Corporate Partners Program -- Spring 2004 Seminar

Free Trade in the Americas: Lessons and Prospects

Spangler Center, Harvard Business School
Friday, April 2, 2004

Executive Summary

General Welcome
John Quelch
Senior Associate Dean for International Development, Harvard Business School

John Quelch opened the seminar by noting the significant value of regional studies programs within the academic community, as they combine global perspectives with local context. He praised the David Rockefeller Center for Latin American Studies (DRCLAS) as an important catalyst of scholarly research on Latin American issues across a wide range of disciplines. DRCLAS, he noted, raises interest as well as awareness about the region within academic circles.

Keynote Speaker on Free Trade
John Coastworth
Director, David Rockefeller Center for Latin American Studies

John Coastworth highlighted the singular role of the David Rockefeller Corporate Program, which provides an open line of communication with professionals whose experience goes beyond the academic environment and therefore contributes with a unique perspective to the work of the Center.

Introducing the Program's agenda, John Coatsworth reflected on the abundant skepticism associated with free trade and globalization in the region. Harvard University President Larry Summers' recent trip to South America, he noted, served as an opportunity to confirm first hand the widespread cynicism prevalent in Latin America about the economic and social benefits of globalization and open markets. Such skepticism prevails even when examined within a rational framework that links trade with economic growth, and consequent positive social outcomes. To understand such disbelief, John Coatsworth proposed a historical perspective of the globalization process.

Globalization in Latin America has occurred in three different major waves. While all of them have been associated with economic progress, they have also represented high social costs. During the first globalization period, a vast majority of the indigenous populations disappeared. The institution of slavery with all its disruptive consequences took place during the second globalization wave. Finally, in the late 19th and early 20th centuries, globalization has brought forth a sharp rise in social inequality.

Professor Coastworth identified in this historical framework the roots of the backlash against the most recent wave of globalization, which by all relevant measures (trade, capital flows, migration) is incipient if compared to previous occurrences. He also cited the political competition process in the region as being responsible for fueling such backlash by exploiting the (sometimes reasonable) fears of American policymakers towards the region. This backlash has also been fueled by political competition in the U.S., where anti-trade stances have find their way into public opinion.

Professor Coastworth suggests three actions to revert the backlash. First, there is a need to promote more education on economic issues, both in Latin America and U.S. universities, as these institutions can play a meaningful role in framing the debate, a task that has remained almost exclusively the responsibility of mass media. Secondly, there is a need for a conscious effort to link free trade with human development as a promotion strategy. The U.S. government, in collaboration with international organizations, has a role to play on this initiative. Finally, there should be a consensus to act unilaterally in the promotion free trade, to facilitate negotiations, and to increase trust between negotiating parties. All governments in the region have the possibility to implement this third policy.

The exchange of opinions following Professor Coastworth's speech centered on the different reactions towards the "Washington Consensus" in Latin America and the links between depth of reform and willingness to participate in new globalization periods.

Panel 1: The Lessons of NAFTA after Ten Years: What Comes Next

Jaime Serra Puche
Serra Associates International, Mexico
Former Undersecretary of Revenue, Secretary of Trade and Secretary of Finance, Mexico

Jaime Serra addressed the backlash of the globalization process in Latin America. He shared with guests his conscious efforts to portray the North American Free Trade Agreement (NAFTA) as an opportunity but never a panacea for Mexico's problems, differentiating between a trade agreement and a complete policy agenda.

Surveying the state of the Mexican economy since the implementation of NAFTA, Mr. Serra highlighted the Agreement's main effects on the country. According to Mr. Serra's interpretation of official data, NAFTA has been successful opening Mexico's economy to trade, expanding and changing the composition of exports, reducing the reliance on natural resources, and expanding manufacturing exports. Mr. Serra pointed out, however, that the change in export growth started with Mexico joining the General Agreement on Tariffs and Trade (GATT) in the 1980s, and was later accelerated by NAFTA. A comparison of Mexican economy with the other Latin American economies leads Mr. Serra to conclude that NAFTA plays an important role in explaining the transformation of Mexico's external sector.

As Mr. Serra pointed out, NAFTA did not bring the feared increase in trade deficits that were often predicted as an expected consequence of the economic gap between Mexico and the U.S. In fact, since NAFTA, Mexico has moved from a small trade deficit to a considerable trade surplus with its neighbor. From a macroeconomic perspective, the most important effect of NAFTA has been stabilization of external accounts, making exchange and interest rates less volatile, and favoring a better environment for investment and business in general.

To conclude his analysis of the effects of NAFTA, Mr. Serra reviewed two very sensitive areas, the labor markets and the agricultural sector. In terms of labor markets, Mr. Serra argued, there is a positive correlation between export growth and real wages. He noted that in Mexico, the increase in trade has had an impact on job allocation, in favor of export-oriented, high-productivity firms, if not in job creation. Therefore it is reasonable to assume that NAFTA has had a positive, but small, effect on labor markets. With regard to the agricultural sector, Mr. Serra noted that the sector has experienced important export growth while it has undergone a consolidation process even if there has not been a proactive movement to make the most of Mexico's comparative advantages in some agricultural products.

Mr. Serra noted that the greatest challenge to Mexico's potential for growth, both in terms of trade and foreign direct investment flows, is the "China effect." By joining the World Trade Organization, (WTO) China has benefited greatly from international trade, obtaining secured markets and reducing the uncertainty of investing. This new reality is already affecting Mexico, as it reduces Mexico's trade share with the U.S., while it limits the amount of foreign direct investment flowing into Mexico. Such a new source of competition could reduce advantages Mexico had during the first ten years of NAFTA. The "China effect" constitutes a threat for companies that only exploit the manufacturing margin. Keeping a strong presence in the North American market will require Mexican firms to become closer to the final consumer by exploiting retail business and branding. Mexico is at an important juncture: if inertia prevails, Mexico will fall back, but if Mexico takes advantage of its geopolitical situation, it might converge to North American living standards.

Luis Serven
Lead Economist, Office of the Chief Economist, Latin America and the Caribbean Region, The World Bank

Luis Serven observed a positive impact of NAFTA on Mexico's trade and foreign direct investment. However, he noted that along with those positive results, very little can be seen in Mexico in terms of GDP growth acceleration, wage increases and poverty reduction since the introduction of the Agreement.

Mr. Serven highlighted the difficulty in identifying the effects of NAFTA after a relatively short period of time. Although NAFTA introduced structural changes to the Mexican economy, other events took place simultaneously. After identifying the "pure NAFTA effect" by using a cross-country approach, Mr. Serven concluded that although the agreement has been positive for Mexico, it has not yet reached its potential. Such a result is reflected both in the very modest impulse towards economic convergence with North America, and the very heterogeneous convergence within Mexico, the latter being a consequence of differences in the levels of human capital, infrastructure, and quality of local institutions among regions of the country. Mr. Serven identified the lack of further reform and complementary infrastructure as the main reasons for these modest achievements.

Luis Serven's research suggests that NAFTA has caused very little trade diversion from the rest of Latin America to Mexico. This finding, in turn, suggests that, by joining NAFTA, Mexico has not affected the rest of Latin American trade with the U.S.

According to Mr. Serven, the positive effect of NAFTA on foreign direct investment flowing to Mexico has been temporary, and similar to that observed for the rest of the region. Other factors, such as policy environment and institutional framework, are also crucial to attracting investment, and are important complements to a trade agreement. In fact, Mr. Serven proposed that it is the institutional gap between Mexico and its NAFTA partners that limits investment and economic convergence. The institutional reform required to bridge the gap remains a challenge for Mexico.

With regard to NAFTA's effect on labor markets and those of the agricultural sector, Mr. Serven commented on the modest progress on Mexican wages relative to the U.S., while noting an increase in agricultural productivity. Finally, Mr. Serven emphasized that a reform remains necessary to transform the agricultural sector and facilitate convergence with North America.

Antonio Madero
President, SanLuis Corporación, Mexico

As an entrepreneur, Antonio Madero noted the dramatic impact of NAFTA on Mexican corporations. The Agreement, he suggested, benefited corporations that could anticipate the changes it introduced, providing them with first-mover advantage. NAFTA broadened opportunities for the manufacturing sector in Mexico and was favorable to firms that could link their long-term vision to the existence of a single North American market that would serve as a platform to the rest of the world. According to Mr. Madero, after ten years, NAFTA has allowed the industrial parks of Mexico to modernize, while providing previously-struggling Mexican companies, the opportunity to become world-class firms.

Mr. Madero introduced SanLuis Corporación's strategy, in the context of NAFTA, as one of compromise, seeking value-creation for employees, clients, shareholders and communities. He identified value creation as crucial in the highly competitive environment created by NAFTA, together with technological readiness and a high skilled working force. All three elements are fundamental to guarantee success within NAFTA. As a platform of trust between Mexico and North America, NAFTA was fundamental to access North American consumers. NAFTA's success depends greatly on assurance of a long-term economic relationship.

The North American market sophistication requires local firms to adjust to clients' demands. SanLuis Corporación's story of success is not unique. Many Mexican companies have become world class after the challenge of building a high quality, well trained labor force. Mr. Madero proposed that no sector can be considered at a disadvantage within NAFTA, except for those that are not able to meet the challenges the Agreement poses.

Among the challenges ahead, Mr. Madero identified the ongoing quest for competitiveness, improvement of social conditions and education, further macroeconomic convergence within the block, and effective management of tensions that from time to time arise in the U.S.-Mexico relationship.

Panel 2: Talks on WTO, FTAA, Local FTA's: Where Will We Be in 2005?

Susan Segal
President and Chief Executive Officer, Americas Society. Council of the Americas

According to Susan Segal, it will be very difficult to reach any comprehensive Free Trade Agreement within the Americas by 2005. At best, there might be hope for a much more limited, less ambitious agreement. The difficulty to reach an all-encompassing agreement is not the result of lack of good will; the two biggest players, the U.S. and Brazil, have shown considerable good will in the negotiation process. Bureaucracy and the lack of any significant progress to date are considerable obstacles to achieving inclusive agreements in such a short time. The electoral year in the US will further compound the difficulties to close the gaps with Argentina and Brazil.

Ms. Segal pointed out that trade liberalization in the Americas moves in different tracks. In the first place, the WTO negotiations are the lowest common denominator, and therefore imply the weakest integration mechanism, by virtue of the sheer number of interests. The Free Trade Area of the Americas (FTAA), the second track, has proven to be heterogeneous enough to make a significant agreement politically difficult. The third track is that of bilateral agreements, broadly used by the U.S. for different reforms. This track, Ms. Segal proposed, has the potential to generate a competitive environment that will encourage countries like Brazil and Argentina to move the processes forward more quickly.

Bilateral agreements are in nature very different from regional agreements like the FTAA. They deal in much more detail with investment opportunities, seeking agreement on specifics of conflict resolution, infrastructure development and intellectual property right protection, among other fundamental issues. Judging from recent developments, Ms. Segal noted, the U.S. will continue to actively promote bilateral agreements as an alternative to a more structured and ambitious FTAA.

According to Ms. Segal, the pursuit of bilateral agreements presents many challenges for U.S. trade policy. Firstly, it requires caution so as not to isolate Mercosur and the Caribbean in the process. Secondly, it is difficult to design a net of bilateral agreements that are not inconsistent with each other. If this objective is attained, the bilateral agreement road can be used as an incremental approach towards FTAA. Finally, it is a challenge for the U.S. to increase domestic faith in such agreements, especially in an electoral year. Since U.S. foreign policy relies heavily on free trade as a prime economic convergence mechanism, a weakened effort on the part of the U.S. to promote free trade in the Americas could compromise US foreign policy towards the region.

Robert Lawrence
Albert L. Williams Professor of International Trade and Investment, John F. Kennedy School of Government

In general, Robert Lawrence regarded world trade liberalization with optimism, even considering the recent failures in negotiations. While he recognized that negotiation rounds are complex, he noted that failures are helpful to clarify positions. According to Professor Lawrence, future negotiation rounds on world trade liberalization will be very similar to rounds in the past, characterized by modest progress. Future negotiations at the world level will succeed because countries that today are less willing to arrive at agreements in the current conditions, as Brazil, China and India, all have an incentive to negotiate some kind of agreement.

At the level of the Americas, Professor Lawrence proposed that a comprehensive FTAA as initially envisioned might not be achieved. Regional agreements are difficult structures not only because of differences in terms of development, but also in levels of willingness and commitment to free trade.

However, he proposed that the prospects for economic prosperity in the region do not need to be bleak, since sound domestic economic policies are a more prominent determinant of well being, rather than the removal of trade barriers.

Professor Lawrence highlighted that the use of bilateral negotiation as a means toward an incremental regional trade agreement. He argued that bilateral negotiation is a convenient approach, as it allows for picking the right battles at the right time, instead of trying to fight all battles at the same time. This is particularly important in a region divided in terms of willingness to negotiate. Negotiating bilateral agreements with countries, or group of countries, willing to do so will help the U.S. constitute a nucleus agreement. This nucleus agreement could eventually become wider and deeper when the remaining countries (Mercosur, Venezuela and the Caribbean) are ready to become part of it.

The pursuit of bilateral agreements with the U.S. will facilitate similar agreements among Central and South American countries, extending the base of free trade in the region. However, he noted, there are important trade issues to be considered. These include subsidies that can only be revised in the context of wide trade agreements and therefore, little will be achieved to address the issue of subsidies through bilateral negotiations.

Donald Mackay
Executive Director, Canadian Foundation for the Americas-Focal, Canada

Mr. Mackay addressed the great progress in trade liberalization achieved at the global level in the last fifty years. In his opinion, trade agreements are now universal at least at some level of compromise. This progress should not be undermined as it reflects the intrinsic incremental characteristic of trade liberalization.

From a Canadian perspective, NAFTA was a way to break the country's North America isolation. This is particularly important, since Canada has become progressively irrelevant in terms of trade for its European partners. By being granted access to the Mexican market, Canada has had to opportunity to broaden its trade prospects to include Latin America.

NAFTA is more than a success in and of itself, stated Mr. Mackay, as it has promoted the export of NAFTA-like agreements within North America and beyond its borders. The success of the free trade initiative within the Americas cannot be reduced to the success of NAFTA and the progress made towards the FTAA. It is also important to recognize other agreements that have facilitated free trade within the region. Mr. Mackay presented Mercosur as an example, where trade within its members has gone up by a factor of five since the group creation. Trade liberalization has been taking place in the Americas at its own pace regardless of the success of the FTAA initiative.

Finally, Mr. Mackay stressed that moving forward towards FTAA will require political will, an explicit recognition of the trade-offs involved in the negotiations, and the realization of the limitations that such agreement would have on generating well-being.

Discussion

A remarkable discussion ensued, in which seminar participants explored the conditions to be met in order to move forward with FTAA. A general agreement was achieved around the impossibility of reaching a comprehensive FTAA by 2005. Participants speculated on where the political will would come from that would boost to the negotiations. The FTAA, as currently devised, was criticized as a mere diplomatic effort rather than a practical agreement. Participants discussed the potential of bilateral negotiations to work towards a comprehensive hemispheric agreement, as well as the risk of incompatibility among various agreements. It was also noted that the FTAA objectives go well beyond free trade. After all, 85% of intraregional trade has already been liberalized. Besides promoting more trade, a hemispheric agreement represents an opportunity to cooperate in many other important issues for the well being of the region.