Twelve Lessons from Five Decades of Regional Integration in Latin America and the Caribbean*

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From Old to New Regionalism

The celebration of INTAL’s 35th Anniversary is an opportune time to stop and reflect on where we have been, where we are and where we are going in our processes of regional economic integration in Latin America and the Caribbean. Indeed, such a review is timely in light of the explosion of regional initiatives over the last ten years. As seen in the attached table, more than twenty new agreements have been signed since 1990 - ranging from free trade areas to customs unions with wider common market objectives - and many more are in different stages of negotiation. Indeed, now virtually all the Bank’s member countries are embarking on one or more regional integration initiatives. Regionalism also is a world-wide phenomenon that is paralleling the forces of globalization: today nearly all members of the World Trade Organization (WTO) are members of a regional agreement and those few who are not are in discussions that could lead to one.

While we recently have witnessed unprecedented interest in regional integration, regional integration itself of course is not new to Latin America and the Caribbean. In Latin America, attempts at integration go back to the days of independence when there were important initiatives promoting political federations; for example, in Central America, Gran Colombia, and Peru-Bolivia. The grandest design of all of course was that of Simon Bolívar who envisioned a unified Latin America as the best way to protect the region’s newly won independence. Meanwhile, the English-speaking Caribbean came close to gaining independence as a political federation encompassing all the countries. This vision received elegant expression in the words of such distinguished leaders and thinkers as Norman Manley, Grantley Adams, Eric Williams and Sir Arthur Lewis.

It was around the time of World War II that strategic economic considerations began to take on a dominant profile in our regional initiatives. For instance, in 1939 Brazil and Argentina discussed sectoral free trade arrangements, while in 1941 there was an attempt to forge a regional trading arrangement involving the River Plate countries. There also were a number of initiatives to create bilateral payments arrangements.

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During the 1950s there was serious discussion in Latin America about the importance for development of increasing intraregional trade and the possibilities of formation of a Latin American Common Market. ECLAC and Raul Prebisch were at the forefront of the initiative, especially at the technical level. These deliberations evolved into some historic and ambitious concrete initiatives in the 1960s: the Latin American Free Trade Association (LAFTA)—which in 1980 evolved into today’s ALADI—; the Central American Common Market (CACM) and the Cartagena Agreement, more commonly known at the time as the Andean Group (AG). Meanwhile, in the English-speaking Caribbean, countries launched the Caribbean Free Trade Association (CARIFTA) which, in the early 1970s, evolved into the more ambitious Caribbean Community (CARICOM).

As you know, while not without their achievements, none of the earlier initiatives fully realized their ambitious objectives. Indeed, all these early Post-War agreements lost momentum during the late 1970s and fell into open crisis in the 1980s.

Is the new wave of integration witnessed in the 1990s just a continuum of the past? In some sense yes. It reflects an ongoing affinity among countries sharing subregional and hemispheric spaces with common historical ties, and cultural and linguistic affinities, all of which are conducive to increasing human, commercial and political interaction. This natural inducement to “getting together” has interacted regularly with other natural forces of sovereignty, independent action, and conjunctural political and economic changes, all of which can create tension that has partly explained the marked ebb and flow of our regional integration processes. However, there also is something very “new” in our current wave of regionalism that is worth highlighting. Indeed, some have coined the term New Regionalism to capture the marked difference with the past.

Regional integration is not an end in itself but is an instrument to support a strategy of economic growth and development. In this context the New Regionalism of today is an integral part of the structural reform process which is designed to make our economies more open, more market-based, more socially equitable and democratic and more internationally competitive in a globalizing world economy. This is in marked contrast with the earlier Post-War initiatives that were meant to sustain and deepen the flagging inward-looking and state-led import substitution industrialization strategy. The different instrumental role played by the New Regionalism in the region’s development is highlighted by some of its main characteristics:

- **Deepening Trade Liberalization.** The New Regionalism is the third tier of an integrated three-tier trade liberalization strategy. The first tier has been unilateral trade liberalization, which has seen our average external tariff fall from over 40% in the mid-1980s to around 12% in the mid-1990s. The second tier is the multilateral system, which has adopted the comprehensive commitments of the Uruguay Round and has recently initiated negotiations in the WTO to further liberalize trade in agriculture and services. Meanwhile, elimination of trade barriers in regional integration arrangements has deepened liberalization commitments among partners, further lowering average levels of protection and increasing competition in our economies.
• **Broadening the Scope of Liberalization Disciplines.** Many of the new agreements go beyond goods trade to effectively incorporate so-called new disciplines in services, intellectual property rights, investment, etc., and complex initiatives such as macroeconomic coordination.

• **Signaling and Locking-in of Structural Reform Commitments.** By establishing a legally binding liberalization and policy coordination arrangement that goes beyond commitments achieved at the unilateral and multilateral levels, countries have used regional integration to signal to the private sector their commitment to the new market-based reforms and to make those commitments less susceptible to reversal than if they had been unilaterally introduced.

• **Creating Trade.** Intraregional trade grew rapidly in the 1990s; indeed regional exports expanded considerably faster than extraregional trade, causing the regional component to rise from 12% of the total at the beginning of the decade to nearly 20% just before the contractionary effects of the Asian crisis. (Indications are that intraregional trade has strongly rebounded in 2000). A regional trade agreement is clearly positive and enhances welfare for the importing country and non-member countries when it generates completely new trade among its members, in contrast to lower welfare when the emerging trade substitutes more efficient sources abroad. This is the much publicized debate over trade creation vs. diversion in regional trading arrangements. While some trade diversion is inevitable in an agreement that balances the political economy interests of two or more countries, one would expect the risks to be minimized in the current context of sharply declining third party protection and comprehensive regional disciplines. In any event, there are a growing number of studies suggesting that the New Regionalism, in contrast to the early Post-War initiatives, is less prone to trade diversion and indeed on balance has generally been trade creating.

• **Attracting Foreign Direct Investment (FDI).** Latin American and Caribbean countries are no longer apprehensive about FDI and are now actively attempting to attract this type of capital with its know-how, technology and access to export markets. Creation of regional markets with a recognizable “trademark” has been a tool for distinguishing an area and its nations from other developing countries in the fierce worldwide competition for FDI. Regional integration has undoubtedly reinforced the effect of economic reforms on the region’s successful attraction of FDI, which led it to nearly tie Asia in 1999 for first place in the developing world.

• **Economic Transformation.** Intraregional exports tend to have a more diversified product mix and a greater representation of knowledge-based manufactured goods than does extraregional trade. This, coupled with the private sector’s lead role in today’s regional integration, raises opportunities for capturing so-called dynamic effects from regional integration through greater specialization in differentiated products, new investments, corporate alliances and efficiencies, new export experience, competitiveness and progressive completion of local markets in finance,
labor and technology. While there is no systematic data available in this critical strategic area of regional integration, there is partial and anecdotal evidence to suggest that these important effects are taking place in some important economic sectors of our regional agreements.

- **North-South Integration.** One of the most striking characteristics of the New Regionalism is the increasing disposition of our countries to enter into reciprocal agreements with industrialized countries. This started with Mexico signing a NAFTA agreement with its North American neighbors in 1994, something that would have been inconceivable only a few years earlier. NAFTA was followed by the Chile-Canada and Mexico-EU free trade agreements, and the initiation of negotiations between Canada and Costa Rica, among the FTAA countries, and between the EU and Mercosur and Chile. Depending on the configuration of these agreements, which are anchored by a credible and large industrialized economy market, they can magnify some of the aforementioned transformation and lock-in effects expected from regional integration.

- **A New Geopolitical Tool.** Regional integration has been a tool to cement peace on our borders and create a network of solidarity to preserve our young democracies. Indeed, our borders today are the most peaceful and heavily trafficked of the entire Post-War period. At the same time, democracy clauses in our regional agreements have helped partner countries stave off real threats to our democratic institutions. Meanwhile, in an era of globalization, effective participation in regional and international fora is of paramount importance. Members of subregional agreements such as Mercosur, Caricom and the Andean Community have each effectively organized themselves into joint negotiations for certain fora; this has clearly enhanced bargaining power beyond that which each country could have expected to achieve individually.

- **Enhanced Regional Cooperation.** Open economies, democracy, peaceful borders and greater regional trade and investment has fostered much cooperation that goes beyond the commitments of formal regional integration agreements. The comprehensive agendas of the Summits of the Americas, the South American Heads of State, the EU-Latin American and Caribbean Heads of State, the Ibero-American Heads of State as well as the APEC process are good testimonies to the new environment for regional cooperation.

In sum, the New Regionalism has an instrumental role that is quite different from the past. Trade as such is only a small part of the story and consequently regional integration must be evaluated in the broader framework of its contribution to the profound structural reform process and institutional development underway in Latin America and the Caribbean since the mid-1980s.
Twelve Lessons from Our Past, Present and for the Future

Looking back at the last five decades of regional integration in Latin America and the Caribbean, there have been important initiatives and achievements, along with mistakes, setbacks and outright failures. The old integration, after a promising start, faltered and fell far short of its original objectives. The New Regionalism of the 1990s has had an even more promising start, but some major agreements have encountered problems and may even be at a crossroads. But this must be put in perspective: regional processes are inherently difficult and do not progress linearly, but rather in fits and starts.

Regional agreements carry benefits, but like any adjustments, also bear costs. A self-examination of our integration process suggests some lessons, which if heeded, can enhance the probability of success of regional agreements and minimize unwanted side-effects.

I. Successful Integration Needs a Firm Foundation of Deepening Structural Reform and viceversa

The New Regionalism has firmly demonstrated that economic integration succeeds better when it works in tandem with an overall strategy of structural reform and liberalization.

- The old integration initiatives were seriously undermined by the national vocation for protectionism, repression of private sector activity, a structurally weak macroeconomic setting, and nationalistic authoritarian political regimes.

- Today’s regional integration has advanced as much as it has because it is accompanying and complementing the structural reform process in the region. Due to more solid fiscal positions, inflation control, deregulation and privatization, the global commitment to trade liberalization, democratization etc., our agreements emerging in the regional arena have enjoyed much more credibility and a more supportive environment than in the past.

- The deepening and widening of structural reforms is necessary in order to deepen regional integration.

- The structural reforms, in turn, receive vital support from the new regional integration.

II. A Strong Multilateral System is Supportive of Regional Integration and Vice-Versa

Just as regional integration prospers in a global environment of structural reform, so too does it benefit from a healthy and developing multilateral system.
• There are many synergies between the WTO and regional integration. On the one hand, the multilateral system serves as a floor and reference point for many regional disciplines, and advances in multilateral negotiations can condition advances in regional agreements. On the other hand, regional integration in principle goes beyond WTO obligations and can serve as a laboratory --as it did in the Uruguay Round-- for new multilateral disciplines. Meanwhile, the multilateral system is a safeguard for open regional systems through the binding of external commitments to third parties and its Article XXIV (and V of the GATS), which establishes rules for formation of regional agreements. Given the proliferation of regional agreements, however, more “teeth” should be given to Article XXIV, including the incorporation of parameters for the operation of rules of origin, which so far have escaped its purview.

• One should not forget that the multilateral system regulates the biggest market of all, the international one. Multilateral negotiations potentially can eliminate the still strong barriers to trade in products where Latin America and the Caribbean have clear international comparative advantage, such as in agriculture and textiles and apparel. The failure in Seattle was tragic for developing countries. Hopefully the multilateral system will regain momentum next year and increase its development focus.

III. Essential Ingredients for Successful Regional Integration are Sustained Political Vision and Regional Statesmanship

The collective interests of partners in a regional integration agreement must share space with the dynamics of national and international developments. In the ebb and flow of regional processes tensions can develop among these three arenas of activity.

• The experience of regional agreements has shown that sustained political vision and regional statesmanship at the highest level is essential to carry the regional dynamic forward in the face of changing conjunctures at home and abroad.

• This requirement of vision and statesmanship is especially important in those countries with the largest market, which anchor an agreement. A disciplined vision, coupled with an ability to rise above narrow short term national interests in favor of the collective objective is a defining characteristic of leadership in a successful regional agreement.

IV. Integration Must be Grounded in the Rule of Regional and Multilateral Law

A firm, transparent rules-based regional agreement with modern contingent remedies and dispute settlement mechanisms is essential for deepening regional integration.

• Non-compliance and ad-hoc, unpredictable and informal remedies to trade and investment problems have been a persistent weakness of Latin America and the Caribbean’s regional agreements and indeed were quite devastating for the old regionalism.
The New Regionalism has made substantial progress over its earlier Post-War counterpart in terms of the scope and speed of implementation of disciplines as well as the use of formal dispute settlement. But lingering “bad habits” in this critical area of regional integration remain and undermine the credibility of agreements, and hence, the efficiency of private sector investment decisions as well as the deepening of the regional market.

V. Automatic and Universal Liberalization with Negative Lists Works Best

The credibility of trade liberalization matters for the sustainability of negotiations and in order to encourage private sector participation and investment.

Reflecting a tradition of high levels of protection for domestic markets, the old integration relied on the laborious development of positive lists to liberalize regional trade (Central America was an important exception). Not surprisingly, liberalization was slow, very incomplete in its coverage, lacked credibility with the private sector and had very limited effects on intraregional trade and investment.

The broader commitment to liberalization in the New Regionalism has reflected itself in the general deployment of automatic liberalization schedules based on limited negative lists and a 10-year time frame for the bulk of trade and other disciplines. The private sector has generally responded to the process by anticipating agreements with new trade and investments, and reorganizing its strategies to exploit the new regional markets.

VI. Eliminating Tariffs is Not Enough

The New Regionalism has been very successful in eliminating and sustaining regional tariff elimination.

However, the potential dynamic economic effects derived from regional tariff elimination are being undermined by lingering protectionist-oriented non-tariff barriers, asymmetric regulatory frameworks and remaining excepted sectors.

The region has been slow in effectively addressing these obstacles to fuller development of the regional market and consequently is not harvesting the full sectoral benefits that could be derived from their politically courageous tariff liberalization commitments.

VII. Growing Commercial Interdependence Demands Growing Macroeconomic Policy Cooperation and/or Coordination

After a decade of the New Regionalism, commercial interdependence has increased sharply among a number of partner countries, while economic cycles have become more
synchronized. Mercosur is a good example of this, but many other partners of regional agreements are now feeling the effects of interdependence. Meanwhile a recent study by the IDB has shown that exchange rate volatility has negative effects on developing country trade, but especially when it is among developing countries.

Macroeconomic settings can condition the deepening of the regional market and its openness to the rest of the world.

- There is a need to lay the basis for macroeconomic policy cooperation in our regional agreements that exhibit high degrees of commercial interdependence, and eventual programs of coordination in agreements with deep objectives.

- While monetary union can only be a distant objective even for our regional agreements with the most ambitious objectives, design of a long term project for monetary union can serve as a useful roadmap for deepening integration.

VIII. Institutional Frameworks Matter

An appropriate regional architecture is essential for regional integration in Latin America and the Caribbean. This architecture should be designed so that form follows function.

- The old regionalism was characterized from its beginning by an institutional structure that was over-dimensioned relative to the existing commitments; costly to administer; and underfunded.

- The New Regionalism has been more parsimonious in its institutional arrangements. The traditional subregional agreements have begun to reform their institutional structure inherited from the past, while newer agreements have relied on more spartan intergovernmental arrangements.

- However, after a decade of strong intraregional trade and investment, some of the newer agreements with deep objectives and important degrees of interdependence must begin to consider strengthening regional institutional arrangements. This development is needed to coherently support emerging challenges in such areas as policy coordination, compliance, dispute settlement, monitoring of the distribution of benefits, migration, infrastructure development, security, and public relations and outreach.

- Not only regional institutions, but also their national counterparts must be strengthened to ensure effective action in areas such as: negotiations, articulation with civil society and the private sector, ex-ante and ex-post impact analysis, application of rights and obligations, regulatory and competition frameworks, enhancement of competitiveness, and socially efficient adjustment assistance and social protection.
IX. Regional Integration and Structural Reforms Increase Demands and Opportunities for Closer Regional Cooperation

Formal regional agreements create a network of legal rights and obligations among partners that stimulate markets and movement of commerce, investment, finance, and people, both within the geographic space of the agreements and between them and third parties. Structural reforms do the same in the broader context of globalization. These developments induce both opportunities and problems that can be addressed by effective regional cooperation.

- Growing regional flows of goods and services have highlighted the urgency of coordinated development of regional infrastructure, more attention to the regulatory environments that conditions the development of that infrastructure and the need to stimulate private sector participation. Regional infrastructure developed very slowly in the old integration due to, among other things, protectionism, a reliance on under-financed state sectors and regional conflict. The New Regionalism, structural reform and the accompanying energy of the private sector, technological advances and peace on most of our borders have created both the demand for, and conditions to, overcome historical bottlenecks in this critical strategic area. Recent initiatives at the Heads of State Summit in Brasilia and the “Plan Puebla-Panama” portend well for our future development of regional infrastructure.

- Closer regional relations and the increased influence of globalization create growing collective interest in cooperation to manage issues that impact on development and the quality of life. This includes such areas as the environment, migration, disaster control, epidemiological problems, culture, protection of indigenous groups, etc.

- In the context of the New Regionalism it is more feasible today for Latin American and Caribbean countries to cooperate in intersubregional, hemispheric and multilateral fora to develop proactive common positions and criteria on burning issues that affect the region’s development. These include the new international financial architecture, international trade protectionism, environmental and labor standards, security, corruption, disarmament, peace keeping and the leadership of our regional and international organizations.

- Common vulnerability and risks of contagion in the region in the face of uncertainties in world financial markets offer incentives to cooperate at the subregional and regional levels to manage threats to stability arising from unpredictable surges and retreats of foreign capital. Our substantial stock of international reserves could, through regional cooperation, be the basis for developing collective contingency mechanisms to assuage shocks arising from movement of capital flows.
X. Local, State, Provincial and Border Development must be an Integral Objective of Regional Integration if it is to Prosper in the Long Run

Market forces will not necessarily deliver the benefits of regional integration evenly within and between partner countries. Hence, coordinated programs, instruments and policies are needed to overcome market failure and restore a degree of balance in the effects of regional integration.

- The emerging concept of regional hubs of integration and development offers potential of providing an overarching unifying concept that can help expand the impact of regional integration to communities that until now have been at the margins of the process.

- Special attention is needed for border areas that serve as public goods in their role as transit points for regional integration. They often enjoy few benefits from their contribution and consequently suffer severe underdevelopment and social problems, some of which negatively affect intraregional trade and investment. A more coordinated and integrated cross-border approach to development is needed for these lagging bi-national communities.

XI. We Must Improve Our Capacity to Evaluate Regional Integration

There has been an intense on-going debate about the potential costs and benefits of regional integration.

- There are many reasons to expect that the New Regionalism will make an important contribution to Latin America and Caribbean’s growth and development. However, integration agreements also bear costs. The distribution of costs and benefits should be continuously monitored in order to evaluate policy and make appropriate adjustments.

- Effective evaluation requires overcoming a serious dearth of disaggregated data and analysis that is needed to evaluate key aspects of the impact of regional integration, such as intraregional investment, the impact of preferences and rules of origin, competition and productivity changes in regional sectoral markets, environmental impacts and compliance with regional norms.

XII. Launching an Integration Initiative is Easier than Sustaining it

Integration is an inherently challenging endeavor that must share space with sometimes more pressing national and international demands.
The old integration launched ambitious integration initiatives that showed great success and enthusiasm in their initial years, but soon lost momentum due to a set of complex reasons related to economics and politics.

The 1990s was a decade of major success in terms of launching new regional integration initiatives. This first stage enjoyed a favorable setting: it began in the context of major initiatives aimed at opening up economies, consolidating democracy and securing peaceful borders; it was launched from a relatively small base of regional interaction (reducing fiscal implications of liberalization) and participating countries benefited from relatively easy access to foreign finance and a stable and expanding world economy.

Consolidation of market access in the regional market is a central consideration in the movement towards a second stage of integration. This is because the regional market is a primary platform for deepening and widening: growing commercial interdependence can endogenously create incentives to more comprehensive regional commitments and cooperation.

The next stage of regional integration facing us now should prove more difficult than recent experience. The expansion and deepening of agreements impinges more on domestic policy, incorporates sensitive sectors, and could confront a less benign international setting. Hence the second stage of integration will require more deliberate policies as well as a redoubling of political vision and leadership. Fortunately, in confronting this challenge the region can now draw on more solidly-based economic fundamentals and on its ample experience in regional integration. This latter has taught us important lessons—some of which are outlined here—that can help guide our countries through the uncharted road ahead.

**The Role of the Bank**

From its inception the Bank has accompanied and supported its member countries in their efforts to pursue regional integration. Indeed, the commitment is captured plainly in the remark of Felipe Herrera, the Bank’s first President, in 1961 in Punta del Este when he affirmed that “Seremos el Banco de la Integración”.

This commitment continues today. Indeed, supporting regional integration was a central objective of the 8th replenishment of the Bank’s capital and is one of the central pillars of our new corporate strategy, along with competitiveness, good governance and social sector development to support growth, development and poverty reduction in the region. The corporate strategy aims to improve our support strategies, enhance Bank products and introduce more accountability in outcomes.

INTAL, now thirty-five years old, has been an important part of the Bank’s overall program to support regional integration. Its fine work has made the banner of INTAL
synonymous with regional integration throughout Latin America and the Caribbean. Many of our distinguished academics, policy makers and politicians have at one time or another been associated with INTAL’s work program. Moreover, like the Bank’s overall program in support of regional integration, INTAL has readily adapted to the changing times, responding to specific demands by governments in areas such as strengthening negotiating capacity, and public outreach to all sectors of civil society. We are grateful to Argentina for hosting INTAL and for its and our other governments uninterrupted and loyal support to the Institute as the latter has evolved over the years.

As we have seen in Europe and in Latin America and the Caribbean, regional integration is an extremely challenging endeavor that, even when successful, suffers moments of triumph and setbacks. Sustained support for the regional ideal can ease the path ahead. In this sense, I am glad to reaffirm here that the Inter-American Development Bank has been, is, and always will be what its founding fathers wanted — the Bank of Integration.
## Trade Agreements in the Americas in the 1990s

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<td>Caribbean Community (CARICOM)</td>
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<td>Central American Common Market (CACM)</td>
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<td>Southern Common Market (MERCOSUR)</td>
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<td>Bolivia-Mexico</td>
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<td>CACM-Dominican Republic</td>
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<td>CACM-Chile</td>
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<td>Mexico-European Union</td>
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<td>Mexico-Israel</td>
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<td>Mexico-Northern Triangle (El Salvador, Guatemala, Honduras)</td>
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### SELECTED AGREEMENTS UNDER DISCUSSION

#### Regional
- Free Trade Area of the Americas; Canada-Costa Rica; Mexico-Panama; CACM-Panama; Northern Triangle-Andean Community

#### Extra-Regional
- MERCOSUR-European Union; Chile-European Union; Chile-South Korea; APEC, Mexico-Japan

*Source: Integration, Trade and Hemispheric Issues Division of the Integration and Regional Programs Department, IDB*

### Notes:
1. CARICOM began its reform process in 1989 (Declaration of Grand Anse) and agreed to launch a harmonized CET in 1990.
2. The two countries substantially revised and upgraded this accord in an agreement that entered into force on August 1, 1999.
3. The Presidents agreed to re-activate the CACM in 1990 (Montelimar Summit) and opted to definitively pursue a customs union in 1993 (Protocol of Guatemala).
4. Preceded by a free trade area between the U.S. and Canada in 1987.
5. In 1988, the Presidents agreed (in the Protocol of Quito) to amend the founding Charter of the Andean Group and alter the existing tariff reduction program. In 1996, the leaders officially agreed to change the Group’s name to the Andean Community and reform certain existing institutional structures (Declaration of Trujillo).
6. Awaiting sufficient legislative approval.