

**Simon Bolivar Rides Again?  
Pathways Toward Integration between NAFTA, MERCOSUR,  
and the Greater Andean Region**

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# **Simon Bolivar Rides Again?**

## **Pathways Toward Integration between NAFTA, MERCOSUR, and the Greater Andean Region**

### **Abstract**

In this paper we analyze the range of possible paths towards economic integration between NAFTA, MERCOSUR, and the Greater Andean Region. We show that a strategic collective action problem within and between these three key trade arrangements will need to be resolved cooperatively if there is to be any form of comprehensive economic integration throughout the Western Hemisphere.

The analysis presents the North American/South American Free Trade Area computable general equilibrium (NASAFTA-CGE) model which was developed to determine the economic impact of a variety of alternative scenarios for Western Hemispheric trade arrangements. The NASAFTA-CGE model is used to generate a variety of alternative scenarios which are possible in the wake of the formation of NAFTA and MERCOSUR, including: Using the NASAFTA-CGE model, we compare a series of possible integration scenarios in the wake of the formation of NAFTA, MERCOSUR, and the Andean Pact, including:

- (1) the status quo with separate NAFTA, MERCOSUR, and Andean Pact blocs;
- (2) NAFTA-centered bilateral FTAs or NAFTA accessions;
- (3) MERCOSUR-centered "4+1" arrangements or a full SAFTA; or
- (4) a Western Hemisphere Free Trade Agreement (WHFTA).

The paper also analyzes the political-economy problems related to these alternatives, evaluating the tradeoffs that each country will have to consider. These tradeoffs involve both the potential economic benefits of alternative trading arrangements as compared to the risks of economic adjustment, as well as an assessment of the likelihood that successful negotiations can be concluded. This assessment uncovers a variety of complicated collective action challenges: while the formation of a Western Hemispheric Free Trade Area (WHFTA) can be identified as the optimal economic scenario for most of the major member countries in NAFTA, MERCOSUR, and the Andean region, the absence of any mechanism to facilitate credible multilateral agreements places a high discount on this first-best option. In the absence of a first-best solution, strategic relations both between and within NAFTA, MERCOSUR, and the Andean region remain volatile, as we demonstrate that each country has a highly divergent set of second-best preferences concerning how and with whom to proceed with trade liberalization.

The analysis indicates that there are essentially two types of trade relationships which could be formed in the Western Hemisphere: one is a competitive race among opposing blocks to build their own hub and spoke system; the other is a single complementary liberalization which is multi-lateralized across all blocks. A prisoners' dilemma type situation is thus revealed whereby, in the absence of cooperation in creating a public good in the form of a multilateral negotiating mechanism for obtaining the dynamic gains from trade, each country is left to fend for themselves in a high stakes and highly competitive environment which will tend to focus on more limited and conflictive short term gains. This situation can potentially be readily overcome, however, by developing mechanisms and institutions which (1) reduce the uncertainty of multilateral negotiations over time and (2) mitigate the dynamic economic costs of integration through financing long term trade deficits and trade adjustment investments.

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**I. Introduction**

The prospect of harmonious integration between the democratic republics of the Western Hemisphere has attracted, and eluded, visionary leaders since the time of Simon Bolivar. Historically, particular sets of economic and political challenges throughout the Western Hemisphere have proved too powerful and complex to overcome. In the last decade, however, economic and political relations among countries in the Western Hemisphere began undergoing a profound transformation, opening up new possibilities while generating new collective action problems. For their part, Latin American and Caribbean countries are shifting to a new development strategy based on an explicit opening to regional and global competition. The United States, meanwhile, is encountering increased competition in a multipolar world economy and is expressing a new willingness to engage in unprecedented regional economic agreements as it seeks to redefine its long run interests in a post Cold War global system. Propelled by both unilateral trade liberalizations as well as the formation of regional accords such as NAFTA and MERCOSUR, there has recently been a dramatic intensification of trade and investment links throughout the Hemisphere, both across North and South and, increasingly, South to South. While the recovery of trade, investment, and growth has been very positive for some sectors and national regions, it has also increased the interdependence of labor market impacts, short term macro-economic stability, and long term development options in the context of wide disparities in productivity and income levels, both within and between North and South.

By accelerating their trade and investment interdependence, the Americas are now directly confronting what is likely to become the major global challenge of the next few decades: what is the optimal pattern of economic integration that can provide for sustainable and equitable development across North and South? What collective action problems will have to be overcome, both within and across countries, to make sustainable development through enhanced integration both politically and economically viable? This challenge has to be seen in the context of a hemisphere characterized by countries which have disparate short term economic interests, divergent geo-political calculations, and different domestic interests groups and institutional dynamics. The Summit of the Americas thus occurred at a very opportune time and could prove very useful if it can begin a process to address both the economic and political issues involved in forming an optimal Hemispheric economic relationship.

This paper is part of a larger project designed to model the economic impacts and analyze the political economy dynamics of alternative scenarios of trade liberalization and regional integration in the Western Hemisphere. In previous papers, we have analyzed NAFTA and the relations between NAFTA, Central America, and the Caribbean. <sup>1/</sup> In this paper we consider the relationship between

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<sup>1/</sup>See Hinojosa and Robinson (1991), Hinojosa and McCleery (1992), and Hinojosa, Lewis and Robinson (1994) and (1995).

NAFTA, MERCOSUR, and the countries of the greater Andean region (the U.S., Mexico, Argentina, Brazil, Venezuela, Colombia, Ecuador, Peru, Bolivia, and Chile). We show that the strategic interaction between these three groups of countries will need to be resolved cooperatively if there is to be any form of comprehensive economic integration throughout the Western Hemisphere.

The analysis presents the North American/South American Free Trade Area computable general equilibrium (NASAFTA-CGE) model which was developed to determine the economic impact of a variety of alternative scenarios for Western Hemispheric trade arrangements. The NASAFTA-CGE model is used to generate a variety of alternative scenarios which are possible in the wake of the formation of NAFTA, MERCOSUR, and the Andean Pact including:

- (1) the status quo with NAFTA, MERCOSUR, the Andean Pact;
- (2) NAFTA center bilateral FTAs or NAFTA accessions;
- (3) MERCOSUR centered "4+1" arrangements or a full SAFTA;
- (4) Andean centered linkages with NAFTA and MERCOSUR; and
- (5) a Western Hemisphere Free Trade Agreement (WHFTA).

The paper also contains an analysis of the political-economy problems related to each of these alternative scenarios, evaluating the trade offs that each country will have to calculate. These tradeoffs concern the potential economic benefits of alternative scenarios compared to the risks of economic adjustment as well as the degree of certainty that successful negotiations in each scenario are actually possible. A number of complex collective action problems are uncovered. While the formation of a Western Hemispheric Free Trade Area is shown to be the most optimal economic scenario for most of the major member countries of NAFTA, MERCOSUR, and the Andean region, the lack of a mechanism for credibly negotiating a multilateral agreement places a high discount on this first best option. In the absence of a first best solution, strategic relations both between and within NAFTA, MERCOSUR, and the Andean region become very volatile as we discover that each country has a highly divergent set of second best preferences as to how and with whom to proceed with trade liberalization.

The analysis indicates that there are essentially two types of trade relationships which could be formed in the Western Hemisphere: one is a competitive race among opposing blocks to build their own hub and spoke system; the other is a single complementary liberalization which is multilateralized across all blocks. A prisoners' dilemma type situation is thus revealed whereby, in the absence of cooperation in creating a public good in the form of a multilateral negotiating mechanism for obtaining the dynamic gains from trade, each country is left to fend for themselves in a high stakes and highly competitive environment which will tend to focus on more limited and conflictive short term gains. This situation can potentially be readily overcome, however, by developing mechanisms and institutions which (1) reduce the uncertainty of multilateral negotiations over time and (2) mitigate the dynamic economic costs of integration through financing long term trade deficits and trade adjustment investments.

The paper is organized as follows. The next section reviews the structure of economic relations and levels of protection within and between NAFTA, MERCOSUR, and the Andean region, describing the base data used in our NASAFTA-CGE model. Section three discusses our NASAFTA-CGE modeling approach and presents the model results for alternative scenarios of potential Western Hemispheric trade relations. Section four evaluates the political economy and collective action problems related to the alternative scenarios and identifies the type of structures and institutions for

hemispheric cooperation that are needed to reach an optimal Hemispheric trade order. Section five presents our conclusions.

## II. Hemispheric Structure of Trade, Production, and Protection

The analysis of the potential impacts and dynamics of Western Hemispheric free trade must begin with the complex network of economic ties which already exist throughout the region. The relative importance of these bonds for each country, however, varies substantially across the region. Tables 1a and 1b present major indicators of this asymmetrical interdependence, including the wide differences in GDP and GDP per capita, as well as in North-South and South-South trade and financial flows as a percentage of GDP. All data is for 1990, the base year of the NASAFTA-CGE model.

The major manifestation of hemispheric asymmetry is evident in the wide disparities in GDP and GDP per capita figures. The GDP of the U.S., for example, is almost 1,200 times that of Bolivia and 13 times that of Brazil. The per-capita GDP of the U.S. is seven times that of Mexico, Brazil, and Argentina and 20 times that of the Central American Common Market (CACM). These gaps are significantly more than those which confronted Western Europe during the enlargement of the EC, yet are in the range of current disparities across Eastern and Western Europe, as well as within East Asia. <sup>2/</sup>

Comparing the relative importance of trade in economic activity for countries in the Hemisphere, the pattern that predominates is that smaller economies are much more dependent on trade than are larger ones. Chile, Ecuador, and Bolivia, among the smallest economies in the region, are also the most open to trade, with exports and imports totaling 57.2, 42.1, and 36.2 percent of GDP respectively. The largest economies, Brazil and the U.S., are the least open, with total trade equaling 16.9 and 13.1 percent. These large countries are also the least dependent on exports as a percentage of GDP, with exports representing 7.3 percent of GDP in the U.S. and 7.6 percent in Brazil. Venezuela, on the other hand, is the most dependent on exports, equaling 37.6 percent of its GDP.

Table 1b also shows that the relative dependence on trade within the Hemisphere also varies substantially, with Latin American countries much more dependent on trade with the U.S. than vice versa. Dependence on the U.S. market, however, declines the further south one travels in the Hemisphere, while trade among Latin American countries and with the rest of the world increases. In the case of Mexico, trade with the U.S. represents a much larger portion of GDP (16.5 percent) than trade with the entire Latin American community (which totals only 1.2 percent). Moving down the continent from north to south, dependence on the U.S. decreases and intra-Latin America trade increases. For Argentina, trade with the U.S. totals only 2.7 percent of GDP while trade within the Latin American community equals 4.9 percent. Still, Argentina and Bolivia are the only country listed that conducted more trade with Latin America than with the U.S. in 1990. While all countries in LAC display a higher dependence on U.S. trade than the U.S. depends on LAC markets, it is important to note that the U.S. trades more with LAC countries as a percentage of its GDP than does

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<sup>2/</sup> See Hinojosa (1993) for a comparative discussion of regional inequalities within Europe, Asia, and the Americas.

Mexico or Brazil. These differences should lead us to expect greater impacts from trade liberalization on the smaller versus the larger countries and relatively larger impacts on Latin American countries compared to the United States.

The asymmetrical interdependence of trade in North and South America can be seen even more clearly in Table 2 which list exports to partners as a percentage of total exports in 1990 (Table 2a) and from 1980 to 1992 (Table 2b). Latin American economies have historically relied on countries in the Hemisphere to buy the bulk of their products. The dependence is focused on the U.S., the destination of the majority of Latin America's exports. Of the 61.3 percent of Latin America's exports that remain in the continent in 1992, 46.7 percent go to the U.S. and other NAFTA countries. With the exception of Argentina and Bolivia, every country and bloc listed sends a greater percentage of its exports to the U.S. than the average for the entire Latin American community combined. Mexico, with 85.6 percent of its exports remaining in the hemisphere in 1992, sent 76.3 percent to the U.S. The dependence is largely one-sided, however, as the majority of U.S. exports are destined for outside the Hemisphere. And though a substantial 36.2 percent of U.S. exports remain in the Western Hemisphere, 85% of these exports go to Canada and Mexico, the two NAFTA countries which are also the first and third largest trading partners of the U.S.

The trends in percentages of exports to partners from 1980 to 1992 displayed in Table 2 demonstrate the powerful effect of the debt crisis and subsequent recovery on trade in the Hemisphere. Not surprisingly, the initial effect of the debt crisis in the early 1980s resulted in a crippling blow to trade within Latin America, while generating a thrust in exports to the U.S. and, to a lesser extent, to other parts of the world. Figures for the 1985 to 1992 period show a recovery of trade within Latin America as well as a continued concentration on exports to the U.S.

Trade within the trading blocs listed (NAFTA, MERCOSUR, and the European Community), all increased over the last decade. Latin American exports to the U.S. and to Latin America now represent a larger percentage than they did in 1980, while the share of exports to Europe and Japan have fallen back below 1980 levels. The levels of intra-MERCOSUR and intra-Andean Pact trade more than doubled from 1985 to 1992. As trade blocs and agreements become more important in the emerging world economic order, fear of exclusion becomes another motivating factor in the policy shift in Latin America in favor of trade alliances.

Mexico's export market has become the most concentrated on the U.S., growing from 64.7 percent in 1980 to 76.3 percent on 1992. Mexican exports to Latin America from 1980 to 1992 have decreased from 5.9 percent to 4.2 percent. After an initial fall in the early 1980s, Brazil and Argentina have increased their export levels within Latin America, mostly as a result of MERCOSUR. While dramatically diversifying their global export partners in the early 1980s, both Brazil and Argentina have equally dramatically reversed their diversification as trade recovered in the Western Hemisphere. Chile, on the other hand, has continued to diversify exports to the rest of the world, while dramatically decreasing its dependence on Latin American markets. Exports to Mexico dropped from 1.4 percent to 0.7 percent, to Brazil, from 9.6 percent to 4.5 percent, and to Argentina from 6.0 percent to 4.6 percent. At the same time, percentages of exports to the U.S., Japan and the rest of the world all increased in the range of four to five percent.

Export figures for the most current period from 1990 and 1992 show a substantial growth in trade within the Latin American community. Between 1990 and 1992, the Latin American community replaced the U.S. as the largest export partner for Brazil and Chile. The LAC was

already the largest export partner for Argentina and MERCOSUR. Except for Mexico, the Latin America community as a whole is becoming a more important market for Latin American exports than the U.S. When Mexico is excluded from LAC export figures, exports to the U.S. dropped from 42.8 percent to 28.5% with a corresponding increase in intra-LAC trade.

The asymmetry in trade dependence between North and South nevertheless appears to be diminishing compared to the 1980's. As economic reforms in Latin America are taking shape and pent-up import demand being fulfilled, the LAC is becoming the fastest growing market for U.S. exports. In 1992, Latin American exports accounted for one-sixth of the total increase in U.S. exports. Increases in U.S. exports to Latin America, however, have also meant the return of Latin American trade deficits with the U.S.

Table 3 displays the base tariff rates of the countries used in the NASAFTA model, demonstrating the extent to which each economy differentially protected its domestic production in the late 1980s. The U.S., Mexico, and Brazil each place their highest tariff rates on corn imports. Mexico's tariff rate on corn, 45 percent, is the highest rate placed on any agricultural sector in any of the countries listed. Chile seeks to protect both domestic corn and program crops equally, placing 21.3 percent tariff rates on both sectors. The highest tariff in Argentina are on program crops and other agriculture, 15.7 percent and 15.8 percent respectively, though both corn and fruits and vegetables have fairly high tariffs rates as well.

Except for Mexico, tariff rates in manufacturing sectors are even higher. Mexico and the U.S. have the lowest rates relative to the other three countries, but the U.S. places a substantial 27.9 percent tariff on food processing imports from Chile, Brazil and Argentina. Overall Chile's tariffs on manufacturing are higher than the U.S. and Mexico, with its highest tariffs on food processing and oil. Brazil and Argentina both have a great deal of potential for tariff reform in all sectors of manufacturing, particularly consumer durables, which have protection rates of 32.9 and 36.7 percent respectively. The most highly protected product in the region in terms of tariffs is Brazilian oil. Imports are taxed 49.5 percent

As the figures in Table 3 indicate, the short run export benefits of trade liberalization should be seen mostly by the U.S. Presently, most Latin American exports are agricultural products and natural resources, sectors that do not have significant tariffs in the U.S. Only 18 percent of LAC exports encounter tariff rates of five percent or higher and only eight percent encounter these rates plus non-tariff barriers. U.S. tariff rates and non-tariff barriers on manufacturing, however, are higher. Due to differences in market competitiveness, nearly all Latin American exports are vulnerable to anti-dumping charges by the U.S., charges which Latin American countries do not have the capital to defend legally (Naim, 1994). The NASAFTA CGE model results of trade liberalization scenarios will tend to reflect this structure of bilateral protection as well as sectoral trade.

### **III. Alternative Economic Scenarios of Hemispheric Integration**

#### **III.i The NASAFTA-CGE Models**

In this paper, Western Hemispheric regional integration is analyzed by means of a computable general equilibrium (CGE) model. The North American/South American Free Trade Area (NASAFTA) CGE model we have developed is in the tradition of recent multi-country CGE models

developed to analyze the impact of the Uruguay Round of GATT negotiations <sup>3/</sup> and more recently, on the impact of the North American Free Trade Agreement and its potential incorporation of Central America and the Caribbean. <sup>4/</sup>

The NASAFTA CGE model developed in this article consists of an 11 sector, five-country model that builds on the multi-regional CGE framework developed by Hinojosa-Ojeda, Lewis, and Robinson (1994), Hinojosa-Ojeda and Robinson (1991), and Hinojosa-Ojeda, Robinson, and Wolff (1992). Hinojosa-Ojeda, Lewis, and Robinson (1995) contains a detailed description of the equation structure of the NASAFTA CGE model which is programed in GAMS. <sup>5/</sup> Each sub-regional or "country" CGE model follow closely what has become a standard theoretical specification for trade-focused CGE models. <sup>6/</sup> Following Hinojosa-Ojeda, Lewis, and Robinson (1994), our NASAFTA-CGE model consists of an 11-sector, eleven-region general equilibrium model composed of ten single sub-regional CGE model<sup>e</sup> (Argentina, Brazil, Chile, Bolivia, Peru, Ecuador, Colombia, Venezuela, Mexico, and the U.S.) inter-connected through trade flows. In addition to eleven sectors for each sub-regional model, the NASAFTA-CGE model has six factors of production in each country: land, capital, rural labor, urban unskilled labor, skilled labor, and white-collar workers. For each sector, the model specifies output-supply and input-demand equations. As in the authors' previous models, there is a simple representation of the rest of the world, which is modeled as a large supplier of imports to, and demander of exports from, each of the five Western Hemisphere countries at fixed world prices. The rest of the world is modeled as having an upward sloping export-supply curves and downward-sloping import-demand curves.

The NASAFTA-CGE model combines a number of innovations compared to the typical multi-country CGE trade model. First, when modeling import demands the Almost Ideal Demand System (AIDS) specification is adopted. This is because an AIDS specification, in contrast to the standard constant elasticity of substitution (CES) function, allows expenditure elasticities to be different than

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<sup>3/</sup> These models, in turn, have built on multi-country models developed to analyze the impact of the Tokyo Round of GATT negotiations — in particular, the multi-country CGE model developed by Whalley (1985). Our model starts from the WALRAS model developed at the OECD to analyze the impact of the current GATT negotiations on the major OECD countries detailed in OECD (1990).

<sup>4/</sup> See Hinojosa and Robinson (1992), Brown (1992), and Schoepfle (1993) for a review of NAFTA CGE models. See Hinojosa, Lewis, and Robinson (1994) for the GNAFTA-CGE model.

<sup>5/</sup> The model is specified and solved using a software package called GAMS (General Algebraic Modeling System). See Brooke, Kendrick, and Meeraus (1988).

<sup>6/</sup> Robinson (1989) surveys CGE models applied to developing countries. Shoven and Whalley (1984) survey models of developed countries. The theoretical properties of this family of trade-focused CGE models are discussed in Devarajan, Lewis, and Robinson (1990).

one. Second, to capture the potential dynamic externality effects of trade liberalization, the NASAFTA-CGE model can include equations for generating positive externalities through both export expansion and the importation of new capital goods.

Each "country" model traces the circular flow of income from producers, through factor payments, to households, government, and investors, and finally back to demand for goods in product markets. Producers are assumed to maximize profits and consumers have price-sensitive expenditure functions. The country models are highly nonlinear, and solve for equilibrium wages, land and capital rental rates, commodity prices, and the real exchange rate. These solution prices achieve market-clearing equilibrium in factor markets, product markets, and the balance of trade.

In common with other CGE models, the model only determines relative prices and the absolute price level must be set exogenously. In the NASAFTA-CGE model, the aggregate consumer price indices in each sub-region are set exogenously, defining the numeraire in both countries. The advantage of this choice is that solution wages and incomes are in real terms. The solution exchange rates in the sub-regions are also in real terms, and can be seen as equilibrium price level deflated (PLD) exchange rates, using the country consumer price indices as deflators. <sup>7/</sup>

The model data base consists of social accounting matrices (SAMs) for each countries, including data on their trade flows. <sup>8/</sup> The SAM starts from multi-sectoral input-output data, which are expanded to provide information on the circular flow of income from producers to factors to "institutions," which include households, enterprises, government, a capital account, and trade accounts for all the partner countries and the rest of the world. These institutions represent the economic actors whose behavior and interactions are described in the CGE model. The parameter estimates for the sectoral production functions, consumer expenditure functions, import aggregation functions, and export transformation functions are drawn from a variety of sources. The various parameters used in the model represent point estimates for the base year (1990) and the model was benchmarked so that its base equilibrium solution replicates the base data.

The ten country CGE models are linked through trade flows. The model specifies sectoral export-supply and import-demand functions for each country, and solves for a set of world prices that achieves equilibrium in world commodity markets.

### **III.ii Description of Scenarios**

The scenarios presented in this paper are designed to evaluate the impact of alternative paths of trade liberalization among countries in North and South America. The scenario results display the static general equilibrium and dynamic externality effects of changing the structure of trade protection in the hemisphere. By systematically altering only the trade policy variables of the countries in the region, we can evaluate the effects of different patterns of protection on the regional structure of

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<sup>7/</sup> De Melo and Robinson (1989) and Devarajan, Lewis, and Robinson (1991) discuss the role of the exchange rate in this class of model.

<sup>8/</sup> Social Accounting Matrices are described in Pyatt and Round (1985).

trade, the pattern of trade with the rest of the world, and the structure of production and income distribution for each country in the hemisphere. For each alternative scenario we can therefore evaluate the impacts of a different path of integration on the whole hemispheric pattern of trade, production, and welfare.

These scenarios should be seen as controlled experiments within a model rather than predictions of the actual pattern of growth that may accompany each of these alternative paths of integration. The actual growth pattern will be the result of many more factors than just trade policy, especially macroeconomic and incomes policies. The CGE modeling framework is used as a simulation laboratory to isolate the size of the impact that can be attributed to changes in a select set of policy variables; in this case, tariff and non-tariff barriers. Both the comparative statics and dynamic externality experiments are meant to describe, therefore, the impact of different patterns of trade liberalization "in the medium to long run". Dynamics here does not imply the actual path of the transition, but rather the net cumulative effect over time of positive productivity externalities that could potentially result from regional integration.

For each alternative scenario, the model generates results concerning the impact on real GDP, output, trade, value added, real wages of each labor category, and the real rental rates of capital and land. Trade diversion and trade creation impacts will be evaluated through data on total, intra-regional, and extra-regional trade.

In addition to the comparative static effects on the pattern of regional interdependence, we also explore potential effects that positive externalities of the process of trade liberalization and integration may have on each country and on the region as a whole. We specifically model the so called "dynamic" effects which are known to be very important in previous cases of export led development, including the effects on aggregate and sectoral productivity of increased exports and economies of scale and well as productivity enhancing importation of new technologies via capital goods. <sup>9/</sup>

Table 4 presents the alternative scenarios studied. The results of each scenario are presented relative to a base run scenario calibrated with the pre-liberalization (late 1980s) structure of protection throughout the region. For each scenario, the "a" version represents the comparative statics effects while the "b" version includes the positive trade externality effects of the same scenario.

In Scenarios 1, 2, and 3, we begin with an analysis of the impact of NAFTA, MERCOSUR and the Andean Pact as individual sub-regional accords. Scenario 1 presents the impact of NAFTA on the U.S. and Mexico, as well as on Brazil, Argentina (without MERCOSUR), Chile, Venezuela, Colombia, Ecuador, Peru, Bolivia, and the rest of the world. The experiment is based on the complete elimination of all tariff and non tariff barriers only between Mexico and the U.S., with the structure of protection between and relative to all other countries left intact at pre-GATT levels. Scenario 2 presents the impact of MERCOSUR on Brazil and Argentina, as well as on Chile, the rest of the world, and the U.S. and Mexico without NAFTA. Scenario 3 present the impact of Andean Pact full trade liberalization in the presence of both NAFTA and MERCOSUR.

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<sup>9/</sup>In modeling the dynamic externality effects, we use functions presented in De Melo and Robinson (1992).

The rest of the scenarios 4 through 32 should be seen as representing alternative paths of liberalization which are cumulative on top of the impact of NAFTA. Scenarios 4 through 18 each present alternative bilateral hub-and-spoke arrangements that could appear after NAFTA with either the U.S. or Mexico emerging as the hub of a series of bilateral FTA. Scenarios 3 and 8 simulate the creation of a series of U.S. bilateral FTAs in addition to NAFTA, culminating in a U.S. center hub and spoke arrangement with each country in the hemisphere. Alternatively, scenarios 9 and 12 model Mexico's recent strategy to be a hemispheric hub, with the U.S. becoming a single spoke via the NAFTA while other spokes are added through individual bilateral FTAs between Mexico and all the countries in the hemisphere. Scenarios 13 through 18, alternatively model the NAFTA accession approach through the multilateral granting of free trade privileges to new member countries.

Scenarios 19 through 24 model the MERCOSUR "4+1" approach to creating bilateral FTAs with outside countries, namely Chile and the Andean countries, culminating in a South American Free Trade Area (SAFTA). Scenarios 25 through 31 model the results of each Andean country or Chile being the only country successful at creating FTAs with both NAFTA and MERCOSUR.

Finally, in Scenario 32 we eliminate all tariff and non-tariff protection between all the major countries in the Western Hemisphere while maintaining all countries' pre-GATT levels of protection with the rest of the world. Scenario 20 thus simulates the creation of a Western Hemisphere Free Trade Area, multilaterally extending all zero tariff and non tariff barriers among a larger set of members.

### **III.iii Scenario Results**

Tables 5 through 11 present the comparative statics and dynamic externality impacts of the twenty alternative scenarios. Tables 5a and 5b respectively present the comparative statics and externality impacts of the twenty alternative scenarios on real GDP, the real exchange rate, and total trade for each country or sub-region as well as for the NAFTA countries as a whole. Tables 6a and 6b display the intra-regional and extra-regional pattern of trade for each scenario in their comparative statics and externality versions. Table 7 static and externality results for real wages paid to the four labor categories and the rental rate of capital and land for each country.

### **The Impact of NAFTA**

Scenario 1, designed to represent NAFTA, replicates the results of virtually all the studies on NAFTA which have shown a very small positive impact on U.S. GDP and total trade while generating a larger positive impact for Mexico (Table 5). While the comparative statics impacts (Scenario 1a) are actually tiny for both countries, the dynamic externality impacts (Scenario 1b) are quite significant for Mexico (3.1%). While still small for the U.S., the externality impacts of NAFTA represent a relatively larger positive improvement over the simple comparative statics impacts of NAFTA. Our results, however, also corroborate the fears that sub-regional accords could have a negative impact on other Latin American countries left out of NAFTA. We show that NAFTA could have negative impacts on all other countries in the region, while MERCOSUR could have a negative impact on Mexico, and a full Andean FTA could have a negative impact on Chile. Yet all these static negative impacts are clearly very small in terms of real GDP. Once the full

dynamic externality effects of NAFTA are taken into consideration, however, the negative impacts on other countries are magnified while NAFTA members gain significantly more.

These negative and differential impacts of NAFTA are a function of an increased concentration of trade between the NAFTA partners and a diversion of imports and exports by the NAFTA partners away from other Latin American countries. As table 6a shows, intra-Hemispheric exports for the U.S. and Mexico increase due to NAFTA by 5.2% and 3.6% respectively while they decline -.29% for Brazil, -.59% for Argentina, and -.20% for Chile. The Andean countries also loose, but less so, from -.13 for Ecuador to -.01 for Bolivia. In the externality results in table 6b, U.S. intra-Hemispheric exports increase by 10.23% while Mexican intra-regional exports rise only by 4.94%, signifying a relatively enhanced competitive position of the U.S. due to NAFTA based externality effects. While total and intra-regional exports and imports decline in the static NAFTA scenario for all countries, all become slightly positive in the externality scenario except for Brazil, Bolivia, Ecuador, and Colombia. In both the comparative statics and externality results, however, the trade performances of Brazil and Argentina lag significantly behind the NAFTA partners (Table 6a and 6b). This widening or differentiation is due both to the NAFTA trade diversion effect as well as to a decline in total exports by Brazil and Argentina, signally the difficulty in fully shifting their exports from North America to the rest of the world.

It should be pointed out, however, that these results also indicate that NAFTA generates much more trade creation than trade diversion. Total Hemispheric intra-regional exports in Tables 6a and 6b grow by 2.5% and 4.0%, far outweighing both the decline in Brazil and Argentina exports and the decline in trade with the rest of the world. While total U.S. and Hemispheric extra-regional exports do decline slightly, there is still much more Hemispheric trade created than there is trade diverted from the rest of the world. Mexico actually increases its exports to both the U.S. and outside the Hemisphere due to NAFTA, but not to Brazil or Argentina. Table 6b indicates, in fact, that the externality effects of NAFTA actually reduce the comparative statics trade diversion effects on exports and imports with the rest of the world, due primarily to increased extra-regional imports and exports by Mexico. <sup>10/</sup>

The impact on factor returns and real wages shown in Tables 7a and 7b also demonstrates the slightly negative effect that NAFTA produces in other countries relative to the NAFTA partners. The rate of return to capital increases slightly in the U.S. and more so in Mexico, but it falls slightly for most of the other countries in the region except for Chile and Peru. All U.S. and Mexican labor categories gain with NAFTA, while most other countries' labor categories loose slightly with NAFTA (except for a slight rise in most rural wages). The movement in North American urban wages is largely a function of the rise two way trade in most manufacturing goods between the U.S. and Mexico due to NAFTA. NAFTA, meanwhile, generates a decline in exports, output, and wages in these same sectors throughout the rest of the region. Most comparative statics effects are basically augmented with the externality scenario, in some cases significantly as in the case of Mexican urban wages.

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<sup>10/</sup>This result is evidence that can help confirm the theoretical proposition that the dynamics effects of regional integration may outweigh their trade diversion impacts. See Chichilnisky (1992) and Gunter (1993).

The NAFTA produces a very large increase in almost all Mexican export sectors except corn, while the U.S. shows moderate increases in exports except for very large increases in corn exports. The dynamic externality effects of NAFTA on Mexican sectoral exports show very large increases in fruits and vegetables and light manufacturing, while the U.S. shows moderate increases in corn and consumer durables. The results also indicate that Brazil would suffer the broadest and largest amount of trade diversion across most of its export sectors, including agricultural and non agricultural goods. Trade diversion for Argentina and Chile would be felt primarily in agricultural sectors, with Chile absorbing relatively larger negative impacts. Table 11 shows that most of this trade diversion is related to the U.S. expansion of export markets in Mexico at the expense of Latin America, as well as U.S. sourcing of goods from Mexico rather than Latin America.

### **The Impact of MERCOSUR**

Scenario 2 simulates the elimination of tariff barriers between Brazil and Argentina, while restoring the NAFTA reduction of tariff and non-tariff barriers between Mexico and the U.S. This scenario simulates the imposition of a common external tariff as of January 1, 1995 while assuming that NAFTA was never implemented. As table 5a and 5b shows, the GDP impact of MERCOSUR more than overcomes any negative impact of NAFTA on Brazil and Argentina in static terms and represents a major improvement in externality terms for MERCOSUR members, particularly for Brazil.

Unlike NAFTA, MERCOSUR does not negatively effect the Andean region and in fact is moderately positive for Bolivia and Venezuela. MERCOSUR does have a slight negative static impact on Mexico. The impact on the U.S. is also negative, but is much more sensitive to assumptions regarding the ability to redirect trade towards the rest of the world. <sup>11/</sup> As can be seen in Table 6, Mercosur causes a huge rise in intra-regional exports among MERCOSUR countries (4.7% for Brazil and 7.6% for Argentina), displacing the exports of non-MERCOSUR countries.

MERCOSUR, nevertheless, generates much more trade creation than trade diversion, although initially less so than does NAFTA. Total Hemispheric intra-regional exports in Tables 6a and 6b grow by 0.45% and .66%, outweighing the decline in exports by the U.S., Mexico, and Chile. Total trade with the rest of the world could actually increase, although this too is sensitive to global demand assumptions. Table 6b indicates, in fact, that the externality effects of MERCOSUR actually eliminate the comparative statics trade diversion within the hemisphere and with the rest of the world, due primarily to a hugely successful response by the Brazilian economy to trade externality effects.

The impact on factor returns and real wages shown in Tables 7a and 7b also demonstrates the very positive effect that MERCOSUR produces in Brazil and Argentina. The results also show slightly negative impacts on NAFTA countries' real wages, as well as for Bolivia and Peru, particularly rural labor (table 7a). The return to capital is particularly strong for Brazil while all

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<sup>11/</sup>The impact on the United States is sensitive to the assumption regarding the slope of the rest-of-world demand function (ETWA). The steeper the slope, and thus the more difficult it is to redirect exports to the rest of the world, the higher the negative impact on the U.S.

MERCOSUR labor categories gain. Most comparative statics effects are basically augmented with the externality scenario, with Argentina rural labor and land rents rising slightly.

MERCOSUR has large positive impacts on all of Argentina's sectoral exports, while Brazil experiences more moderate growth concentrated in manufacturing exports. The dynamic externality impacts, however, show very large growth in both country's manufacturing trade. Results also indicate that Mexico and Chile suffer trade diversion impacts from MERCOSUR in practically all agricultural and non-agricultural exports, while U.S. exports are relatively unaffected except for agricultural program crops.

### **The Impact of an Andean Free Trade Area**

Scenario 3 simulates the elimination of tariff barriers among the Andean Pact countries, while maintaining the NAFTA and MERCOSUR reduction of tariff and non-tariff barriers. As table 5a and 5b show, the GDP impact of an Andean FTA along with MERCOSUR helps to further overcome the negative impacts of NAFTA in static terms and represents a slight improvement in externality terms for Andean members, but not as much as NAFTA and MERCOSUR members benefit from their agreements.

Unlike NAFTA and MERCOSUR, an Andean FTA has virtually no effect on the U.S., Brazil and Mexico and only a slight negative impact on Argentina and Chile. As can be seen in Table 6, an Andean FTA causes a moderate rise in intra-regional exports among most Andean countries, except for Bolivia.

An Andean FTA, nevertheless, also generates more trade creation than trade diversion, although initially less so than does NAFTA and MERCOSUR. Total Hemispheric intra-regional exports in Tables 6a and 6b grow by 1.3% and 2.0%, outweighing the decline in exports by the U.S., Mexico, and Chile. Total trade with the rest of the world could actually increase, although this too is sensitive to global demand assumptions. Table 6b indicates, in fact, that the externality effects of an Andean FTA also eliminate the comparative statics trade diversion within the hemisphere and with the rest of the world.

The impact on factor returns and real wages shown in Tables 7a and 7b also demonstrates the slightly positive effect that an Andean FTA produces in the region. The results also show virtually no impact on non-Andean real wages, except for Mexico rural activities. The return to capital is particularly strong while all Andean labor categories gain, except for slightly negative impacts on particular labor categories in Bolivia, Peru, and Venezuela. Most comparative statics effects are basically augmented with the externality scenario, eliminating most of the negative country specific effects.

### **Alternative Paths of NAFTA, MERCOSUR, and Andean FTA Expansion**

Scenarios 4 through 32 present alternative post NAFTA, MERCOSUR, and Andean FTA paths of expanded trade liberalization, including a variety of hub and spoke arrangements as well as a WHFTA. The impact of these alternative scenarios on each of the countries in the hemisphere point to a complex collective action problem that the region's countries will have to resolve if an optimal

regional pattern of integration is to be achieved. The results reveal that while a Western Hemispheric Free Trade Agreement (scenario 32) is a common first best option for the large majority of countries and the region as a whole in the long run, there also exists a highly divergent set of short run first, second and third best options for each country in the region. If countries do not find a way to cooperate to build a hemispheric-wide free trade arrangement, the danger is that the region will fall into a divisive competition for each country's short term and next best options. This situations would not only initiate a high stakes competition between NAFTA and MERCOSUR, but would also reveal strong conflict of preferences between countries within NAFTA, MERCOSUR and the Andean Region.

Figures 1a and 1b summarizes each country's order of preferences among the various potential scenarios, revealing a number of clear conflicting order of preferences. To begin with, it is important to point out that most larger Latin American countries in the region (the U.S., Mexico, Brazil, and Argentina) and all Andean countries except Peru have the same first preference for a WHFTA over a hub and spoke arrangement in the "long run," defined as the realization of benefits due to the externalities related integration. In the comparative statics "short run" scenarios, on the other hand, an important group of countries (consisting of the U.S., Ecuador and Peru) would slightly prefer to be a regional hub than to be in a WHFTA. The good news from these results is that all hub-and-spoke arrangements for all countries are either inferior to full hemispheric free trade or provide only marginal benefits from trade diversion. The bad news, of course, is that the inability to realize full hemispheric free trade makes hub-and-spoke arrangements the most attractive alternative.

A second important result is that all countries have an incentive to move beyond the current status quo, for both potential gain and defensive reasons. Simply remaining with the current trading arrangements is either highly negative or low on the preference order for all NAFTA, MERCOSUR, and Andean countries. While all countries have the incentive to move beyond the status quo, how any one country seeks to expand its trading relationships will have implication (usually negative) for the others, thus further incentivating all countries to at least act defensively.

Except for the important coincidence of incentives to move beyond the status quo and to favor hemispheric free trade, the order of preferences among alternative scenarios for the region's countries is highly conflictive and complex. In general, each country's order of preference is topped by an attempt to maximize their own access to markets while excluding their trading partners from this access. Their next best set of options is to share their access to third countries with their trading bloc partners by allowing accessions to their existing free trade arrangement. Each country's least attractive set of options is, of course, to be left without access to a market that their partners have free access to.

The ordering of each country's preferences can be visualized as a series of cascading steps seen in Figures 1a and 1b. In the case of the NAFTA partners, each country's close first and second best set of preferences, its top step, is to be part of a WHFTA (scenario 32) or be the hub of preferential FTAs in addition to NAFTA. Thus the U.S. prefers scenario 16 and 8 to 32, while Mexico prefers scenarios 32, 12 and 16. Notice that each country's non-WHFTA second best scenario mostly lie low on the other NAFTA partner's preference list, immediately raising the specter of potential conflict. This conflict would involve MERCOSUR since each NAFTA partner's "hub" scenarios are equivalent to "4+1" arrangements with MERCOSUR. A third best set of options consist of establishing individual FTAs or NAFTA accessions with third countries. In the externality scenarios, each country maintains its own preference of which third country to trade with: the U.S.

prefers free trade with Brazil, while Mexico prefers Argentina. Both partners also disagree as to what are their less favorite scenarios. The U.S. naturally prefers less that Mexico be the hub of a "4+1" relation with MERCOSUR and Andean countries, which actually could be inferior to the U.S. than a mere NAFTA with no further extensions in the externalities scenarios. It is interesting to note, however, that the U.S. prefers almost any expansion beyond NAFTA, even if it helps Mexico become a hub, since the U.S. benefits from any growth in Mexico more than possible trade diversion effects. Both countries agree, however, that MERCOSUR without NAFTA is the worst option.

While both MERCOSUR partners agree on a WHFTA (scenario 32) as their first best option in both the static and externality scenarios, each country's second best preferences is to have preferential accession to NAFTA at the exclusion of other MERCOSUR countries. Thus Brazil's second best preference is scenario 16 while Argentina prefers scenario 17. Notice again that each's second best scenarios are much less preferred by the other MERCOSUR partner, raising the specter of potential intra-MERCOSUR conflict linked with NAFTA politics. A next set of preferences, each country's third through fifth best options, consist of either establishing an "4+1" linkage with a NAFTA partner or establishing individual FTAs outside of MERCOSUR with third countries who are members of NAFTA. Again each partner prefers to have exclusive access to the U.S. market or settle for MERCOSUR access to the U.S. Failing to secure access to the U.S. market, each country has an interesting coincident set of interests as their fourth best option SAFTA. Following SAFTA both countries would prefer an Andean-MERCOSUR FTA and a Andean-NAFTA FTA. Thus if neither Brazil or Argentina can have access to NAFTA countries directly, or an exclusive SAFTA, then they would prefer their Andean-MERCOSUR partners to have access to NAFTA. Both Brazil and Argentina would least prefer, however, that Andean countries have preferential access to NAFTA and that they be excluded. NAFTA or the other country joining NAFTA in the absence of MERCOSUR, are each country's worst options.

### **The Preferences of Chile and the Andean Group**

The position of Chile and each Andean country will play a crucial role in how the options for hemispheric free trade may effect the interests of NAFTA and MERCOSUR countries as well as smaller Latin American countries. While Chile's first best option is WHFTA, this is followed by having exclusive hub and spoke access to both NAFTA and MERCOSUR (scenario 25). The next level of preferences (scenarios 13 and 4) are based on access to the U.S. market, either by joining NAFTA or directly through a bilateral agreement. Chile would gain a third more by joining NAFTA than by having free trade with MERCOSUR (19) or by joining a SAFTA, which are Chile's 5th and 6th preference.

While Chile may prefer NAFTA over MERCOSUR, the results show that free trade with Chile is a very low preference for NAFTA countries. For both the U.S. and Mexico, the static results show that free trade with Chile is actually inferior to not expanding NAFTA, although this is less the case in the externality scenarios. In contrast, Brazil and Argentina prefer expanding MERCOSUR to included free trade with Chile, although this is not highly preferred by Chile.

Most Andean countries also prefer WHFTA as their first best choice in the externality scenarios, although Peru slightly prefers an Andean-NAFTA FTA while Ecuador prefers SAFTA. Like Chile, all Andean countries except Ecuador have as their second best choice to be the nub or their own preferential FTA with both NAFTA and MERCOSUR. These hub and spoke arrangements

are not surprisingly the least cared for options of every country's trading partner. While this may seem an obvious basis for potential conflict among Andean countries, it is important to note that most countries also closely prefer that the Andean Group as a whole have access to both NAFTA and MERCOSUR.

Chile, like the other smaller Latin American countries, is clearly in a very vulnerable situation being left out of the major sub-regional trading arrangements. All would suffer even more trade diversion if free trade would be arranged between NAFTA and MERCOSUR members.

All are also in a position to benefit highly from joining regional trading arrangements, with full hemispheric liberalization producing more static benefits for than accrued by Brazil, Argentina, and the United States (table 5a). Joining NAFTA provides more benefits for than having free trade with MERCOSUR. Joining both arrangements is slightly more preferable than even full hemispheric free trade; allowing these countries to become a regional hub and enjoy the trade diversion effects of continued protection among its various spoke partners.

Joining NAFTA rather than MERCOSUR produces relatively larger export growth in most manufacturing sectors and more moderate growth in agricultural exports, yet produces a larger decline in consumer durable exports. The dynamic externality scenarios show that specializing in intermediate and capital goods, while actually decreasing exports in most other agricultural and manufacturing sectors.

## **SAFTA**

It is interesting to point out that SAFTA is not a first preference for any country in the Hemisphere except Ecuador in the static case. Brazil and Argentina much prefer WHFTA or preferential or joint access to NAFTA countries. It is also interesting to point out that in virtually all scenarios, Chile and all the Andean countries prefer access to NAFTA countries rather than to joining SAFTA. Even Ecuador, which first best prefers SAFTA in the static case, prefers WHFTA and NAFTA access in the externality case. Baring access to NAFTA, however, SAFTA becomes the most attractive second best option for MERCOSUR members as well as all other Latin American countries.

## **Western Hemisphere Free Trade Area**

An alternative to the various hub and spoke configurations being discussed as post-NAFTA paths of regional integration is the formation of a single Western Hemispheric Free Trade Area (WHFTA). In Scenario 32, we eliminate all tariff and non-tariff protection between all the major countries in the Western Hemisphere while maintaining all countries' pre-GATT levels of protection with the rest of the world. Scenario 32 thus simulates the creation of a WHFTA by multilaterally extending all zero tariff and non-tariff barriers among a larger set of members.

While scenario 32 appears as a the first best outcome for regional growth and exports, there nevertheless continue to be a variety of collective action complications. Scenario 32 is the first best outcome for most of the countries in the region as well as the region as a whole both in terms of real GDP and total trade (tables 5a and 5b). Scenario 32 also provides first best outcomes for virtually all factors and labor market segments in every country in the hemisphere (table 7).

The most important exception to WHFTA as the first best is the United States in the static scenarios, although WHFTA becomes a strong first best in the externality scenarios. Clearly the U.S. has the most inter-temporal collective action problem it will have to resolve if the Hemisphere's first choice (WHFTA) is to have a chance. In addition to this inter-temporal decision problem, the U.S. faces some distributional issues which are specific to some U.S. sectors and industry/occupation groupings. Some lower productivity U.S. food processors and light manufacturing producers would face increased competition even though exports in these sectors would also increase in scenario 32 relative to NAFTA.

Finally, the rest of the world clearly suffers more trade diversion from scenario 32 compared to all other scenarios, even though total Hemispheric trade creation is much higher than under NAFTA (table 6). Yet it is important to point out that trade diversion with the rest of the world actually decreases when the externality gains from integration (table 6b) are compared to the comparative statics results (table 6a), again confirming theoretical predictions made to this effect.

#### IV. Collective Action Problems and Solutions

Given this structure of aggregate national and regional preferences, why might countries in the hemisphere be willing to embark upon a less optimal path towards regional integration? What form of strategic interaction can be envisioned within which countries will decide to cooperate and act collectively in building a more economically optimal hemispheric order?

The formation of a regional integration agreement cannot be seen as a process motivated simply by the maximization of potential economic welfare. Rather the decision to participate in increased hemispheric integration must be seen as reflecting a complex calculation by individual countries concerning a series of strategic tradeoffs. In both North and South America, countries will be motivated to maximize the potential economic benefits of interdependence while minimizing the political risks of adjustments costs and geo-political realignments. This calculus will crucially depend on the degree of predictability and certainty that countries have regarding whether a negotiation can in fact be concluded and can yield a reasonable symmetry of benefits, compared to the political price that is perceived will be paid both domestic and internationally in trying to get an agreement. <sup>12/</sup>

The scenario a country chooses as its first best strategy will thus be a function of both the predicted maximization of benefit and the minimization of risks. The alternative scenarios presented here are perceived to be associated with differing degrees of certainty of outcome for each country, thus generating the formation of a hemispheric collective action problem. Whether the first best scenario of a WHFTA can be considered a realistic option will depend on the formation of an as yet

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<sup>12/</sup>In recent interviews with political leaders in Mexico and the U.S. concerning the early formation of NAFTA, the point was made that Mexico decided to go forward with the NAFTA negotiations because of the calculus that the political costs of shifting Mexico's traditional nationalist position vis-a-vis the U.S. and the economic costs of opening Mexico's economy were worth the risks because of the special linkage between the U.S. and Mexico, including national security dynamics.

non-existent collective good: a process of multilateral negotiations that can provide reasonably certain conclusions and be considered reasonably fair. The more multilaterally based the option and the more actors involved, then the outcome is seen as less certain, especially if there is also a material incentive for countries to defect to an individual bilateral strategy. Bilateralism or individual accessions to existing agreements, on the other hand, are currently perceived as providing the greater certainty, predictability, and control, especially because bilateralism can be seen as being locally optimal as a second best. Bilateralism, however, does not appear to provide a path for full regional integration but rather is likely to produce divisive fragmentation due to built-in incentives for exclusionary practices.

#### **IV.i Perspectives on Benefits and Costs of North/South Integration**

The central issue thus becomes the certainty that a hemispheric negotiation can in fact be concluded and a symmetrical agreement achieved, compared to the political costs (both domestic and international) associated with attempting to negotiate an agreement and payoff potential domestic losers. This process can be analyzed in game theoretical terms as a process of constrained maximization by different players involved in interactive negotiations. <sup>13/</sup> It can be evaluated as a "two level" collective action problem among state managers and economic class actors, both within and across countries in North and South, all facing various constraints.

The specific calculation of this trade-off by each national government is dependent on each country's position in the hemispheric economic and state system as well as the structure of domestic state/society relations, both of which limit a government's course of action. On a global scale, it is these international and national institutional structures which delimit the range of options that are strategically possible.

Latin American countries face major tradeoffs in opening to trade with a much more economically advanced market in exchange for potential access to the U.S. markets and reduction in "risk premiums" for foreign investors. The economic significance of this bargain will depend on the relative importance of links with the U.S. for each LAC economy, both in terms of a share of GDP and its relative importance of with respect to total trade and financial relations.

For Latin American countries, the potential benefits of a WHFTA consist of: more guaranteed access to the US market through rules based procedures and insurance against new restrictions; cheaper inputs and access to technology with potential economies of scale effects; and a lock-in effect on reforms as countries seek a reduction in investment discount rates. <sup>14/</sup> Large countries can be made more attractive for DFI due to economies of scale and scope considerations by multinational investors within a WHFTA. <sup>15/</sup> All countries will be attracted to a WHFTA for defensive purposes, trying not to be left out of any potential arrangement.

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<sup>13/</sup>See Hinojosa (1989); Hinojosa and McCleery (1992).

<sup>14/</sup>Thomas (1995:p.5) presents a very explicit statement of how investors and bankers view the impact of NAFTA.

<sup>15/</sup>Vernon (1992), p.25.

These benefits have to be balanced with costs associated with: the politics of labor adjustment and the exposing of local firms to competition with firms of global scale and resources; asymmetrically larger tariff reductions and financial liberalizations that could exacerbate trade deficits and macro-economic risks; limited flexibility of short term policy actions well as the loss of some long term industrial and development policy tools; and possible geo-political problems and/or retaliation by third party trading partners.

#### IV.ii MERCOSUR and SAFTA

Brazil and Argentina perceive that entering into NAFTA or a Western Hemispheric Free Trade Area could lead to retaliation by their other trade partners due to trade diversion effects, a scenario deemed likely with respect to the EU and poorer developing countries who would be put at worse disadvantage relative to the U.S. <sup>16/</sup> Argentina and Brazil could be more vulnerable to this effect compared to Mexico or other countries whose trade is more concentrated with US. For a relatively smaller country like Argentina, there is also a geo-political price to be paid for attempting to join NAFTA on their own, since this would have real implications for its integration with the much larger neighboring country of Brazil. Thus even though it is relatively more in Argentina's interest to have full free trade with NAFTA and Brazil, it negotiated a second best option of a common external tariff with Brazil under MERCOSUR.

For Brazil, being left out of NAFTA, WHFTA, or a hemispheric hub and spoke arrangement is seen as potentially negative due to trade diversion and the consolidations of multinational investors within a US-Mexico nexus. Yet there is also a lack of perceived net economic advantage for Brazil in an FTA with the U.S. since it is seen as more trade creating for the US given that its tariffs are already lower than Brazil's. In any case, U.S. free trade with Brazil is not seen as coming soon after NAFTA, both due to the U.S.'s lack of appetite for further political debate about unemployment and because Mexico is not seen as wanting to let Brazil in to NAFTA. Many therefore conclude that US-Brazil relations would be better off with a relatively slow agenda on hemispheric integration. <sup>17/</sup>

Given these Brazilian perceptions, it is ironic that the NASAFTA model results show Brazil gaining considerably more in aggregate static terms than Argentina from joining NAFTA or creating a WHFTA (table 5a). The benefits to Brazil are dramatically enhanced when the dynamic externality effects of trade with the U.S. are calculated (table 5b). In the longer run, it is actually much more in the interest of Brazil to establish an U.S.-Brazil FTA than to establish MERCOSUR. Yet in the short run, the gains from free trade with the U.S. are apparently not seen as large enough to take the risk of attempting to negotiate with the U.S.

For Chile, being left out of NAFTA has a much greater negative impact than the formation of MERCOSUR. Accession into NAFTA, and to a lesser extent a bilateral FTA with the U.S., is also much better for Chile than joining MERCOSUR, while joining both is obviously the best. Yet doubts about the likelihood of joining NAFTA or of forming a U.S. Chile bilateral FTA are pushing Chile to join MERCOSUR as a first, more likely option.

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<sup>16/</sup>Fritch (1989), Abreu (1993).

<sup>17/</sup>Abreu (1993).

#### IV.iii The NAFTA Countries

It is interesting to point out that the NASAFTA CGE results shed light on a recent controversy concerning Mexico's and other Latin American countries' interest in expanding regional trade liberalization. <sup>18/</sup> An analysis by the Office of the U.S. Trade Representative on "Latin American Trade Policy After NAFTA" observed that:

"Mexico reportedly is **not** interested in allowing other countries in the region into an arrangement that offers considerable benefits, which were achieved because of its relationship to the United States. Obtaining consensus to expand the NAFTA could become increasingly difficult if Mexico's reluctance were overcome for the admission of a couple more countries (e.g. Chile) and one of these newly acceded nations blocked further FTA negotiations." <sup>19/</sup>

The NASAFTA modeling results indicate that it is not the case that Mexico does not have as its first preference the expansion of NAFTA to include all of Latin America. Having secured access to the U.S. market via NAFTA, Mexico is nevertheless taking the more aggressive lead in developing their own hub-and-spoke option through the formation of bilateral FTA throughout the region.

The U.S., on the other hand, is shown to have real short term material incentives to construct an exclusive hub and spoke system. In addition, the U.S. appears to be more preoccupied by its domestic political debate on further NAFTA extensions. This uncertainty regarding a WHFTA could ironically result in scenario 12 where Mexico pursues its option to become the new hub of a hemispheric trading system, with the U.S. defaulting into its relatively lower preference option as a mere spoke in the Mexican led system.

For the U.S., the key "long term" externality based benefits of a WHFTA are based on preferential access to an important export market and enhancing economic growth in an important geo-political region. The U.S. market is practically wide open to products from the region via GSP or other programs (except for some products, like textiles and sugar), while Latin countries have much higher protection rates. More important is thus maintaining the momentum to sustained growth in a key export region, as was the case with Mexico in NAFTA. Unlike in NAFTA and the CBI, there is not much of an incentive for creating a WHFTA as a means for off-shore production for re-exporting back to the U.S. Latin America's greater willingness to open its market is thus a crucial factor in a context where the U.S. is a natural supplier and where the LAC market is expected to grow due to demographic reasons, if nothing else (Garten, 1994).

It is thus in the U.S.'s best interests to expand liberalization among LAC and to have access to that growing market in a form compatible with NAFTA. A WHFTA is also better for the US than just securing bi-lateral market access since it enhances a pattern of market expansion which will directly benefit the U.S. The exercise of U.S. leadership in the Hemisphere is also important for its

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<sup>18/</sup>"Memo Doubts Mexican Resolve on NAFTA Expansion " New York Times, February 21, 1993.

<sup>19/</sup>"USTR Discussion Draft on Post-NAFTA Policy", Inside NAFTA, Vol.1, No. 4, February 23, 1994: p. 18.

potentially global impact of opening other markets and improving the U.S. geo-political standing, while at the same time not alarming the multilateral order. The follow through of the Summit of the Americas will be judged in this regard since it has raised high expectations in the Hemisphere and around the world.

While it is clearly in the economic interest of the U.S. to move towards hemispheric integration, the United States has dropped behind the Latin Americans in providing leadership in actually creating more FTAs. The roots of this current set of ironies can be traced back to issues within U.S. domestic political economy dynamics. The USTR reportedly does not want to push strongly on the post-NAFTA expansions due to the political imagery that NAFTA has produced in the U.S. Congress, a factor which has to be evaluated in cost/benefit terms with respect to the USTR's overall political objectives. It is thus seen as easier to open discussions with Asia, where the NAFTA stigma is less apparent, even though the probability of agreements is lower (Ives, 1994).

#### IV.iv Consequences of Unsolved Collective Action Problems

Both the U.S. or Mexico centric bilateral and the NAFTA-centric accession approaches, as well as the SAFTA/MERCOSUR or even Adecan hub and spoke approaches, posit the danger of producing a broad myriad of idiosyncratic and incompatible trading arrangements. It is completely unrealistic, admitted even by proponents of NAFTA expansion (Hufbauer and Schott, 1994), to assume that the US will be able to achieve the inclusion of all countries as either as bilateral partners or NAFTA accession countries. Nor is it realist to assume that any of the other sub-regional approaches are capable of organizing Hemispheric free trade. In fact, some sub-regional alternatives have been forwarded explicitly as a means to counteract the NAFTA accession route.

The danger is that the current status quo will encourage a wide open hemispheric race to bilateral or sub-regional trade pacts, with potentially disastrous consequences:

-Negative trade diversion would be a clear result for the smaller countries not explicitly included, or for the larger countries explicitly left out, of any sub-regional agreement.

-A lack of clearly obtainable goals in a complex and risky competitive process would slow down trade reforms in many countries and would make trade policy a much more geo-political exercise specific to local interests that would distort liberalization based on multi-lateral principles. In the absence of clear goals for trade liberalization, national macro-economic reforms would also be slowed due lack of external incentives in the new uncertain international environment.

-The US would clearly loose the race for sub-regional trade arrangements and would be excluded from most sub-regional agreements, which in fact turns out to be a worst case result for the US. <sup>20/</sup> The U.S. is already seen as internally divided and as an unreliable negotiating partner. The feeling would be that the U.S. is no longer committed to an aggressive agenda on Western

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<sup>20/</sup>This result, confirmed in the current paper, was also found to be the case with respect to U.S. trade option with Central American and the Caribbean. See Hinojosa, Lewis, and Robinson, 1994.

Hemispheric trade and had squandered the momentum built under NAFTA, EAI, and the Miami Summit to redefine Hemispheric relations.

-The region would become mired in a set of hub and spokes arrangements that would be a nightmare to traders, investors and commercial administrators. They would also be very difficult to undo as special interests would form around them. The left-out countries would then find it very difficult to break into sub-regional trade pacts without clear rules of accessions or docking principles.

-This would set up and accentuate regional geo-political rivalries among larger markets, with smaller countries having to strategically choose with whom and how to associate. This has obvious de-stabilizing consequences for Hemispheric unity around common principles, as well as raising potential security concerns.

What type of strategic pathways towards a new hemispheric order can be envisioned? What new order of strategic interactions are possible given the power asymmetries and institutional structures within and across countries in the hemisphere; one that can generate a context for ongoing bargaining which can produce the needed economic structural changes and build the needed institutional structures; and one that can satisfy short term strategic requirements as well as long term goals? The optimal response to these questions lies in resolving the collective action problem related to the lowering of risks currently associated with attempting to successfully conclude hemispheric negotiations. The key strategic challenge is thus to construct mechanisms and institutions which (1) increase the certainty of successfully negotiating comprehensive trade agreements, while (2) reducing the potential costs associated with integration. 21/

## V. CONCLUSION

The NASAFTA-CGE modeling exercise was designed to establish an empirically rooted economic framework which could be used in the anticipated new round of post-NAFTA analysis and discussions. The modeling results of alternative scenarios provide insights and implications for the formulation of strategic trade policy by both the U.S. as well as all the other countries in the Western Hemisphere.

At first glance, our results would seem to indicate very small incentives to pursue any further regional integration from the point of view of the U.S., while other countries in the Hemisphere have relatively greater incentives to act. The NASAFTA model research results show, as did most research on NAFTA, that any pattern of U.S.-Latin American integration can be expected to have relatively small positive implications for the U.S., but will have much more important positive or negative implications for all the other countries in the Hemisphere. While the aggregate effects of every alternative scenario are small for the U.S., there nevertheless are relatively important difference between scenarios, both for the U.S. and for the rest of the region.

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21/Many of these recommendations were well presented in a recent CEPAL/IDB/OAS publication called Towards Hemispheric Free Trade (1994) .

Whether the U.S. likes it or not, there will be consequences for how the U.S. acts or does not act, which must be taken into account even if it is primarily for geo-political reasons. NAFTA is already perceived to have resulted in a negative impact on the U.S.'s neighbors. The NASAFTA model results confirm this negative, albeit small, trade diversion impact. It should be pointed out that the current post-NAFTA situation also provides a unique opportunity for the U.S., as well as all other countries in the hemisphere, to assume a new leadership role that can help produce a first best cooperative and mutually beneficial outcome.

The scenario results point to a complex set of collective action problems between countries, sectors, and socio-economic groups in the region, a failed resolution of which could result in lower levels of national and regional output and trade. These results also point to a number of essential strategic choices that will have to be made in order to generate the most optimal regional outcome. Such an outcome will be possible if and only if:

(1) the U.S. is able to overcome an inter-temporal and a domestic political economy debate on the distribution of the gains from trade for the U.S. which could then allow the U.S. to provide a longer term strategic leadership role in the region; and

(2) the ability of all countries in the region to resolve an almost classic "prisoners dilemma" collective action problem concerning the ability of countries to lower the uncertainty that will allow them to cooperate to obtain optimal outcomes, or risk a competition where all will end up in a second best world or worse.

From the point of view of U.S. decision makers, a number of issues are currently under consideration for a post-NAFTA Western Hemisphere trading order: (1) whether to establish new FTAs or to rely on NAFTA accession; (2) whether the expansion of free trade should be negotiated with individual countries or with sub-regional groupings; and (3) whether NAFTA extension should only be limited to the Western Hemisphere or should also include other parts of the world. 22/

Our modeling results provide explicit economic answers for each of these questions with respect to their options in the Western Hemisphere: (1) full hemispheric free trade is preferential to new bilateral FTAs as well as an incomplete set of NAFTA accessions; (2) the U.S. is better off through the incorporation of a wider number of multiple regional groupings rather than a smaller number of individual countries; and (3) trade diversion with respect to the rest of the world is a real issue which will grow in importance through the incorporation of more countries into a WHFTA, but can be ameliorated through maximizing the potential externality gains from regional integration.

A Western Hemispheric Free Trade Agreement scenario is much better than a U.S. centered hub and spoke system through individual FTAs or NAFTA accessions in the longer term, but not in the short term. The U.S. gains in real GDP and exports at roughly double its rate of improvement due to the NAFTA alone. This is because the U.S. would not only be able to export to a wider WHFTA market, but also a richer Hemispheric market now enhanced through regional gains from freer trade among all its member countries.

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22/"U.S. Shows Early Favor for NAFTA Expansion Over Separate Pacts," Inside NAFTA, Vol.1, no.1, 1/12/94:p.1-11.

Our results indicate that there are also clearly some distributional issues which are specific to some U.S. sectors and industry/occupation groupings. Some lower productivity U.S. fruit and vegetable growers, food processors, and light manufacturing producers would face increased competition even though exports in these sectors would also increase in scenario 32 relative to NAFTA.

Of all the regional options, a Western Hemispheric Free Trade Agreement provides first best outcomes for most factors and labor market segments in the U.S. This is due to both a fall in the import prices of wage goods and a shifting of production to more productive export activities. But as we saw in the NAFTA debate, crafting institutions that can convince the U.S. Congress that the adjustment burdens of some workers, sectors, and regions will be fully compensated for is a very complex political undertaking. It is nevertheless essential that this challenge be taken up in order for the U.S. to provide the needed leadership to travel down its own, as well as the regions's, optimal path towards regional integration. Failure to assume a leadership role in regional liberalization actually results in a worse option for real wages compared to the post-NAFTA status quo.

In addition to the need for the U.S. to resolve its domestic political economy problems so that it can assume a pre-requisite regional leadership role, our research indicates that two inter-related collective action problems must also be resolved: one between the U.S. and Mexico; the other between Brazil and Argentina. These collective action problems emerge from a situation whereby, in the absence of a willingness to compromise and act collectively in a manner that would generate maximum regional and individual benefits, individualist behavior would most benefit each player at the expense of all others as well as the region as a whole.

Essentially our alternative scenarios uncover a prisoner's dilemma type situation whereby in the absence of cooperation in providing the public good of a multilateral negotiating mechanism, each country is left to fend for itself in a high stakes and highly competitive environment. While the formation of a Western Hemispheric Free Trade Area is shown to be the most optimal scenario for most of the major member countries of NAFTA and MERCOSUR, the lack of a mechanism for credibly negotiating a multilateral agreement places a high discount on this first best option. In the absence of a first best solution, strategic relations both within and between NAFTA and MERCOSUR become very volatile, with each member country having a very divergent set of second best preferences as to how and with whom to proceed with trade liberalization. Yet to create the condition for a first best solution to be organized in the hemisphere, collective action problems must first be addressed within NAFTA and MERCOSUR.

Mexico and the United States have to reach a decision on how to expand beyond NAFTA, for which they have essentially three options: individual hub-and-spoke arrangements; NAFTA Accessions; or an agreement with MERCOSUR on negotiating a WHFTA. As we have shown, the U.S. would slightly prefer slightly to be its own hub in the static short run. Yet if the U.S. tried to pursue its own hub and spoke alternative, or even aggressively push individual NAFTA accessions of non-MERCOSUR countries, this will likely spur Brazil into a defensive strategy to build up a SAFTA around MERCOSUR. Given the relatively lower adjustment costs required to build a SAFTA, MERCOSUR would probably win a race against NAFTA to establish free trade with its neighbors, resulting in a low preference outcome for the U.S. A similar defensive response would likely result from an the highly problematic attempt to get MERCOSUR to join NAFTA, essentially implying the abandonment of the project to build a common market with a common external tariff.

To avoid these conflictive outcomes, Mexico and the U.S. essentially have to be able to cooperate on a common strategy to offer Brazil and MERCOSUR a non-competitive framework for establishing a Western Hemisphere free trade area, abandoning their strategy of individual NAFTA accession or bilateral hub and spoke agreements. This of course would necessitate an assurance that Brazil and other MERCOSUR members would also be willing to go along with a means of reaching a WHFTA.

In the absence of a mechanism for negotiating a WHFTA, Brazil and Argentina, as well as the countries in the Andean region, would also face a prisoner's dilemma set of choices as each would attempt to reach their own second best option at the expense of their partner. The scenarios results indicate that in the absence of a multilateral framework, it is in the interest of both Brazil and Argentina, as well as Andean countries, to compete against one another to individually and exclusively access the U.S. or NAFTA market, while leaving all the other spoke countries out of the regional trading arrangement. The more likely default scenario would thus be Argentina and Brazil choosing a SAFTA strategy for MERCOSUR to develop free trade with other non-NAFTA countries, even though this is not their preferred second best option. This is because attempts by Brazil and Argentina to access NAFTA individually would immediately be complicated by the incentive for Mexico and the U.S. to be the center of their own hub and spoke system, thus seeking to prevent Brazil and Argentina from becoming the other NAFTA partner's additional spoke. For the U.S. and Mexico, as NAFTA partners with veto power, both must make a key decision: to share a wider NAFTA market with all competitors or block any NAFTA accessions and risk the other NAFTA partner achieving a hub and spoke system with their geo-political neighbors.

This situation can only be resolved through a decision by NAFTA and MERCOSUR countries to establish a credible mechanism for the formation of comprehensive Western Hemispheric Free Trade Area. Fortunately, a WHFTA goal represents a first best outcome for the U.S., Brazil, and Argentina, and a close second best outcome for Mexico. This common strategy can be achieved by developing mechanisms and institutions which: (1) reduce the uncertainty of multilateral negotiations; and (2) mitigate the economic costs of integration through trade adjustment investments. While it is true that not all sectors of all countries in the region are yet ready for NAFTA accession, and that the U.S. political system may not be ready to accept them at this time, it is essential to keep the momentum going towards a broader regional liberalization that is commensurate with other short and medium term development objectives.

Furthermore, the results still point to the fact that failure to resolve the outstanding regional problems of low rural productivity and wide income gaps could result in actually exacerbating of inequalities under the auspices of regional integration. The optimal outcome of Greater Hemispheric integration could be part of the solution, but only in combination with a sustained investment in productivity enhancement and poverty alleviation.

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**Table 1a:**  
**Principal Western Hemisphere Blocs, Basic Data**  
(million US\$, million People)

Country	GDP	Population	GDP Per Capita	Total Trade		Trade with U.S.		Trade with LAC		Debt as % of GDP	DFI as % of GDP
				Exports as % of GDP	Imports as % of GDP	Exports as % of GDP	Imports as % of GDP	Exports as % of GDP	Imports as % of GDP		
Andean Pact	141300	91	1549	22.4%	12.1%	10.3%	4.5%	2.9%	2.4%	62.3%	n.a.
CACM	28040	26	1074	15.4%	22.3%	6.3%	8.4%	2.9%	3.8%	80.6%	n.a.
Caribbean	24657	19	1318	20.4%	28.1%	9.0%	12.4%	3.3%	6.7%	82.0%	n.a.
G3	327160	138	2371	15.9%	13.3%	9.5%	7.8%	2.2%	1.1%	45.0%	0.8%
Mercosur	520800	190	2740	8.9%	5.6%	1.9%	1.1%	1.5%	1.2%	35.2%	n.a.
NAFTA	6200100	363	17094	8.8%	10.8%	14.1%	11.9%	0.9%	0.1%	n.a.	n.a.
LAC	974470	425	2292	12.4%	10.0%	5.0%	4.0%	1.6%	1.6%	43.7%	1.7%
EUR-12	5995850	344	17430	22.8%	23.3%	1.5%	1.8%	0.3%	0.6%	n.a.	n.a.

Source: IMF; World Bank; IDB/IRELA

Note: NAFTA trade with U.S. as percent of GDP based on Mexico/Canada GDP  
Foreign debt data for Caribbean is for 1991  
EUR-12 does not include Belgium-Luxemburg

Andean Pact is comprised of Bolivia, Colombia, Ecuador, Peru, and Venezuela

CACM is comprised of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua

Caribbean is comprised of Barbados, Dominican Republic, Guyana, Haiti, Jamaica, Suriname, and Trinidad & Tobago

G3 is comprised of Colombia, Mexico and Venezuela

Mercosur is comprised of Argentina, Brazil, Paraguay, and Uruguay

NAFTA is comprised of Mexico, the U.S., and Canada

LAC is comprised of Andean Pact, CACM, Caribbean, Mercosur, Mexico and Chile

EUR-12 is comprised of Belgium-Luxemburg, Denmark, France, Germany, Greece, Ireland, Italy, Netherlands, Portugal, Spain, and the United Kingdom

**Table 1b:**  
Principal Western Hemisphere Countries, Basic Data  
(million US\$, million People)

Country	GDP	Population	GDP Per Capita	Total Trade		Trade with U.S.		Trade with LAC		Debt as % of GDP	DFI as % of GDP
				Exports as % of GDP	Imports as % of GDP	Exports as % of GDP	Imports as % of GDP	Exports as % of GDP	Imports as % of GDP		
Argentina	93,260	32	2,887	13.2%	4.4%	1.8%	0.9%	3.4%	1.5%	65.6%	0.8%
Bolivia	4,480	7	622	20.6%	15.6%	4.1%	3.5%	9.4%	7.4%	95.4%	n.a.
Brazil	414,060	150	2,753	7.6%	5.5%	1.9%	1.1%	0.8%	0.9%	28.1%	0.5%
Canada	570,150	27	21,117	22.2%	21.0%	16.7%	13.2%	0.4%	0.7%	n.a.	n.a.
Chile	27,790	13	2,105	30.9%	26.3%	5.4%	4.9%	3.7%	6.4%	68.8%	5.7%
Colombia	41,120	32	1,273	16.4%	13.6%	7.3%	4.8%	2.8%	2.9%	41.9%	0.6%
Costa Rica	5,700	3	2,036	25.5%	35.5%	45.7%	40.6%	16.5%	28.1%	66.2%	n.a.
Ecuador	10,880	10	1,088	25.0%	17.1%	12.1%	5.4%	8.2%	4.4%	111.3%	n.a.
El Salvador	5,400	5	1,038	10.9%	23.6%	33.8%	42.4%	34.6%	33.2%	39.8%	n.a.
Guatemala	7,630	9	829	15.2%	21.6%	39.7%	40.3%	33.3%	28.6%	37.2%	n.a.
Honduras	2,360	5	463	34.4%	37.3%	52.8%	39.5%	6.4%	27.6%	157.4%	n.a.
Mexico	237,750	86	2,758	11.4%	13.4%	7.9%	8.6%	0.6%	0.6%	40.7%	1.0%
Nicaragua	6,950	4	1,829	4.7%	9.1%	6.7%	12.3%	22.7%	37.8%	153.8%	n.a.
Peru	36,550	22	1,684	9.0%	7.9%	2.0%	2.2%	0.7%	0.2%	57.7%	n.a.
U.S.	5,392,200	250	21,569	7.3%	9.6%			0.9%	1.2%	n.a.	n.a.
Venezuela	48,270	20	2,450	37.6%	16.6%	19.4%	5.9%	8.6%	1.7%	69.0%	0.3%

Source: IMF; World Bank; IDB/IRELA

Note: Nicaragua data is for 1991

Table 2a:  
1990 Intra-Regional Exports  
(thousands of US\$, percent of total exports)

	Total	Andean Pact	CACM	Caribbean	G3	Mercosur	NAFTA	LAC	W. Hemisphere	EUR-12	Rest of World
Andean Pact	31711	4.1%	1.5%	1.80%	3.3%	2.9%	48.5%	12.9%	60.6%	16.0%	22.3%
CACM	4309	0.6%	15.3%	1.2%	1.9%	0.1%	45.9%	19.0%	63.2%	19.5%	16.7%
Caribbean	5020	1.2%	0.1%	6.8%	1.3%	1.0%	48.1%	9.4%	57.3%	19.4%	22.7%
G3	51964	2.4%	1.6%	1.5%	2.0%	1.6%	61.8%	8.3%	69.8%	13.2%	13.7%
Mercosur	46442	3.1%	0.3%	0.42%	3.3%	8.9%	24.0%	16.7%	38.8%	28.1%	30.8%
NAFTA	546720	1.4%	0.6%	0.79%	6.3%	1.4%	41.4%	9.8%	45.9%	18.2%	34.6%
LAC	123279	2.8%	1.4%	1.11%	2.6%	5.0%	41.8%	12.7%	53.5%	21.1%	22.8%
W. Hemisphere	642832	1.7%	0.7%	0.85%	5.8%	2.1%	40.3%	10.6%	46.1%	19.1%	33.4%
EUR-12	1249871	0.3%	0.1%	0.08%	0.6%	0.5%	8.6%	1.5%	9.7%	52.1%	34.2%

Source: IMF

Table 2b Intra-Regional Exports as Percent of Total Exports

	Year	Andean Pact	CACM	Caribbean	G3	Mercosur	NAFTA	LAC	W. Hemisphere	EUR-12	Rest of World
Andean Pact	1980	3.8%	1.7%	1.48%	3.1%	4.7%	35.1%	14.2%	48.8%	18.3%	30.0%
	1985	3.2%	1.8%	2.27%	2.4%	3.2%	46.4%	12.0%	58.3%	19.4%	21.0%
	1990	4.1%	1.5%	1.80%	3.3%	2.9%	48.5%	12.9%	60.6%	16.0%	22.3%
	1992	6.7%	1.8%	1.85%	5.1%	3.6%	48.0%	16.6%	63.5%	16.8%	18.2%
CACM	1980	0.4%	24.4%	0.5%	0.8%	0.2%	38.1%	26.1%	63.7%	22.6%	12.9%
	1985	0.7%	14.7%	1.1%	1.2%	0.1%	42.8%	17.3%	59.4%	19.5%	19.4%
	1990	0.6%	15.3%	1.2%	1.9%	0.1%	45.9%	19.0%	63.2%	19.5%	16.7%
	1992	1.1%	14.9%	0.8%	3.1%	0.1%	58.6%	19.8%	75.9%	16.0%	7.4%
Caribbean	1980	2.3%	1.2%	7.9%	2.3%	0.6%	51.1%	12.2%	63.2%	17.2%	18.4%
	1985	1.2%	0.2%	7.7%	1.2%	0.6%	58.9%	9.8%	68.6%	16.7%	14.2%
	1990	1.2%	0.1%	6.8%	1.3%	1.0%	48.1%	9.4%	57.3%	19.4%	22.7%
	1992	2.1%	0.5%	6.5%	2.6%	1.6%	49.5%	11.5%	60.3%	19.3%	19.8%
G3	1980	2.3%	2.0%	1.2%	1.8%	3.5%	47.7%	9.9%	57.5%	17.7%	19.5%
	1985	1.7%	1.7%	1.8%	1.3%	1.6%	55.7%	7.7%	63.3%	19.8%	11.8%
	1990	2.4%	1.6%	1.5%	2.0%	1.6%	61.8%	8.3%	69.8%	13.2%	13.7%
	1992	3.0%	1.3%	1.1%	2.2%	1.8%	71.7%	8.1%	79.5%	10.0%	8.1%
Mercosur	1980	3.8%	0.3%	0.29%	3.6%	11.6%	17.7%	20.4%	36.0%	29.0%	32.5%
	1985	3.5%	0.3%	0.35%	3.1%	5.5%	25.8%	12.1%	36.6%	24.3%	36.9%
	1990	3.1%	0.3%	0.42%	3.3%	8.9%	24.0%	16.7%	38.8%	28.1%	30.8%
	1992	4.5%	0.5%	0.37%	4.9%	14.2%	20.8%	25.5%	43.5%	27.1%	26.9%
NAFTA	1980	3.2%	0.8%	0.90%	7.5%	2.9%	33.6%	13.3%	41.8%	20.4%	36.2%
	1985	2.1%	0.6%	0.83%	5.9%	1.5%	43.9%	9.5%	49.2%	16.1%	33.4%
	1990	1.4%	0.6%	0.79%	6.3%	1.4%	41.4%	9.8%	45.9%	18.2%	34.6%
	1992	2.0%	0.8%	0.71%	8.2%	1.7%	43.3%	12.2%	48.9%	16.7%	33.2%
LAC	1980	3.2%	2.3%	1.25%	2.8%	6.7%	35.1%	15.7%	49.9%	22.1%	24.7%
	1985	2.7%	1.5%	1.34%	2.2%	3.7%	42.0%	10.5%	51.9%	21.3%	23.7%
	1990	2.8%	1.4%	1.11%	2.6%	5.0%	41.8%	12.7%	53.5%	21.1%	22.8%
	1992	3.8%	1.4%	0.90%	3.4%	6.9%	46.7%	16.0%	61.3%	18.3%	18.0%
W. Hemisphere	1980	3.2%	1.1%	1.02%	6.6%	3.8%	32.7%	14.2%	42.5%	21.1%	34.7%
	1985	2.3%	0.8%	0.95%	5.3%	2.0%	42.5%	10.0%	48.8%	17.2%	32.5%
	1990	1.7%	0.7%	0.85%	5.8%	2.1%	40.3%	10.6%	46.1%	19.1%	33.4%
	1992	2.4%	0.9%	0.77%	7.7%	2.8%	41.7%	13.4%	49.2%	17.6%	31.9%
EUR-12	1980	0.7%	0.1%	0.16%	1.0%	1.2%	7.1%	2.8%	9.4%	46.4%	42.5%
	1985	0.5%	0.1%	0.12%	0.7%	0.6%	11.9%	1.8%	13.4%	46.4%	38.3%
	1990	0.3%	0.1%	0.08%	0.6%	0.5%	8.6%	1.5%	9.7%	52.1%	34.2%
	1992	0.4%	0.1%	0.08%	0.8%	0.6%	8.1%	1.8%	9.4%	52.4%	33.7%

Table 3 Bilateral Exports as Percent of Total Exports

	Year	Argentina	Bolivia	Brazil	Chile	Colombia	Costa Rica	Ecuador	El Salvador	Guatemala	Honduras	Mexico	Nicaragua	Peru	U.S.	Venezuela
Argentina	1980		1.7%	9.5%	2.7%	0.5%	0.1%	0.2%	0.0%	0.0%	0.1%	1.5%	0.1%	1.5%	8.9%	0.8%
	1985		0.8%	5.9%	1.3%	1.6%	0.0%	0.2%	0.0%	0.0%	0.1%	3.0%	0.3%	1.9%	12.2%	0.9%
	1990		0.5%	11.5%	3.7%	0.6%	0.1%	0.3%	0.0%	0.2%	0.0%	2.6%	0.0%	1.5%	13.8%	1.2%
	1992		1.3%	13.5%	4.7%	0.9%	0.1%	0.6%	0.1%	0.2%	0.0%	1.9%	0.0%	1.9%	10.9%	1.6%
Bolivia	1980	23.7%		3.5%	4.5%	0.9%	0.0%	0.2%	0.0%	0.0%	0.0%	0.3%	0.0%	3.1%	25.7%	0.5%
	1985	55.9%		0.7%	0.8%	0.6%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	1.9%	14.1%	0.0%
	1990	25.6%		8.4%	3.7%	0.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	5.7%	20.0%	0.3%
	1992	21.5%		1.7%	2.5%	3.6%	0.0%	0.4%	0.0%	0.0%	0.0%	0.9%	0.0%	8.2%	16.0%	0.7%
Brazil	1980	5.4%	0.9%		2.2%	0.7%	0.1%	0.2%	0.0%	0.1%	0.1%	2.3%	0.1%	0.6%	17.4%	1.1%
	1985	2.1%	0.7%		0.9%	0.4%	0.1%	0.5%	0.0%	0.0%	0.0%	0.9%	0.0%	0.4%	27.1%	1.2%
	1990	2.1%	0.6%		1.5%	0.5%	0.2%	0.4%	0.0%	0.1%	0.1%	1.6%	0.0%	0.5%	24.6%	0.9%
	1992	8.5%	0.9%		2.6%	1.0%	0.2%	0.4%	0.1%	0.2%	0.1%	3.1%	0.0%	0.6%	19.7%	1.2%
Chile	1980	6.0%	0.6%	9.6%		1.6%	0.0%	0.5%	0.0%	0.0%	0.0%	1.4%	0.0%	1.5%	12.6%	1.7%
	1985	2.2%	0.4%	5.4%		1.4%	0.0%	0.9%	0.0%	0.0%	0.0%	1.3%	0.0%	1.2%	22.5%	0.9%
	1990	1.3%	0.8%	5.6%		0.9%	0.2%	0.5%	0.0%	0.0%	0.0%	0.7%	0.0%	0.9%	17.3%	0.4%
	1992	4.6%	1.5%	4.5%		0.7%	0.2%	0.6%	0.0%	0.1%	0.0%	0.9%	0.0%	1.7%	16.6%	0.8%
Colombia	1980	1.7%	0.1%	0.2%	1.6%		0.1%	2.0%	0.0%	0.2%	0.1%	0.5%	0.1%	0.7%	27.1%	7.1%
	1985	1.0%	0.0%	0.2%	0.6%		0.2%	1.6%	0.3%	0.1%	0.1%	0.2%	0.1%	0.9%	32.8%	3.6%
	1990	0.4%	0.1%	0.4%	2.4%		0.3%	1.1%	0.1%	0.2%	0.2%	0.6%	0.1%	1.3%	44.5%	3.0%
	1992	1.0%	0.1%	0.9%	1.3%		1.0%	1.2%	0.1%	0.2%	0.1%	0.8%	0.2%	4.2%	38.6%	6.8%
Costa Rica	1980	0.2%	0.2%	0.3%	0.2%	0.4%		0.1%	5.4%	6.7%	2.9%	0.1%	12.7%	0.1%	33.8%	0.2%
	1985	0.2%	0.0%	0.0%	0.0%	0.2%		0.3%	5.0%	4.2%	3.3%	0.8%	2.9%	0.0%	39.5%	0.6%
	1990	0.0%	0.0%	0.2%	0.1%	0.2%		0.1%	2.5%	3.6%	1.3%	1.0%	1.9%	0.0%	45.7%	0.2%
	1992	0.2%	0.0%	0.1%	0.3%	0.3%		0.2%	2.8%	3.8%	1.9%	2.0%	2.5%	0.0%	62.3%	0.3%
Ecuador	1980	1.3%	0.0%	1.4%	8.9%	3.8%	0.1%		0.0%	0.0%	0.0%	0.5%	0.0%	0.5%	32.5%	1.6%
	1985	0.3%	0.0%	0.1%	1.6%	2.2%	0.0%		0.0%	0.0%	0.0%	0.1%	0.0%	0.2%	57.1%	0.1%
	1990	0.4%	0.0%	0.2%	2.9%	1.2%	0.7%		0.0%	0.3%	0.0%	0.4%	0.6%	5.1%	48.6%	0.6%
	1992	0.9%	0.0%	0.4%	5.1%	2.1%	0.3%		0.2%	0.8%	0.0%	1.1%	0.0%	3.3%	46.8%	0.4%

Table 3 (continued): Bilateral Exports as Percent of Total Exports

	Year	Argentina	Bolivia	Brazil	Chile	Colombia	Costa Rica	Ecuador	El Salvador	Guatemala	Honduras	Mexico	Nicaragua	Peru	U.S.	Venezuela
El Salvador	1980	0.0%	0.0%	0.0%	0.0%	0.0%	6.3%	0.0%		16.2%	0.0%	0.1%	5.1%	0.0%	41.0%	0.0%
	1985	0.1%	0.0%	0.0%	0.0%	0.5%	3.6%	0.0%		9.0%	0.9%	0.0%	0.5%	0.0%	48.2%	0.0%
	1990	0.0%	0.0%	0.3%	0.1%	0.0%	8.0%	0.0%		17.4%	2.8%	0.8%	1.6%	0.0%	33.3%	0.0%
	1992	0.0%	0.0%	0.0%	0.7%	0.0%	6.6%	0.0%		15.9%	2.2%	1.2%	3.4%	0.0%	49.7%	1.1%
Guatemala	1980	0.0%	0.0%	0.1%	0.0%	0.1%	5.9%	0.1%	12.8%		4.0%	1.5%	6.4%	0.0%	27.7%	0.1%
	1985	0.0%	0.0%	0.0%	0.1%	0.6%	4.1%	0.3%	10.8%		2.4%	1.1%	1.4%	0.0%	33.4%	0.0%
	1990	0.0%	0.0%	0.0%	0.0%	0.0%	6.3%	1.3%	12.4%		3.3%	3.1%	2.8%	0.0%	39.8%	0.0%
	1992	0.0%	0.0%	0.0%	0.5%	0.0%	4.2%	0.9%	8.5%		1.4%	3.4%	2.8%	0.1%	53.9%	0.0%
Honduras	1980	0.0%	0.0%	0.1%	0.0%	0.1%	2.1%	0.0%	0.0%	5.0%		0.1%	3.9%	0.0%	52.8%	0.3%
	1985	0.0%	0.0%	0.0%	0.0%	0.2%	1.5%	0.0%	2.1%	4.3%		0.0%	1.5%	0.0%	55.1%	0.0%
	1990	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	0.0%	1.6%	1.5%		0.2%	0.1%	0.0%	52.8%	0.0%
	1992	0.0%	0.0%	0.0%	0.0%	0.1%	0.3%	0.0%	3.3%	1.6%		0.2%	1.0%	0.0%	52.4%	0.1%
Mexico	1980	0.3%	0.0%	2.6%	0.2%	0.3%	0.6%	0.3%	0.1%	0.4%	0.1%		0.3%	0.2%	64.7%	0.4%
	1985	0.2%	0.0%	1.3%	0.1%	0.5%	0.1%	0.2%	0.4%	0.5%	0.1%		0.1%	0.1%	60.4%	0.2%
	1990	0.4%	0.0%	0.6%	0.3%	0.4%	0.2%	0.2%	0.4%	0.7%	0.2%		0.0%	0.3%	69.3%	0.5%
	1992	0.4%	0.0%	0.7%	0.4%	0.4%	0.2%	0.1%	0.3%	0.3%	0.1%		0.0%	0.2%	76.3%	0.6%
Nicaragua	1980	0.0%	0.0%	0.0%	0.0%	0.0%	8.9%	0.0%	2.4%	3.9%	3.0%	0.0%		0.0%	38.7%	0.0%
	1985	0.0%	0.0%	0.0%	0.0%	0.0%	5.5%	0.0%	1.4%	3.7%	2.0%	2.7%		0.0%	15.9%	0.0%
	1990	0.0%	0.0%	0.0%	0.0%	0.0%	4.1%	0.0%	3.6%	2.0%	2.9%	6.4%		0.9%	4.9%	0.0%
	1992	0.0%	0.0%	0.0%	0.5%	0.0%	3.1%	0.0%	4.9%	0.0%	1.3%	6.2%		0.0%	18.4%	2.5%
Peru	1980	1.5%	1.8%	3.2%	1.2%	1.4%	0.1%	2.1%	0.1%	0.0%	0.0%	2.3%	0.0%		32.1%	1.3%
	1985	1.2%	0.4%	1.8%	1.7%	2.5%	0.5%	2.5%	0.1%	0.0%	0.0%	0.4%	0.1%		33.9%	1.4%
	1990	0.9%	0.6%	3.9%	1.7%	2.9%	0.3%	1.0%	0.1%	0.1%	0.1%	1.2%	0.0%		22.3%	1.7%
	1992	0.8%	1.0%	4.7	1.2%	2.5%	0.2%	1.2%	0.0%	0.1%	0.0%	2.7%	0.0%		21.4%	3.1%
U.S.	1980	1.2%	0.1%	2.0%	0.6%	0.8%	0.2%	0.4%	0.1%	0.3%	0.2%	6.9%	0.1%	0.5%		2.1%
	1985	0.3%	0.1%	1.5%	0.3%	0.7%	0.2%	0.3%	0.2%	0.2%	0.1%	6.4%	0.0%	0.2%		1.6%
	1990	0.3%	0.0%	1.3%	0.4%	0.5%	0.3%	0.2%	0.1%	0.2%	0.1%	7.2%	0.0%	0.2%		0.8%
	1992	0.7%	0.0%	1.3%	0.5%	0.7%	0.3%	0.2%	0.2%	0.3%	0.2%	9.1%	0.0%	0.2%		1.2%
Venezuela	1980	0.3%	0.0%	3.5%	1.3%	1.4%	0.4%	0.1%	0.5%	0.7%	0.4%	0.1%	0.4%	0.1%	27.7%	
	1985	0.0%	0.0%	1.8%	1.7%	1.6%	0.9%	0.0%	0.6%	0.5%	0.7%	0.1%	0.0%	0.2%	46.0%	
	1990	0.0%	0.0%	1.9%	1.0%	2.1%	0.5%	0.4%	0.3%	0.6%	0.3%	1.0%	0.2%	0.2%	51.5%	
	1992	0.2%	0.0%	3.1%	0.8%	2.4%	0.5%	0.3%	0.6%	0.6%	0.1%	0.9%	0.7%	0.9%	55.3%	

Table 4: Description of NASAFTA-CGE Model Scenarios

No.	Scenario	Description
<b>I. Sub-Regional FTAs</b>		
1	NAFTA	Remove tariffs and non-tariff barriers between the U.S. and Mexico, but not with or among other LAC countries and the Rest of World. No MERCOSUR.
2	MERCOSUR	Remove tariffs and non-tariff barriers between Brazil and Argentina, but not with the U.S., Mexico, other LAC countries, and the Rest of World. No NAFTA.
3	Andean Free Trade	Remove tariffs and non-tariff barriers between Venezuela, Colombia, Ecuador, Peru, Bolivia, but not with NAFTA, MERCOSUR, Chile, and Rest of World. Assumes NAFTA and MERCOSUR.
<b>II. North American Centered FTAs and NAFTA Accessions</b>		
4	U.S. FTA with Chile	NAFTA and MERCOSUR plus a U.S.-Chile FTA.
5	U.S. FTA with Colombia	NAFTA and MERCOSUR plus a U.S.-Colombia FTA.
6	U.S. FTA with Brazil	NAFTA and MERCOSUR plus a U.S.-Brazil FTA.
7	U.S. FTA with Argentina	NAFTA and MERCOSUR plus a U.S.-Argentina FTA.
8	U.S. Hub and Spoke Argentina,	NAFTA and MERCOSUR plus separate U.S. bilateral FTAs with Brazil, Chile, Bolivia, Peru, Ecuador, Colombia, and Venezuela.
9	Mexico FTA with Chile	NAFTA and MERCOSUR plus a Mexico-Chile FTA.
10	Mexico FTA with Bolivia	NAFTA and MERCOSUR plus a Mexico-Bolivia FTA.
11	Mexico and G3	NAFTA and MERCOSUR plus a Mexico-Colombia-Venezuela FTA.
12	Mexico Hub and Spoke, Argentina, Brazil, Chile, Bolivia, Peru, Ecuador, Colombia, and Venezuela.	NAFTA and MERCOSUR plus separate Mexico bilateral FTAs with Argentina, Brazil, Chile, Bolivia, Peru, Ecuador, Colombia, and Venezuela.
13	NAFTA Accession of Chile	NAFTA-Chile Accession and separate MERCOSUR
14	NAFTA Accession of Colombia	NAFTA-Colombia Accession and separate MERCOSUR
15	NAFTA Accession of Venezuela	NAFTA-Venezuela Accession and separate MERCOSUR
16	NAFTA Accession of Brazil = Brazil Bilateral Hub	NAFTA-Brazil Accession and MERCOSUR, which is the same as Brazil bilateral FTAs with NAFTA and Argentina.
17	NAFTA Accession of Argentina = Argentina Bilateral Hub	NAFTA-Argentina Accession and MERCOSUR, which is the same as Argentina bilateral FTAs with NAFTA and Brazil.