercosur is a very good option despite all the trade barriers that come along with it. SSE depend almost entirely on Mercosur for their trade belonging to a free trade bloc of only four countries with practically the same level of development (though different size in their economy), makes it easier to come to an agreement dealing with projects of development or difficulties with trade. On the other hand, within the bloc, Uruguay and Paraguay don't really hold any power that would grant them a strong negotiation position to improve trade and reduce the SPS or TBT barriers that exist in the larger partners and which originate trade deviation. Trade is constantly disturbed by SPS or TBT barriers that are within the WTO frame internalized by Mercosur. However, these trade barriers in Mercosur create the same difficulties for the SSE to trade as within the multilateral agreements.

SSE are weak when trade happens to deal with agriculture. Brazil and Argentina have important agricultural sectors; around 25% of the employed population is dedicated to agricultural production. Thus, both large countries are willing to protect the agricultural sector against neighboring countries that have a similar structure of production. Even so, SSE

have upturned their potentials for a better negotiation within Mercosur in the last two years. Uruguay shaped a certain degree of freedom due to the strategic location of its ports, which helped to reduce dependency on Mercosur. As is also the case of Paraguay due to its strategic location that enables the generation of hydro-power that is later exported to other members of Mercosur. Paraguay can then, negotiate better with Brazil or Argentina using energy to gain an advantageous position. Bolivia has increased the amount gas that trades with Brazil and Argentina and this turned to be a negotiation tool in favor of this SSE face to the LSE in their need for energy. Like this, SSE could do increase their potentials for international negotiations: energy (hydrocarbons, electricity, minerals, etc.) could be a key for negotiating against LSE. However, SSE have to still discover this the real potential they have as natural resources for having a better negotiation position.

Contrary to ANCOM, the Mercosur bloc profits from greater advantages than ever before, since a big part of the trade for SSE started to flow towards Mercosur. Certainly, this fact gives a good motivation for other SSE to become an associate member, as Bolivia and Ecuador did. But not everything is perfect for SSE in Mercosur. Even though Brazil is the most important member and the most attractive market for the SSE, it is also the most protectionist economy of the entire region. Brazil does not allow any country to export in large quantities, especially when the product can endanger their national production or directly competes with their agricultural producers. Brazil's government is submitted to interest groups, especially in agriculture. This protectionist behavior acts as a roadblock that hinders the complete integration of South America. Even Brazil does not believe that Mercosur can welcome all the South American countries, due to all the difficulties that come along with embracing countries of different sizes. (Observatorio del Mercosur, 2006). Despite all the common agreements for tariffs and trade measures within the group, Brazil breaks away from these agreements to protect its national producers. For Paraguay and Uruguay, this behavior was so much of a disillusionment that in 2006 decided to quit with Mercosur to sign a FTA with the United States. Both countries questioned the domestic advantages for being a full member in Mercosur which after 15 years did not bring real market integration. The intention of a FTA with US came to a halt because of lobby pressure and because both countries depend too much on Mercosur. Conversely, this idea derived into a US-Uruguay TIFA (Trade and Investment Framework Agreement) trying to search for investment flows. These types of agreements could damage the ability of Mercosur to survive in its present

form. This fact, could also lead to the signature of more FTA that could have a potential for better trade flows with other countries that promise then SSE with better results.

**Box 4-10. Other challenges for Mercosur to improve the SSE participation**

- Paraguay: Smuggling because borders are not controlled.
- Uruguay: Social costs due to a Customs Union that could not be consolidated, little common application of SPS/TBT that avoids easy trade flows.
- Uruguay and Paraguay: Social problems are similar in Mercosur. But the increase of economic and productive asymmetries is worsening since there is no specific integration plan for productive chains, energy or communications.
- Uruguay and Paraguay: Different governance levels inside the country that can favor integration.

Source: Adapted from Mora C., 2006.

Problems within the trade bloc make it difficult for Mercosur to integrate all South American countries (Box 4-10). To overcome the asymmetries of size and problems of trade, it is of utmost importance to keep Mercosur alive. Moreover, it is necessary to surpass the challenges that Brazil has in its economy and that could be extended to the other economies in the bloc. Problems dealing with its policy of human rights, discrimination and perhaps the worst, their policy of zero tolerance as a response to “insecurity”, and the proliferation of illegal weapons on the free market<sup>20</sup>. The bloc also has to overcome different poverty and preventable diseases that increase social instability which in turn leads to economic and political insecurity within the region but overall, that keeps smaller economies in its size problem. Furthermore, there are huge differences in productivity. Both will keep increasing the asymmetries of size and blocking trade between the members of Mercosur. Problems can turn the integration into peril, since Mercosur does not have supranational institutions to solve or avoid differends between them. This fact could endanger the existence of the bloc in the future since SSE are getting upset with the situation and constantly searching for new partnerships for trade. The fact that Paraguay and Uruguay are increasing trade flows with Asia and the European Union is an example of their eagerness to reduce dependency on the Mercosur. The same is happening with Bolivia, who is also trying to increase trade relationships with Venezuela in search of a reduction in the dependency with the Mercosur or Brazil in the sector of hydrocarbon.

Mercosur though, has a constant strategy to adapt rather quickly to new market conditions to meet the main needs of Brazil (especially). First, Mercosur means around 80 % of South

<sup>20</sup> AMNISTIA INTERNACIONAL, 2003. “Paraguay: Reunión Cumbre de MERCOSUR: Una agenda social se hace realidad con la plena vigencia de los derechos humanos”. No 142, from June 16<sup>th</sup>, 2003.

America's GDP and wants to become one of the hemisphere's largest global suppliers of oil, and particularly, natural gas. This is why Mercosur is very interested in having Venezuela and Bolivia as full members<sup>21</sup> of the bloc. Brazil and Argentina want to assure oil and gas provision for their constant growing industries and of course, to assure their development. The proposal of Brazil to have natural resources for the region before thinking in countries outside turns doubtful with the idea that it is only going to benefit the giants of the region and not the small ones.

Many people, analyst and researchers (Observatorio del Mercosur, 2006) think that Bolivia and Venezuela would not have much to offer to Mercosur since their industry is almost non-existent, the same with agriculture. But manufacture and agriculture is not important for the main leader in the bloc in these two sectors, Brazil. Brazil is interested in appending the two countries with the largest reserves in crude-oil and gas of the region. Bolivia and Venezuela are that small that both do not need as much hydrocarbons as they produce. Brazil knows that both are searching for other partners than the United States in order to proceed with their independence from the hegemonic power. This is why PETROBRAS has increased the FDI towards these two countries so both can increase their production. On the other hand, the benefit for both countries to join Mercosur could weaken even more the local non-oil-based economy by opening the borders to cheap imports from largest economy as Brazil. Bolivia, is already suffering from an invasion of manufactured products from Brazil, declining national industry that is not competitive with the Brazilian industry.

Brazil wants to maintain its leadership in the region. For this to happen, their main idea to only create free trade agreements with neighboring countries in the region has to alter. The current events in the South American region have showed the importance for a leader to emerge to assist and cooperate with the development of the countries. Brazil has increased its role in the region, especially with the potential partners for its economy. In the last two years, Brazil has visited different countries and attended different meetings within the region to

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21 Mercosur did the invitation to Bolivia to become a full member of the bloc in 2006. However, as a bloc, Mercosur still has its problems and gaps and lacks a proposal for alternative integration; therefore, Bolivia did not accept this. It is also expecting from Mercosur huge structural changes to deal and solve the asymmetry and trade problems. Once solved this, Bolivia wants to be the bond between the integration of ANCOM with Mercosur. Further details in Americas Program, URL: <http://americas.irc-online.org/am/3779>, accessed on June 11th 2008.

show their concerns about the problems that the countries in the region have<sup>22</sup>. On July 17<sup>th</sup> 2008, Brazil had a meeting with Evo Morales from Bolivia to offer a donation to Bolivia of 230 millions of dollars to build a paved road of 412 Km. starting in La Paz and crossing the Amazon until reaching Riberalta (frontier with Brazil)<sup>23</sup>. Other meetings were to deal problems that the region is facing: democracy, migration, common vision for trade and common welfare for the bloc make us think that Brazil wants to reconcile his leadership in the solution of regional problems.

On the other hand, for Brazil it is important to keep signing FTA with Southern countries as India, China and South Africa. Recently, Brazil has also changed the negotiation consent to the DOHA round independently to the consents that Argentina was willing to give. These facts lead to brawls with Argentina which make it difficult to negotiate with the other members. Its main interest is to structure the largest FTA in the world whose origin is in developing countries and that grants Brazil a stronger position concerning development and trade.

With the facts presented above, it would seem that Brazil does everything in its power to have an improvement in its international insertion forgetting all the other partners and SSE economies that also seek to improve their international insertion through a plan to export to Brazil. Despite the protectionism of Brazil, we have seen that trade share of Mercosur with SSE goes beyond the expected amount, according to the gravity model. Therefore, one could conclude that Mercosur works well for them. However, if the objective is improvement of intra-trade and power of negotiation to gain more international insertion and development, there is still a lot to do. Still, there are two visible aspects to highlight. One is that SSE can also have trade attraction (between the relatively smaller towards the relatively larger) not because of proximity and similarity but because of common vision against the dependence and exclusion of LSE. Paraguay and Uruguay started to develop larger trade shares when they noticed that they were both constantly facing difficulties of trade with Brazil and Argentina. This vision forced them to provide products for each other that do not compete with their national production. Of course trade numbers are very small between SSE and this could be still improved more. The other aspect is that Paraguay and Uruguay, as SSE are

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22 Visits Meetings

23 Cumbre Morales-Lula-Chavez, in Bolivia. The main Topic was integration through roads and environment. July 17th 2008.

attracted to LSE in the bloc and practically are dependent of only them as most important trade partners. This, explained by the gravity model could be due to the close by geographical neighbor, large size of economy as well as similar development, culture, etc. This can be supported by the fact that any other SSE in the region has such rates of trade share with other LSE (developed or less developed) as with Brazil that is so close geographically.

### 4.3 ALBA-TCP

ALBA-TCP stands for Bolivarian Alternative for the Americas or in Spanish, ALBA and TCP stands for Peoples' Trade Agreement (in Spanish: Tratado de Comercio de los Pueblos, TCP). ALBA-TCP is an initiative started by Cuba's ex-President Fidel Castro, together with his close friend, Venezuela's President, Hugo Chavez. The Current member countries are; Cuba, Venezuela, Bolivia (from 2006), Nicaragua and Dominica (from 2007) and Honduras (from August 2008). Nicaragua is also a member of the Central America Free Trade Agreement (CAFTA). ALBA is more of a political, ideological and military group. ALBA-TCP does not represent a significant threat for the US in an economic sense, due to the little amount of trade that the regional bloc offers. Nonetheless, at present ALBA is considered a political threat that can turn into an economic menace for the future. Concerning trade, ALBA-TCP is not as interesting for Bolivia as it is for the neighboring countries that Venezuela and Cuba have. On the other hand, politically seems to have benefited international insertion and development. Even that, the group managed that several countries sign the agreement for its adherence faster than other regional blocs. Ideology is a base for this bloc.

Unlike other neoliberal free trade agreements in the region, ALBA-TCP represents an attempt to have a regional economic integration that is not primarily based on trade liberalization, but on a vision of social welfare, the abolishment of poverty and mutual economic aid<sup>24</sup>. From this starting point we can foresee the advantages for all the members, not necessarily for trade but to offer political measures that seek for social welfare and mutual aid for development in their national economies. The main principles of the bloc are based on solidarity and social values, and in a way, it could be compared to the basics of the European Union bloc. ALBA

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24 Bilaterals, 2008. Cuba, Venezuela use Mercosur to promote ALBA. Written by Aaron Benedek. September, 20th, 2006. Green Left Weekly, Australia

is anchored by “cooperation, solidarity and complementarity as an alternative to the neoliberal model”<sup>25</sup>. Nonetheless, the bloc is often seen as a Venezuelan and Cuban public hidden agenda, made to create a pact against the US’s FTAA who according to them, is , exploiting the countries in Latin America with the free trade agreements. This pact is public in a certain way, since the public speeches of President Chavez (Venezuela) and President Morales (Bolivia) reveal this vision at all times, promoting the idea of achieving freedom from the imperialistic government of the US and managing a regional common development. At first, the Agreement was only signed by Cuba and Venezuela (December 14, 2004). It was focused on the exchange of medical resources and petroleum at low prices between both nations. With this, by 2005, Venezuela was delivering about 96,000 barrels of oil per day at very favorable prices. Cuba in exchange sent 20,000 state-employed medical staff and thousands of teachers to Venezuela’s most poor areas. Cuba receives large amounts of subsidized oil, officially in return for medics who can work in Venezuela. With Nicaragua a trade off was made to forgive the USD 31 million debts it had with Venezuela.

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**Figure 4-3. ALBA-TCP member countries.** SSE Members are geographically close between them and Venezuela whereas Bolivia, a SSE is not that close.



Source: Adapted from Wikipedia, 2010

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ALBA-TCP had a GDP in 2006 of 2.487.381 million dollars and the combined population of all the five members of 51.530.517 million people living in an area of 2.246.894 km<sup>2</sup>. The population inside the bloc has an average of 44.52% within the working age, 49.42% of young people between 0-19 years old and 6.06% of 60 or more years old, which means that 55.48% of the population depends on the income that 44.52% produces. In the last two years (from 2006) different social programs were installed in the majority of the member countries, following an initiative put forth by Venezuela. This is oriented towards having a positive

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<sup>25</sup> Portal ALBA, 2008. Que es el ALBA. URL: <http://www.alternativabolivariana.org> , accessed on August 10, 2008.

impact on the poorest members of the population and providing them with better welfare. Unlike other regional blocs, the ALBA-TCP does not have two wings. All member countries are from a left wing position, and they literally constitute the origin of the ideology. Together, they form the alter-movement against neoliberal policies and against the hegemonic power of the United States. From this perspective, there should not be a differentiation of small size economy or large size economy. Even so, there was a rise of a dominant position, the role of Venezuela inside and outside the bloc. The petrodollars (as often is called) have played an unquestionable role in the rising of the leadership position which fights for a common development and freedom from imperialism. In this sense, Venezuela implicitly takes into account the differences of size when developing the lists of priorities and needs to be funded in each of the member countries. Social welfare, migration, energy crisis, food crisis, military support (for national and regional peace) are some of the main topics in the bloc to be assessed or funded.

ALBA is still facing a juridical-status problem in the signature of the agreement. ALBA was created and signed very quickly between the Presidents of Venezuela, Bolivia and Cuba. The Agreement deals with both deep and mundane topics in trade and social development. Some of the deep topics within ALBA comprise the total liberalization of trade between the three countries, tax compensation for companies that invest between them and investment liberalization, among others. And these points dealing with trade and investment are a threat to Bolivian legislation and to trade barriers that exist for national industry protection. Hence, the agreement was not ratified in the National Bolivian congress. The same happens with Venezuela and Cuba. These countries could not find a base in their law to turn ALBA into an international institution with juridical structure, subject to international Law.

From the legal point of view, this deficiency leaves aside three principles regarding integration: the clause of the Most Favored Nation, National Treatment and the reciprocity between its members. In relation to the last clause, we can observe that Venezuela assumes almost all the commitments in these agreements (execution and materialization of projects); besides Venezuela takes the natural obligation on the principle of good faith and on the international responsibilities<sup>26</sup>. Therefore, as a proposal for a new model of integration,

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26 Embajador Milagros Betancourt, "Otros procesos integradores en marcha en América Latina". Ponencia presentada en el seminario Modelos de Integración y Procesos Integradores en América Latina" Fundación Anela del 14 al 16 de Mayo en Valencia España



ALBA does not count on a communitarian regulation as the Directives of the Andean Presidential Council; the Declarations and Decisions of the Andean Council of Ministers of International Relations and the Decisions of the Commission. All of those norms are comprised in the legal order of the Andean System of Integration (ASI)<sup>27</sup>. Since it does not count with an institutional structure according to its objectives, it is not possible to locate it within the schemes of integration in agreements of communitarian right. To solve this problem, the governments have started a race towards the signature of bilateral ACE (Economic complementary agreement, from Spanish acronym). Bolivia-Venezuela, Bolivia-Cuba, Cuba-Venezuela, etc. in order to solve the international legal problem with the ALBA-TCP and converge with the ACE towards the legalization of the ALBA.

### A) Geo-political interest

The analysis that will be done for ALBA-TCP in this sub-section will be mostly based on the experience that the bloc went through since its creation in 2006 until 2008<sup>28</sup>. It is true that it is difficult to foresee a particular situation or a path towards ALBA with only two years of observation. However, we will still try to analyze the current international relationships that ALBA has with other countries in the world and their economic and political interactions.

**Geographical dimension.** ALBA states that the neoliberal notion to access the markets is limited to the task of enforcing measures to reduce the tariff and to eliminate the ties for trade and investment. In these terms, free trade would only benefit the rich countries which already have a superior level of industrialization and development. ALBA bases its assertions on different research studies that demonstrate the rule of globalization, exposing regional expressions that have ruined the aspirations of a true endogenous development in any South American country. Therefore, ALBA proposes a real integration agreement that have to be submitted first to the objectives of the endogenous development first rather than international insertion as other type of integration. This makes the bloc interesting to join for the SSE because it has new concepts for integration focusing first in national development rather than

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<sup>27</sup> The Andean System of Integration (ASI) is the set of organs and institutions of the Andean Community (ANCOM) that aims to deepen integration and to promote its international insertion.

<sup>28</sup> Unctad Statistics 2007 are only available until 2006. Other sources for statistics were necessary for the analysis. The disadvantage of this is to not have a standard source of the statistics since each country has its own published results.

internationalization of the economy. This would mean that the SSE has to develop internally first in order to be prepared for insertion into the global economy later. Many failures of international insertion are proven to be based on a weakness of the national structure; thus, the national development that ALBA-TCP promotes would help the country to reach a healthy national economy first, rather than improving its production for external markets. Venezuela took the role of the leader in the bloc and seems to have the intention to take the regional leadership responsibility by implementing its own ideas of imperialism, development and international insertion. To reach its goal of dominating the region Venezuela has increased its participation in dialogues, forums, bilateral presidential meetings, financial aid and direct cooperation in security, social projects, etc. Its main speeches lead to reduce the domination of the US into a multi-pole domination that includes Venezuela and Brazil. However, its main objective is to dominate the entire region through its revolutionary ideas for development and South-South cooperation. Basically, the bloc is not ruled by the market power but more from an ideological power and an orientation to left wing or what is mostly known by the “socialism for the 21<sup>st</sup> century”.

**Contractual Force.** ALBA-TCP as a trade-bloc is interesting for international negotiations in two ways, both based on political interest. The first one is at a political level, as the bloc (Venezuela) can offer energy (oil) supply towards other regions and countries that could share its ideology or could be a good support for it. In counterpart, relative LSE countries like China or Russia could offer a good support on its “socialism for the 21<sup>st</sup> century” and increase weight in the balance against the imperialism of the United States. The second way is that the bloc (Venezuela) can offer to its members and to other developing countries financial assistance for their national social programs and this would help the governments to increase popularity among its population. In counterpart, these countries can offer support to the rise of a new dominant in the region: Venezuela. The rise of Venezuela means a counterbalance not only against the imperialism of the U.S. but against an increasing dominance of Brazil in South America by changing the ideology towards the anti-imperialism a change of partnership (opposing to U.S.: Iran, North Korea, China, Russia, Vietnam), the implementation of a new ideology, other type of education, media and structure of government into a more centralized one. The creation of strategic alliances for Venezuela in the areas of economics, politics, technology and military represent a new type of cooperation and a new opportunity for the construction of new power of domination coming from south countries that before were not taken into account for the global decisions and within the

IEOs. Venezuela wants to push the decline of the US as a dominant in Latin American and the rest of the world. Venezuela wants to open up its opportunity for leadership in Latin America and this requires international conflict and the support of countries that are directly opposing to the ideology of the US since this is the only way to reduce or eliminate the uni-pole dominant power of the US and open revendication of the needs and own ideology in the region.

ALBA-TCP was created by SSE at the head of Venezuela, who nowadays have the chance of the high oil prices. With this position, Venezuela is giving the SSE the chance to develop internally first, by financing their development projects. In the V Summit of ALBA<sup>29</sup>, for example, around 5,870 million dollars were announced to be spent by Venezuela in the following order: 250; Bolivia: 241; Cuba: 1.300; Haiti; 318, and Nicaragua: 3.767. The amounts above do not take in consideration the sales of oil with discount or within preferential conditions to these communities<sup>30</sup> or the financing of non government organizations that support Venezuela's ideology. ALBA "is a proposal of different integration for a real integration"<sup>31</sup> in Latin America as the President of Venezuela says continuously. However, Venezuela's dependence on oil prices in particular on oil sales to the United States (its main trading partner) explains why Venezuela would not cut supplies to this country despite its radical speeches. According to the Economist (2008) this calculation was also made in the United States that got immune to the rhetoric of Venezuela against the US. A policy of supplying cheap oil or virtually free to allies has kept most of Venezuela's neighbors happy with the new populist model of "socialism for the 21<sup>st</sup> century" but it has also tied Venezuela more closely to the United States' market since it is the only one that pays. With its petro-dollars, Venezuela could continue its policy of domination in the SSE interfering constantly in the SSE affairs with the excuse to give support and help in its development.

Venezuela gained power in the region thanks to its oil. Because of the high demand for oil and its high prices, Venezuela could finance an anti-American bloc in the region. Moreover, President Chavez managed to initiate oil investments and social projects as part of his great

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29 Ministerio del Poder Popular para la Comunicación y la información V Cumbre de la Alternativa Bolivariana para los Pueblos de Nuestra América (ALBA) Tintorero Venezuela 29 de abril de 2007.

30 Venezuela has a policy of supplying cheap oil and gas oil to all ALBA countries as well as to England, United States and African continent with the objective to benefit the poor societies within those countries.

31 ALBA web: <http://www.alternativabolivariana.org>.

oil-revenue in member countries, encouraging the increase of control in oil, financial assistance and investments in the region. This is why; the income of the bloc (mostly of petrodollars and mostly from Venezuela) is used to subsidize all kinds of social projects that can assist the government development plans (infrastructure and social aid). Oil is therefore involved in almost the entire social sphere of the economy. Sometimes, oil is that much involved in social development that it goes beyond the interest for preserving and increasing the production quota in hydrocarbons, as in the case of Venezuela with PDVSA (The Economist print edition, 2008) and what is a constant threat in Bolivia (Los Tiempos, 2008). Besides, on a national level the oil is also used as a political instrument to help increase their power in international negotiation arenas. The challenge now is to keep this position when the price of oil goes down. For now, Venezuela is increasing its capital in PDVSA with Brazilian, Chinese and Indian joint ventures to be able to increase investments in the exploration, exploitation and industrialization of oil and gas in SSE and the region. The problems that PDVSA and Chavez are facing are that SSE cannot develop in the expected speed due to corruption and lack of governance.

For all these reasons, the creation of ALBA-TCP proves to be a very interesting regional bloc, especially for the SSE. The increase of power for international negotiations to SSE puts them in a stronger position prioritizing their national needs rather than focusing on internationalizing their economies. Venezuela, the largest economy of the bloc constantly negotiates with the same vision and keeps in mind the interest of all the members. On the political side, then, SSE are well represented by a relatively large economy that shares the same vision and needs and promotes the same model without the domination of the US in their economies. More, Venezuela plays the role of a leader worried for providing the basic needs to its members as for energy sources (oil and gasoil) and financial resources to head for their social and infrastructure projects. Venezuela wants to replace the domination of the US and a potential leadership of Brazil for the one of Venezuela. Taking advantage of the petrodollars as a source for the development of an alternative domination, Venezuela would like to become a regional dominator and spread around neighbors its vision for a new model of integration and development. Polarization of the region became possible as second best option or as the US can be blamed for the little development and increase of poverty the region had in the last years and Brazil can be observed as a country that does not interfere in the main issues of the region. Venezuela then could be taking the only role of leader as the first best option. As the European Union, Venezuela wants to gain domination by a deep

integration (political and ideological), to be able to improve their development together. Chavez has the vision towards a regional unification against imperialism and the IEOs and ALBA-TCP is a good option.

**Nature of Activities.** It is very difficult to talk about intra-trade in ALBA-TCP and the participation of SSE in this type of integration, since it has a short time of existence. Bolivia for example, has less than 5% of its total exports and barely 1% of its total imports coming from Venezuela, the largest partner; and almost no trade with the other members (Unctad Statistics, 2010) as will be presented in the economic performance. With this result, it could be thought that ALBA-TCP is not interesting option from the economic side for Bolivia. Actually, Bolivia did not improve its agricultural exports to Venezuela due to the SPS and TBT barriers<sup>32</sup> that Venezuela has with the signature of ALBA-TCP. On the other hand, the political interest is very important for the strengthening of the SSE face to national development and to international insertion. The bloc has different proposals for the members that join (which in majority are SSE from South America and Central America). The first one and maybe the most important is the goal to achieve independence from the imperialism of the United States or the European Union so they can have sovereignty to decide their national management. The second one is to present an alternative to FTAA having a regional integration that is based in complementary, cooperation and solidarity between members. The third principle is to have a regional bloc that starts replacing the IEOs like the IMF, WB and the ICSID. The interest of the bloc is to stop receiving standardized suggestions for the development in Latin America that were ruining the national economies aligned with the benefit for rich countries. This is maybe the reason why the bloc at the head of Venezuela pushed forward to the signature of military agreement in order to maintain peace at national and regional level, created the South Bank for pursuing their own development projects and the constant call for meetings to analyze and negotiate the solution of conflicts in particular member countries or neighboring countries. This somehow, fosters social movements to get rid of the US military base<sup>33</sup> in different countries installed in the past (Condori, 2008).

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32 Agricultural exports were not successful in Venezuela due to the SPS/TBT norms. Nonetheless, gasoil imports at low price were increased due to the lack of productivity in the national industry in Bolivia and problems for a fast adaptation to the increased demand in the national market.

33 El Deber, 2008. "Personal de Usaid se va de Chapare". June, 26, 2008. Santa Cruz de la Sierra.

La Republica, 2008. "La gran pulseada en Bolivia". Written by Niko Schvarz. Year 9, No 3008. August, 24, 2008. Montevideo.

ALBA-TCP wants to achieve the 'new socialism for the 21<sup>st</sup> century' which is the complete opposite of the imperialist system of the US and the neoliberal model. This stand guided the bloc towards political-economic and military cooperation between the members, moving aside from the multilateral IEOs. To achieve the proposed objectives, the bloc aims to common welfare have carried the leader of the bloc (Venezuela) to fund of social projects and development. Unfortunately, the source for their social projects depends highly in the generosity of the petrodollars and the high international prices for oil at present which increases sensitiveness to the international markets' demand. Since Venezuela receives the majority of its payments from the US market, this made Venezuela more tied to the United States, almost the only one that pays with its policy of supplying cheap or virtually free. Therefore, for the SSE is easier at the moment to leave the domination ties of the US aid and cooperation for the ones of Venezuela. On the contrary, for Venezuela, it is almost impossible to leave its US ties since it is an important source of money that Chavez can use for his socialist project on the SSE. Trade though will not be that easy to replace (US for Venezuela) since the closest neighbors (Colombia, Cuba) sell agricultural products to Venezuela cheaper than the allies that are geographically distant (as Bolivia). More, the domination that US have still in the Venezuelan society keeps strong consumption preferences towards the US imported products rather than regional products.

While the ALBA itself has not yet become a hemispheric-wide trade agreement, the five members of it have also signed the adherence to the Peoples' Trade Agreement (Spanish: "Tratado de Comercio de los Pueblos" - TCP) which aims to implement trade between the small producers from those four nations. At this moment the main driver for ALBA-TCP is the large gas and oil reserves in Venezuela and Bolivia and not the agricultural products. These reserves are increasing the amount of money that the leader of the bloc can move towards neighboring countries or other countries that need aid. The decrease of primary sector in Venezuela and the increased demand for primary production has taken Chavez to exchange oil for agricultural products. This motivates and increased international relations within members and potential adherents, sympathizers that were assisted in the last years by Venezuela. This new policy of exchange for co-operative advantages has reduced the social unrest in Venezuela for the scarcity of primary products though; it could not prevent the mount of inflation during 2007-2008 because it turned more sensible to international prices.

The President of Venezuela has been traveling to different countries to not only offer funding for social projects or infrastructure projects but also to spread his idea of a new type of socialism for the 21<sup>st</sup> century, trying to convince the public of how dangerous it is to depend on the imperialism of the US, and behind this rhetoric, he has certainly gained support from different countries. To start with their project of independence from the US domination and its IEOs that only benefit the great powers, ALBA has approved the creation of the ALBA Bank which started with an authorized capital of 2000 million dollars and a subscribed capital of 1000 million. This Bank has the objective to finance the projects of its members without having to depend on multilateral organizations as the World Bank or the IMF. The advantage of having its own bank gives the bloc power to decide its own development and from its own needs at an affordable price. Another advantage of having its own bank is that the board of members can decide priorities based on its own needs without any sort of conditions coming from IEOs. This would gradually eliminate their association to the IEOs and the Washington Consensus for a regional consensus based on its real requirements. During years, the IMF and WB have granted with loans for development under certain conditions these countries were forced to adopt policies even more committed to deregulation and withdrawal of government from insuring public welfare (Eurodad Report, 2006). Washington Consensus was the main flag of protest from Venezuela against the domination of US and the IEOs within their economies because of the social failure, unsustainable development and enormous gap between few rich and lots of poor people.

Hugo Chavez has enough power to influence Bolivia in the development of international policies regarding the IEOs or the building up of sovereignty.

**Role and responsibility of the leader.** The rise in leadership of Venezuela inside the bloc and the region has increased the other country's dependence on oil and financial assistance from Venezuela. This fact has strengthened the dominant position of Venezuela in the region increasing its potential for imposing its ideology, media, foreign investment, military support, etc. So much was the influence of Venezuela that some SSE announced their intention to resign their membership to some IEOs (e.g. Bolivia abandoned the ICSID in 2006; some member countries threatened to not recognize the role of the OAS if the Presidency would not go to a Latin; and Venezuela threatened in May 2007 to abandon the IMF and World Bank) because none of the IEOs benefited the SSE. Nonetheless, Venezuela did not abandon any IEO since it is not convenient for this nation to be isolated from world economy now that

it is trying to increase its leadership role in the region. Venezuela is pushing the functioning of the bloc to prove its leadership and impose its ideology. To consolidate its power, the work of Venezuela in the region is enormous, since the major enemies of its dominant power are poverty and high inequality and a rampant opposition. Therefore, the increased influence of Venezuela over member countries is going to be counterbalanced by the “reduced” influence of the US in these countries. The potential for a minor mistake of Venezuela could again lead to a US re-intervention or to a larger move from Brazil to consolidate its leadership. This is why future conflicts in the region for domination are still to come.

Still, the role of Venezuela has increased in member countries. President Chavez has not only long-term investments in social projects, infrastructure and oil projects but also partly took over the participation of the US in Bolivia for fighting against drug trafficking and managed to insert Venezuelan troops in Bolivia for its national security. Venezuela also turned into a lender in last resort to assist social development in a time when SSE governments have social unrest and turmoil due to lack of public investment until then. Besides, Venezuela is assuming the role of a leader when it comes to suggest common policies for the region as the creation of the Bank of South to stop dependency from the IMF and to increase South-South cooperation for social projects for example. It also has increased its role for demanding a reform of the IMF and the WB at the side of other developing countries like India, Argentina, Brazil, China and Egypt<sup>34</sup>. Venezuela has taken the role to fight against analphabetism in different member countries, one beneficiary is Bolivia that this past December 20<sup>th</sup>, 2008 has declared Bolivia free of analphabetism, next country will be Paraguay.

With the objective to become a regional leader, Chavez intervenes in every regional problem even before Brazil does. Strong tactics from Venezuela in different regional conflicts have even moved Brazil, the mediator, out of the way. Despite his fast interventions, Venezuela's leader has significant civilian opposition in the different neighboring countries who will constantly try to pin mistakes on the model of socialism for the 21<sup>st</sup> century to go back to the domination of the US or the neoliberal model. However, excessive implications on national politics of the SSE as Bolivia or Ecuador left aside their right of sovereignty, accepting direct interventions from President Chavez. Next, the rhetoric that President Chavez uses gets more and more aggressive not only to the United States but also to other neighboring countries that

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<sup>34</sup> EFECOM, 2007. “Un director ejecutivo del FMI duda de que Venezuela abandone el organismo”, *El Economista*, Vol 55, June 30th, 2007.



do not share his point of view. Bolivia, as other SSE face great difficulties to integrate larger international markets due to SPS/TBT barriers and in agriculture, this did not change much with ALBA-TCP. Venezuela and Bolivia as well as the other member countries have a similar productive structure for which they are direct competitors. On the contrary, oil has showed to have no trade barriers due to the constant need for this kind of fuel. For most countries around the world, oil and natural gas are considered strategic assets for development<sup>35</sup>. The geopolitical importance of oil has been viewed as an important asset that draws new members into ALBA-TCP and sympathizers to join the vision. Venezuela, Bolivia and Ecuador (in the case that joins) are seen as important players within the entire region (see table 4-11) considering the hydrocarbon reserves' these three countries have. Important not only because their consumption is little compared to the production they have but important because these countries export most of its production. This fact creates a new configuration of the geopolitical structure in South American due to the power of hydrocarbons (energy). Energy raises two dilemmas in the ALBA-TCP. The first one is if Venezuela should keep helping is neighbors with reduced oil prices to push its ideology of social expenditure and

**Table 4-11. Oil and Gas Reserves.** SSE have the largest amount of gas and oil proven by international investors. Venezuela has the same endowments in larger quantities. This asset has become in the last two years, an asset for strong negotiation position.

Resource	Source	Date	Measure	Venezuela	Bolivia	Ecuador
OIL	BP Statistical Review	Dec-05	BB	79.729	No data	5.060
	Oil & Gas Journal	Jan-07	BB	80.012	0.440	4.517
	World Oil	Dec-05	BB	52.650	0.456	5.145
GAS	BP Statistical Review	Dec-05	TCF	152.320	26.122	No data
	CEDIGAZ	6-Jan	TCF	152.384	26.133	3.178
	Oil & Gas Journal	7-Jan	TCF	152.380	24.000	0.000
	World Oil	Dec-05	TCF	150.890	26.700	0.350

Source: Energy Information Administration – US Government, 2010.

Notes: 1) BP p.l.c., BP Statistical Review of World Energy June 2006, except the United States. Oil includes crude oil, gas condensate, and natural gas liquids; 2) PennWell Corporation, Oil & Gas Journal, Vol. 104.47 (December 18, 2006). Oil includes crude oil and condensate; 3) Gulf Publishing Company, World Oil, Vol. 227, No.9 (September 2006), except United States. Oil includes crude oil and condensate but excludes natural gas liquids; 4) Centre International d'Information sur le Gaz Naturel et tous Hydrocarbures Gazeux (CEDIGAZ), Natural Gas in the World, End of July 2006.

Gas and oil turned into a crucial resource for the Mercosur largest members since they need to keep booting their economies. There is a great pressure for this.

35 For South America (Brazil and Argentina especially), oil and gas turned to be assets to push development of its national industries and national consumption. The reduction of its quantity provided, is already a worrisome factor to keep their growth at good speed. To confirm this, several meetings have been done between Brazil and Argentina with Venezuela and Bolivia to assure higher provision of oil and gas.

national development or should it start charging reducing social investments to push the oil industry into a more efficient path of industrialization. Until now, PDVSA was playing the role of a parallel government that constantly was financially assisting Venezuelan social projects in Venezuela and the region reducing its capacity of re-investment to increase production.

ALBA-TCP has some weaknesses as a bloc that also involves a political foundation. One flaw of the bloc is that the main objectives are submitted to political interest rather than economic interest. This could unknot three problems. The first one is that ALBA-TCP is seen by other countries in the region not as a bloc to foster trade but as a political, ideological and military bloc; it even goes against WTO regulations despite the fact that the current members are also members of the WTO. The second aspect is that ALBA-TCP promotes protectionism and an increased participation of the government, reducing the power of supranational rules from the neoliberal IEOs<sup>36</sup>. It also reduces the open-market as part of the multinational agreements that these SSE signed in 1995 at the WTO. The third weakness is that Venezuela's political power inside the bloc originates in the "petrodollars". Other members depend on this financial assistance to reduce their reliance on the US. Socialism for the 21<sup>st</sup> century seems to attract several governments towards this political wing (Ester, 2006), but this is not enough to persuade these countries to join the bloc or follow the same vision or ideology. Despite the fact that not many countries could ever fully agree with the project of the president Chavez, different countries have submitted to its influence as a result of the great needs for funding that countries as Bolivia, Ecuador, Argentina and even Brazil have (Box 4-12). Nonetheless, only a few countries form the total group that is financially assisted by Venezuela joined ALBA. Still, socialism has showed to be stronger in the region nowadays compared to past attempts in Cuba and Russia. The main difference with socialism in the past is that now socialism can draw upon petrodollars to aid their political movement and to gain enough support from the countries in the region. SSE especially are delighted by the funding propositions that Venezuela does to them avoiding any condition for its aid<sup>37</sup> as the US or the IMF did. This unconditioned aid has promoted and increased cooperation between Venezuela and different SSE in the region.

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36 El Herald, 2008. Cohep rechaza el Alba por ser un convenio político y militar. Written by Iván Vázquez. Aug, 22, 2008. Honduras.

37 Nación, 2008. Gobierno boliviano defiende lazos con Irán y Venezuela, y cuestiona a EEUU. Written by AFP. September, 24, 2007. Costa Rica.

**Box 4-11. Venezuela: Cooperation in South America.**

- **Argentina.** Agreements to create an investment bank for infrastructure development, as well as joint hydrocarbon exploration and development in both countries. Venezuela has also purchased \$3.5 billion in bonds to help pay off Argentina's debt.
- **Brazil.** In May 2008, Petrobras and PDVSA signed an agreement to build an oil refinery in northeastern Brazil, which is anticipated to require \$4.05 billion in investment. Petrobras will hold 60 percent of the refinery's shares. Crude oil will be supplied by both countries to refine a projected 200,000 barrels per day.
- **Colombia.** A natural gas pipeline was opened. It links northern Colombia's La Guajira gas fields to the Paraguana refining complex in western Venezuela. Tensions between the two countries have heightened; nonetheless, since a March 2008 standoff in which Chavez sent troops to the Colombian border and temporarily severed diplomatic ties.
- **Bolivia.** Agreements in January and May 2006 for Venezuela to supply preferentially priced gasoil and invest \$1.5 billion in the Bolivian oil and gas sector in exchange for Bolivian goods and services, according to Oxford Analytica.
- **Ecuador.** Agreement to collaborate on an oil refinery in Ecuador estimated to cost \$5.5 billion, February 2008. Under agreements signed in May 2006, Venezuela is expected to refine up to 100,000 barrels of Ecuadorean crude oil per day at discount prices.
- **Cuba.** Commerce between Venezuela and Cuba soared to \$7 billion in 2007, according to the Cuban government (in 2006, trade was \$1.7 billion). Venezuela is selling up to 100,000 barrels of oil per day to Cuba, discounted by as much as 40 percent. In exchange, thousands of Venezuelans have traveled to Cuba for medical treatment, and Cuban doctors help administer health care programs for low-income Venezuelans.

Source: text extracted from "Venezuela's Oil-Based Economy", authors: Cesar J. Alvarez and Stephanie Hanson, News Editor. Council on Foreign Relations. June 27, 2008.

A second weakness is that geopolitically, Venezuela would like to open up the path for a multi-pole power in the region until Venezuela consolidates its power and can counterbalance better without the US and Brazil. Venezuela however, could have only a temporary power for domination, this power is based in its petrodollars that are sensitive to both international prices and partners that effectively pay for the good. In the case of Venezuela, only US pays for its oil, other countries, for example the SSE receives the oil at favorable prices and pay against agricultural production or other goods. SSE depend on Venezuela because of its financial aid that could let them leave behind the dependence towards the US. Nonetheless, if this assistance would be no longer available, it would be difficult to keep Venezuelan domination in these countries. In the race to gain power and spread its dominant will, Venezuela has been making several trips to different South American countries and other countries that could share the same ideology with Venezuela and grant them their support. Nations like Iran, China or Russia<sup>38</sup> could find themselves in need of financial fund their increased demand for military weapons and war material. The increasing petrodollar income launched Venezuela as a leader between the SSE in the region. Available money provided by

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38 List of countries where Venezuela has been in the last years:

Chavez with a political springboard was positive for the countries that could benefit from it. For the SSE, Venezuela is a good ally. On the other hand, Venezuela is a strong leader that compete the leadership against Brazil; therefore, Brazil also had to increase its participation within the region. Venezuela gave dynamism in the assistance and integration of the region while Brazil was long looking for its own interests. Brazil cannot compete with the petrodollars that Venezuela has to give away around the SSE in the region; however, Brazil is participating more and more in different meetings of the countries in the region assuming also a more active and wiser leader role.

All the same, the third weakness of the bloc is that petrodollars are based on oil prices which are susceptible to a decline in the international market. Venezuela has focused so much on its new role of leader in the region (political position) that it has left aside a good economic plan to increase national production and oil-investments. PDVSA has turned into a bank or a “parallel state” as the Elie Habalian, a former Venezuelan governor of the Organization of Petroleum Exporting Countries (OPEC), calls PDVSA for its social projects and plans<sup>39</sup>. Oil represents hope for the SSE who count on the cooperation of Hugo Chavez for their national social projects. Nevertheless, if PDVSA is running short on cash, this could not only endanger the future production of PDVSA but could also jeopardize the budget set aside for social projects. The political side of ALBA-TCP might not be sufficient over the economic interest that most of the SSE have at this phase of integration. Most of the SSE seem to be more interested in the financial aid that Venezuela is providing them to improve their national economies as this represents social serenity. As President Lula from Brazil said<sup>40</sup>, in South America we are not in the urgent need for a leader at the moment, what the continent needs is political harmony and to take advantage of the opportunity for development that should not be lost to get out of poverty. This idea of economic development is constantly bearing in mind from SSE main policies to keep social movements calm.

With the financial aid of Venezuela, several SSE are obeying the switch of international insertion. SSE, as Bolivia are acting in accordance with all the suggested international

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39 The Economist print edition, 2008. Exxon's wrathful tiger takes on Hugo Chávez. The Americas – Oil in Venezuela, Feb 14th 2008, Caracas.

40 President Lula gave a speech at his arrival back from Europe, where he promoted his interest for ethanol from sugar cane in Brazil. Lula got several promises in Europe to get billions of dollars for investment. Lula now is more concentrated in the development of its economy. Article written by Alexei Barrionuevo under the title “A Resilient Leader Trumpets Brazil’s Potential in Agriculture and Biofuels”. September, 23, 2007. New York.

policies by Venezuela, and three years after, the Bolivian population is noticing the effects of it. The first effect is the loss of trade markets due to political moves and a noticeable orientation towards the extreme left wing. This made some governments reject the idea of investing in Bolivia due to political and social instability. The increasing risk of nationalization forced some governments to reduce their investments to the minimum required in order to stay in Bolivia (e.g. Brazil with Petrobras) The second effect is that the Bolivian government is promoting its national provision before exports. This does not bring economic benefits for large agricultural producers that feel the effect of national protectionism against the export of agricultural products that do not have a national fare price. This measure has reduced the agricultural production from 2007 to 2008 and it is thought to be smaller in 2009. Then, in 2008, agriculture suffered a shortage of provision for both the national and international markets. The third effect is that the government is strongly promoting the plan to focus on exporting natural resources as a part of the strategic goods of Bolivia. This is increasing the risk of national development and international insertion. Venezuela suggested leaving imperialistic economies as the US and EU by replacing them with neighboring countries that could absorb its exports. However, Venezuela and Brazil did not really buy anything to absorb the goods that were destined to the U.S. and E.U.

The United Nations reported in response to Hugo Chavez's Bolivarian Revolution in Venezuela, that 'the left wing theory of creating parallel powers to break down and end the old order is here taken to new breathtaking heights'<sup>41</sup>. This is certainly applicable to the parallelization of ALBA of financial assistance in the attempt to replace the neoliberal dominant leader. There are several examples as the planning of creating an OPEC-style enterprise called Petroamerica in Latin America now consists of Petrosur, Petrocaribe, Petroandina in an effort to replace multinational companies with state oil companies such as PDVSA, Petrobras and Bolivia's YPFB. Other incentives such as the Latin American Parliament (to replace the Organization of American States) the Food Security Fund, the Banco del Sur (in place of the IMF and World Bank) and the latest development proposed in the ALBA Summit; a Monetary Union with the 'Sucre' as its currency unit in order to reduce the influence of the U.S. dollar. So far though, all is in planning phase.

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<sup>41</sup> United Nations, 2006. Report on Development Program Study on Latin American Democracies. New York

ALBA-TCP showed that geopolitics is important in the region. Different SSE countries joined President Chavez in its radical view due to the power he has for funding several development and social projects. Social movements in the SSE have a strong back up for Venezuela because of the hope of welfare that Venezuela and their government promised them. Poor people is not willing to keep waiting for improving their quality of life; and this fact renders democracy in a weak line since they can dethrone the government that does not work for this. Different experiences in the SSE in South American lived this in the last year's show that social unrest in a country can break up democracy in it. The major example is Bolivia, when in 2005 to 2006, three Presidents were removed from government and other two were not even accepted to assume the Presidency (BBC, 2005; Le Monde Diplomatique, 2005)<sup>42</sup> because people was tired of the corruption tied to international relations dealing with gas and other strategic resources of the Bolivians. This example shows clearly the reason why people now support ALBA-TCP better than other type of integration. Nonetheless, ALBA-TCP has no regulation that can assist and strengthen the governments that are having social and democratic crisis. Even when the OAS is heavily criticized by Venezuela in the weakness of its organization to fully assist the SSE, the ALBA-TCP bloc neither has a mechanism to save countries from democratic crisis. In the case of Bolivia, for example, when the government was confronting a crisis for over two months (July-August 2008); Venezuela intervened just to threaten Bolivians with military intervention to keep the elected government. The same type of aggression Chavez in having with its own society fearing that he is not going to be re-elected in 2012 by announcing that if democratic elections do not work out fraud by the opposition, a military intervention will continue the change by the force. These all shows that ALBA-TCP does not follow multilateral conventions and that most of the regulations are done as far as the need urges the bloc to create them.

## **B) Geo-Economic performance**

**Nature and Empirical analysis of trade in the bloc.** ALBA shows that trade alone is not always the main pillar for creating integration. Actually, at this moment it is only active as TCP (Peoples Trade Agreement). Alba's integration relies on social reasons and regional cooperation against the imperialistic power of the US before any reason related with trade.

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<sup>42</sup> Le Monde Diplomatique, 2005. Bolivia: an Aymara for president. Written by Maurice Lemoine. November, 11, 2005. Paris.

BBC, 2005. Bolivian protesters reject offer. June 3, 2005. London.

ALBA focuses especially on people, culture and agriculture and this makes ALBA somewhat similar to the origins of the European Union, which also dealt with topics like social cohesion and free movement. The reduction of trade barriers between ALBA-TCP members is on the agenda but within a wide context of still respecting certain trade barriers and this has not increased trade between the members in sectors other than hydrocarbons. For that reason, it is a bit difficult to see ALBA-TCP as a trade bloc. Nevertheless, ALBA is having an interesting effect on integration. Although governments are working closer together on topics other than trade, it does reduce the generation of other SPS/TBT barriers and brings countries closer together for cooperation. An explanation for this can be that main demand is currently done by the governments or by State companies and the priority for intergovernmental cooperation has a bigger impact than economic interest. Besides, the agreement of cooperation is being carried out in products that countries do not compete with, but in products the market imported before from other neighbor or at higher prices and with the cooperation now they can have access to products with reduced prices or to products that come free as a compensation for another product exchanged before. This is the example of Venezuela exporting gasoil to Bolivia and in exchange gets soybean grains. The risk of a diplomatic problem closing frontiers is less and probably because of this, ALBA has not created regulations for the solution of conflicts and differends in its constitution.

**Table 4-12. ALBA-TCP: Relative Gravity Constants with other countries.** This table shows the relative gravity of ALBA-TCP of each country compared to total world trade and details it for only ALBA-TCP

	Bolivia	Venezuela	Ecuador	Peru	Paraguay	Uruguay
<b>ALBA-TCP: Relative Gravity</b>						
<b>Constants in world trade:</b>	1.06%	5.55%	1.48%	1.33%	0.90%	0.70%
<b>Relative Gravity Constants within ALBA-TCP:</b>						
Nicaragua	2.0%	9.5%	2.5%	2.5%	1.7%	1.8%
Bolivia	0.0%	11.1%	3.6%	10.1%	11.4%	9.1%
Dominica	0.1%	0.9%	0.1%	0.1%	0.1%	0.1%
Cuba	16.9%	78.5%	16.4%	18.1%	15.1%	16.3%
Venezuela	81.0%	0.0%	77.4%	69.3%	71.7%	72.7%

Source: Own elaboration based on GDP and Distances (see appendix)

To see how ALBA-TCP is affecting Bolivia's international insertion, we need to compare table 4-1 with the gravity constants that were calculated in the beginning of this chapter with table 4-12 that contains the relative gravity constants with other countries and table 4-13 that has the trade shares of Bolivia with ALBA-TCP.

**Table 4-13. Bolivia: Trade shares with ALBA-TCP (trade values in thousands USD)**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<b>Exports</b>															
Exports Index	100	92	108	112	119	125	115	116	142	192	248	358	412	590	459
Total Exports to TCP/ALBA	5,641	1,335	1,527	11,441	19,366	51,760	98,449	174,975	176,313	237,464	170,987	201,016	242,965	265,465	299,067
Share TCP/ALBA	0.48%	0.12%	0.12%	0.86%	1.38%	3.52%	7.29%	12.78%	10.53%	10.49%	5.84%	4.76%	5.00%	3.82%	5.52%
Index	100	24	27	203	343	918	1,745	3,102	3,126	4,210	3,031	3,563	4,307	4,706	5,302
<b>Imports</b>															
Imports Index	100	115	133	171	146	141	119	128	118	134	163	197	241	347	311
Total Imports from TCP/ALBA	12,300	15,106	25,541	24,793	21,774	16,164	17,966	14,729	9,132	10,575	40,417	63,204	53,867	258,958	313,258
Share TCP/ALBA	0.86%	0.92%	1.34%	1.01%	1.04%	0.80%	1.05%	0.80%	0.54%	0.55%	1.73%	2.24%	1.56%	5.20%	7.03%
Index	100	123	208	202	177	131	146	120	74	86	329	514	438	2,105	2,547
<b>Average</b>															
Index	100	104	122	144	134	134	117	123	129	160	202	270	318	457	378
Total trade with TCP/ALBA	17,941	16,441	27,068	36,234	41,140	67,924	116,415	189,704	185,445	248,039	211,404	264,220	296,832	524,423	612,325
Share TCP/ALBA	0.69%	0.60%	0.85%	0.96%	1.18%	1.94%	3.81%	5.93%	5.51%	5.93%	4.01%	3.75%	3.57%	4.40%	6.20%
Index	100	92	151	202	229	379	649	1,057	1,034	1,383	1,178	1,473	1,654	2,923	3,413

Source: Own elaboration based on ALADI, [www.aladi.org](http://www.aladi.org)

Table 4-13 shows that the exports of Bolivia to ALBA-TCP countries increased a lot in the last five years. However, one has to bear in mind that ALBA-TCP for Bolivia was not signed until April 29<sup>th</sup> 2006 so the actual increase cannot really be accounted to this treaty but natural trade and increase of markets. Besides a big part of the increase was due to exports of gas which was not only increasing in price but also increasing in production. Even so, trade with ALBA-TCP is about 6%, which is significantly above the level of 1.06% that it should be according to gravity model (table 4-12). Seeing this it might be unlikely that ALBA-TCP can go much beyond what is currently being traded. In this context it might be good actions of ALBA-TCP not focus to strengthen trade but more on the stability and social cohesion.

The idea to create ALBA-TCP was originated in Venezuela, one of the largest donors inside the group. If we check trade gravities towards Venezuela from ALBA members, we can also verify that Venezuela is the country that has more gravity attraction to the bloc and to the world. At the same time, Venezuela is more attracted towards Cuba than to other members. Nonetheless, Cuba is not a trustworthy representative in the economic side, due to the small range of its trade and its economic system. If we look at the real relative trade shares (table 2, appendix), we can see that ALBA-TCP just accounts for 2%-4% in the past years. An improvement might be possible but countries are more specialized in agriculture and this sector has an inelastic demand. Hydrocarbons have the need in the demand side; members do not have the money to pay for its provision which endangers the potential for continuity of ALBA. Moreover, if the price of hydrocarbons would go down at an international level, it would mean that Venezuela is not receiving profits and it would not be able to assist and grant with social projects to the members of ALBA-TCP.



In table 4-14 we see that the real relative trade shares are out of phase with the gravity value of table 4-12. Cuba does not account for the high level of almost 80% but barely reaches 42% in 2009, although these amounts have been very volatile in the past years. However, regarding exports Cuba does account for 90,7% in 2006 but on the imports it is varying a lot between 40% and 8%. Also Bolivia is different on exports it completely underperforms and in imports it outperforms the average at the end is much higher than the expect value trough gravity. Nevertheless, the data does confirm that Bolivia and Cuba are the most important trade partners within ALBA-TCP of Venezuela. This is also according to the gravity values.

**Table 4-14. Venezuela: Real relative trade shares with ALBA-TCP**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<b>Exports</b>															
Bolivia	6%	3%	8%	1%	1%	2%	1%	3%	1%	0%	0%	0%	1%	8%	11%
Nicaragua	13%	20%	62%	11%	85%	90%	86%	87%	16%	26%	6%	5%	1%	7%	2%
Dominica	1%	0%	1%	0%	1%	1%	2%	2%	0%	0%	0%	0%	0%	0%	7%
Cuba	80%	77%	30%	87%	13%	8%	11%	9%	83%	73%	94%	95%	97%	86%	80%
<b>Imports</b>															
Bolivia	72%	20%	15%	85%	90%	93%	92%	96%	62%	66%	79%	90%	88%	88%	54%
Nicaragua	13%	0%	0%	6%	0%	0%	1%	1%	0%	0%	1%	1%	3%	3%	5%
Dominica	1%	0%	18%	0%	0%	1%	0%	0%	0%	0%	0%	0%	1%	0%	0%
Cuba	13%	80%	68%	8%	9%	6%	7%	3%	37%	34%	20%	9%	9%	8%	40%
<b>Average</b>															
Bolivia	14%	3%	8%	4%	25%	32%	53%	55%	16%	12%	10%	12%	45%	73%	53%
Nicaragua	13%	20%	56%	11%	63%	60%	38%	39%	12%	22%	5%	4%	2%	4%	5%
Dominica	1%	0%	2%	0%	0%	1%	1%	1%	0%	0%	0%	0%	0%	0%	0%
Cuba	72%	77%	33%	85%	12%	7%	9%	5%	72%	66%	84%	83%	52%	23%	42%

Source: Own elaboration based on ALADI, [www.aladi.org](http://www.aladi.org)

Still, for Venezuela trade with ALBA-TCP has the potential to increase dramatically. This increase in trade can be launched by the increase of cooperation between ALBA-TCP members in terms of exports of oil at reduced prices and the increasing import demand for agricultural products. Cuba will have potential when it resolves its trade embargo and acquires more market freedom to increase trade with the bloc. In that case, Venezuela is the closest and best trade partner for Cuba. Bolivia is less interesting as it already enjoys a good share with imports although exports to Bolivia are really low and it is not an interesting market for Venezuela because the leader's main exports is oil and Bolivia has its own production of oil. Only in the last years (2007-2010), Bolivia has increased its demand for

gasoil as it could not manage to cover the increased demand with its national production<sup>43</sup>. Bolivia might not win much from ALBA-TCP on the trade side, but is very useful because of the increase in negotiation power and international insertion through the support of Venezuela. Venezuela does have options to win in trade with ALBA-TCP but also it can create a political domination within its members to settle his dominant power in the region. This would mean that Venezuela managed to reduce the dominating power of the US in the political and economic decisions of Latin America, and at the same time, managed to reduce Brazil's increasing power over South America by polarizing the power between the countries mentioned above.

### **C) Game theory on regionalization**

In order to have a better idea on SPS/TBT or other barriers that SSE suffer from relative LSE, we will present different case scenarios. Game theory will be applied to different problems of trade to show the position of SSE and possible ways of reaction. This analysis is important in terms of clarifying how SSE could improve their trade position and international insertion. Therefore, this part could serve as a referent for decision makers in SSE for future negotiation patterns at international level.

#### *Lobby Activity*

Bolivia has a strong lobbying position in the bloc of ALBA-TCP. This nation is an important role player in the bloc and is a fundamental piece in the search for common changes implemented in the bloc by Venezuela. Bolivia can insert its main needs in the agenda of ALBA-TCP in an easier way compared to other blocs where the needs of the SSE are not in ==][;the main agenda. The President of Bolivia, Evo Morales, has a similar vision as Hugo Chavez and then, common policies for social development in the bloc are easy to launch. Moreover, Bolivia has never experienced the potentials of having a regional leader (Venezuela) take its main social and economic needs into account. Moreover, Bolivia has

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43 Demand for gasoil in Bolivia has increased due to the increase of the number of imported cars to the country. Bolivia does not coordinate the imports of cars (quality, quantity, etc.) with the municipality to agree in the planning of the streets, roads, parking, etc., with the environmental institution, and with the production of hydrocarbons. Without a good coordinated plan for importing, the number of second hand cars increased in Bolivia in 20% which increased the national demand for hydrocarbons. Moreover, smuggle of gasoil to Peru and Brazil increased and could not be stopped. All of this has diminished the total provision of hydrocarbons for the national market, increasing the days of shortfall of hydrocarbons in all Bolivia.

only to mention its needs to launch a social project and Venezuela will fund it. ALBA then, is a potential source for development in the SSE that was not seen until now in any other regional bloc or IEO.

**Box 4-12. Chavez announces that Venezuela will sign out from World Bank and IFM**

"We are going to sign out. I want to sign the account (for exit formalization) tonight and request that they give back to us what correspond us", Chavez said during an act on May 1<sup>st</sup>, on the occasion of the Day of Workers. "We do not need to travel to Washington, neither to the IMF or the World Bank or anything of that (.). I want to formalize the exit of Venezuela from the World Bank and the International Monetary Fund" Chavez added, the day after the Summit of the DAWN in which it pleaded for an integration of the towns.

"Gentlemen of the International Monetary Fund, gentlemen of the World Bank: bye with you. Venezuela is free (.) and thanks to God, neither the Venezuelans of today nor the children to be born we have or a single cent of debt with those organisms (.) dominated by hawks north Americans", the minister said then. In declarations to the state transmitter VTV, Heads he detailed that the advance payment of a debt that won in 2012 entails a saving of eight million dollars in interests, and remembered that when in 1998 Chavez he gained elections for the first time, the country already had a debt of 3,300 million dollars with both organisms. " We close an historical cycle of indebtedness with the IMF and the VM that Perez began in 1989 ex- president Carlos Andres, when signing an agreement (.) cause of ' Caracazo' " , it said, in reference to the popular revolt in rejection the rise of the prices of gasoline demanded in exchange for the loan. "It does not need us to be traveling to Washington, neither to the Monetary Fund nor to the World Bank nor does anything (.) come to us. I want to formalize the exit of Venezuela of the World Bank, the International Monetary Fund and everything", Chavez added, the day after the Summit of the DAWN in which it pleaded for an integration of the towns. The minister said that Venezuela would continue negotiating credits" of form moderated" with the Inter-American Development Bank (I.A.D.B.) and with Andean Foment Corporation (CAF), " because they offer financing not conditioned" , but that essentially will concentrate its persistence in the fortification of the Bank of the South. Argentina, Bolivia, Ecuador and Venezuela drive that new institution of credit, on which Brazil could be added. The creation of the Bank of the South was the past decided February by 21 Chavez and the president of Argentina, Nestor Kirchner, in a visit to the oil Strip of the Venezuelan Orinoco.

Source: Journal: Cuba en Encuentro. 01/05/2007. Accessed on August 2007.

### Box 4-13. Case: Bolivian soybean Equilibrium Strategy

#### Background

Since 2005, Bolivia faces different problems in accessing the Venezuelan market. There are restrictive measures imposed by Venezuela to several national products such as soybean and its derivatives. One of the problems is the Venezuela's announcement that they plan to increase the liberalization of the market for soybean so that they can import easier and cheaper. In this case, imports of soybean from the United States are cheaper than the Bolivian due to millionaire subsidies.

The industrialists of soybean oil informed that as a result of the Venezuelan decision, Bolivian exports, that amounted to 58 million dollars in the first semester of 2005 started to decrease. Another problem that threatens the sector (since the end of 2008) is the lack of cooperation from the Government who announced in 2008 the Decree 29480 that prohibits oil exports alleging that the internal consumption is a priority because several countries in the region are going through a food crisis. With these measures the Association of Oil Producers and Wheat (Anapo) indicated that an export of 200 million dollars to six markets (Peru, Colombia, Ecuador, Venezuela, Chile and Cuba). Given the export restrictions, we are going to suppose:

The Bolivian soybean is conventional or organic to a lesser extent transgenic being this an additional advantage and higher competitively to gain other markets. Conventional or organic soybean is highly demanded in European countries that are willing to pay more for a good quality product. On the contrary, Venezuela demands cheaper soybean. This means that for the consumers, it is indifferent if soybean is transgenic or organic as far as the price is competitive. In this sense, the game will be:

- If Venezuela imports soybean from the U.S. and not from Bolivia and Bolivia does not complain, then, Venezuela gains more and Bolivia has less (0,1).
- If Venezuela imports soybean from Bolivia within ALBA-TCP and not from the U.S., Bolivia has a higher gain because of the higher prices-return that Bolivia has. Profitability for both will be in (1,0).

Analyzing other factors like: the TCP ideology, the Court of differends (TA) and supposing that both will be in favor of Bolivia for the fulfillment of the regional agreement within the framework of ALBA-TCP, in this case the game will be:

- If the TA goes against Bolivia, then Venezuela will not import and if Bolivia complains (D), then they will both engage in a conflict that will cause trade to reduce (0,0)
- If the TA goes in favor of Bolivia, then Venezuela must import from Bolivia within the ALBA-TCP agreement and if Bolivia doesn't complain about the agreement (ND), both countries can benefit from a better profit.

		Bolivia	
		D	ND
Venezuela	M from U.S.	(0,0)	(0,1)
	M from Bolivia	(1,0)	( 1,1)

#### Analysis

For Bolivia, the best strategy is to hope that Venezuela fulfills the rules of the established agreement; nevertheless, the strategy of Venezuela is to import from countries that can offer at cheaper prices for its consumers (e.g. the United States) which will difficult regional trade and diminish gains for the ALBA-TCP agreement. On the other hand, when Bolivia undertook new actions destined to defend the pre-established agreements they had the finality of validating the objective of ALBA "benefit the small producer" and to offer its producers and exporters a widening of the international market through the government assessment. It is important that Bolivia searches constantly for improving trade and searches for strategies to avoid trade barriers and low pricing. Currently there are other similar threats since the entrance of Venezuela to the Mercosur, Venezuela has been displacing imports from ANCOM and even ALBA-TCP members to import products from Brazil which is nowadays the second trade partner after the U.S. (before it was Colombia but reduced due to political confrontations in the last 3 years).

#### Box 4-14. Case: Trade Barriers in ALBA-TCP Nash equilibrium strategy

##### Background

Venezuela and Bolivia together with others (Antigua and Barbuda, Cuba, Dominica, Ecuador, Nicaragua and S. Vicente and Granadinas) signed the Peoples' Trade Agreement (TCP in Spanish) in which Venezuela and the other countries committed to the elimination of the tariffs or trade barriers. Inside the normative frame and respecting the norms of the TCP, these tariff measures are not being fulfilled by Venezuela who also has a slow bureaucracy process to authorize receiving foreign currency for imports; the other limiting factor is that there is a long procedure to get the license through the use of the "Certificate of non-production" or "insufficient production" that still are valid despite the TCP. Both factors block Bolivian exports. This proceeding covers more than thousand products in which it is indicated that Venezuela will import everything that is not produced or is produced insufficiently within its territory. This measurement can be viewed as a protectionist practice. The Bolivian exporters criticize the troublesome proceeding of currency allocation, and the licenses for non/production or insufficient production because they contradict the norms of free trade in the TCP. This should automatically add a degree of attractiveness towards the Venezuelan market for nations that want to either sell new products or to benefit from the liberation of the VAT for food products that fall within the Decree No. 5212.

The Institute of Foreign trade of Bolivia (IBCE in Spanish) states that "for Bolivia it constantly becomes more difficult to sell products with added value" to the Venezuelan market because the government only imports if they do not produce. According to IBCE, the Ministry of People's Power for Food in Venezuela imposes the "certificate of not production" as previous step for the authorization for obtaining foreign currency to import. This procedure forces the Bolivians to adapt to new proceedings before embarking their products and Venezuela this contravening with the area of free trade. Bolivia expects with these measures. We suppose that Venezuela does not raise tariff measures (NMA) or in the opposite case it decides to raise tariff measures (SMA). At the moment, Bolivia does not place any type of restriction to Venezuelan products but it can take legal actions in the Court of TCP (D) so that the agreement is fulfilled.

- If Venezuela decides for (NMA), then Bolivia can take legal actions against Venezuela (D) in defense of its economy and they will face a disadvantage since trade will fall. The profit will be low in (0,0).
- If Venezuela chooses (NMA) and Bolivia does not take legal actions at first (NoD), Venezuela has a greater advantage, because Bolivia does not apply any restriction to Venezuelan products. The gains will be in (NMA, NoD) or (1,0).
- If Venezuela chooses (SMA), then Bolivia will not demand to Venezuela (NoD), and both will have a higher advantage in (SMA, NoD) or (1,1).
- A situation that will most likely not take place is has to do with Venezuela deciding on (SMA) and Bolivia demanding Venezuela (D); thus, Venezuela has a smaller advantage in (SMA, D) or (0,1).

		Venezuela	
		NMA	SMA
Bolivia	D	(0,0)	(0,1)
	NoD	(1,0)	(1,1)

##### Analysis:

We see that the best strategy for Venezuela that will lead them to obtain major profit is to have tariff barriers for Bolivia, being that trade will not diminish trade between both. On the other hand, if Venezuela keeps applying restrictive measures or trade barriers like the previous-licenses, Bolivia will not obtain trade gains and TCP will be just a signature that overestimated harmonization, consensus, dialogue, free trade and power to the small producer; incompatible with internationalization and development through trade. Bolivia can turn back then towards traditional FTAs.

*Strategic pay-off within the trade-bloc*

Bolivia has seen the different possible advantages of joining the ALBA-TCP group. These are based on a political benefit that leads to an economic gain rather than just economic benefit alone as it is the case with other regional blocs. Not economic alone because, in the history of Bolivia, Cuba and Venezuela have not traded with Bolivia. While trade of gasoil and gas has increased in the last years; trade in other sectors has not changed much yet. Several explanations can clear up this fact. First point is due to the geographical distance between the countries. For Venezuela, it is easier and cheaper to trade with Colombia; for Cuba it is more beneficial to trade with Venezuela; because they are relatively close geographically. The second reason has to do with the different cultures and income differentiation between the countries. Cuba, Venezuela and the other two members have different habits of consumption and prefer to trade with neighboring countries than with a distant one as the SSE Bolivia. In fact, Cuba and Bolivia have never traded; the numbers that are shown in the statistics of trade between them both is so small that is only the register of clothes and other small goods that Bolivian families send to their family following studies in Cuba. To increase the potential of trade and the trade-off the bloc, the member countries have launched themselves into the signature of bilateral ACE.

Conversely, Bolivia as a SSE benefits politically from ALBA. ALBA has an open agenda for the social-economic development of its members, mostly done by Venezuela. Bolivia does not benefit with oil as the other members but benefits greatly from the financial aid that Venezuelan petrodollars brings to its economy. This is why a political objective could also be regarded as an economic objective. Trade has not been fruitful yet but is full of promises in the TCP agreement. For example, Venezuela has promised in 2006 that if Bolivia was going to lose the Colombian market for oil and soybean due to the FTA Colombia-US, Venezuela was going to buy out the entire Bolivian soybean. Then, the political agreement with ALBA aided Bolivia in not losing a soybean market. Notwithstanding the fact that Venezuela would buy the soybean out, it still demanded different SPS requirements which kept on stand still status in frontiers for several weeks. The fact that ALBA-TCP promotes the selling products that have satisfied the basic needs of the population at national level and then orientate them to international market is a major change in the internationalization policy that the Washington Consensus has promoted until now. Another point to distinguish from this policy is that the country has to analyze what are the products of strategic development and use them to ameliorate its national economy. This entitles the government to keep under the

government administration those resources that will be the base of endogenous development as is the case of hydrocarbons.

Concerning hydrocarbons and energy, ALBA takes as main part of its structure. The bloc knows how important hydrocarbons are for neighboring and main trade partners and how difficult is to leave hydrocarbons by other green source in the short term. Therefore, Venezuela as the main leader is having a profound influence on the ever growing prices. This power has lead Venezuela to include SSE interest as main part of the ALBA-TCP agenda in its pursue to be a good alternative against FTAA and the hegemonic power of the US and IEOs. IEOs left no space for each country to implement its policies of national sovereignty on its own. Besides, these organizations behaved pro-large countries leaving behind the interest and the need of the small economies. The including of the needs of the SSE to develop the national economy first than internationalizing the country is important for a SSE full of social and economic problems. Even so, ALBA does not have a normative related with sovereignty between its members and the existence of supranational communitarian organs, like fundamental components of all processes of integration, which can have a negative pay-off for a SSE. ALBA neither has a rule for the solution of controversies between members in the case any conflict would rise up. These lasts two points are the main weakness of the bloc since there is a high dominance of the Venezuelan government. Its dominant position is not based in rights and obligations and relies pretty much in the opportunity for President Chavez to cooperate to a friendship club where not much is regulated. In fact, most of the obligations and cooperation relies in practice much more in Venezuela than in other countries. This could leave its SSE members with nothing in the case Venezuela has a conflict with one of them.

SSE from the bloc can benefit from the “co-operative advantages” between its members instead of the alleged “comparative advantages” which are based in the neoliberal theory of the international economics. ALBA does not promote the ‘international export orientation’ unless the exported goods are of national interest for the improving of the country’s welfare. Since the bloc is based in the co-operative advantages, this intends to reduce asymmetries between the SSE members and the LSE member as Venezuela is. Venezuela assumes the leader position that is willing to include the basic needs for the SSE in the agenda and this is a great pay-off for the SSE member countries.

## **A) ALBA-TCP conclusion**

### **The impact of regionalization on the SSE is:**

- We see a strong increase of intra-trade that goes beyond the theoretical trade gravity. It is unlikely that this is due to the TCP-ALBA treaty because the increase was already occurring before the treaty became effective. Probably natural trade development and the already improved political relations are on the base of this. Also the energy need and the provision of this within the members could have influenced this number.
- ALBA-TCP could become a tool to increase political power in the world of SSE.
- For TCP-ALBA Venezuela is the key country, which seems to take most of the advantage of the trade-block.

The values of ALBA-TCP probably sound very interesting to most SSE and their aspirations for social improvement in their countries. ALBA-TCP presents a new idea for integration based first on national development (endogenous development), a new type of cooperation South-South, and a new conception of development and international insertion. To achieve these goals, Venezuela fosters an integration South-South in the region, a new type of cooperation between countries with the same level of development but that have different sizes. Since the concept of size creates comparative advantages in the countries in the region, Venezuela is taking advantage to link these countries and create a cooperation agreement between them. The main idea is to create cooperation not competition.

Due to the dominant influence of the US, Latin America has often focused on the liberalization of the market for trade and foreign investment. Nonetheless, in this race, countries have competed one against the other in order to manage a better international insertion which apparently leads to a better development. After several years of the application of the Washington consensus, countries have found themselves contesting to their neighbors. LSE and SSE confronted often for trade partners, quality and prices in the same sectors. LSE value a comparative advantage in its productive structure over SSE and this leads to a greater disparity in development. This competition not only increased the gap of development between them but also increased the social inequality inside each country.



With the idea to change this trend, Venezuela created some conflicts in the region so that the influence and domination of the US would reduce. Venezuela took advantage of the rising economy of oil and used the money for cooperation destined for the SSE. Bolivia and Ecuador were two of the beneficiaries who could increase social investment in their countries. Investments were so large in different countries that Brazil had to start looking at its neighboring countries and assume its role of leadership so as not to lose ground against Venezuela. At the same time, President Chavez started to push his ideology forward by promoting a new type of internationalization and development. This consisted on focusing first the national market and national provision before focusing on international trade. Exports were promoted only as part of the strategy of national development by “*only exporting what is worth high prices and that could bring money to national economy to keep investing in social development*”. Thus, Chavez pushes exports of natural resources only when these were profitable for the national economy so they could improve national welfare. The ultimate goal is to reach development to obtain independence from the dominant position of the United States and the IEOs. Therefore, international insertion is not the ultimate objective for the bloc, and this is what differentiates them from other types of integration that are more oriented towards the WTO principles and the US vision of liberalization of trade. In the idea of pushing the export of *strategic natural resources*, Venezuela convinced the government of Bolivia to leave aside the law and regulations for the control of the coca leaf production and cocaine requisition. This new type of economy could be leading to a short term development of Bolivia, getting peasants rich that were before very poor; and moving up the economy in a short term. The uncontrolled production of the coca leaf is invading the Amazon and other protected areas where the quality of production is high. Besides, neighboring countries as Argentina and Brazil became the most important consumers of cocaine which has raised the negative externalities in the region.

ALBA-TCP offers a new type of integration based on “co-operative advantages” between its members, instead of an alleged “comparative advantages”, that are based on the neoliberal theory of international economics. The co-operative advantages, intend to reduce asymmetries between the member countries. The policy in whole has three main points which are different to other multilateral or bilateral agreements signed before between the SSE countries in the region. The first policy has to do with the manner in which the selling of products has to be done once the country can satisfy the national demand and needs of the population. As a result, internationalization of the national production should be planned once

the national needs are met. The second one is that a country exports the product that it is good at which can be seen as similar to the comparative advantages but with the major difference based on the low prices that the country sells to cooperate with the other member, not necessarily to win in its trade balance or balance of payments, but more focused towards the development of all members at once. The third point lies in the fact that the country has to analyze what the products of strategic development are and use them to ameliorate its national economy. This entitles the government to keep under its own administration those resources that will be the base of endogenous development and will serve as a base for social projects.

At the same time, the policy of supplying cheap or even free energy (oil petrol or gasoil) for the country members, puts Venezuela in a strong position of regional leadership, because its policy is to cooperate in the endogenous development so as to have an influencing intervention and domination in the SSE countries. This contractual force that Chavez gains in the SSE where Venezuela cooperates, goes beyond economic-aid, it also gains economic-power and also justifies the increase of a military force and a diplomatic force that grants Venezuela a political economic position in each of the SSE countries. Then, Chavez can participate as an entity of change and elimination of the current U.S. domination. The simple rhetoric that many people hear in the speeches of Chavez goes more towards changing people's minds and changing the symbols that people were used to seeing as a natural form of governing financial systems, cooperation and aid, sovereignty and global governance, also the trade and development that were shaped before by the US and its IEOs. Venezuela is aiming to be the pushing force that leads the process of change in the region, especially in the SSE. And this is why, Venezuela feels responsible for the new organization of the new economic model in the zone that it wants to dominate. Therefore, the nature of the economic and political activities that Venezuela has been exercising in the last years are aimed to dominate and influence the banking system, international relations, development, type and way of investment, the shape of how to handle strategic resources for a country and the way this country should internationalize. Examples of this are the impulse for the creation of regional banks for development instead of the IADB. This is the proposal for ALBA-TCP and UNASUR, both should have its headquarters in Caracas. Venezuela also is pushing to approach countries with similar economic model (China, Iran, Russia, Cuba) that also contest the U.S. policy and this concerns the world and the region because of the strong influence of Venezuela to the SSE and other countries. The type of international investment changed from an extracting model

into a model with more social and environmental engagement. Strategic resources passed to be part of public management; nationalization became popular between the SSE since Venezuela proposed this. The profits of the nationalized resources are allocated to social and infrastructural projects. International insertion is not the first option anymore; first it has to be national procurement and national satisfaction before exporting.

As ALBA wants to be an effective alternative to the FTAA, ALBA is creating its own supranational organizations to stop their dominance to member countries. To have legitimacy, ALBA could not manage to ratify it with the congress in each of the member countries though its legitimacy is based on the different economic and social actors. ALBA, on the other hand, leaves aside three principles regarding integration that are always included in other types of integration: the clause of the Most Favored Nation, National Treatment and the reciprocity between its members. Regardless of this requirement, it can be observed that Venezuela assumes almost all the commitments in the agreement (execution and materialization of projects). Besides, Venezuela takes the natural obligation on the principle of good faith and on the international responsibilities. Moreover, the bloc offers a compensation mechanism in order to correct the differences in development between members and its different sectors.

The advantage and main difference of ALBA from other types of integration is that the bloc prioritizes solidarity among the members (and not competition), it prioritizes in its agenda the main need for social and economic development of its members. This fact is completely opposite to its main adversary, the FTAA which leaves the decision of their actions, their own interest and free competition with small producers, to the free market and the most dominant companies. ALBA generates cooperation between members even leaving sovereignty aside to advise the SSE member, contrary to the freedom that FTAA promoted of the country as far as they are under the friendliest conditions for foreign investors and international importers. While FTAA kept the cycle of marginalization of small economies and small producers, the ALBA took into account their needs to strengthen them first at national level before competing outside.

All in all, ALBA is still facing some difficulties for proper functioning. One is the lack of legal status as a regional or sub-regional international bloc which does not allow the group to be treated within the international right. Even worse than this, since it does not have a legal

structure, it does not have a system for the solution of controversies in case some conflict takes place between its members. It does not state the rights and obligations of the members, leaving practically all the responsibility of social and economic development to Venezuela.

Venezuela takes advantage of the good prices in oil to increase the assistance and cooperation to the ALBA. Nonetheless, these activities cannot be reached by cross-subsiding with oil money; the need of structural changes in the different economies is of utmost importance. Social and infrastructural projects are fostered between the SSE countries. This is intended to have an endogenous development in a more effective way than the neoliberal structure tried to do in the past. From a trade point of view ALBA is not very impressive since only the trade of hydrocarbons increased within the bloc and is within the cooperation between Venezuela and the SSE members. However, on the political side, the bloc turns very interesting since it aims at different objectives in order to increase the negotiation position of its members, in this particular case, benefiting the SSE. Venezuela's intervention improved the work in the region with a common welfare for its members. At the same time, it is noticeable that Venezuela's motivation moved the motivation for Brazil to increase leadership in the region.

Politically, the bloc has different proposals for the members that join (SSE particularly). First one is to achieve independence from the dominant position and the imperialism of the United States and the IEOs. This keeps sovereignty to decide their national management. Second is to have an alternative to FTAA having a regional integration based in complementary, cooperation and solidarity between members rather than on comparative advantages. The third is to have a regional bloc that starts replacing the IEOs for its own supranational institutions. This last one promotes the management of its own agendas and its own financial funds to promote a real endogenous development rather than delegating it to IEOs. ALBA is trying to create parallel institutions to replace those created by the dominant leader that imposed its own plans and ideas on how to manage the economy. ALBA is now proposing the creation of an OPEC-style enterprise called Petroamerica in Latin America which now consists of Petrosur, Petrocaribe, and Petroandina in an effort to replace multinational companies. Other incentives such as the Latin American Parliament (to replace the Organization of American States) the Food Security Fund, the Banco del Sur (in place of the IMF and World Bank) and the latest development proposed in the ALBA Summit; a

Monetary Union with the 'Sucre' as its currency unit in order to reduce the influence of the U.S. dollar. So far though, all of this is in planning phase.

ALBA is a political, ideological and military agreement that intends mutual cooperation. Venezuela is assuming the role of leader to assist all the member countries in its development and international insertion. Conversely, when Venezuela eventually runs out of oil money, due to an internal crisis, the drop of oil prices, or the decrease of oil production, ALBA is condemned to stay as a debate club. If the political objectives prime over an economic one, ALBA risks depending on oil favorable prices and this could endanger the economic and social welfare in the short term. It is also important to settle the main legal structure and normative in order to have well functioning supranational institutions as fundamental components of all integration processes. This is because the proposal of ALBA to develop at national level first in order to have a better international integration is the most reliable strategy for the SSE countries.

### **Perspectives**

It is clear that there is a change in the geo-strategic balance of the continent, especially in the “hemispherical” relations. Hugo Chavez has played a major role in this matter. Chavez relies on the strength brought on by the power of petrodollars and the military force granted to him in the region, to publicize his project of “socialism for the 21<sup>st</sup> century”. But the presidential rhetoric also promulgates a change in the attitude towards the current U.S. dominant, changing its approach to the US, analyzing its type of cooperation, FDI and trade. This change of mentality in the government and the people in the SSE helps Venezuela to introduce itself as the new dominant in those economies. Vindication is a point that Chavez often uses to mention the sovereignty and freedom from the US in Latin America. But somehow, all of these countries accept the intervention of Chavez in their national decisions as a way to compensate all the money that Venezuela is donating to SSE.

Venezuela is having an increasing participation in the matters of the SSE and the Latin American countries. In the last months of 2008, it promoted Mercosur summits, UNASUR meetings, bilateral encounters with Bolivia, Ecuador and other partners in the region. The topics of the meetings are often focused on the discussion and potential solution to a problem that a certain country is facing. These interventions have propelled Venezuela to a role of one of the leader countries, who worries and tries to solve the regional problems such as

migration laws like the EU rules on expelling illegal immigrants, US army forces settling in the SSE or neighboring countries as in the case of Peru and Bolivia, upheaval in the democracy of Bolivia, etc. Irrespective of this effort, Venezuela could not manage to introduce its own vision and political values to solve regional problems because this was not pacific and it involved a condemnation to the US that is an important trade partner until now for many countries in the region.

The future perspectives show that even when Venezuela cannot convince the larger members to join ALBA-TCP, it would have managed a change of values in the region. Chavez showed that he knows how to use symbols and rhetoric as a main strategy to change values in the population and in other governments of the region. Bit by bit he is managing to introduce his main subjects in the regional agenda, for example the common regional army forces (FAA), regional bank of development and sovereignty.

Venezuela, more so than Brazil, played a fundamental role in the region in showing that neoliberalism of the 90s and first half of 2000s, is obsolete when it comes to covering the basic needs of the population. Different crisis in the region had supported the Venezuelan position against neoliberalism and the domination of IEOs: The financial crisis in Argentina in 2001, bankruptcies, or the high prices in basic services that were privatized between 2002-2005, extreme poverty and reduced participation of the government in the solution of social problems, had lead towards a demand for nationalization and for a major change in the National Political Constitution in Venezuela as well as in the other SSE countries (Ecuador and Bolivia). Despite all this, Venezuela could not manage to influence all the countries in South America to turn into a left-wing "populist government". The election of Ollanta Humana in Peru was a failure despite the cooperation; Christina Kirchner is left-wing but did not join yet the ALBA-TCP probably preferring the Mercosur or the UNASUR. Some countries like Brazil support his social projects in the region but prefer to stay in the regional integration they originally were in. Some of these countries still believe in the free-market though with more control from the government and an improved coordination between neighboring countries which belong to the same regional integration. Moreover, the region's free traders view bilateral FTAs as a 'third best' after multilateral trade liberalization with the WTO and regional integration. Besides, some argue that bilateral deals create an obstacle to regional integration and small regional integration has the same obstacles to a wider integration. This is why, in the last months of 2008, UNASUR was promoted with greater

success than ALBA-TCP which only includes a small number of countries and has a more extreme international participation.

The potential risk of Venezuela's role in ALBA-TCP is the decrease of oil prices. The financial crisis in the US and the reduction of the demand in China for construction has reduced the demand of raw materials (after the ending of the Olympic games in 2008). Everything has taken oil prices to reduce from 147 US dollars (the highest peak) to 75 US dollars in the month of October, 2008. Some leading economists indicate<sup>44</sup> that the price of the current level of imports would become unsustainable if oil were to drop to \$75. Currently, Venezuela depends on oil for over 90% of its export earnings. These earnings come mostly from sales to the United States, its main trading partner and almost the only one that pays. Therefore, despite the rhetoric of sovereignty and independence from the US economy, until now, it was not possible to obtain other trade partners who could absorb the demand of the United States. Worst of all, with the imminent descent of hydrocarbon prices and the possible recession in the US and world economy, the social project of Venezuela over the SSE countries would be a nuisance. Moreover, for Bolivia, crisis has also affected national development, evidenced by the reduction of all hydrocarbon prices and a decrease in the financial aid arriving from Venezuela. This situation could reduce the social development reached in the past three years.

Violence is persistent and is spreading in the SSE due to social differences. Bolivia for example has a strong and substantial opposition ( $\pm 40\%$ ) that does not want to join a socialistic model and is strongly demanding decentralization. This percentage could be increasing without a real improvement in the economy and welfare of the population. Until now, several social projects and infrastructural projects were created with donations of Venezuela or with the increase of prices and taxes of the production of hydrocarbons. If there were an international recession and a reduction of oil prices, the step that was given in front could be forced to step backwards again in the SSE countries that turned their economy due to hydrocarbons<sup>45</sup>. The Revolution that ALBA-TCP proposes is creating transformations for the SSE countries as regards to oil exploitation. Nevertheless, both the socio political order and the symbolic order can be questioned regarding this type of integration since they do not

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<sup>44</sup> The Economist, 2008. Back on his old hobby-horse. From print edition. Sep 18th 2008. Caracas.

<sup>45</sup> The contributions of hydrocarbons to the revenues of the country are important. 40% of the GDP is due to oil exports in Ecuador according to the INEC 2008; and, 43.2% for Bolivia according to the INE 2008.

have a real regalement for their standard functioning. Despite the enormous quantities of donated money in the last two years, the economic order is not changing much in the SSE due to the short time of the model application. Still, regional geopolitics can be endangered in the future without the availability of the petrodollars.



## Chapter 5

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### SSE and the FTAs

FTAs<sup>46</sup> form a part of the RTAs in the world according to the WTO (Jianping, 2007). In recent years, FTAs have been developing rapidly through an approach towards regional economic cooperation, facilitating free trade and investment. FTA emerged due to the slow negotiations between regional agreements and multilateral agreements. During years, the FTAs were regarded as the most demanded type of agreements for SSE, since they appeared to provide development and international insertion, as is the case of any other regional or multilateral agreement. FTAs are opposing to what ALBA-TCP would like to achieve with the SSE in the region being that FTA only promotes cooperation to profit from the exchange of goods and also protection for FDI-flows. Nonetheless, FTAs are the most common signed bilateral agreements. In the last years, different types of FTA were signed in different regions and countries in the search for a common objective to increase their national market size and find the pathway of development. The US and other LSE are the preferred ones for signing an FTA with. Moreover, time has evidenced that trade has increased between the US and the countries that signed an FTA agreement. The dynamic development of national industry and agro-business at national level and as part of the dynamics of globalization to push countries to an international insertion has pushed several South American countries to sign FTA with different regions and countries. Over the past decade, Mercosur signed FTAs with all South American countries, including the SSE; it also started negotiations with the EU and China. ANCOM is negotiating with the EU and examining if the SSE can be left aside for these negotiations, postponing their participation. Chile signed FTAs with the US, the EU, China and others. Peru and Colombia are in the same track and signed several FTA with different countries in the last five years. SSE stayed behind this movement but increased their participation in regional agreements, which are currently negotiating FTAs as well.

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<sup>46</sup> FTAs stand for free trade agreements. It is normally signed among two countries that have no preferences in trade tariffs. For the WTO, a FTA is considered to be a Regional Trade Agreement (RTA).

This chapter will analyze the bilateral and regional FTA that the South American countries have, to get a good idea of the impact that such agreements represent for the SSE. Many SSE have FTA with the US or China; however, there is also a considerable trade share with the US and a substantial increase with China. Therefore, an FTA or another regional agreement, are at the door waiting for the right moment. A marked differentiation will be done between these bilateral agreements with the regional blocs presented in the precedent chapter. The following sub-parts will analyze the type of geo-political interest, the geo-economic interest and a game theory on bilateralism. Geo-political interest and geo-economic performance will be analyzed in each of the SSE countries within a specific type of agreement. This analysis will take into account the past and present behavior that SSE and LSE had towards each other, and how they confront their trade differences and needs today. These sub-parts will review the type of participation that the small states have within the bilateral agreements (FTA) and their position regarding the international political economy. This observation will show how SSE respond to the structural power of the LSE and their continuing demand for trade openness. Finally, we will present an applied game theory on the different issues and problems that the SSE present within the agreement. Game theory will present lobby activity and the strategic pay-off within the trade bloc. This will show how some interest groups have great influence over the international political economy even when the policy poses a danger to the welfare of the rest of the population. It will also try to show how the country responds to the continuing pull of national interest of various sorts where states (and non-state actors) compete for relative advantage in the Global Economy either for a better international insertion at regional level or bilateral level. All of this has the objective to see all the opportunities and threats that SSE could face in their international insertion.

## 5.1 FTAA

Free Trade Area of the Americas (FTAA from now on) also known as ALCA in Spanish. It is an ambitious project that includes 34 states (with the exception of Cuba) of the American continent that aims to create a free trade bloc. The project was launched by ex-President Bill Clinton in 1994 in a meeting with all the Presidents of the continent. This meeting decided to eliminate gradually trade and investment barriers in the whole continent. Moreover, it was decided to conclude these negotiations in the signature of an FTAA agreement in 2005. Different summits followed this decision: Denver (1995), Cartagena (1996), Belo Horizonte

(1997), San Jose (1998), Santiago in Chile (1998) where negotiations started to take into account the asymmetries of size and the development of the implied States, Quebec (2001) was the next and here it was presented a draft of the FTAA agreement. Main principles of the FTAA points that: decisions are made by consensus; negotiations are transparent; the FTAA will be in conformity with the rules of the WTO; the FTAA can coexist with other bilateral and sub-regional agreements; the countries can negotiate individually or as members of groups of sub-regional integration; a special attention will be granted to the needs of small size economies. The FTAA has also a program that is enclosed in following working program gathered in four broad topics: a) to preserve and reinforce democracy in the continent, b) To promote prosperity by the economic integration and free trade, c) defeat poverty and discrimination, d) To guarantee sustainable development and to protect our natural environment for the future generations. The implicated institutions to carry on the signature of all member countries were not specifically created for the FTAA but were the ones created in the WTO already. For instance, the consultative group of the small size economies was going to be assessed by the Organization of the American States (OAS), Inter-American development Bank (IADB) and Economic commission for the Latin America and the Caribbean (ECLAC) to facilitate the participation of the SSE in the agreements of the bloc. This assessment allows SSE only to advice on functions but does not allow intervening or improving the capacity of negotiations for SSE (GRIC, 2003).

The integration plan was considered to be inconvenient for different countries, and was the main reason why the plan came to a stand-still since 2005<sup>47</sup>. Although there were many SSE that presented enormous difficulties for an integration of the FTAA, they continued negotiations in a special cooperation group that did not intend to solve their size problem. In fact, negotiations did not stop because of continuing inconveniences for SSE, but for the problems this meant for Brazil. Brazil declared in 2002 that they did not agree with the FTAA "the United States has recently passed fast track for FTAA negotiations, but in conditions which, if they are taken to the letter, mean that there would be no FTAA" said Fernando Henrique Cardoso (former Brazilian President) in a speech following the House vote in 2002. Then, at the summit in 2005, the four member countries of Mercosur (Argentina, Brazil, Paraguay, and Uruguay) joined by Venezuela acted in unison, and

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47 The last summit was held in November 2005, at Mar del Plata-Argentina but no agreement was reached. 26 of the 34 countries present at the negotiations pledged to meet again in 2006 to resume negotiations, but no such meeting took place again.

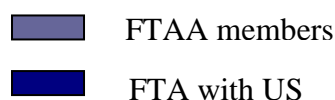
rejected the proposal of George W. Bush. Since then, the FTAA went on a stand-still status. However, bilateral FTA rose up in the last years based on the idea of FTAA agreements. The signature move of FTA is an attempt to generate bilateral agreements with several countries in Latin America that could later derivate in an FTAA.

The FTAA is based on free trade and aims to intensify some uncompleted disciplines in the WTO (e.g. intellectual property, foreign investments, subsidies and countervailing measures, antidumping, trade remedy laws against unjustified barriers to trade) within the hemisphere. Of course, this was all negotiated between all the members of the group with the chance to create a special group of negotiation for the small economies in the bloc. The largest aim of the hemispherical bloc was to have free trade across the countries that shared the same rights and obligations with the intention that all member countries be able to avoid discrimination. This proposition of free trade did not consider a special treatment for SSE or the most favored nation (MFN) anymore as the WTO had, it went further in the proposal to eliminate discrimination. The rules were mostly based in the rules of the WTO deepening some that were not multilaterally concerted yet. One of the core issues in the FTAA were: agricultural free trade and intellectual property rights. These were controversial issues for member countries. At one hand, countries like Argentina and Brazil demanded to have free trade including a clause stating the prohibition of agricultural subsidies on national level. This would seriously affect the situation in US since it presents a twofold issue: a) first it is the economy which subsidizes the most to agriculture; b) US is the largest market and it is the main destination for agricultural production.

On the contrary, small size economies had serious concerns on two issues: a) The US is a productive economy that has a huge scale of agricultural production. This would endanger or even eliminate the small producers in its national economy due to lack of competitiveness. The potential rivalry of the US with small producers could reduce or eliminate national production, which would surely lead to poverty. B) There is a pending accusation on the United States which states that the US is willing to claim patent ownership of technology

(Barlow, 2001) that belongs to indigenous people<sup>48</sup>. All this issues raised great discontents between civil societies (CSOs) in Latin America since all could just keep promoting poverty and food insecurity.

**Figure 5-1. FTAA member countries.**



Proposed FTAA members

Source: Google images, 2010.

The FTAA zone comprises the entire American continent, with the exception of Cuba. 34 countries make the FTAA a GDP of 17478740 million dollars and a population of 898'071.219 million people (2009) living in an area of 42 million km<sup>2</sup>. According to the Unctad Statistics (2010) the United States accounts for 34% of this population, Brazil for 21%, Mexico for 12% and the rest of the countries for 33% of the population. Inside the FTAA, there are enormous differences between the countries inside the bloc, these differences go beyond the obvious differences of development between these countries, but also address the differences of size that the SSE and LSE have. For the first time in regional negotiations, the issue of size came to the table of negotiations having around two thirds of adherents<sup>49</sup> over the total membership of FTAA<sup>50</sup>. The heterogeneity of the different levels of economic development among the members is one of the main characteristics of the bloc. The different size in the economies and the disparity of power and trade participation

48 Maude Barlow (2001), a Canadian nationalist have accused the US of attempting to patent Latin America-made inventions. On the Council of Canadians web site, Barlow wrote: "This agreement sets enforceable global rules on patents, copyrights and trademark. It has gone far beyond its initial scope of protecting original inventions or cultural products and now permits the practice of patenting plants and animal forms as well as seeds. It promotes the private rights of corporations over local communities and their genetic heritage and traditional medicines."

49 Antigua Barbuda, Bahamas, Barbados, Belize, Bolivia, Costa Rica, Dominica, El Salvador, Equator, Grenade, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, Nicaragua, Panama, Paraguay, Dominican Republic, Saint-Lucy, St-Kitts and Nevis, St-Vincent and Grenadines, Surinam, Trinity and Tobago, Uruguay.

50 Twenty six members out of thirty four signed themselves as susceptible to require the Status of Small Size Economy as it is presented in the Report of the Chairman of the Working Group on Smaller Economies, 1997: <http://www.itaiep.doc.gov/ftaa2005/wg7.htm>, p.3.

between its members is huge and this was not taken into account for the main negotiations and special treatment (Lessard, 2000).

The same happens with ANCOM, there are two trends in FTAA: a) one is the leftist group, the ALBA-TCP members and half of ANCOM; b) the other right wing and includes half of ANCOM, Mercosur, CCM, Chile, Mexico. The four SSE in South America are among the small size economies, -Caribbean and Central American countries, in the sense of population and GDP. The United States is the largest in the bloc with 79% of the total GDP; Brazil is 17.5 times smaller than the US and much smaller is Bolivia, 1313 times smaller in fact, and has an impact of 0.1% over the total FTAA's GDP. With this thought in mind, it can be easily understood why Brazil denied the acceptance of the FTAA in 2005. The greatest interest behind the signature of the FTAA was that of reaching free trade in the continent, and profiting from a potential access to the US market. On the other hand, the countries that had former trade relations with US could foresee the huge threatening for high competitiveness in agriculture (the most important sector of Latin America) and likewise most protective economy with a continuous subsidy program (Farm Bills) that any SSE could compete against; not even one of the largest agricultural economy as it is Brazil.

Irrespective of the causes for the failure of the FTAA, the US tried to sign bilateral FTA with different countries as a way of achieving the multilateral FTAA. These FTAs<sup>51</sup> also contained the FTAA's most sensitive topics, which did not take into consideration the huge differences in economic size and development that the US has compared to other countries in the region. This type of integration has a certain impact of a FTA on the development of a SSE which could depend in two factors: the response of FDI towards the SSE and the degree of the market liberalization for trade (from the LSE to SSE so that the last ones can export easily). Higher FDI in Mexico post-NAFTA, were sought by firms to take advantage of preferential access to the US market, since it was one of the main benefits of the deal. However, not all the states have done so well, mainly due to the US protectionism when regarding agriculture.

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<sup>51</sup> The FTAs that US started to sign in the region contain patent protection, no discrimination against foreign investors, elimination of export subsidies, schedule for tariff reduction, application of farming safeguard measures, technical cooperation and assistance programs, effective enforcement of environmental legislation, sovereignty to adopt and modify environmental legislation, mechanisms for environmental cooperation. In labor laws: rigorous enforcement of national legislation, fundamental international labor organization treaties, sovereignty to modify legislation, mechanisms for cooperation, habitat loss due to expansion of mining development, increased US pork and poultry exports funding factory farming, legislation to protect animals could be seen as trade barrier.

This experience has scared away the support of Brazil to sign the FTAA so in 2005, the agreement stood still with no further advancement until now, except with the bilateral FTA.

The FTAA will be analyzed in this thesis because it is still a possibility for the Americas. United States will be analyzed for its major trade share and its influential leadership importance for the region and the four SSE. There are many reasons why the United States will be focused on more than other economies in the continent. First, the importance of the US market for the SSE countries is so huge that it is impossible to eschew. Second, in the last years, several propositions and signatures of bilateral FTA with the US arose in Latin countries. Despite the conclusive NO that the governments of Bolivia and Ecuador gave to the FTA with the US, other nations were more open to the idea, Peru has already signed it, Colombia is on hold to sign; Paraguay and Uruguay have proposed to sign it. The current trend with SSE is to question FTAs and to search for the payback of free trade and open markets in the last years. For instance, with a recently elected socialist government in Paraguay (April 2008), maybe this SSE will step back the request for an FTA. For all this, the United States and its trade relations in South America will be analyzed with a particular interest in the SSE.

### **A) Geo-political interest**

**Geographical dimension.** One of the most important players in the region is the United States. It accounts for 34% of the population in the continent and has the highest GDP in the region that surpasses Brazil by seventeen and half times. Even though Brazil has 56% of the total GDP of South America, it still remains too small to pose a match for a gigantic economy like the US (US 17.5: Brazil 1, in comparative size of their economy). Main trade partners for the United States are Canada and Mexico for their imports and exports, Japan and China are important partners for their imports but not for exports; on the other hand, Brazil is not so important. The US exports are widely spread throughout the different regions of the world to reduce trade dependence. On the contrary, being a partner that equally divided its share on the different regions keeps its dominant position in the world. Many countries are export dependent of the US market. This fact leaves the US as the main dominant leader of the region and of the bloc. Therefore, Brazil that is the main leader in South America reduces its power against the US with the unification of the entire continent.

The bloc aims to reach the rules of multilateralism and become a new example for liberalization of the market and financial systems. Being that the US is the leader, the bloc is based on the neoliberal model that promotes the advancement of development through the internationalization of the economy and submission to supranational rules, thus reducing national sovereignty. This however, does not take into account the specific needs of the SSE that face several difficulties in their national production and the internalization of the SPS/TBT barriers, which makes it difficult to be able to improve their international insertion.

**Contractual Force.** The US wants to implement the rules of supranational institutions that go along the multilateral rules of the IEOs. Because the US is the largest country, it has a larger power of decision in the creation of supra-national institutions that do not yet exist and the adherence of the bloc to the existent IEOs. The US has military power in the region with military bases that constantly increase personnel (see box 4-1). The excuse for deploying these military bases around the continent is the offering of a direct cooperation in social projects, like the fight against drug trafficking, education, military support, etc. Along with the military bases, the financial aid-flow has increased so much in these countries that it dominates their capacity to invest and program. Even though the FTAA could not be a reality, the US tries to assume its dominant leader role to transmit values to Latin America. Values like democracy, free trade and non-discriminating rules (for obligations and rights), multilateralism are not often respected by the SSE. Corruption avoids a real development through the different social projects that SSE have. Besides, the US tries to implement a sustainable development in the SSE through the agricultural production so that drug trafficking can be avoided in the world. There are many actions to avoid drug production, trafficking and violence in the societies through alternative production controlled by DEA and USAID which are part of the international aid agencies controlling the SSE.

**Nature of the Activities.** The proposal of the FTAA has a twofold origin, the economic interest of the US towards the region and the economic interest of the SSE towards the US. The main reason why FTAA was proposed had to do with an economic interest that the US had and still has in the region. The US has a geopolitical interest in having a direct influence on the closest geographical region before other potential leaders (as the EU or China). Furthermore, the US wants to introduce all the disciplines proposed by WTO in the bloc, including the GATS and a failed Multilateral Agreement on Investment (MAI) that was



unable to reach a multilateral consensus. With the FTAA, the US would be the drive shaft in the creation of a new trade powerhouse promoting multilateralism. The second interest of the US was to maintain the dominance of its corporate sector in the region, which was endangered by the proposal of the EU of free-trade and investment agreements in the region. The third interest of the US is to reduce the sovereignty of the governments, in order to have supranational institutions in the bloc that promote a multilateral and equal treatment of all members in the continent. Of course, the FTAA negotiators appear to have chosen to emulate the WTO rather than NAFTA in key areas of standard-setting and dispute settlement, where the WTO rules are tougher. The request for reducing the sovereignty represented a big threat to the Latin American governments which do not want to leave their power of decision in their countries. What is more, SSE form a part of a history of dictatorships which in turn implanted a vision of ruling a country by force, something that has not changed much even with the rise of democracy in the continent. For Latin America, it is very difficult to admit foreign institutions and international organizations to decide their main needs and how to tackle them with standardized solutions as it was the Washington Consensus because Latin governments want their sovereignty to prevail. In fact, every Latin American country could be visualized as components that are very dissimilar, with particular problems and with complex national confrontations, which makes it almost impossible to keep accepting standardized policies as in the past<sup>52</sup>. As we have witnessed in the past, those standardized solutions kept Latin America and the SSE in the same situation of poverty and high discrimination between the population for a period of about fifteen years now. The FTAA agreement wants to even go so far as to take the most ambitious elements of every global trade and investment agreement - existing or proposed in the region<sup>53</sup> - and put them all together in this openly ambitious hemispheric pact. Nevertheless, the FTAA and its standardized trade and investment policies could be seen as a point of failure for a promising implementation of multilateralism.

**For the SSE** or other participants, the FTAA meant a doorway to the US open market; and therefore constituted an **economic interest as well**. The SSE believed that the signature of the FTAA was mainly a signature with the US. The possibility of an US open market means

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52 STIGLITZ, Joseph, 2002. *El Malestar en la Globalización*. Ed. Taurus, Buenos Aires.

53 Negotiators had to study, compare and propose the most innovative agreements in trade and investment to be implemented as standard in the entire continent. For this, the Mercosur, ANCOM, LAIA, NAFTA, CARICOM, CACM and the WTO agreements were going to be analyzed to take the most ambitious elements of multilateralism for the FTAA.

economic growth for the SSE through the imposition of the US' vision for development. Currently, the ATPDEA for ANCOM SSE moves around 50% of the total exports towards the United States<sup>54</sup>. For instance, The US is Bolivia's main market for lumber products, importing \$39.2 million (48% of Bolivia's total exports) in 2005 (INE Bolivia, 2006). This high dependence on the US market pushed the countries to the belief that the concretion of the agreement could represent a larger opportunity to international insertion for trade with more special and differentiated treatments as the ATPDEA. The same, the SSE of Mercosur thought that trading with US would mean a reduction of its dependency with Brazil that normally took advantage of its position as a LSE in the region. All the SSE thought that joining the FTAA would mean that these countries could increase trade preferences with the US, its trade shares and an increased aid-flow to development.

**Role and responsibility of the leader.** The objective of the US is to create a bloc that could promote the rules of multilateralism and give a new example of liberalization of the market and the financial systems. This type of integration prioritizes the economic interests that are supported by the lobby groups of TNCs of the US that want to widen their potential markets. Besides, this integration prioritizes the dominating role of the US as a leader so that it can transmit new values for democracy, free trade and non-discriminating rules (for obligations and rights) without taking into account the size or level of development of a country, less corruption and elimination of drug trafficking and terrorism in the bloc. The role of the government should only focus in the failures of the market and leave to the private sector the rule of the economy. This approach tends to emphasize the possibility of mutual gains between the member countries under the guide of common institutions which can jointly organize profitable arrangements and compromises for all.

Being U.S. the leader in the region means that it has to maintain high flows of: development aid, creation and maintenance of supranational institutions, maintain democracy and fight against poverty. The creation and preservation of these institutions forced the US to provide high flows of aid and direct cooperation<sup>55</sup>. The aid that the US gives is the largest compared to other cooperating partners. In spite of this, this type of aid had a negative element for the

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54 Gobierno Ecuador, 2005. El TLC con EEUU: oportunidades y riesgos en el sector agropecuario. Enero 2005. Investigación financiada por la UNDP, FAO, FTA Ecuador-US, UNICEF, ECLAC.

<sup>55</sup> Direct cooperation here means to send its own military and civil personnel in order to work for the programs that were proposed in the SSE countries. The US has the largest (and probably the only one) military base in these countries.

South American countries, particularly for the SSE. It included different types of control on the *how to do* the programs created to push development. The US imposed its own way of development and its own way to reach it, one of the most important paths to follow was the full liberalization of the markets and the financial system. Then, millions were invested every year in health reforms and agro industrial development under the guidelines of The US and the American citizens, especially the TNCs that were introducing in those markets. However, after many years of applying the US programs for development and liberalization, and providing lots of money aid-flows, it was proven this strategy did not help in the advancement of the economy of the SSE and other countries in the region. Worst, it only created dependence to the US market for the agro industrial products that were produced in small scale and high prices which aimed at small niche markets, eliminating the possibility to export at a competitive price to a wide market in the US or other developed or developing economies. Lack of competitive prices, large scale production and lack of cooperation between small farmers did not change over time despite the direct intervention of the US in the SSE with alternative production. American organizations as PDAR and USAID were directly charged with the development of alternative production to fight the manufacturing of coca leafs. ATPDEA for instance, at the head of USAID, PDAR and DEA offered direct assistance in agriculture for more than 20 years to the producers without establishing a clear deadline for their intervention (being postponed several times) and without showing alternative development as a more interesting way to advance than the coca/drug production. The main idea of the US was probably to dominate the export market share of the SSE which gave them no other alternative for exporting their products to other markets in the world. This created dominance in the SSE and high dependence on the export market. Besides, the producer was not motivated to orientate his production to large scale and higher productivity when niche markets were also paying well. Currently, the ATPDEA allows numerous SSE products to enter the United States free of duty on a unilateral basis subject to a quota that is rarely overpasses due to the high taxes. This fact makes the program interesting for the SSE, the preference and the market without the need to look for other markets<sup>56</sup>. At the same time, it is interesting for the US to keep its people and institutions in the SSE to have a better control of their political and economic issues, maintaining the domination of the US over the SSE.

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<sup>56</sup> The need to look for other markets was eliminated when US granted several times the renewal of the program to the SSE. This enlarged the market dependency of the SSE towards the US.

The US was not a leader that promoted welfare in the region. It failed to promote more development aid or common development with welfare for its members. In fact, an increase of trade and a positive impact on the GDP of a SSE proved to fall short of real development for the whole society, and rather increased the gap between poverty and wealth. US promote the liberalization of the economy and a small participation of the government so that the market can play the most important role in achieving development. The government should even reduce its sovereign participation to leave space for supranational institutions and promote the internalization of common supranational rules in order to reach common welfare. Politically, the bloc neglects the idea of empowering the SSE in negotiations with the US (as small economies with relatively less development). The strong unilateral position of North America made visible the huge losses that this strategy entailed for the majority of the members except for the Northern country. The FTAA was seen as a danger to the economic and political interest of the SSE and even the largest economy of Latin America, Brazil feared to join seeing the reduction of its leadership position in the region eminent. Furthermore, in the last years, the Latin American region became a scenario for anti-imperialism and anti-American actions. Since 2005, South America slowly started to become the breathing ground for new proposals of development which started to germinate at the head of Venezuela.

For the SSE, the FTAA represented many threats. The FTAA represents endangerment because of the reduction or elimination of national sovereignty with the raise of supranational institutions and the internalization of common rules. Nonetheless, any of the member countries refused to sign the first agreement and continued with the path towards the FTAA. For this, a Trade Negotiations Committee (TNC) was settled to guide the work of the negotiating groups so the countries with smaller economies and the ones with different level of development can have a full participation and deal with concerns that they have in the bloc. The wish to sign a free-market agreement with the US was more valuable for that moment that most of the signing countries in 1994 did not asses the real situation for its future. The negotiators in every country were greatly influenced by the big business community and not by the potential threats to the small and medium companies which are the majority in SSE and neighboring countries. Only, the small economies in the Caribbean asked for a special treatment and were added to this group of other South American. Even so, these countries were not willing to sign out the agreement but to join with special and preferential treatments. To provide a special treatment to smaller size economies, different

points were given by the FTAA in a directive (box 5-1) aimed to reduce the difference between the members. Yet, these directives did not include in its agenda the SSE structural problems and needs.

**Box 5-1. Guidelines or directives for the treatment of the differences in the levels of development and size of economies.**

1. Provide a flexible framework that accommodates the characteristics and needs of each one of the countries participating in the FTAA negotiations.
2. Be transparent, simple and easily applicable, while recognizing the degree of heterogeneity among the FTAA economies.
3. Be determined by each of the Negotiating Groups. Nevertheless, when this treatment refers to topics which are crosscutting or not confined to one Negotiating Group, it should be determined by the TNC or other entities designated by the TNC.
4. Be determined on the basis of case by case analysis (according to sectors, topics and country/countries).
5. Include transitional measures, which could be supported by technical cooperation programs.
6. Take into account existing market access conditions among the countries of the Hemisphere.
7. Consider longer periods for compliance with obligations.

Despite the directives show a certain degree of tolerance for the heterogeneity of development and size of the countries; they cannot influence the agenda of the FTAA. This agenda intends to reduce discrimination and differential treatment between the FTAA members. Then, the commission had the purpose to prepare them solving their national problems and make it easier to join the bloc the fastest possible.

Source: Based on FTAA-ALCA, 2002.

Likewise, with time, SSE shifted their position and will to sign the FTAA due to political reasons. The political reasons were raised by Brazil who assessed its situation and realized the dangers for regional leadership and potential losses in agriculture. Therefore, in April 2005, President Lula da Silva announced that the FTAA is a low priority for Brazil and is more interested in boosting trade with its neighbors rather than with the United States, "By strengthening Mercosur, creating the South American community of nations and trying to establish a new standard of relations between South American countries" said President Lula da Silva in a TV conference before leaving to US (Bilaterals, 2005). First, the negotiation groups were only interested in introducing the most important elements of multilateralism and did not pay any attention to the needs of the SSE. The negotiation groups put no effort in respecting the different sizes of the economies, primarily focusing on the levels of development and agricultural production (highly productive or agro-business, and the agriculture of subsistence). This agreement intended to have free-trade in agriculture when there was no potentiality for the majority of the people who dedicated to agriculture in the entire region. This means that around 40% of the population of the SSE dedicated to agriculture. Of their total production, less than 10% is destined to international trade; the rest

(90%) is for self-sufficient consumption. This is a major differentiation with the US which offers larger agro-business and high competitiveness in comparison with any other Latin American countries and even more when compared with the SSE. A free-trade will have an economic negative impact on the SSE and will also mean a political effect on the agricultural policy at a national level. The dilemma would have to be solved between the questions if the SSE wants to favor comparative advantages or the SSE prefers sovereignty for its national consumption and protection for its small subsistence agriculture.

Second, the country to the north exercised its dominant position and applied its own interest at multilateral level. The US tried to implement several multilateral policies that aimed to eliminate the little protectionism that SSE had concerning food security; sovereignty over national interest; and public procurement of basic services at a national level to create multilateral rules that reduce the national sovereignty. At the negotiations, there was a predominant interest in the large agro-business that each country consecrated (although few) and the interest of huge corporations from the US. Neither the governments nor the bloc took into account the cross-border externalities in the promotion of free-market and liberalization of trade and financial systems. Moreover, the entire social nucleus was excluded in the FTAA negotiations. This exacerbated social conflicts within these nations, since the main threats for the population, such as poverty and lack of access to basic services were not going to be taken into account when opening the market for foreign investment in basic services. The economic interest of the US was going to influence the politics at a national level and would increase the gap between sizes of the SSE. US is strong and dominant to make a unilateralist foreign policy and make prevail its dominance for multilateral negotiations.

Third, SSE was going to be submitted to a reduction of its sovereignty. The aim of the FTAA was to implement multilateral regulations in the bloc over which no national policy could dominate. Some norms were aiming for a WTO plus. Moreover, if there was a national regulation that was not compatible with the regulations on the FTAA, the first would have to be eliminated or modified on the same spirit of the signed engagement. For a SSE of Latin America, is difficult to imagine an acceptance of reduction to its sovereignty. Each country wants and is willing to decide its own destiny based on the assessment of its own situation. Therefore, the political implications that the FTAA was presenting were going to lead into a repudiation of the agreement.

Fourth, the only positive interest under political implications was to have common funds for structural correction of asymmetries that would be able to further development. Structural Convergence Funds to correct the disparities in infrastructure and services, technological and innovative capacities, and human capital among the countries was needed to prevent one winner (US) and many losers. Venezuela demanded in several occasions a win-win alliance with Structural Convergence Funds but this topic was obviated by all FTAA negotiations. This demonstrated that the bargaining power that the small economies had in comparison to the power of the US in negotiations was almost null. Therefore, when Brazil denied continuing with the FTAA negotiations in 2005, the reasons could already be recognized. Latin America and the SSE expected more of the FTAA. Beyond the free trade agreement, fundamental values were needed for a complete integration: democracy, protection of human rights, safeguards to environment and poverty, discrimination and crime, focus on a real trade for growth. Nonetheless, none of these topics were foreseen to be treated or negotiated at the heart of the FTAA, keeping South America in its own social problems.

Currently, multilateralism has failed to adequate the entire continent, and the perspectives are lessening even more. It is true that the US is trying the signature of bilateral FTA with different countries in the continent to reach a common agreement at the end but not everyone is willing to sign. Chile signed a FTA agreement implemented in 2004 with the US and Peru did the same in 2007 but Ecuador and Colombia suspended negotiations. The idea of these countries was to eliminate obstacles for trade, consolidating access to goods and services and fostering private investment. Then, when the FTAA went on hold, they still decided to sign an FTA. Besides commercial issues, the FTA incorporates other issues as economic, institutional, intellectual property, labor and environmental policies, etc. The main potential for the Chilean and Peruvian benefits are: to consolidate and extend the trade preferences under ATPDEA; attract foreign investment, generate employment and enhance the country's competitiveness within the region. For the US of course, it also means to improve access to goods and services, strengthen its investments in the region, promote security and democracy and fight against drug trafficking. The FTA results were very good for Chile, from the signing of the FTA trade doubled and the US turned into the main source of Chilean imports and destination for its exports by 2006<sup>57</sup>. Trade has increased between the countries that signed an FTA agreement with the US. Irrespective of the causes for failure of the FTAA, the

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<sup>57</sup> Office of the United States Trade Representative, 2007. Chile FTA Facts. Chile FTA Policy Brief. September 2007. URL: [www.ustr.gov](http://www.ustr.gov)

US tried to sign FTA with different countries as a way to achieve the FTAA. These FTAs<sup>58</sup> also contain the most sensitive topics for the FTAA that do not take into consideration the huge difference in size and development that the US has compared to the partner countries.

While the US searches for a comprehensive coverage and rule-making obligations that go beyond the WTO rules, one can debate on how much this would benefit the SSE potential partner. It is clear that the FTA obligations require significant reforms in both the trade and domestic regulatory practices of the SSE. To engage in an FTA, the SSE must be committed to an extensive reform program that allows them to participate in new bilaterally developed accords, regionally and in the WTO. The same idea as the Washington Consensus, most of the countries have to implement basic reforms in order to have a better international insertion and truly benefit from development. The FTA is both light and deep. It is light in the sense of little engagements from the U.S. towards the SSE and deep in the sense that requests to follow some fundamental reforms for joining the FTA. Besides, it would seem that it is not the SSE that decides when to sign an FTA with the US, but it is this nation who decides which country based on its willingness and ability to change its own policies in order to meet the requirements of a reciprocal free trade pact. The results of these difficulties have delayed the signatures of other FTA with other SSE in the region in the last years. This had somehow taken the SSE towards a new path of development with other trade partners in the world.

For that reason, the weight and importance that the United States used to have as the most important trade and political partner is about to change. The first reason is that for most countries in South America, especially the SSE, the United States symbolizes one of the most significant trade partners (more than 30%). This share had increased due to political trade preferences that existed with some of the SSE (ATPDEA). The international dominance of the US also increased in the SSE countries with the USAID and development programs that arrived with their own ideology and ideas of neoliberal development. US was until 2006, one the largest donor in the region with 1823 US million dollars/year, followed by Spain with 1774 US million dollars (Unctad Statistics, 2010). In the last years, a new political movement

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<sup>58</sup> Patent protection, no discrimination against foreign investors, elimination of export subsidies, schedule for tariff reduction, application of farming safeguard measures, technical cooperation and assistance programs, effective enforcement of environmental legislation, sovereignty to adopt and modify environmental legislation, mechanisms for environmental cooperation. In labor laws: rigorous enforcement of national legislation, fundamental international labor organization treaties, sovereignty to modify legislation, mechanisms for cooperation, habitat loss due to expansion of mining development, increased US pork and poultry exports funding factory farming, legislation to protect animals could be seen as trade barrier.



from Venezuelan has tried to change the political and economic dominance that the US had, replacing it by the Venezuelan aid through petrodollars and continuous bilateral and regional dialogues. SSE economies have fallen for this aid although it does not cover the same quantity of assistance that US provides, it grants the SSE with a seductive increase of negotiation power that hydrocarbons give. Bolivia and Ecuador joined the Venezuela's social project, leaving behind the ties with the US government. This inclination did not come by coincidence; several SSE in the region -where the amount of poor people goes beyond the 50% and were not willing to maintain their poverty situation decided to join the view of Venezuela. Social movements justified the huge social and financial differences throughout one political point of view: after 15 years of neoliberal policies and a large and direct US intervention, there was no improvement of their welfare. Worst, the huge social and economic differences are attributed to this US intervention. As a result, current events make us think that is difficult for the FTAA to be effective in the following years. What is more, it is easier to think that the US government is squandering its power in the region and will not recover it as far as there are petrodollars or any strategic resource to motivate a new type of development. The future for Latin American countries will be towards a new type of regionalization and cooperation South-South that can include an agenda based on common problems to achieve welfare and development that could not be found before with the excessive unilateral domination of the US.

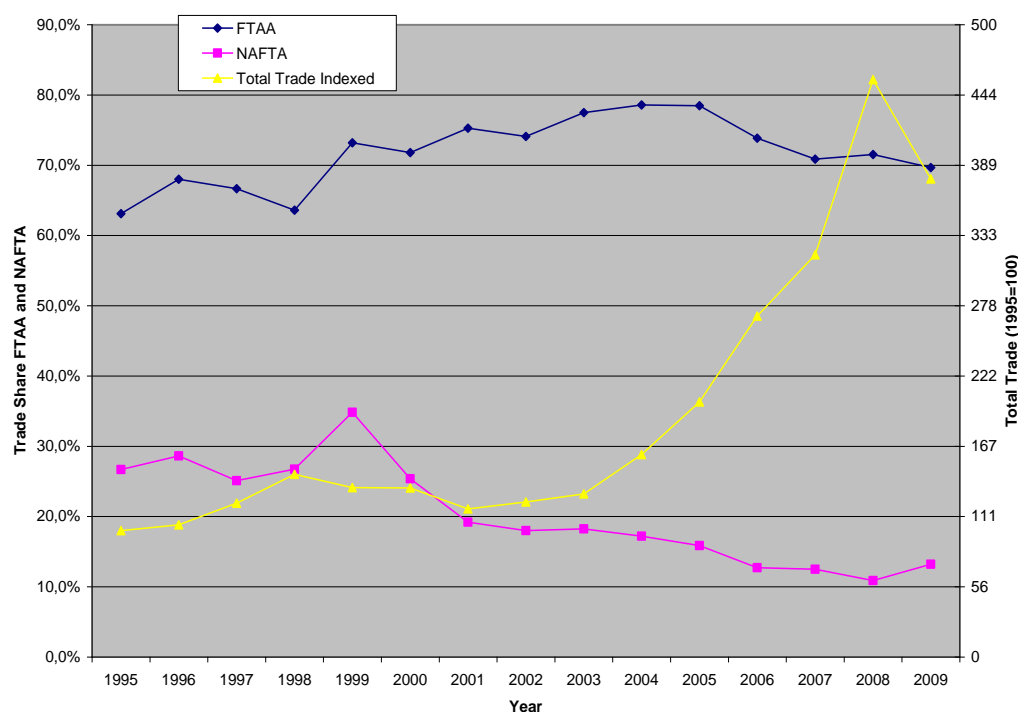
## **B) Geo-Economic performance**

**Nature and Empirical analysis of trade in the bloc.** The Free Trade Agreement of the Americas includes all the countries on the American continent and the islands nearby, except Cuba. The FTAA consist in different level of development of countries (developed and developing), different size economies with huge differences as 1702 times more in the GDP of US compared to the one of Paraguay; different size of trade as 584 times more in the exports of US compared to the one of Paraguay. Although this agreement is not in force yet it is still worthwhile to see how many countries especially SSE could gain from this type of free trade agreement (FTA) based on current trade between the member countries.

**Bolivia.** In 2009 about 70% of Bolivia's trade went to countries within FTAA. Barely 15 % of its Trade was with NAFTA of which 15.5% already belongs to the US. This percentage

has been going down in the past decade from around 25.4% to only 15% (Figure 5-2). This reality is completely opposite to the gravity percentage of 40.02% suggested by table 5-1 for NAFTA of which 39% already belonged to the US. The FTAA seems to be a big market opportunity for Bolivia at first sight. On the other hand, recently Bolivia's trade has shifted more towards the direction of Mercosur countries. This is due to the exports of gas to Brazil and Argentina and increased imports of the region. In figure 5-2 we can see how Bolivia's trade developed in the past twelve years with the FTAA. Trade in general has more than tripled in the last years (can be due to the increase of prices in exports of gas) and the share of FTAA has increased slightly, but the same cannot be said for the shares of NAFTA who have diminished. It needs to be taken into account that part of the increasing trade was caused due to increased oil and gas prices, not much due to an increase of the quantity<sup>59</sup>.

**Figure 5-2. Bolivia: trade development with FTAA and NAFTA**



Source: Own elaboration based on data from ALADI, 2010, [www.aladi.org](http://www.aladi.org)

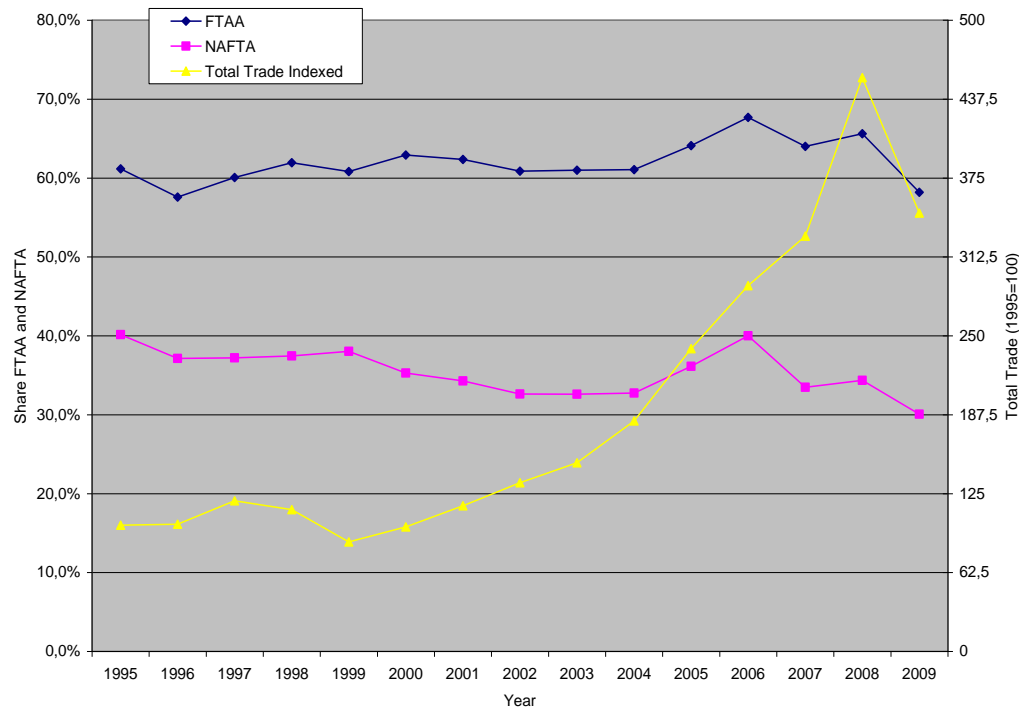
Looking straight-forward at the gravity constants, one would say that FTAA is interesting for Bolivia. Since one can assume that the absolute value of the trade with the neighboring countries will stay the same when trade improves with the signature of FTAA or a FTA, total trade will go up. Even so, due to the differences between Bolivia

<sup>59</sup> Los Tiempos, 2006. "CBH dice que producción de gas está al tope; Ejecutivo garantiza provisión". Written by La Paz agencies. September 26, 2006. Cochabamba.

and the US, an FTA could harm Bolivia economically in a variety of ways. Bolivia is a dominated country, underdeveloped and relatively small, probably due to the fact that it is a poor nation. This would mean that in trade negotiations Bolivia could come out bad. Also at the current trade, Bolivia suffers competing against the US' agriculture and textiles. The US has the knowledge and the power to export any product to Bolivia, taking full advantage of free trade and meeting all the SPS/TBT requirements that Bolivia has for imported products. In the case of second hand clothes, Bolivian producers complained several times to the government, pleading this instance to not let any more clothes from the US in the country, because they cannot afford to compete with their prices. But the government cannot stop these merchants without a valid reason that apparently cannot be found up to date. On the other side, Bolivia has products to export that do not fit with the US demand (richer consumers) or do not comply with its SPS/TBT regulations. Also understanding the regulations for exporting would be a complex task for the small producers that do not have any permanent training program that their government offers.

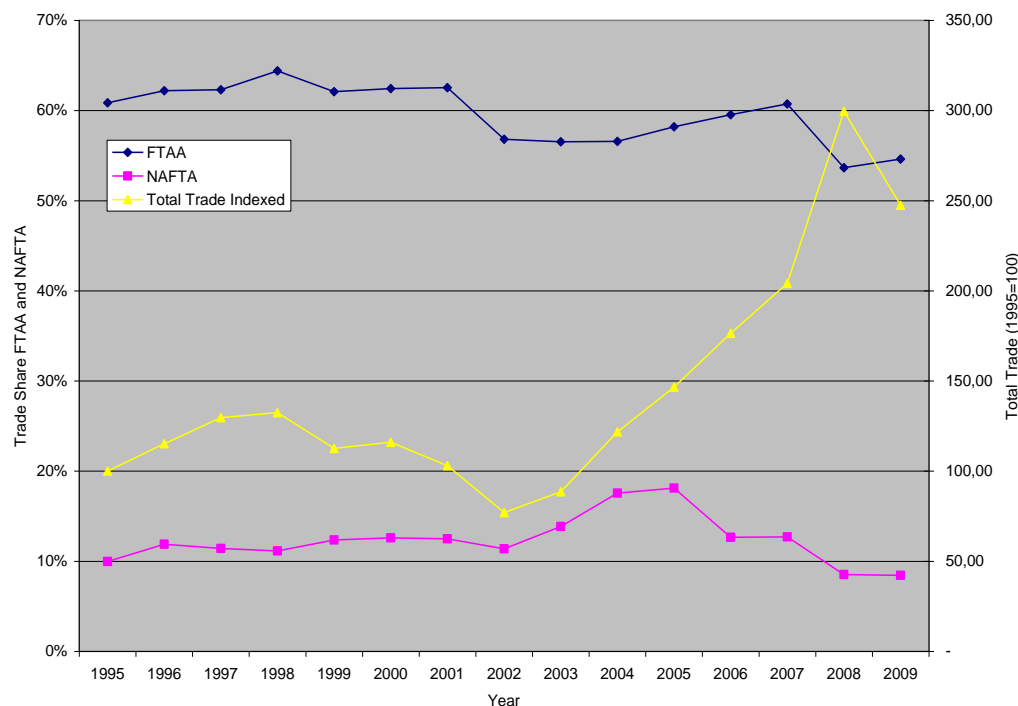
- **Ecuador.** In a bit more than ten years the share of NAFTA of Ecuador's trade went down from about 40% in 1995 to just 30% in 2009 over the total trade. In the same period FTAA stayed more or less stable staying around 60%. This is due to a rise in trade with its neighboring countries like Brazil, (energy especially) but also with the Asian continent that took the share that had previously belonged to the US. Here we see a similar development as that of Bolivia. The US, Canada and Mexico become relatively less important for Ecuador's trade. This proves that Ecuador has been able to attract markets outside ANCOM and NAFTA. In figure 5-3 we can see the development of Ecuador's trade with FTAA and NAFTA. The trade has been rapidly increasing since 2000, and was already tripled in 2007. Although this increase was affecting FTAA and NAFTA, FTAA had a more than positive relative effect.

The increased trade of Ecuador with other countries in the region and with Asian countries is due to different reasons. One is that Brazil is eager for more energy recently expanded its FDI-inflow investments in oil and roads construction. China has increased its demand of oil and agriculture products with Ecuador. Trade however had no significant previous agreement or the signature of bilateral cooperation, it just started by common interest.

**Figure 5-3, Development of Ecuador's trade with FTAA and NAFTA**

Source: Own elaboration based on data from ALADI, 2010, [www.aladi.org](http://www.aladi.org)

- Uruguay.** As we saw before, Uruguay's trade depends significantly on its two neighbors Argentina and Brazil. Besides that, it is closer to NAFTA than Ecuador or Bolivia due to a good access to the sea. Then, NAFTA plays a less important role for Uruguay than for the other SSE. Uruguay's strategic location and a well functioning sea-port enable them to have an easier trade process with other countries that other SSE could only reach by land. Europe and Asia are easy to reach for Uruguay and this fact opens more trading doors for Uruguay. When we take a look at figure 5-4 we can indeed confirm that NAFTA is less popular than it is for the other SSE and that even the FTAA as a whole is less important, and more trade flows towards other regions like Europe and Asia. The dependency on Argentina is also clearly visible with the decline of trade in 2002 when an economic crisis hit Argentina. This also affected the trade share of FTAA, which is interesting since it would mean that trade with FTAA decreased more than with other regions in the world.

**Figure 5-4. Development of Uruguay's trade with FTAA and NAFTA**

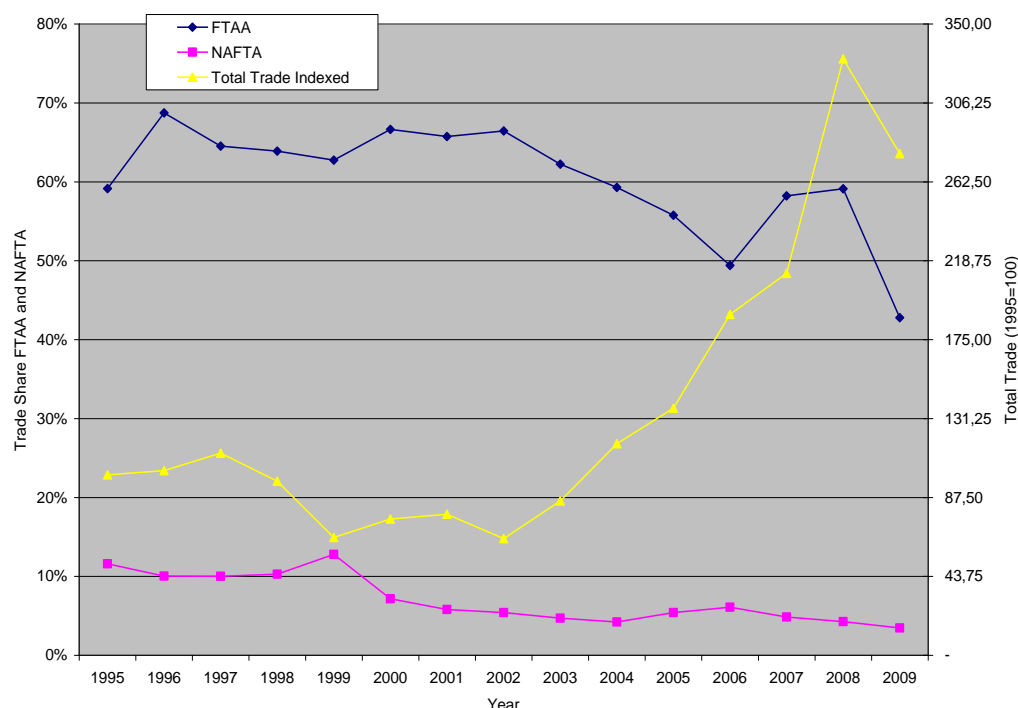
Source: Own elaboration based on data from ALADI, 2010, [www.aladi.org](http://www.aladi.org)

The gravity of Uruguay with NAFTA is according to table 5-1 around 31% and for FTAA around 60%. FTAA performs near to this number. Uruguay trades with Brazil and Argentina and both represent around 60% of its total trade. This somehow raises the question if creating trade agreements is the way to increase trade because, gravity shows here that countries are more attracted to close larger neighbors than to far away ones. Of course, a reduction in trade barriers (SPS/TBT) between them would help to establish a larger increase of trade. We can see that something like that happened, the trade outside FTAA and NAFTA increased most likely due to a reduction of barriers.

- **Paraguay.** One would expect that Paraguay as a landlocked country would be more dependent on its neighboring countries and that the trade with NAFTA would be hard. Looking at figure 5-5 we can see that trade share with NAFTA went down during the past six years. However, surprising is that also the trade share with FTAA countries went down. Peaking in 2000 still on 70% now barely hits 40% in 2009. This is very surprising for a country like Paraguay and also very different for a SSE which one would expect to take more advantage of closer markets. Of course, 40% relying on closer markets is a big

share but seems that Paraguay increased its relative trade with EU and China more at the expense of its closer neighbors. If we compare trade shares of figure 5-5 with the gravity constants of table 5-1 it is clear that NAFTA is much under the gravity value of 36%. An estimate, based on table 5-1, shows that FTAA should reach about 56% which was not achieved.

**Figure 5-5. Development of Paraguay's trade with FTAA and NAFTA**



Source: Own elaboration based on data from ALADI, 2010, [www.aladi.org](http://www.aladi.org)

Paraguay depends for a large part on Mercosur. Nevertheless, trade is increasing towards other regions in the world which are not close (as EU and China). Gravity keeps been working fine in the case of Paraguay; on the other hand, other undervalued regions are becoming more interesting or more open to imports from Paraguay it seem to be accessible partly due to the sea access by river. Trade distortion appears because there are maybe some complex SPS/TBT barriers that neighboring countries demand and which are not easy to achieve.

### **C) Game theory on regionalization**

In order to have a better idea of SPS/TBT and other barriers from relative LSE, we will present different case scenarios. Game theory will be applied to different problems of trade to show the position of SSE and possible ways of reaction. This analysis is important because it will enable us to better understand how SSE can improve their trade position and international insertion. Therefore, this part could be of use to decision makers in SSE for future negotiation patterns at an international level.

#### **Bolivia, Ecuador, Paraguay and Uruguay**

##### *Lobby Activity*

The four SSE as part of a major group within the FTAA don't have much power in the inclusion of their main needs and problems in the FTAA agenda. Still, they could lobby for the creation of a special group that takes the special needs of the SSE into account. In this manner, all of the countries would be assessed by three IEOs and all of them could agree on a plan of action that would aid in the struggle to reach a profound integration of the bloc. Nonetheless, the SSE could gain awareness of the problems they had which could make it easier their participation in the negotiation process. The action plan is based on adjustment at a differentiated speed as well as a delay in the elimination of protectionist measures from them. In spite of this, the SSE has still to reach the suggested structural reforms to integrate better the FTAA. The SSE have to also reach all the negotiated disciplines even when there was a time when these economies would be benefiting from the developed countries from a differentiated temporary treatment.

With the evolution of the FTAA we have witnessed the real progression of the Special and differential treatment (SDT). Beginning with the fifties and the Chart of Havana, all the countries had to accept a position of vulnerability that comes with being a SSE and still tried to protect their infant industries and their balance of payments in order to be able to export later. At the same time, the SSE could receive preferential access to the markets of large economies (Lessard, 2000). Later, the Uruguayan Round established to grant to the Most Favored Nation (MFN) a favorable treatment but in a non obligatory base and only case by case. Now, with the FTAA, the SDT could only be granted temporarily so no country would sidestep the general agreement of non discrimination and thus give every nation the same

treatment. This laudable idea was more than likely, not going to take into account the different levels of development and difficulties that some countries have for trade and real international integration. Moreover, the idea of non discrimination left behind the social and cultural paradigms of the Latin American countries. In fact, the FTAA promotes even tougher measures to protect national citizens at the same time it tries to avoid the SPS/TBT barriers without need. This would mean that the SSE could not be able to negotiate for long term SDT or protect its national economy when it is necessary since SSE have no technical or scientific power as developed countries to demonstrate the need of an SPS or TBT barrier. This reduces the power of negotiation of SSE face to LSE as the United States that can keep protecting its national economy and keep demanding liberalization of trade at the same time.

**Box 5-2. Trade barriers in Mercosur  
Nash Equilibrium strategy.**

**Background.**

Uruguay is one of the main producers of rice in the region. In order to increase their exports even more, Uruguay understood that exporting to the United States and Europe was necessary. The Uruguayan rice has the advantage of being transgenic free which is a step up from the U.S. main world-wide exporter. Both countries are competing for the European market. Both could choose to produce more to reach a larger market (M) or to not extend their market (N).

- If both countries decide to offer their product in the same market, the competition will lead to a diminishment of the international price of rice, causing both nations to lose money (0,0). Uruguay stands to lose more, in the probable case that no European nations agree to pay more for their organic rice.
- The same gains would happen if no decides on getting the European market (0,0)
- If Europe decides to pay for only one type of rice: organic at a higher price or transgenic at a lower price, the producers will take the quota and the other manufacturers will have nothing. In this case the gains will favor the one that decides on the market (3,0) or (0,3).

		Uruguay	
		M	M
USA	M	(0,0)	(3,0)
	N	(0,3)	(0,0)

In this game, we have a Nash equilibrium (M, N) y (N, M), where only can win one of them, not both.

**GOVERNMENT SUBSIDY:**

In 2008, the Government of the U.S. increased the subsidies towards agricultural production, mainly for rice in order to keep its exporter leader position. To complaint about the subsidies, Uruguay filed a letter of protest to the WTO. At the same time, U.S. had some rice contaminations that were not allowed in transgenic varieties and with this, Uruguay could breach new markets like Japan, Korea and the European Union, who currently demand certificates of free transgenic products, a regulation that that Uruguay can comply with. This changes the structure of the game to:

- If Uruguay chooses M, the United States will choose M.
- If Uruguay chooses N because it faces production problems due to U.S. subsidies, the United States still will choose M. As the United States applies subsidy, it causes gains in (M, N).



Nevertheless, there are other factors to consider:

- If the rice is subsidized by the American government, the government of Uruguay can retaliate by denouncing this move to the WTO, alleging that this diminishes the price and causes losses to the Uruguayan producers and to the North American consumers who sustain these subsidies. The gains of Uruguay fall in N giving a total in (M, N).
- If the Uruguayan rice can be seen as competitive due to its advantages, maybe it can win a larger market despite the U.S. subsidies. Gains will be in (M, M).
- In any case, the probable outcome of this situation is that that both countries will choose to discontinue their production, because it is a loss for both and the gains are zero (N, N).

		Uruguay	
		M	N
USA	M	(4,3)	(8,2)
	N	(4,6)	(0,0)

#### Analysis:

In this game, gains will be low if the U.S. continues to apply subsidies. This will cause international prices to fall. On the other hand, Uruguay has a comparative advantage with the non-transgenic rice, which eases the entry to markets willing to pay for this product. In this way, Uruguay would have larger gains because of a wider niche market. Still the U.S. subsidies are meant for keeping larger markets that trade in large scales.

Nowadays, despite the creation of a TNC for smaller economies, there are several facts which show that SSE still face disadvantages when dealing with the trade from the US. First, trade preferences that FTAA could grant to small economies would have a positive impact on SSE, but the preferences would be temporary and eventually they would have to face an enormous threat in the liberalization of their markets. For the FTAA, there is no trade preferences considered for long term since the goal is to have reciprocal free trade pact. Second, the SPS/TBT barriers make it difficult for the SSE to have an effective liberalized market for their export. Third, multinationals have a strong lobby technique to lean towards the signature of an FTAA in the continent because they are eager to gain access to other markets. On the contrary, social movements and small producers in the SSE countries had no power to avoid the extreme competitiveness inside their markets with US companies which could lead to food insecurity, overmatched by the competition due to their small scale production. The problem with small producers is that they were not only incapable of competing internationally but they were not even ready to compete and provide their products at a national level, due to the lack of national infrastructure.

The only time when the SSE can take advantage of more negotiation power, is when dealing with the coca leaf production. The ATPDEA program was granted to the Andean countries that produce coca leafs, and as an incentive to reduce its production to the minimum levels, the US granted SDT and no taxes for these countries. Even so, these countries do not have much chance for lobbying to continue this SDT program in the long term. This is basically

for a double reason. One is because the SSE is not capable to maintain a reduction in the production of coca leaf. The second is that was created a trade dependency with US that the small producers in the SSE could not keep exporting if US market fails. Then, the US is taking advantage of this fact to push SSE to sign and FTA with the US at the terms and conditions that the US requires. The SSE would have to sign it in order to maintain the preferences of the ATPDEA.

### **Box 5-3 ATPDEA -ANCOM countries Nash Equilibrium**

#### **Background**

On December 2010, Ecuador, Colombia and Peru will look forward to the renovation of the ATPDEA with the U.S. which expires on the 31<sup>st</sup> December 2010. Trade preferences were created at the beginning of the decade of 1990 as recognition on behalf of the U.S. for the efforts in the war against drugs in Colombia, Peru, Bolivia and Ecuador and to foment the alternative agricultural production meant for exportation with preferences (ATPD) at a zero tariff. For Bolivia, exports in 2008 towards the U.S meant 489 million dollars (9% of total trade), of which 295 million were exported via ATPDEA. For Ecuador in 2008 the exports with ATPDEA represented 9.325 million dollars (43% of total trade) an increase of 21%. For Ecuador, 66% of the exported products to the U.S. are benefited from the ATPDEA and for Bolivia it was around 60%.

Bolivia was not granted an extension of the ATPDEA since 2009, because it did not cooperate in the fight against drugs, when it actually increased its production instead of reducing it. Bolivia threatened the U.S. with sending a complaint to the WTO for applying discriminatory criteria on Bolivia to revoke the ATPDEA. This was controversial due to the fact that the UN report indicated that Bolivia was more effective than Colombia and Peru in the eradication of coca leafs and the seizure of coca leaf production and cocaine trafficking. But all complaints were vain and after benefiting with 18 years of preference, Bolivia had to resign to not have these preferences again. With this loss, Bolivia lost around 40 thousand employment posts in the textile sector (La Paz and El Alto) where indirectly were benefited around 120 thousand people more and these posts could not be recovered by finding other markets that could absorb these exports despite the offers of Brazil and Venezuela.

Ecuador that decided to not sign a FTA with the U.S. is interested in the renovation of the ATPDEA since thanks to this one 31,000 posts are created in the agricultural sector to whom U.S. grant preferences for export. Peru and Colombia signed a pre-agreement of a FTA with the U.S. but it is still having a procedure to go (one procedure, the legislative approval is still pending and was denied in the U.S. Congress in 2009) and meantime this is happening, the U.S. congress renovated preferences for a year with the three countries until December 2010. Nevertheless, currently these nations are asking for another renovation, so the game could shape out like this:

The United States tries to take ahead bilateral FTA negotiations with several countries in the region and this is the main motivation to stop with the ATPDEA. However, these negotiations are being questioned by the difficulties that countries face with U.S. when exporting agricultural products out of the ATPDEA as a result of subsidies applied to their production which obstructs trade liberalization. Another aspect that limits agreements in the region is the substantial price increase (of agricultural products), particularly in the SSE which have erected barriers on exports, so that governments guarantee the internal provision at an older price. With this in mind, FTAs were sort of postponed in the region. The game shows us that that the U.S. wants to stop the ATPDEA to increase bilateral FTA to open markets. On the other hand, Ecuador, Colombia, Peru (and Bolivia also) (from now on ANCOM) would like to paralyze the FTA debates and resume a deal with the ATPDEA. The game is:

- If the U.S. stops negotiating with the ATPDEA and signs an FTA, they will both have a

greater market. However, the U.S. will have the ANCOM liberalized market to sell its products and the ANCOM will face difficulties to compete with the U.S. agricultural subsidized production and other SPS restrictions. Gains will be (5,2).

- If the U.S. does not sign the FTA and resumes with the ATPDEA, Ecuador and U.S. will benefit. The U.S. because it can still have a tight control on the coca production and eradication in each of these countries; thus, a political influence and a military influence since it can keep its military bases for this purpose. And ANCOM countries because they can keep selling their products without import tariffs and barriers from the U.S. Gains will be in (3,3).
- If the U.S. maintains its position towards the FTA in other countries of the region; it will put more pressure on the countries that did not sign it yet. But it will also improve the U.S. image for the ANCOM countries as a leader that gives trade preference for the smaller economies. Gains will be in (4,3).
- If ANCOM manages to reschedule the ATPDEA but keeps negotiating FTAs with other regions, then, the U.S. does not win much compared to the ANCOM. Gains will be in (3,4)

		ANCOM	
		ATPDEA	FTA
U.S.	ATPDEA	(3,3)	(3,4)
	FTA	(4,3)	(5,2)

#### Analysis

There is a level of uncertainty regarding the direction of the ATPDEA will proceed in. If the agreement of ATPDEA is not renovated, there will be many companies that will close because they depended on the U.S. market to export with zero tariffs. Without these preferences, there will be no chance to export or compete. For the larger agro-businesses in these countries, the ATPDEA represents income through the possibility of exporting. However, the decision to continue or not unilaterally chosen by the U.S. It is also on the side of the U.S. the decision to eliminate the barriers to trade and this can cause interest conflicts in the region and in U.S. But in the case it could eliminate SPS barriers, then free trade will show fruits with clearer rules for the SSE.

#### *Strategic pay-off within the trade-bloc*

Despite the differentiation that the bloc did for SSE, there were no palpable benefits for them. First, the possibilities to carry on negotiations in which the SSE can take advantage of some treaty are unlikely. A tripartite organization, the OAS, IADB, ECLAC, delegated to evaluate them with all the SSE issues for joining the group with less disadvantages. However, this group could not pass their issues for negotiation. SSE had to solve them at national level and not include them in the FTAA agenda. Worst, with a noticeable weakness for negotiation, the tripartite organizations could not assist them in any of the 9 negotiation topics. Despite the fact that the directives show a certain degree of tolerance for the heterogeneity of development and size of the countries; they cannot influence the agenda of the FTAA. This agenda intends to reduce discrimination and differential treatment between the FTAA members, so it is not possible to grant special treatment to any member, at least in the long term. Second, the main directive of the bloc was to submit the economic interest over the interest for welfare and development. This put the SSE interests under the interests of the

trans-national corporations (TNCs) which were the real winners of the agreement. The geopolitical power over Latin America and the TNC interest of the US prevailed over any other interest. Governments in Latin America had to even submit or eliminate national laws and regulations in regards to the public provisions of goods and services. Third, the FTAA was started by an agreement reached between the 34 presidents who wanted to have an easier access to the US market. Access to the forth mentioned market, is possible nowadays thanks to special grants and bilateral agreements on the basis of a one-to-one policy. Normally, this agreement grants market access as a reward for the compliance of a specific program (e.g. ATPDEA). Outside this bilateral agreement, the access to market turns to be difficult since the US has high subsidy programs in agriculture (the most important trade sector for South American and SSE countries). This is why, when the FTA with US-ANCOM was stopped, the US threatened to stop with the ATPDEA program and only granting it to the countries that have a FTA with the US. The dominant position that the US has in the different negotiations leaves no room for the SSE. It is true that the conditions of the ATPDEA are favorable to the SSE but also they are for the US that also dominates the regulations and specific conditions under which the bilateral agreement will take place. Ecuador for example depends half of its exports on the ATPDEA agreement and if this would disappear, it certainly would have a negative impact on its economy.

For SSE, an FTAA in the continent might be interesting, especially to join the market of the United States. Conversely, since they also depend on agriculture, the bloc might be a threat. Firstly because the United States has different subsidies to agricultural production that does not want to cut off and this was not only visible in the FTAA negotiations neither in the DOHA meetings. Worst, the denying the elimination of the subsidy program at once to agriculture in the US was ratified with the signature of the *Farm Bill* law, vetoed by George Bush on May 10<sup>th</sup> 2008. The Farm Bill is the primary food policy and agricultural tool of the United States which has been widely accepted in the Congress. The Farm Bill anticipates that the U.S. government will pay billions to the peasants who reduced their production by an external factor (as climate), pay to the ones who reduced their profits, etc. Other organizations have voiced opposition to the farm subsidy policy of the United States. It was also criticized by the United Nations and the World Trade Organization because it is dangerous for other developed nations as well, but there is no way too change it in the next years. The US came to the conclusion that this was the only way to promote agricultural production and face the food crisis of 2008 and the excess demand for cereals for bio-fuels.

The Farms bills can be highly controversial because they have a great impact on international trade, environment and the overall well-being of the rural communities, but it will also influence agricultural trade within the continent.

SSE do not have any subsidy program and actually it is not one of the most important sectors to promote for the government. Thus, migration and low productivity has made many people to quit with that activity. This also impacted negatively in food provision and different food crisis in SSE in 2008. This new Farm Bill probably seals the failure of the Cycle of Doha. Such a situation raises serious questions for the future of the world governance and common agreements for trade regionalization. As for Bolivia, a better bargain position can be raised from the reduction of the production of coca leaf or at least keep a good relation between US and Bolivia. Similar situation are for example with Ecuador or Colombia, which is also caught up in dealing of drugs. Or for other reasons Venezuela, which is the producer of a big part of the oil consumption in US. Yet, the other SSE have to search for interest points of negotiation against preferences for trade with US.

#### **Box 5-4. Guidelines to negotiate and FTA Bolivia-US**

The people's dialogue organization (2008) suggests the following guidelines for a FTA with the United States with fair trade and cooperation for productive development based on:

- a. Respect for the sovereignty of the parts, which implies recognizing that democracy is when free people make the choices that are best for them;
- b. Strengthening of democratic processes and social inclusion to guarantee the universal freedoms that are the foundation of all genuine democracies;
- c. Economic exchange to ensure poverty reduction and the improved livelihoods of people in all nations that overcomes the deep asymmetries between countries.
- d. Ensuring a healthy environment for our families' futures and the social development that promotes peace and security within and among nations.

These points ensure counteract in some measure to the asymmetry between both countries and to ensure that both countries benefit from the Agreement.

Source: Bolivia Soberana, 12 September, 2006. URL: <http://www.boliviasoberana.org/blog>

Special and differential treatments (SDT) for trade are very important for the SSE. For instance, 85% of the Bolivian exports to the US are under the ATPDEA and are duty free. This is why, SDT are important in the search for an equal relationship between the SSE and the US. Moreover, these SDT have to be free of SPS/TBT measures, which could lead to a distortion of the real trade flow. A real and effective FTAA would not work if SPS/TBT barriers or subsidies are still present in the larger economies. SSE cannot access bigger markets and it is difficult to negotiate in a more efficient way with a LSE because it has a strong bargaining position. When a LSE claims SPS measures to avoid imports, it is difficult

for a SSE of a developing country to quickly demonstrate that the SPS measure is a mistake that will distort trade. Lack of technology and R&D for SSE of developing countries makes it difficult to demonstrate that an SPS/TBT measure from US is just a distortion to fair trade.

Paraguay and Uruguay have a well established agricultural sector with specific products which are internationally competitive. Nonetheless, soya, one of the most important products for both countries finds its difficulties penetrating the US market. For the US, soya is an important product also, and the lobbying process meant to protect its market, is large and benefits from subsidies as well. Soya faces difficulties of SPS/TBT barriers and will have setbacks when raising barriers to protect its national market from a LSE as the United States, who poses a bigger danger than Brazil. The FTAA agriculture pretends to eliminate trade barriers and set rules for the trade of food. Furthermore the FTAA will restrict the domestic agriculture policy, down to the level of support for farmers and the ability to maintain emergency food stocks, set food safety rules and ensure food supply (Barlow, 2001). At the same time, SPS/TBT barriers mean a blockage of exports from the SSE with even higher levels of protectionism than within the WTO that cannot discriminate between international and domestic goods. Then, if a SSE signs the FTAA should be careful in the compliance of the provisions for exporting under good US quality and agree to adapt its national rules to reduce protectionism.

Finally, the biggest threat in signing the FTAA for a SSE concerns the free-trade policy. When FTAA talks about free trade without any blockages, it certainly does not refer to small producers who are unable to compete with high levels of subsidy and scale production. On one hand, this access is not inclusive for the small producers in these countries, only for the productive agro-business that can have a greater potential for exporting. Small producers do not have any preference in the agreement so they are the potential losers once the bloc starts working. The access to the agricultural production of the US is difficult outside the bilateral agreements since there are: a) subsidies that SSE could not even imagine to pay to its producers due to the high amounts of money needed; b) high SPS/TBT barriers that cannot be complied by the small producers; c) different habits and higher quality demands from the consumers in a rich and larger economy than what the small producers are used in the SSE environment. On the other hand, free trade could lead to a free imperfect competence between LSE with SSE. The higher the quantity of products available in the country that are manufactured in the US and are done so (for example) at lower prices than the ones produced at national level, could make the country dependant of the foreign production, leaving behind

policies that promote agriculture or agro-industry. This could endanger food sovereignty and food security for the long term.

### **LSE: Brazil or the US**

For a large country such as the US, the FTAA is interesting not only for the trade potential it implies but also to help maintain a leadership position in the region. The United States is in the position to propose and create supranational rules and institutions for trade and for international governance to trade measures. While a big problem of SSE is internalization of supranational rules (legal trade and smuggling, for instance) that benefits them, US can be the promoter for a better application of these rules. However, the US does not often suggest rules to assure markets for the SSE for its products with added value, except when there is a common interest for that (as the coca switch) for small, non potential production<sup>60</sup>. The United States can exercise the role of leader to reach governance and political stability in the countries of the region. As Kindleberger (1973) mentioned, there is a need for a hegemonic power from the point of view that the world economy needs international common goods and that the production of common goods has free-rider problems. Kindleberger tries to show that one leader can impose a collective choice on other countries against their individual interest in the search for a plan that can benefit the whole international community. In this case, the benevolent leader has to take care of the costs of the supply of common international goods for the small countries that cannot afford them; therefore, the downfall of the leader is then problematic for the preservation of the international system (regime). In this view, small economies are free-riders that gain from the inequalities at international level, blaming in the imperialistic economies that are bigger and richer. Because of this, the leader has to take care of the costs of supply for their common goods as in Latin America would keep a good democracy that avoids dictatorship, production and smuggling of cocaine, terrorism, laundry money, maintain neoliberalism and free trade, migration, secure FDI flows, etc. Being the leader with a greater different size of its economy, it is not a problem to supply with common international goods because the advantages at international level exceed the costs of supply (Kebabdjian, 1999).

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<sup>60</sup> Most of the products that are promoted to export through the ATPDEA for example are originated and produced between small size producers and non-traditional products. This assures that the quantity exported will not change so fast due to lack of knowledge and technology.

As we have seen, Brazil and the US depend less on international trade than the SSE. Even so, part of these economies trade are very influenced by agricultural lobbies that exercise political power; accordingly, free trade agreement is not always the case, being Brazil especially, one of the most closed economies of the region. For the US, the agenda is often more political than it seems and there is something to be gained in this context with FTAA. The US did not stop signing FTA bilateral agreements with other Latin American countries. Having nine FTA<sup>61</sup> within the continent shows that US knows how to open up foreign markets. All the current FTA signed within the continent and outside account for over 42 percent of US exports although those countries comprise 7.5 percent of global GDP, they are beneficial to US<sup>62</sup>.

On the other hand, for Brazil, the signature of FTAA leaves the country in a weak bargaining position for trade when facing the US. Brazil is a big growing country but it still depends greatly on agriculture which can be less competitive when competing with the agricultural products of the US. Brazil is used to being the leader and the largest economy within the South American region. Its bargaining position in the region is important and greater than any other countries. Even when Brazil has higher import tariffs than the US, on the side of exportations, this is not the case. Moreover, the US has quotas for the 15 most important Brazilian exports to the United States which are charged on average, a tariff of 45.6%. When the quotas are surpassed, US tariffs on those commodities can reach 350%. Brazilians acknowledge that many of their exports also confront numerous phytosanitary barriers and quotas, such as those applied to tobacco (IRC, 2002).

Some criticize the US policy for thinking small and negotiating pacts with relatively SSE as found in the entire Latin American continent, since it covers only modest volumes of trade. These critics fall into two camps: those who want bigger deals in economic terms (e.g. Baucus, 2003; US Chamber of Commerce, 2003) and those who argue that the US policy is cherry-picking easy-to-do pacts taking difficult issues that were hard to reach multilateral consensus at the WTO (e.g. Guy de Jonquieres, 2003; Wolf, 2003). In response, US officials defend the policy as maintaining momentum for trade reform, and establishing precedents for broader regional and multilateral initiatives (e.g. FTAA). Conducting parallel talks at the

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61 Several FTA were signed with US: Canada, Mexico, Chile, Peru, Dominican Republic, El Salvador, Guatemala, Honduras and Nicaragua in the continent. For the future it has in sight: Colombia and Panama. Other FTA in the world are: Australia, Bahrain, Israel, Jordan, Morocco and Singapore.

62 International trade Administration, 2007. Free trade agreements. US.



bilateral, regional and multilateral levels generates the constructive process of competitive liberalization and offers channels for pursuing liberalization in case so-called foot-draggers (Zoellick, 2002) that seemed to stop progress in the Doha Round this last July 2008. Despite the work in progress for the signature of more FTAs with other SSE countries seem to come to a halt, the potentiality to open up a market with US will prevail. The US remains a very attractive partner for trade and FDI inflows in the national economies of the SSE. Nonetheless, this potentiality has been reduced by the strong efforts of Venezuela and Brazil to increase their presence in the SSE of the region.

## **D) FTAA conclusion**

### **The impact of regionalization on the SSE is:**

#### **Bolivia**

- Bolivia reduced trade shares with U.S. in relative terms since Bolivia increased trade with Brazil, in the energy sector (oil petrol).
- Real agricultural and manufactured products are exported to U.S. for Brazil for instance is mostly energy what increased in the last years.
- An agreement with U.S. could be difficult for Bolivia, since it will need to import goods from U.S. that harm the Bolivian market, also the products that Bolivia can export are not always demanded by U.S. or do not meet SPS requirements unless the export is within SDT.

#### **Ecuador**

- Trade with FTAA is staying stable. However local markets and regions are taking over as. This is also the case for overseas areas like China.

#### **Uruguay**

- Compensated a relative loss of trade with FTAA to the rest of the world, most likely due to a reduction of the trade barriers in combination with its direct sea access.
- FTAA for Uruguay basically means Brazil and Argentina that are the major partners.

#### **Paraguay**

- Trade with FTAA is underperforming if we compare it to the theoretical trade gravity.

- Trade is shifting to other than FTAA overseas, mainly to China and this can be due to the river access that gives the otherwise landlocked country access to the sea.

For the SSE, joining the FTAA would be interesting as long as the US market is willing to reduce its trade barriers (SPS/TBT), and subsidy its programs to agriculture. The FTAA strives to deepen uncompleted disciplines in the WTO and aims to have free trade across the countries with the same rights and obligations for all member countries to avoid discrimination. It is difficult to have the FTAA without hurting the national economies and agricultural sectors of the SSE. SSE have created a group to assess their small size but not to assist them in negotiations. There are different points that the SSE would need to add to the agenda, mostly dealing with the difficulties to access markets as SSE, or with the case of government expenditure that seek common interest of welfare. Nevertheless, this is difficult if the LSE do not accept to include these issues in the agenda.

In order to have a better negotiation position, all SSE members might lean more towards the strategy to negotiate as a bloc, rather than from an individual position. The group that was formed accounts for more than two thirds of the bloc, and still none of the countries have presented a list of difficulties as a group. On the contrary, each of them has negotiated to solve their own difficulties and has not presented any suggestions on how to solve them; there are no common suggestions. In fact, for the first time, most of the regional blocs were sitting together but could not negotiate as a group. The intention was to copy and compare the best out of every agreement but not to negotiate in a group. The division between the SSE in two ideological groups, leftist and right wing created a division in their negotiations as well. The countries that wanted to continue with the deals in the FTAA and the other group that initially doubted to join which later increased against the position of the US over the region.

Even when the FTAA negotiations in group appeared more interesting than an FTA between two countries, some signed the FTA when the FTAA seemed to have stopped. After all, the FTAA as a trade-bloc is more attractive in the economic sense than the ANCOM bloc for instance, and with the right agreements it might be able to give a push start to certain production. What is remarkable to analyze is the trade exchange between the SSE members of Mercosur and ANCOM. Bolivia and Ecuador depend on ANCOM for a rather small part of their trade, between 8-10%. However, their dependence on FTAA is around 69%, which erases any doubt that the SSE members' are much more interested in the FTAA than only

ANCOM. A different trend applies if we analyze Paraguay and Uruguay. They depend respectively for 73% and 41% on Mercosur. Their dependence on FTAA is only 11% and 18%. This is not too much considering the participation of other trade partners. Therefore, Paraguay and Uruguay are quite good within Mercosur only and would not really push for becoming a member of the FTAA. Maybe they would obstruct it, since both countries heavily depend on agriculture which does not produce any subsidies as in the US. In that case they need to line up their demands together with Argentina and Brazil to make a strong point for their denial of participation in the FTAA.

It is true that Bolivia and Ecuador now are currently not interested to sign an FTA with the US. This refusal is more political than economic. Political because the ideology is different now and has its origin in the bad economic and welfare results in the last twenty years of neoliberalism. The result of a huge gap between poor and rich in their economies is to blame the neoliberalism and the American international politics of dominance in the entire region. The unbearable economic situation and social unrest has led the two SSE to no other position than to change their political strategies to start relying in the region. This new position is leaving behind the dominance of the US in the region. This would not have been possible without the money that hydrocarbons and minerals are bringing to the region through their exports, through a big donor as Venezuela and through the gigantic demand of China to their natural resources. It is also true that Paraguay and Uruguay have requested in 2006 the signature of a FTA with US. This request was more a threat to the Mercosur so they could make evident their protest against a restrictive access to their main partners' market (Brazil and Argentina) due to their SPS/TBT barriers. Nonetheless, the signature of FTA with US would have not been possible since they would endanger their national markets more than doing a benefit for them. A FTA with US is not of much use since most of their trade goes to neighboring countries. Uruguay for instance only signed a bilateral agreement on investment but not on trade. This could still be an option to reduce the dominance of Brazil and Argentina in its economy. Both SSE also had to start up relying in the countries in the region, based in new promises and efforts of Brazil to make it worth being in Mercosur for every member.

Despite, FTAA negotiations are currently frozen or not attractive to SSE, is still a potential for trade and supranational governance and development. The US remains the largest trade partner and the largest donor to development in the region. This keeps a constant American

influence in the region that could keep latent a possibility for signing an FTAA in the future. Nonetheless, FTAA is something that needs to be followed carefully, not only because it affects trade but also because it affects sovereignty and welfare. For this, it is important to enhance negotiation capacities. SSE like Bolivia, Ecuador, Paraguay and Uruguay do not have much power to negotiate with big neighboring countries like Brazil or larger markets like US by themselves. In the case the FTAA exists in the future, this could be a real opponent of the European Union trade-bloc, but shows at the same time that it is also very difficult to have 34 countries agreeing on trade-tariffs and specific agreements because of the huge differences of economy size and different levels of development. Especially, larger and strong economies like US might need to give up certain level of protectionism to give way to trade with smaller economies. Another point of disagreement is agriculture subsidies that such a large economy as the United States has against agriculture based economies of SSE or relative SSE. Those protectionist measures are conquests of the lobby groups of specific sectors in that country and their strong lobby activities exercises such an amount of influence to the government that they do not even want to consider certain points in the political agenda when negotiating the reduction of trade-barriers. The US wants to keep protectionism in agriculture. There are no economic reasons for the larger countries to keep trade barriers but are political reasons that make it difficult to change them. Dropping them would mean that some sectors would suffer but the overall economy would win because it can obtain certain products for a lower price. Hence it is a political decision to not lose votes, since even if it is only a small part of the economy that would suffer the number of people or families affected could still easily go towards thousands due to its big population.

SSE could demand trade rules and mechanisms of cooperation for productive development to reduce the asymmetries between their economies and the US. For this, it would be necessary to establish a funding for concession of credits and grants to strengthen their productive base and market systems. SSE want to have an access to the US market admission to reduce the enormous gap between their production and exporting standards. To make this effective, the US has to abandon protectionism and fulfill their leadership role in a more proficient way, helping smaller economies improve their development conditions and improve their social problems.

An FTAA with immediate release of all the trade barriers would be impossible due to the size differences in the continent. Therefore, the path for a successful FTAA has to be step by step

reduction of the trade barriers, similar to the one of WTO. In this sense, it could be discussed what are the advantages of having such a big trade bloc when similar negotiations are already taking place in the WTO. Each agreement needs to be assessed with surgical precision to know if all countries agree. This can lead to a similar type of negotiations at the WTO. Maybe the FTAA is an ambitious project that should have started with smaller steps. As experiences showed in the WTO, trade negotiations are difficult and susceptible to political and economic climates in the different countries. An interesting paradox is that a larger economy has no problems in handling people who could lose their jobs due to the FTA, but the strong political pressure would still push the idea of integration aside. A small size economy suffers a lot from the downside of free trade and cannot handle the impact. Worst, a small economy does not have the capacity to have a political or economic position to stand strong during negotiations.

At this moment it seems that FTAA has stranded in endless discussions about agriculture and intellectual property rights. Some say the dead-end is because of US hard time to quit with subsidies to agricultural sectors, protectionism and because it does not want to grant effective different treatment to smaller economies. Looking further into that, it shows directly that protectionism is a result of the lobby of certain sectors and not necessarily of politicians. With the exception of Venezuela, Ecuador, Bolivia and Paraguay that now have a different ideology that are against FTAs, the other countries block the agreement due to strong lobby positions. The sectors with power and client politics have more influence than the advantages for consumers to eliminate the FTAA. US, on the other hand, did not stop FTA bilateral negotiations with other economies in the continent and is trying by all means to sign FTA with the most important economies in Latin America. This also represents a threat to the economies who do not sign an agreement with US because this would leave them out of FDI inflows and trade preferences that have a positive impact within national economy and a huge US market potential that could get lost if they are not willing to sign the FTA under the US conditions. For the SSE, FTAA with the current agenda is the expression of domination from the United States over the region. As the current governments say, the FTAA means a deepening of the neoliberalism and would create levels of dependency and subordination without precedents. This is why the majority of the countries at the head of Brazil and later Venezuela rejected an integration on neoliberal bases that represents the lack of unity of the Latin American countries, greater poverty, food dependence and an absolute subordination to the dictations from the outside. On the other hand, the US government will continue trying to

push them in other Latin American countries as a good alternative to economic growth, proposing countries to benefit from free trade and democracy to avoid the protectionist and populist economy models.

### Perspectives

At present, it is getting more notorious that South America is divided in two economy models. Five over nine countries in South America are turning to left-wing, trying with this to close the gap between poor and rich inside the country. The right-wing believes that is free market that will lead towards development. US for the second time had the initiative to welcome on September 24 (after the 63e General meeting of the United Nations) to eleven countries with which US currently has FTAs or is in process to it, to a meeting that proposed going right-wing. Canada, Mexico, Chile, Colombia, the Dominican Republic, Peru and five countries of Central America, plus the World Bank and Inter-American Bank of Development met there to discuss the “Pathways to Prosperity in the Americas”. This meeting intended to put on table another alternative for a political vision of the hemisphere to the “populist economy”, or the model suggested by the presidents Venezuelan and Bolivian. The affirmation of the new left countries has pushed US to modify the geo-strategy equilibrium in the continent and the hemispherical relations going further than just an economic integration but also political. This is why President Bush set the Joint-Declaration to be an economic and political type of cooperation. For the first time, US tries to engage with this declaration into a deeper integration and this engaged positively a group of countries that still believe in the US as a market and as a leader.

Certainly, US has lost a lot of power in Latin America and this space is being taken by President Chavez taking advantage of the large aid-cooperation that can be done with the petrodollars. This has even accrued the discontent towards the domination and imposition of the US in the region with the way it cooperated and the conditions that US settled. Therefore, US have to add new elements to the type of domination that was applying until now: **deep integration** that not only is economic but also political; the second is **space to sovereignty** to stop getting too much involved in the way the SSE solve regional or national problems. If these two aspects are not changed, the US domination in the region will only get weaker since all the countries want to gain more independence when it comes to the solution of their problems. SSE will still need assistance on managing their national social and economic

projects in a more proficient way. A good example of this tendency is the problem of drug control in Bolivia, and the intervention of the DEA and USAID. Bolivia removed these organizations from its territory but pleaded with the US to keep donating money to maintain the drug control project and to extend the program of ATPDEA, which is very important for the national economy of the SSE.

The economic interest of this meeting was to present a “plan B” to the FTAA that came to a halt in 2005. The ideas presented by Bush were to unify and benefit the members on a large scale trade. With this meeting, US also wanted to show that the countries that signed a FTA with US would be benefiting with different preferences for its agricultural products and a free-trade market that others could be missing opting for socialism and based only in oil exports as Bolivia and Venezuela. This meeting gives a threefold option: a) another option for all the countries that do not want to join the extremist socialism of Hugo Chavez and keep searching for options in free-market and neoliberalism. This keeps an important axe in the economy of neoliberalism and freedom to chose against the socialism for the 21<sup>st</sup> century that is also gaining more supporters; b) keeps the region in a multi-pole base: US is still in force despite all the discredit raised by Hugo Chavez between the SSE and will keep being a strong counterbalance against Venezuela’s project in the region and with the SSE.

The revindication of the left-wing is present in the region and the most likely target to move into this faction are the SSE. The adoption of the populist left wing as a political model by Bolivia, Peru and Paraguay is worrisome to say the least, since this shift entitles radical changes in the economy and politics. The triumph of neoliberalism seems outdated and this means the search for a replacement for trade and political partnership at international level. Besides, the radical changes adopted by the SSE means that multilateral integration and institutionalization as the region knew until now is potentially going to change towards a common project of the region and with a stronger common position that avoids the US and other multilateral organizations as the IEOs out of the planning of their national economies. The strengthening of their populist position in the SSE is leading towards the creation of regional institutions (bank of development, meetings to solve common regional problems). The SSE position is shaping a new form of international insertion foreseeing a sustainable development. Challenges for the US and the new type of integration are launched to keep domination in the region and particularly in the SSE. It is difficult though to go back to the level of domination that the US had until now. In this scenario, the SSE played an important

role in exposing the nuisances to international insertion and development when a dominant country like the US reduces the sovereignty in such a way that the SSE are kept in a poverty cycle because they are not able to adapt well to international markets without the help of US aid.

## 5.2 China

China has established nine free trade areas (FTA) with different partners in the world during an interval of a "Five Year Plan" (2001-2005). In addition, in the past five years, China has established relationships with 27 other countries and regions on the grounds of a establishment of FTAs. Several countries in Latin America were included in these talks. Up to date, China signed the China-Chile FTA in November, 2005 and the China-Peru FTA in November 20, 2008. Regarding Costa Rica, they have decided to conduct a feasibility study on an FTA. Furthermore, China has established a strategic partnership and cooperative relationship with Brazil, Mexico, Argentina, Venezuela and Chile. China has always had a friendly relationship with Cuba. Besides, China has signed investment protection agreements with Cuba, Jamaica, Bolivia, Chile, Argentina, Uruguay, Ecuador, Peru and Barbados.

China has not yet signed any FTA with a SSE in the region; on the other hand, China started negotiations with Mercosur and signed agreements with Chile and Peru. Increased warming political ties between China and Latin America are creating the good environment for increasing trade negotiations and overseas investments so China not only can assure its provision of raw materials but also assure that its top steel, metal, oil producers and suppliers are established in Latin America.

In 2003, Luiz Inacio Lula da Silva proposed the creation of a free trade area among the members of the G-20 group of developing countries<sup>63</sup>. The proposal intended to create a concept of discussion and to reach a common position regarding the agricultural issues. This idea was launched because G-20 wanted to apply pressure over the larger nations, with the intent of considering eliminating or reducing agricultural subsidies and opening their markets. Currently the idea is still in the air and no country dared to sign a FTA with China facing the risks of oversupply of their national economies. For China, the basis for signing a bilateral

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63 The G-20 countries include: India, China, Brazil, Argentina, Bolivia, Chile, Cuba, Egypt, Indonesia, Mexico, Nigeria, Pakistan, the Philippines, Paraguay, South Africa, Tanzania, Venezuela and Zimbabwe.



FTA have a “two wheel policy” (Morin, 2008) which means that one is oriented to the signature of FTA with developed countries and another is oriented to the signature of South-South regional agreements<sup>64</sup>. Both types of agreements bring different gains and China takes advantage of both of them as we will see bellow. In any case, China is interested in removing tariffs and restrictions on goods to further promote service and investment markets among member states. China is not only interested in having a greater access to raw materials and energetic sources at lower prices, but it is also focused on finding open markets for its foreign investment, so that their top companies can settle in a determined country and start producing at the standards that China needs. These actions plan to leave out the intention of having a deep integration. Nonetheless, China is improving the FDI investments throughout developing countries with a promise to improve capacities, create a national industry and a compromise with the protection of the host countries environment in the host, increasing the rhetoric towards a new type of cooperation. Since China is offering to become the voice for developing countries in multilateral negotiations in the WTO and different IEOs, many developing countries think that China will play a more important role than the US as a leader. In 2010, China’s total GDP was 2.666.771 billion dollars and a population of 1.305 million people living in an area of 9.596.960 km<sup>2</sup>. With a constant average year growth of 10%, China is lining up to be one of the most important economies in the world in the upcoming years. China’s population has an average of 59.5% for productive population, 33.5% of young people between 0-19 years old and 7% of 60 or more years which means that 40.5% of the population depends on the income that 47% produces. In China the percentage of people that will have access to a retirement pension is scarce and endangers the future welfare of elderly people. Moreover, China has taken advantage of the large availability of human resources in the productive age (59.5%) and a relatively low use of technology compared to the amount of human workforce in use. This however, represents a great threat and challenge for China’s future productivity and growth at international level in the next seven years, because many of the workers will start to retire and companies will face a scarcity of human

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<sup>64</sup> This double strategy is known in China as the “two wheel policy”: one turns for economic and technological cooperation with neighboring developing countries and the other for trade and investment liberalization with developed countries. Large developing countries could strategically become the axle between the developed and the developing worlds.

resources due to the reduced amount of children in the society nowadays<sup>65</sup>. Currently, the growth of the population that came to consumption has also raised new challenges in matters as health, agriculture and energy provision for its own population. This all, affects and influences the potential of cooperation that China has with other developing countries, especially the SSE.

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**Figure 5-6** China and SSE countries.



Source: Adapted from Google images, 2010.

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Currently, there are two types of interests for the SSE in the pursuit of trade deals with China:

- a) one is the left wing group in the SSE headed by Venezuela who searches for political interests. This group is looking to change the global dominant (the US) for a multi-pole dominant which allows the raise of new leaders in each region;
- b) the other interest is the economic interest that searched in China a new large market with reduced or non barriers to trade. SSE hope to change its trade dependence with the US for the one of China, a country that can pay more for imported products as well. In the group, China is the largest size market with 61 times compared to Ecuador's GDP (the largest SSE of the group). Though it is only

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<sup>65</sup> The one-child policy of China raises many questions to the researcher as for the amount of human resources available for work in the future; as a factor to take advantage to reduce prices of the goods offered to the world. Moreover, other questions of the gender imbalance due to abortion and male birth preferences are also to be assessed in the future. It appears that what seemed to be the best way to control the demographic growth of the largest population in the world seems to be also its major threat. This problem is starting to appear in the media of China as the interview the Los Angeles Times got from the state media in China: "The one-child policy was the only choice we had, given the conditions when we initiated the policy," Wu Jianmin, a spokesman for the advisory body to the Chinese parliament said on Sunday March 2<sup>nd</sup>, "So as things develop, there might be some changes to the policy, and relevant departments are considering this." And this is supported by Lu Jiehua, a population studies expert at Peking University "There definitely will be changes in the future. The question is when and what is the most appropriate way to get there" (Los Angeles times, "Questions raised over future of China's one-child policy", in print edition A-6, Tuesday, March 04, 2008, Los Angeles).

2.87 times the GDP of Brazil, China would still be the leader of any bilateral agreement with the SSE due to its GDP and trade size. In trade, China is 66 times larger than Ecuador and 7 times larger than Brazil. With this knowledge in mind, it can be said that the strategy followed by the SSE is to form a pact for trade negotiation against the larger economies of developed countries, especially the United States, with the intention to reduce its dominant position in the region and the world with a country that is socialist and considered to be developing economy.

There are many considerations to take into account when trading with China, who represents a market that is hardly known among the SSE. Since trade has increased greatly and it is predicted to increase even more in the next years, it is important to analyze in detail what it means to trade with China, and what challenges this poses for the SSE. The aim is to try to assess the potentialities and risks of an FTA with China (implicit or explicit) and in this context, it is important to analyze current trade and FDI relations with China, the geopolitical interest, the lobby activity space that China is leaving to the SSE and its perspectives.

### **A) Geo-political interest**

**Geographical dimension.** One of the most important players in Asia in the last years was China, who has a population of 1.330'044.605 inhabitants. To give the reader an idea, all the population of the SSE together represents just the 2.33% of its population. The total GDP of the SSE together is 31 times smaller than the one of China; anyhow, the SSE could still be an interesting negotiation partner, as a group of SSE or as part of any of the South American regions. The main trade partners for China are the other Asian countries and the U.S. In the last years, China has increased trade with other countries in the world and has started negotiations with potential other potential markets. The common interest is twofold. One is based on the search for alternative markets where the products can be exported to, and in this way reducing, the dominant position of the US and the dependence of the SSE and of China on the US market. The other interest is to take advantage of the large size of China and have a counterbalance for the US' position at international negotiations; making China the active voice for developing countries within the IEOs. The objectives for a FTA with the SSE would be: to become the active voice and the axle between developing countries and developed countries. At the same time, China is aiming to sign FTA with developed countries with the

idea to keep improving their economic and technological level with a fluid trade with these countries. Both actions mean for China an amelioration of its negotiation power at international level which will also improve its trade flows with both, developed and developing countries.

For China, the potential for FTA has increased in the last years due to the size of the Chinese economy. Many researchers that have analyzed the impact of China on Latin America (Lall, Weiss and Oikawa, 2005; Machinea, 2005), have either emphasized the potential or the threat that trading with this country implies. Until now, only one study has been done to show the possible impact of China on the small size economies (Cordova, 2007) focused on the opportunities and dangers of increasing international negotiations with China. Currently, all FTA are negotiated with the SSE but in the region, larger economies are in the process of negotiating, or have already negotiated a FTA with China and are already experiencing some of the consequences. This is the main reason to analyze the geopolitical importance for the SSE. Even though there is no FTA with SSE, trade has increased from 0% in 1999 (both imports and exports) to 6% in average by 2009. The bloc with China is ruled basically by market power and an orientation to improve the SSE international insertion to reach development and to improve China's leadership position at international level to be able to suggest new rules for the world within the IEOs. However, even if China is a potential leader for developing countries, it appears to not be easy the delegation of it since in every region, some emerging economies want to establish their dominant position in their region. This is the case of Brazil in South America, who is currently competing with Venezuela for the leadership position. Hence, China is one of the models that countries would follow, but it is not the only option, the US is still very close to the South American countries and is always a good option for the SSE. This situation and China's main goal of having an FTA makes it difficult for the creation and organization of supranational institutions between regions and the harmonization of national trade rules that could benefit the group or bloc. Even when China is not very interested in changing the supranational rules, it has increased its dominant influence in several regions in the world and especially in South America. In the official statistics, trade has increased between China and South America; but this has not happened in a balanced way in the SSE, where imports have increased but not exports. Exports have not increased for Bolivia and Ecuador; nonetheless, Uruguay and Paraguay have increased its export destinations to China. Still, China has visibly increased its aid-assistance for development projects and its participation in the media.

Despite the geographical distance and culture with China, the SSE had seen a considerable increase of trade in the last eight years going in some cases from 0 to 20% of their total trade (Unctad Statistics, 2010). China is considered a developing country but in trade is a large size economy (LSE) due to its productivity level and capacity to reduce the international prices<sup>66</sup>. The main concerns for the SSE in the last years is that the Chinese products have been invading their national economies leaving no space to national industry that is incapable anymore to keep competing with such a reduced price level. Despite the low level of quality of the Chinese products compared with national industry in the SSE, the population –that is within the poor or medium class with great wishes to increase its consumption rates, price is key factor to define a sale. Accordingly, Chinese products are eliminating competence through the elimination of national industry in SSE and neighboring countries.

Contrary to other FTA or regional agreements, trade deals with China involve a economic interest and political interest. As described before, the interest of China is to create domination power through the increasing dependence towards its economy. Aid-assistance, foreign direct investments and an active voice for developing countries are key factors to increase dependence of China between developing countries and are also a way to reduce the dominating power of the US between the SSE in the region. One this increasing dependence occurs; China can consolidate its power face to developed economies, particularly face to the US negotiation power. Then, political interest emerges from the side of China and its desire to have an increasing participation in the world market to increase at the same time their geopolitical participation in the world. Nonetheless, even if this increasing dependence in trade with China is occurring, China has not gained a dominating power between the SSE. Media, trade, FDI, negotiations and culture are still dominated by the US. In the case of the SSE, dominating power from Venezuela or Brazil is increasing in the region, leaving out China. For that reason, the economic interest is more important than the political interest for SSE. SSE are more attracted by the economic growth and international insertion that China gained in the last years despite its economic and political model. Some SSE (Bolivia and Ecuador) even are looking up to China thinking that is the economic and political model that pushed its enormous growth; and they want to follow the same policies (Malamud, 2007). Other SSE

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<sup>66</sup> It is true that many persons would not agree to tag China with a high productive level because of its low use of technology and intensive use of human resources (called non productive factor) in its industries. Nonetheless, the great number of people that can work at the different hours can perfectly replace the technology and reach a higher level of productivity that could even push down the competitive prices of other industries.

(Uruguay and Paraguay) as well as other South American countries see China as a country that separated the ideology from the market, liberalizing its national market to push growth (Razeen, 2007; Malamud, 2007). The lack of a good assessment or governance control in the SSE against asymmetric competition is the cause for SSE to not have yet any policy to control the imports coming from China. Worst, SSE are only trying to adapt to negative consequences in their national markets without any specific policy.

**Contractual Force.** For the SSE, the signature of a FTA with China will mean a direct opening of their national markets which would mean a direct asymmetric competition. Then, a FTA is not feasible to occur between the SSE and China. Nonetheless, SSE continue to increase trade with China even more and there is the need to negotiate with China certain aspects: economic and political. Seeing that SSE have difficulties with international insertion and development face to LSE from developed and developing countries, China could be a partner proposing a new type of integration with these type of economies. Future agreements with similar economies could rise in the world if China is really willing to "*guarantee the economic development*"<sup>67</sup>. Thus, new regulations could be taken now into practice within the small group of SSE to have positive externalities of integration. However, both, China and the SSE see a different contractual force in their relations. On one side, the SSE want to join China (not in a contractual way) in order to reduce the dependence towards the US not only in trade but also in financial assistance and national defense. They also want to take advantage of the large Chinese economic growth and export towards it with high prices that could finance national social programs. On the other hand, China could join the group as part of its global cooperation to developing countries and initiate investments in the sector that mostly interests China, oil and gas. Even so, China has an increasing preoccupation to the new socialist SSE (Bolivia, Ecuador and now Paraguay) and its derivation in nationalism, their consequent nationalization of oil and gas resources along with its unpredictable protectionist programs. This keeps China with cautiousness in the investments (Malamud, 2007). China had already some conflicts with the government of Rafael Correa in the sector of oil investments in 2008<sup>68</sup>. This somehow influenced China to increase FDI-inflows with

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<sup>67</sup> Zhu Hongbo, is a professor at the Latin American Research Institute of Shanghai's Fudan University and assures that his government is not seeking political and military interests in its ties with Latin America.

<sup>68</sup> Given that China is interested in reliable access to primary products, the Chinese government and its investors are probably not pleased by the Ecuadorian government's attempt to force Chinese companies represented by Andes Petroleum to renegotiate its oil holdings in the country into a service contract, just two years after it spent \$1.42 billion to acquire these assets. The People's Republic of China (PRC) also controls a significant portion of petroleum production in Ecuador through the Andes Petroleum consortium and Petroriental. (For more

more stable countries as Brazil, Argentina, Peru and Chile where a “socialistic agenda from extreme left” does not endanger its expansion plan. Chinese may prefer countries that have a political and diplomatic plan that is premeditated as the one of China. Then, trade agreements with China are characterized by strong asymmetries, with preferences for stable LSE and countries that are oriented towards taking neoliberal measures that assure their investment flows. Trade with China is oriented through comparative advantages that each country that trade with China has. Therefore, SSE can negotiate in a better position only when they can offer a product that China needs. However, SSE start up with a disadvantage already and is because China chooses to sign trade deals with stable countries that have large size production and that can offer a constant supply. SSE have small scale supply and this is a great disadvantage for a common agreement with China.

Entrepreneurship in SSE are aware that trade with China is difficult due to the small scale production<sup>69</sup>. However, governments know that integrating with China can have a strong political interest that can derivate in an economic significance as mentioned in geopolitical interest. China could represent the SSE in the IEOs with its political and economic power; and reduce their dependence to the US by supporting their socialist cause. China does not any specific program to cooperate to the SSE in their specific demands to the WTO or other IEOs. In the last meeting of DOHA, China did not engage in fights on behalf the SSE<sup>70</sup>. Moreover, China seems more interested in asking for complete liberalization of markets in developed countries. Nonetheless, China is currently cooperating in other sectors. One of them is national defense. Another is the international relations within the region. China also became an observer of the OECD, OAS, ALADI and ECLAC in order to check the upcoming events in Latin America and how these countries relate with the US and the world. China is one of the many socialist countries that is selling war weapons to Hugo Chavez. Despite that unsettling fact, in January 2005, China announced that it was ready to work together with the Andean Community in reinforcing the mutually beneficial cooperation with the community, in the fields of telecommunications, natural resources, infrastructure and trade and investment promotion, but until now, nothing has been defined yet. Moreover, it started investments in

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information read: Statement of Robert Evan Ellis. “Before the House Committee on Foreign Affairs, Subcommittee on the Western Hemisphere, One Hundred Tenth Congress, Second Session. University of Miami. June 11, 2008)

<sup>69</sup> A fast browse trough the journals in the SSE, one can see that companies ask for the opening of new market possibilities to their governments, except with China due to due to high scale supply requirements.

<sup>70</sup> In the last DOHA meeting, it is India that fought more for a common cause of the SSE and developing countries rather than China and Brazil.

oil and supermarkets in Ecuador avoiding direct signatures with ANCOM. Even so, China and Russia have subscribed an agreement to acquire systems of radars and weapons of war<sup>71</sup> for Venezuela<sup>72</sup>. Part of this weapons have been finding their way into Bolivia as a donation from Venezuela with the excuse of providing national security for oil and gas reserves in the country and keep them far from the right wing and the US. In this area, China has been close to SSE, maybe not with the intention to support them politically but more with the intention to expand its aircraft industry in the region. Bolivia was benefited during the 1990s with the donation from an amount from artillery material, including portable missiles of antitank air defense (MANPADS) and missiles, and recently it contracted the transference of two cargo planes MA60 for 35 million dollars. Professional qualifications: In several occasions, Ecuadorian officials and soldiers went to the Institute of Infantry of the Ground forces of Shi Jia Zhuang (China) to participate in the courses on strategy and commandant's office, acupuncture and combat under special conditions. And the Uruguayan Armed Forces received a donation of personal equipment in 2005 and also logistical support worth 500 thousand dollars whereas the Army of Ecuador received two primary training airplanes Nanchang BT-6. It seems that China is more interested to boost its aircraft industry and a greater expansion of its industrial artillery in the region rather than cooperation with the SSE.

**Nature of the activities.** This type of integration focuses its main activities on the market. China uses these activities to gain more power at international level, and compete with the US. Agriculture is a key sector for all the SSE, and it has proven to be of great importance to China. However, China rarely imports goods from SSE, it prefers to mostly trade with LSE of developing countries that can provide products in large scale. For China, the most important assets are new sources of oil and gas that can cover its energy needs for development in the long run. Western companies worry that the Chinese state-owned firms with which they suddenly find themselves competing, have an agenda beyond commercial gain. As the Economist magazine (2010) says, the Chinese government is willing to pay over the odds for

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<sup>71</sup> Venezuela aspires to acquire China's J-10A fighters; Chavez has disclosed that negotiations with the Beijing government have been under way for some time. Venezuela and China are also close to a deal on the import of 24 Chinese-made K-8 trainer aircraft, according to a source within the Moscow aviation industry. Chavez announced the deal before his visit to China in September, but the Beijing government has not officially confirmed it. Therefore, China has been actively promoting the K-8 to Latin American countries (United Press International, Journal from November 5<sup>th</sup>, 2008).

<sup>72</sup> The Commando of Operations of the Air defense of the Venezuelan Military aviation will receive 28 three-dimensional radars of long reach JYL-1 of China manufacture. The same will be received within an agreement of cooperation signed in August of 2005 by the Venezuelan Minister of Defense and company Electronics Import and Export Corporation of the People's Republic of China.



mining or drilling rights to secure access to physical resources unfairly intervening on behalf of its companies', they claim, by offering big aid packages to countries that welcome Chinese investment. All this, it is feared, will dent the profits of big oil and mining firms; encourage inflation and imperil the West's access to the resources that it needs, even some journals tell that China buys oil exchanging war weapons<sup>73</sup>. And we could see that China is more eager to expand its weapon industry over the world. In any case, China increased oil and mineral extraction investments in the region, taking aside traditional investors as the US and Spain. Notable examples include the \$500 million agreement between China Minmetals and the Chilean national mining company (CODELCO) for the advance purchase of copper, joint ventures between the Chinese firm Baosteel and the Brazilian mining giant CVRD, plus the purchases of the Rio Blanco copper mine in Piura, and the Toromocho mine in Junin, involving a collective investment of almost \$3 billion. They also include ongoing interest by Shandong Luneng in developing some part of the el Mutún iron fields in Bolivia. The Chinese companies and Petrochina recently invested \$1.42 billion to acquire assets in the petroleum sector of Ecuador; China has also provided \$4 billion in loans to Venezuela through the "heavy investment fund" with the possibility of providing up to \$18 billion through this vehicle. With Uruguay is a more double way China-Uruguay, different to the other SSE. The two sides have carried out small-scale cooperation in rice growing, grapes cultivation and light trucks assembling. By the end of June 2002, China had set up 6 joint ventures in Uruguay, totaling an investment of \$4.33 million, with Chinese investment at \$1.83 million. By the end of 2002, China had signed 38 labor contracts worth \$12.16 million in contracted value with \$1064 million completed. Uruguay has invested in 16 projects with China, yielding a total contracted value of \$3.69 million and actual investment of \$1.69 million. These facts show that China is opening up more to FDI-outflows from Latin America, especially in the energy and agricultural sector. For this, Latin America is a promising market where abundant raw material can be found for its growing national needs.

As an exchange of the investment in SSE, inexpensive Chinese clothing, toys, and footwear, both legitimate and smuggled goods are increasingly prevalent in the region. Although it receives less attention from the SSE governments, it can also be evidenced that there is a growing infrastructure in both the formal and informal sectors as a result of selling these

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<sup>73</sup> UPI, 2008. "China penetrates Middle East, Africa with arms-for-oil deals". Written by Andrei CHANG. Nov. 5, 2008 Washington.

UPI, 2008. "China boosts weapons ties with Venezuela, Brazil". Written by Andrei CHANG. Nov. 7, 2008. Washington.

goods. It is visible that SSE moved their economies from national production to importing Chinese goods. This is causing vast failures in national provisions because Chinese products can be found even in small towns. In the case of Paraguay, the President Fernando Lugo mentioned his intentions<sup>74</sup> to strengthening relationships with China with an economic interest in mind. This is all leading to a greater dependence on imports from China at low prices. Unfortunately, for the SSE, China's increasing imports in the region does not leave room for its own industrialization which maintains the SSE in the cycle of raw-material providers, often dependent on price fluctuations. Therefore, China has the power to influence in the main activities of the SSE and the countries in the region now with its long-term investments in oil and minerals. China is also willing to cooperate in the construction of roads in the region to make trade easier to transport its products as well. However, it did not create any institution that can harmonize the regulations for trade between China and these SSE. China vows for the adhesion to the international regulations that the WTO proposes more than vowing for the SSE particular needs.

**Role and responsibility of the leader.** The leader in the bloc is China and planned a strategy to get closer to Latin America in the last 10 years. Its main purpose is to prevent the integration of the entire region through the current types of FTA or regional agreements. Its type of agreement proposed is a FTA that can ease trade and assure its investments with a potential of equity and granting the capacity of industrialization in the country for the SSE; although without much social and welfare cooperation<sup>75</sup>. Being a country that had an enormous economic growth in the last ten years, China is still expanding its dominance across the different regions of the world by proposing new types of trade and investment, than differ from what the United States was offering. This fact is reducing the participation of the US as the main leader and partner in various developing countries, particularly in the SSE economies. Basically its interests with the region are economic. Nonetheless, its political interests are to increase power in front of all developed countries and become an active voice for the IEOs gaining a better negotiation position in front of LSE.

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<sup>74</sup> "If other nations have trade and diplomatic relations with continental China, why should we stay behind?" said Lugo, a former Catholic bishop, whose election Sunday ended 61 years of one-party rule. Read more in: Herald Tribune, "Paraguay's President-elect Lugo vows to establish relations with China for first time", written by the Associated Press. Asuncion.

<sup>75</sup> When Chinese investors come to any of the SSE, they promise to invest and grant the capacity to industrialize national exploited resources. It also assures that operations will take care of the environment. The Chinese government promotes these types of private investments. On the contrary, none of the projects of cooperation are with a social goal as health and social improvement.

If it was their desire, China could take the role of leader in the bloc, but it seems that this nation is not willing to play this role inside the region. The Chinese President, Hu Jintao has been visiting South America with private projects in mind and with proposals for long-term investments in natural resources. These initiatives went according to the scale of production from joint-ventures in agriculture (as with Uruguay) to oil and mineral exploitation (Bolivia, Ecuador). Other type of cooperation or political support to the new nationalistic countries was rejected in the visit of Chavez to Beijing. Chavez had requested cooperation in the political side but President Hu Jintao denied it by offering just economic cooperation and more trade openness (Morin, 2008).

China is increasing its power of influence in the region and this is creating a polarization effect between to the unique dominant (the US) in the region until now. Chinese Foreign Minister Yang Jiechi has stated (2010) that in the current world where multi-polarization and economic globalization continue to deepen, a closer China-Latin America relationship is objectively inevitable and in line with the fundamental interests of the two peoples. For a better common future, the joint efforts made by the two sides would create a model of South-South Cooperation, with mutual political trust as the foundation, economic and trade cooperation as the impetus, and mutual benefits and win-win as the consensus. Increased orientation to Latin America has been showed from China that in the last years has joined several organizations as the UN, WTO, G-77, ASEAN-Pacific, OEAS, ALADI, ECLAC observer. China did all this to benefit its preeminence in the world by reducing the influence of the only U.S in the region. This and the unwillingness of US to perform tighter relations in South America increased the influence of China. Nevertheless, China has some disadvantages for SSE in the political and economic side that would be worth to pay attention on. First one is that China does not ask restrictions to SSE when it is going to provide aid or FDI. Economic and social reforms are not in the objectives of China with the region and hence money is provided easily. For China its most important interest is to have infrastructure available for larger scale production and transportation of its products in these countries. Then, large amounts of money go into this interest. On the other hand, large amounts of money arriving to some SSE are supporting its government's temptation to back-away from market orientation into leftist ideology to handle the country. The second disadvantage is that China has avoided political meddling and has not an oversight on legislative agreements. In fact, with China it does not raise the need to sign any trade or integration agreement to start

up with trade. Moreover, it does not need a country to be more or less democratic to start up trade. This provokes that China does not create a base of the rule of law or a base to assist the SSE in the economic or political development, for instance to increase democracy values or reduce corruption. The third disadvantage is based in the economic side and is that as soon as trade started with China, SSE noticed a huge imbalance on their trade balance which is cause imbalances in the balance of payments of the SSE. This could cost a reduction on long term government investment for improving its economic and social side which at the same time could raise social unrest and migration. Agriculture is a key sector for all the members in the bloc but China has not increased its imports of food with the SSE. China and the SSE have no regulations settled for SPS/TBT measures; therefore, exchanges done are not based on the WTO regulations. Until now, it is not know any difficulties with the SSE in agricultural trade. On the other hand, Chile and Argentina that have signed already a FTA agreement with China have faced difficulties in trade. Argentina even has set a complaint at the WTO office for its differends with China.

The reason why an approach towards China was proposed was based on the economic and political interest of the SSE. China is considered to be a large economy and a good option to substitute the US as a partner. China is the sixth largest economy in the world; it has the third largest defense budget and has the largest middle-low class population in the world. Thus, China seems to be a very interesting market opportunity for SSE's, in terms of improving trade and international insertion. China gained importance in the world trade, with impressive FDI-outflows 226.488 US dollars in 2009 or 14.15% of its GDP towards developing countries and SSE during the last years, it has also internationalized its economy until it reached the first places of exports in the world. SSE have seen that other South American countries as Brazil and Chile have steadily increased their supply of raw materials (agricultural products and minerals) to China, benefiting from high prices and growth in their national GDP. SSE are also searching for ways to improve this mutual attraction with China in order to boost their national economies with steady demands from this nation. This would mean another option to have a better internationalization of their economies within a left-wing vision and maybe a enhanced cooperation with the SSE in trade and development than what other countries were giving. Nonetheless, China represents a potential threat for SSE and their national industries that cannot compete with the low prices that their products offer. In the last years, China's imports have increased at a rate of 200% per year (LAIA, 2008) and this is bound to discontinue and close national industries.

On the other hand, SSE are also interested in China for both, economic and political reasons. Economic reasons can be described in three ways. First, the SSE are in a process of political change and for this initiative to be successful it is important to reduce the influence and dominance of the US in the country. This is why, the SSE is trying to increase potentials for trade with other large country and a potential leader for the world as it is China (Jianping, 2007). Second, trade dealing with China is convenient because it means that exports are large due to its soaring internal demand and also they have a higher price. For the SSE it is better to put efforts in dealing with China if they want to leave behind the dominance of the US. Third, FDI regulations can be settled by the SSE according to their needs and China is willing to accept the conditions, contrary to the US or EU companies. In the months of August and September (2008), Bolivia has been contended with the United States in different issues: interference with the policy of Bolivia, the expulsion of USAID from the regions of coca leaf control, Army forces in Peru and the rescission of the ATPDEA with Bolivia in the month of October.

Politically China is interesting because they belong to the group of developing countries and to the group of socialist countries. As a developing country, China is attractive for the SSE because it has a convenient negotiation position in matters of free access to markets (SPS/TBT measures) within the policy of the most favored nation (MFN). China can improve the inclusion of developing countries in these matters through the benefit of having a stronger position than the SSE. As left wing countries, Bolivia and Ecuador are interested in luring China over to their side, driven by the idea that China is the potential country that will lead the future of trade. Making a political pact with China means a big threat to the United States and its world model of neoliberalism. The possibility to change trade gives the SSE the possibility to have a common fight against the imperialism and colonialism that the US had in the world and particularly in the SSE. It also means the reduction of domination forms that US brought to SSE as the legal system for trade (WTO), financial system (IMF, WB), cooperation for development and directives that the SSE had to follow in order to be considered a country willing to internationalize in trade and working for its national development. As a result, being China the largest socialistic country in the world and having evidenced an enormous economic growth per year together with an increased internationalization in the last ten years, gives a new hope for the alter-model that the SSE want to adopt, “the socialism for the 21<sup>st</sup> century”.

However, it is important to consider China's threat to the national economies of the SSE. Brazil and Argentina for example, are losing market share to China's supply of because their products can compete due to their reduced prices and fare quality. This phenomenon is pushing Brazil to assume a stronger role in the region to hang on to its geopolitical position as a leader. This means that Brazil has been visiting different countries in the region improving its projects of development and cooperation between neighbors, leaving little space for China's intervention. Brazil and Argentina have created import quotas for Chinese products whereas the SSE have not assessed themselves for a common position against the threat that these imports represent for them. On the contrary, SSE have searched the approach and cooperation from China. The reason was mainly political because SSE need to counterbalance the domination of the US in the region and for this, they need another large economy where they can balance the missing power.

The geopolitical attraction of SSE and China seems to be benefiting both parties but there are many facts to take still into account. Any of the SSE has signed any FTA with China yet. The closest neighbor that signed is Chile and this document will serve as a base for a potential analysis with the SSE. The FTA with Chile is based in the norms of multilateralism. Basically, the FTA followed the same procedure for multilateral agreements promoted by the WTO and including the same topics: Institutions and administration of the treaty, access to markets, trade defense regulations, rules of origin, SPS and TBT measures, norms for controversial solution and cooperation. Moreover, it was subscribed a memorandum of understanding for labor and social laws, cooperation in environment and special access to markets. Topics of the negotiation were agreed within the WTO and other international organizations (APEC for example) establishing the FTA under the supranational institutions and multilateral normative. The same, China pushed the creation of a Committee assigned to work on specific programs for SPS/TBT barriers in order to ease trade. The agreement also contains the MFN to stimulate the expansion and diversification of trade eliminating the obstacles for trade and favoring the development of the other nation (Chile). For this, China accepted to sign a detailed agreement for the MFN that promotes the tariff cuts of 92% for the Chilean exports, allowing 7% of sensible products stay under a category of 10 years delay for tariff cuts and 1% of them within the list of exceptions; whereas for China, only 50% will have tariff cuts. China is willing to show other potential partner that since 1978 China is trying to open its markets more and since the join to the WTO, the five-year plan (2006-

2010) includes a program for its economic growth and development together with the countries that cooperate with China. This plan is part of a scientific and strategic strategy that searches for humanitarian development with harmonic social development that allows China to obtain good results and stability of its model and its new phase of change<sup>76</sup>. With this, China intended to show a new type of cooperation and partnership in trade and investment and distance themselves from what the US was offering to the world. This strategy is certainly working for different developing countries who are switching to this partner. The SSE are searching for trade agreements, new foreign investors and new types of Special and preferential agreements.

In the last years, the Chinese domination over the SSE's economies has increased. Currently, China directs the markets (raw materials, products, etc.) with an increasing demand on raw materials and is defining the international prices for such products without taking into account the effects of this on the world's inflation. In the last five years, China has been influencing the market of raw materials in the SSE. This influence had a stronger impact on Paraguay and Uruguay than on Bolivia or Ecuador. China has implemented companies that would extract raw materials from the SSE and later export them back to their native country. The main objective of this is to assure the constant provision of raw materials for its national industry (JIANPING, 2007).

## **B) Geo-Economic performance**

**Nature and Empirical analysis of trade.** Since China became a member of WTO and their production boosted, different regions came in the scope of China as potential target markets, including South America. Without the need of a trade agreement and just by taking advantage of its very competitive prices, clothes, furniture and electronic products started to flow to South America and SSE where not exempted. On one side this was a threat for SSE since many of the products China exported overlapped with their national production. For some local producers this meant big trouble, since consumers obviously preferred the cheaper products. Quality started to be similar compared to the one offered in South America. Competitive prices eliminated barriers of distance and culture; even the SPS/TBT barriers

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<sup>76</sup> Direccion General de Recursos Economicos Internacionales, 2006. FTA China-Chile Agreement. Ministerio de Relaciones Exteriores de Chile. May. Santiago de Chile.

demand in customs where not that much of a problem anymore due to improved prices<sup>77</sup>. This could be the main reason why the Chinese government was not interested in pursuing a bilateral trade agreement with any of them.

China focuses its interest on a country, when the partner has natural resources that could be of potential use to the Chinese industry. The increasing visits of its President to different countries in South America can be seen as a clear example of this interest. There are many reasons that can explain this behavior. The increase of its production destined for trade towards the United States and Europe, raised controls and limitations through quotas for Chinese imports. The reason why China wants to install production bases is to open up possibilities for exporting free-of-tax from developing countries, though it would be hard to prove this with the statistical data available in the SSE. At the same time, the consumption patterns have changed in China, according to its industrial orientation and its high productivity. These changes in Chinese consumption have had an impact on trade patterns in SSE<sup>78</sup>. The imports of raw materials from the SSE have also increased in the last five years, in a percentage of 491% in outstanding tin and oil. This could explain the decrease in the production of raw materials from China (-25.85%) in the last five years. Despite the fact that agriculture and mining are still very important sectors for China<sup>79</sup>; they only represent 17.3% of the GDP unlike the decade of the 80's when the percentage grew to 29%<sup>80</sup>. This means that China moved from a secondary sector into a tertiary one reducing the primary sector. This urge for agricultural and other production from the primary sector is one of the reasons why China is going out its frontiers and Asian region into the SSE and other developing countries. Another reason is the fact that despite the increase of 53.9% in the production of hydrocarbons, the requirements from China have still increased. This has driven China to use other sources of energy, like natural gas (China possesses little gas resources), oil and hydroelectric power, reducing the use of coal. This is the second reason why China is oriented towards finding new providers of energy in South America. One main partner is Venezuela for oil and other potential partner is Bolivia for mining and investments in discovery and exploration in oil. Thus, Bolivia has been promoting China as an important

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<sup>77</sup> The SSE with the exception of Uruguay have more than 50% of their imports done via contraband that avoids SPS/TBT controls and taxing.

<sup>78</sup> SSE trade patterns are increasingly moving to exporting more raw materials (agriculture and energy) and importing more manufactured products.

<sup>79</sup> The government has strong local policies for preventing migration from rural and mining areas, and fosters agricultural production

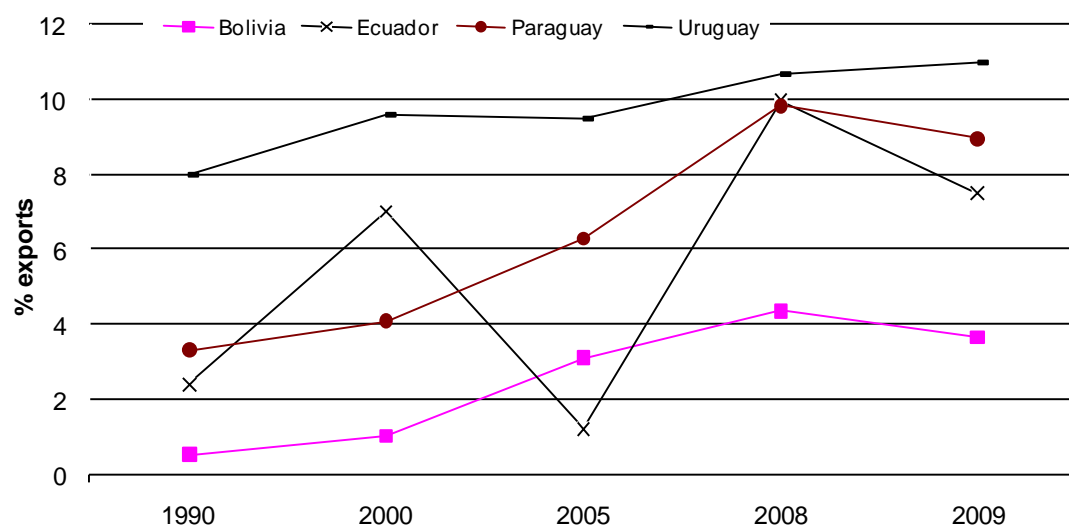
<sup>80</sup> NBS. China Statistical Year Book 2005. Ed. By China statistics press / Beijing statistics press. 2005



partner that not only offered to invest in a different way than the US, involving the society and promoting development with more effective government control to not have an excessive exploitation of natural resources.

Exports of primary products and raw materials from Latin America have been increasing in recent years although not in the SSE because of a comparative advantage for natural resources. Moreover, the development of Sino-Latin American relations is also conducive for the future of SSE countries to further enhance their diversification of foreign economic relations since SSE search for a diversified diplomatic strategy. One of the most important components of this strategy is to expand foreign economic relations, reducing their dependence on the United States market and seeking other trade partners across the world that go along their leftist orientation. Then, the rise of China could enhance cooperation between the South-South, promoting the development for SSE and socialism for the 21<sup>st</sup> century that Chavez is constantly promoting and comparing with the successful case of China. SSE believe that enhancing the relationship will safeguard world peace and development in each of the SSE that maintain relations with China (figure 5-7), the problem is that all other regional countries are following the same pattern, so that competition continues to be based on productivity and comparative advantages.

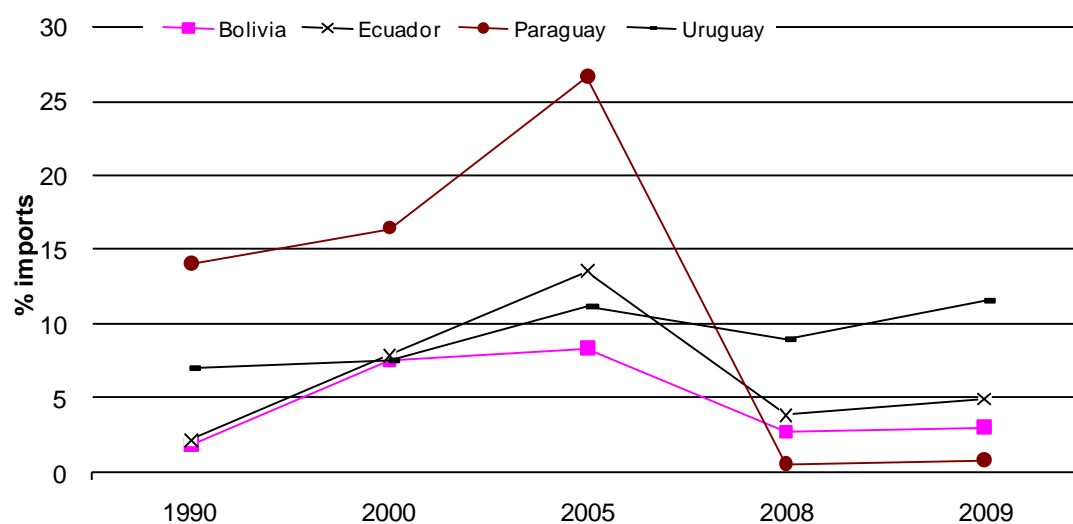
**Figure 5-7. SSE: exports to China and Asia, in percentage, 1990-2009.** SSE have increased the participation in exports with China and Asia in the last years, mostly with raw materials.



Source: Own calculations based on UNCTAD, Geneva, 2010.

China and India for example, have increased export shares with SSE and this raised preoccupation in the SSE because they have been swamped with Chinese products that directly compete with their national industry (clothing, textiles and other manufactures). Worst, imports are higher than what statistics show because of smuggling. Huge shipments of cargo arrive to the different frontiers (Arica and Iquique in Chile; and Montevideo in Uruguay) loaded with Chinese products, free of taxes and free of quality control (SPS/TBT norms), mainly due to a lack of rigorous inspection or to corruption. Figure 5-8 shows the increase of imports towards SSE countries. This type of trade represents a danger for China because of their small competitive labor market and natural resource management. The most affected is Paraguay, well known for smuggling and pirating products that later gets in the markets of all South America, mainly Brazil.

**Figure 5-8. SSE: imports to China and Asia, in percentage, 1990-2009.** SSE have increased imports with China and Asia in the last years in different sectors except in the years of crisis where neighboring countries were more important.



Source: Own calculations based on UNCTAD, Geneva, 2010.

In table 5-1 one can see that the relative trade shares of exports and imports increased rapidly in less than 10 years. Imports from China managed to obtain a significant share in all SSE, which is not the case of exported goods to China, who did not increase much. One of the countries that was most influenced by China is Venezuela in exports and Paraguay in imports.

**Table 5-1. SSE and Venezuela: Relative Trade Shares with China (percentage of total exports/imports)**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<b>Exports to China</b>															
Bolivia	0,0%	0,0%	0,0%	0,0%	0,3%	0,4%	0,4%	0,6%	0,7%	1,0%	0,7%	0,8%	1,2%	1,9%	2,4%
Ecuador	0,4%	1,4%	3,0%	1,2%	1,9%	1,2%	0,2%	0,3%	0,2%	0,6%	0,1%	1,5%	0,3%	1,9%	0,9%
Paraguay	0,0%	0,0%	0,0%	0,0%	0,0%	0,7%	1,1%	0,8%	1,3%	2,7%	3,8%	1,0%	1,8%	2,1%	0,7%
Uruguay	5,9%	4,9%	4,5%	2,8%	2,8%	4,0%	5,0%	5,6%	4,3%	3,9%	3,5%	4,1%	3,6%	2,9%	4,3%
Venezuela	N/A	0,0%	0,0%	N/A	0,0%	0,1%	0,4%	0,4%	0,7%	0,8%	0,4%	0,2%	0,2%	3,8%	16,5%
<b>Imports from China</b>															
Bolivia	1,1%	0,8%	0,5%	0,6%	1,5%	3,5%	5,1%	5,2%	5,1%	5,8%	5,8%	6,8%	7,7%	8,3%	8,4%
Ecuador	0,6%	0,0%	1,1%	1,2%	1,7%	3,2%	4,3%	5,3%	7,4%	9,2%	9,6%	9,6%	11,7%	12,5%	11,7%
Paraguay	0,0%	0,0%	0,0%	0,0%	0,0%	11,4%	11,6%	12,6%	12,4%	15,6%	19,1%	25,6%	27,8%	27,4%	27,4%
Uruguay	1,2%	1,5%	1,7%	2,1%	2,7%	3,2%	4,0%	3,8%	3,9%	5,5%	6,2%	7,3%	9,6%	10,2%	11,9%
Venezuela	0,0%	0,0%	0,0%	0,2%	0,5%	1,3%	2,0%	1,9%	2,1%	2,9%	4,8%	7,2%	9,6%	9,5%	10,4%
<b>Average</b>															
Bolivia	0,5%	0,4%	0,2%	0,3%	0,9%	1,9%	2,7%	2,9%	2,9%	3,4%	3,3%	3,8%	4,4%	5,1%	5,4%
Ecuador	0,5%	0,7%	2,0%	1,2%	1,8%	2,2%	2,2%	2,8%	3,8%	4,9%	4,8%	5,5%	6,0%	7,2%	6,3%
Paraguay	0,0%	0,0%	0,0%	0,0%	0,0%	6,1%	6,3%	6,7%	6,9%	9,2%	11,5%	13,3%	14,8%	14,8%	14,1%
Uruguay	3,5%	3,2%	3,1%	2,4%	2,7%	3,6%	4,5%	4,7%	4,1%	4,7%	4,9%	5,7%	6,6%	6,5%	8,1%
Venezuela	N/A	0,0%	0,0%	N/A	0,3%	0,7%	1,2%	1,2%	1,4%	1,9%	2,6%	3,7%	4,9%	6,7%	13,5%

Source: Own elaboration based on data from ALADI, 2010, [www.aladi.org](http://www.aladi.org)

Taking a closer look at table 5-1 we can see that almost all countries have increased shares on trade with China (average). Paraguay is on top with an average share of 14.1% followed by Venezuela with 13.5%. Then, if we compare these values with the expected gravity in table 5-2, we can see that in 2009, values are way above this value. Therefore, China became more important than expected by Tinbergen's gravity model. In table 5-2, we are also presenting the ratios of the relative real trade shares. For example, the ratio 1.7 in 2006 for Bolivia has been obtained by dividing 3.8% (real relative trade share) with 2.19% (expected gravity). The result of 1.7 shows us that the expected gravity (that should be 1) is over passed by real trade taking place between China and Bolivia. With this table, we can have now an easier way to compare the current situation of each SSE country.

**Table 5-2. Ratios of expected gravity with real relative trade shares with China (if 1, then is equal to expected gravity)**

	Gravity	Ratios with real relative trade share (higher value means more trade than expected based on gravity)														
		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Bolivia	2,19%	0,2	0,2	0,1	0,1	0,4	0,9	1,2	1,3	1,3	1,6	1,5	1,7	2,0	2,3	2,5
Ecuador	1,93%	0,3	0,4	1,0	0,6	0,9	1,1	1,2	1,4	2,0	2,5	2,5	2,9	3,1	3,7	3,3
Paraguay	2,14%	0,0	0,0	0,0	0,0	0,0	2,8	3,0	3,1	3,2	4,3	5,4	6,2	6,9	6,9	6,6
Uruguay	2,02%	1,8	1,6	1,5	1,2	1,3	1,8	2,2	2,3	2,0	2,3	2,4	2,8	3,3	3,2	4,0

Source: Own elaboration based on data from ALADI, 2010, [www.aladi.org](http://www.aladi.org)

For the majority of the SSE, all the ratios that before 2000 were below 1, afterwards present a higher value above expectation. The only exception is Uruguay which had always been above 1. Taking a look at table 5-1 we see that Uruguay always had a steady share of exportations with China, but in the past years this has been reinforced by an increasing share of

importations. We can also confirm that Paraguay has traded more than expected. The ratio of 6.2 is very high and has made Paraguay highly dependent on Chinese imports. The explanation can be found in the fact that Paraguay has a river that has access to the Atlantic Ocean, the Paraguay River. This waterway has always given Paraguay the opportunity to trade legally and illegally. What is imported from the US and Asia for example, is mostly to be sold to Brazil, Argentina and Uruguay. Then, with the chance to import cheap products from China, Paraguay increased this share and in consequently its economy because of trading with its neighboring countries. The underground economy may equal the formal economy in size, although greater enforcement efforts by the tax administration are having an impact on the informal sector in the last years (De Soto, 2002). The same applies for Bolivia, the rates do not seem high enough compared to what one can observe in the streets with the informal sector or with what the companies are selling. Almost all the products are from China; even some companies which used to produce only in Bolivia are now importing cheaper products to sell. The change in the economy is notorious, turning into an economy completely oriented towards importing without paying too much attention to national production. An incredibly dependency on Chinese imports has been settled in SSE and it is expected to keep increasing. One could expect that the ratios have gone out of the normal value because of the rapid adaptation of China to new trade opportunities. The fierce competition makes this interesting for consumers but companies from SSE are not capable to compete with same low prices in the same product ranges. This caused that many close its doors and others fell back to the production of raw materials to export to China and other countries. Industry development then, might take more time than expected and even it may not occur if China increases its exports rates with SSE or Latin America.

Another downside factor is the productivity in the economy of SSE against the rapid increase in the production capability of Asia, and in the last years specially China. The slow growth of per capita income and per capita consumption in the SSE creates the risk of a faster saturation in the SSE markets. This fact can be a negative determinant for FDI inflows. SSE cannot compete with LSE from the region for China's FDI inflows for example. Besides, low labor productivity in the SSE makes production in manufacture industry out of competitiveness. Despite of the several numbers of researches done in labor productivity in the SSE, the data available in them is of one or two years and not in all countries of our analysis. Therefore, no further details can be analyzed on this neither a good suggestion to improve failures. Still, it is well known that wealth and economic growth of a country are in part impacted by the

capacities of research and creation of know-how to translate it into the implementation of new technologies. If this does not happen, then the SSE could remain with low labor productivity and this will keep them in the vicious cycle.

### **C) Game theory on regionalization**

In order to have a better idea of SPS/TBT or other barriers that SSE are confronted with at the hands of China, we will present different case scenarios. Game theory will be applied to different problems of trade to show the position of SSE and possible ways of reaction. This analysis is critical in the search to enlighten the possible ways in which the SSE could improve their trade position and international insertion. Therefore, this part could be of use to decision makers in SSE for future negotiation patterns at international level.

#### **Bolivia, Ecuador, Paraguay and Uruguay**

##### *Lobby Activity*

SSE do not possess much power in negotiations with China for various reasons. One of them, is the fact that China is looking to negotiate agricultural imports in large quantities, and SSE are incapable of providing this amount of most of their products. The energy sector is the only possible advantageous ground for negotiation, since the lack of capacity for investments on industrialization can be covered by China. Besides, China headed in its proposal for better foreign investment conditions which could benefit both, development and international insertion. Having a prosperous energy sector (oil and mining) can be considered strength in negotiations for countries like Bolivia and Ecuador. For Uruguay and Paraguay the strength for negotiation is in the fact to have important ports (Uruguay) and network of distribution (Paraguay and Uruguay) for sales and retails in the region.

Up to now, China has not signed any FTA with SSE, but has made arrangements with neighboring countries in the region, as is the case of Argentina, Peru and Chile. What it can be seen in the neighbors agenda of negotiations is that China can get out of its agreements every time (see case of Peru), showing that there would probably not be much power of negotiation for SSE or the advantage of any special treatment. Bilateral FTA do not give much space to have a common negotiation position for the SSE, neither for getting special and differentiated treatment for all. The tricky aspect in the FTA with China is that this country is not only a vast market but also the world's fastest growing economy. SPS/TBT

agreements then can be drastic and not take into account the difficulties that SSE have for coping with those requirements.

### Box 5-5. Three Cases of FTA with China

#### Case 1: China-Chile

#### Nash Equilibrium Strategy

#### Background:

Chile is the first Latin-American country to sign an FTA with China. Both nations have good complementarities in trade relationships and as a result, both benefit from trade. Chile is the largest producer and exporter of copper in the world. It also counts with large reserves of coal, iron and fishing. China needs large quantities of these minerals for its development. It turns out that China is the largest consumer of copper. They also signed an agreement of cooperation for 15 years at market price for the exportation of copper between Corporación del Cobre (Codelco from Chile) and Minmetals from China. This agreement guarantees a long term provision of these resources to China and ultimately an increase in trade. However, this created a decrease in trade with Europe, North-America and Latin America. China exports many products to Chile like: textiles, Art objects, ceramics, raw materials, Chemicals, handicraft, medical equipment. China imports from Chile: copper, nitrate, cellulose, wood, fish flour, wine and fruits. In this context, the game then will be based on the following assumptions:

Both follow the agreement (A)

Both do not follow the agreement (NA)

Gains will be:

- If China and Chile, follow the agreement, both will receive more income and trade relations will increase (1,1)
- If both do not follow it (NA), Chile will not receive income from Colombia and China will not have sufficient metal. Both will have (0,0)
- If China does not follow (NA), and Chile follows, Chile will have a better gain (0,1)
- If China follows the agreement and Chile does not. Chile will lose in (1,0)

		China	
		A	NA
Chile	A	( 1,1)	(0,1)
	NA	( 1,0)	(0,0)

China and Chile have increased trade exchange to such a degree that China became the second trade partner after the U.S. Nonetheless, Chile has decreased trade with other Partners which can in turn lead to a dangerous reduction of diversification. The game assumes that Chile has to close out contracts with China and will diminish trade with other countries to avoid shortage.

- If Chile exports to China and also to other countries, both nations could benefit with (1,1,1)
- If Chile does not fail contracts with China and to achieve this Chile does not export much to other countries, then Chile increases dependency with China and gains will be less (1,1,0)
- If Chile fail to reach contractual agreements with China but continues exporting to other countries, Chile will have a smaller economic gain but sufficient enough to overcome the lost opportunity of becoming a critical part of China's market (1,0,1).
- If Chile fails to China and fails to other countries, then the rent will be (0,0,0) for all.

Numbering order: 1st Chile, 2nd China, 3rd other countries. From point of view of Chile:

		Other countries	
		A	NA
China	A	( 1,1,1)	(1,1,0)
	NA	( 1,0,1)	(0,0,0)

**Analysis:**

The best strategy would be to continue exporting to China because it is an expanding market and represents a considerable income. However, it is also important to increase the production capacity to continue exporting to other countries with the idea of not falling into a dependency on one or a few markets. This all will maximize its profit.

**Case 2. China-Peru: Tariff reduction****Nash Equilibrium Strategy****Background**

China and Peru intensify its negotiations for the FTA. For Peru, China is a market of 1.300 million inhabitants and constitutes the second country where Peruvian exports are directed. In 2009, it represented a growth of more than 40% than in 2008, particularly with mining products like copper, led, iron, zinc, but also in other products for exportation as is wood and fish. Still, Peru is asking more the agreed reduction in tariff per items, up to 10% for textiles and shoes that are the sensible products of Peru but China denied because they did not want more than 8%. Besides, China had already asked for immediate tariff liberalization for quinoa, kewina and other cereals that Peru wants to do in a period of 5-10 years. Peru criticizes China's policy on the grounds that this nation encouraged negotiated differentiation at first, but now it is unwilling to admit them and it does not want to accept any differentiated treatment. Peru wants a major reduction in the tariffs per items (PA) and China wants a total opening of the Peruvian market, even in the sensible products as textiles and leather. The strategies of both are:

PERU: - Exclude from the list sensible products from a tariff reduction. (EL)

- Do not exclude the sensible products from the list (NEL)

CHINA: - Grants the possibility of tariff reduction by items.(PA)

- Does not grant tariff reduction by items. (NPA)

- If China grants (PA) and Peru chooses (EL), then, Peru has more gains in (0,1).
- If China grants (PA) and Peru chooses (NEL), then, both have a high gain in (1,1).
- If China does not grant (PA) and Peru chooses (EL), then, both lose in (0,0).
- If China does not grant (PA) and Peru chooses (NEL), then, China gains and Peru loses (1,0).

		Peru	
		EL	NEL
China	PA	(0,1)	(1,1)
	NPA	(0,0)	(1,0)

**Analysis**

The best strategy is for China to Grant differentiation, so that Peru can liberalize its market bit by bit and prepare its national industry to face strong competition abroad. Peru should try to put a limit in the time differentiation for the complete liberalization of the market.

**Case 3. FTA China-Argentina****Successive Strategy game****Background**

In 90s, Trade balance among Argentina and China was in deficit, but from 2003 up to 2006 Argentina had a positive trade balance with China. In 2007 it changed again for a deficit of 210 million dollars with China and it keeps in a similar situation until now. Since 2007, imports have increased by 54% while exports only reached 10%. According to statistics of INDEC, Argentinean exports to China reaches 5.380 million, 48% more than in 2006 and imports reaches 5.127 million, 63% more. Main products that are imported from China: machinery (43%), chemicals, metals and plastics. Exports from Argentina to China are: soya, oil petrol, energy derivatives mainly.

When the Argentinean government became aware of this situation they announced in 2007 that they would limit the import of low quality products to protect its local industries and to try to

balance its trade balance. So, restrictive measures were set on final goods, increasing control in costumes for trade fraud, overpricing and tax evasion. For this, every export had to have a visum from the Argentinean embassy. The reaction of China was immediate, claiming that Argentina did not announce anything and that they reserved the right to use retaliate methods blocking 200 thousand tons of soya arguing that was SPS measures. China and Argentina need to find a way to solve these differences (R strategy) or this conflict prolong itself indefinitely (NR).

- If China and Argentina chose (R), then, both will have a major advantage having a free trade (1,1).
- If China and Argentina chose (NR), then both will continue in conflict (0,0).

Considering the point of view of Argentina:

- If Argentina chose (R) and China choose (NR), then China has a higher gain (0,1).
- If Argentina chose (NR) and China choose (R), then Argentina gains more (1,0).

		China	
		R	NR
Argentina	R	(1,1)	( 1,0)
	NR	( 0,1)	( 0,0)

#### Analysis:

Argentina and China chose the strategy NR because anybody wants to cooperate to harmonize its differends. They both want to retaliate in order to benefit one side in trade. The game for both is successive where one is trying to use again its already played strategies. The best strategy for both is that both negotiate better and have common actions to increase trade and benefits together. If actions are taken separately, one player will have more gain than the other.

#### *Strategic pay-off within the trade-bloc*

China has no requirements for legalizing an integration agreement (a bilateral FTA for instance), and is only interested in multiple bilateral investment treaties (BIT), and double taxation treaties (DTT), to protect its investments overseas. Apart from that, SPS/TBT agreements are not settled between countries or defined a common rule. Thus, they are ruled under the WTO SPS/TBT agreements and no special and differential treatment (SDT). Thus, there are no supranational institutions that could watch over the interests of the SSE within the FTA. Another problem is that China does not require neither economic nor social improvements for negotiating an FTA, the agreements are purely economic and related to trade exchange. This aspect can be positive for those SSE that want to exercise sovereignty in the management of the national economy trough their particular vision of development. The disadvantage is that SSE do not have the capacity to orientate their economies towards the path of development and internationalization, if they do not have support (whether political or economic). Another negative aspect is that SSE by themselves, do not have the power to negotiate and make their particular interests and needs prevail. If China would offer to stand



for developing countries of small size at international level, it would be of great benefit for SSE, because China holds a stronger position than any single SSE country.

Intra-trade within the FTA with China, a SSE has to check constantly the economic pay-off as well. This is because, China has easiness with production in large scale and its companies are orientated and prepared for export while a SSE not. This can turn negative for trade balances of SSE, soon after signing the FTA. Therefore, a SSE has to permanently assess the internationalization policies towards trade with China. It is advantageous if the country foresees exporting natural resources with an advantaged position, e.g. under a preferential treatment for instance.

## **D) China conclusion**

### **The impact of regionalization on the SSE is:**

- Venezuela is taking more advantage to trade with China than SSE countries.
- Still, all SSE increased the import shares with China in detriment of U.S. and E.U.
- Exports from the SSE to China seem more complex than thought. It goes from raw materials to manufactured goods depending on the specialization of the SSE.

As soon as an FTA is in the stages of negotiation with China, the smaller economy can easily realize that China has a dominant position (as presented in the game applications presented above). However, China has no intent of influencing the particular view of development at a political or economic level in such a direct way as the U.S. China leans more towards the idea of making the sovereignty of each country prevail and the right to develop their own policy without worrying about the governmental structure of the country. What China is looking for at an economic level, is the chance to gain support from different countries regarding the replacement of the US dollar used in the international economy, for a currency that is reliable and does not suffer the consequences of the financial crisis in U.S. In terms of trade, China can immediately gain a positive balance for its own benefit. Without having any trade agreement with China the SSE have evidenced that their trade balances have become negative in the last five years. This is also caused by the national consumers in these countries, who are willing to buy Chinese products due to the low price and similarities with the latest technology that well-known brands have.

The advantage of arranging a FTA with China is that China has a large vast market in which the consumers consume raw materials (e.g. agricultural, food items without much added value) since their own production is not enough for the entire population. This can be an option to enlarge trading partners for SSE. However, China's trade with developing countries fluctuates overtime greatly. This instability is influenced by changes in each country's trade policy and the international environment. Generally speaking, developing countries' trade policy is usually not as stable as that of developed countries, and their ability to adjust according to the changes in international environments are rather limited (from REF: Trade Pattern between China and Developing Countries, 2009). Having a strong relationship with China also ensures a common and empowered position for negotiation in terms of developing countries, not for small size economies. This is why, SSE should insist to China in a position that also takes into consideration the SSE and their difficulties and needs.

The negotiation of a FTA with China demands a constant assessment of the pay-off of trading with China not only in imports but also with exports. This will help SSE to acquire a clear vision of the future trade and internationalization policies, which need to be adopted in order to have a win-win situation and a better development at national level.

## ***Conclusion of the second part***

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### **SSE: Impact of regional integration**

Multilateralism in Latin America is not as attractive as regionalism, maybe because the effects of trade and internationalization become evident faster than with multilateralism. Besides, with regionalism, sovereignty at a regional level is providing a new way for individual countries to internalize and create new national policies. In South America, Brazil and Venezuela are trying to reduce the dominant position of the US in order to institute their domination and ideology in the region. Brazil bases this dominant urge in its economic needs (internationalization through industrialization) and Venezuela bases its dominant urge in implementing the socialist ideology. China is another example of a leader that has appeared in the region due to economic interest (quest for natural resources), but seems to have no intentions of meaningful cooperation with the SSE or the region. Of course, it still remains to be seen if these leftist SSE will be able to overcome poverty and reach international insertion and development, with a visible lack of government capacity. Efforts to work with South-South countries in the region are currently being undertaken, with the intention to solve local issues or particular national problems, which could help to create a negative externality for the region. In this way, the influence of the US over the SSE has diminished considerably as well as its domination through the IEOs in the last three years. The new type of domination that Venezuela is imposing on the region, is creating new lines of South-South cooperation and financial systems which at the same time, separating the governments from the market. This cooperation injects easy money inflows, which can be destined towards social projects, without asking for anything in exchange, except a change in ideology, focused on leaving behind the US cooperation as much as possible. With this in way, the SSE in South America at the head of Venezuela proposed to create their own bank and currency to pursue a common regional development<sup>81</sup>.

This new ideology could easily turn into a geopolitical threat for multilateral agreements and for a global provision of public goods, since Venezuela, Brazil and China are proposing new

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<sup>81</sup> Journal The voice of Russia. ALBA launches regional common currency. Feb 4, 2010. Moscow

rules and new visions of what is development in the region. This vision is increasing the price of natural resources to have more income for social programs so that the society can back-up the government. Nonetheless, Venezuela, Brazil or China did not propose any other standard rules for a better management of the financial markets or for a liberalized market.

In the last years, trade and FDI have been diversifying and are no longer only managed by the U.S. As we have presented in this second part, other LSE from developing countries (as Brazil or China) are the ones managing international investments. However, numbers show that these new investors still have a relatively small participation in the world, but their share in the market is growing constantly. This creates a polarization of trade and FDI-outflows with at least one leader per region<sup>82</sup>, and in the world. The role of the U.S. in South America has considerably reduced, being that Venezuela and Brazil are taking new steps for South-South integration and cooperation. Venezuela especially, has been proposing different ways to cooperate between the countries without the assistance of the dominant U.S. The cooperation from Venezuela has been changing classic ideas of trade, dealing with a new set of prices and the quality of trade. Another example is China, who has introduced a new concept for cheap and reduced quality, but affordable to many poor people, have had an increasing success in the SSE consumer market. These new trends are not only showing positive results but also a certain degree of threat. The high competition in scale of production, quality and price with the local industries in SSE plus other problems (e.g. smuggling and an excessive import) has increased competition against national industry which leaves no space for local industry and manufacture at small scale. SSE are turning to be net importers for all industrial products and in the worst cases, even importers of agricultural food items which can affect employment, inflation and impact negatively upon society.

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<sup>82</sup> The countries known as the BRICS: Brazil, Russia, India, China and South Africa were leading their trade and FDI-outflows in their region, creating a sort of diversion of power that US or the EU had in those neighboring markets. In South America, also Venezuela has increased its trade and FDI-outflow shares in the region. This all has increased the tendency to a multipolarization of power in the world.

## General Conclusions

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The size of the economy is a consequence of different economic, political and social determinants that are related to one another. In the economic side, the reason why SSE are undersized, is based on their power of negotiation face to international relations (political side). The lack of power of negotiation hampers them, and consequently, they cannot have a better economic situation. The SSE have different characteristics that can explain why they just accept international negotiations (FTAs, bilateral or multilateral agreements) without analysis of their own needs and specific country situation. Most of the time, SSE find out the cost-benefit of the trade negotiation afterwards, sometimes, when their own industries have already suffered or when the impact to the population has created huge disparities and is causing huge social turmoil.

Now that empirical data and economic-political analysis has been done to show the negotiation difficulties that the SSE face in the different types of international arrangements, it is important to take all these multidimensional mechanisms of negotiation into account to settle potential ways of solving the problem, or at best, improving the power of negotiation. Evidently, the intention of this thesis is not to identify the solutions to this complex problem that causes the size of the economy. Nonetheless, after determining the facts and different situations or conditions, it is important to design measures and strategies to reach an improved model of negotiation for the SSE as a group, and to grant them a political-economic position as empowered nations. Ideological and political-economic divergences can still put them into crossroads and this should be taken into account for the effective cooperation and functioning of the inter-American institutions. This will avoid more polarization and high differences in negotiation between large and small size economies in the different arenas of negotiation. Consequently, specific points that we can draw from this thesis are:

*The Power of negotiation at international level do not always depend on the economic size of the country*

SSE can make use of more factors than the size of the economy during trade negotiations. Specific strategic production resources, like gas, oil or its location can be used to offset the

lack of economic power by strategic political power. Even a seemingly negative condition like poverty can be used to get special exemptions.

*Quality of governance important factor in trade negotiations*

An effective and strategically formed government will be able to create a strong team of negotiators with a particularly internal knowledge of the situation that can help to negotiate the key topics for the country and so, obtaining the best possible outcome for the SSE.

*Information available in the country critical for trade negotiations*

A country that is able to be constantly informed about current marketing circumstances in and outside the country, will have a better position in trade negotiations. It makes it possible for negotiators to discuss specific aspects of the economies in detail, and reach a deal that fits exactly to what the economy needs.

*Relative gravity is applicable for small countries if specific factors are taken into account*

Relative gravity gives in a good view of the trade situation of an SSE if taken into account small qualitative correcting factors. Most SSE are reaching are converging towards the relative gravity values (together with an overall increase of trade). Differences observed for SSE are political differences, special trade treatment, access to the sea and cultural differences.

*FDI is affected by SSE government's long-term guarantees and social stability*

A government which offers and shows guarantees and social stability will be able to obtain easier FDI that can motivate economic growth by incoming capital and create national spin-offs.

*A developing SSE depend – in relative terms - more on FDI than LSE*

Due to the lack of capital and research, a developing SSE needs FDI to be able to learn and create spin-off industries. LSE don't suffer from this economic gap, since they can generate sufficient capital and research to overcome that threshold.

*Trade-blocs in LA are not used to full potential*

Despite the effort of creating trade-blocs in Latin America, most of them are not used in their fullest potential. In many cases cooperation within the bloc is not used to create intra-trade

and in other cases the bloc doesn't stand up together in trade negotiations with large countries or other trade-blocs. In some cases the bloc's objectives only stay on paper and never became practice.

## **What would be the best practices for SSE?**

*SSE have to focus on very structured and high capacity governance to be able to cope with trade negotiations*

Trade negotiations are very intensive regarding knowledge and information. Therefore, if governments want to get the best out of these negotiations, it would be smart to prepare a structure to collect the right information with the best possible people. WTO, UN, World Bank would do best to promote an overall quality of government than to promote only the trade negotiation teams since this team is highly depended on information coming from other ministries.

*SSE governments, for the long term, should work on their comparative advantages to increase trader rather than trying to obtain trade preference deals.*

To be able to get the best from a trade negotiation, governments should focus in an advantage. At the current moment they prefer to focus on special trade preferences and exceptions from other countries. Focusing on improving their comparative advantages will, in the long run, improve their offers in the trade negotiations.

*SSE could use integrations/blocs to enhance their trade position but it might be even more interesting if the integration focuses on more than only trade.*

Trade blocs are often used as tools meant to strengthen the market power in trade negotiations, despite that there are many game-theory like problems. A more strategic and guaranteed action would be if the integration focuses on the trade within together with a better flow of goods, people and capital. This context can benefit the region as a whole, and improve their competitive position. Supranational organizations will need to support the stability within these regions in order to promote regional trade development.

*SSE governments need to have a strategic plan that goes beyond administrations about their competitive focus and where the country's industries should focus on and being pushed/subsidized.*

SSE need to focus on a thorough strategic plan that describes where the industries should be heading to. Since SSE normally don't have the luxury to have a wide variety. Therefore, a good industry policy is very important in order to create economies of scale and conglomeration effects. Government aid in infrastructure and research can provide a boost that will help in making these industries successful and to overcome specific trade barriers. Defining these strategies can be a task of WTO and the local governments who have the right information, and understand which path would be the most beneficial to them.



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## **APPENDIX**

## APPENDIX 1. METHODOLOGY

### PART I.

#### *Problem and objectives*

In this part we will talk about the impact of multilateral integration for small size economies (SSE). First, we will draw a typology to define which countries can be called SSE and what are the challenges of these for a better integration and then we will present the two options that SSE have for multilateral integration..

- The problem that we want to analyze in this first part is why after several years of multilateralism proposed by the IEOs, internationalization and development did not improve for some of the South American countries increasing the gaps of poverty and welfare. The international arena was only ruled by the largest economies leaving aside to the majority of the developing countries and their needs. For that reason, we wanted to explore why this was happening, under what circumstances multilateralism and the Washington Consensus was applied and which would be the options to improve the situation for these economies within multilateralism.
- The main objective is to find out what was the impact of multilateralism as proposed by the IEOs, how this impacted internationalization and development and which might be the options to improve this.
- Before proceeding with this analysis, it was important to show that developing countries cannot be analyzed as a whole group because there are fundamental differences based on the size of their economies. This problem took us to define a typology for small size economies (SSE) and within this group were mainly the countries that we wanted to analyze: the South American countries.
- The value for science is double. First, we propose a typology for developed countries of small size so that new strategies and policies can be applied when talking about SSE and a type of integration. Second, we propose a close approach for a type of integration from a point of view of a SSE.

## **Methodology**

### **Focus**

There are thirteen economies for analysis in this research that include South American countries, United States, China and Cuba. The countries that will be studied were taken based in present trade relationships and in expectation of potential partnerships and international relations for the long term. The 13 countries will be distinguished in the following way:

- SSE countries: Bolivia, Ecuador, Paraguay and Uruguay
- The countries for comparison and analysis for regional partnership and international relationship. There will be of three types: a) regional partnership: Argentina, Brazil, Chile, Colombia, Peru and Venezuela; b) larger size economies: United States of America and China, when data available: European Union as one group; c) similar ideology for leftists SSE: Cuba.

### **Data acquisition**

In order to have the same data and statistical source for every chapter and every analysis in this research, we chose the source that contains the greatest number of countries and the same years. In the most necessary cases, data was taken from 1970 up to 2009 but regarding comparative analysis we took in the majority of the cases from 1995 up to 2009. The source for the data comes from UNCTAD Statistics Database 2010.

Information for the typology was collected with a twofold source: a) Interviews to experts in ALADI, Mercosur and ECLAC; research institutes in Argentina, Bolivia and Uruguay (Flacso Buenos Aires-Argentina, South Group –research institute in Bolivia, Universidad Mayor de San Simon in Bolivia and Observatorio del Mercosur-Uruguay), b) statistical collection.

### **Data analysis and calculation**

*Regarding the management of data for the calculation of indexes and its progress:* The information that will be presented is in most of the cases from 1970 until 2009 (39 years). In some of the analysis, the majority of the information was only available from 1975; therefore, only thirty four years were taken into account. For easier comparisons, we used sometimes from 1995 to 2009, so only fifteen years. In some specific cases, that data was only available for one single year; thus, this information was taken for a

single analysis as a picture of the situation. We will introduce criteria of measurement of progress and setback to be discussed below.

- When the available data refers to an interval (for example, 1970–2009) and not to a single year, we adopted the recommendation to centre the data at the middle of the interval (average). When the information was possible to compare for new type of governments with a different international agenda we used the following range: 1995-2005 as first and 2006-2009 as second. When information is only available for one country and one case, the information is referred in a Box as a particular example.
- Tables and figures accompanying comparative analysis and the explanation in this chapter show «past and progress situation» and «the present situation»—according to the distribution of values for each variable. The analysis is based on evaluation and comparison tools between the countries. These take into account the absolute value of the indicators related to the 100% of the information available for world (in the case, world is compared) or for the whole group of studied countries. In order to assess the evolution of each indicator, two aspects were taken into account: all 34 or 39 year values and the rate of change of progress or regression. The situation a country is described according to each indicator that results of the analysis.

The *variables* that will be studied in this chapter will be:

- Foreign direct Investment (FDI). FDI –inflows were taken into account to analyze degree of domination of a country to investment flows and the degree of attractiveness to specific sectors.
- Trade: Export and Import variables are taken into account to analyze export, import and trade domination or openness.
- Gross domestic product (GDP). GDP was taken into account to compare the importance that FDI and trade variables have to the economy of each country.
- Other factors.

*Investment and trade domination* can be analyzed through different factors. One of them is the degree of domination towards partners or products. Dependency here does not imply to have a negative connotation from the beginning, dependency can mean both: dependency to trade in detriment to their national development, or, dependency to trade

in the potential of having a greater international insertion. This insertion will be evaluated as exchanges (investment inflows, import and export) that are considerable for the development of the country.

Domination is a situation in which the SSE has a national political and economic structure that is under a Internationally Dominant Power (IDP) that can impose its vision for trade at multilateral level and this trade domination can change the political values, the type of FDI, the plan for national development. These conditions affect directly the policies and orientation that a SSE has for the international insertion and the expansion in it. Moreover, trade dependency has a considerable impact in the development of the SSE country, maybe more than to any other size of economy as it will be presented both in the typology and the type of integration a SSE has.

## **PART II.**

### ***Problem and objectives***

The main goal of this part, chapter four and five is to analyze the impact that regionalization has in the internationalization of SSE and the degree of attraction for FDI and trade flows that SSE have with the rest of the world. To achieve this, the study of every regional bloc will contain four sub-parts: geopolitical interest, economic performance, game theory on regionalization and the conclusions that will observe the impact of each economic bloc on the internationalization and development of the SSE, both looking for negotiation capacities and difficulties in each type of integration.

### **Objectives**

- Observe if there are forces and influences that bring SSE to a path that would not have been the best for the welfare of the country and what its impacts are.
- Analyze in a numerical way the relative trade gravity, if there are forces that do not seem to make sense for the regional blocs and what are its impacts.
- Analyze if regional blocs are a help for SSE's internationalization and development



or it is just another trade deal for exporting what is needed.

- Determine what the geopolitical implications are and how this affects the economic performance when a bloc is formed.
- Apply game theory for case studies in trade in every bloc.

## ***Methodology***

### **Focus**

This second part will contain a study on the each of the regional bloc that SSE participate in: ANCOM, MERCOSUR, ALBA-TCP, FTAA and FTA with China.

### **Data acquisition instruments**

The data used in Part II are all secondary data sources. In section B secondary data sources were used to give an idea on the content and the amount of trade between the countries of the research and if needed with the rest of the world. The data collected has only been structured and organized primarily used Microsoft Excel and Microsoft Access.

For section C game theory was used to analyze the data. The data provided came from several analyzed documents and journal articles which described certain trade events and disputes that SSE had within the bloc.

### **Data analysis method (section B)**

We are going to use the Tinbergen's Gravity model (Mohlmann, Ederveen, et al., 2009) to set normative values for the relative trade shares. Tinbergen proposed this model in 1962 and the name is an analogy to Newton's gravity model. With this we will be able to compare the different trade shares over the different years. And to show the performance of the country's trade. First, we assume that natural trade barriers are very similar between the countries in the same region (Latin America). Language and culture are very similar as also the level of economic and political development. Also tastes and preferences are same within the consumers. Second, if trade shifts to other regions in the world it can be expected that all countries within a region are equally affected. These assumptions fit perfectly in the relativity since any of these events will affect the values. If the relative values are affecting it should be because of the problems within the

integration like political decisions. For the calculation of the gravity constants we have used the next classical formula:

$$F_{ij} = G * \frac{M_i * M_j}{D_{ij}}$$

Where:  $F_{ij}$  = the assumed trade between country i and country j (gravity constant)

$G$  = a constant to index the trade

$M$  = is the size of country i and j. Here we use the GDP in current prices

$D$  = is the distance between country i and j.

#### Distance

The distance taken between countries has been defined by the most used city or center of the country in the case of several important cities. For example Latin American countries have the tendency to use Miami in USA as main port. Using the center of USA to calculate the distance would not reflect the real situation.

#### Constant

The constant here is only used to make the numbers more readable. This since the final numbers will be only used in relative way and the relativity is independent on the constant. However for our purpose since we are analyzing the relative values de constant was not used since it wouldn't have any impact on the relative values.

#### Procedure

1. Of the countries involved the distance and GDP was taken
2. A table with the original gravity constants was created
3. A table with the relative gravity constants where created where the total of a country reached 100%
4. A global table was created where the relative gravity values where compared with the real relative trade share.
5. For a group of countries (ANCOM, Mercosur, ALBA, FTAA) the tables with the relative gravity constants where created where the total of a country reached 100%
6. A table was created where the relative gravity values where compared with the real relative trade share applying to the same counties.

## 7. Derivate tables where created for additional analyses

By comparing the relative trade values according to Tinbergen's gravity model with the actual relative trade, we can judge if the country is facing somewhere barriers or not.

Relativity was used to be able to index real trade and the gravity constants in a way to be able to compare them in rather fast way without the risk of being prejudiced by indexing it to a certain country.

### **Data analysis method (section C)**

#### **Game theory**

Game theory was analyzed separately because it captures the behavior of each SSE in strategic situations, in which its success in making choices depends on the choices of others countries (relatively LSE). Game theory on regionalization is going to be developed to analyze competitions in which one individual does better at another's expense (zero sum games), in several type of interactions. With this, we attempt to find the best equilibrium in the empirical conflicts translated into theoretical games with sets of strategies in which SSE and LSE are unlikely to change their behavior. Or in asymmetric game possibilities where there are not identical strategy sets for both players where there is a perspective willingness to accept trade injustice or nothing at all. The results of this conclude in an analysis to give an idea on which would be the best strategy to apply.

Game theory tries to capture mathematically the strategic behavior of the SSE and this can be used to analyze if certain strategy is correct or can predict outcomes on strategic decisions. Game theory is used in Part two. Sections C will analyze certain trade events of SSE to be able to see if the chosen strategy was correct and or if there was any possible way to influence for a positive outcome for the SSE using game theory. For each of the regional integration, ANCOM, Mercosur, ALBA-TCP, FTAA and China different cases will be studied. This aims to result in suggestions for the SSE to preview strategies according to different situations.

Due to the nature of the data, Part two is going to be merely descriptive of a series of events during a trade event or dispute; it is hard to make a hard numbered analysis. However, for game theory this is not necessarily a problem and in the cases where it tended to be qualitative it was assumed some value points so that we can have a possible

analysis of what equilibrium the case is heading to. Players and actions play a key part in every game. The players are in our case the SSE and other countries. Actions are referring to the behavior and the decisions the countries took to influence a result. Normally, an action of one player influences the action and decision of the other and this interesting to know for SSE that constantly are having political and trade conflicts between bloc members.

In Figure II-1 we can find a trade-bloc definition tree is presented for use. Countries can have different reasons for trade. Here, we define trade-dependency and the size of the country as important factor to know the trade-bloc dependency. Trade-dependency can be described as the amount of exports-imports expressed in percentage over the GDP. Nevertheless, it needs to be noted that this is not always a fair number and in some cases is undervalued. Then we use the size of the country as a second definer. Though for a more clear definition size is not just GDP or the number of people, it should be taken into account that size based on the quality of governance and the power of negotiation. Take for example a small country like the Netherlands. We cannot say that The Netherlands is small based on the geographical size but we need to evaluate the size in terms of economic performance, the quality of governance and the power of negotiation. Those four are.

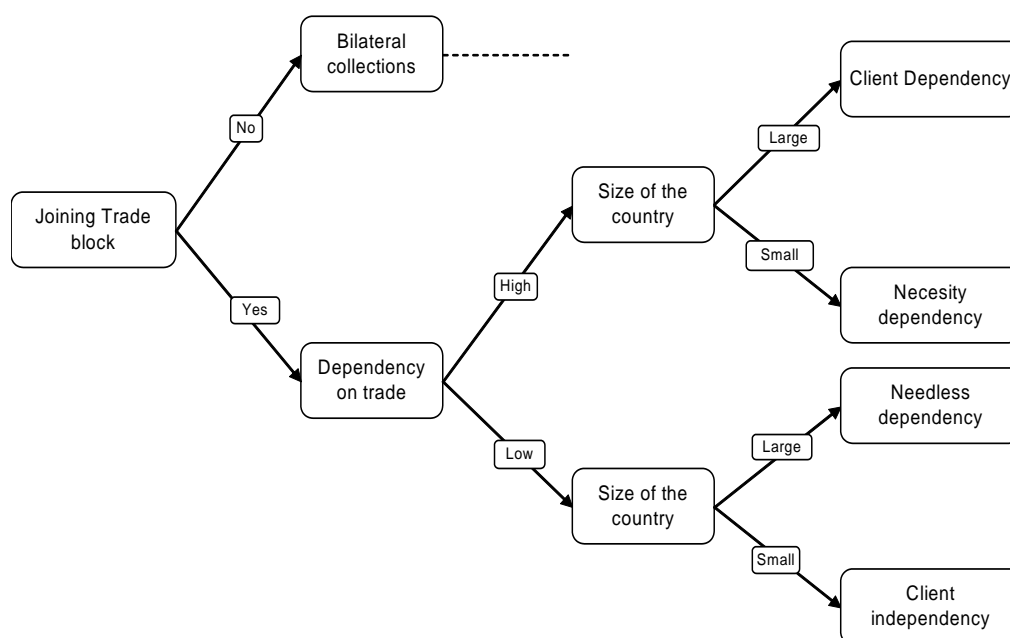
<i>Client Dependency</i>	These are countries which have a high dependency on trade but are also large in size. These countries have a lot of power during negotiation, but do depend on international trade. For example The Netherlands
<i>Necessity dependency</i>	These are countries which have a high dependency but do miss the size and so the economic mass to stay strong during negotiation; for example, Bolivia.
<i>Needless dependency</i>	Some countries are just so big that they actually that they do not really need international trade, all is produced locally. And if this country is also large in size it actually can decide indifferently if it wants to join a trade bloc. For example USA
<i>Client independency</i>	These are small independent countries which hardly depend on any trade but also lack the economic power to

get anything out of negotiations due to its small size.  
Joining a trade bloc wouldn't bring much help.

These dependency levels give an idea on how much a country can benefit from cooperating in the game of forming a trade-bloc. This level of cooperation is important to reach a zero-sum game and resulting in over protectionism which definitely will harm the economy in the long-run. Ironical is, and we will see this also in the detailed discussion of the different trade-blocs that over-protectionism in the short run is preferred by voters and so has a potential to distort the way of cooperation.

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**Figure II-1. The four types of trade-bloc dependencies**



\*size of the country is defined as a combination of quality of governance, income and state of development

Source: Author

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## The equilibriums in international trade

### *Dominant equilibrium*

There is no doubt that there are good reasons why trade exists. Countries can significantly benefit from trade. However, countries can even win more when they introduce protectionism. A simple example is shown in figure II-2. If country A and B decide for free trade they will both win 100. On the other hand, for both countries there is a temptation to introduce protection and win 150. Since both tend to go for protection

the final winning tends to 0; 0 and nobody wins anything. Thus, point P, P is the dominant strategy equilibrium.

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**Figure II-2. Example**

		Country B	
		F	P
Country A	F	100,100	50,150
	P	150,50	0,0

*Source: Author*

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### *Nash equilibrium*

The core part of the Nash equilibrium is that none of the players can improve anymore by a unilateral move. In international trade these situations hardly exist in a natural way since there is almost always a way to suddenly impose tariffs which increase the gains of the country.

## APPENDIX 2. Distances and GDP used for calculation of the gravity constants

Distances(km)	Country-Bloc									
	COMUNIDAD ANDINA					MERCOSUR				
GDP 2009 (USD)	Bolivia	Colombia	Ecuador	Peru	Brazil	Argentina	Paraguay	Uruguay		
394,310	1,445	1,443	1,191	1,067	3,434	3,580	2,821	3,722		
17387	-	2,581	2,125	1,075	2,105	2,224	1,461	2,361		
197334	1,443	-	1,320	1,873	4,364	4,636	3,752	4,756		
50970	1,191	1,320	-	1,320	4,173	4,338	3,565	4,484		
128619	1,067	1,873	1,320	-	3,092	3,122	2,506	3,288		
1,929,119	3,434	4,364	4,173	3,092	-	729	809	710		
1552656	3,611	4,312	4,304	3,453	1,091	1,671	1,135	1,558		
330135	2,224	4,636	4,338	3,122	729	-	1,030	212		
15691	1,461	3,752	3,565	2,506	809	1,030	-	1,072		
30637	2,821	4,756	4,484	3,288	710	212	1,072	-		
18211428.9	3,722	8,625	8,625	10,247	10,382	11,005	10,140	10,884		
17004887.74	9,287	3,381	3,702	4,946	7,515	7,815	6,948	7,932		
NAFTA	4,391	2,429	2,879	4,198	6,729	7,059	6,143	7,171		
14558108	3,589	3,168	3,125	4,236	7,244	7,361	6,674	7,527		
United States	948476.4162	4,545	5,103	6,404	8,573	9,024	8,026	9,099		
México	1498303.191	4,226	3,767	2,454	1,652	1,133	1,549	1,341		
Canada	169607	1,895	16,338	16,635	18,557	19,244	18,271	19,131		
Chile	4348302.843	17,357	15,338	2,735	4,664	5,064	4,084	5,144		
China	331957	2,985	1,747	10,000	10,000	10,000	10,000	10,000		
Venezuela	2,123	10,000	10,000	72,652	85,824	89,246	79,987	90,394		
REST OF THE WORLD	60443637.65	71,380	71,107	87,007	87,007	87,007	87,007	87,007		
48,597,903	70,444	71,783	71,107	72,652	85,824	89,246	79,987	90,394		

**APPENDIX 2 continued. Distances and GDP used for calculation of the gravity constants**

	Distances(km)	GDP 2009 (USD)	Country-Bloc
EUROPEAN UNION	14,346,694	15,555,036	United States
	-	13,283,024	México
	-	840,012	Canada
	-	1,432,000	Chile
	-	145,841	China
	-	2,666,772	Venezuela
	-	180,358	
	-		
	-		
	-		
	-		
	-		
	-		
	-		
	-		
	-		
	-		
	-		
REST OF THE WORLD	394,310	COMUNIDAD ANDINA	
	17387	Bolivia	
	197334	Colombia	
	50970	Ecuador	
	128619	Perú	
	1,929,119	MERCOSUR	
	1552656	Brazil	
	330135	Argentina	
	15691	Paraguay	
	30637	Uruguay	
	18211428.9	EUROPEAN UNION	
	17004887.74	NAFTA	
	14558108	United States	
	948476.4162	México	
	1498303.191	Canadá	
	169607	Chile	
	4348302.843	China	
	331957	Venezuela	
	60443637.65	REST OF THE WORLD	
	48,597,903		

\* all distances from google earth except distances involving Canada (montreal and EU), these were taken from [http://www.mapcrow.info/cgi-bin/cities\\_distance\\_arp2.cgi?city3=-80447%2CM&city4=-1347129%2CA](http://www.mapcrow.info/cgi-bin/cities_distance_arp2.cgi?city3=-80447%2CM&city4=-1347129%2CA)