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Regional Policy in the Americas: The EU Experience as a Guide for North-South Integration?

After ten years the negotiations on the largest free trade agreement to date, the Free Trade Area of the Americas, which is to include 34 countries, have still not resulted in an agreement. What can the countries involved learn, both positive and negative, from the experiences of the EU with regional policy?

The increasing number of regional free trade agreements illustrates the importance of the new regionalism. The question is, however, whether these agreements will be successful and sustainable once completed, given the unequal levels of development of the economies involved. The success of an agreement may depend not only on the (expected) economic effects, but also on the political will of the more developed parties involved to deal with the potentially unequal division of gains or with the potentially negative economic effects caused by an agreement.

Illustrative for the above problem are the negotiations which took place in the context of the Free Trade Area of the Americas (FTAA), the main purpose of which is the elimination of barriers to trade, services and investment. Here, special mechanisms have been proposed to deal with differences in development. While the FTAA negotiations are currently deadlocked, from the perspective of economic equality in integration agreements between developed and developing countries they offer an interesting case with regard to the possibilities for dealing with differences in development. Within the FTAA, some developing countries have proposed special and differential treatment measures and the creation of a fund to assist smaller economies.[1] Such a funding mechanism could be similar to the European Union (EU) regional policy.[2] However, the experiences with the European funds are not univocally positive. This article will argue that there is a need to deal with the differences in development, but in doing so it would be wise to take into account the European motivations and experiences with regional policy.

After introducing the features of new regionalism, this article will address the theory and practice of the consequences of differences in development in integration arrangements. It will then turn to the aims of the Hemispheric Cooperation Programme (HCP) of the FTAA. Subsequently, it will look at the experiences of the EU in dealing with similar issues. The article concludes by comparing the European experience with the needs of, and obstacles to, the future FTAA.

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New Regionalism in the Western Hemisphere

In the past decade, frequent references have been made to the rise of the so-called "new regionalism" in the late 1980s, in contrast to the "old regionalism" (consisting of those free trade areas and customs unions which were erected in the 1960s and 1970s).[3] This new regionalism differs from the old regionalism in several respects. The first difference concerns the environment in which it takes place. Old regionalism was part of the bipolar system. Consequently, global superpowers were a major force behind regionalisation. The new regionalism, on the other hand, is part of a world in which multiple regional superpowers co-exist and where many states and non-state actors are involved in the process of regionalisation. In response to the fragmentation of the former blocs and to the challenges of economic globalisation, which increases the need to join forces, sub-regional and micro-regional organisations have arisen.[4]

[1] In this article, small and less developed economies will be used interchangeably and as a category it emphasises the difference to more developed and developed economies.

[2] The terms regional and structural policy are used interchangeably and refer to both – what in the EU context would be called – structural and cohesion funds.

[3] Rasul Shams: Regional Integration in Developing Countries: Some lessons based on case studies, HWWA Discussion Paper 251, Hamburg 2003, pp. 2-3.

[4] Björn Hettne: Globalization and the New Regionalism: The second great transformation, in: Björn Hettne, András Inotai, Osvaldo Sunkel: Globalism and the New Regionalism, London/New York 1999, Macmillan Press Ltd/St. Martin's Press Inc., pp. 1-24, here p. 7; Raimo Väyrynen: Regionalism: Old and new, in: International Studies Review, No. 5, 2003, pp. 25-51, here p. 26.

Secondly, the old regionalism was based on an inward look. New regionalism on the other hand, some argue, is outward-oriented and therefore more compatible with the current economic interdependence of states. In other words, the aim of import substitution has been replaced with that of export promotion.[5] New regionalism is based on trade reform and liberalisation on three levels: unilateral opening of markets, multilateral commitments in the context of the World Trade Organisation (WTO) and regional integration.[6] This view is, however, contested. New regionalism is also seen as a strategy to defend economies against the strong competition associated with the globalisation process, and therefore as an alternative for globalisation. This is the reason why regionalism is also viewed as a stumbling-block to multilateralism.[7]

Thirdly, most of the old regional arrangements were single-purpose: some based on security considerations, others on economic considerations. The integration arrangements within new regionalism are more likely to be multipurpose, combining economic, environmental, social and other considerations.[8]

The failure of old regionalism was the result of the participating countries' policy of import substitution in order to make use of economies of scale. However, as protection of domestic markets and firms was the dominant strategy in this period, it is no surprise that many of the integration initiatives failed also because of the lack of liberalisation within the arrangement.[9] In addition, there was a limited scope for inter- or intra-industry specialisation as the level of development between the countries was similar and the countries had similar resource endowments.[10] Taking this into account, the current expectations regarding the positive (developmental) effects of new regionalism are higher.[11]

The increasing number of projects initiated or revived under the umbrella of new regionalism is impressive. Between 1958 and 1989, 27 regional trade agreements had been notified to the GATT/WTO. Since 1990, 154 agreements have already been administrated.[12] Some of the most ambitious integration projects are currently taking place in the Western Hemisphere. The North American Free Trade Agreement (NAFTA) has now been accompanied by the Free Trade Agreement of the USA with Chile. More recently, the Central America Free Trade Agreement (CAFTA) joining the USA, Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua was extended to the Dominican Republic (CAFTA-DR). Meanwhile, negotiations on the largest free trade agreement, the FTAA, which will include 34 countries, have after 10 years not yet resulted in an agreement.[13] And precisely the fact that no agreement has been reached has stimulated American efforts to conclude multiple sub-regional and bilateral agreements.[14]

The motivations for entering regional free trade negotiations are manifold. The opening up of regional markets may allow countries to exploit their comparative advantage in certain sectors without being hampered by insufficient market access. Countries are expecting to develop intra-industry specialisation as a result of more intense competition, which may contribute to international competitiveness.[15] In addition, the opportunity to deal with other economic or trade-related interests as well as foreign policy interests is also of importance. The liberalisation of trade is often accompanied by liberalisation of services, the adoption of intellectual property rights and environmental and labour provisions.[16] Furthermore, since many developing countries already enjoy market access under preferential arrangements, for them the main attraction is the expectation of increasing foreign direct investment.[17]

However strong these motivations, the actual effects of integration may not be the ones desired, due to the huge differences in development within some of

[5] Enrique V. Iglesias: Towards Free Trade in the Western Hemisphere: The FTAA process and the technical support of the Inter-American Development Bank, Working Papers Series 217, Washington DC 1997, the Inter-American Development Bank, pp. 2-5; Rasul Shams, op. cit., p. 3.

[6] Enrique V. Iglesias, op. cit., pp. 5-6.

[7] Raimo Väyrynen, op. cit., pp. 32-33

[8] Björn Hettne, op. cit., here p. 8.

[9] Enrique V. Iglesias, op. cit, pp. 2-6.

[10] Rasul Shams, op. cit., p.2

[11] Björn Hettne, op. cit.

[12] WTO: Regional Trade Agreements Notified to the GATT/WTO and in Force (as of 8 July 2005), Geneva 2005, www.wto.org.

[13] In addition, a number of South-South free trade agreements have come into force, the most prominent being the Mercado Común del Sur (Mercosur, involving Brazil, Argentina, Uruguay and Paraguay) and the Andean Community of Nations (Andean).

[14] GAO: Free Trade of the Americas. Missed deadline prompts efforts to restart stalled Hemispheric trade negotiations, report to the Chairman, Committee on Finance, US Senate, and to the Chairman, Committee on Ways and Means, House of Representatives, Washington DC 2005, p. 21.

[15] Enrique V. Iglesias, op. cit., p. 10.

[16] Alvin Hilaire, Yongzheng Yang: The United States and the New Regionalism/Bilateralism, IMF Working Paper WP/03/206, Washington DC 2003, p. 5; Jeffrey J. Schott: The Free Trade Area of the Americas: US Interests and Objectives, Testimony before the Subcommittee on Trade, Committee on Ways and Means, United States House of Representatives, Washington DC, 22 July 1997, Institute for International Economics www.iie.com.

[17] Alvin Hilaire, Yongzheng Yang, op. cit., p. 5.

the above agreements. For example, the 34 countries participating in the FTAA talks are highly unequal in terms of geographic and population size, economic structure and performance, stability and welfare. The vast majority are considered to be developing countries.[18] Illustrative are the differences between the USA and Nicaragua.[19] The first had in 2000-2001 a GDP of US$ 36,924 per capita, the latter a GDP of US$ 750 per capita.[20] The question is, what kind of role do those differences play in theory and in practice, and will the features of new regionalism be able to overcome these differences and prove to be more of a developmental mechanism than old regionalism has been?

The Upside and Downside of Integration

One of the most discussed issues of economic integration is what the possible gains and losses related to the very different levels of development are for the countries involved. In this section, the issue of convergence (the reduction of economic differences) and divergence (the increase of economic differences) will be viewed.[21]

Divergence between economies which integrate not only reflects the situation prior to integration. Increased divergence can also be the result of integration, either because gains are unevenly spread, or because losses are unevenly spread.[22] How do divergence and convergence take place? One of the most important insights comes from the Viner model on the effects of regional integration on trade creation and trade diversion. Trade creation occurs when members of a regional trade agreement (RTA) replace their own production with the import of goods and services from other members of an RTA, if those products are more efficiently produced by the latter. In turn, they export more of those goods and services which they are able to produce more efficiently than their partners. In contrast to the positive effects of trade creation, an RTA may also stimulate trade diversion. This occurs when members of an RTA replace trade with non-member countries by trade with member countries because the products of the latter are cheaper as a result of the elimination of tariffs and other restrictions. However, this is paid for by the importing state in the form of decreasing import duties, while consumers do not benefit in the same way as they would if import duties had been eliminated on the already cheaper products of non-member countries. Especially for smaller economies this decrease in tariff revenue poses an important problem.[23] The negative effects of trade diversion decrease welfare effects and may result in divergence, while trade creation increases welfare effects and may result in convergence.[24]

Several studies have tried to determine the conditions under which trade creation (and therefore, welfare gains) will more likely occur than trade diversion. These conditions are formulated as follows. The higher the trade barriers that are being reduced, the higher the share of the pre-existing trade between the member countries, the larger the member countries and the more diversified their economies, and the closer their prices approximate the world market prices, the higher the trade creation effects are expected to be.[25] In addition, other elements may be taken into consideration when predicting or assessing losses or gains from integration. National and regional policies, quality and quantity of human capital and infrastructure and innovative capacity are all expected to influence the results of an agreement.[26] Likewise, an agreement may involve all kinds of non-trade issues that will affect the impact, such as environmental regulations, intellectual property rights or labour standards.[27]

The above shows that there are a large number of factors to consider where the gains and losses of integration are concerned, especially when integration

[18] Most are considered developing countries, but not all are considered to be small economies. What constitutes a small economy is subject to debate, see for example FTAA-TNC: Venezuela: The treatment of smaller economies and the different levels of development, FTAA.TNC/w/242, 2004, www.ftaa-alca.org.

[19] ECLAC: Issues, Effects and Implications of the Free Trade Area of the Americas (FTAA) Agreement for CARICOM Economies, General LC/CAR/G.773, 2004, pp. 6-8.

[20] UNCTAD: Handbook of Statistics 2004, Geneva 2004, http://stats.unctad.org.

[21] Disparities between regions are usually measured through GDP data at purchasing power standards (PPS). For a discussion of the different measurements cf. Daniel Tarschys: Reinventing Cohesion: The future of European structural policy, Report no. 17, Stockholm 2003, Swedish Institute for European Policy Studies, pp. 35-39.

[22] Mary Farrell: Regional Integration and Cohesion: Lessons from Spain and Ireland in the EU, in: Journal of Asian Economics, No.14, 2004, pp. 927-946, here p. 930.

[23] Robert Scollay: Regional Trade Agreements and Developing Countries: The case of the Pacific Islands' proposed free trade agreement, Policy Issues in International Trade and Commodities Study Series, No. 10, Geneva 2001, UNCTAD, pp. 14-16; Anthony Venables: Regional Integration Agreements: A force for convergence or divergence?, Paper prepared for the Annual Bank Conference on Development Economics, Paris, June 1999, pp. 3-4.

[24] For a useful overview of the discussion on trade diversion and creation cf. Steven Suranovic: International Trade Theory and Policy Analysis, http://internationalecon.com.

[25] Sam Laird: Regional Trade Agreements: Dangerous Liaisons?, in: The World Economy, Vol. 22, No. 9, 1999, pp. 1179-1200, here p. 1180.

[26] Rasul Shams, op. cit.; Mary Farrell, op. cit., here pp. 929-930.

[27] Furthermore, an agreement may result from other motives, such as political or security considerations, that have to be taken into consideration when losses or gains are evaluated. Cf. Sam Laird, op. cit., pp. 1179-1180.

involves countries operating at such different levels of economic development. There is a possibility that developed countries will be able to gain more than less developed countries from an integration agreement, and there is even the possibility that less developed countries will be worse off after integration then they were before, due to the negative effects of trade diversion. If economic divergence occurs, political disagreement will likely follow, thereby threatening the continuation of an agreement. However, it is not only reality that rules. When an unequal division of gains or even divergence is *expected* to occur at national or even sub-national level, negotiations will be intense and an agreement may never see the day of light.

That such an expectation puts the political sustainability of an integration arrangement under pressure is illustrated by the FTAA, where talks have been disrupted by a conflict between Brazil and the USA about issues such as agriculture and intellectual property rights.[28] Given the fact that negotiations related to large trade agreements are time and money intensive and may affect the success or failure of other integration or liberalisation efforts (such as in the WTO), disruption may not be a desirable effect.

The other way around – that developments in other arrangements affect the negotiations in the FTAA and alike – may also be an option. According to a recent study, the NAFTA experience of Mexico shows a productivity increase, but also suggests that developing countries with a high proportion of their labour working in low-productivity agriculture have to negotiate long transition periods to facilitate a slow phasing-out of tariffs. Without this, replaced labour has no time to be absorbed by other sectors of the economy. In addition, the NAFTA experience shows that the competition of Mexican basic crops with highly subsidised US crops has had adverse effects.[29] Such research outcomes may backfire on other future free trade agreements.

The Hemispheric Cooperation Programme

After 10 years of negotiations, the FTAA seems further away than ever. The 2005 completion deadline between the 34 states of the future FTAA has been missed and the November 2005 Americas Summit showed that there is no easy solution to the current disagreements on issues such the US farm subsidies.[30] While the current progress in the FTAA talks is blocked by the disagreement between the regionally powerful Mercosur and the USA, their argument about the gains and losses is certainly not the only one discussed. Other economic problems have been tabled by the small economies engaged in the negotiations. These smaller and less developed economies – which the majority of countries involved in the FTAA negotiations are[31] – are concerned that the size of their economy will limit the advantages of the FTAA, or will even create disadvantages. However, their voice is weaker and their opportunities to put their specific interests at the centre of the negotiations are smaller than is the case for the USA-Mercosur conflict. This does not mean that these less developed countries refrain from attracting attention to their needs. In an effort to highlight the importance of the small economies in the FTAA, the Prime Minister of Barbados, Owen Seymour Arthur, pointed out that the FTAA process will benefit from taking into account the small economies' demands as "… there could be no transcontinental land route without the participation of Panama; and no viable Hemispheric anti-money laundering regime without the participation of all countries".[32]

Besides the question of potential influence, what are the chances of the above-mentioned effects of integration occurring?

As I have shown above, integration may have both positive and negative effects. Both seem to be present in a future FTAA. A study by Venables and Winter expects the FTAA to have contradictory effects. On the positive side the authors state that trade diversion may not be a significant problem in the FTAA as there is economic specialisation, and therefore potential comparative advantage between the future member states. In addition, they expect investments to increase. On the negative side, however, they argue that as firms in many of the lesser developed countries involved are weak they may not be able to adjust to new competition, resulting in closures rather than in creating efficient exporters to northern markets. Furthermore, Venables and Winter conclude that the likelihood that wage divergence overrules wage convergence is high. This is the result of the fact that firms with large domestic markets (for example the USA)

[28] Bridges Weekly Trade News Digest: FTAA Negotiations Encounter Hurdles, Vol. 8, No. 5, 12 February 2004, www.ictds.org.

[29] Sandra Polaski: Mexican Employment, Productivity and Income a Decade after NAFTA, Brief submitted to the Canadian Standing Senate Committee on Foreign Affairs, Washington DC, 25 February 2004, Carnegie Endowment for International Peace, p. 10, www.carnegieendowment.org.

[30] Bridges Weekly Trade News Digest: Summit of the Americas Fails to Resurrect FTAA, Vol. 9, No. 38, 9 November 2005, www.ictds.org.

[31] Richard L. Bernal: The Integration of Small economies in the Free Trade Area of the Americas, Washington DC 1998, Center for Strategic and International Studies.

[32] Owen Arthur: The Promise and the Peril: A Caribbean perspective on the FTAA, Keynote address delivered during the CLAA Miami Conference on Free Trade and Integration. Implications for the Caribbean Basin, Miami, 6 December 2001, www.barbados.gov.bb.

may benefit more than those with smaller markets. The firms located in the lesser-developed countries will only survive when the wage gap is large enough compared to the developed regions.[33] Additional downsides of the FTAA are predicted by ECLAC's study on the CARICOM countries in the FTAA, which shows that while the tariff reduction that is expected from the FTAA will not significantly alter imports, it will prompt governments in the region to widen their tax base in order to compensate for the loss of revenue. In addition, half of the smaller CARICOM countries' exports will be confronted with the loss of preferential market access to the USA, which is currently arranged through one or more special import programmes, while important CARICOM exports products not covered by any of the special import programmes are already rewarded with other kinds of preferential access.[34] As one observer said: "For economies that have enjoyed such high protection in developed countries markets, the adjustment and transitional costs are high … An FTAA that focuses mainly on reducing trade barriers and harmonizing regulations would leave untouched these problems".[35]

Within the FTAA, the huge differences in development between the prospective partners were recognised from the start. In 1994, Guyana proposed the establishment of a regional integration fund, which in 1995 received the support of the CARICOM countries. Guyana argued that "(t)he vast differences in levels of development, size and economic potential among the members of the FTAA – greater than among the members of any other economic integration or free trade area in history – imply that polarization [meaning centralisation of trade and investment in more developed areas – gvr] could be severe".[36] However, at that time this proposal was not transformed into any specific action. Let us look at what happened at a later stage to this important, yet undervalued problem.

The differences in economic development between countries participating in the negotiations led early in the negotiation process to the establishment of the Consultative Group on the Smaller Economies (CGSE).[37] The purpose of this CGSE was to study the factors related to the participation, integration and adjustment of small economies in the FTAA. In 1995, when the first ministerial was held, the participating countries agreed to "… actively look for ways to provide opportunities to facilitate the integration of the smaller economies and increase their level of development".[38]

The activities during the FTAA negotiations to take the concerns of small economies into account were limited to the commitment to provide technical assistance to the smaller countries in the FTAA-process[39] and to instruct the trade negotiations committee to look into the ways in which these differences could be treated in the negotiations.[40] However, the Secretary General of the Association of Caribbean States, Norman Girvan, argued that the fact that reciprocity is one of the main guiding principles of the FTAA tied the hands of the CGSE and limited its activities to requesting attention in the separate negotiating groups for the specific problems of the small economies. Moreover, he said, the initial emphasis of the HCP – an FTAA programme proposed to deal specifically with this issue – was predominantly on the mobilisation of technical assistance to facilitate capacity-building, thereby focusing on supporting the negotiations and the implementation of the provisions.[41] In other words, it aimed only at process-facilitating measures.

This preoccupation with smoothing the process was disrupted when some countries – notably from the Greater Caribbean – questioned the limited attention paid to the core of the problem of unequal development. These countries maintained that the process-facilitating measures of the HCP should be complemented with more substantive ones. Substantive measures are those which are aimed at changing the economic conditions of the countries involved and include for example suitable transitional arrangements to facilitate things for small economies that are not (yet) able to implement all provisions, special and differential treatment of small economies, and structural funding of activities in small economies.[42]

[33] Anthony J. Venables, L. Alan Winters: Economic Integration in the Americas: European perspectives, London/Sussex 2003, London School of Economics/School of Social Sciences, University of Sussex.

[34] ECLAC, op. cit., pp. 30-52.

[35] Anthony P. Gonzales: CARICOM's Vision of the FTAA: The unfinished agenda, Inter-American Development Bank Second Academic Colloquium of the Americas, Buenos Aires, 3-4 April 2001.

[36] Government of Guyana: Regional integration funds for Free Trade Area of the Americas, 1999, http://www.guyana.org/govt/integration_fund.html.

[37] While there is no direct relationship between the size of an economy and development, there are convincing arguments about how size creates a new dimension to the already complex issue of economic growth and development (Richard L. Bernal op. cit., p. 6).

[38] FTAA: Summit of the Americas Trade Ministerial. Joint Declaration, Denver, 30 June 1995, www.ftaa-alca.org.

[39] FTAA: Summit of the Americas. Second Ministerial Trade Meeting. Joint Declaration, Cartagena, 21 March 1996, www.ftaa-alca.org.

[40] FTAA: Free Trade Area of the Americas. Fifth Trade Ministerial Meeting. Declaration of Ministers, Toronto, 4 November 1999, www.ftaa-alca.org.

[41] Norman Girvan: TNC Meeting. A tale of two FTAAs, 2003, http://acs-aec.org.

When the final proposal for the establishment of the HCP was accepted in 2002, it referred to the above considerations. Its objectives include:

- to support the strengthening of the capacity of countries to implement and participate in the FTAA;
- to assist countries to effectively address and overcome the challenges associated with FTAA trade liberalisation;
- to promote greater interrelationship between objectives and requirements of development and trade liberalisation;
- to complement multilateral, sub-regional and national economic policy programmes;
- to enhance institutional strengthening and capacity-building for policy-making, development of negotiating strategies and implementation of the FTAA;
- to increase coordination within the donor-recipient community in order to maximise cooperation and technical assistance.[43]

According to the chairman of the CGSE, the proposed HCP balances between what I have called process-facilitation and substantive measures: the negotiation process on the one hand, and designing development strategies and an effective response to the development requirements and challenges of trade liberalisation of the countries involved on the other.[44] However, the HCP as proposed has a number of drawbacks. Firstly, the FTAA has not chosen to fund the HCP through mandatory member countries' contributions. It has been decided that other, voluntary, resources should be explored, provided by the participating countries through official development aid channels, regional and multilateral financial institutions, and private sector institutions.[45] In order to achieve this, meetings have been organised with potential donors to explore the funding possibilities.[46] This effectively means relying on the existing resources. Secondly, while the 2002 HCP proposal has an extended concept of assistance, it still encounters criticism as many feel that it is still too limited and mainly concerned with assisting the negotiation and implementation process (process-facilitating measures), instead of concretely addressing the differences in a more comprehensive way (substantive measures). Venezuela argued that the HCP lacks a mechanism to create structural convergence and funding to correct asymmetry and disparities between the negotiating countries. According to the Venezuelan position, the FTAA does not decrease differences. Again it was pointed out that the fact that an important norm of the FTAA will be reciprocity between economies that are unequal endangers any possibility of structural convergence.[47] From the Caribbean side, special and differential treatment in the FTAA was emphasised, such as non-reciprocal measures concerned with accessing the markets of industrialised countries (through for example special derogations from agreed liberalisations) and granting flexibility in the design of less developed countries' market policies. In addition to the expectation that this would improve the position of small economies in the FTAA, the Caribbean countries hoped that it would also create support for similar measures in the WTO.[48,49] That the HCP would still need further development was also pointed out by the chairman of the CGSE: in addition to calling for special and differential treatment and other ways to eliminate present asymmetries, he stated that "(i)t seems that a simultaneous or parallel programme to the HCP is needed … an additional financial support mechanism for countries to adapt to the new integration scheme. Asymmetries in countries' development call for this situation to be sufficiently addressed in order for all countries to achieve adequate economic and social development, particularly the small economies …"[50]

Counterproposals made after 2002 therefore show that some countries feel that the HCP should be accompanied by a funding mechanism to address the asymmetries in size and levels of development, emphasising infrastructural and service projects. Venezuela proposed a Structural Convergence Fund (SCF) and CARICOM a Regional Cooperation Fund, both

[42] Richard L. Bernal, op. cit.; Norman Girvan, op. cit.

[43] FTAA: Free Trade Area of the Americas. Seventh Meeting of Ministers of Trade. Ministerial Declaration, Quito, 1 November 2002, www.ftaa-alca.org.

[44] Santiago Apunte Franco: Hemispheric Co-operation Programme, Paper presented at the Workshop-Seminar "The Greater Caribbean in International Trade Negotiations", Port of Spain, Trinidad and Tobago, 14-15 July 2003, www.acs-aec.org/Trade/Projects/ACS_TD_002/SDT_en.htm.

[45] FTAA: Free Trade Area of the Americas. Seventh Meeting of Ministers of Trade, op. cit.

[46] FTAA: Free Trade Area of the Americas. Eighth Ministerial Meeting. Ministerial Declaration, Miami, 20 November 2003, www.ftaa-alca.org.

[47] FTAA-TNC: Venezuela: Working document, FTAA.TNC/inf/w/222/Rev.1, 2004, www.ftaa-alca.org.

[48] Owen Arthur, op. cit.; Antonio Romero: International Trade Negotiations and Small Economies in Latin America and the Caribbean. Asymmetries and special and differential treatment, Paper presented at the Workshop-Seminar "The Greater Caribbean in International Trade Negotiations", Port of Spain, Trinidad and Tobago, 14-15 July 2003, www.acs-aec.org.

[49] To improve the attractiveness of special and differential treatment in the FTAA, the argument was put forward that it is not only requested by small economies, but also by developed countries wishing to protect sensitive sectors (Owen Arthur, op. cit.).

[50] Santiago Apunte Franco, op. cit.

based on similar ideas to those behind EU structural funds.[51] An SCF would, according to Venezuela, correct disparities in infrastructure and service, technological and innovative capacities, and in human capital development.[52]

In sum, the countries proposing the creation of a European-like funding mechanism to assist small economies were concerned about the focus of the negotiations on the technical assistance measures and the extension of deadlines in order to facilitate the FTAA negotiations and implementation.[53] This concern has not been entirely eliminated by the HCP, as the current HCP proposal still differs substantially from a regional policy as is included in the EU.

The question now is that if the proposal for the establishment of a regional fund were to be taken seriously, what could be learned from the European experience? In other words, what kind of considerations should be taken into account when designing a European-like mechanism to help the smaller economies to cope with the new situation and to avoid or minimise possible divergence?

The European Experience

While the Treaty of Rome (1958) mentioned that the states of the European Community should ensure that differences between regions are reduced, the European Regional Development Fund (ERDF) to support such effort was established only in 1975 to help to ease the accession of the UK into the European Community.[54] Armstrong[55] has identified several arguments that have circulated in the EU to support such a policy. The *spillover* argument maintains that no state can expect positive returns from economic problems in other states. On the contrary, the solution of economic problems is expected to generate benefits for all states. The deeper states become integrated, the more economic spillover effects will occur. Furthermore, it is expected that through regional policy *equity* (in fact a non-economic spillover) between the regions will be served. This in turn will help to ensure that member states are willing to support and proceed with the integration process. This argument has been a major influence on the different reforms of European regional policy.[56] Equity may become an issue because, besides the fact that the initial position between countries differs, the integration process itself may also cause divergence. For example, some policies, such as the agricultural subsidies which are mainly spent in the richer parts of Europe, are not thought to serve equity as they may increase regional disparities. In such cases, regional funds may ease the pain. Related to this is the function of regional policy as a *linkage* instrument. Tarschys[57] has illustrated this with the example of the accession of Poland which, when it pointed out that the assigned milk quotas were not satisfying, was offered some financial aid from the regional funds. As he puts it so eloquently: "From its origin until the present time, European Structural Policy has been the flexible companion of other, more inflexible policies".[58] From a *coordination* point of view it is argued that regional policy should be placed on a European level and not on a national one. The reason is not only that it increases cross-border opportunities, but that it also decreases competition between regions already lagging behind. From a *financial* point of view, it is argued that member states with disadvantaged regions already have difficulties in meeting their obligations to develop those regions. Therefore, a regional policy at the European level will be more effective than one at the national level.[59]

Given the above considerations, it is no surprise that aiming for convergence between the member states of the EU has been an important goal. In order to achieve this, a complex system of regional policy has been developed. Regional policy is a combination of the Structural Funds (SF) and Cohesion Funds (CF),[60] and is commonly referred to as cohesion policy. European regional policy is financed through the contributions of the member states to the Community budget. In the period 2000-2006, these contributions are planned to account for €213 billion,[61] which equals one third of the Community budget. Of this, €195 billion will be spent

[51] Norman Girvan, op. cit.

[52] FTAA-TNC: Venezuela: The treatment of smaller economies and the different levels of development, op. cit.

[53] Ibid.; Santiago Apunte Franco, op. cit.

[54] Gregor van der Beek, Larry Neal: The Dilemma of Enlargement for the European Union's Regional Policy, in: World Economy, Vol. 27, No. 4, 2004, pp. 587-607, here p. 590.

[55] H. W. Armstrong: EU Regional Policy, in: Ali M. El-Agraa (ed.): The European Union. History, Institutions, Economics and Policies, Hertfordshire 1998, Prentice Hall Europe, pp. 363-388. Armstrong's classification has been adapted to the purpose of this study.

[56] Gregor van der Beek, Larry Neal, op. cit., here pp. 589-593.

[57] Daniel Tarschys, op. cit.

[58] Ibid., p.19.

[59] H. W. Armstrong, op. cit., here pp. 364-369.

[60] The SF is comprised of the European Regional Development Fund, the European Social Fund, the Financial Instrument for Fisheries Guidance and the Guidance Section of the European Agricultural Guidance and Guarantee Fund. The Cohesion Fund finances projects of transportation and environmental nature in Greece, Portugal and Spain and until 2003 Ireland. Cf. European Commission: Working for the Regions, Brussels 2004, http://.europa.eu.int.

[61] This excludes so-called pre-accession aid, which is the budget made available for the new member states. Cf. European Commission, op. cit.

by the SF, and €18 billion by the CF. About 70% of the €195 spent by the SF is dedicated to the Objective 1 regions, which have a per capita GDP of less than 75% of the EU average. About 11.5% of the SF funding assists economic and social conversion in areas experiencing structural difficulties due to economic and social restructuring, and urbanisation (Objective 2 regions). About 12.3% of the funding promotes the modernisation of training systems and the creation of employment (Objective 3 regions) outside the Objective 1 regions.[62]

Through the SF, multi-annual development strategy programmes aiming at developing and extending infrastructure, projects in telecommunications services and education are financed. The CF, on the other hand, finances specific projects for environmental and transport infrastructure in Spain, Greece, Ireland and Portugal. Other elements of regional policy include programmes aimed at Central and Eastern Europe to promote economic and social development.[63]

Over the years, several forces have been identified that illustrate the divergence that seems to have accompanied the European integration process. Amongst these are the concentration of economic and financial activity in the core regions of the EU, the lack of competitiveness of firms in the poorer regions to meet the competitive challenges of the integration process, and selective labour migration.[64] The question is, however, whether EU cohesion policy has been successful in reducing the economic, social and territorial disparities within the union.

The effects of European regional policy are mixed or at least appreciated differently, and are difficult to measure. To start with the last issue, measuring the effects of structural policy encounters the question as to what exactly the contribution of cohesion policy is. Tarschys for example takes four groups of factors into consideration when trying to separate the effects of the funds from other effects:

- the role of spontaneous long-term forces in the economy, such as the late adoption of technology
- national policies
- other EU policies
- EU structural policy.[65]

Turning to the appreciation of the effects, some studies suggest that there is no evidence that European regional policy affects the long-term growth rates.[66] The study by Ederveen et al.[67] argues that how the impact of cohesion support is judged depends on how one views the aim of the support. If the aim is absolute convergence (meaning that the poorest region in Greece will ultimately catch up with the richest region in the UK), the effect of cohesion policy is likely negative. If the aim is regional convergence (meaning that the poorest region in Greece will converge with the richest region in Greece), the effects seem limited or sometimes even negative. If the aim is national economic growth as such, the effects can be substantial, provided that an economy is open. This is contributed to by the idea that openness disciplines governments to invest cohesion support in a productive manner.[68] In addition, Ederveen et al. conclude that while model simulations have clearly shown the potential of cohesion policy in encouraging convergence, econometric analyses have suggested that the actual effectiveness of cohesion support is limited. This is attributed to a number of factors, including the following.

- The first is inappropriate spending, meaning that a large part of the funds are spent on the relatively richer regions. More than 40% of the EU subsidies are spent on countries with a welfare level higher than the EU average. While at first sight the large share of funds spent on regions within more developed countries may create wider political support, this may not be the case in the long run. Serving both richer and poorer European countries creates an enormous financial burden and reduces the effectiveness of the distributional effects of structural policy and with it its potential for convergence.
- The second concerns rent-seeking behaviour of governments, for example by designing projects that meet EU funding criteria, but which are not necessarily the best projects to stimulate growth.
- The third concerns moral hazard, which means that governments may refrain from investing in a region in order to remain eligible for support.
- The fourth is crowding out. This is the elimination of national support once the European support is received.

62 European Commission, op. cit.; Mary Farrell, op. cit., here pp. 931-932. The rest of the budget is spent on specific community initiatives and projects. Cf. European Commission, op. cit.

63 European Commission, op. cit.

64 H. W. Armstrong, op. cit., here p. 376.

65 Daniel Tarschys, op. cit., pp. 41-54.

66 Michelle Boldrin, Fabio Canova: Regional Policies and EU Enlargement, London 2003, Centre for Economic Policy Research.

67 Sjef Ederveen, Joeri Gorter, Ruud de Mooij, Richard Nahuis: Funds and Games. The economics of European cohesion policy, The Hague 2002, Netherlands Bureau for Economic Policy Analysis.

68 Ibid., pp. 51-60.

• Fifthly, European support may replace other mechanisms that would have stimulated convergence, such as labour mobility and private investments.[69]

Similarly, on the basis of a comparison between Spain and Ireland, Farrell[70] concludes that while structural funds have been important, case studies show that the quality of productive resources and the nature of national government policy are of crucial importance. One example is national education and investment policies in Ireland. In sum: while cohesion policy may have contributed to convergence within or between the member states of the EU, other factors have diminished the potential impact[71] or convergence has been equally stimulated by other factors.[72]

An additional challenge for EU regional policy is the recent EU enlargement. While the balance between payments and receipts has always created tension in the EU, the enlargement has confronted EU regional policy with new challenges. According to Van der Beek and Neal, however, these new challenges have not stimulated the EU to pursue any profound change in its funding system.[73] The accession of the Eastern European countries means the accession of relatively poor countries. Van der Beek and Neal calculated that if Poland, the Czech Republic, Hungary, Slovenia and Estonia received similar regional support from EU funding as Portugal, an extra 2/3 of the existing regional policy budget would be required,[74] and this would "… overstretch the willingness to pay of the established 'paying' countries".[75]

Ederveen et al. suggest, among other things, that structural funds should be based on national rather than regional (sub-national) criteria. In addition to political sustainability, this might help to reduce the occurrence of problems that currently diminish the effects of European regional policy, such as crowding out, rent-seeking and moral hazard.[76]

Potential Implications of the European Experience for the FTAA

The above has shown that while regional integration has a potential to decrease divergence, the actual effects are subject to debate. What are the chances that the FTAA countries create EU-like mechanisms, and what can be expected given the European experience? To answer the first question, two of the arguments for designing the European regional policy are of specific interest to regional integration arrangements such as the FTAA: the spillover and the equity arguments.

First of all, from the point of view of spillover effects it could be argued that the economic prosperity of one state will have benefits for another state, also within the FTAA.[77] While this has likely motivated the negotiations in the first place, it seems to have been taken for granted or even neglected in the subsequent stages of the process.

The second argument maintains that regional policy serves equity. Besides the fact that integration produces fair and equal effects, which can be considered as a goal in itself, the political motivation of aiming at equity is that it supports the willingness of member states to proceed with the integration process. For example, in the 1980s, EU regional policy was given a new impetus to balance the liberal and market-oriented side of the European project. Also, it has been used to compensate for losses that countries experienced in other fields.[78] That this has also been an argument in the FTAA is illustrated by the statement of the chairman of the CGSE with respect to efforts to adopt new approaches to correct present asymmetries: "… this task … will depend on the political commitment and the strategic vision of the participating countries …"[79]

However, while in its role of being a compensating mechanism regional policy has been important in European integration, it can be questioned whether a similar role can be played in the FTAA. It is highly likely that only a conviction of the correctness of the spillover argument (possibly accompanied by the coordination and linkage arguments) appealing to self-interest can compensate for the lack of support for the equity argument. The first reason for this lack of support is the limited political and economic ambition of the FTAA as compared to the EU,[80] which significantly decreases the need for compensation policies. But even if there were the political will to support equity, regional policy in the FTAA context would be a high financial burden. Is the level of economic development simply too low to compensate without each country having to contribute too much?[81] Let us take the European standard

69 Ibid., pp. 37-82.

70 Mary Farrell, op. cit.

71 Sjef Ederveen et al., op. cit,.

72 Mary Farrell, op. cit.; Daniel Tarschys, op. cit., pp. 41-54.

73 Gregor van der Beek, Larry Neal, op. cit., here p. 593.

74 Ibid., here p. 600.

75 Ibid., here p. 601.

76 Sjef Ederveen et al., op. cit., pp. 72-80.

77 Jeffrey J. Schott, op. cit.

78 Daniel Tarschys, op. cit., p. 55, p. 19.

79 Santiago Apunte Franco, op. cit.

80 Anthony J. Venables, L. Alan Winters, op. cit., pp. 4-5.

81 As we have seen, this problem also confronts the EU since the initiation of the enlargement process.

as our point of departure, where 70 per cent of the SF goes to Objective 1 regions, which should have a GDP of less than 75% of the Union's average. The eligibility of a region for CF will be determined by a GDP less than 90% of the Union's average.

The average GDP per capita of the countries – excluding the US Virgin Islands – joining the FTAA is US$ 17,888.[82] This means that if a 75% or 90% rule were applied, 31 of the 34 countries joining the negotiations would be eligible for support under the 75% rule, and 32 under the 90% rule.[83] By contrast, the average per capita of the EU15 is US$ 27,659.[84] If similar standards as mentioned above were applied, only 3 of the 15 countries would be below the 75% and 90%. However, if the EU25 were taken as the point of departure, the 75% and the 90% rule will apply to all 10 newcomers. In other words, this means that within the FTAA, the number of countries eligible for support would be between 91% and 94% of the total, compared to the percentage of countries within the EU15 of 20%, and the percentage within the EU25 of 40%, which is still well below the percentages of the FTAA example. This simple calculation illustrates the extent of the problem. Such a problem can only be solved with a much more limited eligibility policy than that of the EU. Additionally, the eligibility for funding should – in line with the European experience – be based on national rather than regional (sub-national) criteria. This will not only increase political sustainability, but it may help to prevent crowding out, rent-seeking and moral hazard.

Conclusion

New regionalism is often portrayed as an improved version of old regionalism. However, it provides no automatic solution to the problem of divergence. Creating a regional fund similar to the European one is not the only option for dealing with this problem, but it may be a step in the right direction. Clearly, when countries agree to a free trade agreement, they expect it to be economically beneficial. Moreover, especially when they belong to the poorer members, they expect a relatively even spread of benefits. This is not only of importance for economic development as such, but also for maintaining political support. As there are reasons to believe that the FTAA may be confronted with divergence, this article has argued that there is an economic and political need to deal with the differences in development. It has been shown that there is a momentum for smaller economies to demand special efforts in agreements such as the FTAA to deal with differences in development, as similar debates are held in other forums, such as that of the WTO.

However, assessing the need for addressing differences in development and even identifying the momentum differs from assessing the political will. As is the case with many free trade agreements, the FTAA gives no reason to be optimistic about the future success of the efforts of less developed countries to demand a funding mechanism. The scope of the FTAA is much more limited than that of the EU and the economic differences between the FTAA participating countries are much higher than within the EU, which will limit the support from the more developed countries. In addition, the countries that have put the proposal for a fund at the forefront are not the ones with the strongest bargaining position, and this consequently influences the political will of the more developed countries to support a fund. Therefore, the equity arguments that have guided the design of European regional policy may not be sufficient to support similar efforts elsewhere.

The spillover argument, on the other hand, has a higher potential to increase the likelihood that a fund materialises, as it appeals to self-interest. In other words, the more developed countries have to be convinced that the costs of a fund are outweighed by the profits earned by keeping divergence to a minimum (spillover argument). Until this date, however, this argument seems not to have played an important role.

In sum, there has been no sign that the developed countries are convinced that sustaining the political commitment is needed (on the contrary, the USA diminished its own commitment by entering into sub-regional negotiations) or that their economy will be adversely affected by divergence. These developments combined make the prospect for regional policy in the future FTAA and similar arrangements bleak.

If, nevertheless, a regional fund with similar purposes as the EU funding system were established, the European experience tells us that national rather than regional (sub-national) norms should be designed to assess eligibility. National norms will help to ensure that only the least developed countries receive support. This will increase the effectiveness of a regional fund and may improve the developmental side of new regionalism. However, for integration agreements involving a high number of underdeveloped countries, creating a fund will not be an easy task, as a new formula will have to be developed to decide which countries are able to pay and which countries should be on the receiving end.

[82] UNCTAD, op. cit.

[83] This is of course based on the assumption that the poorest countries also have the poorest regions, and therefore this calculation does not entirely do justice to reality as it excludes the poor regions in the more developed countries and the richer regions in the less developed countries.

[84] UNCTAD, op. cit.