THE INSTITUTIONAL ENVIRONMENT FOR AGRICULTURAL TRADE IN THE FTAA

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INTRODUCTION

The Free Trade Area of the Americas (FTAA) is a free trade agreement that is under negotiation among 34 countries of the Western Hemisphere. The agreement, to be implemented in 2005, is expected to remove tariff and non tariff barriers to trade and investment among member countries, and to build more open, transparent and integrated markets. Negotiations are being conducted in nine separate groups, including agriculture, market access, investment, services, government procurement, dispute settlement, and intellectual property rights. An important role of the FTAA will be to reconcile the current proliferation of subregional trade pacts (Figure 1). Over 40 pacts are now in force, with at least a dozen more under negotiation (Stout and Ugaz, 1998).

An FTAA will advance the trend toward trade liberalization in the region that began in the 1980s. Over the past decade, many countries, including Mexico, Argentina, and Brazil, have implemented comprehensive policy reforms, which in general have made these economies more market-oriented. Their shift from import substitution toward outward-oriented trade regimes includes the adoption of significant tariff reductions, compliance with and entry into the GATT, and the negotiation of free trade pacts with neighboring countries.

An FTAA is expected to stimulate agricultural trade within the region (Figures 2 and 3). According to USDA (1998) estimates, the largest export value gains for agriculture would accrue to Brazil ($830 million), the Andean countries ($650 million), Canada ($480 million) and Argentina ($350 million). In percentage terms, the Andean countries would gain the most (10.2 percent), followed by Brazil (8.3 percent), Chile (6.5 percent), and Central American and the Caribbean (4.3 percent). The largest import value increases would be for the United States ($830 million), Central America and the Caribbean ($780 million), and the Andean

group ($580 million). In percentage terms, the largest increases would be for Central America and the Caribbean (19 percent), and for the Andean Group (16 percent), followed by Brazil (10 percent) and Chile (8 percent). Trade liberalization is also likely to stimulate investment and productivity growth throughout the region, and these dynamic gains are expected to further increase the benefits of trade liberalization, beyond those directly related to tariff reduction (Diao, Somwaru, Raney, 1998).

Figure 1: Main RTA's in the Western Hemisphere

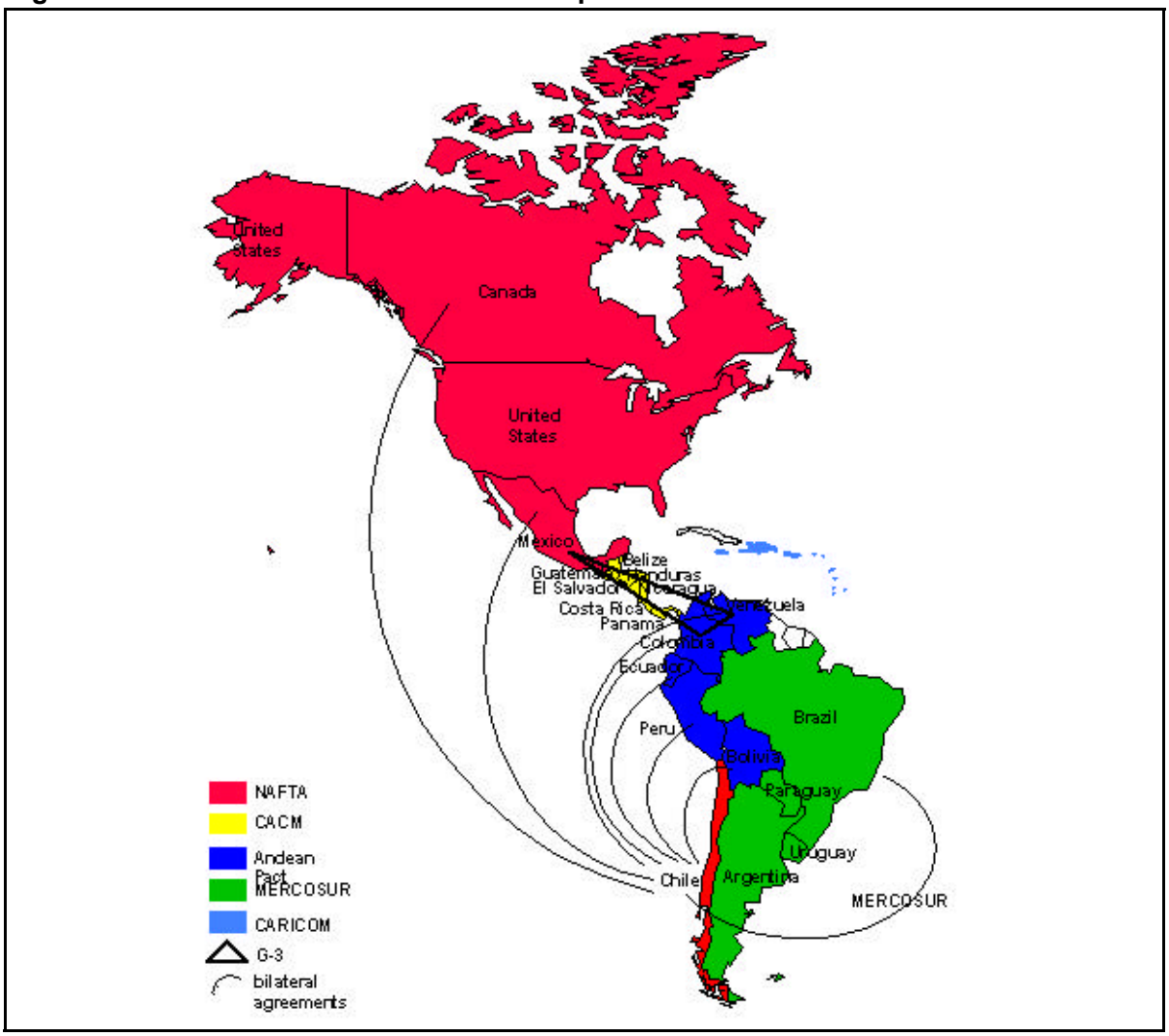


Figure 2: Change in Agricultural Exports under an FTAA

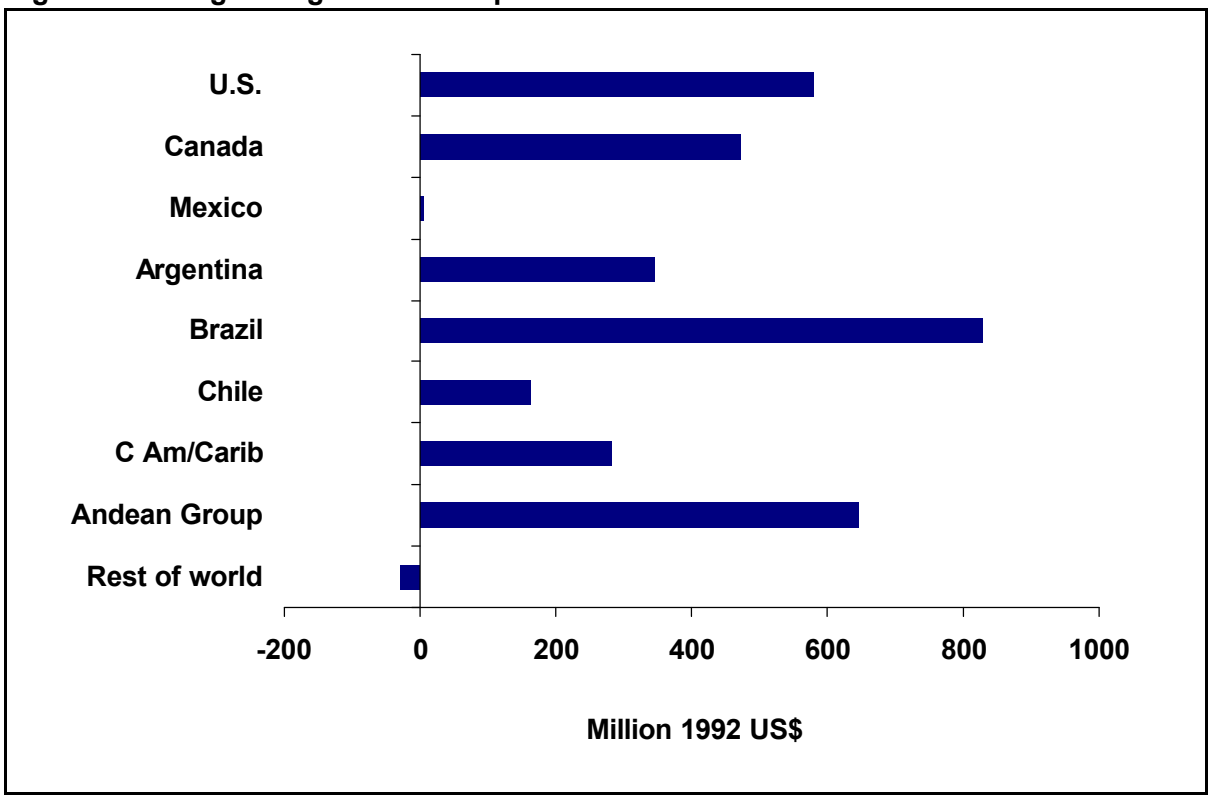
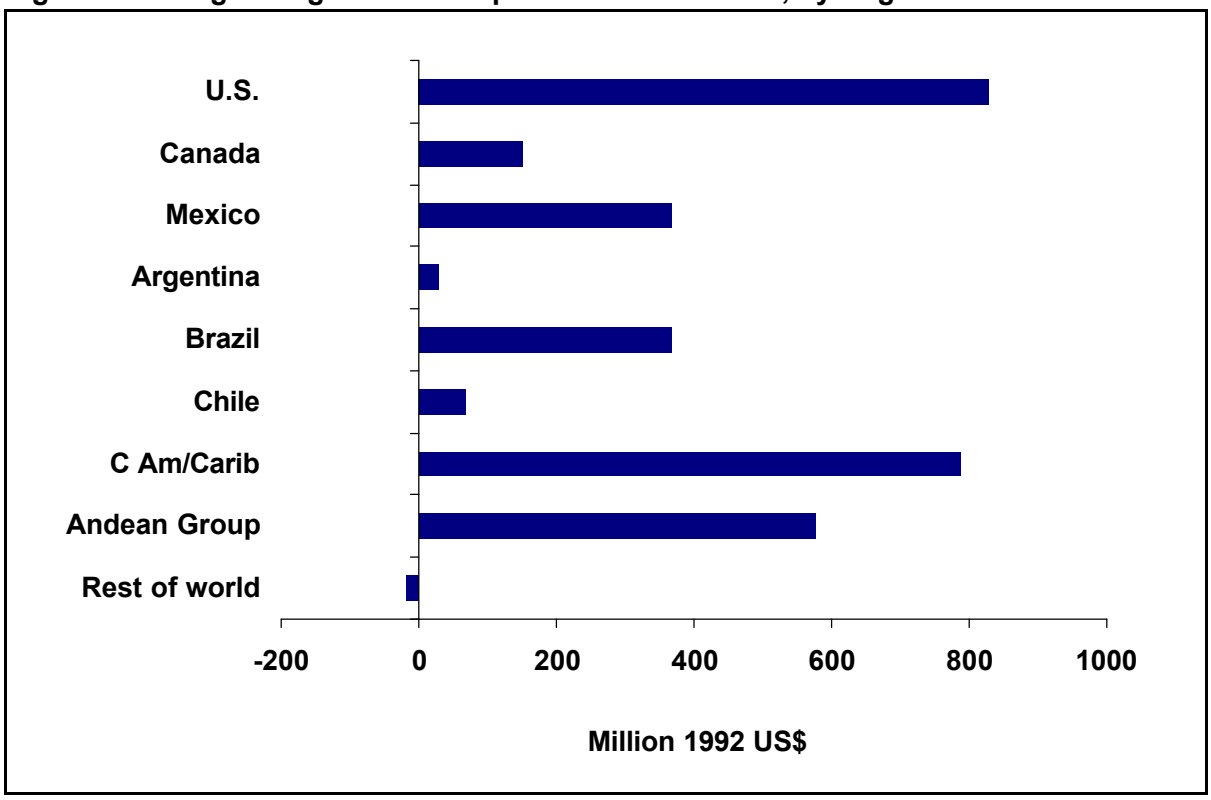


Figure 3: Change in Agricultural Imports under an FTAA, by Region



These expected gains from an FTAA are derived from a standard, neoclassical trade model. Some of the important assumptions made in this framework are that markets are perfectly competitive and that economic agents behave "rationally" in maximizing firms' profit or consumers' utility. In real life, firms must make the decision to enter or expand in markets with a different language, preferences, and business practices, where information on local markets conditions and reputations may be imperfect, and where foreign regulations and laws may be different than those applicable in the home market, or poorly enforced. Before a firm decides to engage in trade, it must invest in information. And before it enters a foreign market, it will probably also need to invest in technology. Firms may need to expand their production, and are likely to need to adapt their products to be competitive in global markets. The firm's decision to invest in information and technology will be influenced by its expectations regarding the security of property rights and contract enforcement in both home and foreign markets.

The effort and expense that a firm incurs to acquire information and to ensure enforcement of contracts are among its transaction costs. Institutions – the formal laws and informal social norms that constitute the "rules of the game" – largely determine the magnitude of these transaction costs. Transaction costs are likely to differ within the FTAA to the extent that institutions differ among countries in the Hemisphere. Transaction costs may change when a trade agreement changes the "rules of the game." Furthermore, firms' or agents' changing calculations of their transaction costs due to a trade agreement can lead to pressures for more institutional change, and perhaps to the development of regional institutions. This paper is about institutions in the FTAA that affect transaction costs in agriculture. It provides a comparative description of institutions in FTAA, and asks how these institutions are evolving, and if they are likely to reduce transaction costs and create incentives for firms to realize the expected gains from free trade under an FTAA.

TRANSACTION COSTS, INSTITUTIONS, AND THE FORCES OF CHANGE

In the framework of new institutional economics, the transaction is the basic unit of analysis. Williamson (1993) describes transactions as the transfer of a good or service across a technologically separable interface. One stage of activity ends and another begins. An example is the manufacture of a car, in which the manufacture of its parts is technologically separable, and may take place within a single firm, or across several firms.

In this system, transaction costs are the friction that can occur as the several components of a process are brought together, and they can slow the process like sand thrown into meshing gears. There are three sources of transaction costs: (1) imperfect information, (2) fixity of assets or sunk costs, and (3) the bounded rationality of humans (Williamson, 1989). Information on which a transaction is based is generally imperfect. The quality or performance of inputs are often unobservable or difficult to monitor, and the quality of output may be difficult to identify or evaluate. Transactions can also require that sunk costs be made in an asset

or technology by one party that, once made, cannot be converted to other uses without further costs. Bounded rationality refers to our human inability to fully process and use information, and our limitations in foresight and judgment (Simon, 1961).

From the institutionalist perspective, humans are not dispassionate maximizers, but "opportunists" who are motivated to advance their own interests at the expense of others. In the presence of opportunism, imperfect information, sunk costs, and bounded rationality set up an inherent conflict in the interests which each party has in a transaction. When information is asymmetrically held, there is an incentive for the knowledgeable party to behave opportunistically, by shirking in performance or output, by not being candid in their objective risk attributes (adverse selection), or by not taking due care when the liability is held by another (moral hazard). Once fixed investments are made by the principal in a transaction, it becomes vulnerable to subsequent demands for changes in terms by the contracting agent. And, while agents develop contracts based on their best, albeit imperfect, judgement, unforeseen circumstances can alter, ex poste, the costs and benefits of a transaction.

The costs related to imperfect information, sunk costs, and bounded rationality are transaction costs for firms. Since transaction costs can result in inefficient outcomes, it is in the interest of agents to devise mechanisms that are designed to limit these costs. These mechanisms are institutions. Ex ante, they attempt to screen economic agents for reliability. Ex post, they rely on credible enforcement by courts or arbitrators to resolve disputes. Institutions might also be called the 'rules of the game' (North, 1997). They are formal rules (laws, constitutions, rules), informal constraints (conventions, codes of conduct, norms of behavior), and the effectiveness of their enforcement.

Why do institutions change? Williamson (1989, 1993) argues that institutional change is an innovation that reduces transaction costs. He defines institutions as transaction-cost-minimizing arrangements, that will evolve with changes in the nature and sources of the transaction costs. Because an institutional environment is associated with certain kinds of transactions, the change in environment should give rise to a change in the nature of transactions, and vice versa.

North (1993, 1997) emphasizes the competition for survival in a world of scarcity as the motivation for agents to try to modify the institutional framework to improve their competitive advantage. Changes in relative prices are a common external trigger for change. In response to price signals, entrepreneurs consider whether to pursue that opportunity within the existing institutional framework, or consider how the costs of changing that framework compare to the benefits. Formal changes are legal – changes in laws or regulations; informal changes are changes in norms, conventions or personal standards. North argues that we can expect to see changes at the margin because larger changes generate a greater number of losers, making opposition to change more likely.

North (1993) describes these key aspects of institutional change:

- there is continuous, two-way interaction between institutions and organizations (firms, agencies, schools), the latter competing in an economic environment of scarce resources;
- competition forces organizations to invest continually to survive. Organizations invest in skills and knowledge that enhance their survival possibilities in an environment of scarcity and competition;
- the institutional framework dictates the kind of knowledge perceived to have the greatest payoff. If the highest payoff accrues to productivity increases, organizations will invest in skills and knowledge to achieve that objective. If it accrues to the players of bureaucratic games, skills will be developed in those areas.

INSTITUTIONS AND AGRICULTURE IN THE FTAA

This paper takes an agricultural focus, and considers important institutions relating to agricultural trade in the Hemisphere. It describes institutional change in agricultural trade and domestic policies, the developing mechanisms for signaling firm reputation and product quality, and the increasing security that regulatory changes have provided for investment in the Hemisphere. It is argued that these institutions are changing in ways that make it more likely that Western Hemisphere countries will achieve the expected gains from an FTAA.

Changing Agricultural Trade Policies

The FTAA region has been characterized by significant trade liberalization over the past decade. Until the mid-1980's, most Western Hemisphere countries provided substantial import protection for their agricultural sectors. In recent years, most have implemented significant trade reforms that include the agricultural sector. Some unilateral trade liberalization has taken place, notably in Mexico and Chile. For most other countries, trade liberalization has been closely linked to the development or resuscitation of subregional trade pacts. Some of these pacts are customs unions, in which the parties remove internal trade barriers and adopt common external tariffs (CET's). These pacts have had the effect of liberalizing internal trade, and reducing the countries' remaining trade barriers against outside countries.

MERCOSUR, the Andean Pact, and the Central American Common Market (CACM) are the three major customs unions now in effect in Latin America. The MERCOSUR agreement among Argentina, Brazil, Uruguay and Paraguay was fully implemented on January 1, 1995. The agreement provided for a common external tariff of 0 to 20 percent, with a zero-tariff on most products traded within the union. MERCOSUR achieved both free internal trade and a substantial reduction in tariffs against nonmembers. Prior to MERCOSUR, Argentina imposed agricultural tariffs of 0 to 38 per cent ad valorem, with about half of the products facing a tariff above 20 percent. Brazil's agricultural tariffs were much higher than Argentina's, ranging from 0 to 105 percent, with most products facing a tariff above 40 percent (Stout and

Ugaz-Pereda, 1998).

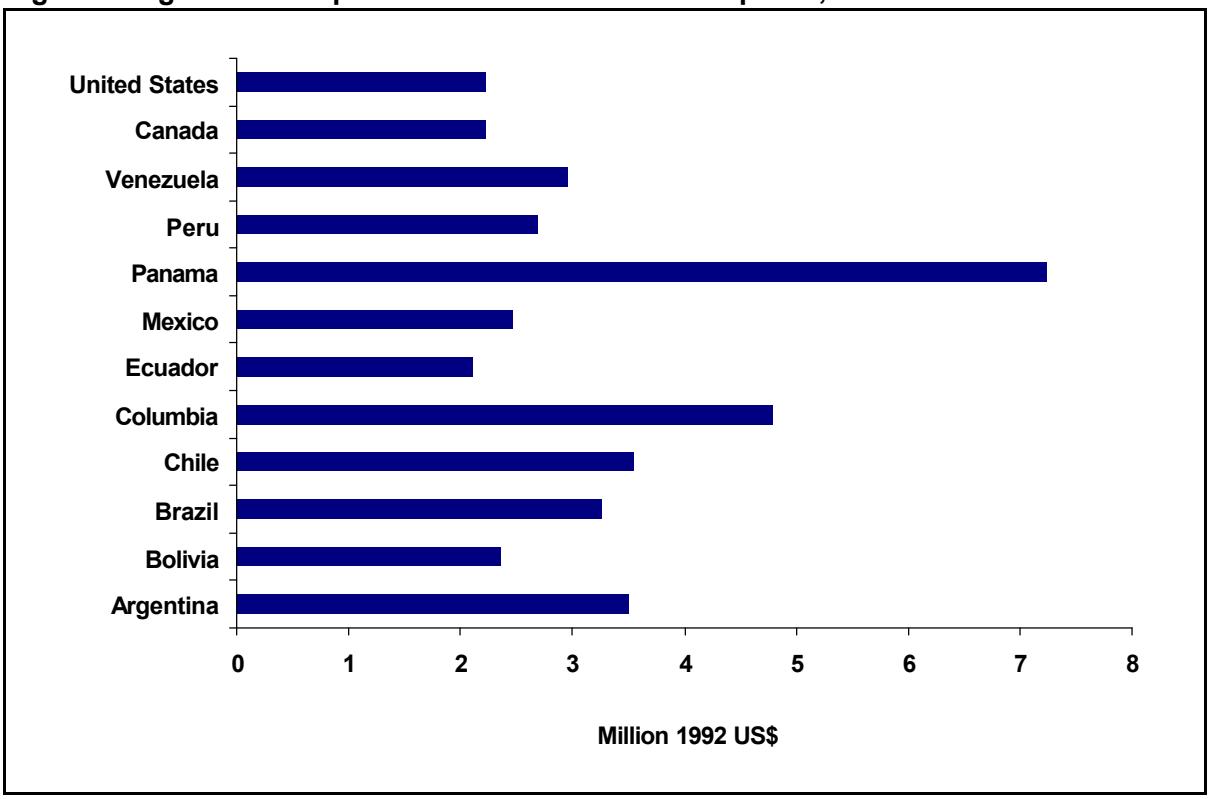
The Andean Pact, which includes Columbia, Ecuador, Venezuela, Peru and Bolivia, has been revived. Columbia, Ecuador and Venezuela implement a common external tariff (CET) that consists of four levels of tariffs: 5, 10, 15, and 25 percent. Peru is currently engaged in a dispute with the other Andean countries and is implementing a higher tariff rate, while Bolivia has a lower CET of 5 and 10 percent. The CACM, first organized in the early 1960's by El Salvador, Guatemala, Honduras, Nicaragua and Costa Rica, has also been revived. Under the negotiated CACM CET, most agricultural products are subject to tariffs of up to 20 percent, with about half of imported agricultural commodities subject to the highest 20 percent rate (Stout and Ugaz-Pereda, 1998).

The North American Free Trade Agreement (NAFTA), a free trade area in effect since 1994, has liberalized internal agricultural trade among the United States, Canada, and Mexico. The agreement addressed tariffs, nontariff barriers, safeguards, rules of origin and sanitary and phytosanitary barriers to trade (USDA, 1997). With few exceptions, the agreement provides for free agricultural trade within the region, although it permits a transitional period of up to15 years for some sensitive products. Under NAFTA, each member's tariffs against other countries remain in place. The United States and Canada both have relatively low import barriers, and the United States provides preferential access for many Latin American and Caribbean agricultural products through the Caribbean Basin Initiative and the Generalized System of Preferences. Mexico unilaterally implemented a substantial reduction in its trade barriers. Tariff rates fell and licensing requirements were liberalized beginning in 1986, after Mexico's entry into the GATT. Subsequent to NAFTA, Mexico has initiated bilateral trade negotiations with other countries in the Hemisphere, including Costa Rica, Chile, Columbia, Venezuela, and Bolivia.

In addition to trade pacts, the Hemisphere has numerous bilateral trade agreements in place. Many of these have been negotiated by Chile. Because of Chile's low, 11 percent ad valorem import tariffs, it has sought out bilateral agreements rather than joining common markets with higher CET's.

A consequence of trade policy reforms has been significant increase in the openness of agricultural markets in the Western Hemisphere. Figure 4 describes the openness of the agricultural sectors of twelve Western Hemisphere countries. Openness is measured as the ratio of agricultural trade (exports plus imports) relative to agricultural production in 1996, compared to the 1989-91 base period ratio (indexed to one). Latin American agriculture has become significantly more open in less than a decade. In particular, Panama's agricultural trade relative to output has increased more than seven fold in less than a decade, while that of Columbia increased five fold, and Argentina's increased three fold. More trade openness means that greater export activity and import competition are exerting competitive pressures on domestic production. The gains from trade liberalization are based on the structural change and efficiency gains that occur as producers and consumers respond to changing relative prices in more open economies.

Figure 4: Agricultural Openess in the Western Hemisphere, 1996



Domestic Agricultural Policies

In many countries in the Hemisphere, trade policy reforms have been accompanied by domestic farm policy reforms. While trade reforms were an effort to get market signals right, domestic reforms were in many cases designed to strengthen market price signals. Fixed and guaranteed prices, price floors, and retail price controls were used widely in the region. With these in place, domestic producers and consumers would have been insulated to some degree from the relative prices changes due to trade liberalization.

The region has moved toward reduction or elimination of domestic farm support, and a decoupling of remaining support from producers' decision-making (Table 1). Commitments in the Uruguay Round of the GATT provided a framework for farm program reforms. Under the GATT, developed countries were required to reduce their "amber" (domestic policies deemed most distorting of agricultural trade) agricultural support by 20 percent from the 1986-88 base year level over a 6-year period. Developing countries agreed to a 13 percent reduction over ten years, and least developed countries agreed not to increase their support from base year levels. Many countries in the region have gone far beyond their GATT commitments. In 1995, farm support expenditures by Argentina, Brazil, Canada, the United States, and Venezuela were substantially below their GATT/WTO reduction commitments

Table 1: Domestic Agricultural Policy Reforms in Selected Western Hemisphere Countries

Country	Domestic Farm Policy Reform
Argentina	Privatized state owned enterprises, eliminated marketing boards for beef, grain, sugar and dairy, eliminated export taxes on most agric. products.
Bolivia	Eliminated domestic subsidies.
Brazil	Privatized agricultural marketing boards, eliminated agricultural subsidies, guaranteed prices, government owned stocks, and export taxes.
Chile	Eliminated domestic subsidies.
Canada	Eliminated grain export subsidies, established revenue insurance programs, maintains supply management for poultry, dairy and eggs.
Mexico	Eliminated government control of agricultural markets, except nonfat dry milk. Replaced guaranteed prices and subsidies with decoupled payments to farmers.
United States	Adopted the FAIR Act in 1996 which replaces coupled payments with direct income payments. Support provided for sugar, dairy, peanuts and tobacco.

Source: USDA, *Free Trade in the Americas* (1998).

The credibility of domestic reforms is an important signal for producers. In the case of Mexico, one motivation for its entry into NAFTA was to lock in its domestic policy reforms, including a dramatic reform of its farm support programs. More generally, the opening of borders through trade pacts with neighbors removes a country's autonomy to reinstate support. As Sumner and Hallstrom (1997) argue, open borders place disciplines on domestic support policies by making them too expensive or ineffective to maintain.

Ex Ante: Signals of Reputation

All agents entering transactions take on the risk that their partners will be not be reliable in fulfilling the contract. And in some cases, the quality of inputs, or the degree of effort that is expended on fulfilling a contract may be hard to observe. Before entering a transaction, agents must therefore look for signals or measurements of quality and reliability. Knowledge of a firm's reputation, if accurate and obtainable at reasonable cost, lowers the risk of a transaction.

When business is conducted locally, the local business community is typically a sufficient source of information and reputation. It can also provide informal pressures for performance because firms that choose to underperform tarnish their reputations and suffer a loss of business in the longer run. But as transactions extend out from the community, and into the national and foreign markets, more formal institutions that provide reliable signals of quality and reputation become increasingly important. In the Western Hemisphere, these institutions are developing rapidly, as demand for better information has led to both public and private sector responses.

Regulatory standards in agricultural trade have often been treated as non-tariff barriers, but they also have a crucial, positive role to play. Increasingly, countries are viewing agricultural product standards as signals of reputation and

quality that will help them to expand their market opportunities. Exporters have much to gain from the recent developments on agricultural product standards in multilateral and regional pacts because the health and safety qualities of raw farm products are frequently unobservable. Exporters' compliance with these standards and regulations can provide scientifically-based signals regarding the quality of their products. The consumer reactions in the United States following reports of tainted strawberry imports from Mexico and poisoned grapes from Chile provide dramatic examples of the stake that all exporters have in participating in the development of internationally recognized standards.

There are three important, international institutions involved in setting standards for agricultural products, two of them under the umbrella of the FAO. The CODEX Alimentarius Commission implements the joint FAO/WHO Food Standards Program, which is designed to protect the health of consumers and to ensure fair trade practices. CODEX, with 163 member countries, has adopted a set of international standards that include the establishment of definitions and requirements for foods. The International Plant Protection Convention (IPPC), in effect since 1952, is an international treaty administered by the FAO to control the global spread of plant pests. Currently, 105 signatory countries adhere to IPPC principles. The IPPC is now being revised to reflect and meet the changing needs of plant protection and international trade.

A third multilateral institution is the Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures, established in the Uruguay Round of the WTO, as a new discipline regulating international trade in farm and food products. The purposes of the agreement are to protect the rights of countries to adopt trade restrictions to protect domestic animal and plant health and the environment, while ensuring that these measures are based on scientific assessment of potential risks. The agreement has proven to be a catalyst for a process of regulatory reform in importing and exporting countries (Roberts, 1998). In the Western Hemisphere, the United States, Canada, and Argentina have undertaken regulatory reviews that have led them to unilaterally modify their regulations to comply with the WTO agreement or as the result of bilateral technical exchanges.

Regional trade pacts have also contributed to the harmonization of agricultural regulations and standards. Under NAFTA, an SPS technical review committee was established to facilitate technical cooperation and to resolve disputes relating to SPS measures. The Committee has eight technical working groups, including animal health, horticulture and processed foods, food additives and contaminants, and inspection services. In addition to the work of the Committee, the three countries engage in technical cooperation to share information and engage in collaborative research relating to the establishment and implementation of standards. The SPS negotiating sub-group in the FTAA has the task of finding measures to facilitate trade that are in accordance with the WTO SPS framework.

As the share of processed products becomes more important in agricultural trade, the development of industrial standards becomes more relevant to the

agricultural sector (Table 2).

Table 2: Share of processed food in agricultural exports, 1996.

Country	Percent
Argentina	57
Brazil	66
Canada	43
Mexico	31
United States	41

Source: UN Trade Data

In industry, the level of development of national standards within the Hemisphere varies considerably (American Electronics Association, 1999). While the United States and Canada have well established systems for industrial product standards, Latin American countries are relatively recent entrants into this area. Mexico created an infrastructure for standards and measures in 1992 and, as its system develops, is planning to incorporate internationally recognized standards. Brazil is considered the Latin American leader in the development of standards, and the harmonization of these standards with those of the United States. The food processing industry is a key sector in the Brazilian effort to harmonize standards. Argentina's initiative, launched in 1994, has been undertaken jointly by the public and private sectors, and is being done in conformity with U.S. standards. The MERCOSUR trade pact between Brazil, Argentina, Uruguay and Paraguay as well as other subregional pacts in the Hemisphere include industrial standards-related provisions.

In international markets, an increasingly important signal of quality and reputation are the ISO standards for quality management, quality assurance, and environmental management. ISO is the International Organization for Standards, a voluntary, non-governmental organization established in 1947. The ISO 9000 series of standards (which includes the 9001, 9002, 9003, and 9004 quality assurance models) provide detailed procedures for ensuring quality at all stages of design, development, manufacturing, installation and servicing of products or services. The ISO 14000 series, introduced in 1996, addresses various aspects of environmental impacts. The standards apply uniformly to companies in any industry and of any size (ISO Easy, 1999).

The number of firms certified as ISO - compliant has grown rapidly in just a few years. In the United States, for example, the number of ISO 9000 firms increased from 220 in February 1992 to nearly 24,000 in January, 1999. In the Western Hemisphere, the United States, Canada and Mexico have the largest number of firms meeting ISO 9000 requirements (Table 3). At present, food processing firms represent just a small share of ISO 9000 firms.

Table 3: ISO 9000 companies in the Western Hemisphere, 1999

Country	Total number of firms	Food processing firms
Unites States	23,895	20
Canada	7,009	77
Mexico	1,015	12
Brazil	983	13
Argentina	66	2
Columbia	35	0
Chile	18	0
Venezuela	15	0
Peru	11	0
Panama	9	0
Costa Rica	2	0
Ecuador	2	0
Guatemala	2	0
Honduras	2	0

Sources: Quality Digest, 1999; Globus Registry, 1999.

Since many industrial companies now require ISO 9000 registration by their suppliers, this certification is rapidly becoming a requirement for firms seeking to do business in the international market. Certification as an ISO 9000 firm not only benefits the firm's customers, it also can impact the suppliers because of the firm's need for quality inputs. In this way, the ISO 9000 certification program for industries can have a significant impact on agricultural production. In Mexico, for example, an ISO 9000 corn milling firm found that ensuring a quality cornflour product depended on acquiring corn inputs of a reliable quality. The firm now works directly with farmers to ensure quality control for seeds, other inputs, and crop management.

Ex Post: The Protection of Investments

Once governments take credible steps to implement trade and domestic reforms, and the "right" prices are being more clearly signaled, firms face pressures to remain competitive in a more open economy. The key to survival is investment. Firms invest in human capital, and in new, improved, or expanded production activities. Firms' decisions about how to invest are governed by price signals; their decision on whether to invest is determined by their perceptions about the security of their investments, and the dependability of local institutions in protecting and enforcing their property and contractual rights.

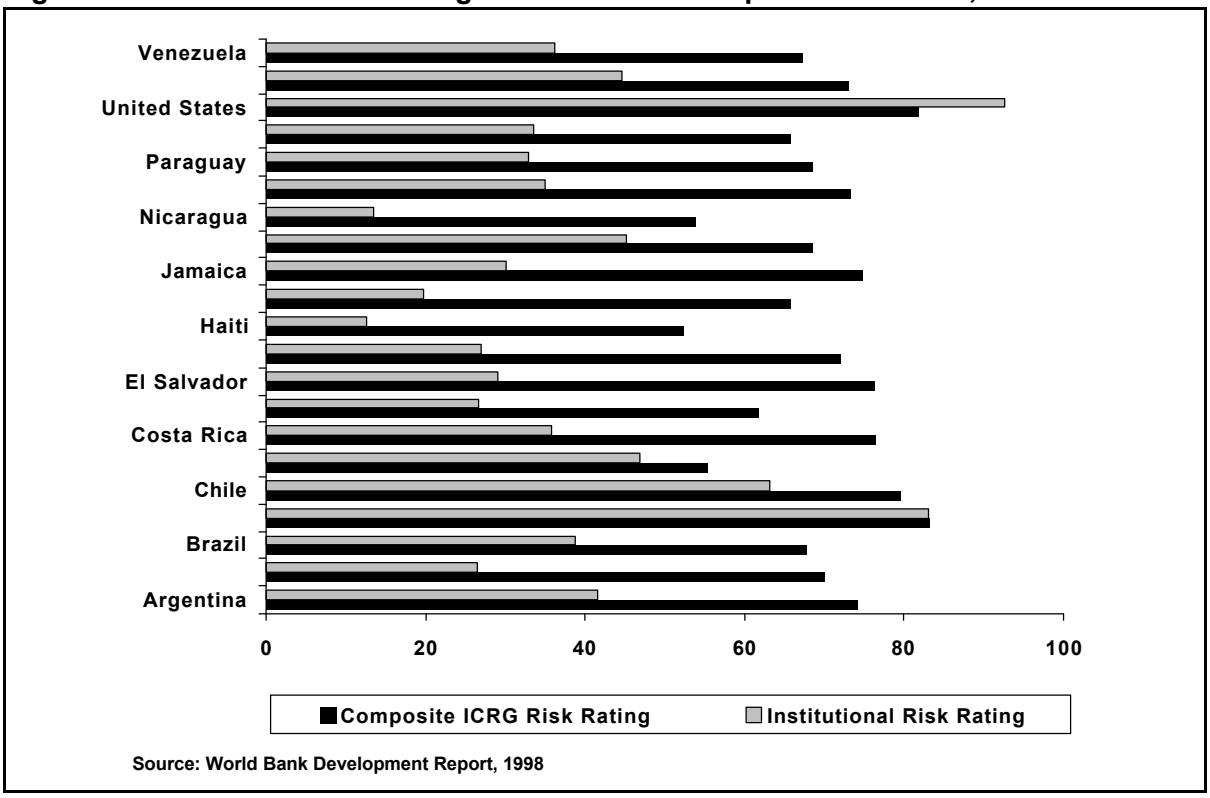
Two approaches to measuring the institutional environment surrounding the investment decision are the *Intercountry Risk Guide* (ICRG) and the more narrow, *Institutional Investor Rating* (IIR). The ICRG provides a composite measure of the legal, economic, and political institutional setting. It includes measurements of creditors' rights, equity shareholders' rights, contract enforceability in both the private and public sectors, and corruption in government. In most categories,

countries are rated from 0 to 6, and the categories summed in the composite index. The IIR measures the probability of a country's default on external debt. It is based on information provided by leading international banks, and can reflect prevailing market perceptions of credit worthiness.

The two measures are on a scale of 0 to 100, with higher numbers indicating lower risk. Because they measure different institutional aspects, they characterize countries differently. For example, in May/June 1998, the two measures exhibited a fairly low (0.55) correlation with each other. Nevertheless, both measures show that the risk environment in Western Hemisphere countries varies widely (Figure 5). On the IIR, scores ranged between 92 for the United States to 14 in Nicaragua. On the ICRG, scores ranged between 52 for Haiti and 82 for the United States.

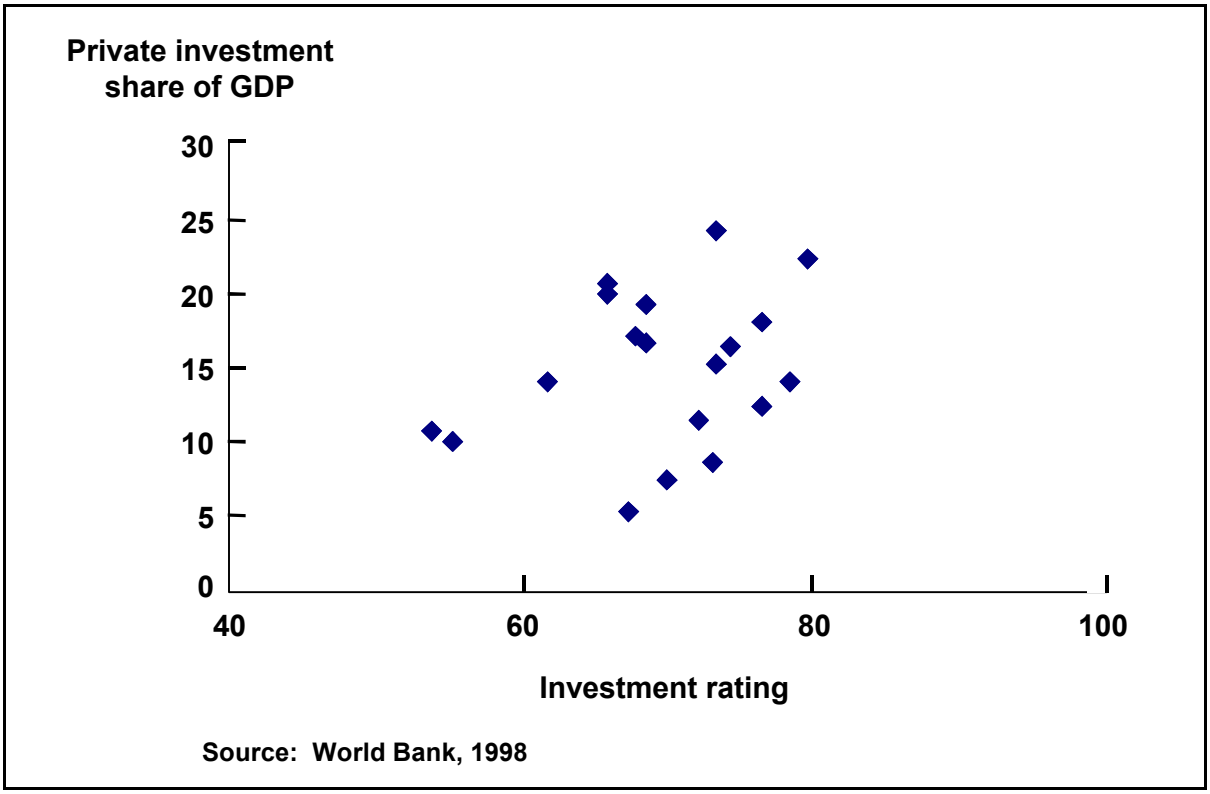
From the perspective of transaction costs economics, it would be expected that investment would be higher the stronger are the institutions that provide protection for property rights and ensure contract enforcement. Data for selected Western Hemisphere countries on private domestic investment as a share of GDP, and the ICRG rating provide some support for this (Figure 6). Countries with stronger institutional capacity for protecting investment tend to have higher relative levels of private domestic investment. Other factors, in addition to the institutional setting, are also likely have important effects on investment, particularly market demand conditions.

Figure 5: Investment Risk Ratings of Western Hemisphere Countries, 1998



Source: World Bank Development Report, 1998

Figure 6: Private Domestic Investment Share of GDP and Composite ICRG Rating, 1997/98

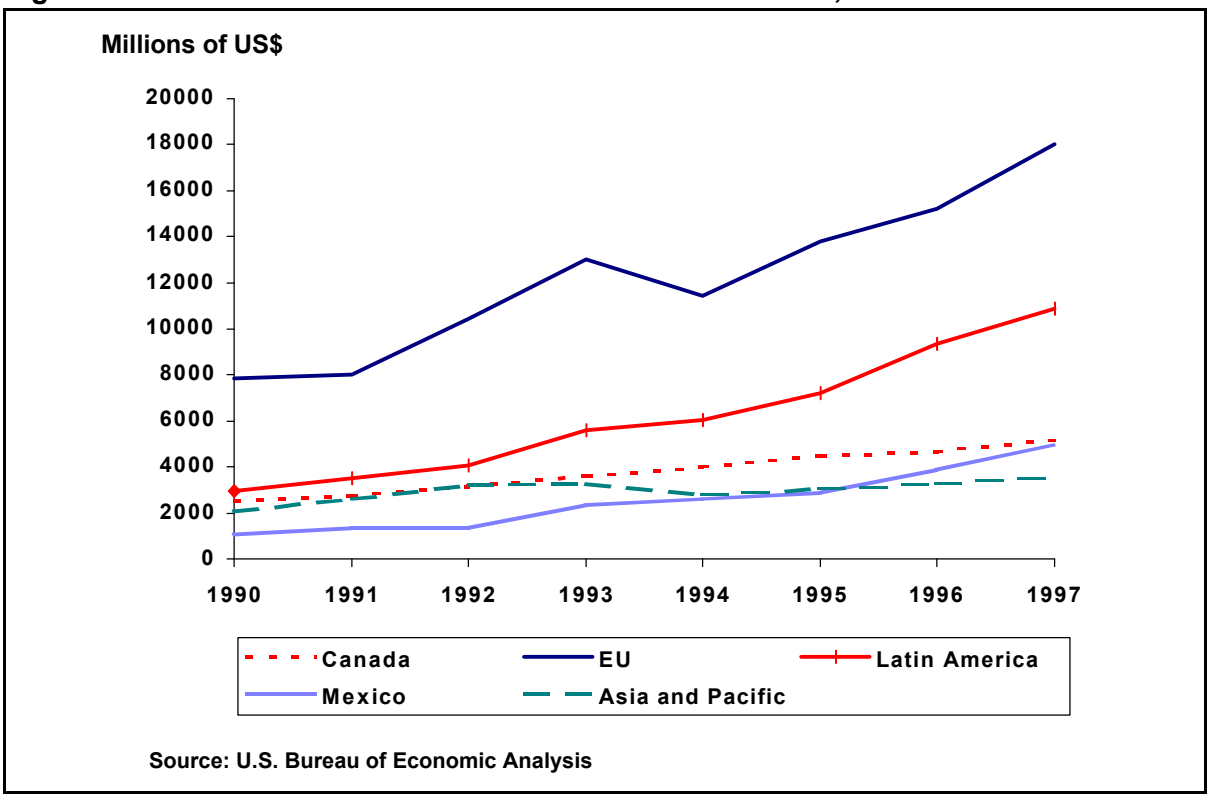


It might also be expected that, as market reforms increase business opportunities, there will be a demand for strengthening property rights and the enforcement of contracts, and that domestic institutions will tend to evolve to provide this. One example of this is the evolving treatment of foreign direct investment (FDI) in the Hemisphere. FDI has become an increasingly important channel for market integration and investment in the Hemisphere, and has certainly been stimulated by the action of several Western Hemisphere countries in liberalizing their foreign investment regulations (Bolling, Neff and Handy, 1998). Argentina liberalized its investment laws in 1993, eliminating registration requirements, and the waiting period for repatriation of profits and capital. New laws also give foreign investors full access to local credit markets. Mexico liberalized its investment laws in 1989, increasing the stake that foreigners are allowed to hold in Mexican enterprises. Canada and Brazil have also revised and liberalized their regulations on foreign investment. In addition, trade pacts have had an important role in strengthening investment protections. NAFTA, for instance, contains a number of provisions on foreign direct investment, including the right to third-party arbitration in investment-related disputes.

Stronger investment protection in the Hemisphere is an important factor in the rapid growth of U.S. FDI in the region (Figure 7). In the food processing sector, the US FDI position in the Western Hemisphere increased from $2.9 billion in 1990 to $10.8 billion in 1997 – representing an average annual growth rate of 38 percent. The fastest growth for U.S. FDI in Latin American food industries occurred in Mexico,

where the U.S. investment position increased nearly 50 percent per year between 1990-97. The U.S. investment position in Latin America grew much faster than in other regions of the world: the average annual growth in the EU was 19 percent, and in Asia was 10 percent.

Figure 7: U.S. Direct Investment Position in Food Industries, 1990-97



Source: U.S. Bureau of Economic Analysis

CONCLUSION

This paper provides a "new institutional economics" perspective in assessing the prospects for a Free Trade Area of the Americas. The FTAA, now under negotiation, will remove tariffs and other impediments to trade and investment in the Hemisphere, and is expected to result in increased specialization, trade, and economic welfare. Whether this will be achieved will depend on whether firms will respond to new opportunities in an expanded regional market.

This paper describes the many institutional changes that have been occurring in the region. Governments are "getting prices right" and strengthening market price signals through trade and domestic policy reforms that have been implemented over the past decade. Very recently, the further development of harmonized standards and regulations in agriculture and food processing, development of greater accessibility of reliable information on product quality, and the strengthening of institutions that protect investments promise to reduce the risks firms take in expanding into global markets. These institutional developments, which are occurring in advance of the 2005 implementation of the FTAA, are likely to build and solidify a regional

constituency for Hemispheric trade reform, and make it more likely that the full potential of regional free trade will be achieved.

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