

Political Economy of Trade Policy in Latin America



Edited by

Jorge Cornick | Jeffry Frieden

Mauricio Mesquita Moreira | Ernesto Stein



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Foreword

International trade and trade policy have always been controversial in Latin America. Ideologues and entrepreneurs, scholars and politicians have long debated whether trade liberalization represents an opportunity to be seized or a threat to be avoided.

Economists find these debates puzzling. Few propositions in economics are as widely accepted as the theory of comparative advantage: If two countries have comparative advantage in the production of different goods and services, trade is welfare-enhancing for both. Even if the theory cannot fully account for observed patterns of trade and productive specialization, its key insights have withstood the test of time. If countries export those goods and services in which they are comparatively more efficient, international trade is welfare-enhancing for all trading partners.

But trade policy is not made by academic economists; it is made in the cauldron of domestic and international politics. Economic theory is but one input in the policymaking process. While economists are sometimes prominent players in the policymaking process, they are at other times marginal players at best.

This book analyzes the trade policymaking process in Latin America. It does so both by evincing basic principles of analysis and by looking at how policy has been made in several countries in the region.

Trade policy is defined by politicians, and in democracies politicians need to gather and maintain the support of their constituents. But those come in many varieties. There is the mass of voters, who have little reason to care about the complexities of trade policy but who do care about economic growth, unemployment, and the cost of living. Constituents may also be concerned about the nature of relations with other countries and how trade affects those relations.

Then there are “special interests,” such as firms and industries that either rely on trade or want to be protected from it. Entrepreneurs, managers, and workers whose livelihoods depend upon trade—or on restricting it—have strong reasons to insist that politicians take their concerns seriously. Policymakers



must balance general interests against special interests, for they often pull in opposite directions.

The nature of political institutions can have a powerful impact on who gets what from whom. Some institutions give disproportionate influence to particular regions or types of interests. Others are biased in one way or another. There are autonomous agencies that can make and implement policy with little input from politicians; and agencies that are highly responsive to political pressure. The analysis of trade policymaking requires a clear picture of the interests at play and the institutions within which they play.

Trade policy is also foreign policy. When a government engages in bilateral or multilateral negotiations, or proposes a new trade agreement, public attention focuses on trade policy in a way that it does not do in other times. Now ideological proclivities, nationalist sensitivities, and a host of other factors are brought into play. When international politics and foreign policy are involved, trade policy usually becomes high politics. In these moments, trade agreements and related international commitments rise to a prominent place on the national political agenda, often as a central topic in national elections and referendums.

The case studies in this volume walk the reader through a complex thicket of contending interests and disparate political institutions to analyze why governments make the trade policies they do. Its chapters show how an array of different governments have attempted to balance the wide range of interests, ideas, and institutions in determining how they will deal with their countries' positions in the international economy. It is to be hoped that the experiences analyzed here can inform the making of future policy—and, perhaps, help improve it.

Jorge Cornick, Jeffry Frieden,
Mauricio Mesquita Moreira, and Ernesto Stein

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About the Authors

Nicolás Albertoni is the founder and senior researcher of the Trade Policy Project at the University of Southern California's Security and Political Economy Laboratory (SPEC Lab).

Maria Angelica Arbelaez is a research associate and former deputy director at Fedesarrollo, Colombia.

Gustavo Córdova Bojórquez is a professor and researcher at the Department of Urban Studies and the Environment of El Colegio de la Frontera Norte (El Colef), Mexico.

Jorge Cornick is a senior partner at DRP Trejos & Cornick, a partner at Eureka Comunicación, and a professor of Economics at Universidad Latinoamericana de Ciencia y Tecnología (ULACIT), Costa Rica.

Jeffry Frieden is Professor of Government at Harvard University.

Ivan Gachet is an economics consultant with ample experience in government institutions, the private sector, and multilateral organizations.

Diego F. Grijalva is an associate professor of economics in the Business School and the Department of Economics at Universidad San Francisco de Quito, Ecuador.

Sebastián Higuera Pedraza is an economist and consultant in education at the World Bank.

Dorotea López is an associate professor and graduate school director at the University of Chile's Institute of International Studies, as well as a WTO chair holder.

Pablo Lucio Paredes is a professor of economics and director of the Institute of Economics at Universidad San Francisco de Quito, Ecuador.



Anabel Marín is a senior researcher on science, technology, and innovation policy at the National Scientific and Technical Research Council (CONICET) in Argentina.

Stephen Meardon is an associate professor of economics at Bowdoin College, Maine.

Mauricio Mesquita Moreira is a principal economic advisor in the Integration and Trade Sector of the Inter-American Development Bank.

Ricardo Monge-González is a professor of economics at LEAD University, Costa Rica, as well as an associate researcher at the CAATEC Foundation, the Academia de Centroamérica, and the Programa Estado de la Nación.

Milenka Montt is a food engineer at the Pontifical Catholic University of Valparaíso, Chile.

Pedro da Motta Veiga is a director at the Center for Studies on Integration and Development (CINDES), an independent think tank based in Rio de Janeiro, Brazil, and a partner at Ecostrat, a consulting firm.

Felipe Muñoz is an assistant professor at the University of Chile's Institute of International Studies.

Karla María Nava-Aguirre is a professor at Universidad de Monterrey (UEM), Mexico.

Martín Obaya is a researcher at the National Scientific and Technical Research Council (CONICET) in Argentina.

Juan O'Farrell coordinates the program on Natural Resources, Innovation, and Environment at the Buenos Aires-based think tank Fundar.

Ivan Oliveira is the director of the Department of International Studies at the Institute for Applied Economic Research (IPEA), Brazil.

Sandra Polónia Rios is a director at the Center for Studies on Integration and Development (CINDES), Brazil, and a partner at the consulting firm Ecostrat.

Andrés Rebolledo has held various positions in the design and execution of Chile's trade policy over the past 20 years, with a particular interest in international economics and international trade negotiations.

Fernando José Ribeiro is a senior researcher at the Institute of Applied Economic Research (IPEA), a governmental think tank linked to the Brazilian Ministry of Economy, where he coordinates the International Economy Studies Division.

Luis Rivera is an economist with more than 20 years of experience in international economics, policy analysis, and project evaluation in various Latin American countries.

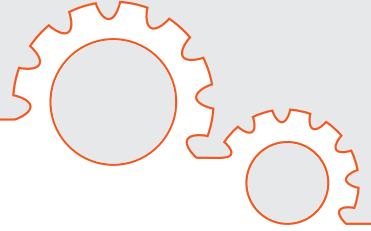
Federico Schaffler-González is the director of the Texas Center for Border Economic and Enterprise Development at Texas A&M International University (TAMIU) in Laredo, Texas.

Ernesto Stein is the country representative of the Inter-American Development Bank in Mexico and a former principal economist for the IDB Research Department.

Roberto Steiner is a member of the board of directors of Banco de la República, Colombia.

Carlos Uribe Terán is an associate professor of economics in the School of Economics at Universidad San Francisco de Quito, Ecuador.

Sandra Zuluaga is a managing partner and consultant at Axia Colombia, where she focuses on competitiveness and management of the organizational environment of companies and institutions.



The Political Economy of Trade Policymaking in Latin America: An Introduction

Jorge Cornick, Jeffrey Frieden, and Ernesto Stein

Reducing trade barriers is almost always controversial, as the positive impact on aggregate social welfare runs up against the interests of those whose profits and jobs depend on trade protection. Most people in Latin America recognize the advantages of integration into world markets, but they also see that the gains from trade are unevenly distributed and can create both winners and losers.

In principle, some of the gains could be used to compensate the losers, so that everybody benefits. In practice, compensation is sometimes politically difficult. Once trade is liberalized, winners may resist sharing the benefits, and ex-ante promises to compensate potential losers may not be credible. Thus, those who expect to be harmed by trade are likely to oppose liberalization. Moreover, liberalization opponents are often powerful and may have the resources and political clout to block reform.

Understanding trade policy, therefore, requires an analysis of the constellation of public and private actors that participate in the trade policymaking process, the interests of those actors, and the nature of the trade policy institutions involved.

Most of the time, trade policy involves policymakers and special interest groups—typically private sector actors for whom the stakes are high. These actors include firms (and their workers) that compete with imports, firms that import, firms that make substantial use of imported inputs, and firms that export and fear retaliatory protection by trading partners. Consumers are not typically active participants in this process, even though they benefit from trade liberalization through access to a wider range of products and lower prices. This is because consumers in general are a diffuse, disorganized group

for whom the stakes are lower. To be sure, policymakers may have broad consumer as well as voter interests in mind as they formulate trade policy, but final consumers rarely impact trade policy directly.

Occasionally, something happens that turns trade policy into a central issue in the broader political game. This may be triggered by a specific trade negotiation (such as the Central America-Dominican Republic Free Trade Agreement, or CAFTA-DR, in Costa Rica) or a recession that turns public opinion against a country's imports. Understanding these episodes requires a better understanding of the general public's attitudes toward trade in terms of its determinants and consequences, both for policy and electoral outcomes.

The trade policymaking process, with its key actors and institutions, helps shape trade policy. But changes in trade policy, in turn, can have substantial feedback effects on trade policymaking. Such was the case with Latin America's "Great Liberalization" of the late 1980s and early 1990s that opened domestic markets to foreign competition while seeking better access to foreign markets for local producers. New exporting firms and economic activities emerged, while previously protected ones either adapted or exited, thus transforming the constellation of actors involved in trade policymaking and their interests. But since the depth of trade liberalization varied across countries, the extent to which the new policies changed the underlying political economy varied as well.

Countries' trade policy experience since the 1990s has varied as well. Some sustained or extended liberalizing policies. Others followed periods of liberalization with policy reversals, increasing tariffs and nontariff barriers. Many governments extended special protection to favored economic sectors and used anti-dumping instruments extensively.

How can the different patterns of trade policy in Latin America be explained? Why has liberalization marched on in some countries, while others have reversed course or applied protectionist measures? Why have some sectors been favored over others? Looking forward, what constraints do governments face to further liberalize? To explore these issues, this chapter uses insights from economics and political economy, along with the country studies that follow in the rest of this volume.¹

1.1. Making Trade Liberalization Last

Once trade is liberalized, there is no guarantee that it will remain liberalized. In fact, countries in the region have followed different policy trajectories since

¹ For a recent review of the literature on the political economy of trade policy see McLaren (2016). An early review can be found in Rodrik (1995). For earlier work on trade policymaking processes in Latin America in the 1990s and early 2000s, see INTAL and IDB (2002) and Sáez (2005).

the liberalization of the 1980s and 1990s. Some, such as Chile, Colombia, Costa Rica, and Mexico, have continued to reduce trade barriers, signed preferential trade agreements with an increasing number of regional and nonregional partners, and persisted in maintaining and deepening open trade. Others such as Argentina, Brazil, and Venezuela have resurrected some trade barriers or come up with new ones. What explains whether trade liberalization persists?

One key source of persistence is mobilized winners. Those regions, industries, firms, and workers that gain from access to world markets constitute a potential force to sustain and extend openness. They can push for trade agreements with other countries and support them in the national public debate. They can oppose protectionist measures when they are proposed. And they can, as in the recent case of Mexican firms faced with the prospect of U.S. protectionism, work with like-minded interests in partner countries to preserve existing commercial ties (see Chapter 8 in this volume).

Indeed, protection changes the very nature of interests in an economy. Trade policies have a powerful impact on the structure of production and, therefore, on the interests in play. In addition to mobilizing winners, liberalization has another important effect relevant for the subsequent politics of trade policy. Over time, firms and industries that had been protected either adjust to import competition or go out of business (and thus no longer lobby for protection). Some, in fact, may discover that the effects are less negative than expected (Fernández and Rodrik 1991), and that liberalization creates new and unexpected opportunities. The Chilean experience clearly illustrates these sources of persistence.

A related point is that once a country liberalizes its trade relations, it can be costly to turn back, particularly when doing so implies renegeing on prior international commitments—even the commitments of previous governments. This may help explain why Costa Rica's *Partido de Acción Ciudadana* (PAC) opposed CAFTA-DR in the country's 2007 referendum but did nothing to reverse course when it reached power in 2014 (see Section 1.1.2 below).

1.1.1. The (Not So) Boring Case of Chile

A prominent Chilean economist once remarked that the political economy of trade policy is not very interesting in his country: "This issue in Chile is boring... everyone is in favor of free trade." However, the story of how this shared vision emerged in Chile, as told in Chapter 4 of this volume, is anything but boring.

The opening of the Chilean economy began in 1973. The military government embarked on a deep process of unilateral trade liberalization, reducing tariff levels from an average of about 100 percent, with high tariff dispersion, to uniform tariffs of 10 percent in 1979. The return to democracy in 1990

represented a critical juncture for Chilean trade policy that could have resulted in policy reversals. Instead, Chile continued along the path of liberalization, this time on the basis of a wide web of bilateral free trade agreements (FTAs). As a result, today Chile has 26 trade agreements with 64 countries in Latin America, North America, the European Union (EU), and Asia. Taken together, these trading partners account for close to 90 percent of world GDP.

A crucial question is why the democratic government that took office in 1990 did not reverse the trade policy of the military dictatorship. One important consideration is that by 1990, the constellation of private actors with a stake in trade policy had changed dramatically from the import-substitution periods. After nearly 20 years of liberalization, many of the influential import-competing sectors—including most car manufacturers and most of the country's textile and footwear industry—were gone.

The export sector had replaced the highly protected import-substitution industries in influence.² By 1991, fresh fruit exports had soared to US\$1 billion, taking advantage of off-season markets in developed countries. Together with other booming export sectors such as fish and wine, these sectors became active participants in the trade policymaking process.

The process of opening did more than change the identity of the players; it also shifted the preferences of some of the remaining players. The result has been a surprisingly broad consensus favoring trade agreements that includes labor unions, along with the remaining textile and footwear manufacturers.

In almost any other Latin American country, the notion of unions and the textile sector both supporting liberalization would be unthinkable. The explanation in Chile is rather simple. Average Most Favored Nation (MFN) tariffs in Chile are now at 6 percent. Due to the extensive network of trade agreements, most important countries already have free access to the Chilean market. Thus, applied tariffs actually average 0.8 percent. When Chile negotiates an FTA with another country, it provides access to an already-open market, while Chilean firms gain access to a more protected one. Chile therefore gives up little and receives much in return. That is why unions support free trade agreements. They believe, correctly, that FTAs generate jobs.

How about textile companies? Consider the case of Caffarena, an apparel company responsible for most Chilean textile exports. Starting in 2007, it relocated an important part of its production to Asia, after opening an Office of Purchases and Development in Shanghai. Design and material selection are still done in Chile, but the company takes full advantage of the FTA with

² The process may also have been facilitated by the fact that Chile's import-substitution industrialization process was not as deep as it was in countries such as Argentina and Brazil, due in part to scale considerations.

China signed in 2005. Some apparel lines are still produced in Chile, and, as of 2010, those lines were exported to nine countries: Argentina, Bolivia, the Dominican Republic, Mexico, New Zealand, Paraguay, Peru, the United States, and Uruguay. Except for the Dominican Republic, all of them have FTAs with Chile. Given the way in which textile companies have adapted to liberalization, it is not surprising that the textile companies that remain support FTAs.

The Chilean experience illustrates how trade policies adopted in one period go on to affect the policymaking process in the next period.³ An open trade regime can lead to broad support for further liberalization, so much so that it can render trade politics almost... well, boring.⁴

1.1.2. Trade Policy as the Citizens' Choice: The CAFTA-DR Referendum in Costa Rica

The general public does not normally focus on trade policy as a prominent political issue. However, there are times when the public, including voters, does pay attention to it. Episodes when major international trade agreements are being considered are among those times. Such was the case of Costa Rica's CAFTA-DR referendum, an example that illustrates the dynamics of mass participation in the political economy of trade policy (see Chapter 6 in this volume).⁵ This episode also illustrates how today's policy decisions affect tomorrow's policymaking process and outcomes. In particular, the dynamics set in motion by the highly contested CAFTA-DR vote would at this point be very costly to revert, even when preferences regarding trade policy remain deeply divided.

Unlike the case of Chile, after years of gradual but steady trade reform in Costa Rica no broad pro-trade consensus had emerged when the country confronted the CAFTA-DR decision. While most of the private sector supported trade, public opinion and policymaking elites were at odds with regard to trade policy.

Costa Rica signed the CAFTA-DR treaty in January 2004, but the country's president, Abel Pacheco, sensing opposition, did not send it to Congress until October 2005. With the 2006 elections looming, Congress postponed the debate. Thus, when President Oscar Arias was elected, CAFTA-DR had not yet been ratified. Facing a March 2008 ratification deadline and the prospect

³ This is in line with the conclusion in Ostry (2002) that "policy influences process and process influences policy."

⁴ Recent discussions seem to be heating up, however, in relation to Chile's participation in the Trans-Pacific Partnership.

⁵ For a more thorough analysis of the political economy behind the CAFTA-DR decision in Costa Rica, see also Hicks, Milner, and Tingley (2014).

of a deadlock in Congress—where procedural rules allow small minorities to stall any debate—President Arias called for a referendum.

The alignment of political parties and civil society organizations for and against ratification had begun years earlier when, in March 2000, a proposal to open up the electric power market polarized Congress and sparked street demonstrations. Most of the private sector and the two major political parties supported the reform, while public sector unions, student organizations, anti-globalization groups, and left-wing political parties were against it. The same forces faced off in the 2006 presidential election. Those in favor of the export-oriented, liberalizing reforms lined up behind Arias, while those opposed to such reforms supported Ottón Solís. Arias won the election by the slimmest of margins.

Public opinion polls tracked public sentiment on CAFTA-DR up until the October 2007 referendum. As public knowledge of the treaty increased, so did opposition. The gap between positive and negative opinion went from +24 percent in May 2007 to a virtual tie in September. Dwindling support did not reflect voters' interests: throughout the period, the share of respondents who thought the treaty would either benefit them or have no impact was stable at around 60 percent. But other drivers of public opinion changed. Between May and September, an increasing share of respondents thought the treaty would reduce public services in health and education (from 32 to 40 percent of respondents), would not benefit the poor (from 57 to 68 percent), and would hurt small farmers (from 55 to 59 percent). Moreover, by October, 66 percent of respondents thought the treaty would give the United States excessive influence over Costa Rica's internal affairs (Rodríguez 2013).

Despite the drop in support, the "Yes" won by a very narrow margin, with 51.2 percent of the vote. There is some evidence of economic self-interest motivations, as "Yes" got more votes in export-oriented districts (Hicks, Milner, and Tingley 2014). However, interviews with leaders of both campaigns highlight the importance of noneconomic, worldview factors (see Chapter 6 in this volume). The virtual draw between the two worldviews and their political expression persists to this day. Nevertheless, in the long run, the triumph of the "Yes" movement has brought with it almost irreversible changes in Costa Rica's trade policy.

In 2014, the *Partido de Acción Ciudadana*, which had opposed CAFTA-DR in the referendum, came to power. The new president, Luis Guillermo Solís, had the authority to unilaterally withdraw from the treaty. However, by the time he took office, a package of 13 legal reforms associated with CAFTA-DR had already been approved by Congress. The telecommunications and insurance markets were already open, and intellectual property rights had been

strengthened. The institutional changes that motivated the “No” movement to oppose CAFTA-DR had already taken place, and repudiation of the treaty would not undo them.

The slim but strategic victory of the “Yes” movement may not have settled the battle of ideas, but the long-term configuration of economic interests has been altered in fundamental ways in Costa Rica. With few exceptions, protection for agriculture and agroindustrial sectors is on a clock. However gradually, protection is slated for disappearance. Once that protection is gone, those who depend on it for survival will no longer be part of the economic landscape, while those who can adapt to the new environment will remain.

This is not to say that CAFTA-DR is irreversible. But the costs of reversal are huge, and barring a dramatic change in the political landscape, the battle for free trade in Costa Rica seems to be over.

1.2. Special Interest Trade Politics

While in special circumstances such as the CAFTA-DR referendum in Costa Rica trade policy becomes central in the broader political debate, most of the time trade policy is the province of interest groups for which the stakes are high: import-competing firms and their representative associations seeking protection; importers and users of protected inputs who stand to lose from protection that raises the prices of what they sell or use; and exporters who favor open markets to lower their production costs, obtain reciprocal access to other markets, and minimize the risk of retaliatory protection by trading partners. A recent episode in Brazil illustrates some of the actors and processes involved.

1.2.1. Players in the Trade Policymaking Game

On July 20, 2016, Brazil initiated an anti-dumping investigation of imports of flat steel from China and Russia at the request of two domestic steel producers. The Department of Trade Defense of the Ministry of Industry and Foreign Trade (MDIC) concluded that imports from both countries were dumped and recommended the application of duties.

The MDIC report generated much controversy. In one corner were the steel producers, represented by their association, Aço Brasil, with the support of the MDIC. In the other corner stood a broad coalition of public and private players, including the Ministries of Finance and Agriculture and some 20 business associations from sectors that use steel intensively, under the leadership of Brazil’s Machinery Builder’s Association (*Associação Brasileira da Indústria de Máquinas e Equipamentos* – ABIMAQ).

On the eve of the decisive meeting at CAMEX, the interministerial council charged with implementing Brazilian trade policy, the Ministry of Finance published a note stressing the adverse effects of duties on downstream sectors and the consumer price index and challenging the claim that steel imports had caused “serious harm” to Brazilian producers. The Ministry of Agriculture also argued against the duties, citing the risk of Chinese retaliation against Brazilian exports. Consumers—who would have been affected through the price of appliances and cars, for example—were nowhere to be found.

This episode, detailed in Chapter 3 of this volume, illustrates the contending private sector interests in play. It also shows that the public sector is not monolithic. Ministries of industry tend to support industries facing import competition; ministries of finance, in contrast, are more likely to consider the impact on the economy as a whole.⁶ All these public and private actors, in turn, interact within the context of a given set of formal and informal institutions that define the way the game is played.

The role of private sector actors can also vary depending on the circumstances. Import competitors are almost always central actors, but the engagement of other private sector actors depends on several factors.

Consider the case of exporters. They may be active if they fear retaliation, but inactive if the threat of retaliation is not serious enough. China accounts for nearly 20 percent of Brazilian exports, including 75 percent of Brazilian soybean exports. Primary exporters cannot risk retaliation by China, and neither can the Minister of Agriculture. Russia, in contrast, receives 1.2 percent of Brazilian exports. If the anti-dumping case were only against Russia, would exporters and the Minister of Agriculture be playing a similar role? Most likely not. Exporters may also engage in the process in the context of bilateral trade negotiations, when providing market access to a partner country entails receiving market access in return. Exporters may be less likely to participate in discussions regarding unilateral liberalization.⁷

Finally, exporters may be active because they care about access to inexpensive and high-quality inputs, which they need to be competitive in export markets. However, exporters can be neutralized by policies such as special drawback regimes that exempt them from paying tariffs on imported inputs. This mechanism, prominent in Brazilian trade policy, solves the exporters’ problem, but in doing so also reduces their incentive to participate in trade policymaking.

⁶ Ministries of agriculture tend to defend the interests of their stakeholders, which may be offensive or defensive depending on the issues under discussion.

⁷ A historical example will be illustrated below in the discussion of the U.S. Reciprocal Trade Agreement Act of 1934.

The Brazilian steel anti-dumping case suggests that sectors that use protected inputs intensively may also play an important role in demanding liberalization. While this coincides with the theoretical expectation, the episodes studied in this volume suggest that this is not always the case. There are instances when, contrary to expectations, suppliers of a protected input and their clients push in the same direction, or at least do not get in each other's way.

Firms producing protected intermediate inputs can purposely attempt to “deactivate” potential challenges by their customers, as in the case of the flat steel industry in Argentina discussed in Chapter 2 of this volume. The dominant firm in the sector uses a number of strategies to align its customers' interests with its own. For example, the company invests heavily in activities for the entire value chain. In 2002, it created a program to support its small and mid-size clients and suppliers that aims to improve their management practices, strengthen their export capabilities, and promote “efficient import substitution.” An example of the company's help in improving management practices is that, according to a firm executive interviewed, all courses available for its executives are also accessible to its clients.

In terms of “efficient import substitution,” the company makes its ample legal resources and expertise available to its clients for their own anti-dumping cases. Rather than be challenged by its clients, who would benefit from lower prices if steel protection were reduced, the company lobbies to protect downstream industries so that everyone's interests align.

In addition to these positive incentives, there are cases where fear of retaliation sometimes discourages challenges to protection. This is particularly relevant when the supplier is a dominant player, and downstream firms cannot risk having their supplies cut off. Even if the downstream firm is successful and obtains access to cheap products from abroad, the risk of policy reversals means that downstream firms must think twice before challenging the dominant supplier. Trade policies may not be enough to deal with this problem. They may need to be complemented by competition policies that challenge the dominant power of the domestic market leader.

1.2.2. The Challenges of Leaving Protectionism Behind

Argentina illustrates the challenges that a reformist government faces when trying to reverse years of protectionist policies in the midst of macroeconomic and political difficulties. The case illustrates why, in pursuing trade liberalization, governments may treat different sectors differently. It also shows the role of compensatory policies in facilitating trade reform.

The administration of President Mauricio Macri from 2015 to 2019 pursued what it characterized as a “smart integration” strategy but needed to proceed gradually given negative public opinion of the 1990s reforms, high unemployment, and an impending midterm election. From the outset, the decision was made to advance faster in liberalizing intermediate inputs and other products affecting downstream competitiveness, while proceeding more slowly in sensitive sectors where many jobs—particularly in politically sensitive electoral districts—would be at stake.⁸

Chapter 2 of this volume compares trade policy in three sectors in Argentina: computers, flat steel, and textiles. Having discussed flat steel above, here the focus is on computers (and other electronics) and textiles.

Computers and Other Electronics

Under the administration prior to that of President Macri, computers were assembled domestically using imported components. Personal computers, notebooks, and tablets were subject to 35 percent tariffs, while imports of their components were levied at 12 percent. More importantly, a discretionary system of import licenses known as the *Declaración Jurada Anticipada de Importación* (DJAI) made it easy to import components, but almost impossible to import the final products.

Protection of computers clearly affected competitiveness downstream and was unpopular with consumers. Local value added was minimal, and little employment was generated. The industry had two main locations: the outskirts of Buenos Aires, populated by specialized small and mid-sized enterprises, and the island of Tierra del Fuego, where large, diversified firms produced cellphones, TVs, and computers under a special industrial promotion regime. These groups of firms are represented by different business associations. The *Asociación de Fábricas Argentinas Terminales de Electrónica* (AFARTE), which represents producers in Tierra del Fuego, has ample access and resources. It is stronger than the two associations that represent mainland firms, the *Cámara Argentina de Máquinas de Oficinas Comerciales y Afines* (CAMOCA) and the *Cámara Argentina de Industrias Electrónicas, Electromecánicas y Luminotécnicas* (CADIEEL). Given that benefits for the island discriminate against mainland firms, the relationship among these associations is characterized by conflict rather than cooperation.

⁸ Obviously, this is not the only possible gradual liberalization path. From a normative perspective, an across-the-board gradual reduction in tariffs and nontariff barriers might have been more efficient, eliminating distortions and discouraging rent-seeking. But it would have been incompatible with Mercosur’s common external tariff and, from a political economy perspective, probably detrimental to electoral success.

Given all these factors, it is not surprising that the computer sector was the first to be liberalized. In February 2017, the government eliminated tariffs on final goods and components and, later that year, eliminated non-automatic licenses as well. Requests for a more gradual approach by CAMOCA, CADIEL, and the worker's union (*Unión Obrera Metalúrgica* - UOM) were denied. AFARTE, meanwhile, was happy to sacrifice computer production in exchange for continued benefits for cellphones and TVs, which make up a larger part of the product mix of its member firms.

The government dealt with the losers with mechanisms of compensation, transformation, and concertation (see Chapter 2 of this volume). Compensation happened through *Conectar Igualdad*, a national program to distribute domestically produced notebooks in schools.⁹ Transformation happened by including several computer manufacturers in the National Productive Transformation Program (*Programa Nacional de Transformación Productiva* - PNTP), which provides expanded unemployment insurance for displaced workers, subsidies for reemployment, and credit to help firms pivot toward activities with more competitive potential.¹⁰

Finally, the government implemented a three-way concertation process designed to increase competitiveness and reduce prices of TV and cellphone production in Tierra del Fuego. Tariffs were preserved temporarily and internal taxes eliminated.¹¹ Labor unions agreed to wage freezes for two years, and firms committed not to fire workers during that time.

Textiles

Prior to the Macri administration, textiles were also heavily protected in Argentina: tariffs were 26 percent on fabrics and 35 percent on apparel. According to the e-commerce platform Linio, Argentina was the most expensive place to buy apparel in Latin America. Nevertheless, the government adopted a more gradual approach to reducing protection of textiles. Several factors explain the difference.

The first factor was employment. In contrast to computers, which directly employed less than 5,000 workers, the textile and apparel sector at the time employed more than 250,000. The second factor was politics: most jobs are located in the politically sensitive Conurbano Bonaerense, the crucial electoral district surrounding the city of Buenos Aires.

⁹ Although the program was deployed prior to the liberalization of computers, the domestic purchases requirement was a clear compensation for such liberalization.

¹⁰ For a discussion of the PNTP, see Mesquita Moreira and Stein (2019, Chapter 9).

¹¹ Over a five-year period, the government will gradually eliminate these taxes on the mainland, effectively ending the special regime.

The third important factor was lobbying. In contrast to computers, the textile sector has strong business representation that acts cohesively on behalf of the entire value chain. Particularly interesting is the case of Pro-Tejer, a nongovernmental organization (NGO) created in 2003 by the owners of a large yarn and fabric company who understood that to survive they had to protect downstream apparel and design firms. They worked to shift the sector's public perception, arguing that the sector was efficient but that systemic "Argentine costs" (taxes, labor regulations, logistics, etc.) hindered its competitiveness. Thus, they proposed that the sector be opened only once these systemic costs were reduced through tax and labor reform.

Given these very different circumstances, it is not surprising that trade policy outcomes were different as well. In this case, tariffs were not changed, and when DJAIs were replaced with non-automatic licenses, more than half of the products covered were in the textile and apparel sector. Still, unlike the DJAIs, which were completely discretionary and did not have time limits (and were successfully challenged at the World Trade Organization), the non-automatic licenses had to be granted within 60 days. As a result, imports of apparel increased sharply and production along the value chain contracted significantly.

Even though the government preserved protection through tariffs and non-automatic licenses, it still introduced a number of compensatory measures in response to the import surge and lobbying by the sector. First, it established a fund to finance consumption of domestic apparel in six interest-free monthly installments. Second, it created an express facility for sensitive industries for the Productive Recovery Program (*Programa de Recuperación Productiva* - Repro), which provides employment subsidies to firms in crisis in exchange for a commitment not to fire personnel. Third, in November 2018 it reduced employers' social security contributions for the textile and footwear industry. Finally, the government and the sector established a sectoral roundtable (*Mesa Sectorial*) focused on resolving labor issues, product quality, and internationalization.¹²

These contrasting cases illustrate the challenges faced by a government that wants to leave protectionism behind and engage in "smart integration." It is not easy, especially in the midst of a recession (as in Argentina now) or with an appreciated exchange rate (as the country had until mid-2018), particularly when the government wants to win reelection.

¹² Not all textile products received the same treatment, however. Consistent with the analysis of this section, synthetic yarns, a highly concentrated, capital-intensive industry that produces intermediate inputs affecting competitiveness downstream, was liberalized more aggressively.

The comparison among these sectors and their differences clearly suggests that, under these circumstances, issues like the number of jobs at risk, the political importance of the districts where those jobs are located, the strength and cohesion of sector representation, and the degree to which protection affects the competitiveness of relevant downstream industries are important elements that contribute to explaining differences in trade policy outcomes.

1.3. From Free Trade to Protectionism and Back

Some countries, such as Brazil, Chile, and Costa Rica, have trade policies that are quite consistent over time (albeit with a protectionist bent in the first case, and a liberalizing bent in the last two). Others, such as Argentina and Ecuador, are remarkable for frequent policy shifts.¹³ But while Argentina's policy shifts as of late have been associated with changes in the party in power, Ecuador's recent policy changes have taken place under the same party, *Alianza País*. The case of Ecuador provides insights into the role of ideas, or ideological preferences, but also shows how the link between these ideas and actual policies is mediated by constraints imposed by the underlying economic conditions.

In spite of widespread political instability, trade policy in Ecuador was consistently liberalizing from 2000 to 2006. Despite last-minute disagreements and a dispute concerning a U.S. oil company, it seemed that Ecuador would eventually sign and ratify an FTA with the United States.

Things changed with the election of President Rafael Correa, who engineered a dramatic shift from liberalization to protectionism. The idea of restarting the FTA with the United States was discarded, and although negotiations for an FTA among Colombia, Ecuador, Peru, and the EU began in 2009, Ecuador withdrew from them soon thereafter.

This shift seemed to arise out of a combination of Correa's preferences, a highly centralized institutional setting that concentrated decision-making authority in the president, and favorable economic conditions that allowed the government to compensate economic sectors that lost from protectionist policies.

Ecuador's concentration of trade policy decision-making authority in the president was stark and was even enshrined in the 2008 constitution.

¹³ This is not just a recent phenomenon. Stein et al. (2006) classified Latin American countries over the previous quarter century according to their overall policy stability and five other features of public policies. Argentina, Ecuador, and Venezuela were the only countries classified as having a low level of policy stability. The rest of the countries included in this volume (Brazil, Chile, Colombia, Costa Rica, and Mexico) were deemed to have high levels of public policy stability.

Article 305 establishes that the executive has exclusive responsibility to create tariffs and determine their level. In line with President Correa's trade policy preferences, Article 206 states that the government should support imports that are necessary for development objectives but discourage those that negatively affect domestic production. And while the National Assembly's approval is required for international treaties such as FTAs, President Correa's party had an overwhelming majority of seats in the legislature, which during his second term became almost an extension of the executive.

President Correa also took steps to limit the influence of the private sector over trade policy. In 2010, the *Consejo de Comercio Exterior e Inversiones* (COMEXI), which included representatives of both the public and private sectors and had played a major role in trade policymaking, was replaced by COMEX, which had no private representation. In this context, President Correa exercised his trade policy authority in a very personalistic way, including assessing particular tariff headings and discussing specific tariff levels.

But while ideology played a primary role in trade policy in Correa's administration, the fact that negotiations with the EU were restarted during his government, while negotiations with the United States were not, shows that other considerations were also in play.

In both cases, failure to conclude an FTA carried with it the danger of losing trade preferences. However, the potential cost was relatively small in the case of the United States, where the Andean Trade Promotion and Drug Eradication Act (ATPDEA) was set to expire in 2006. With oil prices high in the international market, Ecuador's government could afford to compensate exporters, and in fact compensated them, for the loss of preferential market access. That policy in effect turns the typical argument about liberalizing to achieve efficiency and compensating the losers on its head.

In the case of the EU, the situation was different. The cost to Ecuador of losing the Generalized Scheme of Preferences Plus was estimated to be much higher than the cost of losing trade benefits under ATPDEA, because tariffs in Europe were significantly higher than those in the United States. Additionally, Colombia, Peru, and Central America had already signed FTAs with the EU, putting Ecuadorian exporters to the EU at a competitive disadvantage. Finally, the period of high oil prices that had allowed the government to compensate exporters' losses from protectionism was coming to an end by 2013, when negotiations with the EU restarted, and had definitely ended by November 2016, when the treaty was signed. The treaty entered into force in early 2017. Compensation would have been costly in the midst of resource constraints, and ideology gave way to pragmatism.

In the aftermath of President Correa's government, his former vice president, Lenin Moreno, tried to restore relations with the United States and with international financial institutions such as the International Monetary Fund and the World Bank and involve the private sector actors in his cabinet and trade policy. This completed a full circle back to the pro-trade stance of the early 2000s.

1.4. Cross-Border Interests and Alliances

A recurring theme in this book is how trade policy itself changes the political economy of trade policy. The renegotiation of the North American Free Trade Agreement (NAFTA) that culminated with the signature of the new U.S.-Mexico-Canada Agreement (USMCA) provides a perfect example.

When the original treaty was negotiated, trade liberalizers were in office in Mexico, the United States, and Canada. For Mexico, signing this treaty was in many ways the culmination of the pro-market reforms of the administration of President Carlos Salinas de Gortari that were widely regarded at the time as an example of modern, market-oriented economic reforms.

The treaty, however, was strongly opposed by some industrial groups and by unions on both sides of the U.S.-Mexico border. Even though by the time U.S. President Donald Trump was sworn into office the treaty had been in force for more than 20 years, opposition to it had not disappeared. The Trump administration vowed to renegotiate it or repudiate it if Mexico did not accept its demands.

However, when the new negotiations started in 2017, the economic and therefore the political economy landscape on both sides of the border had been dramatically changed by the treaty itself: North America, and particularly the United States and Mexico, had become home to tightly integrated production processes spanning the partner countries.

How did NAFTA-induced integration affect the politics of the NAFTA renegotiation? In order to understand this, Chapter 8 of this volume argues that it is important to go beyond the conventional political economy analysis of trade agreements based on the Grossman and Helpman (1994) model, in which self-interested politicians weigh the concentrated interests of domestic producer alliances versus the dispersed interests of domestic consumers (who are also voters). Chapter 8 shows that the real circumstances that played out in the NAFTA renegotiation had at least as much to do with cross-border producer alliances as with domestic ones, and that, in shaping these cross-border alliances, international mobility of intermediate and final goods via global value chains played a crucial role as well.

Therefore, understanding NAFTA's renegotiation requires augmenting the conventional perspective on how trade agreements are negotiated: given the economic integration that had taken place, players on both sides of the border found that it was in their interest to lobby not only their own government but also the governments of the other parties to the agreement. Moreover, they found a commonality of interest with their counterparts on the other side of the border, particularly in the case of highly integrated industries such as the automotive industry, where auto parts are produced in the United States, exported to Mexico, assembled, and then exported back to the United States in the form of complete vehicles.

Consequently, not only did interested parties such as the Canadian, Mexican, and U.S. Chambers of Commerce mobilize resources to preserve NAFTA, they did so jointly—and their motive for joint action is seen in their common interest to preserve their supply chain security.

The emergence of cross-border alliances depends on the comparison of their benefits—which are related to the extent to which there is commonality of interests and the advantages of sharing resources and information—and their costs—which are related to the difficulty of coordinating with actors operating in a different institutional environment.

Not surprisingly, no effective cross-border alliance was formed for the purpose of ending NAFTA or modifying it in a substantially more protectionist fashion. Being import-competers, producers in Mexico and the United States seeking protection and the rejection of NAFTA were unlikely to be tightly linked to their foreign counterparts by production processes. Absent such preexisting links, their coordination costs would have been high. In contrast, producers that had developed a vested interest in preserving NAFTA trade found it in their interest to share resources and information, particularly when they were in tightly integrated production processes that substantially lowered coordination costs.

As discussed earlier in Section 1.2, losers from free trade policies either adapt or exit the market after those policies have been in place for a long time. In the case of NAFTA, part of this adaptation took the form of increased international value chain integration. Thus, for all of the heated public declarations, NAFTA was transformed into USMCA without causing major disruptions in trade flows or trade regulations among its three partners.

1.5. Agricultural Protectionism: A Hard Nut to Crack

Trade liberalization in agriculture has been slower than in most other sectors. Tariffs have declined more gradually and exemptions in FTAs are more frequent, as is the use of nontariff barriers to compensate for tariff reductions.

The cases of rice and sugar in Colombia (Chapter 5) and Costa Rica (Chapter 6), two countries that are largely open in other sectors of their economies, provide insights into the specific features of the political economy of agricultural trade policy.

1.5.1. Sugar and Rice... and Everything Nice

Sugar and rice are agroindustrial products in that, before reaching consumers, they must be processed at industrial mills. While sugar and rice farms come in different sizes, the milling stage is highly concentrated in both crops. To give an extreme example, Colombia has more than 32,000 rice producers, but only two important rice mills. Small farmers are dependent on millers to sell their crops.

In Costa Rica, rice is the only product with regulated prices at every stage of the value chain. Tariffs are 35 percent, but when domestic production falls short of local consumption, rice millers are assigned tariff-free import quotas in proportion to the share of domestic crop they buy (including their own production when vertically integrated). Average applied tariffs for refined sugar stand at 45 percent. In Colombia, MFN tariffs on rice are 80 percent, and the sector was protected by a price band system until 2003. Sugar, also formerly covered by the price band system, is subject to a 55 percent tariff, and that rate was even higher in the past.

The coexistence of very large and politically and economically powerful millers, and a large number of small, relatively poor farmers or agricultural workers in rice and sugar production in Colombia and Costa Rica, goes a long way toward explaining the strong protection and long tariff phase-out periods these sectors have secured. The millers provide the lobbying capabilities, and the farmers help garner sympathy and support (since no one has ever said "let's rise to defend the millionaire mill owners"). Agricultural support programs and protectionism are always justified as a means to protect small farmers, the quintessential embodiment of the hard-working poor.

Despite this, trade agreements have proved to be a powerful tool for reform. In Costa Rica, tariffs on rice imports from the United States will be phased out over 20 years.¹⁴ In Colombia, the United States was granted increasing tariff-free quotas, and tariffs will be phased out in 25 years for sugar and 15 years for rice. Thus, trade agreements—particularly those with the United States—have achieved what once seemed unthinkable: gradual but significant liberalization of these countries' agricultural trade.

¹⁴ The phase-out period for sugar is 15 years but is contingent on the United States becoming a net exporter, which is not expected to occur anytime soon.

1.6. Impact of the Institutional Structure

Governments are not monolithic: the legislature, the executive, and different ministries may have different trade policy preferences and different capabilities. Thus, the institutional architecture for trade policymaking—that is, who is responsible for what, how different actors engage in the process, etc.—can have a profound effect on policy outcomes. The organization of the trade policymaking process may vary across time and across countries, which helps explain differences in trade policy outcomes.

1.6.1. Legislative and Executive Trade Policymaking in the United States

The U.S. Constitution explicitly assigns Congress the power to set tariffs. Congress is made up of 435 representatives and 100 senators, each representing geographically defined districts (and states).¹⁵ Districts vary enormously in their industrial composition: some are heavily agricultural, others largely urban and industrial. Industries tend to cluster, so many congressional districts (and states) have heavy concentrations of specific industries. For example, Kansas produces grain and cattle, while Detroit—and the state of Michigan—is the country’s automotive leader. Members of Congress fight for industries located in their districts, and if a locally powerful industry is protectionist, the congressperson is likely to support protection. Protection imposes costs on downstream industries and consumers, but these externalities are not fully internalized by the protection-advocating congressperson, who is accountable only to his or her district’s voters. Legislators have incentives to engage in “logrolling,” in which members of Congress trade support for the protection of each other’s industries. This can lead congressional trade policy to a high-tariff equilibrium.

The U.S. president is elected by an Electoral College comprising all districts,¹⁶ which means that, unlike members of Congress, the president internalizes the broad national impact of policies.

For over 150 years, Congress used its constitutional power to dominate trade policymaking, generating a strong protectionist bias. This reached its height during the Great Depression with the passage of the Smoot-Hawley Tariff of 1930, which raised tariffs to among their highest levels in American history and elicited retaliation from trading partners.

¹⁵ This section draws heavily from Frieden (2018).

¹⁶ The distribution of electoral votes across states (based on the number of representatives and senators) is roughly proportional to population.

As the Depression dragged on, the Democratic Party, with a strong base in the pro-trade, export-oriented, and farm-based South, won control of both the Congress and the presidency. As a result, during Franklin Roosevelt's presidency (1933–1945), Congress passed the Reciprocal Trade Agreements Act (RTAA) of 1934, giving the president the authority to negotiate up to a 50 percent reduction in tariffs in exchange for similar concessions from trading partners. Moreover, the reciprocal nature of the deals gave exporters an active interest in supporting liberalization, since reducing tariffs would mean increased access to foreign markets for their products. By 1940, these agreements had been signed with 21 countries, covering 60 percent of U.S. imports.¹⁷

The RTAA and successive related mechanisms—including fast-track authority and, more recently, trade promotion authority—allow the president to present a trade agreement to Congress that cannot be amended or filibustered. This gives the executive agenda control and forces Congress to decide whether it prefers the executive's proposal to the status quo. The fast-track procedure shifts bargaining power from Congress to the president. This may be the actual purpose of the legislation: Congress ties its own hands to keep itself from logrolling its way to higher aggregate trade barriers than it would like.¹⁸

Congress has not given over all control to the executive branch. It can refuse to renew fast-track authority, and it plays a major role in treaty negotiations. Yet in many relevant instances the president controls the agenda and strongly influences outcomes. This typically reduces the impact of the local particularistic interests most represented in Congress, and increases the impact of national-level considerations. Until recently, the ability of the president to make take-it-or-leave-it offers to Congress on trade policy issues pushed policy in the direction of trade liberalization. Box 1.1 discusses contemporary trade politics in the United States, which seem to be at odds with this logic.¹⁹

¹⁷ See Irwin (1998) for details.

¹⁸ The rationale for Congress to delegate fast-track authority has been explored in detail by Bailey, Goldstein, and Weingast (1997) and Schnietz (2000).

¹⁹ For lack of space, this chapter will not discuss another important component of trade policy that has a different institutional structure: the management of anti-dumping and countervailing duties, delegated to the International Trade Commission. These policies act as an escape valve, providing relief through protection to industries facing difficulties due to import competition. For a discussion of the political economy considerations regarding this everyday component of U.S. trade policy, see Frieden (2018) and Irwin (2005).

Box 1.1**The Twists and Turns of U.S. Trade Politics**

At the time of this writing, the United States was engaged in a trade war with China, after having recently renegotiated the North American Free Trade Agreement (NAFTA) with Canada and Mexico. What explains the recent evolution of trade politics in the United States? Recall that the post-1930s logic of U.S. trade policy was to give presidents control of the trade policy agenda, as presidents favor trade liberalization more than members of Congress. That institutional logic depended on the idea that presidents, unlike individual members of Congress, are responsible for the national externalities associated with trade policy.

This logic is challenged in an environment in which most U.S. states are solidly and predictably Democratic or Republican. Presidential candidates must compete over the “swing states,” whose votes determine the outcome of presidential elections. U.S. presidential elections are not decided by the popular vote, but in an Electoral College where all of the votes of nearly every state are allocated to the party that obtains the most votes in that state. This means that presidential candidates need to win the median voter in swing states, rather than the median voter in the country. If the pivotal voters of the pivotal states are protectionist, the president will need to attend to their desires.

In fact, the Industrial Belt contains some of the most hotly contested states in U.S. politics. Elections in such states as Pennsylvania, Ohio, Michigan, Illinois, and Wisconsin are fiercely disputed by Democrats and Republicans, which makes them central to the politics of trade policy.

The dramatic increase in manufactured imports from low-wage developing countries since the 1970s contributed to the decline of traditional U.S. manufacturing, whose share in employment fell from 26 percent in 1970 to 10 percent in 2010. This decline, along with stagnant real wages and median household income, fueled skepticism about international economic integration, especially in the country’s industrial heartland. The pivotal electoral nature of these states profoundly affected the politics of trade policy.

Two important factors contributed to growing dissatisfaction with globalization. First, U.S. social and active labor market policies did little to compensate those harmed by the decline of manufacturing or help them transition into new activities. Second, many Americans felt that the country’s political leaders were not taking seriously the concerns of those who were not doing well. These failures of compensation and representation contributed to an upsurge of hostility toward existing political elites and institutions (Frieden 2018). In 2016, Donald Trump took advantage of this sentiment, and of the country’s electoral geography, to win the presidency. His anti-trade rhetoric played well in regions that had lost many manufacturing jobs to trade and technology.

(continued on next page)

Box 1.1 *(continued)***The Twists and Turns of U.S. Trade Politics**

Recent U.S. trade policy has departed from the standard postwar model under which the executive, generally with a pro-trade stance, negotiates free trade agreements that Congress approves, while sectoral protection is provided by anti-dumping and other special trade barriers. Today, the president's stance regarding trade agreements has shifted, and he gets directly involved in matters of sectoral protection. Moreover, trade has risen from the relative banality of special interest politics to the high drama of national electoral competition.

Public opinion on trade is deeply divided and has become increasingly partisan. As the Republican Party turned toward protection, its voters tended to follow suit, while Democrats moved in the opposite direction. In 2009, 59 percent of Republicans and 53 percent of Democrats supported free trade agreements. By 2017, 67 percent of Democrats supported those agreements but only 36 percent of Republicans. For the first time in decades, Republican voters are significantly more protectionist than Democratic voters (Jones 2017).

This discussion illustrates the fact that while, in general, delegating decision-making power to the executive brings an economy-wide perspective to trade policy, excessive executive discretion may lead to policy volatility as parties with different preferences alternate in power. In this context, preserving or even strengthening the oversight function of the legislature on trade policy may lead to more stable and predictable policy outcomes.

The politics of American trade policy is likely to be increasingly volatile. The Industrial Belt will continue to be a battleground where this conflict plays out. Future presidential candidates may find a winning platform that eschews protection, but a protectionist stance has been an important part of national political success over the past few years and will likely continue to be so.

1.6.2. Institutional Architecture for Trade Policy in Chile and Brazil

As in the United States since the 1930s, trade policy initiative in most Latin American countries is mainly in the hands of the executive branch. Legislatures approve trade legislation and vote on trade agreements but can only vote them up or down (Sáez 2005). While the executive has to consider the preference of Congress, it has agenda-setting power and dominates trade policymaking. Within the executive, the role of different ministries varies from country to country. This can have consequences for trade policy. Ministries of industry or trade tend to be closer to industry and more protectionist than finance ministries, which usually consider the economy-wide implications of protection.

Chile: Strong Trade Institutions

In Chile, trade policy is managed by the Directorate General for International Economic Relations (*Dirección General de Relaciones Económicas Internacionales* - DIRECON), within the Ministry of Foreign Affairs. DIRECON's director is jointly appointed by the Ministers of Foreign Affairs and Finance, which gives the Ministry of Finance influence over trade policy.

In addition, Chile's Interministerial Committee on International Economic Relations (CIREI) advises the president on international economic negotiations. CIREI is composed of the Ministers of Foreign Affairs, Finance, the Economy, and Agriculture, the Secretary General of the Presidency, and DIRECON's General Director, who acts as its Executive Secretary.

CIREI has a ministerial-level decision-making body and a technical committee chaired by DIRECON with representatives from the Ministries of Foreign Affairs and Finance. The committee is instrumental in coordinating negotiations among government agencies over the broad issues raised by trade agreements. When agencies cannot reach consensus on an issue, it is brought to CIREI's technical committee. If the committee cannot resolve the conflict, it is brought to CIREI's ministerial committee. In the rare cases when this does not settle the issue, the president has the final word.

Just such a contentious issue arose during Chile's negotiations with the Southern Cone Common Market (Mercosur) in October 1995, and the process of resolving it (discussed in more detail in Chapter 4 of this volume) illustrates the policymaking process. The Minister of Agriculture wanted a long list of products to be exempted from the agreement, and this was unacceptable to the partner countries. Presented with the inability of CIREI to resolve the conflict, President Eduardo Frei made it clear that Mercosur was a priority and ordered the list of exemptions revised to complete the negotiation.

The negotiations with Mercosur also offer a good example of the role of Congress, as well as the importance of compensation in order to advance trade liberalization. In Chile, as elsewhere in the region, Congress is limited to approving or rejecting international agreements, without amendment. The government does have to take into consideration the political viability of the treaties it proposes, however, so the preferences of members of Congress matter. The Mercosur negotiations potentially affected some sensitive agricultural products in regions that were overrepresented in Congress. Parliamentarians representing these regions conditioned their support on measures to offset the negative impact of opening agricultural markets, especially to Argentine producers.

To gain approval of the deal, the government put together a compensation package committing money and services to agriculture. Much of the compensation program aimed to transform Chilean agriculture into an export

industry. It included (1) a fund to promote agricultural exports; (2) the appointment of representatives responsible for promoting Chilean agricultural exports in target markets; (3) credit guarantees for small farmers; (4) irrigation infrastructure; (5) programs for innovation and for soil and forestry management; and (6) a price band system to shield domestic prices from the volatility of international prices. These commitments exceeded US\$200 million per year and ultimately helped increase Chilean agriculture exports from US\$4 billion in 1996 to more than US\$15 billion today.

In Chile, private actors also take part in trade negotiations, mainly through what is called the *Cuarto Adjunto*, or “Side Room.” This allows for information exchange, public-private consultation, and consensus-building to formulate national bargaining positions. During the Trans-Pacific Partnership negotiations, representatives from civil society, including NGOs, unions, and academia, were added to the Side Room, thereby expanding the set of actors involved in the trade policymaking process.

Brazil: Strong Industries

While Chile is among the most open economies in the region, Brazil ranks last in terms of imports as a share of GDP.²⁰ Tariffs fell substantially at the beginning of the 1990s but have remained around 13 percent on average in the context of Mercosur’s common external tariff. Some manufactured goods, such as automobiles, textiles, toys, furniture, and shoes, have tariff rates of up to 35 percent. Moreover, Brazil has signed few trade agreements. Despite a huge increase in agricultural exports and a substantial drop in the share of manufacturing in GDP over the years, protectionist interests, at least until recently, had continued to dominate Brazilian trade policy.²¹

What are the institutional underpinnings of this result?

Like Chile, Brazil has a high-level interministerial body, the Foreign Trade Chamber (*Câmara de Comércio Exterior* - CAMEX), that is responsible for all trade policy matters and was chaired until 2019 by the Minister of Development, Industry, and Foreign Trade (MDIC). Before 2001, the relatively more liberal Ministry of Finance was responsible for tariff policy, and other protectionist measures were decided jointly by this ministry and the MDIC. Institutional changes in 2001 reduced the power of the Ministry of Finance and strengthened

²⁰ See the World Bank’s goods and services tables, available at <https://data.worldbank.org/indicator/ne.imp.gnfs.zs>.

²¹ The participation of the industrial sector in GDP peaked at 32 percent in the mid-1970s but fell below 12 percent by 2017.

the MDIC, whose main constituency was the import-competing industrial sector (see Chapter 3 of this volume).²²

CAMEX determined anti-dumping, subsidies, and countervailing duties, but the MDIC's Department of Trade Defense conducted investigations and proposed trade remedies. The dominant influence of the MDIC may help explain why between 2010 and 2017 Brazil ranked second in the world in anti-dumping cases, having initiated 230 investigations.²³

The main private sector participant in trade policymaking is the Brazilian Business Coalition (CEB), which brings together industry, agriculture, and services, and participates in trade negotiations through a Side Room. While the CEB seeks consensus among sectors, it is dominated by the powerful National Confederation of Industry (*Confederação Nacional da Indústria* – CNI), which represents Brazilian industry, especially import-competing sectors. Thus, both on the public and private sides, interests of import competitors have been well represented in Brazilian trade policymaking.

Brazil's institutional setup resembles Chile's in some respects. Trade policy in both countries is managed by an interministerial council, with substantial private sector participation through the Side Room. However, there are significant differences. Chile's interministerial council is led by DIRECON, whose director is appointed jointly by the Ministers of Finance and Foreign Affairs, both of whom support liberalization. In Brazil, until recently CAMEX was dominated by the MDIC, which was close to industry and regarded protection as a crucial component of Brazil's development strategy. On the private side, while in Chile protectionist interests were weakened by years of liberalization as exporters gained substantial power in the policymaking process, in Brazil, despite industry's relative decline and the rise of export agriculture, industry continues to dominate the trade policymaking process.

It is puzzling why Brazil's exporting agricultural sector has not been more active in supporting trade liberalization. Perhaps with surging demand from Asia and particularly from China, agricultural interests simply do not think existing trade barriers are significant enough for them to confront powerful industrial interests. As long as exports to China are not threatened, the sector has kept its distance from the trade policy arena, allowing defensive industrial interests to hold sway.

This leads back to the steel anti-dumping case discussed earlier in Section 1.2.1. The case provoked fears of Chinese retaliation, which spurred agricultural export-oriented actors into action. They were represented by the Ministry of Agriculture, which publicly argued against imposing steel anti-dumping duties ahead of the decisive CAMEX meeting. The Ministry of

²² For a discussion of the Brazilian trade policymaking process in the 1990s and the decline in the role of the previously dominant Ministry of Foreign Affairs, see da Motta Veiga (2002).

²³ *PC em Foco—Observatório de Política Comercial*, various issues.

Finance, for its part, issued a technical note stressing the adverse effects of adopting protectionist measures. On January 18, 2018, the CAMEX plenary of ministers decided to apply the anti-dumping measure as recommended by the Department of Trade Defense. However, it suspended the application of duties for one year, and recently extended the suspension for another year.

Brazil's trade policymaking process seems to be changing. The Bolsonaro administration has overhauled the cabinet structure, eliminating the MDIC, and subsuming it as a secretariat under the new Ministry of Economy. While the new institutional architecture for trade policy is still a work in progress and the new composition of CAMEX has yet to be defined, there have already been important changes in Brazilian trade policy. On June 28, 2019, after 20 years of negotiations, Mercosur reached an agreement with the EU, though the agreement must still be ratified by the legislature of each member country. Within Mercosur, changes to the common external tariff are being negotiated, with Brazil taking a more liberal stance. While it is difficult to know for sure the extent to which policy changes are attributable to changes in Brazil's institutional structure—for example, they could be associated with the change of ideology in government—these changes are at least consistent with the idea that trade policies are not independent of the relative power of different ministries in the trade policymaking process.

The discussion of the U.S., Chilean, and Brazilian cases presented in this section suggests that institutional architecture matters. To complement this analysis, Box 1.2 presents the case of a unique institution, Australia's Productivity Commission (and its predecessors, the Tariff Board and Industries Assistance Commission), which played an important role in the process of trade liberalization of what was once a highly protected economy.

Box 1.2

Australia's Productivity Commission

Until the early 1970s, Australia was among the world's most protected economies. A competitive primary sector based on abundant natural resources coexisted with a large, inefficient manufacturing sector protected by substantial trade barriers. Strong unions and highly regulated labor markets ensured that the benefits of protection were shared with workers. Protection had broad support from all parties in Parliament, and from the community at large.

Beginning in the 1970s, Australia embarked on a profound trade liberalization process, which then gathered steam in the 1980s under the labor governments of Bob Hawke and Paul Keating. With some exceptions like autos and textiles, which had special regimes and were liberalized later, trade barriers were gradually but relentlessly dismantled. As a result, Australia has become a substantially open economy. But how did this transformation occur? This box

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Box 1.2 *(continued)***Australia's Productivity Commission**

analyzes the role of a unique institution that played a key role in this process: the Productivity Commission and its predecessors.

From the Tariff Board to the Productivity Commission

The history of the Productivity Commission goes back to the establishment in the 1920s of the Tariff Board, an independent advisory body charged with recommending the level of protection to industry. Early on, the Tariff Board was an instrument of protectionist policy. While its mandate was to encourage the development of “economic and efficient” industries, no clear criteria existed to determine whether an industry was economic and efficient. The common practice was to focus on the level of protection required for domestic production to remain competitive, without considering the impact on downstream industries or consumers. To quote a former official, the Tariff Board was “a calculating machine for made-to-order protection” (interview with Terrence O'Brien, November 2018).

But beginning in the late 1960s, under Alf Rattigan's leadership, the Tariff Board changed. Following recommendations from the influential Vernon Report (Australia Committee of Economic Enquiry 1965), Rattigan championed a new approach that involved an economy-wide, systematic tariff review, rather than piecemeal product-by-product analyses of industries' protection demands. It also recommended that objective criteria be used, namely measures of effective rates of protection, to determine what was economic and efficient.

The new approach was opposed by the powerful Minister of Trade, who favored the status quo, with the support of industry. The fact that the Tariff Board had statutory independence and its chairman could not be fired was crucial for Rattigan to turn it around. In 1973, with the backing of incoming Prime Minister Gough Whitlam, Rattigan transformed the Tariff Board into the Industries Assistance Commission (IAC) (Rattigan 1986).

The IAC could extend recommendations on all forms of industry assistance (not just tariffs) and had an explicit mandate to focus on the economy-wide impact of industry assistance. The new focus required new tools: broader measures of effective rates of assistance, including subsidies and tax breaks; general equilibrium models to understand the economy-wide impact of protection; and a broader inquiry process, including consultation with a wider set of stakeholders.

Australia's first liberalization effort—the sudden across-the-board 25 percent tariff cut in 1973—provoked, in the midst of a recession, considerable backlash in the form of quotas, subsidies, and temporary assistance measures. The policy lesson was learned: subsequent efforts in the 1980s were gradual and preannounced, giving firms and workers time to adjust. The IAC played a central

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Box 1.2 *(continued)***Australia's Productivity Commission**

role, providing evidence-based recommendations, involving all stakeholders, and informing the public debate.

In 1989, the IAC became the Industry Commission, and, in 1998, the Productivity Commission. The focus became broader, incorporating issues such as energy, transportation, infrastructure, and eventually social and environmental issues. However, three key aspects of the commission's approach remained unchanged: its independence, transparent and participatory process, and economy-wide mandate.

Independence

The Productivity Commission was established by an Act of Parliament. Its members, nominated by the Treasury and appointed for five-year periods, cannot be removed by the government. The government can tell the commission what to do (for example, which inquiries to work on), but not what to say (Banks 2012). When conducting an inquiry, the Productivity Commission may investigate any issue it deems relevant. It can also conduct and publish research on any subject of its choice, thus bringing into the public debate policy-relevant issues. The commission has exercised this freedom judiciously. Getting into issues the government would prefer not to discuss would probably not be the best way to ensure the commission's survival.

At the same time, the commission issues its recommendations but leaves decisions to the government without heavy-handed attempts to have its recommendations implemented. This is part of the subtle game by which it retains its independence but respects the prerogative of the government to decide what to do.

Transparent and Participatory Process

Every aspect of the Productivity Commission's work is open to public scrutiny, and the process of consultations surrounding an inquiry ensures that all stakeholders can voice their concerns. References received from the government are made public, and the commission invites written submissions from all interested parties. Submissions are published and can be challenged by other stakeholders. A draft report is followed by a public hearing in which interested parties can provide feedback. The final report itself needs to be presented to Parliament within 25 "sitting days." The government does not need to adopt the commission's recommendations, although it typically does. Otherwise it usually explains why it departs from the recommendations, though it is not formally required to do so.

This transparent and participatory process, together with the commission's high-quality technical analysis, has been instrumental in getting rid of

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Box 1.2 (continued)**Australia's Productivity Commission**

bad policy ideas. Interest groups are less likely to propose self-serving policies if they know their proposals will be subject to careful scrutiny and misleading claims will be challenged.

Economy-Wide Mandate

The commission's mandate explicitly stipulates that inquiries must adopt an economy-wide focus. This mandate, strongly opposed by industry in the 1960s and 1970s, has since become a universally accepted feature of the Productivity Commission's work.

The Commission's Role in the Process of Liberalization

The original Tariff Board and successive commissions were advisory boards without executive responsibilities. So how did they affect trade liberalization? As stated earlier, although governments were not compelled to follow their recommendations, they usually did. Moreover, as the Productivity Commission gained credibility, it strongly influenced the public debate.

Perhaps the most important channel of influence for these entities was as providers of information. In addition to the inquiries, the successive commissions published an annual *Trade and Assistance Review*, including measures of effective rates of assistance by industry. These measures were translated into simple figures that the public could easily understand. For example, the 1997 automotive industry inquiry reported that, due to industry assistance, consumers were paying an extra US\$3,400 per year for their cars (Industry Commission 1997, 214). Another routine practice was to convert assistance measures into dollars per protected job. This information, picked up by the pro-trade press, helped change the narrative from "we need protection to save these jobs" to "why are we spending all this money?"

The Productivity Commission also helped bring into the debate interest groups from exporting sectors that would benefit from liberalization. Most prominent among them was the National Farmer's Federation (NFF), which relied on the commission's analysis to argue its case. In the words of a former NFF economist, "The IAC provided the bullets, and we fired them" (interview with David Trebeck, November 2018). It also provided ammunition to Bert Kelly, a parliamentarian representing agrarian interests, who wrote a very influential column in *The Australian Financial Review* explaining in simple terms the costs of protection for exporters and consumers (Kelly 1981).

The Productivity Commission helped build a coalition for trade reform, but it could not have done it alone. Together with exporters, politicians, academia, and the press, it laid the groundwork that eventually made possible the gradual but irrevocable liberalization process of the 1980s.

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Box 1.2 (continued)**Australia's Productivity Commission****Productivity Commissions in Latin America?**

Countries in Latin America would do well to adopt institutions inspired by Australia's Productivity Commission. In fact, Chile has already done so. That is not to say such a process is easy—as in Australia, those promoting such a commission would face resistance within government and from industry. Building such institutions would take time and require careful strategies.

Today's Productivity Commission in Australia is the result of 100 years of history, so attempting to strictly replicate it in the different settings of Latin American countries would be unwise. Still, much can be learned from the Australian experience. The key question is how to start with a less ambitious, more feasible plan involving a minimum viable product that can then gain credibility and gather support as it produces results.

While statutory independence would make it more likely for such a commission to stick once it is up and running, at least in some countries it would also make it harder to launch. One possibility would be to start with a temporary task force or administrative body with a strong leader and a small but competent staff responsible for producing recommendations on a few key sectors or issues. Another option would be to broaden the mandate of an existing institution that has a reputation for independence and analytical rigor.

Choosing the right leader is essential. Success would require someone with solid analytical skills, a stellar reputation of integrity and independence, and the managerial and soft skills necessary to manage the team and the process, navigating through often-hazardous waters. Choosing the right home is important as well. The Australian experience suggests that a Treasury Ministry is a better choice for a group tasked with analyzing the economy-wide impact of policies than a Ministry of Production or Industry that is more closely aligned with the protected sectors themselves.

1.7. Understanding the Rules of the Trade Policymaking Game

In general, the economics profession supports the notion that countries gain from trade. This is more than just a theoretical expectation—it is strongly supported by evidence, as shown by recent IDB reports such as *Trading Promises for Results* (Mesquita Moreira and Stein 2019). But, as expected, the analysis also shows that trade liberalization produces winners and losers. Moreover, both winners and losers participate in the trade policymaking process, trying to steer outcomes in their favor. And lack of sufficient compensation means that those who stand to lose will try to block reform.

Firms that compete with imports, in particular, will press for protection. Those that want access to cheaper imported inputs and that export, and fear retaliation, favor a more open trade regime. This process takes place within an institutional setup for the management of trade policy that may be more or less favorable to trade liberalization, under governments with differing ideologies that are more or less supportive of open trade regimes.

As a result of all of these factors, since the liberalization of the late 1980s and early 1990s, countries in Latin America have had diverse trade policy experiences. Chile doubled down on its early unilateral liberalization through a wide range of trade agreements with most trading partners. Other countries progressed more slowly, while yet others such as Argentina, Brazil, Ecuador, and Venezuela experienced different degrees of policy reversals. Through the detailed discussion of country cases, this chapter has attempted to show real trade policy in action. Several lessons can be drawn from the analysis:

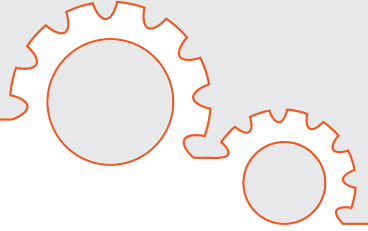
1. ***Trade policy itself impacts the trade policymaking process, affecting the constellation of actors and their interests.*** By creating new economic realities, liberalization, particularly when sufficiently deep and prolonged, can generate the conditions for the liberalization process to take hold and persist. Non-competitive producers adapt or go out of business, while new export producers emerge, as the example of Chile clearly shows. The argument cuts both ways, however. Protection does not just preserve those firms that benefit from it. Policy reversals generate a new cadre of import competitors that will oppose future liberalization and make it more costly to achieve. A case in point is Argentina, where the Macri administration was trying to move to a more open regime after a decade of increased protectionism.
2. ***Compensation can help move liberalization forward, but not all compensation is created equal.*** In the Chilean compensation package for agriculture during the Mercosur negotiations, losers were overrepresented in Congress and, absent sufficient compensation, would have become veto players. Compensation was generous—and fiscally costly—but much of it focused on providing the conditions for transforming Chilean agriculture in a way that favored exports through the provision of public goods. Thus, at the same time that the compensation allowed liberalization to move forward, it also created new actors that would support open markets thereafter. Usually, however, compensation takes the form of inefficient subsidies, price support, or public purchases rather than public goods, and sometimes it delays the reallocation of factors of production toward more competitive firms and sectors. Interestingly, some countries have engaged in what might be called “turning compensation

on its head.” Rather than liberalize and compensate the losers, they kept markets protected and compensated special interest players that would have benefited from liberalization. Ecuador is a good example. Instead of negotiating an FTA with the United States to extend market access provided by the Andean Trade Preference Act (a unilateral concession about to expire), an anti-trade government decided to compensate exporters about to lose such access. So instead of redistributing a larger piece of the pie so that everyone would be better off, the government reduced the size of the pie and compensated those that were powerful enough to block the move or make enough noise.

3. ***Gradual seems to be the way to go.*** Sudden liberalization does not provide private actors time to adapt and may generate significant backlash. A case in point is the across-the-board tariff reduction in Australia in 1973 that led to important reversals. In contrast, the country’s liberalization in the 1980s was gradual and preannounced, and it stuck. Moreover, with the exception of a few sensitive sectors that got longer phase-out schedules, Australia did not discriminate across sectors. Even the Chilean liberalization of 1973 under the military was gradual, with most tariffs declining from about 90 percent to 10 percent uniform tariffs in a period of five years. Argentina’s recent gradualism was different: it had different speeds for different goods, depending on employment and the impact on downstream products. An across-the-board gradual approach would have probably been more efficient, and less prone to elicit rent-seeking. It is not clear, however, whether it would have been consistent with electoral objectives.
4. ***Trade agreements can be a powerful tool for trade reform.*** Several examples from this chapter support this conclusion. FTAs with the United States have been instrumental in opening up rice and sugar markets in Colombia and Costa Rica. While this will be a gradual process with long phase-out periods, the liberalization of these sectors with very powerful lobbies would have been unthinkable without these FTAs. International commitments associated with FTAs can also make it more costly for countries to renege on open regimes, even if society is deeply divided, as the case of Costa Rica and the CAFTA-DR clearly shows.
5. ***The institutional architecture for managing trade policy matters, so public actors with an economy-wide perspective should be heavily involved.*** It is best to involve actors in the decision-making process whose incentives are more closely aligned with those of the economy as a whole. Executives tend to have broader purview than legislators, who care more about protecting industries in their districts. On the other hand, congressional oversight is essential to avoid sudden changes in policy

when executives with different preferences alternate in power. Within the executive, finance ministries tend to have broader incentives than ministries of trade and industry, although the incentives and make-up of the latter vary from country to country. The specific institutional solution may vary across countries, but trade policy is too important to leave in the hands of actors that are too closely aligned with special interests.

6. ***Credible institutions providing independent high-quality analysis can play an important role in moving liberalization forward.*** The case of Australia has important implications for Latin American countries. It shows that an institution like the Productivity Commission can be a powerful catalyst for reform by engaging in high-quality analysis of the costs and benefits of protection, providing advice to government, and disseminating the results. While Latin American countries may not be able to exactly replicate this institution, they may be able to adapt it to their local conditions and preserve its most important features, including some level of independence, transparency, participatory processes, and an economy-wide focus. The early success of the Productivity Commission in Chile suggests that it can be done.
7. ***While the political economy of trade policy is usually dominated by special interests, there are times when voters/consumers become deeply involved.*** This broader participation tends to result from episodes of import surges, negotiation of important trade agreements, or, more broadly, anti-globalization events. At times like these, understanding the incentives of special interests and the way they play the trade policymaking game is not enough. It is important to understand attitudes toward trade among the population as a whole, an issue discussed in some detail in Chapter 6 of this volume on Costa Rica, and, from a more general perspective, in Chapter 6 of Mesquita Moreira and Stein (2019).



The Challenges of Leaving Protectionism Behind: The Political Economy of Trade Policy in Argentina

Juan O'Farrell, Martín Obaya, and Anabel Marín

In 2015, the government of Argentina experienced a significant shift in its programmatic orientation from an administration characterized as left-of-center and interventionist to one considered right-of-center and market friendly.¹ The contrasts between the *Frente para la Victoria* (2003–2015) and *Cambiamos* (2015–2019) administrations were particularly visible regarding trade policy preferences. The administration of Mauricio Marci of *Cambiamos* took power with an ambitious trade liberalization agenda.²

The objective of this chapter is to understand the political economy factors that explain the scope and pace of import liberalization in Argentina between 2015 and 2018. This period offers an interesting case to examine the political and institutional challenges faced by a liberal administration trying to reverse many years of protectionist policies. The chapter aims to address, in particular, the following research questions:

- What political economy factors determined the government's trade policy strategy?
- What were the trade liberalization tactics adopted by the government? This includes the analysis of specific trade policy tools and

¹ For more on these characterizations of the parties see Etchemendy and Garay (2011), Bonvecchi (2011), Vommaro (2017), and Casullo (2016).

² In 2019, *Cambiamos* lost the presidential elections against a left-leaning coalition (*Frente de Todos*) formed by the main leaders and organizations of the *Frente para la Victoria*.

complementary policies to alleviate resistance from the affected groups.

- What mechanisms did import-competing firms put in place to confront trade-opening initiatives?

A multiple case study analysis designed to discuss these questions compares three industries: (1) textiles and apparel, (2) flat steel, and (3) computers. The primary criterion for the selection of cases was to cover different government trade policy strategies. While during the episode covered a higher priority was given to the liberalization of computers and intermediate inputs like steel, a more gradual stance was adopted toward textile and apparel.

The analysis of the trade policy in each industry is conducted around selected revealing episodes that work as starting points for the research. For the textile and apparel sector, the establishment and administration of non-automatic licenses are analyzed. In addition, the analysis examines attempts by key stakeholders to set up a textile and apparel roundtable. For the flat steel industry, the analysis looks at the removal of non-automatic licenses on selected products. Finally, the analysis of the computer industry examines two episodes: first, the removal of import tariffs on personal computers, notebooks, and tablets; and second, a tripartite agreement signed within the framework of Tierra del Fuego's special promotion regime among business associations, trade unions, and government. The analysis also looks at selected episodes related to the administration of other products covered by this special regime, as they offer interesting comparative insights related to the case of computers.³

The analysis of these episodes seeks to understand the influence of three types of factors:

1. Determinants of the government trade policy strategy

The *Cambiamos* administration considered the inward-looking orientation it inherited from the previous administration to be a limitation to economic development. During the presidential campaign, Macri's political coalition advanced the idea of a more open economy, with talk of "intelligent integration into the world." A more open economy was conceived as a necessary condition to improve productivity and living standards.⁴

³ For sources of information, the authors rely on primary and secondary data, including 20 interviews with relevant stakeholders from the private and public sector (see the list of interviews in Annex 2.1).

⁴ As outlined in the Ministry of Production's 2016 *Plan Productivo Nacional*.

However, aware of the majoritarian public rejection of the neoliberal reforms of the 1990s and their association with the 2001 crisis, the government promised a more sensible approach to reform. The *Cambiamos* administration tried to differentiate itself from past right-of-center experiences by presenting its program as a combination of market liberalization with progressive ideals, such as poverty reduction, while rejecting the temptation to revert to Argentine populism (Casullo 2016).

The government also took into consideration the “sensitive” nature of the sectors. This attribute regarded the capacity of producers to face international competition resulting from a process of trade liberalization. Both the apparel and computer industries met this condition. However, the “sensitiveness” also concerned employment levels and the capacity to reallocate jobs to more competitive sectors. This helps to explain why the liberalization advanced faster in the computer sector, where employment levels were lower. By contrast, in the apparel industry the government adopted a more gradual liberalization, while providing support for the migration of workers to more competitive firms. The liberalization of sensitive industries was also affected by strategic political considerations, particularly in crucial electoral districts in the suburbs of Buenos Aires.

2. Tactics adopted by the government to advance with the liberalization process in each of the selected industries

As in previous liberalization processes, the government implemented tactics to minimize opposition from potential losers and gain support from potential winners. This chapter attempts to understand the effectiveness of three types of mechanisms used by the government across the selected episodes, conceptualizing them as mechanisms of compensation, transformation, and consensus.

- *Compensation mechanisms:* “Compensation” is understood as the state granting alternative sources of business or resources to firms or groups negatively affected by liberalization. The purpose is to neutralize resistance to free trade.
- *Transformation/adaptation mechanisms:* Transformation mechanisms are conceived as policy initiatives to strengthen firms’ and workers’ capabilities to transit from firms negatively affected by liberalization toward more competitive and dynamic firms and sectors. In particular, the analysis will look at the role played by the *Programa Nacional de Transformación Productiva* (PNTP). This program sought to facilitate the reallocation of people while protecting displaced workers by providing more generous unemployment benefits and job search assistance to seek out dynamic firms and sectors.

- *Consensus mechanisms:* Consensus mechanisms are understood as the creation of formal institutional spaces for deliberation and negotiation among public and private stakeholders. This includes sectoral dialogues and the Tripartite Agreement for Competitiveness of the electronics industry. The main aim is to create conditions for the industry to adapt to free trade.

3. Sources of influence of import-competing sectors

This analysis looks at how the power of potential losers affected the liberalization process, identifying different sources of influence. Structural power derives from a firm's ability to make decisions to invest or reduce/close down operations, with consequences on employment and economic activity. Citizens' fear of economic deterioration is likely to generate pressure on policymakers (Hacker and Pierson 2002, 281). Instrumental power originates in business relationships with policymakers (partisan linkages, institutionalized consultation, recruitment into government, election to public office, and informal ties) and business resources (cohesion, expertise, media access, and money) (Fairfield 2015).

In addition, this chapter analyzes how intra-value chain coordination affected the trade liberalization process. The literature on business politics argues that sectors that come together to make common demands confer legitimacy to their claims and increase the costs of divide-and-conquer strategies (Fairfield 2015). As a result, they are more likely to get what they want (Frieden 1991). This chapter aims to expand this argument by assessing the role of cooperation between actors operating in different stages of the value chain with prior divergent preferences for free trade.

These business power considerations must be framed in Argentina's economic and trade policy trajectory. Protectionism has been a historical feature of the country that has reinforced protectionist interests (López and Pascuini 2018; Leiras and Soltz 2006). Considering policy feedback effects in which "policy creates politics" (Pierson 1996), the persistence in time of a protected economy politically strengthens the actors that benefited from protection. In this context, the government tactics described above become more relevant to break resistance to liberalization and build export coalitions.

The next section analyzes trade policy tools during the *Cambiamos* administration, and the three sections that follow are dedicated to the specific cases of the textile and apparel, flat steel, and computer sectors. The analysis is guided by the political economy factors mentioned above: government strategy, government tactics, and business power. The chapter then turns to a general discussion of the role of these political economy

factors in the resulting scope and pace of import liberalization during the *Cambiamos* administration.

2.1. Trade Policy in Argentina under the Macri Administration

2.1.1. Policy Tools

In terms of policy tools, the aim of the government can be summarized as follows: (1) to lower tariff barriers within the limits imposed by the Southern Cone Common Market (MERCOSUR) Common External Tariff (CET) rules; (2) to replace the system of non-automatic import licenses (NALs) put in place by the previous administration with a new scheme of licenses that respected the rules of the World Trade Organization (WTO); (3) to introduce changes in anti-dumping measures; and (4) to increase the use of technical regulations to replace nontariff barriers to trade, such as NALs. The sections that follow summarize how these policy tools were managed under the Macri administration.

Tariffs: Lowering Protection within the Limits of the Common External Tariff

As Argentina is a member of MERCOSUR, its tariff protection is largely determined by the CET of the customs union. This constrains Argentina's autonomy to use this policy tool. The Most Favored Nation weighted average CET is around 12 percent, which is much higher than the CETs adopted by other Latin American countries (7 percent), North America (3 percent), and Europe (4.3 percent).⁵

Also, tariff levels applied to basic and intermediate inputs are particularly high. There is a big jump between the tariff applied on raw materials (1 percent) and those applied on basic inputs (10 percent) and intermediate inputs (13 percent). Furthermore, the CET on "sensitive" products is above the average, reaching 20 percent, with peaks of 35 percent in footwear and garments, 25 percent in footwear parts, and 22 percent in yarns and fabrics. The structure of the CET in many cases resulted in negative effective protection on the very goods whose production it was meant to promote. For these reasons, one of the primary objectives of the government was to lower the tariff on basic inputs affecting many downstream industries.

In the short run, the autonomy of the government to change the tariff structure was limited to the exceptions to the CET agreed upon by MERCOSUR member countries. Besides the exclusion of the sugar industry (five tariff

⁵ Source: World Bank, World Integrated Trade Solutions database.

Box 2.1**List of Exceptions from the MERCOSUR Common External Tariff**

National List of Exceptions (LEN): Allowed for 100 tariff lines to be excluded until 2021 from the Common External Tariff. Argentina was near the limit with 90 positions.^a

List of Temporary Increases (LET): Allowed for an exceptional and temporary increase in tariffs in 100 tariff positions. Argentina included 92 tariff lines in this list.^b

List of Capital Goods (BK): Exceptions in these products are allowed until 2021. A total of 322 positions were included with a tariff of 2 percent.^c

List of Computer Goods and Telecommunications (BIT): 182 positions free of tariffs were included in this list.

^a The list of products is defined in Annex I of Decree 847/2018 (September 9, 2018).

^b The list of products is defined in Annex II of Decree 847/2018 (September 25, 2018).

^c The list of products is defined in Annex I of Decree 837/2018 (September 19, 2018).

lines) and automotive industry (57 tariff lines), there are four main types of exceptions from the CET (Box 2.1).⁶

In the short term, the strategy focused on making more efficient use of the lists of exceptions. For instance, in the case of the National List of Exceptions, some intermediate inputs scarcely used in domestic production were replaced by products with a higher share in the import structure. The last modification of the lists was carried out in September 2018. In the medium term, the government intended to negotiate an expansion of the lists. In the long run, an all-encompassing reform of the CET was expected to be discussed with MERCOSUR member countries.

Import Licenses: Gradual Removal of Non-Automatic Licenses

Before the Macri administration took power, the government had already decided to remove the Advance Sworn Statements of Import (DJAI), as the WTO objected to it. The government adopted a strategy of gradual “organized withdrawal” from the scheme—which, in essence, operated as a NAL—to protect jobs and the survival of viable firms with competitive potential. The tariff lines included in the DJAI regime remained covered by the *Sistema Integral*

⁶ Other special non-harmonized trade regimes, preferential trade agreements with third countries, and commercial defense practices have not been considered here.

de Monitoreo de Importaciones (SIMI). The system was designed as a transitory mechanism of import licenses, more transparent and less discretionary than the DJAI. It was conceived as a tool to manage a progressive process of liberalization, particularly for sensitive industries.⁷ The Secretary of Commerce committed to remove restrictions gradually and replace them with technical regulations, regarded as a more transparent tool.

The SIMI included automatic and non-automatic import licenses, neither of which could discriminate among applicants or countries of origin. Whereas the former had to be approved within 10 days, the NALs had to be granted within 60 days. Licenses could only be rejected based on formal mistakes in the application procedures (e.g., incomplete or incorrect data). Therefore, they could be used to delay but not to restrict imports (at least in theory).

With the SIMI, the government enacted non-automatic licenses for 1,665 tariff lines. This included 22 percent of imports across all industrial sectors, with a significant predominance of textiles, which accounted for 44 percent of the total. NALs were to be removed first from products with “natural” protection (e.g., high transport costs) or not produced in the country. Protection would be kept longer for industries that might otherwise be under pressure, especially those with high employment. The liberalization of sensitive industries would be carried out in parallel with a restructuring process.

The first step was the removal of 313 tariff lines in January 2017. In March 2018, 158 lines were eliminated. By October 2018, a total of 1,194 remained in force, with 53 percent corresponding to textiles and apparel.

Anti-Dumping

Two government bodies took part in the process of investigating and determining the anti-dumping duties: the National Commission of Foreign Trade (*Comisión Nacional de Comercio Exterior* - CNCE) and the Unfair Trade Directorate (*Dirección de Competencia Desleal* - DCD). Both operated under the umbrella of the Ministry of Production. Argentina has used anti-dumping measures extensively, being the fifth largest global user. Around 15 percent of the tariff lines were affected by anti-dumping measures, representing around 1.5 percent of imports. The demand for anti-dumping was highly correlated with the macroeconomic situation—particularly the evolution of manufacturing activity and the exchange rate (Nogués and Baracat 2005; Berlinski 2008)—and the level of protection. During the Macri administration,

⁷ The DJAI system, in contrast, was conceived as a tool to curb the external deficit. In fact, the authorization to import was often conditioned on the commitment by the importer to export other products—even products not produced by the firm—to offset the foreign exchange outflow.

requests for advice to the CNCE peaked at 72 in 2016, when the DJAIs were removed. Between 2012 and 2016, when the system was in force, the number of requests had averaged 15.

Progress in the Development of Technical Regulations

Compared to other countries, Argentina uses trade regulations very little. In 2016, Argentina had 566 technical regulations, compared to 4,638 in the United States, 2,369 in China, 2,024 in Brazil, and 1,638 in the European Union. One pillar of the trade policy strategy was to progressively replace NALs with trade regulations. Additionally, this was expected to foster quality in domestic production. Although the government managed to make some progress in this area, the outcomes fell short of expectations.

The design of trade regulations is a complex and negotiated process involving multiple public and private actors and a large variety of activities. It involves the definition of standards, compliance tests, inspection procedures and certifications, among other matters. Interest groups attempt to impose rules that protect them from foreign competition. This effort, plus the fact that the first team created to manage it lacked the capabilities to do so, partly explains why the Argentine government was unable to make much progress in expanding trade regulations.

2.1.2. General Outcome

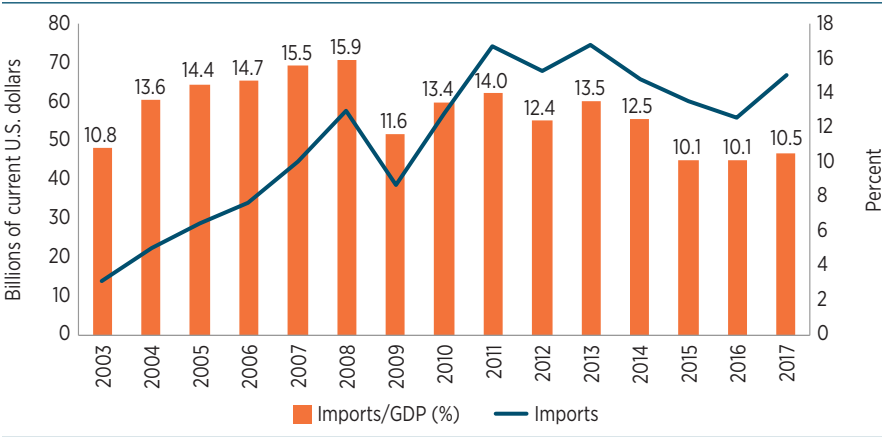
After a moderate drop in 2016, imports increased substantially in 2017. However, they remained below peaks reached in previous years (Figure 2.1). The appreciation of the exchange rate and the adoption of the SIMI—which was more relaxed than the DJAI regime—were among the most important factors accounting for this performance. Despite this expansion, in 2017 Argentina was still one of the most closed economies in the world in terms of its imports-to-GDP ratio, third after only Brazil and Sudan, according to the World Bank.⁸

2.2. Case Study 1: The Textile and Apparel Industry

Given the “sensitive” nature of the textile and apparel industry, the government adopted a gradual opening strategy for it. Nonetheless, there were differences across the various value chain segments and products. The liberalization was faster for products with a high impact on downstream prices and low employment, such as synthetic yarns and low-quality cotton

⁸ World Bank data, available at <https://data.worldbank.org/>.

Figure 2.1
Evolution of Imports and Imports/GDP



Source: Instituto Nacional de Estadística y Censos de la República Argentina.

yarns. The idea was that more dynamic and competitive segments should absorb employment losses of the less competitive segments or products undergoing “transformation.”⁹

Textile and apparel imports increased significantly during this period. However, the pace and depth of trade liberalization fell short of initial government expectations. One of the main limitations was the weakness of consensus and transformation mechanisms adopted by the government in an adverse macroeconomic context. At the same time, some of the private sector actors were able to articulate protectionist interests across the value chain.

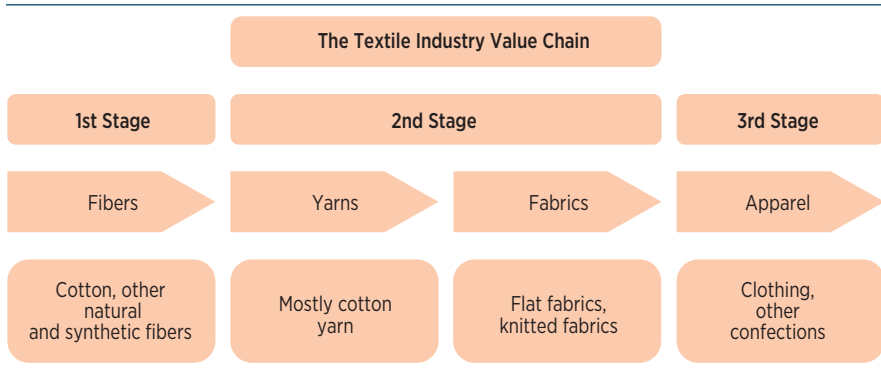
2.2.1. Brief Description of the Industry

Figure 2.2 depicts the structure of the textile and apparel value chain. The first stage corresponds to the production of fibers, such as cotton or other natural or artificial fibers. In the second stage, yarns and fabrics are manufactured. Apparel is produced in the third stage. This chapter focuses on stages 2 and 3.

Yarn production is the most capital-intensive stage of the chain and operates with larger economies of scale. Consequently, it is the most concentrated segment. TN&Platex, Tipoití, and Mafissa are some of the largest players in this segment. These firms have a particular interest in protecting not just their segment, but also downstream segments such as fabrics and apparel, which are their main customers.

⁹ See the Ministry of Planning’s 2016 *Plan Productivo Nacional*.

Figure 2.2
Structure of the Textile and Garment Value Chain



Source: Prepared by the authors.

Although synthetic and cotton yarns share some characteristics, the latter segment is considered to have competitive potential, since Argentina is a large cotton producer.¹⁰ Cotton fabrics are produced by a large number of medium-sized and large companies spread out across the country. By contrast, synthetic flat fabrics were supplied by just one synthetic yarn producer (Mafissa) that had competitiveness and quality problems. Hence, the government decided to keep protection of cotton yarns temporarily while liberalizing synthetic yarns.

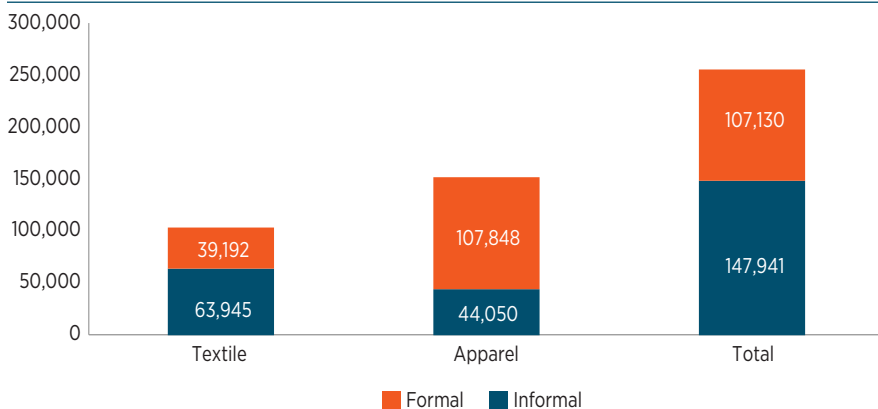
The main clients of yarn producers are companies that produce knitted and flat fabrics. There are around 500 knitted fabric producers, mostly small and medium-sized enterprises (SMEs), with around 10 large companies. They have some natural protection because of product differentiation and timing demands from seasonal and fashion changes. A large majority (95 percent) of imported knitted fabrics are synthetic, mostly from China.

In the third stage, fabrics are used to produce apparel. Clothing production takes place during this stage, which has the highest labor intensity and is the most atomized stage. The most labor-intensive garment products (coats, suits, and jackets) are those with the highest share of imports. Other textiles include both bath and kitchen towels, sheets, and linens, among others.

The value chain is completed with large retailers such as Zara, Falabella, and Walmart. These are the main importers, along with supermarkets and international firms such as Adidas and Nike. This group also includes local apparel firms that make much of their products abroad, like Rapsodia and Cheeky.

¹⁰ See the Ministry of Planning's 2016 *Plan Productivo Nacional*.

Figure 2.3
Total Employment Estimate in the Textile and Apparel Industries in Argentina, 2017



Source: Comisión Nacional de Comercio Exterior based on information from the Observatorio de Empleo y Dinámica Empresarial/Ministerio de Trabajo, Empleo y Seguridad Social.

One important motivation of the government to liberalize this segment was the high domestic prices of apparel. According to estimates by the CNCE, in 2018 a basic wardrobe cost US\$1,790 in Argentina. The average in Latin America was US\$1,200. Price gaps were particularly large in sweaters and coats.¹¹

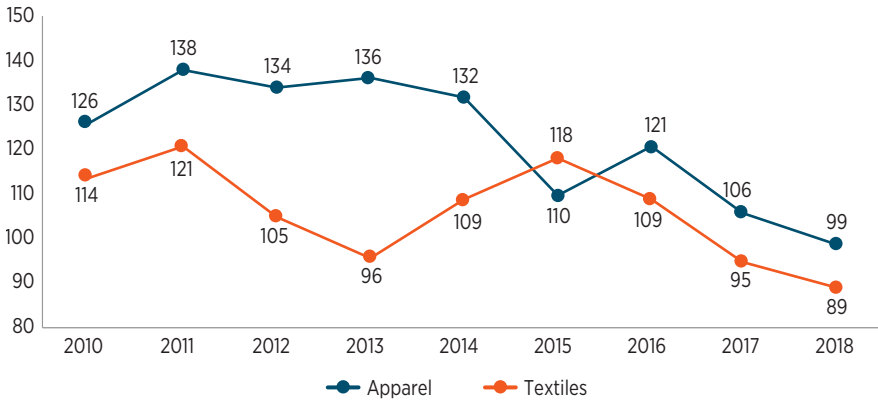
The level of employment at risk was the primary motivation to keep the sector overall protected. By the end of 2017, according to official estimates, the textile and apparel segments employed 255,000 workers,¹² 58 percent of whom were formal and 42 percent informal (Figure 2.3). Informality reached a peak of 71 percent in the apparel segment, which accounted for 60 percent of total employment. This figure almost doubled the share of informality in the textile segment.

2.2.2. Evolution of Production and Imports

Production and employment in the textile industry fell significantly between 2016 and 2018 because of a combination of a sharp contraction of domestic consumption and an increase in imports. The accumulated decline in the production volume of both textiles and apparel was 18 percent (Figure 2.4). As a result, capacity utilization bottomed out in February 2018 to a level of 48.3 percent.

¹¹ Calculations based on data from the e-commerce platform Linio.

¹² Business associations usually state that total employment is 450,000.

Figure 2.4**Textile and Apparel Production, Physical Volume Index, 2010:Q1–2018:Q1 (2004 = 100)**

Source: *Monitor de la Economía Real*, September 2018, Ministry of Production.

During this same period (2015–2017), import values increased 9 percent, with heterogeneity by segment (Figure 2.5). The clothing and other apparel segments were well above the average, with accumulated growth of 63 percent (the largest increase economy-wide) and 46 percent, respectively. By contrast, because of the sharp decline in apparel production, imports of fabrics and other textiles dropped by 4 percent, while that of fibers and yarns fell by 20 percent. Hence, local firms were negatively affected by both a smaller domestic market and a larger import share. In the clothing segment, the share of imports over domestic consumption doubled from 3 to 6 percent, while for fabrics it increased from 15 to 19 percent (Alfie and Tavosnaska 2018).

2.2.3. The Political Economy of Trade Policy in the Textile and Apparel Industry

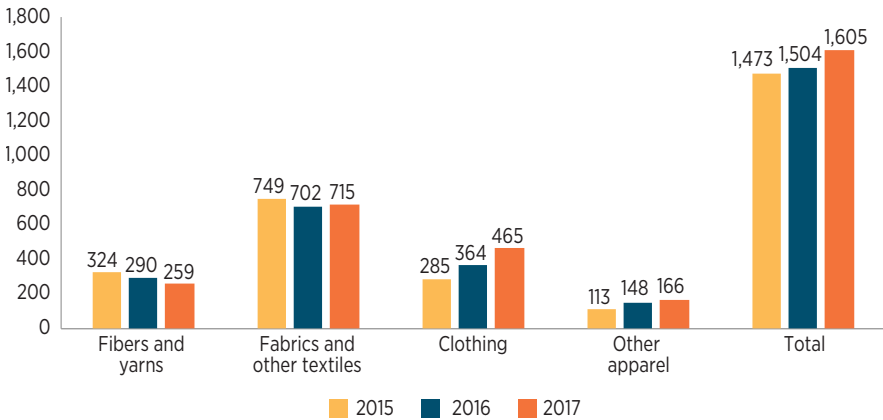
Trade Policy Strategy: The Use of Non-Automatic Licenses as a Tool for Protection

Despite imports increasing sharply, during the *Cambiamos* administration most of the instruments protecting the textile and apparel industries remained in place. The CET levels were maintained: 26 percent on fabrics, 35 percent on apparel, and 14 to 35 percent on other textiles.

The SIMI system—which replaced the DJAI—established non-automatic licenses on 1,665 tariff lines. A total of 633 tariff lines corresponded to textiles

Figure 2.5

Import Value, 2015–2017 (including cost, insurance, and freight; in millions of U.S. dollars)



Source: Comisión Nacional de Comercio Exterior based on information from Customs.

and apparel segments. The sector's main business associations—Pro-Tejer,¹³ *Federación de Industrias Textiles Argentinas*, and *Cámara Industrial Argentina de la Indumentaria*—took part in defining the tariff lines to be subject to non-automatic licenses under the new scheme. The negotiation between the government and the business associations began before the new administration took office,¹⁴ since the former government had already committed to remove the DJAIs.

The textile industry, considered one of the “sensitive sectors” to be preserved,¹⁵ accounted for over 44 percent of the protected products. In fact, the number of tariff lines protected with NALs was greater than those protected under the DJAI regime. The decision was celebrated by the industry, as it dispelled fears about the adoption of an aggressive trade-opening strategy.¹⁶

However, just a few months later, the business associations raised concerns about a surge in garment imports. This increase was linked to a large number of licenses that were pending under the DJAI system but had been

¹³ Technically, Pro-Tejer is not a business association but rather a nongovernmental organization.

¹⁴ The leaders of the business associations stated that they held conversations with the three main candidates before the elections in October 2015. See Carlos Manzoni, “Claudio Drescher: ‘Estoy convencido de que la moda ha muerto,’” September 14, 2015; and Hernán Seara, “Pro Textil 2015: Convención Textil Anual Argentina,” *Textiles Panamericanos*, February 2, 2016.

¹⁵ Resolution 5/2015, Ministry of Production, December 22, 2015.

¹⁶ “El Gobierno mantiene la protección industrial,” *La Nación*, December 24, 2015.

authorized in response to pressures by importers and retailers.¹⁷ Moreover, the SIMI was much more permissive than the DJAI system, which probably contributed to the import increase.

In January 2018, the Secretary of Commerce removed non-automatic licenses on 314 tariff lines, including cotton yarn, which had experienced declining imports because of sluggish demand downstream. Over the course of the year, protectionist pressures relaxed as the Argentine peso devalued. By October 2018 tariff lines applied on textiles and apparel represented 53 percent of the 1,194 NALs that remained in force.

In Search of Dialogue: Consensus and Transformation Initiatives

In April 2016, the Ministry of Production called in the key actors in the value chain to discuss changes in the regulation of the industry. But public participation was kept at a low political level. The private sector interpreted this as a sign of a lack of commitment from the government and a “distraction strategy” to gain time while advancing with the liberalization.

In April 2017, in the context of sluggish demand, job suspensions, and surging imports, the government and business and union representatives of the textile, apparel, and footwear industries agreed to launch a “roundtable for dialogue.” This time, the government was represented by the Ministries of Production, Labor, and Treasury. The agenda was organized around four priority issues: (1) consumption stimulus; (2) employment protection; (3) the drafting of a bill to foster the formalization of precarious jobs; and (4) improvement of export competitiveness of domestic industry.

The government addressed some of these issues early on. First, it established a fund to finance the consumption of domestic products in three to six interest-free installments. Second, it created an “express” facility under the Productive Recovery Program (*Programa de Recuperación Productiva - REPRO*). This program subsidized employment up to a minimum wage for up to one year. Applicant firms had to prove they were in a critical situation, present a plan for recovery (not binding in practice), and commit not to fire personal. Third, it raised export drawbacks from 6 to 8 percent.

In November 2018, the government approved a demand of the industry by decree: a sector-specific reduction in employer contributions. In addition, it announced measures to stimulate consumption by establishing a “fashion week” with credit facilities.¹⁸

¹⁷ “Importaciones: un fantasma que asusta, pero no muerde,” *La Nación*, July 24, 2016; and “Industriales negocian cupos con el Gobierno para regular importaciones el año que viene,” *El Cronista*, September 8, 2016.

¹⁸ See Infobae, November 22, 2018.

The Ministry of Production insisted that firms apply to the PNTF, which provided generous unemployment insurance to laid-off workers, as well as technical and financial assistance to restructure uncompetitive firms and reorient their activities (Mesquita Moreira and Stein 2019). At the same time, the PNTF offered employment and investment subsidies to help place displaced workers in other “dynamic” firms with competitive potential. By October 2018, 10 firms from the textile and apparel value chain were receiving benefits from the PNTF as “transformation” firms, and a similar number were under evaluation. However, many firms thought the program was not adequate to address the problems of the industry given the economic contraction it was going through.

Geographical Distribution of Employment and Electoral Incentives

As seen above, in 2017 the textile value chain in Argentina employed 250,000 people—accounting for 2.1 percent of total national employment—and 58 percent of those employed in the sector were informal (Figure 2.3). Over two-thirds of textile and apparel jobs are in the electorally sensitive area of Metropolitan Buenos Aires, which includes the city of Buenos Aires and its suburbs.¹⁹ The industry accounts for nearly 4 percent of private formal workers in the area, and a much higher proportion of informal workers. In the suburbs, the textile industry is concentrated in the electoral third section of the province of Buenos Aires. This area usually has the highest unemployment rates in the country and has 4.5 million registered voters, representing 15 percent of the national electorate.²⁰

The rest of the textile jobs were distributed among the less developed provinces of the North West and North East. Most of the firms in these provinces benefited from special industrial promotion regimes dating back to the 1970s. According to the Ministry of Production, the industry employed between 20 and 30 percent of workers in these provinces, which have few other dynamic sectors with sufficient capacity to absorb displaced textile sector workers.²¹

Between the first quarter of 2016 and the first quarter of 2017, in the context of a stagnant economy and increasing textile and apparel imports, the textile value chain in the suburbs of Buenos Aires suffered a decline in formal employment of 3.9 percent. In some provinces in the North West and

¹⁹ Observatorio de Empleo y Dinámica Empresarial/Ministerio de Trabajo, Empleo y Seguridad Social.

²⁰ According to the Junta Electoral de la Provincia de Buenos Aires.

²¹ Not-for-attribution interview with an official from the Ministry of Production.

North East, the decline was much larger, particularly in Tucumán, where it reached 18.2 percent.²²

Sources of Influence of Import-Competing Sectors

Another factor explaining trade policy outcomes in this industry is the influence of business organizations representing the textile value chain, particularly Pro-Tejer. This organization is effective in maintaining the cohesion of the industry by promoting intra-value chain coordination and cooperation mechanisms. After the economic turmoil experienced by the country in the early 2000s, the founders of Pro-Tejer—mainly producers of yarns and fabrics—understood that for them to survive they had to protect downstream apparel and design firms, which they characterized as small enterprises with no voice in policymaking. In this sense, their strategy involved achieving cohesion of the different segments of the industry and creating a single voice to project their concerns to society and the government.²³ This comprehensive view of the value chain was a clear departure from traditional business associations in Argentina.

Pro-Tejer had robust technical expertise, which enhanced the effectiveness of lobbying by legitimizing business demands. It was effectively used to frame business interests as congruent with the country's development goals (Fairfield 2015). The organization relied greatly on media access. The strategy to influence policymaking consisted of shifting public discourse about the textile sector. Pro-Tejer financed and organized media and other high-profile events with officials and generated statistical information about the relevance of the sector. It made efforts to change the prevalent image of an inefficient industry and re-affirm its productive capacity, competitive advantages, and value-added contributions. Another goal was to re-legitimize demands for protection and reject “indiscriminate imports” by pointing to the sector's contribution to employment and economic activity (Bisang et al. 2014).

According to officials interviewed for this chapter, Pro-Tejer's influence on public opinion regarding the textile sector contributed to restricting the scope for trade liberalization by increasing the political costs of negatively affecting the sector. Although officials' perceptions and diagnoses about the sector probably remained unchanged, Pro-Tejer's activism might have contributed to influencing the terms of the public debate and defining policy options considered appropriate.

²² Observatorio de Empleo y Dinámica Empresarial/Ministerio de Trabajo, Empleo y Seguridad Social.

²³ Interview with Teddy Karagozian, August 2018.

2.3. Case Study 2: The Flat Steel Industry

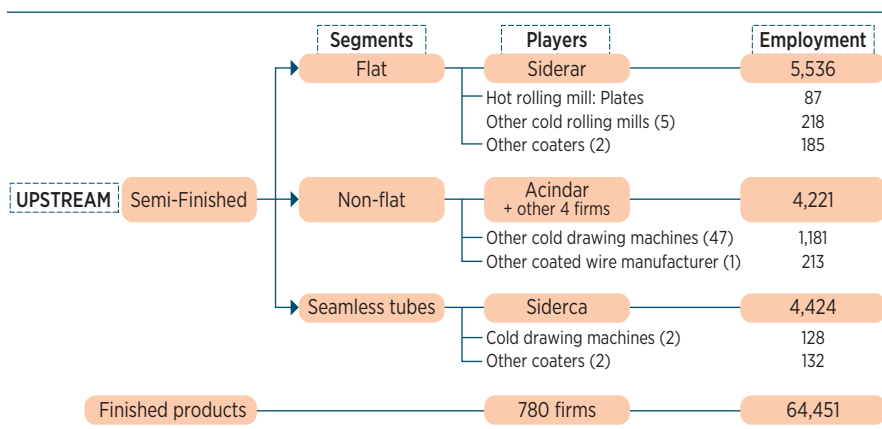
2.3.1. Brief Description of the Industry

The steel industry produces basic inputs for a wide range of manufacturing activities. This places it at the core of many manufacturing value chains of the economy. According to estimates, the price gap between imported and domestically produced flat steel products ranged between 25 and 34 percent in 2018. Due to the industry’s significant influence on the competitiveness of the economy, the Macri administration focused a great deal of effort on lowering the domestic price of steel. One of the primary tools to advance this agenda was the removal of trade barriers.

The upstream segment—that is, steel semi-finished products—can be divided into three sub-segments: flat steel, non-flat steel, and seamless tubes. Together they account for over 14,000 jobs in Argentina (Figure 2.6). In 2018, on the downstream segment of the chain—that is, finished products—there were around 780 firms employing 64,500 workers. This included the automotive, construction, agricultural machinery, and white line appliances industries, among others. Although most final users were formally organized in sectoral business associations, the interaction among these associations was rather limited.

The value chain shows a high level of concentration in the upstream segment with a single dominant firm in each sub-segment: Tenaris in seamless tubes;

Figure 2.6
Structure of the Steel Value Chain



Source: Comisión Nacional de Comercio Exterior.

Note: Ternium Siderar and Tenaris are part of the Techint Group.

Acindar in non-flat steel;²⁴ and Ternium Siderar in flat steel, which is the case study for this chapter.²⁵ At the time of writing, Ternium Siderar had a production capacity of 3,200 tons of crude steel (slabs). The company was operating at 77 percent of installed capacity and accounted for at least 90 percent of domestic production in each product line. Import penetration of flat steel products remained at an average level of 14 percent between 2002 and 2016. This represented a fall from the average of 23 percent between 1994 and 2001. Flat steel imports remained highly concentrated in a few hands, with Ternium Siderar the largest importer, accounting for 44 percent of total imports. The rest of imports were distributed among a few service centers and distributors. In the case of the distributors, many of them had exclusivity contracts with Ternium Siderar, which set conditions on the types of products that could be commercialized.

2.3.2. The Political Economy of Trade Policy in the Flat Steel Industry

Trade Policy Strategy

Liberalization of the steel industry—together with other basic inputs, such as aluminum and plastics—was one of the main targets of the trade policy strategy of the Macri administration. The government considered that the protection offered by the CET to basic inputs was excessive—in the case of steel, 12 percent for most tariff lines. However, although the government made progress in its liberalization agenda, some domestic and external factors hindered the advance of the plan.

Non-Automatic Licenses

The most significant progress on the government's liberalization objectives was achieved with NALs. With the adoption of the SIMI in 2016, the government implemented NALs on 29 of over 55 tariff lines of steel without alloy products. This accounted for 95 percent of the total imports of these products (US\$186.6 million) (Figure 2.7). In January 2018, the Secretary of Commerce promulgated Resolution 5-E/2018, which removed NALs affecting 314 tariff lines, including all those imposed on flat steel products.

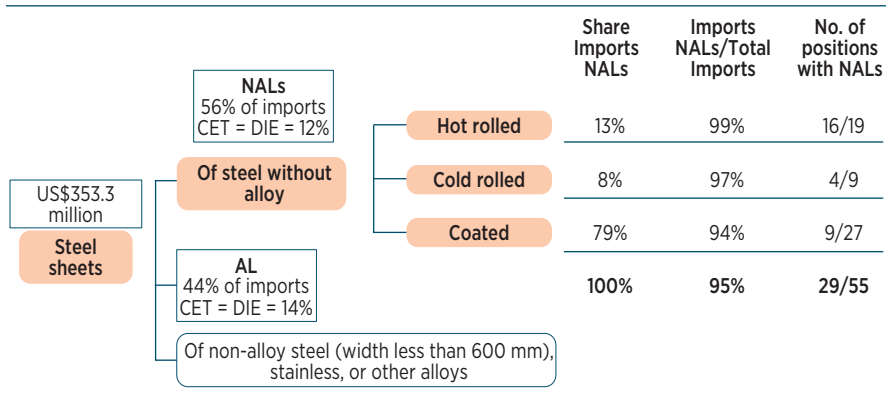
Tariffs

When the Macri administration took power in December 2015, the MERCOSUR CET applied to flat steel products remained unchanged at a level between

²⁴ Currently, Acindar is being investigated by the National Commission of Defense of Competition of Argentina for alleged anti-competitive practices and abuse of dominant power.

²⁵ Ternium Siderar is part of the holding group Techint.

Figure 2.7
Non-Automatic Licenses in Flat Steel Products, 2016



Source: Comisión Nacional de Comercio Exterior.

Note: AL: automatic import license; CET: Common External Tariff (MERCOSUR); DIE: Import Right Extra-MERCOSUR; NAL: non-automatic import licenses (MERCOSUR).

12 and 14 percent. According to both officials and industry representatives, the Secretary of Commerce was about to remove or lower these tariffs in March 2018. However, the initiative was canceled when the U.S. government issued Proclamations 9704 and 9705 raising import duties on imports for steel mill (25 percent) and aluminum (10 percent) articles.²⁶ President Macri’s team had to shift its focus from trade liberalization to the negotiation of an exception for Argentina with the United States. The government was not in a position to remove external tariffs when the United States was increasing them. After almost two months of negotiations, Argentina was exempted from the 25 percent tariff. Instead, an import quota of 180,000 tons per year (exempted from the tariff) was established. The quota was based on the average of steel exports during the past three years plus an additional 35 percent.

Technical Regulations

In September 2018, the Secretary of Commerce enacted Resolution 21/2018, a technical regulation framework establishing the essential quality and safety requirements for products used in construction. Among other products, the resolution regulates 36 percent of flat steel tariff positions. The negotiations between the government and the industry on a technical regulation were tough. The leading firms in the industry were the chief promoters of a protectionist

²⁶ See “Trade Remedies,” U.S. Customs and Border Protection website (<https://www.cbp.gov/trade/programs-administration/entry-summary/232-tariffs-aluminum-and-steel>).

technical regulation. They wanted a larger number of products regulated by the norm, the adoption of standards meeting the preferences and capabilities of domestic firms, and the establishment of certification procedures operating under the sphere of influence of the players of the industry.

Sources of Influence of the Lead Firm

The analysis of trade policymaking in the steel industry should take into consideration the power accumulated by the sector leader, crystallized in a wide variety of institutionalized and informal instrumental powers. Institutionally, the leading firm has a powerful presence in the *Unión Industrial Argentina* (UIA) and in the sectoral business association, *Cámara Argentina del Acero*. However, according to interviewees for this chapter, the holding group to which the firm belongs also exercised influence through informal channels. For instance, several former employees have been recruited as civil servants. Some interviewees pointed out that this created a shared vision between the company and areas of the public sector, allowing them to influence the policymaking process. Another channel of influence was through technical expertise. The managers and staff of the group are highly skilled, which boosted the firm's ability to influence the drafting of technical regulations or the investigation of anti-dumping procedures.

Intra-Value-Chain Cooperation and Coercion Mechanisms

As a dominant supplier of an input that is key in a wide variety of downstream manufacturing industries, Ternium Siderar occupies a strategic position and has multiple resources that may be used to align the interests of the sector and curb demands for liberalization. In particular, two main channels through which the firm exerted its influence across the value chain can be identified.

The first one is a "soft" channel, exercised through its participation in the Propymes Program.²⁷ This program, created in December 2002, sought to foster long-term relationships among small and medium-sized suppliers and clients of the Techint group.²⁸ The program provided support and training to improve productivity and to enhance management practices, among other issues. Of particular importance for this chapter is its effort to contribute to "efficient import substitution." Toward this end, the company helped participating firms prepare anti-dumping dossiers to be presented to the CNCE. These services reduced the willingness of firms operating downstream to voice

²⁷ For more information, see <http://www.programapropymes.com>.

²⁸ In 2018, some 850 firms participated in the program.

their discontent about the price charged for flat steel in the domestic market. Rather than seek a reduction in the price of their inputs through lobbying for reduced protection of steel, the support received in anti-dumping cases helped input users reduce the competitive pressures on their own products.

However, there was another mechanism that kept downstream firms from demanding reduced protection for flat steel. Interviewees stressed that even if barriers were reduced, allowing these firms to source cheaper inputs from abroad, they would have to think twice before challenging the dominant supplier. In case of a policy reversal, they would probably have to buy inputs again in the domestic market and would not want to risk having their supplies cut off or operating under uncertain conditions.²⁹

These intra-value-chain mechanisms suggest that trade policy alone may not be an effective mechanism to foster competition. Liberalization may need to be complemented with a competition policy that challenges the dominant power of the domestic market leader. Some interviewees suggested that encouraging the development of service centers and distributors could be a cornerstone of a pro-competitive strategy for basic input products. These intermediaries could provide the same services as the dominant firm and sell steel to final users in small quantities, thus protecting customers from uncompetitive practices.³⁰

2.4. Case Study 3: The Computer Industry

2.4.1. Brief Description of the Industry

After the currency devaluation in 2003, the administration of President Néstor Kirchner implemented certain measures to promote domestic industrial production. In this context, medium-sized firms started assembling computers. Between 2007 and 2015, annual manufacturing outcome averaged about 2.3 million units per year. Until 2016, this production covered around 70 per cent of domestic demand (CAMOCA 2018).

²⁹ Due to the informal nature of these mechanisms, it is difficult to find information about them beyond anecdotal evidence.

³⁰ In a closely related sector, in July 2018 the National Commission for the Defense of Competition of Argentina issued a report regarding the case of non-flat steel products, a market controlled by Acindar AcerlorMittal. The report argues that the “competitive pressure exerted by imports is limited” and concludes that, to a large extent, this is a consequence of the functioning of the distribution network controlled by Acindar. The report is available at https://www.argentina.gob.ar/sites/default/files/investigacion_de_mercado_de_acero_no_plano.pdf. See Delgobbo (2004) for an account of a 1998 antitrust investigation involving the purchase by Siderca of Comesi, a competitor of Siderca in the coated steel sector and a client of Siderca's cold rolled steel.

A defining feature of the computer industry in Argentina is the fragmentation between production on the “continent” and that under the special promotion regime on the island of Tierra del Fuego. Although most electronics production is concentrated in Tierra del Fuego (around 61 percent of total employment in the national electronics industry), computers manufactured on the island only accounted for 26 percent of the units produced nationally between 2011 and 2015. The bulk of production was manufactured in the suburbs of the cities of Buenos Aires, Santa Fé, and Córdoba (CAMOCA 2018).

Firms on the continent were mostly SMEs for which computers represented most of their business. By contrast, firms on the island were part of large diversified business groups producing electronics and home appliances under the special regime.³¹ In 2016, five groups—IATEC-Mirgor, Electronic System, Newsan, Brightstar Fueguina, and BGH—represented 74 percent of electronics production in Tierra del Fuego. Computers represented only 5 percent of this production, with the bulk going to mobile phones (57 percent) and TVs (33 percent).

The fragmentation of production was reproduced in the arena of interest representation. Firms on the continent were represented by the *Cámara Argentina de Multimedia, Ofimática, Comunicaciones y Afines* (CAMOCA), and *Cámara Argentina de Industrias Electrónicas, Electromecánicas y Luminotécnicas* (CADIEEL). Producers in Tierra del Fuego were represented by the *Asociación de Fábricas Argentinas Terminales de Electrónica* (AFARTE), which represents nine large firms with national, international, and mixed capital. The trade union representing electronics production workers is the *Unión Obrera Metalúrgica* (UOM). With approximately 260,000 affiliate members, it is one of the largest and most influential unions in the country, representing workers in steel, aluminum, auto parts, and electronics, among others.

2.4.2. The Political Economy of Trade Policy in the Computer Industry

Background: Protectionism and the “Continent-Island Cleavage”

Until 2015, electronics production in Argentina was protected through import tariffs and the DJAI system. Computers had a 35 percent import tariff. Inputs and accessories were protected as well: cables and printers (35 percent), mice, keypads, code bar readers, motherboards, PC memories, and plotters (12 percent), hard disks (8 percent), and scanners (2 percent).

³¹ Newsan and BGH are the only firms producing both on the island and the continent.

In addition, electronics production was protected by the industrial promotion regime of Tierra del Fuego created in 1972. This regime established exemptions on income taxes and value-added taxes (VAT) and on input import tariffs. The Cristina Kirchner administration extended the special regime until 2023. In addition, her administration enacted Law No. 26.539 in 2009 that removed exemptions to internal taxes and doubled the VAT (from 10.5 to 21 percent) for electronics not produced or assembled in Tierra del Fuego.

This decision sparked tensions between the firms operating on the continent—represented by CAMOCA and CADIEEL—and those on Tierra del Fuego—represented by AFARTE. While the latter celebrated the initiative to protect national production, CAMOCA’s authorities complained that this norm was putting jobs on the continent at risk. The conflict was settled by excluding computers from the law, as demanded by continental producers (Rabinovich 2018).

Trade Policy Strategy: Rapid Removal of Import Tariffs

The computer sector is one of the few examples of a transition from high protection to complete liberalization under the Macri administration. During the 2015 election campaign, *Cambiamos* authorities gave clear signs of discontent with the high prices of electronic consumer goods. Access to better quality and cheaper computers and mobile phones was a demand from its electoral base and a hoped-for consequence of the proposed “intelligent integration to the world.”

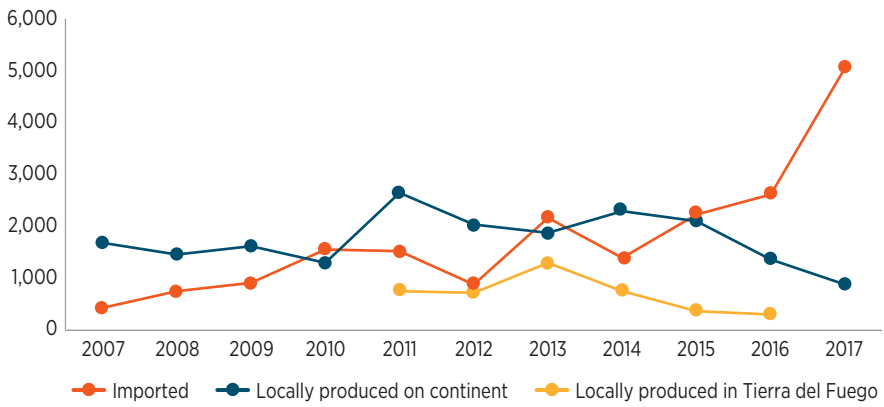
In August 2016, CAMOCA, CADIEEL, and UOM met with the Minister of Production to argue that liberalization would generate significant job losses. They presented an alternative liberalization plan. However, in November 2016, the government announced publicly the total elimination of tariffs on computers and inputs.

After the announcement, CAMOCA and CADIEEL issued strong statements warning that more than 10,000 jobs in the electronics value chain would be lost.³² These statements contrasted with AFARTE’s softer reaction, which estimated that only 500 jobs were at risk on Tierra del Fuego.³³ In their response to the episode, some of AFARTE’s members publicly recognized that computers were not very significant in their portfolios, and that they understood the government’s view.

³² This estimate included not only direct manufacturing computer jobs but also indirect ones from suppliers of the computer industry.

³³ “Tierra del Fuego: entre la reconversión productiva y la clausura lisa y llana,” *Tiempo Argentino*, December 12, 2016.

Figure 2.8
Production and Imports of Computers, 2007–2017 (thousands)



Source: Prepared by the authors based on CAMOCA (2018).

In February 2017, the government removed the 35 percent tariff applied to personal computers, notebooks, and tablets and the 12 percent tariff on computer inputs. The UOM was very active in its opposition. Members protested in the Plaza de Mayo, organized a demonstration at the Ministry of Production, and pressed the *Confederación General del Trabajo* (CGT) to organize a general strike, which took place on April 6, 2017. Despite these protests and the complaints from CAMOCA and CADIEEL, in November 2017 the government removed the non-automatic licenses.

Restructuring of the Industry

As a result of the new trade policy strategy, the share of imports in domestic consumption increased from 31 percent in 2014 to 85 percent in 2017 (Figure 2.8). This led to a loss of 500 jobs on Tierra del Fuego and a sharp reduction in workers on the continent of almost 3,000 jobs.³⁴ According to official estimates from the Ministry of Production, average computer prices in U.S. dollars dropped by 24 percent.³⁵ This fell short of the 50 percent target that had been used by the government to sell the reform to the public.

Most companies on the continent reconverted their business models. They became importers and providers of services. For instance, PC Arts, owner

³⁴ Interviews with representatives of AFARTE, CAMOCA, and CADIEEL.

³⁵ “A un año de la quita de aranceles, se incrementó 47% la venta de computadoras,” *Economía*, April 1, 2018 (<https://www.telam.com.ar/notas/201804/265929-a-un-ano-de-la-quita-de-aranceles-se-incremento-47-la-venta-de-computadoras.html>).

of the Banghó brand, became Dell's "master dealer" for the Argentine market and a wholesale distributor of other leading brands such as Intel, Microsoft, and Lenovo, among others. BGH closed its computer-assembling factory in Tierra del Fuego but kept a factory in the province of Buenos Aires that in 2017 produced notebooks for government programs such as *Conectar Igualdad*. Moreover, it commercialized and distributed the imported brand Vaio.³⁶

Government Tactics

Transformation and Compensation: The Role of PNTP in Reducing Labor Conflict

The government found two ways to alleviate the impact of tariff liberalization. First, it required *Conectar Igualdad* to procure its notebooks from domestic producers. The industry received this decision well. Second, it invited firms to benefit from the PNTP, which was effective in reducing labor conflict after tariff liberalization.³⁷ However, only two firms from the computer sector entered the program—PC Arts on the continent and Informática Fuegoína S.A. on the island. At PC Arts, the dismissal of 183 workers led to a two-day occupation of the factory. The fact that the firm entered the PNTP, which paid displaced workers very generous unemployment insurance, was important for the management of this conflict.

There was consensus among representatives of the public and private sectors, however, that the PNTP was more effective in reducing conflict than in supporting transformation. In addition, in the context of a recession, incorporating workers fired from "transformation" firms into "dynamic" firms was challenging. In the case of PC Arts, only 20 percent of workers who entered the program were successfully incorporated into dynamic firms, and for Informática Fuegoína the reincorporation rate was even lower.³⁸

Consensus: The Tripartite Agreement for Competitiveness and Gradual Liberalization of the Tierra del Fuego Industrial Promotion Regime

While the liberalization of computer production was abrupt and unnegotiated, the reduction of the benefits provided by the special industrial promotion regime was a gradual and negotiated process. The government decided to keep import tariffs on the two most important electronics products of Tierra del Fuego: cell phones and TVs.

³⁶ "'Adaptarse o morir,' la consigna que llevó a Banghó y a Positivo BGH a un drástico cambio de foco," *IProfesional*, September 13, 2017.

³⁷ Not for attribution interviews with officials from the Ministry of Production and the Ministry of Labor.

³⁸ Not for attribution interview with a government official.

The tripartite agreement signed among the business association, trade unions, and the national and provincial governments was one of the most important episodes in this process. On November 13, 2017, the national and provincial governments, AFARTE, and UOM signed an agreement designed to “increase competitiveness and reduce prices.” The agreement included two main commitments. First, it eliminated internal taxes for all electronics produced on Tierra del Fuego and gradually reduced internal taxes on electronics imported or produced on the continent (from 10.5 percent in 2018 to 0 percent in 2023). This equated production conditions with the industrial promotion regime (Decreto 979). Second, it froze wages for two years, with the commitment of employers not to fire workers during that period.

While the reduction of internal taxes on the continent was a significant blow to the special promotion regime, this negotiated solution was much more gradual than the government’s first proposal. The gradual approach softened resistance from AFARTE. Regarding the agreement on employment conditions, freezing wages in a context of high inflation (35 percent in 2016, 26 percent in 2017, and about 40 percent in 2018) entailed a large reduction in real wages. The general secretary of the UOM Río Grande affiliate said that the alternative was layoffs.³⁹

Some weeks later, on November 30, 2017, the Ministry of Production eliminated NALs for all electronics products, including computers and cell phones (Resolución 898). The purpose was to increase competition and reduce prices, in line with the agreement signed weeks earlier with sectoral business associations and trade unions. Since most computer factories had already closed production with the elimination of tariffs, this measure had no effect on the computer industry.

In October 2018, the government signed a decree (Decreto 864/18) eliminating import tariffs for over 180 technological inputs and products, including modems and routers and cell phone and TV components (in Tierra del Fuego, the tariff was already 0 percent). The measure aimed to lower the price of information technology inputs not produced in the country.⁴⁰ AFARTE’s president expressed concerns that this would encourage the assembly of cell phones on the continent, thus negatively affecting firms on Tierra del Fuego, where large investments had been made.⁴¹ AFARTE’s representatives met with

³⁹ “Electrónicas fueguinas acuerdan congelar salarios por 2 años pero sin despidos,” *Ámbito Financiero*, November 10, 2017.

⁴⁰ “Bajan o eliminan aranceles de importación a productos de informática y telecomunicaciones,” *Télam*, September 7, 2018.

⁴¹ “Electrónicas: Afarte denuncia que el decreto 864 propicia la radicación de ‘armaduras’ en el continente,” Radio Fueguina, October 10, 2018.

the Minister of Production and focused on four specific tariff lines regarding components for cell phone and TV production. They argued that the inclusion of these products in the decree would have a negative impact on production and employment on the island. As a result, the minister revised the decree and excluded the tariff lines questioned by AFARTE.⁴² Although many special regime benefits were reduced, cell phones, which represent more than half of electronics consumption goods produced on the island, remained protected by a 16 percent import tariff.

Sources of Influence: Institutional Fragmentation and Low Structural Power

Several structural factors can be identified that help to understand why resistance from the private sector to liberalization of the computer industry was weak: (1) lack of cohesion because of economic and institutional fragmentation; (2) low structural power, measured in terms of value added and employment; (3) the absence of a concentrated input provider with protectionist interests; and (4) lack of legitimacy among experts and the general public because of high prices and subsidies.

The fragmentation between the continent and the special promotion regime on Tierra del Fuego generated diverging interests and a lack of cohesion among computer producers in their response to liberalization. The defense of the special promotion regime was the primary interest of producers on Tierra del Fuego. This inevitably generated tensions with continental producers. Given the government's stated intention to reduce or put an end to the benefits of the special regime, AFARTE took a defensive strategy. The priority was to preserve the benefits and tariff protection related to cell phones and TVs, while avoiding conflict with the government over computers. As stated by one of the business representatives interviewed for this chapter, the production of computers—representing just 6 percent of electronics production on the island—was “handed over” to the government in exchange for keeping the benefits for the island's most important production lines. This allowed firms to reallocate some of their employees in computer product lines to other business segments.

Continental producers were medium-sized firms with much less economic power than the diversified business groups on the island. Total sales of the largest firm manufacturing computers on the continent, PC Arts, were less than 10 percent of that of the largest firms on the island, such as Grupo

⁴² “Marcha atrás del gobierno con un decreto que afecta la producción de celulares y televisores,” *IProfesional*, October 6, 2018.

Mirgor or Brightstar Fuego. The degree to which the government advanced was correlated with the structural power of each group.

Furthermore, unlike the case of steel, there was no concentrated input supplier with protectionist interests that could coordinate the value chain. In the electronics industry, most inputs were imported or produced by SMEs.

The most recent episode, in which the government revised the removal of import tariffs for cell phone components on the continent, stands in sharp contrast to the process of removal of computer import tariffs. AFARTE immediately met with the Minister of Production. After listening to the association's warning about the potential impact on activity on Tierra del Fuego, the government revised the contentious tariff lines. In contrast, representatives of the computer industry on the continent pointed out that they were not received by the Secretary of Industry to discuss sector policies. In addition, they complained about the differential treatment of computers and cell phones. This suggests that, as expressed in the literature, structural power can increase access to policymaking spaces (instrumental power).⁴³

While in the textile industry government officials expressed concerns over the social and electoral impact of layoffs and unemployment, this was not the case for the computer industry. Total employment was not only low—about 3,000 direct jobs, according to the sectoral associations—but geographically dispersed among different provinces (Buenos Aires, Tierra del Fuego, Córdoba, and Santa Fé). Although the closing of factories generated significant labor conflicts, government officials had the resources to moderate them. This included subsidies from the PNTP and licenses of *Conectar Igualdad*.

A remaining question is why the government liberalized computers abruptly but protected cell phones. Beyond the relative strength of the two groups, the geographical concentration of jobs is another factor that helps understand this. While not large at the national level, cell phone production accounts for a very significant share of industrial employment on Tierra del Fuego.⁴⁴ Closing cell phone factories would have had a significant social impact at the local level.

⁴³ In an interview with the press, the director of PC Arts said the government promised cheaper computers and cell phones, but did not make progress on cell phones because of pressure from the industry. See "'Adaptarse o morir,' la consigna que llevó a Banghó y a Positivo BGH a un drástico cambio de foco," *IProfesional*, September 13, 2017.

⁴⁴ With 13,000 jobs, the electronics industry represented 85 percent of industrial employment on the island. The cell phone industry was one of the most important employment sources, and represented 57 percent of electronics production.

2.5. Discussion

Trade policy was one of the cornerstones of the *Cambiamos* government's ambitious reform agenda after taking office in December 2015. This chapter has analyzed the factors explaining the scope and pace of import liberalization during the Macri administration, comparing the trade policymaking process and outcomes across three industrial sectors: textiles and apparel, flat steel, and computers. The analysis focused on (1) the determinants of the government's trade liberalization strategy; (2) the tactics adopted by the government to advance the liberalization process, including compensation, transformation, and consensus mechanisms; and (3) the sources of influence of import-competing sectors, including the instrumental and structural power of firms as well as intra-value-chain coordination and coercion mechanisms.

2.5.1. Determinants of the Government's Trade Liberalization Strategy

The scope and pace of liberalization across different sectors can be explained by sectoral characteristics that guided the government's strategy. Low competitiveness of domestic producers, relatively few jobs at risk, and a high impact on downstream sectors are characteristics shared by both of the liberalized sectors (i.e., computers and synthetic yarns). On the other hand, "sensitive" sectors—characterized by high employment at risk and low impact on downstream sectors—in essence maintained the trade policy instruments inherited from the previous administration (with the exemption of NALs). For basic inputs such as steel, a product with a significant impact on a wide range of downstream sectors, the liberalization strategy proved not to be as aggressive as in computers and synthetic yarns. This can be partly explained by the fact that the dominant producer is relatively more efficient than in those latter industries. Moreover, the steel industry's share in total employment is significantly larger than that of the other industries.

The structural power of import-competing sectors was an important determinant of the government trade liberalization strategy. The scope and pace of the liberalization agenda incorporated considerations of the activity and employment levels at risk, and their possible impact on voter sentiment. This is consistent with business politics theories that argue that structural power generally plays a role as a signaling device in the agenda-setting stage of the policy process—the prospect of disinvestment can help to define or rule out alternatives, but this signal cannot tell governments what to do (Hacker and Pierson 2002, 282).

The findings in this chapter are in line with those of Leiras and Soltz (2006), who found that in the early 1990s in Argentina, “politically influential” groups producing intermediate goods (e.g., steel and paper), along with “politically salient” sectors producing labor-intensive final consumption goods (e.g., textiles, footwear, and toys), managed to maintain high levels of protection.

Policymakers determined that the closing of medium-sized computer factories in the suburbs of large affluent cities would not significantly affect the level of activity and employment—or at least not at a level that exceeded the benefits associated with better access to technology (and thus increased productivity) in downstream sectors and lower prices for consumers. Warnings from sectoral associations and trade unions about the negative effects of liberalization were ignored. The computer sector lacked social legitimacy because of its high prices, high import content, and large subsidies. The government therefore perceived that trade opening would not have a negative impact on economic activity, social stability, or votes.

The fact that the government did not liberalize other electronics goods (e.g., cell phones and TVs) affected by the same weaknesses as computers helps shed light on the importance of structural power for the scope and pace of liberalization. The structural power of producers on the continent—which specialized in the production of computers—was much lower than the structural power of producers on the island of Tierra del Fuego, which was much more diversified within the special promotional regime. Operating in an isolated and scarcely diversified geographical area with geopolitical significance was a source of structural power for producers on Tierra del Fuego that forced the government to curb its reformist push. It is also clear from the interviews conducted for this chapter that structurally powerful firms had more access to policymaking spaces (i.e., they had more instrumental power) than structurally weak ones, a finding consistent with recent literature on business influence that stresses how these two sources of power reinforce each other (Fairfield 2015).

The case of the textile and apparel industry, in which the scope and pace of the liberalization was more limited, strengthens the relevance of structural power in setting the government’s agenda. In this case, influence largely emanated from the large number of people employed across the value chain (250,000 jobs, from yarns to garment design). Furthermore, these jobs were mainly located in economically disadvantaged regions in the North East and North West provinces, with little opportunity for job reallocation, and in the suburbs of the province of Buenos Aires, a strategic district for the political aspirations of *Cambiamos*. In line with Rodrik (1995), this chapter has argued that employment generated by the textile value chain, its geographical distribution, and its vulnerability to import competition help explain why the

government maintained protection for apparel. These factors are important because they affect the government's electoral incentives, as well as broader objectives such as achieving social stability.

The case of flat steel introduces nuances in the analysis of structural power by showing how it may vary in accordance with changes in domestic and international conditions. Ternium Siderar, the main flat steel producer, is part of the largest business group in Argentina. It is a multinational company employing over 55,000 people (20,000 in Argentina) with operations across several sectors at a worldwide level. Despite structural power conditions, until early 2018 the government was determined to advance its liberalization of the industry. With the objective of lowering the price of inputs affecting downstream sectors' competitiveness, NALs were removed and tariffs were about to be eliminated. However, changes at the domestic and external levels improved the bargaining position of the industry and contributed to restraining the opening push. On the international side, the U.S. decision to raise barriers on steel imports in March 2018 shifted the focus of the government. Rather than lowering tariffs, the main priority became to negotiate access of local steel products to the U.S. market. Domestically, prospects for reducing trade barriers were further undermined by the context of a stagnant economy, with increasing unemployment.

2.5.2. Tactics: Limitations Faced by the Government in Building Pro-Liberalization Coalitions

The three coalition-building mechanisms examined in this chapter—compensation, transformation, and consensus—had a relatively small effect on minimizing resistance to liberalization from potential losers or on gaining support from potential winners. The reasons for that are multifold and specific for each case.

The PNTP was an innovative instrument design to relocate factors of production toward firms and sectors with higher competitive potential. It proved especially effective in mitigating labor conflicts in “transformation” firms. However, it did so only on a very small scale, being labeled by officials as a “boutique” initiative facing challenges for escalation. Only 1,500 workers and 100 firms were approved for and benefited from the program. To have an aggregate impact, the program's scale should have been increased significantly. Challenges identified by government officials and business representatives related to skill specificity and geographical location considerations that complicated worker reallocation. Also, evaluations of the program pointed to the weakness of the initiatives in training displaced workers. Finally, an important limitation faced by the PNTP was the lack of enough dynamic

firms in a stagnant economic context characterized by systematic loss of industrial employment.

As for consensus mechanisms, the format of the first dialogue roundtables held by the government in 2016 and 2017 proved to be ineffective in building trust among the actors. The low political priority given by the government to this initiative partly accounts for the poor results. To some extent, the position of the government reflected the authorities' initial preference for "horizontal" policies addressing market failures and its reluctance to advance a sectoral agenda to guide the transformation of the industries. This changed with a new round of the dialogue roundtables more closely patterned after the Peruvian *mesas ejecutivas*. Launched in the second semester of 2018, this second group of roundtables was much more successful (Obaya and Stein 2021).

By contrast, the Tripartite Agreement for Competitiveness reached with electronics producers on Tierra del Fuego in November 2017 paved the way for gradual liberalization. It was important for creating some room for public-private deliberation and negotiation with the explicit aim of preparing for an in-depth institutional transition. One difference with the textile dialogue roundtables is that both firms and jobs in Tierra del Fuego were facing a concrete threat, that is, the end of the special promotion regime in 2023. Also, the government had shown determination to move forward with reduction of trade protection. The liberalization of the computer sector made this threat credible. In a context in which they had much to lose, business and labor actors had incentives to negotiate.

In contrast to the experience of the structural reforms in the 1990s, *Cambiamos* made scarce use of compensation mechanisms to build support coalitions. During the 1990s the large business groups that dominated industrial sectors like steel, automobiles, oil, and cement were negatively affected by liberal economic reforms. The government was able to head off their opposition and gain their support through "market-share compensation" mechanisms, that is, by directly awarding state assets during the privatization of telecommunications and utilities, and through partial deregulation (Etchemendy 2011).

2.5.3. Sources of Influence of Import-Competing Sectors: Intra-Value-Chain Coordination and Coercion Mechanisms

The cases of flat steel, textiles, and apparel show that the capacity to coordinate the value chain is a relevant source of power to limit the scope and pace of liberalization. Large and concentrated potential losers from trade liberalization, occupying upstream positions within the chain, had the capacity to constrain demands for liberalization from subordinated final users.

As a result, in the absence of an organized import-demanding coalition, the government had less leverage to liberalize. Many officials complained that users of protected products did not demand reductions in tariffs (at least not publicly). As discussed above, value-chain control may be exerted through both soft and tough mechanisms. As for soft mechanisms, the provision of services from the value chain leader is the primary mechanism to keep discipline among final users. In the case of steel, this was channeled through Techint's Propymes Program for SMEs. In the case of textiles it crystallized, for instance, in the articulation of a common negotiation position collectively demanding protection for the entire chain within Pro-Tejer. Tough mechanisms relate to the capacity of dominant firms to discipline potential importers and reduce incentives for downstream clients to voice their liberalization demands through price discrimination and non-competitive practices.

The question arises as to why firms using protected inputs intensively did not import them or lobby for liberalization. In the steel value chain, the scale of production usually does not justify imports by most individual firms. Furthermore, they lack the capabilities to adapt the imported basic products to their specific needs (e.g., to cut and mold the steel sheets). Moreover, lean production requires geographical proximity between users and suppliers. As argued by some interviewees for this chapter, some of these problems could be solved through the establishment of large service centers specializing in importing steel and providing technical services to final users. However, such actors did not proliferate or were controlled by Ternium Siderar. Some interviewees suggested that their absence could be linked to practices by the dominant firm coupled with uncertainty about the sustainability of the liberalization policy—that is, buyers may have feared being cut off from supplies in case of policy reversals. Others questioned whether there would be a profitable business opportunity for service centers independent of such practices. The reasons why large service centers did not proliferate deserves further research. Still, this discussion sheds light on the potential limitations of trade liberalization strategies and stresses the importance of complementary antitrust policies in the case of sectors with dominant input suppliers.

Annex 2.1. List of Interviews

October 7, 2018: Not for attribution interview with official 1 from the Ministry of Production.

October 24, 2018: Ariel Schale, Executive Director, Fundación Pro-Tejer.

August 1, 2018: Teddy Karagozian, co-founder of Pro-Tejer.

August 2, 2018: Patricia Marino, Textile Division, Instituto Nacional de Tecnología Industrial (INTI).

August 6, 2018: David Uriburu, Director of Institutional Relations, Techint.

August 7, 2018: Jose de Mendiguren, Vice-President, Cámara Industrial Argentina de la Indumentaria (CIAI).

August 9, 2018: Not for attribution interview with official 2 from the Ministry of Production.

August 10, 2018: Not for attribution interview with official 3 from the Ministry of Production.

August 15, 2018: Claudio Drescher, President, Cámara Industrial Argentina de la Indumentaria (CIAI).

August 15, 2018: Carlos Alberto Vaccaro, Executive Director, Cámara Argentina del Acero.

August 17, 2018: Diego Coatz, Chief Economist, Unión Industrial Argentina (UIA).

August 30, 2018: Not for attribution interview with official 4 from the Ministry of Production.

September 17, 2018: Rubén Oscar García, Cámara Importadores de la República Argentina (CIRA).

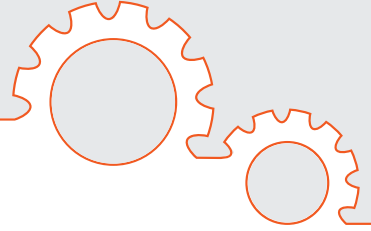
October 1, 2018: Federico Hellmeyer, President, Asociación de Fábricas Argentinas Terminales de Electrónica (AFARTE).

October 3, 2018: Carlos Scimone, Executive Director, Cámara Argentina de Multimedia, Ofimática, Comunicaciones y AFines (CAMOCA).

October 5, 2018: Not for attribution interview with representative from the agricultural machinery sector.

October 10, 2018: Not for attribution interview with manager from a group operating in Tierra del Fuego.

November 10, 2018: Not for attribution interview with representative from the computer sector.



Strong Industries and Resilient Protectionism: The Political Economy of Trade Policy in Brazil

Ivan Oliveira, Pedro da Motta Veiga, Sandra Polónia Rios, and Fernando Ribeiro

Brazil is a latecomer among developing countries in opening up its economy. Its trade policy still corresponds to the import-substitution paradigm, despite the fact that Brazil has a large and diversified industrial base and that import-substitution dynamics have lost traction since the 1980s.

In contrast to other large developing economies, the last trade liberalization episode in Brazil occurred in the late 1980s and early 1990s. Since then, the levels of tariff and nontariff protection have not been reduced—on the contrary, nontariff barriers have significantly increased in the last 15 years. In its trade policy, Brazil completely ignored the deep changes that have affected the world economy since 1995.

Brazil is among the least active countries in the arena of preferential trade negotiations. Its trade policy has relied almost exclusively on the multilateral track of negotiations, and the country remained at the margins of the boom of preferential trade agreements during the 1990s and 2000s. Beyond the Southern Cone Common Market (MERCOSUR) and other agreements with South American countries, Brazil has only a few free trade agreements with economically irrelevant partners and very limited trade agreements (based on fixed preferences) with other emerging economies (e.g., India and the Southern African Customs Union).

Indeed, despite the unilateral trade liberalization of the early 1990s, Brazilian trade strategies continued to be designed in accordance with the broad political framework defined by the basic assumptions of foreign economic policy put in place during the long period of protectionist industrialization.

Hence, it is not by chance that, even though Brazil entered into many trade negotiations during the late 1990s and the beginning of the 2000s, those negotiations generated few economic results.

The main question this chapter aims to answer, then, is: “Why is protectionism so persistent in Brazil?”

Two domestic factors seem especially important in explaining the persistence of protectionism in Brazil’s trade and industrial policies. The first refers to the role of incumbent interests, which seem to have also accounted for the continuity and resilience of the country’s trade policy paradigm. The relevant point here is the primacy that import-competing sectors managed to maintain in the area of trade policy vis-à-vis exporting sectors and interests from the liberalization episode of the 1990s until today. This primacy persists, despite the growing evidence that the industrial sector lacks competitiveness and is gradually losing relevance in the Brazilian economy.

The second domestic factor points to the weight of noneconomic sources of preferences (Jamal and Milner 2013) or ideas (Rodrik 2013) in shaping public policies. Here, the central role of ideas contributes to explaining the persistence of the foreign economic policy paradigm consolidated during the period of import-substitution industrialization. This paradigm survived the liberalization episode of the 1990s and remains the hegemonic set of ideas in the country that apply to policies dealing with Brazil’s integration into the world economy.

To answer the main research question posed above, this chapter will address the following issues:

- Which sectors are favored by the structure of import tariff and other trade and industrial policy instruments? Have there been any major changes in the structure of protection since the beginning of the 1990s in Brazil?
- Has the manufacturing sector been able to be more influential than other sectors in Brazilian trade policy?
- If the answer to the last question is yes, then why have manufacturing interests been successful in exerting influence on trade policy, even when this sector is shrinking in terms of its share in Brazil’s GDP? How do different sectors such as agribusiness and services exert their influence in trade policy? Have labor unions been active in influencing trade policy in Brazil?
- What is the role of the institutional architecture in shaping Brazil’s trade policy? Does it allow or encourage the capture of trade policymaking by some sectors?

To address these questions, this chapter first describes the evolution of trade policy in Brazil as well as its current agenda, with the aim of setting the

scene for the discussion about the weight of interests in shaping trade policy presented in the sections that follow. The chapter describes the institutional stage of the trade policy and the main public and private players that interact in trade policymaking, stressing their motivations and the modes of organization they choose to influence and participate in trade policymaking. It also identifies and analyzes the main drivers of the setting and the evolution of the institutional framework of trade policy. The chapter then addresses the interplay between institutions and (public and private) players, summarizing the trajectory of trade policymaking since unilateral liberalization and discussing the political economy's dynamics that drove this trajectory. In addition, the chapter presents three episodes on Brazil's trade policymaking, selected because they reveal important features of the political economy of the country's trade policy. The final section summarizes the main conclusions of the chapter and presents some reflections on the evolution of trade policymaking under the government of President Jair Bolsonaro.

3.1. Main Features, Recent Evolution, and Current Policy Agenda of Trade Policy in Brazil

Protectionist tradition has been hegemonic in Brazil for the last 80 years among policymakers, business, and trade union associations. A set of import-competing industrial sectors benefit from high levels of protection and make intense use of the mechanisms of public policy (high tariff rates, special import regimes, credit incentives, etc.). Even though these sectors have lower import tariff rates compared to those they enjoyed before the 1990s, they have been among the most protected since the unilateral trade reform, just as they were before it.

A large share of the stock of foreign direct investment in Brazil is also concentrated in most of these sectors. The sectors played the protagonist role in the political economy of trade policy before the unilateral liberalization of the early 1990s and were able to keep this central position afterward. The sources of power and influence of these actors arise from different factors, including their large number of workers, their ability and resources for lobbying, and the Brazilian preference for high-value-added industries.

This influence in trade policymaking is rooted in the successful experience of Brazilian industrialization. The foreign policy model that complemented domestic policies was historically oriented by a focus on "neutralizing" outside factors perceived as capable of hindering the objectives of national economic development and the consolidation of industrial capacity. Attaining these objectives was considered crucial for ensuring that the country could operate autonomously in the international system. These domestic conditioning

factors were only partially impacted by the trade liberalization of the 1990s, and so the trade policy underpinning them continued to prevail during the phases following the “liberal decade.”

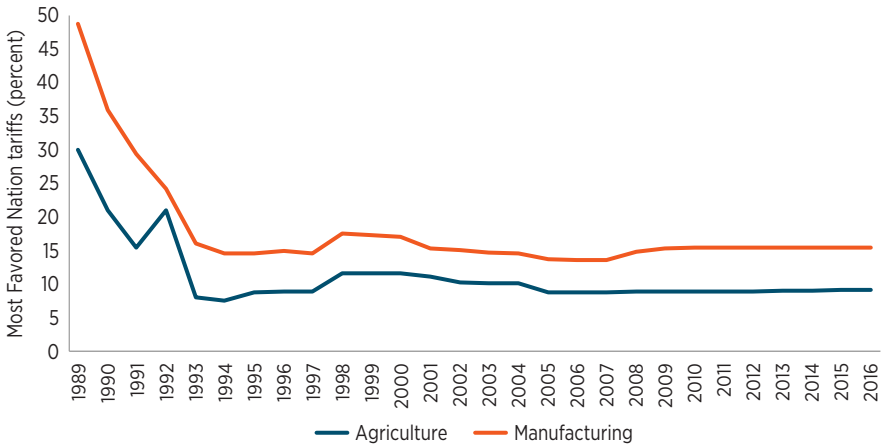
Trade liberalization put into practice by Brazil at the start of the 1990s promoted a significant reduction in the levels of tariff rates. Nevertheless, the process generated a structure of protection based on tariff escalation, with higher rates of protection for the same sectors favored by trade and industrial policies of the previous decades under the import-substitution strategy: automobiles, electro-electronic, textiles and apparel, and capital goods, among others. Many of these sectors also benefited from the setting of new sector regimes that provided incentives for investment and production.

The emergence of a competitive and export-oriented agricultural sector from the beginning of the 21st century onward, with offense-oriented interests and positions in trade negotiations, could have challenged the protectionist tradition of Brazilian trade policy. The trade-off between agriculture and industry has become a distinctive feature of the Brazilian trade negotiation strategy, as in the case of the negotiations of the European Union-MERCOSUR trade agreement. However, this process has not deeply impacted trade policy and its design in Brazil, with the agricultural sector focusing on trade negotiations (multilateral or preferential) and showing scarce interest in challenging the unilateral protectionist policies affecting manufactured goods. Moreover, there are several subsectors of Brazilian agriculture (non-exporters) that call for protection against imports.

The services sector, which accounts for more than 70 percent of Brazilian GDP, has also been sheltered from import competition. The aggregated productivity level of the Brazilian services sector is relatively low compared to other developing countries and is similar to levels for Colombia and Peru, but lower than those for Chile, Mexico, and India. Moreover, productivity has stagnated in recent decades (CNI et al. 2016). A set of regulatory barriers and a tax regime that discriminate against imports are in place and increase the costs of imported services or, in some cases, impede the participation of foreign providers in the domestic market. Even those sectors that export—such as financial services, information technology, and construction services—are relatively sheltered from import competition.

3.1.1. Main Features of Brazilian Trade Policies

Until the beginning of the trade liberalization process in 1988, the tariff structure in place in Brazil was practically the same as the one implemented 30 years earlier, when the import-substitution strategy was at an early stage. At the end of the 1980s, the import-penetration coefficient barely passed 5 percent

Figure 3.1**Brazilian Average Most Favored Nation Tariffs: Agriculture and Manufactured Goods, 1989–2016 (percent)**

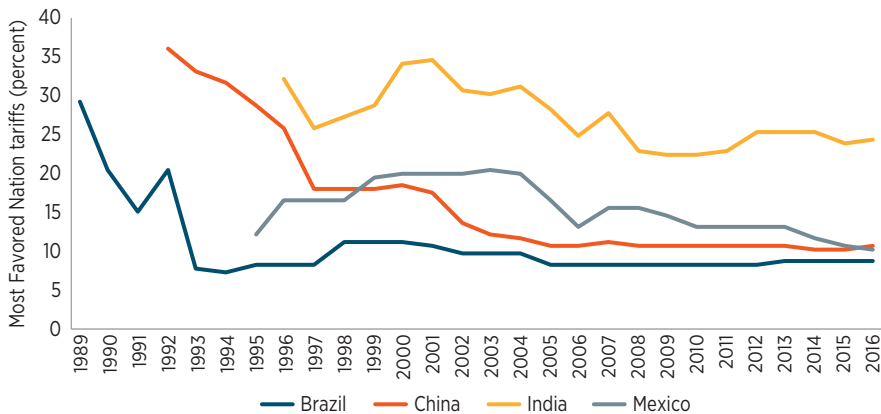
Source: World Bank, World Development Indicators (<https://data.worldbank.org/indicator/TM.TAX.MRCH.SM.AR.ZS>).

(and stood at 3 percent in the manufacturing sector). The liberalization began cautiously in 1988 by eliminating tariff redundancy, suppressing certain surcharges applicable to imports, and partially eliminating the 42 special tax regimes applied to imports. These measures decreased the average nominal tariff rate from 57.5 percent in 1987 to 32.1 percent in 1989.

Unilateral trade liberalization was extended in 1990 and concluded in mid-1993, eliminating the extensive range of nontariff border barriers and reducing the average tariff to around 13 percent. In 1994, when Plano Real was put into effect to fight hyperinflation, and certain additional tariff reductions were applied, the average nominal tariff rate that year dropped to 11.2 percent.

Currently, the simple average nominal tariff rate is at 13.4 percent. As shown in Figure 3.1, the average tariff rate for agricultural goods is lower than the one applied to manufactured goods. Despite the lower level of protection in the agricultural sector in Brazil, the maximum tariff for some goods in this sector reaches 55 percent (e.g., for grated coconut), while for manufactured goods the maximum tariff rate is 35 percent for automobiles, textiles, toys, furniture, and shoes.¹

¹ The maximum tariff rate bound by Brazil at the World Trade Organization is 55 percent for agricultural products and 35 percent for manufactured goods.

Figure 3.2**Agricultural Goods: Average Most Favored Nation Tariff Rates, Brazil, China, India, and Mexico, 1989–2016 (percent)**

Source: World Bank, World Development Indicators (<https://data.worldbank.org/indicator/TM.TAX.MRCH.SM.AR.ZS>).

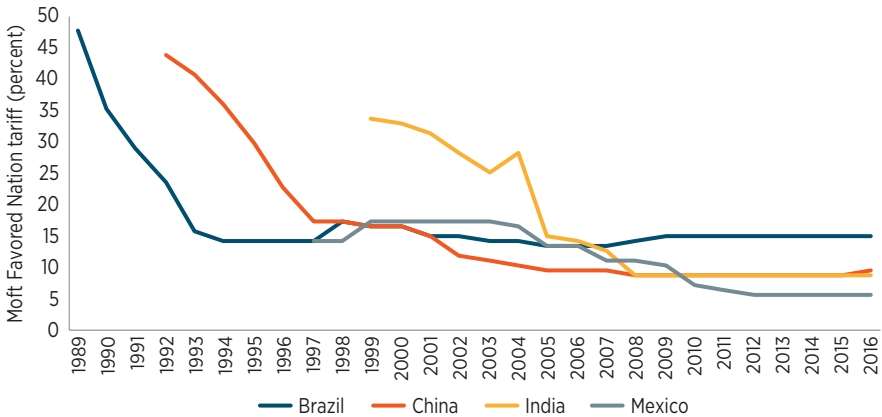
Compared to other emerging economies such as China, India, and Mexico, Brazilian tariff levels for agricultural products are relatively low (Figure 3.2). Indeed, the other three economies are not competitive and are traditionally protectionist in agriculture. Nevertheless, China (after its accession to the World Trade Organization) and India went through processes of Most Favored Nation (MFN) tariff reduction starting in the 2000s, and Mexico did so starting in 2004. India lowered its tariff rates in the first part of that decade but still maintains tariff levels that are twice as high as those applied by China and Mexico.

In terms of manufactured goods, Brazil's unilateral trade reform of the 1990s was sufficient to take the average tariff rates to the level applied by Mexico and below those applied by China and India at that time (Figure 3.3). However, the country did not follow the unilateral liberalization policies pursued by most of the emerging countries in the 1990s and 2000s, and, as a result, average MFN tariff rates applied by China, India, and Mexico to manufactured goods became much lower than Brazil's rates from 2008 onward.

One feature of the import tariff structure is the low degree of selectivity in the protection offered for domestic production of manufactured goods. Only 15 percent of agricultural goods are subject to tariff rates considered as a tariff peak by the World Trade Organization (WTO) (above 15 percent). On the other hand, almost 40 percent of tariff lines are subject to duties higher than 15 percent in the manufacturing sector, as shown in Table 3.1. This frequency distribution is considerably different from those seen in most emerging economies.

Figure 3.3

Manufactured Goods: Average Most Favored Nation Tariff Rates, Brazil, China, India, and Mexico, 1989–2016 (percent)



Source: World Bank, World Development Indicators (<https://data.worldbank.org/indicator/TM.TAX.MRCH.SM.AR.ZS>).

Tariff escalation was a key parameter used in the design of the tariff reform implemented in the 1990s. This could have resulted in negative rates of effective protection in some competitive sectors such as agriculture, mining, or even services. It is difficult to measure effective protection in the services sector, but Castilho and Miranda (2017) provided an estimate for goods. According to their estimation, the only sector with negative rates of effective protection in 2014 was petroleum and natural gas. As Table 3.2 shows, vehicles, apparel, textiles, tobacco, home appliances, furniture, and leather products were among the sectors enjoying the highest effective protection rates in Brazil in 2014.

Table 3.1

Frequency Distribution by Range of Most Favored Nation Applied Rates in Brazil, 2017 (percent)

	Brazilian Import Tariffs						
	Duty-free	0 <= 5	5 <= 10	10 <= 15	15 <= 25	25 <= 50	50 <= 100
Agricultural products	7.2	6.8	57.1	14.2	13.4	1.1	0.1
Nonagricultural products	5.2	15.2	13.3	27.7	24.9	13.7	0

Source: World Trade Organization Tariff Profiles (https://www.wto.org/english/res_e/booksp_e/tariff_profiles17_e.pdf).

Kume (2018) compares the effective protection rates of the Brazilian tariff structure to those of other groups of countries for 1995 and 2011.² The evolution of MFN tariff rates and the distribution of sectors by range of effective protection rates suggest that the trade liberalization reform of the 1990s

Table 3.2
Nominal and Effective Protection by Sector in Brazil, 2014 (percent)

Sector/Activity	Nominal Tariff	Effective Tariff
Trucks and buses	31.9	72.5
Motor vehicles, trailers, and bodies	29.7	65.5
Wearing apparel	32.7	39.9
Textiles	23.8	30.3
Tobacco products	16.5	29.1
Home appliances	18.4	26.4
Furniture and other manufactured products	18.3	23.8
Leather products and footwear	18.1	22.5
Paints, varnishes, enamels, and lacquers	13.0	20.3
Perfumery, hygiene, and cleaning	14.7	20.0
Metal products, except machinery and equipment	15.1	18.9
Rubber and plastic products	13.8	18.6
Electrical machinery and apparatus	14.3	18.2
Parts and accessories for motor vehicles	15.2	17.7
Manufacture of resins and elastomers	10.4	17.2
Food products and beverages	11.8	17.0
Alcohol	12.0	16.5
Celulose and paper products	12.4	14.7
Manufacture of steel and its derivatives	11.2	14.5
Agricultural defensive	11.1	13.1
Medical/hospital instruments, measurement and optics	12.5	12.9
Other transport equipment	12.2	12.6
Other products of non-metal ores	10.2	12.4
Machinery and equipment, including maintenance and repairs	11.9	12.2
Chemical products and preparations	10.4	11.8

(continue on next page)

² The estimates for effective protection provided by Kume (2018) are different from those calculated by Castilho and Miranda (2017) due to differences in the aggregation level of information and methodological details.

Table 3.2 (continued)**Nominal and Effective Protection by Sector in Brazil, 2014 (percent)**

Sector/Activity	Nominal Tariff	Effective Tariff
Electronic material and communications equipment	11.8	11.5
Newspaper, magazine, disks	10.6	10.3
Products of wood, except furniture	9.0	9.5
Manufacture of nonferrous metals	7.7	7.6
Chemical products	5.6	6.9
Agriculture, silviculture, lumbering	6.6	6.4
Cattle and fishery	7.3	6.4
Pharmaceuticals	6.3	5.4
Office machinery and computer equipment	8.6	4.1
Cement	4.0	2.2
Iron ore	2.0	1.4
Refining of petroleum and coke	0.9	0.9
Other of extractive industry	3.2	0.7
Petroleum and natural gas	0.0	-1.4
Average	11.7	16.7
Median	12.0	13.1
Maximum	55.0	72.5
Minimum	0.0	-1.4

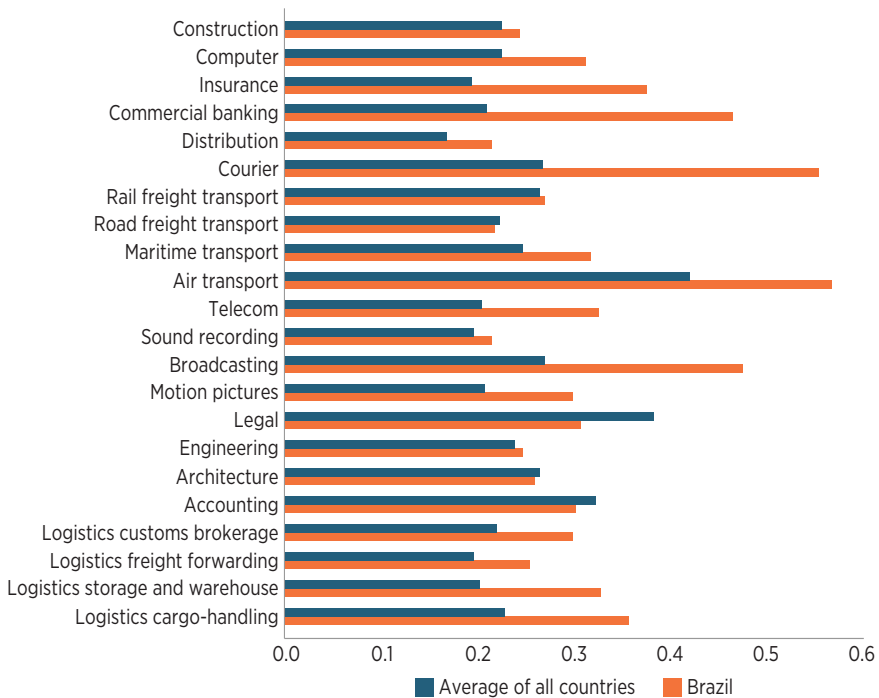
Source: Castilho and Miranda (2017).

updated Brazilian protection policy by bringing it in line with most developing countries. However, the same analysis for 2011 shows a very different picture. In Brazil, although the number of sectors classified in the upper range of rates fell from nine to six, the effective protection for vehicles and textiles, clothing, and footwear substantially increased. In the other groups of countries, most sectors had migrated to the lower range of duties.

This analysis is revealing of the peculiar Brazilian stance regarding tariff protection policy. While the world was moving toward trade liberalization—be it along unilateral or negotiated tracks—Brazil remained stuck in the tariff structure inherited from the trade reform of the early 1990s, promoting only perfunctory changes, some of them in the opposite direction.

Protectionism is present in the services sector, as well. The Organization for Economic Co-operation and Development (OECD) calculates an indicator of services trade restrictiveness by considering national regulations that affect the imports of services in developed and some developing economies. As

Figure 3.4
Services Trade Restrictiveness Index, Brazil, 2017



Source: Organization for Economic Co-operation and Development, “Services Trade in the Global Economy” (<http://www.oecd.org/tad/services-trade/services-trade-restrictiveness-index.htm>).

shown in Figure 3.4, the levels of restrictiveness faced by foreign providers in Brazil is higher than those observed, on average, in all countries included in the OECD data for almost all sectors.

High tariffs on goods probably hinder the competitiveness of Brazilian services providers in international markets, but the reverse is also true: Brazilian industry representatives complain that high protection from foreign competition in the services sector jeopardizes their export competitiveness. This is particularly true for services such as logistics and transportation, courier services, commercial banking, and insurance.³

The protectionist paradigm has been driving Brazilian trade negotiation stances as well. Supported by an extensive coalition of bureaucrats and

³ See “Tributação para contratar serviços estrangeiros chega a 51% no Brasil,” Agência de Notícias CNI, June 14, 2013 (<http://www.portaldaindustria.com.br/agenciacni/noticias/2013/06/tributacao-para-contratar-servicos-estrangeiros-chega-a-51-no-brasil/>).

business associations from the industrial sector, which played a central role in crafting national positions in the area of international trade and investment negotiations, the protectionist paradigm dominated negotiation strategies under presidents Fernando Henrique Cardoso, Luiz Inácio Lula da Silva (Lula), and Dilma Rousseff. The main consequence of this hegemony is that, even though Brazil has engaged in several trade negotiation initiatives, the country has systematically adopted defensive stances.

Brazil has been lagging behind in the race to negotiate preferential trade agreements that have dominated the international trade system since the beginning of the 1990s. Besides free trade agreements signed with South American countries (Bolivia, Chile, Colombia, Ecuador, Peru, and Venezuela), after a long period of negotiations, and with Israel, other trade agreements in force are very limited in scope (India, Mexico, and the South African Customs Union). There are also free trade agreements negotiated with Egypt and Palestine.

More recently, the perception that Brazilian companies are not integrated in global value chains and that the country needs to depend on exports to recover economic growth has prompted a domestic debate about the need to open up the economy.

There is a growing convergence of visions coming from segments of the business community and trade policymakers regarding the importance of deepening the participation of Brazil in preferential trade agreements. In 2019, MERCOSUR's negotiations with the European Union and the European Free Trade Association (EFTA) were successfully concluded. Currently, MERCOSUR is negotiating with Canada, the EFTA, Singapore, and South Korea. Trade talks to enlarge the preferential agreement with India and to launch negotiations with Lebanon and Tunisia are on the official agenda as well.

Much less convergence exists around the idea of a new round of unilateral import liberalization and its role as a driver of productivity and economic growth in Brazil. Unilateral trade liberalization is strongly resisted by incumbent interests and seems to have been left aside in the current policy agenda. Trade facilitation is, perhaps, the only area where relevant progress has been made in recent years.

3.2. Trade Policymaking: Institutions and Players

Since the beginning of the 1990s, trade policymaking has gone through deep changes in Brazil involving the internal organization of the executive branch, the participation of different groups of civil society, and the forms and channels of dialogue and negotiation between the state and these groups.

The main drivers of the resetting of the institutional structure of trade policy have been (1) unilateral trade liberalization in the early years of the

decade and the tariff structure that resulted from that reform; and (2) Brazil's commitments in MERCOSUR—most notably the common external tariff—and in the WTO's Uruguay Round.

Specifically on the export policy side, the concerns generated by the 1995 Mexican crisis and the appreciation of the real after 1994 created incentives to establish new financing and guarantee instruments as well as a new trade promotion agency.

In addition to contributing to establishing the institutional structure of trade policy in the 1990s, the Free Trade Agreement of the Americas (FTAA) and the European Union-MERCOSUR negotiations triggered an intense mobilization of players from civil society—especially from the business sector—that went beyond the impact of these agreements on the state's institutional structure and the public players. The thematic scope of these negotiations was wide, and the issues dealt with in many areas were almost unknown to Brazilian officials or the civil society organizations involved.

At the same time, trade policy is the domain of the executive branch of the government, with the role of Congress in trade policy limited to ratifying the trade agreements negotiated and signed by the executive. Perhaps reflecting this distribution of power within the state structure, trade policy has historically received very little institutional attention from the Congress.

3.2.1. Institutions of the Executive: CAMEX and the Institutional Framework of Protection Policies

After the unilateral liberalization episode of the early 1990s, the institutional structure of trade policy was gradually revamped, and the different policy issues—financing and guarantees, export promotion, and trade defense—were distributed among different bodies of the executive branch.

A high-level interministerial body—the Foreign Trade Chamber (CAMEX)—was established as a mechanism to streamline the decision-making process in trade policy and to improve policy coordination among the different institutions in charge of issues related to trade policy. Initially CAMEX had no operational functions in trade policymaking, and its tasks did not affect those that corresponded to other public institutions acting in the trade policy arena.

When it was established in 1995, CAMEX was part of the office of the president, but it was moved in 1998 to the Ministry of Development and Foreign Trade, where it remained until 2016, when it was moved to the Ministry of Foreign Affairs. At the start of 2019, the newly created Ministry of Economy absorbed the Ministry of Development and Foreign Trade, and CAMEX became part of the structure of the new ministry.

Constituted as an Executive Secretariat and a Council of Ministers—despite being institutionally assigned to a specific ministry—CAMEX gradually established in its structure a network of bodies that generally involved the same ministers who make up its council. These bodies act as working groups and advise the council on specific policy issues, such as foreign direct investment policies, trade and investment negotiations, trade facilitation, trade defense, services, etc.

In 2001, CAMEX was assigned to take binding decisions (by consensus) in trade policy through its resolutions. In the same year, CAMEX was granted the right to decide on import and export tariffs and on the adoption of trade defense measures. Previously, changes in tariffs made by the Ministry of Finance and trade defense measures were adopted through a joint decision by the Ministry of Development and Foreign Trade and the Ministry of Finance.

These were important institutional changes because they reduced the power of the Ministry of Finance—historically more liberal than other ministries intervening in trade policy—in defining import protection policies. This shifted the balance in favor of the Ministry of Development, Industry, and Foreign Trade, whose main constituencies are the import-competing industrial sectors.⁴

Gradually, CAMEX's institutional profile moved away from its original coordinating functions to a more operational one specializing in the daily operation of topical issues on the trade agenda, while at the same time strengthening its linkages to the industrial sector (Fernandes 2013).

Although CAMEX's institutional tasks cover all the fields of trade policy, in practice its role is especially relevant in the management of four areas: tariff policy, trade defense, trade negotiations, and, more recently, trade facilitation. Trade promotion and export financing and guarantees have institutional structures that operate *de facto* in a relatively autonomous way *vis-à-vis* CAMEX, despite being formally subordinated to the chamber.

The sections that follow summarize the main features of the institutional structures and policy functions that operate under the umbrella of CAMEX and play a relevant role in managing the protection for domestic producers and in the political economy of trade policy: tariff policy, trade defense, and trade negotiations.

⁴ Article 237 of the Federal Constitution assigns the control and supervision of Brazil's foreign trade to the Ministry of Finance, following a "tax collection" rationale (since the national tax authority is institutionally located within the structure of the Ministry of Finance). However, the power to change import tariffs was moved to CAMEX on the grounds that tariffs are a regulatory tool for industrial policy, not a tax instrument (Fernandes 2013).

Management of Tariff Policy

Brazil's tariff structure as it emerged from the 1990s trade reform is characterized by high dispersion in terms of nominal and effective protection, as well as by a large number of tariff levels.⁵ This tariff structure imposes high management costs because it creates incentives for sectoral interests to lobby for specific increases or reductions of tariffs.

The fact that the tariff policy includes “exception mechanisms”—allowing for the shifting of product-specific tariffs between different levels—adds complexity to its management, and increases its vulnerability to the pressures and demands of lobbies.

There are two main “exception mechanisms”: the so-called “exception list” to MERCOSUR's common external tariff (*Lista de Exceções à Tarifa Externa Comum* - LETEC), and the *ex-tarifário* regime, a unilateral tool that allows for the reduction of tariffs on capital, information technology, and telecommunications goods when there is no domestic production of the goods to be imported.⁶

MERCOSUR's exception list is limited in the case of Brazil to a small number of goods whose composition has varied over time. However, in June 2018, the *ex-tarifário* mechanism affected 4,119 goods (at the HS 10-digit level), with 64 percent of them capital goods; 24 percent related to optical, photographic, cinematographic, measuring, checking, precision, medical, or surgical instruments and apparatus, parts, and accessories thereof; and 9.2 percent information technology and telecommunications goods. The analysis of the existence (or lack) of domestic production of the goods to be imported involves the business associations representing the sectors affected and is far from transparent.

In addition to these two main exception mechanisms, Brazilian trade policy incorporates several special import regimes.⁷ These regimes provide for the exemption or suspension of the payment of tariffs and other taxes depending on the end use of imported products.⁸ The instruments allow for

⁵ The number of tariff levels further increased following negotiations to establish MERCOSUR's common external tariff.

⁶ In addition to the list created within MERCOSUR's normative structure, there are other exception mechanisms to the tariff policy that allow for temporary reductions for reasons of supply shortages of specific products. This tool is regulated through MERCOSUR Resolution 08/2008 and was most intensively used by Brazil between 2014 and 2016.

⁷ The special import regimes include Drawback, Reporto, Repetro, and Recof. See <http://www.mdic.gov.br/index.php/competitividade-industrial/aco-es-e-programas-13/estatisticas-dados-abertos>.

⁸ See <http://idg.receita.fazenda.gov.br/orientacao/aduaneira/regimes-e-controles-especiais/regimes-aduaneiros-especiais/>.

the nonpayment of tariffs when the Imported products will be incorporated into the production of goods destined for export, or for domestic consumption in some cases. In order to access these special regimes, companies must go through bureaucratic processes that are burdensome and costly. Most of the regimes benefit large companies, since small and medium-size firms are not able to meet the bureaucratic requirements.

These exceptions and special regimes reduce the import costs for large exporting companies that incorporate imported inputs and parts in their production processes. Hence, they act as a compensation scheme for the exporting companies that could support import liberalization in Brazil.

In broader terms, the main features of Brazil's tariff structure and the presence of exception mechanisms, as well as the various special import regimes (such as the drawback regime), make the management of tariff policy in Brazil complex and subject to negotiations with private sector entities demanding tariff "adjustments." Such an environment is conducive to activities by special interests aimed at preserving the protected domestic market for local producers.

Management of Trade Defense Instruments

A Department of Trade Defense dedicated specifically to conducting trade defense investigations was created within the Ministry of Development and Foreign Trade in 1995, when Brazil internalized the WTO agreements on anti-dumping and on subsidies and countervailing measures.

In 2001, the legal task to decide whether to apply trade defense measures was given to CAMEX, but the Department of Trade Defense maintained the responsibility to conduct the investigations and formulate the proposals to be submitted for CAMEX's decisions.

During the period from 2010 to 2017, Brazil was second in the world ranking of users of the anti-dumping instrument, only surpassed by India. During this period Brazil initiated 230 anti-dumping investigations. Between 2010 and 2014, Brazil was responsible for a significant share of initiated anti-dumping investigations (ranging from 10 to 23 percent depending on the year considered).⁹

Management of Trade Negotiations

In the 1990s, trade negotiations took on unprecedented importance in Brazil's trade policy as a consequence of the simultaneity of intra-MERCOSUR, FTAA,

⁹ *PC em Foco - Observatório de Política Comercial*, various issues.

and European Union-MERCOSUR negotiations. This development had effects on the institutional structure of trade policy, with huge implications not only for the organization of the public entities involved, but also for the relationships between public and private stakeholders.

At the government level, taking part in negotiations with a broad thematic scope required that many public entities not directly in charge of trade issues be brought into the trade policymaking process for the discussion and formulation of negotiating positions.

Consultation and coordination mechanisms were established that went beyond the scope of the public sector, as they involved representatives from civil society. In fact, the FTAA negotiations were the driving force behind a broad mobilization and organization of different social groups around the trade negotiation issue, although intra-MERCOSUR negotiations (mainly between 1994 and 1997) and WTO-related activities (between 2005 and 2008) also provided the opportunity for different social groups to approach the trade negotiation agenda and policy arena.

From 2003 onward, as the FTAA and European Union-MERCOSUR negotiations were halted or lost traction, the network of intra-governmental coordination entities was almost completely dismantled. The relevance of trade negotiations in the Brazilian agenda faded—with some episodic surges of mobilization, as in 2008, during the “Lamy package” negotiations at the WTO—and trade policymaking turned to the business-as-usual management of unilateral tools.

3.2.2. The Legislative Branch and Trade Policy

In Brazil, trade policy is the domain of the executive branch of the government, with the role of Congress in trade policy limited to ratifying the trade agreements negotiated and signed by the executive. Perhaps reflecting this distribution of power within the state structure, trade policy has historically received very little institutional attention from the Congress.

However, the FTAA negotiations captured the interest of the Congress. In fact, as the FTAA negotiations ensued, the trade policy issue began to draw the attention of members of Congress, especially those close to leftist parties that were against the very idea of the agreement. A Special Commission on the FTAA negotiations was created in the Congress in 1997 as a forum to monitor the process and participate in it.

Later, in another episode involving trade policy, the Congress, under pressure from the Textile Parliamentary Front, rejected Brazil’s commitment at the WTO to eliminate import duties and quotas applying to imports from least developed countries.

In sum, while the institutionalized presence of the Congress in the trade policy arena has been limited, the same cannot be said of members of Congress individually or grouped in specific product-driven coalitions. As stressed by one of the interviewees for this chapter, a former Secretary of Foreign Trade of the Ministry of Development and Foreign Trade, “There is almost no interest in trade policy among Congressmen, but they can be active on very specific issues.” In general, those issues relate to the interests of constituencies from the congresspersons’ electoral base. According to the interviewee, “It happens all the time, and it absorbs a lot of the working time of the government agents” working with trade policy.

3.2.3. The Involvement of Civil Society in the Trade Policy Arena

The Industrial Sector

In the mid-1990s, there was a widespread perception inside the business sector that the lack of mobilization to influence trade policy during the unilateral liberalization and the early MERCOSUR years was a mistake. This perception provided the incentive for strong and growing participation of the business sector during the FTAA negotiations.

Pushed by the FTAA negotiations and articulated around the National Confederation of Industries (*Confederação Nacional da Indústria - CNI*), the Brazilian Business Coalition (*Coalizão Empresarial Brasileira - CEB*) was founded in 1996 to bring together the industrial, agriculture, and services sectors. The CEB is an institutional novelty not only because it brings together different sectors on a voluntary basis (and on an autonomous basis vis-à-vis the government) and acts as a forum for direct negotiations and consensus-building among these sectors, but also because it is a business organization focused on one issue: trade negotiations.

Despite its broad sectoral coverage, the CEB is strongly dominated by the interests of Brazilian industry and, within industry, the import-competing sectors. Consequently, the positions expressly presented by the business sector in trade negotiations through the CEB have focused mainly on issues relating to the protection of the domestic market (tariff issues, rules of origin, and instruments of trade defense) and have given priority to the need to moderate any new initiatives to liberalize trade—whether preferential or multilateral. In these preferential negotiation processes, the positions advocated by the CEB have traditionally been close to those adopted by the Brazilian government, such as defense of asymmetric reciprocity in the trade liberalization schemes negotiated with northern countries, and adoption of the General Agreement on Trade in Services (GATS) model of services agreements, among others.

The CEB also follows WTO negotiations, and its documents usually emphasize the key relevance of the multilateral sphere for Brazil, especially as regards negotiations on trade rules and new issues—a position that is also very close to the one adopted by state players. The CEB articulates the various sectoral interests of the business sector by coordinating interlocution with the organs of the federal government. Depending on the dynamics of the negotiations, there can be frequent meetings with the negotiators, and negotiating positions in areas related to market access for goods are the main topics of the CEB's consultations with the government. Through its website, the CEB makes the consultations available to its more than 100 (sectoral and other) associations and collects and systematizes the positions received from them before forwarding them to the government. In addition, the CEB follows the rounds of preferential negotiations by means of a “next-door room,” where the interlocution with the government agents is processed before and after the negotiations.

The Agricultural Sector

Until 1990, agricultural exports were concentrated in traditional primary goods—coffee, cocoa, and cotton, among others—and the sector was protected from imports and strongly regulated by the government, including through entities dedicated to specific products (sugar and ethanol, cocoa, coffee).

However, in the early 1990s, the sector benefited from a series of market deregulation measures that dismantled the state's institutional structure responsible for managing the prices, exports, and stocks of agricultural products. The unilateral trade liberalization also played a relevant role, as it reduced tariffs on inputs and machinery for the agricultural sector. New legislation exempting agricultural exports from subnational taxes gave an additional impetus to change the policy environment in which the agricultural sector operated and to boost exports.¹⁰

The response of Brazilian agriculture to this new environment was impressive: productivity grew rapidly, exports of commodities expanded, and, at the end of the decade, the sector became a net exporter. The sector “discovered itself as a player internationally competitive that faced export barriers in other countries.”¹¹ At the time, the sector's representatives adopted a proactive strategy, pushing the government toward more aggressive negotiating positions in agriculture in the FTAA as well as in European Union-MERCOSUR

¹⁰ Interview with a former secretary in the Ministry of Agriculture who is also a business leader from the agricultural sector.

¹¹ Interview with the former CEO of ICONE.

trade talks. In the WTO, this new stance from the private sector was crucial for the government decision to require the establishment of three dispute-settlement panels against the United States and the European Union at the start of the 2000s.¹²

From 2004 onward, the policy dynamics that gave traction to the participation of the agricultural sector in trade negotiations faded. At the same time, China emerged as a huge potential importer of Brazil's commodities, giving the agricultural sector a new "big push" based on rising productivity, increased mechanization, and the strengthening of export-oriented production.

This new context significantly reduced the interest of the modern and export-oriented agricultural sector in trade policymaking and in the trade policy agenda. The sector turned to Asian markets and left aside paying attention to the negotiations on market access and subsidies with developed countries.

By contrast, recent years have witnessed activism in trade policy by agricultural subsectors that compete with imports. According to an expert from the export-oriented sector, "These segments (dairy, apple, wheat, coffee, and even ethanol) have occupied the trade policy arena with a protectionist agenda."¹³ Recent episodes confirm that some agricultural segments have been active in demanding protection from imports for their products. The most notorious episodes, both in 2017, involve coffee and imports of it from Vietnam, and ethanol and imports of it from the United States.¹⁴

3.2.4. Drivers of the Evolution of the Institutional Framework

The institutional framework of trade policy established in the 1990s showed a high degree of continuity. From 1995 onward, the institutional structure was quite stable even though it underwent some changes, reflecting the growing complexity of the trade policy agenda and the dynamics of its political economy.

¹² The products involved in the dispute settlement cases were cotton, soya, and chicken meat.

¹³ Interview with the former CEO of ICONE.

¹⁴ In the first case, in February 2017, under pressure from the coffee sector, CAMEX quantitatively limited annual imports of the conilon type of coffee from Vietnam. However, the mobilization of the sector, including through the National Confederation of Agriculture as well as members of Congress from different political parties and from the producer states, led President Michel Temer to suspend imports of the product, even within the quota set by CAMEX. In the second case, in September 2017, CAMEX approved a quantitative quota for tariff-free imports of ethanol. Beyond the quota, the imports will be taxed at 20 percent. The decision was welcomed by the business organization that represents the sugar and ethanol sector, which in trade negotiations had always adopted offense-oriented positions and advocated for the suppression of tariffs and quantitative restrictions to trade by the other negotiating partners.

There are two main drivers of the evolution of the institutional framework established during the 1990s. The first is the thematic expansion of the trade policy agenda as a result of the participation of Brazil on different negotiating fronts—particularly those involving developed countries (the European Union and the United States). The fact that a wide array of state institutions have some kind of responsibility related to the control of trade flows has also contributed to amplifying the trade policy arena and bringing new public sector players to it. Besides pushing for institutional evolution at the public sector level, the negotiations with developed countries triggered a strong mobilization of segments of civil society, most notably the business sector.

The second driver relates to the central role gradually acquired by the Ministry of Development and Foreign Trade in the formal coordination and enforcement of trade policy (through the CAMEX Executive Secretariat) and, particularly, in the control and management of the tools relevant to protection policy—most notably, the tariff exception mechanisms and trade defense instruments. As stressed by Fernandes (2013, 10), “The control over the import and export tariffs and over the trade defense instruments widened the range of measures available to the Ministry of Development, Industry and Foreign Trade to attend its main constituency: the industrial sector.”

Moreover, the ministry has consolidated a strong position as the main governmental interlocutor for the industrial sector, whose views and interests it expresses within the government. This role appears clearly in the process of position-building for the business sector, where the main business organization in the field of trade negotiations (the CEB) and the Secretariat of Foreign Trade of the Ministry have interacted actively.

Hence, besides having a privileged position to set the CAMEX agenda and coordinate the committees and working groups within its scope, the ministry manages a large part of the interest agenda of the import-competing industrial sectors, positioning itself within the government as the “representative” of these sectors’ interests and concerns.

Formally, this strategic positioning did not require major institutional shifts other than the assignment of CAMEX’s Secretariat to the ministry and the concentration in the Department of Trade Defense of tasks to conduct the anti-dumping investigations and decide on the application of the duties.

In this sense, the evolution of the institutional structure of trade policy has given import-competing industrial sectors an edge in advancing their interests. Agricultural segments that compete with imports and have protectionist positions—dairy products, wine, coffee, peaches, etc.—have also benefited from this evolution. In fact, the Ministry of Development and Foreign

Trade manages the protection tools geared not only to the industry, but also to agriculture (tariffs, trade defense, import licenses, etc.).¹⁵

3.3. Trade Policymaking: The Interplay between Institutions and Players

Until the end of the 1980s, the trade policy arena in Brazil was almost completely dominated by a few government agencies, among them CACEX, the foreign trade branch of Banco do Brasil that controlled the bulk of trade policy instruments and especially the tools for administrative protection against imports. Compared to administrative barriers imposed through CACEX's tools, tariffs played a very secondary role in the management of protection.

Informal and formal channels of dialogue between the government and the business sectors did exist. For instance, the business sector was formally represented on the Customs Policy Council (*Comissão de Política Aduaneira* - CPA), the agency in charge of the micro-management of tariffs according to the companies' annual import programs previously approved by CACEX. However, it seems correct to argue that informal channels played a relevant role in this dialogue, as CACEX's powers over imports were discretionary and managed through a myriad of non-transparent instruments.

Trade negotiations were limited to the Latin American Integration Association agreements based on reciprocal concessions that were carefully designed not to hurt vested interests in the countries involved. The interplay between the public and private players in this case involved the official negotiators and the companies and sectors that could be affected by the concessions or interested in them.

3.3.1. The Trajectory of Trade Policymaking since Unilateral Liberalization: A Stylized Description

The unilateral trade liberalization undertaken at the beginning of the 1990s and the early years of MERCOSUR are usually cited as an example of non-participation by the private sector and of government resistance to private sector attempts at interference. As shown below, the real picture is somewhat

¹⁵ It should be added that, in contrast to the ministry that is the main interlocutor of the export-oriented agricultural sector—the Ministry of Agriculture—the Ministry of Development and Foreign Trade was considerably strengthened in institutional terms during the 1990s and into the 2000s. Human and technical capabilities in the institutional areas dedicated to trade policy were considerably reinforced, a process that was not matched by the Ministry of Agriculture.

different as far as negotiation and enforcement of the new tariff structure with the business sectors concerned.

The negotiation of MERCOSUR's common external tariff (CET) reopened the doors of trade policymaking for the business sector. The Brazilian government pushed the business sector to participate in the process because the sector was looking for a CET as close as possible to the tariff structure that resulted from the country's unilateral trade liberalization.¹⁶

At the same time, MERCOSUR's institutional structure was defined, accommodating the participation of business sector and trade union representatives through the Social and Economic Consultative Forum (*Fórum Consultivo Econômico-social* – FCES) and the Technical Working Subgroups of the Common Market Commission.

The beginnings of the FTAA negotiations provoked an “earthquake” in the trade policy arena. The net output of these developments was gradual but impressive growth in the number of players involved in the policy process, both from the state and civil society. As a consequence, there was a significant diversification of positions with respect to the issues treated in the trade negotiations, largely as a result of new players appearing in the political arena. A policy arena almost entirely dominated by a traditional type of protectionist coalition that assembled state actors and import-competing business sectors was replaced by a more diversified policy landscape.

On the business side, the export-oriented agricultural sectors assumed unprecedented offense-oriented positions in the negotiations. Positions on the nongovernmental organization (NGO) side combined elements of classic protectionism—but geared to benefiting small-farmer sectors—with an important “societal” component that was made explicit in the work of the NGOs focusing on public health, the Agreement on Trade-Related Aspects of Intellectual Property Rights (known as TRIPS), and the environment.

On the state side, as the trade agenda was enlarged by incorporating issues that until then had been considered to be strictly domestic, the Ministry of Foreign Affairs' monopoly in trade negotiations was eroded and other government agencies needed to participate in the negotiation processes. In addition, different ministries expressed different (and at times divergent) positions—this was the case, for example, between the Ministries of Agriculture and Land Reform concerning negotiations at the WTO.

Changes to the orientation of trade policy under the Lula administration were the second major tipping point in trade policymaking after 1995—the

¹⁶ Interview with a former Brazilian official negotiator for the CET. It is worth remembering that development of the timetable for the unilateral trade liberalization in Brazil was still in progress during the CET negotiations.

first having been the launching of the FTAA negotiations. The semi-institutionalized structures created within the state and between the public sector and civil society gradually lost their relevance. The interruption of the preferential trade negotiations in 2004/2005 led to a rapid demobilization of the state's institutional structure dedicated to these negotiations as well as of the mechanisms of consultation with civil society.

The third post-1995 tipping point in trade policymaking in Brazil started in 2010 with the resurgence of protectionist measures to deal with the increase in industrial imports and ongoing difficulties faced by the industry to recover growth after the 2008 global financial crisis. The main instruments mobilized in this new protectionist cycle were nonborder measures, such as the requirement of local content, the setting of new government procurement rules favoring domestic producers, tax exemptions, and a huge subsidized program for investment financing through the Brazilian Development Banks.

As far as trade policy instruments in a narrow sense (e.g., border measures) are concerned, priority was given to trade defense mechanisms and the management of tariff exceptions—both instruments managed by the Ministry of Development and Foreign Trade.

A fourth tipping point came into play after the impeachment of President Rousseff in 2016 and after two years of economic recession. Many industrial policy tools with an anti-import bias were discontinued or revised, the use of trade defense instruments was reduced, and preferential trade negotiations returned to the trade policy agenda. In this new scenario, the debate on the country's trade policy and the need to open the Brazilian economy to the world gained some traction.

3.3.2. Trade Policy in the Making: What Drives the Political Economy of Trade Policy?

The Weight of Interests

Even for those players involved in the policymaking process, it is difficult to assess the actual influence exerted by civil society organizations and interests in the setting of the trade strategy.

There are many examples of this kind of influence at the micro level of negotiations. The negotiations on the European Union-MERCOSUR agenda for rules applying to trade in goods owe a lot to the positions taken by the CEB. In the FTAA negotiations, the pressure exerted by NGOs and labor unions did not lead the government to abandon the process, but it surely abetted political support behind the government's reluctant position toward the negotiation process.

Maybe an iconic example is that provided by the MERCOSUR-Gulf Cooperation Council free trade negotiations launched in 2006. From the Brazilian side, there were different offense-oriented interests (especially among agricultural sectors) pushing for the agreement, with the only defensive interest being concentrated in the petrochemical sector. On the Gulf side, the petrochemical sector was the only offense-oriented interest. The sector's nationwide chemical association requested the exclusion of the petrochemical sector from the tariff elimination schedules, which was rejected by the Gulf countries. Establishment of a special safeguard for the sector was envisaged, and the Gulf countries agreed on limited market access regulated by quotas. These proposals were rejected by the main petrochemical companies in Brazil—Petrobras and Braskem—and by the sectoral association. CAMEX ratified the position of the companies, and the negotiations were abandoned.¹⁷

Despite these striking examples of almost direct influence of vested interests in trade policy decisions, the political economy of these policies should not be reduced to the interplay of public and private actors set in motion exclusively according to economic interests.

This leads to a central question about the drivers of trade policymaking in Brazil during this period and the sources of influence of different players on the direction and options of trade policy.

In the case of the export-oriented segments of the agricultural sector (agribusiness), influence on trade policy between 1995 and 2003 relied on a structural change—namely, the huge expansion of this sector's productivity and the striking growth in exports from the 1990s onward. By the same token, that the agribusiness sector distanced itself from trade policymaking after 2003 can be explained by the growing dynamism of new markets for its products in Asia, particularly in China, and their impact on commodity prices. Therefore, in the case of the agribusiness sector, its relationship with the trade policy arena seems to be strongly related to structural factors. It approached the arena of trade negotiations as its offense-oriented interests became clear, but it distanced itself when new markets emerged, commodity prices boomed, and trade negotiations proved to be a hard road as a market access strategy.

In the case of the manufacturing sector, structural change goes in the opposite direction from that observed in the agribusiness sector: the weight of the manufacturing sector in GDP and in exports has decreased sharply, labor productivity has stagnated, and manufacturing exports have lost market share in their main foreign markets. In addition, in contrast to what happened in the agricultural sector, development of an export-oriented sector was essentially marginal in the

¹⁷ Interviews with two former high-ranking officials of the Foreign Trade Secretary.

manufacturing sector. Except for very few sectors (aeronautics among them), manufacturing focuses on the domestic market, where it competes with imports.

As the influence of the agricultural sector grew in tandem with its contribution to Brazil's exports and trade balance, one might have expected that the "shrinking" of the manufacturing sector would lead to a decreasing influence on trade policymaking. However, this is not what happened. To the contrary, for more than 50 years, and despite the trade liberalization episode of the early 1990s, the interests of the manufacturing sector have continued to dominate the political economy of trade policy in Brazil. How can one make sense of this privileged stance in trade policymaking given to the manufacturing sectors that compete with imports?

What has played a major role here has been the ability of the industrial sector to effectively organize and mobilize to defend its interests since the unilateral trade liberalization, but especially during periods when major threats were perceived. To exert its influence, the industrial sector not only put in place a unique organization geared toward trade negotiations (the CEB), it also created technical teams exclusively dedicated to trade and investment issues, especially in nationwide "horizontal" and sectoral organizations.

According to representatives of industrial associations interviewed for this chapter, technical studies and documents produced by these teams play a major role in the relationship the sector has established with government agencies, particularly the Ministry of Development, Industry, and Foreign Trade—which is the main interlocutor of the associations for a broad array of policy issues—and the Ministry of Foreign Affairs (when the issue relates to trade negotiations).

In the case of horizontal (cross-sectoral) associations such as the CNI, more institutionalized channels of influence are also available. For example, the CEB is a permanent partner of the public entities in charge of trade negotiations, and the CNI participates in some committees created within CAMEX's structure and presents its ideas in the media through articles signed by its president.¹⁸ However, both horizontal and sectoral business associations have also stressed the relevance of direct contacts and informal dialogue with the government.

In addition, the industrial sector has been able to influence the power shifts taking place in the state institutional structure, fostering those changes that were favorable to its interests and contributing to block shifts seen as unfavorable.

¹⁸ In a few cases, when a trade issue becomes a source of public disagreement between the players, advertising in newspapers to expose the position of an association (or a group of associations) has also been a tool used to influence governmental decisions. This was the case in the intra-industrial dispute on the enforcement of anti-dumping duties on imports of steel from China and Russia (see Section 3.3.3).

In this sense, while the evolution of the institutional structure of trade policy has given import-competing industrial sectors an edge in advancing their interests, that evolution itself was strongly influenced by the organization and mobilization of the industrial sector in pushing for increasing control by the Ministry of Development, Industry, and Foreign Trade over protectionist policy tools.

In an apparent paradox, there is little if any conflict in Brazil between the export-oriented agricultural sectors, on one side, and industrial and agricultural sectors competing with imports,¹⁹ on the other. Conflict has emerged at very specific moments, such as when trade negotiations in the FTAA and with the European Union seemed to reach decisive steps, but otherwise frictions between these interests have been quite mild. The export-oriented sectors do not push for unilateral import liberalization.

How to make sense of this? On one hand, the agribusiness sector exports the bulk of its production, and its exports have largely benefited from high international prices and strong demand from Asian countries during much of the period analyzed here. On the other hand, imports of inputs can be made through drawback mechanisms, exempting the imports of export-oriented sectors from the cost of industrial tariffs (and other taxes charged to imports).

In the case of the few export-oriented manufacturing sectors, something similar occurs. These sectors do not carry the burden of the import tariffs applied to their inputs because they benefit from drawback mechanisms (or other mechanisms that are even more favorable). At the same time, they get some protection from tariffs for their products in the domestic market, while often facing zero or residual tariffs in their export markets. This leads to a situation in which export-oriented and internationally competitive industrial sectors do not press for trade liberalization in Brazil.²⁰ To the contrary, they support the protectionist status quo that guarantees them some non-residual level of tariff protection in comparison to export markets, where they frequently face no tariffs.

The Role of Ideas

The “privilege” granted to the manufacturing sector cannot be understood without referring to the weight of noneconomic sources of preferences (Jamal

¹⁹ Although industry is by far the main beneficiary of the protectionist trade policy historically adopted by Brazil, this policy does not stop at the limits of industry. In fact, recent years have witnessed activism in trade policy by the agricultural sectors that compete with imports—even when they also export.

²⁰ The mining sector, despite being essentially export-oriented, has never been active in the trade policy arena. It benefits from drawbacks and special import regimes when importing inputs and equipment and does not face barriers in external markets.

and Milner 2013) or ideas (Rodrik 2013) in shaping public policies. Here the central role of ideas points to the resilience of the protectionist paradigm of foreign economic policy consolidated during the period of import-substitution industrialization, even after that process lost traction as an engine of growth and industrial diversification. This resilience relies on the fact that support for the policy paradigm goes far beyond the economic interests that benefit from the policies adopted and are based on a set of ideas largely shared by different segments of Brazilian society.

On the domestic front, this set of ideas is based on identification of the industrialization process as a “national economic project” and “national development”—the ultimate economic goal of an underdeveloped country. That view was crafted during the import-substitution period and widely shared by politicians, academics, business, and trade unions.

In addition, in contrast to other Latin America countries, there is a widespread perception that the Brazilian import-substitution experience was successful. Brazil was able to build a very diversified industrial sector under the import-substitution model, a performance that appears to stand in clear contrast to the poor performance of Brazil’s economy in the first decades of the 20th century, when the economy was open and based on primary exports (Bacha 2016).²¹

In addition, starting in the 1950s, protecting domestic production against imports and favoring foreign investment (over imports) as an engine to increase domestic productive capacity was the favorite mix of “development policies.” This policy mix was widely perceived as positive in any situation, regardless of the incurred costs. It would not be excessive to argue that this perception became almost the standard wisdom among Brazil’s policymakers and its public bureaucracy within different ministries dealing with trade and industrial policies and issues.

On the external front, Brazil’s foreign policy—historically driven by economic concerns—emphasized the search for “autonomy” within the world economic order that emerged from World War II. The international order and its regimes were taken as expressions of the interests of developed countries—as opposed to the aspirations of developing countries—and as threats to the “autonomous” industrialization development model. As a consequence, Brazil’s participation in trade fora (such as the GATT/WTO) and in preferential

²¹ As asserted by one of the interviewees for this chapter, an ambassador who occupied high ranks in the Ministry of Foreign Affairs and CAMEX, “The costs of the model were not clear at the time and they appear later on. Competitiveness problems associated with this model were hidden by the transfer of resources, through different policies, from the government to the private sector.”

trade negotiations was driven by the demand for special and differentiated treatment (as a developing country) and by the objective of avoiding external commitments that might jeopardize national economic development and the consolidation of industry.

This set of ideas about the international order and the challenges it imposed on Brazil's development managed to influence the political economy of trade policy because the ideas were embedded into institutions in charge of defining the direction of that policy. These ideas have largely informed the positions taken by the Ministry of Foreign Affairs since the period of import substitution. As a strategic component of the model of industrial development, the ideas institutionally leveraged the role of the Ministry of Foreign Affairs and professional diplomacy in trade policy.²²

Without taking into account the hypothesis that ideas matter for understanding the political economy of trade policy in Brazil, it seems impossible to make sense of the continuity that has characterized the political economy of the country's trade policy before and since the unilateral trade liberalization of the 1990s. The influence of these ideas owes a lot to the fact that they have been absorbed and sustained by several public institutions in charge of trade policy and by their bureaucracies.

3.3.3. Some Revealing Episodes of the Political Economy of Trade Policy

The Unilateral Trade Liberalization of the 1990s and the Negotiations of MERCOSUR's Common External Tariff: Rupture and Continuity

The current Brazilian tariff structure is the output of two consecutive initiatives: the unilateral trade liberalization and the setting of MERCOSUR's common external tariff (LETEC). These episodes are relevant because they are landmarks in the trade policy trajectory of the last 30 years, but also because they still provide the basic reference for the Brazilian debate on trade liberalization and its impact, costs, and benefits.

The first movement toward reforming the tariff structure took place starting in 1985. The decision was taken to "modernize" the Brazilian tariff structure to adapt it to the needs for the development of industry. The CPA presented a proposal to rationalize the protection structure, which reduced

²² As expressed by an ambassador interviewed for the chapter, "Rigorously speaking, the Ministry of Foreign Affairs has no role in the setting of trade policy, but its influence derives from the fact that it acts as the external interface of the policy and it has bureaucratic autonomy and continuity, in contrast with other ministries."

the average level of nominal tariffs for manufactured goods to 51 percent (and the average for all products to 50 percent). A small number of special import regimes were eliminated—although the bulk remained in force—some surcharge taxes levied on imports were extinguished, and tariff peaks were reduced. However, the system of nontariff barriers itself remained in place.

The limited reach of the reform did not prevent it from being resisted by highly ranked diplomats and the bureaucracy in charge of managing the import programs of the companies and investment projects supported by government incentives.²³

The next step was the trade liberalization initiated in 1990. The original timetable for tariff reduction was scheduled to conclude in December 1994, but the timetable was subsequently moved up and the tariff levels targeted were reached at the end of the first half of 1993.

The myriad of nontariff barriers that characterized Brazilian trade policy was also targeted by the reform, which eliminated the import prohibition applied to 1,200 goods, the requirement for firms to present their annual import programs, and the requirement to get prior authorization from the government for the import of specific goods, among other measures.

The decision to enforce a trade reform was taken before the inauguration of Fernando Collor de Mello, who was elected president in December 1989. Collor had previously been the governor of a small state in the Northeastern region—the poorest region of the country—and was at the time an outsider vis-à-vis Brazil's economic and political establishment. Outsider as he was, Collor brought to the Brazilian state a set of new ideas and policy guidelines that strongly valued openness to the world economy, industrial modernization, privatization, and macroeconomic stabilization, all working together. These ideas were almost nonexistent in the state bureaucracy prior to that time, and from the viewpoint of the Ministry of Foreign Affairs they diverged considerably from the foreign policy prevailing since the 1960s.²⁴

The first proposal for tariff reform that circulated within the government included a 40 percent maximum tariff, with the tariff mode defined at 20 percent and the average tariff at 14 percent. The tariff structure was then gradually filled out based on certain criteria. The decision was taken to reduce tariffs on capital and intermediate goods more rapidly than those on final goods. The

²³ Ibid. At this time, the CPA also worked on the texts internalizing the GATT Codes on Antidumping and Subsidies and Countervailing Duties, which Brazil had signed at the Tokyo Round.

²⁴ Interview with an ambassador who held high-ranking positions in the Ministry of Foreign Affairs and the Ministry of Finance. Not by chance, the official's team that designed and enforced the new guidelines in trade and industrial policy was institutionally distant from the political and economic establishment in Brasília. Many team members came from Rio's Catholic University (PUC-Rio) and had economic ideas close to the so-called "Washington Consensus."

rationale behind this decision was a political economy one. As the liberalization was scheduled to be gradual, pressures were expected to increase, and the government opted to gather the support of the sectors negatively impacted by the protection afforded to capital and intermediate goods.

Pressures arose even before the official announcement of the new tariff structure in February 1991, surprisingly coming mainly from high-ranking officials of the Ministry of Economy.²⁵ These pressures addressed specific sectors that were the traditional targets of industrial policies, including information technology (strongly protected by a highly protectionist sectoral policy), vehicles, and electronics sectors. The tariffs of these sectors were set at 20 percent, but under pressures they were raised to 30 or 35 percent.²⁶

The changes under the trade reform of the early 1990s were significant. Besides the withdrawal of many nontariff barriers, the reform led to a decline in the average tariff from 50 percent in 1989 to 13.2 percent in 1993 and decreases in the maximum tariff from 105 to 40 percent and in the modal tariff from 40 to 20 percent over the same period. Between 1990 and 1995, the import coefficient of industry grew from 9.1 to 13.8 percent, while the export coefficient went from 9.1 to 12.8 percent (Markwald 2001).

Despite these impressive outputs, previous assessments of the tariff structure resulting from the trade reform of the early 1990s have stressed that some major features of the tariff structure in force before the reform were not challenged. The highest levels of post-reform protection benefited the same sectors that had been favored by the industrial and export policies in the previous decades: vehicles, capital goods, and electronics (Motta Veiga 1999). Under the post-trade reform scenario, some of the sectors that benefited from high levels of protection before the reform were further favored by sectoral incentives and regimes that survived the reform process (e.g., the *Zona Franca de Manaus* for the electronics sector) or that were established after it (e.g., the *Regime Automotivo* for the auto sector).

As far as the political economy of the trade reform is concerned, opting for a tariff structure based on “tariff escalation” and benefiting the same industrial sectors favored by the pre-reform structure seemed to have smoothed the reactions of the private sector.

MERCOSUR provided the opportunity for resetting the close relationship that had prevailed before the trade reform between the governmental

²⁵ The Collor government promoted a reorganization of the state structure by merging different ministries. The newly created Ministry of the Economy united the former Ministries of Finance, Planning and Industry, and Trade.

²⁶ Interview with a former coordinator at the Technical Tariffs Committee (*Comite Técnico de Tarifas* - CTT).

entities in charge of tariff policy and the different manufacturing sectors. The negotiation of MERCOSUR's CET in 1992 and 1993 made clear that Brazil's MERCOSUR partners were interested in negotiating an expressive reduction of the tariffs as compared to the previous subregional average tariffs and to the Brazilian tariff, especially in some sectors considered as sensitive. Besides this horizontal issue, there were strong divergences between Brazil and its partners regarding tariffs applying to capital, information technology, and telecommunications goods. In order to accommodate these divergences, several exception mechanisms were deployed in addition to the exception list to MERCOSUR's CET.

As for the political economy of trade policy, if the unilateral trade liberalization is a landmark of state autonomy in setting and enforcing a public policy, the negotiation of MERCOSUR's CET can be seen as a process that re-established the "bridges" between trade policymakers and representatives of the industrial sector.

Brazil and the FTAA Negotiations: The Foreign Policy Paradigm at Work in Trade Negotiations

As previously noted, the FTAA negotiations triggered an "earthquake" in the trade policy arena in Brazil. In part, this impact owes to the novelty of the FTAA concept, as seen from the point of view of Brazil's public and private sectors: a broad and multi-thematic free trade agreement inspired by the North American Free Trade Agreement (NAFTA) model, in sharp contrast to the gradual integration methodology adopted by MERCOSUR at the start of the 1990s.

In addition, Brazil had just concluded its unilateral trade liberalization initiated in 1990 when the FTAA negotiations were launched at the Miami Summit in December 1994. Less than a year after, the process gained traction at the First Meeting of Trade Ministers, where the main parameters for establishing the free trade area were defined and seven working groups created to deal with the main issues to be negotiated.²⁷ High-ranking Brazilian diplomats and officials report that they were surprised by the ambitious goals and timetable set for the FTAA by the U.S. government. As stated in Lampreia (2010, 3), "There was strong pressure to go forward with the FTAA, to make it an ambitious liberalization agreement, a kind of generalization of NAFTA to all of Latin America."²⁸

²⁷ At the Second Ministerial meeting in Cartagena (1996), four other negotiating groups were added.

²⁸ Fernando Henrique Cardoso attended the Miami Summit in 1994 as president-elect. He admitted in his interview for this chapter that he had "no idea on the FTAA" and that he was surprised by the timetable and the goals set by the United States.

However, the impact of the launch of the FTAA in Brazil and the positions adopted by the country during the negotiations cannot be understood without reference to the paradigm that has dominated Brazilian foreign policy for at least half a century. In the case of the FTAA, this reference is relevant for three reasons.

First, as already explained, Brazil's foreign policy has avoided international commitments perceived as potentially limiting the space for industrialization and development policies. The FTAA "model" and its broad thematic agenda were soon perceived by the Brazilian establishment as threats to the autonomous management of such policies.

Second, Brazil's bilateral relationship with the United States has historically been a sensitive issue for Brazilian foreign policy. Brazil is located within the U.S. "sphere of influence," and the United States is the main sponsor of international trade regimes that Brazil has traditionally identified as a risk to its autonomous development.

Not by chance, one of the permanent objectives of Brazilian foreign policy has been the geographical diversification of partners and alliances deemed to be a factor of power "rebalancing" in the bilateral relation between Brazil and the United States. In this sense, the negotiations between MERCOSUR and the European Union—carried out at the same time as the FTAA negotiations—were perceived by the Ministry of Foreign Affairs as a "healthy alternative" to the FTAA option and to the concession of exclusive preferences (among developed countries) to the United States.

Third, MERCOSUR was at the time the main priority on the Brazilian foreign policy and trade agenda, and its consolidation was seen as the first step toward its expansion to all of South America. As stated by Ricupero (2017, 5), "From this point of view, the FTAA was obviously a de-structuration threat (of this project) more than an opportunity for market enlargement."²⁹

This foreign policy factor, in its three dimensions, is by far the more relevant to understanding Brazil's reluctance regarding the hemispheric project during the entire period of negotiation.³⁰ It points to the fact that Brazil's positions in trade negotiations with Northern countries—and especially with the United States—owe a lot to the main assumptions of its foreign policy paradigm.

As the FTAA negotiations evolved and the Brazilian business sector got involved in the process, the defensive stance derived from this foreign policy

²⁹ Since the Cartagena Ministerial Meeting (1996), MERCOSUR countries have acted as a sole player in the FTAA negotiations by presenting common proposals in the different working groups and other entities, setting the institutional structure for the negotiations.

³⁰ The other two factors were relevant immediately after the launching of the negotiations and during their initial stages but declined in importance as the negotiations evolved.

paradigm was reinforced by the mobilization of the import-competing industrial sectors concerned about what they perceived as the risks of the agreement.

Brazil's ambivalence towards the FTAA became a permanent feature of its participation in the process. In the FTAA's first years, that ambivalence was manifested in several positive proposals by Brazil apparently aimed at extending as much as possible the pre-negotiation and then the negotiation periods and to make it difficult to reach a consensus at the end of the process. In addition, Brazil defended the adoption of the "single undertaking" as a principle, conditioning its accession to the FTAA on agreements on all the topics under negotiation.

Once the negotiations started, Brazil—through MERCOSUR—was one of the most active participants, presenting a huge number of proposals for the texts of the different chapters that would make up the agreement. Except for agriculture, the proposals presented by MERCOSUR—largely reflecting Brazil's positions—were defensive and backed by an increasingly mobilized business sector.

As is well known, the negotiations did not narrow the position gaps between MERCOSUR, on one side, and the United States—followed by a wide number of Latin American countries—on the other. Tensions and divergences on the content of different chapters multiplied, but Brazil kept to its positions and even reinforced them when President Cardoso, at the Americas Summit in Quebec in 2001, presented in a speech a list of conditions to be met to avoid the FTAA being what he called "irrelevant or undesirable." President Cardoso's speech, seven years after the start of the negotiations, completely ignored the evolution of the negotiations and the issues at stake. To the contrary, it merely reiterated the well-known principles and main elements of the Brazilian agenda for the FTAA, presenting them as conditions to the country's commitment to the hemispheric process.

The Steel Anti-Dumping Controversy

In the middle of 2016 Brazil initiated an anti-dumping investigation on imports of hot rolled flat steel from China and Russia at the request of two domestic steel producers.³¹ The investigation, conducted by the Department of Trade Defense of the Ministry of Industry and Foreign Trade, concluded that the imports from both countries were dumped and set the level of anti-dumping duties to be applied. The department's report was then taken to the plenary of CAMEX for confirmation. However, what has followed has been far from the normal processing of decisions on the adoption of anti-dumping measures.

³¹ In November of the same year, a countervailing duties investigation was also initiated against imports of the same product from China.

As the report's conclusions were made public through the press, the case turned into a controversy. On one side of the debate were the steel producers—represented by the nationwide steel association and supported by the Ministry of Development and Foreign Trade. On the other side was a broad coalition of public and private players that included the Ministries of Finance and Agriculture and some 20 business associations, led by the nationwide machinery builders' association (*Associação Brasileira da Indústria de Máquinas e Equipamentos* – ABIMAQ), representing the sectors consuming steel products. Other powerful sectoral associations, such as those representing the auto sector and electronics associations, joined ABIMAQ, and the coalition undertook a public campaign against adoption of the duties defended by the steel producers. The coalition's main argument pointed to the impact that the adoption of the duties would have on the production costs and prices of the sectors consuming steel.

This unusual situation led the CAMEX plenary in October 2017 to postpone its decision on the matter until its January 2018 meeting. The campaign against adoption of the duties intensified as the date of the decision approached, and on the eve of the decisive CAMEX meeting the Ministry of Finance made public a Technical Note stressing the adverse effects of application of the duties on main industrial consumers of steel and on domestic prices indexes. Furthermore, in the days preceding the CAMEX meeting, the Ministry of Agriculture publicly announced that its vote would be against imposition of the anti-dumping duties. In this case, the rationale for the vote was the risk of Chinese retaliation against Brazil's decision and the negative effects that it could have on Brazilian agricultural exports to China.

On January 18, 2018, the CAMEX plenary of ministers decided to apply the anti-dumping measure, as recommended by the Department of Trade Defense investigations and conclusions, but it suspended application of the measure for one year for public interest reasons. During the period, the evolution of the market would be monitored to support the decision-making after the suspension period. This intermediary decision saved face for the Department of Trade Defense, but should be perceived as a result of the strong mobilization of the productive sectors potentially affected by adoption of the measure and of the Ministry of Finance.

3.4. Assessment of the Trade Policymaking Context in Brazil and Its Recent Evolution

This chapter has analyzed the main drivers of trade policymaking in Brazil starting with one general question: “Why is protectionism so persistent in Brazil?” The assessment of protectionism was based on an evaluation of the

role of two main factors in shaping trade policy in the country: ideas and interests.

The first conclusion is that interests count. Common sense suggests that manufacturing interests still dominate trade policymaking in Brazil, considering that the structure of protection heavily favors this sector. It would also be expected that there exists a high level of conflict between industrial sectors demanding protection and agriculture and services sectors calling for trade liberalization. As the process of deindustrialization of the Brazilian economy deepens and the industrial sector loses more of its share in the country's GDP, the interests of this sector should be losing ground in trade policy.

While the findings confirm the hypothesis that industry is still highly benefited by tariff and nontariff protection instruments, and that it has been able to deploy a broad and efficient structure to influence trade policy, one of the main conclusions of the chapter is that manufacturing is not the only sector to have protectionist interests in Brazil. Conflict over trade policy between industrial sectors demanding protection and agricultural sectors demanding liberalization has not played a relevant role in the dynamics of the political economy of trade policy. This is because, on the one hand, some economically relevant agriculture segments are oriented to the domestic market and do not want to face competition from imported goods. Their interests converge with those of the manufacturing sectors. On the other hand, the agribusiness sector has become competitive and seen its exports grow rapidly, having benefited significantly from high international prices and from strong demand from Asian countries during a large part of the period considered. These exports can rely on drawback mechanisms to benefit from exemptions of industrial tariffs (and other taxes charged to imports) when importing agricultural inputs for production.

This leads to a situation where export-oriented and internationally competitive sectors (be they in agribusiness or manufacturing) do not press for trade liberalization in Brazil. To the contrary, especially in the case of export-oriented manufacturing sectors (e.g., pulp and paper), they support the protectionist status quo that guarantees them some nonresidual level of tariff protection in comparison to export markets where they face no tariffs (or only residual tariffs).

So, in an apparent paradox, there is little or no conflict between agricultural sectors that are export-oriented and industrial and agricultural sectors competing with imports in Brazil. Conflicts have emerged at very specific moments, such as during the FTAA and European Union-MERCOSUR negotiations, but most of the time the export-oriented sectors do not push for domestic liberalization.

The implications of this situation for the political economy of trade policy are twofold:

1. On the trade negotiation front, export-oriented agricultural sectors are the only offense-oriented interest, but their presence in the negotiation arena varies according to circumstances. In the last few years, those sectors have not acted as a counterweight to the defense-oriented interests in trade negotiations, as they focused on the Asian markets.
2. On the unilateral trade policy front, no pressure in favor of liberalization comes from the business sector, either agricultural or industrial.

The second main conclusion is that ideas are also essential to explain Brazil's persistent protectionism. First, there is a widespread perception that Brazil owes its diversified industry base to the import-substitution model of industrialization. Second, the matching of a protected and large domestic market with the stimulus for foreign investment as an engine to spur national production is perceived as a winning strategy for industrialization.

These views are widespread among policymakers and business representatives in Brazil and continue to have the support of segments of academia in the country. This is why, even in the absence of specific lobbies or pressures, the Brazilian bureaucracy continues to devise policy mechanisms to stimulate the increase of domestic content in national production and to avoid the pressure of imported goods competition.

However, these ideas were challenged in the presidential campaign, in 2018. The program of the winning candidate, Jair Bolsonaro, acknowledged the costs of trade protectionism to the Brazilian economy and included a commitment to open the economy to foreign trade.

Accordingly, some relevant steps were taken through preferential trade agreements, with the conclusion of MERCOSUR negotiations with the European Union and the European Free Trade Area in 2019. This has been a landmark in the history of Brazil's economic foreign policy.³² For the first time, Brazil (through MERCOSUR) concluded a comprehensive trade agreement with developed countries whose objective is the setting of a free trade area between the regions involved.

Although relevant as a change in the historical trajectory of Brazil's economic foreign policy, liberalization through preferential trade agreements seems to have replaced, in the rhetoric and practice of trade policy, calls for

³² Brazil has historically avoided trade and investment agreements with developed countries, whose trade liberalization goals are perceived as threats to Brazil's import-competing industrial sector, and which view the sector's rules and disciplines as restrictions to "policy space," especially for industrial policies.

unilateral trade liberalization. This shift in priorities—from unilateral liberalization to liberalization driven by preferential trade agreements—was broadly supported and influenced by import-competing industrial sectors.

As a matter of fact, however, during the first 18 months of Bolsonaro's term, no relevant unilateral measure geared toward reducing the protection afforded to domestic producers was implemented. A proposal to reduce tariffs on capital and information technology and telecommunications goods developed under the previous government and discussed in the first months of the new one was ultimately not adopted, under pressure from the potentially affected sectors. At the same time, in the agricultural sector, some protectionist measures were enforced unilaterally, targeting specific products, such as bananas and powdered milk.

To sum up, the trade liberalization agenda was substantially downgraded in the ranking of policy priorities, which, consequently, reduced the priority given to the envisioned broad tariff reform. That reform overlaps with the MERCOSUR issue, because Brazil shares a CET with the other member countries.³³ From the outset of its term, the new government announced that it would propose a systemic review of the CET aimed at a 50 percent reduction of the applied tariffs across the sectors. Today the CET reform is still formally on the agenda, but no one expects that the discussion will lead to concrete outcomes in the near future.

It is worth noting that broad institutional reform was put in place at the outset of the new government's term, concentrating on the newly created Ministry of Economy. The trade policy institutions that were under the aegis of the Ministry of Industry and Foreign Trade, as well as that ministry itself, have been absorbed by the Ministry of Economy. This institutional shift seems to have been relevant for the successful conclusion of Brazil's negotiations (through MERCOSUR) with the European Union. Brazil made some relevant concessions during the final stage of the negotiations, and it is difficult to imagine that these changes would have occurred under the institutional arrangement in which the Ministry of Development and Foreign Trade played the major role, together with the Ministry of Foreign Affairs.

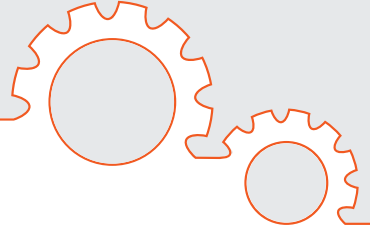
At the same time, however, the institutional change had no effect on the agenda of unilateral trade liberalization, which points to the limits of an understanding of Brazil's trade policymaking that might overemphasize the role of institutions. As stressed by Motta Veiga (2018), changes in trade policies rely essentially on strategic orientations shared by public and private players, and the role of the institutional framework is to facilitate or foster the strategy, not to replace it.

³³ While MERCOSUR is a customs union and supposedly has a common trade policy, in practice it is limited to an incomplete common external tariff.

Annex 3.1. List of Interviewees

1. **Abrão Arab Neto** – Foreign Trade Secretary at the Ministry of Development, Foreign Trade, and Services.
2. **Adriano Ramos** – Director of the Department of Trade Defense at the Ministry of Development, Foreign Trade, and Services.
3. **Carlos Márcio Cozendey** – Ambassador, former General Undersecretary for Economic Affairs at the Ministry of Foreign Affairs and Secretary of International Affairs at the Ministry of Finance.
4. **Daniel Godinho** – Former Foreign Trade Secretary at the Ministry of Development, Foreign Trade, and Services.
5. **Denise Gregori** – Former Advisor at CAMEX.
6. **Diego Bonomo** – Executive Manager Foreign Trade at the National Confederation of Industry (CNI).
7. **Domingos Mosca** – Consultant, ABIT, Brazil's Textile Industry Association.
8. **Fernando Henrique Cardoso** – Former Minister of Foreign Affairs, Minister of Finance, and President of the Republic.
9. **Honório Kume** – Former Coordinator of the Tariff Technical Commission at the Ministry of Economy.
10. **José Botafogo Gonçalves** – Ambassador, former Executive Secretary of CAMEX, and Minister of Ministry of Industry, Foreign Trade, and Services.
11. **José Tavares de Araújo, Jr.** – Former Director of the Tariff Policy Commission.
12. **Lígia Dutra** – Responsible for International Affairs at the National Confederation of Agriculture.
13. **Marcelo Estevão** – Secretary of International Affairs at the Ministry of Finance.
14. **Marcos Jank** – Former CEO of ICONE.
15. **Marco Polo Lopes** – Director of the *Instituto Aço Brasil*, a nationwide steel association.
16. **Marcos Pinheiro de Sá** – Advisor to the Secretary of International Affairs at the Ministry of Agriculture.
17. **Maria Sílvia Portella** – Advisor to the *Central Única dos Trabalhadores*, a trade union confederation.

18. **Mário Branco** – Advisor to the Brazilian Electrical and Electronics Industry Association.
19. **Pedro Camargo Neto** – Former President of the Brazilian Rural Society and former Agricultural Production Secretary at the Ministry of Agriculture.
20. **Pedro Passos** – CEO of Natura.
21. **Renato Baumann** – Undersecretary of International Affairs of the Ministry of Planning.
22. **Ronaldo Costa** – Ambassador – General Undersecretary for Economic Affairs at the Ministry of Foreign Affairs.
23. **Rosária Baptista** – Former Director of the Technical Department of Tariffs and of the Department of International Negotiations at the Ministry of Industry, Foreign Trade, and Services.
24. **Rubens Barbosa** – Ambassador, former General Undersecretary for Economic Affairs at the Ministry of Foreign Affairs, Brazilian Ambassador to Great Britain and the United States.
25. **Tomás Zanotto** – Director of International Trade at the *Federação das Indústrias do Estado de São Paulo* (FIESP), São Paulo’s Industry Federation.
26. **Tatiana Rosito** – Former Executive Secretary of CAMEX.
27. **Welber Barral** – Former Foreign Trade Secretary at the Ministry of Industry, Foreign Trade, and Services.



The Not-So-Boring Political Economy of Trade Policy in Chile

Nicolás Albertoni, Dorotea López, Milenka Montt, Felipe Muñoz, and Andrés Rebolledo

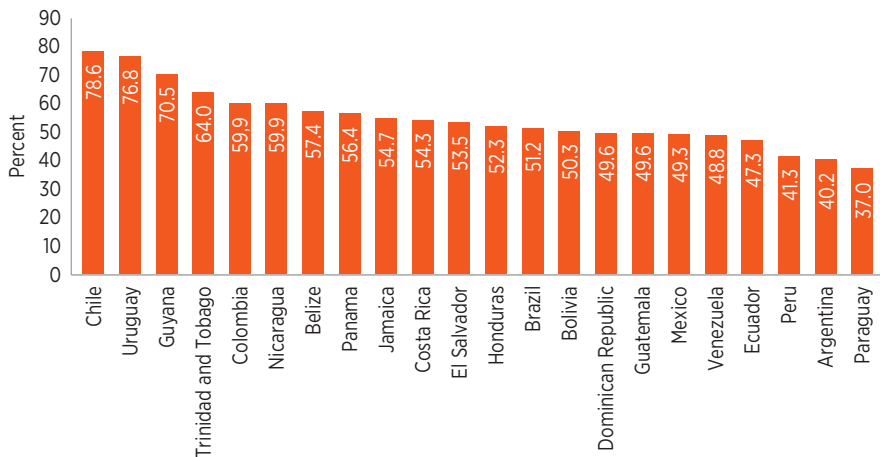
Chile's trade policy has been very active for the last 25 years, including implementing an open-economy strategy that adequately complemented unilateral instruments and conducting multilateral and bilateral trade negotiations, with the latter being fundamental to inserting the country into international markets and promoting growth and economic development.

Today Chile is among the countries in the world with the most extensive networks of trade agreements, with 26 in force with 64 countries that account for nearly two-thirds of the world population. The agreements cover more than 90 percent of Chile's foreign trade and almost 100 percent of its investment flows, which means that Chile has negotiated trade agreements with countries that account for 90 percent of GDP worldwide.

This result dates to a critical juncture in Chile's history: the end of the dictatorship and the beginning of democracy in the early 1990s. Although the trade policy at the time could have headed in different directions, including a reversal, it was decided to continue liberalizing policies that had begun in the 1970s and to resume historical ties with Chile's neighbors in the region and with the international community. The trade agreements, especially those signed with the Latin American countries, were conceived as the most appropriate way to resume international relations, which had been suspended or diminished during the 17 years of military government, and to bring more opportunities for Chilean products and services in international markets and greater liberalization of its local market.

This process of opening involved important productive and social adjustments that affected productive sectors that had to adapt, with the consequent political and economic challenges. The winning sectors that

Figure 4.1
Support for Free Trade Agreements in Latin America and the Caribbean, 2017 (percent)



Source: Prepared by the authors based on data from the Latin American Public Opinion Project.

began to export became allies and drivers of greater trade opening. The consensus in Chile on these agreements is much greater than in other countries of Latin America and the Caribbean (over 80 percent, compared to the 53 percent regional average) (Figure 4.1), and it includes unexpected actors: labor unions as well as manufacturing industries that compete with imports.

The main hypothesis of this chapter is that Chile has succeeded in liberalizing trade policy for two main reasons:

1. The economic success associated with the trade opening implemented during the dictatorship brought about a change in the winning and losing economic sectors that facilitated greater openness within the framework of the free trade agreements (FTA). In addition, the experience of political actors in exile (in social democratic countries) who led the country after 1991 contributed to the continuity of trade policy in the democracy.
2. The partners with whom FTAs were negotiated were always more protected than Chile, so the relative gain of the opening was much more attractive for Chile. In addition, the opening was based on a strong institutional structure, with the accumulation of negotiating skills in both

the public and private sectors. The use of compensation mechanisms for the losers, especially in the agricultural sector, was very relevant.

The main research question for this chapter is, what are the main elements that explain why Chile implemented a consistent trade liberalization policy, especially in the period after the return to democracy? To drill down into this question, the chapter will examine the role of Chile's textile and footwear sector, Price Band System, and labor unions in the Chile-U.S. free trade agreement.

4.1. A Brief History of Chile's Trade Policy

4.1.1. Chilean Trade Policy, 1973–1990: Economic Liberalization

In the 1970s, Chile was not an exception among Latin American countries, pursuing like others a strategy of import-substitution industrialization. The strategy was based on the thesis of Raúl Prebisch and Hans Singer in which the economic goal behind import-substitution industrialization policies was to shift the imbalanced fixed structure of global trade under which poor countries exported primary commodities to the rich countries, which then manufactured products from those commodities and sold them back to the poorer countries. Chile's import-substitution industrialization policy toolbox included high tariffs and heavily regulated trade (tariffs averaged 105 percent and were highly dispersed).

The main difference between Chile and the other Latin American countries was that in the mid-1970s, under the dictatorship of Augusto Pinochet, Chile changed its development strategy from import-substitution industrialization policies to an open trade regime (export-oriented strategy). More specifically, in 1974, tariffs were slashed and replaced by a uniform and significantly lower tariff. Protectionist measures were significantly reduced, which was an important incentive to increase imports and exports. Between 1974 and 1981, exports of fruit, timber, and fish products grew to equal exports of copper in value.

In sum, starting in 1974, Chile unilaterally adopted an open trade regime characterized by low uniform import tariffs, a lack of exchange controls, and minimum restrictions on capital movements. By 1979, Chile's trade policy had become highly liberalized. A 10 percent uniform import tariff took effect.

Chile persisted with its policies in the 1980s. After a brief increase to 15 percent in 1982, the uniform tariff fell back to 11 percent. One of the effects of that liberalization was lowered cost of imported agricultural inputs and capital goods, which allowed the agricultural sector to become more competitive internationally.

4.1.2. Chilean Trade Policy, 1991 to the Present: Consolidation and Modernization

This second period was marked by the return to democracy in Chile. In this period of transition, the country faced a critical juncture when it was decided to continue the policy of opening, as will be discussed in detail in the next section of this chapter. By the early 1990s, exports had become the main source of economic growth, and the Chilean trade reform was winning praise from multilateral institutions and analysts of different ideological persuasions. Largely because of the boom in exports between 1986 and 1991, particularly the increasing growth in exports of fresh fruits and manufactured products, Chile experienced the highest rate of GDP growth in Latin America, with an annual increase of 4.2 percent.

The first democratic president, Patricio Aylwin (1990–1994), elected in December 1989, maintained most of Pinochet’s foreign trade policies. This permitted Chile to enter into bilateral FTAs with several member countries of the Southern Cone Common Market (MERCOSUR) (Colombia, Ecuador, and Venezuela) and Canada. Aylwin decided to continue the liberalization process, and it was his administration that reduced import tariffs to a uniform 11 percent instead of 15 percent. Later, this tariff was dropped to 6 percent, and today it is 0.6 percent as a result of the trade agreement network.

In January 1995, Chile became a member of the World Trade Organization (it had been a contracting party to the 1947 General Agreement on Trade and Tariffs since March 16, 1949). This provided an international framework where Chile could start international trade expansion. First, Chile initiated its process of international trade negotiations through preferential trade agreements within the framework of the Latin American Integration Association (ALADI).

Between 2000 and 2003, the main step in Chile’s trade policy was the negotiation and signing of an FTA with the United States and the European Union. This occurred within a democratic context, when Chile began to confirm politically that it needed trade openness to grow. An example is the Congress approving a bill in 1998 that lowered Chile’s across-the-board import tariff (for countries with which it had no trade agreement) by a percentage point each year from 1999 until 2003. In November 2002, Chile signed an agreement with the European Union and in June 2003 with the United States. Two additional important agreements at the time were the FTAs with the European Free Trade Association (EFTA) and the Republic of Korea, both signed in 2003.

The period from 2003 to 2018 was marked by the negotiations of agreements with Asian countries, the consolidation of trade relations with Latin American countries, and Chile’s participation in plurilateral negotiations.

Another relevant milestone in this subperiod was the creation of the Pacific Alliance in 2014.

4.2. The Institutional Framework behind Chile's Trade Policy

4.2.1. Public Institutions

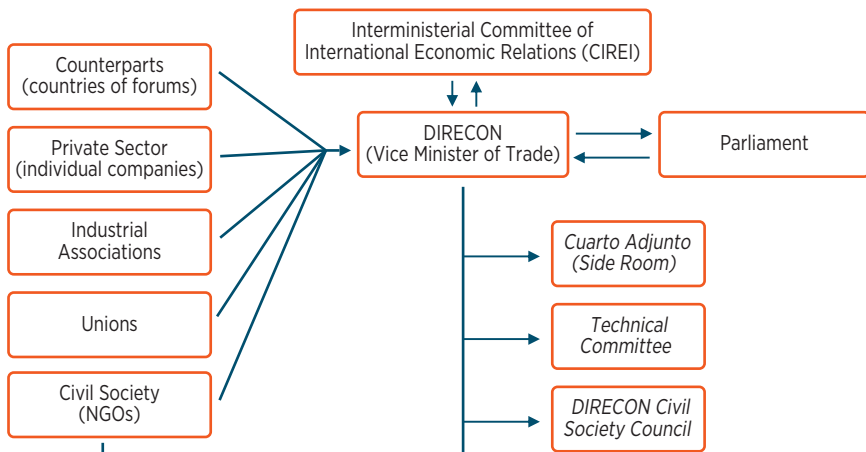
Directorate General for International Economic Relations (DIRECON), Ministry of Foreign Affairs

DIRECON was created on January 10, 1979, through Decree Law No. 53. It is a public entity under the Ministry of Foreign Affairs whose purpose is to implement and coordinate the policy formulated by the President of the Republic in terms of economic relations with the outside world, including collaboration with development of the country's exports.¹

The Minister of Foreign Affairs and the Minister of Finance jointly appoint the head of this institution, which means there is a formal arrangement of double guardianship. This type of appointment shows the necessary relationship that must exist so that internal agreements can be reached. The trade policy ultimately is a combination of foreign and economic policy.

Figure 4.2

Trade Policy: Roles of the Directorate General for International Economic Relations (DIRECON)



Source: Prepared by the authors.

¹ DIRECON has 54 offices located in 45 countries.

DIRECON began to become a more socially and politically relevant actor in the negotiations with MERCOSUR and Canada. As a consequence, DIRECON took on greater importance in the growing social and political legitimacy of Chilean political constituencies and society. It was this feature that afforded it undisputed leadership in the conduct of trade policy in Chile.

The Trade Negotiations Committee

The Interministerial Committee of International Economic Relations was created by Decree No. 419 of the Ministry of Foreign Affairs published on May 10, 1995. Its purpose was to advise on and make proposals to the President of the Republic regarding specific policies related to international economic negotiations. The committee is composed of the Minister of Foreign Affairs, who presides over it, the Minister of Finance, the Minister Secretary General of the Presidency, the Minister of Economy, Development, and Reconstruction, DIRECON (which acts as Executive Secretary), and other ministers when negotiations involve matters related to their competencies. The committee may also invite public officials, experts, academics, or representatives of the private sector related to the matters in question.

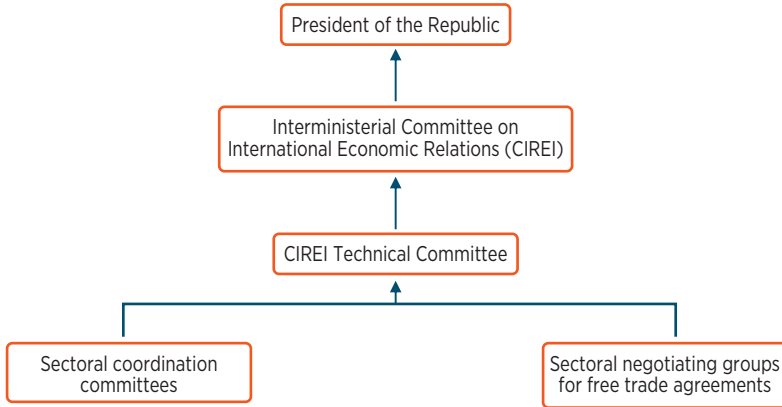
This committee is composed of two entities: a level of ministers and a technical committee chaired by the DIRECON General Director that summons the representatives the ministers call upon. An important element is that the representatives of the ministers on the technical committee do not need to have a formal position within the structure of the ministries (advisors with high decision-making capacity and political power).

There is a formal institutional link between these two subentities, since the general director of DIRECON is in turn the executive secretary of the inter-ministerial committee (at the ministerial level), which is why he reports on the progress and pending resolutions of the technical committee.

If no agreement is reached in the technical negotiation groups, the issue is raised to the Technical Committee of the Interministerial Committee on International Economic Relations (CIREI) for resolution (Figure 4.3). If this entity does not resolve the conflict between the positions of the different ministries or public agencies, the topic scales up to be addressed by the CIREI-Ministerial Committee. On the few occasions when the internal conflict has not been resolved at this ministerial level, it has been necessary that it be taken to the President of the Republic.

The National Congress

In Chile, the role of the Congress is limited to the approval or rejection of international agreements signed by the government, without the right to modify

Figure 4.3**Interministerial Committee on International Economic Relations (CIREI) Decision-Making Process**

Source: Prepared by the authors.

the content (Article 54, No. 1 of the Political Constitution of Chile). However, the influence of Congress on the country's trade policy is important, since governments always take into consideration the internal political viability of the treaties and internalize the preferences of members of Congress during the negotiations and in the process of discussing the treaty in order to ensure its approval. In fact, in the case of the MERCOSUR agreement, the compensations that the government implemented for the losing agricultural sectors is evidence of the importance of the Congress in trade policy.

All of the above has meant that processes of discussion of FTAs in Congress, in general, have been relatively comfortable, without many difficulties and with positive results in terms of the approval of agreements with broad majorities. (It should be noted, however, that this situation has been changing in recent years due to a new political force with representation in Congress that has an anti-trade perspective.) Table 4.1 shows the results of the voting on the main FTAs in the two chambers of the Congress.

In the course of the negotiations of Chile's network of trade agreements, a turning point in discussions with Congress was Chile's agreement with MERCOSUR. Despite being an agreement within the framework of the ALADI that legally did not require approval by Congress, the government decided to send the proposal for discussion and approval in Congress.

Obtaining approval from Congress on the agreement with MERCOSUR was complex because of the sensitivities of the agricultural sector and the

Table 4.1
Free Trade Agreements and Congress

Agreement/Year	Votes in Low Chamber			Votes in Senate		
	In Favor	Against	Abstentions	In Favor	Against	Abstentions
MERCOSUR, 1996	74	26	3	36	3	1
European Union, 2002	107	3	1	41	1	1
Canada, 1997	78	21	10	34	6	3
United States, 2004	87	8	8	34	0	0
China, 2006	96	1	3	31	0	0

Source: Prepared by the authors based on information from www.camara.cl, www.senado.cl, and www.bcn.cl.

overrepresentation of the sector in the Congress. To gain approval, it was necessary to develop and commit to a support plan for the country's agriculture sector that, although not explicitly described as a compensation program, in practice operated as such.

Another milestone in the role of Congress in the approval of trade agreements was the FTA with the United States, which was the first agreement of much greater complexity that was negotiated in Chile. For this reason, it was agreed jointly between the government and the main congressional leaders to create a single, ad hoc commission composed of parliamentarians from the Chamber of Deputies and the Senate for discussion of all the issues involved.

4.2.2. Main Actors of the Private Sector

It is important to point out that the definition of the private sector that was involved with trade policy and negotiations of the FTAs evolved over time, becoming broader and more complex as the thematic coverage of the FTAs widened. As explained in Estevadeordal and Robert (2001), "The expansion of what is traditionally understood by the private sector must be noted. Indeed, the inclusion of chapters on cross-border trade in services, investments, intellectual property, among other issues, requires the integration and consultation of representatives of activities that were previously mere observers of trade negotiations. Thus, for example, a chapter on services requires consultation with all professional associations."

The private sector also shared the advantages of Chile's free trade approach, even sectors traditionally reluctant to support trade liberalization, such as the textile and footwear sector.

An interesting aspect that came up in interviews for this chapter with leaders of business associations is the value assigned to establishing associations with broad representation of different productive sectors, thus avoiding atomization in representation and facilitating the dialogue with the government. (An example is ASOEX, which in Chile represents the entire fresh fruit export sector.) Such associations understand the role of the government in many functions of trade policy, as in the case, for example, of the phytosanitary area, which is fundamental for the international competitiveness of food sectors that are important to Chile's exports.

In contrast, during the 1980s, negotiations in Latin America focused on sectors where there was no local production, since the import-substitution approach still prevailed. In addition, before the 1990s, private representatives were members of official delegations and therefore participated in the official negotiating meetings. This approach changed with more governments became democratic, which meant that although the private sector was consulted, it was no longer part of official negotiating teams.

In Chile, in 1990, which marked the beginning of the broadest and most complex trade negotiations, teams of professionals were reinforced and other technical specialties that did not previously exist in institutions were incorporated into the negotiations, which contributed to the government taking leadership of the process.

In the case of the negotiation processes for FTAs, the private sector understood that it was necessary to reach a consensus-based national position, so private sector representatives accompanied the government and even occasionally collaborated with their public and private counterparts to address complex positions during the negotiation process. To the extent that the FTAs were successful for Chilean exporters, it was the private sector itself that encouraged and promoted the following negotiations.

Cuarto Adjunto (Side Room)

After the negotiation of the FTA signed between Chile and Korea, DIRECON implemented the participation mechanism called the "Side Room," which was originally composed of representatives of producer business associations and exporters of goods and services. This instrument has been fundamental to communicate progress of negotiations as well as to develop the consensus that allows for configuring national positions in the negotiations. This entity has been very active in recent years, even accompanying official teams during rounds of negotiations.

Starting in March 2014, at the beginning the second presidential term of Michelle Bachelet and during the last stage of negotiations on the Trans-Pacific Partnership (TPP), there was growing demand from the public for

information about the negotiations. A new, expanded version of the Side Room was implemented that was made up of representatives of nongovernmental organizations (NGOs), trade unions, academic institutions, and representatives of business associations, who were able to participate in specific aspects of the TPP negotiations. Subsequently, this entity was replicated for other negotiation processes of interest. It continuously developed and provided updated information on a specific website, highlighting the Trade in Services Agreement, modernization processes of bilateral agreements, and, more recently, the European Union and Pacific Alliance with Associated States. In short, the Side Room has served as an open space for information and discussion with civil society and the private sector about ongoing trade negotiations. As it has evolved, the Side Room is now made up of representatives from trade unions and associations, civil society, industry associations, producers and exporters, NGOs, foundations, small and medium-sized enterprises, academic institutions, and any other group that expresses its interest to the DIRECON negotiating teams within the framework of FTA negotiations.

A web platform has been created that contains information about the negotiation processes, including national negotiating positions (offers presented by Chile), a calendar of negotiation rounds, and reports of each negotiation round.² The minutes of discussions in Side Room meetings are also published.

4.2.3. Main Civil Society Actors

During the first years of democracy, NGOs were oriented to domestic social and political issues and less to negotiations of trade agreements. NGOs became more vocal in their views during the process of negotiating the FTA with the United States and the European Union, expressing apprehensions about the benefits of trade agreements, with a particular concern about environmental issues.

Today there is more interest than ever on matters of trade and growing demands for more transparency and engagement entities. Behind this interest is an increasing distrust in the objectives and future results of current trade policies and agreements, and widespread awareness that these policies and agreements have impacts on the lives of people and the development of their countries.

In specific terms, today's FTAs and regional agreements are evolving beyond traditional disciplines, including next-generation issues that have begun to attract greater levels of public interest. In some instances, stakeholders have taken critical or defensive stances on issues such as the environment, health, intellectual property, and e-commerce, among others. One of the main problems related to this is the lack of access to information during the

² The website is available at <https://www.direcon.gob.cl/cuarto-adjunto/>.

processes of trade negotiations. The configuration of new trade agreements has been characterized by what may be perceived as strict confidentiality in its negotiation processes. However, this may be in contrast with the need to provide greater transparency and information to domestic stakeholders and better communicate trade contents that are relevant for the common interest.

Providing greater transparency and enforcing communication channels is also essential to attain wider support for ongoing trade initiatives and new commitments, ensuring that these are widely beneficial for parties.

4.3. The Process of Negotiation and Interaction between Actors in the Decision-Making Process for Chile's Trade Policy

Table 4.2 systematizes what has been developed in the previous points and summarizes the main mechanisms through which institutional actors intervene and influence the development and implementation of the trade policy of Chile.

4.3.1. Return to Democracy: Critical Juncture for Trade Policy

With the return of democracy, it was decided to apply a policy of continuity in trade liberalization, even deepening liberalization through multiple negotiations of FTAs based on the following concerns and developments, as discussed below.

Table 4.2
Institutional Actors in Trade Policy

Actors	Main Objective	Channel of Influence	Instruments
Executive			
Directorate General for International Economic Relations (DIRECON)	Conduct trade policy	Press, executive, social media, congress	Publications, seminars, digital platforms, official minutes
Ministries and public services	Represent sectoral interests	Press, executive, social media, Congress	Publications, seminars, digital platforms, official minutes
Inter-ministerial Committee on International Economic Relations	Reach consensus on Chile's position on trade policy	Executive	Official minutes
Legislation			
Congress	Discuss and approve/reject trade agreements	Press, social media, Congress	Publications, digital platforms

(continue on next page)

Table 4.2 (continued)**Institutional Actors in Trade Policy**

Actors	Main Objective	Channel of Influence	Instruments
Private Sector			
Industry associations (SOFOFA, ASOEX, ASILFA, CHILETEC, etc.)	Represent sectoral interests	Press, executive, social media, Congress	Ads, publications, seminars, lobbying, digital platforms
Chambers of Commerce	Represent sectoral interests	Press, executive, social media, Congress	Ads, publications, seminars, lobbying, digital platforms
Other Stakeholders			
Think tanks, academia, and NGOs	Participate in the negotiation process to influence the process in accordance with their interests	Press, executive, social media, Congress	Publications, seminars, lobbying, digital platforms, demonstrations, rallies
Civil society – Cuarto Adjunto	Channel the visions of its members	Executive	Official minutes
Consumer associations	Represent the interests of consumers	Press, executive, social media, Congress	Ads, publications, seminars, lobbying, digital platforms
Counterparts from other countries	Reach a convenient trade agreements	Press, executive	Official minutes
Multilateral organizations	Negotiate global trade rules	Press, executive	Official minutes, publications, seminars, digital platforms

Source: Prepared by the authors.

Note: “Digital platforms” refers to instruments such as Twitter, Facebook, Instagram, etc.

Concern about Economic Performance

The political and technical leaders responsible for developing trade policy during the first democratic government in 1990 paid special attention to the signals sent by the economic agenda. There was a conviction among those in charge of the process that the new government of President Aylwin would not be evaluated by his national reconciliation efforts, nor by advances in the respect of human rights, nor by social policies, as the public trusted that all of these issues would be addressed. However, there was uncertainty about economic issues such as what policies the new government would put in place. This was an area that citizens would pay particular attention to given

that the Pinochet dictatorship had set a good standard with its economic performance following the 1982 crisis against which the performance of the new coalition government would be measured.

Moreover, some political parties in the new coalition had been active supporters of the government of President Salvador Allende, which had faced big economic difficulties. Some of the interviewees for this chapter who were protagonists during the period of the new democratic government said they believed at the time that strategic economic decisions would be fundamental to determining the governability and continuity of the political coalition.

Ideological Changes and Correlation of Forces

Political Primacy of the Christian Democratic Party at the Beginning of the Democratic Transition

One strategic political decision of the new government was that Chile would not go back to an import-substitution model, even among members of the government who had been involved in that model but would later become ministers close to President Aylwin. There was a strong presence of the Christian Democratic Party compared to left-wing parties that had just become legal again after the end of the dictatorship.

Alejandro Foxley, who was the Finance Minister of President Aylwin, said in an interview with a magazine of the time:

“Pinochet made the most important transformation of the Chilean economy in this century. He had the merit of anticipating the process of globalization that occurred a decade later, which all countries of the world were trying to incorporate. We must recognize his visionary capacity and that of the team of economists who entered that government in the 1973, with Sergio de Castro at the head....That is a historic contribution that will last for many decades in Chile and that, for those who were critical of some aspects of that process at the time, today recognize as a process of historical importance for Chile that has ended up being accepted practically by all sectors.”

Socialist Renewal

Another reason for the continuity of the economic and trade policies from the Pinochet regime was the renewed thinking of new political leaders who had been living in exile in Europe, which was already integrated with open markets under social democratic models in contexts of open economies. They understood that that model that could be reproduced in Chile

In this context, maintaining and deepening the opening of the economy to the world was a fundamental element of the policy of continuity of central aspects of the economic model. There was a conviction that Chile was doing well with the opening of its economy, so it was appropriate to maintain this policy.

Readjustment of Productive Sectors

Winners

After the 1982 crisis, important export promotion measures were implemented, and there was a second export boom in the context of a depreciated exchange rate and public policies of incentives for non-traditional exports. In other words, this promotion of exports together with the opening of the economy made for growth and even created new export sectors that became new players in the private sector with influence on the authorities and an interest in maintaining access to cheap inputs and opening external markets via negotiations of trade agreements.

Tables 4.3 and 4.4 show the sectors that stood out as winners of this opening process both in the second part of the 1980s and during the 1990s, when the opening was deepened. These sectors coincide with some of the most active and main drivers of the opening and of negotiations of trade agreements.

A Losing Sector: The Automotive Industry

Some sectors lost competitiveness and disappeared from Chile as a result of the opening, so by the time they would have the opportunity to exert

Table 4.3

Exports of Goods, 1984–1989 (in millions of U.S. dollars)

Product	1984	1985	1986	1987	1988	1989
Fresh fruit	293.6	357.3	478.9	608.5	586.2	544.4
Fresh fish	37.5	49.1	69.9	114.4	168.7	216.2
Fish flour	275.5	279.0	315.1	362.5	458.8	507.0
Canned fish	39.6	41.0	75.0	109.5	108.2	116.8
Canned fruit	15.2	16.2	27.8	34.2	47.7	75.3
Dried fruit	10.0	13.8	22.3	31.7	32.6	38.9
Bottled wine	7.2	8.5	10.3	13.9	17.9	28.2
Wood	116.3	112.0	135.0	217.3	310.8	350.8
Paper and cellulose	259.6	210.4	272.4	365.2	417.1	422.5
Total exports of goods	3,650.6	3,804.1	4,191.2	5,302.5	7,054.1	8,078.4

Source: Banco Central de Chile (1999).

Table 4.4
Exports of Goods, 1990–1998 (in millions of U.S. dollars)

Product	1990	1991	1992	1993	1994	1995	1996	1997	1998
Mining	4,639.5	4,412.0	4,723.5	3,976.0	5,191.5	7,850.1	7,324.0	8,131.5	6,504.4
Fruit sector	756.7	984.1	1,005.0	869.5	975.9	1,172.4	1,266.1	1,283.6	1,261.3
Fish flour	379.7	464.6	538.4	363.7	449.2	627.7	608.3	549.6	345.8
Salmon	98.6	136.6	216.5	224.4	250.2	377.6	392.4	469.0	515.6
Drinks and tobacco	83.1	118.9	162.5	166.5	182.5	219.4	342.0	466.2	583.2
Celulose paper	423.2	445.6	684.4	617.1	923.6	1,542.2	1,008.9	967.9	972.0
Total exports of goods	8,372.7	8,941.5	10,007.4	9,198.7	11,604.1	16,024.2	15,404.8	16,663.3	14,829.6

Source: Banco Central de Chile (1999).

pressure for a reversal policy during the democratic transition, they were already gone.

One sector that lost with the opening of the Chilean economy was the automotive industry. The industry had an important presence in the local economy for almost 40 years, especially in certain regions of the country. However, many international companies closed their production plants during the 1970s and 1980. There was a time when companies such as Citroën, Ford, Fiat, Peugeot, Renault, Mini, and General Motors had assembly plants in Chile, but one by one they closed (Table 4.5).

Free Trade Agreements: The Joining of Trade and Foreign Policy

Accessing more markets under better conditions became a priority of the democratic government in order to diversify and provide incentives for the export sector to continue to expand. This put the export sector at the center of the economic growth, which led to a structural change in the country in terms of developing an export culture.

The Aylwin administration considered that an economy open to the world would have two great benefits: first, it would lead Chile to reinsert itself in markets and gain competitiveness of its products; and, second, it would improve the image of the country internationally. Both of these axes had been damaged during the dictatorship. It was necessary for Chile to reinsert itself in the international context in order to re-establish an economic, political, and socio-cultural exchange with the rest of the world after 17 years of ostracism (Cuellar 2013).

Table 4.5
Closing Year of International Automobile Production Companies in Chile

Company	Plant Location	Closing Year of Production
Mini	Arica	1974
Ford	Arica y Casablanca	1975
Peugeot	Arica	1979
Citroën	Arica	1982
Fiat	Rancagua	1983
Renault	Arica, Los Andes	1991, 2004
General Motors	Arica	2008

Source: Prepared by the authors.

However, the opening of the economy in 1990 was done differently, negotiated within the framework of trade agreements so that the opening would be rewarded by markets open to Chilean exports—that is to say, a “reciprocal opening.” This is how a long history of trade negotiations began during the decade that focused on agreements with the countries of Latin America. This policy of international insertion, called “open regionalism,” was developed mainly by the Economic Commission on Latin America and the Caribbean (ECLAC) by several professionals who later became involved in the new Chilean government.

The trade agreements signed in the 1990s were also a foreign policy tool and the main instrument used in what was conceived as a return to the international community after 17 years.³ One interpretation of the tariff reduction and opening of the economy that took place in the second half of the 1970s and into the 1980s comes from the interview with C. Mladinic: “It was carried out unilaterally because there was no other alternative given Chile’s isolation during the dictatorship. He [Pinochet] had no alternative, the conviction was to open up and that was the feasible modality.”

In short, it was in the 1990s that the foundations were laid for the trade policy model that Chile has today. As Ffrench-Davis (2018) explains, the decade “marked a new era for Chilean commercial insertion. The export dynamism was stimulated by a more integral policy that sought to combine the functioning of an open economy and the advance of processes of economic integration and trade liberalization, first with Latin America and then with various developed countries and other regions. All this was done in a context characterized by high internal investment and rising productivity.”

³ Pinochet had traveled abroad only rarely.

Gap in Tariff Level

The negotiations of Chile's FTAs were always asymmetric in terms of the degree of protection and tariff levels. Given the process of opening the Chilean economy, the partners with which the country negotiated always had an average tariff higher than that of Chile. That is, the relative concession of the partners was higher than that conceded by Chile (without considering relative market sizes). This situation helped certain sensitive sectors in Chile see an opportunity to increase their exports and be available to open the domestic market to foreign competition.

The fact that Chile was a market that was already open when it began its trade negotiations facilitated those negotiations and the concessions and tariff reductions that were granted to partner countries, while the gains obtained were relatively higher given the high level of protection of those markets. The more agreements that Chile signed, the more the tariff gap with partners was accentuated.

Institutional Aspects

Primacy of the Economists

Several interviewees for this chapter highlighted the importance of economists in the handling of the Chilean economy since 1990. Before 1990, the critique by economists opposed to the model installed by the Pinochet government questioned what they perceived as its naïve belief in the unregulated free market and the passivity of the state in the economy. In addition, they criticized the absence of a global conception of the development of the country. However, over time there was an important shift among opposing politicians and economists that would become fundamental for the consolidation of the economic model inherited from Pinochet. The economic and political debacle of the USSR and the countries of Eastern Europe prompted a profound reflection by Chile's leftist parties. Bureaucratic socialism ceased to be a reference point and market economies were once again viewed positively. Consequently, the concern for economic efficiency and the role of markets became incorporated into the thinking of the traditional left.

For the economists who came to occupy a fundamental role in programmatic processes in the new government, it was essential to resume growth and reduce macroeconomic vulnerability. This came from a sort of Neo-Keynesian consensus that implied a consensus to avoid past mistakes in episodes such as hyperinflation. That is, the priority was to keep the national accounts in order and at the same time design policies that encouraged entrepreneurs to export. There were reasons for their concern; inflation was at 20 percent when

the Alywin administration took office, on top of high government external debt of 50 percent of GDP. Therefore, ensuring a period of economic expansion would allow wages to rise, generate jobs, and improve the quality of life.

The group of economists who came from ECLAC and who began developing the policy of open regionalism in the late 1980s postulated a combination of unilateral openness with trade agreements. In addition, the economists who had been working with the consensus had developed the conviction that growth in Chile was going to come through the export boom, and that this boom required a much more open economy.

Many economists trained at U.S. universities who began to take increasing leadership positions in Chile determined the nature of the transition. One of the milestones that marked the commitment of the model was maintaining an autonomous central bank, which was one of the most important institutional decisions. Another contributing factor to maintaining the open model was that economists from the Latin American Institute of Transnational Studies (ILET) did not question economic policy at the international level, that is, economic openness. This model was understood not just as pure liberalism, but also as having a social economic priority.

Constitutional Restrictions

The 1980 Constitution, designed and promulgated during the dictatorship more than 30 years ago, continues to serve as a guideline for the country and reflects many of the liberal principles that still prevail in Chile. These include the protection of property rights, free markets, international economic insertion, freedom of work and association, the subsidiary role of the state, and an autonomous central bank. Enrique Correa, who served as a minister in the first democratic government, said, “We decided to reform economic policy and not change it, not replace it with another, but reform it. We gave support to a reformed market economy” (as quoted in Cuellar 2013).

The negotiated political transition that took place in Chile on the basis of the 1980 Constitution has been fundamental to Chilean policymaking (Boeninger 1997) and marked a change in the vision of the leaders of the coalition government who have been in power since 1990.

In the negotiation agreed on during the transition to democracy, the representatives of the consensus did not question the moorings of the economic model in the 1980 Constitution. As a result, the model was given a virtual go-ahead and later became an accepted and recognized model for the entire political class and its economists. The concepts of a non-interventionist state, the market as the sole allocator of resources, indiscriminate opening to the world, liberalization of the exchange rate, neutrality policies, an independent central bank, and the consolidation of Pinochet’s privatizations and social-targeting policies are accepted and have become the undisputed axes of national economic life.

4.3.2. Trade Policy Instruments

Table 4.6 presents some of the main instruments that were mainstays of trade policy during Chile's transition to democracy, starting in 1990.

Flat Tariff

A distinctive feature of the foreign trade policies implemented by the dictatorship in 1973 was the profound and unilateral liberalization of imports initiated in the first months of power. It was done with an intensity then unprecedented in other semi-industrialized economies; all selectivity was suppressed in a process that culminated in a uniform tariff of 10 percent for virtually all imports in 1979 (Ffrench-Davis 2018).

In 1990, there was a uniform tariff of 15 percent, which was then reduced to 11 percent in 1991. In November 1998, Law No. 19.589 was published, which gradually reduced the customs tariff from 11 to 6 percent from 1999 to 2003 and then reduced it further by 1 percent a year.

In parallel, on November 18, 1998, Chilean President Eduardo Frei Ruiz-Tagle participated in the annual meeting of the leaders of member economies of the Asia Pacific Economic Cooperation Forum (APEC) in Malaysia. During previous meetings held earlier that month, the Chilean position, presented by the Minister of Foreign Affairs, José Miguel Insulza, highlighted the country's interest in maintaining the forum as an entity of economic cooperation that allows for facing the complex crisis scenario and announced the tariff reduction plan that would reach 6 percent in 2003. This represented Chile's contribution to the commitments assumed in the Bogor goals of APEC.

Table 4.6
Trade Policy Instruments

Instruments	Description	Effects on Trade Policy
Flat tariff structure	Flat tariff applied to imports of all products	Facilitates internal negotiation with the different productive sectors
Modalities of negotiation in bilateral trade negotiations	Mechanisms and procedures included in the market access negotiations, especially the different ways to reduce tariffs	Has an impact on the relationship with the different productive sectors and with other public agencies, both from the macroeconomic and sectoral perspectives
Compensations programs	Government programs applied to specific sectors to offset the potential negative effects of the tariff reduction included in the trade agreements	Contributes to the process of approval of trade agreements within both the government and Congress

Source: Prepared by the authors.

The economic rationale for applying a uniform tariff is to grant all the national productive sectors the same level of protection, heading off the administration of different levels of protection that imply tariff categories with higher and lower levels for imported products. The flat tariff has been a central instrument from the point of view of the political economy because it facilitated internal negotiations between the productive sectors in the liberalization process in Chile, both unilateral and bilateral.

The different levels of protection between productive sectors occurred *de facto*, and the flat rate structure began to be perforated after the tariffs applied to products and countries become different in each trade agreement. For example, the tariff applied to imports from Latin American countries was lower throughout the 1990s than the tariff applied to the rest of Chile's partners in Asia, Europe, and the United States. This discrimination began to disappear as trade agreements with these partners were also made to the point that, today, 95 percent of Chile's foreign trade is covered by this network of trade agreements, and the tariff is almost uniform again and close to 0 percent.

In summary, the political economy challenges of the opening in Chile were transferred to the trade negotiations and incorporated into the modalities to open the different productive sectors as part of the different trade agreements. Some interviewees for this chapter also pointed out that the adoption of the uniform tariff by Chile allowed for the implementation of a trade policy without sectoral distortions and with simplified administration procedures, which also contributed to the development of a more efficient tariff structure.

Modalities of Negotiation in Bilateral Trade Negotiations

Margins of Preference versus Residual Tariffs

Negotiating trade agreements based on preferential margins corresponds to the ALADI tradition of the 1980s. This means that only a discount is applied to the tariff without consolidating the tariff reduction against future potential increases. The rationale of this modality is that it allows for preserving the value of what was negotiated when one of the parties changes its customs tariffs in the future. Preferential margins are well suited to the context of limited coverage agreements. Despite this, Chile and MERCOSUR agree on preferential margins that may even result, during the tariff reduction period, in a higher residual tariff when the importing country raises its tariffs vis-à-vis third parties.

Traditionally the Partial Scope Agreements of the ALADI covered a limited universe of products and preferences. Partial Scope Agreements generally had a limited duration. FTAs, generally in the form of Economic Complementation Agreements, radically changed both the scope (negotiations covered all

products) and the time dimension (they were of indefinite duration) (Jara 2005). These agreements and future ones were negotiated based on residual tariffs, that is, the tariff was consolidated, so future increases after the agreement was signed would not affect the reductions committed to in the agreement.

Free Trade Zone with or without Exceptions

Another important element in relation to the modality of the negotiations refers to the configuration of the structure of the tariff liberalization schedules. Prior to the 1990s, negotiations in this area were based on the rationale of including positive lists of products for which tariffs were being reduced; that is, only those products explicitly identified had their tariffs eliminated.

After the first trade agreement signed a year after Chile's democratic transition in 1990, the logic of trade negotiations changed to a general principle that all products were included in the tariff reduction, except for what would be excluded, that is, outside the coverage of the tariff reduction for very specific and defined reasons. This modality also coincided with the sectoral non-discrimination approach that the country had taken.

The trade agreement with Mexico was fundamental to Chile's trade policy because for the first time the approach to negotiation changed, and the principle that guided the negotiation was that all sectors are opened, except only certain products for very justified reasons.

Jara (2005) explains this process:

“First it is defined that almost everything is linearly liberalized within an agreed period (four years). If an industry presents sensitivities in a well-founded manner, the reduction can be granted for a longer period (six years). Finally, it is established that a product can only be excluded from the liberalization program if it meets certain criteria. In these negotiations, four criteria are elaborated: (i) that there is a distortion in the counterpart market, such as subsidies, official prices; (ii) that they are products subject to the price band system; (iii) that there are products with high fiscal impact (tobacco and oil); and (iv) that there are sectors undergoing reconversion, such as some textiles. In this way, the private sector knows from the beginning what the rules of the game are and that they operate on the basis of relatively objective and politically acceptable criteria.”

In Chile's FTA signed with MERCOSUR and Canada, it was decided that there would be no products excluded from the tariff reductions, that is, there would be no exception lists. The only adjustment variable referred to the time-frame and modality of the tariff reduction. That is to say, these negotiations

pursued the creation of a free trade zone of wide coverage with 100 percent of the tariff universe subject to tariff reduction.

Compensation Policies

Support for Agriculture

As a consequence of the approval of the Chile-MERCOSUR Economic Complementation Agreement in September 1996 and the tariff reduction in 1998, an agreement and a protocol of understanding were signed between the Chilean executive and the parliamentarians of various parties that committed greater financial resources to strengthen certain areas of work of the Ministry of Agriculture and other services to improve the competitiveness of the agricultural sector.

The agreement and protocol, which together were known as the “Commitment to Agriculture,” established that additional funds would be allocated to those agricultural subsectors that had more difficulties accumulating capital, incorporating new knowledge, improving productivity, and generating adequate levels of profitability due both to the trade liberalization in the MERCOSUR agreement and the unilateral reduction of five points in the general rate of the customs tariff between 1999 and 2004 at a rate of 1 percent per year.

In particular, within the framework of the discussion of the MERCOSUR Trade Agreement in Congress, parliamentarians representing agricultural areas conditioned their yes vote on the implementation of measures to support the sector to offset the negative effects that would result from the opening of agricultural products to competition, especially from Argentina. In 1995, the Ministry of Agriculture drew up a plan that laid the foundation for this compensation program and that later became a permanent policy over time and key to the subsequent internationalization and expansion of Chile’s agro-industrial exports.

The objective was a productive transformation of agriculture while alleviating the problems that affected the sector by committing the government to apply measures for adjustment.

It is interesting to note that the program also ratified and recognized that Chile supported trade liberalization. In a speech in 1995, the Minister of Agriculture emphasized that, “in the long term, the tendency that will prevail will be the free trade of agricultural products. This will be a long horizon for which it is necessary to prepare.”

That is why Chile’s position was not to leave products outside the tariff reductions, but rather for the negotiations to focus on the modalities of openness under which all products without exception would reduce their tariffs

to 0 percent, with the adjustment variable being the timeframe of this opening.⁴ In the end what was accepted, according to an account at the time, was “a gradual transition for sensitive products. To this end, all the mechanisms accepted in the negotiations will be used to protect the interests of medium and small agricultural producers” (Ortega 1995).

The resources of the support program were allocated to training and education, strengthening information systems, research and technology transfer, investment in infrastructure, technical and financial assistance, and quality certification. Undoubtedly the most important measure, conceived by the government, was the “opening and consolidation of external markets as a main strategy that will put Chile on the threshold of development” (Ortega 1995).

With the MERCOSUR agreement the Fund for the Promotion of Agricultural and Livestock Exports was created, but support was also provided to farmers in the south of Chile who were most affected by the agreement. This support came for irrigation and recovery of degraded soils, for which the amount of resources surpassed that provided by the Export Support Fund (Table 4.7).

It is interesting to see how, in counterpoint with these resources, agricultural exports evolved over the 20 year period from 1996 to 2016 (Table 4.4).

Table 4.7
Agricultural Commitment Support, 1996–2006 (millions of U.S. dollars)

Year	Agricultural Export Fund	Development of Irrigation	Innovation and Management	Recovery of Degraded Soils	Forestry Development	Health Improvement	Total Agricultural Commitment
1996	6.9	59.6	37.0	4.8	1.1	0	109.4
1997	7.8	86.3	45.0	13.7	1.4	0	154.2
1998	9.5	103.6	60.8	17.2	4.5	0	195.6
1999	11.6	102.7	73.2	29.8	2.1	1.7	221.1
2000	11.4	91.0	76.0	43.1	2.5	1.5	225.5
2001	11.2	86.1	81.7	49.2	28.0	4.3	260.5
2002	13.8	77.8	88.3	43.5	10.1	6.0	239.5
2003	12.7	63.3	85.2	42.1	8.0	8.0	219.3
2004	12.5	63.8	85.6	40.5	8.3	9.1	219.8
2005	12.5	68.8	99.4	41.9	8.2	12.1	242.9
2006	12.4	74.2	99.7	42.7	10.4	13.7	253.1

Source: ODEPA (2006).

⁴ Tariffs on vegetable oils, sugar, and wheat flour were eliminated in years 15, 16, and 18, respectively.

4.4. Episodes

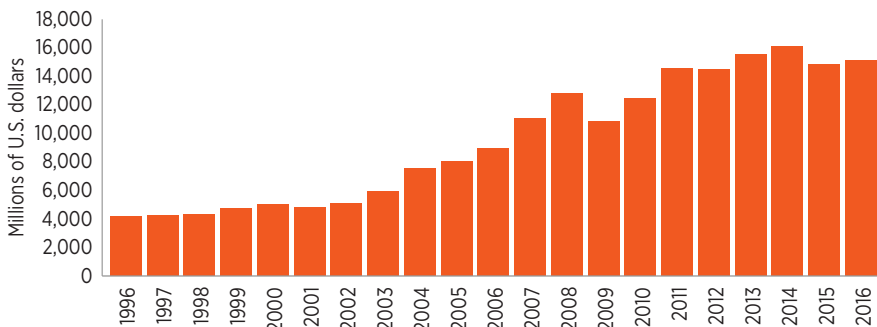
4.4.1. Textiles and Footwear

By the beginning of the 1990s, Chile had already experienced a profound opening of its economy that affected some commercial manufacturing sectors. Trade policy and signed agreements later deepened this process. Chile is not a producer of hydrocarbons or cotton as it does not have comparative advantages for those products. The textile and footwear sectors had to adapt to these new conditions of competition, redesign their business models, complement local production with commercialization of imported products, and focus on and specialize in niches where they were competitive in export markets. This process required public policies to support this transformation, along with an ongoing and frank dialogue, which was not always easy, with the companies and unions in the sector. In this, the explicit support of the majority of parliamentarians who shared this vision was important.

As a result of this policy, when Chile decided to negotiate its FTA with China in 2005, these sectors had already been exposed to international competition for more than a decade and were even exporting to previously unthinkable markets by taking advantage of new FTAs signed by Chile (Figure 4.4). This led to both sectors supporting the negotiation with China, which in turn also facilitated the parliamentary discussion of that FTA.

This was also the case of the textile and footwear sector in the negotiation of the FTA with the United States. These sectors were highly protected, with tariffs of around 40 percent. On the other hand, Chile applied equal tariffs of 6 percent. Table 4.8 presents some products that illustrate this situation.

Figure 4.4
Chilean Agricultural, Livestock, and Forestry Exports, 1996–2016



Source: Prepared by the authors based on data from the Oficina de Estudios y Políticas Agrarias.

Table 4.8
Gaps in Tariff Levels between the United States and Chile (percent)

Product/Tariff	United States	Chile
Pantyhose	16.3	6
T-shirts	16.3	6
Coats	16.2	6
Waterproof footwear with rubber and plastic top and sole	37.5	6
Footwear with a sole and rubber or plastic top with a value exceeding US\$12	20	6

Source: Prepared by the authors based on information in the Chile-United States Free Trade Agreement.

Footwear

The footwear industry in Chile is represented by the Chamber of the Leather and Footwear Industry (known as Fedeccal F.G.), which is the institution that groups together Chilean companies in the sector. It was created in 1999 from the grouping of all trade associations of businesspersons, professionals, and technicians who constituted the entire sector in order to guarantee its protection and development, mainly in terms of protecting against import distortions.

During the military dictatorship, a social market economy was assumed and the sector, intensive in labor, was not prepared to face that challenge. Many decided to withdraw from the business association instead of thinking that this was precisely the moment that it should have been more united. The new model was applied “without anesthesia,” unlike, say, in Germany which prepared the country before a social market economy through education and capacity-building for innovation and competitiveness.

National production of the footwear sector grew under protectionist policies, reaching 24.7 million pairs in 1972. However, successive adjustments of the country’s economic policy and strong restrictions on demand strongly impacted the industry. Due to differences in productivity, costs, and export subsidies provided by governments such as Brazil, China, South Korea, and Taiwan Province of China, imports reached 4.4 million pairs by 1980 and rose to 9.2 million the following year (with an estimated internal consumption of 17 million pairs). Starting in 1986, the national industry began to recover thanks to an export initiative, some compensatory measures against imports of finished products, and the constant growth of the national economy; this stimulated the installation of new plants, especially for production of sports footwear.

With the arrival of democracy, the trade liberalization model was retained and opened Chile's borders even further. As shown in Table 4.9, since the beginning of the 1990s, imports of footwear have been growing rapidly. The Chilean market was opened to suppliers from ultracompetitive countries in Asia, such as China, Indonesia, Malaysia, and Vietnam. Exposed to this greater competition, Chile's footwear sector began to have concerns about technological development, innovation, and strengthening of competitiveness.

In 1994, the challenge for the sector was to harmonize private efforts with those of the state in searching for markets through trade agreements such as those with MERCOSUR and APEC, as well as obtaining information, macroeconomic stability, and protection against unfair competition (e.g., subsidized footwear from China). This would allow companies to plan their export effort and move to more developed stages of internationalization that would necessarily require increasing the professionalization of their executives and the incorporation of new technology.

For the technological development of the sector, entities such as the Corporación de Fomento de la Producción de Chile (CORFO) and ProChile provided support to learn about new technologies that were being developed abroad, participate at technology events, etc. The liberalization process radically changed the structure of the sector, as shown in Table 4.9.

The footwear industry today in Chile has been completely transformed by the opening process. The same shoe company in Chile can both export and import products to complement products manufactured in Chile. The sector is atomized, exporting mainly to Latin America. Large companies have reduced their numbers of workers due to technology.

In terms of trade negotiations, the sector has requested a set of flexible rules of origin and the possibility of accumulation of materials produced in the partner country in order to have more options to fulfill the rules.

Table 4.9
Chile's Footwear Industry, 1991 and 2017

Item	1991	2017	Difference
Footwear production (millions of pairs)	35.7	5	30.7
Footwear imports (millions of pairs)	2.2	114.5	112.3
Footwear exports (millions of pairs)	6.1	0.31	-5.79
Number of workers employed in the sector	35,000	13,145	-21,855
Consumption per capita	2.4	6	3.6
Number of companies	1,000	491	-509

Sources: Banco Central; Dirección Nacional de Aduanas; SII; and Fedeccal F.G.

Textiles

In the case of the textile sector, the depth of the liberalization before 1990 determined the position of the sector in the FTA negotiation process. The greater competition that local firms had to face from Chinese and Asian suppliers in general was not possible to counteract with the tariff level applied by Chile. The gap in the price of imported products with respect to domestic products was such that the only way to control the entry of these products was with the application of tariff surcharges that were applied during the 1990s, but only temporarily.

Therefore, FTAs signed by Chile were an opportunity to expand the sector's exports. By the end of 1990s the sector reached exports of US\$200 million. However, these flows then declined due to competition from Chinese products in export markets where Chilean products also flowed. Trade agreements opened markets for companies that became more efficient and survived the opening to imports. That is why the sector ended up supporting the FTAs.

The economic groups that owned the largest companies in the sector in the 1990s experienced expansion and diversification of their businesses. Many of them moved their main economic activity to other sectors such as real estate. For this reason, the influence of the textile association with the government and Congress waned. The tariff in the 1990s began to be irrelevant in terms of external competition, so the FTAs has less and less impact on the internal sector and rather were an opportunity to develop export markets.

4.4.2. Price Bands: Compensation Policy and the World Trade Organization Case

The price band system was designed with the aim of stabilizing the domestic prices of certain agricultural products and avoiding sudden fluctuations caused by international prices. In that sense, the system sought to compensate agricultural sectors competing with imported products by giving them signs of price stability for their sowing and harvesting decisions.

Under the system, if international prices fell, domestic prices were maintained in a higher range and within the price band. Consequently, the compensation should be measured by the difference between the international price and the domestic price. In the case of wheat, when prices fell sharply, the band kept domestic prices higher, protecting the sector from more competitive producers and compensating it for this fall in international prices.

The protectionist measure that Chile maintained for years in certain traditional agricultural categories were price band systems that inversely correlated international prices of these products with the level of protection and surcharge

that imports had to pay upon entering the Chilean market. This instrument was questioned in the WTO, but above all, it was one of the elements more complicated to negotiate in the trade agreements. Keeping this instrument in force signified paying costs in these negotiations and losing advantages for other Chilean productive sectors in export markets. However, it was the only viable option to gain approval for the FTAs in the National Congress. In the Chile-MERCOSUR Trade Agreement (1996), this instrument was partially eliminated in the very long term and was accompanied by a support program for other agricultural and agrobusiness sectors for which the promotion and market opening programs of the FTAs were fundamental to their export growth. That process also facilitated the subsequent negotiation with the United States and the European Union that led to this instrument being completely dismantled.

In July 2003, the bill to modify the price band system applied to wheat, sugar, and edible vegetable oils was submitted to Congress. The modification to the instrument was made necessary as a result of a WTO Dispute Settlement Body resolution, in response to a claim by Argentina, specifically for cases of wheat and edible vegetable oils. The resolution determined that Chile should adjust its price band system to meet WTO rules, finding that the instrument had similarities with a variable tariff and with a minimum import price, both border measures not allowed under WTO rules. The resolution argued that the system was not transparent, not predictable, and discretionary.⁵

Adjusting the price band system to comply with WTO rules meant a substantial change in policy. Due to this, the system was thoroughly studied, and a wide discussion was initiated within the public sector and with the private sector on the modifications that could be included, always bearing in mind the limitations imposed by the WTO regulations.

As noted, the WTO ruling only referred to wheat and edible vegetable oil products, as claimed by Argentina, so there was no requirement to modify the instrument applied to sugar. However, modification of that instrument was also necessary, considering the high probability that the sugar band would later be questioned.

The adjustments to the price band system took into account the reduction on the tariffs for the products involved already included in the agreement with MERCOSUR, which specified that by 2015 the products would be in free trade conditions.

Therefore, the modification and its complementary provisions to comply with the WTO ruling constituted the policy that would be in force for the coming

⁵ The WTO said that Chile had the legal standard (Article 12 of Law 18,525) that determines the existence of the price band system but did not have any regulations detailing the application procedures.

years. In addition, the modification of the instrument and its application had to be transparent, predictable, and non-discretionary, as required by the WTO.

4.4.3. Labor Unions and the Chile-United States Free Trade Agreement

The negotiation of the FTA with the United States marked the first time representatives from Chile's labor unions actively participated in the process. The agreement included a specific chapter on labor rights, which enabled progress on the enforcement of Chile's own labor laws. The labor unions in the region and in the United States had long been critical of these agreements. At first, this was also the case in Chile. However, after much dialogue and participation, the unions came to share the vision that open markets contribute to more and better jobs by expanding and diversifying Chilean exports. Finally, the Chilean unions provided great support in the negotiations. They publicly opposed the positions of the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) and then explicitly supported their approval in Congress.

The position of the labor unions has stayed the same since the Chile-U.S. FTA negotiations, which has facilitated the negotiation processes with other partners such as China, the European Union, India, and Korea. It has also helped to ensure approval of all of the FTAs with large majorities in Congress.

The main reasons for the position taken by labor union representatives in FTA negotiations were as follows (interview with D. Olivares):

1. A valuation of the benefits for economic growth and the employment of openness. There was a recognition that Chile had already determined the economic destiny of the country with its opening policy, that the country had changed, and that workers needed to participate in this opening and have a voice in it. Those who defended the FTA saw this moment as an opportunity to strengthen the union movement.
2. The political will of the President of the Republic and the evaluation that the FTA would inevitably be negotiated, so the intelligent decision for the unions was to get the most out of this process.
3. A fundamental commitment of transparency and permanent information from the negotiating team to the union leaders and the latter's participation in the negotiation process.
4. Including labor issues in the FTA was a positive step toward establishing standards to make labor legislation more binding, representing an opportunity for workers.
5. The Workers' United Center (CUT) made an effort to share with its bases the benefits of the FTA, implementing a dissemination mechanism for

sectoral unions not only in Santiago but in the country's regions. In particular, work was carried out with representatives from unions from sectors potentially affected by the FTA, such as textiles, metal mechanics, and agriculture.

6. The AFL-CIO, the largest union in Canada and the United States, opposed the FTA, maintaining that it did not comply with labor rules close to those in force in the United States. It also insisted that free trade reduced the number of jobs and working conditions in the United States (Cuellar 2013). However, among Chilean unions there was a conviction that these arguments responded to a protectionist position of defending jobs in the U.S. market, and that in fact the FTA would bring more investment to Chile and therefore more employment not only in Chile but in the United States as well.
7. Finally, the support of the international trade union movement was fundamental for CUT in Chile to support the FTA. Several associations of international workers valued the process of transition to democracy in Chile and supported CUT's role in this process.

4.5. Conclusions and Challenges for Chilean Trade Policy

Today, Chile is the most open economy in Latin America. Tariffs are uniform and very low (6 percent, but de facto less than 1 percent) and the country has FTAs with countries that account for around 90 percent of world GDP. Chile does not apply nontariff barriers, and trade barriers that existed, such as price bands, have been eliminated as a result of multiple trade negotiations.

The opening of the Chilean economy began with a unilateral reduction of tariffs during the years of the Pinochet dictatorship. This deep and persistent policy brought about a change in the private actors, reducing the influence of competing sectors on imports and increasing the influence of exporters. Chile became increasingly competitive due to gaining access to cheaper imported inputs and at the same time gaining preferential access to many export markets. This scenario generated an interesting starting point for the negotiation of bilateral agreements because Chile's tariff concession was always significantly lower than the reduction that it granted in the export markets.

This policy forged a great national consensus around the benefits of the opening policy for the country. The consensus included actors that in other countries would be unexpected, such as labor unions, the textile sector, and some agricultural sectors that otherwise benefited from extensive compensation programs. The years of negotiations developed a strong institutional

structure with increasing transparency, and during which both public and private actors accumulated professional technical skills.

The focus of this chapter was to understand why Chile has formed a broad consensus around the benefits of free trade. This shared vision was fundamental in the implementation of Chile's international economic insertion strategy and its multiple negotiations of FTAs. The result of this can be seen in Table 4.1, which shows that the vast majority of FTAs were approved in the National Congress, often by wide margins.

However, today this reality is challenged because Chile's Congress is much more diverse than it has been in past decades, with a relevant presence of political forces that oppose free trade. This new scenario will make the next discussions of FTAs in the Congress much more complex, with the first test likely to be discussion of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

The chapter identified the main reasons why Chile has applied a policy centered on bilateral and plurilateral trade liberalization in numerous international agreements. The chapter examined the main actors and instruments and how they interacted with each other. Several findings resulted from interviews conducted specifically for this chapter.

A fundamental reason behind Chile's trade policy is the strategic decision to continue the economic model of opening when democracy returned to the country in 1990. Although the emphasis of the policy was changed—with the opening implemented through negotiation with main trading partners and not unilaterally as was done during the dictatorship—the political and economic authorities remained committed to the benefits of trade liberalization policy. What followed was a long period of strong consensus that this policy was beneficial for the country. In short, Chile is a case study where ideology and economic interests coincided.

In this context, the trade policy instruments used by Chile were consistent with this liberalization process. The instruments included the application of the flat tariff, ambitious modalities in market access implemented in the negotiations of FTAs, and compensation programs that provided public goods to enable new exporter capabilities.

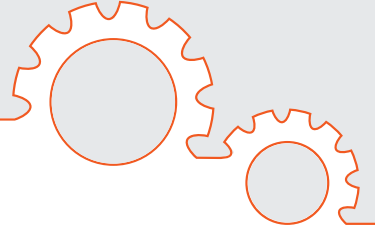
In the institutional field, the chapter highlights the roles of DIRECON in conducting trade policy and CIREI in the process of internal decision-making among the ministries and public agencies involved in trade negotiations. Concerning the Congress, its role was limited to approving the FTAs negotiated by the executive, so the challenge going forward is to strengthen its role in the future. Civil society has also been more active in recent years, and for this reason the Side Room has been institutionalized. This instrument has allowed for channeling the participation of many new

actors now interested in participating in the design and implementation of trade policy.

The episodes included in this chapter also help to understand in practical terms the mechanisms that have operated in the decision-making of trade policy in Chile, especially in the negotiations of FTAs during the last 25 years.

Finally, the chapter provided some lessons that will be useful in the current debate in Chile about the effectiveness of trade policy. Some important challenges that the country must face in the coming years are the following:

- Implementation of the new legal framework for DIRECON that approved its rank of Vice Ministry. How can the country take advantage of this new stage in order to reap better benefits from the network of trade agreements it has signed? This includes working to diversify exports that incorporate more added value and incorporating them into global value chains that today dominate international trade.
- Explore new governance in Chile's international economic relations. This might include, for example, combining into a single institution diverse functions such as trade negotiations, export promotion, promotion of foreign investment, promotion of the country brand, and tourism promotion.
- Given that the agreements are more "intrusive"—that is, they involve matters that have traditionally been the responsibility of national authorities—coordination among public agencies is a priority for implementation of trade policy.
- Current FTAs are evolving beyond traditional disciplines, including issues that have gained increasing public interest. In some cases, stakeholders have critical or defensive positions on issues such as the environment, health, intellectual property, and electronic commerce. In other words, the broader scope of trade agreements, including regulatory issues, imposes new challenges for a higher standard of transparency in these processes.
- This wide range of new issues being negotiated under trade agreements requires putting in place mechanisms that promote the participation of relevant stakeholders with specific knowledge and experience that can strengthen negotiating positions to achieve agreements that are satisfactory to the interests of each party involved.
- It is necessary to strengthen the role of Congress in the process of negotiating and approving FTAs. This includes the preparation of studies and the analysis of costs and benefits prior to any trade negotiations, along with evaluations of FTAs already in force, to benefit from lessons learned.



The Political Economy of Protection of “Sensitive” Agricultural Products in Colombia

Maria Angelica Arbelaez, Sebastián Higuera, Roberto Steiner, and Sandra Zuluaga¹

In 1990, Colombia transitioned from an import-substitution economic model to a more liberalized framework known as the *apertura económica*, or “economic opening.” The main pillars were a reduction in tariffs and an aggressive integration strategy. Despite some progress, three decades after having launched the liberalization effort Colombia remains a rather closed economy.

The 1990s reform failed to significantly correct the anti-export bias of the import-substitution policy it replaced. Protection is particularly pronounced in some agricultural subsectors via tariffs and nontariff barriers (NTBs), and those subsectors have been either excluded from trade agreements or have obtained long tariff phase-out periods (Nieto, Betancur, and Calderon 2016). The Trade Promotion Agreement (TPA) with the United States was the one scenario in which the liberalization process, albeit gradually, was intensified for so-called “sensitive” products.²

To be sure, Colombia’s complex geography and weak transport infrastructure do not facilitate international trade. This empowers those who hold

¹ The authors thank Ernesto Stein, Jeff Frieden, and Jorge Cornick for their comments. The authors also received valuable suggestions from Luis Fernando Mejía and other participants at Fedesarrollo’s weekly seminar. Finally, the authors are grateful to the many persons who agreed to be interviewed for this chapter (see Annex 5.1).

² An agricultural product is deemed sensitive if it has strategic importance to generating rural employment and legally occupying the territory, and if it is highly vulnerable to imports (FENALCE 2006).

protectionist views and focus primarily on the domestic market. Although Colombia is a land-rich country, it is one of the few in the region that did not take advantage of the recent commodity price boom.³ In most middle-income countries, an argument put forward to justify protection of agriculture is that it is the inevitable consequence of protectionism in rich economies. In Colombia this argument is strengthened by the notion that 50 years of guerrilla warfare have brought misery to millions living in the countryside and made agriculture a challenging activity.

The opening process has been the subject of several academic endeavors from a political economy perspective (Cepeda 1994; Urrutia 1994; Beaulieu 2000; Edwards and Steiner 2000, 2008). Several studies have documented the extent of protection of agriculture (OECD 2015; García et al. 2014; Anderson and Valdés 2008; Jaramillo 2002) and a few have made meaningful contributions on the effects of protection on sectoral performance (Perfetti and Botero 2018). However, not much has been written on the political economy of agricultural trade policy—that is, why the protectionist trade policy is in place. This chapter attempts to fill that gap by focusing on two products, rice and sugar, that are among the most protected and weigh heavily in the consumption basket.

The chapter begins by describing trade policy following liberalization efforts in the 1990s, with an emphasis on the protection of agriculture and on illustrating the sector's underperformance. The chapter then addresses the political economy of protection of the two “sensitive” products, rice and sugar, identifying the main actors involved and their main channels of influence. The chapter touches on the relevance of the free trade agreement with the United States before putting forth overall conclusions and policy recommendations.

5.1. Setting the Stage

5.1.1. Three Decades into Apertura, Trade Liberalization Remains Elusive

The trade liberalization policy implemented in the early 1990s sought to correct the failures of an import-substitution model that had caused the concentration of property structures, low productivity, high prices, few incentives for innovation, and an anti-export bias. Liberalization involved reducing tariffs, eliminating quantitative restrictions on imports, simplifying procedures,

³ While in Argentina, Brazil, and Peru the agricultural sector grew on average by 3 percent, 3.5 percent, and 4 percent during 2004–2014, respectively, in Colombia it expanded at an annual rate of only 1.8 percent.

undertaking institutional reforms, and negotiating several trade agreements (Hommes, Montenegro, and Roda 1994).

Measures implemented at the beginning of the 1990s reduced tariff positions subject to quantitative restrictions on imports from 43 to 3 percent (Hommes, Montenegro, and Roda 1994), while the average tariff fell from above 40 percent in the 1980s to 11.7 percent in 1992 (Echavarría and Gamboa 2001). Changes to the tariff structure also occurred as a result of integration with Andean countries. Until 2009, the average nominal tariff remained between 11 and 12 percent largely due to the search for an Andean community common external tariff. In 2010, once autonomy over tariffs was regained, tariff sub-headings with levels of zero and 5 percent rose sharply. In 2011, the average nominal tariff fell to 8.6 percent, and is now close to 6 percent. However, the reduction of tariffs that came about with *apertura* was soon partially offset by an increase in NTBs across the board (García et al. 2014). Some sectors traditionally shielded from foreign competition—particularly agriculture and agroindustry—reached even higher levels of protection with new measures.

Efforts to simplify the tariff structure have fallen short of expectations, and high dispersion prevails. The reduction in tariffs has been important in manufacturing and mining, particularly since 2010, although liberalization was not uniform across sectors (e.g., textiles and apparel continued to have high tariffs). Agriculture and agroindustry remain highly protected, with average nominal tariffs of 12 percent and 18.8 percent, respectively. “Sensitive” products such as sugar, beef, rice, and milk have much more protection on account of a price band system and in some cases because of the application of fixed tariff rates that can reach up to 80 percent. In terms of the tariff rates resulting from these mechanisms, the average nominal tariff for 2002–2015 was 12 percent for agricultural products and 20.3 percent for agroindustry. When taking into account imports entering with preferences from trade agreements, tariffs are of course lower. Perfetti and Botero (2018) show that during 2002–2015 the average effective tariff was 4.7 percent on agricultural goods and 5.2 percent on agroindustry. It is important to bear in mind that most of these preferences are linked to tariff quotas, so the effective tariff applies to a volume of imports that is not significant compared to production.

5.1.2. Protection of and Underperformance in Agriculture

Trade policy for most commercial agriculture products has shown an important degree of inertia. This is explained primarily by political reasons and the existence of important producers that consolidated as suppliers to industry during the import-substitution strategy phase. The 1993 Agricultural Law reflects a midpoint between dismantling the *apertura* in agriculture and

maintaining it with the adoption of several provisions to address private sector requests (Jaramillo 2002). The semi-structured interviews undertaken for this chapter revealed a perception that there is a “historical debt” to the rural sector because it has been most affected by civil unrest, deficient transportation infrastructure, and distortionary trade practices in other countries. From that perspective, protection is an easy way to pay that historical debt—that is, raising tariffs and nontariff barriers is more expeditious and less of a fiscal burden than providing public goods.⁴

A share of the agricultural sector has remained protected either through tariffs or through special treatment in trade agreements, particularly with tariff-rate quotas and safeguards.⁵ Since the early 1990s, a group of products deemed as “sensitive” has been subjected to special treatment, with the main policy instrument being a price band system introduced in 1992 and harmonized with Andean countries. The system, which provides a variable tariff, initially included eight products but was subsequently expanded to 13 and to close to 150 tariff derivative or substitute products at any given time. Although the main purpose of the system was to stabilize domestic prices, its design generates a protectionist bias. The system is still in force for some products, while for others it has been replaced with ceilings or fixed tariffs. The trade reform in the 1990s was complemented with price stabilization funds meant to promote exports and with crop absorption agreements and minimum guaranteed prices for some products deemed to be sensitive.

Support to agriculture has continuously increased, reaching 2 percent of GDP in 2013, with Colombia being one of the countries providing more assistance (Figure 5.1, panel 1). Total support to agriculture in member countries of the Organization for Economic Co-operation and Development (OECD), as measured by the total support estimate, declined from 1.3 percent of GDP in 1995–1997 to 0.7 percent in 2015 (OECD 2018). A large part of aid is in the form of distortionary market price support and border measures,⁶ with the provision of public goods lagging behind (Figure 5.1, panel 2).⁷ The OECD shows that market price support is mainly captured by large producers and is a regressive

⁴ Annex 5.1 lists all the persons interviewed for this chapter.

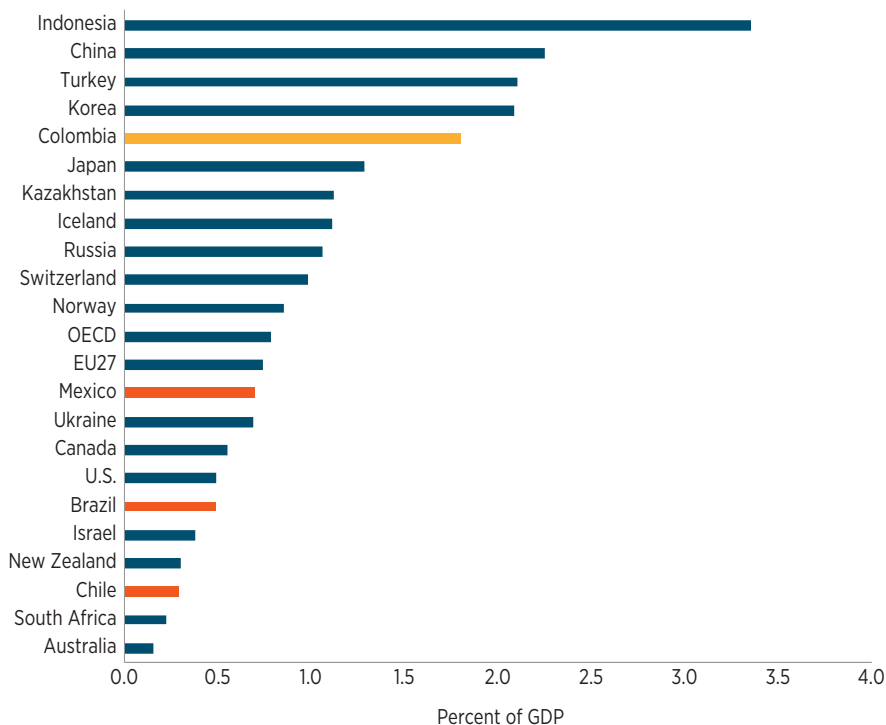
⁵ During 1999–2013, safeguards were applied five times, mainly in response to strikes by farmers (OECD 2015).

⁶ According to the OECD definition, market price support refers to transfers from consumers and taxpayers to agricultural producers from policy measures that create a gap between domestic market prices and border prices of a specific agricultural commodity, measured at the farm gate level.

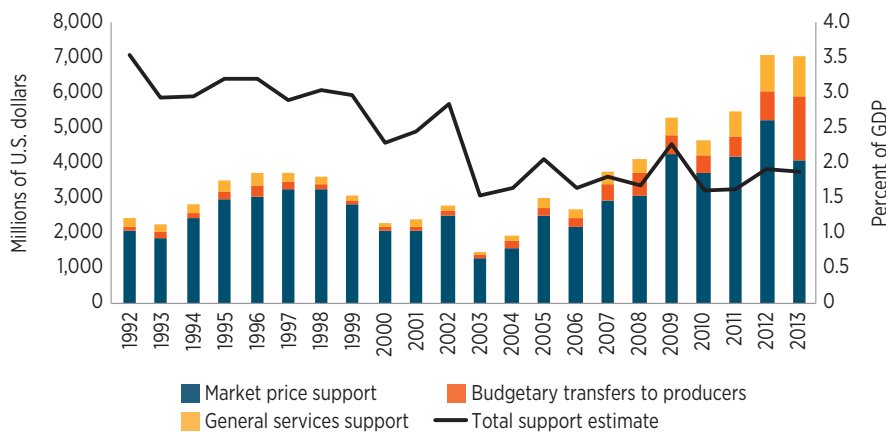
⁷ Junguito, Perfetti, and Becerra (2014) estimate that 90 percent of public funds going to agriculture is in the form of direct subsidies to producers, with only 10 percent provided as “public goods.” In Brazil, 70 percent of support is via public goods.

Figure 5.1
Total Support Estimate for Agriculture

1. Total Support Estimate, 2011–2013



2. Colombia: Level and Composition of Total Support



Source: OECD (2015).

Note: Total support estimate is the value of all gross transfers from taxpayers and consumers to producers arising from policies supporting agriculture. It includes market price support, direct budgetary transfers, and general services support.

Table 5.1
Single Commodity Transfers (as a percentage of gross receipts)

	1991-1995	1996-2000	2001-2005	2006-2010	2011-2015	2016-2017	Average
Rice	27	58	57	49	63	57	51
Maize	41	39	36	34	30	51	37
Refined sugar	33	52	49	30	25	12	36
Milk	48	52	19	20	25	7	31
Poultry	36	29	11	25	29	2	24
Pork	-13	15	9	40	30	27	17
Beef	6	15	23	13	3	0	11
Palm oil	7	11	25	10	4	5	11
Eggs	1	7	-1	13	12	12	7
Coffee	7	1	9	6	8	0	6
Plantains	0	0	0	5	4	7	2
Bananas	0	0	0	5	4	7	2
Flowers	0	0	0	0	0	0	0

Sources: OECD (2015); Perfetti and Botero (2018).

Note: Total value of subsidies and other transfers from consumers/taxpayers to agricultural producers. Estimates include price stabilization funds, commercialization funds, productive alliances, and incentives.

tax on households. The effectiveness of these schemes has also been questioned from the point of view of agricultural development and the construction of value chains (Reina et al. 2011; Junguito, Perfetti, and Becerra 2014). By almost any metric, protection and support have not delivered strong sectoral performance.⁸

Transfers from consumers and taxpayers to agricultural producers are particularly high for refined sugar, rice, milk, and poultry, mainly because of their market price support levels. These products also exhibit the highest single commodity transfers indicator (Table 5.1).⁹

⁸ During the last two decades, agriculture has underperformed the rest of the economy. This mediocre growth is in contrast to what happened in most of the region. Although labor productivity with respect to the United States is low in general, it is dismal in agriculture, with significant dispersion across subsectors, with notable exceptions being cut flowers and sugar. Since 1990 the volume of agricultural exports has increased 39 percent, a poor performance in comparison to Argentina, Brazil, Chile, Mexico, and Peru. Furthermore, Colombia's export basket remains concentrated in hydrocarbons, coal, plantains, and flowers.

⁹ Oviedo, Perfetti, and Higuera (2018) provide a similar picture. When considering the tariff stemming from the price band system, the 2002-2015 average tariff for rice is much higher than the nominal average tariff for agriculture. Likewise, tariffs for refined sugar (22.8 percent) and dairy products (38.8 percent) are higher than the nominal average tariff for agroindustry.

In sum, Colombia provides significant support to agriculture, in particular to products such as rice, sugar, poultry, and milk that weigh heavily in the consumption basket, particularly for low-income households. This is indicative of producers exercising more influence than consumers regarding trade policy. Although the relationship between protection and price elasticity is not clear cut, it can be argued that in the cases of rice and sugar their low price elasticity provides comfort to producers that their claims for protection are not self-defeating, with higher prices leading to lower revenue. Rice and sugar are particularly interesting case studies because their dynamics involve a multiplicity of actors beyond producers and consumers—the milling industry in the case of rice, and the food and beverage industry in the case of sugar. While similarities are interesting, important differences are also worth highlighting. For instance, while sugar production takes place in one region and producers are mostly large landowners, rice is produced in several regions, generally by small and medium-size farms that must deal with a concentrated milling industry.

5.2. Protection of Two “Sensitive” Products

The seminal paper on the political economy of trade policy is Grossman and Helpman (1994). In their model, protection is the result of interest groups lobbying politicians through different activities—including political contributions—that also serve to maximize the welfare of politicians. In this model, governments are not seen as passive executors of a trade policy that maximizes social welfare, but rather as actors interacting with organized interest groups to maximize an objective function in which social welfare is but one element. Another important finding is that organized sectors are more effective and, therefore, receive higher protection and face lower import penetration. Thus, an organized exporter is able to “buy” an export subsidy while an organized import-competing industry is able to “buy” protection.

Cadot, Melo, and Olarreaga (2004) help to better understand protection throughout the production chain, including the relationship between farmers and agribusiness. They extended the Grossman and Helpman model and introduced the idea that all sectors are organized and have lobbying capacity, which gives rise to “counter lobbying” by sectors that are not the direct beneficiaries of trade protection. In this scenario, the equilibrium pattern of protection results from the net effect of these opposing forces. However, although different interest groups may have similar lobbying capacity, they also have different incentives to counter lobby. The authors find that the net political power of fully processed industries is greater than that of intermediate goods industries, and so the former are more likely to obtain more protection.

This finding provides empirical support to the notion that protection escalates with the degree of processing, both in agriculture and manufacturing. However, the incentives to lobby in manufacturing and agriculture differ, and farmers in rich countries have a greater incentive to seek protection—which explains why agriculture is more protected than manufacturing.

However, the authors argue that lobbying capacity is not always the main determinant of the protection pattern throughout the production chain. Counter-lobbying incentives also play a key role. The analysis by Cadot, Melo, and Olarreaga (2004) of manufacturing and agriculture finds that the incentives to lobby differ between these sectors for reasons beyond the notion that protection escalates with the degree of processing. In the case of rich countries, farmers have had a greater incentive to seek protection and, despite being in the first echelons of the production chain, have obtained greater protection.

On the other hand, based on Olson (1965), large farmers are better at overcoming collective action problems and can be more effective in their lobbying activities. Along those same lines, there is the perception that food and processing agribusiness firms are few and are concentrated, and it is therefore easier for them to organize, while farmers are more dispersed. In such a situation, lobbying by industry should be more effective than that by farmers.

With regard to the role of consumers, in the political economy literature in general consumers and voters are viewed as passive actors who do not engage in political activities because it is difficult for them to organize, and there is little incentive for them to do so because the returns to such engagement are low. Interestingly, a new stream of literature has found that the general public affected by agricultural protection—consumers, taxpayers, and voters—is rather active and, if anything, tends to favor protectionist policies.¹⁰

The section that follows identifies the actors involved in the trade policymaking process in Colombian agriculture and then moves into the specific cases of rice and sugar. For both sectors, the determinants of trade policy are analyzed from a political economy perspective. The analysis is based on secondary information and on the main issues that emerged from several semi-structured interviews.

¹⁰ Moona and Pino (2018) show that the importance attached to national food security, family farms, environmental sustainability, and multifunctionality of agriculture prompts most U.S. citizens to support agricultural protection. In the same vein, Naio and Kume (2011) find that consumers in Japan oppose food imports; their sympathy for farmers makes them willing to accept high-priced agricultural products.

5.2.1. Main Institutions and Actors

Government

As part of the liberalization process undertaken in 1991, a comprehensive law established that the “foreign trade sector” would be composed of a group of public entities and the private sector. The law also created several coordination entities. In the public sector, the Higher Council of Foreign Trade (*Consejo Superior de Comercio Exterior* – CSCE) led by the president is the advisory body in charge of defining policies; and the Ministry of Foreign Trade, Industry, and Tourism (MoFT) implements policies defined by the CSCE and leads trade negotiations. The CSCE had a preponderant role in the early 1990s but has faded over time.¹¹ Treaties must be presented to Congress jointly with the Ministry of Foreign Relations. Ministries such as those for agriculture, health, and the environment are involved in specific areas.

In the context of the case studies in this chapter, the Ministry of Agriculture and Rural Development (MoA) has played a prominent role. In sharp contrast to the technical nature of other government agencies such as the Ministry of Finance, Public Credit, and Tourism (MoF), National Planning Department, Central Bank, and MoFT, the prevalence of career politicians in the higher echelons of the MoA has been notorious. When the ministry has not been headed by a career politician, it has generally been led by a former president of one of the sector’s business associations, creating conditions for capture by vested interests. This situation worsened in the last decade due to the increase in the MoA’s budget, partly to execute compensation mechanisms derived from the TPA. The MoA administers significant financial resources, employs a huge number of people, and has ample regional coverage. In 2015, the number of personnel at the MoA and its associated agencies was almost four times larger than in the MoFT, while in 2017 the MoA budget was three times higher than the budget of the MoFT (Arbeláez et al. 2019).

Interviews conducted with former officials of the MoFT and academics suggest that because it is highly politicized and generally lacking technical capacity, the MoA is easily captured by the private sector. Its views on trade policy have almost always been geared toward protecting importable

¹¹ When the CSCE was created, its main functions were to define guidelines to facilitate foreign trade in goods and services, and to promote competitiveness as well as foreign investment. The law gave the CSCE a central role in the formulation of trade policy. However, in recent years the frequency of its meetings has been reduced and it has concentrated its work on the application of trade protection measures, the selection of countries with which to carry out trade negotiations, and the reform of the customs code (García, Collazos, and Montes 2015). The perception that the CSCE’s role has blurred over time was shared by some of those interviewed for this study.

commercial products rather than opening markets. The policy changes that occurred during the first half of the 1990s, if anything, apparently empowered the protectionist wing within the agricultural sector.

The 1991 reform created a coordinating entity, the *Comisión Mixta de Comercio Exterior*, made up of the CSCE and private sector representatives. In 1999, that entity became the *Comisión Mixta de Comercio Exterior y Competitividad*, with the participation of the ministries of labor, health, and social security and with representatives of labor unions and academia. According to the president of the business association ANALDEX (*Asociación Nacional de Exportadores*), the *Comisión Mixta* is rarely convened and its institutional coordination is weak.

Business

Private business can influence economic policy in general and trade policy in particular at three different levels: (1) large firms acting individually; (2) business associations operating at the sector level; and (3) business consortiums with interests in companies operating in different sectors.

Diverse interests prevail within many sectoral business associations. Three revealing cases are ANDI, ANALDEX, and SAC.¹² These organizations, particularly the first two, are composed of firms and subsectors that do not necessarily share a common view with regard to trade policy. SAC is extremely active in lobbying for protection, and some of its subsectoral associations (i.e., Asocaña, Fedegan, Fenavi, and Fedearroz) have been successful in maintaining protectionist measures.¹³ On the other hand, given that in many subsectors that do export the domestic market remains the most relevant, even exporting subsectors might have rather protectionist views with regard to trade policy.

Another dimension of how businesses are organized is as entrepreneurial groups—the so-called *cacaos* (“big shots”), which are consortiums of firms in different sectors with common ownership. In their discussion of compensation mechanisms used by President César Gaviria to facilitate the passing of his 1990–1991 reform program, Edwards and Steiner (2008) argue that *cacaos* negatively affected by certain reforms such as trade liberalization that compromised the profitability of import-competing

¹² ANDI is the *Asociación Nacional de Empresarios* (previously the *Asociación Nacional de Industriales*); and SAC is the *Sociedad de Agricultores de Colombia*.

¹³ Asocaña is the *Asociación Agroindustrial de Caña*; Fedegan is the *Federación Colombiana de Ganaderos*; Fenavi is the *Federación Nacional de Avicultores de Colombia*; and Fedearroz is the *Federación Nacional de Arroceros*. Section 5.3 will discuss Fedearroz and Asocaña in some detail, as they are the most important business associations for rice and sugar.

Table 5.2
Three “Cacaos” Play an Active Role in the Media

Conglomerate	Sectors	Media
Luis Carlos Sarmiento Angulo	Finance	El Tiempo
	Agro industry: rice seeds, cattle, rubber, palm oil	Portafolio
	Infrastructure	ADN
	Hotel industry	City TV
	Mining	
	Energy and gas	
Grupo Santodomingo	Manufacturing	El Espectador
	Finance	Caracol TV
	Transportation industry	Blu Radio
	Agro industry: cereals and oilseeds	
	Commerce	
Organización Ardila Lulle	Agro industry: refined sugar, biofuels, agro chemicals	RCN Televisión
	Beverage industry	RCN Radio
	Automotive industry	NTN 24
		Diario La República
	Sports	Mundo FOX

Source: Prepared by the authors.

businesses benefited from the privatization of the mobile phone business.¹⁴ Today, large business organizations exert significant control over the media (Table 5.2). As will be discussed later in this chapter, one of these groups recently played a critical role in derailing the government’s attempt to tax sugar-sweetened beverages.

Finally, the *Consejo Privado de Competitividad*, a think tank sponsored by private business, interacts with government, the private sector, academia, and other organizations that promote productivity and competitiveness. The council was created to articulate the positions of different actors and to advocate for cross-cutting interests rather than particular ones. It has always supported a liberalized and non-distortive trade regime. However, its success in coordinating positions along the productive chains has been rather limited.

¹⁴ Rettberg (2003) provides evidence that although in 1996 the *Consejo Gremial Nacional* (CGN) was of the view that President Ernesto Samper (1994–1998) should resign from office once it became evident he had received campaign contributions from a drug cartel, he was able to remain in power thanks to support from the *cacaos*.

Labor Unions and Dignidades Agropecuarias

Labor organizations have been particularly active on two fronts: wage bargaining, notably regarding the minimum wage, and labor market reforms. On trade matters, while labor groups opposed the 1990–1991 liberalization effort, they were not vocal actors (Edwards and Steiner 2008). However, the TPA negotiations drove them to organize two national strikes. Their actions, carried out jointly with U.S. labor unions, ended in a side agreement on the protection of labor rights but did not affect the liberalization outcome.

While unionization in agriculture in Colombia is low (less than 3 percent in 2016), the politicization of agriculture has become significant. In August 2010, some 4,000 rice producers convened a “protest for the dignity of rice producers,” demanding higher prices, limits to imports and contraband, and resources for research and development (R&D). In 2012, with the intention of establishing the National Agriculture Dignity Movement (*Movimiento por la Dignidad Cafetera*), some 700 coffee growers gathered in Riosucio, Caldas. In 2013, thousands of farmers took part in one of the largest protests in recent history, the National Agriculture Strike. It was called to reject the TPA and denounce the lack of government support, poor working conditions, low prices, and strengthening of the peso.¹⁵ It was in the context of the strike that the National Agriculture Dignity Movement was established.¹⁶ If anything, the Dignity Movement suggests that traditional trade unions had become quite ineffective. Protests and strikes by agricultural producers are now common. Of note is the fact that in 2017, another labor movement, *Dignidad Arrocerá*, demanded the renegotiation of the TPA, fair prices, incentives for storage, and attention to the high costs of production.

Congress

The Colombian Congress consists of two chambers, the Senate and the House of Representatives. Senators are elected in a nationwide district, and representatives in regional districts (under proportional representation). The overrepresentation of departments where agriculture and cattle-raising are important is evident in the Senate. In the 2014 elections, Córdoba and Sucre, where cattle-raising is dominant, provided 5 and 6.6 senators per 1 million

¹⁵ In 2014, after conversations with the MoA, the *Dignidad Arrocerá* movement managed the establishment of a mandatory price range for millers, differentiated by region.

¹⁶ Comprised of *Dignidad Arrocerá* (rice), *Dignidad Cacaotera* (cocoa), *Dignidad Papera* (potatoes), *Dignidad Cafetera* (coffee), *Acopaneleros* (brown sugar), the Córdoba and Mojana Salvation Movement, and the *Movimiento por la Defensa de la Ganadería* (cattle raising).

inhabitants, respectively. This is in sharp contrast to Bogota. While 20 percent of the population lives in the capital city, in the 2018 Congress only eight senators (out of 102) had traditionally made their home there. Interestingly, agricultural departments have higher participation in congressional than in presidential elections. In 2014, 64.4 percent of voters in Sucre participated in the elections for Congress, but only 38.8 percent in the presidential contest (which happened a few weeks afterward); in Cordoba, the relevant numbers are 58.3 percent and 36.1 percent. In contrast, Bogota voters participated more actively in the presidential election (48.3 percent) than in the one for the Senate (35.5 percent).

Congress has the authority to enact laws related to the regulation of foreign trade, the modification of tariffs and rates, and the customs regime. Through so-called *Leyes Marco* (Framework Laws), it defines the objectives and criteria by which the government must abide when drawing up bylaws. With regard to a free trade agreement, the Congress exercises political control at two points in time. During the negotiation phase it may require ministers and the negotiating team to report on the progress of negotiations. When the treaty has been signed, it is submitted for congressional approval, but the Congress does not have the authority to modify it. The Constitutional Court, in turn, has to opine that no commitments agreed to in a treaty are contrary to the constitutional order.

5.2.2. The Political Economy of Rice Protection

Rice constitutes an interesting political economy case study because the sector's influence arises from there being thousands of medium-size and small producers throughout several regions who capture most of the price differential generated by the tariff on paddy rice (the current Most Favored Nation rate is 80 percent). However, protection to growers explains only part of the difference between the world price and the price paid by Colombian consumers. Indeed, the oligopolistic structure of the milling industry, coupled with the high tariff on white rice (also a Most Favored Nation rate of 80 percent), allow millers to fully transfer to retailers the cost of protection afforded to growers. Consumers pay prices that account not only for the protection for growers, which are the costs associated with an oligopolistic and protected milling industry, but also for the costs arising from an inefficient commercialization chain. In 2014, the *Misión para la Transformación del Campo* estimated commercialization margins of more than 80 percent for some products. The price differential between the mill and the final consumer suggests there is scope for producers and millers to appropriate an additional portion of this margin, if they are able to reach the final consumer.

Fedearroz's strategy to participate in industrial and commercialization activities points in that direction.

Sector Characterization

According to data from the MoA, rice accounted for 5 percent of total agricultural production and 12 percent of the harvested area in 2015. Data from the 2016 census undertaken by Fedearroz and other sources illustrate the main characteristics of the sector:

- Most of the rice cultivated is mechanized (570,802 hectares in 2016), with rain-fed rice being by far the most widespread form of cultivation.
- There are over 16,000 mechanized rice producers. In 2013, there were also 16,971 manual dry rice producing units—that is, bread-to-catch crops with very low productivity.
- Small and medium-size producers predominate, and most do not own the land they cultivate. The average size of a production unit is less than 10 hectares, with some 63 percent of producers functioning as tenants.
- There is great regional disparity in productivity; importantly, between 2007 and 2016 output expanded in areas of relatively low productivity (Table 5.3, panel 1).¹⁷
- Colombia's average yield for 1990–2014, while higher than the world average, is significantly lower than that of Peru and the United States (Table 5.3, panel 2).
- Import penetration has been low, with an average of 7 percent before 2015 and 12 percent for 2015–2017 (Table 5.3, panel 3). It is expected that imports will increase as a result of market access commitments derived from the TPA.

Main actors in the rice value-added chain are growers, mills, and a heavily populated distribution chain.¹⁸ Rice growers are members of Fedearroz and mills are part of Induarroz, which operates under the umbrella of the *Asociación*

¹⁷ According to Fedearroz, the decline in yield is explained by the increase in sowing in the rain-fed system, which is less productive; by an expansion of the crop to less suitable areas; by a greater proportion of tenant producers who have low investment levels; and by a shortage of combined machines.

¹⁸ In addition to traditional retailers—including small stores, supermarket chains, and hard discount retailers—some producers and millers occasionally become involved in wholesale distribution. In addition, in some cases mills sell rice to packaging companies that, in turn, sell to the commercialization channels. In other cases, mills pack and sell to the commercialization channels themselves.

Table 5.3
Rice Production, Yields, and Imports

1. Yields by Region				
Region	Weight in Production, 2007	Yield in 2007 (ton/hectare)	Weight in Production, 2018	Yield in 2018 (ton/hectare)
Huila	9%	6.9	6%	7.2
Tolima	31%	7.6	20%	7.2
Norte de Santander	6%	6.3	6%	5.9
Casanare	13%	5.5	34%	5.7
Meta	17%	5.6	14%	4.0
Others	24%	3.5	21%	4.0
Colombia	100%	4.0	100%	4.4

2. Yield Evolution by Country		
Country	Average Yield (10 ton/hectare)	Share of World Production
	2000–2017	2000–2017
China	65.1	22.3%
United States	78.7	1.1%
India	33.2	16.6%
Brazil	43.1	1.3%
Peru	71.5	0.3%
Colombia	46.9	0.3%
World Average	36.7	

3. Paddy Rice Penetration (tons)			
	Production	Imports	Imports/Production
2000–2004	2,276,103	126,686	6%
2005–2009	2,202,021	151,893	7%
2010–2014	1,908,810	113,875	6%
2015–2017	2,396,465	296,521	12%

Sources: Panel 1: Agronet – Ministry of Agriculture; Panel 2: Faostat; Panel 3: Fedearroz and Agronet.

Nacional de Empresarios de Colombia. This productive chain is characterized by a high concentration in milling activity. There were eight important mills in 1996, and that number is down to only two today (Molinos Roa and Arroz Diana), with a few additional small and medium-size mills.¹⁹ According to data from the *Superintendencia de Sociedades*, in 2017 Molinos Roa accounted for 36 percent of total sales of the rice milling sector and Arroz Diana for 33 percent.

Rice Trade Policy

Since the launching of the *apertura* in 1991, rice growers have managed to persuade the government to introduce protectionist policy measures, including the signing of a voluntary agreement with Venezuela in 1992 to limit exports (Jaramillo 2002) and the establishment in 1996 of a regime to control imports through a Rice Policy Committee composed of government, millers, producers, and traders. Rice was covered by the price band system from 1991 until 2003, when the mechanism was replaced by an 80 percent fixed tariff. The average tariff resulting from the price band system had been 52.8 percent between 1998 and 2003. In 2004, the tariff was increased and several phytosanitary NTBs were introduced.

Until 2005 the sector was very active in requesting safeguards against Andean countries, since rice has a tariff preference of 100 percent with those countries. During 1994–2004 rice stood out as one of the products with the highest number of investigation applications for dumping and safeguards (Reina and Zuluaga 2005). In recent years, nontariff measures (i.e., limiting the issuance of phytosanitary certificates) and noncompliance by Colombia with commitments with Andean countries have restricted imports from Ecuador and Peru.

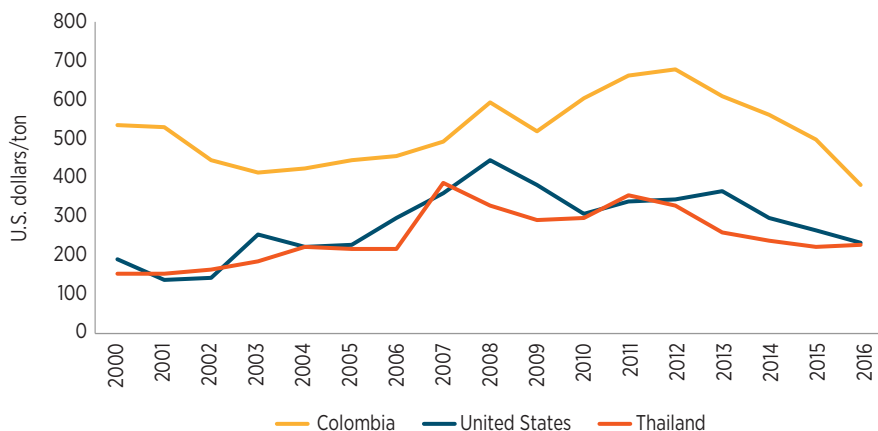
If local prices are compared with those of other producing countries, it is clear that tariffs have had an impact, particularly after 2006 (Figure 5.2, panels 1 and 2), coinciding with having gone from the price band system to the 80 percent fixed tariff. On average, between 2009 and 2018 the differential between international and domestic prices for paddy was 76 percent; for white rice it was 108 percent compared to the United States and 139 percent compared to Thailand (Figure 5.2). The larger differential for white rice is indicative of the relative ability of millers to capture rents. For both types of rice, differentials have been declining on account of the downward trend in domestic prices (Figure 5.2, panel 3), in part the consequence of the increase in production and more recently because of imports from the United States.

¹⁹ In 2015, Molinos Roa merged with Flor Huila, two large companies belonging to a family group, and the Roa Flor Huila organization was established.

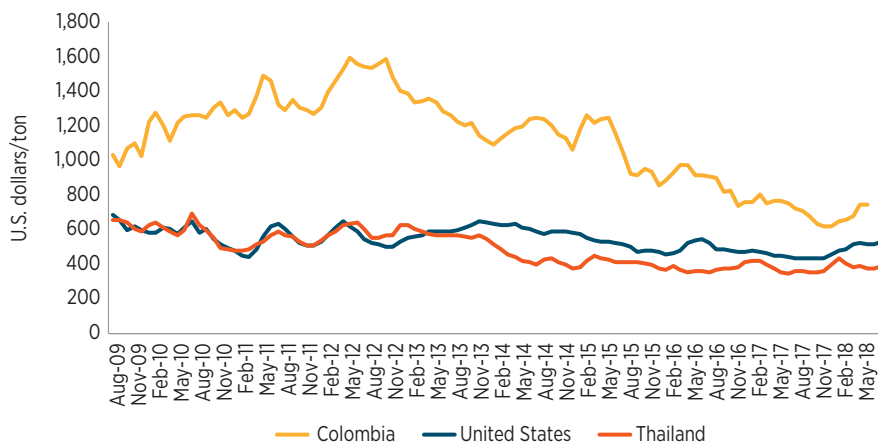
There is a controversy within the rice chain that is not focused on trade issues. Growers seek protection because their productivity is low, in a context in which the milling industry is equally protected and able to transfer tariffs to consumers. The milling industry has expressed that its main interest is that the market be allowed to operate without government intervention, as the industry considers that minimum guarantee prices do not allow it to take advantage of price changes arising from market conditions, while at the same time inducing growers to increase production. This generates a vicious circle

Figure 5.2
Rice Prices (in constant terms)

1. Paddy Rice



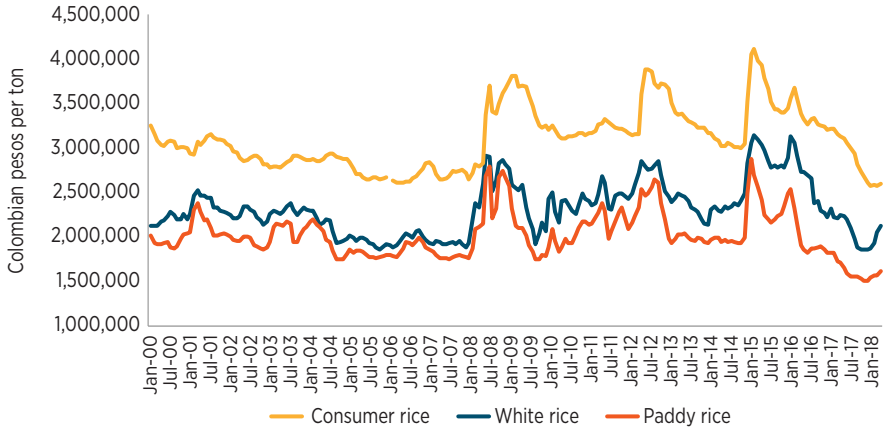
2. White Rice



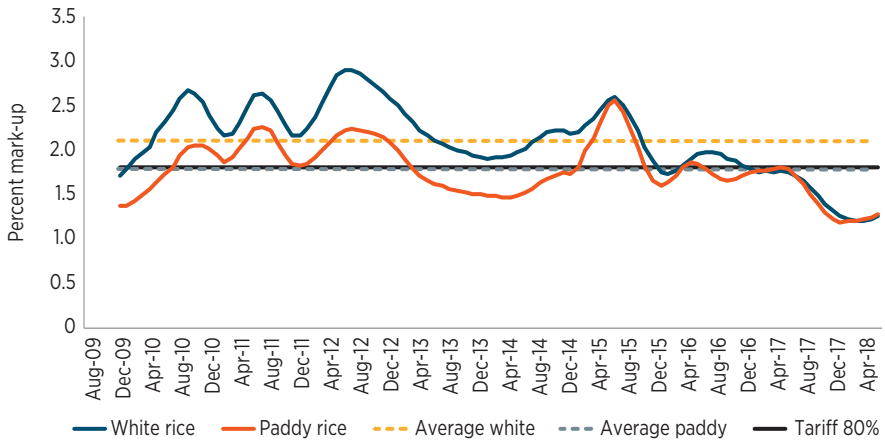
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Figure 5.2 (continued)
Rice Prices (in constant terms)

3. Domestic Prices^a



4. Price Differentials (Colombia/United States)^b



Sources: Panel 1: FAO (2018) (not adjusted by purchasing power parity); Panels 2, 3, and 4: authors' calculations based on Fedearroz – creed rice.
 Note: All prices are expressed in white rice equivalent.
^a Consumer prices are an average of white rice prices in supermarkets, stores, and marketplaces.
^b Five-month moving average of the original series.

in which the government must eventually intervene with more support, including for storage and commercialization. Since 2015 the differential between the domestic and the U.S. price has been falling for both paddy and white rice, while the difference between the two ratios has been closing—the high domestic prices for paddy that prevailed until 2016 eventually delivered a significant over-supply followed by a sharp price correction (Figure 5.2, panel 4).

Rice growers argue that they face adverse conditions owing to the oligopolistic structure of the milling industry, compounded at certain junctures by the impact of smuggling, which reinforces their case for protection. In 2004, the competition authority, the *Superintendencia de Industria y Comercio* (SIC), which is part of the MoFT, investigated several mills for infringement of competition, allegedly for having entered into agreements to fix the price of paddy rice. The investigation ended in 2005 with the imposition of hefty fines. In 2012, the SIC opened an investigation into the Roa and Florhuila Mills for influencing the consumer price of white rice, and in 2015 it imposed a fine. Evidently, the milling industry exercises the power derived from its structure, and this is used by growers as an argument to command “support for the small guy.”

Beyond this controversy in the productive chain, what stands out is that growers and millers have managed to obtain high levels of trade protection. In this process, growers have been particularly influential, with millers adopting a more passive stance, presumably because the tariff structure for rice has no impact on their effective protection and on account of their ability to transfer any inefficiencies arising from protection to consumers.

Interviews with academics and former government officials evidenced two sources of influence from growers. The first arises from the structure of the sector (small and medium-size producers scattered throughout the country), representing the potential threat of paralyzing vast regions through strikes. In fact, since 2010 the *Dignidad Arroceros* movement has opted for de facto means to express its views and demands, and since 2014 growers have carried out several strikes to oppose competition from the United States and complain about low prices. In 2018, under the threat of another strike, the government and growers entered into conversations in order to decide between a policy of a minimum purchase price or the adoption of a plan to reduce production, as on previous occasions.

Another source of influence of rice growers has to do with what has been called the revolving door between the producer’s association and government. Several ministers of agriculture have previously served as presidents of production associations, and ministers are a particularly important channel of influence for large producers. Congress, given the agricultural vocation of many of its members, defends the interests of farmers, although most of the interviewees for this chapter agreed that the role of Congress is secondary to the channels of influence stemming from the relationship of Fedearroz with the MoA and from movements such as *Dignidades*.

The increase in the Most Favored Nation (MFN) tariff rate in 2003 is an interesting episode to illustrate the power of Fedearroz, with the support of the MoA. In December 2003, prior to the start of the TPA negotiations,

Colombia modified the tariff for rice, and an annual tariff quota of 75,118 tons was introduced. The measure established a fixed MFN tariff of 80 percent for imports outside the quota, while the quota would enter with the tariff resulting from the price band system.²⁰ In 2003, the MoA saw in the country's agenda to comply with World Trade Organization commitments—in particular the need to modify its crop absorption policy—a window of opportunity to increase protection. The change consisted of establishing a Mechanism for the Administration of Agricultural Import Quotas, a preferential tariff quota providing more certainty and transparency to importers. In implementing this tariff, Colombia could modify the tariff on rice and justify such a change to FTAA countries.

According to some interviewees for this chapter, the argument with which the MoA initially justified the measure had to do with the fact that the price band system was not fulfilling its purpose. However, other interviewees pointed out that this measure was part of a defensive strategy that the MoA orchestrated in 2003, presumably with the approval of some sectoral business associations, to increase tariff rates before having to deliver a base tariff in a possible FTAA negotiation at that time, or with the United States later in case the FTAA initiative collapsed. Juan Ricardo Ortega, the Deputy Minister of MoFT in 2004, said that he attended a coordination meeting of Andean countries in Lima at which Colombia's MoA proposed reforming tariff policy not only for rice but for agriculture in general, with a markedly protectionist view.

The FTAA stagnated, and in 2004 Colombia began negotiating the TPA with the United States on the basis of a new (higher) tariff for some agricultural products, including rice. In practice, this was an ex-ante compensation mechanism that certainly facilitated within Colombia the negotiation of the TPA. For rice producers this measure was a very important achievement. In 2015, Fedearroz's president was quoted in the *Vanguardia Liberal* daily as saying, "The removal of that 80 percent import duty would ruin everything that is being implemented to catch-up and compete openly in international markets."

5.2.3. The Political Economy of Support to Sugar

Sugar protection has been the result of well-organized producers/farmers effectively lobbying the government and politicians through, among other methods, campaign contributions and political support, and through other groups of interest less organized and not as influential.

²⁰ In 2005, the MFN tariff of the quota was set at 70 percent and set to reduce to zero starting in 2008. The extra MFN tariff of the quota remains at 80 percent. Currently, this tariff treatment is different only for the United States under the TPA and for countries in the Andean Community.

Characterization of the Sector

Although Colombia is among the main sugar producers in the world, its output (2.3 million tons in 2016) is well below that of the two major players (Brazil, 39 million tons, and India, 25 million tons). At 50 percent, sugarcane has the largest volume share in total agricultural production and represents 4.7 percent of total harvested area, sixth largest among agricultural products. According to the Food and Agriculture Organization (FAO), Colombia, together with Peru, is among the countries with the highest yields per hectare.

Production is concentrated in the department of Valle del Cauca. Historically, mills cultivated in large areas they owned. By the 1990s, however, they had adopted a scheme based on suppliers. Today, 25 percent of the land planted with sugarcane belongs to mills and the remaining 75 percent to cane growers.²¹ The mills use a contract that allows them to exert control over around 50 percent of the cultivated area (ECLAC 2002).²² The political clout of the sector is enhanced when thousands of small and medium-size suppliers, rather than a few big landowners, are involved in production. In 2017, some 56 percent of production was sold in the domestic market, 27 percent exported, and 17 percent destined for bioethanol production. In interviews for this study it became clear that exports and biofuels are important to manage surplus production.²³ More than 50 percent of output sold domestically is consumed by households, and the rest is used as raw material in the food and beverage industry. Main actors in the sugarcane agroindustrial chain include 2,750 growers, 13 mills, 6 bioethanol distilleries, 12 electric power cogeneration plants, two paper-producing companies from sugarcane bagasse, one sucro-chemical company, and Asocaña, the sugarcane producers' trade association.

Large economic groups own several mills and concentrate around 65 percent of sales. They include the Manuelita group, a regional Latin American organization with interests in sugar, bioethanol, palm oil, fruits and vegetables, and aquaculture; the Riopaila group, with businesses in sugar, alcohol, and palm oil; and the Ardila Lulle Group, a leader in the production of soft drinks and vertically integrated with three large sugar mills. This last group did not

²¹ According to Asocaña, the average size of farms is 63 hectares, with 69 percent having less than 60 hectares.

²² These contracts include schemes such as lease agreements, accounts in participation, and contracts of suppliers in administration, generating medium-term relationships with cane growers.

²³ Colombia has put in place a policy geared toward fostering the production and use of bio-fuels. Notwithstanding the fact that this policy has merit along several dimensions, it is quite evident—and confirmed by the head of an important sugar mill in an interview for this chapter—that the introduction of the biofuels policy in the first half of the previous decade coincided with the dire situation of the sugar industry at the time.

originate in the sugar business. In a move much praised by the sugarcane business association, the Ardila Group invested in this sector in order to access the main raw material for its soft drink industry. Additionally, this group has ample presence on TV and radio and in the written press (Table 5.2).

Since 1959 sugarcane producers have been represented by Asocaña. Its main activities include coordinating the sector's position in trade negotiations and managing the Sugar Price Stabilization Fund (*Fondo de Estabilización de Precios del Azúcar* - FEPA).²⁴ Asocaña is composed of all sugar mills and a significant number of cane growers. The association's activity has enabled the sugar sector to become one of the most organized and active in research and technology through *Cenicaña* (R&D) and *Tecnicaña* (training and technology transfer).²⁵ The sector is recognized for its contribution to development in its area of influence (Arbeláez et al. 2010; Nuñez et al. 2018).

Sugar Trade Policy

Mainly on account of the distortions in the international market, Colombia's sugar industry has developed in a mostly protected environment. These distortions originate mainly from large producing countries that, on account of their support policies, generate huge surpluses. In addition, the international market operates under a complex system of quotas in most importing countries that, at certain junctures, make it difficult to absorb these surpluses. In Colombia, sugar has been covered by the price band system and also benefits from the FEPA. Analysts and the agroindustry have criticized its protectionist bias. At the center of the debate is the timeframe with which the price band adjusts to reflect international price trends (the floor and ceiling prices of the band are estimated using prices of the previous 60 months). In the opinion of sugar producers, the mechanism does not isolate them from international price signals; those in the downstream of the productive chain claim otherwise.

The Agricultural Law of 1993 created the FEPA to promote agricultural exports by compensating producers (in this case the mills) for the differential

²⁴ Price stabilization funds seek to stabilize producer income, regulate production, and promote exports. Several price stabilization funds have been questioned because their operation might impede competition. Also subject to criticism is the fact that there is a bias in the estimation of prices, yielding, at the expense of consumers, prices higher than those prevalent in international markets.

²⁵ In 1961, several of the mills joined forces to establish Ciamsa, a company dedicated to the international commercialization of sugar. Dicsa, which is no longer in operation, commercialized sugars within the country for use in the animal feed industry, liquor production, and the sucro-chemical industry.

between the domestic and the international price, the former including tariff protection, thereby rendering producers indifferent as to selling in either market. The FEPA obtains funds from producers during favorable market conditions (defined as “cessions”) and provides them with “compensations” when conditions become adverse. The FEPA has a steering committee made up of representatives from the MoA and MoFT, seven members representing sugar producers, and four who represent cane growers. An important criticism of these mechanisms is that their operation influences market conditions to the extent that they can be used to exchange sensitive information among producers. This was one of the central issues in the competition authority’s 2012 investigation of the FEPA. In 2016, some adjustments were made to the fund’s information management policy.

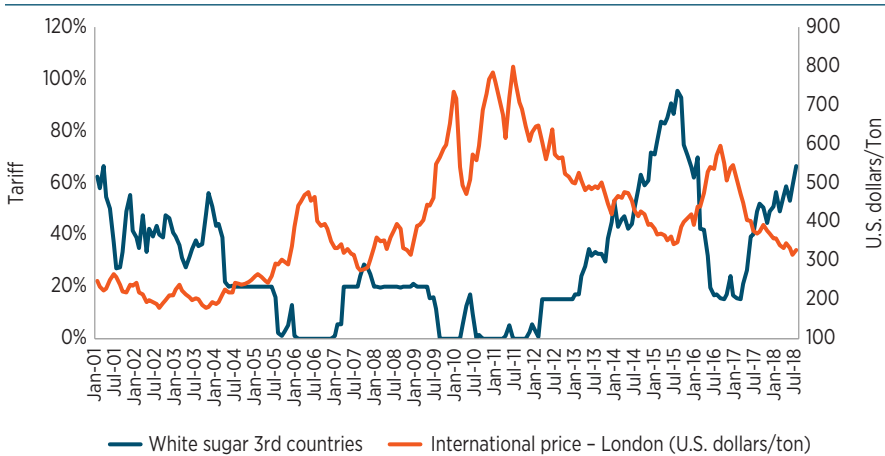
Some of the interviewees for this chapter expressed the view that although both the price band system and the stabilization funds were designed as transition mechanisms to stabilize prices rather than to restore protection, the estimation methodologies and parameters actually used were adapted to meet both stabilization *and* protection objectives. Besides, as in other sectors, sugar has numerous NTBs that not only increase prices but, in some cases, virtually close the market. A relevant example in this regard was the requirement, in place during 2009, that all sugar imports come through the port of Buenaventura (on the Pacific Coast), making imports from Brazil virtually impossible.

To respond to complaints by the food processing industry regarding the anti-export bias of the tariff policy, the sugar mills created the joint exports mechanism in 1993. Under this mechanism, mills sell sugar to the food processing industry at international prices (i.e., without tariffs) if the sugar will be used in products destined for exports. However, according to the food processing industry, this mechanism only attacks part of the problem. Products like sweets, cookies, and chocolates that are produced for the domestic market must still use sugar purchased at a price (much) higher than the international price. This affects their competitive position vis-à-vis imported final products, in as much as the latter are not covered by the price band system and were liberalized in free trade agreements signed by Colombia.

Trade policy for sugar has been managed with the same criteria used for other products of commercial agriculture, even though sugar is an exportable good. While the tariff resulting from the price band system has fulfilled its stabilization purpose (in times of rising international prices, the tariff is reduced, and vice versa), in some instances it has reached levels close to 100 percent (Figure 5.3).

When comparing the international price with an estimate of the domestic price ex-mill (which considers the tariff resulting from the price band

Figure 5.3
White Sugar International Price and Colombia's Tariff Rate



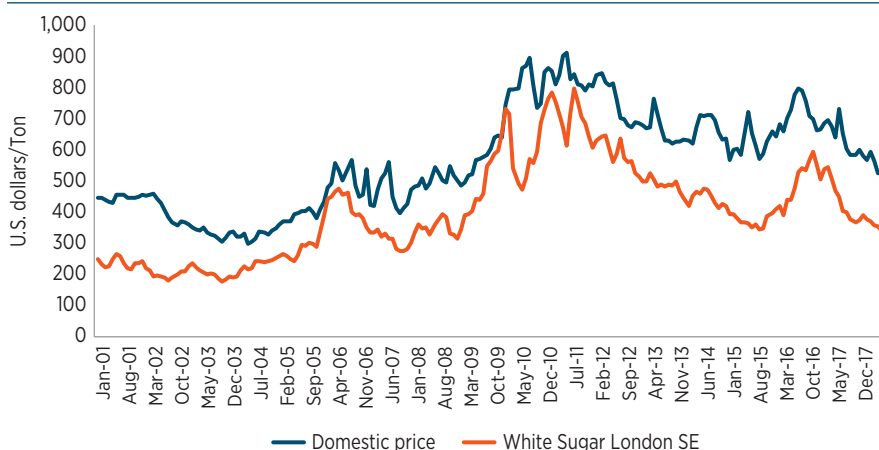
Source: Asocaña.

system), it is evident that there is a differential between the two, which has been expanding, especially since 2011 (Figure 5.4).

For the last two decades, the impact of raw materials covered by the price band system on the competitiveness of the food industry has been the subject of a heated debate between the actors in the different productive chains and between the Ministries of Agriculture and Foreign Trade—the former taking sides with the agriculture sector, the latter supporting the enhancement of competitiveness of the value chain. In the case of sugar, a key element in this discussion is its share in the cost structure of the sweets, confectionery, and chocolate industry, a topic over which there is no consensus.²⁶ As will be seen later in this chapter, this dispute has been present in trade negotiations, particularly during the TPA negotiation.

²⁶ Espinal, Martínez, and Acevedo (2005) state that sugar has a 26 percent share in the cost of candies. Leibovich (2014) presents information based on the 2007 input-output matrix according to which intermediate sugar purchases in confectionery represent 19 percent of production costs and 10.9 percent of production costs in chocolates. Piedrahita and Reina (2016) indicate that in the case of Nutresa—one of the most important downstream producers—sugar's share in costs is 30 percent for chocolate for hot drinks, 20 percent for sweet cookies, 10 percent for ice cream, and 8 percent for chocolates. Information provided by Asocaña cites sugar participation of 6.95 percent in the cost structure of the sugar and chocolate sector, based on the 2009 input-output matrix. Asocaña also has made its own calculations for some products in which the sugar share in costs does not exceed 16 percent.

Figure 5.4
Domestic and International Sugar Prices



Source: Asocaña.

Note: Domestic price is an ex-mill price according to a survey by the Sugar Price Stabilization Fund (FEPA).

The productive chain of sugar-confectionery, sweets, and chocolates illustrates a political economy game involving powerful actors: a sugar industry that exhibits high yields and a processing industry that is among the most dynamic in exports (Perfetti and Botero 2018). In the controversy within this production chain, the interests of sugar mills have generally prevailed on account of (1) the importance of sugar for the socioeconomic development of Valle del Cauca;²⁷ (2) the ties that sugar mills have with the political class on account of campaign financing; and (3) the fact that there are very important firms, such as Postobon, that are vertically integrated with sugar mills, with few incentives to counter lobbying.

Having said this, measures have been adopted to address some of the most salient distortions. Since 2015 some aspects of the operation of the FEPA and of the methodology for estimating cessions/compensations have been reviewed as a result of the fines imposed on the sugar industry. In 2015, the government established a 70 percent ceiling on the tariff resulting from the price band system. As a consequence, the resulting tariff fell from an average of 82 percent in 2015 to 55 percent in 2018. Despite these changes,

²⁷ This has been recognized in the sector's impact assessments as well as in Congress; it has been highlighted by Senator Jorge Enrique Robledo when referring to the fines imposed by the competition authority on Asocaña and sugar mills as well as during the debate on taxing sugar-sweetened beverages (more on both later in this chapter).

it became evident based on the interviews for this chapter that the processing industry that is not vertically integrated considers that sugar producers are able to maintain their privileged conditions at the expense of industry, whose expectation is to have domestic prices that much more closely follow the international price.

The political economy game allowing sugar producers to have such privileged conditions has had an impact not only on actors in the middle of the productive chain of sugar-confectionery, sweets, and chocolates, but also on final consumers. To illustrate this, two episodes are presented. The first refers to the restriction on imports and the impact of this practice on the manufacturing industry, which led the competition authority to intervene. The second, although not related to foreign trade, illustrates the economic and political clout of sugar producers that has allowed them to heavily intervene in derailing attempts to impose a tax on sugar-sweetened beverages.

Episode: In 2015, the competition authority fined Asocaña and 12 mills for cartelizing in order to block imports and ordered a revision of the FEPA.

According to the SIC,²⁸ in 2010 the Deputy Minister of the MoFT referred a letter from manufacturers of *bocadillo* (a popular artisanal sweet) complaining about the negative impact on their activities of the sharp increase in sugar prices and the insufficient supply of raw material. Later, Coca Cola FEMSA, Bavaria, Nestlé, Bimbo de Colombia, Compañía Nacional de Chocolates, Compañía de Galletas Noel, Meals, and Casa Luker—the most important national and multinational companies in the productive chain—requested an investigation of the sugar market on account of what they claimed to be anti-competitive practices. The claimants argued that operation of the FEPA was going beyond determining cessions/compensations and was in effect being used to restrict competition.

In 2012, an inquiry was formally opened under which (1) Asocaña and the 12 mills were investigated for entering into an agreement to assign production quotas; and (2) Asocaña, Ciamsa, Dicsa, and the 12 mills were investigated for entering into an agreement to prevent or obstruct the entry of third parties into the market. The inquiry concluded in 2015 with the imposition of fines for corporate cartelization with the purpose of obstructing or restricting the entry of third parties into Colombia's market.²⁹ The SIC found evidence that imports from Bolivia, Costa Rica, El Salvador, and Guatemala had been restricted. In addition, it ordered a review of the FEPA in order to ensure that

²⁸ SIC Resolution 5347 of 2012.

²⁹ SIC Resolution 80847, pages 4 and 187.

it did not serve as an instrument to regulate production quotas or supply in the local market.

Although this episode did not have an impact on the price band system, it touched on two central issues: the restriction on (and for all practical purposes the impossibility of) importing due to binding NTBs and to the FEPA’s role in regulating supply. While the investigation did not have a direct impact on sugar prices, it brought to the forefront the debate on the conditions of competition in the market and set a precedent for the operation of other stabilization funds, some of which, like the one for palm oil, have been questioned in the same way that the FEPA was.

After the imposition of fines, the methodology for estimating stabilization operations was modified, and an information management policy was adopted that distinguishes information as public, semi-private, private, and reserved and establishes the conditions for its delivery and dissemination. In the interviews undertaken for this chapter, it became evident that the processing industry does not perceive that there have been significant corrections to the problems that have characterized this market.

This episode illustrates how different actors approach the political economy game. Plaintiffs managed to transfer part of the debate to a technical area. Although the demand was not related to the price band system, it touched on the topic of prices in the domestic market and on the FEPA’s impact on it. In addition, plaintiffs took the issue out of the sphere of business organizations. Several interviewees for this chapter pointed out that ANDI had not been effective in finding a solution to the conflict among the actors in the value-added chain.

Within the government, the issue of value-added chains has been a matter of much debate between the Ministries of Agriculture and Foreign Trade. According to entrepreneurs interviewed for this chapter, while the MoFT generally has the upper hand on technical issues, the MoA, due to political considerations, usually manages to impose its point of view. Bringing the debate to the SIC broke with that dynamic. Asocaña and the sugar mills investigated questioned the SIC for favoring the interests of large economic groups and multinational companies. The SIC replied that the obstruction of imports impacted intermediate or final consumers and that its mandate was to promote efficiency. The composition of the plaintiff group, including multinational corporations, was convenient to address an episode that reflected the difficult relationship among different actors in the production chain. Producers sought support from the MoA in explaining the nature of the FEPA and questioned why public officials, who act as members of FEPA’s Committee, were not investigated. Additionally, they challenged the SIC’s jurisdiction to investigate the FEPA, a government intervention mechanism.

The SIC pointed out that although it did not have the authority to fine FEPA administrators, it could order that its operation be amended.

Episode: Tax on sugar-sweetened beverages

Although this episode is not directly related to trade policy, it certainly illustrates the power and mechanisms of influence of the sugar industry. Within the context of the 2016 Tax Reform, the MoF and Ministry of Health (MoH) raised the possibility of taxing sugar-sweetened beverages. The reform contemplated applying a US\$300 tax per liter of sugar-sweetened beverage, approximately 20 percent of its commercial value. The purpose of the tax was to reduce consumption while generating revenue for the health sector. The discussion regarding this tax was quite heated; the sugar-sweetened beverage industry firmly opposed it, and the project did not even reach the floor of the Congress.³⁰

Reputable scientists and public health academics supported the proposed measure. On the other hand, opposition to the tax was relentless and included the soft drink industry, sugar mills, sugarcane producers, and large associations such as Fenalco (representing the retail sector) and ANDI (representing manufacturing). Those in opposition argued that taxation would reduce the sales and profits of sugarcane growers and retailers and would directly affect the production chain, with direct implications for output and employment. They also argued that public health issues such as people being overweight or obese were due mainly to lack of exercise rather than to sugar consumption.

Even before the tax was included in the initial text of the tax reform proposal, various stakeholders were lobbying against it. The carbonated beverage industry met with Minister of Health Alejandro Gaviria on various occasions, voicing the argument that taxation would have severe negative consequences for the industry.³¹ It is worth mentioning that, as reported by the *New York Times*, neither Coca Cola nor Pepsi visibly opposed the tax, leaving the spotlight to Postobon.³² U.S. companies, rather than taking the lead in terms of supposedly “carrying a big stick,” stood on the sidelines as “free-riders” to the strong opposition from a local and very powerful economic consortium.

³⁰ Colombia’s soft drink market is dominated by two groups. The Ardila Lulle Group owns five brands that in 2017 controlled 50 percent of the market, with Postobon alone having a 26 percent market share. Its main competitor, CocaCola – FEMSA, is foreign-owned and has a 42 percent market share.

³¹ A small group of economists and public health experts supported the campaign against the tax.

³² Andrew Jacobs and Matt Richtel, “Nos silenciaron’: La lucha en Colombia por gravar las bebidas azucaradas,” *New York Times*, November 13, 2017. (<https://www.nytimes.com/es/2017/11/13/colombia-impuesto-bebidas-azucaradas-obesidad/>).

Lobbying against the tax increased after the government submitted draft legislation to Congress. In early December 2016, Congress called a public hearing in which various senators from different political parties and ideologies argued against the tax. Some supported the soft-drink industry, others the sugarcane producers, and several the labor unions. Once the Minister of Health finalized his presentation of the proposal, a member of Congress told him that he had never in the history of Congress witnessed such strong lobbying as the one against the reform. Later that night, the minister was informed that the tax had been removed from the tax reform proposal.³³ Indeed, members of Congress unanimously conditioned their support for the reform package on its removal.

The tax proposal not only received no political support whatsoever, it actually gave rise to the most unexpected of bedfellows. The right-wing Centro Democrático party took a strong stance against the initiative, arguing that sweetened soft drinks only have limited responsibility for obesity and that, furthermore, the tax would heavily affect the poor. Centro Democrático’s views were very much in agreement with those of the vociferous and highly influential leader of the left-wing Polo Democrático party, who argued that the tax would mainly affect the poor and would cause a reduction in their consumption of other products, including healthy ones. Both parties expressed the view that the purpose of the tax was not to reduce consumption but rather to raise fiscal revenue.

According to the Minister of Health, during the period of these discussions, several media outlets played a key role in lobbying against the proposal, specifically those under the control of the Ardila Lulle Group. This conglomerate includes many businesses potentially affected by the proposed tax, including Postobon (Colombia’s largest sweetened beverage company) and three sugar refineries. Importantly, as already mentioned, the Ardila Lulle Group owns RCN (a huge radio and TV conglomerate) and the *La Republica* newspaper (Table 5.2). During the period when the tax reform was discussed,³⁴ RCN systematically questioned the proposal put forward by the MoH. There were frequent headlines such as “Taxes to sugar-sweetened beverages will affect employment” and “Increasing rejection toward the tax proposal on sugar-sweetened beverages.” Over the radio, RCN and La FM (owned by RCN) consistently argued against the proposal. These stations published 10 texts on the Internet in reference to the tax, eight of which

³³ Conversation with Alejandro Gaviria, the Minister of Health at the time of the proposed reform (August 17, 2018).

³⁴ For easiness of access, the analysis is based on material published by the news organizations on their webpages between the second half of 2016 and the first half of 2017.

harshly questioned it. On television, RCN also went on the attack. Of the 27 television entries, 18 were negative and only two mentioned the potential benefits of the proposed tax. In comparison, Caracol TV, RCN's main competitor, intervened much less in the public debate, generally in a neutral manner. Regarding the written press, *La Republica* criticized the tax proposal while, in contrast, the two most important dailies (*El Tiempo* and *El Espectador*, both part of important business conglomerates not involved in the sugar or sweetened beverage industry), had a neutral if not favorable view with regard to the proposed tax. Finally, there were a few op-ed pieces in newspapers not related to the aforementioned economic group in which some analysts also opposed the tax reform.³⁵

Interestingly, the SIC, the competition and consumer protection authority, which had played a key role in the process that fined the sugar industry for cartelization practices, sided this time around with the beverage industry and against consumers. In particular, through Resolution 59176 of September 2016, it ordered the *Asociación Colombiana de Educación al Consumidor* to suppress a television ad according to which consuming sugar-sweetened beverages negatively affected health. According to the SIC, the ad provided no verbal or visual scientific evidence supporting claims of the high sugar content of the beverages alluded to. Nor did the ad, according to the SIC, provide evidence of the incidence of sugar in the pathologies mentioned. However, in November 2017, the Constitutional Court upheld an April 2017 Supreme Court ruling ordering the SIC to revoke Resolution 59176. According to the Constitutional Court's ruling, "Timely access to this type of information facilitates protection and prevention on health matters by acknowledging plausible risks associated with the consumption of these products while enabling consumers to freely choose the products they wish to consume."

5.2.4. Colombia-U.S. Trade Promotion Agreement

The TPA was signed in 2006 and entered into force in May 2012, as it took almost six years to get U.S. congressional approval. The agreement marked a milestone because, for the first time in decades, so-called "sensitive" products (in particular, cereals, rice, wheat, and soy) were subjected to liberalization, albeit with long tariff elimination schedules. Another unprecedented issue is that Colombia gave up the use of the price band system with the United States.

³⁵ The following articles in *Portafolio* are worth mentioning: Andrés Espinosa, "Perverse and Regressive Tax on Sugar-Sweetened Beverages," April 5, 2016; Andrés Espinosa, "Regressive and Confiscatory Tax on Sugar-Sweetened Beverages," November 22, 2016; and Mauricio Botero, "Taxes in Baby-Sitting Mode," July 8, 2016.

The TPA was approved despite strong opposition from traditional agricultural producers and associations at the highest levels of government and in Congress. With support from the MoA, they pushed for their products to be excluded from this agreement, as had been the case in most previous agreements. Some key factors were behind the TPA outcome, particularly the commitment of President Alvaro Uribe under pressure from the United States and from some exporters, mainly those that were beneficiaries of the ATPDEA.³⁶ Compensation mechanisms were used to garner the support of sectors opposed to the agreement, and negotiations were structured in such a way that the MoFT was in full control of the process.

Sugar was a particularly difficult product in the negotiation. While Colombia wanted a high tariff-rate quota (TRQ) to access the U.S. market and for glucose to be excluded, the United States excluded sugar (the only exclusion) and requested preferential access to the Colombian glucose market. In the end, the United States granted Colombia a TRQ of 50,000 tons with a yearly increase of 750 tons, and a gradual tariff phase-out of 15 years for both sugar and glucose (Table 5.4). This outcome was more favorable for sugar refiners than for the food-processing industry: sugar remained protected during a long phase-out period of 15 years, and manufacturers of products with high sugar content had to share the same (low) TRQ when exporting to the United States. Rice was one of the last products to be negotiated. While Colombia wanted to exclude it from the TPA, access to the Colombian market was one of the main interests for the United States. In the end, in exchange for the exclusion of sugar by the United States, Colombia achieved a very long tariff phase-out scheme for rice of 19 years in total with six years of grace, as well as a special safeguard clause. However, Colombia also granted a TRQ of 79,000 tons for imports of U.S. rice, which increases every year. Given the size of U.S. production, this constitutes a significant change and poses new challenges for Colombian rice producers who will have to increase their productivity in order to face U.S. competition. Tariffs started to decline in 2019 and will reach zero in 2031. Other sensitive products were also subject to a gradual tariff phase-out for the first time in a free trade agreement, some with special safeguard clauses (Table 5.4).

As part of the agreement and in order to compensate rice growers, a mechanism to administer the tariff quota through an Export Trading Company (ETC) gives growers resources to enhance productivity. The ETC is composed of trade associations representing the rice industries of both countries as

³⁶ ATPDEA is a trade preference system by which the United States grants duty-free access to a wide range of exports from four Andean countries. It replaced the Andean Trade Preference Act enacted in 1991.

Table 5.4
Sensitive Products

	Base Tariff	Tariff Phase-Out	Tariff Rate Quota (tons)	Tariff Rate Quota Annual Increase	Special Safeguard ^a
Rice	80%	19 years (6 years of grace)	79,000	4.5%	120% of TRQ
Poultry and leg quarters	70%-164.4% (leg quarters)	18 years (5-10 years of grace)	26,000 (leg quarters); 400 (poultry)	3%-5%	130% of TRQ
Dairy products	20%-33%	11-15 years	100 to 5,000	10%	
Sugar and glucose	28%-47%	15 years			
Fresh beef meat and offal	80%	10 years	2,000 (fresh meat); 4,400 (offal)	5%	140% of TRQ (fresh meat)
Beans	60%	10 years	15,000	5%	120% of TRQ
Corn, corn products, and sorghum	15%-28%	8-10 years	8,000 to 2 million (yellow corn)	5%-8%	
Soybean oil	24%	10 years	30,000	3%	

Source: Office of the United States Trade Representative (<https://ustr.gov/trade-agreements/free-trade-agreements/colombia-tpa>).

^a An automatic safeguard clause is triggered when import volumes exceed a certain percentage of the tariff-rate quota (TRQ).

well as the six U.S. Rice Research & Promotion Boards. Fedearroz participates on behalf of Colombia. The mechanism will remain in place until the tariff quota ceases to operate and the market is opened. The ETC manages the quota through an auction in which interested U.S. exporters participate. Benefits obtained from the auction are shared between producers of the two countries and in Colombia are being used by Fedearroz to provide technical support. The benefits were also recently used to build storage and milling plants. Thus, the resources derived from the ETC are not only being used to improve productive aspects but have also generated a realignment of the relative power of the different actors in the productive chain. Fedearroz is complementing this strategy with a white rice commercialization program that it plans to implement with supermarkets and through the opening of more than 20 stores in several cities. These strategies are geared toward capturing part of the commercialization margin currently appropriated by millers and retailers.

As already mentioned, the substitution of the price band system for fixed tariffs and the inclusion of some agricultural products (like beans and beef) in a special treatment—which implied in both cases an increase in tariffs not only for the negotiation with the United States, but also for the MFN tariff—was key to facilitating the negotiation of these sensitive products.

In addition, as Colombia opened its market for the first time to sensitive products, the government offered a series of compensation mechanisms under the *Agenda Interna*, an umbrella program aimed at providing the private sector with both public goods and mechanisms to enhance competitiveness. Those mechanisms were vital for the government to garner the support of the private sector, in particular from agriculture. However, the *Agenda Interna* and *Agro Ingreso Seguro*, one of its main components, failed to fulfill the private sector’s expectations, and discomfort among producers of sensitive agricultural products persists. As a result, ever since the TPA was negotiated those producers have opposed the inclusion of those sensitive products in other trade agreements and often organize protests demanding the renegotiation of previous ones.

5.4. Conclusions and Recommendations

Despite Colombia’s liberalization policy enacted in the 1990s, parts of the agriculture sector remain highly protected. This has induced and supported weak performance by several subsectors. The major concern is that the cost of this trade policy is borne by consumers, and particularly by the poorest households—which pay high prices for goods that heavily weigh in the consumption basket—and by downstream producers in the value chain.

The TPA marked the first time sensitive products were liberalized, albeit gradually, an unprecedented outcome that imposes important challenges in terms of enhancing productivity and competitiveness. This achievement was aided by the use of various types of compensation mechanisms—including an increase in protection for some products prior to the tariff reduction program, the adoption of a program of aid and incentives to farmers, and a broad agenda of national and regional policies (*Agenda Interna*) that sought to improve competitiveness. Unfortunately, the most relevant compensation mechanisms fell short of expectations. This lack of delivery set a bad precedent and could have strengthened the voice of those who call for more protection.

The protectionist policy stance in Colombia is the result of political interactions that have not changed much since the *apertura*. The interviews conducted for this chapter make it clear that in order to generate a change in this dynamic, it is necessary that interventions in agriculture be focused on delivering public goods rather than directly supporting producers.

The protectionist bias has persisted to a large extent due to highly politicized agricultural institutions that lack technical capacity, starting with the MoA and replicated in subordinate entities. This has favored the capture of public policy by powerful sectors that seek to maintain protection. Interviewees for this chapter perceive the MoFT as a technical entity, but with a limited scope when dealing with agriculture. As a result, a protectionist vision of the sector prevails. The analysis of rice and sugar in this chapter shows that when a more technical public institution such as the Superintendence of Industry and Commerce becomes involved, critical issues such as consumer protection and promotion of free markets and competition are better addressed.

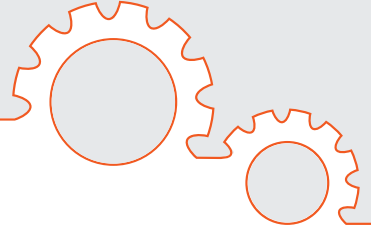
The “sensitive” agricultural private sector is well organized in associations that exercise strong influence at all levels, including Congress, and in some instances is supported by pressure groups such as *Dignidades*. Economic groups also play a critical role and, as in other countries, their influence is particularly strong when they control the media. Given the case studies chosen, this chapter highlighted the role played by one of the large economic conglomerates. However, it is important to bear in mind that, unfortunately, several large business organizations exert significant control over the media.

Several interviewees pointed out that formal channels for government and private sector coordination are in many cases inoperative, leading to the use of informal channels such as direct communication by businesspersons, associations, and economic groups with the government at the highest levels. Entities such as the *Comisión Mixta de Competitividad y Comercio Exterior* should become the prevailing forum for coordination between the public and private sectors, as well as with other relevant actors.

The institutional framework governing trade policy is complex, hampering trade and making it particularly vulnerable to the influence of private interests. Although the MoFT is a technical-oriented institution, its capacity to define and coordinate trade policy dissipated after the *apertura*. In line with García et al. (2014), it is therefore critical to promote efficiency and coordination among entities in charge of trade policy. The role of the MoFT and the *Consejo Superior de Comercio Exterior* should be strengthened in order to improve coordination of entities involved in international trade. The MoFT should also reinforce a productive chain vision and be more aggressive in seeking new markets for Colombian exports. Since the *apertura*, bilateral and regional trade agreements have been key instruments to open markets, and the intention of the administration of President Ivan Duque to not move forward in that direction is a matter of concern.

Annex 5.1. Semi-Structured Interviews

Name	Profile
Jorge H. Botero	Former Minister of Foreign Trade
Carlos G. Cano	Former Minister of Agriculture; former president of the <i>Asociación Nacional de Industriales</i> ; former president of National Federation of Rice Growers
Rosario Córdoba	President of the Private Council on Competitiveness
Javier Díaz	President of the National Association of Foreign Trade (ANALDEX)
Juan José Echavarría	Former Deputy Minister of Foreign Trade; director of the 2015 project on a tariff reform proposal
Carlos Ignacio Gallego	President of Grupo Nutresa
Hernando José Gómez	Former negotiator of the U.S.-Colombia Free Trade Agreement
Miguel Gómez	Former congressman; former director of the American Chamber of Commerce in Colombia
Silverio Gómez	Director of the Industrial Rice Chamber of the <i>Asociación Nacional de Empresarios</i> (ANDI)
Harold Éder	President of Ingenio Manuelita S.A.
Rafael Hernandez	President of the Rice Growers Federation
Rudolf Hommes	Former Finance Minister
Ana María Ibañez	Academic expert on land concentration and informality
Roberto Junguito	Former Minister of Agriculture and of Finance
José Leibovich	Independent consultant on agriculture and trade
Cecilia López	Former Minister of Agriculture and former senator
Olga Lucía Lozano	Former Deputy Minister of Foreign Trade
Juan Carlos Mira	President of the Sugarcane Growers Association
José Antonio Ocampo	Former Minister of Agriculture; Director of the Mission for the Transformation of Agriculture 2014
Juan Ricardo Ortega	Former Deputy Minister of Foreign Trade
Juan José Perfetti	Former Deputy Minister of Agriculture; independent consultant on agriculture and trade
Carlos E. Piedrahita	Former president of Grupo Nutresa



Trade Policy as a Citizen's Choice: The CAFTA-DR Referendum in Costa Rica

Ricardo Monge-González and Luis Rivera¹

This chapter evaluates the main forces involved in the design and implementation of trade openness policies in Costa Rica. A political economy approach is used to assess the participation and influence of the main interest groups and how their interests have been incorporated into policy. The chapter presents a historical perspective on Costa Rica's trade policy since the mid-1980s, with relevant context and stages, focusing on a salient revealing episode of the policymaking experience: the Dominican Republic-Central America-United States Free Trade Agreement (DR-CAFTA) referendum.

One of the most meaningful changes in Costa Rica over the past 35 years has been the significant advance in the economic openness of the country, accelerated through unilateral tariff reductions, private competition in formerly state-owned companies' captive markets, attraction of foreign direct investment (FDI) and diversification of exports, accession to the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO), and the signing of preferential trade agreements (PTAs).² At the same time, Costa Rica's integration with the world economy has been reinforced by the revolution in information and communication technology, the reduction of transport costs, the growth of logistics companies, the enforcement of contracts, and improvements in the protection of intellectual property rights (Blyde 2014).

¹ The authors thank Ernesto Stein, Mauricio Mesquita Moreira, Jorge Cornick, and Jeffry Frieden for their valuable inputs.

² Including free trade agreements, association agreements, and other forms of regional and bilateral trade agreements.

Costa Rica is a global business player, increasingly integrated into world trade, international capital markets, and the expansion of global value chains. Structural changes in the productive sectors toward higher-value-added activities, an increasingly diversified export supply, and greater efforts to improve the country's business climate are direct outcomes of trade policy developments during the last three decades (Monge-González et al. 2016). The country has consolidated the trade openness and liberalization process that started in the mid-1980s, together with greater integration with international markets. To achieve this, in addition to a long-term trade policy, Costa Rica has created a very solid institutional framework to support foreign trade (COMEX 2012).

Trade policy has moved decidedly toward ever-greater integration with the global economy. While there are still entrepreneurial, political, and civil society leaders who oppose trade openness, since the mid-1980s strong support for trade and foreign-investment-led development strategies has continued through eight administrations from three different political parties. Despite policy inaction in many relevant areas for development (for instance, infrastructure development and fiscal balance), the commitment to trade and global integration has been resilient. Trade liberalization has strong institutional support.

Costa Rica has signed more than a dozen PTAs, notably DR-CAFTA, the European Union-Central America Association Agreement (EU-CAAA), and free trade agreements (FTAs) with Chile, China, Colombia, and Singapore, among others. All of the FTAs have included exceptions to tariff reductions, extended tariff phase-out periods, special rules of origin, safeguards, tariff rate-quotas, and other mechanisms to protect "sensitive" goods. During PTA negotiation processes, interest groups have been successful in achieving some level of protection for their products or industries (Rivera and Rojas-Romagosa 2010). Thus, there are still important activities that are protected from import competition through tariff and nontariff barriers (mainly food products) a significant burden for both manufacturing producers (food processing) and final consumers (mostly the poor). In other words, the trade openness process is still incomplete.

This chapter aims to explain the importance of trade openness for Costa Rica, a small economy with a solid democratic system. The chapter analyzes how vested interest groups participate and influence public opinion to incorporate their interests into trade policy, specifically in the case of the DR-CAFTA referendum.

Two main approaches to trade policy preference formation are used for the analysis: a "bottom-up model" and "a top-down model." Hicks, Milner, and Tingley (2014) indicate that a bottom-up model in trade policy assumes

that individuals form preferences based on their particular circumstances, such as the personal economic consequences of a policy change (Scheve and Slaughter 2001; Baker 2005). On the other hand, a top-down approach suggests that voters can be swayed by political elites who have the capacity to influence public opinion (Oldendick and Bardes 1982; Brody 1991; Zaller 1992; Berinsky 2007; Baker 2008). This chapter explores the evidence that could support either of these approaches and discusses the possibility of a joint explanation of the result of the DR-CAFTA referendum process.

Furthermore, the chapter develops a Distributive Politics Spreadsheet (Baron 2012) to identify the main forces involved in the process.³ This serves to identify the ability of opposing and supporting actors to generate political action for each policy instrument, as well as the expected benefits from that support or opposition (the magnitude and per capita distribution of benefits). The incentive for a policy is the main objective for supporting or opposing it. The collective action variables (group number, available resources, cost of organizing) are also described, as the interests and political influence of the main actors ultimately determine the final policy design and implementation.

DR-CAFTA was approved by most of its members shortly after the end of negotiations in 2004. However, the agreement did not go into effect in Costa Rica until January 1, 2009, because of rising opposition. Indeed, the process of ratification in Costa Rica went through a contentious political landscape involving intense legislative battles, massive public demonstrations, and finally a national referendum in October 2007 (Willis and Seiz 2012). The referendum passed with 51.6 percent of the vote (59.2 percent of the electorate cast ballots). This compares with a 65.4 percent turnout in the closely contested February 2006 presidential election, typically the biggest event in the Costa Rican electoral cycle (Urbatsh 2013).

The first hypothesis regarding DR-CAFTA is that it was a face-off between two opposing interest groups: one supporting the export-oriented model and another opposing it. Moreover, the discussion evolved into a broader-scoped discussion regarding the future of Costa Rican society. For this reason, this chapter tries to answer the following questions: Was DR-CAFTA an instrument to consolidate the process of opening the Costa Rican economy? That is, was this discussion about the continuation and consolidation of the export-oriented model instead of the agreement itself? To answer these questions, the chapter draws on 71 interviews with opponents and supporters of DR-CAFTA documented by Estado de la Nación (2017a, 2017b) to explore and analyze

³ The Distributive Politics Spreadsheet is intended to summarize rather than substitute for the analysis of the benefits and costs of political action and its outcome on policy.

the main arguments expressed against and in favor of DR-CAFTA during the referendum discussion.

The chapter also addresses additional questions about the debate over DR-CAFTA. What were the main mechanisms of influence used by opponents and supporters of the agreement? How different was the organization and funding of these groups? In short, how different was the power of influence of each group? Finally, can the differences in political influence help explain the approval of DR-CAFTA in Costa Rica?

Another hypothesis about DR-CAFTA is that at present, more than 10 years after the agreement was approved, the discussion on Costa Rica's future focuses more on how to make the current development strategy more inclusive, and not on the export-oriented model itself. To reject or support this hypothesis, the chapter reviews the literature and explores and analyzes the results of the aforementioned interviews of both opponents and supporters of DR-CAFTA (Estado de la Nación 2017a, 2017b). The chapter also analyzes the trade policy strategy followed by the past two consecutive administrations of the main anti-DR-CAFTA political party, the *Partido Acción Ciudadana* (PAC) (2014–2018 and 2018–2022).

The analysis finds that both opponents and supporters share similar concerns regarding the inclusiveness of the development strategy. This could represent a good opportunity for Costa Rican authorities to address, with productive development policies,⁴ important challenges that could improve the current development conditions to attain higher rates of economic growth and more inclusiveness, creating development opportunities for all.

6.1. The Opening Process of the Costa Rican Economy

As a starting point, it is convenient to keep in mind that the movements for and against DR-CAFTA cannot be fully understood from the perspective of a single point in time (Finley-Brook and Hoyt 2009). In fact, the coalitions that fought in the referendum on DR-CAFTA in 2007, as discussed below, began organizing decades prior to the proposed agreement, on a topic different than the free trade agreement itself: support for or opposition to the export-oriented model. For this reason, it is important to start the discussion about the political economy of changes to protection in Costa Rica in the mid-1980s, when the

⁴ Melo and Rodríguez-Clare (2006) define productive development policies as those that aim to strengthen the productive structure of a particular national economy—that is, any measure, policy, or program aimed at improving the growth and competitiveness of large sectors of the economy (manufacturing, agriculture) or specific sectors (textiles, automobile industry, software production, etc.) or the growth of certain key activities (research and development, exports, fixed capital formation, human capital formation).

country decided to embrace a new development strategy: the export-growth-led model.

Starting in the 1960s Costa Rica adopted an import-substitution model as a new development strategy. According to Monge-Gonzalez (1994), the implementation of this development strategy required substantial government intervention (enactment of new laws, regulatory controls, and public enterprises), which generated opportunities for the rise of directly unprofitable profit-seeking activities.⁵ These activities created rents and introduced all kinds of distortions in the Costa Rican economy, resulting in an inefficient allocation of resources and a negative impact on output growth as well as reduced welfare for most of the population.

From a political economy point of view, new interest groups gradually emerged such as the urban labor force (workers in manufacturing), the bureaucracy (expansion of the public sector), the industrial middle class, and the professional middle class (managers, economists, lawyers, technicians), all of which attempted to capture a larger portion of the pie through their participation in the political process. It is important to mention that at that time (and at present), the process advanced through democratic mechanisms—that is, formal and informal negotiation rounds and new collective organizations such as labor unions, chambers of businesspersons, professional associations, community organizations, cooperatives, and others increasingly took part in policy decisions (Monge-González and González-Vega 1995).

The characteristics of trade policy during the import-substitution model also limited the attraction of FDI flows aimed at producing nontraditional goods for export. Because of this, the Costa Rican authorities decided at the end of the 1970s to use compensatory measures (fiscal incentives) to attract foreign companies, whose production was oriented toward exporting to third markets. Thus, the Free Zones regime began in December 1981 through the Law on Export Processing Zones and Industrial Parks (Law 6695). Through this law, incentives were granted to foreign companies that were established in Costa Rica under the Free Zones regime.

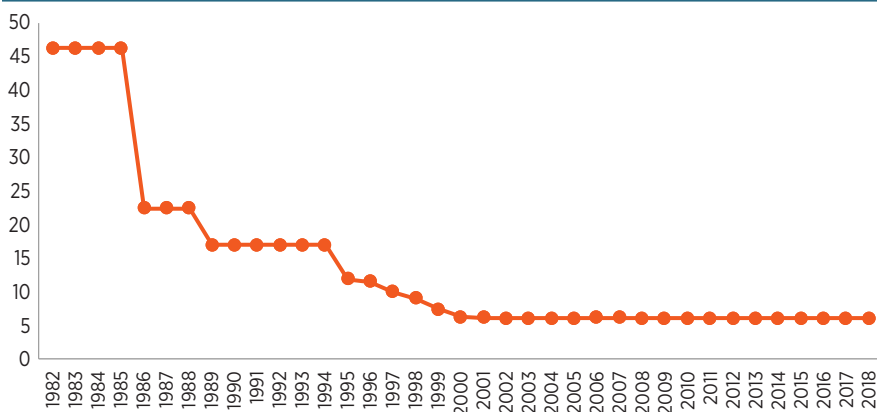
⁵ According to Bhagwati (1991) directly unproductive profit-seeking activities are defined as ways of making a profit (i.e., income) by undertaking activities that are directly unproductive (i.e., immediately, in their primary impact), in the sense that they produce pecuniary returns but do not produce goods or services that enter a conventional utility function or inputs into such goods and services. A typical example of such activities is tariff-seeking lobbying that is aimed at earning pecuniary income by changing tariffs and therefore factor income. While this is clearly a profitable activity, its output is zero. Hence, it is wasteful in its primary impact, recalling Pareto's distinction between production and predation—"they use real resources to produce profits but not output" (Bhagwati (1991, 129).

In general terms, although the Costa Rican authorities maintained a strategy of import substitution as a model of economic development from the 1960s up to the mid-1980s, they recognized the importance of diversifying the country's exports, both in terms of products and destinations. In fact, not only were they interested in creating important trade policy instruments to promote nontraditional exports to third countries, but they also initiated the creation of an institutional framework for such purposes (institutional-building). Although these efforts did not provide the expected results due to the high bias against exports from protection for import-competing activities, they started a process that was later strengthened in response to the economic crisis of the late 1970s.

During the 1980s, several events contributed to the deepest economic crisis in the recent history of Costa Rica. This crisis evidenced the necessity to revise the development strategy. According to Gonzalez-Vega (1989), the crisis resulted from a combination of structural and short-term factors, reflecting a contradiction between the country's basic characteristics (a small domestic market, relative labor abundance, and very specialized natural resources) and the features of the import-competing development strategy. The short-term determinants of the crisis included the oil shocks and the coffee boom after the mid-1970s, the unfortunate domestic policies adopted in response to those shocks (Gonzalez-Vega 1989), and the international inflation-recession at the end of the decade and the beginning of the 1980s.

To overcome the crisis, the Costa Rican authorities decided to promote a change in the development model toward one based on the export of non-traditional goods and services to third markets: the so-called export-oriented model. The objective was a greater insertion of the Costa Rican economy into the world market, as the domestic and Central American markets were limited for growth in the long run. The Costa Rican economy had to become more competitive in third-country markets. The main obstacle was the anti-export bias generated by the strategy of import substitution. In response, in 1986 the Costa Rican authorities adopted new trade and other types of policies to implement the export-oriented model.

The Costa Rican protectionist system was modified in 1986 through a unilateral trade opening process, with few exceptions. Nontariff barriers, on the other hand, were applied in Costa Rica to some agricultural products and to imports of goods produced by state enterprises, both during the import-substitution strategy period and during the first part of the export-oriented model. Although Costa Rica continued to make progress in eliminating nontariff barriers to imports, even today there are still a few barriers of this type, especially in the case of rice, for which private firms have a monopoly on imports (Monge-González, Rivera, and Rosales 2010).

Figure 6.1**Costa Rica: Average Import Tariff, 1982–2018 (percent)**

Source: Prepared by the authors based on data from the Central Bank of Costa Rica and COMEX.

In short, the unilateral trade liberalization policy can be divided in three stages. The first, between 1986 and 1995, was characterized by a sustained and systematic tariff reduction process that simplified and significantly reduced the high protectionism that existed up to 1985, but not the disparity in protectionist levels between the different productive activities of the country. The second stage, between 1996 and 1999, saw mostly specific tariff reductions for raw materials and inputs but not for final goods, responding essentially to pressures from interest groups and fiscal considerations. The third stage, since 2000, has seen the abandonment of the unilateral opening policy. In fact, the average import tariff has not changed during this period (Figure 6.1).

In addition to the unilateral trade opening policies, the strategy to open international markets for Costa Rican exports starting in the 1990s included the country's accession to the GATT and the WTO and the signing of bilateral and multilateral trade agreements with several countries and regions, including Mexico, the Dominican Republic, the rest of Central America, Chile, Canada, the countries of the Caribbean Community, the United States, Panama, Singapore, China, South Korea, Peru, Colombia, and the European Union.⁶

Furthermore, in order to support the export-oriented model the Costa Rican authorities created a sound institutional framework that facilitated the design and implementation of trade policies, as well as the

⁶ A broad discussion can be found in COMEX (2012).

management and deepening of the opening process. The most important institutions in this regard were the Center for the Promotion of Exports and Investments (CENPRO, 1968-1995), the Costa Rican Coalition for Development Initiatives (CINDE, 1982 to date), the Ministry of Foreign Trade (COMEX, 1996 to date), and the Foreign Trade Corporation (PROCOMER, 1996 to date).⁷

However, trade reform is still incomplete in Costa Rica. For instance, there are still high tariffs on imports from several agricultural activities that produce raw materials and final goods important for the agroindustrial sector and consumers. Moreover, agricultural goods have been excluded from most free trade agreements signed by the country or have obtained long tariff phase-out periods, thus allowing for the continuation of high levels of protection (Rivera and Rojas-Romagosa 2010; OECD 2017).

6.2. The DR-CAFTA Negotiations and Pre-Referendum Process

Beyond the expected economic effects of a free trade agreement, its negotiation is a political process. It is therefore necessary to understand why a country adopts a particular position when negotiating and ratifying an FTA. There are individuals or groups who attempt to influence the design of an FTA, including the “demand-side” players (e.g., import-competing domestic industries, exporters, labor unions, nongovernmental organizations), and “supply-side” players responsible for formulating and implementing trade policy (e.g., government bureaucrats, politicians and political parties). Every country has a different configuration of political and economic actors (Condo, Colburn, and Rivera 2005).

Although the process of negotiating a FTA is extensive and participatory, and the net impact for a country is expected to be positive, the final balance of interests might favor specific groups or sectors. Consequently, the process of negotiation and ratification of the FTA, and its potential outcomes, depend on the balance of different economic and political forces.

On January 16, 2002, U.S. President George W. Bush announced his intention to explore a free trade agreement with Central America. After signing the Trade Act of August 2002, which included the Trade Promotion Authority (TPA), he formally notified Congress of his intention to negotiate a U.S.-Central America Free Trade Agreement (CAFTA).⁸ The TPA was the

⁷ See Monge-González and Rivera (2019) for a detailed description of the institutional framework.

⁸ The Dominican Republic joined the agreement in 2004, after the negotiation of the CAFTA, turning it into DR-CAFTA.

basis of the new wave of FTAs pursued by the United States. At that time, the Bush administration had completed FTAs with 12 countries.

The countries officially agreed to start negotiating a free trade agreement on January 8, 2003. El Salvador, Guatemala, Honduras, Nicaragua, and the United States concluded the negotiation in December 2003. However, Costa Rica's interests were different from the rest of the region in many ways (Condo, Colburn, and Rivera 2005). During the ninth (and final) round of negotiations, Costa Rican negotiators were not satisfied with the results achieved, particularly in the textiles, agriculture, and services sectors.⁹ Furthermore, there was no agreement with the insurance and telecommunications sectors and on the exclusion of sensitive agricultural products. Thus, Costa Rica requested an additional meeting with U.S. trade representatives during the third week of January 2004. After five days of negotiations, Costa Rica signed the DR-CAFTA.

One of the main objectives sought by the Central American countries through the negotiation with the United States was to eliminate customs duties and other duties and charges that affected exports from Central America to the United States by consolidating and expanding the commercial benefits established in the Caribbean Basin Initiative (CBI) and in the Generalized System of Preferences.¹⁰ In addition, the region's priorities included the promotion of both trade in services and investment flows, establishment of intellectual property rights, regulation of government purchases (public procurement), establishment of a dispute settlement mechanism, institutional arrangements for the agile and timely application of the agreement, and establishment of standards and principles that protect the environment and labor rights (González-Vega 2006; Condo, Colburn, and Rivera 2005).¹¹

⁹ A Central American statement was presented at every negotiation round. However, it was not possible to end the negotiation process with a joint Central American position. A general conclusion from the negotiation process is that the different level of skills among the negotiating teams, the diversity of interests of sectors in every country, and the relative urgency of some parties made a unified position impossible (Condo, Colburn, and Rivera 2005).

¹⁰ Under the U.S. Caribbean Basin Trade Partnership Act (CBTPA) and the Generalized System of Preferences, most exports from Central America entered the United States duty-free. The CBTPA was enacted in May 2000 as part of the Trade and Development Act. The CBTPA enhanced the 1984 CBI benefits. DR-CAFTA planned to consolidate those benefits and make them permanent.

¹¹ According to USTR (2004), DR-CAFTA goes beyond Chile and Singapore FTAs to "create a three-part strategy of worker rights that will ensure effective enforcement of domestic labor laws, establish a cooperative program to improve labor laws and enforcement, and build the capacity of Central American nations to monitor and enforce labor rights. It also seeks to develop a robust public submissions process to ensure that views of civil society are appropriately considered, and for the benchmarking of environmental cooperation and the input from international organizations."

Most opposition to the agreement emerged from well-organized civil society groups (public labor unions, agricultural organizations, environmental groups, academia, left-wing political parties, and religious organizations, among others), which basically demanded a better quality of life for the poor and the “forgotten” and supported the defense of social rights and national autonomy from “foreign interests” (Condo, Colburn, and Rivera 2005). Those issues certainly preceded DR-CAFTA, but there was little discussion of them during the economic reforms of the 1980s and 1990s. In 2000, those groups reunited and formed a solid network of social organizations opposed to legal reforms that envisioned the market opening of two of Costa Rica’s most traditional state monopolies: electricity and telecommunications (known as the *Combo del ICE*). Civil society groups were successful in stopping those legal reforms with demonstrations, strikes, and political lobbying. Thus, the Costa Rican Electricity Institute (*Instituto Costarricense de Electricidad* - ICE), founded in 1949, maintained its state monopoly status.

By the beginning of DR-CAFTA negotiations in 2003, those groups had recovered their political influence and started their fight against the agreement. The ideological background of the civil society groups opposing DR-CAFTA was similar to the international mainstream that Bhagwati (2004) described as “a trilogy of discontents,” including anti-capitalism, anti-globalization, and anti-corporation attitudes.

An important sector participating in the protests against the market opening of *Combo del ICE* was the country’s peasantry (Hoffman 2008). Agricultural organizations across the country had been demanding increased government support because of productive problems and low prices for their goods. Protests by these rural groups merged with the anti-*Combo* demonstrations, mainly by blocking overland roads, an action that disrupted transportation and economic activities and exerted strong pressure on the government. When DR-CAFTA negotiations started, those same farmers’ groups were actively supporting the anti-agreement movement.

Most agricultural producers were against the agreement, arguing that it would result in unfair competition with U.S. producers who receive substantial government subsidies.¹² For instance, rice producers recommended importing just the deficit in rice consumption to protect local farmers and

¹² The United States agreed to review agriculture subsidies only within the WTO rules (USTR 2004). As a response, several protection mechanisms were negotiated to classify the minimum number of products in Category A (immediately tariff-free and with full access to imports), including long tariff phase-out periods (backloaded with out-of-quota imports subject to safeguards) and tariff-rate quotas.

only rice in the husk. For their part, sugar exporters wanted to expand their U.S. market share and asked for broader access beyond the tariff-rate quota under the WTO (Condo, Colburn, and Rivera 2005). To address these protests and pressures, a long-term tariff phase-out agenda was agreed upon for most agricultural products. Moreover, onions and potatoes (local producers of which were particularly active during the *Combo del ICE* demonstrations) were excluded from the agreement and maintained their high tariff protection.

The opposition contrasted with the enthusiastic support and promotion of DR-CAFTA from the productive sectors. Exporters, prominent businesspersons, investors, and, in general, those companies integrated with regional and international markets were seen as major potential winners from the agreement. For them, the consolidation of “clear rules of the game” with the biggest market in the world was expected to foster growth and business development in Central America (Condo, Colburn, and Rivera 2005). The business associations of Costa Rica (as represented by an umbrella organization, *La Unión Costarricense de Cámaras y Asociaciones del Sector Empresarial Privado - UCCAEP*) created a technical commission, the *Consejo Empresarial para las Negociaciones de Centroamérica con Estados Unidos - CONCAUSA*) to participate in and follow up on the negotiation process. Its representatives took part in all meetings and discussions held in Central American countries and U.S. cities.

A point to be highlighted in the negotiation was the establishment of a mechanism called the *cuarto adjunto* (“Side Room”) as a form of contact, information, and consultation during the negotiation rounds among the governments of the Central American countries, private sector representatives, and other groups from civil society. The call for business and social actors to participate in the side rooms was broadly disseminated through various informative channels developed by COMEX, including through public consultation hearings and discussion seminars where the negotiating team explained to participants all the details related to the agreement (Quinteros, Ochoa, and Salcedo 2005).

The Side Room was set up to enhance the communication process between negotiators and interest groups. Invitation to participate in the Side Rooms was publicly open. Any individual or group representative could attend the meetings (COMEX 2003). In general, participation was broad and active, with the exception of public sector unions, which preferred other channels to communicate their position and influence the movement against DR-CAFTA. In addition, before, during, and after every round of negotiations COMEX prepared and distributed a briefing of key points of discussion, achievements, and advances. Moreover, after the DR-CAFTA negotiations ended, COMEX

produced a series of documents with all the information about the agreement and its relevance for the country (COMEX 2004).¹³

According to González (2006), Side Room meetings organized in Costa Rica included 42 during the negotiation rounds and nine before and nine after the rounds. They were attended by some 175 representatives of 153 organizations, including 97 from the productive sectors and 48 from other civil society groups. Participants included representatives from export processing zones, academia, consumer associations, cooperatives, nongovernmental organizations, and business associations from industries such as dairy, cattle, chemicals, food products, textiles, fisheries, and software (COMEX 2004).

Despite the open access to Side Rooms, not all groups were able to send their representatives to the negotiation rounds in foreign countries, or to U.S. cities in particular. According to Arias (2015), continuous attendance at the negotiation rounds and participation in the Side Rooms required resources that for the most part only business groups had. In many cases, negotiators had to make immediate decisions as a reaction to their counterparts, which opened the possibility for the Side Room's participants to generate an influence in situ. The limited availability of information regarding negotiated texts was a central concern of civil society groups and agreement opponents in general (Condo, Colburn, and Rivera 2005). In this regard, COMEX representatives argued that it was bound by the confidentiality clause agreed upon by all the countries participating.

DR-CAFTA was signed by the seven parties on August 5, 2004. It was approved by Congresses in the following order: in July 2005, by the United States; on March 1, 2006, by El Salvador; on April 1, 2006, by Honduras and Nicaragua; on July 1, 2006, by Guatemala; and on March 1, 2007, by the Dominican Republic. In Costa Rica, it was not approved by Congress until November 10, 2008, and became effective on January 1, 2009.

The Abel Pacheco administration (2002–2006) was initially reluctant to send the DR-CAFTA bill to the Congress after the agreement was signed by all seven parties in 2004. In this case, collective action by veto players increased the perceived political costs for the executive and reduced willingness to

¹³ COMEX established six specific information tools to facilitate and structure the participation of civil society groups in the negotiation process, including an electronic library and a website, permanent liaison contacts, and an electronic consultation line. Furthermore, COMEX created consultation spaces to communicate the objectives, contents, and progress of the negotiation and receive feedback from different sectors, including producer organizations, workers, businesspersons, consumers, religious organizations, universities, and environmentalists, among others. In addition to side rooms, other consultation mechanisms included a foreign trade advisory council, bilateral meetings with organizations' representatives, debates, and discussion forums (COMEX 2003).

ratify the agreement.¹⁴ Pressure from public sector labor unions, academia, and left-wing political parties discouraged President Pacheco.

The DR-CAFTA bill was finally sent for discussion in Congress in October 2005. At that time, in the middle of a presidential election, the Congress avoided the sensitive and polarizing political issue. Moreover, the February 2006 presidential election gravitated around the approval or rejection of DR-CAFTA.¹⁵ The most popular parties, *Partido Acción Ciudadana* (PAC) with its candidate, Ottón Solís, led the opposition to the agreement, while the *Partido Liberación Nacional* (PLN), with Oscar Arias as its candidate, supported ratification.¹⁶ The presidential elections were won by PLN by a small margin. By that time, the deadline for ratification of DR-CAFTA was approaching (March 2008). According to Martí (2008), Costa Rica faced the real possibility of being left out of the agreement.

José Miguel Corrales, a prominent leader of the PLN who opposed DR-CAFTA, asked the Electoral Court (*Tribunal Supremo de Elecciones* - TSE) whether the agreement could be submitted to a referendum, and the TSE ruled on April 12, 2007, that it could (Rojas 2009). According to Martí (2008), the request to the court was in fact aimed at drawing out the process, which involved the collection of signatures, legislative discussion on the referendum call, and organization in order to arrange the vote on the agreement before the deadline. But as the opposition had threatened to collect the signatures needed for the referendum, the Arias government preempted this move by calling itself for a referendum (Hoffmann 2008).¹⁷ The government and other political and social actors finally saw in the referendum an exit ramp that would prevent social confrontation (Mora 2009).¹⁸ The referendum was finally scheduled for October 7, 2007.

¹⁴ According to Mansfield and Milner (2012) veto players represent political interests other than the leader's party and have the institutional capacity to prevent change. The more veto players, the greater the potential costs for leaders and the harder it is to gain the ratification of a PTA.

¹⁵ According to Rojas (2009), besides the DR-CAFTA discussion, salient issues that influenced the election included a climate of skepticism among voters about politicians in general, exacerbated by allegations of corruption against three former presidents and other prominent politicians; an atmosphere of pessimism related to the economic situation; the perception of a stagnant country; and the presence of a "silent majority" that did not manifest its political preferences in opinion polls.

¹⁶ Solís, the founder of PAC, was a former Deputy and Minister for the *Liberación Nacional* administrations.

¹⁷ The premise was that the "ballots referendum" was the only mechanism that could defeat the "street referendum."

¹⁸ According to Mora (2009), at the beginning the referendum proposal was not endorsed by the NO Movement. However, at the end the movement accepted it, even knowing that it was a government strategy to deactivate social protests.

The Costa Rican government considered DR-CAFTA to be essential because, historically, the United States has been Costa Rica's main trading partner (COMEX 2012). It is the main destination of Costa Rican exports and the main supplier of imports. Indeed, once concluded, the negotiators claimed that the agreement would consolidate and expand economic relations with the United States, boost economic growth, promote development, and improve living standards for Costa Ricans (González-Vega 2006).

As part of the trade outcomes of the agreement, Costa Rica agreed to undertake significant regulatory reforms to open its telecommunications market in three key areas: private network services, Internet services, and wireless services. The country also agreed to fully open its insurance market to competition. Until then, both industries had operated as state monopolies for decades. In both cases, the state monopoly was eliminated, while the state-owned companies were strengthened and modernized instead of privatized. Moreover, new legislation and a regulatory framework for each market were created.

DR-CAFTA was an important test for the trade liberalization process started by Costa Rica in the mid-1980s (Condo, Colburn, and Rivera 2005; Francois, Rivera, and Rojas Romagosa 2008; World Bank 2013). It was a logical step forward in Costa Rica's global integration process not only in consolidating trade and investments with the United States but also in creating a business platform in the region to attract more companies and investors interested in entering the U.S. market. The agreement was expected to improve the business environment and strengthen the integration of a Central American market of 35 million people (Condo, Colburn, and Rivera 2005; Rivera and Rojas-Romagosa 2010). The long-term benefits of DR-CAFTA would outweigh the costs, it was believed, but the positive outcomes would depend on how effectively the countries could manage the process of transforming their productive capacity and addressing the needs of those at risk of being left behind.

6.2.1. Groups Against and in Favor of the DR-CAFTA Referendum

According to Raventós (2008), the "NO Patriotic Movement" against DR-CAFTA was organized in so-called "Patriotic Committees" across the country. The committees were responsible for circulating documents with relevant information, discussion, and analysis of the agreement. Mora (2009) indicates that it was a heterogeneous movement network whose main forms of interaction were the Internet, face-to-face meetings, and information through brochures, videos, theatrical performances, songs, banners, and stickers used to publicize the NO position.

The movement incorporated a diverse group of social actors including public sector unions, public universities (with active involvement of rectors, faculty, and students), environmental organizations (local and international), peasant organizations, women's rights organizations, religious groups (mainly Catholic, including the ecclesiastical hierarchy), organizations for gender diversity, and other groups. The committees integrated alternative civil society groups with more structured organizations like the National Liaison Commission and the anti-FTA Fight Coordinator (created in 2003 and 2006, respectively).

From a political perspective, the main support for the NO movement and against DR-CAFTA in Congress came from the PAC, the leftist *Partido Frente Amplio* (FA), and the *Partido Accesibilidad sin Exclusión* (PASE). Their opposition was strong and effective. They delayed the discussion of the agreement bill and later supported the Patriotic Committees. Political leaders from other parties joined the NO movement as well (Martí 2008).

The "YES Movement" was organized under the so called "Citizen Alliance for YES" created in May 2007 with supporters that played a direct role during the negotiation process. Its executive committee had members from political parties (*Partido Liberación Nacional*, *Partido Unidad Social Cristiana*, and *Movimiento Libertario*), business associations (Chamber of Industries and the Union of Business Chambers, as well as CONCAUSA members) and prominent business leaders. The alliance was chaired by the Minister of Production under the Arias administration. President Arias had been a major supporter himself since the presidential election campaign (Martí 2008).¹⁹ The alliance integrated other civil society groups such as university students, peasants from the National Horticultural Corporation (an export-oriented organization), the *asociaciones solidaristas* (private sector worker organizations), local governments, and prominent figures from political parties (Mora 2009).

Martí (2008) argues that the YES movement avoided "overselling" the agreement as a "magic formula" and instead adopted a moderate campaign slogan: "The FTA, our great opportunity." Their strategy had three main components: "Educate, Motivate, and Mobilize." The education segment was carried out over three-and-a-half months with the distribution of printed and electronic materials (brochures, flyers) and the holding of workshops and open debates.²⁰ This effort was based on available polls that indicated

¹⁹ In fact, the minister of trade during the Arias administration was one of the key business leaders of the DR-CAFTA negotiation process and the director of CONCAUSA.

²⁰ Three publications were used as communication tools: (1) "The ABC of the FTA" (1 million printed copies) for a wide audience; (2) "What Happens If It Does Not Happen?" (a short flyer for electronic distribution); and (3) "Why YES?" (20,000 printed copies) for a more targeted audience (mainly people with higher education).

that 90 percent of Costa Ricans wanted more information about DR-CAFTA in order to decide. The motivation phase was deployed two weeks before the referendum, with intense use of mass publicity on radio and television and in the written press. Finally, the mobilization of voters took place on the referendum day, with information and logistics support.

An approximation of the preferences regarding DR-CAFTA can be obtained from the presidential and congressional election results in 2006. In that election, 14 political parties were registered by the TSE.²¹ The TSE created a webpage where all the parties could load a copy of their government program, and the nine most influential political parties at the time shared their programs on the page.²² A guide issued by the TSE and entitled “Political Proposals on Issues of National Interest” asked the political parties about their positions on DR-CAFTA because it was a “national interest issue” for the presidential election (La Nación 2016). Indeed, Urbatsch (2013) claims that the 2006 election was largely, though not exclusively, fought over the free trade agreement.

The parties that sent information to the TSE can be grouped as follows: (1) Supporting the agreement: PUSC, UN, UPC, PLN, RC, and the ML; (2) The agreement should be renegotiated: PAC and PIN; and (3) Against the agreement: UP, PP, FD, DNA, IUM, and RN (Table 6.1). According to La Nación (2016) the electoral discourse and political debates followed this orientation. An analysis of the presidential election results shows that the parties that supported the agreement obtained 56.82 percent of total votes, the two parties that argued for renegotiation got 39.17 percent, and those expressly opposed to the agreement received 1.86 percent (Table 6.1). In short, the parties supporting the agreement accounted for 56.82 percent of the votes while those against it (in favor of a renegotiation and opponents) accounted for 41.03 percent. If such an exercise is done based on the total votes obtained by all these parties in the congressional election, the results are 67 percent in favor of the agreement and 33 percent against it (La Nación 2016).

It can be argued that the environment around DR-CAFTA was relatively in favor of the agreement at the time of the presidential and congressional election in 2006. However, as pointed out by Willis and Seiz (2012) the process

²¹ *Coalición Izquierda Unida (IU), Integración Nacional (PIN), Renovación Costarricense (RC), Acción Ciudadana (PAC), Unión Patriótica (UP), Unidad Social Cristiana (PUSC), Alianza Democrática Nacionalista (AND), Liberación Nacional (PLN), Patria Primero (PP), Movimiento Libertario (ML), Rescate Nacional (RN), Fuerza Democrática (FD), Unión Nacional (UN), and Unión para el Cambio (UPC).*

²² Only IU, RC, ADN, ML, and RN did not send information to the TSE.

Table 6.1

Costa Rica: Votes for Different Political Parties in the 2006 Presidential Election, according to the Position of Each Party on DR-CAFTA

Position on DR-CAFTA	Votes	Percent of Total
In Favor		
Unidad Social Cristiana (PUSC)	57,655	3.5
Unión Nacional (UN)	26,593	1.6
Unión para el Cambio (UPC)	39,557	2.4
Liberación Nacional (PLN)	664,551	40.0
Renovación Costarricense (RC)	15,539	0.9
Movimiento Libertario (ML)	137,710	8.5
Subtotal	941,605	56.8
Should Be Renegotiated		
Partido Acción Ciudadana (PAC)	646,382	38.9
Integración Nacional (PIN)	5,136	0.3
Subtotal	651,518	39.2
Against		
Alianza Democrática Nacionalista (AND)	3,670	0.2
Unión Patriótica (UP)	1,864	0.1
Patria Primero (PP)	17,594	1.1
Fuerza Democrática (FD)	3,020	0.2
Coalición Izquierda Unida (IU)	2,291	0.1
Rescate Nacional (RN)	2,430	0.2
Subtotal	30,869	1.9
Null votes	39,256	2.4
TOTAL	1,663,248	100

Source: La Nación (2016).

of ratifying DR-CAFTA in Costa Rica went through a contentious political landscape involving intense legislative battles, massive public demonstrations, and finally a national referendum in October 2007.

The spatial distribution of the referendum vote was substantially different from the 2006 presidential election. YES obtained majority support in the provinces where the PLN had lost in the 2006 elections (San José and Heredia), while NO won in the provinces that had given the victory to that party (Guanacaste and Puntarenas). In general, the YES won in the urban counties with relatively high development levels, middle-income levels, and the presence of export-oriented production activities. On the other hand, the

NO vote was higher in 34 counties in rural areas, with the exception of the province of Cartago (Rojas 2009).

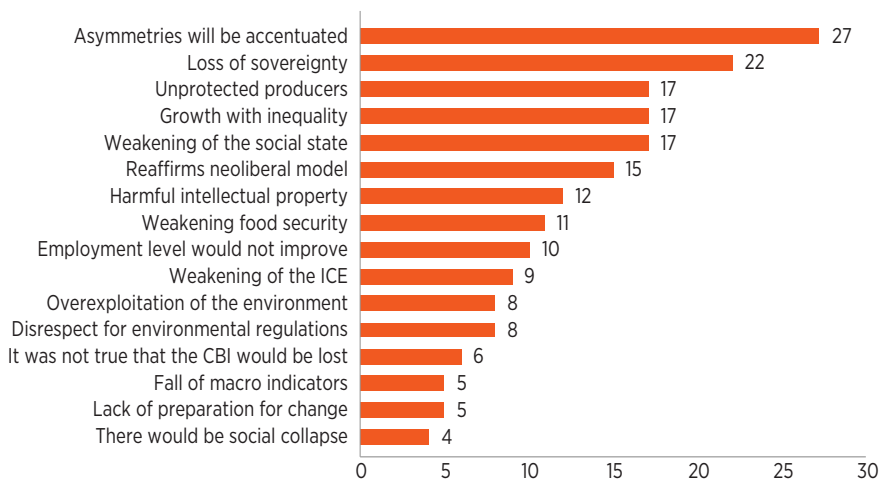
A discussed earlier, the NO group was composed of different social actors such as public sector unions, small farmers, professors and students from public universities, and environmentalists, while the YES group was made up mostly of representatives of private firms, the *solidarismo* movement (the most prevalent private sector labor organization), and the government. The funds to finance the activities of the opposition group came from public sector unions, as well as from other participants that supplied logistic support (voting guide materials, refreshments, meeting rooms, etc.). In contrast, the funds for activities carried out by the YES group came from the private sector. In both cases, there was a lead team that managed the strategy and resources of the respective campaign. In parallel, in the political arena the confrontation during the referendum process between President Arias (in favor) and PAC leader Solís (against) was central.

One important point regarding the organization of the NO group is that core coalition members began organizing decades prior to the DR-CAFTA proposal around a topic different from free trade (Finley-Brook and Hoyt 2009). Two main groups participated in the NO coalition: “seat-at-the-table” and “total-rejection” groups. There was strong disagreement between these two groups on how and why the DR-CAFTA bill should be changed. While some opponents argued that the DR-CAFTA should be stopped, others argued that it could be changed or improved. However, there was an important reason for these two opposing groups to work together, as explained by Finley-Brook and Hoyt (2009, 43): “The two groups needed each other: the seat-at-the-table groups needed to be able to point to the total rejection groups outside with signs and slogans as the alternative to not taking them seriously; and the total-rejection groups looked to the seat-at-the-table groups for cover when they were accused of having no positive proposals.”

6.2.2. Arguments Against and in Favor of DR-CAFTA

Finley-Brook and Hoyt (2009) point out that the “Stop DR-CAFTA Coalition” decided to reject rather than attempt to reform the agreement because this was the position of its Central American partner organizations. In fact, the anti-free-trade position was maintained even as members of the coalition cooperated within networks representing distinct interests, as noted earlier.

Rosenberg and Solís (2007) state that significant elements of the DR-CAFTA opposition did not necessarily share a common agenda, and therefore

Figure 6.2**Costa Rica: Main Arguments Against DR-CAFTA: Numbers of Interviewees Out of a Total of 37 Who Mentioned Each Argument**

Source: Adapted from Estado de la Nación (2017a).

Note: CBI: Caribbean Basin Initiative; ICE: Instituto Costarricense de Electricidad.

their demands were seldom expressed in a unified action platform. Moreover, Finley-Brook and Hoyt (2009) point out the difficulty of defining clear-cut positions of the opponents of DR-CAFTA due to the existence of multiple affinities (e.g., with U.S. labor unions, with Central American garment workers or subsistence farmers, with socialist or anti-U.S. intervention groups). In contrast, it seems that the group in favor of DR-CAFTA shared a similar set of arguments, as will be discussed later.

U.S.-based DR-CAFTA opponents argued that the agreement would lock Central America into an exploitative relationship and pressure other countries to reduce domestic protection and lower environmental and labor standards in order to compete (Finley-Brook and Hoyt 2009). Others indicated that the agreement would harm Central Americans, especially low-income and vulnerable populations, and would bring negative consequences for some U.S. sectors (Ricker and Stansbury 2006).

In contrast, supporters of the agreement claimed that although most of the Central American products were already imported duty-free into U.S. markets under the CBI, these provisions were temporary and required renewal (González-Vega 2016). For that reason, the supporters of the agreement saw in DR-CAFTA a way to eliminate the need for renewal of the CBI (Estado de la Nación 2017a). In addition, U.S.-based DR-CAFTA

supporters viewed the agreement as an opportunity to expand or revive several manufacturing, agribusiness, and service industries (Finley-Brook and Hoyt 2009).

Based on interviews with key opponents and defenders of the agreement, most important arguments in favor and against DR-CAFTA are summarized in Figure 6.2 (Estado de la Nación 2017a).²³ Most opponents interviewed (27 out of 37) claimed that economic asymmetries, such as the high subsidies granted to some agricultural producers in the United States, were not considered when the agreement was negotiated.²⁴ Therefore, domestic agriculture sectors would be in increasingly disadvantageous and asymmetrical positions between U.S. and local producers. According to these interviewees, extraordinary concessions were given to U.S. producers in exchange for a minimum improvement in preferences to Costa Rican exports with respect to CBI.

Regarding the loss of sovereignty, 22 of 37 interviewees considered that the negotiated concessions would bind the Costa Rican government in the economic, social, and environmental spheres, for example, in the case of privatizations and dispute resolutions. In addition, 17 of 37 interviewees claimed that the elimination of the state monopolies (telecommunications) would threaten the solidarity approach that characterized service provided by ICE (the state-owned telecommunications company). A similar number of interviewees (17) wondered whether intellectual property regulations could have serious effects on the financing of the social security system (*Caja Costarricense del Seguro Social* - CCSS) because of the substitution of generic medicines for more expensive drugs.

With all the above in mind, the opponents of DR-CAFTA questioned the capacity of the Costa Rican government to protect those sectors that would be affected by the reduction of tariffs and a massive influx of imports from the United States. Regarding this last argument, the opponents considered that small and medium-sized firms (SMEs), domestic producers for the local market, and small agricultural producers were the main candidates to be negatively affected by the agreement. Since these sectors generated a lot of employment in Costa Rica, there was a fear that

²³ In total, 71 interviews were conducted (with 37 persons who opposed the agreement and 34 persons in favor of it). The authors of this chapter had access to the information collected through the interviews. A description of the interview guide, a summary of results, and the transcription of all interviews are available in Estado de la Nación (2017a, 2017b). The authors thank Estado de la Nación for sharing this valuable information.

²⁴ Other arguments about asymmetries were that FTAs always favor the largest country, arbitration and dispute resolution would be resolved outside the national jurisdiction, and the CBI would still be without the FTA.

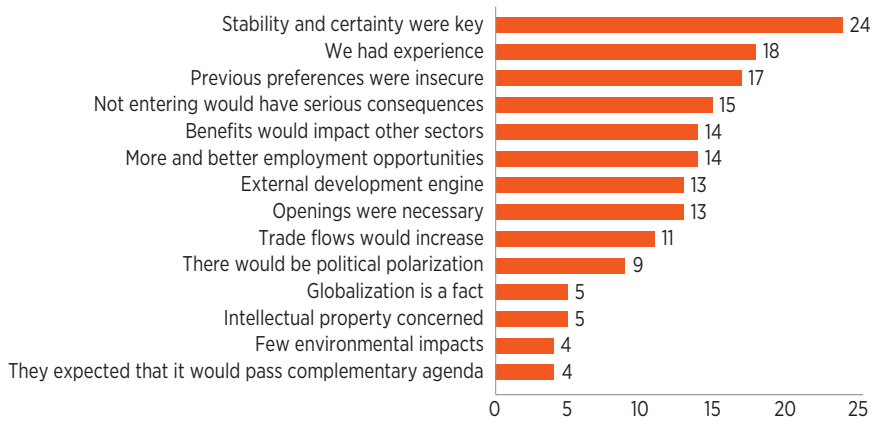
a large number of jobs would be lost, putting more pressure on informality and underemployment. Two other arguments posed by the opponents of DR-CAFTA were that the agreement reaffirmed the “neoliberal model” (i.e., export-oriented model) (15 of 37 interviewees) and that it would weaken food security (11 of 37).

The opponents of the agreement also thought that DR-CAFTA would benefit only a few sectors in Costa Rica (exporters, importers, and large corporations) and therefore would increase inequality. Other less-mentioned arguments by opponents were environmental concerns, the lack of competition readiness by firms, and that CBI would not be lost even if DR-CAFTA was not approved.

In sum, the main arguments raised by opponents of DR-CAFTA were the negative impact of the agreement on domestic farmers and SMEs; that the agreement would weaken some public companies (i.e., ICE) and social security (i.e., CCSS); and that DR-CAFTA would consolidate the export-oriented model. Because of all of these arguments, opponents believed that the agreement could produce a large amount of job losses, causing more poverty, informality, and inequality. Moreover, some opponents considered that the export-oriented model was inadequate because Costa Rican authorities did not care about those who did not benefit directly from the development strategy (the “excluded”). For instance, they pointed to the absence of efforts to develop productive linkages between exporting firms and domestic SMEs.²⁵

In contrast to the arguments against the agreement, the arguments by those promoting DR-CAFTA were based on two main concepts: the importance of certainty of the legal rules for foreign trade activities and the attraction of FDI, as well as the continuity and consolidation of the export-oriented model that had been strengthening with the negotiation of other FTAs since 1995 (Figure 6.3). Indeed, 24 of 34 interviewees claimed that the most important argument to approve DR-CAFTA was the stability and certainty that the agreement would grant to both local and foreign exporters and investors—that is, that DR-CAFTA would increase both trade and FDI flows toward Costa Rica. Related to this argument, 17 of 34 interviewees claimed that nothing guaranteed that CBI preferences granted by the United States

²⁵ It is worth mentioning that the initial efforts to develop local suppliers in Costa Rica were by the private sector (multinational companies) in the mid-1990s. By 1999, a Supplier Development Project for High-Technology Multinational Companies was created with the support of the Inter-American Development Bank and managed by FUNCENAT (part of the Board of Presidents from public universities), the Chamber of Industries, CINDE, and PROCOMER (Monge-González, Rivera, and Rosales 2010).

Figure 6.3**Costa Rica: Main Arguments in Favor of DR-CAFTA: Numbers of Interviewees Out of a Total of 34 Who Mentioned Each Argument**

Source: Adapted from Estado de la Nación (2017a).

Note: Number of interviewees (out of 34) that mentioned each argument.

to Central American countries would continue in the future, since they were unilateral concessions from the U.S. government.

Although negotiating an FTA with a large country like the United States represents a challenge for small and open economies like Costa Rica, 18 of 34 interviewees indicated that the local authorities had the experience to do this successfully thanks to the learning process from having negotiated other bilateral and multilateral FTAs. There was a belief among some of the interviewees (14 of 34) that better access to the U.S. market through DR-CAFTA could bring benefits to other sectors in addition to those already included in the CBI preferences. Thus, 13 of 34 interviewees claimed that international flows would increase thanks to the agreement. Because foreign trade was viewed as an economic growth engine, the agreement would promote economic growth as well as more and better employment opportunities (14 of 34). Thus, the agreement would not only generate more economic growth opportunities, but also create more wealth, reduce prices of goods, services, and inputs, and lead to higher fiscal revenues that could be used to combat poverty through social spending.

Moreover, some DR-CAFTA supporters (15 of 34) also considered that not approving the agreement would have serious consequences for Costa Rica. They were concerned about the loss of geopolitical relevance of Central America for the U.S. government with respect to countries like Colombia and

Mexico, as well as about the loss of competitiveness of Costa Rican exports in goods and services compared to the other signatory countries that would obtain free access to the U.S. market through DR-CAFTA. Finally, regarding environmental concerns, some DR-CAFTA supporters argued that the agreement would ensure the continuity of national legislation, with more enforcement and sanctions.

In short, it can be argued that the DR-CAFTA discussion, beyond its expected outcomes for particular sectors and the country as a whole, was about two opposing ideas of what type of society Costa Rica should embrace in the future. At its core, the contest was a confrontation between an “export-oriented model” with a smaller state, elimination of state monopolies (instead of privatization) through the introduction of competition for state-owned enterprises, and market-determined prices and resource allocation, versus a “state-centered development model” with interventionism, public monopolies, and the government regulating prices, allocating resources, and distributing income.

Nevertheless, both groups shared a similar vision about the importance of social spending (i.e., health, education, and anti-poverty programs) and protection of social security. In fact, three different political parties have governed Costa Rica during the last three-and-a-half decades, and all of them have supported these types of programs and institutions regardless of their ideology.

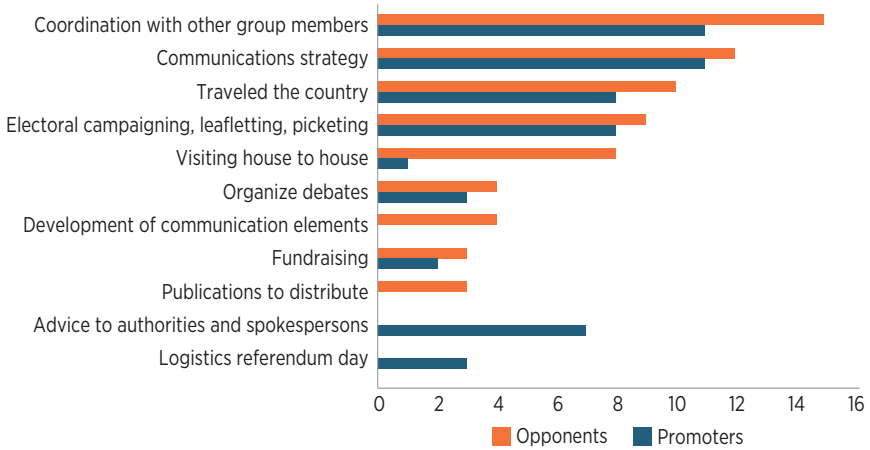
Finally, although during the referendum debate the confrontation between President Arias from the PLN and Ottón Solís from the PAC was explicit, the composition of the two opposing groups (against and in favor of the agreement) included people from both political parties, as mentioned earlier. Thus, the discussion on DR-CAFTA was not mainly a discussion between two political parties, but a discussion between two groups with different vested interests and a different vision of Costa Rican society and its future.

6.2.3. Mechanisms of Influence

Most interviewees had been involved in the DR-CAFTA debate since 2002 or even before (Estado de la Nación 2017a). In fact, 19 of 34 supporters of the agreement (trade negotiators, former government officials, and representatives from private sector chambers) and 8 of 37 opponents (representatives of labor union, public universities, and academia) stated that they started participating in some activities between 2001 and 2003. Another important segment (9 supporters and 13 opponents) became involved during the electoral campaign prior to the second election of President Arias in February 2006 or during the first months of that administration.

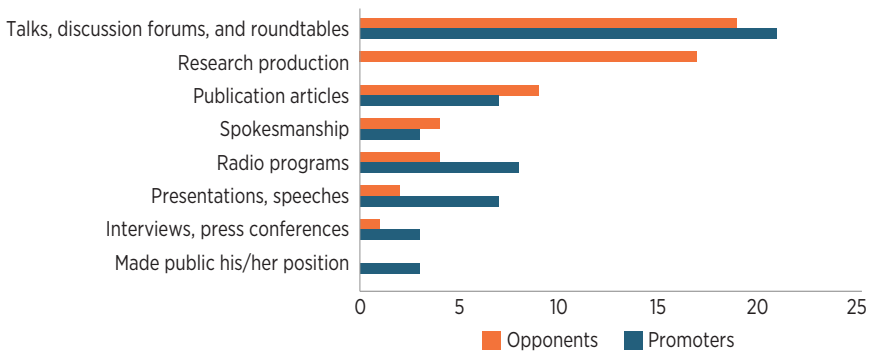
As shown in Figures 6.4 and 6.5, regardless of the group to which they belonged, both the opponents and supporters of DR-CAFTA par-

Figure 6.4
Costa Rica: Activities Related to the Campaign Prior to the DR-CAFTA Referendum (number of interviewees)



Source: Adapted from Estado de la Nación (2017a).
 Note: Number of interviewees (out of 34 in the case of promoters and 37 for opponents) that mentioned each activity.

Figure 6.5
Costa Rica: Efforts to Shape Public Opinion about DR-CAFTA (number of interviewees)



Source: Adapted from Estado de la Nación (2017a).
 Note: Number of interviewees (out of 34 in the case of promoters and 37 for opponents) that mentioned each activity.

anticipated in various activities related to the referendum campaigns, the shaping of opinions, activities in the Congress, and/or participation in forums, debates, and/or demonstrations, among other activities. In terms of activities related to the campaign prior to the referendum there are not too many differences between the NO and YES groups. One exception is that while supporters of the agreement played a major role in advising authorities and serving as spokespersons, those opposed were more involved in house-by-house work, distributing publications and talking with citizens (Figure 6.4).

Regarding efforts to shape public opinion, it is clear that both groups had followers who actively participated in talks, debates, forums, and roundtables. However, a difference between the two groups is the generation of publications by the NO side regarding the potential effects of the agreement. It should be clarified here, however, that at the request of the government there were other studies carried out under the sponsorship of international organizations such as the World Bank about the agreement (Monge-González, González-Vega, and Monge-Ariño 2003; Monge-González, Loria, and González-Vega 2004). Another difference between the opposing groups was the greater participation of YES followers in presentations and speeches (Figure 6.5).

Those who favored the agreement and held a seat at the Congress emphasized their exhaustive work on committees and in the plenary to grant the “fast track” for approval of the agreement, approve the call for the referendum, and process the approval of the implementation agenda of the agreement. On the other hand, among the NO interviewees there were higher levels of participation in marches, debates (not as panelists, but as the audience), and in the formation and strengthening of the Patriotic Committees, both in their own communities and in communities mainly in rural areas. Finally, there was greater participation among those who favored the agreement during the negotiation phase of DR-CAFTA, both by taking the reins of the negotiations and in discussions in the Side Rooms. Twelve members of the YES group carried out such activities versus only one of the NO group (Estado de la Nación 2017a).

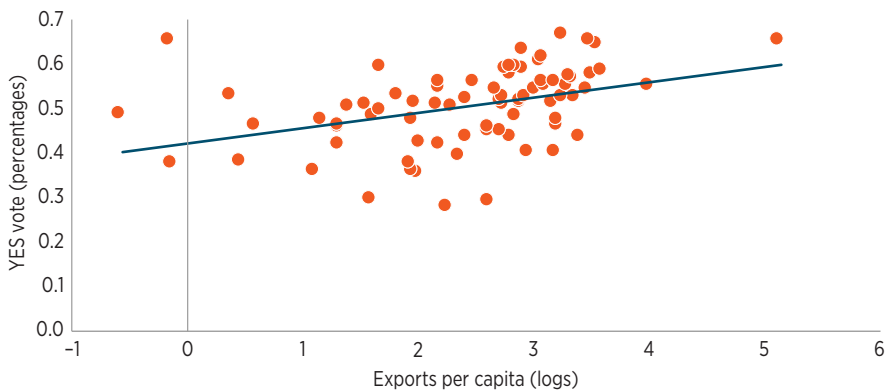
According to Estado de la Nación (2017a) although there are some similarities between both groups regarding the activities undertaken during the referendum debate, there are some relevant differences that reflect the characteristics indicated by the interviewees themselves when assessing the campaign of the other side. On one hand, more structured, institutional, and strategic work by the YES group was oriented to specific audiences and very focused around the issues of legal security, economic growth, and employment. In contrast, the NO group conducted a broader, participatory, and pluralistic

effort based on broad and complex concepts such as independence and sovereignty, pointing out potential negative impacts in many different areas. The importance of this argument is supported by Hicks, Milner, and Tingley (2014), who found that, after controlling for economic factors, the more organized PLN (the YES group) was better able to get its message out and therefore had a larger influence on voter preferences than less-well-organized parties such as the PAC (the NO group).

As mentioned in previous sections, in order to successfully establish the export-oriented model, it was necessary not only to remove trade restrictions on imports and to get prices right, but also to support the creation of new interest groups for which the import-substitution strategy was incompatible with their interests. One such important group was exporters. Figure 6.6 explores whether voters from counties where exporting activities are relatively important favored approval of DR-CAFTA. In doing so, the figure analyzes the relationship between the percentage of voters that said YES and exports per capita by county (*cantón*) in Costa Rica during 2007. The analysis finds a positive and statistically significant relationship between both variables, as shown in Figure 6.6. Furthermore, the Spearman's rank correlation coefficient, which is a measure of the degree to which these two variables are associated with each other (not necessarily in value, but in rank or ordering), is 0.4945 (significant at 5 percent).

The above result is supported by findings from Hicks, Milner, and Tingley (2014), who claim that economic bases of support for DR-CAFTA fit the

Figure 6.6
Costa Rica: Voters Who Said YES in the Referendum and Exports Per Capita, by County, 2007



Source: Prepared by the authors based on data from the Tribunal Supremo de Elecciones and COMEX.

Ricardo-Viner specific-factor model of trade, since according to their results industries with a strong orientation toward exports were more supportive of DR-CAFTA. In fact, these authors claim that in Costa Rica high-skilled individuals in export-oriented sectors supported free trade, while low-skilled individuals in import-competing sectors opposed it. This last outcome is also in line with the findings of Urbatsch (2013).

In developing countries, political cleavages around trade and globalization discussions may follow a more specific factors model (Ricardo-Viner) than the Stolper-Samuelson prediction. Osgood et al. (2016) find strong links between export intensity and trade policy interest by firms, and strong correlations between export scale and engagement in trade policy activity. That is, the high share of export sales influences firms' pro-trade political activity. High-productivity firms are more likely to export than low-productivity firms (Melitz 2003; Bernard et al. 2007. Evidence for Costa Rica supports this hypothesis (Rivera 2010). According to Plouffe (2015), highly productive firms involved in foreign markets are more likely to support trade liberalization than smaller, less productive firms with prospects of competing only in the domestic market. Betz (2017) argues that trade agreements, and the resulting lobbying by exporting firms, mute the protectionist bias of import-competing firms.

Another interesting result from Hicks, Milner, and Tingley (2014), although not discussed by the authors, is that the relative importance of employment in the public sector at the district level also helps explain the formation of preferences regarding DR-CAFTA. Thus, since the composition of the two opposing groups suggests public versus private sector worker divisions regarding DR-CAFTA, one would expect that public employers would have opposed the agreement. In fact, the authors found a negative and significant relationship between the percentage of public employment at the district level and the percentage vote of YES. A possible explanation for this result is the concern from public labor union leaders about losing political power if public monopolies in telecommunications and insurance were eliminated due to DR-CAFTA (consistent with the bottom-up model of trade policy preferences).

6.2.4. Distributive Politics Spreadsheet

Table 6.2 presents a summary of the main forces involved in the process of the DR-CAFTA referendum. The table describes collective action variables (group number, available resources, and the cost of organizing). The main actors' interests and their political influence determine the final outcome in various ways.

Table 6.2 Distributive Politics Spreadsheet for the DR-CAFTA Referendum
Costa Rica: Distributive Politics Spreadsheet for the DR-CAFTA Referendum

Main Actors	Channels of Influence	Instruments	Demand Side: Benefits from Political Action			Supply Side: Ability to Generate Political Action			Prediction: Amount of Effective Political Action	
			Main Objectives (Incentives)	Magnitude	Per Capita	Number	Coverage	Resources		Cost of Organizing
Supporting Interests										
Executive										
COMEX (Ministry of Trade)	Executive, Congress, the press	Side Rooms, seminars, publications, political advocacy	Guarantee access to U.S. market for Costa Rican exports (beyond the CBI); promote private participation in the telecom and insurance sectors (traditional state monopolies); open the Costa Rican market to highly protected agriculture and food processing goods excluded from other FTAs; attract FDI from the United States and other countries (export platform); support investment and employment growth.	Small	Small	Small	Small	Large	Small	Large

(continue on next page)

Table 6.2 (continued)

Costa Rica: Distributive Politics Spreadsheet for the DR-CAFTA Referendum

Main Actors	Channels of Influence	Instruments	Demand Side: Benefits from Political Action				Supply Side: Ability to Generate Political Action				Prediction: Amount of Effective Political Action	
			Main Objectives (Incentives)	Magnitude	Per Capita	Number	Coverage	Resources	Cost of Organizing			
Foreign Trade Corporation (PROCOMER)	Executive, Congress, the press	Seminars, publications, political advocacy	Guarantee access to U.S. market for Costa Rican exports (beyond the CBI); attract FDI from the United States and other countries (export platform).	Large	Small	Small	Small	Large	Large	Large	Small	Large
Ministry of Foreign Affairs	Executive, Congress, the press	Political advocacy	Achieve closer integration with foreign markets and pursue international agreements on key issues such as trade, environment, and labor rights.	Small	Small	Small	Small	Medium	Small	Medium	Small	Small
Ministry of Agriculture	Executive, Congress, the press	Political advocacy	Support agricultural goods exporters; exclude sensitive agricultural goods and obtain long tariff phase-out periods to offset concerns regarding sensitive agricultural goods.	Small	Small	Small	Small	Small	Small	Medium	Small	Small

(continue on next page)

Table 6.2 (continued)
Costa Rica: Distributive Politics Spreadsheet for the DR-CAFTA Referendum

Main Actors	Channels of Influence	Instruments	Benefits from Political Action				Supply Side: Ability to Generate Political Action				Prediction: Amount of Effective Political Action	
			Main Objectives (Incentives)	Magnitude	Per Capita	Number	Coverage	Resources	Cost of Organizing			
Private Sector												
Union of Business Chambers	Executive, Congress, the press	Ads, publications, lobbying, CONCAUSA, Citizen Alliance for YES	Guarantee access to U.S. market for Costa Rican exports (beyond the CBI); promote private participation in the telecom and insurance sectors (traditional state monopolies).	Large	Small	Small	Small	Large	Large	Large	Small	Medium
Chamber of Industries	Executive, Congress, the press.	Ads, publications, lobbying	Guarantee access to U.S. market for Costa Rican exports (beyond the CBI); promote private participation in the telecom and insurance sectors (traditional state monopolies).	Large	Small	Small	Large	Large	Large	Large	Small	Medium
Chamber of Exporters	Executive, Congress, the press	Ads, publications, lobbying, Citizen Alliance for YES.	Guarantee access to U.S. market for Costa Rican exports (beyond the CBI).	Large	Small	Small	Large	Large	Large	Large	Small	Medium

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Table 6.2 (continued)

Costa Rica: Distributive Politics Spreadsheet for the DR-CAFTA Referendum

Main Actors	Channels of Influence	Instruments	Demand Side: Benefits from Political Action				Supply Side: Ability to Generate Political Action				Prediction: Amount of Effective Political Action
			Main Objectives (Incentives)	Magnitude	Per Capita	Number	Coverage	Resources	Cost of Organizing		
Export Processing Zones Association	Executive, Congress, the press	Ads, publications, lobbying, Citizen Alliance for YES	Guarantee access to U.S. market for Costa Rican exports (beyond the CBI); attract FDI from the United States and other countries (export platform).	Large	Small	Small	Small	Medium	Large	Small	Medium
Costa Rican Coalition for Development Initiatives (CINDE)	Executive, Congress, the press	Seminars, publications, political advocacy, Citizen Alliance for YES	Guarantee access to U.S. market for Costa Rican exports (beyond the CBI); attract FDI from the United States and other countries (export platform).	Large	Small	Small	Small	Medium	Large	Small	Medium
Agriculture Business Chamber	Executive, Congress, the press	Ads, publications, lobbying	Support agricultural goods exporters; exclude sensitive agricultural goods and obtain long tariff phase-out periods to offset concerns regarding sensitive agricultural goods.	Medium	Small	Large	Large	Medium	Medium	Medium	Small

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Table 6.2 (continued)
Costa Rica: Distributive Politics Spreadsheet for the DR-CAFTA Referendum

Main Actors	Channels of Influence	Instruments	Benefits from Political Action			Supply Side: Ability to Generate Political Action				Prediction: Amount of Effective Political Action	
			Main Objectives (Incentives)	Magnitude	Per Capita	Number	Coverage	Resources	Cost of Organizing		
Political Parties											
Movimiento Libertario (ML)	Congress, the press	Seminars, publications, political advocacy, Citizen Alliance for YES	Guarantee access to U.S. market for Costa Rican exports (beyond the CBI); attract FDI from the United States and other countries (export platform); support investment and employment growth.	Small	Small	Small	Small	Small	Small	Medium	Small
Partido Liberación Nacional (PLN)	Executive, Congress	Seminars, publications, political advocacy, Citizen Alliance for YES	Guarantee access to U.S. market for Costa Rican exports (beyond the CBI); attract FDI from the United States and other countries (export platform); support investment and employment growth.	Small	Small	Small	Small	Large	Large	Small	Medium
Partido Unidad Social Cristiana (PUSC)	Congress, the press	Seminars, publications, political advocacy, Citizen Alliance for YES	Guarantee access to U.S. market for Costa Rican exports (beyond the CBI); attract FDI from the United States and other countries (export platform); support investment and employment growth.	Small	Small	Small	Small	Medium	Medium	Small	Medium

(continue on next page)

Table 6.2 (continued)
Costa Rica: Distributive Politics Spreadsheet for the DR-CAFTA Referendum

Main Actors	Channels of Influence	Instruments	Demand Side: Benefits from Political Action				Supply Side: Ability to Generate Political Action				Prediction: Amount of Effective Political Action	
			Main Objectives (Incentives)	Magnitude	Per Capita	Number	Coverage	Resources	Cost of Organizing			
Other Stakeholders												
Consumers Association	Congress, the press	Ads, publications, lobbying	Gain access to more and cheaper imported goods; promote private participation in the telecom and insurance sectors (traditional state monopolies); open the Costa Rican market for highly protected agriculture and food processing goods excluded from other FTAs.	Small	Small	Small	Small	Small	Small	Medium	Small	
Think tanks (e.g., Academia CA, CLACDS-INCAE)	Executive, Congress, the press	Seminars, publications	Guarantee access to U.S. market for Costa Rican exports (beyond the CBI); attract FDI from the United States and other countries (export platform); support investment and employment growth.	Small	Small	Small	Small	Medium	Medium	Small	Small	

(continue on next page)

Table 6.2 (continued)
Costa Rica: Distributive Politics Spreadsheet for the DR-CAFTA Referendum

Main Actors	Channels of Influence	Instruments	Main Objectives (Incentives)	Demand Side: Benefits from Political Action				Supply Side: Ability to Generate Political Action			Prediction: Amount of Effective Political Action
				Magnitude	Per Capita	Number	Coverage	Resources	Cost of Organizing		
Solidarismo (a special type of private labor organization)	Executive, Congress, the press	Seminars, publications, Citizen Alliance for YES	Guarantee access to U.S. market for Costa Rican exports (beyond the CBI); attract FDI from the United States and other countries (export platform); support investment and employment growth.	Large	Small	Large	Large	Medium	Small	Medium	
Opposing Interests											
Political Parties											
Partido Acción Ciudadana (PAC)	Congress, the press	Seminars, publications, political advocacy, Patriotic Committees	Demand a better quality of life for the poor and the “forgotten” and support the defense of social rights and national autonomy from “foreign interests.”	Small	Small	Small	Medium	Small	Medium	Medium	

(continue on next page)

Table 6.2 (continued)
Costa Rica: Distributive Politics Spreadsheet for the DR-CAFTA Referendum

Main Actors	Channels of Influence	Instruments	Demand Side: Benefits from Political Action			Supply Side: Ability to Generate Political Action			Prediction: Amount of Effective Political Action		
			Main Objectives (Incentives)	Magnitude	Per Capita	Number	Coverage	Resources		Cost of Organizing	
Partido Frente Amplio (FA)	Congress, the press	Seminars, publications, political advocacy, Patriotic Committees	Demand a better quality of life for the poor and the "forgotten" and support the defense of social rights and national autonomy from "foreign interests."	Small	Small	Small	Small	Small	Small	Large	Medium
Partido Accesibilidad sin Exclusión (PASE)	Congress, the press	Seminars, publications, political advocacy, Patriotic Committees	Demand a better quality of life for the poor and the "forgotten" and support the defense of social rights and national autonomy from "foreign interests."	Small	Small	Small	Small	Small	Small	Large	Small

(continue on next page)

Table 6.2 (continued)
Costa Rica: Distributive Politics Spreadsheet for the DR-CAFTA Referendum

Main Actors	Channels of Influence	Instruments	Main Objectives (Incentives)	Demand Side: Benefits from Political Action				Supply Side: Ability to Generate Political Action				Prediction: Amount of Effective Political Action
				Magnitude	Per Capita	Number	Coverage	Resources	Cost of Organizing			
Other Stakeholders												
Labor Unions (public sector)	Executive, Congress, the press	Ads, strikes, demonstrations, picketing, protests, lobbying,	Demand a better quality of life for the poor and the "forgotten" and support the defense of social rights and national autonomy from "foreign interests"; prevent competition in public companies (telecom and insurance) in order to maintain high levels of affiliation with the public employees union and preserve a politically high level of power and influence.	Large	Small	Large	Large	Large	Large	Small	Small	Large
Academia (Public Universities)	Executive, Congress, the press	Ads, publications, seminars, demonstrations, NO Patriotic Movement (Patriotic Committees)	Demand a better quality of life for the poor and the "forgotten" and support the defense of social rights and national autonomy from "foreign interests."	Small	Small	Large	Medium	Medium	Medium	Small	Small	Medium

(continue on next page)

Table 6.2 (continued)
Costa Rica: Distributive Politics Spreadsheet for the DR-CAFTA Referendum

Main Actors	Channels of Influence	Instruments	Demand Side: Benefits from Political Action			Supply Side: Ability to Generate Political Action				Prediction: Amount of Effective Political Action	
			Main Objectives (Incentives)	Magnitude	Per Capita	Number	Coverage	Resources	Cost of Organizing		
Nongovernmental organizations (environmental)	Executive, Congress, the press	Demonstrations, picketing, protests, NO Patriotic Movement (Patriotic Committees)	Demand a better quality of life for the poor and the "forgotten" and support the defense of social rights and national autonomy from "foreign interests."	Small	Small	Small	Small	Small	Small	Small	Small
Catholic Church	Executive, Congress, the press	Mass, preaching, lobbying.	Demand a better quality of life for the poor and the "forgotten" and support the defense of social rights.	Small	Small	Small	Medium	Large	Large	Small	Large

Source: Prepared by the authors based on a framework developed by Baron (2012).

Note: CBI: Caribbean Basin Initiative; FDI: foreign direct investment; FTA: free trade agreement.

6.2.5. DR-CAFTA at Present

More than a decade after passage of the DR-CAFTA referendum, the results have been positive for Costa Rica, and additional important outcomes are expected (World Bank 2013; Xirinachs-Salazar 2017). For instance, the agreement has contributed to modernizing Costa Rican legislation on intellectual property, insurance, telecommunications, and distribution contracts and has facilitated mechanisms to ensure the effective application of labor and environmental legislation. However, it can be said that, overall, the agreement has generated neither the extreme problems predicted by its opponents nor the great benefits promised by its supporters (Estado de la Nación 2017a).

One important characteristic of Costa Rica is that three different political parties have governed the country during the last three-and-a-half decades, and all of them have supported the trade openness process, including the anti-DR-CAFTA referendum political party (PAC) that has governed during the last two administrations (since May 2014). What seems important at present is how to get the most from integration into international markets instead of reversing the trade openness process initiated in the mid-1980s. Indeed, during the administration of President Luis Guillermo Solís Rivera (2014–2018) the concern of trade policymakers was not a shift away from or reversal of trade openness, but rather how to promote FDI inflows in rural areas by improving the business climate in those regions, as well as how to generate more productive linkages between exporters (local and multinationals) and domestic firms (mainly SMEs).²⁶

In the case of DR-CAFTA, evidence suggests a continuity of policy support even during two consecutive center-left ideology administrations. Furthermore, those administrations have appointed COMEX authorities who

²⁶ However, the Solís Rivera administration did decide to stop the possible accession of Costa Rica to the Pacific Alliance. Furthermore, the new administration of President Carlos Alvarado Quesada (2018–2022) from the same political party as Solís Rivera has also declared its intention not to negotiate accession to the Pacific Alliance. Costa Rica (together with Panama) had expressed its interest to be part of the Pacific Alliance after Chile, Colombia, Mexico, and Peru signed the Framework Agreement in June 2012. The Pacific Alliance has gained important interest at the global level, with 42 observer countries and others exploring new forms of association (Argentina and New Zealand, for instance). On May 1, 2016, the Additional Trade Protocol to the Framework Agreement came into force with the creation of a free trade zone. The four member countries eliminated tariffs on 92 percent of the traded goods. They also negotiated a unique set of rules of origin that support the creation of regional production chains. Moreover, the recent signing of the Trans-Pacific Partnership by 12 countries—three of which are Pacific Alliance members (Chile, Mexico, and Peru)—is an important step for stronger regional integration and trade liberalization.

have been active supporters of the trade openness model, notwithstanding their different political affiliations. The leading role of COMEX—by law responsible for conducting trade agreement negotiations with a strong institutional framework—contrasts with other government entities such as the Ministry of Agriculture and the Ministry of Economy, Industry, and Commerce, which have traditionally expressed interventionist preferences and political sympathy with protection-seeking groups.

In short, it can be concluded from the above discussion that 10 years after DR-CAFTA was approved, the discussion on the future of Costa Rica focuses more on addressing issues concerning how to make the current development strategy more inclusive and sustainable, and not on the continuity of an export-oriented model. This presents a good opportunity for Costa Rican authorities to address—with appropriate actions and through productive development policies—important challenges that could enhance the current development strategy aimed at higher economic growth and more inclusiveness.²⁷

6.3. Main Findings and Policy Recommendations

The analysis in this chapter has found evidence that supports its main hypotheses. First, the DR-CAFTA referendum was a face-off between two opposing interest groups, one supporting the export-oriented model and another one opposing it. Furthermore, besides the potential impact of the agreement itself, the discussion of DR-CAFTA raised broader questions about the future direction of Costa Rica. Second, more than 10 years after the agreement was approved, the discussion today in Costa Rica is focused more on addressing issues concerning not the continuity of an export- and market-oriented model, but on how to build a more inclusive and sustainable development strategy. This represents a good opportunity for Costa Rican authorities to address those challenges with appropriate actions and through productive development policies. Third, the formation of trade policy preferences regarding DR-CAFTA seems to be explained by the combination of a process in which individuals formed their preferences based on particular circumstances such as the personal economic consequences of a policy change (bottom-up models), and a process in which voters can be swayed by political elites who have the capacity to influence public opinion (top-down approaches).

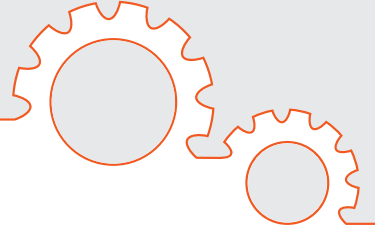
In the first (bottom-up) case, the chapter presented evidence about the rise of new interest groups in favor of the export-oriented model since the beginning of the opening process that began in the mid-1980s, as well as about

²⁷ For example, the development of clusters in productive activities with comparative advantages (Monge-González 2018).

a positive relationship between the YES vote and the relative importance of exporting activities in Costa Rica. Thus, for these interest groups the continuity and consolidation of the export-oriented model appears to be in their own interest. On the other hand, recent literature shows that the relative importance of employment in the public sector at the district level also explains the formation of preferences regarding DR-CAFTA. In fact, evidence shows a negative and significant relationship between the percentage of public employment at the district level and the percentage vote of the YES vote, indicating that the approval of DR-CAFTA was against the interests of public labor unions.

In the second (top-down) case, findings from recent literature support the idea that a particular and influential political party in Costa Rica (PLN), which was in office during the referendum, influenced public opinion in favor of the agreement. In addition, new evidence from interviews with supporters and opponents of DR-CAFTA suggests that the YES group work was better structured and more institutionally and strategically oriented than the work of the NO group.

The political economy of the DR-CAFTA referendum process and the current position of the groups that opposed each other in that process—which focuses now on how to build a more inclusive and sustainable development strategy—is an example of how a country with a long-standing democracy and strong foreign trade institutions can address important policy issues.



The Political Economy of Trade Policy in Ecuador: Dollarization, Oil, Personalism, and Ideas

Diego F. Grijalva, Ivan Gachet, Pablo Lucio-Paredes, and Carlos Uribe-Terán¹

How is trade policy determined in Ecuador? This chapter seeks to answer this question from a political economy perspective. Ecuador is an interesting case for several reasons. Its official currency—the U.S. dollar—provides benefits but also makes trade-related policies more relevant, since it limits the set of tools available to respond to external shocks (Broz, Duru, and Frieden 2016). Indeed, Ecuador remains highly vulnerable to these shocks because its exports are composed mainly of commodities, particularly oil.

Since 2007, Ecuador has been part of the “turn to the left” shift in Latin American politics, marked by inward-looking policies. The opposition to a free trade agreement with the United States (FTA-USA) along with the implementation of broad-based safeguard import tariffs in 2009–2010 and 2015–2017 and a large increase in nontariff barriers since 2014 attest to this policy perspective.

Yet, Ecuador’s ratification of a free trade agreement with the European Union (FTA-EU) in 2016 and a free trade agreement with the European Free Trade Association (FTA-EFTA) in 2020 highlight the intricacies of the political economy of the country’s trade policy. Indeed, since the 2017 presidential

¹ The authors thank María de la Paz Vela for her help in designing the interview script and leading several interviews, and Daniela Tufiño, Felipe Puga, Priscila Beltrán, and Joaquín Moscoso for outstanding research assistance. The authors also thank Jorge Cornick, Ernesto Stein, Mauricio Mesquita Moreira, Jeffry Frieden, Juan O’Farrel, and Martin Obaya for valuable comments and discussions, as well as participants at two IDB workshops in Washington, DC.

election, Ecuador's trade policy has shifted toward gradual openness (USTR 2019). This policy reversal was unexpected, as the current president, Lenin Moreno, previously served as President Rafael Correa's vice president, and was elected as Correa's successor. President Moreno, however, has expanded the dialogue with the private sector and has directed policy toward diversification and liberalization of Ecuador's trade relations, for instance, by initiating negotiations for a FTA-USA and to enter the Pacific Alliance.

This chapter focuses on the political economy of trade policy in Ecuador since the implementation of dollarization in 2000. The analysis is qualitative and uses inputs from interviews with more than 20 key actors from the public and private sectors and civil society (some of them interviewed more than once) who have influenced trade policy during the last two decades. The chapter provides a general description of the prevailing institutional framework related to trade policy, along with an analysis of the main actors involved, their interests, and the mechanisms of participation and influence.

The analysis identifies three periods since 2000 with important differences. Between 2000 and 2006, Ecuador's political economy of trade policy was characterized by openness and active participation on the demand side in a context of high political instability. Between 2007 and 2017, the determination of trade policy shifted toward the supply side, with reduced influence of the private sector. This period was marked by a new Constitution, the peak of the commodities boom, and a strong and stable government that implemented an inward-looking set of policies. Finally, since 2018, there has been a reversal of policy toward openness along with renewed influence by the private sector.

One of the main findings of the chapter is that the political economy of trade policy in Ecuador needs to be analyzed from a broader perspective than is common in the literature both in terms of its interaction with the entire set of government policies and with regard to the elements that are relevant from a political economy perspective. In Ecuador, trade policy varies depending on the government's stance regarding economic, industrial, labor, and other policies. This common ground that defines public policies lies beyond the standard analysis of interest group politics proposed by, for example, Baldwin (1989) and Grossman and Helpman (1994). Moreover, as

² See Annex 7.1 for the list of interviewees.

³ Indeed, Hall and Nelson (2004) and Mansfield and Mutz (2009) conduct empirical analyses showing that individual trade policy preferences are determined by factors beyond self-interest, and Gawande, Krishna, and Oarreaga (2009) provide empirical evidence showing that governments have heterogeneous degrees of self-interest.

argued by Rodrik (2014) and Rodrik and Mukand (2018), ideas play a key role in the definition of trade policy. Including the broader set of policies and the role of ideas allows for explaining Ecuador's reversals of trade policy, and in particular the shift that has taken place since 2018.

The private sector's influence on trade policy in Ecuador is minor relative to other countries, and private sector lobbying tends to focus on other areas such as infrastructure and fuel subsidies. Within this context, protection for sale lobbying (Grossman and Helpman 1994), according to which interest groups exchange some form of payment (e.g., campaign contributions) with the decision-maker for a policy favor, still plays an important role in the definition of trade policy. However, informational lobbying, according to which lobbyists affect policymakers' decisions by influencing their beliefs or information, has become increasingly relevant.

Economic conditions play a key role in the determination of trade policy. The inward-looking policies implemented in Ecuador between 2007 and 2017 could be sustained only because of windfall oil revenue. In addition, previous literature shows that public support for protectionism rises as economic conditions worsen (Mansfield and Busch 2011) but also that economic crises may foster liberalization because the need for adjustment trumps the distributional considerations related to openness (Rodrik 1994). Each argument applies in the case of Ecuador, though at different times, as policy is determined at the intersection of ideas and economic conditions, especially fiscal and balance of payments needs. Thus, faced with reduced oil revenues starting in 2014, Ecuador's government adopted a protectionist stance up to 2017, but then shifted when the stance of the leader of the government changed, even though the economic conditions had not varied.

The dependence of trade policy on broad ideas, specific leaders' ideas, and economic conditions implies that the relative relevance of the supply and demand sides of trade policy varies over time (Rodrik 1995). Although trade decisions are influenced by the private sector, they can be limited or enhanced by the government's relative power, which is determined in large part by economic outcomes and the leader's governing style. Thus, during the decade that President Correa was in power, trade policy was determined largely by the government—that is, the supply side—while since 2017 there has been a turn toward the demand side.

Finally, dollarization does constrain trade policy and has served as a justification for protectionist policies in light of balance of payments problems. The reason is that such imbalances are regarded not only as a threat to the economy but also as a threat to dollarization itself, which enjoys high popularity.

7.1. Determinants of the Political Economy of Trade Policy in Ecuador

Since 2000, trade policy in Ecuador has been driven mainly by the government's stance on free trade and industrial policy, combined with the specific economic and political conditions. Thus, considering the theoretical framework proposed by Rodrik (1995), under the country's stable economic and political conditions between 2007 and 2017, the supply side of trade policy was dominant. However, faced with negative economic and political conditions, before 2007 and since 2017, the demand side has been relatively more important.

This section looks at the underlying elements that determine the political economy of trade policy in Ecuador by first examining the economic and political context. The section then turns to a discussion of the institutional framework, which serves as the basis for a brief analysis of the formal and informal actors involved in the determination of trade policy.

7.1.1. Economic and Political Context

Dollarization and oil price dynamics are structural determinants of trade policymaking in Ecuador. Dollarization promotes trade with the United States and other dollarized economies (Frieden, Levy-Yeyati, and Sturzenegger 2003; Lin and Ye 2010), generating support from both the importing and exporting sectors. However, since the value of Ecuador's local currency is determined by U.S. monetary policy, exchange rate fluctuations become exogenous to local policymaking. As a consequence, dollarization affects importers' and exporters' leverage against the government.

On the one hand, exporters lose the ability to lobby and gain competitiveness based on exchange rate variations, since nominal devaluations are eliminated from the policy toolkit. Exporters' lobbying efforts thus shift to other sources of fostering competitiveness, such as fuel subsidies. In recent years, due to fiscal pressures, these mechanisms have become more limited. As an example, the diesel subsidy for the tuna and shrimp sectors was reduced in September 2018 and eliminated on January 15, 2019. However, the two sectors lobbied to obtain a compensation of US\$0.70 per gallon, limiting most of the costs associated with elimination of the subsidy.

On the other hand, a strong and stable currency reduces inflationary pressures, sustaining consumers' real income over time, and thus benefiting

⁴ "Los subsidios a cuatro tipos de combustibles se han ajustado," *El Comercio*, January 17, 2019 (<https://www.elcomercio.com/actualidad/subsidios-combustibles-economia-gasolina-diesel.html>).

importers. In Ecuador, despite the existence of tariffs and monetary/quantitative restrictions on imported goods, middle- and upper-class consumers procure products online from foreign providers on a regular basis.

Potential balance of payments problems are more difficult to handle in dollarization. According to Broz, Duru, and Frieden (2016), the tools that countries can use to respond to balance of payments crises are to (1) sell reserves, (2) raise interest rates, (3) impose capital controls, (4) apply trade restrictions, and (5) depreciate the currency. The authors argue that the choice of policy responses is affected by their political costs, and thus election-minded politicians adopt less transparent policies first (drawing down reserves and imposing capital controls), followed by a rise in interest rates, and finally devaluation and trade protection. Dollarization constrains this set of options to capital controls and trade restrictions, meaning that trade-related policy tools become central. The Ecuadoran government has been quick to respond to external shocks using precisely these tools. In addition to the protectionist measures discussed above, Ecuador also charges a 5 percent currency remittance tax (*Impuesto a la Salida de Divisas*) on the exit of foreign exchange (World Bank 2019).

Oil price dynamics are also key to understanding trade policymaking in Ecuador. During the oil boom (2005–2014), high oil prices reduced the tension generated by current account deficits and, through their impact on internal demand, also eased the distributional conflicts of trade policy. Producers, exporters, and importers benefited from increased aggregate demand, reduced tariffs on capital and raw material, and increased fuel and energy subsidies. However, as discussed by Gachet et al. (2017, 2019), the 2009 fall in oil prices changed Ecuador's macroeconomic structure. The trade balance became negative in 2009 and remained negative until 2015; the government primary surplus became negative and shifted from a peak of 4.83 percent of GDP in 2006 to a deficit of 5.88 percent in 2016; and total public internal and external debt as a percentage of GDP more than doubled between 2009 and 2016.

The effects of dollarization and oil prices are also conditioned by the shifts in ideas within the Ecuadoran government. Most importantly, as in other Latin American countries, a left-wing nationalistic perspective dominated Ecuadoran policy for most of the period, particularly following the rise of Rafael Correa, who was briefly appointed as finance minister in 2005 before serving as president from 2007 to 2017. The mix of ideology and high commodity prices allowed the government to stimulate aggregate demand without worrying about currency flight caused by the increase in imports. Indeed, the

⁵ See Gachet et al. (2019, Table 6) for the details.

fall in the price of oil in 2014 was the main reason for the protectionist trade policies adopted in the aftermath of the commodity boom.

7.1.2. Institutional Framework

From the perspective of formal institutions (North 1990), current trade policy in Ecuador is set under the umbrella of the 2008 Constitution established by the Constitutional Assembly under President Correa. The Constitution promotes national sovereignty, highlighting the role of the state as central planner of Ecuador's development and emphasizing a social and solidarity-based economic system, with the objective of achieving what is called "good living" (2008 Constitution of Ecuador, Article 275). The Constitution also includes a condemnation of imperialism (Article 423 § 8) and a deepening of promotion of regional integration (Article 423). Furthermore, it provides more power to the executive in an attempt to improve governance. The National Development Plan determines the specific objectives and policies to achieve "good living" (2008 Constitution of Ecuador, Article 280).

The 2008 Constitution is very explicit on trade policy, with objectives set forth in Article 304 as follows:

1. To develop, strengthen, and give impetus to domestic markets on the basis of the strategic objective set out in the National Development Plan.
2. To regulate, promote, and implement actions conducive to boosting the country's strategic insertion in the global economy.
3. To bolster the domestic productive system and production.
4. To contribute to guaranteeing food and energy sovereignty and the reduction of internal inequalities.
5. To foster the development of economies of scale and fair trade.
6. To prevent monopolies and oligopolies, particularly in the private sector, and other practices that might affect market functioning.

⁶ The concept of *buen vivir* ("good living") is inspired in the practice of *Sumak Kawsay* ("a life of fullness") by the Andean indigenous peoples (Villalba 2013). It emphasizes harmony with nature, respect for diversity (particularly the values and worldviews of indigenous peoples), satisfaction of basic needs in terms of rights and guarantees, social justice and equality, participatory and deliberative democracy, and a broad understanding of what constitutes a desirable life objective (Ramírez Gallegos 2008; Villalba 2013; Caria and Domínguez 2016).

⁷ The translation of the text from the 2008 Constitution is taken from the Political Database of the Americas (2018), available at <http://pdba.georgetown.edu/Constitutions/Ecuador/english08.html>.

⁸ In comparison, the 1998 Constitution (Article 243 § 5) stated simply among its economic objectives "the competitive and diversified participation of Ecuadorian production in the international market."

The 2008 Constitution provides the formal support for an inward-looking trade regime along with selective import substitution. It also specifies which imports and exports to support and promote. Article 206 states:

The State shall promote environmentally responsible exports, giving preference to those creating more employment and added value, and in particular the exports of small and medium-sized producers and the artisan sector.

The State shall support the imports necessary for development objectives and shall discourage those that negatively affect domestic production, the population, and nature.

International agreements are signed and ratified by the executive (Article 418), requiring a ruling of constitutionality by the Constitutional Court (Article 438 § 1) and approval by the National Assembly (Article 419 § 6).

In addition to the Constitution and the National Development Plan, three documents complete the formal structure related to trade policy during the period analyzed. The first is the Law of Foreign Commerce and Investments (*Ley de Comercio Exterior e Inversiones* - LEXI), enacted in 1997. It created the Council of Foreign Commerce and Investments (*Consejo de Comercio Exterior e Inversiones* - COMEXI) and the Corporation for the Promotion of Exports and Investment (*Corporación para la Promoción de las Exportaciones e Inversiones* - CORPEI).

The second document is the Productive Transformation Agenda (*Agenda para la Transformación Productiva*) approved in 2010, which details the mechanisms for the transformation of the production matrix and also specifies the two main legal changes designed to restructure the institutional framework (Consejo Sectorial de la Producción 2010). These changes were introduced in the third document, the Organic Code of Production, Commerce and Investment (*Código Orgánico de la Producción, Comercio e Inversiones* - COPCI), which replaced LEXI in 2010. COPCI created the Committee on Foreign Commerce (*Comité de Comercio Exterior* - COMEX), in charge of trade policy formulation and regulation (COPCI Articles 71 and 72), replacing COMEXI, and it created PROECUADOR, in charge of institutionalizing export promotion, sidelining CORPEI.

7.1.3. Key Actors

Given the political and economic context and the formal institutional factors, trade policy is determined through the interaction of formal and informal

⁹ Similar provisions were included in the 1998 Constitution, except that the ruling of constitutionality came from the Constitutional Tribunal and the approval came from Congress.

actors. This section provides a description of the key actors that influence trade policy in Ecuador.

Two conflicts lie at the heart of this interaction. The first is the degree of influence of the private sector. President Correa's view was that the private sector should not be involved in the generation of policy. As a consequence, the role of the private sector was weakened early on during his presidency, as confirmed by the creation of COMEX and PROECUADOR in 2010. This changed significantly under President Moreno, who appointed former members of the private sector to key Cabinet positions and, more generally, opened up to private sector participation.

The second conflict is within the public sector. The changing needs of trade policy toward the end of Correa's presidency created a gap within the Cabinet, complicating the definition of a shared objective for trade policy. This continues to be true under President Moreno, albeit under a different perspective.

These conflicts led to the policy reversals in Ecuador that have contributed to the perception that the country has not had a well-defined trade policy, or that the existing trade policy has been ineffective.

Formal Actors

Executive Branch

Ecuador is a presidential democracy in which the executive is the head of state and government. Since the return to democracy in 1978, Ecuador's policymaking process has been characterized as "muddling through" (Mejía et al. 2008). As a way to improve governability, the executive has been given more power under the recent constitutions, particularly the 2008 Constitution.

With regard to trade policy, under the Constitution the executive has the exclusive responsibility to create tariffs and determine their levels (Article 305). In practice, the executive plays a significant role in the definition of trade policy in general.

Between 2007 and 2017, President Correa set a personalistic tone to the executive and was directly involved in many trade policy decisions. Indeed, despite the formal structure and the changes implemented, the mandate for general and specific policies in many cases came directly from the president. For instance, according to members of the Cabinet and of COMEX, the president actually looked at particular tariff headings and discussed specific tariff levels.

The trade policymaking dynamic under President Moreno has been much different. He has delegated authority to COMEX and to the Minister of Production, Foreign Commerce, Investment, and Aquaculture.

The Cabinet

The Cabinet has endured significant changes in recent years regarding both appointments and structure. At the beginning of Moreno's presidency there were 23 ministries and 12 secretariats. After some changes, by 2020 the number of ministries and secretariats had been reduced to 29, accompanied by broader structural changes.

Regarding trade policy, the key ministries and secretariats are the following:

- Ministry of Production, Foreign Commerce, Investment, and Aquaculture
- Ministry of Foreign Relations and Human Mobility
- Ministry of Economics and Finance
- Ministry of Agriculture
- National Planning Secretariat

During the initial years of President Correa's administration, he appointed ministers who shared his views on economic and trade policy. On the economic side, this meant a concern for balancing the budget under expansionary fiscal policy and limiting the exit of dollars; on the trade side, it meant a transformation of the production matrix by using selective import protection policies and promoting exports.

When economic conditions changed, the worldview alignment became a liability, as policy had to change. In particular, due to the need to advance the FTA-EU, the Ministry of Foreign Commerce and Investments was created in 2013 as an entity separate from the Ministry of Foreign Relations and Human Mobility, thus generating a division within the Cabinet.

This division was inherited by President Moreno, who has made efforts to address it based on a different underlying worldview. The originally appointed Minister of Foreign Commerce and Investments and the current Minister of Economics and Finance are businessmen. The latter is also the former representative of the Ecuadoran Business Committee (*Comité Empresarial Ecuatoriano* - CEE).

¹⁰ President Correa created several of them and also the Coordinating Ministries, which were eliminated by President Moreno. See "Moreno tendrá Gabinete de 23 ministros y 2 secretarios; sin Secretaría del Buen Vivir ni ministerios coordinadores," *El Comercio*, May 23, 2017 (<https://www.elcomercio.com/actualidad/leninmoreno-gabinete-ecuador-ministros-secretarios.html>).

¹¹ "Gobierno se queda con 17 ministerios y 12 secretarias," *El Universo*, May 23, 2020 (<https://www.eluniverso.com/noticias/2020/05/23/nota/7849368/proceso-optimizacion-reduccion-estado-gobierno-lenin-moreno>).

Legislative Branch

The National Assembly exercises the legislative branch of government and is in charge of approving international treaties (2008 Constitution of Ecuador, Article 419 § 6).

Following a divided legislature at the beginning of the dollarization period that was characterized by polarization and an extreme number of parties, the legislature transitioned to a hegemonic party system during Correa's presidency. More than 100 out of 137 members of the National Assembly belonged to Correa's movement (*Alianza País* - AP) during his second presidential administration (2013–2017). More generally, in contrast to the typical conflict between the executive and the legislature since the return to democracy, the legislature became essentially an extension of the executive during the last years of Correa's presidency.

Since 2017, AP has been weakened by President Moreno's break with former President Correa and thus the legislature has become a relevant actor once again. At the beginning of Moreno's presidential term, AP had 74 Assembly members, but after the disaffiliation in January 2018 by Correa and 28 Assembly members, this number was reduced to 43. Further differences within AP have led to additional separations such that the current number of AP Assembly members is now 39. The weakening of AP has meant a return to "muddling through" policymaking, which has become increasingly costly as Ecuador's economic conditions deteriorate, particularly in the face of the coronavirus pandemic. With respect to trade policy, the division within the National Assembly has meant significant delays in the decision-making process. As an example, the Ecuador-EFTA agreement signed in June 2018 was only finally approved by the National Assembly on April 21, 2020.

Trade-Related Governmental Organizations

There are several organizations in charge of defining trade policy in Ecuador. Up to 2010, COMEXI was in charge of trade policy in general and CORPEI was a nonprofit private legal entity with public representation. In 2010, COMEXI was replaced by COMEX. While the former included a balanced representation of the public and private sectors, with the president having a decisive vote, the latter completely eliminated private representation, leaving the decision

¹² "Rafael Correa y 28 assembleístas se desafilian de Alianza País," *El Comercio*, January 16, 2018 (<https://www.elcomercio.com/actualidad/asambleistas-correistas-anuncian-desafiliacion-alianzapais.html>).

¹³ "Alianza PAÍS tiene cada vez menos assembleístas," *La Hora*, February 9, 2020 (<https://lahora.com.ec/noticia/1102305001/alianza-pais-tiene-cada-vez-menos-asambleistas>).

¹⁴ "Asamblea Nacional de Ecuador aprobó acuerdo con EFTA," *El Comercio*, April 21, 2020 (<https://www.elcomercio.com/actualidad/asamblea-aprobacion-acuerdo-comercial-efta.html>).

to include additional actors to the discretion of the president. Given this modification, private interests are not directly represented within COMEX, but are channeled through ministries and other public institutions. To “guarantee intersectoral participation,” COPCI created the Advisory Council on Productive Development and Foreign Commerce (COPCI, Article 7).

COPCI also created PROECUADOR as an institute ascribed to the Ministry of Foreign Affairs, Commerce, and Integration, with the objective of institutionalizing export promotion within the public sector. In this way, CORPEI was sidelined, and although it continues to exist, its functions have shifted to development and internationalization. Since 2018, PROECUADOR has been part of the Ministry of Production, Foreign Commerce, Investment, and Aquaculture.

Three additional modifications were made to the assignment of the ministry in charge of foreign commerce. In 2007, the competency on trade issues was transferred to the Ministry of Foreign Affairs, and its name changed to the Ministry of Foreign Affairs, Commerce, and Integration. In 2013, trade competencies were moved to the newly created Ministry of Commerce and Investments. Under President Moreno, the Strategic Committee for the Promotion and Attraction of Investment was created in 2017, highlighting the new administration’s change of direction. Finally, in 2018, the Ministry of Production, Foreign Commerce, Investment, and Aquaculture was created from the fusion of the Ministry of Commerce and Investments, the Ministry of Industry and Productivity, the Ministry of Aquaculture and Fisheries, and PROECUADOR.

In addition, Ecuador has a set of organizations in charge of establishing sanitary and phytosanitary (SPS) measures and technical controls. The Ecuadoran Standardization Institute (*Servicio Ecuatoriano de Normalización* – INEN) is responsible for setting national standards that generally follow international ones. SPS measures are administered by the Ministry of Public Health and the Ministry of Agriculture and Livestock and its ascribed Animal and Health Regulation and Control Agency (AGROCALIDAD), created in 2008.

The Judiciary

The judiciary plays a key role in trade policy regarding international agreements. All international treaties require a ruling of constitutionality by the Constitutional Court (2008 Constitution of Ecuador, Article 438 § 1).

¹⁵ Any member of COMEX may raise an issue to be decided jointly, following a technical discussion on the specifics of the issue.

¹⁶ The Undersecretariat of Commercialization and the Undersecretariat of Livestock Development are the key entities within the Ministry of Agriculture and Livestock.

¹⁷ AGROCALIDAD replaced the Animal and Plant Health Inspection Service.

Informal Actors

Voters

In Ecuador, as in other countries, approval rates are closely tied to economic results (Murillo and Visconti 2017). Profiting from the stability provided by dollarization along with the windfalls from the oil boom and increasing public debt, President Correa managed to sustain his popularity and to accumulate electoral successes. This occurred despite reduced freedom and civil rights as well as important policy reversals on environmental policy (the Yasuní ITT Initiative), trade policy (FTA-EU), and constitutional amendments, among others.

Because of Correa's ability to set the political agenda and limit political opposition, his administration was able to keep the average voter aligned with the executive's viewpoint. The only exception occurred during the first half of 2015 following the drop in oil prices. Several policies were implemented in response to the change in macroeconomic conditions, including the signing of the FTA-EU in 2014. This led to widespread street protests, the momentum of which was stopped with the visit of Pope Francis at the beginning of July 2015.

President Moreno has faced a much bigger challenge, as he has neither former President Correa's charisma nor the oil windfalls to sustain his popularity among voters. As a consequence, his administration has built new alliances while trying to keep a semblance of Correa's perspective. In this process, however, his popularity and political support have declined, and political conflict has re-emerged both at the formal and informal levels. This was clear both in October 2019, when the government attempted to eliminate fuel subsidies, and in 2020 in response to the measures adopted to address the coronavirus pandemic and the recent corruption cases.

Business Associations

Business associations play an important role in the definition of trade policy. The most visible is the Ecuadoran Business Committee (*Comité Empresarial Ecuatoriano* - CEE), which represents Ecuador's broadly defined private sector. It was created in 2004 to represent business interests in the context of the negotiation process of the FTA-USA, but its current scope of influence is much broader. It includes 84 associations, including Chambers of Commerce, Industry, and Production, binational Chambers of Commerce, and representatives of several economic sectors. Another key business association is

¹⁸ "Estudiantes, trabajadores, y sectores sociales movilizaron este 25 de mayo en contra de las medidas del Gobierno," *El Comercio*, May 25, 2020 (<https://www.elcomercio.com/actualidad/protestas-medidas-gobierno-ecuador-coronavirus.html>).

the Council of Chambers and Production Associations (*Consejo de Cámaras y Asociaciones de la Producción* - CCAP), which also represents around 20 chambers and associations.

In both cases, broad representation implies that there are contradictory interests regarding trade policy. Indeed, there are conflicting interests within sectoral associations. Probably the clearest example is the case of vehicles. This is a highly protected industry with two broad groups of firms: vehicle importers and import-competing vehicle assemblers, with their respective associations – the *Asociación de Empresas Automotrices del Ecuador* (AEADE) for vehicle importers and the *Cámara de la Industria Automotriz Ecuatoriana* (CINAE) for import-competing vehicle assemblers. Following the elimination of import quotas to the sector, AEADE has emerged as the larger entity, combining and dealing with both sets of interests.

The CEE was not successful in pushing for approval of the FTA-USA, and its role was reduced during Correa's presidency. Since then, however, the CEE has become much better at dealing with its internal differences and influencing policy. For instance, the CEE supports Ecuador's accession to the Pacific Alliance, but its president has stated that the negotiation needs to be handled well, particularly regarding sectors such as vehicles and appliances in which Mexico is highly competitive. Likewise, the CEE has played a pivotal role in building a unified front for the private sector regarding the restart of the negotiations for an FTA-USA.

In addition to the CEE and the CCAP as entities, many of their members also exert influence independently, particularly in the context of possible FTAs or as a reaction to government policy. The Association of Textile Industries of Ecuador (*Asociación de Industriales Textiles del Ecuador* - AITE) was very vocal during the negotiation of the FTA-USA, and AEADE tried to influence policy in the case of vehicle import quotas imposed in 2012-2016. There are several associations in the agricultural sector that also exert influence, but agricultural protectionism is favored mostly as a government initiative aimed to protect employment in rural areas and among indigenous groups.

On the export side, several sector-based associations have influenced policy mainly by accompanying negotiations in the context of FTAs. Consistent with the literature, these associations have become active only in the face of large potential losses and/or gains. In the case of the signing and approval of the FTA-EU, ACORBANEC and AEBE (bananas), ATUNEC (tuna fish), CNA (shrimp), CNP (fisheries), and EXPOFLORES (flowers) were the most important actors, along with CORPEI, FEDEXPOR, and the government faction that was in favor of the FTA.

Finally, it is important to mention the existence of important regional divisions within the private sector. An export-based production structure on

the coast means that these regional associations are more open to free trade than their counterparts from the highlands.

Unions

There are three main macro labor organizations in Ecuador: the *Frente Unitario de Trabajadores* (FUT), *Central Unitaria de Trabajadores* (CUT), and *Parlamento Laboral Ecuatoriano* (PLE), the last one created in 2013. These organizations are made up of large union centers, which in turn aggregate over 1,400 labor organizations from a total of almost 3,000 active ones. FUT, CUT, and PLE are active in national politics related specifically to labor issues, where they act through collective bargaining, political alliances, and protests. Regarding trade policy, their influence has focused on opposing FTAs, mainly by means of general strikes.

Labor unions played an important role during the negotiations of the FTA-USA, typically showing their concern about its potential impact on employment. They supported Rafael Correa's candidacy in large part because of his proposals favoring labor (e.g., increasing the minimum salary) and his opposition to the FTA-USA. They were less vocal during Correa's presidency regarding, for example, negotiation of the FTA-EU. This occurred in part because several of their requests were indeed adopted during the Correa administration. However, following the changes in government policy in the last few years, some of the unions have moved to oppose the government. Indeed, they have been key actors in recent protests related to the government's response to the coronavirus pandemic.

The teacher's union (*Unión Nacional de Educadores* - UNE) has also been traditionally influential, mainly through its participation in general strikes. Since its dissolution in 2016, it has been involved in legal processes aimed at restoring its legal status, severely limiting its influence.

Indigenous Movement

The indigenous movement became salient in Ecuadoran politics following the creation of the *Confederación de Nacionalidades Indígenas* (CONAIE) in 1986 and particularly the 1990 indigenous uprising. The movement exerted significant political pressure, mainly through general strikes.

The founding in 1995 of CONAIE's formal political branch, the *Movimiento Unidad Plurinacional Pachakutik-Nuevo País* (MUPP-NP) led to formal

¹⁹ "2969 sindicatos con baja representación," *El Comercio*, May 1, 2017 (<https://www.elcomercio.com/actualidad/sindicatos-baja-representacion-ecuador-trabajadores.html>).

²⁰ "ECUADOR: Movilización de trabajadores con apoyo indígena," Encuentro Sindical Nuestra América (<http://encuentrosindical.org/?p=7553>).

indigenous political participation. As discussed by Freidenberg (2008), this led to a strong division within the social movement between those who did and did not consider the movement ready to enter formal politics, and also between those who favored participation in formal politics (i.e., within the party system) and those who favored informal participation (i.e., strikes). Since then, the indigenous movement has acted on both fronts, although the formal one has become increasingly relevant.

The indigenous movement played an important role in the ousting of presidents between 1997 and 2006 as well as in coordinating protests against the FTA-USA. At the same time, they supported the candidacy of Lucio Gutiérrez (president from 2003 to 2005) and also of Rafael Correa. In the latter case, after acquiring Cabinet participation and achieving specific goals in the 2008 Constitution such as the denomination of Ecuador as a pluricultural nation, most of the indigenous movement has since become critical of the government. Still, although the indigenous movement declared its opposition to the FTA-EU, its influence was limited.

In October 2019, the indigenous movement showed its power once again, becoming one of the key actors in the protests that paralyzed the country for 11 days and that forced the Ecuadoran government to reverse course regarding the elimination of subsidies.

Organized Civil Society

Other organizations from civil society have emerged that have relatively high coordination capacity, most notably the Ecuadoran Confederation of Organizations of Civil Society (*Confederación Ecuatoriana de Organizaciones de la Sociedad Civil* - CEOSC). However, due to attacks on these organizations during the Correa administration, they have focused on other topics related to democratic fundamentals such as freedom of speech.

7.2. Trade Policy Influence and Determination

How do the key actors identified in the previous section interact to define trade policy in Ecuador? This section describes this process, emphasizing the period after the 2008 Constitution, which defines the current institutional framework.

During the period analyzed, three phases of trade policy are distinguished: 2000–2006, 2007–2017, and 2018 to the present. These phases highlight two key elements of the political economy of trade policy in Ecuador. First, because the importance of the demand side relative to the supply side varies significantly, trade policy itself changes dramatically over time. Second, trade policy is highly dependent on shifts in ideas, macroeconomic conditions, and

on who the specific leader is. Thus, ideas are not by themselves sufficient to define trade policy, depending on these additional elements.

7.2.1. From 2000 to 2006

This period was characterized by a transition into dollarization accompanied by an economic rebound from the crisis of 1998–1999, along with political instability. Trade policymaking followed a liberal perspective in line with the 1998 Constitution.

During this period, private sector participation was based on maintaining communication with the relevant ministries and COMEXI as a means of influencing trade policy. However, this was inherently complex due to widespread political instability. Following the ousting of President Jamil Mahuad in January 2000, Gustavo Noboa—Mahuad’s former vice president—assumed the presidency between 2000 and 2003. President Lucio Gutiérrez was then in power between 2003 and 2005, followed by Alfredo Palacio—his former vice president—between 2005 and 2007.

Despite this instability, Ecuador chaired the negotiations of the Free Trade Area of the Americas (FTAA) between May 2001 and October 2002 and agreed, together with the members of the Andean Community, to enter exploratory talks on a possible FTA with Canada. In 2003, Ecuador, along with the members of the Andean Community, signed a Political Dialogue and Cooperation Agreement with the European Union and, in 2004, held the first round of negotiations of the FTA-USA together with Colombia and Peru (WTO 2005).

The “neoliberalism by surprise” character of President Gutiérrez—along with evident corruption—gave rise to strong opposition against the government and the negotiation process of the FTA-USA, culminating in the ouster of President Gutiérrez in April 2005. A weak government led by President Palacio reversed many of Gutiérrez’s policies and, importantly, appointed Rafael Correa as Minister of Economics and Finance. Correa became a very popular public figure to the extent that his resignation after barely three months caused significant protests. Still, in March 2006, President Palacio affirmed that the FTA-USA was going to be signed, though this did not occur amid widespread opposition and the rise of Correa as a presidential candidate.

²¹ See Stokes (2001) for the development of this concept.

²² “Palacio tiembla por renuncia de Correa,” *La Hora*, August 6, 2005 (<https://lahora.com.ec/noticia/1000346475/home>).

²³ “Presidente Alfredo Palacio dice que sí firmará TLC con Estados Unidos,” *La Hora*, March 7, 2006 (<https://lahora.com.ec/noticia/402491/presidente-alfredo-palacio-dice-que-si-firmarc3a1-tlc-con-estados-unidos>).

In 2005, a few days before the final round of negotiations of the FTA-USA, Ecuador suspended the process due to disagreements with its U.S. peers. Colombia and Peru then followed suit. Peru, however, managed to conclude the negotiations by mid-December 2005. Likewise, in the first quarter of 2006, Colombia restarted negotiations and successfully agreed on an FTA with the United States. An extra round of negotiations was held between the United States and Ecuador in Washington at the end of March and the beginning of April of 2006 (Andean Community 2006), during which 16 out of 19 groups of negotiations were concluded. The inconclusive areas were agriculture, intellectual property rights, and SPS measures.

Despite the remaining differences, according to several interviews conducted for this chapter (including with former members of the FTA-USA negotiating team) there were mechanisms in place to reach an agreement. However, the key element that determined the fate of the FTA-USA was the decision of the Ecuadoran government to terminate the contract with the U.S. firm Occidental Petroleum over an alleged breach of contract in May 2006, following 21 months of a judicial dispute. The U.S. government had said that it would not close the FTA-USA until the case with Occidental Petroleum was resolved. As the situation worsened, it became impossible to conclude the negotiation.

7.2.2. From 2007 to 2017

The rise to power of Rafael Correa changed the underlying principles regarding the government's trade policy as well as the mechanisms that defined it. Trade policy was aimed at supporting domestic production, conducting selective import substitution, and promoting exports and their diversification. Correa's view appears in the introductory chapter in Acosta et al. (2006), which provides a broad-based criticism of free trade in general and FTAs in particular. Importantly, this book was published in 2006 before Correa became president and thus provides clear evidence that the ideas implemented during his presidency were developed before he came to power. Furthermore, several of Correa's intellectual collaborators who later assumed top positions in his government also expressed similar views in this and other publications (Acosta et al. 2006; Jácome 2012). Consistent with this perspective, the interviewees for this chapter agreed that, during his first term, President Correa would not even accept starting the negotiation of an FTA because, in his view, all FTAs were inherently against Ecuador's interests.

President Correa attracted support from a wide variety of political parties and groups, controlled the different branches of government, and maintained

²⁴ See https://wikileaks.org/plusd/cables/06QUITO403_a.html.

high levels of popularity. As a consequence, many of the formal and informal trade-related veto players were subsumed under the executive's power.

The Correa administration also relied on widespread propaganda to control public opinion and undermine political opposition. Correa himself conducted a three-hour "Citizen's link" every Saturday during which he talked about the administration's activities and achievements, presented his worldview, and criticized the opposition. Three elements regarding the content of the administration's communication are worth noting. First, it was always strategic. For instance, safeguards were consistently explained as a mechanism to protect national industry, although the key reasons were fiscal and trade deficits. Second, it generated and then revolved around specific slogans/names to attack the opposition or defend the government. For instance, President Correa referred to the "the long neoliberal night" when attacking previous policies or to the "partidocracy" when referring to the previous political system. Third, it was highly personalistic in the sense that it focused on Correa himself and other specific persons.

The decision-making process was streamlined and centered in the executive to the extent that Ecuadoran democracy transited from an institutional blockade to univocal personalism (Basabe-Serrano, Pachano, and Mejía Acosta 2010). This characterization applies particularly to trade policy, where Correa himself was simultaneously the key agenda-setter and veto-player, enabling or limiting trade policy in a highly discretionary fashion.

The combination of charismatic leadership, ideas, and resources allowed for a fundamental shift in the political economy of trade policy from the demand side to the supply side—that is, Correa's administration was able to implement its desired trade policies because oil revenues allowed it to gather support from different sectors, concentrating power in the state while limiting opposition. Indeed, several interviewees for this chapter agreed that, relative to other countries (and particularly the United States) the influence of Ecuador's private sector on trade policy has traditionally been limited, and that this was exacerbated during the Correa administration.

During Correa's presidency, it became increasingly relevant for the private sector to speak with him directly. Also, parts of the private sector learned that they needed to be prepared to offer something back (e.g., investment, employment) in order to obtain something in exchange from the government. An interesting example of this strategic approach is the shrimp sector. Having realized that the way to reach the president and win public opinion was to exploit Ecuadoran nationalism and pride, the sector launched a campaign under the slogan "Ecuadoran Shrimp: The Best of the World." At the core of the campaign was a short documentary that was later shown on all Ecuadoran public TV stations at no cost to the sector.

However, interviewees for this chapter agree that there is wide variation within the private sector in terms of its ability to influence policy. Some sectors, such as the shrimp industry, are better organized, strategic, and proactive, while others are dispersed and do not have a clear perspective. Also, influence tends to occur through personal networks, and thus leaders of large businesses and/or economic groups tend to have direct access to policymakers.

More generally, during this period, Ecuadoran businesses seemed to simply react to the government's actions and respond mainly with limited informational lobbying. For example, although many sectors complained about the safeguards and their negative impact, very few conducted studies or tried to lobby to lower them. According to the interviewees for this chapter, lobbying has not been very effective because the private sector has not assigned resources where they are relevant. An important exception to this is the hiring of a lobbyist in Europe to help with the negotiations of the FTA-EU.

A key episode that highlights the logic of the trade decision-making process in Ecuador during this period is the policy reversal regarding the FTA-EU.

Following several meetings in 2007, the final negotiations among Colombia, Ecuador, the European Union, and Peru started in the first quarter of 2009. Soon thereafter, however, Ecuador withdrew from the negotiations for two stated reasons: first, that the agreement was narrowed to a trade agreement, and not an association agreement that included political dialogue and cooperation; and second, that the European Union maintained high tariff levels on banana exports, which was against World Trade Organization (WTO) resolutions. Yet, even though the second issue was resolved in June 2010, Ecuador did not restart trade negotiations until 2013. In contrast, Colombia and Peru went ahead and signed a trade agreement with the European Union in the second quarter of 2012.

In January 2013, Ecuador and the European Union restarted negotiations. After four rounds and 19 months, negotiations concluded with most of the tariff items in the agricultural and industrial sector being included in the agreement. In November 2016, Ecuador joined the EU-Colombia-Peru FTA, with the subsequent entry into force at the beginning of 2017.

²⁵ In July 2009, President Correa ordered the government to stop negotiations until the European Union lowered the tariffs on Ecuadorian bananas. See "Ecuador suspende negociaciones con UE por banana," *El Universo*, July 18, 2009 (<https://www.eluniverso.com/2009/07/18/1/1356/ecuador-suspende-negociaciones-ue-banano.html>).

²⁶ "EU completes first round of trade talks with Ecuador," Andean Community, January 17, 2013 (http://www.sice.oas.org/TPD/AND_EU/negotiations/1_round_ECU_e.pdf).

Why was the FTA-EU signed while the FTA-USA was not? In both cases a key aspect was the potential loss of preferences. However, since tariffs are significantly higher in the European Union than in the United States, the potential costs of losing preferences were much higher in the former case. Indeed, regarding the FTA-USA, the Andean Trade Promotion and Drug Eradication Act (ATPDEA) was set to expire on December 31, 2006, thus creating a sense of urgency for approval of the FTA. Yet, the actual benefits received from the ATPDEA were limited, with only around 10 percent of Ecuadoran exports to the United States entering under this scheme. Indeed, following the expiration of the ATPDEA in July 2013, Ecuador left it unilaterally and created a tax credit called the *abono tributario* to compensate exporters for the loss of the tariff reductions. The estimated cost of this credit was US\$34 million to US\$38 million in 2014. This tax credit provides a clear example of the relevance of Correa's ideas and the willingness to use resources to sustain them. It is a trade-related compensation mechanism that instead of favoring the losers of free trade favored the losers of the *absence* of free trade.

According to several interviewees for this chapter, the cost of losing the Generalized Scheme of Preferences Plus (GSP+) was the main reason behind the decision by President Correa to return to negotiations and sign the FTA-EU. Internally, President Correa would say that he did not like it because he was not in favor of this sort of trade agreement, but, given the situation, Ecuador had to do it. Publicly, President Correa defended the FTA-EU, arguing that it was an "agreement for development."

In addition to the direct costs of losing trade preferences, another key aspect was that Colombia and Peru (as well as the Central American countries) had already signed the FTA-EU, and their products were entering the European market with reduced tariffs. As a result, Ecuadoran products, and most importantly bananas, were losing market share.

The approval of the FTA-EU constituted a clear policy reversal that ran against one of the core tenets of Correa's worldview, and it led to significant criticism from his former allies. However, there was really no general public backlash against the signing of the FTA-EU, which raises the question of whether government policies represented Ecuadorans' opinions more broadly.

Analyzing this question requires first asking to what extent the government acted in line with public opinion about the benefits of FTAs.

²⁷ "Un año sin Aptdea sí impactó en los exportadores," *El Comercio*, June 26, 2014 (<https://www.elcomercio.com/actualidad/atpdea-exportadores-comercio-aranceles-ecuador.html>).

²⁸ "El retorno de las carabelas," Plan V, August 31, 2014 (<http://www.planv.com.ec/historias/sociedad/el-retorno-carabelas>).

Figure 7.1**Ecuadorans' Perception of the Effects of Free Trade Agreements on the Economy (various years)**

Source: Prepared by the authors based on data from LAPOP (2018).

Figure 7.1 shows the distribution of answers to a question on the extent to which people believe that FTAs help improve the economy, taken from the Latin American Public Opinion Project (LAPOP) surveys for 2004 (N=2,981), 2008 (N=2,781), and 2010 (N=2,629) (LAPOP 2018). The answers take values ranging from 1 (nothing) to 7 (a lot). Clearly, in 2004 there was strong support for FTAs, which declined significantly in 2008 before recovering partially in 2010. Even in 2008 the median answer was 4—that is, in the year that showed the least support for FTAs, the median perception among LAPOP respondents was of indifference and not opposition.

Although LAPOP (2018) does not contain similar data for Ecuador in other years, Zepeda and Verdesoto (2011), Mena and Muñoz (2013), and Zepeda and Mena (2015) provide evidence of Ecuadorans' support for free trade for the years 2010, 2012, and 2014. Table 7.1 summarizes these results. To the question on the extent to which people believe that foreign investment benefits Ecuador, more than 75 percent of respondents answered “a lot” or “somewhat.” Similarly, to the question, “In general, do you believe that free trade is very good, good, indifferent, bad, or very bad for the Ecuadoran economy?” 58.4 percent responded that it was good or very good in the 2010 survey, and this percentage increased in subsequent years.

²⁹ The other response options were “A little” or “Nothing.”

Table 7.1
Ecuadorans' Opinions on Trade-Related Issues (percent)

	2010	2012	2014
Opinion on general trade and investment issues			
Foreign investment is beneficial (a lot + somewhat)	75.5	77.8	77.2
Free trade is good for the Ecuadoran economy (very good + good)	58.4	60.0	67.6
Opinion on FTAs			
Agree with the signing of an FTA-USA	50.3	46.7	63.0
Agree with the signing of an FTA-EU	—	54.1	78.0
Opinion about the United States			
Score on the United States	68.9	69.4	65.2

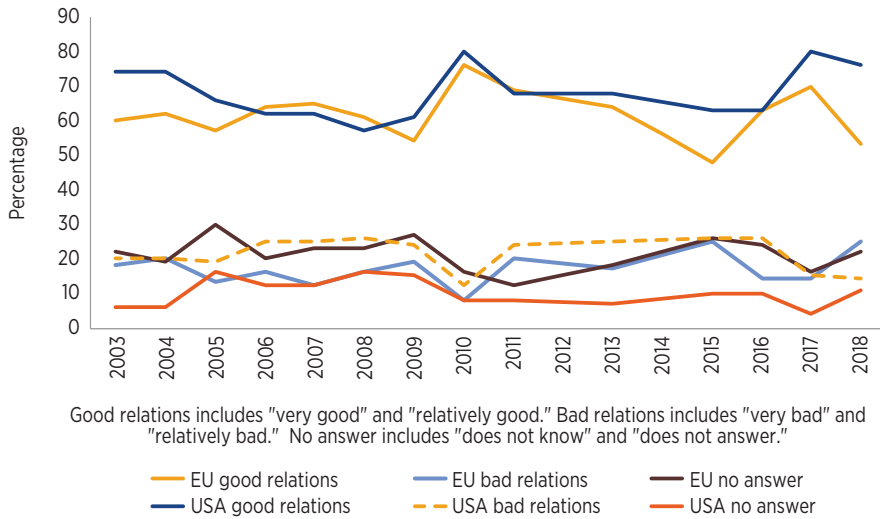
Sources: Zepeda and Verdesoto (2011) for 2010; Mena and Muñoz (2013) for 2012; and Zepeda and Mena (2015) for 2014.

Note: FTA: free trade agreement.

Regarding FTAs more specifically, to the question on whether people agree that Ecuador should sign an FTA with the United States, 50.3 percent of respondents in 2010 agreed, and although there was a slight decline in 2012, there was a very large increase in 2014, possibly associated with the signing of the FTA-EU in that year. Similarly, in 2014, 78 percent of respondents agreed with Ecuador's signing of a trade agreement with the European Union. A similar question in 2012 showed only 54.1 percent of respondents holding that view. This change provides some initial evidence that public opinion *follows* the administration's preferences. In particular, when the government's discourse shifted toward favoring the signature of the FTA-EU, public opinion also showed a more favorable opinion toward it. It thus seems that during these years the Ecuadoran government did not establish trade policies according to voters' preferences. On the contrary, the government managed to implement its own policies, and voters' preferences shifted (somewhat) following them.

Still, it might be the case that approval of the FTA-EU was not costly politically precisely because the agreement was with the European Union, and not the United States. There is some anecdotal evidence that Ecuadorans' perception of the United States is much worse than their perception of the European Union. Consistent with this view, some of the interviewees for this chapter considered that the Ecuadoran government would not have approved an FTA-USA at the same time and under the same circumstances as the FTA-EU.

To evaluate this hypothesis, Figure 7.2 provides comparative data on Ecuadorans' opinion of their country's relations with the United States and

Figure 7.2**Ecuadorans' Opinion of Relations with the United States and the European Union 2000–2018 (percent)**

Source: Prepared by the authors based on data from Latinobarómetro (2020).

the European Union for 2000–2018 based on Latinobarómetro (2020). The percentages are aggregated corresponding to “relatively good” and “very good,” as well as for “relatively bad” and “very bad.” Percentages are also aggregated for “does not answer” and “does not know.” From the available data, Ecuadorans have a good opinion of their country’s relations with both the United States and the European Union, with a somewhat better opinion of the United States, except between 2006 and 2008. Although the share with a negative opinion is much smaller, it is interesting to note that it is higher for the United States than for the European Union, particularly between 2005 and 2010. This is offset by a higher share of Ecuadorans not answering this question regarding the European Union.

Zepeda and Verdesoto (2011); Mena and Muñoz (2013); and Zepeda and Mena (2015) provide evidence on Ecuadorans’ opinions about various countries for 2010, 2012, and 2014, respectively. Among the 24 countries considered, the authors found that Ecuadorans had the most positive opinion about the United States. The last line of Table 7.1 presents the score for the United States. Based on this analysis, it seems that the Correa administration’s

³⁰ There is no available information for 2012 and 2014, and thus a simple average of the percentages corresponding to the adjacent years is used.

opposition to FTAs and to the United States more generally was not in line with Ecuadoran public opinion. Yet, although public opinion in general has been favorable toward the United States and FTAs, this does not imply that there was no opposition against them. As discussed above, several key actors with high organizational capacity (e.g., indigenous groups) played a key role in the decision not to sign the FTA-USA.

7.2.3. From 2018 to the Present

Following the fall in oil prices in 2014, President Correa's popularity started to decline along with his power. This was evidenced by street protests in 2015 and by the contested 2017 presidential election in which his successor Lenin Moreno became the current president of Ecuador.

President Moreno has established new coalitions incorporating the private sector in the trade decision-making process. At the beginning of his term he appointed Pablo Campana as Minister of Commerce. Campana is from the private sector and is aligned with trade openness. His appointment reintroduced private sector representation within COMEX, without any legal change. Campana was very vocal locally and internationally regarding Ecuador's shift in trade policy aimed at attracting FDI and promoting openness. In 2019, Campana was replaced by Iván Ontaneda, also a businessman in favor of free trade. In 2018, President Moreno appointed Richard Martínez (then President of the CEE) as Minister of Economics and Finance, further increasing private sector representation within COMEX. The appointment of professionals from the private sector as Cabinet members is a very strong signal of President Moreno's support for a policy shift, as he does not concentrate power like his predecessor, nor does he micromanage every aspect of policy.

Yet, the policy transition has been slow and difficult. At the beginning of Moreno's presidency, while negotiating the FTA-EFTA, the government introduced a short-lived "Customs Control Service Fee" (*Tasa de Servicio de Control Aduanero*).³¹ This fee was implemented by the Ecuadoran National Customs Service (*Servicio Nacional de Aduana del Ecuador - SENA*) despite the opposition of COMEX. Additionally, in 2018, as part of the government's economic reform program, a proposal to raise tariffs for 375 consumption products to their WTO-allowed bounds was discussed but was not included in the law that was finally approved.

³¹ The Customs Control Service Fee was levied on foreign goods that pass through customs and that benefit from import customs regimes. However, following a resolution by the Andean Community that effectively considered it a tax—initially disputed by the Ecuadoran government—the fee was eliminated on June 7, 2018.

In hindsight, these policy contradictions seem a remnant of the previous government's policies. According to several interviewees for this chapter, there is a clear break with the previous government's trade policy insofar as there is a much closer relationship with the private sector as well as clear support for trade liberalization. President Moreno holds a favorable view of the private sector to the extent that much of his first-year report highlighted its relevance for the economy regarding such key areas as employment creation and his administration's goal of directing economic policies toward strengthening it. Regarding trade, President Moreno has spoken of the need to open new markets, supported the FTA-EFTA, and shown support for Ecuador becoming a member of the Pacific Alliance, a potential FTA-USA, and a future FTA with Japan. He also has shown a strong commitment to attracting investment and tourism, affirming that the "previous scheme did not work."³² In general, Moreno's vision is to reverse Ecuador's "isolation" under President Correa.³³

Since trade policy in Ecuador cannot be understood separately from the broader set of economic policies, two key characteristics of Moreno's presidency need to be highlighted: openness to dialogue, along with a discourse of unity, and a transparent approach to policymaking.³⁴ These differences imply a shift toward a more democratic governmental approach. Table 7.2 shows the evolution of Freedom House scores for Ecuador for the period 2006–2019.³⁵ In line with repeated episodes of criticism of and attacks on the press and political opposition, a judicial overhaul that was deemed unconstitutional, revisions to the electoral law that appeared to favor the ruling party, the dissolution of Ecuador's largest teachers' union, among other measures and activities, Ecuador's Freedom House total score declined from 69 in 2007 to 57 in 2016. The decline reflected the country only having partial components of an electoral process, political pluralism and participation, freedom of expression and belief, and freedom of association.

³² "Lenin Moreno dice que fomentará el intercambio comercial con los EE.UU.," *El Comercio*, May 30, 2018 (<https://www.elcomercio.com/actualidad/leninmoreno-comercio-economia-negocios-relacionescomerciales.html>).

³³ "Ecuador hacia la apertura comercial y financiera con el objetivo de ser 'hub'," *La Vanguardia*, February 20, 2018 (<https://www.lavanguardia.com/politica/20180220/44930211949/ecuador-hacia-la-apertura-comercial-y-financiera-con-el-objetivo-de-ser-hub.html>).

³⁴ A clear example of this openness to dialogue is found in the government's slogan. While Correa's slogan was *El Gobierno de la Revolución Ciudadana* ("The Government of the Citizens' Revolution"), making specific reference to his political followers, Moreno changed it to *El Gobierno de Todos* ("Everyone's Government").

³⁵ Freedom House awards 0 to 4 points for each of 10 political rights indicators (within three broad dimensions) and 15 civil liberties indicators (within four broad dimensions). The range for the score is 0–100, and a higher score means more political rights and civil liberties.

Table 7.2
Ecuador's Freedom House Score and Components, 2006–2019

Indicator	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Political Rights														
1. Electoral process	9	9	9	9	9	8	7	7	7	7	7	7	7	8
2. Political pluralism and participation	15	14	14	14	14	13	11	11	11	11	11	11	11	12
3. Functioning of government	4	4	6	6	5	6	6	6	6	6	6	7	7	7
Civil Liberties														
4. Freedom of expression and belief	15	15	14	14	14	13	13	13	12	12	11	12	12	12
5. Associational and organizational rights	11	11	10	9	9	7	7	7	7	7	6	7	9	8
6. Rule of law	5	6	6	6	6	6	6	6	6	6	6	6	7	8
7. Personal autonomy and individual rights	10	10	10	10	10	10	10	10	10	10	10	10	10	10
Political rights score (1+2+3)	28	27	29	29	28	27	24	24	24	24	24	25	25	27
Civil liberties score (4+5+6+7)	41	42	40	39	39	36	36	36	35	35	33	35	38	38
Total score	69	69	69	68	67	63	60	60	59	59	57	60	63	65

Source: Freedom House (2020).

Note: Higher scores mean higher political rights and civil liberties. The total score range is 0–100.

This downward trend was reversed following the change in administration in 2017. President Moreno “unmuzzled the press and stopped meddling in the judiciary” (*The Economist* 2018). He also carried forward a referendum on February 4, 2018, that introduced term limits disallowing Correa from becoming president. In December 2018, the National Assembly approved a set of reforms to the Organic Law of Communication from 2013, notably eliminating the Communication Superintendence and the law’s punitive nature.

Several specific policy changes have occurred in the last three years. In December 2017, President Moreno declared as state policy the attraction and promotion of investment and created the Strategic Committee for the Promotion and Attraction of Investments with the aim of facilitating foreign investment in Ecuador, approving investment projects, and accompanying their implementation.³⁶ This committee clearly runs contrary to the Correa administration’s negative regard for FDI. Indeed, in May 2017, days before leaving office, President Correa signed executive decrees eliminating 16 bilateral investment treaties, including the one with the United States.³⁷

In November 2018, following a nine-year hiatus, a meeting was held of the USA-Ecuador Council of Commerce and Investments (*Consejo de Comercio e Inversiones entre los Estados Unidos y el Ecuador* – TIC). This council plays an important role as the initial entity for restarting negotiations for an FTA-USA.³⁸ Finally, also in November 2018, the Moreno administration eliminated COMEX Resolution 116, thereby removing 50 technical requirements applied to 220 tariff subheadings. During the announcement, the Minister of Foreign Commerce mentioned that the message for importers was that “importing is not bad.”

Regarding Ecuador’s relations with the rest of the world, the United States, and particularly the International Monetary Fund (IMF), there have also been significant changes. Correa’s relationship with the United States was tense and marked by various impasses. In 2007, Correa expelled the World Bank representative from Ecuador;³⁹ in 2008, he refused to renew a lease for the Manta Air Force Base and defaulted on US\$3.2 billion of Ecuador’s

³⁶ See Executive Decree 252 (<https://www.produccion.gob.ec/wp-content/uploads/downloads/2019/05/Decreto-Nro.-252-Declarese-pol%C3%ADtica-de-Estado-la-promoci%C3%B3n-y-atracci%C3%B3n-de-Inversi%C3%B3n1.pdf>).

³⁷ “Rafael Correa firmó 16 decretos que finalizan Tratados Bilaterales,” *El Universo*, May 18, 2017 (<https://www.eluniverso.com/noticias/2017/05/18/nota/6188140/correa-firmo-16-decretos-que-finalizan-tratados-bilaterales>).

³⁸ “Ecuador y Estados Unidos dan detalles sobre el TIC,” *El Universo*, November 17, 2018 (<https://www.eluniverso.com/noticias/2018/11/17/nota/7054059/ecuador-eeuu-dan-detalles-sobre-tic>).

³⁹ Importantly, according to the representative, Eduardo Somensatto, the differences with President Correa boiled down to the existence of a rainy-day fund, which President Correa was not willing to have but that would have been very useful in the current economic situation.

foreign debt;⁴⁰ in 2009, he withdraw Ecuador from the International Centre for Settlement of Investment Disputes;⁴¹ in 2011, he expelled the U.S. ambassador; in 2012, he gave political asylum in Ecuador's London embassy to WikiLeaks founder Julian Assange; and in 2014, he closed the U.S. Agency for International Development office in Ecuador. The only time Ecuador approached the IMF during Correa's administration, which occurred following the April 2016 earthquake, led to an IMF loan.⁴²

Ecuador's relations abroad have changed radically under President Moreno.⁴³ First, the relationship with the United States has improved greatly and there is a sentiment of amicability and potential for collaboration. Second, in light of Ecuador's financial constraints and reduced access to domestic and international financing, President Moreno's administration has approached multilateral organizations. In March 2019, an agreement with the IMF was announced after the mid-term elections. However, due to the coronavirus pandemic, the terms of this agreement are no longer feasible and Ecuadoran authorities are working toward a renewed agreement under the IMF's Extended Fund Facility (EFF). In the meantime, in May 2020, Ecuador received financial assistance from the IMF under the Rapid Financing Instrument for US\$641 million.

Along those same lines, in 2018 Ecuador announced its intention to become a member of the Organization for Economic Co-operation and Development.⁴⁴ Also, there is support for Ecuador becoming a full member of the Pacific Alliance,⁴⁵ as well as undertaking a trade agreement with the United States.⁴⁶

⁴⁰ The default gave rise to the acquisition of expensive debt with China associated with infrastructure projects and the signing of oil pre-sales contracts. More recently, several Chinese-financed infrastructure projects have shown severe design problems and there are investigations of corruption under way. See "It Doesn't Matter if Ecuador Can Afford This Dam. China Still Gets Paid" ([nytimes.com/2018/12/24/world/americas/ecuador-china-dam.html](https://www.nytimes.com/2018/12/24/world/americas/ecuador-china-dam.html)).

⁴¹ See "Ecuador oficializa su salida del Ciadi," *La Hora*, July 3, 2009 (<https://lahora.com.ec/noticia/898738/ecuador-oficializa-su-salida-del-ciadi>).

⁴² See "Ecuador Gets \$364 Million IMF Loan to Tackle Earthquake Reconstruction" (<https://www.imf.org/en/News/Articles/2016/07/21/18/20/NA070816-Ecuador-Gets-364-Million-IMF-Loan-to-Tackle-Earthquake-Reconstruction>).

⁴³ Elliot Gabriel, "Ecuador Bows to US and IMF, Entering New Neoliberal Era," MPN News, July 14, 2018 (<https://www.mintpressnews.com/ecuador-us-imf/245896/>).

⁴⁴ "Ecuador quiere medirse con los países ricos," *El Comercio*, October 12, 2018 (<https://www.elcomercio.com/actualidad/ecuador-ocde-paises-ricos-inversion.html>).

⁴⁵ "Ecuador planea convertirse en miembro pleno de la Alianza del Pacífico," *El Comercio*, September 18, 2018 ([dohttps://www.elcomercio.com/actualidad/ecuador-miembro-alianza-pacifico-comercio.html](https://www.elcomercio.com/actualidad/ecuador-miembro-alianza-pacifico-comercio.html)).

⁴⁶ "Moreno se juega por la apertura, pero no basta," *El Comercio*, October 29, 2018 (<https://www.elcomercio.com/blogs/lanzando-numeros/moreno-juega-apertura-basta-opinion.html>).

The policy reversal is by no means complete and there remain many concrete steps to be implemented. However, it is clear that there is a change in the government's broad vision with an orientation toward Ecuador's internationalization.

7.3. Conclusions

This chapter has analyzed the political economy of trade policy in Ecuador since 2000. The discussion sheds light on the reasons behind the reversals and contradiction of Ecuador's trade policy. This section reviews the main lessons and provides policy recommendations.

The political economy of trade policy in Ecuador must be understood in connection with the broader set of the government's policies (e.g., economic, industrial, and labor), as it is highly related to and dependent on them. This is because trade policy in Ecuador is implemented in a highly personalized manner in which leaders and their trade-related ideas play a key role that affects the entire policy spectrum. The effect of ideas, however, is dependent on economic conditions. In particular, the inward-looking policies implemented between 2007 and 2017 were sustainable only because of oil windfalls.

Dollarization and oil price dynamics also matter in the determination of trade policy. Dollarization restricts the set of policies available to face balance of payments problems. Up to 2014, this restriction was not salient because of large remittances, a depreciated U.S. dollar, and, most importantly, the oil boom. The windfalls from the boom helped ease the conflicts associated with trade policy.

Ecuador's dependence on oil exports and its lack of sustainable fiscal policies means that drops in the price of oil, temporary in 2008–2009 or more permanent as in 2014 up to the present, generate large pressures on the current account and the fiscal stance. In these instances, Ecuador's government has been quick to respond with capital controls as well as increases in tariff and nontariff barriers. The clearest examples are the implementation of broad-based balance of payments safeguards in 2009–2010 and 2015–2017. In this regard, dollarization has also served to justify such protectionist trade policies because politicians successfully convey the message that problems with the balance of payments constitute a threat to dollarization itself and thus need to be swiftly controlled.

As a consequence of these broad changes, the relative relevance to trade policy of the supply side (policymakers' preferences and the institutional setting) and the demand side (individuals' preferences and channels of aggregation) is highly variable. During Correa's presidency, his charisma, along with the availability of resources, meant that the supply side had the

upper hand regarding trade policy decisions, while the demand side was systematically sidelined. President Moreno's conciliatory style has restored relevance to the demand side.

Ecuador's trade policy reversals and contradictions could in principle be associated with shifts in public opinion. Recent data, however, do not seem to support this idea. Public opinion in Ecuador consistently favors free trade, foreign investment, and FTAs. Moreover, Ecuadorans have a very favorable opinion of the United States.

Finally, although models of the political economy of trade policy typically focus on its local aspects, the case of Ecuador shows that foreign actors play a key role. Not only does Ecuador tend to align with the region's political waves, but the decisions of Ecuador's neighbors also affect the evaluation of its own trade policy. As other countries continue on a path of liberalization, Ecuador's set of options will continue to shrink and to push the country in the same direction as the others.

These lessons provide important insights for trade policy design in Ecuador. Following a history of highly variable and unpredictable trade policy, Ecuador needs a well-defined, long-term trade policy aimed at maximizing the inflow of U.S. dollars. What direction should this policy take? Considering that the argument in favor of trade has become much stronger (Kym 2014) and that countries in the region are becoming increasingly open, Ecuador's trade policy should aim for stepwise liberalization, combining new FTAs with better compliance with WTO rules and unilateral reduction of tariff and non-tariff barriers. As argued by WTO (2019), Ecuador's trade policy should aim for stability, predictability, and transparency.

Ecuador also needs complementary policies, including the promotion and diversification of exports, improvement of productivity, availability of infrastructure, a responsible fiscal policy, and a better business climate, particularly regarding investment and dispute resolutions.

The key actors need to be clear that trade liberalization does result in losers. Those consequences need to be considered seriously, and there must be mechanisms in place to facilitate the transition of labor and capital away from the losing sectors, as well as public-revenue-compensating sources.

Considering recent policy developments in Ecuador, it seems that the country will become more open in the years ahead. There are several reasons for this. First, following a decade of state dominance, the private sector is acquiring a protagonist role, and it now controls key positions in the Cabinet with a clear view of promoting openness. Second, following the failure of the FTA-USA, and the successful negotiation of the FTA-EU, the private sector has learned to organize better and to include potential losers from trade openness in the negotiations, greatly diminishing opposition and allowing for a more

unified position. Third, the incentives for openness have become stronger as many of Ecuador's neighbors, with strong participation in competing industries, have signed FTAs with other regions of the world.

In the past, there have been important attempts to establish a long-term trade policy in Ecuador. The most important recent effort was the PLANEX 2020 established in 2006 to define the 2006–2020 National Foreign Policy Plan.⁴⁷ This plan incorporated the views of broad segments of the population, taking into account local and foreign actors. Following the broad-based institutional changes that took place starting in 2007, the plan failed to materialize, but many of its recommendations remain relevant and timely.

Ultimately, a long-term trade policy cannot be defined as long as the basic institutions are not in place. The key challenge in Ecuador remains to build such institutions.

⁴⁷ To view the plan, see https://www.cancilleria.gob.ec/wp-content/uploads/2013/05/planex_2020.pdf.

Annex 7.1. Interviewees

The following key actors involved in Ecuador's trade policymaking process were interviewed for this chapter, some of them more than once:⁴⁸

1. Roberto Aspiazu, Executive Director, Ecuadoran Business Committee (CEE).
2. Carlos Andrés Baca, General Manager, Consultpolitik.
3. Genaro Baldeón, Executive President, Association of Automotive Companies (AEADE).
4. Juan Carlos Casinelli, former Minister of International Trade (2016–2017); signed the FTA-EU.
5. José Antonio Camposano, President, Ecuador's National Chamber of Aquaculture (CNA).
6. Eduardo Egas, Executive Director, Corporation for the Promotion of Exports and Investments (CORPEI); former Minister of Industry and Competitiveness (2015–2016); former Deputy Minister of Trade (2008–2009).
7. Cristian Espinosa, Director of International Affairs, Municipality of Quito; former Head Negotiator of the FTA-USA.
8. Juan Falconí Morales, Coordinator of International Negotiations, Ministry of International Trade.
9. Carlos González, General Manager, La Fabril.
10. Juan Pablo Grijalva, General Manager, Livestock Producers Association (AGSO).
11. Eduardo Ledesma, Executive Director, Ecuadorean Association of Banana Exporters (AEBE).
12. Daniel Legarda, Executive President, Ecuadoran Federation of Exporters (FEDEXPOR).
13. Alejandro Martínez, Executive President, EXPOFLORES; President, Council of Production Chambers and Associations.
14. Pabel Muñoz, Member, National Assembly; former head of the National Planning Secretariat (SENPLADES).
15. Luis Luna Osorio, International Trade Analyst.
16. Mauricio Pinto, former Minister of Industry and Trade (1992–1993); former Minister of Finance; member of the negotiation committee for the FTA-USA.

⁴⁸ The interviews are available upon request.

17. Francisco Rivadeneira, Ecuador's delegate to the International Monetary Fund; former Minister of International Trade (2013-2015); closed the FTA negotiations with the European Union.
18. Ana Dolores Román, CM & PEH Lead, Pfizer Ecuador, Peru, and Bolivia.
19. Edwin Vásquez, Technical Negotiations Coordinator, Ministry of Commerce.
20. Andy Wright, Executive Vice-President, Corporación La Favorita.
21. Interviews were also conducted with three persons who asked to remain anonymous.

Annex 7.2. Trade Policy in Ecuador

Ecuador is a small, dollarized, and fairly open economy that is highly vulnerable to external shocks due to its dependence on oil and other commodities, and that has a low level of economic complexity.⁴⁹ Although Ecuador's openness has increased substantially, reaching a maximum of 61 percent in 2008, the rise has not been consistent, with large fluctuations associated with policy changes and the dynamics of oil prices, particularly the second oil boom in 2005–2014.⁵⁰

Since the early 1970s, oil has been Ecuador's main export. Indeed, Ecuador's exports are highly concentrated, with one or two products representing over 50 percent of the total. Yet, there has been some diversification over time, with products such as flowers, shrimp, tuna fish, cocoa beans, gold, and others becoming more relevant. In 2017, shrimp surpassed bananas as Ecuador's largest non-oil export.

Imports are naturally much less concentrated, and they have become more diverse over time. The most important import is machinery, followed by different types of chemical products (such as mineral tars, medicines, perfumery and cosmetics, and vaccines), and electronics.

Participation in International Organizations

Ecuador has been a member of the World Trade Organization (WTO) since 1996 and belongs to various international associations. The country has signed several trade agreements and is the beneficiary of unilateral trade preferences.

Regarding preferential and regional trade agreements, Ecuador is a member of the Andean Community (CAN), which also includes as members Bolivia, Colombia, and Peru.⁵¹ Since 1993, a CAN free trade area has been in place, but the original goal of a customs union has not materialized because CAN members have not been able to set common external tariffs. Ecuador joined the Union of South American Nations (Unasur) in May 2008, and joined the Bolivarian Alternative for the Nations of Our America (ALBA) in August 2009. President Moreno has since distanced the country from these organizations. In August 2018, Ecuador decided to leave ALBA, citing the

⁴⁹ See Romero, López, and Jiménez (2018); see also <https://oec.world/en/profile/country/ecu>.

⁵⁰ Díaz (2018) presents a detailed analysis of Ecuador's trade policy since dollarization.

⁵¹ Venezuela withdrew from CAN in 2006 following the signing of an FTA with the United States by Colombia and Peru, which according to then-president Hugo Chávez "made regional unity unviable." See "Venezuela anuncia su salida de la CAN," *El Universo*, April 21, 2006 (<https://www.eluniverso.com/2006/04/21/0001/9/D8D3374A8E61488CBBBE305ADBDC4C69.html>).

lack of solutions to the economic and political crisis in Venezuela.⁵² Likewise, in September 2019, the National Assembly approved Ecuador's exit from Unasur.⁵³

Ecuador has been a member of the Latin American Integration Association (ALADI) since August 1980. Within this framework, Ecuador has signed Partial Scope Agreements with Mexico (1987), Cuba (2000), MERCOSUR (2005), Chile (2010), Guatemala (2013), El Salvador (2017), and Nicaragua (2017). In 2014, Ecuador signed an FTA with the European Union (FTA-EU), which was ratified in 2016 and entered into force on January 1, 2017. Likewise, in June 2018 Ecuador signed an FTA with the European Free Trade Association (FTA-EFTA). Following an long delay, the agreement was finally ratified amid the coronavirus emergency on April 21, 2020, and is expected to enter into force in late 2020. Ecuador also signed an FTA with the United Kingdom in May 2019 that is pending ratification in the Assembly.

Since 2018, the two main objectives of the Moreno administration have been an FTA with the United States and Ecuador's inclusion in the Pacific Alliance.⁵⁴ Regarding the FTA-USA, in November 2018, the Ecuador-USA Trade and Investment Council (TIC) was reactivated after a nine-year hiatus. After additional high-ranking meetings in 2019, President Moreno met with U.S. President Donald Trump in February 2020. A key objective of this meeting was to establish an initial commitment for an FTA.⁵⁵ Regarding the Pacific Alliance, on February 21, 2020, Ecuador and Chile signed a trade agreement.⁵⁶ A similar process remains to be concluded with Mexico.

Ecuador remains a beneficiary of the Generalized System of Preferences with the United States, which were renewed in March 2018 until December 31, 2020. Ecuador had also been a beneficiary of the Andean Trade Promotion

⁵² "Ecuador abandona la ALBA y crítica a Venezuela por la crisis migratoria," Agencia EFE, August 24, 2018 (<https://www.efe.com/efe/america/portada/ecuador-abandona-la-alba-y-critica-a-venezuela-por-crisis-migratoria/20000064-3728374>).

⁵³ "Asamblea Nacional de Ecuador ratifica salida del país de la Unasur," DW, September 18, 2019 (<https://www.dw.com/es/asamblea-nacional-de-ecuador-ratifica-salida-del-pa%C3%ADs-de-la-unasur/a-50468501>).

⁵⁴ The negotiations with other countries such as Costa Rica, South Korea, and Turkey have recently been put on hold due to limited resources. See "Estados Unidos y la Alianza del Pacífico marcan la agenda comercial," *El Comercio*, March 4, 2020 (<https://www.elcomercio.com/actualidad/eeuu-alianza-pacifico-comercio-ecuador.html>).

⁵⁵ "Se abre ruta para el tratado comercial ente Ecuador y EE.UU.," *El Comercio*, February 13, 2020 (<https://www.elcomercio.com/actualidad/compromisos-reunion-moreno-trump-washington.html>).

⁵⁶ "Ecuador concretó el Acuerdo de Integración Comercial con Chile," *El Comercio*, February 21, 2020 (<https://www.elcomercio.com/actualidad/ecuador-acuerdo-integracion-comercial-chile.html>).

and Drug Eradication Act (ATPDEA) despite several impasses with the United States. Ecuador resigned from the ATPDEA in June 2013.

Trade Restrictions

Ecuador has a broad set of tariffs and nontariff barriers in place. These barriers were further deepened starting in 2010 once the Organic Code of Production, Commerce, and Investment (COPCI) entered into force, and even further with SENPLADES's National Plan for Good Living 2013–2017.

Since Ecuador's accession to the WTO, most tariff rates have been bound at 30 percent ad valorem, with the exception of agricultural products covered by the Andean Price Band System (APBS). The system covers 153 products, with 13 "marker" products and 140 "linked" products.

Figure A7.2.1 provides a summary of Ecuador's Most Favored Nation (MFN) weighted average tariffs for the period 2000–2018 by broad economic sector (panel 1) and type of good (panel 2).⁵⁷ Consistent with the international evidence, panel 1 shows that agricultural products face higher tariffs than nonagricultural ones. During the period shown, the MFN weighted average tariff was 14.76 percent for agricultural products, 8.32 percent for industrial goods, and 4.34 percent for petroleum goods. Importantly, the average tariff for industrial goods dropped from a peak of 11.03 percent in 2001 to a low of 6.39 percent in 2009, but then increased again to 9.74 percent in 2018. Panel 2 shows that the average tariff of capital, intermediate, and consumer goods followed a U-shaped path, decreasing during the first half of the period, particularly in 2008–2009, but increasing after 2012, and especially since 2015.

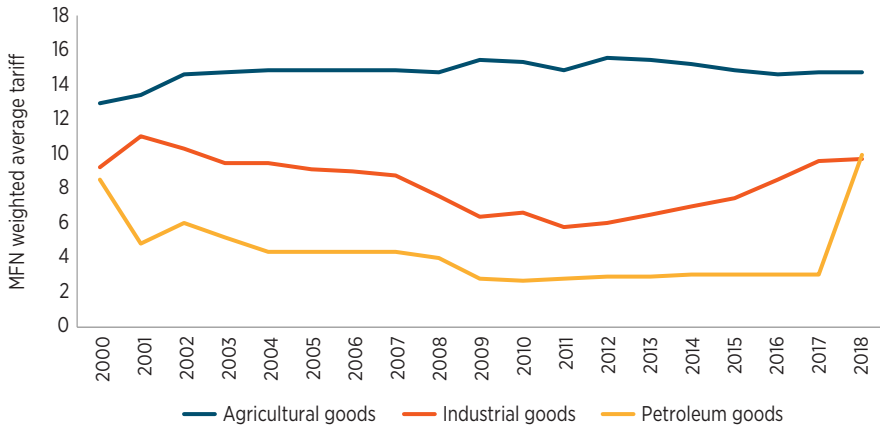
This dynamic comes from the interaction between the government's aim of promoting local production and the reality of the trade and fiscal balances. As long as oil prices allowed it, the government could lower tariffs for the products used in the local production processes. However, when oil prices fell and the trade and fiscal balances deteriorated, the government shifted to more protectionist policies.

Most importantly, in March 2015, the government implemented safeguard import tariffs. Initially, they were supposed to remain in place for 15 months until June 2016, but following an earthquake in April 2016, they were extended for another year, with a partial phase-out starting in July 2016. They were completely eliminated in June 2017. The safeguards affected 2,955 10-digit subheadings, representing 38 percent of total subheadings and 31 percent of total import value in 2014.

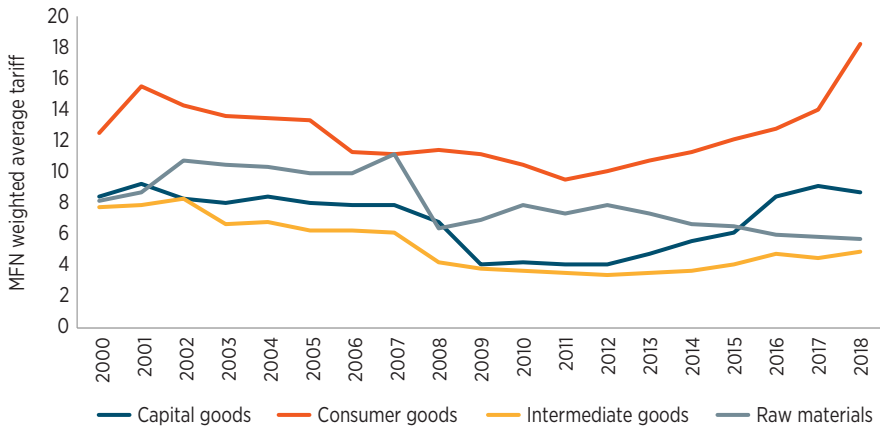
⁵⁷ Data for 2013 are not available from the World Bank (2018), and thus a linear interpolation for this data point is used in the figure.

Figure A7.2.1
Ecuador: Evolution of Tariffs, 2000–2018 (percent)

1. By Economic Sector



2. By Type of Good



Source: Prepared by the authors based on data from World Bank (2018).

Note: MFN: Most Favored Nation.

Consistent with the dynamic of tariffs, nontariff barriers (including anti-dumping measures, safeguards, sanitary and phytosanitary measures, and technical barriers to trade) have increased significantly in the last 15 years. Table A7.2.1 provides a summary of the number of nontariff barrier measures established from 2000 to 2019. Sanitary and phytosanitary measures are by far the most important. They were not used during the first years of dollarization, but they have become very common since 2008.

Table A7.2.1**Ecuador: Number of Nontariff Barriers Initiated by Year and Measure, 2000–2019**

	ADP	SG	SPS	TBT	Total by Year
2000					0
2001					0
2002		1			1
2003		4		1	5
2004					0
2005			8		8
2006			7		7
2007			3		3
2008			63		63
2009			1	1	2
2010	2	1	1		4
2011			7	1	8
2012			21		21
2013			24	4	28
2014		1	26	10	37
2015			13	1	14
2016			18		18
2017			18	1	19
2018			12	1	13
2019		1	13	1	15
Total by measure	2	8	235	21	266

Source: Prepared by the authors based on WTO (2020).

Note: Numbers include specific trade concerns. ADP: anti-dumping measures; SG: safeguards; SPS: sanitary and phytosanitary measures; TBT: technical barriers to trade.

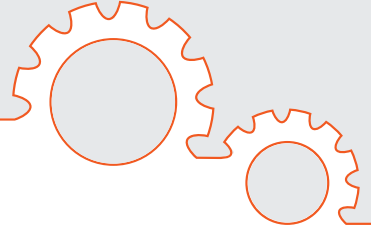
Traditionally, non-transparent procedures along with inefficiencies have made the import registration process cumbersome, effectively turning it into a trade barrier. Following the introduction of new regulations in 2001, bureaucratic procedures improved somewhat but still appeared to discriminate against foreign products (USTR 2001).

A particular barrier regarding agricultural products that has been used over time is the “consultative committees” put in place by the Ministry of Agriculture and Livestock. These committees exist for several agricultural products and are composed of private sector representatives and government officials. Although conceived as advisory bodies whose mission was to

recommend production and agricultural development policies, in practice they often advise the Ministry of Agriculture and Livestock against granting import permits for foreign suppliers. Indeed, the issuance (or lack thereof) of import permits is deliberately used to impede trade (USTR 2018).

As part of the policy of import substitution, the Correa administration established commitments with companies to increase local production and decrease imports. By October 2014, 905 agreements had been signed with the government.⁵⁸ According to importers, the government coerced them into these agreements by blocking their imports until they signed them (USTR 2015).

⁵⁸ “900 convenios se firmaron para sustituir a las importaciones,” *El Comercio*, November 16, 2014 (<https://www.elcomercio.com/actualidad/900convenios-sustituir-importaciones-ecuador.html>).



The Political Economy of Trade Policy in the U.S.-Mexico Border Region

Gustavo Córdova Bojórquez, Stephen Meardon, Karla Maria Nava-Aguirre, and Federico Schaffler-González¹

The renegotiation of the North American Free Trade Agreement (NAFTA) promised by then-U.S. presidential candidate Donald Trump in 2016 and then initiated in 2017 spurred interested parties to try to influence the outcome. Canadian, Mexican, and U.S. Chambers of Commerce, among many other private sector actors, mobilized resources to preserve the agreement. Others lobbied to make significant modifications concerning a variety of provisions: rules of origin, government procurement, settlement of disputes over investor-state relations, agriculture, invocation of trade-remedy laws, and more. The renegotiation process culminated with the signing of the new U.S.-Mexico-Canada Agreement (USMCA) on November 30, 2018.

A curious aspect of the renegotiation and the lobbying for it is that the process took place in a political-economy environment transformed by the very agreement being renegotiated. North America, and particularly the Mexico and the United States, had become a site of tightly integrated production processes spanning the partner countries. How did NAFTA-induced integration affect the politics of the NAFTA renegotiation?

A conventional political economy perspective on the coalitions doing the lobbying and the reception they received from political actors will help

¹ The authors would like to thank the project team at the Inter-American Development Bank, including Jorge Cornick, Jeffry Frieden, Mauricio Mesquita Moreira, and Ernesto Stein, for guidance during the preparation of this chapter, and the Universidad de Monterrey as the host research institution.

to address the question. But its helpfulness is complicated by post-NAFTA realities. The convention is for politicians to weigh the dispersed interests of consumers, who are also voters, against the concentrated interests of domestic producer alliances. Alliances typically organize by class or industry, depending on the degree of inter-industry mobility of domestic productive factors.² However, the real circumstances that played out in the NAFTA renegotiation had at least as much to do with cross-border producer alliances as with domestic ones; and at least as much to do with international mobility of intermediate and final goods via global value chains (Gereffi, Humphrey, and Sturgeon 2005) as with inter-industry domestic factor mobility.

Consequently, not only did interested parties such as the Canadian, Mexican, and U.S. Chambers of Commerce mobilize resources to preserve NAFTA, they did so jointly—and their motive for joint action is seen in their emphasis, in one way or another, on the imperative of “supply chain security” (Hackbarth 2017). Therefore, understanding NAFTA’s renegotiation requires augmenting the conventional perspective on how trade agreements are negotiated.

The perspective in this chapter emerges from posing and answering three specific sets of questions. Who are the leading private sector producers undertaking cross-border cooperation to influence Mexico-U.S. trade policy? Under what circumstances are cross-border alliances between Mexican and U.S. producers most likely to be undertaken? And how were those alliances built for purposes of influencing NAFTA, and how did they function?

The “who” question is addressed in this chapter by drawing on interviews with actors involved in cross-border Mexico-U.S. alliances. The other questions are answered by observation and induction from the same interviews, participation in other meetings and conferences, and other documentary sources. The analysis begins with the basic framework of Grossman and Helpman (1994) that assumes self-interested politicians will weigh the competing interests of consumers and producers and attend to them with trade policy, including trade agreements. It is assumed, though, that producers may find advantage in lobbying (either individually or in concert with others) not only their own government but also the governments of the other parties to the agreement.

It is the latter possibility that gave rise to cross-border alliances of producers for NAFTA lobbying. It is further assumed that whether producers form such alliances or eschew them depends on the weight of their benefits versus

² See Grossman and Helpman (1994) on the calculus of political actors in relation to the interests of their different types of constituents, and Hiscox (2002) on the unity and effectiveness of class-based versus industry-based lobbying coalitions under different assumptions about inter-industry factor mobility.

their costs. The benefits of cross-border alliances lie in the possibilities they offer to share resources and information. Sharing resources may be especially desirable when legal barriers to foreign lobbying prevent a producer from lobbying a government that is not its own. Sharing information is desirable when one anticipates that the foreign government's negotiating position might be aligned with one's own if only the government could be apprised of that position or of other circumstances of which it is unaware. The costs of cross-border alliances lie in the difficulty of coordinating with actors operating in a different institutional setting and possibly speaking a different language.

From these assumptions three observations can be made about the NAFTA renegotiation process:

1. Cross-border alliances were not useful for purposes of renegotiating NAFTA in a protectionist direction. In the United States, producers with protectionist interests had little benefit in seeing the renegotiations succeed given President Trump's statement that the alternative was U.S. withdrawal from the agreement. On the other hand, they faced high costs in forming cross-border alliances. Because they were import-competing, protectionist producers were unlikely to be tightly linked to their foreign counterparts by production processes. Absent tight production links, costs of communication and coordination were high.
2. Cross-border alliances were most useful for maintaining the NAFTA status quo or for tinkering at the margins. Producers that had developed a vested interest in NAFTA trade found advantages in sharing information and resources to protect their interests by maintaining the existing agreement. What is more, insofar as their production processes were integrated, they had existing channels of communication and methods of coordination that could be used for lobbying as well as for productive purposes.
3. Cross-border alliances were more common and worked to greater effect where the sharing of resources and information was made less costly either by proximity to the border or by the allied producers sharing a tightly integrated production process.

To corroborate these observations, this chapter examines a pair of cross-border lobbying episodes related to NAFTA. To begin, however, the chapter provides a preliminary description of the mechanisms of trade policy formation and lobbying in Mexico and the United States from the early years of NAFTA to the present. The description sets the stage for the examinations of how the mechanisms worked in the episodes that followed. The first episode concerns the cross-border trucking dispute from NAFTA's inception in 1994

through the 2000s. The second concerns the wrangling over automotive industry rules of origin during the recent negotiations. The chapter then puts forth conclusions, including some closing remarks about the political scenario during the final stage of the renegotiation.

8.1. Mechanisms of Private-Public Communication

The efforts of private actors in the early 1990s to shape NAFTA offered parties interested in the recent renegotiations—including more than a few of the same people—a general template for action. Beyond that general template, however, the institutional framework for private sector involvement in public trade policy deliberations evolved in the interim. Private actors on both sides of the border tried both separately and jointly to influence the negotiations by applying the lessons of the past to their lobbying within that evolving framework.

In the United States, the Department of Commerce and specifically the International Trade Administration (ITA) are supposed to constitute the main channel for private sector participation in administrative deliberations about trade policy. The Trade Act of 1974 created a structure of Industry Trade Advisory Committees (ITACs) currently comprising 16 committees representing industry sectors and cross-industry subjects, including aerospace equipment (ITAC 1), automotive equipment and capital goods (ITAC 2), services and finance (ITAC 10), small and minority business (ITAC 11), customs matters and trade facilitation (ITAC 14), and standards and technical trade barriers (ITAC, 16) (International Trade Administration, undated). Each committee includes a chairman, vice-chairman, and a varying number of “cleared advisors” numbering from around 10 to 30 who may or may not be federally registered lobbyists (Federal Register 2014). The committees provide advice, including mandatory reports and advisory opinions on trade agreements, to the president, the U.S. Trade Representative (USTR), and Congress. Other administrative advisory committees coordinated by the Department of Commerce include the President’s Export Council, the Travel and Tourism Advisory Board, and the Manufacturing Council—the first advising the president on policy concerning exports in general, the second advising the Secretary of Commerce on tourism exports in particular, and the third advising the Secretary of Commerce on policy affecting manufactures, including but not limited to trade policy.³

Despite the supposed relevance of the ITAC structure and the other administrative advisory committees since their inception, a great part, and perhaps the greater part, of NAFTA lobbying took place outside of that

³ International Trade Administration, Office of Advisory Committees, available at <https://www.trade.gov/oac/> (accessed August 11, 2018).

structure. One participant in NAFTA lobbying both in the early 1990s and in the recent renegotiation recalls that in the political climate of the earlier period—with U.S. presidential candidate Ross Perot warning about a “giant sucking sound” of U.S. jobs being siphoned to Mexico via NAFTA—ITAC members were reluctant to go on the public record with explicit advice and reports that were favorable to the agreement (interview with Gerald Schwebel, 2018). Representatives of companies of both national and international scope were apprehensive of facing public blame for the “sucking.” Rather than working through ITACs, companies and extra-governmental coalitions arranged to meet with congressional representatives and testify to congressional committees with the purview over NAFTA negotiations. One coalition was the Border Trade Alliance, a nonprofit network of businesses, chambers of commerce, academic institutions, and local governments founded in 1986 that advanced shared interests in fostering international trade for development of the Mexico-U.S. and Canada-U.S. border regions. Companies felt greater protection from negative publicity in the numbers and alliances afforded by such coalitions.

In the recent NAFTA renegotiation, the ITAC structure and other administrative advisory committees continued to be of dubious relevance. As recently as August 2018, the ITA had conspicuously not published any agenda for meetings of the President’s Export Council or the Manufacturing Council since prior to the November 2016 election.⁴ The ITA website continued to post a call for nominations for appointments to ITACs from 2014 that were due to expire in February 2018 (Federal Register 2014).

The ITACs discharge their nominal responsibilities, but one interviewee for this chapter noted that active committee members are commonly former congressional staffers rather than industry operatives, and, what is more, they seek out representatives of companies and coalitions to learn about their views, while the latter endeavor to influence policy mainly through other channels (interview with Gerald Schwebel, 2018).

The more relevant channels facilitate cross-border cooperation in a way that the ITAC structure, which bars participation by non-U.S. citizens or entities, deliberately impedes. The U.S.-Mexico High Level Economic Dialogue—established in 2013 by President Barack Obama and Mexican President Enrique Peña Nieto and chaired jointly by the U.S. Departments of State and Commerce, the USTR, and the Mexican Ministries of Foreign Relations, Finance, and Economy—provided for private sector input by way of the U.S. Chamber of Commerce and Mexico’s Business Coordinating Council (*Consejo Coordinador*

⁴ International Trade Administration, Office of Advisory Committees, op. cit. (accessed August 13, 2018).

Empresarial – CCE) (International Trade Administration, undated).⁵ The U.S. Chamber and Mexican CCE created, in turn and in the same year, the U.S.-Mexico CEO Dialogue, comprising approximately 25 company chief executive officers from each country. That entity meets biennially, once in the United States and once in Mexico (U.S. Chamber of Commerce, undated). In 2017, with the initiation of NAFTA renegotiations, the organization rebranded as the U.S.-Mexico Economic Council (USMEXCO), broadened its participation, and directed itself expressly to influencing the renegotiations in a manner jointly favorable to the Chamber of Commerce and the CCE (Morales 2017). A favorable result to the renegotiations, in their common view, would be one that “modernized” the agreement without opening all of its chapters for modification; that would “do no harm” (a common refrain) to what already purportedly worked; and that fostered greater investment and employment growth in less-developed regions of Canada, Mexico, and the United States.

The adjustment of USMEXCO’s sights to include Mexico occurred simultaneously with the joint creation by the U.S. Chamber of Commerce, the CCE, and the Canadian Chamber of Commerce of the North American Economic Alliance (NAEA). The NAEA carried the same “do no harm” refrain but went farther toward articulating detailed joint positions regarding the negotiations and publicly disseminating data that could be helpful to bolstering those positions. It expressly resisted the preference of the USTR to renegotiate the agreement bilaterally, answering with insistence that all three parties should “keep the agreement trilateral” (North American Economic Alliance 2018).

In Mexico, trade policy decisions made ultimately by the president are the result of the work of ministries at the federal level, working teams, and consultation with chambers of commerce and services, tourism, and industry representatives. The *Ley de Cámaras Empresariales y sus Confederaciones*, enacted in 2005 and amended in 2009, obliges federal authorities to consult the opinion of experts, representatives, and leaders of the trade and industrial chambers and associations (Cámara de Diputados 2009).

According to the 2016 *Ley de Comercio Exterior*, the federal government, represented by the president, delegates to the *Secretaría de Economía* (formerly SECOFI) the work of international negotiations that determine the future of the trade policy of the country and the region. The negotiating team is composed of the *Secretaría de Economía* and three executives of the same ministry who have extensive experience and a political background dating to the 1990s. The private sector is informed and consulted through the *Cuarto*

⁵ The CCE was founded in 1976 as a response by the national productive sector to increased government intervention in the economy. The objective was, and is, to coordinate policies and activities of business organizations, contribute to the formulation of public policies, and raise the rate of economic growth and level of competitiveness, both private and public (CCE 2018).

de Junto (“Side Group”), which includes representatives of the most important productive sectors of the country and civil society. The CCE, through the Strategic Council for International Negotiations (*Consejo Consultivo Estratégico para las Negociaciones Internacionales* – CCENI), is the agency responsible for coordinating the work of the *Cuarto de Junto* and defending the interests of the private sector in government.

The CCE’s central role in the formation of Mexico’s trade policy began in 1988, when the federal government invited business organizations and representatives in the foreign trade arena to a series of meetings to analyze the situation in the country, consider future scenarios, and formulate policies and action plans for Mexico. At these meetings the CCE established a new entity that became a privileged one in mediating between the Mexican private sectors in the trade arena: the *Coordinadora de Organizaciones Empresariales de Comercio Exterior* (COECE). One of the early activities of the COECE was to participate in the NAFTA negotiations, which were led by the Mexican government’s *Secretaría de Comercio y Fomento Industrial* (SECOFI). To that end, the CCE integrated all of its members into COECE, creating the organization established in 1990, as shown in Table 8.1.

Table 8.1
Members of the Coordinadora de Organizaciones Empresariales de Comercio Exterior (COECE) in 1990

Consejo Coordinador Empresarial (CCE)				
Coordinadora de Organizaciones Empresariales de Comercio Exterior (COECE)				
Confederation of Industrial Chambers in Mexico (CONCAMIN)	National Confederation of Chambers of Commerce (CONCANACO)	Patronal Confederation of Mexico (COPARMEX)	Mexican Association of Insurance Institutions (AMIS)	Mexican Council of Businessmen (CMHN)
National Council of Agriculture (CNA)	Mexican Association of Casas de Bolsa (AMCB)	National Chamber of Commerce in Mexico City (CANACO)	National Chamber of Manufacturing Industry (CANACINTRA)	Mexican Business Council of International Issues (CEMAI)
National Association of Importers and Exporters of the Mexican Republic (ANIERM)	National Council of Foreign Trade (CONACEX)	Chamber of Commerce Mexico-United States	Chamber of International Trade. Chapter México (ICI)	

Source: Prepared by the authors based on Alba (1997).

COECE was modeled after analogous organizations in Canada and the United States. From the United States, the ITAC system was the main reference; from Canada it was a similar system divided into 13 industrial committees and one general affairs committee. A notable difference is that in the COECE, unlike in the Canadian and U.S. systems, association members are not elected by the government. However, Mexico does have, in addition to the COECE, a government-elected Advisory Committee on International Trade (*Comité Asesor en Comercio Internacional* – CACINT), created by the SECOFI in 1991.

At the beginning of the NAFTA negotiations, private and public actors alike understood that the Mexican government lacked full and timely information about business realities and characteristics of industrial sectors both at home and abroad. The COECE responded by undertaking studies, formulating a negotiation strategy, advising the SECOFI during the negotiations, and establishing channels of communication with business organizations in the United States as well as in Mexico—collaborating in these tasks with CACINT (Alba 1997). CACINT had two purposes: first, to communicate the progress of the negotiations to Mexican society, and second, to transmit the interests of the private sector to the official negotiating team.

The consultative process that emerged during the original NAFTA negotiations remained in force during the recent renegotiations. The former SECOFI, now the *Secretaría de Economía*, was determined not to negotiate any issue without prior consultation with the private sector, while private sector representatives for their part sought close access to the government's negotiating team.

The *Cuarto de Junto* is the main conduit of information between the Mexican private and public sectors, and for communication of both with private sector counterparts outside Mexico. An Intelligence Room within the CCENI generates information that is conveyed to the *Cuarto de Junto*, but the information flows in both directions, and in both directions it is highly centralized. The government communicates objectives and negotiating impediments in a coordinated way with the private sector, which is represented in the *Cuarto de Junto* broadly by sector and extensively by stages of production upstream and downstream. Table 8.2 presents the members the *Cuarto de Junto* during the renegotiations of 2017–2018.

The high degree of centralization in Mexican trade policy lobbying has advantages, according to Moisés Kalach, General Coordinator of CCENI. The Mexican private sector appears to present a united front. Representatives of various sectors have the opportunity to give their opinions, and the government acts upon their opinions more transparently than it might otherwise do. The information running in both directions is disseminated by people of high repute: “There is so much talent both in the... *Cuarto de Junto* and

Table 8.2**Members of the Cuarto de Junto during NAFTA Renegotiations in 2017–2018**

Association	Name	Position
Cuarto de Junto	Moises Kalach	Coordinator
	Eugenio Salinas	Technical Secretary
Business Coordinating Council (Consejo Coordinador Empresarial – CCE)	Juan Pablo Castañón	President
Strategic Council for International Negotiations (Consejo Consultivo Estratégico de Negociaciones Internacionales – CCENI)	Moises Kalach	General Coordinator
Confederation of Industrial Chambers (Confederación de Cámaras Industriales – CONCAMIN)	Manuel Herrera	President
Confederation of National Chambers of Commerce, Service, and Tourism (Confederación Nacional de Cámaras de Comercio, Servicios y Turismo – CONCANACO)	Ricardo Navarro	Vice President
National Confederation of Unions (Confederación Patronal de la República Mexicana – COPARMEX)	Gustavo de Hoyos Walthner	President
National Chamber of Industrial Transformation (Cámara Nacional de la Industria de la Transformación – CANACINTRA)	Enrique Guillen Mondragón	President
National Council of Agriculture (Consejo Nacional Agropecuario – CNA)	Bosco de la Vega	President
Association of Banks in Mexico (Asociación de Bancos de México – ABM)	Marcos Martinez	President
CULTIBA (holding company)	Juan Gallardo Thurlow	President
Mexican Council of the Consumer Products Industry (Consejo Mexicano de la Industria de Productos de Consumo – CONMEXICO)	Jaime Zabłudovsky	Executive President
IQOM (consulting firm)	Herminio Blanco Sergio Gómez Lora	President/Undersecretariat of International Trade at SECOFI and member of the NAFTA negotiation team in 1994; General Director/Director of International Agreements at SECOFI and member of the NAFTA negotiation team in 1994

(continued on next page)

Table 8.2 (continued)**Members of the Cuarto de Junto during NAFTA Renegotiations in 2017–2018**

Association	Name	Position
National Chamber of Iron and Steel Industry (Cámara Nacional de la Industria del Hierro y el Acero – CANACERO) and TENARIS TAMSA (a member company)	Guillermo Vogel	Vice President
PRODENSA (an international strategic services company)	Emilio Cadena	CEO
National Council of Maquiladoras (Consejo Nacional de la Industria Maquiladora y Manufacturera de Exportación – INDEX)	Federico Serrano	President
Rassini (auto parts company tier 1)	Eugenio Madero	CEO
Zimat (consulting and communications agency, and founding member)	Martha Mejía	Founder
Mexican Automotive Industry Association (Asociación Mexicana de la Industria Automotriz – AMIA)	Eduardo Solís	President
American Chamber of Commerce (AMCHAM), Mexico	Mónica Flores	President
Confederation of Mexican Customs Agents Associations (Confederación de Asociaciones de Agentes Aduanales de la República Mexicana – CAAAREM)	Ricardo Zaragoza Ambrossi José Antonio Vidales	President Former President
White & Case (law firm)	Francisco de Rosenzweig Ismael Reyes Retana	Members

Source: Prepared by the authors based on information from Jiménez (2017) and Morales (2017).

Intelligence Room. We have very talented people in Mexico with more than 25 years of experience working on these international issues, including many former public officials” (interview with Moisés Kalach, 2018).

Another advantage is the greater ease for the Mexican government to solicit information from the Mexican private sector’s counterparts in the United States, and the greater ease for the Mexican private sector to lobby the U.S. government by association with the same counterparts. As Kalach stated, “Communication with the U.S. private sector was key” to the completion of an agreement replacing NAFTA. The prevailing view in the *Cuarto de Junto*

held that the interests of the Mexican and U.S. private sectors with respect to NAFTA were by and large overlapping. The problem was to inform the Mexican negotiators of those interests systematically and to foster the U.S. negotiators' adoption of those interests as their own.

That problem was overcome by the *Cuarto de Junto's* facilitation of alliances between certain of its members and U.S. counterparts: the Confederation of Industrial Chambers in Mexico (*Confederación de Cámaras Industriales* – CONCAMIN) and the National Association of Manufacturers in the United States; the National Council of Agriculture in Mexico and the U.S. Farm Bureau Insurance; the Mexican Council of Business and the U.S. Business Roundtable; and the CCE and the U.S. Chamber of Commerce. The partners exchanged information continually and arranged monthly meetings in the United States to discuss sensitive chapters of NAFTA, propose alternatives, and refine the joint lobbying strategy. The meetings, which during the period of renegotiations numbered approximately 300, included more than the principal Mexican and U.S. partners. They also included other business leaders (106), U.S. congressmen and congresswomen and media representatives (54), U.S. senators (25), other public officials (more than 40), and state governors (50) (Smith-Ramos 2018). The Mexican negotiating team and the *Cuarto de Junto* also directed their U.S. lobbying efforts toward political actors from the border region, particularly Texas, where geographical proximity implies a close alignment of interests and familiar networks of communication. Through the Texas-Mexico Trade Coalition and Greater Houston Partnership, Mexican leaders arranged meetings with Texas Governor Greg Abbott, former governor and U.S. Energy Secretary Rick Perry, Senator John Cornyn, Texas Secretary of State Rolando Pablos, and Texas representatives in the U.S. House of Representatives including Henry Cuellar, Joaquin Castro, and Will Hurd (IQOM 2018).

While actors who were directly involved saw advantages in the centralization of Mexican trade policy lobbying, a close analysis reveals some disadvantages. Gawande, Krishna, and Olarrega (2012) extend the Grossman-Helpman model to allow lobbying competition between upstream and downstream producers. Such competition may explain why even governments that are not very “welfare-minded” adopt liberal trade policies. Downstream producers that use tradable intermediate goods as inputs are more amenable to free trade than the goods' upstream domestic producers. Lobbying activities of upstream and downstream producers—the former for protection and the latter for free trade—may cancel each other out. It follows conversely that if upstream and downstream producers have formed a single coordinated lobby, as with the *Cuarto de Junto*, competitive lobbying and its liberal effects are attenuated. Producers will have thus formed a lobbying cartel, a monopsony in the market for trade policy—an effective vehicle for the pursuit of protection.

The protectionist-monopsony understanding of Mexican trade policy lobbying may appear on its face to contradict the facts of the case. Aside from the question of whether the *Cuarto de Junto* is a monopsony, the trade policy for which it lobbied, and which the Mexican government sought in NAFTA renegotiations, was decidedly more liberal than that which the U.S. government sought. But there is another fact to consider. The *Cuarto de Junto*'s purpose of preserving NAFTA represented at least partly an interest in trade diversion. The purpose is consistent with Stoyanov's (2009) argument that free trade areas foster protectionist interests with a stake in maintaining and even extending trade diversion, and that those interests may be (and, in the case of Canada, were indeed) promoted by foreign lobbying.

A disadvantage of Mexico's highly centralized trade policy lobbying system, then, is that it amplifies the voices in Mexican trade policy of those interests benefiting from protection in the form of NAFTA/USMCA-induced trade diversion.

From this sketch of how trade policy is influenced in Mexico and the United States by the private sector, the next section turns to two episodes that illustrate how the influence has been exercised in relation to NAFTA. The episodes emphasize the role of cross-border alliances of producer interests as vehicles for trade policy lobbying. One of the episodes, pertaining to the U.S.-Mexico dispute over cross-border trucking, is drawn from the past (1994). The other pertains to more recent events: namely, the sticking points with respect to automotive rules of origin in the NAFTA renegotiations (2017-2018).

8.2. Early NAFTA Lobbying: The Cross-Border Trucking Dispute

As NAFTA was written and signed in December 1992, the agreement provided for opening Mexico and the United States to commercial trucks from all partners. At the time, trucks from Mexico and the United States alike were allowed only within a 26-mile zone of the partner country. Cargo had to be transferred to a domestic carrier to complete shipments outside of that zone. In NAFTA's Annex I, which catalogued the "non-conforming measures" that each country reserved from the liberalization otherwise required by the agreement, a schedule was laid out for the liberalization of cross-border trucking, over time and with exceptions. The liberalization of Mexican but not U.S. cross-border trucking is most relevant to the controversy that followed, so that is the focus here. First, Mexican trucks would have complete access to roadways in the four states bordering Mexico: California, Arizona, New Mexico, and Texas. The second step permitted Mexican trucks to travel freely on U.S.

Table 8.3
Timetable of the Original NAFTA Trucking Provisions

NAFTA signed: December 17, 1992/Implemented: January 1, 1994	
<p>December 17, 1995 (three years after the agreement was signed)</p>	<p>Cross-border trucking services by Mexican carriers were to be allowed to and from U.S. border states: California, Arizona, New Mexico, and Texas. (Truck services by Mexican carriers between U.S. points in any state would remain prohibited.)</p> <p>Mexican carriers were to be able to enter and depart the United States through any port of entry.</p> <p>Mexican nationals were to be allowed to establish a U.S. enterprise for the provision of trucking services between points in the United States for international cargo. (The moratorium on point-to-point transportation within the United States by Mexican carriers of goods other than international cargo would remain.)</p>
<p>January 1, 2000 (six years after the implementation of NAFTA)</p>	<p>Cross-border trucking services by Mexican carriers were to be allowed throughout the United States. (Trucking services by Mexican carriers between U.S. points in any state would remain prohibited.)</p>

Source: NAFTA Annex 1 – United States, pp. I-U-18 to I-U-20.

roadways by January 1, 2000 (Richman 2009; Folsom 2014). The steps and their timing are presented in Table 8.3.

Under the steps taken, Mexican nationals are permitted to own U.S. trucking companies (and, likewise, U.S. nationals may own Mexican companies). But the U.S. government declined to open the border states, much less the rest of the United States, to Mexican cross-border trucking. The reasons given pertained to safety and the environment: skeptics raised safety concerns, questioning whether Mexican drivers should be allowed on U.S. roads because they purportedly worked longer hours, because Mexican trucks were maintained according to lower standards, and because Mexican cargo included hazardous materials.⁶ The upshot was that Mexican trucks continued to service only a narrow geographical band in the United States (interview with Reynaldo Gómez, 2018).

Some years later, Mexico invoked its right to a NAFTA Chapter 20 arbitration of the dispute. In 2001, a NAFTA arbitration panel ruled in Mexico's favor, holding that U.S. noncompliance was not credibly motivated by the cited reasons—that is, it was not based on objective evidence of the validity of safety and environmental concerns. The United States responded to the

⁶ David E. Sanger, "Dilemma for Clinton on Nafta Truck Rule," *New York Times*, December 17, 1995; cited in Puig (2015, 20).

panel's ruling, albeit tardily. In 2007, the administration of President George W. Bush launched a pilot program allowing up to 100 Mexican carriers to operate beyond the 26-mile zone, with the expectation of compiling safety evidence and preparing for full implementation of U.S. commitments under NAFTA. However, Congress and the Obama administration eliminated the program's funding in 2009. In retaliation, Mexico imposed tariffs on numerous U.S. products and sought damages under Chapter 11 of NAFTA.⁷ In 2011, the United States announced a new liberalization program, "The Cross Border Demonstration Pilot Program," under which a limited number of Mexican trucks would enter the United States after inspections to guarantee safety and quality standards. In response, and once again in anticipation of full implementation of U.S. commitments, Mexico withdrew its retaliatory tariffs (Puig 2015).

Little changed between 2011 and the completion of NAFTA renegotiations. The operation of Mexican trucks in the United States is still restricted largely to the 26-mile commercial zone. Lawsuits brought against the latest pilot program by the International Brotherhood of Teamsters (whose president since 1998, James P. Hoffa, called it "a guest worker program on wheels"),⁸ the nonprofit group Public Citizen, and the Owner-Operator Independent Driver's Association (OOIDA) were unsuccessful. The pilot program continues. But its continuation is hardly satisfactory to the Mexican government or Mexican truckers, as participation in the program is miniscule: according to one industry source, as of 2014 only 15 Mexican carriers had been approved for the program. The Mexican government has maintained its threat of re-imposing retaliatory tariffs if U.S. commitments are not honored but has not followed through.⁹

The impediment to trade in trucking services was one of the live questions in the NAFTA renegotiations. The Mexican objective was to maintain the gist of the original agreement and at last see it implemented. The U.S. position was complicated by a conflict between two objectives that were at least circumstantially opposed to one another. One continued to be the protection of U.S. motorists against purportedly inadequate Mexican safety regulations for trucks and drivers; another was to bring about a greater liberalization of trade in services, as the United States exports more than it imports vis-à-vis Mexico, just as it does vis-à-vis the world. The focus of the USTR under the Trump administration on mitigating the overall U.S. deficit in trade in goods

⁷ This is the investment chapter of NAFTA. It establishes a framework of rules and disciplines for investors from NAFTA countries.

⁸ Melanie Trottman, "Teamsters Sue Over Mexican-Truck Plan," *Wall Street Journal*, September 3, 2011.

⁹ "Supreme Court Nixes Mexican Truck Challenge," *Journal of Commerce*, February 7, 2014.

and services kept the latter objective close in view even as certain trucking industry groups emphasized the former.

The principal interest groups speaking to the question on both sides of the border have remained the same since the trucking dispute began, but their lobbying methods, effectiveness, and power have shifted. On the U.S. side, the relevant groups still included the OOIDA and the Teamsters Union. The Teamsters Union numbers 1.4 million members working in 21 industrial divisions and myriad occupations, public and private.¹⁰ Its lobbying position with respect to trade was what one might expect from a group representing a domestically mobile but relatively scarce factor, labor, in a country contemplating liberalization. The Teamsters pressed that position with the U.S. government during the Obama administration, and effectively so—hence the elimination of the first pilot program. The union continued to count on the support of the public advocacy group Public Citizen. These groups maintained the same positions as before, alleging safety and quality concerns about Mexican trucking and seeking protection for domestic jobs in the industry. They opposed a U.S. government proposal to resolve the decades-old dispute by implementing a safeguard provision but otherwise opening the border to Mexican trucks: “North American workers have borne the brunt of nearly 25 years of bad trade policy under NAFTA, and the Teamsters, fellow unions, and some in Congress are demanding that it stop now” (Teamsters 2017). That position was opposed by another industry group, the American Trucking Association, which represents trucking companies and favors measures toward implementing the original U.S. NAFTA commitments. Producers of myriad goods that use trucking services intensively as an input also took an interest in the question, but their interest was diffuse. The U.S. Chamber of Commerce championed the pilot programs of 2007 and 2011, but during the renegotiations did not speak to the question of trucking. It warned generally against “Buy American” rules that are “deeply embedded in U.S. law and regulation.” But in making the warning it did not bring up specifically the prohibition on Mexican trucks.¹¹

In the United States, the federal agencies relevant to the dispute are the U.S. Department of Transportation (DOT) and the Federal Motor Carrier Safety Administration, a division of DOT and the leading federal government agency responsible for regulating and providing safety oversight of commercial motor vehicles. The DOT has the power to negotiate trucking issues in NAFTA with its counterparts in Mexico.

¹⁰ See the Teamsters website at <https://teamster.org/about>.

¹¹ Christian Zur, “The Illusion of ‘Buy American’ Policy,” U.S. Chamber of Commerce, July 11, 2017 (<https://www.uschamber.com/series/modernizing-nafta/the-illusion-buy-american-policy>).

In Mexico, on the other hand, there is no labor union equivalent to the Teamsters that represents truckers. Representing the trucking companies are the National Chamber of Trucking (*Cámara Nacional de Autotransporte de Carga* - CANACAR), which is active in the *Cuarto de Junto*, and the National Confederation of Mexican Transporters (*Confederación Nacional de Transportistas Mexicanos* - CONATRAM). Relevant public agencies include the Federal Trucking Agency (*Dirección General de Autotransporte Federal* - DGAF) and the Secretariat of Communication and Transportation (*Secretaría de Comunicaciones y Transporte* - SCT). Those entities can request meetings with the U.S. DOT to resolve cross-border administrative disputes, such as those that may occur in relation to the pilot program. During the NAFTA renegotiation, the common position of all of these actors, together with the *Secretaría de Economía* and *Consejo Coordinador Empresarial* (as the business coordinator of the *Cuarto de Junto*), was to maintain the original NAFTA agreement, including the trucking provisions of Annex 1.

That position appeared promising at the beginning of NAFTA renegotiations in 2017. Although the original draft statement of intent to negotiate from the USTR did not mention trucking, it offered as the general U.S. objective “to obtain fairer and more open conditions” of NAFTA services trade (USTR 2017c). The focus, which was maintained in the first official summary of U.S. objectives after the mandatory period of public comment, was on market access for U.S. exporters of services, not on preserving restraints on services imports (USTR 2017a). The revised objectives of August 2017 did express a willingness to “retain flexibility for U.S. non-conforming measures, including U.S. non-conforming measures for... long-haul trucking services” (USTR 2017b, 7), which implied more willingness to compromise than the United States had shown over much of the preceding two decades. To “retain flexibility” in the non-conforming measures was consistent with anything from continuing the existing pilot program to re-inscribing the original NAFTA commitments, which always maintained the “non-conforming” moratorium on the provision of truck services by Mexican carriers between points in the United States. The Mexican (and U.S.) proponents of liberalization never had any quarrel about that.

The flexibility of the USTR during the renegotiations with respect to cross-border trucking reflected the new reality of the industry. Cross-border commerce burgeoned under NAFTA: U.S. imports from, plus exports to, Mexico grew from \$81.5 billion in 1993 to \$525.2 billion in 2016, an increase of 544 percent (Villarreal and Fergusson 2017). Over 80 percent of that amount crossed by truck over the U.S.-Mexico border.¹² Protests against the

¹² This figure is from Federico Schaffler’s “World Without NAFTA” presentation at Texas A&M International University, March 30, 2017.

expansion of Mexican cross-border trucking, of the kind that the Teamsters staged in 1995 in Laredo, Texas, the most important point of entry, were unlikely to occur in the environment that prevailed more than two decades later.¹³ The American Trucking Association sees a shortage of qualified drivers, and its border-region affiliates such as the Laredo Motor Carriers Association sees it most acutely. Under the circumstances, the prospect of Mexican cross-border trucking posed no threat to their interests, and so the contrary case of the Teamsters, Public Citizen, and OOIDA lost some of its force.

What is more, the case of the American Trucking Association and its Mexican counterparts, particularly CANACAR, for re-inscribing the original NAFTA commitments gained force in consequence of the partial extent to which the United States honored them. The reciprocal allowance by the U.S. and Mexican governments of ownership of domestic trucking companies by each other's nationals has fostered the industry's integration. Cross-border integration has facilitated cross-border lobbying to maintain and expand integration. For example, Ernesto Gaytan Sr., owner of Super Transport International (STI), a trucking company with locations throughout both Mexico and the United States, is the Vice President of CANACAR. His son, Ernesto Gaytan Jr., represents STI in (and is president of) the Laredo Motor Carriers Association, which is itself a member of the American Trucking Association. So it happens that a quarter century after the inception of NAFTA, and even with its most conspicuous promises about trucking unkept, the coordination of lobbying by U.S. and Mexican trucking companies may be done practically (and sometimes literally) across the dinner table. By the same token, it happens that for practical purposes, there is only one degree of separation between the American Trucking Association and (by way of the *Cuarto de Junto*) the Mexican negotiators of NAFTA.

The final text of the USMCA (the new version of NAFTA) is not far advanced from the status quo at the beginning of the negotiations (an ineffectual pilot program and a de facto ban on cross-border trucking outside of the border commercial zone) in terms of reaching some sort of common ground among the ATA, CANACAR, and the Mexican government. But neither does it retreat from the U.S. commitment, and it holds out the possibility of further liberalization. USMCA Annex I states that "operating authority from the Department of Transportation is required to provide cross-border bus or truck services in the territory of the United States." It does not include a schedule, as did NAFTA Annex I, for the expansion of operating authority;

¹³ David E. Sanger, "Dilemma for Clinton on Nafta Truck Rule," *New York Times*, December 17, 1995.

but neither does it state that the authority must be given as sparingly as it is presently. In other words, it punts on the question.

Ultimately the United States obtained the “flexibility” it sought in Annex II, where it “reserves the right to adopt or maintain limitations on grants of authority for persons of Mexico to provide cross-border long-haul truck services in the territory of the United States outside the border commercial zones if the United States determines that limitations are required to address material harm or the threat of material harm to U.S. suppliers, operators, or drivers.” The ATA, CANACAR, and the Mexican government opposed this language but acquiesced to it in the expectation that “material harm” could not be demonstrated under any foreseeable circumstances. “Material harm,” they expect, will be construed to mean a significant loss of market share for the entire U.S. trucking industry to Mexican trucks providing cross-border long-haul services.¹⁴

If their expectation is right, then the flexibility in the trucking provisions of the USMCA will more likely work toward liberalizing cross-border trucking rather than restricting it. In that event, the cross-border integration of the industry and cross-border lobbying by industry representatives will have paved the way for the gains that were promised and yet proved to be impossible under the political economy of NAFTA.

8.3. NAFTA Renegotiations: The Case of the Automotive Industry

The automotive industry has become one of Mexico’s most dynamic and important industries. It is one of the main drivers of the national economy, contributing 3 percent of GDP in 2016 (Gobierno de Mexico 2017). The industry includes production of light vehicles, auto parts, and heavy vehicles (ProMéxico 2015). The production of heavy vehicles tripled in the decade following the 2008 global financial crisis. Auto parts became the most important automotive export. Of total production of light vehicles in NAFTA member countries in 2017, the United States accounted for 64 percent, Mexico 23 percent, and Canada 13 percent. As for light vehicles, Mexico became the seventh-largest manufacturer in the world and the third-largest exporter behind Japan and Germany (AMIA 2018; Oxford Business Group 2018; Secretaría de Economía 2017a; ProMéxico 2016). In 2019, the automotive industry accounted for 20.8 percent of the Mexican manufacturing sector’s share of GDP (INA 2020).

¹⁴ Correspondence between the authors and Melissa Huddleston, Executive Director, Laredo Motor Carriers Association; and Ernesto Gaytan Jr., President, Laredo Motor Carriers Association (including insert by Bob Costello, Chief Economist and Senior Vice President, ATA, November 30, 2018), September 27 and December 3, 2018.

An industry that is so important and relevant within North America had to be expected to take special interest in NAFTA's renegotiation (Secretaría de Economía 2017b). Understanding the industry's interests and how the numerous companies involved advanced their interests during the renegotiation by forming cross-border alliances requires a description of the industry's emergence and the relations among its productive units.

A key factor in shaping the development of Mexico's auto industry was the country's industry-specific trade policies (ProMéxico 2016). During the 1980s, a period of market liberalization that included Mexico's accession to the General Agreement on Tariffs and Trade, the government introduced the *maquiladora* program for cars and, in 1990, the *Programa Temporal para Producir Artículos de Exportación* (PITEX). Through these programs the Mexican government promoted domestic production for export by allowing producers to avoid taxes on the importation of raw materials, provided that the final product was exported. In 2006, the *Programa de la Industria Manufacturera, Maquiladora y Servicios de Exportación* (IMMEX) consolidated the two previous programs into an administratively easier program permitting the export of products with inputs temporarily imported without payment of tax (Klier and Rubenstein 2017; CEFP 2017). To this day, IMMEX remains in force and applies to other industrial sectors of the country, including textiles.

The more comprehensive liberalization under NAFTA accelerated the trends of the automotive industry's growth and vertical and international integration, which were already under way prior to the agreement. While total production of light vehicles in the NAFTA region increased from 15.68 million vehicles in 1994 to 18.2 million in 2017 (17.9 percent of global vehicle production), Mexico's share increased from 7 to 23 percent (CLAUT 2018; OICA 2017). Yet, light vehicles were not, and still are not, the most important automotive export as measured by value. The automotive supply chain consists not only of the finished vehicle manufacturer but also its parts suppliers, including original equipment manufacturers and their own parts suppliers, classified as Tier 1 and Tier 2. The links in this chain are produced, exported, assembled, and exported again. In 2017, Mexican exports of auto parts of all kinds amounted to \$65 billion, most of which exports were to the United States, while U.S. auto parts exports to Mexico amounted to \$24 billion (CLAUT 2018).

Practically all of the major worldwide auto producers are present in Mexico.¹⁵ The competitive advantages of the country include a qualified and technically adept labor force, competitive operational costs, agreements and

¹⁵ Tier 1 companies supply components directly to the original equipment manufacturers and offer the most advanced processes in the supply chain. Tier 2 companies provide components to those in Tier 1 and are less sophisticated.

treaties with more than 45 countries worldwide, a privileged geographical location near the U.S. market, an integrated supply chain, and ample export experience. These advantages have attracted the abundant foreign direct investment that has yielded further advantages and contributed to the industry's success. From 2013 to 2016, investment in the automotive industry in Mexico was \$14.8 billion, 22 percent of the total among NAFTA members (CLAUT 2018; Mexico Business Publishing 2017).

8.3.1. Interest Groups and Alliances

This economically successful automotive industry in Mexico also has a political side. Its leading private sector interest groups are the Mexican Automotive Industry Association (*Asociación Mexicana de la Industria Automotriz* - AMIA), created in 1951 as an agency of representation and conciliation with government authorities; the National Auto Parts Industry (*Industria Nacional de Autopartes* - INA), dating from 1962; and the National Association of Manufacturers of Buses, Trucks, and Tractor-Trucks (ANPACT), created in 1992. The Mexican Association of Automotive Distributors (*Asociación Mexicana de Distribuidores de Automotores* - AMDA), constituted in 1945, also warrants mention, although its interests are distinct because it represents car sales agencies and distributors and is more national than international in scope.

Another important group is the network of automotive clusters strategically located in eight Mexican states that resulted from the initiatives of state governments but are civil associations. The clusters are composed of business executives, governments, and academic institutions and are divided into committees and subcommittees such as supply chain, international trade, supplier development, operations, innovation, and so on. They aim to promote competitiveness and growth in the sector through collaboration, networking, and synergies through what is known as the "triple propeller."¹⁶ Although clusters did not have a direct voice in the NAFTA renegotiations, they were represented by AMIA, INA, and ANPACT in the Mexican *Cuarto de Junto* with coordination by the CCE. The networks and those participating in them have had an impact, as reflected in the comment by one interviewee for this chapter: "Metalsa [for example], as a Tier 1 automotive supplier, has helped these associations raise their voices, push, and do lobbying according to the needs of the business... for example on the issue of rules of origin" (interview with Luis Ibarra, 2018).

The lobbying alliances in which the likes of Metalsa participated to influence NAFTA were not only domestic. Mexican automotive associations met

¹⁶ Triple propeller is a type of organization that works through collaboration, connection, and synergy among government, academia, and business.

actively with their Canadian and U.S. counterparts. The AMIA and INA belong to the Council of Motor and Equipment Manufacturers Association (MEMA) in the United States,¹⁷ and the Automotive Parts Manufacturers Association (APMA) from Canada also participated in this alliance.¹⁸ These groups met every two months and sometimes more frequently in extraordinary circumstances.

The general interest of participants in the automotive industry in Canada, Mexico, and the United States alike is to consolidate the supply chain in the NAFTA region. Even though Mexico has a large auto industry, Tier 2 suppliers are few. The local content of components of Tier 1 suppliers ranges from just 10 to 30 percent (CLAUT 2018). The automotive associations have voiced a common interest in raising that number, reflecting the fact that while trade policy over the past generation fostered increased competitiveness, it also fostered a proclivity for collaboration.

Alliances that have helped the industry grow and become more competitive embody collaboration among producers of similar products. But they also embody collaboration between the automaker and the supplier. This collaboration is sought by the industry itself in the MEMA Council, as evidenced in the remarks of two prominent industry participants: “The value chain, customers and suppliers, assemblers, Tier 1 suppliers, Tier 2 suppliers... partnerships between companies has actually generated the successful case of the automotive industry in North America... [I]t is more than what we can do as an association or the government” (interview with Manuel Montoya, 2018); and “Our own carmakers have sought the development of local suppliers to try to lower their logistics costs and integrate national components in the supply chain of these industries” (interview with Luis Ibarra, 2018).

Regarding how alliances are created, the AMIA presents a special case, as it has pioneered collaborative cross-border lobbying. Eduardo Solís, AMIA president, explained that, unlike in Mexico, where there is only one association representing the interests of light automobile manufacturers in particular, the United States has three and Canada two such associations. Those of the United States are the Global Automakers, the Alliance of Automobile Manufacturers (Auto Alliance),¹⁹ and the American Automotive Policy Council.

¹⁷ Created in 1904, MEMA is the trade association for motor vehicle and mobility suppliers and parts manufacturers and remanufacturers in the United States. MEMA serves the industry as the voice of the motor vehicle and mobility supplier industry, speaking on behalf of the largest manufacturing sector in the United States (MEMA 2018).

¹⁸ APMA is Canada’s national association representing original equipment manufacturers of parts, equipment, tools, supplies, advanced technology, and services for the worldwide automotive industry.

¹⁹ Auto Alliance is the legacy representative group for the auto industry and represents 70 percent of all car and light truck sales in the United States.

Those of Canada are the Canadian Vehicle Manufacturers' Association and Global Automakers Canada. AMIA's close contacts with its multiple sister associations in both partner countries continued throughout the recent negotiations and continue still in their aftermath (interview with Eduardo Solís, 2018). They have formed in effect a lobbying chain corresponding to the associations' interlocking supply chains, helping to consolidate the North American automotive industry.

During the NAFTA renegotiations the lobbying chain was linked decisively to the *Cuarto de Junto*, where the AMIA had meetings with government authorities, members of Congress, senators, and even governors from specific U.S. states trying to create or consolidate partnerships and influence the form of the agreement. The meetings enabled the AMIA to have privileged access to information and agreements as well as a venue to discuss the present and future of the industry with government representatives. The CCE facilitated these exchanges by identifying the key players in the United States and drawing them into parallel meetings. Yet the Mexican private sector took the lead in Mexico's negotiations with key authorities in the United States even before their meetings at the *Cuarto de Junto*.

For instance, one of the AMIA's initiatives with its U.S. counterparts was to form a common front with the same goal to strengthen the industry. "Here for America," they branded it, and by way of that initiative they tried to influence NAFTA with a shared vision and rhetoric. The AMIA and its counterparts participated in discussions, formulated proposals, and advanced its proposals to the negotiating teams. In the United States, John Buzella, President of Global Automakers, was a leader in the coalition.

Meanwhile, the AMIA advanced its interests in collaboration with four major private groups in Mexico. First, it maintained a close relationship with the CONCAMIN, INA, and other business associations, including the CCE and ANPACT. Second, the AMIA made use of its relationship with the three levels of Mexican government: municipal, state, and national. An example lies in the special visits to governors that AMIA's president made once a month. Third, it strengthened its links to higher education, sponsoring research centers in the country and abroad for purposes of development of the automotive sector, and also scheduled meetings with academic institutions and research centers in Mexico every two months. Fourth, it conversed with the media to influence the news that the public received about the sector. Meetings with the media were held as workshops in an informal format (interview with Eduardo Solís, 2018).

According to private sector actors, cross-border collaboration among business associations in the country in the partner countries were decisive in the renegotiation of NAFTA.

8.3.2. Influence of Interest Groups and Rules of Origin

The collaborative relationship among producers in the North American supply chain fostered an allied response to the U.S. desire to change NAFTA rules of origin for the automotive industry, while also complicating the response. Existing NAFTA rules required vehicles to have at least 62.5 percent of their value manufactured in one of the three NAFTA countries in order to enjoy duty-free treatment. The U.S. goal was to increase the number to 85 percent so as to reduce imports of auto components from outside the NAFTA region—or even better, from outside the United States. (For some time, U.S. negotiators floated the prospect of a U.S.-specific content rule.)

The AMIA and its counterparts in Canada and the United States such as Auto Alliance lobbied to keep the rules unchanged. With little Tier 1 and particularly Tier 2 production in Mexico, the Mexican automotive clusters have imported a great deal of these inputs, and not only from Canada and the United States. Mexico mainly imports Tier 2 components from the United States, but also from Canada, China, Germany, Japan, and South Korea (CLAUT 2018). Nor have Canadian and U.S. producers imported all of their inputs from each other or Mexico. On the one hand, the automotive alliances had a vested interest in the status quo, including the continuation of substantial importation of components from outside North America. On the other, many alliance members, especially upstream producers, stood to benefit from more stringent rules of origin and the corresponding diversion of trade. The INA supported the position of the AMIA at the beginning, but later both diverged and adopted a position more amenable to compromise with the Trump administration, which the Mexican government came to see as presenting an opportunity for the automotive industry (interview with Alberto Bustamante, 2018). The renegotiation led to an increase to 75 percent North American value content with the support of the Mexican industry and private sectors. One Mexican automotive association leader and member of the *Cuarto de Junto* well expressed the ambivalent reaction to this decision: “Ideally, it would have stayed at 62.5 percent, but in a choice between 75 and 85 percent, 75 percent will always be better... and it will be better for Mexico because we are going to focus on the development of regional supply chains now and we are going to strengthen as a country” (interview with Alberto Bustamante, 2018). The *Secretaría de Economía* in consultation with industry leaders estimated that 70 percent of Mexican automotive exports to North America already complied with the stricter standard; another 10 percent would comply in little more than a year; and the rest would have to adjust during a transition period (interview with Guillermo Malpica, 2018).

In reaching this deal, the Mexican government, like its interlocutors in the Canadian, Mexican, and U.S. private sectors, sought to avoid damage to the regional supply chains that since 1994 have integrated ever more North American companies—and not only in manufactures of vehicles and parts. As one trade policy scholar observed, “It is not just a topic of duties and taxes when crossing the border, it’s a chain of logistics services that is generated each time a product crosses the border before turning into a final product” (interview with Jennifer Hillman, 2018). The comment points to how, in the case of automotive rules of origin, cross-border alliances of producers with a common interest in maintaining the NAFTA status quo were able to accommodate the Trump administration’s desire to renegotiate, and how they managed to get the Mexican government to do the same. Their interest lay in maintaining not only the high volume of automotive trade that has burgeoned in all three NAFTA countries over the past generation, but also the intra-NAFTA direction of that trade. The logistics services providers at the border would obviously have suffered from a U.S. exit from NAFTA, whereas they may not suffer at all from more stringent rules of origin. The same goes for manufacturing producers in the supply chain, especially the ones farther upstream.

The alliances came to an understanding that President Trump could have more stringent rules of origin and they could have more trade diversion, and these interests were compatible. The North American automotive industry’s interest was articulated in a common position and then adopted by the Mexican government because the cross-border integration of automotive production had already given rise to the industry associations that were the mechanism for understanding.

8.4. Conclusion

By reducing the importance of national borders in North America, NAFTA proved to be a turning point in economic relations on the continent and in the world. This chapter has aimed to show that it was also a turning point in political economy.

NAFTA yielded not only a greater abundance of goods and services produced in North America than would have been enjoyed otherwise. It also yielded closely integrated goods and capital markets and intricately criss-crossing value chains. The nature and economic implications of the integration have attracted a good deal of scholarly attention. The political economy implications have attracted less. Since NAFTA’s inception, the economic actors have lobbied the politicians who in turn have manipulated policy for the benefit of the formerly developed lobbying alliances in the same channels where their interests flow. As their interests flowed ever more extensively across borders,

so did their alliances. The political economy of trade policymaking turned into a game played by actors lobbying not only their own governments but also foreign governments by way of cross-border alliances, and then again lobbying their own governments with the information and resources gained from the effort.

In Mexico as in the United States there is an official institutional and legal framework for cooperation of private actors with the federal government in formulating trade policy. In Mexico the official framework has been more effective of late than in the United States. The dynamic of the NAFTA renegotiations involved the *Secretaría de Economía* and *Consejo Coordinador Empresarial*, counting on the participation of business associations and civil society in the *Cuarto de Junto* to understand and help determine the negotiating positions. Indeed, from the negotiation of NAFTA in the 1990s to the renegotiation beginning in 2017, there was increasingly active participation of the private sector in the economic policy of Mexico, such that the state was no longer the only principal actor. The private associations participating in the *Cuarto de Junto* were closely related to and even included Canadian and U.S. actors with common interests.

In the United States, the formal Industry Trade Advisory Committee framework for aligning private industry with government policy since the pre-NAFTA days was moribund. It was designed precisely to exclude foreign actors. The greater part of U.S. trade policy lobbying worked around rather than through it. The U.S. Chamber of Commerce, the Business Roundtable, and the National Association of Manufacturers were among the largest entities lobbying the U.S. government on trade policy. The chamber in particular was active in forming cross-border alliances to lobby more effectively. The North American Economic Alliance, which conjoins the U.S. Chamber with the Canadian Chamber and the Mexican CCE, is a salient case.

It is useful to think of the motives for forming cross-border alliances for lobbying purposes in terms of benefits and costs. The benefits lie in the resources and information that may be gained through the alliance to lobby more effectively both at home and in the foreign country. The costs lie in the impediments to communicating and sharing resources with would-be foreign allies. The tighter the preexisting production links, the greater the geographical proximity; and the fewer the other impediments, including even language, the lower the costs of participating in cross-border alliances.

This chapter has examined the allied actors and their interests, methods, and effectiveness in cross-border lobbying in two different NAFTA episodes. In the cross-border NAFTA trucking dispute dating from the early years of the agreement, lobbying worked more or less along the lines of the old pattern. Mexico's adamancy in seeing the free entry of Mexican trucks into the

United States was informed by its domestic motor carrier associations and U.S. opposition by the Teamsters and independent trucking owner-operators. More recently, the growth of border-region U.S. commercial service providers and their alliance with Mexican counterparts, with whom they have common interests and low costs of communication, presages a shift to the new political economy model described in this chapter.

The most striking illustration of the function of cross-border alliances for NAFTA lobbying is seen with respect to rules of origin in the automotive industry. There, more than anywhere else, supply chains are developed most extensively. Producers know well how to communicate with their counterparts in one country or another, whether they are in the U.S. Council of Motor and Equipment Manufacturers Association, the Mexican Association of the Automotive Industry, or some other association. What is more, the opening of renegotiations of rules of origin strongly motivated these associations to communicate. More stringent rules of origin sought originally by the United States had the potential to break the supply chains that gave the industry its dynamism under NAFTA.

The episode shows how cross-border alliances proved their worth, though the way the alliances played out introduces a cautionary note. Cross-border automotive industry alliances aided the Mexican government in finding common ground with the USTR not just despite U.S. protectionism, but also because of it. Within limits, more stringent rules of origin may further divert trade in a way that is advantageous to the alliances—and detrimental to U.S. consumers. The political economy game has changed, but not entirely.

After two years of renegotiations, the agreement succeeding NAFTA, the USMCA, was signed by presidents Enrique Peña Nieto,²⁰ Justin Trudeau, and Donald Trump on November 30, 2018. Ten days later, on December 10 at the presidential palace in Mexico City, Mexico's newly inaugurated president, Andrés Manuel López Obrador, Canada's deputy prime minister, Chrystia Freeland, and U.S. Trade Representative Robert Lighthizer signed an amended version with respect to environmental and conservation provisions, intellectual property, and labor regulation. In the months that followed, the agreement was ratified by all three countries with an effective date of July 1, 2020.

President López Obrador was a third-time candidate for the office during the electoral campaign of 2018. He represented *Juntos Haremos Historia* (a left-right coalition) and the *Morena* party. Mexicans hoping for a change and political transformation in the country gave him 53 percent of the vote. At the beginning of the campaign, López Obrador was a critic of NAFTA for reasons that mirrored President Trump's: it hurt Mexicans, he alleged, mainly

²⁰ Peña Nieto signed the agreement on the last day of his presidency.

the poorest. Later, López Obrador expressed the conviction that a new agreement would benefit all three member countries if it were properly negotiated.

That conviction was born during the political transition through cooperation between the outgoing and incoming Mexican administrations. López Obrador designated an experienced economist, Jesús Seade Kuri, to join President Peña Nieto's NAFTA renegotiation team. Seade stayed some months working and supporting the team in Mexico and the United States. He participated in all meetings with the private sector in Mexico, mainly members of the CCE and the *Cuarto de Junto*. He also joined the negotiation team in Washington. In short, by way of Seade, López Obrador was afforded a voice on the renegotiation team before he became president of Mexico.

To project the extent of Mexico's political transformation in the wake of the momentous 2018 election is beyond the scope of this chapter. For purposes here, it is worth noting that, to date, the transformation has accommodated rather than ruptured the cross-border lobbying alliances that accompanied the economic transformation of the preceding two-and-a-half decades.

Annex 8.1. Interviews

1. Alberto Bustamante, Foreign Trade Director at Industria Nacional de Autopartes (INA); active member of the Cuarto de Junto. Interviewed by Karla Nava, September 7, 2018.
2. Michael Camuñez, former U.S. Assistant Secretary of Commerce; President & CEO of Monarch Global Strategies, LLC. Interviewed by Federico Schaffler, September 20, 2018.
3. Angela Collins, Chair, Canadian Society of Custom Brokers. Interviewed by Federico Schaffler, September 20, 2018.
4. Reynaldo Gómez Leyva, General Director of Swift, Mexico. Interviewed by Karla Nava, November 30, 2018.
5. Jennifer Hillman, Professor of Law at Georgetown University. Interviewed by Karla Nava, August 9, 2018.
6. Luis Ibarra, North American Free Trade Coordinator at Metalsa (Tier1). Interviewed by Karla Nava, August 6, 2018.
7. Moisés Kalach, General Coordinator of Consejo Consultivo Estratégico de Negociaciones Internacionales del CCE; Coordinator of Cuarto de Junto. Interviewed by Karla Nava, November 12, 2018.
8. Jaime King, former President of the International Federation of Custom Brokers Association (IFCBA); current Vice Chair of the Private Sector Consultative Group at the World Customs Organization (WCO). Interviewed by Federico Schaffler, September 5, 2018.
9. Guillermo Malpica, Head of the Trade & NAFTA Office, Ministry of Economy, Mexican Embassy in Washington, DC. Interviewed by Federico Schaffler, September 20, 2018.
10. Manuel Montoya, General Director of Cluster Automotriz de Nuevo León (CLAUT), Mexico. Interviewed by Karla Nava, August 3, 2018.
11. Juan Carlos Sapién de Anda, President of Consejo Coordinador Empresarial (CCE), Chihuahua, Mexico. Interviewed by Gustavo Córdova, August 6, 2018.
12. Gerald Schwebel, Corporate Executive Vice President, International Bank of Commerce (IBC Bank). Interviewed by Stephen Meardon, August 7, 2018.
13. Eduardo Solís, President of the Asociación Nacional de la Industria Automotriz (AMIA); active member of the Cuarto de Junto. Interviewed by Karla Nava, October 16, 2018.
14. Manuel Sotelo Juárez, Vice President of the Cámara Nacional del Autotransporte de Carga (CANACAR), Chihuahua, México. Interviewed by Gustavo Córdova, September 6, 2018.

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Few propositions in economics are as widely accepted as the theory of comparative advantage: If two countries have a comparative advantage in the production of different goods and services, trade can be welfare-enhancing for both. But trade policy has always been controversial in Latin America, as it is not made by academic economists but by politicians who need to gather and maintain the support of constituents who in some cases have much to lose or gain from different trade policies. This book walks the reader through a complex thicket of contending interests and disparate political institutions to analyze why Latin American governments make the trade policies they do. Its chapters show how an array of different governments have attempted to navigate frequently conflicting interests and ideas, and how different institutional arrangements impinge on trade policy design and outcomes. It is to be hoped that the experiences analyzed here can inform the making of future policy—and, perhaps, help improve it.

