2014

Latin America and the Caribbean
in the World Economy

Regional integration and value chains
in a challenging external environment

UNITED NATIONS

ECLAC

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Notes

The following symbols have been used in the tables in this publication:

- Three dots (…) indicate that data are not available or are not separately reported.
- A dash (-) indicates that the amount is nil or negligible.
- A comma (,) is used to indicate decimals.
- The word "dollars" refers to United States dollars, unless otherwise specified.

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Foreword

The 2014 edition of *Latin America and the Caribbean in the World Economy: Regional integration and value chains amid challenging external conditions* has four chapters.

Chapter I examines the main features of the international context and their repercussions for world and regional trade. In the first half of 2014, annual global output was expected to grow significantly faster than in 2013. However, successive downward revisions mean that the estimated growth rate is now hovering around, or slightly above, the 2013 figure (2.2%). The chapter also considers economic trends in developed countries, particularly the difficulties in the eurozone and the constraints that these impose on global economic growth. Developing economies are set to expand at a similar rate to 2013 (about 4.7%), led by East and South Asia, with China and India expected to grow by about 7% and 5%, respectively.

In 2014, world trade in goods and services will grow less than the 4% projected during the first half of the year. As in 2013, the volume of global goods trade is likely to grow more slowly than the global economy, contrasting with the pattern observed prior to the international economic crisis of 2008 and 2009, when exports expanded at double the rate of global output.

Regional exports are expected to grow only marginally in 2014, with export values gaining only about 0.8% after contracting slightly in 2013, while the value of imports is expected to slip by 0.6%. The lacklustre foreign trade performance is largely due to a drop in intraregional trade and slack external demand in key markets, chiefly the European Union. This is compounded by falling prices for a number of exports, especially metals, and lower export volumes in certain commodities and manufactured goods.

Chapter II looks at Latin American and Caribbean participation in global value chains and confirms that the region, with the exception of Mexico and Central America, has only limited linkages with the three major regional value chains of Asia, Europe and North America. The region is not a leading supplier of non-primary intermediate goods for these chains, nor is it a significant importer of intermediate goods from their constituent countries. Conversely, Mexico's intermediate goods exports to its partners in the North American Free Trade Agreement (NAFTA) include a sizeable proportion of medium-technology products. Nevertheless, Mexico's trade relations with its counterparts to the North are based mainly on the exportation of final goods produced using imported inputs, with little domestic value added.

This chapter also looks at how participation in value chains may contribute to more inclusive structural change, by analysing three core microeconomic aspects. The first is the distribution of power (governance), innovation and upgrading within value chains. The results of several case studies show that the region needs to build capacity in process and product innovation. A second aspect of value chains is the participation of small and medium-sized enterprises (SMEs), which is crucial for achieving greater inclusion. However, case studies in the primary sector show that many SMEs lack competitiveness, which prevents them from entering or remaining in value chains. A third aspect is the financing of SMEs engaged in value chains. Evidence shows that two of the main challenges facing these firms are complex trade credit application procedures and the associated collateral requirements.

Chapter III identifies various spheres in which regional integration and cooperation can help strengthen production integration between the economies of Latin America and the Caribbean. It concludes that the region's potential for diversifying its export and production structure is closely tied to the future of its integration process. Indeed, intraregional trade is typically more diversified and intensive in manufacturing products, has a higher technological content, is more accessible for SMEs, and thus creates relatively more jobs than trade with other regions. Consequently, it is an essential link not just for regional production integration, but also for national strategies to achieve structural change for equality.

Two core challenges emerge from this analysis, which must be addressed in order to make progress towards greater regional production integration. The first is to ensure that the region's enterprises are guaranteed full access to the enlarged market, which is a basic premise of any economic integration project. The second is to coordinate national industrial policies in a regional or subregional framework. The two challenges are closely related, in that industrial and trade policies will have to be closely aligned if strategies for promoting regional and subregional value chains are to be successful.

The fourth chapter explores the intra- and extraregional trade relations of the countries of the Caribbean Community (CARICOM) and considers how to strengthen production integration in the subregion by taking advantage of linkages beyond trade and building on commercial and production complementarities among the members. In this regard, the particular characteristics of the Caribbean countries, including the constraints imposed by their small size and island geography, result in significant heterogeneity which increases the cost of integration. The chapter also reviews the differences between the countries in terms of income, population and production and export structure, in a context of marked macroeconomic vulnerability.

The Caribbean countries need to address better the structural rigidities that prevent improvements to their production and export structures. The greatest difficulties reside in the need for full interconnectivity, trade facilitation and the full harnessing of technology to integrate production between the CARICOM countries. In addition, trade integration and development cooperation in CARICOM should be extended to the Greater Caribbean, especially Cuba, the Dominican Republic and Central America.

Summary

A. Adverse impacts of the weak international environment on Latin American trade

The steadily deteriorating global economic outlook is likely to dampen trade in Latin America and the Caribbean in 2014. Growth rates in developed countries are projected to show only a slight improvement over 2013. In the eurozone, the stagnation of the French and German economies caused growth projections to be revised down to less than 1%, while preliminary data for the second half of 2014 suggest that several eurozone countries could come perilously close to another recession. Meanwhile, Japan experienced exceptional first-quarter growth as consumers brought forward purchases ahead of a consumption tax hike in April, but this was followed by a plunge in economic activity as consumption subsequently slumped. Slight gains are expected over the remainder of the year, with Japan's growth rate for 2014 now estimated at about 1%. The United States economy contracted in the first quarter, but returned to growth in the second. Overall, the world economy in 2014 is expected to grow more slowly than was projected in July, at close to the 2013 rate (see table 1).

Table 1
GDP growth, 2010-2013, and projections for 2014 and 2015, as of July 2014
(Percentages)

	2010	2011	2012	2013	2014
World	4.0	2.8	2.3	2.2	2.8
Developed countries	2.6	1.5	1.3	1.1	2.0
United States	2.4	1.8	2.8	1.9	2.5
Eurozone	2.1	1.6	-0.7	-0.4	1.2
Japan	4.5	-0.6	1.4	1.5	1.4
Developing countries	7.7	5.9	4.7	4.6	4.7
China	10.3	9.3	7.7	7.7	7.3
India	9.6	7.3	4.7	4.8	5.0
Latin America and the Caribbean	5.5	4.3	2.9	2.5	1.8

Source: Economic Commission for Latin America and the Caribbean and United Nations Department of Economic and Social Affairs (DESA), *World Economic Situation and Prospects 2014, Update as of Mid-2014*, New York, 2014.

As a group, the developing economies will grow at a similar pace to that of 2013 (about 4.7%), led by East and South Asia. China and India are projected to grow at around 7% and 5%, respectively. However, as in developed countries, the outlook for these economies has darkened. This is partly because tepid demand from developed countries is acting as a drag on export growth in developing countries. It is also thought that developing countries could already be growing at close to their potential, while international financial conditions are worsening and commodity prices, with the exception of oil, are stabilizing. A slight deceleration in China, along with the authorities' goal of shifting the country's development model from investment and exports towards consumption, could sap demand for primary products from other emerging economies.

Slower growth in some emerging countries may also be explained by domestic factors such as the withdrawal of economic stimulus, supply constraints, ongoing structural reforms and complex political situations. The expected hike in the United States monetary policy rate by the Federal Reserve could also act as a drag on the growth of emerging economies from the second half of 2015. The higher monetary policy rate, along with a hike in long-term rates, could push up the cost of financing for emerging economies. The emerging countries that stand to be worst hit by harsher external conditions include those that run larger current account deficits, as well as those whose exports go in large measure to China. Accordingly, Brazil, India, Indonesia, South Africa and Turkey could be among the most vulnerable countries.

As the global outlook worsened over the year, the World Trade Organization (WTO) lowered its growth projection for global trade volume for 2014, from 4.6% in April to 3.1% in September.[1] This figure is a slight improvement over the rates of 2.3% and 2.1% posted in 2012 and 2013, respectively, but the performance over the past three years falls far short of pre-crisis levels, when exports were growing twice as fast as global output. These figures are also less

[1] See WTO, "WTO lowers forecast after sub-par trade growth in first half of 2014", press release, 23 September 2014 [online] http://www.wto.org/english/news_e/pres14_e/pr722_e.htm.

than half the average annual growth rate for global trade during the 20 years preceding the financial crisis (6.0%). Moreover, goods trade volumes grew more slowly than the world economy in 2013. World trade grew even less in value terms than it did by volume, as a result of falling export prices. Weak trade performance in 2013 is largely attributable to slack demand for imports in developed countries, partially offset by a modest increase in the demand for imports in developing countries. The eurozone, whose imports fell by almost 1% as a result of the recession, accounted for much of the decline in imports by developed countries. The ratio of world trade growth to world GDP growth plummeted after the economic crisis of 2008 (see table 2). Meanwhile, developing country exports to developed countries (South-North exports) fell in 2013 (see table 3).

Table 2
Ratio of world trade growth to world GDP growth
(Average annual growth rates in percentages, and ratio)

	Growth in global export volumes (A)	Growth in real global GDP (B)	Exports/GDP (A/B)
1960s	7.5	4.1	1.8
1970s	9.0	5.6	1.6
1980s	5.1	4.1	1.2
1990s	4.4	3.3	1.3
2001-2008	6.0	3.0	2.0
2011-2014	2.5	2.2	1.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from World Trade Organization (WTO) and United Nations projections for 2014.

Table 3
Growth in world trade between major country groupings, [a] 2010-2013
(Annual growth rates in percentages)

	North-North	North-South	South-South	South-North	World
2010	12.3	25.7	36.3	28.1	22.5
2011	15.2	18.6	32.5	21.4	21.0
2012	-4.6	0.8	12.0	17.7	4.8
2013 [b]	3.0	3.1	3.9	-0.4	2.6

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from United Nations Commodity Trade Statistics Database (COMTRADE).

[a] The group of countries of the North includes Australia, Canada, Japan, New Zeeland, the United States and the countries of the European Union and the European Free Trade Association (EFTA); the group of countries of the South includes the countries of Africa, Latin America and the Caribbean, the Community of Independent States, the Middle East and the countries of developing Asia.

[b] The information available for 2013 was completed using mirror statistics for a grouping of economies which represent 9.7% of total global trade: Bolivarian Republic of Venezuela, Hong Kong (Special Administrative Region of China), Iran, Libya, Nigeria, Qatar and United Arab Emirates, among others. Figures from COMTRADE at 8 September 2014.

Multilateral trade negotiations have reached a virtual stalemate. The Ninth Ministerial Conference of the World Trade Organization (WTO), held in Bali, Indonesia in December 2013, took place in a difficult context for the multilateral trading system, marked by the prolonged impasse of the Doha Round. Nevertheless, the ministers at the meeting adopted the "Bali Package", a series of decisions on trade facilitation, agriculture and development. These agreements are the most tangible result achieved by WTO in its capacity as a forum for negotiation since the initiation of the Doha Round in 2001. However, WTO members were unable to approve the trade facilitation protocol by the deadline set in Bali (31 July 2014), owing to opposition from India. As a result, the entry into force of the Bali Package is currently suspended. Consultations to overcome this impasse resumed in September 2014.

Recently begun plurilateral negotiations show that several WTO members are interested in exploring options to circumvent the blockages that have held up the Doha Round for a number of years. For example, March 2014 marked four years since the beginning of negotiations on the Trans-Pacific Partnership (TPP). Although it was initially hoped that negotiations could be concluded in two years, the inclusion of new countries in the process (Canada, Mexico and especially Japan) added to the complexity of the issues under consideration and resulted in the time frame being extended.

Negotiations on the Transatlantic Trade and Investment Partnership (TTIP) —aimed at creating a free trade area between the United States and the European Union— entered their second year in June 2014. Given that the tariffs on trade between the two parties are already relatively low (2% to 3% for most goods), the main objectives of TTIP are to reduce non-tariff barriers to bilateral trade and to achieve greater regulatory harmonization and compatibility between the systems currently in place in the two markets.

Negotiations for the establishment of a Regional Comprehensive Economic Partnership (RCEP) formally commenced in 2012 among the 10 member States of the Association of Southeast Asian Nations (ASEAN), plus Australia, China, India, Japan, New Zealand and the Republic of Korea. RCEP is the culmination of efforts by ASEAN to set up a larger integrated economic space between the aforementioned countries, through the creation of a free trade area. This process is potentially significant, since it includes all the main members of "Factory Asia". The RCEP negotiations are expected to be concluded by the end of 2015.

During the first half of 2014, the value of Latin American and Caribbean merchandise exports slipped by 0.3% against the year-earlier period. This change was the result of a 5.2% increase in exports by volume, and a 5.5% drop in prices. The value of imports also dropped by 0.6%, as a 2.2% increase in volume was not enough to offset a 2.8% fall in prices. The drop in export prices was widespread and occurred across all the subregions, but was felt particularly in the Andean Community.

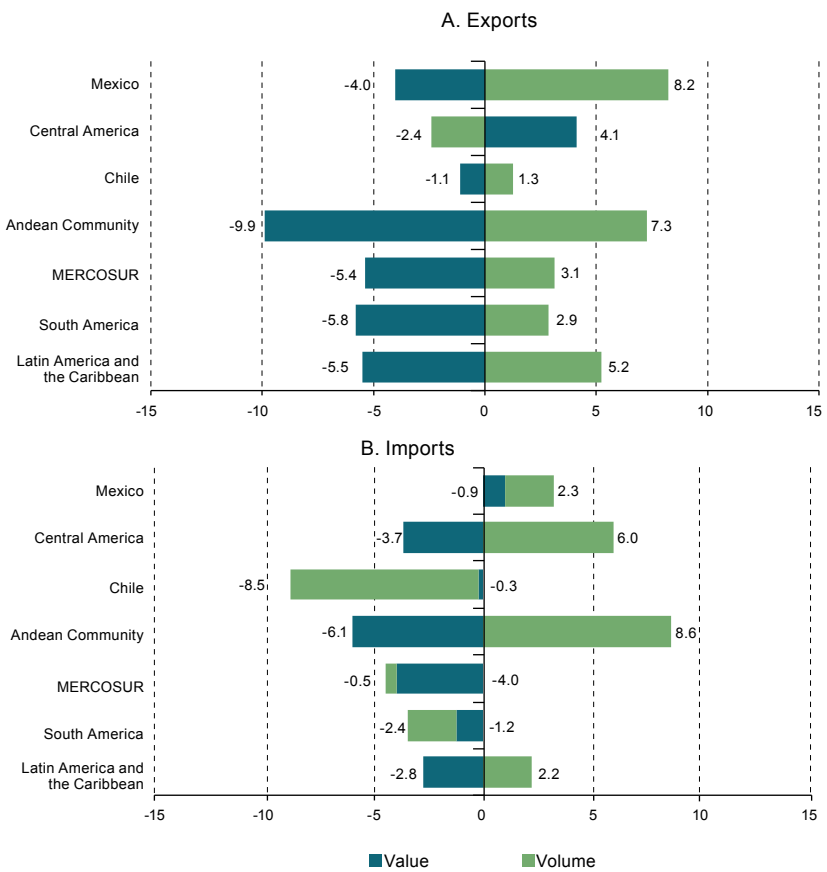
During the first half of 2014, goods exports to other countries in Latin America and the Caribbean, Asia (not including China) and the European Union, fell by 5.6%, 1.3% and 0.5%, respectively, in value terms, compared with the same period in 2013. The region's exports to China and the United States posted the fastest growth. The goods imports that declined most were again those from within the region and those from the European Union. Imports from China continued to grow at over 5%.

For 2014 overall, the region's exports are projected to grow by a modest 0.8% and its imports, to contract by 0.6%. This would represent a third consecutive year of slack growth in export values, a situation that is attributable mainly to sluggish external demand from within the region itself and from the European Union. Other factors behind this performance are lower prices for many items in the region's export basket, especially mined commodities, and falling export volumes in some of the region's core commodities and manufactured goods.

Figure 1

Latin America and the Caribbean: year-on-year variation in foreign trade by value and volume, January to June 2014

(Percentage variation)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the countries.

B. Participation and upgrading in global value chains

Following the analysis of the current international situation, the region's participation in world trade is now examined from a more structural perspective, looking specifically at its engagement in international value chains, especially intraregional chains. A general assessment based on data for international trade in intermediate goods confirms that, except for Mexico and Central America, the region has limited participation in the three value chains known as Factory North America, Factory Europe and Factory Asia. In fact, the region is not an important supplier of non-primary intermediate goods for any of these chains, nor is it a major importer of intermediate goods from the participating countries. Mexico is an exception, as medium-tech products represent a large share of its intermediate goods exports to its North American Free Trade Agreement (NAFTA) partners. All the same, the country's integration into Factory North America is based mainly on the export of final goods produced from imported inputs, with little value added domestically.

For a preliminary analysis of value chains in the region, data on bilateral trade can be combined with information from input-output tables to link the products exported by each country with the imported inputs potentially used to produce them. This analysis reveals significant differences between the Andean Community and the Central American Common Market in the textiles and clothing industries, although a common factor is the low level of linkages within each country grouping. Although the main Andean producers have ramped up their exports in recent years, these goods still represent a small proportion of national export baskets, unlike in the Central American Common Market.

Export destinations for the textile and clothing industries also vary considerably between the Andean Community and the Central American Common Market. Peru and Colombia export a large proportion of their products to South American countries outside the trading bloc, while the United States has declined significantly as an export destination (see figure 2.A). The Andean Community itself is also a major export destination for Colombia, in particular since 2000. Exports of textiles and clothing from El Salvador and Guatemala to the United States market, meanwhile, have surged, while the share going to the Central American Common Market has contracted sharply (see figure 2.B).

The analysis of imported inputs for the textiles and clothing exported by the Andean Community and Central American Common Market countries confirms that both trading blocs have little production integration in this industry. Most inputs come from outside the region, although this does vary. The main suppliers in 2012 to Colombia and Peru (the primary importers of textile inputs in the Andean Community) were the Asian countries (members of the ASEAN+3 grouping[2] and India, although the latter is included in the "rest of the world" category in the figures), whose share has increased dramatically since 2000 (see figure 3.A). With regard to the Central American Common Market, El Salvador imports a considerable proportion of its textile inputs from the United States, while Guatemala's largest source of these inputs is Asia (see figure 3.B). For Ecuador and the Plurinational State of Bolivia in the Andean Community, and for Honduras and Nicaragua in the Central American Common Market, trading partners within the bloc are major suppliers of textile inputs. However, given that these countries are not significant exporters of textile and clothing products (and do not import large amounts of inputs in value terms either), the backward linkages in the respective blocs are of limited importance.

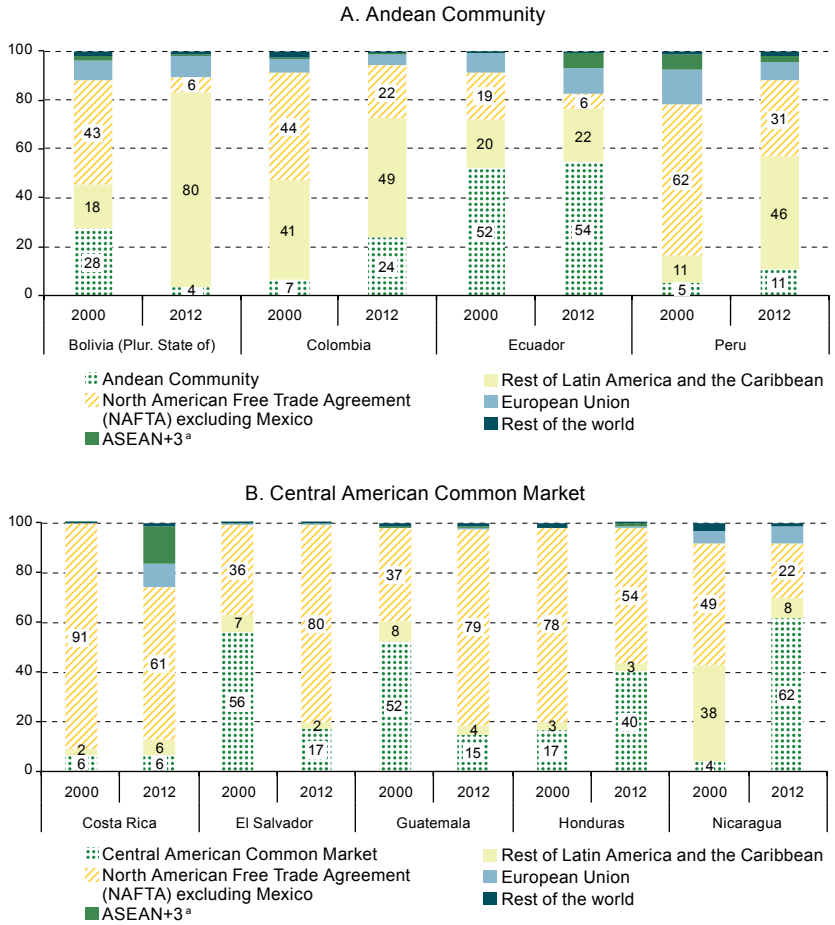
To complement the quantitative analysis set out above, a number of case studies are summarized which illustrate value chain development within the region. The way in which participation in value chains affects structural change, company heterogeneity, productivity and the creation of productive employment within a country hinges basically on three things: (i) the specific segment in the chain in which the company, sector or country participates, governance of the chain and the potential to upgrade to higher-value-added segments; (ii) the extent to which small and medium-sized enterprises (SMEs) participate in value chains and the role they play in them; and (iii) the facilities offered by the financial system, in particular to SMEs, to encourage value chain participation. These three aspects largely determine whether participation in regional or global value chains will have a positive, neutral or negative impact on development of the production system.

[2] The ASEAN+3 grouping comprises the member countries of the Association of Southeast Asian Nations (ASEAN) plus China, Japan and the Republic of Korea.

Figure 2

Andean Community and Central American Common Market: textile and clothing exports by destination market, 2000 and 2012

(Percentages of total textile and clothing exports from each country)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Statistics Database (COMTRADE).
[a] Association of Southeast Asian Nations plus China, Japan and the Republic of Korea.

Figure 3

Andean Community and Central American Common Market: textile imports by market of origin, 2000 and 2012

(Percentages of total textile imports from each country)

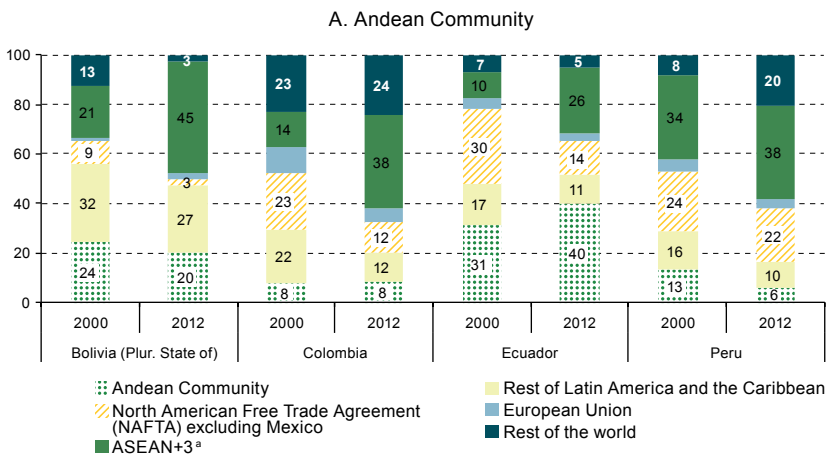
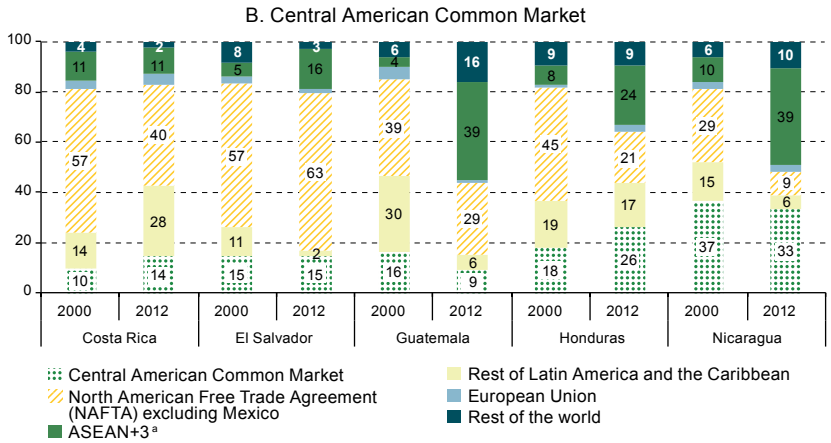


Figure 3 (concluded)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Statistics Database (COMTRADE).
[a] Association of Southeast Asian Nations plus China, Japan and the Republic of Korea.

Governance refers principally to the members of the chain with the most power and influence and to the incentives system, while upgrading indicates the possibility of moving up to links in the chain with higher value added through process or product innovation. Governance is addressed here via a chain assessment methodology, in which the agents participating in the chain and its governance are mapped out, and bottlenecks are identified where it is proving difficult to boost value added through innovation. In addition, international best practices are analysed and strategies are formulated. This methodology is applied to four Central American chains: in El Salvador, the shrimp farming chain and the synthetic fibres sportswear chain, and in Guatemala, the value chains of non-traditional export vegetables and timber products obtained from the forestry concessions of the Department of Petén.

Global business services in Costa Rica and pharmaceutical services in Mexico represent two other interesting examples of upgrading into higher-value-added segments. Costa Rica is a preferred location in the region for multinational corporations looking to set up subsidiaries and offer various kinds of international services. Costa Rica's integration into this chain represents the third phase of a strategy to attract subsidiaries of multinational corporations selling agricultural products, clothing, electronic goods, medical devices and international services. The number of multinational corporations operating in these sectors in the country has grown and their contribution to GDP is almost 6%. Costa Rica has managed to upgrade the business services chain by offering increasingly complex services. Simple tasks such as the services provided by call centres have been transferred to other Latin American countries and replaced by others of higher value added, thanks to capacity-building and learning undertaken by the local workforce.

Another example of upgrading in the services sector is that of Mexico and the highly knowledge-intensive services associated with the pharmaceutical industry. The country has recorded rapid growth in investment in clinical research over the past decade. The Mexican experience shows that the regulatory framework is a determining factor for establishing a sustainable offshore services industry and for participating in the value chains of advanced industries such as pharmaceuticals.

SME participation is another factor influencing the extent to which value chain participation is able to impact structural change with equality. SME participation in value chains brings many potential benefits, such as technology transfer, access to a wider market and higher productivity. However, value chain integration is not without risk for SMEs. In contrast to the large firms dominating the chains, they have less power to negotiate a reasonable margin and retain a portion of the value added generated in the chain. Two international agricultural value chains in which SMEs participate to a significant degree are the dairy sector in Costa Rica and the cocoa sector in Ecuador.

SMEs are deeply integrated into Costa Rica's dairy value chain. Several producer groups and at least five large firms are engaged in the processing and marketing of milk. One key player is Dos Pinos, a milk producers' cooperative which controls almost 80% of the country's milk stock. The cooperatives law in Costa Rica and the tax benefits enjoyed by the country's cooperatives mean that this and other smaller cooperatives can pay better prices to producers, thus encouraging production and associativity. Costa Rican firms have remained competitive despite the additional cost of complying with environmental protection measures by emphasizing that their product is environmentally friendly,

which is a key selling point in the international market. The competitiveness of its product has made Costa Rica the largest milk exporter in the Central American subregion.

Another agricultural chain known for its high proportion of small producers is the fine aromatic cocoa industry in Ecuador. The country is the largest producer and exporter of aromatic cocoa worldwide, accounting for 60% of global sales by volume. Furthermore, 90% of the country's cocoa is produced by 100,000 small and medium-sized producers. However, the benefits reaped by agricultural producers in those markets are eroded by a long chain of up to 10 intermediaries and by low relative productivity. A project was thus implemented to reinforce trade links between producers and buyers, which not only boosted farmers' income (see table 4) but also reduced poverty.

Table 4

Ecuador: impact of a programme run by the German Agency for International Cooperation (GIZ) to boost the competitiveness of some small producers in the fine aromatic cocoa export value chain, 2006 and 2010

(Dollars)

Producer association [a]	Type of income	Participating producers	Non-participating producers
KALLARI (590 Quechua families in the Amazonia)	Cocoa income	2006: 151 / hectare 2010: 473 / hectare	2010: 137 / farm
	Other agricultural income	2,097 / farm	1,242 / farm
APROCANE (430 producers in the Esmeraldas province)	Cocoa income	2006: 116 / hectare 2010: 457 / hectare	2010: 33 / farm
	Other agricultural income	3,696 / farm	2,004 / farm
FONMSOEAM (Afro-Ecuadorian organization in the Esmeraldas province with 610 members)	Cocoa income	2006: 750 / hectare 2010: 499 / hectare	2010: 344 / farm
	Other agricultural income	3,975 / farm	1,913 / farm

Source: German Agency for International Cooperation (GIZ), "Study of the impacts of value chain promotion on associations of producers in Napo. KALLARI case study", 2011.

[a] The producer associations KALLARI, APROCANE and FONMSOEAM represent 590, 430 and 610 producers, respectively.

Another factor examined is the facilities offered by the financial system to SMEs participating in value chains. Where SMEs have links with large enterprises in value chains, they can access more credit by either: (i) obtaining direct financing from large enterprises, or (ii) leveraging their connections to a large company in order to obtain bank loans.

Two case studies are presented as examples. The first relates to three sectors of the agrifood industry in Argentina: dairy cattle, broiler chickens and food-processing (mainly flour-based products). With regard to the dairy chain, La Serenísima (one of Argentina's largest companies) has set up a loan guarantee association, which offers commercial and financial guarantees and technical, administrative and financial assistance to its suppliers. A similar process was observed in the broiler chicken value chain.

The second case study concerns the furniture industry in Brazil. There are around 17,000 furniture companies all over the country, but one of the largest clusters is located in Serra Gaúcha in the State of Rio Grande do Sul. Commercial credit granted to the furniture producers in this region by large particleboard and veneer suppliers of Argentine, Brazilian, Chilean and Portuguese origin represents the most common type of financing among firms participating in this chain.

C. The contribution of regional integration to production integration

Value chains are rapidly gaining traction worldwide as a means of organizing production. Accordingly, the governments of Latin America and the Caribbean have identified strengthening production integration as a priority in their development agendas and in their regional integration agreements. The aim is to exploit the production complementarities between the countries involved and promote the participation of SMEs and, in general, companies based in relatively less developed countries. The aforementioned emphasis on production integration is driven by awareness of the region's persistent lags in terms of production and export diversification and in terms of achieving a territorially balanced distribution of production processes. South America, in particular, remains largely outside the global trend towards rising trade through multinational value chains.

The fact is that, for most of the region's countries, intraregional trade has characteristics that make it qualitatively superior to exporting to other markets. First, the regional market is the most favourable to export diversification since it absorbs the greatest number of export products (see table 5).[3]

Table 5
Latin America and the Caribbean (selected countries and subregions): average number of products exported to selected destinations, 2013

	Latin America and the Caribbean	United States	European Union	China
South America	2 312	1 149	1 204	308
Central America	2 141	1 034	479	120
The Caribbean [a]	824	792	404	57
Mexico	3 841	4 136	2 855	1 419

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United Nations Commodity Trade Database (COMTRADE).
[a] Includes Belize, Dominica, the Dominican Republic and Jamaica.

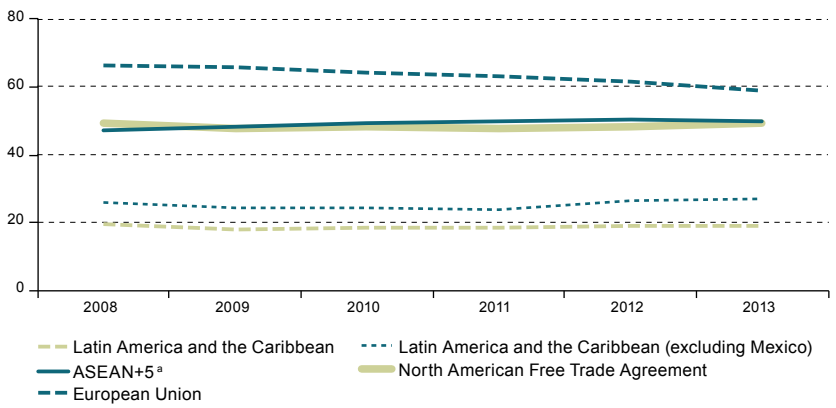
Second, the regional market is the main outlet for the medium- and high-technology manufacturing exports of most of the region's countries, often taking over 70% of these goods. In fact, the regional market's share of Latin American and Caribbean manufacturing exports has increased greatly in the last decade, notwithstanding the fact that the period also saw a major reprimarization of exports. The regional market is particularly important for intra-industry trade, which is typically associated with economies of scale, production linkages and technological externalities.

Third, the regional market is hugely important for Latin American export firms, which export in greater proportion within the region than to any other market, except in the case of Mexico.

Fourth, the regional market is also increasingly important from the perspective of foreign investment flows. The intraregional component of FDI rose from 4% of FDI inflows in 2000-2004 to 14% in 2012, although the figure is much higher in some economies.

Although the regional market has strong potential to boost production and export diversification, the region is not taking advantage of this. In 2013, just 19% of regional exports stayed within the region. This figure rises to 25% if Mexico is left out but, even so, the intraregional portion of total exports is far smaller in Latin America and the Caribbean than in other major regions of the world economy (see figure 4).

Figure 4
Selected groupings: intra-group exports as a share of total exports, 2008-2013
(Percentages)

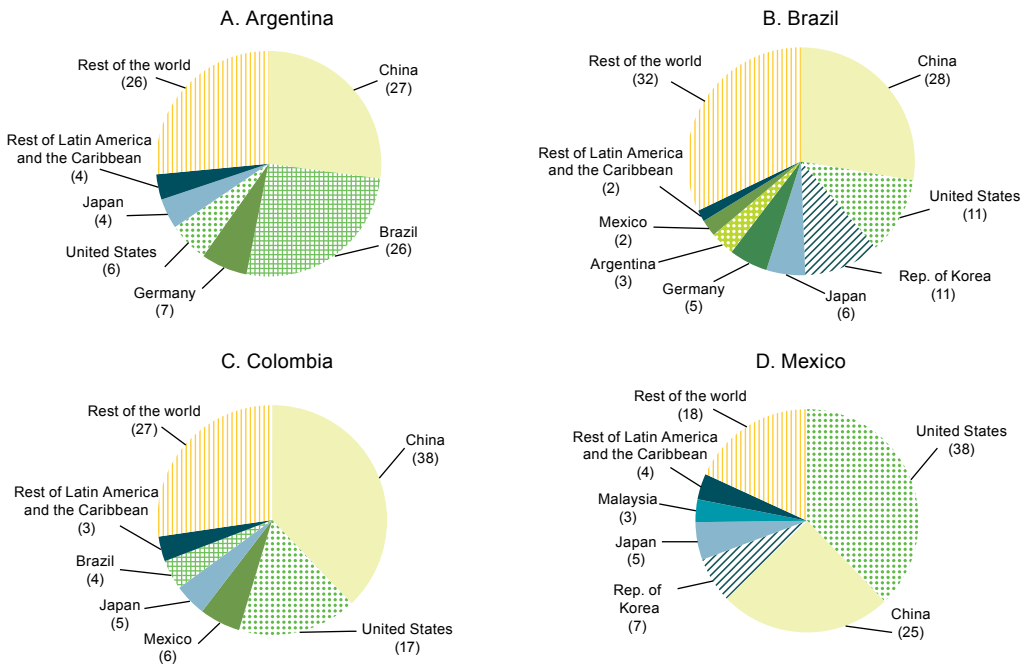


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United Nations Commodity Trade Database (COMTRADE).
[a] Includes the 10 member countries of the Association of Southeast Asian Nations (ASEAN) and China, Japan, the Republic of Korea, Hong Kong Special Administrative Region of China and Taiwan Province of China.

[3] The great exception is Mexico, which, given its close production ties with the United States, exports a higher number of products to that country than to the region.

Despite the high manufacturing density of intraregional trade, most of it consists of finished products, as the small share of intermediate goods reveals. Intermediate goods account for over 30% of the value of goods traded between the countries of "factory Asia" and for almost 20% between the member countries of the North American Free Trade Agreement (NAFTA), but for only 10% between the countries of Latin America and the Caribbean. This is evidence of a low degree of production integration between the Latin American and Caribbean economies. In fact, imports of parts and components by the region's largest economies originale mostly from extraregional suppliers (see figure 5).

Figure 5
Latin America (selected countries): distribution by origin of parts and components imports, 2013
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United Nations Commodity Trade Database (COMTRADE).

In short, for most of the region's countries, the most immediate opportunities for engaging with value chains lie within the regional market. There are three explanations for this. First, trade within value chains is particularly sensitive to distance-related costs. Second, the relatively high manufacturing density of intraregional trade suggests that it is the most conducive setting for establishing production linkages. Third, the bold regionwide expansion of the trans-Latins opens up similar opportunities, provided that those companies establish networks of local suppliers of goods and services in the countries where they set up.

The above analysis points to the need to start with a new understanding of integration, based on the competitive creation of value chains. That challenge far transcends the trade agenda. In particular, there is growing recognition of the crucial role to be played by a modern industrial policy in encouraging the transition to activities characterized by higher levels of productivity and greater knowledge-intensity, whether in the manufacturing, natural-resource or services sector. This can be done either through policies to strengthen existing comparative advantages or through policies to create new competitive advantages. Certainly, modern industrial policy needs to be responsive to the context the region is operating in, characterized by greater openness to trade and FDI and by the constraints some trade and investment agreements place on the use of certain instruments.

Pursuing a more active industrial policy does not mean neglecting the competitiveness of natural resource exports. On the contrary, the idea is for industrial policy to enhance these sectors, which can then be used as a lever to increase the complexity of the production base in general and avoid respecialization in primary production. Indeed, the likely expansion of global demand for materials, energy and food, especially in Asia, opens up unprecedented opportunities in the region. Making good use of these within the framework of a production transformation strategy

means each country retaining a larger share of the surpluses generated by natural resource exports and using these resources to enhance technological innovation, training and entrepreneurship.

The pursuit of greater regional production integration and stronger intraregional trade should not be taken as a call to raise trade barriers against the rest of the world. The new methods of organizing production in value chains are driving a natural process of segmentation, stimulating trade in intermediate goods. Accordingly, the net effect of measures to limit access to imports should be assessed with the greatest care. Specifically, such measures could undermine local competitiveness by making imported capital goods, inputs, services or technologies prohibitively expensive or complicating access to them. In short, the new import substitution must be genuine, that is, based on improvements in innovation and competitiveness and not on high levels of protection.

A number of national-level initiatives are being pursued in the region to stimulate the production of more knowledge-intensive goods and services with greater value added. These initiatives share several elements, including their strategic vision, selective nature, the active part they confer upon the State, the emphasis on internationalization, the important role of public-private partnerships and the pursuit of environmental sustainability, balanced territorial development and social inclusion. There are also similarities between some of the instruments used, such as programmes for supplier development, human capital formation and the improvement of financing for SMEs and innovative start-ups. However, these initiatives also present significant differences in terms of their institutional framework, timescales, specific objectives, operational modalities and instruments. Unquestionably, the region is going through a period of intense exploration of various industrial policy options, with each country guided by its distinct realities.

Industrial policy in the region has traditionally been formulated and implemented with a bias towards national objectives. However, if the aim is to promote cross-border production linkages, action at the national level alone may be insufficient and even ineffective (for example, if the countries involved in a given chain implement conflicting rather than mutually reinforcing policies). Accordingly ECLAC has proposed taking the first steps in developing industrial policies with some components that are multinational.

Two central challenges to greater regional production integration can be defined. The first is to ensure full access for companies based in the region to the expanded market. The second is to ensure the coordination of national industrial policies within a regional or subregional framework. The two challenges are closely linked: if strategies designed to promote regional and subregional value chains are to be successful then industrial and trade policy must be closely aligned.

Ensuring full access to the expanded market is a task that goes beyond removing traditional trade barriers. Indeed, the main obstacles to international value chains often relate to the high transaction costs of operating in several countries with different regulatory frameworks. Therefore, moving towards an integrated regional market involves a gradual convergence of regulatory frameworks in the areas that have the greatest impact on trade and investment flows.

The regulatory dimension of integration is inextricably linked to industrial policy, which typically employs a range of regulatory instruments. Consequently, making progress towards a regional market with common rules also implies moving towards the regional coordination of national industrial policies. However, that challenge must be addressed if the region is to position itself on the world map of value chains and exploit the full potential of its market. This is borne out by the experience of other regions.

A practical consideration is that it is not enough to formulate a good, coordinated industrial policy without also improving the capacity to implement it. This means building the technical capacity of the responsible government agencies and integration mechanism secretariats and allocating enough resources for action to have the desired impact. Monitoring and evaluation must also be enhanced.

Lastly, policymakers and the economic agents operating within the framework defined by such policies need to be in closer touch. In particular, if they are to promote competitive regional or subregional value chains, governments must maintain a fluid dialogue with the main actors in these chains: the business and labour sectors. This is necessary to ensure that production integration and industrial policy coordination initiatives adopted in the future will be relevant. The trans-Latins should play a pivotal role in that dialogue, given their strong position in the region and their ability to generate linkages with local suppliers.

D. CARICOM, fostering trade and production integration to boost external trade

This chapter analyses the intra- and extraregional trade relations of the member countries of the Caribbean Community (CARICOM), focusing on the need for greater regional integration of production by making the most of relationships that go beyond merely mercantile concerns. To this end, trade flows between the member countries of the grouping were examined to determine trade and productive complementarities.

The analysis focused on the multidimensional nature of the countries of the Caribbean and the particular features that define them, such as the geographical constraints of their small size and, often, island nature, which makes the subregion very heterogeneous. The fact that so many Caribbean countries are islands also makes integration a costlier process than it would otherwise be. Moreover, the disparities between countries in terms of income, population and the structure of their production and export sectors are a cause of great macroeconomic vulnerability (see table 1).

Table 6
Latin America and the Caribbean: measures of regional asymmetries, 2012
(Dollars, percentages and number of times)

Region, subregion or country	GDP per capita	Current account *(as a percentage of GDP)*	Share of Latin America and the Caribbean in total exports	Percentage share of extraregional trade
Latin America and the Caribbean	**9 510**	**-1.9**	**19.8**	**80.2**
Central America	4 233	-6.1	44.3	55.7
South America	10 335	-1.8	24.1	75.9
Caribbean Community (CARICOM)	4 307	-5.2	27.8	72.2
Organization of Eastern Caribbean States (OECS)	8 405	-17.1	49.5	50.5
Larger economies [a]	9 738	-4.3	24.2	75.8
Haiti	776	-4.6	2.8	97.2
Measures of asymmetries	**Percentage share**	**Number of times**	**Number of times**	**Number of times**
CARICOM/Latin America and the Caribbean	45.3	2.7	1.4	0.9
OECS/CARICOM	195.1	3.3	1.8	0.7
OECS/Latin America and the Caribbean	88.4	9.0	2.5	0.6
Haiti/CARICOM	18.0	0.9	0.1	1.3
Haiti/Latin America and the Caribbean	8.2	2.5	0.1	1.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Larger economies: Bahamas, Barbados, Guyana, Jamaica, Suriname and Trinidad and Tobago.

A further cause for concern in CARICOM is the heavy public debt burden —which in several countries exceeds 100% of GDP— that uses up resources that could otherwise be devoted to production activities. Another factor contributing to the precarious macroeconomic circumstances of the Caribbean has been the fiscal deficit, which was estimated to be over 3% of output in the four years from 2010 to 2013.

This macroeconomic vulnerability is compounded by the environmental risks faced by the region, notably its high level of exposure to natural disasters such as hurricanes, tropical storms, volcanic eruptions and earthquakes. The small island States of the Caribbean are also disproportionately exposed to the risks associated with climate change. Their geography and economic structure make them highly vulnerable to local environmental damage, such as the pollution of coastal areas, surface water and groundwater caused by inadequate waste management. Given the size of their economies and the minimum efficient scales required for certain solutions, subregional cooperation is all the more necessary. Furthermore, shared ecosystems such as the Caribbean Sea cannot be managed without concerted action for a sustainable approach to sea traffic, coastal tourism and fishing.

The circumstances described above, far from being isolated situations, constitute a set of interrelated factors that condition the development of Caribbean countries. For example, public debt often becomes more onerous in the wake of extreme weather conditions or natural disasters, as countries are obliged to take out successive loans to cover the extrabudgetary cost of rebuilding efforts, thus aggravating the fiscal deficit. This dynamic is compounded during periods of shrinking international demand.

This chapter reviews the state of regional integration in CARICOM and the Greater Caribbean, including trade relations with the Dominican Republic, Cuba and the other associate members of CARICOM, and identifies sectors with productive and commercial complementarity at the regional level. Although the CARICOM member States have made great strides in integration in the past 25 years by means of the mechanism known as the CARICOM Single Market and Economy (CSME), and have gradually removed barriers to the free movement of goods, services, capital and people, they have come up against obstacles in making the legislative amendments needed to implement all the agreements reached. The full implementation of CSME, which had originally been scheduled for 2015, has therefore had to be postponed.

The Organization of Eastern Caribbean States (OECS) is the fruit of the most advanced process of economic integration in the subregion. Progress made thus far has focused on implementing legislative and administrative commitments to the free movement of citizens and establishing a framework for the harmonization of labour laws. Common policies have also been formulated in the areas of agriculture, tourism, education and social safety nets.

Intraregional exports account for only 15% of total trade in CARICOM, and continue to be dominated by the larger economies, particularly Trinidad and Tobago, which provides 72% of such exports. By contrast, OECS member States account for only 5% of exports within CARICOM, although it must be borne in mind that intrasubregional trade within OECS is more even.

CARICOM has forged deeper links with the Greater Caribbean by stepping up cooperation and developing closer trade relations with Cuba, the Dominican Republic and its other associate members from the Greater Caribbean. Major progress has been made in its relations with all these countries, including the elimination of regulatory and administrative barriers to trade with Cuba, the granting of special and differential treatment to OECS countries, Belize and Haiti, and advances made in talks on expanding the list of products covered by the existing preferential trade agreement.

Productive and trade complementarity among CARICOM countries is a particular focus of analysis, since integration efforts to date have been largely pro-market and have not given sufficient consideration to a value chain and production integration-based approach. An analysis of bilateral trade flows among all CARICOM countries was conducted to ascertain the sectors and industries presenting the most potential for intra-industry trade and possible linkages.

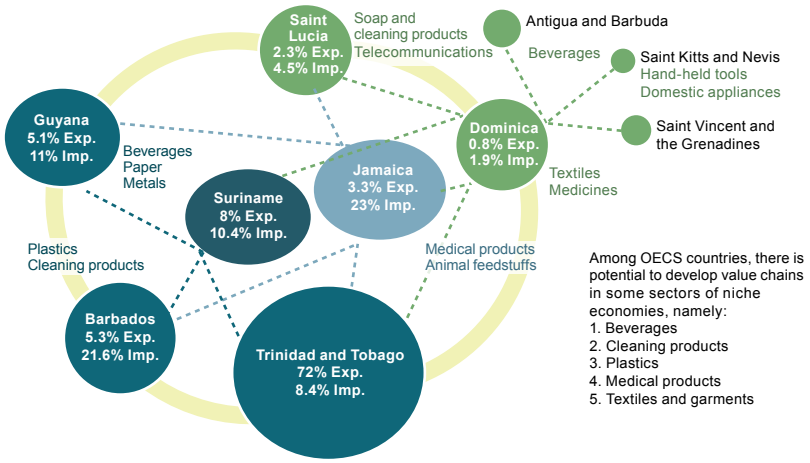
It was found that the closest linkages were between the largest countries and certain OECS countries. On this basis, three countries (Jamaica, Suriname and Dominica) were selected for case studies to identify the industries with the closest links and highest potential for production linkages, given the comparative advantages that these countries enjoy in bilateral trade.

Figure 6 provides a schematic overview of some sectors with high degrees of production linkages within CARICOM, concentrated in a small core of countries, particularly Suriname, Jamaica, Dominica, Saint Lucia, and some other trading partners within CARICOM. The sectors with the greatest potential are beverages, paper and paperboard and plastics cleaning products and toiletries, medical products and animal feedstuffs. The figure also draws attention to the importance of niche economies in the OECS countries.

The main destinations for Caribbean exports —in addition to the subregion itself, which is of great importance for the small island States of the OECS— are the United States, Canada and the European Union (see figure 7). Special emphasis is placed on the trade link with the European Union, since the signing of the Economic Partnership Agreement (EPA) between CARICOM and the European Union has brought a new impetus to integration within the subregion that could strengthen its institutions and regulatory framework in line with the new requirements of regional integration.

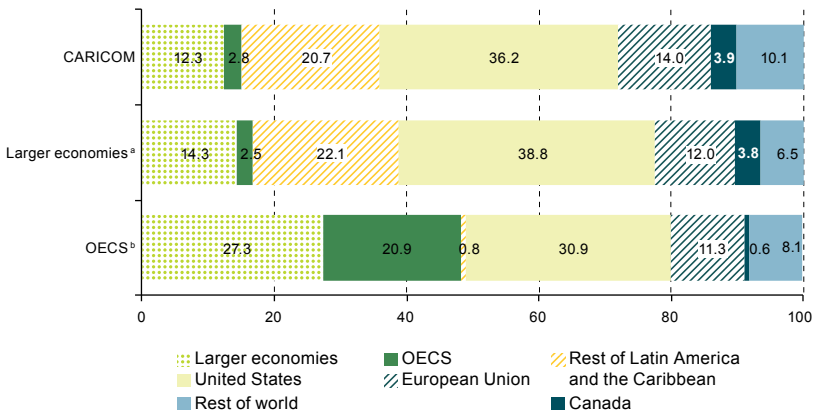
The major development in relations with the United States was the recent signing of the Trade and Investment Framework Agreement (TIFA). This agreement updates the system of unilateral preferences granted by the United States to the Caribbean countries under the Caribbean Basin Initiative and the programme of trade preferences for Central America and the Caribbean. It also modernizes trade relations by providing a framework for dialogue on greater cooperation, future negotiations and the deepening of relations on other topics of interest for CARICOM, such as trade and investment facilitation, multilateral cooperation, intellectual property rights, labour rights, social and environmental protection and the elimination of barriers to bilateral trade.

Figure 6
Caribbean Community (CARICOM): schematic overview of possible value chains, 2011-2012 [a]



Source: ECLAC, on the basis of information from the United Nations Commodity Trade Database (COMTRADE).
[a] The percentage share of its exports (Exp.) and imports (Imp.) in total CARICOM exports and imports is indicated next to each country.

Figure 7
CARICOM: breakdown of exports by trading partner, 2011-2013
(Percentages)



Source: ECLAC, on the basis of the COMTRADE database and information from International Monetary Fund (IMF).
[a] Larger economies: Bahamas, Barbados, Guyana, Jamaica, Suriname and Trinidad and Tobago.
[b] Organization of Eastern Caribbean States.

In October 2008 an Economic Partnership Agreement (EPA) was signed between the CARICOM countries and the Dominican Republic (as part of the Caribbean Group of African, Caribbean and Pacific States (CARIFORUM)) and the European Union. This is a North-South agreement binding two regions, one developed and one developing. Its focus is on trade in goods, but CARIFORUM was particularly interested in facilitating trade in services, investment and other trade-related issues, such as innovation and development assistance. Considering the Caribbean's diminished eligibility for international assistance and the reduction of preferential market access for small developing countries, the agreement is an instrument for continued European Union support for the diversification and the sustainable development of the economies of the Caribbean countries.

The economic slowdown in the eurozone countries has severely curtailed the trade benefits of the agreement, however. Nonetheless, some new products and goods that had been of limited importance have increased their market share, such as ferrous metal products, medications dispensed in doses, scrap aluminium and ammonium nitrate. The agreement has therefore given trade something of a boost. Meanwhile, goods such as petroleum gas, sugarcane, ethyl alcohol, and rum continue to lose market share.

A preliminary evaluation shows that Caribbean countries have not yet taken full advantage of the agreement, as it has so far failed to deliver the anticipated welfare gains. Empirical analyses have demonstrated that the country benefiting the most has been the Dominican Republic, as its exports are undoubtedly more competitive than those of the CARICOM countries. Moreover, Guyana, Saint Kitts and Nevis and Saint Lucia have all seen the number of commodities for which they enjoy a comparative advantage with the European Union fall. Studies show that without policies to improve production capacity and alleviate the infrastructure and logistics-based limitations that beset the subregion's economies, EPA is unlikely to have a significant effect on its exports. Further, several studies attempting to measure the fiscal and welfare impact of EPA on CARICOM countries have indicated that Caribbean economies are likely to experience significant declines in tariff revenues on imports from the European Union.

The small size of the CARICOM market and the low degree of trade complementarity between its economies also imply a need to enhance integration with other countries that are geographically close to the subregion and are its natural trading partners, particularly Cuba, the Dominican Republic and the Central American countries (including Panama). In view of this fact and the low level of trade with South America, ECLAC is promoting greater coordination among the Latin American countries to make use of innovative cooperation mechanisms to support the development of the CARICOM economies and their connection with Cuba, the Dominican Republic and Central America. This group of countries complement each other naturally by virtue of their relative import and export structures. The CARICOM member countries' small size, macroeconomic and environmental vulnerability, limited manufacturing base, heavy dependence on external markets and continued exposure to natural disasters mean that greater cooperation with Latin America is urgently required. Some of the region's more developed countries could join forces to carry out joint cooperation activities in areas of greatest need for the Caribbean so as to maximize the impact of such measures. The Community of Latin American and Caribbean States (CELAC) could play an essential role in establishing dialogue between the Caribbean and the rest of the region, with a view to identifying the main cooperation needs and to coordinating, monitoring and evaluating the actions resulting from this dialogue.

Lastly, despite the limited level of intraregional trade, the Caribbean countries do have the beginnings of intra-industry linkages within the subregion. These are important in some sectors, confirming the fledgling nature of regional value chains in CARICOM. Although the regional private sector has attempted to exploit existing differences in factor endowments as sources of comparative advantage and move towards the regionalization of production, the research conducted in this chapter has revealed significant untapped opportunities for trade in intermediate goods, the main building blocks of regional value chains. In this regard, the analysis undertaken here provides evidence of unrealized potential for production integration.

The value chain analysis conducted shows that there are areas in which the Caribbean private sector could forge production linkages. The findings, although merely indicative at this stage, show that Jamaica, Suriname and Dominica present strong regional intra-industry linkages within CARICOM, the potential of which remains largely untapped. The initial analysis also suggests the existence of a disparity in intra-industry linkages across CARICOM countries, with the OECS countries enjoying more opportunities for such linkages in their bilateral trade than with other CARICOM countries.

There is still unfinished business in terms of full implementation of the CARICOM Single Market and Economy and the OECS Economic Union. This means that, de facto, the movement of goods, services and capital is not as free as would be expected under such arrangements. Moreover, extraregional trade relations, even under preferential conditions enshrined in trade agreements, provide no guarantee that the desired increase in exports will actually occur. For this to happen, Caribbean countries need to address the structural rigidities that stand in the way of the necessary transformation of their production and export systems. The principal difficulties in this area lie in the need to achieve full interconnection, facilitate trade effectively and harness the benefits of technology so as to integrate production in the CARICOM countries. Moreover, trade integration and cooperation for development in CARICOM should be extended to the Greater Caribbean, especially to Cuba, the Dominican Republic and Central America.

Chapter I

Adverse impacts of the international environment on Latin American trade

A. Introduction

Global economic growth forecasts have been progressively scaled back since the beginning of 2014. As of September, the predominant mood is that global economic activity in 2014 will improve only slightly, if at all, in comparison with 2013. Of the main developed economies, only the United Kingdom is set to post significant growth (in excess of 3%), while the United States and Japan are likely to grow by about 2% and 1%, respectively. Any growth in the eurozone will be less than 1%. The available data for the second half of the year suggest that the eurozone is perilously close to another slump, with the German economy deteriorating sharply, France stagnating and Italy facing a new recession. Developing economies are also likely to see some deceleration. With the exception of India, all of the BRICS economies (Brazil, Russian Federation, India, China and South Africa) are likely to post slower growth, as are the Association of Southeast Asian Nations (ASEAN), the Commonwealth of Independent States (CIS), and Latin America and the Caribbean. Besides the structural challenges facing developed countries, which act as a drag on their growth, a number of one-off factors are darkening the global outlook. These include a drop in GDP in the United States in the first quarter and in Japan in the second quarter, financial market turbulence and armed conflicts in the Middle East and Ukraine. The economic sanctions imposed on the Russian Federation by the United States, the European Union and Switzerland seem to be weighing on growth expectations in Germany and, by extension, the eurozone as a whole.

As a result, several international organizations have shaved between 0.2 and 0.4 percentage points off their earlier global GDP growth forecasts. However, it is expected that global economic prospects will brighten somewhat in the second half of 2014. In short, global GDP growth for 2014 is expected to fall short of the 2.8% that was initially forecast in the first half of the year (United Nations, 2014a).

As a group, in 2014 the developing economies will probably grow at a pace similar to the one posted the past two years (about 4.7%), led by East Asia and South Asia. China and India are projected to grow at rates of 7% and 5%, respectively.

However, as in developed countries, the outlook for developing economies has darkened, with two trends weighing on growth. First, the poor performance of developed countries is a drag on export growth in developing economies. Second, it is thought that the latter could already be growing at close to their potential (World Bank, 2014), while international financial conditions are worsening and commodity prices (with the exception of oil) are stabilizing or falling. As a result, in 2014, the difference between the growth rate of the countries of the North and that of the countries of the South could be the smallest since 2002.

These trends are likely to impact global trade and foreign direct investment (FDI) flows. For 2014, it is expected that the volume of global trade in goods and services will grow at a rate of 4.1%, up from 2.5% in 2013 (United Nations, 2014a). This is still slower than during the pre-crisis period, when world trade was growing twice as fast as global output. Having performed weakly in the first half, trade is expected to pick up in the rest of 2014. Greater demand for consumer and capital goods should be particularly beneficial for exports from developing countries that specialize in manufacturing. Meanwhile, global FDI flows are set to grow by more than 10% in 2014 (UNCTAD, 2014). This growth is likely to be concentrated in developed countries, partly owing to uncertainties and vulnerabilities in a number of emerging economies. This shift represents a return to a traditional pattern of growth, after developing countries received larger FDI inflows than developed countries in 2011 and 2012.

The slow growth of the world economy is taking place in a context in which financial conditions remain favourable. Until mid-2014, the monthly tapering of asset purchases by the United States Federal Reserve had no impact on developing countries' access to finance. This is partly because most developed-country central banks confirmed that they would continue to keep their interest rates low for some time. China's stable growth in the first half of 2014 has also calmed the financial markets. Nevertheless, the value of cross-border financial flows in 2012 was down 70% from its pre-crisis peak of mid-2007, having fallen from 21% of global GDP to 5% of global GDP. That is even lower than in 2002, when the world was recovering from the dot-com bust.[1]

[1] Much of the reduction in financial flows is due to the bursting of the global credit bubble and the deleveraging of the financial system. The drop in global financial flows may largely be explained by the slump in cross-border lending (down 96%), which fell from US$ 5.8 trillion in 2007 to just US$ 235 billion in 2012. Most of this decline was between developed economies, notably within Europe, while cross-border lending to emerging markets decreased by 80%, from US$ 750 billion to US$ 140 billion (McKinsey Global Institute, 2014).

This chapter examines —in addition to the global scenario— the situation of the main developed economies (section B) and the outlook for emerging countries (section C). National economic trends in world trade and major recent developments in the sphere of multilateral and plurilateral trade negotiations are also addressed (section D). The chapter concludes with a section on international trade prospects for Latin America and the Caribbean.

B. Slow growth in the three main developed economies

Four years after the global economy began to recover from the financial crisis, most developed countries have still not managed to leave behind their lacklustre performance. Leading composite indicators reveal a degree of stagnation in the United States and the eurozone, and a weakening of activity in Japan (see figure I.1A). While the eurozone has managed to emerge from recession, its growth rate remains very low, giving the European Central Bank (ECB) cause for concern over a possible deflation scenario. Indeed, as figure I.1C shows, inflation has been falling since January 2014.

The weak recovery of recent years in the United States, Japan and the eurozone is also mirrored by the labour market. By the end of 2013, none of these three economies had returned to the absolute employment levels reached in 2008. Unemployment rates in the United States and the European Union remain higher than they were before the crisis.

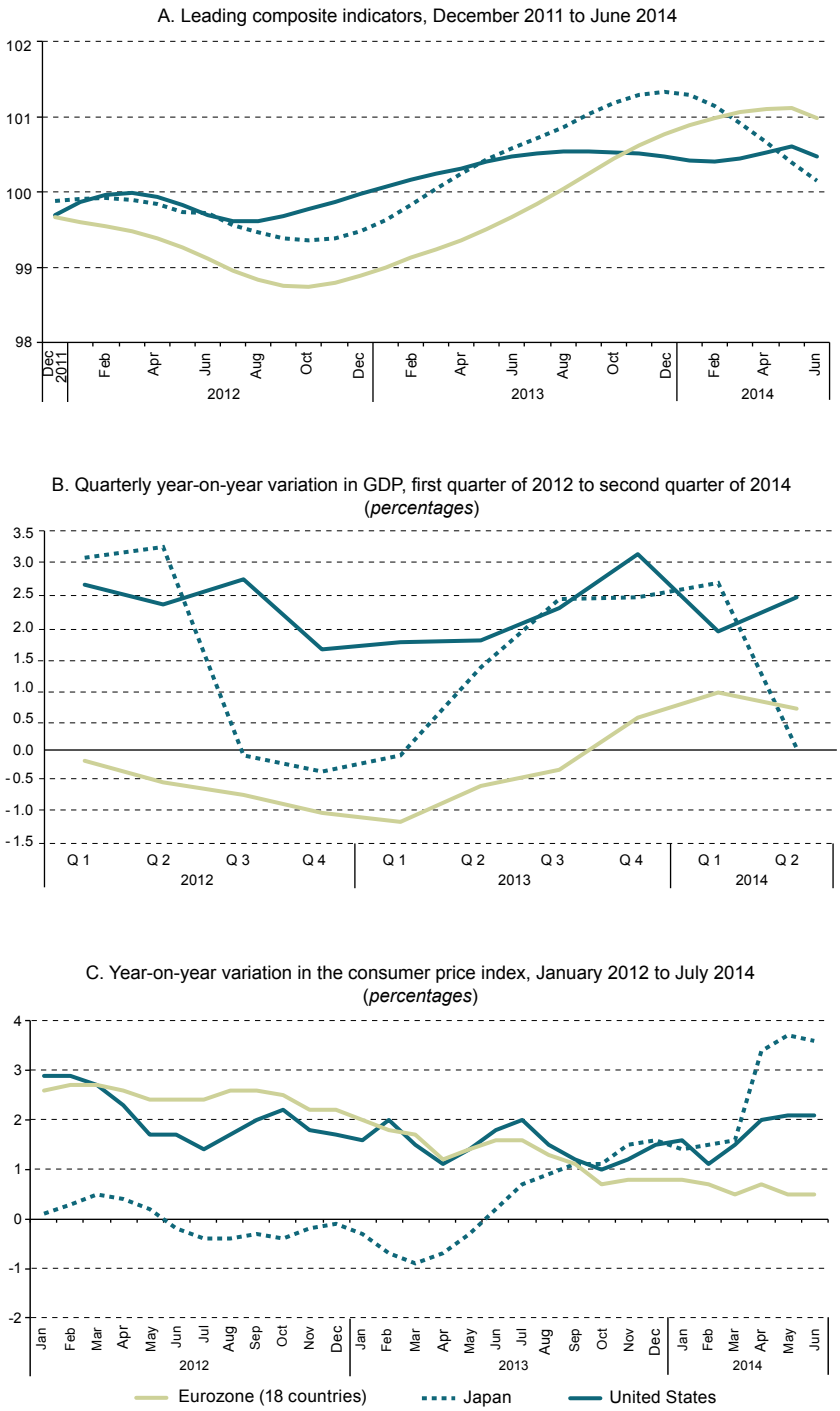
The United States posted modest growth in 2013, with GDP expanding by just 1.9%, almost one percentage point less than in 2012. Activity picked up in the second half of 2013, thanks to the revival of domestic demand, strong inventory accumulation and export growth. However, bad weather in early 2014 and a drop in private investment put the brakes on this recovery, so that economic activity in the first quarter dropped by 2.1% compared with the previous quarter. In the second quarter, the United States economy picked up again, with quarter-on-quarter growth of 4.2%. The recovery is expected to consolidate over the second half of the year, but projections for 2014 still indicate that annual growth will be lower than in 2013.

Consumption began to strengthen from the second quarter of 2014, as households saw their economic situation improve thanks to a steady decrease in unemployment (see figure I.2B). The unemployment rate stood at 6.1% in August 2014 and could dip below 6% before the end of the year. Other positive factors are the recovery of housing prices, stock-exchange gains and improving access to credit. These factors, along with the Federal Reserve's announcement that it would probably hold the interbank interest rate at close to zero until 2015, helped boost consumption and private investment. Several trends suggest that this recovery will take hold in 2015. In the external sector, net exports made a significant contribution to growth between 2011 and 2013. However, the resurgence of consumption and investment make it likely that imports will grow faster than exports in 2014 and that the trade deficit will widen again. Nevertheless, greater energy autonomy (owing to increased shale gas and oil production) should reduce energy imports so that the deficit will probably widen by less than in previous recoveries.

With the economic recovery apparently taking hold and unemployment falling, the Federal Reserve began to scale back its expansionary monetary policy measures, trimming its monthly asset purchases from US$ 85 billion to US$ 75 billion in December 2013.[2] Similar reductions were applied over the following months (see figure I.2A). The Federal Reserve is planning to end its purchasing programme in late 2014. However, the impact of this reduction in quantitative easing on long-term interest rates remains weak. This is due to the gradual nature of the withdrawal, and the keeping of the benchmark interest rate at close to zero. It is expected that the first effects on long-term interest rates will be felt from mid-2015.

[2] The third round of quantitative easing (QE3) started in September 2012. This programme consisted in the monthly purchase of US$ 40 billion in mortgage-backed securities and US$ 45 billion in Treasury bonds from banks. These purchases were designed to bring down interest rates on loans and to stimulate investment and consumption.

Figure I.1
Eurozone, Japan and United States: economic activity and prices, 2011 to 2014

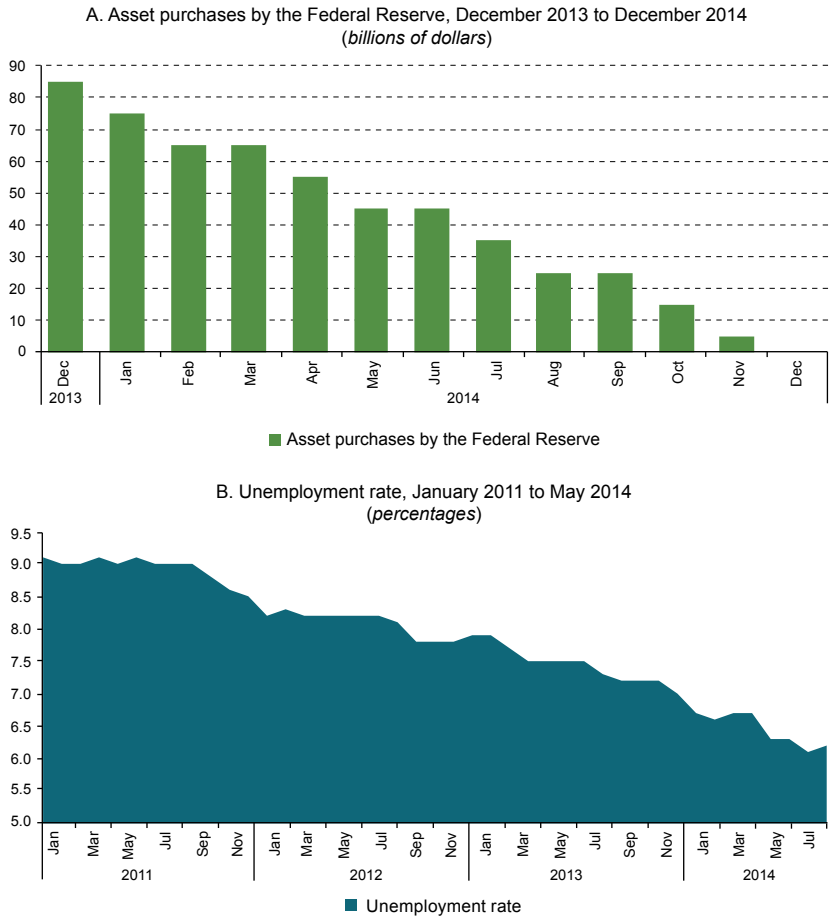


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organization for Economic Cooperation and Development (OECD), Main Economic Indicators, 2014.

The United States faces several medium-term challenges in boosting its growth rate. First, the sustainability of its fiscal situation is worrying. Suspending the public debt ceiling until March 2015 provided a temporary breathing space. However, a balanced fiscal plan needs to be developed that is capable of reversing the rise in the public debt. Any plan to cut spending and raise taxes carries a heavy ideological burden and would be fiercely debated in Congress.

Second, there is some concern that the economy's potential growth rate might be diminished by falling employment rates in recent years (caused by the slow post-crisis recovery and the ageing of the population) and weaker growth in productivity (*The Economist*, 18 July 2014). Another challenge is to correctly time any interest-rate increase, both to avoid choking off the incipient recovery and to prevent the economy from overheating. Some analysts suggest that the legislation adopted in 2010 to avoid future banking crises has also weighed against the country's growth.[3] Furthermore, the swift conclusion of negotiations on the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP) would give a boost to exports. For this to happen, it is crucial that the President manages to renew the Trade Promotion Authority (TPA), under which Congress would be able to approve or reject trade agreements negotiated by the executive branch, without any possibility of amendments (see section D). It is doubtful that action on this legislative procedure will be taken in the remainder of 2014, since congressional elections are due in November.

Figure I.2
United States: monetary stimulus and unemployment rate



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information provided by the Federal Reserve and the Bureau of Labor Statistics of the United States.

[3] The Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law in July 2010, followed by the Volcker Rule in April 2014. These reforms separate commercial and investment banks, introduce tighter regulation for high-risk markets (such as credit default swaps) and protect consumers from abusive practices in relation to credit, loans and mortgages, among others. These new rules have reduced the number of insolvencies but have also made certain financial products more expensive. They have also reduced access to small business loans, which may have held back economic growth (*Financial Times*, 2014b).

During 2013, the eurozone emerged from a recession that lasted six quarters, and embarked on a slow and heterogeneous transition towards weak growth. Eurozone GDP contracted by 0.4% in 2013, while that of the European Union as a whole grew by 0.1% (see [online] ec.europa.eu/eurostat). Of the 17 economies making up the eurozone in 2013, only Austria, Belgium, Estonia, France, Germany, Latvia, Luxembourg, Malta and Slovakia were able to avoid recession that year.

The eurozone performed below expectations in the first half of 2014, with quarter-on-quarter GDP growth of just 0.8% in the first quarter and 0.0% in the second quarter. The outlook for the remainder of the year is mixed. On the one hand, it is expected that there will be less pressure to make further budget cuts, owing to an agreement between the European Commission and some member States to prolong the fiscal adjustment period. In a similar vein, the introduction of the outright monetary transactions programme has reduced the risk premiums on default swaps and the outflow of capital from the monetary union's peripheral countries. In these economies, the situation is also improving owing to the effect of private-sector deleveraging and a rise in exports. However, the data for July to September show that the recovery of the eurozone's key economies will be slower than previously expected.

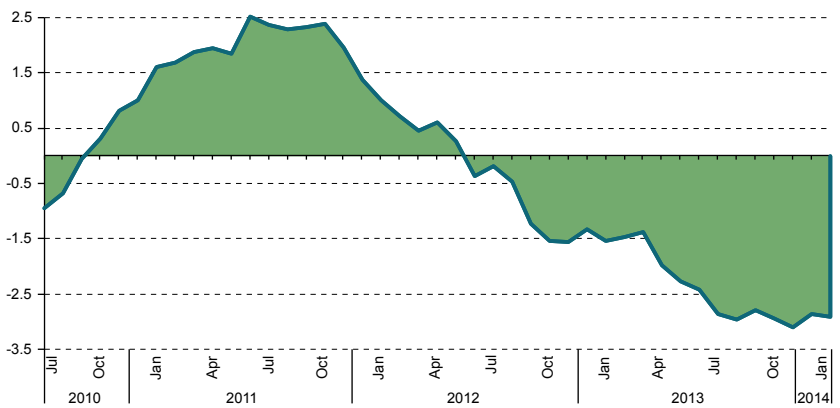
It is estimated that average growth for the entire eurozone in 2014 will barely exceed 1%. France and Italy are likely to grow even more slowly; Cyprus will probably be the only country still in recession. Eurostat figures suggest that unemployment in the eurozone remained high (11.5% in July 2014); this is only 0.5 percentage points lower than the peak rate of 12% recorded in mid-2013. The youth unemployment rate is much higher, and stood at 23% in mid-2014. These rates conceal a huge disparity within the eurozone: some countries, including Austria and Germany, have unemployment rates of close to 5%, while others, notably Greece and Spain, have unemployment levels above 25%.

Europe is still coping with the effects of the deep recession that struck the region in 2012-2013. Despite national and regional stimulus efforts, as yet the recovery is neither robust nor strong (IMF, 2014c). The recovery in private investment has been weaker than in previous recessions and financial crises. Public and private debt levels remain high, forcing banks to limit corporate lending. The eurozone's fragile banking sector continues to pose a substantial threat, as became apparent in Portugal in mid-2014.[4] In fact, the volume of lending to the private sector has continued to shrink over the past year (see figure I.3). All of the above calls for rigorous asset quality reviews and bank stress tests, accompanied by bank recapitalization where necessary. These reforms are regarded as complex but important for reducing financial fragility and reviving lending and investment through monetary policy efforts.

Figure I.3

Eurozone: year-on-year variation in lending to the private sector, July 2010 to January 2014

(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organization for Economic Cooperation and Development (OECD), *OECD Economic Surveys: Euro Area 2014*, Paris, 2014.

[4] A financial crisis at Banco Espírito Santo sent the Portuguese stock market tumbling in July 2014, with limited international impact.

Another challenge facing the eurozone is low inflation, which in August 2014 had a cumulative 12-month rate of 0.4%. A potential scenario of deflation could undermine the frail recovery, since the debt burden would increase and consumption might weaken as consumers delay their purchases in the expectation of even lower prices. Some countries, including Portugal, were already posting negative inflation in mid-2014.

In this context, in June 2014 the ECB announced five policy measures to promote bank lending to the private sector, to prevent deflation and to promote growth. These were:

- Lowering the benchmark interest rate from 0.25% to 0.15%, and the deposit facility interest rate from 0% to -0.10%.
- Injecting 400 billion euros of liquidity into banks, between September and December 2014, for lending to businesses and households, through targeted longer-term refinancing operations (TLTROs).
- Suspending the bond-buying programme, launched in 2010, by which the ECB had sterilized 170 billion euros.
- Providing emergency financing to banks, through operations with one-month maturities and fixed interest rates, until December 2016.
- Purchasing asset-backed securities (ABS), which are financial instruments underpinned by loans to SMEs.

The possible consequences of geopolitical tensions with the Russian Federation over the conflict in Ukraine present another risk to European growth. These tensions led to the intensification of European Union sanctions against the Russian Federation in July 2014, consisting of limits on access to long-term financing by some Russian State-owned banks and an embargo on exports of weapons and energy-related equipment and technology. The Russian Federation is the source of one third of Europe's fossil fuel imports and two thirds of its natural gas imports, meaning that these measures could have an impact on the availability and cost of energy in Europe. In response to these sanctions, in August 2014 the Russian Federation banned imports of fruit, vegetables, meat, fish, milk and dairy products from Australia, Canada, the European Union, Norway and the United States.

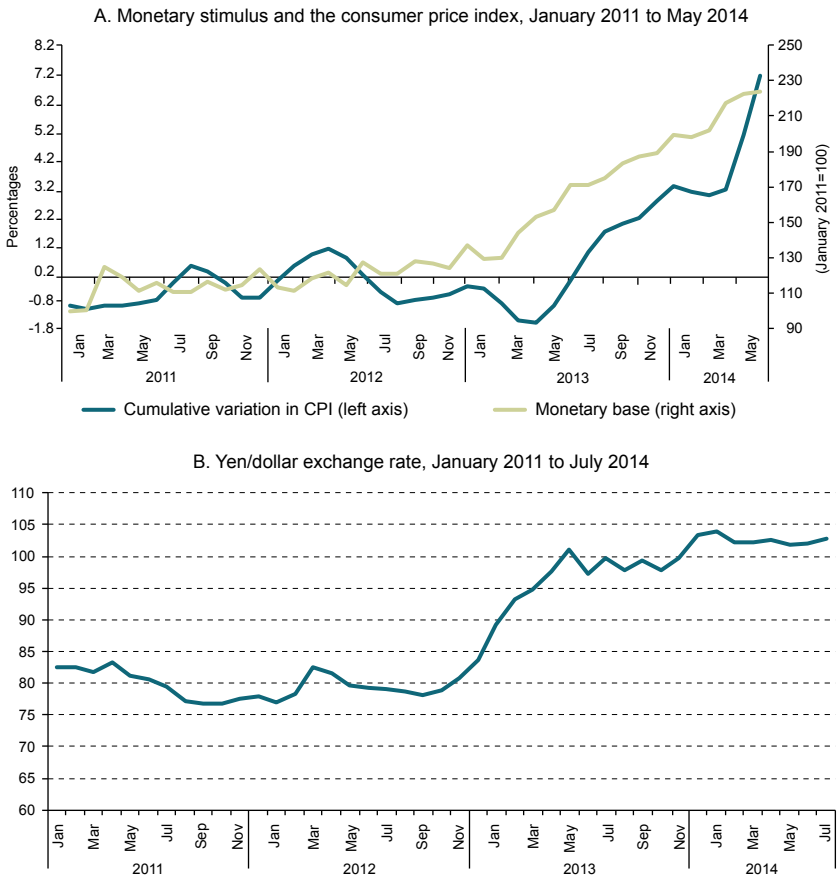
In Japan, the main objective of government policies implemented since December 2012 has been to bring an end to two decades of deflation. The unprecedented monetary stimulus injected into the economy —doubling the size of the monetary base between April 2013 and the end of 2014— led to a 3.6% increase in nominal inflation and a 1.1% rise in core inflation to August 2014, while the yen depreciated by more than 20% in 2013 (see figure I.4). However, the weakening of the currency did not boost exports, which were stagnant over the first half of the year and diminished in May and June.

Japanese GDP jumped 6.1% in the first quarter of 2014, largely on the back of booming consumption following the announcement that the sales tax would increase from 5% to 8% in April.[5] As expected, consumption weakened dramatically after the tax rise was implemented in the second quarter, and GDP fell by 6.8%. A second package of structural reforms was announced in June 2014, with a view to reviving the economy. Notable measures included making the labour market more flexible, reducing support for agricultural producers and deregulating public services. With consumption sluggish and net exports at a standstill, the central bank is projecting growth of just 1% for the fiscal year as a whole (from April 2014 to March 2015).

Japan must overcome a number of challenges if it is to accelerate its growth rate, notably the stabilization of its medium-term public debt through fiscal consolidation. This would require boosting tax revenues and capping social-security related spending. In the external sector, the depreciation of the yen has not yet yielded higher export volumes, partly owing to the slowdown in China, which is the country's main trade partner. Another challenge for the government is to successfully conclude Trans-Pacific Partnership negotiations; one of the main sticking points is negotiating with the United States for opening Japan's automobile and agricultural markets (see section D).

[5] The plan is to raise this tax to 10% in October 2015. The two hikes are fundamental for reducing the primary fiscal deficit from 8.5% of GDP in 2014 to 4.8% of GDP in 2015 (IMF, 2014b).

Figure I.4
Japan: monetary stimulus and its impact on inflation and the exchange rate



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), *International Financial Statistics*.

In late July, the Prime Minister of Japan, Shinzo Abe, visited five Latin American and Caribbean countries (Brazil, Chile, Colombia, Mexico and Trinidad and Tobago), following the visits of the presidents of China and the Russian Federation. His visit had several objectives, which could result in improved trade links with the region. The first of these was to improve Japan's access to the region's energy and mineral resources, through the signing of agreements to provide technical assistance and loans to these five energy- and metal-exporting countries. The second objective was to strengthen political ties and support for development. For example, in Trinidad and Tobago the Prime Minister participated in a meeting of the Caribbean Community (CARICOM), at which he designated 2014 as Japan-CARICOM Friendship Year. Several agreements were signed to help the Caribbean region adapt to the effects of climate change and to promote the development of renewable energy sources. In Chile, Japan undertook to cooperate in the sphere of natural disaster risk mitigation. The third objective was to reinforce existing trade agreements. Colombia and Japan agreed to speed up negotiations on a free trade agreement and to cooperate in intellectual property matters to facilitate patent acquisition. Discussions were also held in Chile and Mexico regarding the Trans-Pacific Partnership. One final goal was to support infrastructure investment in the region, for example through a contract to build a metro line in São Paulo (Brazil) and a fibre-optic network in Colombia.[6]

[6] For further information, see The Japan Times (2014); El Mercurio (2014); *América Economía* (2014), and *Latin American Herald Tribune* (2014).

C. Slowdown in the emerging economies

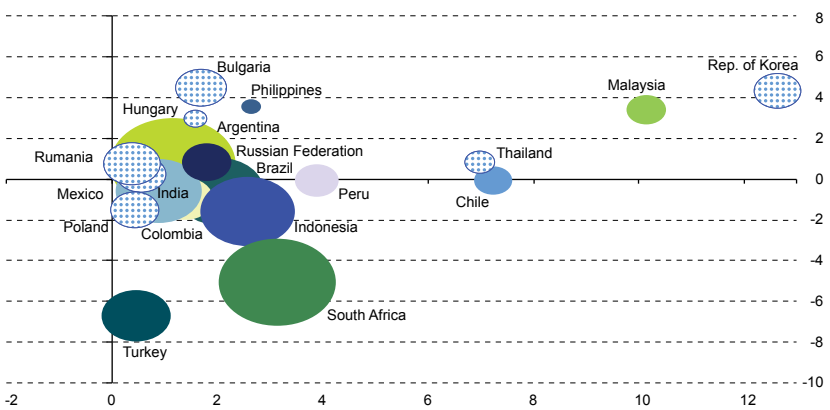
1. General trends

Emerging economies will account for two thirds of global economic growth in 2014. But they are expanding more slowly than in previous years even though international financial conditions are projected to remain favourable despite the reduction in monetary expansion entailed by the tapering of asset purchases by the United States Federal Reserve.[7] A number of other trends are weighing on the performance of emerging economies. First, tepid growth among advanced economies leads to low demand for emerging economies' exports. Second, natural-resource-exporting emerging countries are facing a slight fall in the prices of these products (with the notable exception of oil). Slower growth in China, along with the authorities' goal of reorienting the country's investment- and export-based development model to focus on consumption, could sap demand for primary products from other emerging economies. Third, growth in some emerging countries could also be curbed by domestic factors such as the reduction of economic stimulus measures, supply constraints, ongoing structural reforms and complex political situations.

One additional external factor that might be detrimental to the growth of emerging economies in 2015 is that the United States Federal Reserve is expected to raise the monetary interest rate in the first half of 2015. This increase, along with a hike in long-term rates, could reduce capital flows to emerging countries and bring about a more constrained international financial environment.

The emerging countries most likely to be affected by adverse external events are those with greater external financing requirements (as determined by the sum of their current account balance and net FDI inflows as a percentage of GDP), as well as countries that direct a large proportion of their exports to China (see figure I.5). According to these criteria, the countries in the bottom right-hand quadrant are the most vulnerable, including Brazil, India, Indonesia, South Africa and Turkey.

Figure I.5
Selected emerging countries: sum of current account balance plus net FDI inflows (vertical axis) and exports to China (horizontal axis), 2013
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development (UNCTAD), UNCTAD-Stat database; United Nations Commodity Trade Database (COMTRADE) and BBVA Research, "Global and Spanish Outlook", May 2014.
Note: The size of the circle indicates exchange-rate volatility caused by the May 2013 announcement on the possible withdrawal of monetary stimulus.

The BRICS group of countries (Brazil, Russian Federation, India, China and South Africa) decided at their seventh summit, held in Fortaleza, Brazil, in July 2014, to create a Contingent Reserve Arrangement and a New Development Bank. This decision was partly motivated by frustration at the slow pace of the approval and implementation of

[7] While the central banks of the United States, Japan and the eurozone continue to hold their benchmark interest rates at close to zero, investors from these countries are seeking greater returns in emerging markets. Between July 2013 and May 2014, US$ 221.7 billion were invested in emerging markets. As a result of these inflows, the stock markets in some of these countries have already recovered from the falls reported at the beginning of the year (*Wall Street Journal Americas*, 19 July 2014).

international financial system reforms designed to give emerging economies greater representation as their weight in the world economy has increased.[8] Officially, the Bank will complement the efforts of multinational and regional financial institutions; however, the Bank could also be seen as a possible alternative to the World Bank and the International Monetary Fund (IMF). In this regard, the Bank presents an opportunity for BRICS countries to take on a greater role in ongoing efforts to reform global financial governance (see box I.1).

Box I.1

New Development Bank: opportunities and challenges

The purpose of the New Development Bank (NDB) is to finance public and private infrastructure and sustainable development projects in BRICS (Brazil, Russian Federation, India, China and South Africa) and other developing countries. The Bank will have an initial capital of US$ 50 billion contributed in equal parts by the five founding countries, each with equal voting power. The Bank will have its headquarters in Shanghai (China) and a regional office in Johannesburg (South Africa). India will assume the first rotating presidency, which will have a term of five years, while the first chair of the Board of Directors shall be from Brazil, and the first chair of the Board of Governors, from the Russian Federation. Membership will be open to all countries wishing to join, regardless of whether they are beneficiaries of loans. The Bank is expected to commence operations in early 2016, following approval of the Agreement establishing the NDB by the parliaments of the founding countries. An additional capital reserve of US$ 100 billion, known as the Contingent Reserve Arrangement (CRA), has also been established and is intended to help BRICS countries forestall short-term liquidity pressures and to provide assistance in the event of a financial crisis.

It may be argued that NDB and CRA represent a break point in the evolution of the international financial system. In principle, these new financial instruments may soften the current asymmetries caused by the governance structure of international financial institutions, and alleviate the least developed countries' scarcity of resources for funding projects and defraying the costs of sustainable and inclusive development. They may also help reduce financial volatility and instability, providing BRICS countries with a greater opportunity for financing without the conditions applied by multilateral financial institutions.

Yet for this initiative to achieve its goals, it will have to rise to a number of challenges. The fact that any Member State of the United Nations is allowed to join as a non-debtor member raises the possibility that developed countries may exert influence over decision-making. Moreover, the imposition of borrowing limits during build-up of the CRA watered down the latter's potential as an alternative source of funding. An even greater challenge is that of ensuring that the trade policies of donor countries are consistent with the objectives of sustainable and inclusive development. For example, the nature of trade relations between China and African and Latin American countries reinforces the much-criticized reprimarization of exports. The test facing the Bank's founding countries is to promote the diversification of exports in borrowing countries. Should they manage to resolve these potential inconsistencies, then the initiative could make a contribution in support of the United Nations post-2015 development agenda, which aims to achieve similar goals.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Osvaldo Rosales, "El banco BRICS: por una globalización con menos desigualdades," *Foreign Affairs Latinoamérica*, 18 August 2014 [online] http://revistafal.com/index.php?option=com_content&view=article&id=1835:logo-nel-banco-brics-por-una-globalizacion-con-menos-desigualdades&catid=156&Itemid=490; and C.P. Chandrasekhar, "Banking with a Difference", *Economic and Political Weekly*, vol. XLIX, No. 32, 9 August 2014.

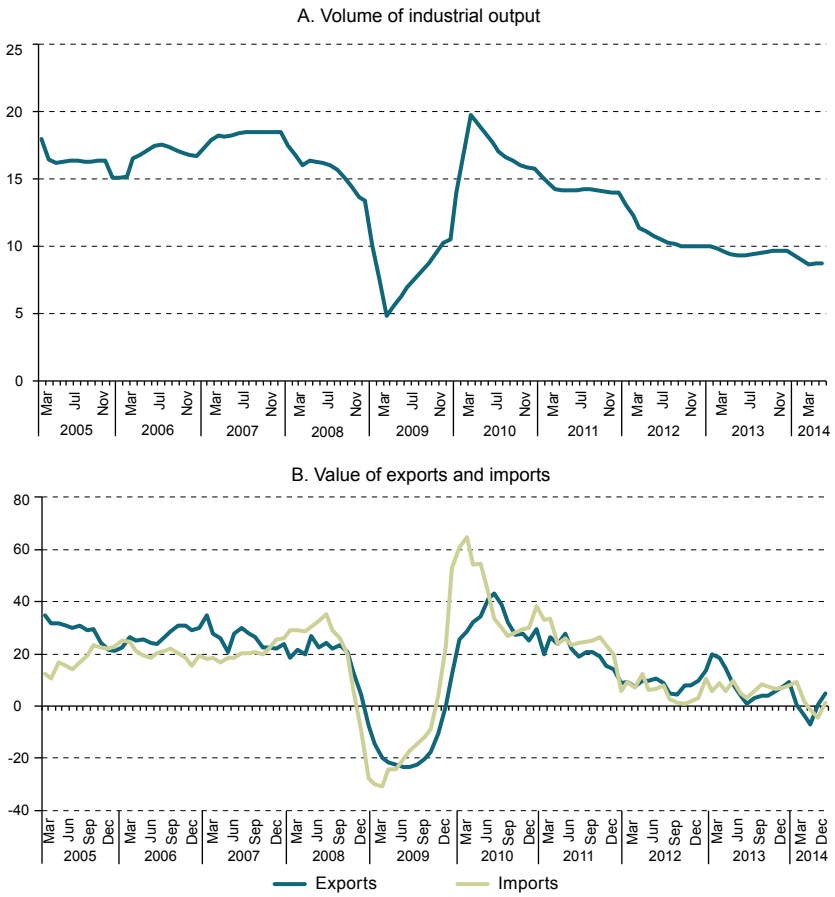
2. China

The Chinese economy decelerated slightly between early 2012 and the second quarter of 2014 as the growth rate slipped from 7.7% to about 7.5%. Fearing a slowdown of greater proportions, the authorities introduced some stimulus measures, such as easing restrictions on bank lending and increasing public spending on infrastructure. These measures do not seem to have exacerbated existing distortions —such as the real estate bubble and investment-dependent growth— partly because most investment was made by the central government, whose debt is low, rather than by heavily indebted local governments. In fact, one of the key objectives of the current reforms was achieved in the first half of 2014: the rebalancing of growth so that it is based more on consumption and less on fixed capital investment. Other rebalancing indicators also showed positive progress in the first quarter of 2014, except for investment in residential real estate, which grew faster than GDP.[9] Industrial output (measured by value-added) increased slightly from 8.8% to 8.9% between the first and second quarters of 2014 (see figure I.6).

[8] In 2010, the IMF implemented governance reforms to better reflect the growing importance of emerging economies. Nevertheless, the voting power of these countries is still smaller than their share of global GDP. BRICS countries hold just 10.3% of the votes but represent almost a quarter of the world economy. Conversely, four European countries (France, Germany, Italy and the United Kingdom) hold 17.6% of the votes but represent only 13.4% of the world economy.

[9] Each quarter, the Peterson Institute for International Economics publishes a composite rebalancing indicator on China. Rebalancing is positive where (i) urban disposable income grows faster than GDP; (ii) the real interest rate on deposits is positive; (iii) residential real estate investment is growing at a slower pace than GDP; (iv) loans to small enterprises are growing faster than those to all enterprises; and (v) the tertiary sector is growing faster than the secondary sector. For further details, see [online] http://blogs.piie.com/china/?p=1635.

Figure I.6
China: variation in industrial output and foreign trade, March 2005 to March 2014
(Percentages, compared with the same month the previous year)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures provided by the National Bureau of Statistics of China.

China's foreign trade changed little during the first half of 2014 (see figure I.6B). Sluggish export growth is mainly due to the weak recovery of demand in developed countries. Considering that export orders increased for the third consecutive month in June 2014, export growth is expected to gather momentum over the remainder of the year. Imports also seem to be picking up slightly, partly on the back of stronger consumption and an upturn in imports of inputs for export products.

Restraints on Chinese growth include a weak real estate market and the economy's high debt levels. As of late May 2014, the number of unsold apartments was up by 30% on the previous year, which in turn has a bearing on the construction of new housing, and by extension the demand for intermediate goods such as cement, iron and non-ferrous metals, both domestic and imported. Another concern is the high level and rapid growth of indebtedness in the Chinese economy. The total national debt rose from 147% of GDP at year-end 2008, to 251% in June 2014. This is much higher than for other emerging markets and is comparable with the United States (260%) and the United Kingdom (277%). For 2014, the People's Bank of China forecasts credit growth of 16% and GDP growth of 7.5%. The fact that lending is growing faster than GDP could be unsustainable in the medium term, leading to a possible misallocation of capital, as indicated by surplus production capacity in several industries (such as cement and solar panels) and in the real estate market. There may also be a risk of a financial crisis, though this possibility is limited in China where the external debt is just 10% of GDP and most of the financial system is owned by the State, which facilitates loan roll-overs (*Financial Times*, 2014a).

Shadow banking practices are gaining ground within the Chinese financial system. The term refers to all activities, and especially lending, carried out by financial institutions other than formal banks. In 2013, shadow banking accounted for approximately one quarter of the national financial system. In 2012 alone it grew by 42%. The sector is mainly engaged in lending, but it also performs other functions similar to banking, such as dealing in corporate bonds of traditional firms. Shadow banking activities are, by nature, difficult to oversee. Box I.2 presents further information on this sector and its potential impact on China's financial stability.

Box I.2

Shadow banking in China and its financial risks

In China there are several types of banks that operate in parallel to the formal financial system, using a variety of instruments. Until 2008, virtually all lending activities in China were carried out by conventional banks (mostly State-owned and regulated). However, since the global financial crisis, which led the authorities to focus on investment as a source of growth, credit conditions were relaxed. Restrictions on lending were reintroduced in 2010, but were unable to curb the sector's expansion. In fact, lending spread to other institutions outside the formal financial system. The main causes of this expansion are the limits placed by the government on deposit rates, as well as credit restrictions in some sectors of the economy, in which regulators block loans if they detect possible bubbles. Various parallel financial mechanisms are utilized, including loans by trust firms, leasing companies, credit insurance providers and money market funds. Some shadow institutions avoid prudential regulations regarding how much banks can lend, to which companies and at what rates.

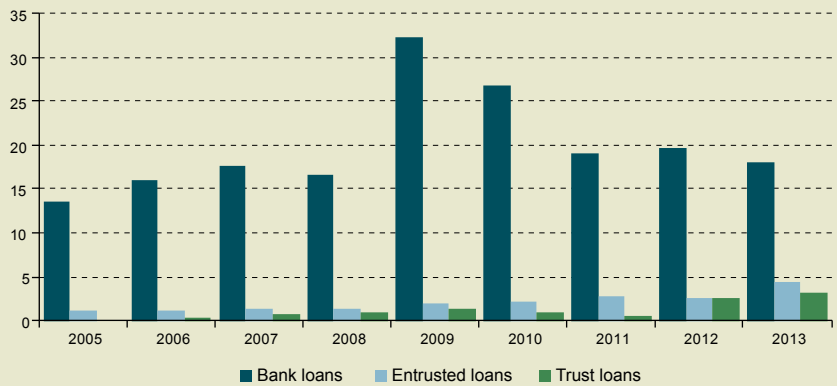
The regulators are particularly concerned about trust loans. Offering returns of up to 10%, they raise money from individuals and businesses that are dissatisfied with the low interest rates offered by the regular financial system. However, trust companies also charge higher interest rates to businesses unable to obtain loans from official banks. With the recent slowdown in the economy, a number of loans have defaulted. In 2014, US$ 400 billion in trust loans will fall due, most of which will be rolled over. However, if some investors lose confidence in the sustainability of these products, they may withdraw their funds and cause a run. Given that these products are regulated by the China Banking Regulatory Commission (CBRC), the risks are well known and measures may be taken if deemed necessary.[a]

Entrusted loans are another shadow banking product. These loans are provided by companies with significant financial resources, many of which have close ties with State-owned enterprises, to other firms with fewer resources and connections. Entrusted loans, which are often made through agent banks to get around regulations prohibiting such loans, also increase the risks to the financial sector. Companies borrowed US$ 117 billion via entrusted loans in the first three months of 2014 alone; corporate bond issuance over the same period amounted to just US$ 63 billion. Meanwhile, in another form of inter-company lending, small- and medium-sized enterprises having difficulties in securing loans from official banks form a consortium that helps them obtain credit during times of prosperity (in other words, mutual lending). However, with the slowing of the economy, some weaker firms are beginning to default, destabilizing the system overall.

Figure

China: variation in different types of lending, 2005 to 2013

(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organization for Economic Cooperation and Development (OECD), "Economic Outlook", May 2014.

It is not just businesses and individuals that are turning to the shadow banking sector for loans, but also local governments. Since 1994, municipal and provincial governments have been forbidden from borrowing, except through a mechanism whereby the central government issues bonds on their behalf. For years, local governments have avoided these restrictions by setting up specific companies known as local government finance vehicles (LGFVs) that issue bonds or take loans from shadow banking institutions. There are more than 10,000 LGFVs and their debts amount to 32% of GDP (double the central government debt). The central government has attempted to shut down bond sales and bank borrowing by LGFVs, but local governments continue to turn to the shadow banking sector to remain solvent, since they are already in debt. Since the debt of LGFVs is backed by local governments, defaults by said vehicles could destabilize public finances and the entire financial system. To steer clear of these solvency risks, for the first time in 20 years the central government has allowed some local governments to sell bonds.

The impact of a shadow banking crisis would be significant but manageable. Such a crisis could be triggered by a downturn in the real estate market, since real estate is frequently used as collateral for trust loans. The consultancy firm IHS estimated that a combined real estate and shadow banking crisis would reduce China's GDP growth rate from the current projection of 7.5% to 6.6% in 2014 and 4.5% in 2015. This presents a dilemma for the Chinese financial regulators. On the one hand, restricting shadow bank lending could prompt a panic that would have serious repercussions for economic growth; on the other, without tighter controls they run the risk of an even bigger financial crisis in future.

Source: Economic Commission for Latin America and the Caribbean (ECLAC) on the basis of Central Bank of Chile (2014), "Informe de política monetaria", March 2014, pp. 17-18; and *The Economist*, "Shadow banking in China: Battling the darkness", 10 May 2014.

[a] Trust beneficiary rights (TBRs) are another way around the restrictions on dealings between banks and trusts. In this case, a regular bank sets up a firm to buy loans from a trust; it then sells the rights to the income from those loans to another official bank. Using this mechanism, banks are able to evade capital requirements and minimum loan-to-deposit ratios by means of products that look like safe loans between banks.

In 2014 and 2015, China's GDP is expected to grow by about 7.3% and 7.1%, respectively (United Nations, 2014a). This projection is based on the assumption that the authorities gradually rein in rapid credit growth and make progress on reforms to guide the economy along a more balanced and sustainable growth path based more on consumption than on investment and exports. On the basis of this growth forecast, in 2014 China is poised to become the world's biggest economy in terms of purchasing power parity according to the International Comparison Programme (ICP). By comparison, in 2005 the Chinese economy was equivalent to just 43% that of the United States, a figure that rose to 87% in 2011.

As part of its international trade and cooperation policies, China is seeking closer ties with Latin America and the Caribbean. This mutual interest was confirmed by President Xi Jinping's July 2014 visit to the region, during which he attended a meeting with ten Heads of State and representatives of the member countries of the Community of Latin American and Caribbean States (CELAC), held in Brasilia. The occasion marked the creation of the China-CELAC Forum and saw China commit US$ 35 billion to cooperation with the countries of the region. These new resources will be divided among three different funds, subject to the creation of a permanent forum. The first fund will have an initial capital of US$ 20 billion and will be for financing infrastructure projects in the region. The second will have US$ 10 billion in capital and will finance development projects. The third fund, with US$ 5 billion, will finance specific projects at China's discretion. During the trip, in addition to Brazil, President Xi Jinping visited Argentina, the Bolivarian Republic of Venezuela and Cuba (see box I.3).

Box I.3

Outcomes of bilateral visits by President Xi Jinping in Latin America and the Caribbean

In the area of development cooperation, China proposed a joint cooperation framework, known as "1+3+6", with a three-tiered pyramid structure. The top level consists in a cooperation plan for 2015 to 2019, focused on inclusive growth and sustainable development. The second level refers to what are regarded as the three engines for promoting development, namely trade, investment and financial cooperation. The third level relates to the six sectors in which cooperation would be concentrated: agriculture, energy and natural resources, infrastructure, information technologies, manufacturing, and scientific and technological innovation.

In the framework of this strategy, 141 bilateral agreements were signed between China and four countries in the region: 54 with Brazil, 38 with the Bolivarian Republic of Venezuela, 29 with Cuba and 20 with Argentina. Bilateral agreements on financing matters were signed under the second tier of the framework, and included a yuan- Argentine peso swap agreement valued at US$ 11 billion over a period of three years. Another example is the agreement signed with the Bolivarian Republic of Venezuela, which provides financing in exchange for oil at preferential prices. China has provided the region with an estimated US$ 100 billion in loans since 2005, principally in the areas of energy, mining and infrastructure. The main commitments signed between China and the four countries visited by President Xi Jinping are summarized below.

In the energy and natural resources sector, China reached an agreement with Argentina to build two hydroelectric power plants and one nuclear power plant. In Brazil, it was agreed that Eximbank of China would open a US$ 5 billion credit line to the Brazilian mining firm Vale do Rio Doce. The State Grid Corporation of China signed an agreement with Brazilian power utility Eletrobras to build transmission lines for the Belo Monte dam in Amazonia, and the China Three Gorges Corporation will cooperate with Brazilian electric companies to build a dam on the Tapajós River. In addition, rechargeable batteries and energy storage systems will be manufactured in Brazil by China's BYD. In Cuba, an agreement was reached to expand the Cienfuegos oil refinery; in the Bolivarian Republic of Venezuela, a financing agreement was signed for the certification and exploitation of mineral reserves, as well as for copper and gold production.

Further agreements envisage investment in infrastructure, notably the construction of a railway linking the Atlantic coast of Brazil with the Pacific coast of Peru. Brazil, China and Peru have agreed to combine efforts in drawing up feasibility studies for this purpose. Progress has also been made on the feasibility study for the construction of a new canal in Nicaragua, connecting the Pacific Ocean and the Caribbean Sea. The US$ 40 billion budget for this project would be met by the private sector. China will also fund infrastructure works in Argentina (the construction of two hydroelectric dams in Santa Cruz, and a railway project) and Cuba (modernization of the port of Santiago).

In agriculture, a protocol was signed on phytosanitary requirements for Argentine exports of apples and pears. In Cuba, China secured cooperation agreements on agricultural genetics, cultivating moringa trees and developing moringa-based products and sericulture. In the manufacturing sector, China agreed to collaborate on the construction of heavy water pressure tubes in Argentina. In Brazil, China agreed to purchase 60 passenger aircraft from Brazilian aircraft manufacturer Embraer and promised that the Chinese manufacturer Sany would invest in a plant in the city of Jacareí, while automaker Chery would invest in a further factory.

In terms of promoting scientific and technological innovation, in Cuba an agreement was reached to launch digital television and to supply technology for water meters and transport equipment. Lastly, in the area of information technologies, China will support a national broadband access project in Argentina and will develop cloud computing technologies in Brazil.

Source: China Office of Commercial Development in Panama, "Xi Jinping asiste a encuentro de líderes de China y América Latina y el Caribe," 18 July 2014 [online] http://pa.chinacommercialoffice.org/esp/zgyw/t1176900.htm; *América Economía*, "China ofrece 35.000 millones de dólares para proyectos en Latinoamérica", 20 July 2014 [online] http://www.americaeconomia.com/economia-mercados/finanzas/china-ofrece-us35000-millones-para-proyectos-en-latinoamerica; *La Voz*, "Los acuerdos que firmaron Argentina y China", 18 July 2014 [online] http://www.lavoz.com.ar/politica/los-acuerdos-que-firmaron-argentina-y-china; *El Mercurio*, "Presidente de China Xi Jinping firma 54 acuerdos con Brasil y consolida alianza", 17 July 2014 [online] http://www.emol.com/noticias/economia/2014/07/17/670406/china-y-brasil-acordaron-expandir-sus-relaciones-comerciales.html; Aporrea, "Suscribieron Cuba y China 29 acuerdos de cooperación", 23 July 2014 [online] http://www.aporrea.org/internacionales/n254868.html.

3. Other emerging economies

Trends differ among the other emerging economies. The Indian economy is picking up pace, with growth projections of 5.0% in 2014 and 5.5% in 2015 (United Nations, 2014a). After the recent elections, it is anticipated that the government's efforts to implement new reforms and revive investment will bear fruit, and that export growth will gain momentum following the recent depreciation of the rupee and the strengthening of international demand. In other emerging and developing economies in South Asia, growth is set to remain at 5.5% in 2014 and rise to 5.8% in 2015 as external demand rises and national currencies weaken.

Forecasts for the Russian Federation and other CIS economies have been revised downward for 2014, since growth is likely to be hampered by the recent confrontations between the Russian Federation and Ukraine and the geopolitical tensions that these have stoked.[10] Investment has been weak, partly owing to political uncertainty. The United Nations (2014a) projects that the Russian economy will grow by 1.0% in 2014 and by 1.5% in 2015, down 1.9 and 2.1 percentage points, respectively, on the forecasts made in January. European transition economies are set to experience cooling growth in 2014 amid ongoing political instability, though they should see some modest improvement in 2015.

The Russian Federation is also pursuing a foreign policy of closer ties with Latin America and the Caribbean. In July 2014, President Vladimir Putin visited four Latin American countries (Argentina, Brazil, Cuba and Nicaragua). The Russian leader made offers of cooperation in sectors in which the Russian economy specializes, and those that are of common interest to the countries visited. Agreements were signed with Argentina on nuclear energy and on gas production. In Brazil, agreements were signed relating to defence, technology, energy, agriculture, education and health. In Cuba, deals were signed in the oil, energy, transport, infrastructure and technology sectors, with studies being conducted on modernizing the Mariel seaport and building an airport with a cargo terminal. In Nicaragua, the links between the two countries were reaffirmed, especially in relation to Russian economic and financial assistance. The Russian Federation also supplies Nicaragua with wheat, buses and automobiles. The President also showed interest in participating in the construction of the proposed Interoceanic Canal.[11]

D. Recent trends and future prospects in international trade and trade negotiations

1. Global trade

In 2013, the volume of world trade in goods expanded by 2.1%, just short of the 2.3% growth posted in 2012 (WTO, 2014a) (see figure I.7).[12] Both figures are less than half the average annual growth rate for global trade during the 20 years preceding the financial crisis (6.0%). The volume of trade in goods also grew more slowly than the world economy in 2013. Falling export prices (down by 0.4%) meant that global trade grew even more slowly in value terms than it did by volume.

Weak trade performance in 2013 may be attributed above all to the slackening of demand for imports in developed countries (which dropped 0.2% in volume terms), partially offset by a modest increase (4.4%) in the demand for imports in developing countries. The eurozone, whose imports fell by almost 1% as a result of the recession, accounted for much of the decline in imports by developed countries. Of the developing economies, Latin America recorded the fastest growth in import demand (9.3%). In terms of exports, the difference between the growth rates of developed

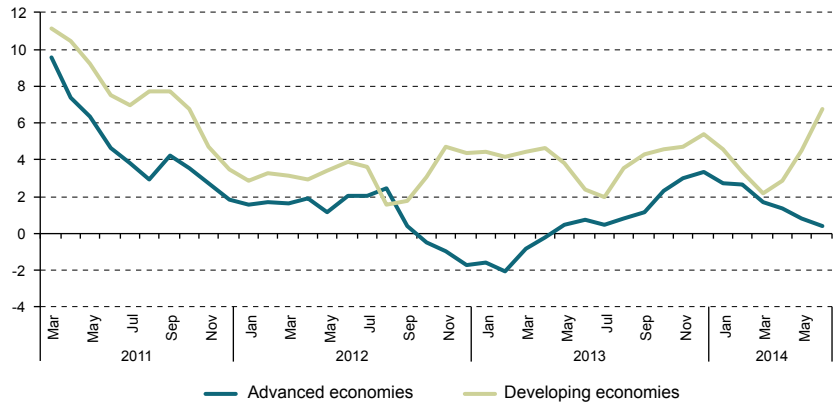
[10] According to BBVA Research, the dispute between Ukraine and the Russian Federation accounts for about 65% of the correction seen since mid-February. See [online] https://www.bbvaresearch.com/wp-content/uploads/2014/05/2014_EAGLEs_Economic_Outllok-Annual.pdf (page 17).

[11] See [online] www.infolatam.com/2014/07/15/balance-de-la-gira-de-vladimir-putin-por-america-latina/.

[12] Over the past two decades, the value of world trade in goods has generally grown more slowly than the value of trade in goods and services as a whole, which expanded by 5.3% during this period owing to the faster growth of international trade in services (WTO, 2014a). The stronger performance of world trade in services is due in part to the trend for trade and production to be increasingly structured around regional and global value chains, which are highly intensive in cross-border services.

and developing countries was smaller: 1.5% and 3.3%, respectively. Adopting a longer- term view, it should be noted that in 2013 developed-country exports had barely recovered from the crisis of 2008 and 2009 (with volumes increasing by just 2.4%), while those of developing countries showed significant growth (30.1%) (CPB Netherlands Bureau for Economic Policy Analysis, 2014). Another cause of slow growth in world trade in 2012 and 2013 was the lack of trade finance, which became more acute in 2013.[13]

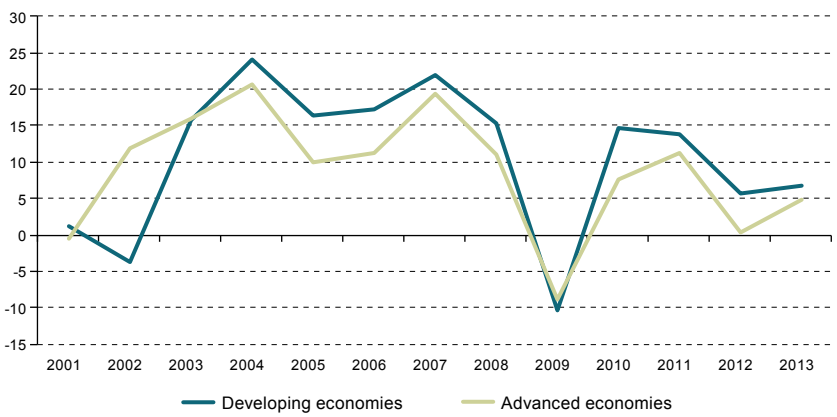
Figure I.7
Advanced and developing economies: year-on-year variation in the volume of goods exports, March 2011 to March 2014
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of CPB Netherlands Bureau for Economic Policy Analysis, *World Trade Monitor*, 2014.

In value terms, world trade in services grew at a rate of 5.5% in 2013, outpacing world trade in goods but below the medium-term trend. The fastest-growing categories were travel, insurance services, computer and information services, and other business services. By contrast, construction services contracted. One of the most dynamic economies in this sphere was China, whose services imports and exports surged by 17% and 9%, respectively. This year, China overtook Germany as the world's second largest importer of services. In 2013, services exports from the United States and the European Union (EU) grew by 5%, which was less than the global average.

Figure I.8
Developing and advanced economies: annual growth in the value of services exports, 2001-2013
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Trade Organization (WTO), Statistical Database.

[13] In 2013, trade finance decreased for the second year in a row, falling by 32%, from US$ 181.5 billion to US$ 124.1 billion (see *Dealogic's Trade Finance Review, 2013* [online] http://www.tradefinancemagazine.com/Article/3294639/Dealogic-Trade-finance-volumes-fell-again-in-2013.html). The trade finance squeeze was confirmed by the Asian Development Bank and by data from SWIFT, which processes international financial transactions (see [online] http://www.ibtimes.co.uk/global-trade-growth-slows-again-banks-fail-meet-demand-finance-1455289).

The growth projection for the volume of world trade in goods and services in 2014 was revised downward from 4.7% to 4.1% (United Nations, 2014a), considering the weakness of the world economy. The data for the first half of 2014 showed meagre growth. For example, the volume of goods exports from the United States increased by 3% in the first half of the year compared with the same period in 2013. Japan's exports grew more slowly over this period (at close to 1.5%). Eurozone exports grew at a pace similar to that of Japan, with positive growth in exports to external markets and stagnating exports to other eurozone countries. Together, Asian countries experienced export growth of 4% during this period. On the imports side, the fastest growth in volume was in certain developing countries (especially in Africa and the Middle East, with 8%), as well as Japan (6%). The slowest growth in import volumes was in the eurozone (2%) and emerging countries in Asia (2%) (CPB Netherlands Bureau for Economic Policy Analysis, 2014).

China, given its size and the pace of its economic expansion, has made a decisive contribution to the robust performance of developing economies over the past decade, especially economies that are exporters of raw materials. As such, it is important to recognize the potential consequences for these economies of China's demand shift away from exports and investment and towards consumption, as proposed under the Chinese government's reform programme. This shift is tied to two factors. First, the government is placing less emphasis on the promotion of investment and exports. Second, China's per capita income is rising and its consumption basket is transitioning from primary goods and services towards more processed products. China's consumption pattern is following a similar trajectory to that of other Asian economies that underwent rapid growth, such as the Republic of Korea and Japan. This scenario presents opportunities for countries that export more advanced goods and services, but raises challenges for those countries whose export baskets consist of commodities with little value-added (IMF, 2014b). However, given that its per capita income is relatively low, it is unlikely that China's consumption of raw materials has peaked.

Developing economies that export raw materials have only recently begun to respond to forecasts of a slowdown in Chinese demand for raw materials. Some investors are selling off their raw materials stocks, thereby exerting downward pressure on prices (*The Economist*, 2014). A drop in prices could have a major impact on the trade balances of countries that depend on these exports. In addition to this slackening demand, the trade-finance currency portfolio mix has changed, with the yuan increasing its share to 8.7% and pushing the euro into third place (*The Economist*, 2014). This reflects how important the Chinese economy has become in world trade.

2. The World Trade Organization

The Ninth Ministerial Conference of the World Trade Organization (WTO), held in Bali, Indonesia, in December 2013, took place in a difficult context for the multilateral trade system, marked by the prolonged Doha Round impasse. However, at this meeting consensus was reached on the "Bali Package" of decisions aimed at facilitating trade, agriculture and development. These agreements are the most tangible result achieved by WTO in its capacity as a forum for negotiation since the Doha Round began in 2001. It is estimated that the entry into force of the Trade Facilitation Agreement would deliver increased trade flows in the range of US$ 400 billion to US$ 1 trillion annually, and that international trade costs would be reduced by between 10% and 15% (WTO, 2014c). Indeed, customs formalities often cost more than tariffs. For this reason, the greatest benefits could stem from aspects such as harmonizing documents, streamlining customs procedures and increasing the predictability of customs regulations (OECD, 2013). Nevertheless, the ongoing uncertainty over the entry into force of the Trade Facilitation Agreement has cooled some of the optimism that had prevailed at WTO since the Bali conference (see box I.4).

In parallel with the Doha Round, a number of plurilateral trade liberalization initiatives have been undertaken at WTO (see table I.1). Some are intended to update existing plurilateral agreements that have been in force for nearly two decades, such as the Agreement on Government Procurement (AGP) and the Information Technology Agreement (ITA). Others seek progress in areas included in the Doha Round (particularly the liberalization of trade in environmental goods and services) in respect of which consensus has not yet been reached. In some plurilateral processes, the benefits obtained will be extended to non-participant countries, while other initiatives will only yield benefits for the parties to the agreement in question. Some of these plurilateral processes have an organic relationship with WTO, whereas others have an indirect connection.

Recent plurilateral negotiations, despite their diversity, reflect the interest of a number of WTO members in exploring options for breaking the years-long Doha Round impasse. At the same time, these initiatives raise questions over the future of the multilateral trade system, considering that many WTO members (mainly developing and least developed countries) are not participating in the negotiations.

Box I.4
The WTO Agreement on Trade Facilitation

The Agreement on Trade Facilitation (ATF), reached at the Ninth Ministerial Conference of WTO in Bali, Indonesia, is aimed at streamlining customs processes, reducing the costs and time associated with trade procedures, increasing efficiency and transparency, and utilizing advances in technology to facilitate international trade. Although articles V, VIII and X of the General Agreement on Tariffs and Trade (GATT) contain provisions relating to trade facilitation, the transit of goods, fees and formalities connected with importation and exportation, and the publication and administration of trade regulations, the Agreement covers these matters in a more specific and up-to-date manner.

The Agreement contains two main sections. The first includes several commitments that the members of WTO must apply in the following areas:

(i) the publication of import and export rules and procedures;
(ii) the issue of advance rulings on the tariff classification and origin of imported goods;
(iii) procedures for appeal or review;
(iv) fees and charges imposed on imports or exports;
(v) release and clearance of goods;
(vi) procedures for expedited shipments and perishable goods;
(vii) border agency cooperation;
(viii) the use of international standards and best practices;
(ix) the development of single windows for foreign trade;
(x) common border procedures and uniform documentation requirements.

The Agreement also created a Committee on Trade Facilitation within WTO, and stipulates that members of the Organization must establish national committees to facilitate the domestic coordination and implementation of the provisions of the Agreement.

The second section of the Agreement, on special and differential treatment for developing and least developed countries, states that these countries may implement the provisions contained in the first section in accordance with the conditions set forth in one of three categories. These categories are as follows:

- Category A: provisions that each country designates for implementation upon entry into force of the Agreement, or in the case of a least-developed country, within one year after entry into force.
- Category B: provisions that each country designates for implementation at a later date, determined by the country.
- Category C: provisions that each country designates for implementation at a later date, determined by the country and subject to the provision of assistance and support for capacity-building.

Each developing and least developed country will self-designate the provisions it is including in each category. This approach to special and differential treatment is far from the habitual practice of prior WTO agreements, both because it is applied on an individual basis and because the implementation of certain provisions is conditional on the countries receiving the assistance they require for this purpose (Neufeld, 2014). Similarly, grace periods were agreed upon, during which the dispute settlement mechanism of WTO would not be applied against developing and least developed countries in relation to the implementation of provisions under categories A, B and C. These periods range from two to eight years following the entry into force of the Agreement, depending on whether provisions are applied by developing or least developed countries, as well as on the category of the provision in question.

Although the trade facilitation talks adhere to the "single undertaking" principle under which the Doha Round is being negotiated, the agreements reached in Bali foresee the possibility that the Agreement enter into force independently of developments in the other areas of negotiation. This requires the approval of a protocol of amendment that formally inserts the Agreement on Trade Facilitation into the current list of WTO agreements. This protocol must in turn be ratified by the various Member countries. The Agreement will enter into force among States that have ratified the protocol when these account for two thirds of the members of WTO. However, the members of WTO were unable to approve the protocol by the deadline that was set in Bali (31 July 2014) owing to India's opposition due to the lack of progress on some of the agreements on agriculture that were reached in Bali. Entry into force is therefore currently suspended, with consultations due to resume in September 2014.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Trade Organization (WTO), Agreement on Trade Facilitation [online] http://wto.org/english/thewto_e/minist_e/mc9_e/balipackage_e.htm#trade_facilitation [date of reference 9 June 2014]; Nora Neufeld, "The long and winding road: how WTO members finally reached a Trade Facilitation Agreement", *Staff Working Paper* ERSD 2014-06, Geneva, April 2014 [online] http://wto.org/english/res_e/reser_e/ersd201406_e.pdf; Organization for Economic Cooperation and Development (OECD), *Trade Policy Implications of Global Value Chains*, Geneva, May 2013 [online] http://www.oecd.org/sti/ind/Trade_Policy_Implicatipns_May_2013.pdf; WTO, *Annual Report 2014*, Geneva, 2014 [online] http://www.wto.org/english/res_e/publications_e/anrep14_e.htm.

Table I.1
Main plurilateral trade negotiations, August 2014

	Agreement on Government Procurement	Information Technology Agreement	Trade in Services Agreement	Environmental Goods Agreement
Aim	To update the rules of the original 1994 agreement, and to expand the coverage of entities subject to its commitments on openness.	To expand the coverage of products included in the original 1996 agreement to reflect progress in this sector.	To liberalize trade in services among its members.	In the initial stage, to eliminate tariffs on a list of environmental goods, as yet to be determined. In the second stage, to eliminate non-tariff barriers and liberalize trade in environmental services.
Relationship with WTO	WTO agreement	WTO agreement	No official relationship, though negotiations are based on the WTO General Agreement on Trade in Services.	No official relationship
Number of participants	43 [a]	78 [a]	51 [a]	43 [a]
Percentage of world trade in the respective sector	Not available	97	70	86
Application of most-favoured-nation (MFN) treatment	No	Yes	To be determined	Yes
Latin American and Caribbean participants	None	Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Peru	Chile, Colombia, Costa Rica, Mexico, Panama, Paraguay and Peru [b]	Costa Rica
Status	Negotiations were finalized in 2012. The agreement entered into force in April 2014.	Negotiations commenced in June 2012 and are in progress. The main disagreement is between China and the United States over the extent to which the coverage of the original agreement should be expanded.	Negotiations commenced in March 2013 and are in progress.	Negotiations commenced in June 2014 and are in progress.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from World Trade Organization [online] www.wto.org; Directorate-General for Trade of the European Commission [online] http://ec.europa.eu/trade/policy/eu-and-wto/; and Office of the United States Trade Representative [online] www.ustr.gov.
[a] Includes the 28 member States of the European Union, and the European Union in its own right.
[b] Uruguay has requested to participate in the negotiations.

3. The Trans-Pacific Partnership

March 2014 marked four years since the beginning of talks on the Trans-Pacific Partnership (TPP). Although it was initially hoped that negotiations could be concluded within two years, the inclusion of new countries (Canada, Mexico and especially Japan), as well as the complexity of the issues under consideration, led to this time frame being extended on several occasions.

One of the main topics presently under negotiation concerns conditions for access to the Japanese market for some highly sensitive agricultural products, such as beef and pork, dairy products and cereals. Since Japan's accession to TPP negotiations in 2013, the United States has sought to reduce the high tariffs and other barriers that Japan imposes on imports of these products. These negotiations have been largely bilateral, raising the possibility that any concessions by Japan will not be extended on an equal basis to all TPP countries, which would contravene one of the basic initial premises of the agreement. It thus remains a possibility that Chile, Mexico and Peru will be unable to obtain more favourable terms of access to the Japanese market under TPP than were agreed in their respective free trade agreements with that country.

There are also difficulties in other areas related to market access. For example, an agreement has still not been reached on the rules of origin applicable to clothing exports from Viet Nam. These provisions of TPP are of special concern for Central American countries and the Dominican Republic, which have expressed worries over the impact that Viet Nam's preferential access to the United States market might have on the extensive textile and clothing supply chains developed under CAFTA-DR (ECLAC, 2013).[14]

Sticking points in market access negotiations have spilled over into the talks on chapters covering trade rules, since various countries have taken the position of explicitly linking progress in the two areas. For example,

[14] This issue was raised in April 2014 by the President of the Dominican Republic, Danilo Medina, in a letter to the President of the United States, Barack Obama. President Obama responded that the United States would weigh the interests of its CAFTA-DR partners in its negotiations on this sector (World Trade Online, 2014a).

agreements have not yet been reached on a number of issues related to intellectual property (especially the protection of pharmaceutical and biological products, as well as copyright), investments (such as the possible inclusion of a mechanism for investor-State dispute settlement) and State-owned enterprises, or on the possible application of the dispute settlement chapter to labour and environmental commitments.

Another fundamental issue in these negotiations is that the Trade Promotion Authority (TPA) has not yet been renewed in the United States. This legislative procedure is required so that the United States Congress can vote on the TPP without the opportunity for amendments. Any delay in enacting the bill to renew TPA, which was submitted in January 2014, could affect the time frame for the conclusion of TPP negotiations, since several countries have indicated that the agreement cannot be finalized without this legislation (World Trade Online, 2014e). However, in June 2014, President Obama stated that negotiations should be concluded in November 2014. Meanwhile, a number of Asian economies have continued to express an interest in joining the talks, and the Republic of Korea and Taiwan Province of China have already launched feasibility studies in this regard. Despite this, it is not likely that new members will be admitted to TPP until negotiations between the current participants have been completed.

4. The Transatlantic Trade and Investment Partnership

Negotiations on the Transatlantic Trade and Investment Partnership (TTIP), which aims to create a free trade zone between the United States and the European Union, entered their second year in June 2014. Given that the tariffs on trade between the two parties are relatively low (2% to 3% for most goods), the main objective of TTIP is to reduce or harmonize non-tariff barriers to bilateral trade. This would involve greater compatibility in the regulations that are currently in place in the two markets (USTR, 2014a). This is no small challenge, since the two systems have significant differences in terms of processes, structures and content. Two components are being addressed in the TTIP framework: (i) horizontal regulatory cooperation (or regulatory coherence), which focuses on the process of drafting regulations; and (ii) sectoral regulatory cooperation.

In terms of horizontal cooperation, the United States is seeking to increase the involvement of stakeholders, whether public or private, local or foreign, in the process of drafting regulations in the European Union. This proposal has encountered considerable resistance from the European business sector. The European Commission recently stated that horizontal cooperation should focus on avoiding conflicts between the two regulatory systems, and that stakeholders could participate in the regulatory process, albeit subject to the respective legal and institutional frameworks (World Trade Online, 2014d). In practical terms, this might be an indication of the European Union's willingness to implement notification and comment processes prior to the entry into force of new regulations that might have an impact on trade. Nevertheless, this is a lesser degree of participation than was proposed by the United States.

On sectoral compatibility, the European Union is pursuing specific gains in areas such as trade in automobiles, pharmaceuticals and chemicals and medical equipment, as well as rules for determining compliance with safety standards for certain products (World Trade Online, 2014b). The European Union also stated that TTIP should promote regulatory compatibility in the financial services sector. The United States has rejected this position, arguing that any cooperation in this sphere should take place under multilateral bodies such as the Financial Stability Board or the Group of 20 (G20). The United States is also advocating regulatory compatibility in the agricultural sector, especially for products such as beef. However, the European Union has said that it will not amend its regulations prohibiting the importation of hormone-treated beef (World Trade Online, 2014b).

Another area in which the European Union and the United States broadly differ is that of personal data protection. In March 2014, the European Parliament enacted data protection legislation containing strict provisions on when firms can collect information on consumers and the responsibilities of third parties should they have obtained access to these data. Meanwhile, a European Parliament report, based on an investigation into the surveillance activities of the National Security Agency of the United States, stated that the approval of TTIP could be in jeopardy if the United States does not protect consumers' rights to privacy. The United States maintains a position favourable to the free flow of data.

Partly owing to the recent crisis in Ukraine, the European Union wishes to include a chapter in TTIP referring to trade in energy and raw materials, especially liquefied gas and oil. The European Union is seeking ambitious commitments in this area, since one of its priorities is to reduce its energy dependence on the Russian Federation by diversifying its

suppliers. Geographical indications are an important intellectual property issue that is a priority for the European Union but is meeting resistance from the United States (World Trade Online, 2014c). Lastly, options are being studied for the inclusion of an investor-State dispute settlement mechanism in TTIP. The European Union was initially against the inclusion of such a mechanism, though it has recently showed signs of greater flexibility and even proposed an appeal mechanism.

5. The Regional Comprehensive Economic Partnership

Negotiations for the establishment of a Regional Comprehensive Economic Partnership (RCEP) formally commenced in 2012 and included the 10 member States of the Association of Southeast Asian Nations (ASEAN), plus Australia, China, India, Japan, New Zealand and the Republic of Korea. RCEP is the culmination of ASEAN efforts to set up a larger integrated economic space by creating a free trade zone between the aforementioned countries. Outside of Asia, this process has received less attention than TPP and TTIP. However, it is potentially significant, since it includes all the main actors of "Factory Asia" (notably China, which is not involved in TPP negotiations). As such, a potential agreement on RCEP would, like TPP, form a natural reference point for subsequent negotiations on a free trade area for Asia and the Pacific, which has been among the Asia-Pacific Economic Cooperation objectives since 2006.

In accordance with its guiding principles and objectives, RCEP would be broad in scope, covering trade in goods and services, investment, economic and technical cooperation, intellectual property, competition policy, dispute settlement and institutional and legal aspects. In 2014, negotiations have mainly focused on trade in goods, services and investments. Progress is already being made on commitments to eliminate tariffs and non-tariff barriers, and on customs procedures, trade facilitation, sanitary and phytosanitary measures and rules of origin, among others. In terms of trade in services, the parties have begun to determine the scope of the commitments to be addressed.[15] It is expected that negotiations will be concluded in late 2015.

E. Trade in Latin America and the Caribbean

1. Foreign trade in the first half of 2014

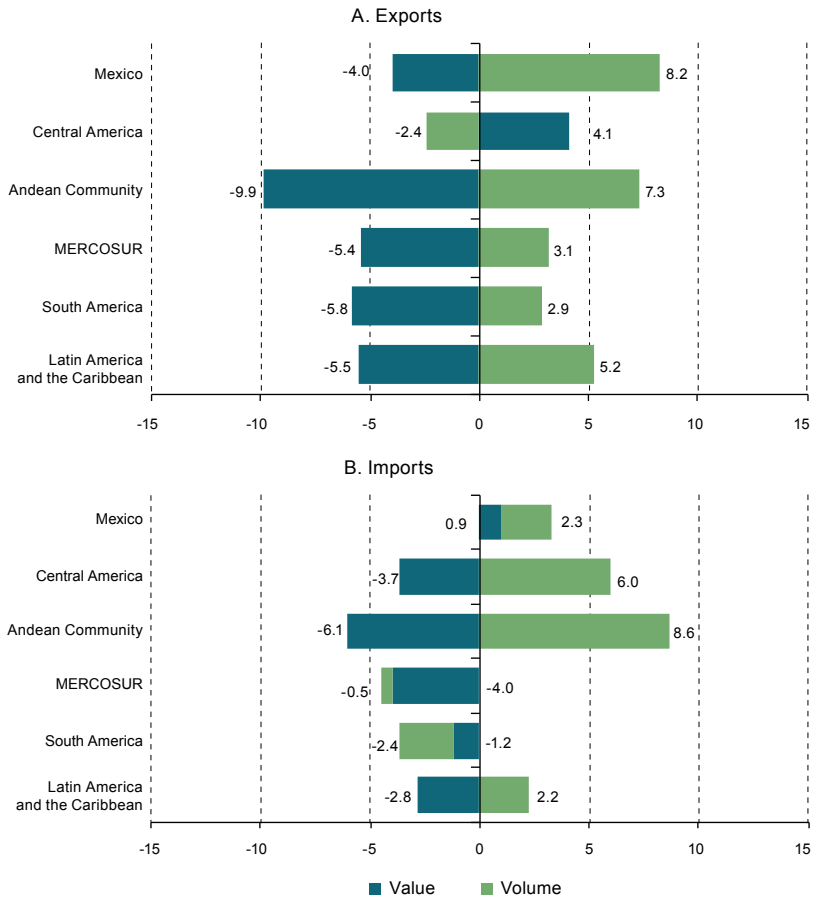
During the first half of 2014, the value of Latin American and Caribbean exports slipped by 0.3% compared with the same period in 2013. This change was the result of a 5.2% increase in the volume of exports, and a 5.5% drop in prices. Imports dropped by 0.6%, as a 2.2% increase in volume failed to offset a 2.8% fall in prices. The fall in export prices was widespread and affected all subregions. Prices declined most sharply in the Andean Community (see figure I.9).

In the first half of 2014, the countries that posted the sharpest year-on-year increases in exports were Ecuador (9.7%), Paraguay (9.2%), Uruguay (8.2%) and Nicaragua (8.2%). Peru and Argentina recorded the largest decreases (10.2% and 10.1%, respectively). Trends varied somewhat in the other countries, with exports diminishing in El Salvador (by 5.5%), Colombia (4.4%) and Brazil (3.4%), and rising in Cuba (up by 6.9%), the Plurinational State of Bolivia (6.6%), Mexico (4.2%) and Guatemala (4%). Among the subregional integration schemes, exports from the Caribbean Community (CARICOM) declined (by 5.3%), as did those of the Southern Common Market (MERCOSUR) (3.6%) and the Andean Community (2.6%). However, exports from the Central American Common Market (CACM) were up by 1.7% (see table I.2).

Mexico and Central America made a positive contribution to regional exports, thanks to rising demand from the United States. By contrast, the MERCOSUR countries experienced a drop-off in exports to the European Union that was more than three times the figure for the region. The value of intraregional trade flows decreased in eight of the region's countries, a trend that was most pronounced in Argentina and Brazil (falls of 16.1% and 12.7%, respectively), followed by Colombia (11.1%) and, in Central America, El Salvador (4.3%). Mexico and Chile also reported declining trade with the rest of the region.

[15] See New Zealand Ministry of Foreign Affairs and Trade [online] http://mfat.govt.nz/Trade-and-Economic-Relations/2-Trade-Relationships-and-Agreements/RCEP/index.php [date of reference: 30 June 2014].

Figure I.9
Latin America and the Caribbean: year-on-year variation in foreign trade by value and volume, January to June 2014
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the countries.

Table I.2
Latin America and the Caribbean: year-on-year variation in half-yearly growth in foreign trade in goods, by main destination, January to June 2014
(Percentages)

Region/Subregion/Country	Exports					Imports				
	Latin America and the Caribbean	United States	European Union	Asia	World	Latin America and the Caribbean	United States	European Union	Asia	World
Latin America and the Caribbean	**-5.6**	**2.6**	**-0.5**	**1.6**	**-0.3**	**-5.2**	**2.7**	**-6.0**	**1.8**	**-0.6**
Latin America	**-6.0**	**3.0**	**-0.3**	**1.6**	**-0.2**	**-5.5**	**2.6**	**-5.2**	**1.8**	**-0.6**
South America	**-7.4**	**-4.0**	**-0.6**	**2.0**	**-2.9**	**-6.1**	**-1.8**	**-7.5**	**0.2**	**-3.4**
Southern Common Market (MERCOSUR)	**-10.0**	**5.8**	**-2.6**	**-0.8**	**-3.6**	**-6.2**	**-5.0**	**-7.6**	**-1.1**	**-4.5**
Argentina	-16.1	-3.5	7.4	-11.4	-10.1	-18.8	11.9	-10.9	-2.5	-7.5
Brazil	-12.7	11.0	-4.3	1.9	-3.4	-10.1	0.1	-6.1	-0.5	-3.8
Paraguay	24.2	-39.7	-14.5	28.2	9.2	-0.6	-6.2	-0.4	-14.8	-5.3
Uruguay	7.9	3.4	-5.8	7.0	8.2	3.7	35.4	26.0	7.7	9.2
Venezuela (Bolivarian Republic of)	-1.3	3.6	-1.5	-3.2	-0.9	20.8	-30.3	-21.7	0.3	-5.9
Andean Community	**-1.9**	**-14.9**	**3.8**	**9.1**	**-2.6**	**-4.5**	**7.5**	**3.0**	**6.3**	**2.6**
Bolivia (Plurinational State of)	-0.1	46.4	3.4	8.1	6.6	1.4	-5.3	32.9	35.1	10.7
Colombia	-11.1	-30.6	18.8	42.1	-4.4	-6.0	14.2	1.9	11.8	6.1
Ecuador	11.2	5.8	1.8	1.5	9.7	-2.9	0.3	2.1	-8.2	-1.6
Peru	-2.8	-13.9	-15.0	-4.6	-10.2	-5.6	3.1	0.1	4.7	-1.1

Table I.2 (concluded)

Region/Subregion/Country	Exports					Imports				
	Latin America and the Caribbean	United States	European Union	Asia	World	Latin America and the Caribbean	United States	European Union	Asia	World
Central America	**4.8**	**1.0**	**-2.1**	**-6.4**	**1.7**	**-8.7**	**13.6**	**-4.3**	**13.6**	**2.2**
Costa Rica	1.7	1.4	3.4	-2.4	1.7	-0.9	7.4	6.7	15.7	1.4
El Salvador	-4.3	-3.4	-20.9	-10.7	-5.5	-3.9	6.3	-0.6	3.5	-0.7
Honduras	9.0	0.9	-8.5	-7.7	2.0	-6.9	6.7	23.7	17.2	5.1
Guatemala	10.7	2.4	0.9	-14.6	4.0	-3.9	34.1	-21.0	18.7	3.0
Nicaragua	8.6	5.8	-5.4	10.4	8.2	...	...	...	...	1.4
Panama	...	...	...	...	1.0	...	...	...	...	3.2
Caribbean Community (CARICOM)	**8.8**	**-13.3**	**-6.6**	**...**	**-5.3**	**2.4**	**5.9**	**-34.1**	**...**	**2.0**
Mexico	-6.6	5.8	2.2	-0.1	4.2	2.0	4.0	-0.1	3.2	3.2
Chile	-1.3	-15.8	3.0	8.1	0.1	-8.4	-10.7	-20.6	-3.0	-8.8
Cuba	13.0	...	-58.9	...	6.9	-0.3	...	-3.6	...	-3.3
Dominican Republic	...	...	...	...	2.3	...	...	...	...	3.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the countries.

By destination, the goods exports that diminished most during the first half of the year were those to other countries in the region and to the European Union, which fell by 5.6% and 0.5%, respectively. Conversely, the region's exports to the United States and Asia grew —the latter because rising exports to China offset a downturn in exports to the rest of Asia. Goods imports from within the region and from the European Union decreased, while those from Asia rose by 1.8%, again thanks to imports from China, which continue to grow at rates in excess of 5% (see table I.3).

Table I.3

Latin America and the Caribbean: year-on-year variation in half-yearly growth in foreign trade in goods, first half of 2012 to first half of 2014

(Percentages)

	Exports			Imports		
	January to June 2012	January to June 2013	January to June 2014	January to June 2012	January to June 2013	January to June 2014
World	**3.9**	**-1.2**	**-0.3**	**6.8**	**4.1**	**-0.6**
United States	4.6	-2.1	2.6	8.9	1.6	2.7
European Union	-4.0	-8.2	-0.5	10.9	7.5	-6.0
Asia	11.0	5.4	1.6	7.6	10.0	1.8
China	13.2	-1.0	4.6	11.9	6.6	5.2
Other countries in Asia	8.8	8.6	-1.3	3.2	2.5	-2.4
Latin America and the Caribbean	3.4	0.8	-5.6	1.1	0.6	-5.5

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the countries.

During the first half of 2014, the imports that diminished most within subregional integration schemes were those of intermediate and capital goods. In MERCOSUR, exports from Argentina to the other members of the bloc decreased by 20%, with imports and exports of industrial manufactures falling by 30% and 14%, respectively (INDEC, 2014).[16] Meanwhile, Brazil's imports from other MERCOSUR countries dipped by 11% in the first half of 2014 (notably imports from Argentina, which were down 17%) (SECEX, 2014).

Reciprocal goods purchases between the countries of the Andean Community were down 4.2%. The sharpest declines were in the category of manufactured goods, as reflected by a 12% fall in Colombian exports to the rest of the group (and particularly to Ecuador). Overall, exports of capital and intermediate goods were down, especially fuels and lubricants, essential oils, perfumes and cosmetics, as well as plastics and plastic manufactures (DANE, 2014). Similarly, exports from Peru to the rest of the group diminished by 11% (MINCETUR, 2014).

The products that have recorded the steepest decline in exports are sugar, beverages, meat, soybeans, oil and some minerals, especially coal, copper and zinc. As of June 2014, the export value of 70% of the region's most important export products had slid by 20% (see ECLAC, 2014a).

[16] Bilateral exports between Argentina and Brazil fell the most, especially in the categories of capital goods parts and accessories (down 28%), passenger vehicles (28%) and capital goods (22%) (INDEC, 2014).

Colombia and Peru were the countries hit hardest by the softening of oil prices, as well as by the steep drop in the prices of coal and metals (the main products in their export baskets). In South America, the Plurinational State of Bolivia, Ecuador, Paraguay, Uruguay and, to a lesser extent, Chile, saw improved export performance.

2. Foreign trade growth projections for 2014

In view of developments in foreign trade in the region in the first half of 2014 and the information available up to July for Argentina, Brazil, Chile, Mexico and Uruguay, projections for the entire year are for modest growth (0.8%), with imports contracting by 0.6%. Leaving out the countries of CARICOM, Latin America's exports and imports are expected to edge up by 0.9% and down by 0.5%, respectively. This is likely to be the third consecutive year of slack growth in exports by value, a picture that is mainly attributable to (i) sluggish external demand, mainly from the region and the European Union, leading to lower export volumes in some of the region's commodities and manufactures; and (ii) falling prices for a considerable number of goods in the region's export basket, especially mined commodities (coal, copper, iron, zinc, nickel and gold, among others). Decreases are expected in exports of bananas, cereals, legumes, fruits, copper and oil, while manufactures likely to be affected include intermediate agro-industrial products (such as sugar and other inputs for the food and beverage industry, animal oils and fats and cereals), automobiles and auto parts and electrical machinery and equipment.

Goods exports are expected to rise by around 1.9% in value in the second half of 2014, which would mean a recovery in respect of the first six months of the year. Imports, however, are likely to continue on a negative growth track (see table I.4).

Table I.4

Latin America and the Caribbean: year-on-year variation in half-yearly growth in foreign trade in goods, 2013 and 2014

(Percentages)

Region/Subregion/Country	Exports				Imports			
	2013	January to June 2014 [a]	July to December 2014 [b]	2014 [b]	2013	January to June 2014 [a]	July to December 2014 [b]	2014 [b]
Latin America and the Caribbean	**-0.4**	**-0.3**	**1.9**	**0.8**	**2.6**	**-0.6**	**-0.6**	**-0.6**
Latin America	**-0.2**	**-0.2**	**1.9**	**0.9**	**2.7**	**-0.6**	**-0.5**	**-0.5**
South America	**-1.8**	**-2.9**	**-0.6**	**-1.7**	**3.1**	**-3.4**	**-2.3**	**-2.8**
Southern Common Market (MERCOSUR)	**-1.4**	**-3.6**	**-0.9**	**-2.3**	**3.9**	**-4.5**	**-2.6**	**-3.6**
Argentina	0.9	-10.1	-0.3	-5.2	7.5	-7.5	-5.8	-6.6
Brazil	-0.2	-3.4	-2.7	-3.0	7.4	-3.8	-2.6	-3.2
Paraguay	29.5	9.2	19.7	14.1	5.1	-5.3	-4.5	-4.9
Uruguay	4.1	8.2	18.7	13.6	-0.1	9.2	2.9	5.9
Venezuela (Bolivarian Republic of)	-9.1	-0.9	-0.8	-0.8	-11.2	-5.9	0.7	-2.8
Andean Community	**-3.0**	**-2.6**	**-0.5**	**-1.5**	**3.2**	**2.6**	**0.3**	**1.4**
Bolivia (Plurinational State of)	3.3	6.6	10.5	8.6	9.2	10.7	2.9	6.5
Colombia	-2.2	-4.4	0.7	-1.8	0.5	6.1	1.9	3.9
Ecuador	4.5	9.7	8.9	9.3	8.5	-1.6	2.3	0.4
Peru	-9.7	-10.2	-10.9	-10.6	2.7	-1.1	-3.6	-2.3
Central America	**-0.6**	**1.7**	**6.2**	**3.9**	**1.9**	**2.2**	**3.6**	**2.9**
Costa Rica	2.6	1.7	5.5	3.6	2.4	1.4	2.4	1.9
El Salvador	2.8	-5.5	2.8	-1.5	5.0	-0.7	1.5	0.4
Honduras	-10.6	2.0	5.0	3.4	-3.0	5.1	-2.3	1.3
Guatemala	0.5	4.0	9.7	6.7	3.0	3.0	7.9	5.5
Nicaragua	-10.3	8.2	6.6	7.4	-3.9	1.4	-1.8	-0.2
Panama	2.7	1.0	2.4	1.8	3.2	3.2	7.7	5.5
Caribbean Community (CARICOM)	**-10.3**	**-5.3**	**-3.2**	**-4.3**	**-2.1**	**2.0**	**-5.1**	**-1.6**
Mexico	2.5	4.2	5.8	5.0	2.8	3.2	1.5	2.3
Chile	-1.6	0.1	1.4	0.8	-1.2	-8.8	-5.3	-7.0
Cuba	-2.3	6.9	2.0	4.3	-0.3	-3.3	12.3	4.4
Dominican Republic	6.4	2.3	4.1	3.1	-7.1	3.7	-4.6	-0.6

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the respective countries.
[a] Preliminary official figures issued by the statistics offices, customs service and central banks of the countries of the region.
[b] ECLAC projections.

For 2014 as a whole, the most vigorous growth in export values is expected in Paraguay, Uruguay, Ecuador and the Plurinational State of Bolivia, which already posted the best export performance in the first half. The sharpest drop-offs are expected in Peru, Argentina, the CARICOM countries and Brazil. The low growth rate in the region is principally due to the relative economic weight of the five countries whose exports declined (Argentina, Colombia, Brazil, Peru and the Bolivarian Republic of Venezuela), which together account for 40% of the region's export bill. Mexico, Chile and the Central American countries, meanwhile, boosted regional exports, accounting for 36%, 7% and 3.5% of the total, respectively. Intraregional exports are expected to contract by 4,9% and exports to the European Union by 0.7%.

Imports are expected to continue to slow down in the second half of 2014, albeit only slightly (contracting by 0.6%). A reduction in external demand for capital and consumer goods is forecast for the year as a whole, with the steepest drop-off in capital goods imports expected in Chile, Peru and the member States of MERCOSUR (with the exception of Uruguay) and CARICOM (see table I.4).

The region ran a trade deficit of about US$ 8.5 billion in the first half of 2014. As in previous years, the CARICOM and Central American countries, Cuba and the Dominican Republic had large unfavourable trade balances which outweighed the surpluses posted by South America's major primary goods export economies. Argentina, the Bolivarian Republic of Venezuela, Chile and the Plurinational State of Bolivia were the only countries to register surpluses in the first half of 2014. A trade deficit of some US$ 1.5 billion is expected for the entire year, with the surpluses of the aforementioned countries proving insufficient to offset both the large deficits caused by the region's sluggish export growth and the reversal of the surplus built up by some South American countries over a decade of growth in raw materials exports.

The sharpest falls in exports are expected to occur in the mining and petroleum sectors, which, according to estimates, will contract by 3.2% between July and December 2014. Argentina, Guatemala and Mexico have already seen their crude oil exports slip back during the first half of the year, while mineral exports from Chile and Peru slumped, particularly copper in the former, and minerals such as copper, gold, lead, iron and refined silver in the latter. On the whole, the sector has suffered from falling prices, which are projected to be below 2013 levels (see figure I.10).

As noted above, exports of manufactured goods are expected to grow more slowly than in previous periods. This can chiefly be explained by reduced levels of activity in intraregional supply chains, which consume a particularly large amount of the manufactures produced in the region.

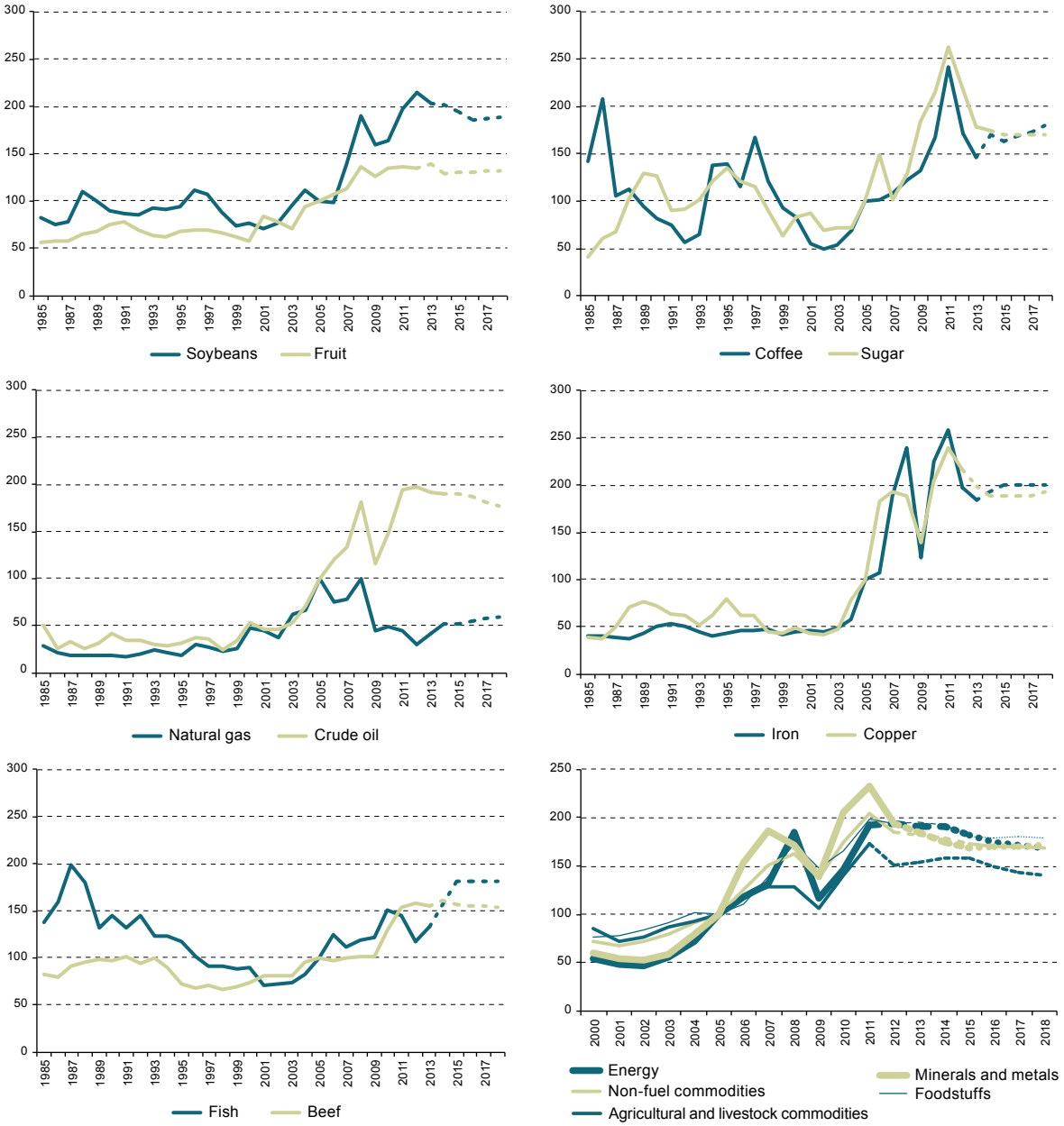
Exports of agricultural and livestock products are expected to pick up in the second half of 2014 as a result of the Russian Federation's freeze on food imports from the European Union. The Russian embargo on European products has opened up access to this market for Latin American exporters (see table I.5). Imports, especially of capital and consumer goods, will fall over the final six months of 2014.

In 2014, export growth is expected to be driven by an increase in volume, since prices will remain comparatively low, albeit above trend levels. Figure I.10 shows a historical index of prices for the region's ten main export products, together with projections for 2014 to 2018. Prices for the most recent period are, in all cases, above levels seen in the 1980s and 1990s (see figure I.10). This remains the case even when prices are considered in real terms, as pointed out in *Latin America and the Caribbean in the World Economy, 2012* (ECLAC, 2012).

Figure I.10

Latin America and the Caribbean: prices of main export products, 1985-2018

(Index 2005=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from the World Bank, the International Monetary Fund (IMF) and the Organization for Economic Cooperation and Development (OECD).

Table I.5
Latin America: half-yearly interannual growth of foreign trade in goods, by main sectors, 2013 and 2014
(Percentages)

	Product group/Period	January to June 2013	July to December 2013	2013	January to June 2014 [a]	July to December 2014 [b]	2014 [b]
Exports	All sectors	-1.3	1.1	-0.1	-0.3	1.9	0.8
	Agricultural and livestock products	10.9	-3.4	3.5	-4.0	11.3	3.4
	Mining and oil	-9.7	-4.7	-7.2	-1.2	-3.2	-2.2
	Manufactured goods	1.1	5.4	3.3	1.5	2.0	1.8
Imports	All sectors	4.3	1.7	3.0	-0.6	-0.6	-0.6
	Capital goods	7.3	-2.1	2.3	-5.3	-7.0	-6.1
	Intermediate inputs	2.5	1.8	2.2	2.6	1.7	2.2
	Consumer goods	5.8	4.0	4.8	-0.9	-8.6	-4.9
	Fuels	5.1	3.2	4.2	-4.8	11.5	3.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the respective countries.
[a] Preliminary official figures issued by the statistics offices, customs service and central banks of the countries of the region.
[b] ECLAC projections.

Table I.6
Latin America and the Caribbean: foreign trade growth by country groupings, by value and volume, 2014 [a]
(Percentages)

Region/Subregion/Country	Exports			Imports		
	Price	Volume	Value	Price	Volume	Value
Latin America and the Caribbean	**-0.4**	**1.2**	**0.8**	**0.8**	**-1.4**	**-0.6**
Latin America	**-0.5**	**1.4**	**0.9**	**1.8**	**-2.4**	**-0.5**
South America	**-1.5**	**-0.2**	**-1.7**	**1.0**	**-3.8**	**-2.8**
Southern Common Market (MERCOSUR)	**-2.0**	**-0.2**	**-2.3**	**1.2**	**-4.8**	**-3.6**
Argentina	-0.8	-4.4	-5.2	0.5	-7.1	-6.6
Brazil	-2.3	-0.7	-3.0	1.6	-4.8	-3.2
Paraguay	-1.6	15.7	14.1	3.2	-8.1	-4.9
Uruguay	1.6	12.0	13.6	-0.6	6.5	5.9
Venezuela (Bolivarian Republic of)	-2.9	2.0	-0.8	0.4	-3.2	-2.8
Andean Community	**-0.3**	**-1.2**	**-1.5**	**1.7**	**-0.2**	**1.4**
Bolivia (Plurinational State of)	6.5	2.1	8.6	2.3	4.2	6.5
Colombia	-1.3	-0.6	-1.8	1.1	2.8	3.9
Ecuador	2.7	6.6	9.3	0.3	0.1	0.4
Peru	-3.6	-7.0	-10.6	3.2	-5.5	-2.3
Chile	**-0.7**	**1.5**	**0.8**	**-1.5**	**-5.5**	**-7.0**
Central America	**0.1**	**3.8**	**3.9**	**0.0**	**2.9**	**2.9**
Costa Rica	-1.6	5.2	3.6	-1.2	3.1	1.9
El Salvador	-0.6	-0.9	-1.5	0.3	0.1	0.4
Honduras	0.4	3.0	3.4	-0.4	1.7	1.3
Guatemala	1.4	5.3	6.7	0.4	5.1	5.5
Nicaragua	2.4	5.0	7.4	-0.5	0.3	-0.2
Panama	3.4	-1.6	1.8	1.6	3.9	5.5
Mexico	**1.7**	**3.3**	**5.0**	**1.4**	**0.9**	**2.3**
Dominican Republic	**2.2**	**0.9**	**3.1**	**-1.1**	**0.5**	**-0.6**
Caribbean Community (CARICOM)	**-6.8**	**2.5**	**-4.3**	**-7.0**	**5.4**	**-1.6**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the respective countries.
[a] ECLAC projections.

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Chapter II

Participation and upgrading in global value chains

A. Introduction

Entering regional and global value chains and upgrading within them, in terms of specialization, market share or value added, can be a powerful mechanism for promoting structural change, reducing structural heterogeneity among companies of different sizes, increasing economic productivity and generating productive employment opportunities. Over time, development policy in many emerging economies has shifted its focus from import substitution and export promotion towards finding a suitable entry point in vertically integrated global production chains or networks and subsequently upgrading within them. A priority for these countries is to attract foreign direct investment (FDI) from multinational corporations and promote the participation of domestic firms in these international production chains.

Participating in international chains has many potential benefits for domestic production systems. First, global value chains boost demand and support the host country in various areas through forward and backward supply-chain linkages. Such links generate technological benefits and improve the productivity of domestic firms through the dissemination of knowledge, technologies and organization and management processes. Moreover, participation in global value chains can raise the quality and the price of intermediate goods imports, depending on a country's openness to trade. Second, the benefits can spread to companies that do not participate directly in global value chains, thanks to greater competition and the demonstration effect of good business practices. Third, global value chains promote investment in infrastructure and services, which benefits the entire economy. For example, better logistics leads to more on-time, reliable transport of goods, enabling countries to enter global value chains with better results. Global value chains also benefit the labour market, as transnational corporations and domestic companies operating abroad require higher levels of training. Better training as a source of productivity (in the form of skilled workers) is not limited to these companies, because some of these workers will move on to domestic firms (Taglioni and Winkler, 2014).

The benefits of participating in these chains in terms of structural change with equality are not automatic, and they depend on at least three factors that will be discussed in this chapter. First, any benefits garnered by a company, sector or country as a result of its participation depend on the segment, chain governance and the potential for upgrading to higher-value-added segments. This potential, in turn, depends to a large extent on product, service or process innovation. Second, the inclusiveness of a chain depends on the participation of small and medium-sized enterprises (SMEs). The benefits for SMEs of participation do not occur automatically, but rather depend on such factors as their gains in terms of technology transfer, for example. The third factor is the facilities offered by the financial system for participation in value chains, in particular to SMEs.

At the regional level, few empirical studies provide analysis of the participation of companies, sectors and countries in regional or global value chains. And there are few studies on the nature of such participation and its contribution to structural change. ECLAC therefore organized a number of conferences in 2013 and 2014, and has published a number of papers on this subject.[1] This chapter summarizes the main findings of these studies. It concludes that the countries of Latin America have in general made little progress in the creation of regional chains or in their participation in global production networks or chains. Furthermore, the benefits of this limited participation in terms of structural change have been modest, given scant upgrading, the minimal presence of SMEs and limited access to financing. However, this chapter describes a number of good practices in some of the region's countries and sectors, which provide inputs for the design of better support policies.

Section B presents an overview of the extent to which the countries of Latin America participate in international value chains. Section C then looks at governance, innovation and upgrading within specific value chains. Sections D and E deal with two key aspects of a chain's inclusiveness: SME participation and access to financing. Lastly, section F presents the main conclusions.

[1] These papers deal with, among other subjects, the prospects and challenges for Latin American participation in global value chains (Hernández, Martínez-Piva and Mulder, 2014), Latin America's emergence in global services (Hernández and others, 2014), value chains as an industrial policy instrument (Padilla, 2014), inclusive development in Paraguay (ECLAC/JICA, 2014) and global value chains and export diversification in Costa Rica (ECLAC, 2014).

B. Participation of the countries of Latin America and the Caribbean in global and regional value chains

Available data for the countries of Latin America and Caribbean show that the region's inclusion in the three main global value chains (Factory North America, Factory Europe and Factory Asia) has been limited to date. Looking at this insertion in terms of trade in intermediate goods (an indicator commonly used to measure a country's participation in international value chains), the region is not a significant supplier of non-primary intermediate goods for global value chains. Nor is it a major importer of intermediate goods from the countries in these chains (especially in the case of the European Union —that is, Factory Europe— and Factory Asia) (Durán and Zaclicever, 2013). The exception is Mexico and, to a lesser extent, Central America, both of which participate (mostly in unsophisticated segments) in a number of different value chains centred in the United States (Factory North America) owing to their geographical proximity to that market and their lower labour costs. Levels of production integration within Latin America are also low, as illustrated by the small share of intraregional trade in total regional trade and the paucity of intra-industry linkages.

Disaggregating exports by goods category and geographical destination shows that intermediate goods account for just under 55% of intraregional exports (which equated to around 20% of total exports in 2012), versus around 65% of exports to extraregional markets. However, if primary products (basic intermediate goods) are excluded, the proportion falls to 33% and 27%, respectively (see figure II.1.A).[2] If Mexico is excluded, the region's exports of primary intermediate goods represent 52% of extraregional exports (see figure II.1), compared with 38% when Mexico is included. The largest proportion of primary intermediate goods goes to Factory Asia countries (represented here by the ASEAN+3 grouping)[3] followed by the European Union.

At the subregional level, intermediate goods make up around 70% of South American exports to the world, versus just under 50% in the case of Central America and Mexico; however, many of these goods are classified as primary. Regardless of destination market, South American exports are more skewed toward basic and semi-finished (natural-resource-based) intermediate goods than is the case for other countries of the region; non-natural-resource-based intermediate manufactures account for a very small share (see figure II.2.A). Intermediate goods with greater technological content (high- and medium-tech) account for a tiny proportion of extraregional exports, in particular exports to ASEAN+3 countries. In the case of Central America, however, high-tech intermediate goods make up a large share of exports to the Asian grouping, owing mainly to Costa Rican exports (see figure II.2.B).

Mexico is distinctive in that medium-tech products represent a large share of its intermediate goods exports to its North American Free Trade Agreement (NAFTA) partners (which —mainly the United States— receive over 80% of total Mexican exports) as well as to the region itself, accounting for around 20% of total exports in both cases (see figure II.2.C). However, medium- and high-tech end-use goods also make up a significant portion of Mexican exports, especially to these two destinations (where these categories of goods make up a combined share of almost 40%). The composition of Mexican exports reflects how the country is integrated in Factory North America: its participation consists primarily of exporting finished goods of low domestic value (Durán and Zaclicever, 2013). Its exports to the European Union, the ASEAN+3 grouping and the rest of the world, which account for a very small percentage of Mexican exports, are more concentrated in natural-resource-based intermediate goods.

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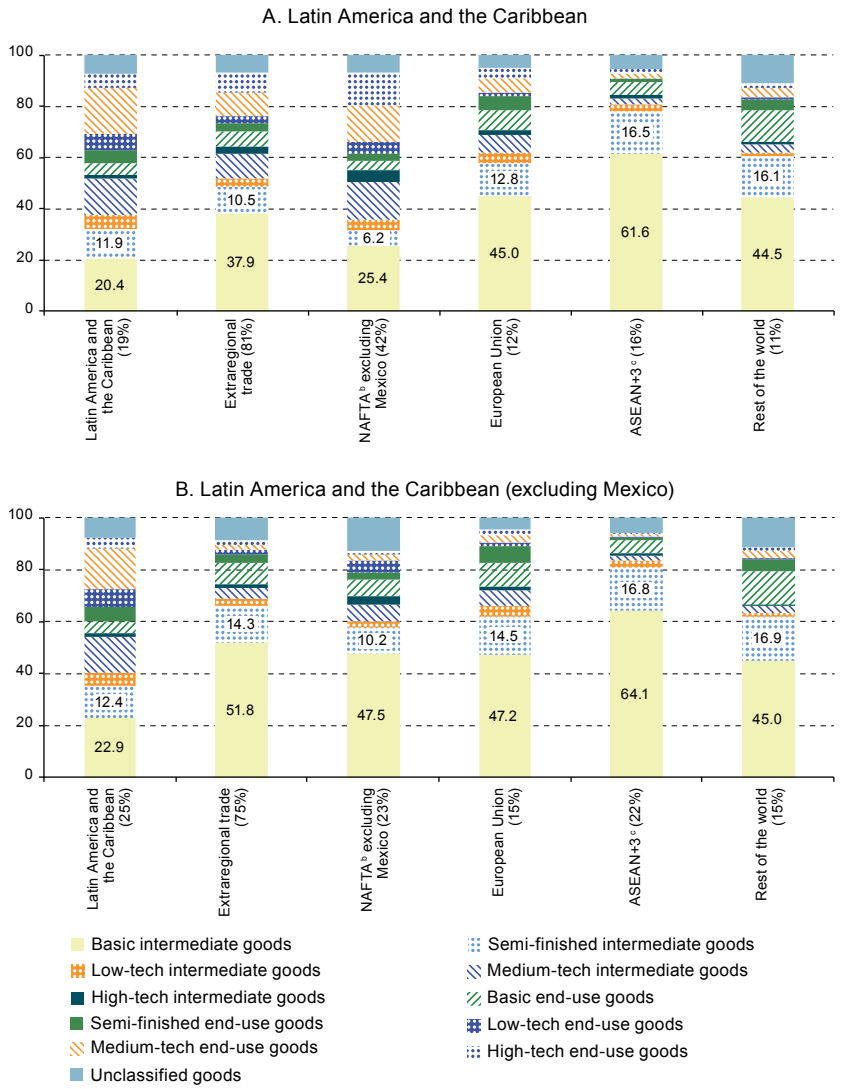
2 The categories of goods were constructed by combining the Classification by Broad Economic Categories (BEC) with a categorization of goods by technology content based on Lall (2000). The definition of the term "intermediate goods" in this chapter differs from that used in Chapter III (see figure III.3), which is much more restrictive since it includes only products classified as "parts and components" and some textile products, and excludes primary goods. Here, all goods that are not end-use (that is, consumption or investment) are classified as intermediate, but integration into international value chains is measured on the basis of trade in non-primary intermediate goods.

3 The ASEAN+3 grouping comprises the member countries of the Association of Southeast Asian Nations (ASEAN) plus China, Japan, the Republic of Korea, the Hong Kong and Macao Special Administrative Regions of China, and Taiwan Province of China.

Figure II.1

Latin America and the Caribbean: structure of goods exports by category and by destination, 2012 [a]

(Percentages of total goods exports to each destination)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Statistics Database (COMTRADE).

[a] The figures in parentheses on the horizontal axis of each figure indicate the share of each destination in the total goods exports of the Latin America and Caribbean grouping under consideration.

[b] North American Free Trade Agreement.

[c] The ASEAN+3 grouping comprises the member countries of the Association of Southeast Asian Nations (ASEAN) plus China, Japan, the Republic of Korea, the Hong Kong and Macao Special Administrative Regions of China, and Taiwan Province of China.

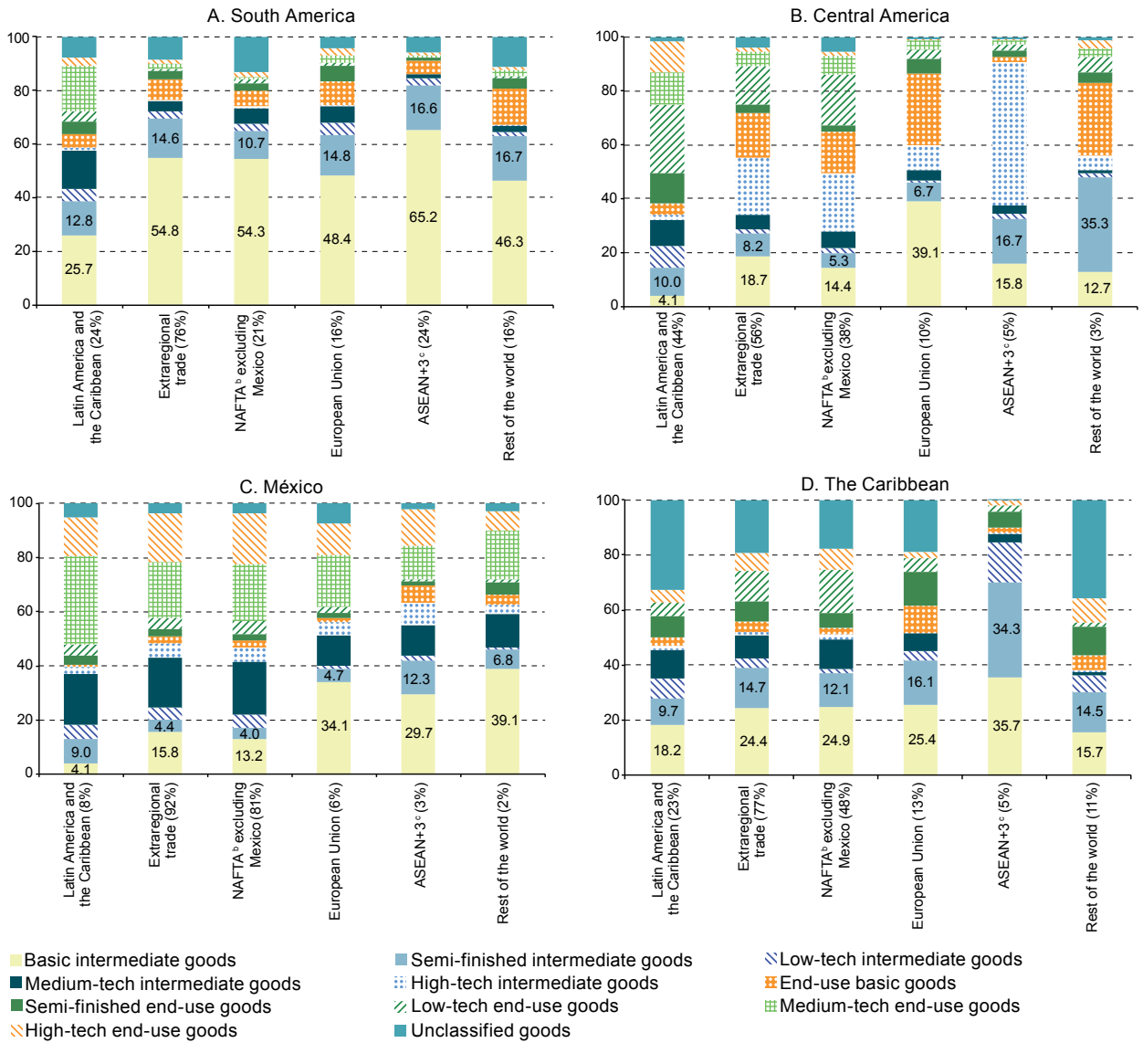
If the analysis were to focus solely on trade within Latin America and the Caribbean, aggregated data such as those presented above would suggest that few intraregional production networks have been developed. However, value chains do exist within some groups of countries. These include the members of the Central American Common Market; Colombia, Ecuador and Peru within the Andean Community; and Argentina, Brazil and Uruguay within the Southern Common Market (MERCOSUR). In order to perform a more detailed analysis of some of these intraregional chains, identified in ECLAC (2013) based on intra-industry trade indicators, a new approach is used here that combines bilateral trade data with information from input-output tables. The tables make it possible to connect products exported by a country with the imported inputs potentially used to produce them, thereby identifying production links between the countries participating in the different stages as suppliers or purchasers of the traded goods.[4]

[4] For more details on the methodology used, see Finot and Zaclicever (2014).

Figure II.2

Latin America and the Caribbean: structure of goods exports by category and by destination and subregion, 2012

(Percentages of total goods exports to each destination)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Statistics Database (COMTRADE).

[a] The figures in parentheses on the horizontal axis of each figure indicate the share of each destination in the total goods exports of the Latin America and Caribbean grouping under consideration.

[b] North American Free Trade Agreement.

[c] The ASEAN+3 grouping comprises the member countries of the Association of Southeast Asian Nations (ASEAN) plus China, Japan, the Republic of Korea, the Hong Kong and Macao Special Administrative Regions of China, and Taiwan Province of China.

The textile and clothing industries in the Andean Community and the Central America Common Market are used as examples. There are significant differences between them, although a common factor is the low level of linkages within each country grouping. In the Andean Community, the main exporters of textiles and clothing (both intermediate and end-use goods) are Peru and Colombia, whose exports amounted to around US$ 2.2 billion and US$ 1.2 billion, respectively, in 2012 (see table II.1). Although the value of these exports has risen sharply over the past decade, they represent a very small percentage of the respective countries' total exports (4.7% and 2% in 2012). In terms of export destination, most Peruvian textile and clothing exports go to South American countries that are not part of the grouping, whose share has soared since 2000, while the percentage going to the United States, the second-largest destination, has declined considerably. Colombian exports show a similar pattern (a focus on South American countries outside the grouping and a significant drop in the proportion going to the United States), although the Andean Community

itself is also a major destination whose share is markedly larger than in 2000. The percentage of textile and clothing exports from the Plurinational State of Bolivia and Ecuador —which are not significant in value terms— going to the United States has declined as well (especially in the case of the Plurinational State of Bolivia, whose exports now go primarily to the countries in the region that are not members of the Andean Community). The European Union and the ASEAN+3 grouping are not significant destinations for textile and clothing exports from the Andean bloc.

Table II.1
Andean Community and Central American Common Market: textile and clothing exports by destination market, 2000 and 2012
(Millions of dollars and percentages of total textile and clothing exports from each country)

	Exports of textiles and clothing *(millions of dollars)*		Andean Community		Central American Common Market		Rest of Latin America and the Caribbean		North American Free Trade Agreement (NAFTA) excluding Mexico		European Union		ASEAN + 3[a]	
	2000	2012	2000	2012	2000	2012	2000	2012	2000	2012	2000	2012	2000	2012
Andean Community	**1 576**	**3 592**												
Bolivia (Plurinational State of)	47	83	27.6	3.7	0.0	0.0	17.6	79.7	43.1	6.0	8.1	8.4	1.4	1.1
Colombia	791	1 167	6.6	23.8	3.7	4.7	37.0	43.9	43.6	21.6	6.0	4.4	0.2	0.7
Ecuador	56	164	52.3	54.4	1.0	0.9	18.8	20.7	19.3	6.4	7.5	10.3	0.2	6.1
Peru	683	2 177	5.2	10.7	0.4	0.7	11.0	45.7	61.8	30.9	14.2	7.4	5.9	2.8
Central American Common Market	**684**	**3 937**												
Costa Rica	428	263	0.1	0.7	6.4	6.4	2.3	5.6	90.7	61.4	0.3	9.7	0.0	14.9
El Salvador	143	2 166	0.3	0.1	56.1	17.4	6.8	2.2	35.8	79.8	0.9	0.4	0.0	0.2
Guatemala	102	1 479	0.1	0.1	52.5	14.8	8.0	3.9	37.0	78.5	0.4	0.8	0.3	0.3
Honduras	11	29	0.6	0.5	16.5	40.4	2.9	2.5	77.9	54.4	0.0	0.7	0.0	1.3
Nicaragua	3	3	38.5	0.2	4.3	61.7	0.0	7.9	48.9	21.9	4.8	7.0	0.0	0.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Statistics Database (COMTRADE).
[a] The ASEAN+3 grouping comprises the member countries of the Association of Southeast Asian Nations (ASEAN) plus China, Japan, the Republic of Korea, the Hong Kong and Macao Special Administrative Regions of China, and Taiwan Province of China.

The declining share of the United States as an export destination is due in part to the removal of the trade preference regime in early 2011. The arrangement had granted the four Andean Community countries tariff-free access to the United States market for a wide range of products in order to promote their economic development (and combat drug production and trafficking).[5] For Colombia and Peru, this instrument was replaced by bilateral free trade agreements signed by both countries with the United States (which entered into force in 2013). But Ecuador and the Plurinational State of Bolivia lost their preferential access to the United States market. Another key factor that explains the drop in textile and clothing exports from the Andean countries to the United States —and to extraregional markets in general— is rising competition from China and other Asian countries, especially since the World Trade Organization (WTO) Multi Fibre Arrangement came to an end in 2005.

In the Central American Common Market, El Salvador and Guatemala are the principal exporters of textiles and clothing, with sales of around US$ 2.2 billion and US$ 1.5 billion, respectively, in 2012 (see table II.1). Unlike in the Andean Community, these exports account for a substantial proportion of these countries' total exports, especially in the case of El Salvador, where the share was 40% in 2012 (versus 15% for Guatemala). Another difference is that the portion of textiles and clothing exports from El Salvador and Guatemala going to the United States has surged (representing almost 80% of total exports of these products in 2012 for both countries), while the share going to the Central American Common Market has contracted. Textile and clothing exports from the other countries in the grouping are not significant, and the percentage going to the United States has been falling, although this has been offset by an increase in the share going to Central American Common Market countries (in the case of Honduras and Nicaragua) or to destinations outside the region (for Costa Rica). The rising importance of the United States as a destination for Salvadoran and Guatemalan textile and clothing exports may be associated with the Dominican Republic-Central America-United States Free Trade Agreement, which entered into force for these two countries in 2006.

A breakdown of textile input imports associated with textile products and clothing exported by the countries of the Andean Community and Central American Common Market complements this initial presentation of the industries under consideration. As shown in table II.2, the main importers of these inputs are Colombia and Peru in the Andean Community, and El Salvador and Guatemala in the Central American Common Market. In other words, the principal

[5] The regime was initially established by the Andean Trade Preference Act (ATPA), enacted in 1991. It was replaced in 2002 by the Andean Trade Promotion and Drug Eradication Act (ATPDEA), which was in force until early 2011.

exporters of textiles and clothing in each regional grouping are also the main importers of textile inputs. With regard to the geographical origin of these imports, Colombia and Peru's main suppliers in 2012 were the Asian countries (members of the ASEAN+3 grouping and India, although the latter is not included in table II.2), whose share has increased considerably since 2000. The Andean Community itself is not an important source of textile input imports for Colombia or Peru (nor was it in 2000), which would indicate a low level of backward linkages from these countries to their partners in the bloc. By contrast, for Ecuador and, to a lesser extent, the Plurinational State of Bolivia, their Andean partners are significant suppliers of textile inputs (Colombia and Peru, in that order, for Ecuador, and Peru for the Plurinational State of Bolivia), although Asian countries are also a major source, especially for the Plurinational State of Bolivia. Given that Ecuador and the Plurinational State of Bolivia are not major exporters of textiles and clothing, their backward linkages in this industry within the Andean Community are of limited significance. With regard to extraregional sources, the United States is a significant supplier of inputs for Peru and, to a lesser extent, for Colombia (in addition to Ecuador). This may reflect some degree of integration of these countries into the North American chain (given that the NAFTA countries are still an important destination for Peruvian and Colombian exports, despite the decline seen in recent years).

Table II.2

Andean Community and Central American Common Market: textile imports by market of origin, 2000 and 2012

(Millions of dollars and percentages of total textile imports from each country)

	Imports of textile inputs *(millions of dollars)*		Andean Community		Central American Common Market		Rest of Latin America and the Caribbean		North American Free Trade Agreement (NAFTA) excluding Mexico		European Union		ASEAN+3 [a]	
	2000	2012	2000	2012	2000	2012	2000	2012	2000	2012	2000	2012	2000	2012
Andean Community	**874**	**2 961**												
Bolivia (Plurinational State of)	59	166	24.4	20.2	0.0	0.1	31.8	26.8	9.0	2.9	1.3	2.3	20.6	45.2
Colombia	513	1 358	7.9	8.3	0.3	0.3	21.4	11.5	22.7	12.5	10.6	5.3	13.9	38.0
Ecuador	118	445	31.2	40.1	0.0	0.1	16.6	11.4	30.2	13.8	4.7	3.3	10.1	26.4
Peru	184	992	13.1	5.8	0.0	0.0	15.6	10.3	23.9	21.6	5.0	3.6	34.2	38.3
Central American Common Market	**372**	**2 333**												
Costa Rica	147	309	1.8	5.0	9.9	14.4	12.3	23.3	57.4	40.5	3.1	3.9	11.3	10.8
El Salvador	114	987	1.4	0.2	14.5	14.7	10.0	1.7	57.5	62.8	2.9	1.6	5.5	16.2
Guatemala	77	935	1.6	0.7	16.5	8.9	28.2	5.6	38.6	28.8	4.9	1.0	4.2	38.8
Honduras	17	66	1.5	2.0	17.7	26.3	17.6	15.2	44.6	20.6	1.3	2.6	7.9	24.0
Nicaragua	17	36	0.2	0.3	36.7	33.4	14.9	5.3	29.5	9.3	2.6	2.6	9.7	38.6

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Statistics Database (COMTRADE).
[a] The ASEAN+3 grouping comprises the member countries of the Association of Southeast Asian Nations (ASEAN) plus China, Japan, the Republic of Korea, the Hong Kong and Macao Special Administrative Regions of China, and Taiwan Province of China.

In the case of the Central American Common Market, there are important differences between the two leading exporters of textile products and clothing (El Salvador and Guatemala). While El Salvador imports a considerable proportion of its textile inputs from the United States, the main source of these inputs for Guatemala is Asia (whose share has increased dramatically since 2000, while that of the United States has fallen). Nicaragua and Honduras import a large proportion of their inputs from other Central American Common Market countries. However, owing to the low value of these imports and of their textile and clothing exports, any linkages within the regional bloc are insignificant.

Using network analysis techniques, the data on textile and clothing exports may be combined on a bilateral basis with the flows of textile inputs associated with those products, thus providing a representation of the two industries being analysed here. Diagram II.1 illustrates the Andean Community's textiles and clothing industry, considering only exports with a comparative advantage (that is, those for which the exporting countries have advantages in the destination markets over other exporters)[6] and the production linkages in this industry established in 2000 and 2012 between the countries of the Andean bloc and the rest of the world (disaggregated by grouping). Such linkages are based on the fact that Andean Community countries import textile inputs from other countries (within or outside the

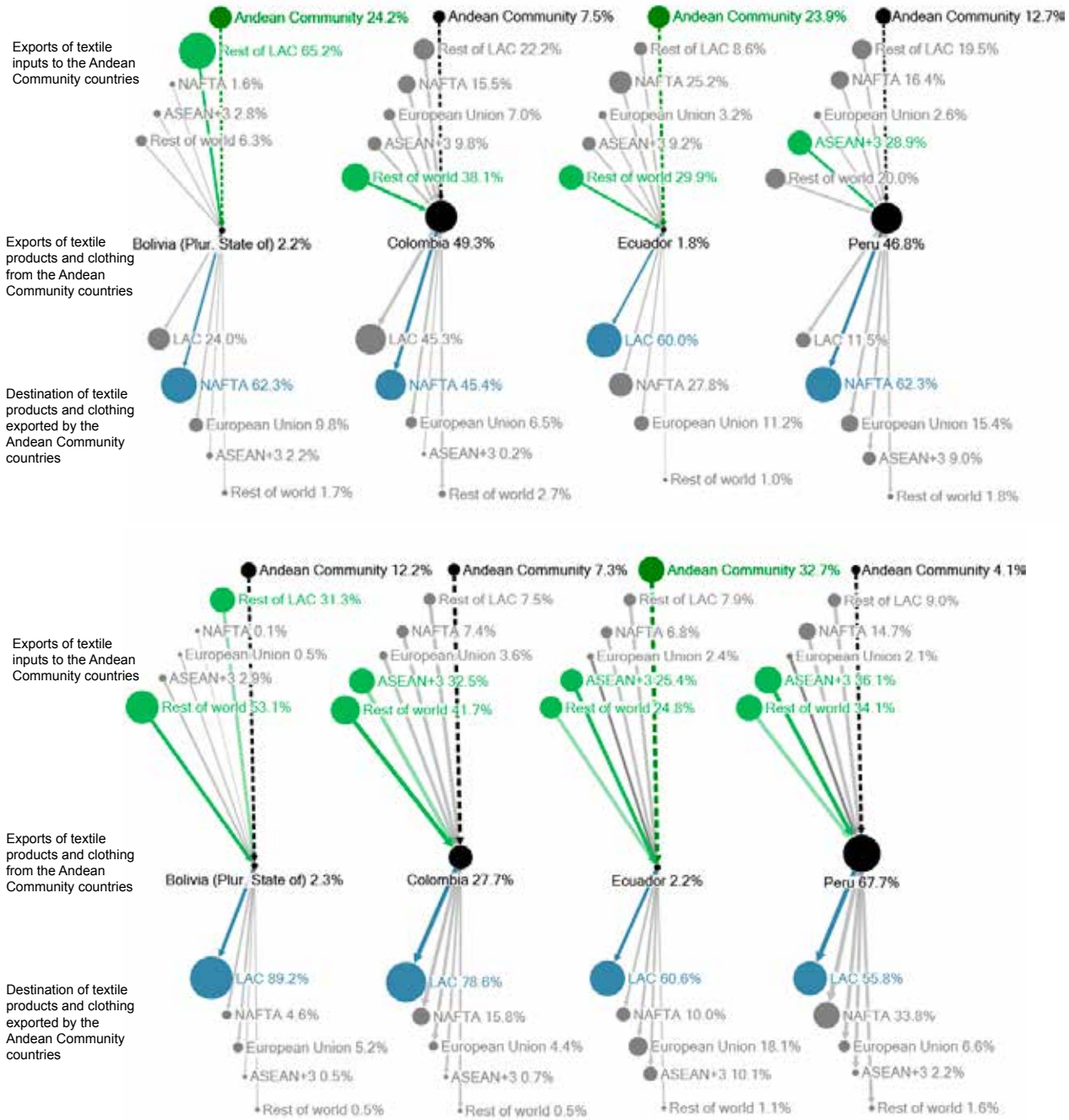
[6] Exports with comparative advantages are those for which the symmetric revealed comparative advantage (SRCA) index is positive. This index, based on Balassa (1965), was calculated for each product k (defined at the 6-digit level of the Harmonized Commodity Description and Coding System) as: $SRCA^{k}_{ijt} = (RCA^{k}_{ijt} - 1) / (RCA^{k}_{ijt} + 1)$, with $IVCR^{k}_{ijt} = \left(\frac{X^{k}_{ijt}}{\Sigma_k X^{k}_{ijt}}\right) \Big/ \left(\frac{\Sigma_i X^{k}_{ijt}}{\Sigma_{ki} X^{k}_{ijt}}\right)$; where e X^{k}_{ijt} are the exports of product k from country i to country j in the year t, $\Sigma_i X^{k}_{ijt}$ are the total exports from country i to country j in the year t, $\Sigma_{ki} X^{k}_{ijt}$ are the world exports of product k from country j in the year t, and $\Sigma_{ki} X^{k}_{ijt}$ are the total world exports to country j in the year t. A positive value for $SRCA^{k}_{ijt}$ indicates that country i presented in year t advantages in country j as an exporter of product k (in comparison with other exporting countries).

same group) and use them to produce other textile products and clothing that are then exported to countries within the same grouping or outside the bloc (thus creating an international value chain).

Diagram II.1

Andean Community: international linkages in the textiles and clothing industry, 2000 and 2012 [a]

(Percentages of total trade in each segment of the chain)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Statistics Database (COMTRADE).

[a] LAC: Latin America and the Caribbean; Rest of LAC: Rest of Latin America and the Caribbean; NAFTA: North American Free Trade Agreement (excluding Mexico); ASEAN+3: Association of Southeast Asian Nations (ASEAN) plus China, Japan, the Republic of Korea, the Hong Kong and Macao Special Administrative Regions of China, and Taiwan Province of China. The percentages corresponding to the shares of countries or groups as the origin or destination of exports in each segment of the chain (indicated next to the name of the country or group) were calculated on the basis of flows at constant 2005 prices in order to isolate the effect of price changes. The size of the nodes (circles) reflects the importance of the origin or destination in the total exports in each segment of the chain. The thickness of the lines connecting the respective nodes of the chain corresponds to the value of the exports; thus, a thicker line indicates that the trade flow has a higher value.

The upper portion of each diagram shows the textile inputs exported to Andean Community countries by their partners in the bloc and by other groupings. As noted earlier, the two main Andean exporters of textile and clothing products (Peru and Colombia) import most of their inputs from outside the region, in particular from Asia (the members of ASEAN+3 and India, the latter being included in the rest of the world category) (see diagram II.1.B). Neither the Andean Community nor the rest of Latin America and the Caribbean is a major supplier of these inputs for these two countries. Ecuador's trading partners within the bloc, however, are a major source of textile inputs (accounting for 32.7% in 2012), although the Asian countries taken as a whole account for more. In the case of the Plurinational State of Bolivia, supplier countries in Latin America but outside the bloc accounted for 30% in 2012, significantly higher than their share of the supply of inputs to the rest of the Andean Community. Compared with 2000, the biggest change for Colombia and Peru is that the Asian countries' share as a source of textile inputs has increased (especially for Colombia), while the region's share has fallen (from 30% of total inputs exported to both Colombia and Peru to less than 15% in 2012) (see diagram II.1.A). Although the Andean Community and the rest of the region have lost ground as suppliers of textile inputs to Ecuador and the Plurinational State of Bolivia (especially to the latter), their share overall is still significant (around 41% and 44%, respectively). Nevertheless, given that these countries are not major textile and clothing exporters (either in terms of export value or as a percentage of total national exports) and the value of their textile input imports is not significant either, any backward linkages from these countries to the rest of the region are of limited importance.

The centre of each diagram relates to textile products and clothing exported around the world from the Andean Community countries, whose production entails the use of inputs imported from other countries in the bloc and elsewhere. Peru and Colombia were the main exporters of these products in both 2000 and 2012. Peru's share increased sharply between these two years, rising from 47% of total Community exports in 2000 to 68% in 2012, while Colombia's share dropped from 49% to 28% over the same period. The share of the other Andean countries was very small in both years, and no significant changes were observed. Lastly, the breakdown by export destination (depicted in the lower portion of the diagrams) illustrates the declining share of NAFTA excluding Mexico (specifically, of the United States) as a destination for textile and clothing products exported by the countries of the Andean Community, as well as the overall increase in the percentage going to the region.

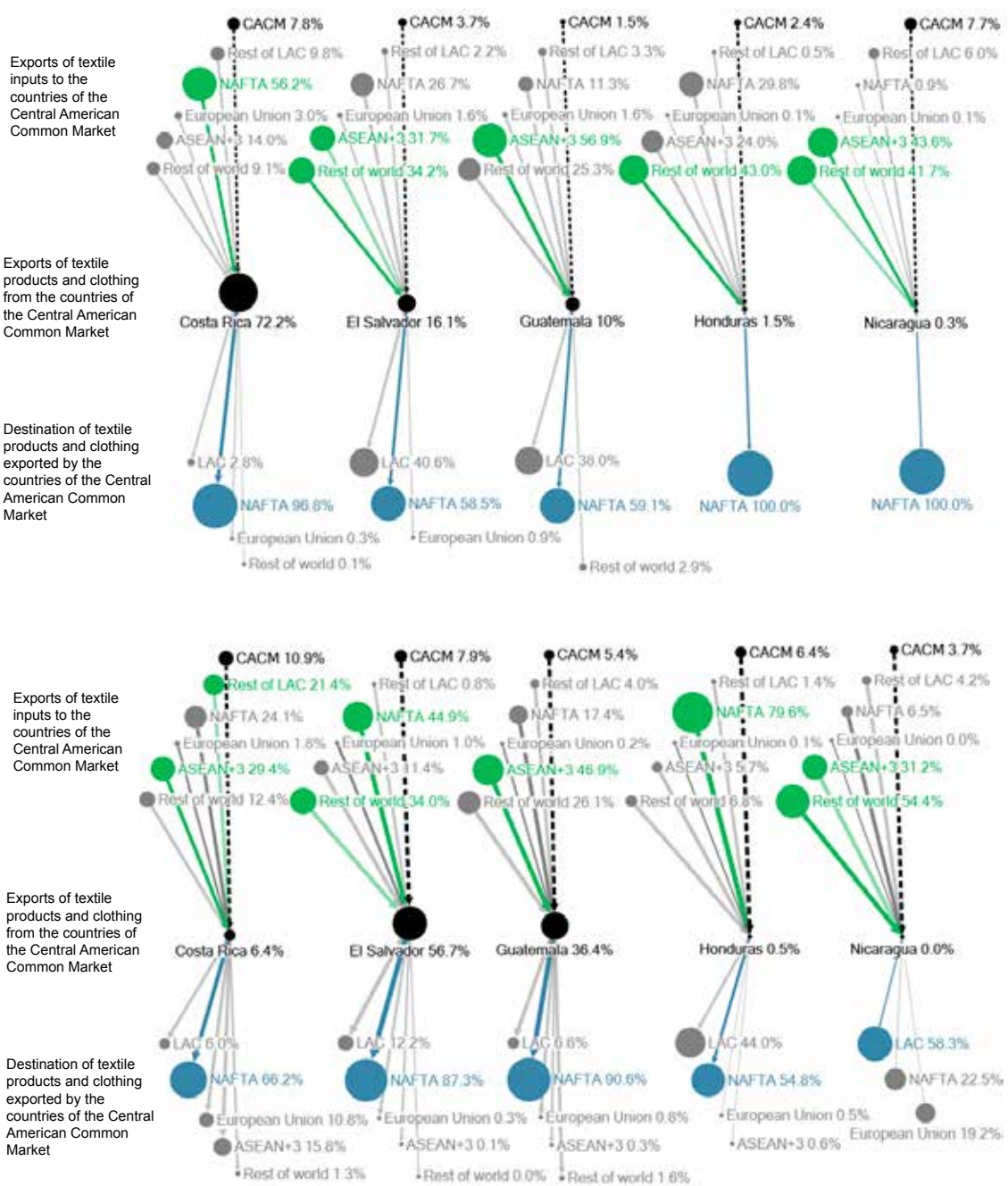
Since the partners in the bloc are not a major source of inputs for the leading textile and clothing exporters in the Andean Community (Peru and Colombia), it may be concluded that there are no substantial internal linkages in this industry. Nevertheless, the analysis set forth herein could help identify potential production links between these countries, which could be enhanced by policy measures that contribute to further integration within the bloc.

Diagram II.2 depicts the international linkages of the textiles and clothing industry in the Central America Common Market in 2000 and 2012. Once again, only exports enjoying comparative advantages in the destination markets are considered. This diagram, which should be interpreted in a similar manner to diagram II.1, illustrates the differences already observed with regard to the origin of textile inputs for the countries of this trading bloc: while the United States is El Salvador's main supplier of inputs, Guatemala receives most of its inputs from countries in Asia (although their share is large for all members of the Central American Common Market, except for Honduras). Neither the Central American Common Market itself nor the rest of the region is a major supplier of textile inputs for the countries in this grouping (with the exception of Costa Rica, which imported around a fifth of these inputs from countries in the region outside the Central American Common Market and 11% from within it). This suggests a paucity of backward linkages in regional value chains. The analysis of the share of Central American Common Market countries as exporters of textile and clothing products (the centre of diagrams II.2.A and II.2.B) illustrates the sharp rise of El Salvador, and to a lesser extent, Guatemala, which accounted for 57% and 36% of total exports (with comparative advantages) from the bloc in 2012, versus 16% and 10%, respectively, in 2000. Costa Rica's importance as an exporter of these products, however, declined. With regard to export destination, the aforementioned focus on Factory North America (and on the United States in particular) that characterizes the textile product and clothing industries of Guatemala and El Salvador may be observed; it has become more marked in recent years owing to the entry into force of the Dominican Republic-Central America-United States Free Trade Agreement (see the lower portion of diagrams II.2.A and II.2.B). For the other countries in the trading bloc, on the other hand, the United States has become less important as a destination; the share of the rest of the region has increased (for Honduras and Nicaragua) as has that of extraregional destinations (for Costa Rica and Nicaragua).

Diagram II.2

Central American Common Market: international linkages in the textiles and clothing industry, 2000 and 2012 [a]

(Percentages of total trade in each segment of the chain)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Statistics Database (COMTRADE).

[a] LAC: Latin America and the Caribbean; Rest of LAC: Rest of Latin America and the Caribbean; NAFTA: North American Free Trade Agreement (excluding Mexico); ASEAN+3: Association of Southeast Asian Nations (ASEAN) plus China, Japan, the Republic of Korea, the Hong Kong and Macao Special Administrative Regions of China, and Taiwan Province of China. The percentages corresponding to the shares of countries or groups as the origin or destination of exports in each segment of the chain (indicated next to the name of the country or group) were calculated on the basis of flows at constant 2005 prices in order to isolate the effect of price changes. The size of the nodes (circles) reflects the importance of the origin or destination in the total exports in each segment of the chain. The thickness of the lines connecting the respective nodes of the chain corresponds to the value of the exports; thus, a thicker line indicates that the trade flow has a higher value.

Although El Salvador and Guatemala (the leading exporters of textiles and clothing in the Central America Common Market), are deeply integrated into the United States market, their participation is limited to the assembly of finished goods from inputs imported from the United States (especially in the case of El Salvador). The quality of this integration should thus be more closely analysed, with a view to formulating strategies that would enable these countries to upgrade towards segments of the chain with higher domestic value added.

C. Value chains: governance, innovation and upgrading

1. Methodology for studying the business dynamic of value chains

Value chain governance refers to the factors determining the behaviour of actors in the chain, on the basis of different types of relationships and both explicit and tacit rules. Specifically, value chain governance refers to aspects such as the structure through which actors operate, the members who wield the greatest power and influence, the incentives system, the regulations applicable to members of the chain, the traditions relating to forms of production, and the impact of the transfer of new technologies (Padilla, 2014). Value chain governance, along with other themes such as innovation and upgrading, may be studied using the methodology developed with the support of the Federal Ministry for Economic Cooperation and Development (BMZ) of Germany and the German Agency for International Cooperation (GIZ). This methodology aims to strengthen critical links, through, for example, the integration and upgrading of domestic producers in regional and global value chains by means of process or product innovation. The priority phases covered by the methodology are chain assessment, the analysis of international best practices, and the formulation of solutions to address the bottlenecks identified. Following the assessment, a map is drawn up of the agents participating in the chain and its governance. At the same time, bottlenecks are identified that are making it difficult to boost value added through innovation. ECLAC has recently used this methodology in several countries in the region to design and implement a new set of industrial policies.[7]

The methodology is participatory; it involves a dialogue between public and private stakeholders, who are asked to validate the information presented in the assessment (diagnostic study) and the upgrading strategies proposed. This process makes it possible to identify most of the constraints, reaffirm the commitments undertaken, foster innovative proposals for strategy formulation, facilitate the formation of agreements and promote greater transparency in decision-making. Collaboration between the public and private sectors increases the likelihood of finding solutions to the constraints that hamper the upgrading of production, innovation and exports (Devlin and Moguillansky, 2010; ECLAC, 2008).

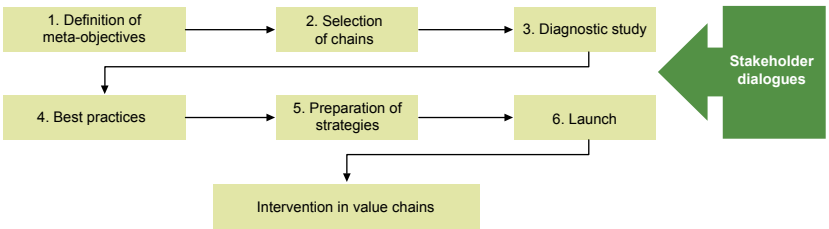
The ECLAC methodology consists of six steps (see diagram II.3). The first step involves defining meta-objectives, which are the ultimate economic and social development aims being pursued by chain strengthening. Examples include increasing employment and raising real wages, expanding exports, increasing participation by micro, small and medium-sized enterprises, and technological change. The second step is chain selection, which is carried out on the basis of criteria consistent with the meta-objectives: the potential of the chain to help reduce poverty, to contribute to growth and to a change in its own governance, allowing new stakeholders to participate; export growth; and the integration of micro, small and medium-sized enterprises, among others. Chain selection uses both quantitative and qualitative criteria.[8]

The third step consists of diagnostic studies. The aim of this exercise is to identify constraints and opportunities in three key areas: within each segment of the chain; the real and potential links of each segment; and the participation of new strategic players. The diagnostic study, which is discussed and validated during a roundtable attended by the main stakeholders of each value chain, determines how the chain is governed, identifies key segments where innovation could take place and formulates actions to upgrade towards higher-value-added segments.

[7] ECLAC has supported the Governments of Argentina, Ecuador, El Salvador and Guatemala in the analysis of production chains and in the design of policies to strengthen them.

[8] In the first case, each chain's contribution to employment, exports, value added and the incorporation of SMEs can be measured. Input-output tables can also be used to estimate the production linkages in each chain. With regard to qualitative criteria, specific territories or sectors may be considered in order to address a governance problem or the needs of vulnerable groups.

Diagram II.3
ECLAC methodology for strengthening value chains



Source: N. Oddone, R. Padilla Pérez y B. Antunes, "Methodology of the ECLAC-GIZ project for the design of value chain strengthening strategies", *Strengthening value chains as an industrial policy instrument. Methodology and experience of ECLAC in Central America*, Libros de la CEPAL, No. 123 (LC/G.2606-P), R. Padilla (ed.), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2014. United Nations publication, Sales No. E.14.II.G.9.

The fourth step is the analysis of international best practices. These provide a benchmark regarding similar chains in other countries, and lessons may be drawn from those experiences. The paths taken to upgrade in the value chain and influence its governance are examined. The fifth step consists of preparing strategies to overcome the constraints and exploit the opportunities identified by the diagnostic study.

The value chain methodology makes it possible to identify actions at the microeconomic level to strengthen the links and the chain as a whole. These are specific strategy lines to strengthen the chain where there is greater value, focusing on the stakeholders that govern it or who have significant influence. Ideally, a roadmap is drawn up at this stage setting out responsible entities, timeframes and resources. The second roundtable is held at this point to discuss strategies and obtain a commitment from all participants in terms of the actions each will undertake. The last step prior to strategy implementation, known as the launch, is to present the set of proposals. This should be a participatory event with media coverage, in which the public and private actors announce the commitments assumed.

2. The experience of four Central American value chains

The methodology proposed in the previous section has been applied to four Central American chains: in El Salvador, the shrimp farming chain and the technical-fabric sportswear chain (such as Dri-FIT and Climacool), and in Guatemala, the value chains of non-traditional export vegetables and timber products from the forestry concessions of the Department of Petén. These chains were selected during meetings with governments and the private sector on the basis of the following meta-objectives: to promote SME integration and upgrading, to expand exports, and to increase employment.

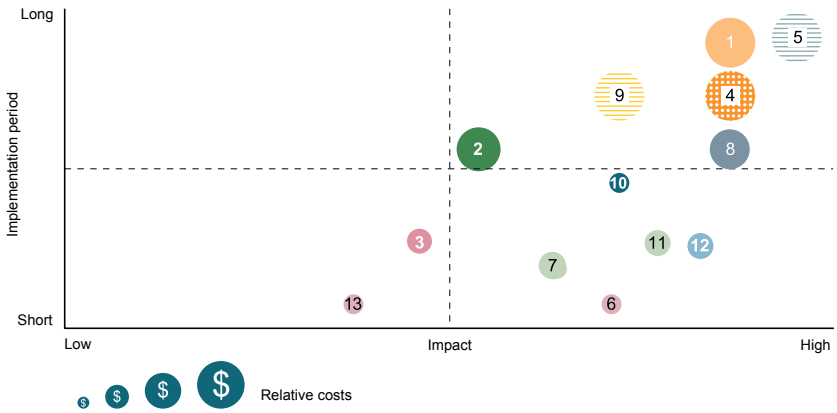
In El Salvador, the shrimp farming chain sells exclusively to the domestic market. However, the chain includes international links for importing inputs and equipment, seeds (post-larval shrimp), concentrated feed, microalgae, brine shrimp (*Artemia salina*), chemicals (tetracycline and Neguvon, among others), chemical and other fertilizers (superphosphate 12-24-12 and urea, among others). Inputs are sourced in the United States, Guatemala, Honduras and Nicaragua; the microalgae come from Taiwan Province of China.

To foster internationalization, a processing segment should be created for domestic production. Technically, this link already exists, but it does not process Salvadoran shrimp. The new link could supply international markets in accordance with the differing requirements for cutting and refrigeration. Another strategy under consideration, which would create value and ensure that Salvadoran shrimp are more integrated in the world economy, is to create a national brand in order to improve quality and boost the country's output. A number of financing strategies have also been considered to support upgrading through allocations from El Salvador Development Bank (BANDESAL) or "blended services" packages for shrimp farmers.

Smuggling from neighbouring countries was identified as one of the constraints affecting the value chain, which led to the revival of the Aquaculture Technical Roundtable. This is a forum created by the Ministry of Agriculture and Livestock and subsequently joined by the Ministry of Economy and other public and private institutions that also have an impact on chain governance. The proposed border control project will strengthen bilateral ties with Honduras and Central American regional integration in general. Figure II.3 shows the proposed strategies, along with costs, timeframes for implementation and impacts. Costs and timeframes are relative, since in absolute terms they vary considerably from one chain to another. The horizontal axis corresponds to the impact that a particular strategy could have on the chain, while the vertical axis tracks implementation timeframes. The size of the circles represents the estimated cost. The aim is

to offer guidance that will facilitate the decision-making process for the members of the chain. For example, the creation of a research and technologies centre for the aquaculture and fisheries sector (strategy 5), including shrimp-farming research, will take a minimum of five years and will require financial resources for implementation and operation. Innovation in the production of genetically improved seed and regular renewal of broodstock, the development of new feed concentrates, and the technical, economic and social validation of technologies is particularly important so as to diversify aquaculture and increase fish and seafood production capacity for sale to domestic and export markets.

Figure II.3
El Salvador: matrix of costs, implementation times and impacts of the proposed strategies to strengthen the shrimp farming value chain [a]



Source: R. Padilla Pérez (ed.), *Strengthening value chains as an industrial policy instrument. Methodology and experience of ECLAC in Central America*, Libros de la CEPAL, No. 123 (LC/G.2606-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2014. United Nations publication, Sales No. E.14.II.G.9.

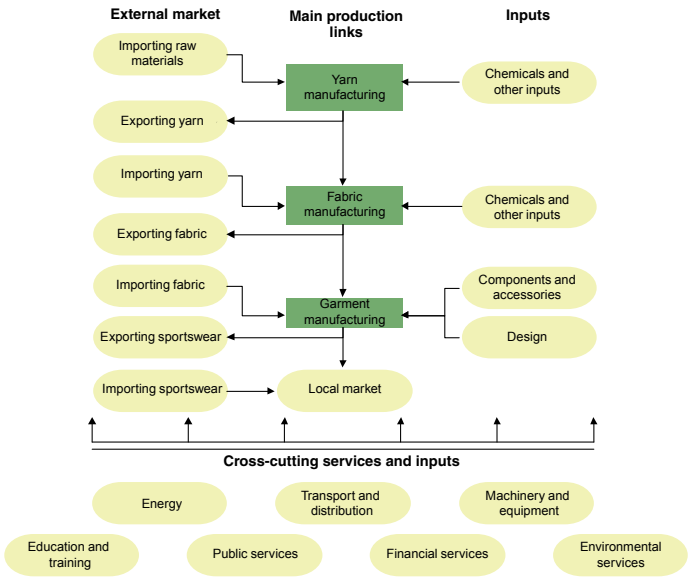
[a] The numbers relate to strategies for the following themes: 1: Biosafety and seed-production laboratories; 2: Safety standards; 3: Disease prevention, diagnosis and control; 4: Eco-efficient management; 5: Aquaculture technology centre; 6: Quality and safety; 7: International technical standards; 8: El Salvador shrimp brand; 9: Contraband; 10: Handling and transport; 11: Price information; 12: Business management; and 13: Dialogue between public and private actors. The cost, implementation period and expected impact of each strategy are averages calculated on the basis of subjective estimates provided by all members of the chain. This figure is for illustrative purposes only. It remains necessary to determine the relevant factors through specific analysis at a later stage.

Synthetic-fibre sportswear is one of the most internationalized chains in El Salvador. In the first place, the textile and clothing sectors account for some 25% of El Salvador's industrial value added and more than half of manufacturing jobs. Second, synthetic-fibre product sales have soared in recent years. This chain exports yarn and fabric to the other countries of Central America and garments to the United States. Given the competition from Asian firms (whose position would be strengthened by the entry into force of the Trans-Pacific Partnership agreement), it was deemed necessary to develop an innovation programme to enable Salvadoran companies to compete with more differentiated, high-quality, high-value-added products. The upgrading strategies proposed included the creation of a centre for innovation and technological development in textiles and garment-making, which would facilitate the manufacture of products with new functional features. In addition, the educational profile of the technical workforce needs to be upgraded by revising the content of the courses run by training centres, so as to meet the need for specialists in order for the chain to be able to compete with quality products under the "full-package" model, which ranges from yarn to garment-making. Given that electricity costs can represent up to 60% of textile companies' total costs, efficiency programmes to reduce expenditures were tested. Changes to customs procedures and measures were also proposed to streamline border formalities, while attempts were made to scale up the production cluster in order to incorporate new innovation processes and add new markets. Diagram II.4 presents the synthetic-fibre sportswear chain in El Salvador and its main segments.

Guatemala's non-traditional export vegetable chain encompasses peas, broccoli, courgettes, French beans, baby corn and baby carrots. The first link in the chain is dominated by foreign seed-producing enterprises, which invest heavily in research and development. Seed is sold on the domestic market through import agencies. Given that domestic producers tend to have financing problems, a system for rating their creditworthiness was proposed to enable them to upgrade within the chain in terms of the financial terms provided. In the marketing segment, both domestic and international agents handle exports. To achieve international positioning, in-depth market studies are needed and production processes must be refined, paying particular attention to quality and the potential for adding value, and diversifying the supply of products in accordance with international market standards.

Diagram II.4

El Salvador: major links to the main production activities in the synthetic-fibre sportswear value chain

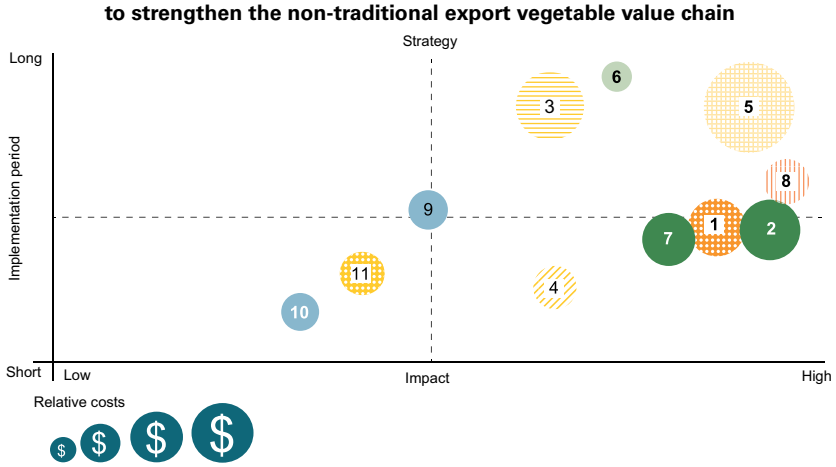


Source: R. Padilla Pérez (ed.), *Strengthening value chains as an industrial policy instrument. Methodology and experience of ECLAC in Central America*, Libros de la CEPAL, No. 123 (LC/G.2606-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2014. United Nations publication, Sales No. E.14.II.G.9.

The absence of internationally recognized laboratories and the high cost of international certifications are constraints that affect processing, packaging, export and marketing. As a result, proposals were made to establish a national certification centre, create export protocols and establish a country brand to back up the quality of the products and the implementation of good agricultural practices. In addition, the high cost of sea transport has a marked impact on the entire chain. The solutions put forward thus included new forms of negotiation with shipping companies and the entry of new maritime transport providers into the domestic market. Figure II.4 summarizes the strategies presented for the Guatemalan non-traditional export vegetable chain, as well as their estimated costs and implementation periods.

Figure II.4

Guatemala: matrix of costs, implementation times and impacts of the proposed strategies to strengthen the non-traditional export vegetable value chain



Source: R. Padilla Pérez (ed.), *Strengthening value chains as an industrial policy instrument. Methodology and experience of ECLAC in Central America*, Libros de la CEPAL, No. 123 (LC/G.2606-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2014. United Nations publication, Sales No. E.14.II.G.9.

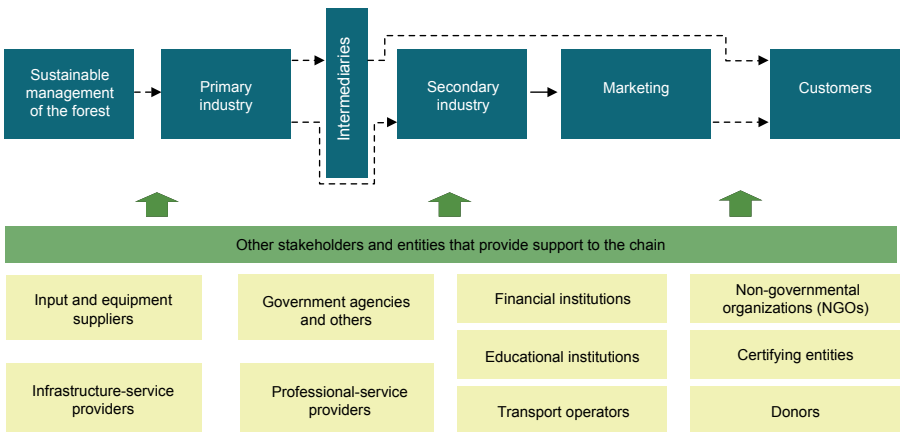
[a] The numbers relate to strategies for the following themes: 1: Good agricultural practices; 2: Pesticide control laboratories; 3: Certifications and importer requirements; 4: Market intelligence; 5: New crops and seed reproduction; 6: Domestic production of inputs; 7: Chain information; 8: Access to credit; 9: Irrigation system; 10: Maritime transport; and 11: Customs procedures.The cost, implementation period and expected impact of each strategy are averages calculated on the basis of subjective estimates provided by all members of the chain. This figure is for illustrative purposes only. It remains necessary to determine the relevant factors through specific analysis at a later stage.

The value chain of timber products from the forestry concessions of the Department of Petén in Guatemala is structured around three large segments: sustainable forest management (11 concessions —9 community and 2 private), processing and marketing. Sustainable forest management is aimed at maintaining and improving sustainable forestry production by incorporating natural forests into productive economic activity; incorporating suitable unforested land areas into forestry activity by creating and maintaining forestry plantations or natural regeneration areas; generating a critical mass of forests; and maintaining natural forests to provide environmental services. This segment brings together activities related to the use, recovery, protection and conservation of natural forests and requires the formulation of a forest management plan for their good governance, mainly within the public sector. Experience has shown that forests are better preserved in concessions than out of them, where there is more depredation due to lack of controls.

Within the processing segment, there is both primary industry and secondary industry. The first uses simple machinery for manufacturing large volumes of standardized products, while the second involves the use of specialized machinery and adds more value. The leading markets for primary industry products, which have low value added, are the United States, El Salvador, Honduras and Mexico. The part of the secondary industry aimed at the domestic market is complemented by the import of timber products by large furniture companies. Marketing is mainly carried out by domestic intermediaries that sell to foreign companies and play an important role in chain governance, since they provide transport and financing to producers. Diagram II.5 illustrates the structure of the production chain of these concessions. Cooperatives have financing difficulties, lack skilled labour to work in the concessions, face product innovation problems and have little experience in market intelligence activities.

Diagram II.5

Guatemala: Petén forestry concessions timber products value chain



Source: R. Padilla Pérez (ed.), *Strengthening value chains as an industrial policy instrument. Methodology and experience of ECLAC in Central America*, Libros de la CEPAL, No. 123 (LC/G.2606-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2014. United Nations publication, Sales No. E.14.II.G.9.

The upgrading proposals relate to the promotion of research and innovation with a view to expanding the portfolio of higher-value-added products, based on the organoleptic, physical and mechanical properties of the species. It is therefore essential to strengthen the community forest service enterprise FORESCOM and improve marketing processes by incorporating the export of wood from the Department of Petén into national export plans. A technical-vocational training programme would encourage concession workers to acquire new skills. It would also facilitate the use of new technologies and the development of new administrative and management systems. The supply chain must also be strengthened by forging new commercial links and improving infrastructure, access roads and logging areas, which would change the current governance of the chain. Quality certification and the development of new support services for this value chain also form part of the proposed upgrading strategies.

On the basis of the upgrading proposals, prospective value chain studies aim to identify ways to increase productivity and improve competitiveness. They also promote better social appropriation of innovation by the private stakeholders that make up each segment and by the public institutions providing support, involving them in preparing these measures and in committing to implement them. Strategies, implemented through public policies, can modify internal balances between the links and governance, provided that there is a shift in the relative weight of each

link in the chain and in each stakeholder's relationship with the other links. The goal is, then, to reduce structural heterogeneity through productivity gains and gains in the links that suffer from greater production lags in the region, which is characterized by small highly productive sectors and large low-productivity sectors. At the same time, the entry of new economic actors is supported, in particular small and medium-sized enterprises, which play a significant role in job creation in Latin America and the Caribbean.

3. Costa Rica: upgrading in the offshore services chain[9]

Costa Rica is a pioneer in attracting offshore services to Latin America. Since the 1990s it has been a preferred location in the region for multinational corporations looking to set up service provider subsidiaries and thus reduce their overall costs and benefit from the country's fiscal and competitive advantages. These include being in the same time zone as the central time zone area of the United States, having a large part of the workforce that speaks relatively good English and having a relatively safe environment and favourable tax treatment under free trade zone regimes.

Costa Rica's integration into the international services chain represents the third phase of a relatively successful strategy to enter a number of global value chains by attracting subsidiaries of multinational corporations. In the 1970s, Costa Rican exports consisted primarily of a few agricultural products (bananas, coffee and beef), which represented 65% of total goods exports. Following the creation of the temporary import regime in 1972 and the free trade zone regime in 1981, American multinational companies began to set up garment-making operations in Costa Rica. That was the first step in the export sophistication process, in a transition towards manufactured products and services with greater value added. In 1980, these clothing products accounted for 14% of exports.

Following the crisis during the first half of the 1980s, free trade zone expansion drove successive changes in the country's export basket. Their share of exports reached 52% in 1999, the level at which they stand today. The second free trade zone phase was the emergence of the electrical and electronics product cluster, after Intel set up operations in Costa Rica in 1997. These products represented 29% of goods and services exports in 2000. A third transformation took place during 2000-2012, as two other export chains joined the free trade zones: medical devices and business services.

Surging FDI inflows (which expanded by 13% a year between 1990 and 2012) were the main driver of growth in the new export sectors. The number of multinational corporations operating in these sectors grew from 16 in 1990 to more than 250 in 2013. The United States has consistently been the largest investor in Costa Rica, accounting for nearly two-thirds of FDI inflows. Over the past decade, significant investments have also been received from Canada, Colombia, Mexico and Spain.

With regard to the international services sector, in 2000 only three call centres (Sykes, Amadeus and Equifax) and three shared services centres (Procter & Gamble, L.L.Bean and Western Union) were operating in Costa Rica. Today there are more than 120 companies, according to data provided by the Costa Rican Investment Promotion Agency (CINDE). During this period, employment in the sector has soared from 1,000 jobs to more than 32,000 jobs. Between 2000 and 2012, the sector's contribution to GDP almost tripled, rising from around 2% to nearly 6%, a slightly higher percentage than the contributions from tourism and agriculture. Most of the sector's growth took place after 2004.

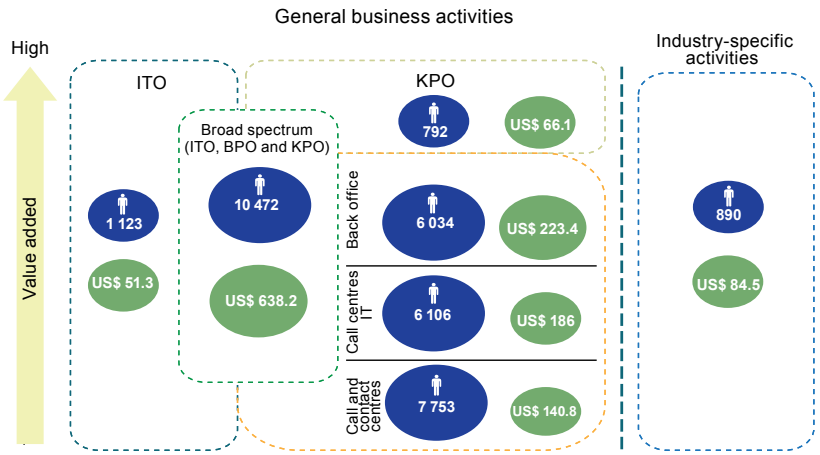
Business outsourcing may be divided into three categories: information technology outsourcing (ITO), business process outsourcing (BPO) and knowledge process outsourcing (KPO). As in many developing countries, Costa Rica has concentrated initially on the first two (ECLAC, 2014; Fernandez-Stark, Bamber and Gereffi, 2013). Most subsidiaries of multinational corporations with operations in the country offer ITO and BPO, and they may be taking the first steps towards the most sophisticated level of the chain, that is, setting up KPO centres. Only two companies are operating in this last segment, and they employ 800 people in Costa Rica. Half of all operations of multinational corporation subsidiaries in Costa Rica are "captive", that is, they provide services only to the parent company; the other half sells services to other companies.

Costa Rica has managed to upgrade in the business services chain by providing increasingly complex services. Simple tasks such as the services provided by call centres (which many companies setting up in the country performed initially) have been transferred to other Latin American countries with lower labour and operating cost structures.

[9] This section summarizes the themes presented in ECLAC (2014) and Fernandez-Stark, Bamber and Gereffi (2013).

These tasks have been replaced by other, higher value-added ones, thanks to local workforce capacity-building and learning. This process is expected to continue in the coming years (ECLAC, 2014). Diagram II.6 presents this upgrading process in two dimensions: the horizontal axis shows the increasing sophistication of the services rendered, while the vertical axis indicates the increase in value added in these services. A higher level for this variable suggests a rise in the level of the human capital involved and their corresponding wage, which represents most of the value added in the services sector.

Diagram II.6
Costa Rica: upgrading in global offshore services, [a] 2012
(Millions of dollars and number of workers)



Source: K. Fernandez-Stark, P. Bamber and G. Gereffi, "Costa Rica in the Offshore Services Global Value Chain. Opportunities for Upgrading", Durham, Duke University, Center for Globalization, Governance and Competitiveness [online] http://www.cggc.duke.edu/pdfs/2013-08-20_Ch5_Offshore_Services.pdf.
[a] The red circles show export value; the blue circles show the number of workers. ITO: information technology outsourcing; BPO: business process outsourcing; KPO: knowledge process outsourcing.

Many multinational corporations believe that their subsidiaries have been able to upgrade from activities with a low level of sophistication to medium-level ones thanks to the quality of the Costa Rican workforce. Graduates from the country's technical universities and high schools have played a key role in this process; for example, 70% of the workforce of one of the larger service operations is composed of technical high school graduates. Competition for these graduates is fierce, with recruitment teams offering contracts to students who still have three years of school remaining before graduation (Fernandez-Stark, Bamber and Gereffi, 2013).

Notwithstanding the above, one of the challenges affecting the country's ability to continue to upgrade within the chain and attract KPO activities from multinational corporations is the limited availability of highly qualified human capital. For example, 1,134 engineering students graduated from the most prestigious State universities in 2012; according to the National Council of Rectors, over 400 companies are competing to recruit these graduates. In other words, Costa Rica has so far not managed to increase the number of students in the disciplines most sought by companies in this sector. Another challenge is that ties to domestic companies are weak. Some of the staff trained by multinationals move on to work for Costa Rican firms, thus transferring the knowledge they have acquired. Less commonly, former staff go on to set up their own companies and put into practice what they have learned in multinational corporations (ECLAC, 2014).

To overcome these constraints, multinationals in Costa Rica invest in worker training. All of the multinational companies have internal training programmes that focus on technical skills, interpersonal abilities and languages. For entry-level positions, firms prefer to hire motivated young adults directly from technical high schools and universities and provide them with in-house training. In addition, multinational corporations in Costa Rica encourage employees to continue with their professional development by facilitating and partially financing university studies. Firms also pay for workers' certifications in certain technologies.

4. Mexico's participation in research and development in the pharmaceutical industry[10]

Another regional example of upgrading in the offshore services sector is that of Mexico and the highly knowledge-intensive services associated with research and development (R&D). These are among the fastest-growing service sectors of the twenty-first century, jumping 27% a year on average between 2000 and 2010 and ranking second only to services associated with information technologies (IT), which grew 34% a year on average over the same period. Only advanced industries make use of these services— the pharmaceutical industry, for example, is one of the leading users of offshore R&D services. The high cost of research is the main reason behind this trend, and has it led transnational corporations in this sector to carry out some of these activities in developing countries, especially in the investment-intensive areas of biotechnology and pharmacogenomics.[11] The pharmaceutical industry has thus become the largest user in the world of these scientific-technical services (Hernández and others, 2014).

There are multiple economic benefits to be gained from joining this kind of value chain, both for the pharmaceutical corporations and for the countries supplying the services. Pharmaceutical corporations, in addition to significantly lowering research costs, are able to develop products that are better suited to the countries providing the offshoring services. The timeframes for introducing new drugs to domestic markets are thus shorter. Participating in global pharmaceutical chains enables the countries providing these services to develop skills in other areas, such as human resources, scientific expertise, scientific-technical skills and infrastructure. Moreover, cooperation between universities and health institutions (hospitals and clinics) makes it possible to set up research centres and laboratories tailored to this industry.

Mexico is a relative success story in the provision of services to pharmaceutical companies. The Mexican Association of Pharmaceutical Research Industries (AMIIF) has recorded rapid growth in investment in clinical research over the past decade. In 2003, there were fewer than 100 clinical studies,[12] but by 2005 these had increased to 2,025, grouped into 425 protocols for 22 therapeutic areas. Investment in these studies grew at an annual rate of almost 15% during the 2000s, reaching US$ 86 billion in 2008 and US$ 106 billion in 2009. The accelerated growth in outsourcing clinical trials reflects the high demand for such services from the pharmaceutical industry in developing countries (see table II.3). From 2007 to 2012, sales in the sector grew by 12% a year, on average. Sales in 2012 reached US$ 14 billion, of which US$ 1.2 billion were exports, mostly to other countries of Latin America. Pharmaceutical companies invested US$ 2 billion in R&D in 2011 and US$ 2.5 billion in 2012.

The increase in drug sales in Mexico was accompanied by a parallel increase in the demand for clinical studies and by changes in regulations. For example, the duration of health authorizations for drug distribution was reduced to five years, whereas previously they were indefinite. Pharmaceutical companies must now constantly update the information generated by their clinical studies, which carries a cost of between US$ 75,000 and US$ 150,000 per drug. The structure of the industry was also affected by a presidential decree published in August 2002, which eliminated the "plant requirement" that had prevented laboratories with no infrastructure in Mexico from importing drugs. This decision favoured transnational corporations, because it exerted a strong pressure on local generic drug companies to sell their operations or become more closely associated with transnational corporations.

In many countries, pharmaceutical companies require no authorization to combine, in unit-dose packaging, active ingredients that have been on the market for 10 or 15 years. In Mexico, however, the regulatory authority, the Federal Commission for Protection against Health Risks (COFEPRIS), ruled that a "technical and scientific justification" would be needed to produce these therapeutic doses and established regulations for practices that, in many countries, need no express approval. Furthermore, although demand for the services of public research centres has been rising with regard to clinical studies and the procedures needed to comply with COFEPRIS requirements, the work that these centres can carry out is limited because the new services required by transnational corporations have yet to be regulated. If a research centre wishes to offer a new service, it must ask the Secretariat of Finance and Public Credit one year in advance to include that specific service in its sales catalogues and estimate the cost. Since business with the pharmaceutical companies risks being delayed or cancelled as a result, research centres currently classify the requirements of transnational corporations as "research projects", when they are actually services commissioned exclusively by those companies.

10 This section summarizes the findings of Pozas (2014).

11 Pharmacogenomics refers to research into the adverse effects of new drugs and the development of treatments that target specific genetic groups of patients.

12 Clinical trials are the scientific tests necessary to obtain approval for the distribution of drugs in domestic markets.

Table II.3
Mexico: type of scientific and technical knowledge commissioned by hospitals and pharmaceutical companies from public research laboratories, 1999-2012

Company	Type	Project
Clínica de Reproducción Asistida S.A.	Health clinic (Mexican firm)	Analysis of endometrial genetic expression
Sangre de Cordón S.A.	Health clinic (Mexican firm)	Development of a new method to control cervical-uterine cancer
Laboratorio de Reproducción Asistida S.A.	Health clinic (Mexican firm)	Proteomic analysis and techniques of assisted reproduction
Banco de Semen Mexicano S.A.	Health clinic (Mexican firm)	Proteomic analysis of spermatozoon
Laboratorios SILANES S.A.	Pharmaceutical company (Mexican firm)	Development of a serological testing system for the early detection of human papillomavirus (HPV) antibodies
Astra Zeneca Laboratory	Pharmaceutical (TNC) [a]	Clinical trial for diabetes mellitus control
Bayer	Pharmaceutical (TNC) [a]	Evaluation of penetration effectiveness of pesticides for vector control
Abbott Laboratories	Pharmaceutical (TNC) [a]	Evaluation of automated polymerase chain reaction (PCR) tests for the detection of HPV
The Pfizer Global Investigator-Initiated Research (IIR) Programme. Pfizer	Pharmaceutical (TNC) [a]	Home perimeter infection as a determinant of dengue transmission
Sanofi Pasteur	Pharmaceutical (TNC) [a]	Clinical trial phase II to evaluate vaccine immunogenicity and security
Steri-Pharma	Pharmaceutical (TNC) [a]	Evaluation of inhibitory activity of antiseptics and disinfectants in clinical bacterial insulation in hospitals
Wyeth Pharmaceuticals	Pharmaceutical (TNC) [a]	Sensitivity to broad-spectrum antibiotics in clinic insulation of entire bacterium responsible for nosocomial infections; sensitivity to broad-spectrum in vitro antibiotics in clinic insulation; effect of supplementation with polyunsaturated fatty acids in neurologic development
Laboratorios Roche	Pharmaceutical (TNC) [a]	Identification of individuals with high probability of HCV infections
Danone S.A.	Food company (Mexican firm)	Randomized clinical study of a complementary diet programme in adult Mexican women
Nestlé	Food company (TNC) [a]	Food intake of urban Mexican population
UNILEVER	Food company (TNC) [a]	Evaluation of fatty acids intake by the Mexican population
LICONSA S.A.	Food company (Mexican firm)	Evaluation of the impact of fortified milk on the nutritional condition of beneficiary children
Tresmontes Lucchetti	Food company (TNC) [a]	Viability of school programmes in the National Strategy against obesity and excess weight
Mead Johnson Nutrition	Food company (TNC) [a]	Evaluation of the efficacy of increasing milk intake in children with severe malnutrition; effects of vitamin D on the health of pre-school children
Harvest Plus S.A.	Food company (TNC) [a]	Efficacy of consuming iron-enhanced beans for humans
Kellogg's S.A.	(TNC) [a]	Intake of a diet high in vitamins and minerals in Mexican women

Source: M.A. Pozas, "Scientific-technical services for the pharmaceutical industry in Mexico", *Latin America's Emergence in Global Services: A new driver of structural change in the region?*, Libros de la CEPAL, No. 121 (LC/G.2599-P), R. Hernández and others (eds.), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2014.
[a] Transnational corporation.

The Mexican experience shows that the regulatory framework is a determining factor for establishing a sustainable offshore services industry and for participating in the value chains of advanced industries such as the pharmaceutical industry. Although research centres have developed capacities in the areas of human resources, scientific experience, technical abilities and infrastructure, current legislation imposes restrictions that impede the efficient supply of offshore services. International experience has shown that such restrictions may hinder the transfer of technology and knowledge between pharmaceutical companies and local research centres.

D. SME participation in value chains

1. General considerations

Participation in global value chains offers SMEs many potential benefits. First, it enables them to enter external markets indirectly, and hence participate in the globalization process and reduce their dependence on the domestic market. Second, it can lead to productivity and efficiency gains. Large companies in charge of a chain may transfer their technology to the smallest companies, engendering a technology spillover effect. Global value chain participation also brings SMEs into line with international standards and gives them better access to financing and data (regarding, for example, demand trends). In short, value chains can potentially close productivity gaps between large and small actors and promote inclusive trade.

However, value chain integration is not without risk for SMEs. Having little power compared to large firms that dominate the value chains, SMEs have difficulties in negotiating a reasonable margin and retaining a portion of the value added generated in the chain. This occurs in particular when SMEs lack specific knowledge or technologies. Another limitation is that larger companies may only transfer production-related knowledge, leaving out design or marketing information. Lastly, there is always the risk that a large company will suddenly switch suppliers. This is more likely to happen if an SME lacks specific technologies or knowledge.

Set out below are two case studies on international agricultural value chains in which SMEs participate to a significant degree: the dairy sector in Costa Rica and the cocoa sector in Ecuador.

2. The dairy product chain in Costa Rica[13]

The Central American countries specialize in dairy production and are competitive in this sector, although there is considerable variation in the structure of their production chains. While the dairy industries mainly operate within their respective local markets, they also export to the Central American market. Some firms export to extraregional markets, especially to the United States, the Caribbean, and to a lesser extent, Europe.

The intraregional dairy product trade in Central America is a dynamic one, with the main exporters being Costa Rica and Nicaragua. Honduras is the third-largest exporter of dairy products. El Salvador and Guatemala are net importers, although El Salvador exports milk derivatives to the United States.

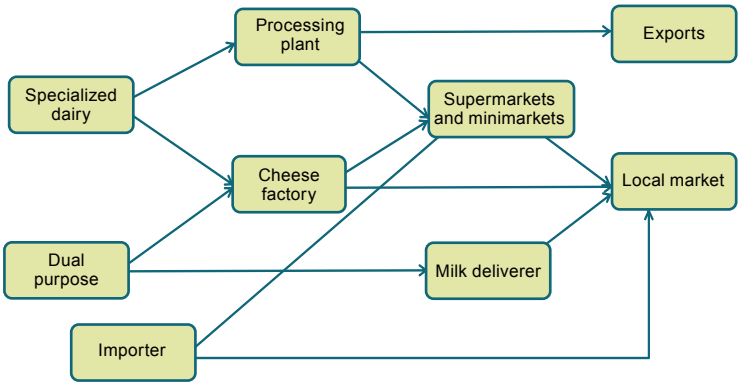
The structure of dairy production chains in the subregion varies considerably, but SME integration has been most successful in Costa Rica. Several producer groups and at least five large firms are engaged in the processing and commercialization of milk. One key player is Dos Pinos Milk Producers Cooperative, which controls almost 80% of the country's milk supply (see diagram II.7) The cooperatives law in Costa Rica and the tax benefits enjoyed by the country's cooperatives mean that this and other smaller cooperatives can pay better prices to producers, thus promoting production and associativity. The cooperatives also provide technical assistance services and inputs at competitive prices, which boosts overall productivity and competitiveness.

Most milk producers in Costa Rica, even the smallest ones, form part of the production processes of the companies that dominate the market, some of them on the basis of an associative structure. Over 90% of these companies' partners are small producers, which has ensured a better distribution of income and the democratization of ownership. The dairy farms in the cooperatives are subject to quality controls in the form of incentives (reflected in the prices paid to the producer) and penalties. There is a fairly high standard of milk quality and high levels of mechanization.

Significant progress has also been made in Costa Rica in the area of environmental livestock management. There are water treatment plants, plants that use solid animal waste to produce fertilizer, and plants that convert dairy by-products into feed for other animals. Costa Rican farms have remained competitive despite the additional cost of complying with environmental protection measures by differentiating their product on the basis of environmental performance (which is a key selling point in the international market). The ties between large enterprises and their smaller partners have generated mutual benefits of quality and productivity that have made Costa Rica the largest milk exporter in the Central American subregion.

[13] This section summarizes Zúñiga-Arias and Martínez-Piva (2014).

Diagram II.7
Costa Rica: dairy product chain



Source: Guillermo Zúñiga-Arias, "El desarrollo de cadenas de valor agroindustriales en Costa Rica, El Salvador y Nicaragua. El caso de estudio de la agroindustria láctea", *Estudios y Perspectivas series*, No. 126 (LC/L.3332-P; LC/MEX/L.996.Rev.1), Mexico City, ECLAC subregional headquarters in Mexico, 2011.

3. The cocoa chain in Ecuador[14]

Indigenous groups make up a large part of Ecuador's population and depend for their livelihood on agriculture, fishing and, to some extent, hunting. Farms are small and tend to be worked by the family; they are not capital-intensive. The resulting low productivity not only contributes to poverty, but also places more intense pressure on resources —land, biodiversity and forests. In this context, the Federal Ministry for Economic Cooperation and Development (BMZ) of Germany and the German Agency for International Cooperation (GIZ), in the framework of a bilateral cooperation programme on sustainable natural resources management (GESOREN), have developed a project aimed at providing the poor rural population with economic alternatives that can help them boost the productivity of their land. The resulting higher incomes are expected to relieve pressure on natural resources and mitigate poverty. With this goal in mind, GIZ decided to focus on value chains, given that production linkages connecting remote rural areas with domestic and export markets are inefficient, resulting in economic losses and poverty not only for rural families but for the Ecuadorian economy as a whole.

GIZ applied the value chain approach to the domestic fine aromatic cocoa (also known as "cacao nacional" or "cacao arriba") industry. Produced in areas endowed with considerable natural resource diversity, it is highly valued internationally for its quality.[15] It is estimated that 202,243 hectares are planted in cacao in Ecuador. The country is thus the largest producer and exporter of aromatic cocoa worldwide, accounting for approximately 60% of global sales volume. Furthermore, 90% of the production of this type of cocoa comes from 100,000 small and medium-sized producers. They do not have a comparative advantage in the traditional market for common cocoa; a long chain of up to 10 intermediaries and low relative land productivity erode profits for agricultural producers in those markets.[16] Alternative or speciality markets, however, offer opportunities for product differentiation; they include the fair trade markets (which require that the production come exclusively from small farmers) and gourmet markets (which emphasize the origin of the product), and thus offer advantages for smallholders.

Speciality markets differ from the traditional or conventional markets in which smallholders normally participate in the following ways: (i) producers must quickly adapt to emerging consumer preferences; (ii) higher prices are paid for differentiated products; (iii) product quality translates into recognition and certifications; and (iv) consumers react positively to stories and ethical messages regarding the preparation of these products. These characteristics produce unique value chain structures, and producers develop a more personal relationship with the buyers because chains are shorter and there is more coordination among participants.

14 This section is a summary of Lehmann and Springer-Heinze (2014).
15 These areas are the provinces of Esmeraldas, Morona Santiago and Zamora Chinchipe, the Sumaco Biosphere Reserve in Amazonia and the Ambato River basin in the Andean region.
16 Rural families normally grow cacao in combination with other products, using traditional farming practices, in order to supplement their diet, boost their income and diversify their production.

The Government of Ecuador, supported by GIZ, thus decided to implement a project to strengthen the fine aromatic cocoa value chain. First, trade links between producers and buyers (the companies and the cooperatives that act as intermediaries) were reinforced. The creation of forums for coordination and consensus between public and private stakeholders was also encouraged, with a view to providing better public services. Implementation of this project had a positive impact on the industry: it boosted farmers' income and reduced poverty (see table II.4). These results were achieved by strengthening horizontal and vertical production linkages, improving technology, standardizing production processes and establishing cooperation agreements between the public and private sectors. As a consequence, the value chain for fine aromatic cocoa from Ecuador, in which thousands of small producers participate, became more competitive.

Table II.4

Ecuador: impact of the programme run by the German Agency for International Cooperation (GIZ) on the competitiveness of the KALLARI cooperative [a] cocoa export value chain, 2006 and 2011

Indicator	Change observed	
	2006	2011
Number of members	1 214	2 150
Export volume	27 metric tons	101 metric tons
Export price	US$ 90 per quintal of conventional cacao	US$ 195 per quintal of certified cacao
Type and number of destination markets	Export market for cocoa beans (1 customer)	Export market for cocoa beans (3 customers)

Source: German Agency for International Cooperation (GIZ), "Study of the impacts of value chain promotion on associations of producers in Napo. KALLARI case study", 2011.

[a] This cooperative, comprising 590 Quechua families in Amazonia, received support from the Ministry of Agriculture, Livestock, Aquaculture and Fisheries, the Ministry of Economic and Social Inclusion, the Provincial Government of Napo and two non-governmental organizations (Catholic Relief Services (CRS) and GEO Schützt den Regenwald Foundation).

This experience shows that, in chains comprising many small producers whose productivity is low, orientation toward segmented or niche markets can help to reduce high production costs. Differentiation makes it possible to take advantage of opportunities in new markets by means of higher quality products, product certification and more linkages, which also helps reduce production costs. In order to ensure the sustainability of the production process, attention must be paid to defining the characteristics that ensure a unique and original product. Development of the final product cannot be approached from the supply side only; it must also involve the consumers.[17]

E. SME access to financing in value chains[18]

1. General considerations

Banks and other financial institutions take into account two conditions when lending money. The first is the borrower's ability to repay the loan. The second is some form of collateral to cover borrower default risk. Both conditions are easily met by major companies: they have more assets to offer as collateral and more information is available about them. SMEs generally have none of these advantages. It is more difficult and expensive for banks to assess SME credit risk, and SMEs are less able to provide the collateral that banks demand.

In this globalized world, SMEs thus rely increasingly on larger firms for access to markets and financing. For larger firms, it is useful and cost-effective to outsource and split their operations among SMEs in different markets. Production linkages between SMEs and larger firms, such as the vertical linkages in value chains, have become increasingly common forms of industrial organization.

The literature on SME financing highlights the potential for linkages with large firms in value chains to improve access to credit for SMEs. In value chains, financial flows towards SMEs may be facilitated through two mechanisms:

[17] Identifying the product and the market requires a careful analysis, which can establish the requirements that must be fulfilled further up the value chain. Having a market access perspective also motivates all actors to cooperate in implementing the strategy proposed.

[18] This section summarizes Navas-Alemán, Pietrobelli and Kamiya (2014).

(i) a large company offers direct financing to an SME (for example, for buying materials and machinery); or (ii) the link to a larger firm strengthens the SME's capacity to borrow from banks. This may be because of the reputational effect of working for a larger company, or because this link will provide future cash flows and purchase orders. Access to financing may in turn improve linkages owing to (i) reputation effects, which are important as they reduce the risk of default and thus could be viewed as a kind of guarantee by the larger firms; and (ii) fewer information asymmetries, since the financial position of a local SME becomes more transparent and accessible to the larger firms. However, much of the literature on value chains emphasizes issues of coordination and governance of those linkages and their effects on industry upgrading, with little mention of the financial implications for SMEs.

The two case studies presented here show that the main problems encountered by SMEs in need of financing are paperwork (procedural obstacles) and credit guarantee requirements. With regard to the second point, projects such as those run by the National Bank for Economic and Social Development (BNDES) and Caixa Federal in Brazil, which offer pre-approved unsecured credit lines at competitive interest rates, tend to be very attractive for SMEs. Lastly, the role of third parties such as governments, business associations and local government associations in facilitating SME financing and helping SMEs to forge closer links with the larger firms in their sector cannot be overstated. The two international case studies summarized below show that government policies need to focus on providing the right incentives and remedying the coordination failures that are likely to emerge between SMEs, banks and large firms.

2. The agrifood industry in Argentina

Three agrifood industry sectors in Argentina were studied: dairy cattle, broiler chickens and flour processing (mainly to make pasta and biscuits). In the first two sectors, processing companies source inputs from small farms that specialize in niche production, such as broiler chicken grow-out. In dairy and poultry production, processors not only outsource to independent farmers but also coordinate and supervise production. This gives rise to concerns for the large companies. First, processors may wish to drive improved production processes along the chain. They may therefore be interested in implementing scientific approaches to feeding and breeding, which may require expert guidance on farm unit management. Second, processors may be interested in improving the management of these units in order to increase the value chain's overall productivity. Third, the reliability of inputs is crucial to the efficiency of processing plants, making ongoing supervision of the production process essential. Consequently, processors depend upon maintaining a reliable group of input providers who can deliver the required volumes and make the investments necessary for improving production. Thus, through value chain financing, processors both support their suppliers and tie them into their supply networks.

In the case of the dairy value chain in Argentina, the largest company is La Serenísima, which has 5,000 employees. In 1999 the company founded a loan guarantee association (LGA) with a view to strengthening its value chain by providing its suppliers with commercial and financial guarantees and technical, administrative and financial assistance. This LGA now has 1,046 participants (all La Serenísima suppliers), who represent around one third of its total suppliers; 65% of them are dairy farms, 27% are transport firms and 8% are medical services companies. To encourage the creation of LGAs, the Government of Argentina provides tax exemptions to large firms, where those firms act as guarantors and SMEs benefit from the guarantees. While in 2002 the LGA provided 743 guarantees for a total of US$ 1.8 million, in 2009 it provided 1,345 guarantees for a total of US$ 5.5 million. Continuous contact between the LGA and the farmers enables the association to gain in-depth knowledge of the farms and their financial health.

A similar process took place in the poultry value chain. In this case, large firms strengthened their capacity to monitor and direct activities along the chain by increasing the financial opportunities of their SME providers. Expansion of the sector, whose output increased from 764,000 tons in 2003 to 1,680,000 tons in 2010, made it necessary to increase the production capacity of all the firms in the value chain, from small farmers to transporters, who were hampered by limited access to credit. The Argentine poultry value chain is patterned on a global model that is also used in Brazil and the United States; it is characterized by strong vertical coordination.

The dairy and poultry chains provide examples of how large firms can improve access to financing for small suppliers by large firms through trade credit, input and machinery acquisitions and short-term loans. However, indirect assistance through the provision of guarantees is also useful. In Argentina, small producers in the dairy and poultry chains have much easier access to finance than their counterparts in other sectors of the food industry, such as flour processing (see table II.5). Links with larger firms enhance the creditworthiness of SMEs, and thus their access to financial institutions outside the value chain, such as banks.

Table II.5
Argentina: use of financial instruments in agrifood chains, 2010

Instrument type	Specific instrument	Dairy value chain	Poultry value chain	Flour processing value chain
Self-financing	Self-financing	Frequently used 75% of interviewees declare that they finance almost 100% of their expenses with own resources; 50% use resources from another agricultural business they own	Frequently used	Frequently used
Inter-firm/arm's-length finance	Factoring or reverse factoring[a]	Not observed	Not observed	Not observed
	Leasing	Frequently used by transporters and occasionally used by farmers	Occasionally used, in particular by transporters and distributors	Occasionally used
	Purchase order finance	Frequently used between La Serenísima and input and machinery suppliers	Not observed	Not observed
	Warehouse receipt finance	Not observed	Not observed	Not observed
Relationship finance	Trade credit	Frequently used. Capital advances from producer to its suppliers, later deducted from product supply Occasionally used. LGA buys inputs and sells them to its partners at better financial terms than the market	Frequently used. A large firm buys equipment and sells it to farms The price is deducted from product supply. Common financing of smaller amounts, such as for fencing	Not observed
	Deferred payment checks	Frequently used by SMEs with support provided by the La Serenísima LGA	Occasionally used Thanks to the La Serenísima LGA, SMEs can cash checks at better discount rates	Occasionally used
Other	Angel investors	Not observed	Not observed	Not observed
External financing	Commercial bank	Frequently used. SMEs use credit cards, leasing, regular loans and overdrafts	Frequently used. Loans and leasing	Occasionally used (most SMEs are self-financing)
	Microcredit	Not observed	Not observed	Not observed
	Public bank	Frequently used Subsidized loans	Frequently used Subsidized loans	Not observed
Other	Buyer/supplier technical assistance	Frequently used Producers offered financial assistance for debt restructuring after the 2001 crisis. The La Serenísima LGA provides financial management assistance	Frequently used Large firms provide veterinary assistance and maintenance services to new farms	Not observed

Source: L. Navas-Alemán, C. Pietrobelli and M. Kamiya, "Access to finance in value chains: New evidence from Latin America", *Global Value Chains and World Trade: Prospects and challenges for Latin America*, Libros de la CEPAL, No. 127 (LC/G.2617-P), R. Hernández, J.M. Martínez-Piva and N. Mulder (eds.), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2014.

[a] Factoring is a financing and administration mechanism based on selling invoices: a company sells its invoices to a factor (third party), which handles collection in return for a fee plus interest. In reverse factoring, the factoring company collects invoices for a few large firms with many small suppliers. Reverse factoring thus facilitates access to credit for SMEs that supply large firms with goods and services.

3. The furniture industry in the Serra Gaúcha cluster, Brazil

The Brazilian furniture industry is the largest in Latin America, with production exceeding US$ 8 billion (of which US$ 968 million are exports) in 2010. The industry comprises almost 17,000 firms spread all over the country. One of the largest clusters is located in Serra Gaúcha (Rio Grande do Sul). Its development began in the 1970s, when an expanding domestic market was fuelling a steady increase in demand for furniture from this region. In the 1990s, the Brazilian economy opened up to international markets; this trend set off modernization of the sector. Serra Gaúcha's leading producers and largest firms invested heavily in machinery and technology, which enabled them to expand their production capacity.

Exports peaked around 2005. Serra Gaúcha producers were selling to Latin American, United States and European markets. But they also continued to cater to the domestic market, where demand remained high owing to (i) cheaper and abundant consumer credit; (ii) conditional cash-transfer programmes to low-income groups; (iii) the accelerated rate of credit growth in Brazil over the last decade; (iv) growth of the construction industry and the resulting demand for furniture; and (v) skilled negotiation by business associations, which persuaded government entities to buy furniture from domestic producers. National-currency appreciation between 2004 and 2008 also made the domestic market more attractive to furniture firms.

Two strong values that prevailed in Serra Gaúcha during this period of strong growth were self-financing and the avoidance of overindebtedness. In many cases, large firms and SMEs alike used networks of family and friends and trade credit from other firms to finance their short-term projects. Younger firms were more likely to seek loans to finance their long-term projects, preferring public banks with lower interest rates than private banks (see table II.6).

Table II.6
Brazil: sources of finance for sampled furniture firms in Serra Gaúcha, 2010
(Percentages)

	Self-finance from the firm and its partners	Family and friends	Public banks	Private banks	Other firms
Percentage of sample firms using this source	88	88	100	50	77

Source: L. Navas-Alemán, C. Pietrobelli and M. Kamiya, "Access to finance in value chains: New evidence from Latin America", *Global Value Chains and World Trade: Prospects and challenges for Latin America*, Libros de la CEPAL, No. 127 (LC/G.2617-P), R. Hernández, J.M. Martínez-Piva and N. Mulder (eds.), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2014.

Although the interest rates charged by other firms or by networks of family and friends are often not competitive, these loans have served to cover SME needs and projects on a timely basis because they involve less paperwork than bank loans and require no collateral (which SMEs are not in a position to provide). Public banks, particularly the National Bank for Economic and Social Development (BNDES), Caixa Federal and Banco do Brasil, offer credit lines and financial products (leasing and financing for working capital and innovation) at more competitive interest rates than private banks, to facilitate SME access to the loans they need.

The most common type of financing used by the companies in this chain is commercial loans granted to the furniture producers by large particleboard and veneer suppliers from Argentina, Brazil, Chile and Portugal. These suppliers wield enormous power to set prices and production parameters for their client companies, and may limit credit or even stop granting it altogether if a firm is in financial difficulty or if there are doubts about its ability to continue selling. Companies that buy furniture, meanwhile, rarely provide credit to producers. There is therefore considerable potential for financial institutions to provide credit for financing working capital and input purchases. Factoring is almost non-existent in this industry, given the high levels of interest charged (over 10% per month).

F. Conclusions

Following an overview of the participation of Latin America and the Caribbean in global value chains, this chapter has analysed three central microeconomic aspects of the contribution that value chain participation could make to more inclusive structural change. The first of these aspects is governance, innovation and upgrading in value chains. Using a methodology developed by ECLAC, four value chains were studied in El Salvador and Guatemala, and different strategies were formulated to boost the countries' participation in these chains. There is clearly a need to enhance the Central American subregion's capacities in process and product innovation. More innovation which would translate into higher value added. Progressive changes are thus required to make the production process more efficient and develop radically new products and services. For the four chains analysed, it is also clear that associativity within and among the segments must be reinforced. Greater associativity offers benefits in the form of economies of scale for the purchase of inputs and the sale of products and services, access to new technologies, and the availability of joint funding for innovation, which changes chain governance. Strengthening the links between segments will, among other advantages, improve products and services, make buying and selling more efficient and expand production.

A second microeconomic dimension of value chains is SME participation, which is key to promoting inclusiveness. The case studies reviewed in the primary sector (the cocoa sector in Ecuador and the dairy sector in Costa Rica) illustrate the tenuous competitiveness of many SMEs, which makes it difficult for them to enter and remain in value chains. SMEs require assistance from larger firms and from the government to enhance their performance in critical areas such as access to markets, training and finance, and the development of collaborative horizontal and vertical links. Several countries have thus implemented public or public-private programmes to develop SME suppliers, which will be examined in more detail in chapter III. As shown by the case study of the dairy sector in Costa Rica, associativity and links between small and large firms are essential for SME participation in value chains.

The case studies on access to financing for SMEs in value chains indicate that two of the main problems they encounter are complicated loan application procedures and the requirement for guarantees. With regard to the second point, pre-approved unsecured credit lines from public banks at competitive interest rates could benefit many of these firms. In addition, third parties such as governments, business associations and local government associations have an important role to play in facilitating SME financing and helping them to forge closer links with the larger firms in their sector. Government policies need to focus on providing the right incentives and remedying any coordination failures that emerge between SMEs, banks and large firms.

Global value chain participation can foster structural change with equality. Countries need to create an environment that encourages such participation and the formation of links between multinational and domestic firms. This involves effective coordination between public policies, including those relating to attracting FDI, logistics, workforce education and training and international trade. A more proactive industrial policy is also needed to overcome market failings that could limit the benefits of chains for the rest of the economy. Without the appropriate policies, value chain participation could have a negative impact on structural change. It may, for example, depress wages and job opportunities for certain categories of workers. In addition to national policies, areas and lines of action must be identified in which regional cooperation could help strengthen production integration among the economies of Latin America and Caribbean. This subject will be covered in chapter III.

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Chapter III

The contribution of regional integration to production integration

A. Introduction

Value chains are rapidly gaining traction worldwide as a means of organizing production. In that context, the governments of Latin America and the Caribbean have identified strengthening production integration as a priority in their development agendas and in their regional integration agreements. Although there is no single definition of regional production integration, it is usually understood as a process by which the production of goods or services is shared between two or more countries in the same geographical area. The aim is to exploit the production complementarities between the countries involved and promote the participation of SMEs and, in general, companies based in relatively less developed countries. Thus, along with the improved efficiency normally associated with value chains, production integration also has broader aims relating to social and territorial development. With the right policies, production and development asymmetries can be reduced between the members of an integration scheme, as well as within countries.

Underlying the aforementioned emphasis on production integration is the notion that intraregional trade liberalization alone has not done enough to stimulate production and export diversification in Latin America and the Caribbean nor has it resulted in a territorially balanced distribution of production processes. Consequently, all the regional economic integration mechanisms have placed production integration high on their working agendas. While this is positive, the region (and particularly South America) remains largely outside the global trend towards rising trade through multinational value chains.

This chapter aims to identify areas and action lines where regional integration and cooperation can contribute to strengthening production integration between the economies of Latin America and the Caribbean, reinforcing the action that the governments are taking to this end at the national level. The rest of the chapter is divided into a number of sections. Section B summarizes the main stylized facts underpinning the importance of the regional market for the development prospects of Latin America and the Caribbean, and in particular for the integration of their economies in production chains. Section C analyses certain areas in which enhancing the regional economic space would contribute to greater production integration among the countries involved. Section D highlights the need for greater regional or subregional coordination in relation to national industrial policies. Lastly, some conclusions are drawn in section E.

B. The importance of the regional space for production integration and structural change[1]

Although it may seem paradoxical at first sight, the current global economic context, marked by the shift of wealth to emerging economies, particularly those of Asia, presents obstacles to progress with structural transformation in Latin America. This is because it has encouraged trade specialization that has not been conducive to the accumulation of production capabilities in the region. The resulting context tends to hold the region back in the so-called "middle-income trap".

The boom in raw material prices that began in 2003 as a result of strong Asian demand has brought good and bad news to the countries exporting these products, most of them in South America. On the one hand, they have benefited from stronger growth, a reduction in poverty, better terms of trade and lower inflation (because of strengthening currencies and the lower import costs that have resulted). On the other hand, these countries have increased their specialization in primary sectors, often characterized by low levels of direct job creation, few linkages to the rest of the economy and growing environmental problems. At the same time, currency appreciation has reduced the competitiveness of sectors that are not exporters of raw materials, worsening the symptoms of Dutch disease and encouraging the appearance of speculative bubbles in non-tradable sectors. Lastly, there are the risks associated with the volatility of raw material prices.

[1] This section is based in part on ECLAC (2014c), chapter IV.

Meanwhile, those countries of the region that have built up an export specialization in labour-intensive manufactures (Mexico and some Central American countries) have had to deal with strong competition from China and the rest of Asia in their own markets and in their main export markets, particularly the United States (Dussel Peters and Gallagher, 2013). In this context, it is often said that the global economic rise of China and the other Asian economies has not only stimulated growth in the region but also been instrumental in its deindustrialization. It should be stressed, in any case, that the difficulty the region has experienced in developing dynamic comparative advantages in the manufacturing sector is also symptomatic of its own competitiveness problems, which have been exacerbated by Asian competition.

The international context described above does not seem likely to change substantially in the coming years. For one thing, Asian demand for raw materials should remain fairly robust, not just in China (despite its moderating growth since 2012), but also in other large economies, particularly India. For another, although China will gradually move towards a production structure in which knowledge- and technology-intensive industries play a larger part, other Asian countries —such as Bangladesh, India and Viet Nam — will very likely come to occupy the labour-intensive manufacturing niches currently dominated by China (CAF/ECLAC/OECD, 2013). Consequently, the strong Asian competition currently faced by these industries in Latin America and the Caribbean is likely to persist.

In the light of these considerations, deepening the regional market is an indispensable strategy if Latin America and the Caribbean is to move towards an international role that is more conducive to structural change. The fact is that, for most of the region's countries, intraregional trade has characteristics that make it qualitatively superior to exporting to other markets. First, for the great majority of them, the regional market is the most favourable to export diversification, absorbing by far the greatest number of export products (see table III.1).[2]

Table III.1
Latin America and the Caribbean (selected countries): number of products exported to selected destinations, 2013[a]

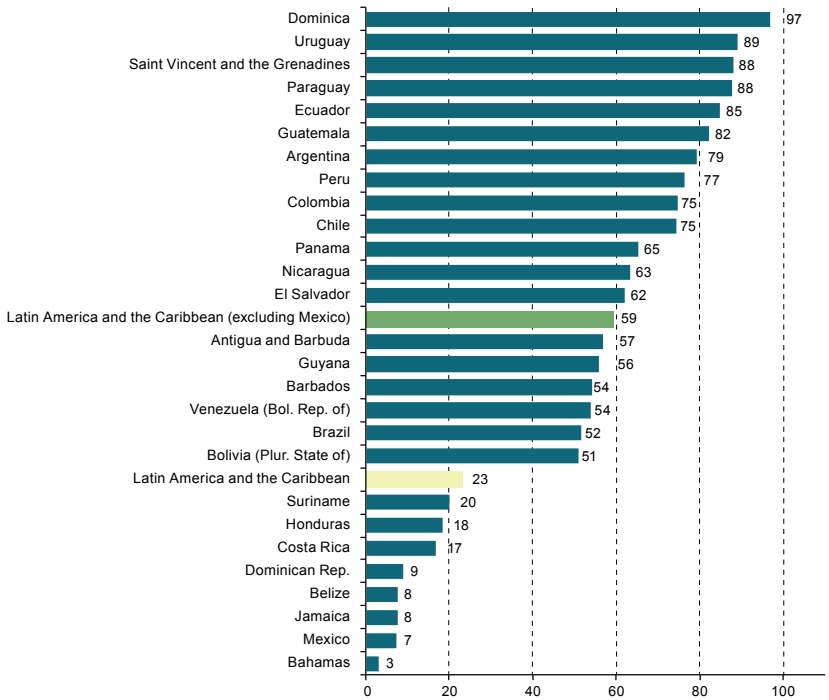
Country	Latin America and the Caribbean	United States	European Union	China	Japan
Argentina	3 510	1 388	1 681	434	355
Belize [b]	97	87	26	23	8
Bolivia (Plurinational State of)	630	290	258	51	59
Brazil	3 869	2 751	2 995	1 359	1 202
Chile	2 927	1 261	1 356	381	259
Colombia	3 167	1 777	1 349	227	197
Costa Rica	2 810	1 704	1 037	273	169
Dominica [b]	353	291	226	4	
Dominican Republic [b]	2 021	1 903	898	126	58
Ecuador	1 969	1 044	829	89	88
El Salvador	2 522	1 077	390	73	49
Guatemala	3 258	1 428	729	194	101
Jamaica [b]	823	888	465	73	44
Mexico	3 841	4 136	2 855	1 419	1 280
Nicaragua [b]	1 816	797	159	29	30
Panama	300	163	78	32	10
Paraguay	937	347	317	43	26
Peru	3 092	1 837	1 568	281	496
Uruguay	1 374	424	727	105	53
Venezuela (Bolivarian Republic of) [c]	1 645	370	959	110	36

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United Nations Commodity Trade Database (COMTRADE).
[a] Products at the six-digit level of the Harmonized Commodity Description and Coding System.
[b] Figures are for 2012.
[c] The number of products exported was obtained using mirror data of the imports of various trading partners.

[2] The great exception in this regard is Mexico, which, given its close production ties with the United States, exports a higher number of products to that country than to the region.

Another striking feature of the regional market is that it is the main outlet for the medium- and high-technology manufacturing exports of most of the region's countries, often taking over 70% of these (see figure III.1).[3] The regional market is particularly important to intra-industry trade (otherwise known as "two-way trade"), where two countries export products from the same industry to each other. This kind of trade is typically associated with economies of scale, production linkages and technological externalities, and it therefore tends to lead to greater benefits for the countries involved than inter-industrial trade. Regional markets are very important in the formation of manufacturing value chains, especially in textiles, wearing apparel, alcoholic beverages, cleaning products, medicines, chemicals and petrochemicals, electronics, and vehicle parts and accessories, among other sectors. In all of these sectors, although there are no fully fledged value chains, there is evidence of considerable potential, especially in intermediate products.[4]

Figure III.1
Latin America and the Caribbean (selected countries): share of medium and high-technology manufactures exported within the region, 2013 [a]
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United Nations Commodity Trade Database (COMTRADE).
[a] Data for Antigua and Barbuda, Bahamas, Belize, Dominica, the Dominican Republic, Honduras, Jamaica, Nicaragua and Saint Vincent and the Grenadines are from 2012, and those for the Bolivarian Republic of Venezuela and Suriname are from 2011.

The potential for intra-industry trade is higher between countries with relatively large and diversified economies, that are geographically close or that are linked by economic integration agreements (Durán and Zaclicever, 2013; Gayá and Michalczewsky, 2014). Intra-industry trade is particularly pronounced between Argentina, Brazil and Uruguay in the Southern Common Market (MERCOSUR); between Colombia, Ecuador and Peru within the Andean Community; between Costa Rica, El Salvador, Guatemala and Honduras in the Central American Common Market; and between Mexico and Central America (ECLAC, 2013). Although goods trade among the countries of the Caribbean Community (CARICOM) is markedly inter-industrial, the potential exists to create Caribbean value chains in some service segments, especially tourism and financial services.

[3] As in the previous case, the exception is Mexico, which in 2013 sent just 7% of its medium- and high-technology manufacturing exports to the regional market. Some other countries, particularly in the Caribbean, are in a similar situation, with exports heavily oriented towards the United States market.
[4] See Durán and Zaclicever (2013) for further sectoral details and a fuller analysis.

Third, the regional market is hugely important for Latin American export firms. A greater proportion of these firms export to Latin America and the Caribbean than to any other market. This is true of all the countries for which information is presented in table III.2, other than Mexico (where 74% of firms that export do so to the United States). The concentration of exporting firms tends to be particularly high in subregional markets. Thus, in all the member countries of MERCOSUR other than the Bolivarian Republic of Venezuela, a higher proportion of firms export within MERCOSUR than to the rest of the region. The same is true of Costa Rica and Guatemala in Central America.

Table III.2
Latin America (selected countries): share of all exporting firms that export to selected destinations, around 2011
(Percentages)

Group	Country	Same group [a]	Rest of Latin America and the Caribbean	United States	Unión Europea	China	Rest of the world
MERCOSUR	Argentina	62.8	52.4	20.2	28.5	4.8	24.5
	Brazil	45.7	43.3	29.6	39.4	10.1	41.2
	Paraguay	67.1	26.3	12.3	21.2	7.4	21.3
	Uruguay	47.7	25.8	19.3	22.3	10.8	45.7
	Venezuela (Bolivarian Republic of)	9.3	50.2	25.6	19.8	2.1	12.9
Andean Community	Bolivia (Plurinational State of)	19.7	54.0	27.0	21.0	8.7	18.8
	Colombia	25.5	54.5	30.8	15.4	1.5	24.1
	Peru	30.5	43.2	33.9	25.9	5.6	23.0
Central America	Costa Rica	50.5	26.2	39.9	20.7	3.2	22.0
	Guatemala	57.5	27.6	32.6	12.2	2.3	20.7
	Panama	35.8	36.1	28.5	13.4	3.5	19.3
Ungrouped	Chile [b]	Not applicable	68.7	29.0	29.2	12.3	30.4
	Mexico [b]	Not applicable	29.0	73.8	15.4	4.4	18.4

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the customs services of the respective countries.
[a] Percentage of exporting firms in each country that export to other countries within the same grouping.
[b] Because Mexico and Chile are classified as ungrouped, exports to the "rest of Latin America and the Caribbean" are exports to the whole region.

In the countries of the Andean Community for which information is available, exporting firms do not concentrate to the same extent on the subregional market as do their counterparts in MERCOSUR and Central America. In Colombia, this is explained by the large number of firms exporting to the Bolivarian Republic of Venezuela (about 25% of the total), Brazil and Mexico. In the case of Peru, it is due to the many firms exporting to the Bolivarian Republic of Venezuela (15% of the total) and Chile (15%). In the Plurinational State of Bolivia, lastly, it is due to the large number of firms exporting to Brazil (12% of the total) and Argentina (10%). In all three cases, the destinations are geographically close markets to which the Andean countries have access under preferential tariff conditions within the framework of different trade agreements.

The regional market is especially important for small and medium-sized exporters. These represent over 70% of all export firms in the region, although their share of the total value exported is very small. Excluding Mexico, the share of total exports from such firms going to the regional market for a group of 13 countries in the region is 55%, more than twice the figure for large firms (see table III.3).

Fourth, the regional market is also increasingly important from the perspective of foreign investment flows. Intraregional FDI (that is, direct cross-border investment between Latin American and Caribbean countries) rose from just 4% of inward FDI in the region between 2000 and 2004 to 14% in 2012. The weight of intraregional FDI is much greater in some economies, especially smaller ones. Indeed, in 2013 the share of intraregional FDI reached 46% in Ecuador, 39% in Central America and 30% in Colombia. By contrast, the region accounted for less than 1% of FDI inflows to Mexico (ECLAC, 2014d).

Table III.3
Latin America (14 countries): export orientation by type of firm and share of the total, around 2011[a]
(Percentages)

Type of firm	Share of the total (percentages)		Export orientation (percentages of total exports)		
	Number of firms	Exports	Intraregional (A)	Extraregional (B)	Export orientation index (A/B)
Including Mexico					
Large firms	26.9	95.7	17.8	82.2	0.2
Small and medium-sized export firms	73.1	4.3	43.0	57.0	0.8
Total	100.0	100.0	18.3	81.7	0.2
Excluding Mexico					
Large firms	27.5	95.7	26.3	73.7	0.4
Small and medium-sized export firms	72.5	4.3	55.2	44.8	1.2
Total	100.0	100.0	26.9	73.1	0.4

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the customs services of the respective countries.
[a] The countries are Argentina, the Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Mexico, Panama, Paraguay, Peru, the Plurinational State of Bolivia and Uruguay.

The growing importance of intraregional FDI reflects the investment strategies of the main trans-Latin firms. An analysis of those strategies shows that most of their investments go to other countries in the region, and particularly those closest to the firm's home country. Thus, Chilean firms have focused their investments on Argentina and Peru and, more recently, Brazil and Colombia. Colombian firms started by opening subsidiaries in the Bolivarian Republic of Venezuela and now invest mainly in Central America and Peru. Mexican firms divide their investments between other Latin American countries and the United States. Brazilian firms also invest mainly in the region, although, being larger, they also have a significant presence outside it, particularly in the United States. Meanwhile, Central American firms show a preference for investing in their own subregion, although some have begun to invest in other nearby markets, including Colombia and some Caribbean countries (ECLAC, 2014d).

It can be said, then, that Latin America forms a corporate integration space where the most successful firms from each country find their natural outlet for expansion. Thus, large regional groups have been formed and become leaders in particular markets, such as América Móvil in mobile telephony, Sura in insurance and pensions and Avianca, Copa and Latam in air transport. This space does not usually extend to the English-speaking Caribbean, where few Latin American firms have invested, despite its geographical proximity. The cement firms CEMEX (of Mexico) and Argos (of Colombia) are perhaps the most notable exceptions. The Caribbean is an independent business integration space, as there is FDI from Caribbean firms in other economies of the subregion. Although the amounts of these investments are small in absolute terms, for the recipient economies and in particular industries they can prove substantial (see chapter IV).

The data presented illustrate the regional market's strong potential in relation to production and export diversification and the development of value chains. However, the region is not taking advantage of that potential. In 2013, just 19% of regional exports stayed within the region, a share that has been essentially unchanged since 2007.[5] The total export share of the intraregional market rises to 27% if Mexico is excluded, since that country, the region's largest exporter, sends almost 80% of its shipments to the United States (see figure III.2A). Even excluding Mexico, however, the intraregional share of total Latin American and Caribbean exports is far below levels in the main regions of the world economy (see table III.4).

[5] There is considerable heterogeneity in this respect between the different subregions of Latin America and the Caribbean. The share of intra-group trade is about 25% among the Central American countries, 15% among the members of MERCOSUR and CARICOM, and 8% among the members of the Andean Community.

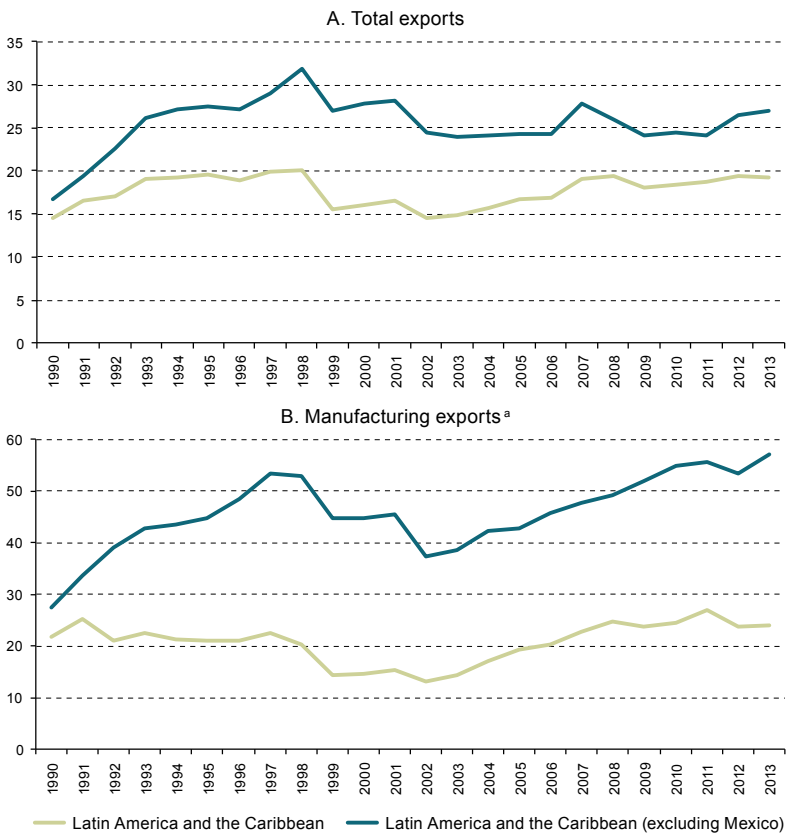
Table III.4
Selected groupings: intra-group exports as a share of total exports, 2008-2013
(Percentages)

Grouping	2008	2009	2010	2011	2012	2013	Average for 2008-2013
European Union	66.3	65.9	64.4	63.4	61.4	59.1	63.4
North American Free Trade Agreement	49.3	47.6	48.3	48.0	48.4	49.6	48.5
ASEAN+5 [a]	47.0	48.4	49.4	49.7	50.4	49.8	49.1

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United Nations Commodity Trade Database (COMTRADE).
[a] Includes the 10 member countries of the Association of Southeast Asian Nations (ASEAN) and China, Japan, the Republic of Korea, Hong Kong Special Administrative Region of China and Taiwan Province of China.

Given the large share of raw materials in the region's export basket (especially where South America is concerned) and the fact that these go mainly to extraregional markets, it is useful to calculate the share of Latin American and Caribbean manufacturing exports going to the regional market. When this exercise is carried out, the share of the regional market proves to be considerably larger than for total exports. This difference is particularly marked when Mexico is excluded, as then it transpires that over 50% of the manufacturing exports of all the region's other countries taken together go to the regional market (see figure III.2B). Furthermore, the regional market's share of Latin American and Caribbean manufacturing exports has increased greatly in the last decade, from 13% in 2002 to 24% in 2013 (and from 37% to 57% if Mexico is excluded). In short, in the same decade in which Latin America and the Caribbean saw a major reprimarization of exports, the regional market became the main destination of its industrial exports.

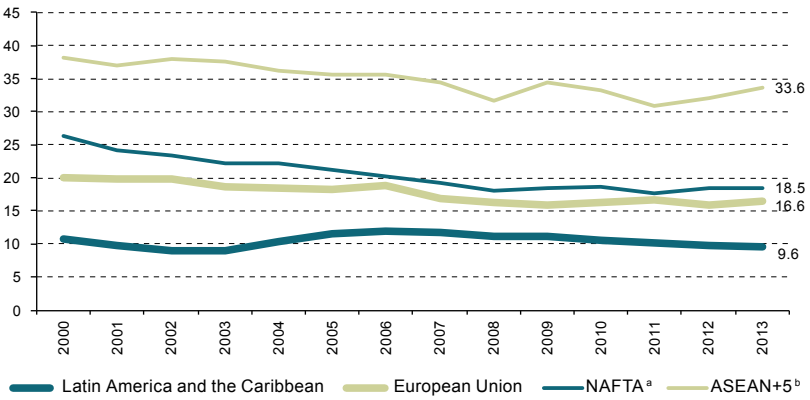
Figure III.2
Latin America and the Caribbean: intraregional exports as a share of worldwide exports, 1990-2013
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United Nations.Commodity Trade Database (COMTRADE).
[a] Includes high-, medium- and low-technology manufactures. Excludes natural-resource-based manufactures.

Despite the high manufacturing density of Latin American and Caribbean intraregional trade, most of it consists of finished products, as the small share of intermediate goods (parts and components) reveals. Intermediate goods account for over 30% of the value of goods traded between the countries of "factory Asia" and for almost 20% between the member countries of the North American Free Trade Agreement (NAFTA), but for only 10% between the countries of Latin America and the Caribbean (see figure III.3). This is evidence of a low degree of production integration between the Latin American and Caribbean economies, which, with some exceptions, have made only limited progress in constructing regional or subregional value chains. This not only restricts the potential for corporate alliances and intra-industry trade but leaves greater scope for protectionist temptations of various kinds.

Figure III.3
Selected groupings: parts and components as a share of intra-group exports, 2000-2013
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United Nations Commodity Trade Database (COMTRADE).
[a] Includes the 10 member countries of the Association of Southeast Asian Nations (ASEAN) and China, Japan, the Republic of Korea, Hong Kong Special Administrative Region of China and Taiwan Province of China.
[b] North American Free Trade Agreement.

In short, for most of the region's countries, the most immediate opportunities for engaging with the dynamic of value chains lie within the regional market. There are three explanations for this. First, trade within value chains is particularly sensitive to the costs deriving from distance, which is why such value chains are predominantly regional (WTO, 2011; Lim and Kimura, 2010). Second, the relatively high manufacturing density of intraregional trade (including some instances of intra-industry trade) suggests that it is the most conducive setting for establishing production linkages. Third, the bold regionwide roll-out of the trans-Latins opens up similar opportunities, provided that those companies establish networks of local suppliers of goods and services in the countries where they set up.

C. The role of an integrated regional market in fostering production linkages[6]

The Latin American and Caribbean region has made substantial progress in lowering the tariff barriers to intraregional trade. This is the result of efforts within the different subregional integration schemes, the signing of a large network of agreements connecting countries and groupings in different subregions, and the unilateral opening undertaken in many countries since the second half of the 1980s.[7] The liberalization achieved is an asset

[6] Sections C and D are based largely on ECLAC (2014c), chapter V.
[7] According to estimates by the Secretariat of the Latin American Integration Association (ALADI), the proportion of tariff-free items in trade among its 12 member countries (prior to the entry of Panama) increased from 21.8% in 1995 to 70.9 % in the present day. This figure is expected to increase in the coming years, as the provisions on tariff reduction contained in the economic complementarity agreements signed between MERCOSUR and the member countries of the Andean Community enter into full force. See [online] http://www.aladi.org/boletin/espanol/2014/MarzoAbril/Proceso5_01.htm.

that should be valued and preserved. Nonetheless, the limitations of this process also need to be recognized. First, there are large "missing links" in the form of intraregional relationships that have not been liberalized. The most glaring of these is between Mexico and MERCOSUR, and between the latter and the Central American countries.[8] Progress in liberalizing trade between the Caribbean and the rest of the region is still very incipient too.

Second, the dense architecture of trade agreements within the region has resulted in increasing fragmentation. This is because the content of the different agreements varies widely, in terms of both the scope and the depth of the commitments negotiated. The rise of value chains has shifted the spotlight from tariffs to non-tariff issues, such as trade facilitation, the mobility of businesspeople, technical standards applicable to products and services and the treatment of foreign investment and intellectual property. This explains the strong regulatory emphasis (also known as deep integration) of the megaregional agreements currently being negotiated in Asia, Europe and North America (ECLAC, 2013). Nonetheless, the thematic coverage of many of the trade agreements between countries in the region does not yet reflect these global trends (see table III.5). Consequently, the lowering of tariff barriers aside, progress towards the establishment of an integrated regional space characterized by common trade and investment regulations is still very limited. This in turn has disincentivized the development of regional or subregional value chains.

Among the deep integration issues that are least frequently dealt with in the agreements signed between countries in the region are intellectual property and public procurement. This reflects the great sensitivities involved in both cases. First, the inclusion of intellectual property rules in trade agreements is a source of major controversy in the region and beyond. This is because such provisions can entail a net transfer of wealth from countries that are net importers of intellectual property (usually developing countries) to countries that are net exporters (usually developed countries). Too much intellectual property protection can discourage the spread of new works and inventions and have a negative impact on public policies in areas such as health, education, culture and innovation. Consequently, it is unsurprising that the region's countries should have opted not to include this topic in several of their trade agreements. Nonetheless, the issue is unavoidable in the context of the knowledge economy. Excessively lax intellectual property protection regimes do not help to promote patentability or innovation in the region or protect its cultural heritage and biodiversity. Consequently, it would be beneficial to pursue a more in-depth debate on the possibility of creating regional or subregional regimes in this area that are adapted to the policy priorities collectively determined by the region's governments.[9]

A number of the region's countries use public procurement as a mechanism for industrial policy and the promotion of SMEs.[10] This explains the reluctance of some governments to commit themselves to opening it up as part of trade and integration agreements. Nonetheless, given sufficient flexibility, it seems perfectly possible to reconcile the benefits of greater regional or subregional opening (in terms of scale and a better cost-quality ratio for the goods and services purchased) with the preservation of scope for promoting different public policy goals. Thus, for example, any agreements could include different forms of preferences for local SMEs or for firms that meet particular environmental objectives, such as the use of green technologies or unconventional renewable energy sources.

8 Two exceptions are the automotive industry (where trade between Mexico and MERCOSUR has been partially liberalized by a number of bilateral protocols) and the relationship between Mexico and Uruguay, which is governed by a bilateral free trade agreement.

9 In this connection it is worth noting the experience of the Andean Community, which has established common regimes on industrial property (Decision No. 486), copyright and related rights (Decision No. 351), protection of the rights of plant breeders (Decision No. 345) and access to genetic resources (Decision No. 391).

10 This is also the case in developed countries such as the United States and Japan.

Table III.5

Thematic coverage of trade agreements between Latin American and Caribbean countries as of July 2014

Agreement	Cross-border services	Investment	Intellectual property	Competition policy	Public procurement	E-commerce	Temporary entry of business people	Trade facilitation	Harmonization or mutual recognition of technical, sanitary and phytosanitary standards
Pacific Alliance (protocol)	Yes	Yes	No	Yes [a]	Yes	Yes	No	Yes	Yes
Andean Community (CAN)	Yes	Yes	Yes	Yes	Partial [b]	No	Yes	Yes	Yes
Caribbean Community (CARICOM)	Yes	Yes	Yes	Yes	In preparation	No	Yes	Yes	Yes
Central American Common Market	Yes	Yes	Yes	Yes [a]	Yes	Yes	Yes	Yes	Yes
MERCOSUR	Yes	No [c]	Yes	No [d]	No [e]	No	Yes	Yes [f]	Yes
CAN-MERCOSUR [g]	Exhortatory	Exhortatory	No [h]	Exhortatory	No	No	No	No	Yes
Bolivia (Plurinational State of)-Mexico	No	No	No	No	No	No	No	Yes	Yes
Central America-Mexico	Yes	Yes	Yes	Yes [a]	Yes	Yes	Yes	Yes	Yes
Central America-Panama	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes
Chile-Central America	Yes	Yes	No	Yes	Yes	No	Yes	Yes	Yes
Chile-Colombia	Yes	Yes	No	No	Yes	Yes	Yes	Yes	Yes
Chile-Ecuador	To be negotiated	To be negotiated	No	No	To be negotiated	No	To be negotiated	Yes	Yes
Chile-MERCOSUR	Yes	No	No	Exhortatory	No	No	No	No	Exhortatory
Chile-Mexico	Yes	Yes	Yes	Yes	No	No	Yes	Yes	Yes
Chile-Panama	Yes	Yes	No	No	No	No	No	Yes	Yes
Chile-Peru	Yes	Yes	No	Yes	To be negotiated	No	Yes	Yes	Yes
Colombia-Central America [i]	Yes	Yes	No	No	Yes	Yes	Yes	Yes	Yes
Colombia-Costa Rica	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Colombia-Mexico	Yes	Yes	Yes	Yes [a]	Yes	No	Yes	Yes	Yes
Colombia-Panama	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Colombia-Venezuela (Bolivarian Republic of)	No	No	No	No	No	No	No	No	No
Costa Rica-CARICOM	Exhortatory	Yes	No	Exhortatory	Exhortatory	No	Yes	Exhortatory	Exhortatory
Costa Rica-Peru	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes
Ecuador-Guatemala	No	No	No	No	No	No	No	Yes	Yes
Mexico-Peru	Yes	Yes	No	No	To be negotiated	No	Yes	To be negotiated	Yes
Mexico-Uruguay	Yes	Yes	Yes	Yes	To be negotiated	No	Yes	Yes	Yes
Panama-Peru	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes
Dominican Republic-CARICOM	Exhortatory	Exhortatory	Exhortatory	No	Exhortatory	No	Yes	No	Yes

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organization of American States (OAS), Foreign Trade Information System [online] www.sice.oas.org.

[a] In the telecommunications chapter. In the case of the Central American Common Market, the reference is to the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR).

[b] National treatment is applied to the acquisition of services by government agencies or public bodies (Decision No. 439). No commitments have been negotiated on goods.

[c] Guidelines for entering into an investment agreement in MERCOSUR were agreed by Council of the Common Market (CMC) Decision No. 30/10 of December 2010. No information is available on subsequent progress.

[d] The MERCOSUR Agreement for the Defence of Competition (CMC Decision No. 43/10 of December 2010) is not operational.

[e] The MERCOSUR Public Procurement Protocol, established under CMC Decision No. 23/06, did not come into force. CMC Decision No. 23/10 mandated a review, and a number of postponements to the deadline have subsequently been agreed. There is currently no information on the outcome of this process.

[f] The MERCOSUR Customs Code, approved in 2010, is not operational at the time of writing.

[g] Refers to the agreements between MERCOSUR and the Plurinational State of Bolivia, between MERCOSUR and Peru, and between MERCOSUR and the Bolivarian Republic of Venezuela, Colombia and Ecuador.

[h] It is indicated that the parties will be governed by the World Trade Organization (WTO) Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) and by the 1992 Convention on Biological Diversity. It is also noted that the parties will seek to develop standards and disciplines for the protection of traditional knowledge.

[i] The agreement is between Colombia on the one side and El Salvador, Guatemala and Honduras on the other.

Given the information set out, the goal of moving towards an integrated regional space via gradual convergence between existing agreements remains fully applicable. Nonetheless, efforts to move in this direction over the past decade have not prospered, and this reflects profound differences over trade issues within the region.[11] Consequently, a large dose of flexibility and pragmatism will be required to accommodate any advances that are made among smaller groups of countries, always ensuring that the door is left open to subsequent convergence between these initiatives at the regional level. At the same time, progress can be made on several non-tariff issues that have a considerable impact on intraregional production linkages. Some of these are addressed below.

First, since one goal shared by the governments of the region is to promote multinational production linkages, it would be advisable to explore options for progressing gradually towards full regional cumulation of origin.[12] Provisions of this kind already exist in the different subregional integration mechanisms, as well as in some agreements that connect integration mechanisms with each other (for example, the economic complementarity agreements between MERCOSUR and the members of the Andean Community) or with individual countries (such as the free trade agreement between five Central American countries and Mexico). However, the impact on production integration would be greater if progress could be made towards a single regional cumulation system with more SME-friendly rules. The standardization of the different certificates of origin currently in use and the widespread use of digital certification of origin would also contribute to reducing the transaction costs paid by the companies involved in intraregional trade, particularly SMEs.

Second, greater coordination would be desirable in relation to the actions being implemented by a number of governments and integration mechanisms to facilitate intraregional and extraregional trade. The conclusion in December 2013 of a Trade Facilitation Agreement in the framework of the World Trade Organization (WTO) could serve as a catalyst for this convergence. The agreement includes several measures that are already being implemented in the region, albeit not necessarily in a concerted fashion. For example, this is the case for the implementation and interconnection of single windows for external trade, the adoption of authorized operator schemes[13] and the issuance of advance rulings.[14] The contribution that these and other instruments can make to stimulating intraregional trade will be enhanced if they are designed and implemented with a truly regional vision. Thus, for example, agreeing at the regional level the criteria that companies must meet to be considered authorized operators or the content of the advance rulings seems preferable to each country or subregional integration scheme doing so separately. Also, the design of the procedures required to ensure full interoperability of national single windows necessarily calls for coordination at the regional level.

Third, and following the same logic, another promising line of work is the gradual harmonization or mutual recognition of technical, sanitary and phytosanitary standards. This work is already under way in the different subregional integration mechanisms, which have made progress on defining common standards for some categories of goods (see box III.1). This is an important development because it reduces the fragmentation of the regional market and promotes production integration. Nevertheless, a company wanting to export a single product (such as cosmetics) to three subregional markets (for example, a country in MERCOSUR, one in the Andean Community and one in the Central American Common Market) may still face the need to meet at least three different sets of quality and safety standards. The logical next step would be to try to define common standards with a regional scope or to reach regional agreements on mutual recognition of different national or

[11] This was the case with the initiatives aimed at creating free trade areas between the members of the Latin American Integration Association (ALADI) and the then South American Community of Nations (now UNASUR).

[12] This concept refers to the possibility that inputs from any country in the region, incorporated into an end product to be exported by another country in the region to a third country also within the region, may be considered to be from the country exporting the end product. This would increase the range of regional suppliers to which Latin American and Caribbean export firms have access, without losing the tariff preferences negotiated as part of integration agreements.

[13] An authorized operator is a company that receives certain benefits in terms of trade facilitation (such as fewer physical inspections or documentation requirements). To qualify for those benefits, the firm must meet certain criteria, such as having a history of compliance with customs regulations or being able to provide sufficient guarantees of the security of its supply chain.

[14] Advance rulings are written decisions issued by the customs service (or other relevant authorities) of an importing country to an applicant prior to import, specifying the treatment that will be granted to the respective good in terms of tariff classification, origin and other details, such as applicable tariffs or quotas.

subregional standards. This work is necessarily sectoral and should begin with the product families that have already seen progress at the subregional level.

Box III.1
The subregional technical regulations agenda

The main subregional economic integration mechanisms have included on their agendas the development of common standards on quality, safety and environmental impact, for example, which all products circulating within the respective subregion must meet. The aim is to reduce regulatory barriers to the free movement of goods among the partner countries while safeguarding various public policy objectives such as the protection of human, animal and plant health, consumers and the environment. The main institutional arrangements and developments in each integration scheme are outlined briefly below.

The Andean Community has the Andean Quality System, created pursuant to Decision No. 376 of 1995. The System was set up to facilitate trade and enhance the quality and safety of the goods produced and traded within the Andean Community. It operates using the Andean networks for standardization, accreditation, technical regulation and metrology. Specifically, the technical standardization activities, carried out within the framework of the Andean Standardization Network, are pursuing the harmonization and adoption of (voluntary) Andean standards in sectors of interest to the subregion. These include food, textiles and clothing, footwear and other leather products, automobiles, wood and furniture, among other categories. Decision No. 562 of 2003 establishes requirements and procedures for the preparation, adoption and application of (mandatory) technical regulations in member countries and at the Community level in order to prevent such regulations from becoming unnecessary technical barriers to intra-Community trade.

The members of the Southern Common Market (MERCOSUR) adopt technical regulations under sub-working group No. 3 (SGT 3) on technical regulations and conformity assessment. Other working groups, such as those relating to telecommunications (SGT 1) and health (SGT 11) also develop technical requirements for their respective sectors. Between 1992 and 2012, MERCOSUR adopted nearly 200 technical regulations applicable to a wide range of products including food, electrical equipment, personal hygiene products, toys, shoes, elevators and personal protective equipment. No information is available on how many of these regulations have been incorporated into the legal systems of the member countries, which is a prerequisite for their application.

In Central America, the programme of work on technical regulations within the framework of the Secretariat for Central American Economic Integration (SIECA) includes various categories of goods: foods (additives, labelling, safety criteria), medicines and related products (good manufacturing practices, mutual recognition of sanitation records for natural medicinal products), veterinary medicines and related products, pesticides and textiles (labelling), among others. Financial support for the development of these standards and technical regulations in Central America is being received from the European Union, through the programme to support the creation of a regional system for quality control and the application of sanitary and phytosanitary measures in Central America (PRACAMS), which comes under the implementation of the Association Agreement signed between the European Union and Central America in 2012.

In the Caribbean Community (CARICOM), the CARICOM Regional Organization for Standards and Quality, (CROSQ) was established in 2002 to facilitate the development of regional standards, promote the harmonization of metrology systems and support the sustainable production of goods and services under the project known as the CARICOM Single Market and Economy. As in Central America, the activities of CROSQ receive financial support from the European Union through a specific project under the Economic Partnership Agreement signed between the Forum of the Caribbean Group of African, Caribbean and Pacific States (CARIFORUM) and the European Union in 2008.

Lastly, the members of the Pacific Alliance are negotiating a chapter on regulatory coherence. In that context, the countries are considering establishing tools to enable the systematic implementation of measures to ensure transparency and public consultation, the review and ex ante and ex post measurement of the impact of regulation and the simplification of procedures and services. Also, there has been progress in the cooperation between regulatory authorities in the pharmaceuticals and cosmetics sectors.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the secretariats of each integration scheme.

From a medium-term perspective, a permanent challenge is to move towards greater formal integration between Brazil and Mexico, the region's largest and most sophisticated economies. It is around these two large economies that it is most feasible to begin structuring production linkages that can subsequently be joined by companies located in smaller countries. In this respect, the invitation issued by members of the Pacific Alliance in June 2014 to MERCOSUR to explore a possible agenda of common interest is a positive step and should be followed up with concrete action.

Lastly, the pursuit of greater regional production integration and stronger intraregional trade should not be taken as a call for protectionism against the rest of the world. The new methods of organizing production in value chains are driving segmentation, stimulating trade in intermediate goods and intra-industry trade as typical features of productive complementarity. Accordingly, the net effect of measures that limit access to imports should be

assessed with the greatest care. Specifically, the analysis should include the adverse impact they might have on the competitiveness of a country's production processes by excessively raising the cost of imported capital goods, inputs, services or technologies or depriving companies of timely access to them.[15] In short, the new import substitution must be genuine, that is based on improvements in innovation and competitiveness and not on administrative barriers or on economies with closed borders.

D. The centrality of industrial policy

The challenge of enhancing trade and productive integration between the region's economies far transcends the trade agenda, covering a wide range of public policies. In particular, there is growing recognition of the crucial role to be played by a modern industrial policy in this effort. In South America in particular, this recognition has given rise in a number of countries to strategic initiatives seeking to transform production and exports (see box III.2). The persistence in most of the subregion's countries of export patterns based on natural resources with little processing has stimulated a debate about how industrial policy (also known as production development policy) might unleash processes that dynamize comparative advantages in sectors where innovation plays a leading role. These sectors are not confined to manufacturing, as there is great scope for innovating and adding value in sectors associated with natural resources and modern services. In fact, the rise of value chains in world production and trade is tending to blur the boundaries between sectors, because closely interlinked extractive, manufacturing and services activities are typically found along a single chain.

Box III.2
Towards a resurgence of industrial policy in South America?

Recently, several South American governments have announced or implemented initiatives aimed at transforming the production and export structure of their economies. Specifically, the aim is to stimulate the production of new goods and services characterized by higher value added and knowledge content. This is expected to reduce the current high dependence on the exploitation and export of raw materials, as well as vulnerability to price fluctuations. It also attempts to reduce internal and external productivity gaps, and thus also inequality by providing more and better employment options for the whole population. Underpinning these initiatives is the idea that true productive and export diversification is a prerequisite for development.

Two of the most recent initiatives are the Agenda for Productivity, Innovation and Economic Growth in Chile and the National Plan for Production Diversification in Peru, both announced in May 2014. Other existing initiatives include the Greater Brazil Plan, 2011 (which replaced the Production Development Policy, 2008), the Productive Transformation Programme of Colombia (created in 2008), the Strategic Industrial Plan 2020 in Argentina (created in 2011) and the Strategy for Transforming the Production Matrix in Ecuador (announced in 2012). With obvious nuances, these initiatives share many common traits, including:

- Strategic vision: with a focus on transforming the current production and export structure.
- Selectivity: efforts targeting a limited number of industries, sectors or activities.
- A more active role for the State, particularly in: (i) identifying priority industries, sectors or activities; (ii) providing infrastructure and public goods necessary for their development (transport, logistics, telecommunications, energy, financing and research and development (R&D)); (iii) identifying and eliminating market failures or bottlenecks; (iv) involving relevant stakeholders and coordinating action through public-private partnerships; and (v) setting up appropriate institutions for decision-making and the execution of these tasks.
- An emphasis on exports and internationalization: promoting international competitiveness in the export of new goods and services is promoted, as is the expansion of the number of export companies, both direct and indirect. In particular, the aim is to encourage the integration and upgrading of national production sectors in value chains, whether regional or global. In addition, the Greater Brazil Plan is pursuing corporate internationalization through the promotion of outward FDI.
- The important role of public-private partnerships, recognizing that the capabilities of the two sectors are complementary: on

[15] For instance, about 85% of Brazilian imports of manufactures from China are intermediate and capital goods purchased by Brazilian industry to manufacture finished goods that are then exported or sold in the local market (Pedro da Motta Veiga, presentation at the WTO Public Forum in September 2012). Recent studies also bear out the crucial role played by access to modern services in the evolution of competitiveness and in adding value to exports (WTO, 2013a).

Box III.2 (concluded)

the one hand, the private sector is generally better positioned to identify opportunities, but is often prevented from seizing them by market failures; and on the other, governments have the tools to address these failures, but do not necessarily know how to identify the best opportunities. This creates ample space for collaboration and coordination.

- An emphasis on environmental sustainability: including aims regarding the sustainable use of biodiversity and the development of renewable energy sources.
- An emphasis on promoting territorially balanced development: seeking to strengthen the competitiveness of the regions or territories by reducing development disparities and providing greater opportunities for regional and local actors to participate in the design and implementation of concrete actions.
- An emphasis on social inclusion: prioritizing measures specifically targeting SMEs, women entrepreneurs and other vulnerable or historically excluded actors.

The main action lines set out in the documents on the initiatives that were analysed were as follows: [a]

- Strategic public investment, either in enabling infrastructure (such as roads and ports) or the creation and operation of new production facilities (for example, shipyards and refineries).
- Support for the development of clusters.
- Supplier development programmes, aimed particularly at SMEs.
- Programmes to improve the financing available to SMEs and innovative ventures (such as new technology ventures).
- Promotion of infrastructure for quality (ISO certifications, sanitary certification, traceability).
- Human capital training programmes consistent with the needs of the production sectors.
- Creation of industrial and technology parks.

While the initiatives analysed all demonstrate a similar concern for enhancing production and export diversification, they differ in terms of their temporal and institutional frameworks, specific objectives, operating modalities and instruments, among other dimensions. Some of the main differences are summarized here.

All of the initiatives analysed focus their efforts on certain target sectors, with the exception of the National Plan for Production Diversification in Peru.b However, those sectors vary greatly from country to country. In Chile, the aim is to promote new goods and services in sectors with proven high growth potential, which generally reflect the country's current comparative advantages: mining, agro-industry, tourism, fishing and renewable energy. In Ecuador, along with adding value to existing production, the initiative seeks to develop new strategic industries, incluing refining, shipbuilding, petrochemicals, metals and steel. The programmes in Argentina, Brazil and Colombia contain several common priority sectors, with the three countries pursuing expansion in vehicles and parts, footwear and leather, textiles and garments, and software, among other sectors, and at least two of them promoting other areas (capital goods, chemicals and petrochemicals, and medicine in Argentina and Brazil; cosmetics, cleaning products and biofuels in Brazil and Colombia; and dairy products in Argentina and Colombia). Colombia stands out for placing a relatively stronger emphasis on services, which make up 6 of the 20 priority sectors (including business process outsourcing and different types of special interest tourism).

The initiatives also differ with regard to whether they include the aim of replacing imports with local production. Argentina, Brazil and Ecuador are pursuing import substitution in several priority sectors, particularly in industry. The various instruments provided to this end include tariff protection, trade protection measures (such as anti-dumping duties), technical standards, domestic taxation, subsidies, local content requirements and preferences in public procurement processes. By contrast, import substitution is not an explicit objective of the initiatives that have been announced or that are under way in Chile, Colombia and Peru.

A third difference relates to which portion of the prioritized value chain each country decides to promote. In simple terms, the initiatives in Argentina, Brazil and Ecuador place greater emphasis on developing complete vertically integrated chains, at least in certain industries. Whereas the initiatives in Chile, Colombia and Peru seek to promote the development of specific segments in the different priority chains.

Finally, there are differences in the types of goals that are set. The Greater Brazil Plan and the Strategic Industrial Plan 2020 contain precise quantitative goals, whether for the country as a whole (such as share of investment in GDP, the country's share of world exports or share of domestic value added in production) or for specific sectors (in terms of production, employment, exports and imports). These types of objectives are not stated in the initiatives announced or under way in Chile, Colombia, Ecuador and Peru. However, since some of those initiatives are still very new, quantitative targets may be incorporated at a later stage.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of selected country initiatives.

[a] Not all of these action lines are contained in every initiative and, where they are included, they are not necessarily addressed in the same way. However, all of the action lines mentioned here appear in more than one of the documents analysed.

[b] For this instrument, the priority areas will be identified on the basis of three criteria. First, studies of global chains will identify potential external demand. Second, regional studies will highlight barriers to growth in the regions and the sectors that could help to reduce them. Lastly, sectoral studies will determine the sectors that are beginning to show potential in the form of high growth rates even if they are not yet macroeconomic heavyweights, and those which, despite having potential, have not yet taken off.

Industrial policy, broadly understood, comprises a diverse array of instruments (see table III.6). These include instruments designed to improve companies' access to financing, those whose purpose is to generate and disseminate new technologies and know-how, training instruments, incentives for SME partnership and internationalization, quality certification programmes and production cluster policies.

Table III.6
Types of industrial policy

Policy type	Goals	Instruments
Horizontal and passive	Non-discrimination among activities	Competitiveness policies: - Stable macroeconomy - Contract enforcement - Ease of new business start-up - Investment protection and building of infrastructure Trade and inward FDI policies: - General unilateral opening initiatives - Signing of bilateral or multilateral agreements that do not distinguish between or protect specific sectors - Opening up to foreign capital
Horizontal and active	Correct market failures	Policies to foster scientific and technological development and innovation: - Direct support for private-sector R&D activities - Promotion of joint R&D projects to internalize externalities Policies for human resource training and the development of business skills: - Funding for specialized human resource training and intellectual property protection Policies to support SMEs and microenterprises: - Credit support policies Policies to correct problems resulting from imperfect information: - Organization of events, fairs and congresses, preparation of business directories - Seminars and conferences
Policies for structural change without challenging comparative advantages	Development strategies based on existing comparative advantages	Direct State action policies: - Provision of information on new industries consistent with comparative advantages - Coordination of investment in related industries and infrastructure improvements - Direct fiscal subsidies - Untargeted tax exemptions - Targeted lending with subsidized interest rates - The use of incubators or inward FDI promotion measures to catalyse the development of new industries - Tariffs on external trade
Policies for structural change that create new competitive advantages	Altering and challenging comparative advantages	The industrial policy instruments used with this approach combine all the foregoing with direct State intervention instruments in areas including financing, fiscal stimuli, public investment and public procurement. With this approach, industrial policy must be coordinated with macroeconomic, social and labour policies if structural change is to be achieved.

Source: Ramón Padilla Pérez and Jennifer Alvarado Vargas, "The revival of industrial policy", *Strengthening Value Chains as an Industrial Policy Instrument. Methodology and experience in Central America*, Libros de la CEPAL No. 123 (LC/G.2606-P), Ramón Padilla (ed.), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2014.

Industrial policy is a central element in the proposal for structural change that ECLAC has been advocating in the region in recent years (ECLAC, 2010, 2012 and 2014b). What it is meant to do is encourage the transition to activities characterized by higher levels of productivity and greater knowledge-intensity, whether in the manufacturing, natural-resource or services sector. This can be done either through policies to strengthen existing comparative advantages (by incorporating more technology into natural resource exports, for instance) or through policies to create new competitive advantages. Certainly, modern industrial policy needs to be responsive to the globalized context the region is operating in, characterized by greater openness to trade and FDI and by the constraints some trade and investment agreements place on the use of certain instruments. In other words, what is being pursued is an industrial policy that supports both value-chain integration and the development of virtuous links between value chains and the local economy of each country.

Industrial policy in the region has traditionally been formulated and implemented with a bias towards national objectives. However, if the aim is to promote cross-border production linkages, action taken only at the national level may be insufficient and even ineffective (for example, if the policies implemented by the different countries in a given chain are conflicting rather than mutually reinforcing). This is why ECLAC has suggested the possibility of taking the first steps in the development of industrial policies with some components that are multinational, that is shared by a number of countries. A useful tool to this end may be the methodology developed by ECLAC and the German Agency for International Cooperation (GIZ) for strengthening value chains (see chapter II).

To date the ECLAC-GIZ methodology has been used primarily to orient the formulation of national industrial policies (for example, in Argentina, El Salvador and Guatemala). However, with appropriate adjustments it could provide a useful conceptual framework for the coordination of industrial policies between two or more countries participating in a given value chain. By applying the methodology to certain priority value chains identified by the countries involved and assessing the corresponding constraints and opportunities, it would be possible to implement a range of convergent initiatives aimed at participating firms in different critical areas. Those initiatives will depend on the specificities of each chain, but could include supplier development programmes, partnership initiatives, quality certification, training, technical standards, sanitary and phytosanitary measures, traceability, measurement and the reduction of environmental footprints.

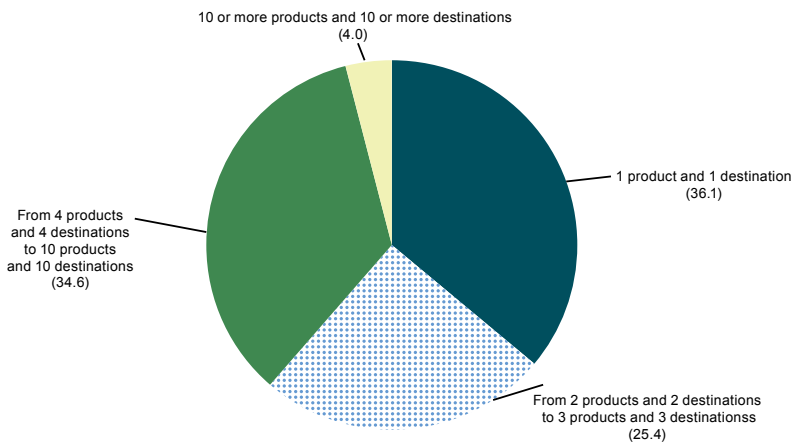
A concrete example of the potential offered by regional or subregional cooperation for industrial policy implementation concerns the internationalization of SMEs. In the region, SMEs are typically characterized by low productivity and a high degree of informality, and they experience serious human capital constraints and strategic management problems. They also usually have limited access to trade financing (Pérez-Caldentey and others, 2014). This results in a limited capacity to meet the requirements applied in export markets, such as technical, quality, sanitary, phytosanitary and environmental sustainability standards. In fact, micro and small enterprises in Latin America hardly export at all, in stark contrast to the situation in the industrialized economies (see table III.7). Also, a high proportion of the region's export firms (mainly SMEs) depend on a small number of products and target markets, which makes it difficult for them to sustain their involvement in export activity (see figure III.4).

Table III.7
Selected countries: total export shares by company size, around 2010 [a]
(Percentages)

	Argentina	Brazil	Chile	Spain	Italy	Germany	France
Micro	0.3	0.1	-	11.1	9.0	8.0	17.0
Small	1.6	0.9	0.4	13.3	19.0	12.0	10.0
Medium-sized	6.5	9.5	1.5	22.6	28.0	18.0	15.0
Large	91.6	82.9	97.9	47.1	44.0	62.0	58.0

Source: Organization for Economic Cooperation and Development/Economic Commission for Latin America and the Caribbean (OECD/ECLAC), *Latin American Economic Outlook 2013: Structural Policies for SME Development* (LC/G.2545),Santiago, Chile.
[a] The figures for Brazil do not include special micro- and small enterprises, which account for 6.6% of total exports. In the case of Chile, the figure for small enterprises includes microenterprises. In Spain, 5.9% of exports are attributable to companies whose size is unknown and so are not included here. The figures for Germany cover only exports within Europe.

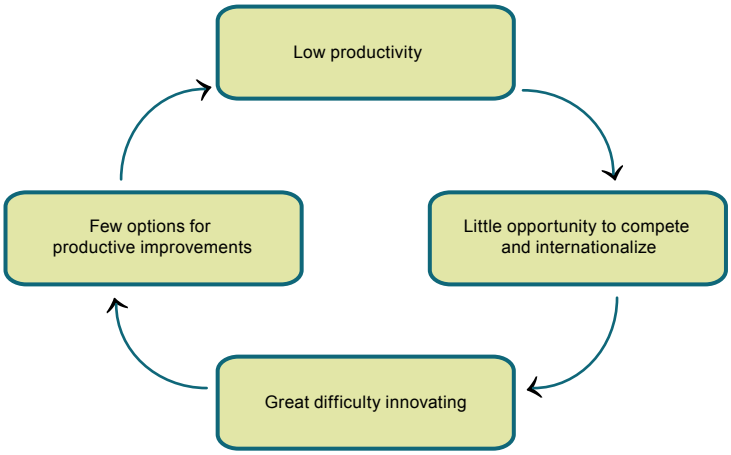
Figure III.4
Latin America (10 countries): distribution of exporting firms by number of markets and products, around 2010 [a]
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the customs services of the respective countries.
[a] Includes information for Argentina, the Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Mexico, Panama, Paraguay, Peru and Uruguay.

As already indicated, the dynamic of value chains results in many activities formerly located in a single country being shifted to different locations throughout the world. In this context, large firms are increasingly externalizing production processes to specialized SMEs. This is creating unprecedented opportunities for the region's SMEs to act as suppliers of goods and services to larger firms. However, strict requirements in terms of scale, cost, quality and time frames constitute barriers that often prevent firms from taking advantage of these opportunities. It is therefore necessary to break the vicious circle that constrains and limits the internationalization of the region's SMEs (see diagram III.1).

Diagram III.1
The vicious circle of SME internationalization



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Supplier development programmes are increasingly being used in the region to strengthen the linkages between large companies and local SMEs. Those programmes usually include interventions aimed at increasing the capacity of SMEs to meet the requirements of current and potential client firms, for example, by incorporating improved management techniques and new technologies. The considerable heterogeneity of these programmes in the region can be seen in various dimensions. For example, while the Production Linkages Programme of Costa Rica is specifically designed to promote coordination between local suppliers and multinational export companies (ECLAC, 2014a), other programmes, such as those in Chile, El Salvador and Mexico, do not have an explicit link to exports.

From an institutional perspective, the supplier development programmes in several countries (including El Salvador, Honduras and Mexico) began as international cooperation initiatives. The challenge in those countries is then to embed the programmes more permanently in public institutions. By contrast, the supplier development programmes in Chile and Costa Rica have a relatively long history and started out as national initiatives. The differences between the various national experiences also extend to issues such as the type of support provided to participating companies and the duration of that support.

The growing number of national supplier development programmes forms the basis for taking more ambitious steps in relation to regional production integration. One area that could be explored, for example, would be mechanisms to connect the demands of large enterprises in each country (including trans-Latins) with regional or subregional suppliers, thus overcoming the limitations imposed by a purely national supply.

Industrial policy is also vital for penetrating and moving up global service chains, as the experience of some of the region's countries shows. There are two possible ways of entering these chains: attracting multinationals, and internationalizing local firms (Taglioni and Winkler, 2014). The region's governments have concentrated on the former, using a combination of policies. For example, the fiscal and other benefits applicable in export processing zones, which were originally introduced to promote the export of goods, have now been extended to companies exporting services (López and others, 2014). However, as several countries in the region already have free trade zones, their value as an incentive to attract multinationals is declining.

Another essential set of policies concerns human resource training. They include teaching English to workers whose work is oriented towards the United States or other international markets and strengthening specific skills for specialized services such as accounting, different types of engineering, and information technologies.[16] This specific

[16] Because higher education curricula are not necessarily designed specifically to meet the needs of firms, some countries such as Colombia and Costa Rica have created courses lasting between six months and two years to provide this knowledge (known as "finishing schools"). The Outsource to Colombia (O2CO) programme, which was launched in 2013 as part of the Productive Transformation Programme, co-finances specialized training intiatives to address the shortcomings presented by some companies interested in participating in the global services market. The programme also provides support for developing business plans and obtaining relevant quality certifications.

know-how is increasingly important in an international context where there is a need to scale towards more complex tasks, and where it is consequently ever harder to compete on the basis of low labour costs alone. In this connection, skills certification programmes, whether operating independently or in conjunction with training programmes, are key.[17]

In some countries, such as Chile in the 2000s and Uruguay, governments have also provided other incentives, such as partial funding of set-up costs, office rental and technological infrastructure. A number of countries in the region offer incentives for innovation, research and development. These include not just tax breaks but also incentives to patent new services and measures to provide better protection for intellectual property. In all these areas, as well as in relation to skills training and certification, there are important opportunities for mutually beneficial cooperation between the private sector, universities and local research centres.

Another important tool for promoting the growth of local service companies is the strategic use of public procurement. For example, in the region, multinational companies are often the main providers to the State of services relating to information and communications technologies (ICTs), including those relating to e-government services. This is because they usually have several advantages in terms of reputation and experience over their local competitors. This makes it difficult for local companies to accumulate the experience they need to participate successfully in public procurement processes abroad (López and others, 2014). Granting a certain degree of preference to local suppliers, particularly the smaller ones, can help break this vicious circle.

A number of governments in the region are also providing specific support to help local businesses internationalize. These efforts ought to be directed both at companies with the potential to sell their services to other export firms in the country (indirect internationalization) and to those with the potential to market their services in foreign markets (direct internationalization). Many firms in the region have good technical skills, but lack the management and marketing know-how required to sell their services abroad. Public-sector support could be designed to overcome these weaknesses, for example by preparing companies to obtain the certifications required internationally for the sale of services.[18]

Another example of the potential that can be unlocked by coordinating industrial policies at the regional or subregional level is the possibility of reaching agreements to prevent competition between countries (who are sometimes members of the same integration scheme) to attract FDI or establish certain activities in their territories using tax or other incentives. In the absence of such agreements, the result is usually a concentration of investment and activities in the jurisdictions (whether national or subnational) that provide the greatest benefits, marginalizing other actors and weakening the possibilities of achieving true production integration. Regulating incentive policies at the regional —or at the very least subregional— level therefore seems a logical move.

Furthermore, progress is needed on mechanisms for adequate financing of intraregional trade, involving national and regional development banks in this effort. An analysis of 111 trade financing programmes provided by 23 development financing institutions in 14 countries in the region by Pérez-Caldentey and others (2014) found that the vast majority of them had a general approach and were not specifically designed to support intraregional trade. That finding may indicate a bias in favour of extraregional trade, given that larger firms have greater access to trade financing programmes offered by financial intermediaries and trade relatively more with extraregional markets than SMEs. It therefore follows that having more programmes specifically oriented towards intraregional trade would particularly benefit export SMEs (both direct and indirect), and would thus contribute to the aim of achieving more inclusive trade.[19]

Lastly, regional cooperation in science, technology and innovation is another promising field for the development of new industrial policies with multinational components. This was recognized at the ministerial meeting entitled "Innovation and structural change in Latin America and the Caribbean: strategies for inclusive regional development"

[17] For example, the ispeak programme, created in 2009 by the Ministry of Commerce, Industry and Tourism of Colombia, aims to evaluate and certify the proficiency in English of Colombian residents, in order to provide this information to interested companies. Since 2012, ispeak has been coordinated under the Productive Transformation Programme. In 2013 it was incorporated into a training component for employees of companies in the sectors that work with the Productive Transformation Programme.

[18] For example, ISO 9000, Capability Maturity Model Integration (CMMI) and Information Technology Infrastructure Library (ITIL).

[19] The study also found that only 18% of the 100 trade financing programmes analysed exclusively targeted micro-, small and medium-sized enterprises (MSMEs), while 74% had no restrictions on access according to the size of the company. For the reasons given above this policy could in practice result in a bias against MSMEs.

held in Rio de Janeiro, Brazil, in June 2013. At that meeting, ministers and high-level science, technology and innovation authorities from the region resolved to promote industrial policies oriented towards the creation of new sectors, over and above the enhancement of competitiveness of existing sectors, thereby contributing to progress with an environmentally sustainable technology paradigm. The Conference on Science, Innovation and Information and Communications Technologies of ECLAC, convened for its first session in June 2014, provides an enabling institutional framework for defining a regional cooperation agenda in this field. For example, national efforts (which in most cases are on too small a scale) can be pooled to create regional technology centres in areas of common interest, such as climate change, energy efficiency, renewable energy and biotechnology for agriculture and mining.

In sum, there are many areas where the governments of Latin America and the Caribbean could benefit from greater coordination of production promotion policies at the regional or subregional level. While the current picture is very heterogeneous, in general coordination in this field is still lacking. MERCOSUR stands out for the highly developed institutional framework of its production integration agenda (see box III.3). However, to date, the specific objectives, activities, timelines, budgets and responsible parties for the many initiatives that are under way have not been clearly defined, which makes it difficult to assess their impact. It is also impossible to ignore the effect on production integration of the various types of barriers that still hinder trade between the members of the bloc.

Box III.3

The treatment of production integration in the Southern Common Market (MERCOSUR)

The first presidential mandates aimed at institutionalizing the treatment of production integration on the MERCOSUR agenda date back to 2006. These led to Council of the Common Market (CMC) Decision No. 12/08 of 30 June 2008, establishing the Production Integration Programme, which aimed at strengthening the production complementarity of MERCOSUR enterprises, with a particular focus on integrating small and medium-sized enterprises (SMEs) and firms in the countries with relatively smaller economies into production chains. The 17 specific goals that are mentioned (not an exhaustive list) include goals to boost partnerships between firms in the bloc, for example through the development of clusters, export consortiums or partnerships between larger companies ("anchor companies") and networks of regional suppliers. Other objectives include identifying the adjustments required in the regulatory framework in which businesses operate (for example, in the field of technical standardization) and improving their access to financing, to an adequate services infrastructure and to technologies.

To achieve its objectives, the Production Integration Programme contains seven horizontal and two sectoral action lines. The former are: cooperation between agencies associated with business and production development, provision of support for research and development and technology transfer, human resource training, coordination with other MERCOSUR institutions, information generation and processing, the coordination of trade facilitation measures and financing. At the sectoral level, the programme provides for the setting up of forums to promote sectoral competitiveness and various other sectoral integration initiatives. Pursuant to the same CMC Decision No. 12/08, the Production Integration Group was created, consisting of representatives appointed by the governments of the member States to coordinate and implement the programme. The activities of the Production Integration Programme are not subject to measurable targets or specific deadlines, and they do not have an assigned budget allocation. Subsequently, CMC Decision No. 67/12 of 6 December 2012 led to the creation of the MERCOSUR Production Strengthening Mechanism, which aims to promote integrated action to strengthen joint production capacities. To date, the Production Strengthening Mechanism is not operational as its rules of procedure have not yet been agreed. It is therefore unclear what its specific relationship will be with the Production Integration Programme and the Production Integration Group.

Within the Production Integration Programme framework, several committees on production integration are promoting linkages in the aeronautical, maritime and wind energy sectors. Moreover, since 2013 a project for production integration in the auto parts sector has been implemented using funds from the MERCOSUR Structural Convergence Fund (FOCEM). Another project, this time in the oil and gas sector, is expected to be launched soon also financed by FOCEM. Both projects are expected to last two years and will receive total financing of about US$ 8 million. Lastly, bilateral production integration projects are also under way, such as those between Brazil and Uruguay in the automotive, maritime and wind power generation sectors since 2013.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Other subregional economic integration mechanisms —the Andean Community, the Central American Common Market and the Pacific Alliance— do not have the same kind of specific institutions devoted to production integration as MERCOSUR. In all three cases, with natural nuances, production integration is being pursued mainly through the removal of barriers to the free movement of goods, cumulation of origin, trade facilitation and harmonization or mutual recognition of technical and sanitary standards. These measures are often accompanied by specific action to promote the internationalization of SMEs, through the organization of business conferences and participation in joint stands at international fairs.

The existence of a critical mass of highly internationalized large Latin American companies is an asset base for efforts towards greater regional production integration. More specifically, a high-level dialogue should be set up with the principal trans-Latin companies regarding the possibility of their forming the backbone of efforts to internationalize the region's SMEs. This does not mean forcing the trans-Latins to undertake efforts that would undermine their competitiveness. Rather, it is a case of knowing which minimum requirements (of quality, opportunity and volume, among other dimensions) regional SMEs must meet so that the trans-Latins are willing to use them as goods and services suppliers. As these requirements could diverge substantially from the reality of SMEs, this would be exactly the right space in which to apply industrial policy instruments to help SMEs raise their technical and professional standards.

Regional or subregional cooperation in the production development sphere should be clearly slanted towards the construction of production and technology capabilities in the smaller or relatively less developed economies. A variety of instruments can be used for this, such as structural funds, multilateral and development bank financing and partnerships with foreign investor firms to facilitate access to training, technology and value and distribution chains. The important thing is to ensure that the less developed economies have outside support to enable their firms to enter and move up value chains and their workers to raise their productivity and wages.

It should be repeated that pursuing a more active industrial policy does not mean neglecting the competitiveness of natural resource exports. On the contrary, the idea is for industrial policy to enhance these sectors, which can then be used as a lever to increase the complexity of the production base in general and avoid respecialization in primary production. Indeed, the likely expansion of global demand for materials, energy and food, especially in China, India and the rest of Asia, opens up unprecedented opportunities for development and employment in the region. Making good use of these within the framework of a production transformation strategy means each country retaining a larger share of the surpluses generated by natural resource exports and using these resources to enhance technological innovation, training and entrepreneurship (Bitar, 2014).

To move up natural resource value chains, a deliberate and systematic effort is needed to incorporate technology into agricultural, mining, forestry and energy exports. Likewise, there is a need to stimulate the formation of business clusters and partnerships around these sectors and to strengthen the links between primary activities, manufacturing and services. Industrial policy has an irreplaceable role to play in all these areas, and there are numerous areas in which the region's countries could act in a more coordinated fashion.

E. Conclusions

The potential to diversify the region's production and export structure is closely related to the prospects of its integration process. As noted in this chapter, intraregional trade is typically more diversified and manufacturing-intensive, has higher technology content, is more SME-friendly and creates more employment than trade with other regions. It is therefore an essential link not just for regional integration, but also for national strategies to achieve structural change for equality.

Escaping the "middle-income trap" that threatens to ensnare the region requires innovation, increased productivity, production diversification and investment in infrastructure and human capital. It is therefore crucial to start with a modern understanding of integration, based on the competitive creation of value chains. Such an understanding has helped shape the region's growing consensus to give a more prominent role to production integration, promoting regional or subregional value chains. To be consistent with this approach, it will be necessary to raise the profile of national industrial policies and to make production integration a central component of regional integration and cooperation activities. In the light of the information given above, the region has made greater progress on the first task than on the second.

The analysis in this chapter reveals two central challenges to greater regional production integration. The first is to ensure full access for companies based in the region to the expanded market, which should be the basic premise of any economic integration project. The second is to ensure the coordination of national industrial policies within a regional or subregional framework. The two challenges are closely linked: if strategies designed to promote regional and subregional value chains are to be successful then industrial and trade policy must be closely aligned.

Ensuring full access to the expanded market is a task that goes beyond removing the various kinds of traditional trade barriers that persist, to a greater or lesser extent, in the various subregional integration mechanisms. Indeed, today the main obstacles to international value chains often relate to the high transaction costs of operating in several countries with different regulatory frameworks. Therefore, moving towards an integrated regional market necessarily involves addressing the fragmentation of national and subregional markets through a gradual convergence of regulatory frameworks in the areas that have the greatest impact on trade and investment flows.

The regulatory dimension of integration is inextricably linked to industrial policy, which typically employs a range of regulatory instruments. This is the case for policies on incentives, public procurement, the treatment of foreign investment and the adoption of technical standards. Consequently, making progress towards a regional market with common rules also implies moving towards the regional coordination of national industrial policies. This necessarily entails sacrificing degrees of national autonomy in the formulation and implementation of policies. However, that challenge must be addressed if the region is to position itself on the world map of value chains and exploit the full potential of its market. This is borne out by the experience of Europe and East Asia, and by the strong regulatory emphasis in the negotiations under way of the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP) between the United States and the European Union.

In a global economy that operates increasingly on the basis of integrated macroregions, convergence between the different Latin American and Caribbean integration schemes seems not just necessary, but urgent. This convergence goes far beyond the scope of trade policies, particularly when it comes to managing regional or subregional value chains, which are highly dependent on the quality of regional transport, logistics, energy and communications infrastructure, as well as on regulatory convergence between countries. As such, and setting aside the differing approaches to certain trade and tariff issues, there is plenty of scope for making necessary progress in many public policy areas.

The task facing the region's countries is not simply to join some regional or global value chains, although that is a necessary starting point. The challenge is to increase the value added generated locally and to move up chain hierarchies from simple to more complex activities. This process is neither straightforward nor spontaneous. It depends critically on public policies that engage with this objective. Ultimately, the challenge is to construct factors of differentiation that transcend natural resource endowments or low labour costs. To that end industrial policy has an indispensable role to play.

The best way of maximizing the benefits and minimizing the risks associated with value chains is through policies to: (i) enhance the synergy between trade and investment policies by pursuing both in tandem and by including measures to stimulate these chains in industrial development policies; (ii) deal with infrastructure bottlenecks that limit the potential of these chains; (iii) foment the production capabilities of local firms; and (iv) help the local workforce to acquire specialized knowledge. Across the board, those efforts should be slanted in favour of productive and technological capacity-building in smaller or relatively less developed economies.

In short, industrial policy seems to be a key vector today in renewing the integration process. Of course, the coordination of national industrial policies presents a number of political, technical and even budgetary challenges, which is why these initiatives must be gradual and progressive, advancing through trial and error in those activities that have a bigger impact on intra-industrial trade and subregional value chains.

A second practical consideration that arises from the region's experience is that it is not enough to formulate a good, coordinated industrial policy without also improving the capacity to implement it. This means improving the technical capacity of the responsible government agencies and integration mechanism secretariats and allocating enough resources for those actions to have the desired impact. Monitoring and evaluation must also be enhanced as these are central to correcting any deficiencies in the design or implementation of policies and to legitimizing resource allocation to them.

A third consideration bears on the relationship between policymakers and the economic agents who must operate within the framework defined by such policies. The decisions taken by the region's main corporate actors have little connection, at present, with those taken by regional and subregional integration institutions. This has to change. In particular, the promotion of competitive regional or subregional value chains requires a fluid dialogue with the business and labour sectors that are the main actors in these chains. That dialogue, grounded in solid technical information, would increase the relevance of future production integration and industrial policy coordination initiatives. As indicated above, the trans-Latins should play a pivotal role in that dialogue, given their strong position in the region and their ability to generate linkages with local suppliers.

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Chapter IV

Fostering regional integration in the Caribbean to strengthen external trade relations

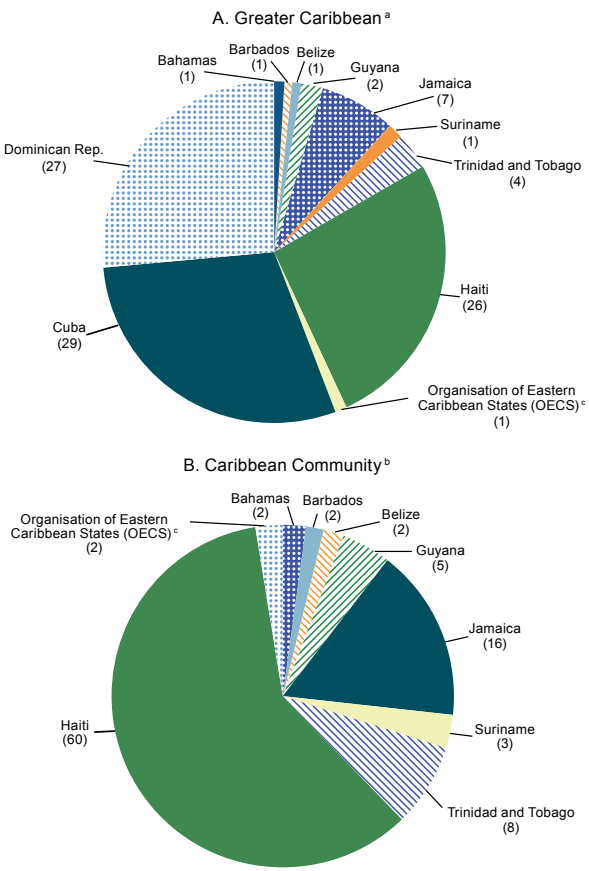
A. Special characteristics pose a challenge to subregional integration

The specific features, circumstances and constraints characteristic of the Caribbean countries present challenges for their integration processes. These include geography, large differences in income and population, the small scale of production and exports, high dependence on external markets, and macroeconomic and environmental vulnerability, with a high degree of exposure to natural disasters.

Geographically, 12 of the 15 member States of the Caribbean Forum of African, Caribbean and Pacific States (CARIFORUM) are islands, with a total area of only 60,000 km^2. Just three Caribbean Community (CARICOM) member countries are on the continent: Guyana and Suriname in South America and Belize in Central America. All of the Caribbean countries are classed as small island developing States (SIDS). Their island geography does not preclude integration, but it does pose certain challenges, notably in terms of transportation and logistics costs.[1]

There are large variations in income and population among the CARICOM members. Per capita GDP ranges from less than US$ 800 in Haiti to over US$ 21,000 in the Bahamas. In terms of population, Haiti and Jamaica account for 75% of the Community's inhabitants (with populations of 10 million and 2.8 million, respectively), whereas the seven countries of the Organisation of Eastern Caribbean States (OECS) have just over half a million inhabitants between them. These data confirm that the Caribbean is the most heterogeneous subregion of Latin America and the Caribbean (see figure IV.1).

Figure IV.1
Greater Caribbean and Caribbean Community: population distribution, 2013
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information.
[a] The figures for the Organisation of Eastern Caribbean States (OECS) include data from Antigua and Barbuda, Dominica, Grenada, Montserrat, Saint Kitts and Nevis, Saint Lucia and Saint Vincent and the Grenadines.

[1] Logistics costs in the Caribbean have been estimated to be twice the global average. It is faster, easier and cheaper to transport cargo overland from Mexico to Belize than to move it to any other destination in the Caribbean (Stoneman, Pollard and Inniss, 2012).

Another noteworthy characteristic is the small scale of Caribbean countries' production and exports, and the concentration in a few export markets. Although they are open, export-oriented economies, they account for only a small share of global and regional trade (less than 0.2% and 1.2%, respectively, in 2013). Only a few of the CARICOM member countries can be categorized as goods producers, and in such cases, production is confined to a small number of commodities. In the other CARICOM countries, services account for the lion's share of GDP and exports, often in excess of 70%. This is especially the case among the OECS members (see table IV.1).

Table IV.1
The Caribbean: selected GDP and export indicators, 2012 [a]
(Dollars and percentages)

Country/subregion	GDP indicators					Exports of goods (percentages of total exports)	
	Per capita GDP (dollars)	Services (percentages of GDP)	Current account balance (percentages of GDP)	Public debt (percentages of GDP)	Official development assistance (percentages of GDP)	To Latin America and the Caribbean	Top three products [b]
Caribbean countries	**4 860**	**52.5**	**-6.1**	**52.5**	**2.1**	**39.0**	**32.5**
Caribbean Community	4 307	56.8	-5.2	67.8	3.0	25.7	45.0
Bahamas	21 908	76.5	-17.5	54.5	...	3.1	91.3
Barbados	16 203	81.7	0.0	87.3	...	31.1	41.0
Belize	4 858	58.7	-2.2	72.8	2.7	13.7	62.6
Guyana	3 585	47.8	-14.4	62.0	4.5	31.0	58.3
Haiti	776	...	-4.6	28.2	20.1	2.8	89.0
Jamaica	5 374	66.3	-12.8	134.1	0.6	7.8	64.1
Suriname	9 182	52.7	4.9	28.6	2.6	14.6	95.5
Trinidad and Tobago	17 899	37.2	4.0	45.0	...	31.6	63.6
Organisation of Eastern Caribbean States	8 405	75.6	-17.1	82.90	4.8	49.5	69.6
Antigua and Barbuda	13 405	80.4	-14.0	89.4	0.2	29.1	69.7
Dominica	6 919	70.7	-11.1	72.7	12.0	78.4	69.2
Grenada	7 598	77.8	-24.1	88.6	4.5	58.7	42.8
Montserrat	13 104	...	-33.1	...	72.1	...	...
Saint Kitts and Nevis	13 659	74.2	-11.4	129.3	4.3	13.8	82.7
Saint Lucia	6 558	73.2	-14.2	71.0	4.0	44.9	58.6
Saint Vincent and the Grenadines	6 349	73.5	-27.8	67.0	3.2	90.9	54.8
Cuba	6 288	...	...	...	...	5.0	77.3
Dominican Republic	5 795	54.7	-7.2	33.3	1.0	25.0	22.4
Latin America and the Caribbean	**9 510**	**53.5**	**-1.9**	**46.3**	**0.5**	**19.8**	**19.6**
Andean Community	**6 616**	**52.6**	**-2.5**	**30.3**	**0.8**	**28.9**	**45.0**
Southern Common Market	**11 397**	**53.8**	**-1.4**	**52.8**	**0.4**	**23.8**	**20.7**
Central American Common Market	**4 233**	**55.9**	**-6.1**	**36.1**	**2.1**	**44.3**	**20.7**

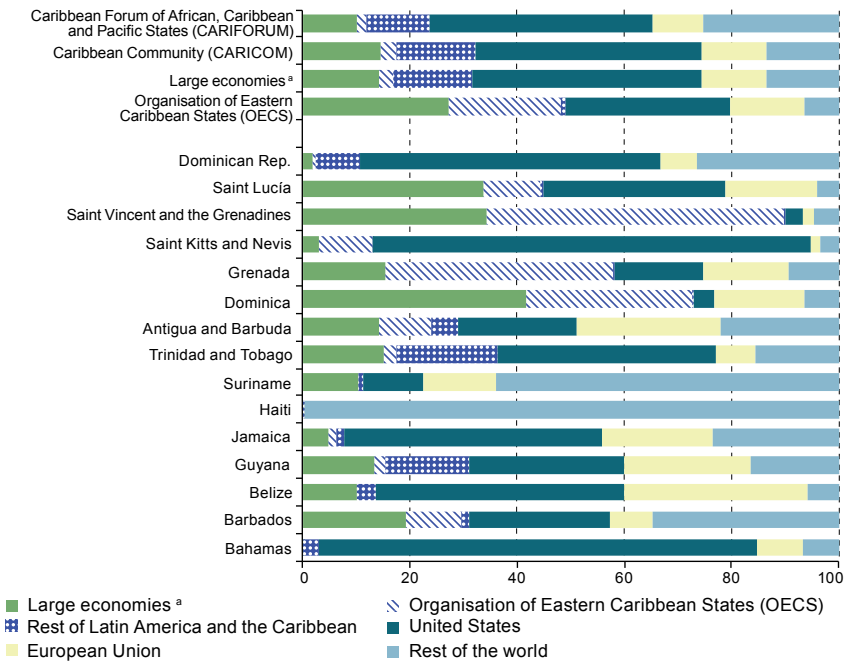
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] The indicators calculated for the different subregions and the whole region are averages weighted by GDP or exports, as appropriate.
[b] At the four-digit level of the International Standard Industrial Classification (ISIC), Revision 2.

The dependence on exports of a few primary products makes these countries vulnerable to external shocks, particularly changes in commodity prices. All CARICOM countries, with the exception of Trinidad and Tobago and Suriname, regularly post large current account deficits. In 2013, this deficit reached 5.2% of GDP, more than double the figure for Latin America and the Caribbean as a whole (1.9%). This is compounded by the heavy burden of public debt, which exceeds 100% of GDP in several countries. In 2008-2009, debt interest payments reached 14% of GDP in Jamaica, 9% in Saint Kitts and Nevis and 4% in Saint Lucia (ECLAC, 2010). Owing to their unsustainable external debt levels, Belize, Grenada, Jamaica and Saint Kitts and Nevis sought to restructure portions of their debt in 2012 (United Nations, 2013). There is evidence that some small States have reduced the face value of their debt after restructuring; however, in several cases, especially in the Caribbean, the debt stock was not reduced, rather maturities were simply lengthened and interest rates were lowered (United Nations, 2014). Another factor contributing to the precarious macroeconomic circumstances of the Caribbean has been the fiscal deficit, which was estimated to be over 3% of output in 2010-2013 for the group as a whole (ECLAC, 2013c). The weakness of public finances is particularly apparent in the smallest economies: with fiscal deficits of 10% of GDP in Dominica and 20% in Montserrat (Alleyne and others, 2013).

The subregion's exports are dominated by extraregional markets such as the United States, Canada, the United Kingdom and the rest of the European Union. The Caribbean regional market accounts for 15% of the subregion's total

exports. Another notable feature is the small proportion of total CARICOM exports going to Latin America. Although the Latin American and Caribbean market accounts for 26% of the group's total exports, there are economies for which extraregional markets are more important than intraregional trade, for example, the region is the destination for less than 10% of the exports of the Bahamas, Haiti and Jamaica (see figure IV.2). Trade between CARICOM members, meanwhile, is dominated by the more developed countries.[2]

Figure IV.2
Greater Caribbean and Caribbean Community: distribution of total exports by trade partner, 2012
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] The Bahamas, Barbados, Guyana, Jamaica, Suriname and Trinidad and Tobago.

The merchandise exports of the Caribbean countries are highly concentrated, with the top three export products typically accounting for between 40% and 90% of the total. These top products are generally commodities (see table IV.1). Guyana depends on agriculture (especially sugar and rice) and mining (gold, bauxite and alumina), and Belize on sugar, citrus and bananas, as well as petroleum. Oil, chemicals and natural gas dominate economic activity in Trinidad and Tobago; mining (aluminium and bauxite) in Jamaica, and mining (gold and aluminium) and petroleum in Suriname. Only in a very few cases do exports consist of manufactured products, and even then they tend to be confined to just a few goods. Examples include polymers from the Bahamas (46% of total exports), apparel from Haiti (89%), medicines from Barbados (15%) and electrical equipment and telecommunications appliances from Saint Kitts and Nevis (73%).

Unlike the commodities exported by the CARICOM countries, which are transported in tankers, the subregion's imports of manufactures and consumer goods are shipped in containers. Because cargo volumes are small, shipping services are irregular and expensive. In general, the highest-volume international liner routes in the area are those connecting North America to South America and European countries to North America. Of the 17 largest ports in CARICOM, only three are global and regional trans-shipment hubs (Kingston in Jamaica, Freeport in the Bahamas and Port of Spain in Trinidad and Tobago) (Sánchez and Wilmsmeier, 2009). The other islands are not served by international shippers so this service is provided by small feeder vessels that trans-ship cargo between the small ports of the Eastern Caribbean (Cordero, 2014). A mere five ports accounted for 84% of total containerized cargo handled by the ports of the Greater Caribbean in 2010-2012, with the Dominican Republic and Cuba accounting for a large proportion of the total (26%).

[2] The Bahamas, Barbados, Guyana, Jamaica, Suriname and Trinidad and Tobago.

The high shipping costs experienced by CARICOM countries adversely affect their competitiveness and options for tapping into regional or global value chains. In particular, the fact that only Guyana and Suriname share a land border highlights the importance of efficient maritime transport infrastructure. In this context, the CARICOM countries have included the creation of a rapid trans-shipment service in the southern Caribbean and the modernization of regional port infrastructure among the five "anchor projects" of their 2013-2015 Regional Aid for Trade Strategy. It is hoped that international resources will be mobilized to implement these projects (McLean and Yoshida, 2014).

A similar situation can be seen with respect to air transport between the CARICOM countries. In 2009, each of the member countries had direct scheduled services with an average of just four of the other member countries (CARICOM, 2009). Coverage was therefore equivalent to 23%, leaving some islands practically disconnected from one another (the Bahamas, Dominica, Haiti and Saint Kitts and Nevis are especially lacking in connections with the other countries). Antigua, Barbados and Trinidad have more than 10 services linking them with other islands. Where there are no direct routes, passengers have to connect via Central America, the United States or Puerto Rico, which complicates connectivity and the flow of business between members of the Community.

Less developed economies in CARICOM depend heavily on imports of intermediate products and energy supplies for local production, especially fuels (oil and gas). Their main suppliers of these products are Trinidad and Tobago and the Bolivarian Republic of Venezuela. With respect to the latter, the PetroCaribe initiative[3] has provided the CARICOM countries with financing for oil purchases worth about 3.5% of subregional GDP and about 6% of GDP for the small islands of OECS.[4] Mention should be made of the CARICOM energy policy approved by its member States in March 2013. Its objectives include: attaining a more sustainable pattern of renewable energy supply and use, reducing regional dependency on fossil fuels, achieving greater energy efficiency and conservation, and adopting a low-carbon development path (McLean and Yoshida, 2014).

Another factor contributing to the external vulnerability of the Caribbean is its dependence on foreign direct investment (FDI), since these economies receive significant FDI inflows relative to their size. In 2013 the ratio of FDI inflows to GDP stood at 8.9% for the whole region, with many countries above 10%. By comparison, in the same year the ratio for Latin America stood at 3.1% (see table IV.2). In 2013, the Caribbean received US$ 6.052 billion in FDI, down 28% on 2012, when the subregion received US$ 8.413 billion. A drop in foreign investment in the Dominican Republic accounted for about half of this decline.

Table IV.2

Caribbean countries and Latin America: foreign direct investment inflows, 2008-2013

(Millions of dollars and percentages)

Country	2008	2009	2010	2011	2012	2013	Share of GDP in 2013
Antigua and Barbuda	161	85	101	68	134	138	11.2
Bahamas	1 032	753	960	971	575	410	5.0
Barbados [a]	464	247	290	700	544	...	12.9
Belize	170	109	97	95	194	89	5.6
Dominica	57	43	25	14	23	18	3.6
Dominican Republic	2 870	2 165	1 896	2 275	3 142	1 991	3.3
Grenada	141	104	64	45	34	78	9.4
Guyana	178	164	198	247	294	214	7.1
Haiti	30	38	150	181	179	186	2.2
Jamaica	1 437	541	228	220	490	567	3.9
Saint Kitts and Nevis	184	136	119	112	94	112	15.1
Saint Lucia	166	152	127	100	80	88	6.6
Saint Vincent and the Grenadines	159	111	97	86	115	127	17.5
Suriname	-231	-93	-248	70	61	113	2.2
Trinidad and Tobago	2 801	709	549	1 831	2 453	1 922	7.5
The Caribbean	**9 617**	**5 264**	**4 654**	**7 015**	**8 413**	**6 052**	**8.9**
Latin American and the Caribbean	**139 842**	**83 723**	**129 427**	**169 538**	**177 021**	**184 920**	**3.1**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and estimates at 8 May 2014.
[a] No data available for 2013.

[3] The PetroCaribe Energy Cooperation Agreement was signed on 29 June 2005 by 14 countries: Antigua and Barbuda, the Bahamas, Belize, the Bolivarian Republic of Venezuela, Cuba, Dominica, the Dominican Republic, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines and Suriname.

[4] Estimates based on information for the quotas provided by Petróleos de Venezuela S.A. (PDVSA) and PetroCaribe to the Caribbean countries, the percentage of long-term financing (SELA, 2013) and official prices for the Venezuelan oil basket obtained from the Venezuelan Ministry of Oil and Mining for 2008-2012.

The most important feature of FDI in the Caribbean is that there are two partially opposing trends at work (De Groot and Pérez Ludeña, 2014). On the one hand are the economies that are primarily specialized in natural resources, such as Trinidad and Tobago, Suriname and Guyana, which have seen an increase in FDI in recent years (especially until 2012). Most economies in the Caribbean, however, depend on the tourism sector. FDI inflows in tourism-related activities have been decreasing since the financial crisis of 2008, but 2013 saw a resurgence of activity in many of these countries, which could lead to the creation of new jobs. In addition to natural resources and tourism, the Caribbean has also seen a flurry of activity in the field of electricity generation (ECLAC, 2013).

Another particular feature of the Caribbean is its high level of exposure to, and the frequent occurrence of, natural disasters such as hurricanes, tropical storms, and even earthquakes. These events usually have a direct effect on infrastructure and coastal ecosystems and an indirect impact on tourism and agriculture, thereby curbing economic growth. For example, Haiti suffered losses equivalent to 113% of its GDP as a result of the earthquake that struck in January 2010. That same year, Hurricane Tomas caused losses equivalent to 36% of GDP in Saint Lucia (ECLAC, 2010). In Grenada and Jamaica, GDP fell by approximately 10 percentage points and 2.5 percentage points, respectively, as a consequence of Hurricane Ivan in 2004; and in Belize GDP contracted by 4% after the passage of Hurricane Dean in 2007. In total, the region has suffered 187 extreme events in the past 60 years (Fraser, 2013).

The small island States of the Caribbean are disproportionately exposed to the risks triggered by climate change. Their physical configuration and economic structure make them highly vulnerable to local environmental damage, such as the pollution of coastal areas, surface water and groundwater caused by inadequate waste management. The size of their economies and the minimum efficient scales required for certain solutions (such as waste treatment, fisheries management and exploitation, and marine conservation) make subregional cooperation even more necessary. Furthermore, shared ecosystems such as the Caribbean Sea cannot be managed without concerted action for a sustainable approach to sea traffic, coastal tourism and fishing.

This set of interrelated factors has shaped the development of the countries. For example, a natural disaster may exacerbate public debt conditions because of the need to finance reconstruction costs, thus worsening the fiscal deficit. This dynamic is compounded at times when international demand is contracting, such as in 2009 and during the recent period of reduced economic activity in the United States and the European Union. In these circumstances, efforts to promote greater regional integration and improve the competitiveness of the subregion's economies are constantly restricted by budgetary constraints. As a result, trade-related infrastructure, logistics and connectivity have remained weak.

A final characteristic is that official development assistance (ODA) has declined over time as most countries have graduated from concessional development assistance upon achieving middle-income status. There are three exceptions: Haiti, the only low-income country in the region; Montserrat, which received substantial assistance to cope with the fallout from the volcanic disaster in 2010; and Dominica, which has garnered assistance from China. However, these resources fall short of meeting the subregion's requirements (McLean and Yoshida, 2014).

B. The state of regional integration in the Caribbean Community and the Greater Caribbean

In the past 25 years, the member countries of CARICOM have made efforts to consolidate their integration process through a mechanism known as the CARICOM Single Market and Economy (CSME), which aims to create an environment conducive to competitive production, economic development and investment. This platform of open regionalism provides a mechanism for facilitating the deeper integration of Caribbean countries. For CARICOM, the regionalism-driven CSME offers a framework for strengthening integration and cooperation among its member economies, and a base from which individual member States can integrate into the global economy (McLean and others, 2014).

Through its advances towards a single market, CARICOM is in the process of creating an internal space in which goods, skills, capital and commercial enterprises can move relatively unhindered. The single market essentially extends the domestic markets of individual member States, effectively constituting an internal market of 19 million people.

Moreover, the consolidation of subregional integration among the eastern Caribbean States through the establishment of the OECS economic union has added a new dimension to the Caribbean subregional integration process.

Recognizing the small size of the subregional market compared with extraregional ones, a series of bilateral free trade agreements and preferential arrangements provides a second tier of integration. Consequently, a significant proportion of the subregion's exports are afforded duty-free access to the markets of its major trading partners: Canada, Colombia, Costa Rica, European Union, United States and the Bolivarian Republic of Venezuela. However, bilateral free trade agreements have not yet yielded the intended expansion and diversification of exports.

This section examines the potential for productive complementarity between the countries of the subregion, highlighting the challenges in this area and developments in other fields, especially the progress made towards implementing the CSME. The following sections examine four main issues: (i) progress made on the CSME initiative; (ii) deeper integration in OECS; (iii) linkages between CARICOM and the Greater Caribbean; and (iv) the identification of sectors with potential for productive complementarity at the subregional level.

1. Progress on the CARICOM Single Market and Economy initiative

The Caribbean Community has made considerable progress towards establishing a single market. In 2012, the CARICOM Secretariat announced an overall completion rate of 64% for the initiative (CARICOM, 2012).[5] More recent estimates place the figure closer to 68%. The initiative includes the free movement of goods, services, capital and skilled workers, right of establishment within the Community, and regulations governing intraregional trade (standards, sanitary and phytosanitary measures, subsidies, safeguards and anti-dumping). The facilitation of intraregional trade in services has proved most difficult.

Originally, the CARICOM single economy was to be finalized by 2015. However, the CARICOM heads of Government subsequently recognized that full implementation would take longer than initially anticipated and agreed to consolidate the gains of the single market before proceeding with other elements, such as the creation of a single currency (CARICOM Secretariat, 2011). In addition, as trade complementarity among member States has traditionally been low, there is a concerted effort to create more complementary production and export structures. This is important since intraregional trade accounts for only 15% of the Community's total trade. Moreover, intraregional exports continue to be dominated by the larger economies, particularly Trinidad and Tobago (72%). By contrast, OECS countries accounted for only 5% of intraregional trade in 2012 (see table IV.3). In addition, there exist significant intraregional trade deficits in both goods and services.

Table IV.3
Caribbean Community: intraregional trade by country, 2012
(Percentages)

Country	Share of total intraregional trade		Share of intraregional trade in total exports	
	Exports	Imports	Caribbean Community	Organisation of Eastern Caribbean States
Bahamas	0.1	5.3	0.2	0.0
Barbados	5.3	21.6	29.7	10.2
Belize	1.1	0.7	10.2	0.1
Guyana	5.1	11.0	15.5	2.0
Haiti	0.0	0.4	0.1	0.0
Jamaica	3.3	26.1	6.2	1.3
Suriname	8.0	10.4	10.3	0.1
Trinidad and Tobago	72.0	8.4	17.7	2.6
Organisation of Eastern Caribbean States	**5.2**	**16.1**	**48.2**	**20.9**
Antigua and Barbuda	0.2	1.7	23.9	9.9
Dominica	0.8	1.9	72.8	31.1
Grenada	0.6	2.4	58.2	42.7
Saint Kitts and Nevis	0.2	1.4	12.9	9.8
Saint Lucia	2.3	4.5	44.2	10.6
Saint Vincent and the Grenadines	1.2	4.2	90.0	55.4
Caribbean Community	**100.0**	**100.0**	**15.1**	2.4

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Database (COMTRADE).

[5] The degree of compliance with commitments in various spheres of integration is 66% for the free movement of skills, 80% for the free movement of goods, 37% for the free movement of services, 72% for the free movement of capital and 64% for the right of establishment.

2. Deeper integration in the Organisation of Eastern Caribbean States

The Organisation of Eastern Caribbean States (OECS) was established by the Treaty of Basseterre in 1981 as a means of coordinating foreign policy among its member States (Antigua and Barbuda, Dominica, Grenada, Montserrat, Saint Kitts and Nevis, Saint Lucia, and Saint Vincent and the Grenadines). The period following its establishment saw high GDP growth (6.2% per year on average in the 1980s). Average annual growth slowed in the following decades to 3.2% in the 1990s and fell below 2% in the 2000s. The global financial crisis of 2008 exposed structural weaknesses in the OECS economies and led to a contraction in economic output. In response to declining economic growth, weak competiveness, falling export earnings and poor fiscal performance, the governments sought to stimulate economic activity and transform their economies. To this end, in 2010 they established the OECS economic union through the Revised Treaty of Basseterre. This union included provisions for the creation of a single financial space and the implementation of the Eastern Caribbean Currency Union (ECCU) Eight-Point Stabilization and Growth Programme.[6] The revised treaty has been ratified by all of the member States.

The Revised Treaty of Basseterre also established the organs of the economic union, including the Authority of Heads of Government of Member States, the Council of Ministers, the OECS Assembly, the Economic Affairs Council and the OECS Commission. Thus far, progress has been made towards implementing legislative and administrative commitments to free movement of citizens and establishing a framework for the harmonization of labour laws. Common policies have also been formulated in the areas of agriculture, tourism, education and social safety nets.

Trade complementarity among the OECS countries is stronger than among the other CARICOM members (Khadan and Hosein, 2013). Accordingly, intraregional trade within the OECS is relatively balanced among the member States (see table IV.4), who appear to be natural trading partners. With targeted development support from international donors, OECS has the potential to intensify intraregional trade and promote the economic welfare of its members.

Table IV.4
Organisation of Eastern Caribbean States (OECS): intraregional trade by country, 2012
(Percentages of total OECS intraregional exports)

	Antigua and Barbuda	Dominica	Grenada	Saint Kitts and Nevis	Saint Lucia	Saint Vincent and the Grenadines	Organisation of Eastern Caribbean States
Antigua and Barbuda		0.4	0.3	1.3	0.7	1.2	4.0
Dominica	4.3		0.3	8.4	1.2	0.6	14.7
Grenada	1.4	7.0		3.6	4.7	1.4	18.1
Saint Kitts and Nevis	1.9	1.4	0.7		1.5	0.6	6.1
Saint Lucia	5.2	6.3	4.1	1.6		6.8	24.1
Saint Vincent and the Grenadines	7.4	4.6	2.1	3.7	15.3		33.1
Organisation of Eastern Caribbean States	**20.2**	**19.6**	**7.5**	**18.7**	**23.4**	**10.5**	**100.0**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Database (COMTRADE).

3. Linkages between the Caribbean Community and the Greater Caribbean

With the aim of deepening economic and trade ties with other Caribbean economies, CARICOM has negotiated several trade and cooperation agreements. These agreements are fundamental to give exporters from the subregion preferential access to markets beyond CARICOM, provide consumers with a broader choice of goods and services, and promote wider investment opportunities for firms.

[6] This encompasses suitably adapted financial programmes for each country; fiscal reform programmes; debt management programmes; public-sector investment programmes; social safety net programmes; financial safety net programmes; amalgamation of the indigenous commercial banks; and rationalization, development and regulation of the insurance sector.

In 2000, CARICOM concluded its Trade and Economic Co-operation Agreement with Cuba, which aims to remove regulatory and administrative barriers to trade and addresses issues related to investment, taxation, trade promotion and facilitation, tourism and intellectual property rights. It provides special and differential treatment to the less developed countries of CARICOM, namely the small and vulnerable OECS Member States, Belize and Haiti, exempting them from granting reciprocal preferential access to Cuba. The Agreement also provided for future negotiations to convert the partial scope agreement to a free trade agreement. Both parties are currently negotiating an expansion of the number of products granted preferential treatment under the Agreement.

CARICOM concluded a free trade agreement with the Dominican Republic in 1998, which provisionally entered into force in December 2001. Similar to the agreement with Cuba, special and differential treatment was granted to the OECS Member States, Belize and Haiti. The Agreement promotes investment protection, harmonizes technical regulations and addresses double taxation and government procurement issues. However, implementation of the market access commitments under the Agreement has been uneven across the CARICOM countries. Moreover, the liberalization of trade in services foreseen by the Agreement has not yet been addressed.

The connection between CARICOM and the Dominican Republic is important, as they jointly signed the Economic Partnership Agreement (EPA) between the CARIFORUM States and the European Union in 2008. The Agreement seeks the promotion of regional integration within CARIFORUM, economic cooperation and the deeper integration of the CARIFORUM States into the global economy. Unlike the European Union, CARIFORUM is not a customs union and the Agreement therefore does not provide for the free movement of goods originating from the European Union within CARIFORUM. However, with technical support from the European Union, CARIFORUM members have committed to a CARIFORUM-wide regime to apply the concessions granted to the European Union (Article 238). A staggered schedule of application was to be applied with the more developed countries of CARICOM (the Bahamas, Barbados, Guyana, Jamaica, Suriname and Trinidad and Tobago) and the Dominican Republic to be given one year, the less developed countries of CARICOM (Antigua and Barbuda, Belize, Dominica, Grenada, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines) and in certain cases again the Dominican Republic to be given two years; and Haiti to be given five years (McLean, 2008). This schedule, however, has not yet been applied.

In respect to the links between CARICOM and the Greater Caribbean, it should be noted that Anguilla (1999), Bermuda (2003), the British Virgin Islands (1991), the Cayman Islands (2002) and the Turks and Caicos Islands (1991) are currently associate members of CARICOM. Sint Maarten and Curaçao have formally requested associate membership of the Community. The French overseas departments of Guadeloupe, Martinique and French Guiana have also expressed an interest in applying for associate membership of CARICOM. It is not clear yet whether associate membership is a step towards full CARICOM membership, or how associate membership can strengthen the Community as a whole.

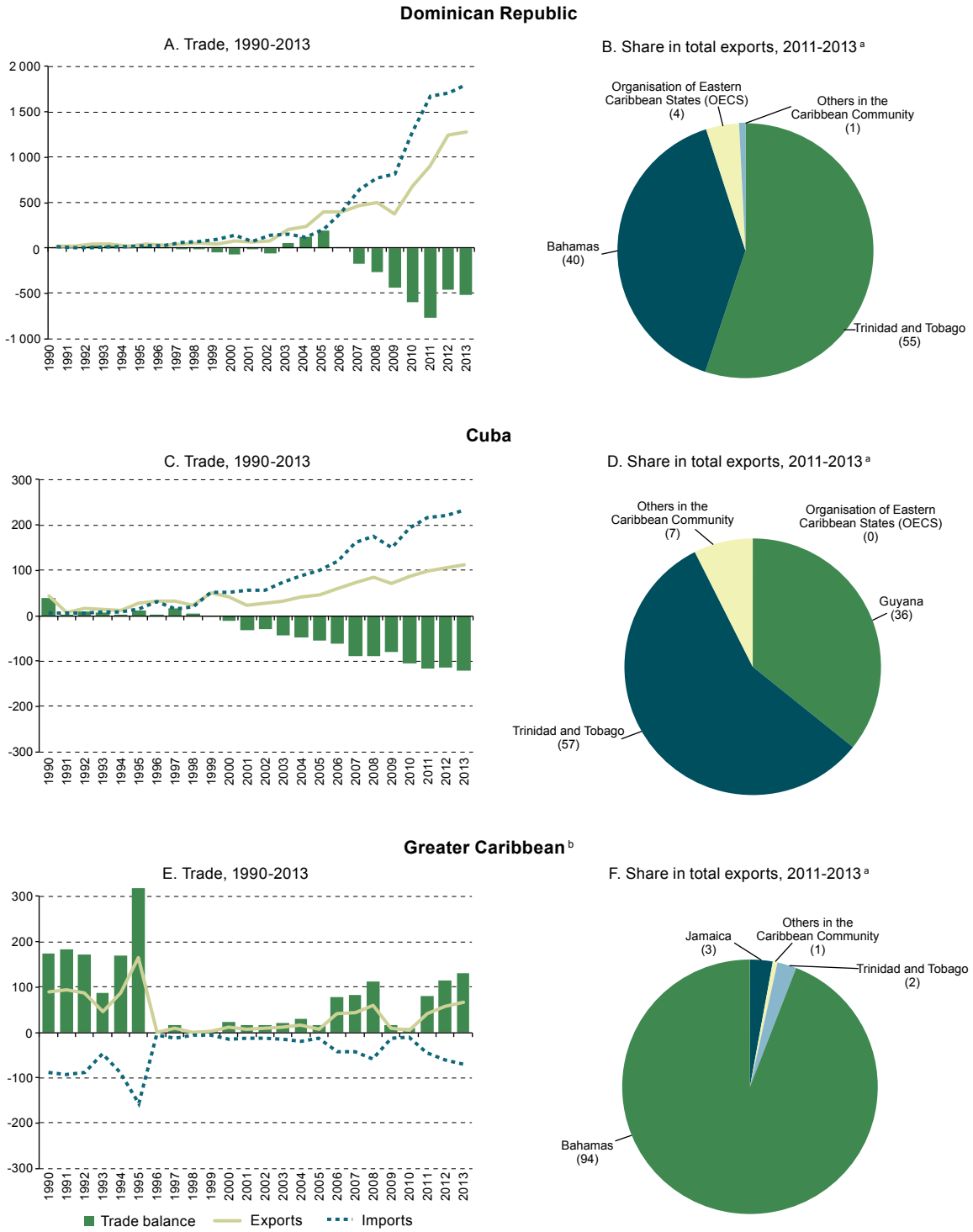
With regard to its trade performance under these agreements, CARICOM has consistently posted deficits in its trade in goods with the Dominican Republic and Cuba. Trinidad and Tobago (55%) and the Bahamas (40%) dominate the Community's exports to the Dominican Republic, while Trinidad and Tobago (57%) and Guyana (36%) are the major exporters to Cuba. The OECS countries account for only 4% of CARICOM exports to the Dominican Republic and do not appear to export to Cuba. The Community has unexploited opportunities in both markets. In the case of Cuba, it has comparative advantages in non-alcoholic beverages, pesticides and disinfectants, organic chemicals, and wood products. With respect to the Greater Caribbean as a whole, CARICOM posts trade surpluses and has comparative advantages in products such as petroleum and petroleum products, natural gas, textile fibres, paper and paper products and feeding stuff for animals (see figure IV.3).

These findings indicate that the Community has been unable to take advantage of the market access opportunities opened up by its trade agreements. The liberalization of trade in services with the Dominican Republic and Cuba may allow CARICOM member States to exploit their comparative advantages in many services sectors (including education, health, professional services, creative industries and tourism) and broaden their export base to these markets. The Community could also step up its efforts to promote exports from the OECS countries to the Greater Caribbean.

Figure IV.3

Caribbean Community: trade with main partners in the Greater Caribbean, 1990-2013

(Millions of dollars and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Database (COMTRADE) and International Monetary Fund (IMF), International Trade Statistics.

[a] Annual average.

[b] Exporters include Bermuda and the Turks and Caicos Islands.

4. Using a value chain approach to enhance production and trade complementarity

This section identifies sectors[7] with the potential for productive complementarity at the regional level, since integration efforts to date have been purely pro-market and have not given sufficient consideration to a production integration approach. This analysis is a first step towards formulating more active policies for strengthening subregional production complementarities among CARICOM countries, in a context where most previous policies have focused on improving the functioning of markets and have yielded few results.

If bilateral trade between countries is predominantly intra-industry,[8] meaning that the countries exchange similar types of goods, there is clear potential to strengthen production linkages. To identify which countries show the highest degree of intra-industry trade, a detailed analysis of bilateral trade between member countries was conducted, using the methodology of Durán and Zaclicever (2013).

Table IV.5 shows the map of intra-industry trade among CARICOM countries. The intra-industry trade indices show potential links between the largest countries (such as Barbados-Jamaica; Guyana-Suriname; Trinidad and Tobago-Suriname) and between some of the OECS countries (Saint Kitts and Nevis-Saint Lucia; Grenada-Saint Vincent and the Grenadines; Dominica-Antigua and Barbuda). Suriname and Jamaica have greater potential for intra-industry trade with the largest countries, whereas Saint Lucia and Dominica have the most options with the smaller OECS countries. Most other bilateral trade is of an inter-industry nature, meaning the countries exchange significantly different baskets of goods.

Table IV.5
Caribbean Community: intra-industry trade by trading partner, 2012-2013
(Grubel-Lloyd index)

	Bahamas	Barbados	Belize	Guyana	Jamaica	Haiti	Suriname	Trinidad and Tobago	Antigua and Barbuda	Dominica	Grenada	Saint Kitts and Nevis	Saint Vincent and the Grenadines
Barbados	0.00												
Belize	0.00	0.02											
Guyana	0.03	0.07	0.00										
Jamaica	0.02	0.19	0.14	0.06									
Haiti	0.01	0.00	0.00	0.00	0.03								
Suriname	0.31	0.01	0.00	0.10	0.01	0.00							
Trinidad and Tobago	0.00	0.06	0.01	0.05	0.03	0.00	0.10						
Antigua and Barbuda	0.00	0.09	0.00	0.01	0.00	0.00	0.00	0.04					
Dominica	0.00	0.05	0.00	0.02	0.03	0.00	0.13	0.03	0.14				
Grenada	0.00	0.04	0.00	0.00	0.02	0.00	0.01	0.04	0.00	0.00			
Saint Kitts and Nevis	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.04	0.03	0.02	0.00		
Saint Vincent and the Grenadines	0.00	0.06	0.04	0.02	0.00	0.00	0.00	0.03	0.01	0.01	0.19	0.02	
Saint Lucia	0.07	0.19	0.00	0.07	0.12	0.00	0.00	0.04	0.3	0.1	0.06	0.31	0.07

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Database (COMTRADE).
Note: The data for Grenada are from 2008 and those for Trinidad and Tobago are from 2010.

Having identified the most intra-industry intensive bilateral trade relations, some examples are presented below of potential value chains between Jamaica, Suriname and Dominica, one the one hand, and the rest of CARICOM, on the other hand. In this context, a distinction is made between production linkages in final and intermediate goods, which help to identify the segment incorporated within the regional value chain.

7 In this section, the terms "industry" and "sector" refer to products at the three-digit level of the Standard International Trade Classification (SITC), Revision 2.

8 A pair of countries is understood to be engaging in intra-industry trade if they export products from the same sector to one another. Intra-industry trade is measured using the Grubel-Lloyd index: an index value of more than 0.33 indicates a high incidence of intra-industry trade, a value between 0.10 and 0.33 indicates the potential for such trade, and a value lower than 0.10 indicates inter-industry trade (exports of products from different sectors). The Grubel-Lloyd index was calculated for bilateral trade flows between each country and its intraregional partners on the basis of product categories at the three-digit level of the Standard International Trade Classification (SITC), Revision 2.

(a) Linkages between Jamaica and the rest of the Caribbean Community

Although Jamaica's trade relationship with many CARICOM countries is primarily inter-industrial, the initial analysis conducted here has unearthed relatively strong potential regional intra-industry linkages with CARICOM countries in the following industries: food and beverages, chemicals, pharmaceuticals, plastics, and some other manufactures. However, the most emblematic is the agro-industry sector (food, beverages and tobacco).

Table IV.6 shows that exports from the top 7 SITC categories represented 56% of total exports from Jamaica to its CARICOM partners. The greatest linkages were recorded in relation to food and beverages. Under the category of feeding stuff for animals, the most important products are brewing or distilling dregs; cat food put up for retail sale; flours, meals and pellets of fish or of crustaceans, molluscs or other aquatic invertebrates; oil cake and other solid residues, whether or not ground or in the form of pellets, resulting from the extraction of soybean oil.

Table IV.6
Jamaica: main product groups exported to the Caribbean Community, 2011 [a]
(Grubel-Lloyd index and percentages)

Rank	SITC Rev. 2 code	SITC Rev. 2 description	Share of total exports	Grubel-Lloyd index[b]	Predominant type of good	Share of intermediate goods [c]
1	081	Feeding stuff for animals (not including unmilled cereals)	14.7	0.02	Intermediate	90.9
2	112	Alcoholic beverages	11.4	0.27	Consumption	6.7
3	111	Non-alcoholic beverages, nes	8.9	0.06	Consumption	0.0
4	048	Cereal, flour or starch preparations of fruits or vegetables	8.4	0.23	Consumption	12.5
5	058	Fruit, preserved, and fruits preparations	4.7	0.12	Consumption	9.4
6	541	Medicinal and pharmaceutical products	4.2	0.16	Intermediate	82.0
7	098	Edible products and preparations, nes	3.8	0.42	Consumption	17.6
8	893	Articles, nes of plastic materials	3.7	0.19	Intermediate	80.6
9	533	Pigments, paints, varnishes and related materials	3.2	0.32	Intermediate	92.0
10	014	Meat and edible meat offal, prepared, preserved, nes; fish extracts	3.2	0.63	Consumption	7.7
11	553	Perfumery, cosmetics, toilet preparations, etc.	2.3	0.55	Consumption	0.0
12	278	Other crude minerals	1.5	0.22	Intermediate	100.0
13	554	Soap, cleansing and polishing preparations	1.5	0.19	Consumption	35.7
14	074	Tea and mate	1.1	0.17	Consumption	0.0
15	892	Printed matter	1.0	0.09	Consumption	33.3
16	821	Furniture and parts thereof	0.8	0.07	Consumption	14.3
17	699	Manufactures of base metal, nes	0.8	0.59	Intermediate	93.3
18	846	Under-garments, knitted or crocheted	0.7	0.09	Consumption	0.0
19	523	Other inorganic chemicals; compounds of precious metals	0.7	0.15	Intermediate	100.0
20	752	Automatic data processing machines and units thereof	0.7	0.25	Capital	0.0
		Top 20 SITC categories	**77.1**			**55.7**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Database (COMTRADE).
[a] Product groups at the three-digit level of the Standard International Trade Classification (SITC), Revision 2.
[b] Weighted averages of bilateral Grubel-Lloyd indices of Jamaica with Barbados, Guyana, Saint Lucia and Trinidad and Tobago.
[c] Calculated on the basis of the ratio between the number of intermediate goods exported in the respective group of the Standard International Trade Classification (SITC) and the total number of goods exported in that group; the number of goods is measured using the six-digit Harmonized Commodity Description and Coding System.

Medicinal and pharmaceutical products, articles of plastic, pigments, paints, varnishes and related materials appear prominently dominated by intermediate goods. All these categories demonstrate relatively considerable intra-industry trade in intermediate goods. Trinidad and Tobago,[9] Barbados and Guyana[10] dominate Jamaica's intra-CARICOM intra-industry linkages among the largest CARICOM partners, and Saint Lucia[11] carries the most weight among the small OECS countries.

[9] Feeding stuff for animals, alcoholic beverages, other crude minerals, printed matter, manufactures of base metal, under-garments knitted or crocheted, other inorganic chemicals, compounds of precious metal, cereal, flour preparations of fruit and vegetables, medicinal and pharmaceutical, edible products and preparations, articles of plastics, pigments, paints and varnishes, perfumery, cosmetics, toilet preparations, etc. and automatic data processing machines.

[10] Non-alcoholic beverages, cereal, flour preparations of fruit and vegetables, medicinal and pharmaceutical, edible products and preparations, articles of plastics, pigments, paints and varnishes, meat products, perfumery, cosmetics, toilet preparations, etc., soaps, cleansing and polishing preparations, furniture and furniture.

[11] Fruit, preserved and fruit preparations, articles of plastics, pigments, paints and varnishes, printed matter and automatic data processing machines.

(b) Linkages between Suriname and the rest of the Caribbean Community

Suriname's top 10 export sectors account for 80% of the country's total exports and, of these, 48% are intermediate goods. Intra-industry linkages with other CARICOM members (especially with Trinidad and Tobago) are strongest in the natural-resource-based sectors, predominantly in refined petroleum products (intermediate goods), as well as in alcoholic and non-alcoholic beverages. Suriname also has some regional intra-industry trade in medium technology capital goods (for example, civil engineering, contractors' plant, equipment and parts) and intermediate capital goods (such as measuring, checking, analysis, controlling instruments, nes, parts), in particular with Trinidad and Tobago. Other exports from Suriname which are an integral part of CARICOM value chains include articles of plastic, chemical products, paper and paperboard and articles thereof, soaps, cleansing and polishing preparations (intermediate goods), and edible products and preparations (consumption goods) (see table IV.7).

Table IV.7
Suriname: main product groups exported to the Caribbean Community, 2011 [a]
(Grubel-Lloyd index and percentages)

Rank	SITC Rev. 2 code	SITC Rev. 2 description	Share of total exports	Grubel-Lloyd index [b]	Predominant type of goods	Share of intermediate goods [c]
1	334	Petroleum products, refined	62.8	0.06	Intermediate	66.7
2	111	Non-alcoholic beverages, nes	6.8	0.25	Consumption	0.0
3	723	Civil engineering, contractors' plant and equipment.	6.3	0.20	Capital	28.6
4	112	Alcoholic beverages	1.5	0.20	Consumption	0.0
5	874	Measuring, checking, controlling instruments	0.9	0.30	Capital	24.0
6	554	Soap, cleansing and polishing preparations	0.9	0.34	Consumption	41.7
7	893	Articles, nes of plastic materials	0.6	0.14	Intermediate	82.6
8	98	Edible products and preparations, nes	0.4	0.08	Consumption	20.0
9	598	Miscellaneous chemical products, nes	0.3	0.69	Intermediate	100.0
10	642	Paper and paperboard and articles of paper	0.3	0.19	Intermediate	60.0
		Top 10 SITC categories	**80.9**			**48.2**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Database (COMTRADE).
[a] Product groups at the three-digit level of the Standard International Trade Classification (SITC), Revision 2.
[b] Weighted averages of bilateral Grubel-Lloyd indices of Suriname with Barbados, Guyana, Jamaica and Trinidad and Tobago.
[c] Calculated on the basis of the ratio between the number of intermediate goods exported in the respective group of the Standard International Trade Classification (SITC) and the total number of goods exported in that group; the number of goods is measured using the six-digit Harmonized Commodity Description and Coding System.

Some of Suriname's intra-industry trade with other CARICOM countries is concentrated in food preparations, such as soups and broths, sweet corn prepared or preserved; sweetened or flavoured water, beer made from malt, wines, vodka and whiskies. These linkages are strongest with Trinidad and Tobago, followed by Barbados, Guyana, and Jamaica.[12]

(c) Linkages between Dominica and the rest of the Caribbean Community

Dominica's top 15 export products account for 89% of total exports, of which 48% are intermediate goods. The major intra-industry linkages with other CARICOM countries in the group of intermediate goods are in stone, sand and gravel; pigments, paints and related materials; electrical machinery and apparatus; articles of plastic; structures and parts of iron, steel or aluminium; and miscellaneous chemical products. With regard to consumption goods,

[12] In trade with Trinidad and Tobago, the highest intensity intra-industry trade is found in the following sectors: petroleum products; civil engineering, contractors' plant, equipment and parts; measuring, checking, analysis, controlling instruments, nes, parts; soap, cleansing and polishing preparations; articles of plastic materials; miscellaneous chemical products, nes; manufactures of base metal, nes; and trailers, and other vehicles, not motorized, nes. In the case of Barbados, the highest intensity intra-industry trade is found in the following sectors: non-alcoholic beverages, paper and paperboard and articles thereof. In the case of Guyana, the highest intensity intra-industry trade is found in the following sectors: alcoholic and non-alcoholic beverages, edible products and preparations. In the case of Jamaica, the highest intensity intra-industry trade is found in the following sectors: soap, cleansing and polishing preparations, articles of plastic materials, manufactures of base metal.

Dominica has intra-industry value chain linkages in soaps, cleansing and polishing preparations, and alcoholic and non-alcoholic beverages. Dominica has more value chain linkages with its OECS partners than with other CARICOM countries. Other potential intra-industry relations are in plastic doors and window frames; structures and parts of structures, iron or steel; lighting/visual equipment for signalling; dentifrices; and some agricultural products (for example arrowroot and sweet potato) (see table IV.8).

Table IV.8

Dominica: main product groups exported to the Caribbean Community, 2012 [a]

(Grubel-Lloyd index and percentages)

Rank	SITC Rev. 2 code	SITC Rev. 2 description	Share of total exports	Grubel-Lloyd index [b]	Predominant type of good	Share of intermediate goods [c]
1	554	Soap, cleansing and polishing preparations	55.6	0.23	Consumption	26.9
2	892	Printed matter	15.4	0.20	Consumption	41.9
3	273	Stone, sand and gravel	5.6	0.19	Intermediate	100.0
4	533	Pigments, paints, varnishes and related materials	4.8	0.33	Intermediate	96.2
5	764	Telecommunication equipment, nes; parts and accessories, nes	2.9	0.32	Capital	27.9
6	778	Electrical machinery and apparatus, nes	1.4	0.47	Intermediate	58.5
7	553	Perfumery, cosmetics, toilet preparations, etc	1.0	0.71	Consumption	0.0
8	893	Articles, nes of plastic materials	0.5	0.17	Intermediate	74.2
9	691	Structures and parts, nes, of iron, steel or aluminium	0.5	0.16	Intermediate	100.0
10	665	Glassware	0.3	0.10	Consumption	48.6
11	112	Alcoholic beverages	0.3	0.66	Consumption	1.0
12	111	Non-alcoholic beverages, nes	0.2	0.04	Consumption	0.0
13	598	Miscellaneous chemical products, nes	0.1	0.19	Intermediate	100.0
14	695	Tools for use in the hand or in machines	0.1	0.03	Capital	32.0
15	743	Pumps, compressors; centrifuges; filtering apparatus; etc, parts	0.0	0.41	Capital	13.8
		Top 15 SITC categories	**88.6**			**48.1**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Database (COMTRADE).

[a] Product groups at the three-digit level of the Standard International Trade Classification (SITC), Revision 2.

[b] Weighted averages of bilateral Grubel-Lloyd indices of Dominica with Antigua and Barbuda, Bahamas, Barbados, Saint Lucia, Saint Vincent and the Grenadines, Suriname and Trinidad and Tobago.

[c] Calculated on the basis of the ratio between the number of intermediate goods exported in the respective group of the Standard International Trade Classification (SITC) and the total number of goods exported in that group; the number of goods is measured using the six-digit Harmonized Commodity Description and Coding System.

C. The Caribbean Community's external links

This section examines the external trade of CARICOM countries, in particular with the United States, Canada, the European Union and with other countries in the region (Central America, Cuba, the Dominican Republic and the rest of Latin America). Special emphasis is given to the trade link with the European Union in the light of the Economic Partnership Agreement (EPA), which focuses on both trade and cooperation geared towards strengthening regional integration. Key areas under the Agreement include trade in goods and services, intellectual property rights, government procurement, future regulatory challenges and harmonizing legislation.

1. The Caribbean Community and the United States

In May 2014, CARICOM and the United States signed a Trade and Investment Framework Agreement, superseding the 1991 agreement establishing the bilateral Trade and Investment Council. The Trade and Investment Framework

Agreement modernizes the trade relations anchored in the Caribbean Basin Initiative.[13] Many Caribbean economies have benefitted from unilateral preferences granted by the United States under two programmes: the Caribbean Basin Economic Recovery Act (CBERA) and the Caribbean Basin Trade Partnership Act (CBTPA). These instruments provide non-reciprocal duty-free market access for nearly all goods from beneficiary CARICOM countries. As some export commodities of interest to CARICOM were excluded, now may be a good time to negotiate their inclusion with relaxed rules of origin in order to facilitate a scheme of pan-Caribbean production rooted in the integration of the factors of production under the CARICOM Single Market and Economy.

After the unilateral preferences granted by the United States under CBERA and CPTBA were called into question at the World Trade Organization (WTO), a waiver was obtained to maintain these preferences until 2014. WTO is unlikely to extend the waiver in the future. In this context, CARICOM and the United States should explore new possibilities for trade, aid and investment. The Trade and Investment Framework Agreement covers a wide range of topics, such as trade and investment facilitation, multilateral cooperation, intellectual property rights, labour rights, social and environmental protection, and the elimination of barriers to bilateral trade.

Despite this long-standing non-reciprocal access to the Community's major export market, only Trinidad and Tobago has been able to generate significant levels of exports and, along with Guyana, has posted trade surpluses with the United States (2011-2013). Trinidad and Tobago accounted for 72% of the Community's exports to the United States between 1990 and 2013. Its exports declined by 10.3% from 2011 to 2013 as the development of shale gas in the United States diminished demand for crude oil, natural gas and petrochemicals from abroad, thus eroding the Community's bilateral trade balance with the United States in 2013 (see table IV.9 and figure IV.4).

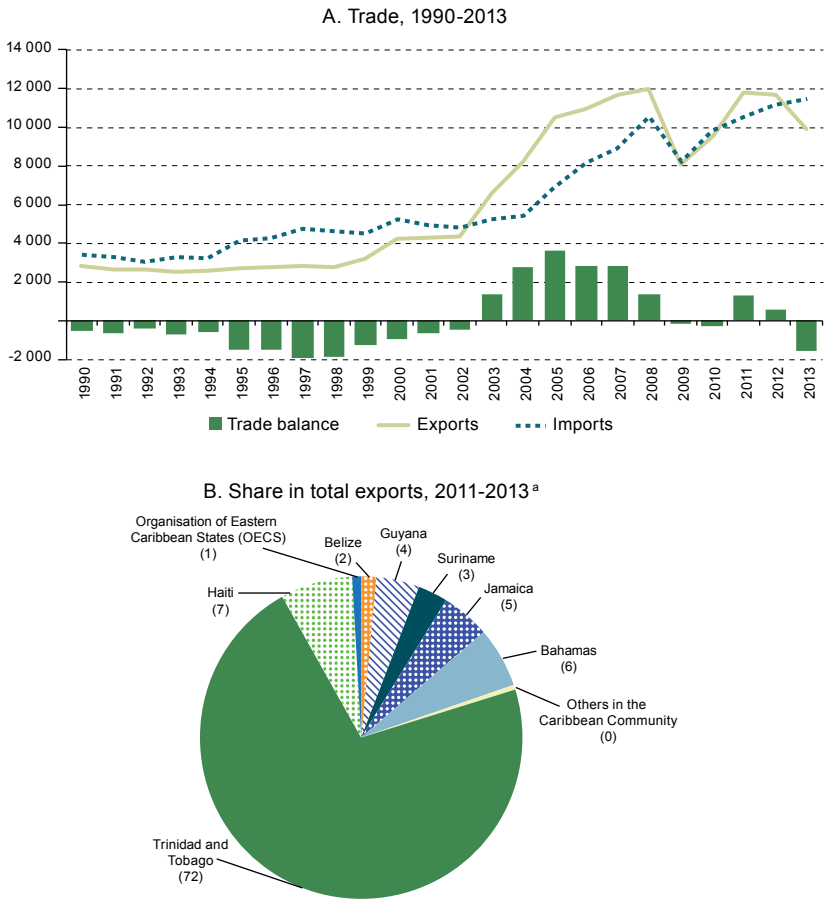
Table IV.9
Caribbean Community: trade with the United States, 2011-2013 [a]
(Millions of dollars and percentages)

	Trade (2011-2013) [b] (millions of dollars)			United States share in total trade (percentages)		Annual growth rate (2011-2013) (percentages)	
	Exports	Imports	Trade balance	Exports	Imports	Exports	Imports
Bahamas	671	3 509	-2 838	24.6	32.6	-12.3	4.4
Barbados	54	401	- 347	7.9	10.4	9.1	1.1
Belize	168	282	- 114	26.7	13.9	-18.2	-21.3
Guyana	482	329	153	34.4	29.3	5.3	-7.0
Haiti	806	1 093	- 287	83.8	35.4	6.7	8.2
Jamaica	543	1 842	-1 299	39.7	45.4	-14.5	2.2
Suriname	332	447	- 115	22.6	29.6	-2.3	0.8
Trinidad and Tobago	7 984	2 180	5 804	41.5	32.9	-10.3	3.1
Organisation of Eastern Caribbean States	**99**	**964**	**- 865**	**4.3**	**16.6**	**4.1**	**22.6**
Antigua and Barbuda	9	162	- 153	0.5	6.9	22.1	-5.7
Dominica	2	73	- 71	2.9	33.4	17.7	3.0
Grenada	9	77	- 68	21.8	46.8	19.5	10.2
Montserrat	2	7	- 6	51.1	44.1	109.1	13.6
Saint Kitts and Nevis	57	109	- 52	60.3	22.6	-0.3	8.6
Saint Lucia	18	449	- 431	15.7	21.0	-4.9	47.5
Saint Vincent and the Grenadines	3	86	- 84	3.7	19.3	20.7	7.5
Caribbean Community	**11 139**	**11 046**	**92**	**36.2**	**28.4**	**-8.5**	**4.2**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United States International Trade Commission (USITC), Tariff and Trade Database [online].
[a] Data for the Caribbean Community countries were constructed using mirror statistics from the United States.
[b] Annual average.

[13] The Trade and Investment Framework Agreement provides a basis for discussion of many important CARICOM issues: cooperation, intellectual property protection, the development of e-commerce infrastructure and the removal of barriers to bilateral trade.

Figure IV.4
Caribbean Community: trade with the United States, 1990-2013
(Millions of dollars and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Database (COMTRADE).
[a] Annual average.

The Community's exports to the United States are largely concentrated in commodities, agricultural and agro-based processed products. CARICOM exporters have increasingly lamented that their sales are hit by the stringent regulations under the United States Food Safety Modernization Act, which points to a clear need for the Community to focus on modernizing regional sanitary and phytosanitary infrastructure in order to ensure that it can satisfy the food safety requirements in its major markets. This is important considering the region's comparative advantage in food products in the United States market (sugar and sugar preparations, beverages, fish and fish products, vegetables and fruit, cereals and cereal preparations, coffee, tea, cocoa, spices and manufactures thereof).

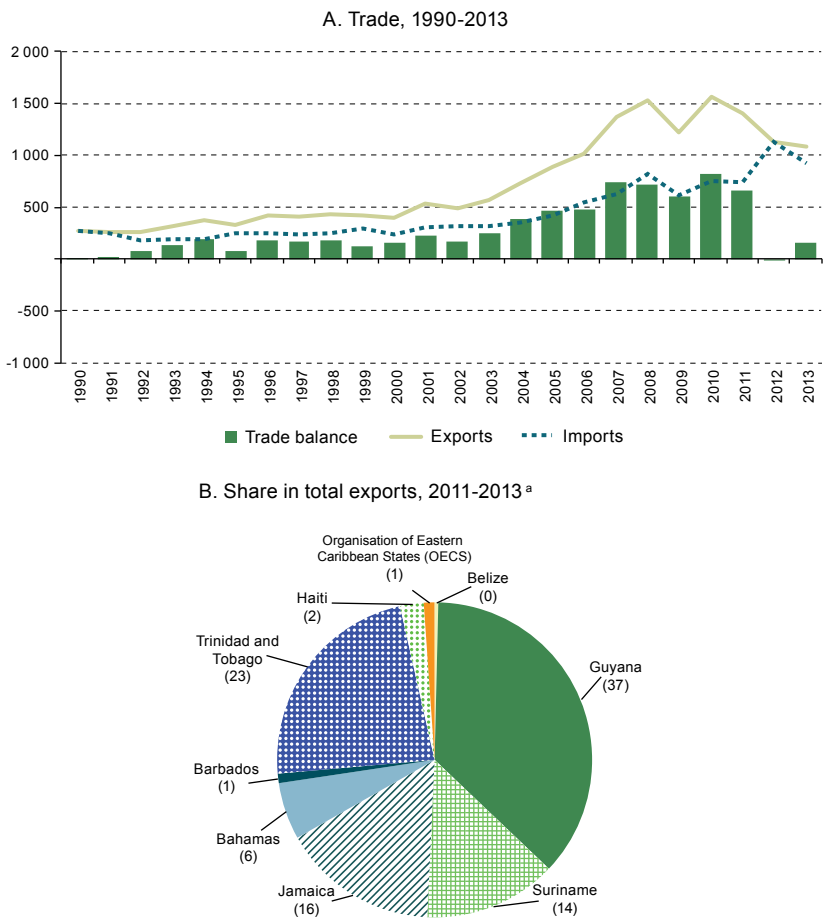
2. The Caribbean Community and Canada

Trade and development cooperation between the Caribbean Community and Canada is governed by the Trade and Economic Cooperation Agreement between the Government of Canada and the Governments of the Member States of the Caribbean Common Market (1979) and its protocols, including the Protocol on Rum (1998). The Agreement (known as "CARIBCAN") provides duty-free access to the Canadian market for a wide range of products from the Caribbean. In addition, Barbados and Trinidad and Tobago have bilateral investment treaties with Canada. This country also has facilities, protected under the General Agreement on Trade in Services (GATS) Most Favoured Nation (MFN) exemptions, with Barbados, Jamaica, Trinidad and Tobago, and OECS countries, to allow farm workers seasonal employment in Canada. Moreover, Canada has been a source of FDI and development support to CARICOM.

Owing to its non-reciprocal nature, the Trade and Economic Cooperation Agreement between Canada and CARICOM is inconsistent with the principle of MFN treatment and thus requires an MFN waiver from WTO. The most recent waiver expired in December 2013 and, although Canada has continued to grant duty-free access to exports from the CARICOM countries, it will not apply for another waiver extension. Instead it has chosen to pursue a free trade agreement with CARICOM. However, after six years and seven rounds of talks, the negotiations are still ongoing and several obstacles remain in the areas of tariff liberalization, services and investment. Regarding tariff reductions, Canada had made several offers, but CARICOM has been unable to define a common position in this area. With respect to services and investment, discrepancies remain over the modalities for liberalization: Canada opts for a negative list approach, meaning that all sectors will be liberalized, except those explicitly exempted; whereas, CARICOM prefers a positive list approach, which includes only the sectors to be liberalized. Canada has indicated that it does not have a mandate to negotiate beyond June 2014, which has created uncertainty with regard to the rules that currently govern the subregion's exports to Canada.

On average, Canada accounted for only 4% of CARICOM exports between 2011 and 2013. The Community's exports are concentrated in the larger economies: Guyana (37%), Jamaica (16%) and Suriname (14%). All three exporters have trade surpluses with Canada. CARICOM has comparative advantages with Canada in relation to products such as sugar and sugar preparations, beverages, fish and fish products, vegetables and fruit, cereals and cereal preparations. Hence, a failure to conclude a bilateral trade agreement in the short run may impact negatively on these economies (see figure IV. 5 and table IV.10).

Figure IV.5
Caribbean Community: trade with Canada, 1990-2013
(Millions of dollars and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Database (COMTRADE).
[a] Annual average.

Table IV.10
Caribbean Community: trade with Canada, 2011-2013 [a]
(Millions of dollars and percentages)

	Trade (2011-2013) [b]			Canada's share in total trade		Annual growth rate (2011-2013)	
	Exports	Imports	Trade balance	Exports	Imports	Exports	Imports
Bahamas	70	267	- 197	2.6	2.5	38.7	20.9
Barbados	12	83	- 71	1.7	2.1	61.2	83.7
Belize	4	7	- 3	0.7	0.3	-43.4	28.3
Guyana	442	27	415	31.6	2.4	8.8	-27.3
Haiti	29	36	- 7	3.0	1.2	10.0	0.8
Jamaica	193	119	74	14.1	2.9	-15.1	5.9
Suriname	164	15	149	11.2	1.0	-31.6	16.9
Trinidad and Tobago	275	330	- 55	1.4	5.0	-31.8	-0.2
Organisation of Eastern Caribbean States	**13**	**47**	**- 33**	**0.6**	**0.8**	**-0.3**	**17.5**
Antigua and Barbuda	1	14	- 14	0.0	0.6	20.2	26.8
Dominica	1	4	- 4	0.7	1.9	95.9	15.6
Grenada	2	5	- 3	4.8	2.9	3.1	2.1
Montserrat	0	0	0	5.1	2.0	-65.7	-6.8
Saint Kitts and Nevis	9	6	3	9.6	1.2	-4.8	28.2
Saint Lucia	0	9	- 9	0.2	0.4	4.4	11.8
Saint Vincent and the Grenadines	0	7	- 7	0.3	1.7	-19.9	14.6
Caribbean Community	**1 202**	**930**	**272**	**3.9**	**2.4**	**-12.1**	**11.5**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Database (COMTRADE).
[a] Data for the Caribbean Community countries were constructed using mirror statistics from Canada.
[b] Annual average.

3. The Caribbean Community and the European Union

(a) The Economic Partnership Agreement

Building on the foundations of the conventions of Yaoundé and Lomé, and the later Cotonou Agreement, the European Union and CARIFORUM (which includes most of the CARICOM countries and the Dominican Republic) signed an Economic Partnership Agreement (EPA) in 2008.[14] For CARICOM members, this marked a milestone as the first genuinely comprehensive North-South trade agreement. The primary aim of the Economic Partnership Agreement is to promote trade, investment and development cooperation between CARIFORUM and the European Union on the basis of mutual interest. The Agreement also seeks to promote the sustainable development of CARIFORUM by facilitating export development and regional integration.

The Cotonou Agreement, signed in 2000, was the immediate predecessor of the EPA. It provided for three major areas of partnership, namely, development cooperation, trade and political dialogue. Although its goals were similar to those of the Lomé Convention, the Cotonou Agreement set out a general framework for addressing the political, economic, social, cultural and environmental aspects of development in the relations between the European Union and members of the African, Caribbean and Pacific Group of States (ACP). Not only did the Cotonou Agreement maintain the non-reciprocal trade preferences established under the fourth Lomé Convention (Lomé IV), it also envisaged the expiry of these preferences, to be replaced by the provisions of the EPA, at the end of 2007. The CARIFORUM-European Union EPA sought to satisfy the requirements of Article XXIV[15] of the General Agreement on

[14] The first Yaoundé Convention was signed to promote cooperation and trade between the European Economic Community (EEC) and 18 former colonies in Africa in 1963. The second Yaoundé Convention was signed by 21 countries in 1969. The convention was the extension of the European Development Fund created by the Treaty of Rome in 1957. The EEC subsequently signed the Lomé Convention with African, Caribbean and Pacific (ACP) countries in 1975. In 2000, this convention was superseded by the Cotonou Agreement, involving 78 ACP States.

[15] The provisions of GATT Article XXIV relating to customs and free trade areas require customs unions and free trade areas to eliminate duties and other restrictive regulations of commerce with respect to substantially all the trade between the parties, either immediately or over a reasonable length of time, in order to satisfy the free trade criteria.

Tariffs and Trade (GATT), as well as bring the European Union's trading relations with CARIFORUM into conformity with the WTO MFN principle. Under article 36.1 of the Cotonou Agreement (2000) ACP States and the European Union agreed "to conclude new WTO compatible trading arrangements, removing progressively barriers to trade between them and enhancing cooperation in all areas relevant to trade".

The EPA pursues partnership in three main areas: trade, political dialogue and development cooperation. It covers not only trade in goods, but also trade in services, investment and other issues, such as innovation and development assistance. Despite the Caribbean's diminished eligibility for international assistance and the reduction of preferential market access for small developing countries, under the EPA the European Union continues to provide support for the diversification and the sustainable development of the Caribbean.

The objectives of the EPA are:

- To gradually dismantle trade barriers between the two regions.
- To deliver European Union support for the eradication of poverty and help Caribbean countries to better achieve the Millennium Development Goals and forthcoming sustainable development goals.
- To foster dialogue on trade-related issues with the aim of boosting free trade of goods and services, attracting foreign direct investment and making the signatory countries' legal frameworks more predictable and transparent.
- To use European Union support to improve the competitiveness of Caribbean economies.
- To improve cooperation in all spheres.

To date, the main outcomes of the EPA are:

- Immediate duty-free and quota-free access for Caribbean products to the European Union market.
- The asymmetrical opening of trade in favour of the Caribbean countries, which have up to 25 years to open their markets to European imports. The EPA allows Caribbean countries to prepare sensitive sectors for competition with their European counterparts.
- The liberalization of trade in services.
- The abolition of the double charging of customs duties.
- The promotion of cooperation.

Caribbean countries and exporters have received support for capacity-building under various areas of the agreement, notably through technical assistance to comply with international standards and labelling requirements.

The parties also agreed to apply the existing WTO rules on anti-dumping and countervailing duties, including the possibility of applying constructive remedies before such duties are imposed, and undertook a commitment to provide notification of receipt of properly documented complaints before initiating an investigation.

(b) Cooperation between the European Union and the Caribbean Community: the European Development Fund

The cooperation that began between Europe and the Caribbean over 40 years ago was intensified following the creation of CARICOM in 1973. The Caribbean maintains a multifaceted relationship with the European Union. First, it participates in the framework of strategic cooperation between the European Union and the Community of Latin American and Caribbean States (CELAC) through its involvement in bi-regional dialogue on sectoral policies and other matters at the summits of Heads of State and Government. Second, regular meetings are held between the European Union and CARIFORUM to discuss issues relating to development cooperation. As members of the Africa, Caribbean and Pacific Group of States (ACP), Caribbean countries receive financial assistance the European Union through the European Development Fund. The exception is Cuba, which receives resources under the European Union's financing instrument for development cooperation for the Latin American countries.

The European Development Fund was set up in 1957 to provide technical and financial assistance to African countries and overseas territories with links to the European Union. Since 1964, the European Union's relations with the ACP countries have been governed by various legal instruments, including the conventions of Yaoundé and Lomé and the Cotonou Agreement.

Between 1975 and 2013 the European Commission allocated more than 5 billion euros for assistance to the Caribbean, including regional and national programmes, emergency aid, drug control and support for the rum

industry and banana production. More recently, assistance has been provided through the European Investment Bank. National programmes and bilateral aid accounted for 52% of the official development assistance (ODA) received from the European Union by Caribbean countries between 1975 and 2013. Loans and investment from the European Investment Bank made the next largest contribution (25.1%), followed by regional programming (9%) (see table IV.11).

Table IV.11
European Union development cooperation in the Caribbean, 1975-2013
(Millions of euros)

Cooperation instrument	1975-2001 (1)	2002-2007 (2)	2008-2013 (3)	Total (4)=1+2+3	Share
National programmes/bilateral aid	1 234	571	1166	2 971	51.8
Regional programming	353	...	165	518	9.0
Export stabilization mechanism	252	...	...	252	4.4
Structural adjustment	165	...	...	165	2.9
Special Framework of Assistance for bananas	132	...	...	132	2.3
Programme of support for the rum industry	70	...	...	70	1.2
Emergency aid	117	...	...	117	2.0
Drugs control	25	...	...	25	0.4
Caribbean Investment Facility (CIF)	...	...	40	40	0.7
Development cooperation (not including EIB)	2 348	571	1 371	4 290	74.9
European Investment Bank (EIB)	854	157	428	1 440	25.1
Development cooperation (including EIB)	3 202	728	1 800	5 730	100.0

Source: José Durán and others, "El Caribe y la Unión Europea: una asociación estratégica", *Project Documents*, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC)/Spanish Agency for International Development Cooperation (AECID), 2014, forthcoming; on the basis on European Commission, *Regional Strategy Paper 2003-2007*; European Investment Bank (2011, 2012), and information on funds spent under multi-annual programmes of 2002-2007 and 2008-2013.

The parties should take advantage of the first five-year review of the CARIFORUM-European Union EPA, mandated in the joint declaration on the signing of the Agreement, which is scheduled for November 2014, as an opportunity to recalibrate, where necessary, the development cooperation support and aid-for-trade resources provided the European Union with the updated development priorities of CARICOM. The idea is for the EPA to be as conducive as possible to enhancing the competitiveness and trade performance of, and bilateral investment flows into, CARICOM countries.

It is important to take into account that the first five years of implementation of the Agreement coincided with the worst global economic and financial crisis since the Great Depression and that several CARICOM economies are still recovering from the economic downturn. Moving forward, the dialogue on trade policy reform, technical assistance and development resources should focus on optimizing the gains accruing to CARICOM economies from the market access opportunities provided under the EPA.

Accordingly, the real benefits of the EPA may lie in leveraging its technical assistance and development cooperation commitments to address the most detrimental trade-related infrastructural constraints within CARICOM; to improve competiveness (especially of SMEs); and to facilitate regional production chains in order to place CARICOM economies on a path towards structural change for sustainable development. Certain key interventions will go a long way to promoting the development of CARICOM SMEs, particularly in the services sector (for example, creative industries, health, education and professional services) and with respect to exports of non-traditional goods to Europe. These interventions include assisting CARICOM to institute export financing regimes; formulate region-wide export strategies; to support business support organizations, such as coalitions of services industries; and increase coherence in the area of intellectual property. It is important for the parties to engage on these issues during the first five-year review of the CARIFORUM-European Union EPA.

(c) The Caribbean Community and the European Union: a preliminary assessment of trade under the Economic Partnership Agreement

The economic slowdown affecting the eurozone and CARICOM makes it more difficult to gauge the trade benefits of the Agreement at this time. Some new products, such as ferrous metal products, medications, aluminium scrap metal and ammonium nitrate (urea), have expanded their market share, indicating that the Agreement may have had

a positive effect on trade. Meanwhile, traditional exports such as petroleum, gas, sugar cane, ethyl alcohol and rum continue to lose market share in the European Union market.

Caribbean goods trade with the European Union is highly concentrated in a small number of products. The top five products account for 90% or more of total trade for most countries. The concentration levels are somewhat lower for Dominica and the Dominican Republic, but nevertheless the top five goods still account for over 60% of trade. The main export products from the Caribbean to the European Union are fuels and mining products, particularly gas and petroleum, bananas, sugar, rum, gold, corundum, aluminium oxide and hydroxide, iron ore and fertilizers. The exports of the small OECS economies are highly concentrated in agricultural products destined for the European Union, especially fruit and nuts, chiefly bananas, as well as prepared food products.

CARIFORUM countries import a wide range of goods from the European Union, including industrial products such as medical equipment, electrical appliances and machinery, passenger vehicles, pharmaceutical products and medications, plastics, and consumer durables (printers and furniture, among others). Agro-industrial imports include alcoholic beverages, milk and cream, and fresh and preserved vegetables. The main CARIFORUM importers are the Dominican Republic, Jamaica, Suriname and Trinidad and Tobago, which together account for 83% of the total. In the small OECS economies, imports of food and medications answer for more than a third of the total, and largely comprise milk, cream, cheese, meat and cereals.

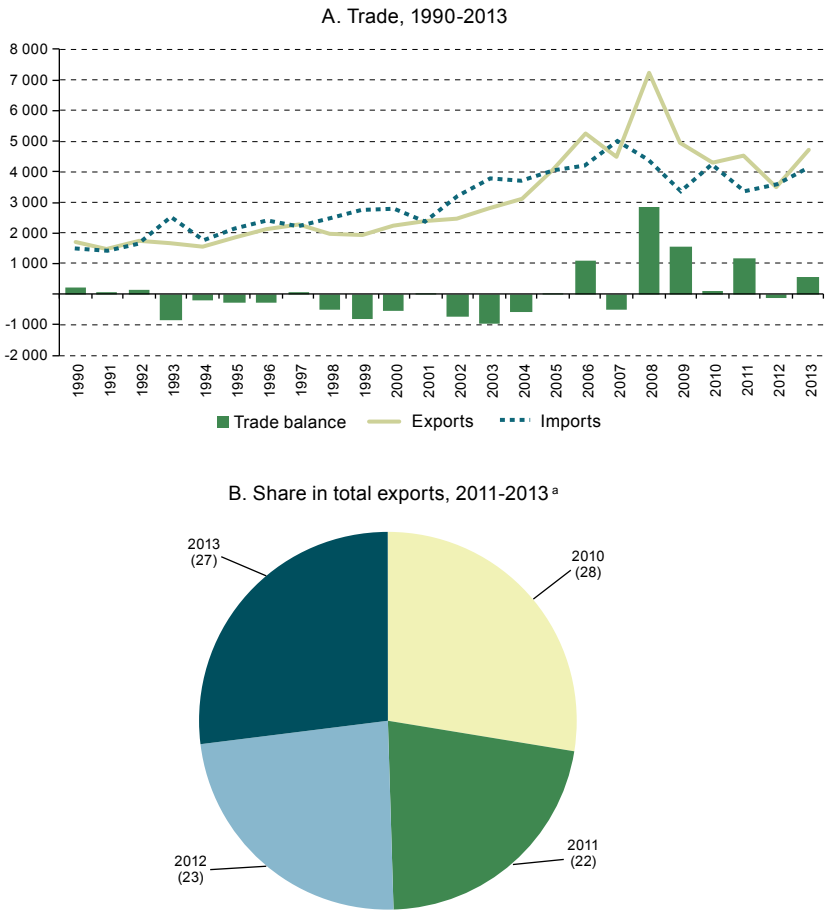
Within CARICOM, Trinidad and Tobago (54%), the Bahamas (10%), Suriname (9%) and Jamaica (8%) are the primary goods exporters to the European Union. The OECS countries and Guyana account for 6% of the subregion's exports to the European Union in 2011-2013. The European Union represents a major export market for Saint Lucia (57%), Grenada (33%), Saint Vincent and the Grenadines (31%), Belize (26%), Suriname (26%) and Jamaica (25%). Between 2011 and 2013 OECS exports to the European Union declined by 16%, although much larger reductions in exports were recorded for Saint Lucia (-69%), Saint Vincent and the Grenadines (-31%) and Dominica (-28%). Only Trinidad and Tobago, Guyana and Jamaica generated trade surpluses during the period under review (see table IV.12 and figure IV.6).

Table IV.12
Caribbean Community: trade with the European Union, 2011-2013 [a]
(Millions of dollars and percentages)

	Trade (2011-2013) [b]			European Union share in total trade		Annual growth rate (2008-2013)	
	Exports	Imports	Trade balance	Exports	Imports	Exports	Imports
Bahamas	447	796.3	- 349	16.4	7.4	1.9	4.2
Barbados	69	179.1	- 110	10.2	4.6	-4.2	-5.4
Belize	163	163.3	- 1	25.9	8.0	21.2	15.6
Guyana	255	148.8	106	18.2	13.3	-0.7	2.0
Haiti	37	246.6	- 210	3.8	8.0	22.1	-17.6
Jamaica	340	335.3	5	24.8	8.3	15.6	-7.9
Suriname	377	519.4	- 143	25.7	34.4	-3.3	31.7
Trinidad and Tobago	2 296	777.4	1 519	11.9	11.7	2.5	13.6
Organisation of Eastern Caribbean States	**261**	**536**	**- 276**	**11.4**	**9.2**	**-16.0**	**39.9**
Antigua and Barbuda	132	264.9	- 133	7.0	11.3	12.2	47.8
Dominica	14	25.5	- 12	18.5	11.7	-27.6	-11.2
Grenada	13	22.1	- 9	33.0	13.5	15.6	-0.5
Montserrat	1	6.0	- 5	15.1	35.2	-12.6	124.3
Saint Kitts and Nevis	15	83.8	- 69	15.9	17.4	94.7	81.5
Saint Lucia	64	51.3	13	57.0	2.4	-69.3	-4.3
Saint Vincent and the Grenadines	22	82.6	- 61	31.0	18.5	-30.6	42.6
Caribbean Community	**4 244**	**3 703**	**541**	**13.8**	**9.5**	**2.0**	**10.9**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis United Nations Commodity Trade Database (COMTRADE).
[a] Data for the Caribbean Community countries were constructed using mirror statistics from the European Union.
[b] Annual average.

Figure IV.6
Caribbean Community: trade with the European Union, 1990-2013
(Millions of dollars and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Database (COMTRADE).
[a] Annual average.

The impacts of the EPA have been uneven across the CARIFORUM countries. Analyses conducted by ECLAC suggest that for most CARICOM members (with the possible exception of Trinidad and Tobago), the Agreement has not yet delivered the anticipated welfare and trade gains. Empirical analyses[16] have unmasked a clear disparity between the competitiveness of the Dominican Republic and CARICOM exports in the European Union market. Since the introduction of the EPA, the Dominican Republic's comparative advantages in and trade complementarity[17] with the European Union have improved, while the corresponding measurements for CARICOM have remained weak or are declining. Indeed the analyses show that Guyana, Saint Kitts and Nevis and Saint Lucia now enjoy comparative advantages in the European Union on a smaller number of commodities than before. Furthermore, using a gravity model, Khadan and others (2014) show that the EPA has not had a significant effect on the Caribbean's exports. This should give cause for concern since many see the Agreement as a tool for quickening the pace of integration of Caribbean economies into the multilateral trading system. Furthermore, several studies seeking to measure the fiscal and welfare impact of the EPA on CARICOM countries have indicated that Caribbean economies are likely to experience significant declines in tariff revenues on existing imports from the European Union and from other sources which are diverted towards the European Union on account of the EPA (Khadan and Hosein, 2014).[18]

16 For example, using TradeCAN, vector autoregressive models, partial equilibrium analysis, gravity models and computing revealed comparative advantage (RCA) index.
17 Assessed using computations of the revealed comparative advantage (RCA) index and the trade complementarity index (TCI), respectively.
18 The members of the Eastern Caribbean Currency Union (ECCU) are more dependent on tariff revenues than other CARICOM countries.

4. The Caribbean Community, Central America and the rest of Latin America

With regard to its trade and economic integration with Central America and the rest of Latin America, CARICOM currently has partial scope trade agreements with the Bolivarian Republic of Venezuela (1998) and Colombia (1994), as well as a free trade agreement with Costa Rica (2004). However, despite having made scant use of the market access opportunities that these trade agreements open up, Central America and the rest of Latin America accounted for 13.3% of CARICOM exports in 2013, underscoring the growing importance of this market to CARICOM.

Trinidad and Tobago has sought to deepen its economic integration with Central America and signed a partial scope trade agreement with Panama in October 2013. It is currently negotiating a similar arrangement with El Salvador, which is scheduled for completion in 2014. A partial scope agreement was concluded between Trinidad and Tobago and Guatemala in April 2013. Similarly, Guyana and Suriname have taken steps to integrate with Latin America at a number of levels and are often viewed as providing a gateway for the rest of the Caribbean to Latin America. Guyana and Suriname are both members of the Union of South American Nations (UNASUR), which represents an important step towards cementing closer ties with Latin America; and they are also an integral part of the Initiative for the Integration of the Regional Infrastructure of South America (IIRSA), a development plan to link South America's economies through new transportation, energy and telecommunication projects.

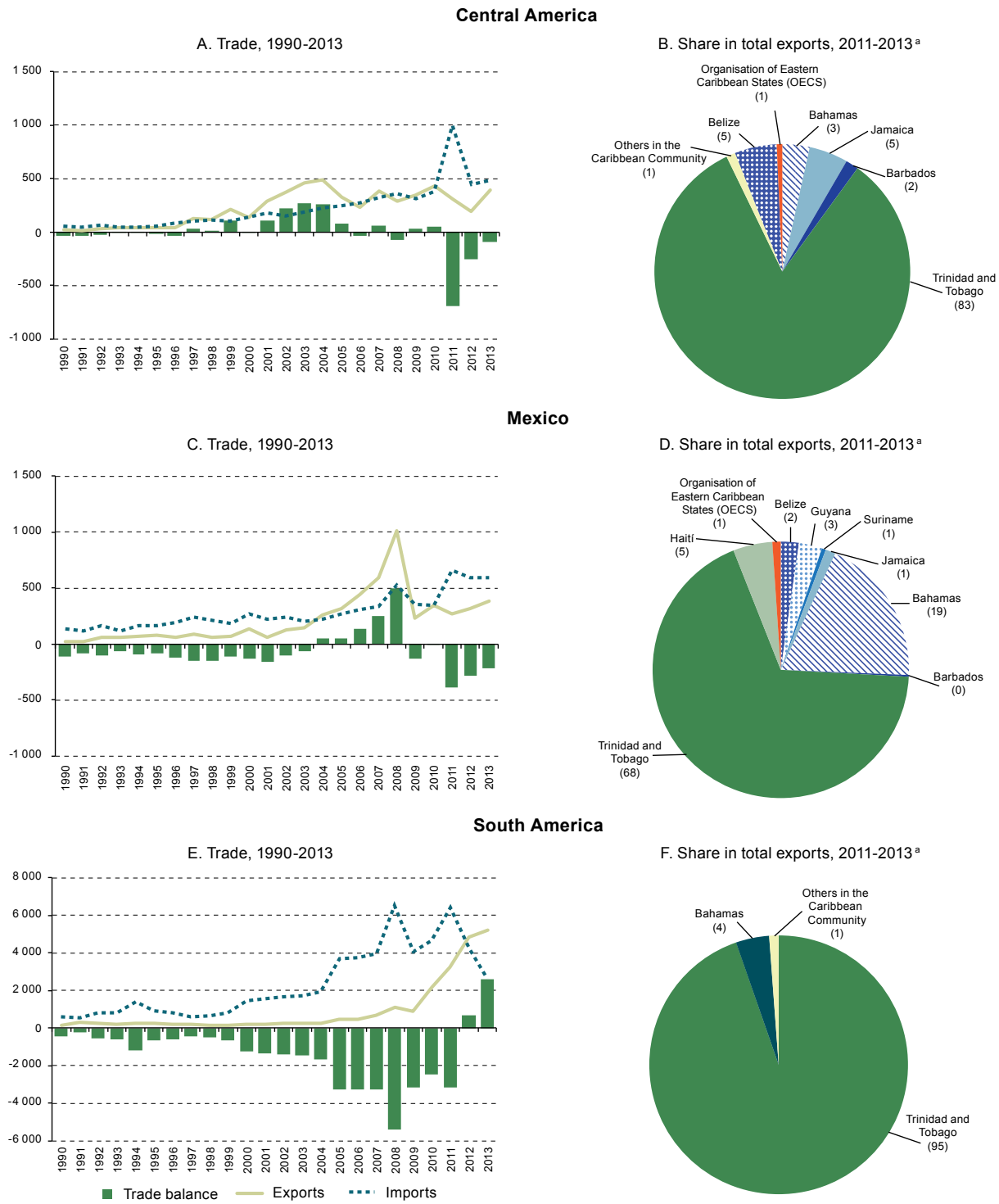
Guyana is a member of the Amazon Cooperation Treaty Organization (OTCA) and has a Partial Scope Trade Agreement with Brazil, which was subsequently expanded to include Saint Kitts and Nevis. The country has also signed a Trade and Economic Cooperation Agreement with Argentina. In 2005, Suriname concluded a bilateral partial preferential agreement with Brazil. Meanwhile, Belize, the only member State of the Caribbean Community in Central America, signed a partial scope agreement with Guatemala in 2006 and a Bilateral Investment Treaty with El Salvador in 2001.

Trinidad and Tobago is the primary CARICOM exporter to the Central American market, accounting for 83% of exports. The Community has posted trade deficits for the last three years. Products in which CARICOM has a comparative advantage in Central America include fertilizers, petroleum and petroleum products, beverages, gold, cereals and cereal products and organic chemicals.

Trinidad and Tobago and the Bahamas (19%) are the top exporters from CARICOM to Mexico. The Community similarly recorded a trade deficit with Mexico in the period 2011-2013. Trinidad and Tobago (95%) has also dominated the Caribbean Community's exports to South America, with the only other exporter of note being the Bahamas (4%). Trinidad and Tobago's exports to South America have increased steadily since 2009, translating into trade surpluses for CARICOM in 2012 and 2013. The Caribbean Community's trade balance with Latin America as a whole is negative, with only Trinidad and Tobago posting a surplus (2011-2013). On average, over the past three years, only Haiti (33.7%), Trinidad and Tobago (28.9%), Grenada (4.3%) and the Bahamas (0.9%) recorded growth in exports to Latin America (see figure IV.7 and table IV.13).

The above analysis has shown that the Central American and CARICOM economies possess relatively strong and increasingly complementary trade structures and are, to a large extent, natural trading partners. CARICOM enjoys modest trade complementarity with the rest of Latin America, particularly the Southern Common Market (MERCOSUR) and Chile. Exploring avenues for South-South aid for trade and public-private partnerships geared toward strengthening the Community's complementarity structures would therefore be a useful first step towards deeper trade and economic integration (McLean and others, 2014).

Figure IV.7
Caribbean Community: trade with main partners in Latin America, 1990-2013
(Millions of dollars and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Statistics Database (COMTRADE) and International Monetary Fund (IMF), International Trade Statistics.
[a] Annual average.

Table IV.13
Caribbean Community: trade with Latin America, 2011-2013 [a]
(Millions of dollars and percentages)

	Trade (2011-2013) [b]			Latin America's share in total trade		Annual growth rate (2011-2013)	
	Exports	Imports	Trade balance	Exports	Imports	Exports	Imports
Bahamas	255.8	819.6	-565	9.3	7.6	0.9	4.5
Barbados	19.8	99.0	-79	2.9	2.6	-28.6	-0.7
Belize	25.7	236.5	-211	4.1	11.6	-33.5	2.9
Guyana	21.0	97.3	-76	1.5	8.7	-12.3	-28.6
Haiti	18.5	391.2	-373	1.9	12.6	33.7	-16.8
Jamaica	29.9	610.7	-581	2.2	15.1	-37.3	-18.8
Suriname	6.7	138.8	-132	0.5	9.2	-26.6	-9.3
Trinidad and Tobago	4 670.3	1 651.9	3 018	24.3	24.9	28.9	-28.2
Organisation of Eastern Caribbean States	**13.8**	**1 624.6**	**-1 611**	**0.6**	**28.0**	**-28.6**	**-70.9**
Antigua and Barbuda	0.7	15.3	-15	0.0	0.7	-6.4	-18.2
Dominica	8.2	20.7	-13	10.9	9.5	-35.3	-31.2
Grenada	0.1	14.8	-15	0.3	9.0	4.3	-15.2
Montserrat	0.2	0.2	0	5.1	1.1	-47.8	10.9
Saint Kitts and Nevis	3.7	18.6	-15	3.9	3.9	-8.8	169.4
Saint Lucia	0.5	1 545.3	-1 545	0.4	72.3	-42.2	-76.2
Saint Vincent and the Grenadines	0.4	9.9	-9	0.6	2.2	-44.5	0.3
Caribbean Community	**5 060.4**	**5 669.4**	**-609**	**16.5**	**14.6**	**25.2**	**-32.7**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Statistics Database (COMTRADE).
[a] Data for the Caribbean Community countries were constructed using mirror statistics from the Latin American countries.
[b] Annual average.

D. Towards greater cooperation between the Caribbean and Latin America

The small size of the CARICOM market and the low degree of trade complementarity between its economies imply a need for enhanced integration with other countries that are geographically close to the subregion and are its natural trading partners, particularly Cuba, the Dominican Republic and the Central American countries (McLean and Yoshida, 2014). ECLAC is promoting greater coordination among the Latin American countries to use innovative cooperation mechanisms to support the development of the CARICOM economies and their connection with Cuba, the Dominican Republic and Central America. Their import and export structures make this group of countries naturally complementary. Central America is a major source of industrial and consumer goods and the Caribbean of the tourism services and energy sources that Central America needs, while Panama is a logistical and financial services centre that complements the needs of the Caribbean countries (see box IV.1).

The CARICOM member countries' small size, macroeconomic and environmental vulnerability, limited production base, heavy dependence on external markets and exposure to natural disasters make more cooperation from Latin America essential. Some of the region's more developed countries could join forces to carry out joint cooperation activities to maximize their impact. CELAC could play a central role in opening a dialogue between the Caribbean and the rest of the region, with a view to identifying the main cooperation needs and to coordinating, monitoring and evaluating the actions resulting from this dialogue. Specifically, some areas in which Latin American technical cooperation could have a positive impact on the Caribbean are:

- Enhancement of tax collection and public spending management capacities.
- Establishment of public procurement management systems.
- Development of civil registry schemes.
- Establishment of single windows and interoperability of customs information technology systems.

- Harmonization of sanitary and phytosanitary standards.
- Development of service provider coalitions.
- Specific actions to promote, coordinate and assist with the financing of policies to develop air and sea transport between CARICOM members and with the rest of the region. There is great scope for cooperation in this area, especially as regards the improvement of transport links between CARICOM countries and Panama.

Box IV.1

Some recent examples of integration and cooperation between the Caribbean and Central America

Several recent experiences have revealed a strengthening of integration and cooperation ties between the countries of the Caribbean and Central America. These include:

- In March 2012, Panama signed a partial scope agreement with Trinidad and Tobago. As part of the agreement, Panama can buy butane gas from Trinidad and Tobago without intermediaries and sell it on to other countries in Central America.
- El Salvador and Trinidad and Tobago have signed a tourism agreement as part of the negotiations for a partial scope agreement, and Guatemala has a tourism and culture cooperation agreement in force with Trinidad and Tobago.
- In the business sphere, there has been cross-investment between the two subregions, with firms based in Central American countries expanding their operations to the Caribbean and vice versa. Examples include the Panamanian firms Del Monte Panamerican, Carnes de Coclé and Conservas Panameñas Selectas S.A., all in the food sector. The Bermúdez Group, also in the food industry and based in Trinidad and Tobago, has been investing in Costa Rica since 2010. From that country it re-exports prepared banana products to Trinidad and Tobago and the rest of the Caribbean. Similarly, a financial services firm that already had a presence in Panama, Sagicor Life Jamaica, entered the Costa Rican market in 2013. In 2012, Sur Electrica Holding of the Bahamas bought 100% of the equity of three Guatemalan firms, TPS Guatemala One, TPS San José International and TECO Guatemala Services.
- Close links are maintained between the Central American Integration System (SICA) and CARICOM. Since 1992, there have been a number of ministerial meetings and summits of heads of State. The main topics dealt with have been trade and investment, climate change, risk management, security, cooperation, air transport, poverty reduction, foreign policy coordination and tourism.
- Both groups of countries, along with the Bolivarian Republic of Venezuela, Colombia, Cuba, the Dominican Republic and Mexico, are members of the Association of Caribbean States (ACS). This organization has been the channel for cooperation initiatives such as the Plan of Action of Pétion Ville, agreed in Haiti in April 2013 during the fifth Summit of Heads of State and Government of ACS. The plan includes actions in the fields of sustainable tourism, trade, transport, natural disasters, education, culture, science and technology.
- The Convention establishing the Sustainable Tourism Zone of the Caribbean came into force on 6 November 2013, and the Agreement for Regional Cooperation on Natural Disasters took effect on 31 March 2014.
- In April 2014, the city of Mérida, Mexico, hosted the third Mexico-CARICOM Summit and the sixth Summit of the Association of Caribbean States. The Heads of State and Government of all ACS member States and Territories signed the Declaration of Mérida, calling for the establishment of a space for cooperation spanning the Caribbean coasts of Central America, the Bolivarian Republic of Venezuela, Colombia, Mexico and the islands as a means of securing greater investment and boosting trade, and highlighting communication, transport, agriculture and tourism as central areas of interest for the intensification of joint efforts.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

E. Conclusions

The relatively low rate of intraregional trade and limited intra-industry linkages underscore the fledgling nature of regional value chains within CARICOM. Although the region's private sector has attempted to exploit differences in factor endowments and sources of comparative advantage and move towards the regionalization of production, there are still significant untapped opportunities for cross-country trade in intermediate goods —the building blocks of value chains. In this regard, the analysis undertaken in this chapter provides evidence of unexploited potential for cross-country production integration that suggest that more systemic constraints are at work.

The value chain analysis conducted in this chapter (based primarily on a detailed examination of Jamaica, Suriname and Dominica at this stage) reveals some strong regional intra-industry linkages within CARICOM whose potential remains largely untapped. This initial analysis also points to a disparity in intra-industry linkages across CARICOM countries, with the OECS countries enjoying more opportunities for intra-industry trade than other CARICOM countries.

More work remains to be done in order to make the CSME and the OECS economic union fully operational. The movement of goods, services and capital is not yet as free as might be expected under such arrangements. Furthermore, there are interconnection, trade facilitation and technology gaps that have consistently held back the Caribbean

Community's production integration efforts, and which must be bridged through the production of key regional public goods. Investment in regional transport, customs, information and communications technologies (ICTs) and innovation infrastructure is crucial for bringing about the structural transformation and upgrading of the CARICOM product set necessary for optimal value chain participation (McLean and others, 2014). To this end, complementary aid-for-trade resources, South-South development cooperation, development financing, technical assistance and public-private partnerships all have a key role to play in assisting the Community to establish a pan-Caribbean maritime corridor, address trade facilitation challenges and bottlenecks, develop renewable energy potential, promote innovation, and create a single ICT space in the Caribbean.

Trade agreements are a necessary but not sufficient condition for increasing exports. Achieving that aim requires countries to address structural rigidities and transform production systems, which necessitates a regional integration process based on broader comparative advantage-based production. Moreover, trade integration and development cooperation processes should be extended to the Greater Caribbean, with a focus on Cuba, the Dominican Republic and Central America in the first instance, and subsequently on other economies in Latin America and other emerging regions (McLean and others, 2014).

This analysis supports the view that the major constraints on production integration and trade competiveness in CARICOM are not necessarily related to market access, but rather may stem from the Community's suboptimal trade and production-related regulatory reform and inadequate trade-related economic infrastructure. Addressing these twin issues in the short term will help place CARICOM on a development path towards value-chain-led export expansion as a major driver of the sustainable development of its economies.

CARICOM may need to speed up the implementation of its single market, recalibrate its agenda for establishing the central elements of its single economy and forge ahead with the production of key regional public goods (such as transport, energy and ICTs), if it is to optimize cross-border inter-industry and intra-industry trade. This calls for a shift from a regional integration approach dominated by market considerations towards the pursuit of a broader agenda that embraces structural transformation on the basis of comparative advantage-based production transformation and factor integration. This shift must occur if the region is to have a realistic chance of regionalizing and diversifying its production base, moving from the periphery and tapping into hemispheric and global value chains.

Lastly, greater congruence should be sought between aid-for-trade resources and the subregion's priorities. Only a small number of Caribbean countries are eligible for these resources, as many are classed as middle- and high-income countries, and where countries do have access, such resources should be used to redress urgent problems relating to supply-side constraints and structural rigidities, which have reduced export competitiveness and have emerged as the principal barriers to regional development and integration.

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