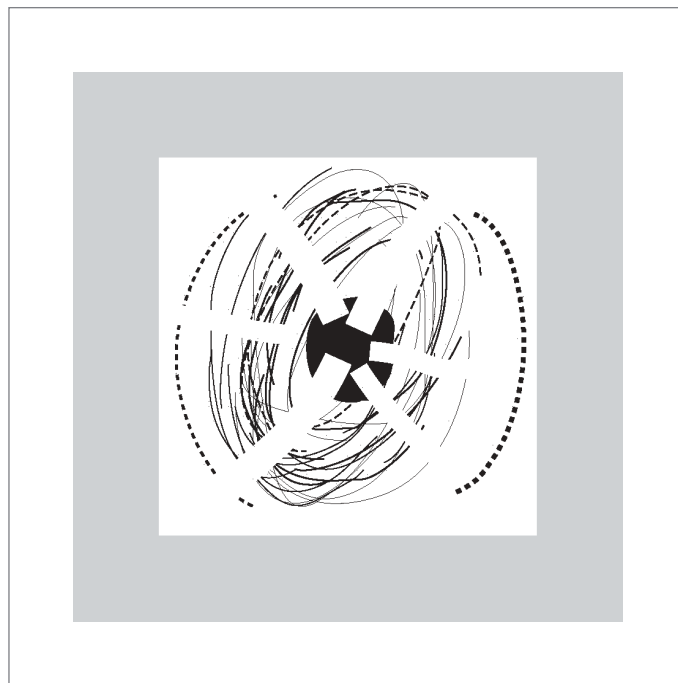


**2005-2006**



**Latin America  
and the Caribbean  
in the World Economy**



UNITED NATIONS

**ECLAC**

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The statistical appendix, which is provided on the enclosed CD-ROM, was prepared by Jaime Contador with the assistance of Andrés Yáñez.

## Notes

The following symbols have been used in this Study:

Three dots (...) indicate that data are not available or are not separately reported.

A minus sign (-) indicates a deficit or decrease, unless otherwise indicated.

A full stop (.) is used to indicate decimals.

The word "dollars" refers to United States dollars, unless otherwise specified.

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## Abstract

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The 2005-2006 edition of *Latin America and the Caribbean in the World Economy* is divided into six chapters.

The first chapter analyses recent trends in the international economy and trade, capital flows and the region's trade performance. The causes of external imbalances are examined, along with the behaviour of the economies of the United States, Japan and the European Union, oil prices, interest rates and exchange rates. It also presents Latin American trade projections for 2006 and 2007, as well as looking at the main risk factors that could undermine the favourable conditions now existing in the region.

The second provides an overview of recent economic developments in China and India and examines these countries' trade relations with Latin America and the Caribbean. Trade relations between these two Asian nations and the Latin American and Caribbean region have recently been flourishing thanks, in particular, to the prospects for securing access to South America's natural resources. Nonetheless, these two countries have yet to take full advantage of the Latin American and Caribbean region's potential as a supplier and buyer.

The main issues raised by the Doha Round of trade negotiations following the Ministerial Conference held in the Hong Kong Special Administrative Region (SAR) of China are explored in chapter III. The participants in the Hong Kong Conference changed the direction of these talks and agreed to proceed on an "aid for trade" platform,

but they failed to alter the political climate for decision-making sufficiently to permit the main stakeholders to reach agreement on a package of measures in the first half of 2006. In order for this to have happened, three of the major parties to these negotiations would have had to meet very specific demands: the European Union would have had to agree to lower its agricultural tariffs; the United States would have had to make greater commitments to cut agricultural subsidies; and the Group of 20 (G-20) would have had to reduce industrial tariffs and undertake certain commitments on trade in services. The chapter concludes with an analysis of the uncertain future of this recently suspended round of trade talks.

The fourth chapter assesses the current status of regional integration efforts and calls for the revitalization of the various initiatives being pursued in this area, not only in order to help form closer trade relations within the region, but also as a means of capitalizing upon the potential benefits of new trade agreements reached by Latin American and Caribbean countries and blocs with trading partners in other parts of the world. To this end, consideration is given to a variety of approaches for bringing about convergence among the trade rules governing the many different free trade agreements (including subregional integration accords) in effect in the region.

Chapter V looks at how Latin America's competitiveness indicators measure up against those of a set of OECD countries that are major natural-resource exporters. The

competitiveness and innovation strategy used by Australia and New Zealand (which have export structures similar to those of some South American countries) is then examined as an example of a successful effort to use competitiveness and technological innovation to position these countries advantageously in the international economy.

The main economic losses associated with bird flu and foot-and-mouth disease are discussed in chapter VI.

The chapter reviews a number of specialized studies on the economic and social costs of recent outbreaks of these two transboundary animal diseases, which pose a formidable challenge for world trade in beef and poultry meat. Consideration is also given to how they have affected the trade flows of the main exporters of these products, and regional policy proposals for dealing with their implications are offered.



## Summary

---

### Introduction

The international economy has generally provided favourable conditions for the region in 2005-2006, including strong international prices for its commodity exports, low international interest rates, low inflation and ready access to external financing. These trends are now gradually beginning to change somewhat, but without threatening the favourable international outlook for the rest of 2006 and for 2007.

The United States economy has been slowing little by little, partly as a result of higher interest rates. These trends, combined with the fact that the dollar continues to depreciate against the euro, should help to reduce its current account deficit. The growth of the European Union and Japanese economies in 2006 has outpaced the projections made in 2005, and this has helped to offset part of the downturn in the United States' performance. The main risk factors continue to be petroleum prices and the misalignment of China's economy, which stems from its continued exposure to the risk of overheating and the fact that the yuan remains tied to the dollar and is thus depreciating against the euro, thereby adding further to the country's already hefty trade surplus.

Petroleum prices have become a crucial variable in the region's economic performance. The Latin American and Caribbean region as a whole is a net oil exporter, but many of its small and medium-sized countries are net importers, and prices of around US\$ 75 per barrel therefore saddle

them with considerable fiscal and balance-of-payments costs. In Central America, in particular, the increase in the oil bill is the main reason for the 14% deterioration observed in the subregion's terms of trade since 1998-1999 and for a loss of income equivalent to nearly 4.5% of its GDP. Meanwhile, oil-exporting countries, which have witnessed a strong improvement in their terms of trade, are confronted with a significant fiscal challenge as they look for ways of using these windfalls to save, pay down debts or invest in competitiveness.

The possibility of a sudden correction in the United States' current account deficit and the trend in oil prices are not the only risks facing the world economy, however. The Doha Round's uncertain future and the threat of a resurgence of protectionism and of spiralling growth in bilateral trade accords are also looming large. Outbreaks of avian flu are yet another threat that could have extremely serious human, economic, and commercial implications of global proportions.

Within Latin America and the Caribbean, the debate about trade negotiations and their possible impacts on regional integration is heating up as renewed proposals are put forward for making integration schemes more pliant and adapting them to changing conditions by, inter alia, introducing more flexible types of trade associations, both within Latin America and the Caribbean and between countries in this and other regions. Experiences of other

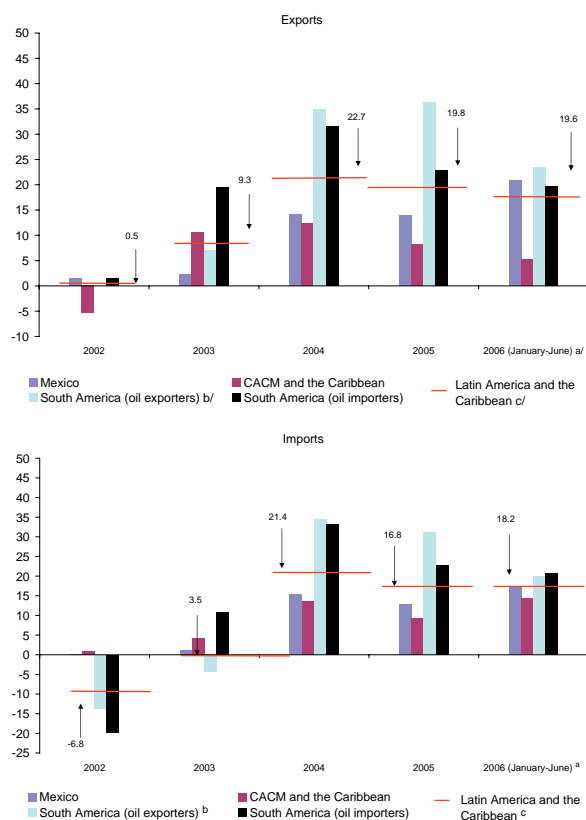
countries with generous endowments of natural resources—such as Australia and New Zealand—that have used innovation and competitiveness policies to improve their position in the international economy also point up relevant strategic considerations for the region. All of these elements will have a strong influence on the Latin American and Caribbean countries' economic and trade performance.

## Chapter I: World economic trends and their impact on the Latin American and Caribbean region's position in the international economy

For the fourth year in a row, in 2006 the world economy has been growing at over 4% in terms of purchasing power parity (PPP). This is the first time such economic buoyancy has been seen since the early 1970s and, although it is likely to slacken slightly in late 2006 and in 2007, no dramatic change in the present growth-friendly international economic environment is expected. The major emerging economies (China, India and the Russian Federation) have been the most dynamic, with higher-than-expected growth being led by investment and exports. In fact, when calculated on the basis of purchasing power parity (PPP), China's and India's combined growth accounted for one third of the increase in world GDP in 2005, thereby overtaking the combined contribution of the United States, the European Union and Japan (although, in terms of current dollars, the European Union and the United States continue to be the largest components of the world economy). The current growth pattern exhibited by China, India and developing Asian countries, as the new global trend-setters in terms of production, trade and financial movements, offers an encouraging outlook for the trade performance of the countries in the region.

There are a number of potential risks to be considered, however. The greatest threat is the impact of the surge in oil prices in response to mounting world demand and geopolitical tensions in the Middle East. High petroleum prices are beginning to have an impact not only on general inflation in developed and developing countries alike, but also on these economies' core inflation rates. As a result, the central banks of the United States and, to a lesser degree, the euro area have been hiking interest rates, which could dampen growth in these economies, as is already occurring in the United States. In addition, higher interest rates will make it harder for countries of the region to borrow on international financial markets.

Figure 1  
LATIN AMERICA AND THE CARIBBEAN: GROWTH RATES OF EXPORTS AND IMPORTS OF GOODS, 2002-2006  
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and estimates based on official data reported by national statistical office, customs bureaus and central banks of the countries concerned.

a Preliminary estimates.

b Bolivarian Republic of Venezuela, Colombia and Ecuador. The oil importers in South America are Argentina, Bolivia, Brazil, Chile, Paraguay, Peru and Uruguay.

c 37 economies.

These higher interest rates' effects in reining in the United States economy, in conjunction with the dollar's depreciation against the euro, should pave the way for a reduction of its current account deficit, which is one of the main imbalances in the world economy. The slowdown in the United States economy is being partially offset by stronger growth in Japan and the European Union. These factors point in the right direction and suggest that the international economy may be headed for a gradual reduction in global disequilibria. However, this process is hindered by China's and the oil-exporting countries' persistent current account surpluses, as well as the yuan's stickiness against the dollar. This situation and the persistence of high petroleum prices are the main sources of concern for the world economy at present. The most likely scenario, therefore, is not a recession, but instead a modest decline in world economic growth, coupled with a gradual correction of economic imbalances.

The change in the geographic location of the engines of growth and higher interest rates will have less of an impact on Latin America and the Caribbean than they would have had a decade ago. While the region's export volumes will certainly be hurt by slower growth and slack demand in the United States (its biggest trading partner), China's sustained demand will tend to keep commodity prices high. Nor will the rise in interest rates have the same impact as before, since most of the countries of the region are less vulnerable than they used to be, thanks to their larger foreign-exchange reserves and the higher level of ongoing inflows of export earnings relative to debt amortization and interest payments. For some Latin American countries (Argentina, Ecuador and Uruguay), however, wider spreads could endanger the sustainability of their public debt positions, since the sum of these obligations remains at over 50% of GDP and a portion of it is denominated in or indexed to the dollar.

For the time being, Latin American and Caribbean trade continues to be spurred by strong international demand, especially from China, and the greater strength of the European and Japanese economies. The region continues to have relatively easy access to international financial markets, as interest rates are still fairly low. In 2005, foreign direct investment (FDI) inflows expanded less, however, than they did in more buoyant economies, such as those of China, other Asian countries and Africa.

In real terms, Latin America and the Caribbean posted the second-largest increase in exports, after China, in 2005. South America posted a sharper upswing in exports than Mexico and Central America did because it specializes more heavily in commodities, whose prices have been climbing steadily. ECLAC projections for 2006-2007 indicate that Latin American export volumes will grow at much the same rate as they did in 2005 (around 7%-8%), thereby once again coming in second, with China remaining in the lead.

In 2006, the region's exports will continue to benefit from a strong improvement in its terms of trade. In 2005 its terms of trade improved again, with a 5.0% rise following the 5.3% upturn recorded in 2004, although sharp differences across subregions remain. Oil- and copper-exporting countries (Bolivarian Republic of Venezuela, Chile and Ecuador) saw the largest increase in their terms of trade in 2005, while net oil importers (Central America and the English-speaking Caribbean) witnessed a deterioration. Raw material prices may stay high for a while longer because of the strong demand being fuelled by world economic growth and especially by China and India, but the geopolitical uncertainty associated with the conflict in the Middle East and its effect on oil prices will continue to generate volatility and uncertainty in the world economy.

---

## **Chapter II: China's and India's trade relations with Latin America and the Caribbean: opportunities and challenges**

Asia is the most dynamic area of the world economy in terms of growth, international trade, FDI, technological innovation and its role as a source of financial resources that help maintain international balances (see chapter I). One of the most conspicuous features of Asia's emergence as a lynchpin of the world economy is China's and India's dynamic entry onto the stage as leading players around which the rest of Asia is arraying itself. Asian countries are also displaying

an unprecedented interest in forming strategic relationships with Latin America and the Caribbean. The high growth rates projected for China and India ought to secure their position at the very centre of world growth in the coming years. As a result, they can offer the countries of Latin America and the Caribbean a huge potential (and thus far, except in the case of a few commodities, largely unexploited) market for their exports of both goods and services.

China's and India's combined merchandise exports represented 8.2% of the world total in 2005, compared to 4.5% in 2000. During 2005, Chinese exports jumped by 28% to US\$ 760 billion (nearly 1.5 times as much as the external sales of the Latin American and Caribbean region).<sup>1</sup> By 2005, China had become the world's third-largest merchandise importer and exporter. In India's case, merchandise exports and imports in 2005 totalled US\$ 90 billion and US\$ 132 billion, respectively, thus widening its trade deficit. These two countries are also among the world's top 10 exporters and importers of tradable services. In addition, China is one of the largest recipients of FDI in the world. Its US\$ 72.4 billion in FDI inflows for 2005 represents a 19.4% increase over the 2004 level and attests to the growing importance of transnational corporations in its economy. In contrast, FDI inflows to India are much smaller owing to the more cautious approach it has taken in opening up its economy to these investment flows.

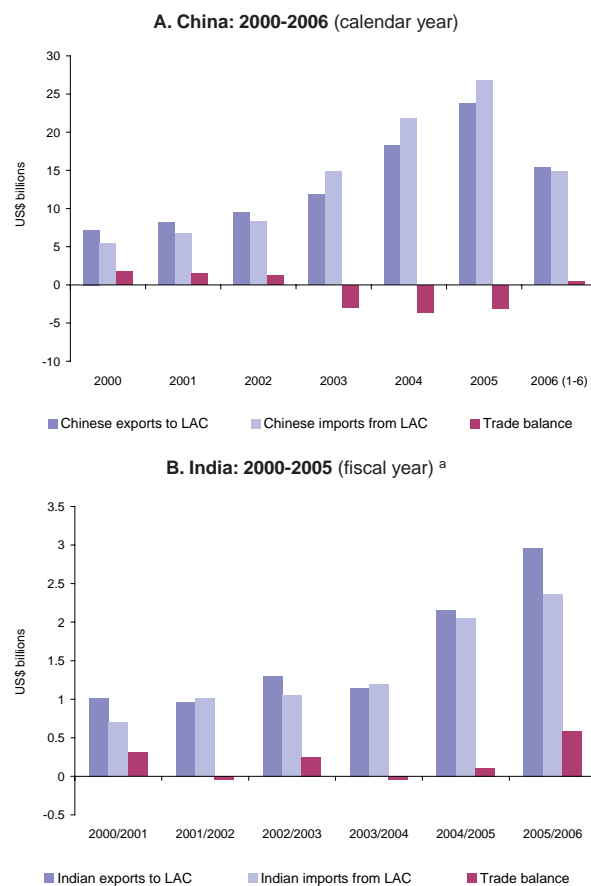
Despite the Chinese authorities' attempts to cool down the economy, it has continued to surge ahead: in the first half of 2006, it posted year-on-year growth of 10.9% as a consequence of strong investment and export growth, and everything seems to indicate that its growth rate for 2006 will top 10%. For the first time since 2004, China raised its benchmark interest rate in April and again in August in an effort to rein in the headlong growth in bank lending, but to little avail. The acceleration witnessed in 2006 by the already buoyant Chinese economy illustrates the risks involved in unrestrained growth. This economic expansion is being fuelled by the country's enormous trade surplus and is leading to well-grounded calls for a steeper appreciation of the yuan.

The short-term outlook for India is promising, given its solid economic growth and moderate rates of inflation. Challenges it will have to meet in the medium term include the management of its high levels of public indebtedness and growing current account deficit and the need to embark upon a series of essential reforms. The government must continue to consolidate its fiscal position while proceeding with much-needed improvements in infrastructure (especially the supply of electrical power and the road system) to backstop its industrial development, training human resources in service-related sectors, and promoting public investment aimed at boosting rural productivity.

The Chinese economy's remarkable growth has turned it into the central pillar of Asia's dynamism. India is gradually becoming part of the Asian production chain as it reconfigures itself around China. Meanwhile, China is

deepening its specialization in high-technology and high-value-added sectors while gradually moving away from the areas in which it has traditionally had a comparative advantage, such as textiles and clothing. India has a great deal of potential in the heavily export-oriented information and communication technology (ICT) and business process outsourcing (BPO) sectors, which continue to perform very well. The reductions in tariff and non-tariff barriers being made under China's trade agreement with the Association of Southeast Asian Nations (ASEAN) and under the agreement between China and India, which will enter into effect in 2007 and cover agricultural as well as industrial goods, may have highly significant implications for trade between Latin America and Asia.

Figure 2  
CHINA AND INDIA: TRADE WITH LATIN AMERICA  
AND THE CARIBBEAN  
(Billions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from the Chinese Ministry of Commerce [[www.mofcom.gov.cn](http://www.mofcom.gov.cn)] and the Indian Department of Commerce [<http://dgft.delhi.nic.in>].

<sup>a</sup> India's fiscal year runs from April to March of each calendar year.

<sup>1</sup> These trends carried over into the first half of 2006, when exports climbed by over 25% to US\$ 429 billion, while imports rose by 21%, to US\$ 367 billion.

The figures on trade flows with Latin America and the Caribbean reported by Chinese and Indian authorities differ substantially from those cited by countries of the region, mainly because some of the statistics are f.o.b. values while others are c.i.f. and because of some degree of trade triangulation through the Hong Kong Special Administrative Region of China (see figures 2a and 2b). These discrepancies notwithstanding, trade between the region and China has been active throughout this decade. Trade between India and the region has been growing briskly during the past two fiscal years, although starting from a very low baseline.

China has already become a major export market for a number of countries in the region. Trade relations between South America and China tend to be complementary, taking the form of inter-industry trade in which the region exports primary commodities and imports manufactures, whereas Mexico's and Central America's trade with China is more asymmetrical. In fact, China buys less than 1% of Mexico's total exports but is its second-largest supplier of imports. As a result, Mexico and Central America have been building up a growing trade deficit with China.

Mexico and Central America export many of the same types of products to the United States market as China does. In fact, China has actually superseded Mexico as the United States' top trading partner. This shift is evident not only in textiles and clothing but also in such sectors as electrical equipment and electronics, including computer hardware.

The Latin American and Caribbean region is still a small—but growing—market for India. As in the case of China, the pattern of trade between India and South America differs from the structure of trade flows between India and Central America and Mexico. In South America, India has already concluded trade agreements with MERCOSUR

and Chile. This subregion should therefore consolidate this trend by further strengthening its trade links based on the attainment of greater productive complementarity with both China and India and the necessary trade and technology partnerships.

Given the inter-industrial pattern of trade between South America and these two Asian countries, the next step for the subregion is to encourage its firms to share in the success of Asian enterprises by becoming part of their production units' supply chains and by furnishing more highly processed inputs with greater technological content. One way they could start to make headway in this direction is by increasing their processing of the natural-resource-based products they already export to Asia. The recent tendency to consolidate trade relations between Latin America and these two Asian countries by concluding various sorts of trade agreements will facilitate Latin American firms' incorporation into Asian supply chains focusing on China and India.

In order to promote Mexico's and Central America's strategic relations with China and India, an effort needs to be made to ensure a place for this Latin American subregion within Asia's market-led productive integration process, in which the two Asian giants are playing a decisive role. Increased intra-industry trade between these two Asian countries and Mexico/Central America would provide this subregion with new access routes to the Chinese and Indian markets. This, in turn, would help Mexico and Central America find opportunities for incorporating new technologies rather than having to compete face-to-face in third markets. The logistical advantage of their proximity to the North American market is a key variable that should be factored into the relevant commercial and technological partnerships.

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### Chapter III: The Doha Round: an uncertain future

Towards the end of July 2006, the Director General of the World Trade Organization (WTO) recommended that the negotiations be suspended in view of the fact that the main parties to the negotiations have been unable to find common ground, particularly with regard to the liberalization of trade in agricultural products. This step makes it unlikely that the Doha Round can be concluded in 2006 and has given rise to a great deal of uncertainty about the inroads that had been made to date in this negotiation

process, many of which were in the interests of developing countries. As of late August, the press was following the crossfire of accusations among the main stakeholders, as they insisted that they would only soften their positions on the condition that the others would do the same, and tracking the progress of the various attempts being made to get the talks moving forward again.<sup>2</sup> In some circles, the expectation is that the Round may take between one and three years to complete.

<sup>2</sup> To that end, Brazil proposed that a meeting of the G-20 be held on 9 and 10 September.

Since the Uruguay Round led to the founding of WTO in 1995, the multilateral system has had both successes and failures. It has helped to expand international trade, has brought a wide range of sectors and issues into the multilateral system, has created new rules and has supported the creation of a more stable environment for trade activity. Yet significant constraints and distortions still exist in agricultural trade. Seven years into the implementation of the Uruguay Round agreements, these and other factors were the underlying reasons for the initiation of the current trade talks, which have now been going on for approximately five years.

The sixth WTO Ministerial Conference, held in Hong Kong SAR in December 2005, plotted a course for the Doha Round talks, which are the first to be undertaken under the aegis of WTO. The text reflecting the consensus reached by all the participants set out a work plan and an exact timetable,<sup>3</sup> but its progress stalled in the first half of 2006 (see table 1). Despite exhaustive efforts, three key issues have proven to be very hard to tackle, with greater efforts being required chiefly from three major stakeholders: the European Union, which is being called upon to lower its agricultural tariffs; the United States, which is being asked to make stronger commitments in relation to the reduction of agricultural production subsidies; and the Group of 20 (G-20), whose members are being urged to lower tariffs on manufactures and services.

Table 1  
MILESTONES IN THE DOHA ROUND OF TRADE TALKS

1995	Founding of WTO and start of the Uruguay Round agreements' implementation
1999	Demands made by developing countries at the Third WTO Ministerial Conference in Seattle
2001	Launch of the Doha Round (also known as the Doha Development Round) at the fourth WTO Ministerial Conference
2003	The fifth WTO Ministerial Conference, in Cancún, was to address a number of crucial issues but ended in deadlock
2004	The "July package" of framework agreements for revitalizing the Doha Round is unveiled
2005	Original completion date for the Doha Round Sixth WTO Ministerial Conference held in December in Hong Kong, China, and reactivation of the Doha Round
2006	New completion date for the Doha Round set at the sixth WTO Ministerial Conference. Suspension of the negotiations (24 July)
2008-2013	Deadlines called for at the sixth Ministerial Conference: implementation of Doha Round agreements and elimination of agricultural export subsidies

Agreement was reached on the least problematic of the three major agricultural issues, i.e., setting a deadline for the elimination of export subsidies (2013). Domestic supports in the farm sector and market access have proven to be more

difficult issues to resolve, and the level of ambition regarding these points has also defined the scope of the other issues on the agenda. This level of ambition reflects a combination of commercially significant reductions, on the one hand, and, on the other, a range of flexibility which should be defined by the parameters of a package of measures in these areas.

There was no shortage of proposals regarding different definitions, however, including the use of a system of bands for reductions in domestic farm supports, a "Swiss formula" for phasing down bound non-agricultural tariffs and determinations concerning various technical issues (such as the conversion of specific tariffs into their ad valorem equivalents). Attention was also devoted to disciplines on fisheries subsidies and antidumping and to arrangements for plurilateral negotiations on services sectors. Greater progress was made in the areas of trade facilitation and transparency in preferential trade agreements, however.

The Hong Kong Declaration carries on the Round's tradition of "developmentalist" rhetoric as a key aspect in maintaining the involvement of most developing countries. Nevertheless, recommendations and decisions are increasingly focused on the least developed countries (LDCs), and Haiti is the only country in the region that falls into this category. Although the participants at this latest WTO Conference placed emphasis on technical assistance and capacity-building (including the Integrated Framework), LDCs will be exempt from virtually all of the new Doha commitments, and there are practically no new disciplines that call for implementation efforts on the part of developing countries, which was the main criticism made of the Uruguay Round outcomes. More attention is also being devoted to the Work Programme on Small Economies, which could benefit a larger number of countries in the region, especially in the Caribbean. Work on special and differential treatment and on implementation has been deferred on numerous occasions, however, and viewpoints on these issues differ widely.

As a complement to the Doha agenda and in the light of the development dimension that constitutes its central objective, the decision was also taken to strengthen the aid for trade to be offered to developing countries. In fact, the aid-for-trade platform is seen as one of the most important achievements of the sixth Conference. The aid for developing countries and particularly LDCs provided for in the Ministerial Declaration is based on a useful, innovative approach to building these countries' supply capacity and related infrastructure so that they will be able to implement WTO agreements, benefit from them and expand their trade flows.

<sup>3</sup> The United States trade promotion authority—which is of key importance for the conclusion of the negotiations—will be in force until mid-2007, when the member countries of WTO planned to ratify the Doha outcome.

Debates among the most influential WTO members have eclipsed the advances made in these areas as well as the more lasting importance of WTO as the mainstay of the multilateral trading system, which offers a number of opportunities not available under regional, bilateral or other preferential arrangements. Its importance lies in the possibility of fashioning a reliable system of consensus-based rules, providing a level negotiating table where parties in widely differing positions can address the asymmetries existing in their capacities and needs, and furnishing a sound scheme for dealing with disputes. The recent suspension of negotiations (as of the closing date for this edition) has therefore generated a great deal of uncertainty regarding the fate of existing agreements and those that were nearing completion, many of which—such as the aid-for-trade recommendations—are highly important for developing countries.

Another question has to do with how effective the outcomes of this round will be in providing ways of dealing with the problems and challenges of the twenty-first century, such as those posed by cross-border anti-competitive practices; e-commerce and information technologies; and domestic security, environmental and other regulations and their impact on trade. The multilateral system has lagged behind bilateral rules on these subjects agreed upon by many of its members, including developing countries, in other international forums.

The countries of the region have continued to play an active role in a number of interest groups, particularly with

regard to agriculturally related issues (the Cairns group, G-20, G-33). Brazil, in particular, has assumed a highly important role in various parts of the negotiations through its leadership of the G-20 and its involvement in key groups such as the G-6 (Australia, Brazil, the European Union, India, Japan and United States). Other subjects that have drawn the region's interest include trade facilitation, antidumping measures, and fisheries subsidies. The varying interests stemming from the different countries' positions in the international economy and their priorities in this connection have prompted them to adopt differing stances on some points, however.

In addition, as first occurred during the Uruguay Round negotiations, shifting alliances are being formed that transcend the North-South dichotomy as the major stakeholders seek to coordinate their interests. The G-6, for example, which has played a central role in this phase of the negotiations, is the object of developing-country demands for representation and participation. On the one hand, attempts are being made to differentiate between the larger developing countries and the rest of the developing world and to pressure the former to make greater concessions. On the other, specific demands are being lodged with a view to winning consideration of the special conditions existing in small economies or LDCs. All of these different factors go to show just how difficult it is to coordinate negotiations within WTO, which employs a consensus-based decision-making system, as the number of participants grow (the number of members currently stands at 149).

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## Chapter IV: Regional integration and trade-agreement convergence

The region's recent experiences have shown that intraregional trade facilitates export diversification, is more SME-friendly and is more intensive in value-added than trade with the rest of the world is. Progress has also been made in establishing integration policies and institutions, perhaps most notably in the Andean Community and Central America. Recent advances include the Andean Community's creation of social development programmes, the structural convergence funds established by MERCOSUR and the efforts made to agree upon uniform customs codes and extend the application of the common external tariff to all tariff items. Similar inroads are being made in Central America and the Caribbean. Given the urgent nature of the challenges faced by countries' seeking to position themselves on a competitive basis in the international economy, however,

the regional debate tends to centre on the weaknesses and shortcomings of the integration process.

In the first half of the 1990s, intraregional trade was liberalized with the help of agreements signed under the aegis of LAIA. In the second half of that decade, particular importance began to be placed on signing agreements with trading partners outside the region, such as Canada, the European Union, Japan, the United States and, more recently, China and other Asian countries. This heralds a new phase in Latin American and Caribbean trade policy, as well as a definite reconfiguration of trading patterns that poses a formidable challenge for existing integration schemes.

Substantive differences exist between the scope of the rules and disciplines included in each type or category of agreement. Intraregional agreements tend to be composed

primarily of trade defence instruments designed to expedite tariff reduction schedules and avert the introduction of non-tariff trade barriers. These arrangements do not, however, provide for broader coverage of other types of rules which, because they are not fully harmonized, also act as non-tariff barriers (e.g., sanitary and phytosanitary measures and technical regulations). In addition, in the case of disciplines on trade-related matters (services, investment, government procurement, intellectual property), intraregional agreements fall far short of the coverage afforded by agreements with outside countries.

The coverage of commitments on trade disciplines also varies from one intraregional agreement to the next. South America's customs union arrangements and the associated bilateral agreements offer a high degree of coverage in terms of trade defence and dispute settlement, but this is not the case for sanitary and phytosanitary measures or technical barriers. In contrast, the free trade agreements (FTAs) signed between Chile and Mexico and by them with Central American countries provide more comprehensive coverage in these areas.

There is a striking asymmetry between bilateral and plurilateral agreements within the region and the agreements reached with countries elsewhere, especially some of those in the North. The latter contain more stringent commitments backed up by more binding mechanisms entailing greater legal certainty than do subregional arrangements, which, by the same token, are less demanding in terms of trade and non-trade disciplines and rules.

The present assemblage of bilateral, plurilateral and regional trade agreements in Latin America and the Caribbean could result in discrimination against some countries or subregional groups as a consequence of the wide variety of provisions in force with regard to coverage, types of treatment and the depth of the commitments entailed by the various disciplines and rules included in these agreements. Unless urgent steps are taken to achieve convergence among these different agreements, trade diversion will increase and the transactions costs for intraregional trade will climb.

Four types of problems need to be addressed: (i) operational issues, such as customs, transit and storage procedures and rules, where a lack of familiarity with the formalities or confusion about methods of application can become hidden trade barriers; (ii) the presence of rules and disciplines that are formalized in some agreements but absent from others (investment, services and intellectual property, for example), that have different depth and coverage in intraregional agreements than they do in agreements with outside countries, or that have differing provisions regarding similar issues (national treatment) or treat identical subjects differently (commitment or negotiation models); (iii) the institutional structure of trade agreements,

and (iv) discrimination between trading partners (less favourable treatment) as a result of differences between intraregional and extraregional agreements' regulations, policies and liberalization measures.

Convergence can be promoted by various sorts of stimuli and different sorts of modalities, which should be examined on a topic-by-topic basis. In order to do so, a flexible outlook that is conducive to creative solutions must be maintained.

Regional integration is both necessary and a matter of urgency. In addition to the traditional reasons for pursuing it, the current phase of the globalization process generates integration-oriented demands, such as the need for strategic international alliances in the areas of production, logistics, marketing, investment and technology. The demand for competitiveness and technological innovation are mounting, while China's, India's and other Asian nations' competitive leapfrogging has redrawn the global map of trade flows and comparative advantages. Expanded markets, legal certainty and the convergence of rules and disciplines, in conjunction with advances in infrastructure, energy and connectivity, are now essential ingredients of growth with equity.

While recognizing countries' differing sizes and trade orientations, the gains of existing integration schemes must be preserved by fostering convergence on trade and non-trade issues alike. Certainly, the countries belonging to each individual integration scheme must ask themselves what that scheme is doing to contribute to their growth and competitiveness. Be this as it may, prevailing conditions make it advisable to place a higher priority on regional cooperation than on trade negotiations as such.

Current integration efforts should focus on establishing common ground as a platform for convergence in energy and infrastructure policies, first of all, and, later, in policies on the environment, tourism, connectivity, ICTs, e-commerce, regulatory practices and other matters. If regional cooperation efforts in these areas succeed in rebuilding confidence among the countries, then, in addition to paving the way for competitiveness gains, they will make it less difficult, later on, to build bridges among the various intraregional trade arrangements by defining a basic set of shared obligations and flexible timetables, particularly for the smaller economies, together with infrastructure, trade facilitation and connectivity programmes that would provide for special and differential treatment.

Progress also needs to be made in gradually building institutional bridges among the various integration schemes, without abandoning any of their overarching objectives, such as expanded markets, the free movement of goods and factors of production, macroeconomic coordination, binding dispute settlement procedures, appropriate treatment of asymmetries, structural funds, social policy coordination and bold initiatives in the fields of energy and infrastructure.



The most pressing task of all, however, is to re-establish a climate for dialogue in which no party is excluded or disparaged. This stage in the process calls for tolerance of the diversity of national interests and trade strategies. The validity of existing mechanisms should be respected and used as a basis for identifying areas and instruments that can serve as a platform for progress, first, in carrying forward regional cooperation initiatives and, later, in devising means of fostering convergence in the areas of trade and integration.

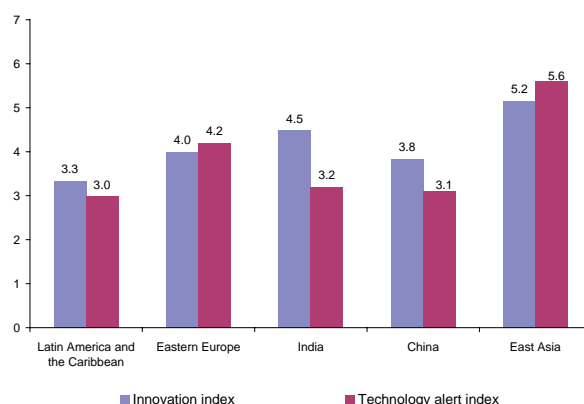
In order to achieve these objectives, the approach used in promoting integration must be a suitable one based on respect for differences, observance of established procedures and structures, mechanisms for providing flexibility, an understanding of the interests of each country and of their diversity in terms of economic and commercial conditions, priority on consensus-building and a focus on the most meaningful areas of agreement, and an awareness of the relevance of integration efforts and of the need to adapt them to the demands of today's world.

## Chapter V: Competitiveness, technological innovation and natural resources: the experiences of Australia and New Zealand

The region's competitiveness indicators show that, although Latin America has seen strong export growth in recent years and has gained improved market access, its progress in this area has been limited. Since the mid-1990s, economic reforms, market liberalization, trade agreements and greater macroeconomic stability have enabled the region to regain some of the ground it had lost in world markets, but it still has a long way to go. This slow pace of progress in boosting competitiveness has been coupled with no more than limited advances in the area of innovation, although the region's innovation indicators are nonetheless similar to the averages for other developing regions, including India and China (see figure 3).<sup>4</sup>

This chapter analyses Australia's and New Zealand's international competitiveness and positioning strategies. These two countries have similar production structures to those of many Latin American countries and have achieved per capita export levels that are five or six times greater than the region's, high per capita income levels and stable economic growth. Innovation has become a lynchpin of their development strategy and their position in the international economy. Information about this experience can therefore be very useful for the region, particularly at a point in time when a number of its economies are enjoying highly favourable terms of trade and are in the process of debating how to make the best use of their windfalls.

Figure 3  
LATIN AMERICA AND THE CARIBBEAN: INNOVATION AND TECHNOLOGY INDICES<sup>a</sup> AS COMPARED TO OTHER DEVELOPING REGIONS, 2005



Source: World Economic Forum, *Global Competitiveness Report 2005-2006*, New York, Oxford University Press, 2006.

<sup>a</sup> The indices go from a minimum of 0 to a maximum of 7. The closer an index is to zero, the weaker a country or region is in these areas; higher ratings point to strength in these spheres.

Competitiveness and innovation strategies are discussed and promoted at the highest level of government in these countries. Programmes in these fields are not only amply funded (through grants, research and development (R&D) subsidies, tax breaks, business start-up subsidies, international marketing subsidies, etc.) but are also based

<sup>4</sup> Innovation and technology readiness indices are components of the competitiveness growth index. The former measures factors that have to do with innovation capacity and management, the available supply of scientists and engineers, intellectual property protection, and the degree of collaboration between the academic and business communities. The latter measures how fully ICTs have been incorporated into production and government services and how developed the country's technological infrastructure is.

on precisely defined targets and objectives, as well as indicators for evaluating their results and outputs.

The authorities of both countries realize that policy implementation is extremely difficult without close collaboration among business, the public sector and the scientific community. Their national innovation systems are therefore envisaged as a complex network of interdependent relationships rather than as an uncoordinated assemblage of separate agencies and stakeholders. Business plays a leading role, but academic institutions also perform an essential function by virtue of their ability to create new knowledge and transmit it to businesses. The State makes a determined effort to set up links among scientists working at different universities, independent research centres and business enterprises with a view to building trust and creating incentives for collaboration.

These countries target their policies, placing priority on the development of innovations in natural-resource-processing industries, but also in new industries, especially in the fields of biotechnology and ICTs. This is not by coincidence, but is instead focused on devising cross-cutting mechanisms for covering the requirements and needs of the widest possible range of activities. Biotechnology provides the foundation for newly created knowledge, contributes a large part of the value added to natural resources and makes it possible to market new agribusiness, forestry, aquaculture and mining products. Information technologies that can be applied to such tasks as database administration are key components of the integrated management systems that play a vital role in innovation.

This chapter of the report suggests that the following aspects of these experiences can be particularly helpful in guiding the regional debate on competitiveness and technological innovation:

- innovation is at the very core of policies for promoting productivity, competitiveness and economic sustainability;
- the innovation process is systematically linked to the competitiveness policies advocated by line ministries;
- efforts to help the business and academic sectors work together have led to the creation of different types of organizations and the establishment of associated institutional structures;
- this institutional framework ensures that SMEs will have suitable access to technological modernization and innovation processes;
- both Australia's and New Zealand's innovation systems include programmes and funds to meet the needs of the businesses situated along the entire length of the innovation chain: R&D; new business start-ups; service, technology or product marketing; and incentives for the formation of ties with international networks;
- these business funds account for an increasingly large part of system-wide innovation expenditure and play a particularly important role in supporting the marketing of innovations; and
- public financing for these numerous programmes is locked-in for the medium term so that funding will not be interrupted by changes in the Administration or by cyclical factors.

The differing configurations of these innovation models reflect these countries' histories, culture and growth processes, but the above aspects are of key importance in strengthening any national innovation system. Consequently, once the relevant institutional adjustments have been made, the steps they have taken in these areas can serve as a source of inspiration for policymakers in Latin America and the Caribbean.

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## Chapter VI: **Bird flu and foot-and-mouth disease: impacts and regional cooperation**

Transboundary diseases are one of the main challenges for the world meat trade and for the stability of the agricultural exports of the Latin American and Caribbean region, where many worldwide poultry and beef exporters are based. Bird flu, foot-and-mouth disease and "mad cow" disease have strongly influenced the direction of trade flows for meat products in recent years by prompting the diversion of such flows to uninfected countries.

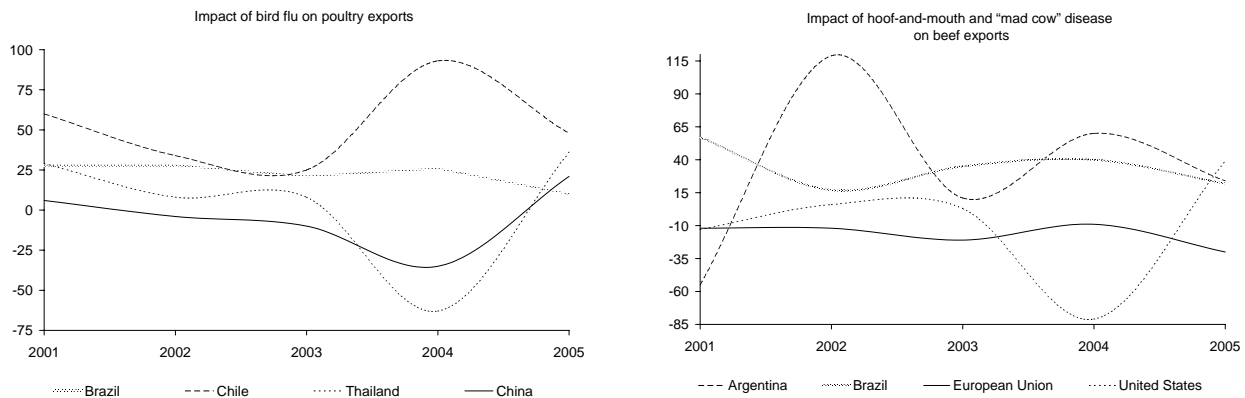
Bird flu is unequalled in its ability to spread, its human dimension and the scale of its possible social and economic impact, which could include the loss of many human lives, as well as of days worked and labour productivity, and enormous medical costs. The present outbreak began in East and South-East Asia, has spread to a number of other continents and could reach the Americas, which has so far been free of the highly pathogenic H5N1 strain. In Asia alone—the region that has been hardest-hit by this disease—the

poultry-raising sector's economic losses are estimated at around US\$ 10 billion.<sup>5</sup> As a consequence of this disease, Asian exports of chicken products were down sharply in 2004. The greatest losses in that year were sustained in Thailand and China, where the volume of poultry exports plunged by 63% and 35%, respectively.

As the outbreaks in Asia were mounting, the main Asian exporters' poultry sales gradually declined while the poultry exports of South America, which has still not been infected by the H5N1 virus, have soared. In 2004, South America's exports jumped 28% by volume, with particularly steep increases being registered by Chile (93%) and Brazil (26%) (see figure 4). Japan, which is

one of the world's largest consumers of poultry, imported as much as 70% of the poultry exports of China and Thailand in 2001, but this figure slipped to 49% in 2004, which represents a drop from 609,000 to 360,000 metric tons.<sup>6</sup> During that same time period, Brazil's share in the Japanese import market swelled from 15% to 44% (from 131,000 to 328,000 metric tons) and its exports to Saudi Arabia climbed from 257,000 to 334,000 metric tons, while China's shrank from 40,000 to 5,000 tons. The disease-control measures put in place by the Chinese and Thai Governments helped these countries regain part of this lost ground in 2005, however, when they posted growth rates of 21% and 36%, respectively (see figure 4).

Figure 4  
REPERCUSSIONS OF BIRD FLU AND FOOT-AND-MOUTH DISEASE ON THE REGION'S MEAT EXPORTS, 2001-2005  
(Growth rates for export volumes, in percentages)



Source: Food and Agriculture Organization of the United Nations (FAO), *Meat Market Assessment and Statistics*, June 2006.

Note: Up to 2003, the calculations refer to the 15 countries that belonged to the European Union at that time; the estimates for 2004 and the projected figures shown for 2005 correspond to the present European Union membership of 25 countries.

Uncertainty about the spread of the disease sparks widespread fear that rattles all the world's markets, not just those where the disease is present, both because worldwide consumption of poultry products decreases and because of the effects of the resulting increase in sanitary and health restrictions. In Europe, for example, poultry consumption has plunged by between 70% in Italy and 20% in France. This situation is exacerbated by the widespread tightening of sanitary and health restrictions in general, which makes it harder to penetrate consumer markets and thus dampens the growth of the region's main poultry exporters' sales. The growth rate for Brazil's export volumes, for example, tumbled from 26% in 2004 to just 10% in 2005 (see figure 4).

The cases of "mad cow" disease found in the United States, Canada and various European countries have also had the effect of diverting world beef imports. This disease has caused United States and European exports to plummet, with the United States registering the steepest drop following the case discovered in December 2003 in the State of Washington, which triggered an 82% slide in the volume of exports in 2004 (see figure 4). Latin American countries have seen their share in the international beef market increase as a result, but the presence of another transborder disease in South America (foot-and-mouth disease) has prevented them from taking greater advantage of the void left by North America.

<sup>5</sup> Values and figures registered as of April 2006.

<sup>6</sup> This is primarily attributable to the reduction in imports from China from 367,000 metric tons in 2001 to 288,000 in 2003 and to 199,000 in 2004 (FAO, *Meat Market Assessment and Statistics*, June 2006).

Foot-and-mouth disease poses the biggest threat to the stability of the region's meat trade and is regarded as one of the main health problems for the stock-raising sector in South America. It has been an influential factor in a reshuffling of market shares in the region that threatens to undermine Brazil's position as the world's largest exporter now that the country faces the imposition of trade embargoes in a number of import markets in response to the outbreaks that occurred in the states of Paraná and Mato Grosso do Sul in 2005. The region's second-largest beef exporter, Argentina, has also been hard hit. When outbreaks of this disease occurred in Argentine territory in 2001, its export volume plunged by 55%. The Argentine Government then implemented a strict disease-control programme and won official recognition of the improved health status of some of the country's regions. This set the stage for an export recovery in 2002. This trend was cut short, however, by another outbreak in 2003. Exports are expected to decline once again in 2006 in the wake of the outbreak of foot-and-mouth disease in February in Corrientes Province.

The presence of transboundary diseases has interrupted export growth for meat and related products and has redirected these products' trade flows in recent years. In the long run, world markets are likely to import the bulk of such products from countries that remain free of these diseases and succeed in meeting consumer markets' increasingly stringent health and sanitation standards. In order to maintain its access to major markets, the industry will have to restructure and adopt biosafety measures that are up to increasingly rigorous international standards. Unless public programmes are put in place that support efforts to increase competitiveness, small and medium-sized producers will be at a serious disadvantage, since

they will be unable to afford to make the necessary changes to meet the world market's new requirements.

Success in normalizing exports and in expanding and recovering major international markets will depend on efficient, effective collaboration between the public and private sectors of the sort seen in East and South-East Asia and Argentina in 2002. A number of regional initiatives to control and prevent bird flu and foot-and-mouth disease are beginning to be implemented, but their effectiveness hinges on intersectoral cooperation (especially between the health and agricultural sectors) and on coordinated action by the countries concerned. Steps should also be taken to ensure that trading partners apply the regionalization principle, which has safeguarded Latin American meat export flows despite some countries' reticence to implement such schemes.

Under such circumstances, preventive measures are a matter of urgency, since the difficulty of recovering from international trade bans and of regaining consumer markets' confidence makes the re-establishment of lost commercial ties a very slow process. The region needs to act swiftly to firm up coordinated disease-control plans and programmes based on sound scientific evidence and international organizations' expertise. If the region is to deal with these threats, it will have to place priority on pooling the efforts of the agricultural, animal health, health care and financial sectors and on taking advantage of the technical and financial assistance proffered by international agencies and developed countries. Regional cooperation can be especially effective in strengthening surveillance, prevention and disease-control measures, as well as in developing a harmonized system of health and sanitation standards and regulations that will ensure a balanced form of protection for the region that is compatible with the circumstances in each country.

## Chapter I

# World economic trends and their impact on the Latin American and Caribbean region's position in the international economy

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### Introduction

Despite the high prices of petroleum and other non-renewable resources, international trade and the world economy continued to expand apace in 2005 and the first half of 2006. Midway through the year, however, the increasing severity of various risk factors began to generate greater volatility in financial and commodity markets, and economic growth is therefore expected to slow in the second half of 2006 and in 2007. Even so, world economic growth measured in terms of purchasing power parity (PPP) is set to exceed 4% in 2006 for the fourth year in a row, making this the longest uninterrupted growth spurt since the 1970s. Moreover, all the world regions are experiencing growth, including Japan and the European Union, for the first time in many years. Latin American and Caribbean trade is still benefiting from persistently strong international demand, especially from China and the United States, and from highly favourable terms of trade. In addition, the region has been enjoying ready access to international financial markets at low interest rates. Thus, as in 2005, Latin America and the Caribbean should post a growth rate of around 5% this year. This is a positive result when viewed from the standpoint of the region's medium-term and potential growth trends, but is less heartening when compared with the considerably higher rates being recorded in emerging economies in Africa, Asia and Eastern Europe.

Although external disequilibria in the major economies pose a threat to continued world economic growth, a number of trends are mitigating this risk. It is particularly significant that the engine of economic growth has shifted from the United States to Japan and the European Union, which will help to lessen external imbalances. Economic growth in the United States slowed from 5.6% in the first quarter of 2006 to 2.5% in the second, with consumption exhibiting a particularly sharp decrease, as a result of the Federal Reserve's steady increase of interest rates up to July 2006. Some analysts fear that the United States may slip into a recession, but this seems unlikely given the strength of other components of demand. Meanwhile, the European Union's growth rate rose from 1.7% in the last quarter of 2005 to 2.4% in the second quarter of 2006. Japan's economic recovery has also remained on track, since its pace of expansion is expected to pick up in the second half of 2006 after slack growth in the second quarter. Another positive trend is the United States dollar's depreciation against the euro, since this also helps to ease imbalances among the world's large economies.

Nevertheless, persistently high oil prices and the inflexible yuan-to-dollar exchange rate continue to fuel external imbalances. In fact, two thirds of the increase in the United States' current account deficit in 2005 was attributable to rising petroleum prices. The Chinese monetary authorities' reluctance to allow the yuan to appreciate more against the dollar is another contributing factor. The dollar has depreciated considerably against the euro, however, thereby generating fresh surpluses with the European Union, which may account in part for the new high recorded by China's total trade surplus in July 2006.

The slowdown in the United States economy should affect Latin American and Caribbean commodity export volumes and prices less than other downswings have done during the past decade. In the last few years, the region's terms of trade and international commodity prices have been less vulnerable to fluctuations in the United States economy's growth rate<sup>1</sup> thanks to China's emergence as the world's largest importer of natural resources. The weakening of United States demand will thus be offset by China and, to a lesser extent, by Japan and Europe, thereby softening its impact on the volumes and prices of the Latin American and Caribbean region's commodity exports.

World growth and the region's access to international financial markets could also be hurt if interest rates are raised further in an effort to contain inflation (and inflation expectations) in the face of persistently high oil prices. Petroleum prices are pushing up core inflation in developed countries, and their central banks (including those of the United States and the euro area) are therefore stepping up their interest rate hikes. This appears to herald the end of the period of low real interest rates that has lasted for most of this decade. It is also prompting a flight to quality in capital flows, which is detrimental to emerging markets. Although Latin America is now much less vulnerable to financial volatility than it was a few years ago, a number of countries are still carrying large amounts of dollar-indexed public debt and could therefore be negatively affected by this situation. The region may also feel the dampening effects of higher interest rates on world economic activity, which would undoubtedly act as a brake on demand, commodity prices and exports.

To sum up, then, interest rates are rising in the United States, economic activity is slowing, the dollar is depreciating against the euro, and the current account deficit is narrowing. Japan and the European Union are partly making up for slower growth in the United States economy, but trends in China are moving in the other direction, as economic growth in 2006 has been even higher than it was in 2005 and has been paired with a mounting trade surplus and a depreciation of the yuan against the euro. The most likely outcome is not a recession, however, but rather a soft landing for the world economy and a gradual correction of its current disequilibria.

This chapter looks first at recent trends in the major economies and their international trade activity, capital flows, foreign direct investment (FDI) and the Latin American and Caribbean region's trade performance. It then goes on to examine the various external disequilibria and the forces shaping them, such as the economic performance of the United States, Japan and the European Union, oil prices, interest rates and exchange rates. The chapter concludes with regional trade projections for 2006 and an overview of the main factors that could influence the currently positive economic environment.

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<sup>1</sup> The correlation between the United States industrial production index and commodity prices, not including energy products, declined from 0.52 in 1986-1995 to 0.11 in 1996-2005 (J.P. Morgan, 2006).

## A. World economic conditions in 2005 and 2006

In 2005 and 2006, the world economy has continued to outstrip expectations. The major emerging economies (China, India and the Russian Federation) have been the most dynamic, with higher-than-expected growth being led by investment and exports. In fact, when calculated on the basis of purchasing power parity (PPP), China's and India's combined growth accounted for over one third of the increase in world GDP in 2005, thereby

overshadowing the combined contribution of the United States, the European Union and Japan (see table I.1). This means that China and India are definitely playing a role in keeping the world growth rate above the 4%-mark since 2003. When GDP is measured in terms of current dollars, however, the European Union and the United States are still the largest components of the world economy (see table I.1 and IMF, 2006).

Table I.1  
**CONTRIBUTION TO WORLD GDP GROWTH, BY COUNTRY AND REGION**  
(Percentages of the world total)

	Contribution to growth <sup>a</sup>							Share of world GDP, 2005	
	2001	2002	2003	2004	2005	2006 <sup>b</sup>	2007 <sup>b</sup>	Current dollars	Purchasing power parity
United States	13.4	14.5	16.0	17.7	17.2	15.9	16.7	28.1	20.1
European Union	19.9	13.8	11.8	13.6	12.0	12.5	13.1	30.3	20.3
Japan	3.7	2.1	3.7	4.4	4.1	3.8	3.2	10.3	6.4
Latin America and the Caribbean	7.0	4.5	2.5	5.0	7.8	7.0	6.5	5.5	7.4
Developing Asian countries	39.9	44.7	43.6	37.2	41.7	42.3	42.5	8.9	27.1
China	27.1	30.0	27.7	23.7	27.2	28.1	27.8	5.0	15.4
India	6.9	7.4	8.9	7.3	8.2	7.7	7.9	1.7	5.9
<b>Annual GDP growth<sup>c</sup></b>	<b>1.6</b>	<b>1.9</b>	<b>2.8</b>	<b>4.1</b>	<b>3.6</b>	<b>3.6</b>	...	...	...
<b>Annual GDP growth (PPP)<sup>d</sup></b>	<b>2.6</b>	<b>3.1</b>	<b>4.1</b>	<b>5.3</b>	<b>4.8</b>	<b>5.1</b>	<b>4.9</b>	...	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF) and the United Nations Department of Economic and Social Affairs.

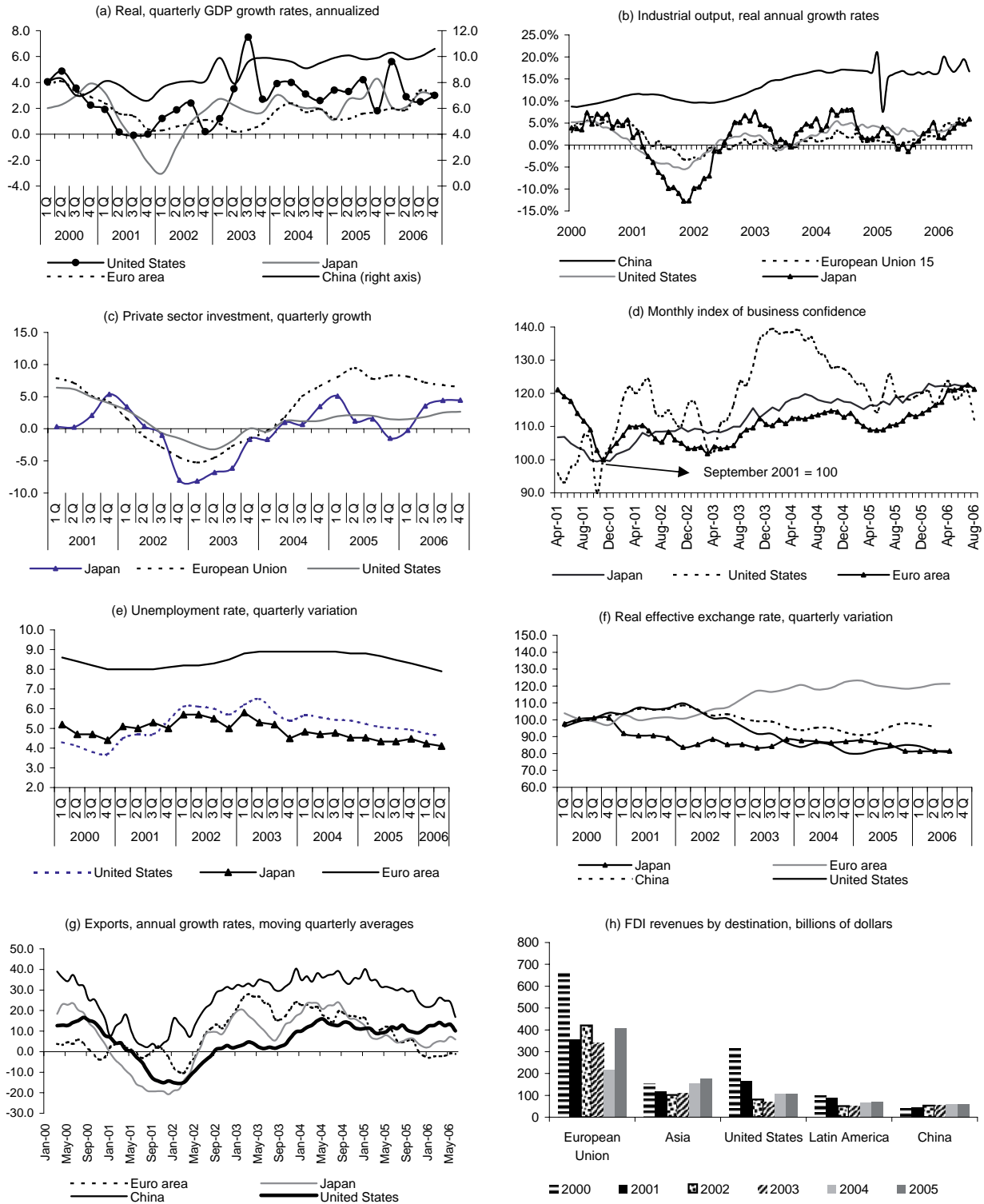
<sup>a</sup> Contributions were calculated on the basis of GDP expressed in terms of purchasing power parity. <sup>b</sup> On the basis of projections by the International Monetary Fund (IMF).  
<sup>c</sup> In constant 2000 dollars. <sup>d</sup> In purchasing power parity (PPP) dollars.

In 2005 the developed economies (with the exception of Japan) grew more slowly than in 2004. The rate for the United States declined to 3.9% in 2004, although this was still the highest in the developed world, and its current account deficit swelled to almost US\$ 800 billion. The European Union witnessed a sharp slowdown to 1.5% owing to weak domestic demand, especially in its larger member countries, such as Germany, Italy and the United Kingdom. Japan's economic growth rate was surprisingly strong, at 5% in the first half of 2005, though slightly lower in the second. Japan also turned in an impressive export performance thanks to China's dynamism and stronger domestic demand against a backdrop of job creation and a net increase in credit.

International trade slowed less than had been expected at the start of 2005, partly because commodity prices (except for agricultural goods) remained high. Exporters of energy products and metals, including those of Latin America and the Caribbean, benefited the most from this situation.

The world economic outlook for 2006 is also quite positive, and analysts project a growth rate similar to that of 2005 (see figure I.1), despite a number of risk factors appearing on the horizon. For now, the large countries' industrial output and investment continue to expand rapidly. Unemployment is still declining, and trade and financial flows remain buoyant. In addition, the engine of growth has shifted from the United States to the European Union and Japan, with the United States economy slowing in the second quarter after a very dynamic first quarter. Meanwhile, the Japanese economy is gaining momentum, with an annualized growth rate of 3.1% in the first quarter and, despite a slack second-quarter performance, is expected to expand more swiftly in the second half of 2006. The euro area's economy is also showing signs of more robust activity, with an expansion of 2.4% in the second quarter, and emerging economies continue to grow briskly.

Figure I.1  
**WORLD ECONOMIC INDICATORS**  
*(Percentages and billions of dollars)*



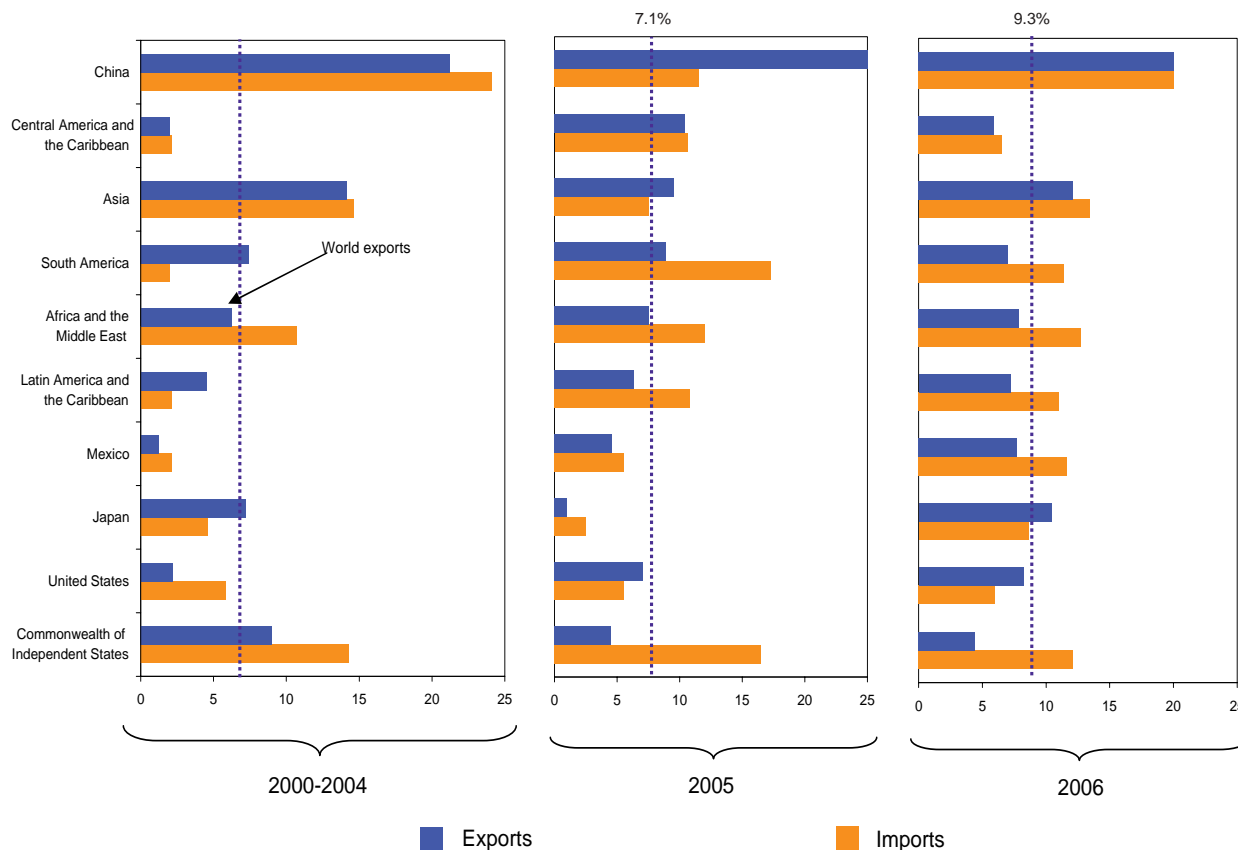
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund, United Nations Conference on Trade and Development (UNCTAD), Statistical Office of the European Communities (EUROSTAT), Cabinet Office of the Government of Japan, Bureau of Economic Analysis of the United States and official figures from the countries.



In line with economic growth, world trade volumes surpassed expectations in 2005. For example, IMF raised its 2005 growth estimate from 7.0% in September 2005 to 7.3% in September 2006 and revised its 2006 projection upward, from 7.4% to 8.8%. These rates are lower than the 10.3% recorded in 2004, however. The slowdown seen in 2004 and 2005 was even steeper in current values (from 21% to 13%) because prices rose less in 2005 than in 2004. Trade in services also expanded more slowly in current values, sliding from 19% in 2004 to 11% in 2005, and has performed quite evenly across its subcategories (transport, tourism and other business services).

In real terms, Latin America and the Caribbean recorded the second-largest increase in exports, after China, in 2005. South America posted a sharper upswing in exports than Mexico and Central America did because it specializes more heavily in commodities, which were more buoyant than other products (see figure I.2). The region also ranked second in terms of real import growth. In nominal terms, however, the region registered an even sharper increase in imports, while the faster expansion of exports was attributable to trends in trade flows of petroleum and petroleum products (WTO, 2006).

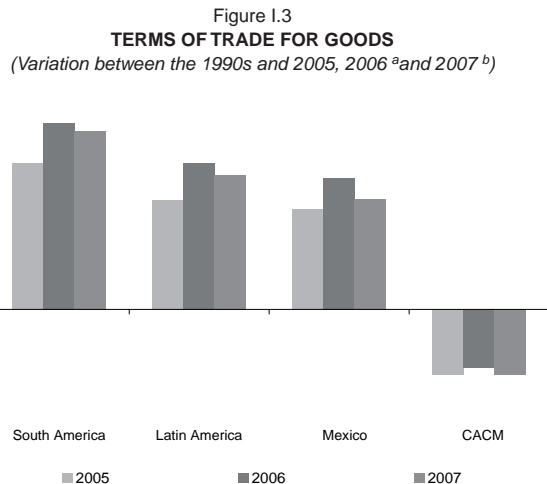
Figure I.2  
**REAL GROWTH IN LATIN AMERICAN MERCHANDISE IMPORTS AND EXPORTS  
 IN THE GLOBAL CONTEXT, 2000-2004, 2005 AND 2006**  
 (Annual growth rates)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the countries and World Trade Organization (WTO), *World Trade 2005, Prospects for 2006*, April 2006; International Monetary Fund (IMF), *World Economic Outlook, Globalization and Inflation*, April 2006; Asian Development Bank (ADB), *Asian Development Outlook, 2006*, March 2006. For the subregions of Latin America and the Caribbean, Economic Commission for Latin America and the Caribbean (ECLAC), "Latin America and the Caribbean. Projections 2006-2007", *Estudios estadísticos y prospectivos series*, No. 42 (LC/L.2528-P), Santiago, Chile, April 2006.

High commodity prices continue to contribute to the region's satisfactory performance. The terms of trade (including the prices of petroleum products) have improved significantly in the last few years for both South America and Mexico, although less markedly in the latter case (see figure I.3). The Central American countries have witnessed a steep downturn in their terms of trade, however, mainly because of the rising prices of energy imports.

Financial flows to emerging economies were up by almost 10% in 2005. As part of this pattern, FDI flows rose for the second consecutive year in 2005, with an increase of 29%, or almost US\$ 900 billion, over the 2004 figure. The FDI growth rate in developing countries overall was on a par with the rate for developed countries, but flows to Latin America and the Caribbean climbed more slowly (11%), and the region thus continues to lose ground to more dynamic FDI destinations, such as China, other Asian countries and Africa (ECLAC, 2006a).



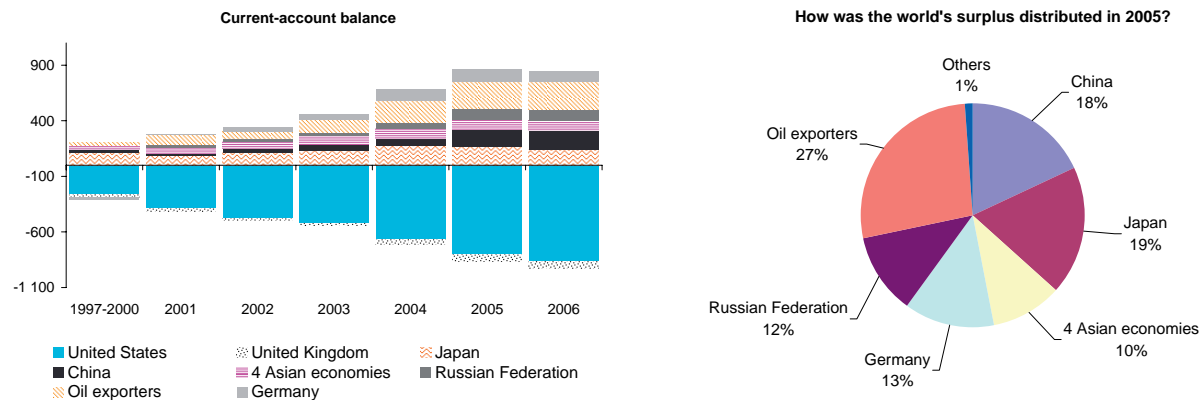
Source: Economic Commission for Latin America and the Caribbean (ECLAC).  
<sup>a</sup> Preliminary figures.  
<sup>b</sup> Projections.

## B. External disequilibria: trends and prospects

Trade imbalances continued to worsen in early 2006. The United States' current account continued to show a deficit in 2005, with the negative balance standing at US\$ 792 billion at the year's end. This represented almost 6.4% of GDP and a year-on-year increase of US\$ 126 million (5.7% of GDP). The deficit widened slightly to 6.6% of GDP in the first and second quarters of 2006 and is expected to reach 7% of GDP by the

end of the year. Two thirds of the 2005 increase is attributable to increased imports (40%) and rising petroleum prices, while the remainder is due to the country's deepening trade deficit (25%) with China. The United States deficit is offset by the mounting surplus of the emerging Asian economies, petroleum-exporting countries and the nations of Latin America and the Caribbean (see figure I.4).

Figure I.4  
**CURRENT ACCOUNT IMBALANCES IN SELECTED ECONOMIES, 1997-2006**  
*(Billions of dollars and percentages)*



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

## 1. Performance of the United States economy and savings trends

The pace of growth of the United States economy has gradually slowed in 2005 and 2006 relative to its 2004 level, with an especially sharp downswing being registered in late 2005 in the aftermath of Hurricane Katrina. The economy rebounded strongly in the first quarter of 2006, but slowed again in the second. Growth is expected to continue to decelerate throughout the rest of the year. One of the main reasons for this trend is the more sluggish expansion of private consumption in response to higher gasoline prices and the apparent end of the real estate boom, which may erode consumer confidence in the short term. Export and import volumes are both rising more sedately, but in value terms imports are continuing to outpace exports, partly because of the high cost of oil imports, all of which has steepened the deterioration in the trade balance.

The greatest risk factor for the United States economy's growth is an increase in inflation and in inflationary expectations, which are being spurred by rising fuel prices, the strong demand for labour and the upward pressure on import costs exerted by a depreciating dollar. In view of this situation, the Federal Reserve has continued to increase interest rates up to mid-2006.

The Latin American and Caribbean region has reaped the benefits of rapid growth in the United States, which is its main export market. In fact, the United States absorbs half of Latin America's exports and accounted for 40% of the increase in the region's external sales in 2005, although

this share varies sharply across countries, standing at over two thirds in the case of Mexico and Central America, one half in the case of the Andean Community and only a small fraction for the MERCOSUR countries (see table I.2).

Table I.2  
TRADE RELIANCE ON THE UNITED STATES, 2005  
(Millions of dollars and percentages)

	Exports to the United States	Percentage of exports going to United States	Trade balance with United States	Trade balance with the world
Mexico	183 351	85.8	65 089	-7 559
Honduras	3 309	75.6	154	-106
Nicaragua	991	63.0	401	-619
El Salvador	2 051	60.6	272	-3 332
Guatemala	2 694	50.1	29	-3 431
Ecuador	4 950	46.5	4 107	420
Costa Rica	3 177	44.8	- 119	-2 717
Panama	973	14.8	-1 009	-2 000
Dominican Republic	4 325	77.9	- 26	-1 544
CARICOM	9 167	52.2	2 330	1 052
Cuba	0	0.0	- 361	-2 970
Venezuela (Bolivarian Republic of)	32 587	58.8	25 987	29 674
Colombia	8 849	41.8	2 843	1 988
Peru	5 173	30.4	3 052	4 917
Uruguay	761	22.4	489	-474
Brazil	22 472	19.0	8 918	44 758
Chile	6 248	15.8	1 821	9 142
Bolivia	383	14.0	59	1 007
Argentina	4 321	10.8	1 357	11 320
Paraguay	54	3.2	- 774	-1 564

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

## 2. Japan's recovery

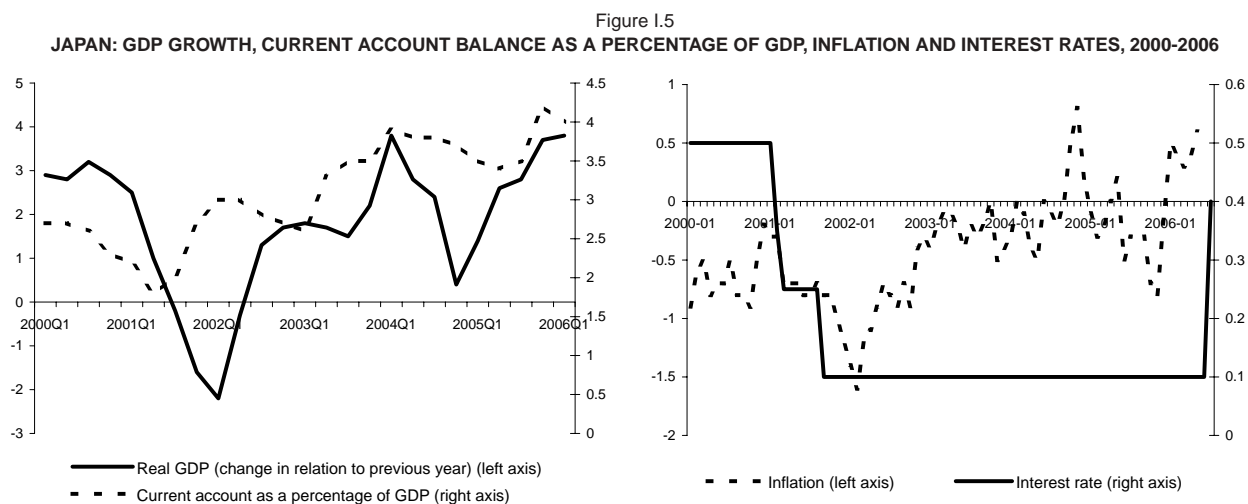
The Japanese economy is showing signs of recovery. In fact, in 2005 it posted a growth rate of 2.6%, after four sluggish years (2001-2004) owing to slack private consumption and investment. In the first quarter of 2006 Japan's economy continued to expand robustly and, although its second-quarter performance was somewhat disappointing, stronger growth is expected in the second half of the year. Unemployment is declining and wages have risen. Industrial output and exports continue to climb,

and increased profits have enabled firms to absorb their higher energy costs.

The first few months of 2006 marked the end of eight years of deflation and of the central bank's expansionary policy. Prices had continued to decline in 2005, and the 1.7% year-on-year drop in the GDP deflator was the steepest since early 2003. Early in 2006, however, prices began to climb, partially in response to sharply rising energy prices. With the end of deflation, Japan's central bank dismantled the

expansionary monetary policy it had been implementing for the last five years (see figure I.5). The bank raised its benchmark interest rate in July 2006, and long-term rates are also on the rise.<sup>2</sup> The country will now be called upon to undertake a large-scale fiscal restructuring effort, given

its huge public debt (160% of GDP) and fiscal deficit, which will reach 5.5% of GDP in 2007. The government will thus have to cut spending and raise taxes and employer contributions, which could dampen private consumption and corporate profits over the medium term.



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of the Cabinet Office of the Government of Japan [online] <http://www.esri.cao.go.jp/jp/sna/qe054-2/kiyo-jcy0542.csv>.

With domestic demand growing briskly, Japan's imports are expected to rise and, although exports are continuing to expand, its trade and current account surpluses are narrowing, which means that Japan is helping to reduce the disequilibria affecting the world economy. Japan is running a hefty surplus with the rest of Asia, Europe and the United States, but has a large and growing deficit with the Middle East. It is also posting a surplus with Latin America and the Caribbean.

From Japan's standpoint, the Latin American and Caribbean region is a relatively small market, and its importance as a trading partner is waning. In fact, in 2005 the region accounted for only 4% of Japan's exports and 3% of its imports. Meanwhile, Japan absorbed less than 2% of the Latin American and Caribbean countries' exports in 2005, except in the cases of Chile (12%), Bolivia (5%), Peru (4%) and Brazil (3%). China, on the other hand, accounts for a much larger percentage. Trade between Mexico and Japan expanded considerably in 2005, thanks to the Agreement between Japan and the United Mexican States for the Strengthening of the Economic Partnership, which came into effect in April 2005. Among Mexico's exports to Japan, the main items

are fuels, which represent three quarters of the increase recorded in 2005 and the first two months of 2006, iron ore and non-ferrous metals.

Japan is a relatively significant source of FDI for Latin America and the Caribbean, however, since it contributed US\$ 6.4 billion of a total of US\$ 45 billion in FDI inflows in 2005. Apart from FDI in tax havens such as the Cayman Islands, Japan invested quite heavily in Brazil (mainly in transport equipment, food and some services sectors) and Mexico (transport equipment and textiles). The upswing seen in Japanese FDI in Mexico since the two countries signed a free trade agreement (FTA) shows that FTAs may be a way of encouraging Japan to invest in the region. Japan is currently negotiating an FTA with Chile.

In view of the Asian economies' dynamic performance, which is led by China but has clear implications for the countries of the Association of Southeast Asian Nations (ASEAN), Latin America and the Caribbean will have to compete with Asian economies to attract Japanese FDI. Under its preferential agreement with ASEAN, since July 2005 China has begun to cut tariffs on many goods from ASEAN member countries, and in December 2005 the Republic of Korea signed a

<sup>2</sup> The interest rate on the Japanese Government's 10-year bonds (the market's main benchmark) rose to almost 2.0% in mid-2006, up from the 1.3% level recorded just two months earlier. This was the highest point it had reached since September 2000.

framework agreement with this association. After an eight-month interruption, Japan resumed negotiations on an FTA with the most developed ASEAN economies, with the idea being that the scope of the agreement might be extended to the entire bloc at a later stage.

Japan already has a strategic partnership agreement with Singapore, has an accord with Malaysia that is awaiting ratification, and is looking at other schemes with Thailand and the Philippines, with which it has already worked out the basic principles.

## Box I.1

**ECONOMIC PARTNERSHIP AGREEMENT BETWEEN JAPAN AND THE UNITED MEXICAN STATES**

This is the first broad-ranging agreement that Japan has signed. It has 18 chapters, which contain rules and disciplines on: (i) market access; (ii) sanitary and phytosanitary measures; (iii) rules, technical regulations and compliance assessment procedures; (iv) rules of origin; (v) investment; (vi) services (transboundary trade and financial services); (vii) government procurement; (viii) competition; (ix) safeguards, and (x) entry for nationals and temporary leave to remain for business purposes. In addition, as a partnership agreement, it contains provisions on improving the business climate (chapter 13) and bilateral cooperation (chapter 14), aimed at strengthening economic relations between the two countries. Under the agreement, Japan will eliminate duty on 95% of tariff items applicable to Mexico, 91% immediately and 4% in the medium term. Conversely,

Mexico will eliminate tariffs on only 44% of tariff lines immediately.

Between April and December 2005, bilateral trade was up by 21.9% year on year (surpassing the previous decade's average growth rate of 7.9%). Japan's imports from Mexico rose by 19.2% to US\$ 1.9 billion, while Mexican imports of Japanese goods jumped 22.3%, to reach US\$ 10.4 billion. In 2005 Japan's direct investments in Mexico amounted to US\$ 629 million, triple the 2004 figure.

In Japan, the automobile sector has benefited the most as regards exports to Mexico, with a surge of 42.0% to US\$ 996 million in total. In Mexico, agriculture has gained the most from the free trade agreement. Exports of orange juice to Japan were up by 46.3%, to US\$ 2.5 billion, and exports of bananas by 7.3%, to US\$ 2.82 billion. Mexico's beef exports

to Japan tripled to US\$ 38 million as a result of Japan's ban on beef imports from the United States, which made Mexico an alternative source of supply for Japanese butchers. Japan is the world's largest importer of beef, importing almost US\$ 50 billion per year.

Thanks to the legal certainty consolidated under the agreement, Japanese firms are showing mounting interest in investing in Mexico and more confidence in its economy. In January and February 2006, a number of Japanese firms announced 10 investment projects worth a combined US\$ 924.5 million, including three in the automobile and autoparts sector: Toyota and JATCO are to extend their plants in Baja California and Aguascalientes, respectively, and Suzuki Motor has invested in new sales points for its vehicles.

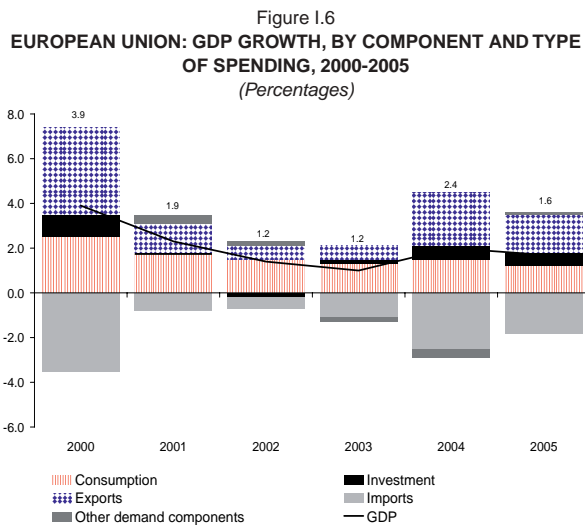
**Source:** Organization of American States (OAS), "Agreement between Japan and the United Mexican States for the Strengthening of the Economic Partnership" [online] Foreign Trade Information System (SICE) <[http://www.sice.oas.org/Trade/JPN\\_MEXDraftEPA\\_s/JPN\\_MEXind\\_s.asp](http://www.sice.oas.org/Trade/JPN_MEXDraftEPA_s/JPN_MEXind_s.asp)>; Japan External Trade Organization (JETRO) "Report examines effects of Japan-Mexico EPA one year after its entry into force", press release, April 2006; *El Economista*, "Se dispara intercambio comercial México-Japón" [online] <<http://www.economista.com.mx/articulos/2006-04-07-10623>> and *La Crónica*, "Explotan TLC México-Japón" [online] <http://www.cronica.com.mx/nota.php?idc=231361>.

### 3. Renewed strength in Europe

In 2006 the European Union (25 members) showed a stronger performance, after having posted a growth rate of only 1.5% in 2005. Although the economy's expansion slowed in the last quarter of 2005, better first- and second-quarter results in 2006 confirm the existence of an upturn. Growth is being driven by domestic demand, particularly private investment, which is, in turn, being spurred by optimistic expectations regarding future trends in consumption, still-low interest rates and limited idle capacity. Private consumption is also up, thanks to more robust job creation. With external conditions remaining favourable, exports are climbing rapidly. Imports, too, are on the rise owing to the strength of domestic demand (see figure I.6).

Monetary and fiscal policy is sustaining this economic reactivation in 2006. The European Central

Bank raised the interest rate by 25 points in December 2005 and in March, June and August 2006 in response to the upswing in inflation caused by high oil prices and the brighter economic outlook. The euro area's budget deficit remained at 2.3% of GDP in 2005 and is unlikely to narrow in 2006. In 2005, a number of countries strove to observe the rules of the Stability and Growth Pact, but budget deficits worsened in some others, including Italy and Portugal. Several countries have announced that they are embarking on a fiscal consolidation effort—including Germany, which intends to reduce its deficit to 3% by 2007, and France, which is to cut public spending by 1% in 2006—but these measures will probably be insufficient to ensure compliance with the terms of the Pact.



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of the Statistical Office of the European Communities (EUROSTAT), *Economic Forecast Spring 2006*.

A major challenge facing a number of European Union countries is to find a way of maintaining their growth potential and sustaining job creation in the medium term. The most difficult task in this respect is to build a public consensus around reforms in several key areas, including the labour market. One recent illustration of this point was the French Government's attempt to introduce more flexible contracts for young people, known as "first-job contracts". The move was intended to improve the situation of young people, among whom unemployment is extremely high in France. After several weeks of mass protests in March and April 2006,

the government had to withdraw the proposal. Another area that holds out great growth potential, but in which consensus-building for liberalization poses difficulties, is the European services market.

The euro area's trade surplus decreased from €72 billion in 2004 to €23 billion in 2005, while the European Union's deficit widened from €63 billion to €106 billion. This deterioration is largely attributable to the higher cost of importing petroleum and petroleum products. Europe's surplus with the United States increased, its deficit with China and the Russian Federation deepened, and its deficit with Japan stabilized.

In 2004 and 2005 the European Union succeeded in stabilizing its trade surplus with Mexico, Central America and the Caribbean (almost €9 billion) and its deficit with South America. Within South America, its balance with the Bolivarian Republic of Venezuela and Ecuador worsened, but improved with respect to the other countries of the subregion. Latin America maintained its relative position among Europe's extraregional trading partners, representing around 5.7% of exports and 6.0% of imports. Between 2000 and 2005, the European Union's share in Latin American exports rose by one percentage point to 12%. In 2005, it was the largest single destination for Brazilian and Chilean exports (29% and 25%, respectively), but represented a very small proportion of Mexican, Venezuelan and Central American exports (except for Panama). Negotiations between the European Union and the regional blocs had stalled for a time, but then gained fresh impetus at the fourth European Union and Latin American and Caribbean Summit, held in May 2006 in Vienna (see box I.2).

#### Box I.2

##### ADVANCES IN NEGOTIATIONS BETWEEN THE EUROPEAN UNION AND LATIN AMERICA AND THE CARIBBEAN

The fourth European Union and Latin American and Caribbean Summit, held in May 2006 in Vienna, saw a number of advances in trade negotiations between the two regions and in modalities of cooperation. Given the positive impacts of accords already in place between the European Union and Mexico and Chile, it is important to consolidate a strategy of trade liberalization and to heighten cooperation between the European Union and the regional blocs:

- **MERCOSUR:** the Summit paid much attention to completing negotiations for a partnership agreement encompassing political, economic, trade and cooperation ties between the European Union and MERCOSUR. The negotiators were instructed to step up their efforts to move the process forward, even though,

the task is admittedly not an easy one, and the outcome of these negotiations also depends on progress in the Doha Round.

- **Andean Community:** the Summit resolved to start working in 2006 towards the negotiation of a partnership agreement between the European Union and the Andean Community. To this end, the Andean Community and the European Union agreed to hold as many meetings as necessary prior to 20 July 2006 to clarify and define the bases of the negotiation.
- **Central America:** the Summit resolved to undertake negotiations on a partnership agreement, taking into account an evaluation exercise conducted by the two regions. The Central American countries undertook to ratify the Central American agreement on investment and trade

in services and to develop a regional mechanism to ensure the application of regional economic legislation. Panama is also to participate in these negotiations, after it formally joined the Central American economic integration process.

- **The Caribbean:** the European Union and the countries of the Caribbean Forum of African, Caribbean and Pacific States (CARIFORUM) are negotiating bilateral economic partnership agreements under the Cotonou Agreement signed by the European Union and the African, Caribbean and Pacific States. This framework agreement contains provisions on trade, assistance and political cooperation and it enshrines preferential relations between the countries of the group and the European Union on market access and technical cooperation, among other matters.

Source: European Union, official site [online] <http://europa.eu.int>; bilaterals.org, official site [online] <http://www.bilaterals.org>; *Puentes quincenal*, vol. 3, No. 9, 8 May 2006; Council of the European Union, "Declaration of Vienna", fourth European Union and Latin America and the Caribbean Summit, Vienna, 12 May 2006.

## 4. Petroleum

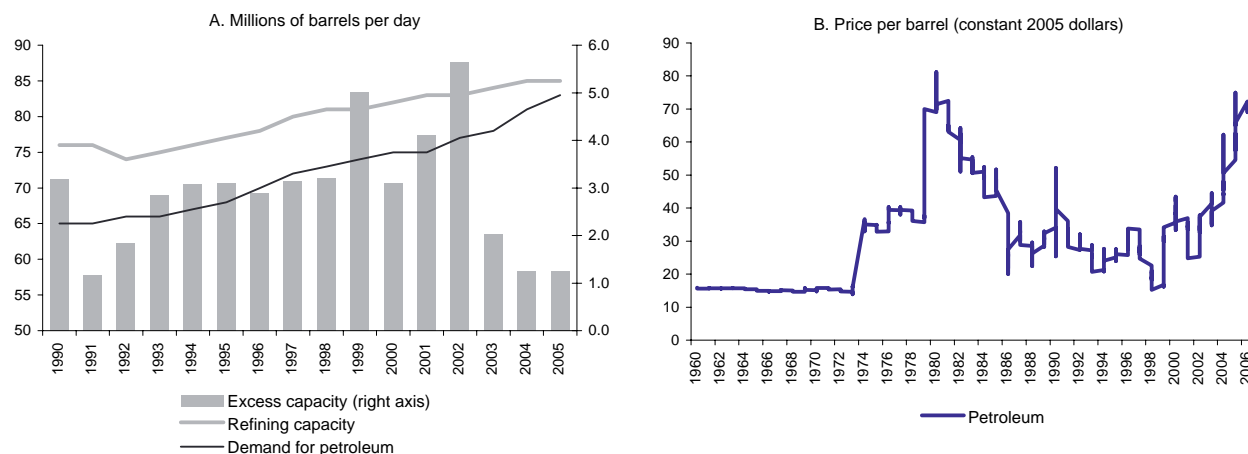
Steadily rising oil prices have added to trade imbalances around the world in the last few years and, in particular, have exacerbated the United States' current account deficit. In fact, two thirds of the increase in its deficit in 2005 was attributable to this factor. Oil-producing countries have seen their trade surpluses swell, thus contributing to expanded savings and liquidity.

Prices for petroleum and petroleum products continue to trend upward and to display considerable volatility. In 2005, prices shot up in the wake of Hurricane Katrina and the damage it caused in the

southern part of the United States in September, but later subsided to previous levels thanks to the release of strategic oil reserves and augmented supplies from OPEC countries. Prices have risen again since early 2006, however, driven mainly by mounting geopolitical uncertainty in the Middle East, Iraq and Nigeria (see figure I.7).

Oil consumption rose less sharply in 2005 (1% compared with 4% in 2004), partly because of the declining pace of economic growth. The sharpest slowdowns were in the United States and China.

Figure I.7  
**PETROLEUM: DEMAND, EXCESS CAPACITY AND PRICES,<sup>a</sup> 1990-2005 AND 1960-2006**



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from Organization of Petroleum Exporting Countries (OPEC); British Petroleum (BP) and the Bureau of Labor Statistics, Department of Labor of the United States.

<sup>a</sup> Petroleum prices have been deflated using the United States producer price index and are expressed in constant 2005 dollars (January-December 2005).

At the world level, petroleum output rose slightly in 2005, in keeping with the OPEC countries' decision to increase supply, while the production levels of non-OPEC countries were flat. Within the latter group, production declined in the United States and the Russian Federation but rose in African oil-producing countries. Developed

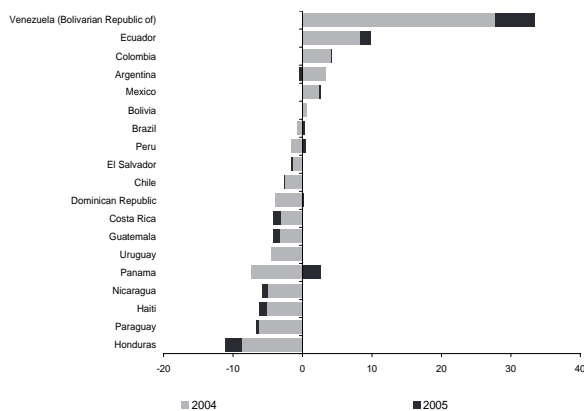
countries' oil reserves expanded in 2005, despite the high price levels. This is just the opposite of what has occurred on past occasions and reflects the precautions being taken by governments and consumers with a view to the future.

The International Energy Agency (IEA) expects demand to rise by at least 1.2 million barrels per day

in 2006 and, in view of existing geopolitical tensions, projects further price rises. Investment in expanding capacity was up in nominal terms in 2004 and 2005, but is probably not enough in real terms to keep pace with the rapid increase in demand. This means that excess capacity will continue to be quite limited for several more years, and prices are therefore likely to remain high for some time, as suggested by current trends on the relevant futures markets.

In 2004-2005 the rise in oil prices was reflected in two different trends in Latin America and the Caribbean: expanding surpluses in exporting countries and increasing deficits in net oil importers. The petroleum surplus in the Bolivarian Republic of Venezuela, for example, has jumped from less than 30% of GDP to almost 40%. In Ecuador and Colombia the increase has been comparatively smaller, while in a majority of the other countries in the region, oil-related deficits have widened (see figure I.8).

Figure I.8  
TRADE BALANCE FOR PETROLEUM AND PETROLEUM  
PRODUCTS, 2004 AND 2005  
(Percentages of GDP)



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

## 5. Interest rates

At present, interest rates are facilitating the financing of the United States' external deficit, since short-term spreads between the major economic blocs widened in the first half of 2006. Specifically, higher rates in the United States have made it easier to cover the current account deficit. These increasing spreads are the reflection of differing stages in the monetary policy cycle in the United States, on the one hand, and in Japan and the euro area, on the other. In the United States, the Federal Open Market Committee gradually raised the federal funds rate from 1% in June 2004 to 5.25% in June 2006 in order to ease mounting inflationary pressure and slow the economy's rapid growth. The latter objective was achieved, judging by the slowdown in the second quarter. The euro area's central banks are gradually abandoning their expansionary stance, as reflected in an increase of 25 basis points in December 2005, followed by similar hikes in March and June 2006. Lastly, Japan's central bank discontinued its policy of monetary flexibility in mid-July 2006, when it raised the interbank rate from 0% to 0.25%.

Yield curves, which represent the profile of interest rates on bonds at different maturities, are flat or slightly inverted<sup>3</sup> at the moment in the United States and, to a lesser degree, in Europe due to the fact that, unlike short-term rates, long-term rates are rising very little. In Japan, in response to the change in the direction of monetary policy and to the economy's recovery, the long-term rate rose to almost 2% in April 2006, from 1.5% in February, thus reaching its highest level since mid-2000.

Interest rate spreads in emerging economies are also at historical lows, which reflects the fact that these countries have achieved more solid economic fundamentals, thanks to their lower public debt levels and more abundant foreign exchange reserves. With developed-country interest rates on the rise, however, this period of abundant liquidity is coming to an end, and capital flows are veering towards less risky markets in a flight to quality assets. This has a negative impact on emerging markets, as is shown by the slight increase in Emerging Markets Bond Index (EMBI+) spreads in 2006.

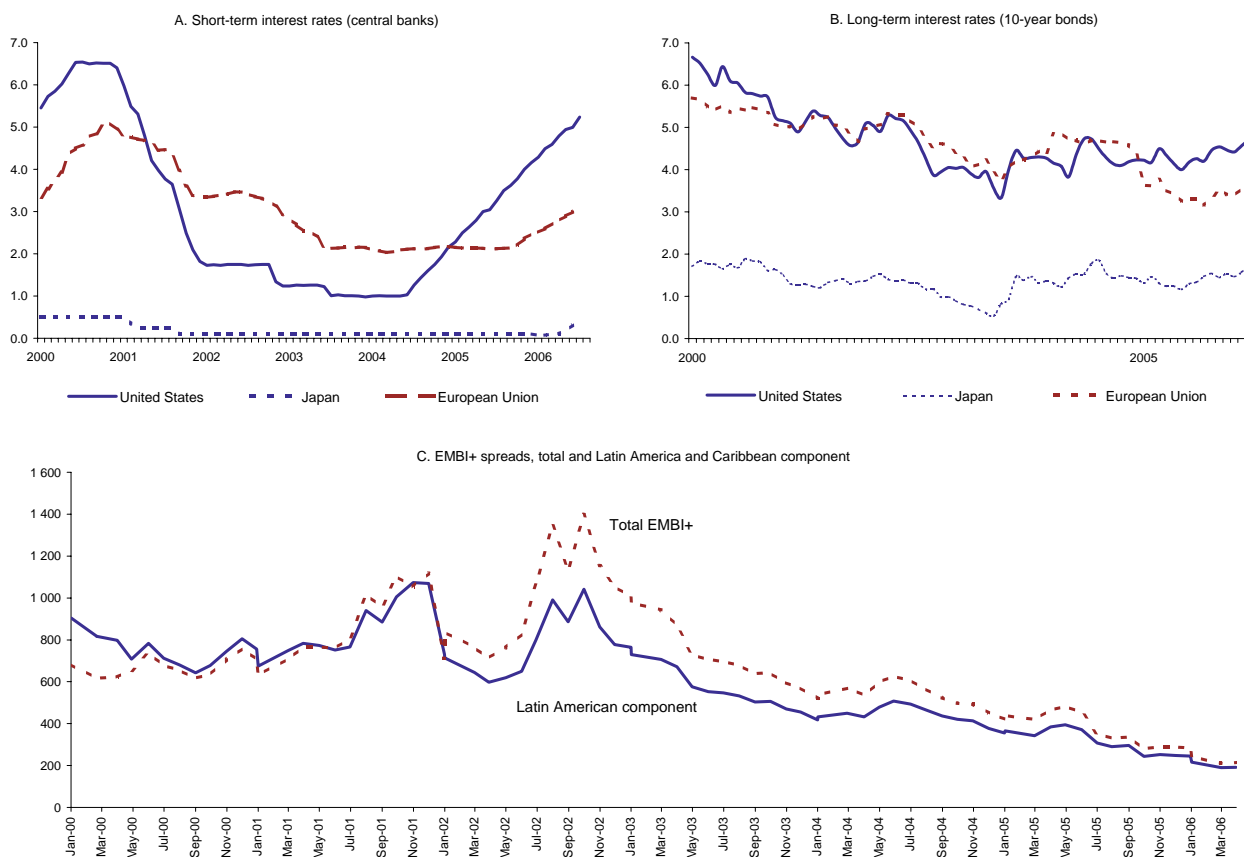
<sup>3</sup> This profile differs from the usual upward slope because, at longer maturities, investors demand a higher interest rate to cover the risk of inflation and other economic uncertainties. Variations in the shape of the curve are very important, as they may reflect changes in the growth rate, in central bank policy, or institutional and other types of changes.



The United States Federal Reserve has been hiking interest rates for a number of reasons. The main purpose is to check inflationary expectations, which have mounted recently owing to the rise in core inflation in the first half of 2006. (The desired target range for inflation is around 2%.) Second, higher rates are needed to keep foreigners interested in continuing to finance the country's deficit in a context of increased exchange-rate uncertainty. The willingness of

emerging economies and oil-producing countries to continue financing the United States' external deficit depends largely on the size of interest rate spreads across the various countries and their expectations with regard to the exchange rate. With a very low real yield of 2% at the most, and with the dollar expected to continue declining in the near future, yields on investments in the United States will drop even further and may in fact turn negative.

Figure I.9  
**INTEREST RATES IN MAJOR MARKETS AND RISK LEVELS IN FINANCIAL MARKETS AND IN LATIN AMERICA, 2000-2006**  
*(Percentages and basis points)*



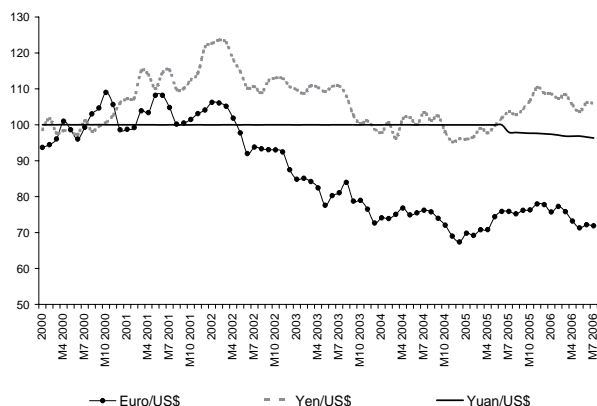
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the United States Federal Reserve, Bank of Japan, European Central Bank and J.P. Morgan, "Emerging Markets Index Bond Monitor".

## 6. Exchange rates

Exchange rates and expectations regarding their behaviour are another important variable in relation to international external disequilibria. A depreciation of the dollar, among other things, could lessen these imbalances. Just the opposite

pattern was seen in 2005, since the dollar appreciated as interest rate spreads between the major blocs widened. In the first half of 2006, however, the dollar depreciated against the euro (see figure I.10).

Figure I.10  
**NOMINAL EXCHANGE RATES, 2000-2006**  
*(January 2001=100)*



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

Trends in Asian currencies in 2005 did little to help correct external disequilibria. Despite the flexibilization of the yuan's exchange rate in July 2005, the Chinese currency continues to fluctuate very close to the dollar.

The yuan appreciated by 2.5% in 2005, after the Chinese authorities revalued the currency by 2.1% against the dollar and replaced their exchange-rate peg with a controlled crawling peg regime, with daily adjustments of up to 0.3% against the dollar and 1.5% (3% as of September) in relation to a currency basket. In practice, the authorities allowed the currency to rise only slightly; the rate of appreciation will probably increase as a more sophisticated foreign-exchange market develops, however. More financial agencies (including foreign ones) have now been authorized to participate in the interbank foreign exchange market and to engage in over-the-counter trading through 13 financial operators (IMF, 2006; Scotiabank, 2006). The yuan depreciated considerably against the euro in the first half of 2006, however, making Chinese export prices more competitive relative to the European Union's.

With the normalization of monetary policy almost concluded in the United States and starting in Japan, the yen is likely to appreciate against the dollar in 2006 and 2007.

## C. Outlook and risks <sup>4</sup>

External demand will continue to help drive growth in Latin America and the Caribbean thanks, among other factors, to a 6% improvement in the region's terms of trade in 2006, which will mainly benefit oil- and metal-exporting countries. The nations that stand to gain the most will be the Bolivarian Republic of Venezuela, Bolivia, Chile and Peru, which will see their terms of trade increase by 25%, 22%, 18% and 14%, respectively. As a result, exports and imports in current dollars will expand by 20% and 17% in 2006, respectively (see table I.3). Just over half of this rise will reflect higher export prices, while in the case of

imports, only one fifth of the increase will be attributable to prices and the remainder to volumes. Projections point to a continuation of the uptrend in the region's trade balance for goods, expressed in current dollars, which began in 2001. Costa Rica, the Dominican Republic and Mexico are the only countries to have posted merchandise trade deficits since 2001.

According to ECLAC projections, in 2006-2007 Latin America's exports will expand at a similar rate to 2005 in terms of volume, that is, between 7% and 8%, although with large differences across countries (see figure I.11).

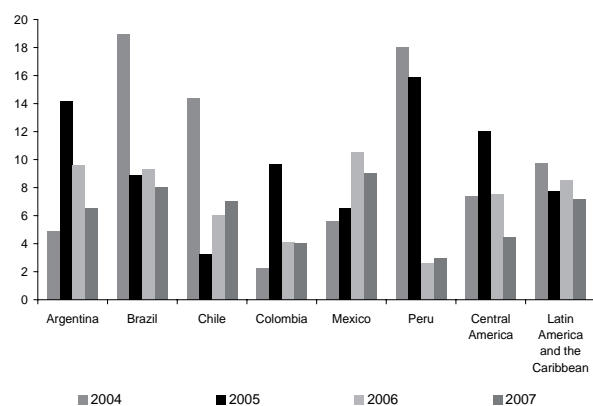
<sup>4</sup> The international trade projections given in this section are based on ECLAC (2006b).

Table I.3  
**LATIN AMERICA: EXTERNAL TRADE IN GOODS AND SERVICES, 2006-2007**  
*(Annual percentage rates of variation)*

	Millions of current dollars			Local currency at constant prices			
	2006			2006		2007	
	Exports	Imports	Balance	Exports	Imports	Exports	Imports
Argentina	13.9	23.0	-5.5	9.6	19.2	6.5	11.5
Bolivia	28.0	20.0	84.9	7.7	8.0	7.0	7.4
Brazil	17.0	22.0	8.8	9.3	13.0	8.0	9.0
Chile	43.1	23.1	102.8	6.0	14.0	7.0	11.5
Colombia	18.8	17.4	36.9	4.1	12.6	4.0	10.0
Costa Rica	17.0	12.0	4.6	6.3	7.3	8.8	9.6
Ecuador	21.7	18.0	80.3	5.5	10.2	4.0	8.0
Guatemala	13.0	9.0	-5.4	5.3	6.4	4.0	5.2
Honduras	10.0	11.3	-13.5	5.4	2.3	5.0	2.0
Mexico	15.8	14.1	32.4	10.5	13.0	9.0	12.0
Nicaragua	11.3	12.4	-13.6	8.4	7.6	8.0	7.0
Peru	31.8	19.0	61.9	2.6	9.7	3.0	8.0
Dominican Republic	5.0	10.0	-18.8	4.0	4.8	3.1	5.8
Uruguay	13.1	17.7	-268.6	12.0	10.0	1.1	3.5
Venezuela (Bolivarian Rep. of)	30.4	20.5	37.9	3.5	17.0	3.0	10.0
<b>Total</b>	<b>19.8</b>	<b>16.7</b>	<b>38.4</b>	<b>8.5</b>	<b>13.7</b>	<b>7.2</b>	<b>10.3</b>

Source: Economic Commission for Latin America and the Caribbean (ECLAC), Economic Projections Centre, 2006.

Figure I.11  
**LATIN AMERICA: INCREASES IN EXPORTS, 2004-2007**  
*(Billions of current dollars).*



Source: Economic Commission for Latin America and the Caribbean (ECLAC), Economic Projections Centre, 2006.

The greatest risk is inflationary pressure, owing to the persistently high prices of petroleum and some other commodities, especially metals, both in the United States and in other developed countries. Data for mid-2006 reflect upward trends not only in total inflation, but also in core inflation, and this is a matter of great concern to central banks. The United States and European monetary authorities, among others, are raising their benchmark rates accordingly. Interest rate hikes in developed countries have generated greater risk aversion and are steering capital flows in the direction of a flight to quality, which negatively impacts emerging markets. As a result, emerging-economy stock exchanges and commodity prices have been very volatile since mid-2006.

This situation is compounded by uncertainty over how global external disequilibria will evolve. More specifically, it is unclear whether the drop in the United States' external deficit in the first quarter of 2006, combined with smaller external surpluses in other countries, constitutes a trend that will firm up in the future. The narrowing of the deficit reflects two trends: first, a geographical shift in world growth dynamics, with a deceleration in the United States and acceleration in Japan and in the European Union. Slower growth in the United States is the result of a series of increases made in the federal funds rate up to July 2006, which also encourages domestic saving and, hence, helps reduce the external deficit. Second, the dollar is depreciating in relation to the euro, which helps to diminish trade imbalances between these economies.

There are two other trends that hinder the reduction of external disequilibria, however. First, petroleum prices remain very high and could rise further, given geopolitical uncertainty in the Middle East and relatively tight supply. Second, the Chinese currency's partial link to the dollar, combined with the dollar's effective depreciation against the euro, has helped China's exports retain much of their buoyancy and thereby generated yet another record trade surplus for China in July 2006.

The change in the geographic location of the engines of growth and higher interest rates will have less of an impact on Latin America and the Caribbean than they would have had a decade ago. While it is true that the region's export volumes will undoubtedly be hurt by slower growth and slackening demand in the United States, the present high prices of commodities are not likely to fall substantially, thanks to steady and mounting demand from China. The

region will also feel the impact of interest rate hikes less than in the past because most of the countries are now less vulnerable, among other things because they have larger foreign-exchange reserves and, thanks to higher export earnings, a better ratio of debt and interest payments to stable export revenues. For some Latin American countries (Argentina, Ecuador and Uruguay), however, wider spreads could endanger the sustainability of their public debt positions, which total well over 50% of GDP, and part of the debt is denominated in or indexed to the dollar (ECLAC, 2006b).

Bird flu, which could have severe human and economic impacts, represents another risk factor for trade activity. The disease, which began in South-East

Asia, has already spread to several continents and could reach the Americas, where the highly pathogenic H5N1 virus has not yet been detected. Fear among the general population could drive down world poultry consumption. In Europe, consumption has already declined by between 70% in Italy and 20% in France, and trade in poultry is down by 8%. The impact could be significant in the Americas, since Brazil and the United States are the world's two largest exporters of poultry. Consumption, production and trade in poultry products are all expected to contract again in 2006 in countries where bird flu has been detected. In view of these developments, the adoption of preventive measures is a matter of urgency.

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## Chapter II

# China's and India's trade relations with Latin America and the Caribbean: opportunities and challenges

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### Introduction

The robust growth occurring in China and India is of great importance for the world economy and in particular for Latin America and the Caribbean. As indicated in chapter I of this report, these two countries together have accounted for over 30% of annual world GDP growth (measured in terms of purchasing power parity (PPP)) since 2001. Their contribution to the global rate has therefore been significant. In 2005, the Chinese economy (US\$ 2.2 trillion) overtook the United Kingdom and France and now ranks as the world's fourth largest economy (the second in terms of purchasing power parity), after the United States, Japan and Germany. India—the second-most populous country on the planet, after China, with 1.08 billion inhabitants—has emerged as a world power in recent decades and now ranks as the eighth-largest economy in the world (US\$ 868 billion).

Both countries have rapidly taken their places among the leading world economies, are making a notable contribution to economic growth and world trade with their high growth rates, are helping to maintain fragile world equilibria and are generating a strong and growing demand for commodities in the region. This is particularly true of China, which competes with Latin

America and the Caribbean in third markets. Given the high growth forecast for both of these Asian countries, they are expected to continue to be the most important pole of world growth in the coming years, since they offer countries in the region a market of huge potential for their exports, which so far has been largely underexploited except in some primary sectors.

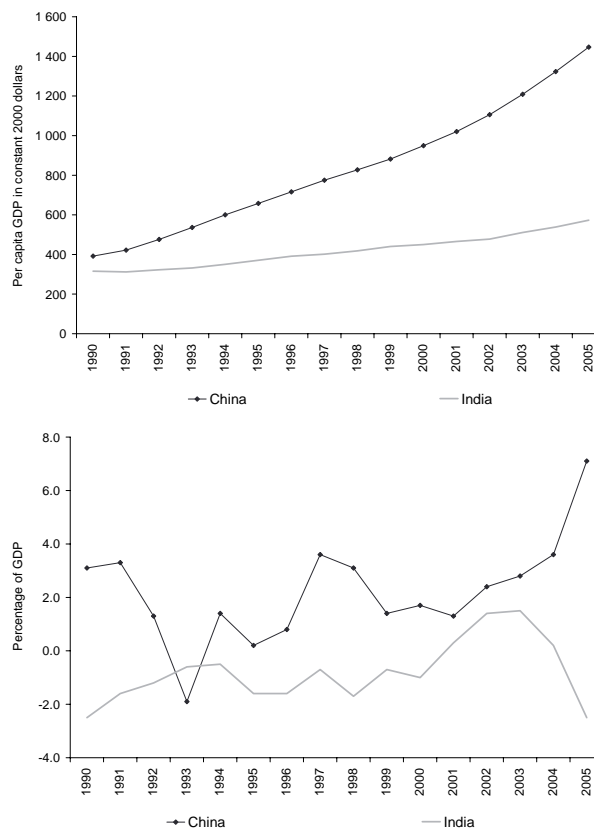
## A. Main characteristics and economic and trade performance

The Chinese economy grew by 10.2% in 2005, thanks to strong domestic investment and buoyant exports. This figure corroborates the close-to-double-digit average that the country obtained over the past 28 years. For its part, India displayed growth that was no less appreciable, at 8.4%, in the fiscal year ending 31 March 2006, with a similar level of expansion in domestic consumption (8%) (see figure II.1). Following the application of the country's new economic policy in 1991, based on promotion of economic liberalization and the correction of macroeconomic disequilibria, it posted annual growth of between 4% and 8% in the period 1999-2004. Between 1990 and 2005, the economy underwent a major structural change: the share of services in GDP expanded from 34% to 54%, while the agricultural sector saw its share shrink from 47% to 20%. The industrial sector continued to account for between 20% and 25% of GDP.

In 2005, the Indian manufacturing sector grew by 9.0%. The most dynamic categories were textiles and basic metals and their alloys, and transport equipment. Thus, India's comparative advantages in the industrial sector are fairly similar to those of some Latin American economies. The agricultural sector grew by a mere 2.3% in 2005 due to low productivity. This growth rate is expected to hold in the next few years, while the services sector will continue to function as the engine of economic growth, expanding by 10% per year.

China's prominence is evident not only in global trade but also in the financial sphere. The country is playing an increasingly important role in maintaining world economic equilibria, since, with its abundant cheap supply, it is helping to sustain high, low-inflation demand in the United States; it provides cheap savings for that country by helping to keep interest rates under control, and it builds up reserves by buying treasury bills, thus helping to finance the United States current account deficit. China's reserves stood at US 853 billion in February 2006, exceeding, for the first time, Japan's reserves, which in the same month stood at US\$ 850 billion.<sup>1</sup>

Figure II.1  
PER CAPITA GDP AND THE CURRENT ACCOUNT BALANCE  
(In constant 2000 dollars and percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund and the World Bank.

China's weight in world trade far overshadows India's. The boom in Chinese exports, which had intensified since the beginning of the current decade, continued apace in 2005. Exports expanded by 28% to stand at US\$ 762 billion, almost 1.5 times the total exported by Latin America and the Caribbean and equivalent to 7.3% of world merchandise exports. Imports also increased by 18% and amounted to US\$ 660 billion or 6.1% of world imports.

<sup>1</sup> In December 2005, treasury bonds held by the Chinese authorities totalled US\$ 257 billion, but Japan was the main purchaser, with US\$ 680 billion in its possession. India's reserves are much smaller. The Reserve Bank of India holds reserves of US\$ 137 billion and only US\$ 12.6 billion in United States treasury bonds (United States Department of the Treasury, 2006).

In 2005, China became the third importer and exporter of goods world-wide (WTO, 2006a), which resulted in an even greater expansion of its trade surplus. India's role in world trade is much smaller: in 2005, its exports and imports totalled US\$ 89.8 billion and US\$ 131.6 billion, respectively.

India's trade openness is much more limited than China's (see table II.1). While China presents a much smaller and more linear tariff structure, India still harbours pockets of protectionism, especially in the agricultural sector. The reduction in tariffs and other non-tariff barriers being implemented under the trade agreement between the Association of Southeast Asian Nations (ASEAN) and China may have serious implications for the future of Latin American trade with this Asian region, in particular in terms of trade diversion. Similar reductions envisaged as part of the India-China trade agreement (scheduled to enter into force in 2007 and encompassing industrial as well as agricultural products) will also affect Latin American trade.

Table II.1  
CHINA AND INDIA: DIFFERENT TRADE POLICIES

China 100% tariff binding coverage scheduled for 2010 (Simple average of ad valorem tariffs)		
	Applied 2004	Final bound (2010)
All goods	10.4	10.0
Agricultural goods	16.2	15.8
Non-agricultural goods	9.5	9.1
Non-ad valorem lines (percentage of total tariff lines)	0.5	0.0
India 73.8% tariff binding in 2005 (Simple average of ad valorem tariffs)		
	Applied 2004	Final bound (2005)
All goods	29.1	49.8
Agricultural goods	37.4	114.5
Non-agricultural goods	27.9	34.3
Non-ad valorem lines (percentage of total tariff lines)	0.0	7.2

Source: World Trade Organization (WTO), "Trade profiles" <http://stat.wto.org/CountryProfile/WSDBCountryPFHome.aspx?Language=E>, 2006.

China still exports more services than India, but the latter is expected to catch up shortly, since its exports are growing at a faster rate. As an exporter of services,

China ranked eighth in 2005, accounting for US\$ 81.2 billion, and, as an importer of services, it was seventh with US\$ 85.3 billion. India was in tenth place in exports (US\$ 67.6 billion) and imports (US\$ 67.4 billion). However, between 2003 and 2005, exports of services from India grew at more than twice the rate recorded by China (WTO, 2006a).

India has continued developing and still has a strong potential within the information and communications technology (ICT) sector and in the area of business process outsourcing. These two areas are strongly export-oriented and continue to perform well, thanks to the growing demand for labour that is cheap but reasonably proficient in English, the advantages of the time difference with the northern hemisphere and the construction of an undersea fibre-optic network. During 2004-2005, India accounted for 65% of the global market for ICT trade services and 46% of the business process outsourcing market. ICT services still represent a small part of the overall services sector. In the 1990s, the country's software sector expanded systematically, growing by close to 50% per year, and in the current decade it continues to grow by 25% per year. The ICT sector is expected to reach 7% of GDP (currently 4%) and 35% of total exports in 2008. Thus, exports of ICT services and business process outsourcing could generate US\$ 60 billion in 2010. A major challenge for the expansion of the ICT sector is the current underinvestment in technological capital (Government of India, Ministry of Finance, 2006) and human capital, due in both cases to the scope of the dynamic expansion of the ICT sector.

In the first half of 2006, China recorded growth of 10.9% compared with the same period in 2005. Initial forecasts put growth at between 9.5% and 9.9% in 2006 and between 8.8% and 9.0% in 2007 (IMF, 2006; ADB, 2006). Despite the authorities' plan to reorient demand towards private consumption instead of investments, growth in 2006 and 2007 will probably continue to be investment-driven. Fixed capital formation could account for a larger share of GDP, rising to close to 50% in the coming years (ADB, 2006). In fact, there is no guarantee that growth will moderate. At present, indications are that the monetary base will expand and may be granted to the industrial sector as additional credits.<sup>2</sup>

Growth in exports is expected to abate to between 15% and 20%, owing to the voluntary restrictions applied to some sectors, the reduction in indirect subsidies and

<sup>2</sup> Money in circulation (M2) in May 2006 increased by 19.5% over the amount recorded in the same month in 2005, far exceeding the goal set by the People's Bank of China, and bank lending almost doubled during the same period (*The Economist Intelligence Unit*, April 2006; *Financial Times*, 2006). Partly thanks to this growth in the money supply, industrial production expanded by 17% in the first five months of 2006. For the first time since 2004, China raised its benchmark rate by 0.27% in April and again in August in an attempt to put a brake on the economy, discouraging the excessive growth in bank loans.

escalating labour costs.<sup>3</sup> Imports are forecast to increase by a similar rate, since demand for energy products, raw materials, agricultural products and intermediate industrial inputs will continue to expand rapidly. A growing trade surplus could offset the services deficit. The Asian Development Bank (ADB, 2006) estimates that the current account surplus could range between 5% and 7% of GDP for 2006-2007, adding further pressure on the yuan.

It should be noted that 2006 is the first year of the eleventh Five-Year Plan for National Economic and Social Development (2006-2010).<sup>4</sup> This plan addresses the country's structural weaknesses, the result of rapid industrialization and modernization, such as the idle capacity in some sectors, the expansion in income inequality, in particular between urban and rural areas and between the coastal areas and the interior of the country, as well as the acute environmental problems.<sup>5</sup> The main objective of the Plan is to promote a more balanced, equitable and sustainable approach to growth, using strategies designed precisely to correct these problems.<sup>6</sup> This plan could change the composition of aggregate demand and

rein in economic growth to levels that would be more sustainable in the long term.

For India, the outlook for the short-term is promising, since sound economic growth has been recorded (between 7% and 8% for 2006-2007)<sup>7</sup> (IMF, 2006; ADB, 2006), together with moderate inflation. Indeed, according to preliminary figures, the Indian economy grew by 8.9% in the first quarter of the fiscal year (April-June), compared with 6.9% in the same period of 2005-2006. Inflation was below 5%, despite the rise in oil prices. However, the high levels of public debt, a growing current-account deficit and the need to address crucial reforms are the main challenges for the medium term. The government must, as a matter of urgency, consolidate its fiscal position, while implementing the necessary infrastructure improvements (especially in the area of electricity supply and the road system) in order to support industrial development, human resource training in service-related sectors and public investment in rural initiatives to increase productivity in these areas. The growing trade deficit could lead the country to speed up the process of depreciation of its currency (the rupee), which would boost exports.

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## B. Latin America and the Caribbean: growing trade relations with China and India

Between 1990 and 2005, trade between the countries of the region and China and India expanded considerably, with increases recorded especially in the most recent five-year period. These two countries have developed similar

patterns of trade with the subregions of Latin America. While South America shows trade surpluses with both countries, Mexico and Central America maintain growing deficits. China, in particular, plays a very important role

<sup>3</sup> These figures are, however, at variance with the high rate of growth in exports in the first half-year (25% higher growth than in the same period of 2005).

<sup>4</sup> One of the main objectives of this plan is to raise the volume of external trade to US\$ 2.3 trillion by 2010. This would almost double the 2005 figure (US\$ 1.4 trillion), which represented a 23.2% increase over the previous year's value.

<sup>5</sup> The high levels of investment have been reflected in idle industrial capacity, which in turn has meant an increase in stocks and a fall in prices in sectors such as aluminium, automobiles, cement and steel (ADB, 2006). Another problem is the growing debt of municipal corporations that finance urban infrastructure projects, especially road construction, through land purchases or loans to municipal governments, an item that is not accounted for in these governments' budgets. In 2005, China constructed approximately 128,000 kilometres of roads, of which only 6,400 were funded by the central government (*Wall Street Journal*, 2006).

<sup>6</sup> Recently, President Hu Jintao pointed to the need to change the structure of China's growth, improving the national capacity for innovation, modernizing industry as a whole, encouraging the development of advanced manufacture and services, but always taking into account energy-saving and environmentally-friendly practices as well as the need to step up training for workers. The eleventh Five-Year Plan states that in the next five years, the priority will be placed on upgrading rural infrastructure ahead of urban areas, ensuring that students in rural areas receive nine years of schooling to match the achievement already made in urban areas and setting aside more resources for research and scientific development.

<sup>7</sup> The fiscal year in India runs from April to March.



as a trading partner for Latin America and the Caribbean. Regional exports to China exceeded US\$ 19 billion in 2005 or close to 3.5% of the region's total exports, while exports to India stood at just US\$ 3 billion, a very low figure accounting for only 0.5% of the regional total. The main exporting countries in the relationship with China are, by order of magnitude in 2005, Brazil, Chile,

Argentina, Peru and Mexico; in the case of India, the same countries are present except Peru. India's share as an importer is very low (see table II.2).

Latin American imports from India are equivalent to barely one tenth of those originating in China. Recently, however, purchases of Indian products have been on the rise.

Table II.2  
LATIN AMERICA AND THE CARIBBEAN: EXPORTS TO CHINA AND INDIA, 2005  
(Millions of dollars and percentages of total)

Trade flows Countries	Total exports by destination			Percentage of total for Latin America and the Caribbean		Percentage of total of each country	
	India	China	World	India	China	India	China
<b>Latin America and the Caribbean Andean Community</b>	<b>3 048</b>	<b>19 442</b>	<b>555 445</b>	<b>100.0</b>	<b>100.0</b>	<b>0.5</b>	<b>3.5</b>
<b>Andean Community</b>	<b>115</b>	<b>3 009</b>	<b>106 981</b>	<b>3.8</b>	<b>15.5</b>	<b>0.1</b>	<b>2.8</b>
Bolivia	1	19	2 734	0.0	0.1	0.0	0.7
Colombia	5	237	21 187	0.2	1.2	0.0	1.1
Ecuador	26	82	10 649	0.8	0.4	0.2	0.8
Peru	79	1 826	17 001	2.6	9.4	0.5	10.7
Venezuela (Bolivarian Republic of)	4	845	55 410	0.1	4.3	0.0	1.5
<b>MERCOSUR</b>	<b>1 875</b>	<b>10 317</b>	<b>163 414</b>	<b>61.5</b>	<b>53.1</b>	<b>1.1</b>	<b>6.3</b>
Argentina	729	3 302	40 013	23.9	17.0	1.8	8.3
Brazil	1 137	6 834	118 308	37.3	35.2	1.0	5.8
Paraguay	5	61	1 688	0.2	0.3	0.3	3.6
Uruguay	4	120	3 405	0.1	0.6	0.1	3.5
<b>Chile</b>	<b>493</b>	<b>4 390</b>	<b>39 536</b>	<b>16.2</b>	<b>22.6</b>	<b>1.2</b>	<b>11.1</b>
<b>Central American Common Market</b>	<b>17</b>	<b>349</b>	<b>21 806</b>	<b>0.6</b>	<b>1.8</b>	<b>0.1</b>	<b>1.6</b>
Costa Rica	8	245	7 090	0.3	1.3	0.1	3.5
El Salvador	2	2	3 383	0.1	0.0	0.0	0.1
Guatemala	3	80	5 381	0.1	0.4	0.1	1.5
Honduras	5	15	4 377	0.2	0.1	0.1	0.3
Nicaragua	0	7	1 574	0.0	0.0	0.0	0.4
<b>Mexico</b>	<b>522</b>	<b>1 091</b>	<b>213 711</b>	<b>17.1</b>	<b>5.6</b>	<b>0.2</b>	<b>0.5</b>
<b>Other countries of Latin America and the Caribbean</b>	<b>26</b>	<b>287</b>	<b>9 998</b>	<b>0.9</b>	<b>1.5</b>	<b>0.3</b>	<b>2.9</b>
Panama	22	23	2 013	0.7	0.1	1.1	1.1
Cuba	2	247	2 430	0.1	1.3	0.1	10.2
Dominican Republic	3	17	5 554	0.1	0.1	0.0	0.3

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries and figures from the International Monetary Fund, *Direction of Trade Statistics*, 2006.

## 1. Trade relations with China: South America compared with Central America and Mexico

China's trade interests in Latin America vary considerably depending on whether it is dealing with South America or Central America and Mexico. A number of factors enter into its interests in South America. First, its rapid growth calls for the supply of raw materials, food products and energy products. Second, it has sought a favourable market context for its exports and, in an attempt to limit accusations

of trade defence measures, such as antidumping, which it considers "abusive", it has been keen to obtain market economy status with 27 countries, seven of which belong to Latin America and the Caribbean (ECLAC, 2005).

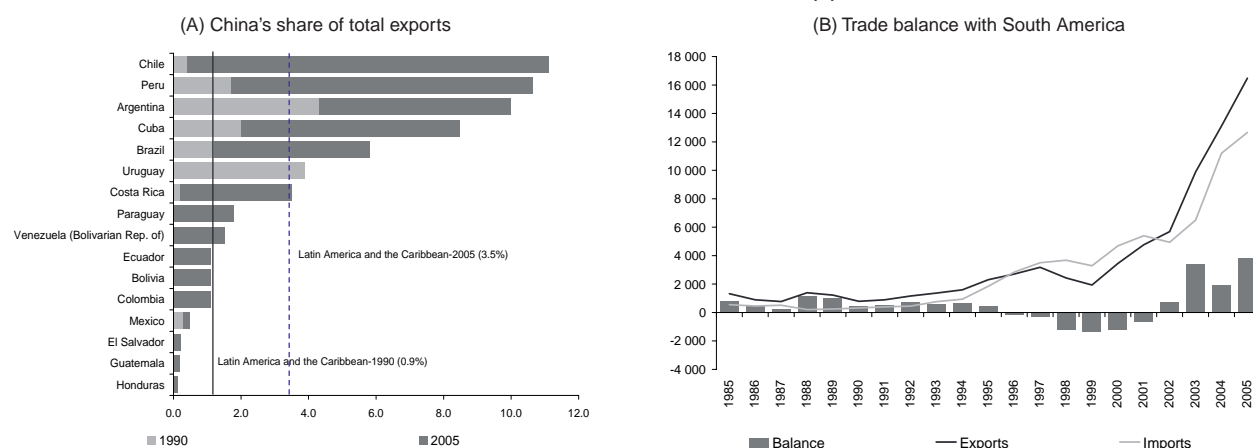
China is already one of the main export markets for several countries of the region (see figure II.2-A). South American trade flows have been quite strong, and the

subregion has posted a trade surplus for four consecutive years up to 2005 (see figure II.2-B). However, the accumulated surplus is concentrated in primary products and resource-based manufactures, and the deficit in technology-based manufactures has increased.

Given its extensive natural resource endowment, the region has become an important supplier of primary

products to China, since it provides, for example, more than 60% of Chinese imports of soybean (chiefly from Brazil and Argentina), 80% of fishmeal (from Peru and Chile), close to 60% of edible poultry offals (from Argentina and Brazil) and 45% of wines and grapes (from Chile) (see table II.3).

Figure II.2  
CHINA'S IMPORTANCE AS A DESTINATION FOR EXPORTS FROM LATIN AMERICA AND THE CARIBBEAN (A) AND SOUTH AMERICA'S GROWING TRADE BALANCE WITH CHINA (B)



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

Table II.3  
THE 15 MAIN PRODUCTS IMPORTED BY CHINA FROM SOUTH AMERICA, 2004  
(Millions of US\$ and percentages of total, SITC Rev.2)

Main products	Argentina	Brazil	Chile	Peru	Rest of South America	South America (A)	World (B)	% of total C= (A)/(B)
Soybean (2222+4232)	2 555	2 619	0	0	0	5 174	8 528	60.7
Iron (2815+2816+6712+6725+6746)	25	3 252	168	256	208	3 909	19 677	19.9
Copper (2871+2882+6821+6822)	12	40	2 793	540	73	3 456	13 532	25.5
Wood and woodpulp (2482+2483+2517+6416)	36	527	371	4	6	943	4 584	20.6
Crude oil (3330)	183	423	0	0	139	745	33 912	2.2
Fishmeal (0814)	17	0	103	502	2	623	770	80.9
Leathers and wools (6114+6512+6129+2681)	145	301	2	1	88	537	4 152	12.9
Ferro-alloys (6713+6716+6727+6749)	6	203	0	0	233	442	9 613	4.6
Lead (2874)	0	0	0	122	0	122	437	27.9
Aluminium (2873+6845)	0	67	0	0	37	105	2 069	5.1
Other vehicle parts and accessories (7849)	3	101	0	0	0	104	7 305	1.4
Poultry, dead and edible offals (0114)	37	53	0	0	0	90	154	58.7
Cotton (2631+2632+2633+2634)	0	31	0	0	49	80	3 242	2.5
Tobacco (1211-1212)	0	74	0	0	0	74	232	31.6
Grapes and wine (0575+1121)	1	0	61	0	0	61	135	45.4
Total sample	3 019	7 690	3 497	1 424	834	16 465	108 342	15.2
Other products	236	978	170	99	148	1 630	442 973	0.4
<b>Total Imports</b>	<b>3 255</b>	<b>8 669</b>	<b>3 667</b>	<b>1 523</b>	<b>982</b>	<b>18 095</b>	<b>551 315</b>	<b>3.3</b>

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

The mix of products that Mexico and Central America export to the United States market is fairly similar to that of the products that China sends to that market (see figure II.3-A). This subregion exports more intermediate- and high-technology-intensive manufactures (for example, electrical and electronic articles, including computer equipment, and automotive industry products), both in absolute and relative terms, while China specializes more in low-technology products (for example, textiles and garments). Although each group exports high-technology products equivalent to US\$ 40 billion to the United States market, the greater competition between the two is still in the manufactures of low and intermediate technology manufactures. From this perspective, the protectionist tendency of the United States affects both regions in an interrelated manner, as occurred with the negotiation of the Dominican Republic —Central America— United States Free Trade Agreement (CAFTA-DR) in 2005 (ECLAC, 2005).

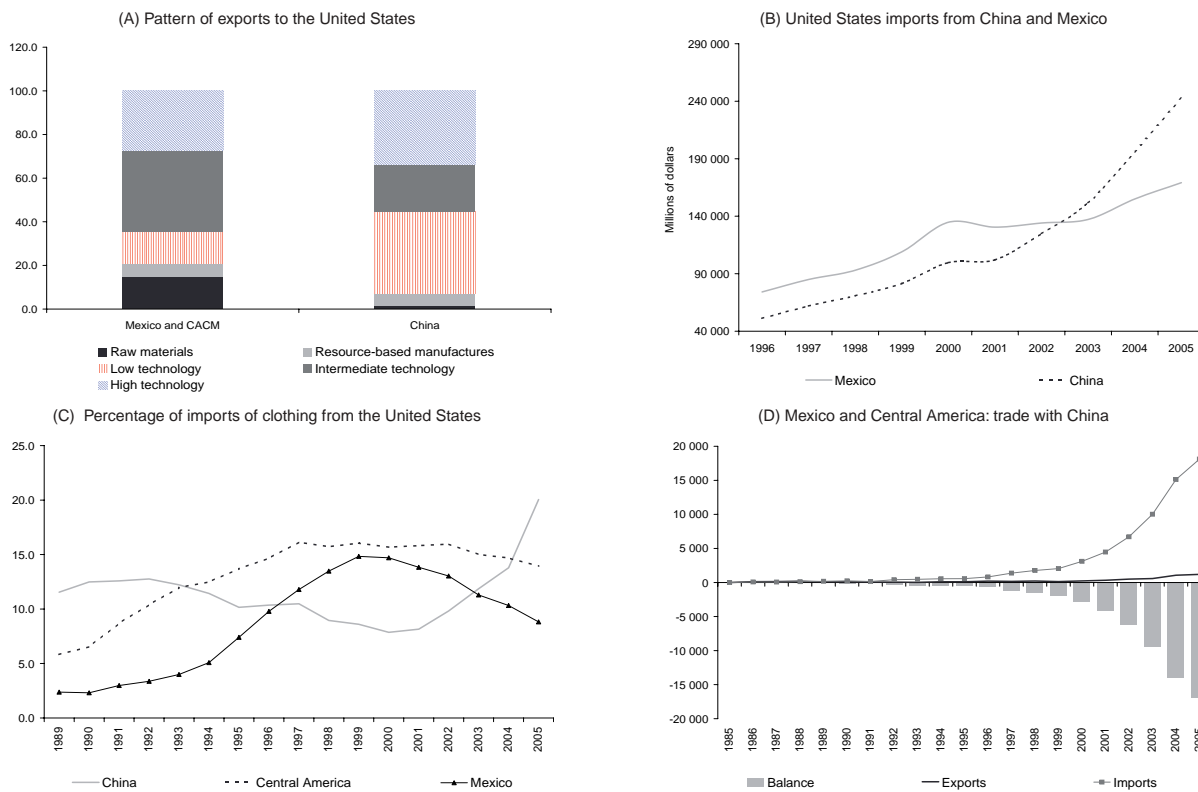
China has displaced Mexico as the United States' main trading partner (see figure II.3-B). This displacement is very evident in the case of textiles and clothing,

where both Mexico and Central America have lost an important share of the market (see figure II.3-C). The situation is even more acute in the case of the electrical and electronics sector, especially computer equipment (Dussel Peters, 2005). Trade between the two groups is very asymmetrical; China imports less than 1% of Mexico's total exports but is the second supplier for Mexico's imports. Consequently, Mexico and Central America have a growing trade deficit with China (see figure II.3-D). This asymmetry is also reflected in the fact that the 15 main imports into China from Mexico and Central America are manufactures, especially in the electronic sector, with the exception of copper and iron ore. The share of each product in the Chinese market is still very limited (see table II.4).

In view of this trend, rather than competing only in the main markets (United States and European Union), the subregion should strengthen its trade links and seek greater productive complementarity with China by establishing the necessary trade and technological alliances. This could help to avert the protectionist pressures that could arise in these industrialized countries.

Figure II.3

THE RELATIONSHIP BETWEEN MEXICO AND CENTRAL AMERICA AND CHINA AND ITS REPERCUSSIONS IN THE UNITED STATES MARKET



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

Table II.4  
**THE 15 MAIN PRODUCTS IMPORTED BY CHINA FROM MEXICO AND CENTRAL AMERICA, 2004**  
*(Millions of dollars and percentages, SITC Rev.2)*

Main products	Mexico	Costa Rica	Other Central America	Mexico and Central America (A.1)	World (B)	Percentage of total C=(A.1)/(B)	South America (A.2)	Percentage of total C=(A.2)/(B)
Electronic parts and accessories (7599)	322	0	0	323	13 887	2.3	0	0.0
Electronic microcircuits (7764)	263	592	0	856	61 047	1.4	2	0.0
Copper minerals and concentrates (2871)	133	0	0	133	2 236	5.9	1 217	54.4
Iron ingots (6725)	125	0	0	125	1 443	8.7	186	12.9
Non-ferrous base metal waste and scrap (2882)	116	1	20	138	3 577	3.8	144	4.0
Other electrical machinery and equipment (7788)	110	1	1	111	7 503	1.5	14	0.2
Diodes, transistors and photocells (7763)	74	8	0	82	7 416	1.1	0	0.0
Electrical apparatus for making/breaking electrical circuits (7721)	65	2	0	67	8 673	0.8	8	0.1
Heterocyclic compounds with oxygen (5156)	58	0	0	58	1 247	4.6	8	0.7
Polycarboxylic acids (5138)	55	0	0	55	5 106	1.1	4	0.1
Parts n.e.s. internal combustion engines (7139)	53	0	0	53	1 671	3.2	33	2.0
Synthetic filament tow (2666)	51	0	0	51	383	13.2	2	0.5
Other parts and accessories of motor vehicles (7849)	48	0	0	48	7 305	0.7	104	1.4
Iron ore agglomerates (2816)	41	0	0	41	1 824	2.2	741	40.6
Telecommunications parts and accessories (7649)	39	2	0	41	17 868	0.2	5	0.0
Total sample	1 553	606	21	2 180	141 187	1.5	2 470	1.7
Other products	587	35	55	704	410 128	0.2	15 625	3.8
Total imports	2 140	641	76	2 900	551 315	0.5	18 095	3.3

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

## 2. Latin America and the Caribbean: trade with India

The Latin American and Caribbean market is still not very significant for India, although it is gaining in importance. In 2005, the region accounted for only 3.0% (US\$ 2.168 billion) of India's exports and 1.8% (US\$ 1.882 billion) of its imports, which yielded a surplus in favour of India. Nevertheless, these figures indicate that its exports to the region tripled and its imports doubled in the past two years.

As in the case of China, India's pattern of trade with South America is different from the pattern it maintains with Central America and Mexico. Under existing trade agreements with India, the countries of MERCOSUR and Chile exported to India in 2004 vegetable oils (37% of

exports to that country), minerals and their concentrates (21%) and sugar and honey (12%). Similarly, these countries imported from India refined petroleum products (36% of imports from this country), medicines and pharmaceutical products (8%), other organic chemicals (6.7%) and textiles (5.7%).<sup>8</sup> On the other hand, trade between India and Mexico and Central America is very limited. This subregion exports mainly oil, pharmaceutical products and telecommunications equipment and imports automobiles and automobile parts as well as textiles and clothing, items that seem to offer a comparative advantage to the region.

## 3. China as the key actor in the intra-Asian trade boom

Based on its vigorous economic growth, China has become the key actor in the Asian trade boom. The other Asian countries have, of course, played an important role as suppliers

for China: in 2005, Japan, Taiwan Province of China, the Republic of Korea and the ASEAN countries supplied half of China's imports. China's overall trade balance with these

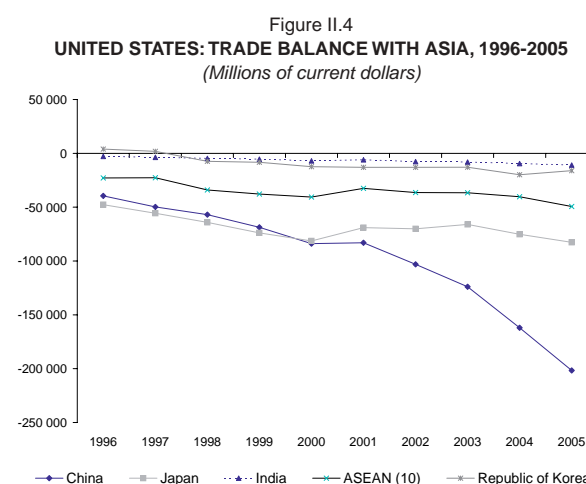
<sup>8</sup> On the basis of official figures from United Nations Commodity Trade Statistics Database (COMTRADE).

countries—especially the Republic of Korea and Japan—is negative, since they are the main source of capital goods and intermediate inputs for its manufacturing sector. The manufactures it produces are then exported to the rest of its trading partners, in particular the United States and the European Union, with which it invariably maintains the highest

trade surpluses in low- and high-technology manufactures and, to a lesser extent, in intermediate-technology products (ECLAC, 2005). Thus, the trade deficit with Asia, which exceeded US\$ 70 billion in 2005, has been offset by huge and growing trade surpluses with the United States (US\$ 114 billion) and the European Union (US\$ 70 billion).<sup>9</sup>

#### 4. Trade between China and the United States: “exuberant” growth

As indicated, China and India have become important trading partners for the United States and imports from those countries have skyrocketed. China accounted for 16% of United States imports from Asia in 1996 and for as much as 41% in 2005, with an exponential growth rate of 19%, five times more robust than the average for Asia without China (just 3.7%). During the same period, India’s share of total United States imports increased from 2% to just over 3.2%, while Japan, Singapore, Taiwan Province of China and the Philippines lost some of their share of this market. These overall trends meant that from 2000 the United States trade deficit with China increased four-fold, which represents half of the United States’ trade deficit with that zone (see table II.5 and figure II.4). In the same period January-May 2006, United States purchases grew by 17%, which suggests that the United States deficit will remain high.



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of the United States Department of Commerce Data bank ([http://dataweb.usitc.gov/scripts/user\\_set.asp](http://dataweb.usitc.gov/scripts/user_set.asp)).

Table II.5  
UNITED STATES: TRADE BALANCE WITH ASIA, 1996-2005  
(Millions of current dollars)

	1996-1999 <sup>a</sup>	2000	2001	2002	2003	2004	2005
<b>Total Asia</b>	<b>-164 991</b>	<b>-245 374</b>	<b>-221 430</b>	<b>-247 287</b>	<b>-263 760</b>	<b>-319 690</b>	<b>-373 388</b>
China	-53 708	-83 810	-83 046	-103 115	-123 961	-161 978	-201 626
Japan	-60 346	-81 322	-68 963	-70 055	-65 965	-75 194	-82 682
India	-4 153	-7 024	-5 973	-7 720	-8 067	-9 467	-10 849
ASEAN (10)	-29 325	-40 609	-32 527	-36 392	-36 597	-40 315	-49 347
Republic of Korea	-2 471	-12 398	-12 988	-12 979	-12 865	-19 829	-16 109
Rest	-14 989	-20 211	-17 933	-17 025	-16 306	-12 906	-12 775

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of the United States Department of Commerce Data bank ([http://dataweb.usitc.gov/scripts/user\\_set.asp](http://dataweb.usitc.gov/scripts/user_set.asp)).

<sup>a</sup> Annual averages.

<sup>9</sup> United States statistics put its current account deficit with China at US\$ 202 billion in 2005, almost double the level reported by the Government of China. There is a similar statistical problem with other countries and regions of the world, including Latin America and the Caribbean. According to the Japanese authorities, Japan continues to record a large trade deficit with China. This deficit may be related to the triangulation of Chinese trade via the Hong Kong Special Administrative Region of China.

## 5. The trading partners of India and China: the role of ASEAN and Latin America

India's export basket is quite distinct from China's. While the specialization of Chinese exports has changed significantly, India's export mix has not changed much during the past 15 years. China is becoming increasingly specialized in high-technology and value-added sectors and, little by little, has graduated from the areas that offer traditional comparative advantages, such as low-technology manufactures (including textiles and garments). India, on the other hand, has not managed to penetrate the markets for cutting-edge technology products and has specialized essentially in traditional industrial products. That is, in seeking its place in the global economy, India has not produced significant synergy between the hardware and software sectors linked to information and communications technologies and outsourcing relating to these sectors. In India, trade and foreign direct investment are still not closely linked, unlike the situation in China. This not only poses a difficulty for the country in terms of carving a niche for itself in world markets for value-added and knowledge products, but also hinders its entry into the dynamic network of Asian intra-company trade and intra-industry trade.

Nevertheless, as shown in table II.6, which presents China's and India's percentage shares of trade flows with the two groups of developing countries (that is, ASEAN and the Latin American Integration Association (LAIA)), India is starting to join the network of Asian intra-industry trade. For India, the ASEAN countries are a very important supply source for primary goods and resource-based manufactures, much more so than the LAIA countries. Moreover, ASEAN countries account for a relatively high percentage of India's imports of manufactures. Approximately 16% of India's imports of high-technology manufactures and over 8% of intermediate- and low-technology manufactures originate in neighbouring countries that belong to ASEAN. Besides, the LAIA countries play a very insignificant role as destinations for India's exports.

At present, China depends more on LAIA than on ASEAN countries for its supplies of primary products. As far as resource-based manufactures are concerned, however, the ASEAN share is twice that of LAIA on the Chinese market. Around 20% of high-technology manufactures imported by China come from ASEAN countries and more than 8% of Chinese high-technology exports and more than 11% of resource-based manufactures are sent to ASEAN countries. These relatively high percentages indicate that

there is an intra-industry trade network between China and ASEAN countries and that a significant proportion of raw materials and resource-based manufactures belong to sectors in which LAIA member countries face stiff competition from their Asian counterparts.

Table II.6  
**CHINA AND INDIA: COMPOSITION OF TRADE WITH ASEAN AND LAIA COUNTRIES, 2004**  
(Percentage shares of trade flows of each group of products)

Category	Group	China		India	
		Imports	Exports	Imports	Exports
Primary	ASEAN	9.0	9.9	16.1	8.4
	LAIA	13.3	0.9	6.8	0.3
Resource-based manufactures	ASEAN	15.6	11.1	14.5	16.5
	LAIA	7.8	3.4	3.9	3.1
Low-technology manufactures	ASEAN	5.0	4.1	8.2	3.4
	LAIA	2.4	2.2	0.9	1.3
Intermediate-technology manufactures	ASEAN	6.2	8.4	8.3	11.5
	LAIA	1.2	3.1	1.5	3.7
High-technology manufactures	ASEAN	19.5	8.3	15.9	9.7
	LAIA	0.6	1.7	0.4	4.4
Other	ASEAN	4.7	3.2	2.1	23.8
	LAIA	0.6	0.5	0.1	0.5

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

India has been a largely unexploited market for Latin America and the Caribbean. In addition to growth of the information and communications technology sector, there has been a noteworthy advance in other sectors, such as the automotive industry, electronics and transport equipment. In addition, the Government of India supports the pharmaceutical industry as well as the biotechnology sector, which is flourishing, the idea being to make maximum use of its human and biogenetic resources. Furthermore, given the rate of population growth, it is predicted that India will become not only a labour market with an abundant skilled labour force, but also a major consumer market, the outcome of the rising purchasing power of the middle class. In order to participate in the Chinese and Indian markets, Latin American firms must seek ways of effectively fitting into the value chains in different manufacturing sectors in Asia. This will promote reciprocal foreign direct investment between China, India, the ASEAN countries and those of Latin America and the Caribbean.

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## 6. Free trade agreements with China and India

In recent years, China and India negotiated several trade agreements. Initially, China signed special trade agreements with Hong Kong Special Administrative Region and Macao Special Administrative Region, then concluded a free trade agreement with Chile and an “early harvest” arrangement with Pakistan and started to reduce trade tariffs it applied to the ASEAN countries. China has signed or is negotiating free trade agreements with at least 27 countries (see table II.7) (*People’s Daily Online*, 2006). India is also creating a complex network of trade agreements; it has signed 13 free trade agreements, including the partial scope agreements with Chile and MERCOSUR, is negotiating agreements with three other groups of countries and is exploring the possibility of reaching agreements with another eight individual countries (see table II.8).

Chile is the first Western country with which China has signed a partial scope agreement focusing mainly on goods. On the basis of this agreement, a zero tariff will be applied to 92% of current exports from Chile to China, including exports of copper, vegetables and pulses, and cotton. With respect to other products, such as salmon, grapes, cherries, peaches and apples, the agreement calls for the progressive phaseout of tariffs 10 years after the entry into force of the agreement. Excluded from the agreement are cereals, flour, oils, sugar, wood articles, paper, cements and textile products, which together account for 1% of exports. The agreement establishes a

dispute settlement mechanism and incorporates the issue of cooperation in areas such as science and technology, social security, education, investment promotion, culture, small and medium-sized enterprises, intellectual property and the environment. The two countries have planned to include other issues in addition to liberalization of merchandise trade.<sup>10</sup>

The Partial Scope Agreement between India and Chile—signed on 8 March 2006 and currently being ratified by the Chilean Congress—stipulates that (i) 98% of Chilean exports and 91% of Indian exports will obtain an average tariff rebate of 20%; (ii) Chile will lower the tariffs on 296 Indian products, while India will lower the tariffs for 178 Chilean products. These rebates will vary between 10% and 50% of rates. Among the Chilean exports favoured are copper, wood pulp, wood panels and salmon.

The Partial Scope Agreement between MERCOSUR and India is important from the point of view of South-South cooperation.<sup>11</sup> Although the Agreement is not expected to result in any immediate wide-ranging trade benefits (reciprocal trade accounts for barely 1% of the trade of each bloc), India aspires to expand its exports of strategic items, such as those of pharmaceuticals and chemicals, transport equipment, textiles and clothing, while the MERCOSUR countries are interested in diversifying their existing export basket, which consists mainly of vegetable oils (soybean), of ferrous mineral concentrates and non-electrical machinery.

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## C. China and India: different approaches to international integration and their outcomes

China and India have adopted significantly different strategies for international integration. While China bases its international expansion on the attraction of foreign

direct investment geared to production for export, India until recently showed caution in opening up its economy to this type of investment.

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<sup>10</sup> For additional information, see [www.direcon.cl/](http://www.direcon.cl/).

<sup>11</sup> MERCOSUR and India signed a framework agreement on trade on 17 June 2003, which provides, as a first step, for the negotiation of a partial scope agreement. In this context, on 25 January 2004, a preferential trade agreement was signed between the countries that regulates the safeguards, antidumping and countervailing measures, technical barriers to trade, sanitary and phytosanitary measures, as well as dispute settlement procedures. The lists of concessions have not yet been completed.

Table II.7  
**CHINA: PREFERENTIAL AGREEMENTS SIGNED OR CURRENTLY BEING NEGOTIATED**

Country or group	Date of entry into force	Date of GATT/WTO notification	Provisions	Type of agreement	Notes
<b>Signed/in force</b>					
Asia Pacific Trade Agreement (formerly referred to as the Bangkok Agreement) <sup>a</sup>	17/06/1976	02/11/1976	Enabling clause	Non-reciprocal agreement	Positive list with the possibility of future tariff reductions through negotiations (annual reviews). China joined the Agreement in 2002. Notification of WTO for its accession in accordance with the enabling clause in 2004
ASEAN	01/07/2003	21/12/2004	Enabling clause	Framework agreement Regional preferential agreement	Positive list. Elimination of tariffs by 2010 for the ASEAN 6 (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand) and China, and by 2015 for the new members of ASEAN. The "early harvest" programme will reduce tariffs on most of the products to less than 5% in 2004-2010. Dispute settlement agreements and subsequent negotiations for services are envisaged
Hong Kong (Special Administrative Region of China) ( <i>Closer Economic Partnership Agreement (CEPA)</i> )	01/01/2004	12/01/2004	GATT Art. 24, GATS Art. V	Bilateral free trade agreement	Hong Kong (Special Administrative Region) continues to apply zero tariffs to products from China. Services included. Provisions relating to its own rules of origin
Macao (Special Administrative Region of China) ( <i>Closer Economic Partnership Agreement (CEPA)</i> )	01/01/2004	12/01/2004	GATT Art. 24, GATS Art. V	Bilateral free trade agreement	Macao (Special Administrative Region) continues to apply zero tariffs to Chinese products. Services included
Pakistan	2005	Not notified		Bilateral free trade agreement	"Early harvest" programme for a number of products, whose liberalization will be accelerated in the subsequent phase
Chile	Signed in October 2005. Ratified in August 2006	Not notified		Partial scope agreement	Immediate tariff reduction on 92% of Chile's exports to China and on 50% of China's current exports to Chile. Further reductions will be implemented in one, five and 10 years on access of Chilean products to China and in one, two, five and 10 years for Chinese exports to Chile
<b>Under negotiation</b>					
Australia				Bilateral free trade agreement	Fifth round of negotiations in May 2006. Covers goods and services, recognition of standards, customs cooperation, intellectual property and investments
Gulf Cooperation Council (GCC) <sup>b</sup>				Regional free trade agreement	Includes investments, goods, services, government procurement and rules of origin
New Zealand				Bilateral free trade agreement	Sixth round of negotiations in March 2006. Includes goods, rules of origin, trade defence, sanitary and phytosanitary rules, technical barriers, customs, services, investments and intellectual property
South African Customs Union (SACU) <sup>c</sup>				Regional free trade agreement	Announcement of intent to sign a free trade agreement between the two in June 2004, as a result of South Africa's recognition of China as a market economy
<b>In the study phase</b>					
India	2003			Bilateral free trade agreement	The first meeting of the study group in Beijing in March 2004
Iceland					A study on the feasibility of a free trade agreement was completed in July 2006
Peru					Discussions since 2004 on the basis of a comprehensive cooperation partnership

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of *People's Daily Online*, "China accelerates pace on FTA establishment in past five years" [online] 2006 [http://english.people.com.cn/200601/29/print20060129\\_239189.html](http://english.people.com.cn/200601/29/print20060129_239189.html); Economic and Social Commission for Asia and the Pacific (ESCAP) "Asia-Pacific Preferential Trade and Investment Agreements Database (APTIADA)", Asian Development Bank, 2005 and [bilaterals.org](http://www.bilaterals.org), official site [online] <http://www.bilaterals.org/>.

<sup>a</sup> Initially, the five States participating in the agreement were Bangladesh, India, Lao People's Democratic Republic, Republic of Korea, and Sri Lanka. The United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) acts as secretariat for the agreement.

<sup>b</sup> The members are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

<sup>c</sup> The members are Botswana, Lesotho, Namibia, South Africa and Swaziland.



Table II.8  
INDIA: PREFERENTIAL AGREEMENTS SIGNED OR BEING NEGOTIATED

Country or group	Date of entry into force	Date of GATT/WTO notification	Provisions	Type of agreement	Notes
<b>Implemented/signed</b>					
Asia Pacific (formerly Bangkok Agreement)	17/06/1976	02/11/1976	Enabling clause	Non-reciprocal agreement	Applies principally for Bangladesh, India, Republic of Korea and Sri Lanka. Positive list with the possibility of negotiating further tariff reductions (annual reviews)
ASEAN	2004	Not notified		Economic Cooperation Framework Agreement (EC)	Includes an "early harvest" programme. Gradual tariff reduction from 2004 to 2007/2010 (ASEAN 6/New ASEAN members)
Singapore	01/08/2005	Not notified		Bilateral free trade economic cooperation agreement	Twelve negotiating rounds carried out prior to signing
Bhutan	2/03/1995	Not notified		Bilateral free trade agreement	The 1995 agreement was renewed in 2005 and will hold until a new agreement enters into force
Afghanistan	Signed 06/03/03	Not notified		Preferential agreement	Preferential tariffs for a limited number of products
Sri Lanka	15/12/2001	27/06/2002	Enabling clause	Bilateral free trade agreement	India complied with the schedule for tariff reduction down to zero in March 2005 except in the case of 429 products Sri Lanka will do the same by 2008. A Closer Economic Partnership Agreement (CEPA) is being negotiated
Bangladesh	01/04/2006	Not notified		Framework agreement	Will be in force for three years; subject to renewal
Thailand	2003	Not notified		Bilateral free trade agreement	"Early harvest" programme with products that are freed with effect from 2004
MERCOSUR	Signed 25/01/2004	Not notified		Preferential agreement	Framework agreement signed 17/06/2003. Positive list. Does not envisage total tariff elimination. The object is to reach a free trade agreement
Nepal	06/03/2002	Not notified		Bilateral	Positive list. Preferential treatment for Nepalese products. Transit agreement in force since 5 January 1999 and a cooperation agreement in force since 6 March 2002
South Asian Association for Regional Cooperation (SAARC)	07/12/1995	25/04/1997	Enabling clause	Preferential agreement	Tariff preferences initially by product. Five negotiating rounds have been held for more than 5,000 products
Bangladesh, India, Myanmar, Sri Lanka and Thailand	Signed 08/02/2004	Not notified		Framework agreement	Negative list. Tariff elimination by 2012 (2017 for the least developed countries)
Chile	Signed 08/03/2006	Not notified		Preferential agreement	Positive list. An average 20% tax rebate will be applied from the outset (entry into force) to 98% of Chilean exports and 91% of Indian exports
<b>Being negotiated</b>					
Southern African Customs Union (SACU)				Preferential agreement	Negotiations have been underway since 2002. The Joint Group finalized the draft framework agreement in September 2004
South Asia <sup>a</sup>	Signed in January 2004	Not notified		Regional free trade agreement	Formally known as the South Asian Preferential Trade Agreement (SAPTA). Negative list for sensitive products. Tariff rebates of 0% to 5% in 7 years (8 years for Sri Lanka, 10 years for the least developed countries)
Gulf Cooperation Council (GCC)				Regional free trade agreement	The first round of negotiations took place in March 2006
<b>Being studied</b>					
China				Bilateral free trade agreement	With study group (March 2004)
Egypt				Bilateral free trade agreement	The draft text of the preferential agreement has been drawn up
Indonesia					The Memorandum of Understanding for the creation of a study group has been signed
Japan				Bilateral free trade agreement	With study group (July 2005). The two countries agreed to start negotiations in July 2006
Malaysia				Economic cooperation	With study group (2005)
Mauritius				Bilateral free trade agreement	With study group (2003)
Peru				Bilateral free trade agreement	In June 2006, the parties agreed to start discussions for an agreement on a limited number of products, along similar lines to the agreement negotiated between India and Chile
Republic of Korea				Bilateral free trade agreement	With study group (free trade agreement + Cooperation)

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Economic and Social Commission for Asia and the Pacific (ESCAP) "Asia-Pacific Preferential Trade and Investment Agreements Database (APTIADA)", Asian Development Bank, 2005; National Informatics Center (NIC), "India's trade: business opportunities" [online] <http://www.indiabusiness.nic.in/trade-india/fta-rt-a.htm>, *India Economic Survey 2005-2006*, chapter 6 [online] <http://indiabudget.nic.in/>; General Directorate for International Economic Affairs (DIRECON) [online] [http://www.direcon.cl/documentos/India2/antecedentes\\_generales\\_india.pdf](http://www.direcon.cl/documentos/India2/antecedentes_generales_india.pdf) and bilaterals.org, official site [online] <http://www.bilaterals.org/>.

<sup>a</sup> Refers to Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

The Ministry of Commerce of China released revised statistics in June 2006, which indicate that China's actual foreign direct investment (FDI) amounted to US\$ 72.4 billion in 2005, up 19.4% over the 2004 figure; this points clearly to the increasingly important role that transnational corporations have been playing in the Chinese economy. Official calculations show that although foreign firms account for only 3% of all firms in China, they contribute 28.5% of the country's total industrial value added and 20.5% of tax revenue.<sup>12</sup> The latest information available indicates that in the first four months of 2006, 12,639 foreign capital firms set up operations in China and foreign direct investment amounted to US\$ 18.48 billion, which represents a 5.7% increase over the same period in 2005 (*China Daily*, 2006 and *Xinhuanet*, 2006). In 2005, exports by foreign firms accounted for 58% of the

total exported by China. In the first quarter of 2006, this percentage had increased to 60%.

India has been slower to open up its economy. Foreign capital inflows amounted to just US\$ 5.135 billion in fiscal year 2005-2006. However, this value is the highest that has been recorded and represents an increase of 60% over the previous year. In March 2006 alone (last date available) FDI inflows were US\$ 831 million, an increase of 200% compared with March 2005. Once reinvested earnings have been calculated, total FDI for the period 2005-2006 should be close to US\$ 8.3 billion, an increase of 50% over the previous year (Ministry of Commerce and Industry, 2006). This new FDI boom seems to come in response to the new policies for attracting investors, including the establishment of special economic zones (see box II.1).

#### Box II.1

##### SPECIAL ECONOMIC ZONES IN INDIA

A policy was introduced in April 2000 for the establishment of special economic zones in India with a view to providing an internationally competitive and hassle-free environment for exports. Units may be set up in such zones for the manufacture of goods and rendering of services. All the import/export operations of the units are on a self-certification basis. The units in these zones have to be net foreign exchange earners but they are not subjected to any value added or minimum export performance requirements. Sales in the domestic tariff area by special economic zone units are subject to the payment of the full customs duty and to the import policy in force. Furthermore, offshore banking units may be set up in these zones.

The policy provides for the establishment of special economic zones in the public, private, joint sector or by State governments. Some of the existing export processing zones are also earmarked to become special economic zones. Accordingly, the government has converted export processing zones located at Kandla and Surat (Gujarat),

Cochin (Kerala), Santa Cruz (Mumbai-Maharashtra), Falta (West Bengal), Madras (Tamil Nadu), Visakhapatnam (Andhra Pradesh) and Noida (Uttar Pradesh) into special economic zones. In addition, three new special economic zones approved for establishment at Indore (Madhya Pradesh), Manikanchan-Salt Lake (Kolkata) and Jaipur have since commenced operations.

In addition, approval has been given for setting up 42 special economic zones in various parts of the country in the private/joint sectors, or by the State government.

##### Characteristics of Indian policy relating to the special economic zones

- The proposal is that the private sector or State governments in association with the private sector should establish the zones and that the private sector should be invited to set up infrastructure in the zones.
- The State governments have a leadership role in the creation of special economic zones

- A commercial framework is being developed by creating special windows under existing rules and regulations of the central government and State government for the special economic zones.

##### Requirements for the creation of a special economic zone

In order to create a special economic zone, it is necessary: (i) to generate new economic activities; (ii) to promote exports of goods and services; (iii) to promote investment based on national and foreign sources; (iv) to create employment opportunities; (v) to develop infrastructure; and (vi) to maintain the sovereignty and integrity of India, State security and friendly relations with foreign States.

##### Units in operation, investment and employment

As at 31 March 2005, there were 811 units in operation in the eight operational special economic zones, representing an investment of some US\$ 2 billion (18.309 billion rupees). These units provided employment for almost 100,650 persons, of whom 32,185 were women.

**Source:** Ministry of Commerce and Industry, "Special Economic Zones in India" [online] Department of Commerce <http://www.sezindia.nic.in/>, 2006.

<sup>12</sup> In addition, the official statistics show that in 2005, foreign firms accounted for 87.89% of high-technology exports.

## D. Conclusions

China's and India's economic, strategic and demographic importance place them at the forefront of development in Asia. Their relations with Latin America and the Caribbean are, however, in the early stages. While the relationship with China has recently been spurred essentially by that country's interest in securing guaranteed access to natural resources from South America, for both countries, Latin America remains largely unexploited as a trading partner (both as supplier and purchaser).

The countries of Latin America and the Caribbean must take advantage of the growing importance of Asia and of these two countries particularly in the present international economic environment. As shown in this chapter, South America's trade with China and India has so far been centred on the export of resource-based products, while the region's purchases from these sources tend to be low-, intermediate- and high-technology manufactures. It should be remembered that China has become one of the main destinations for exports from countries of Asia and the Pacific and that, gradually, these exports are becoming specialized, so that these countries have ceased to be just suppliers of resource-based manufactures and have become providers of more complex inputs. In this way, the other Asian countries are becoming part of the distribution chains of the large companies that have been attracted by the low cost of labour and China's large market potential; thus, China has ceased to be just one option for avoiding the high wages of the developed countries in the sector of products with a low technological content, and has become an inexhaustible source of new advanced-technology products.

Given the inter-industry relationships between South America and these two Asian countries, the region must be prepared to allow its companies to build ties with successful Asian firms by forming part of the supply chains

of the production units, with more complex inputs and incorporation of technology. In addition, it could consider the possibility of participating in these chains by producing more manufactures based on the natural resources that are currently being exported to Asia. As regards Mexico and Central America and the strategic relations maintained with these two countries, this subregion should become involved in the regional process of productive integration stimulated by the Asian markets in which China and India are playing an increasingly crucial role. The strengthening of trade relations through the signing of different types of trade agreements by Latin America and China and India tends to facilitate the possible incorporation of Latin American companies into Asian trade chains, whose activities centre on these two Asian countries. Rather than competing in major third markets, Mexico and Central America should seek to become part of a more intensive intra-industry trade with these two countries, as this will provide this subregion with new access routes to the Chinese and Indian market, thereby fostering the incorporation of new technologies.

Latin America should take advantage of the opportunities offered by both China and India to become part of existing production and distribution chains. One way of achieving this integration is to seek trade agreements with both of these Asian countries. The agreement already signed by Chile and China and the agreement negotiated between India and MERCOSUR are promising, but require further deepening and a wider scope. Thanks to the investments in the Asian and Latin America countries, it should be possible to achieve greater mutual understanding and this could form the basis for more flourishing trade relations between China and India, on the one hand, and Latin America, on the other.

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## Chapter III

# The Doha Round: an uncertain future

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### Introduction

The previous issue of *Latin America and the Caribbean in the World Economy* reviewed the trade negotiation process launched in 2001 as the Doha Round in the World Trade Organization (WTO), discussing in particular the impetus and shift in focus arising from the “July package” of 2004. This latest edition of the report describes the debates surrounding the main negotiation topics, including market access, particularly for the agriculture sector, and the deepening of trade rules. As on previous occasions, it also explores the interests and involvement of the Latin American and Caribbean countries in this process. This year’s issue reviews the negotiations in the light of the guidelines that emerged from the sixth WTO Ministerial Conference and examines the approach now being taken to the development dimension in the Doha Round, particularly as regards “Aid for Trade”.

A week from the end of July 2006, the Director-General of WTO recommended the negotiations be suspended after the main actors had failed to bridge their differences, particularly on agricultural liberalization. This means that the Doha Round will not be concluded this year, and the progress made in the negotiations thus far, much of it beneficial to developing countries, is now shrouded in uncertainty.

The sixth WTO Ministerial Conference, held in Hong Kong Special Administrative Region of China (SAR) in December 2005, had given renewed focus to the Doha Round negotiations (the first trade round held under WTO auspices) and set a tight decision-making schedule. The conference made it possible to maintain the pace of

negotiations with a view to their conclusion in late 2006, promoting the development dimension as proposed. Since then, however, and despite moments of high expectation, the successive deadlines set for defining modalities have been missed; and to all intents and purposes the process ground to halt in the first half of 2006. Despite intensive negotiations, three key issues have proven extremely difficult to resolve and require major efforts from a triangle of leading players: the European Union on agricultural market access, the United States on domestic agricultural subsidies, and the Group of Twenty (G-20) on industrial tariffs and the liberalization of services (WTO, 2006b). Ultimately, the talks were suspended because the gaps remained too wide, especially in the first two of these areas.

## A. How the process has unfolded since the launch of the Doha Round in 2001

### 1. The economic dimension of the Doha Round: the interests at stake

Since WTO was created in 1995 as part of the results of the Uruguay Round, the multilateral system has had both achievements and setbacks. It has contributed to the expansion of international trade, brought a broad range of sectors and issues into the multilateral arena, created new rules and supported a more stable trade environment. At the same time, however, considerable barriers and distortions remain in agricultural trade (ECLAC, 2005b).

Econometric estimates of the potential welfare gains from trade liberalization in the Doha Round vary according to the methodology used and the scenarios modelled (see UNCTAD, 2003; Newfarmer, 2005; OECD, 2006 and World Bank, 2006a); but they tend to coincide on a number of key aspects. First, further openness would yield proportionally greater benefits in agriculture than in the non-agricultural sector, because of the higher levels of protection currently prevailing. Second, the greater benefits from trade liberalization in agriculture come from tariff reductions rather than cuts in domestic support or export subsidies, although subsidies

are essential in gaining market access for some agricultural goods. Third, there would be large potential gains from liberalization in developing countries, especially in the agriculture sector, and this would impact on South-South trade (OECD, 2006).

Table III.1 summarizes the findings of two of the most widely used models: the Global Trade Analysis Project (GTAP) and the World Bank's LINKAGES model. The main difference between the two is that GTAP is a static general equilibrium model while LINKAGES is a dynamic one. As the table shows, the gains from full liberalization of goods trade are quite small in relation to GDP. As with previous multilateral trade negotiations, however, the Doha Round does not aim at the full liberalization on which the exercise reported in table III.1 is based, so its outcomes are likely to be even more modest. The estimates suggest small gains for developing countries; and even these would be confined mainly to just a few countries: Argentina (6%), Brazil (23%), China (24%), India (7.7%) and Viet Nam (8.6%).

Table III.1  
POTENTIAL GAINS FROM TRADE LIBERALIZATION <sup>a</sup>

	Year	Benefits from full liberalization <sup>b</sup> (in billions of dollars)			Benefits from full liberalization <sup>b</sup> (percentages of GDP)			Doha benefits <sup>c</sup> (percentages of GDP)		
		Developing countries	Developed countries	World	Developing countries	Developed countries	World	Developing countries	Developed countries	World
Global Trade Analysis Project (GTAP)	2005	22	59.5	84	0.44	0.23	0.27	0.08	0.10	0.09
Global Trade Analysis Project (GTAP)	2002	108		254						
LINKAGE	2005	90	197	287	0.80	0.60	0.70	0.14	0.24	0.23
LINKAGE	2003	539		832						

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of F. Ackerman, "The shrinking gains from trade: a critical assessment of Doha Round projections", *Global Development and Environment Institute Working Paper*, Nº 05-01, 2005.

<sup>a</sup> The LINKAGE model projects results to 2015.

<sup>b</sup> Assumes tariffs on all products and all agricultural subsidies are lowered to 0%.

<sup>c</sup> For trade in agricultural goods, reductions of 45%, 70% and 75% in three tariff bands for developed countries, and cuts of 35%, 40%, 50% and 60% in four tariff bands for developing countries; non-agricultural tariffs, a reduction of 50% in developed countries and 33% in developing countries. Does not include estimates for liberalization of the services sector.

Table III.1 also reveals differences between the most recent estimates and previous exercises using these models. These occur for a number of reasons, including:

- Differences in the base year used for the simulations (1997 versus 2001). This is important because a change in base year can capture a trade expansion that is not attributable to liberalization.
- The incorporation of new information, particularly regarding actually applied tariffs, free trade agreements and special tariff arrangements, such as the Generalized System of Preferences (GSP), the Cotonou Agreement, the Andean Trade Promotion and Drug Eradication Act (ATPDEA), and so forth. This helps to pinpoint the real impact of reducing most favoured nation (MFN) tariffs because, when the tariffs actually applied are already below MFN rates, lowering the latter does little to boost trade. Moreover, the tariffs negotiated under WTO auspices are bound tariffs, which are higher than those actually applied, and so reducing bound rates also has no direct impact on trade. The free trade agreements negotiated in various parts of the world are in practice generating a kind of extra-WTO trade liberalization.
- The models that used 1997 as the base year do not factor in the positive effects on world trade of China's accession to WTO, whereas this liberalizing effect is reflected in the more recent models.

An evaluation of the benefits of the Doha Round should also take into account the role of WTO as an international institution, particularly in terms of stabilizing trade flows and anchoring the terms and conditions under which trade

takes place. During the Asian crisis, for example, WTO helped to contain potential protectionist pressures, since member countries could not alter their tariffs or take unilateral steps to restrict trade that were not allowed under WTO agreements. The tariff cuts secured have in practice consolidated market access conditions. By the same token, the possible elimination of export subsidies and lower levels of domestic support for agricultural goods represent headway in building a fair trading system, which is proving to be a difficult and costly process. Also, the greater certainty afforded by improvements to a number of trade rules, such as those concerning the use of antidumping measures, provides a broader horizon for investment decisions.

The problem in reaching agreements broadly stems from differences between one group of developed countries that favours substantive agricultural liberalization (the United States and Australia) and another that would prefer to keep significant levels of protection (the European Union, Japan and the Republic of Korea). The negotiations are also highly complex, because of the differential impact of liberalization among developing countries (not all of which gain from liberalization in the short term), not to mention the nature of negotiations themselves, in which delicate balances have to be struck to produce a single undertaking that draws together a matrix of interdependent countries and issues. Moreover, the emergence of the developing countries, including the least developed countries (LDCs), as active participants in the negotiating process, makes an outcome that fails to provide substantive responses to their demands less likely.

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## 2. Five years into the Doha Round

The WTO Ministerial Conference held in Hong Kong SAR, which coincided with the tenth anniversary of the creation of WTO, breathed new life into the Doha Round,<sup>1</sup> which had been launched at the fourth Ministerial Conference at Qatar in 2001, almost seven years after the entry into force of the Uruguay Round agreement.

### (a) Ambition of the agenda

The Doha Agenda expanded the negotiations on agriculture and services trade envisaged in the outcome

of the Uruguay Round (the “built-in agenda”), to address traditional areas of trade in non-agricultural goods, along with new areas and, in particular, the implementation-related problems reported by developing countries. The adoption of agreements on 1 August 2004, known collectively as the “July package”,<sup>2</sup> narrowed the coverage of new trade-related issues, by excluding three of the four issues identified at the first WTO Ministerial Conference in Singapore in 1996 (investment, competition policy and transparency in government procurement), while retaining the fourth (trade facilitation), along with aspects

<sup>1</sup> Sutherland and others (2004) make a broad assessment of the functioning of the multilateral trade system. The results and initial evaluations of the Ministerial Conference are contained in ECLAC (2006a).

<sup>2</sup> These agreements made it possible to break the impasse that had arisen at the 2003 Ministerial Conference in Cancún. For a review of this subject see the previous edition of this report (ECLAC, 2005a; chapter II); see also WTO (2005b) and ICTSD (2005).

of the trade-environment relationship. A more precise interpretation of the agreement on intellectual property and its relationship with public health was reached at Doha and refined during subsequent phases, particularly during the Hong Kong meeting.

### **(b) Development dimension**

The core objective of the Doha Round was divided into two broad areas of negotiation: issues relating to the implementation of the Uruguay Round accords, and the application and strengthening of special and differential (S&D) treatment. Integration of these two issues into the debate on other specific areas or negotiation topics failed to keep pace with the schedule leading up to the Hong Kong Conference. For example, the systemic aspects of S&D treatment were not taken up again until the start of 2006, when the mechanism for supervising this, which had been proposed several years earlier, underwent a further review.<sup>3</sup> In addition, three areas of interest for developing countries are being addressed through task forces, namely debt and financing, technology transfer and the specific aspects of small, vulnerable economies. Of these, only the last has permeated the general negotiations, specifically in relation to access to goods and services markets.<sup>4</sup> Lastly, a relative consensus is emerging on the relation between “aid for trade” and the capacity of developing countries to fulfil commitments (conditionality), which seems to be

creating a new focus in the treatment of the development dimension in the multilateral trading system.

On 24 July 2006, the WTO Director-General announced that the Doha Round negotiations were being suspended “to enable the serious reflection by participants which is clearly necessary.” He did not specify when the process originally scheduled to conclude in 2005 might be resumed; but the hiatus is likely to last several months or even years. The announcement came after the failure of the most recent meeting of the Group of 6 (G-6), consisting of Australia, Brazil, the European Union, India, Japan and the United States, which had become the main interlocutors of the process. This decision was justified because the gaps between the interlocutors remained too wide (see ECLAC 2006d).

The United States refused to give way on further reductions to agricultural subsidies. The European Union, meanwhile, failed to adopt a clear position on additional tariff cuts on agricultural products, still less regarding its intentions concerning the universe of sensitive products to which such reductions would not apply. Brazil and India were reluctant to accept significant commitments to lower their bound tariffs to help ensure a satisfactory outcome to the negotiations. The large number of issues that remain outstanding because of the backlog of key decisions in this domain, compounded by the suspension of negotiations, further reduce the chances of conclusion in 2006.

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## **B. Pillars of the negotiations and results achieved since the sixth Ministerial Conference**

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### **1. Main contributions and challenges**

The sixth Ministerial Conference began by considering a wide-ranging draft based on the guidelines of the 2004 July package, but which called for political and

technically complex decisions that ultimately could not be taken.<sup>5</sup> In the days leading up to the conference, a number of potentially beneficial agreements were reached for

<sup>3</sup> Developing countries feared that this mechanism would be used as a tool for classifying and differentiating between countries.

<sup>4</sup> The demands and proposals of small, vulnerable economies are attracting increasing attention. Several initiatives have been presented by an active group of 22 countries, mostly from Latin America and the Caribbean, together with a number of island states. Landlocked countries, meanwhile, have formulated the Asunción Platform for the Doha Development Round (WT/COMTD/SE/3).

<sup>5</sup> In particular, decisions requiring specific numbers to give content to the formulas being bandied about.

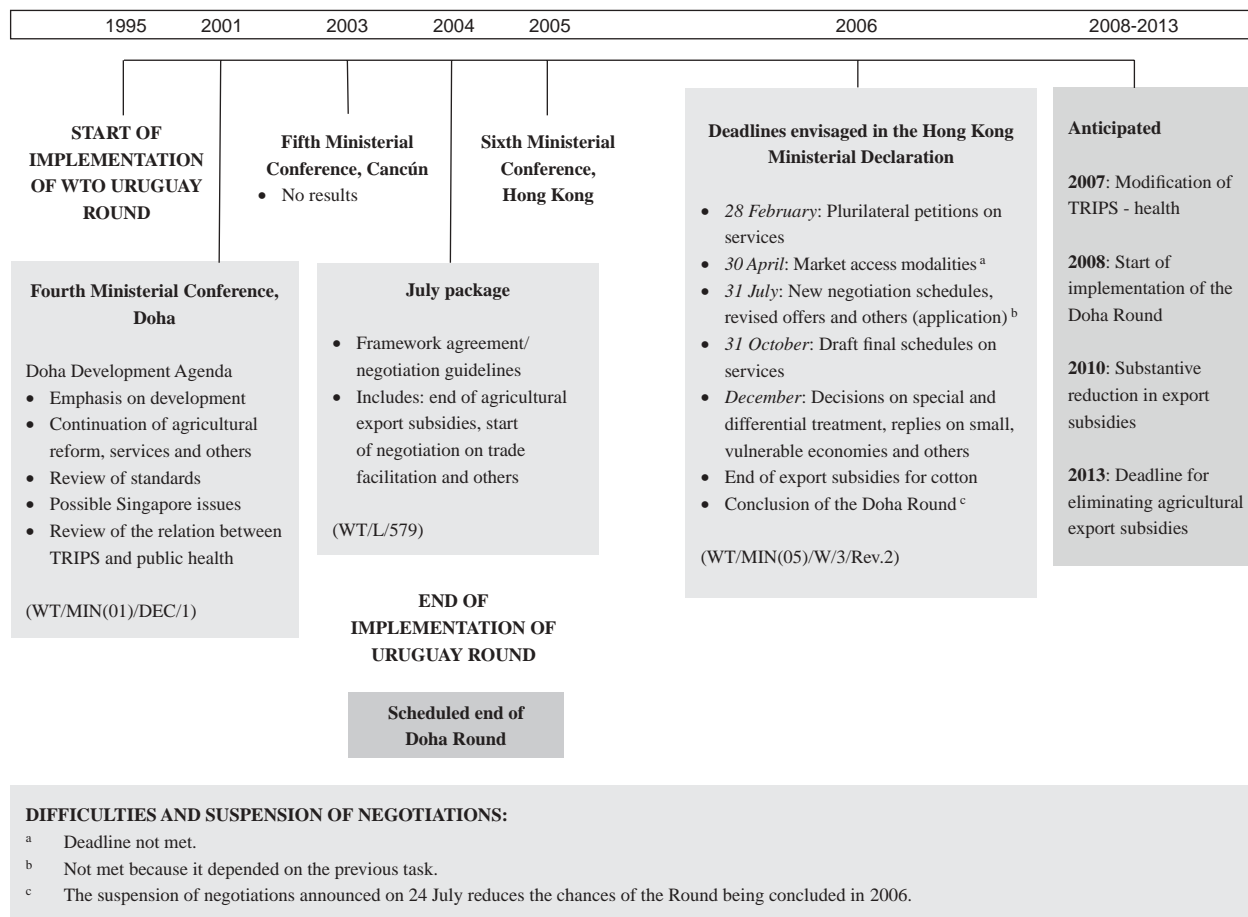


developing countries, this time in the area of intellectual property, which eased the ministers' agenda somewhat. On taking office as WTO Director-General in September 2005, Pascal Lamy inherited a troubled scenario and a very poor outlook for the upcoming Ministerial Conference to be held in Hong Kong SAR (see ECLAC, 2006a). For that reason, several weeks earlier he acknowledged the need to adjust expectations, while insisting that WTO Members still maintained their level of ambition for the results. In fact, it proved possible to focus the work and formulate a consensus-based declaration, agree upon a work plan with precise dates, and assume the commitment to conclude negotiations by late 2006. The fact that a declaration was approved, unlike what happened in Cancún, regardless of its substantive content and even though the commitments established in it have subsequently not been fulfilled,

allows that Ministerial Conference to be duly recorded in the history of the Organization (see WTO, 2005c).

The main results were to keep the negotiating process going, set deadlines for its conclusion, provide detailed —albeit not always consensual— guidelines and adopt various decisions that specifically address the issues of LDCs (on market access and intellectual property, among other things)<sup>6</sup> and to complement the Doha Agenda with aid for trade. In addition, the least complicated of the three agriculture pillars was resolved, i.e., a date for eliminating export subsidies, which should be completed in 2013 (see scheme III.1). No progress was made on market access, the area in which the European Union had most problems. In addition, the resolution to successfully conclude the Doha Round by late 2006 was reaffirmed, which implied starting implementation in 2008.<sup>7</sup>

Scheme III.1  
TIMETABLE OF NEGOTIATIONS AND IMPORTANT EVENTS IN THE WTO DOHA ROUND



<sup>6</sup> With regard to S&D treatment, the decision was taken to adopt five proposals put forward by LDCs, including a seven-year extension to the transition period for the agreement on trade-related investment measures (Hong Kong Ministerial Declaration, paragraph 36).

<sup>7</sup> The negotiating authority of the Government of the United States — a key element for concluding, although not for holding the negotiations — will be valid until mid-2007. That year had been intended for ratification of the results of Doha in WTO member countries.

That the negotiating process faced enormous difficulties in 2006 was revealed in July, when the process had to be suspended. On agriculture, simultaneous movement was needed on market access, the ending of export subsidies, and a substantive reduction in domestic support. On market access, in addition to tariff reductions, the number of exclusions had to be reduced and compensated by substantial increases in existing quotas. Domestic support had to be reduced from the amounts authorized in WTO, which are considerably higher than those currently in force, and the negotiation had to come close to the current situation at least, to avoid regression to the practices prevailing prior to the Doha Round.<sup>8</sup> This reduction was intended to preempt the use of devices for allocating the same resources through other channels, by broadening the definition of the blue box, as proposed by the industrialized countries. This delicate agricultural balance then had to be weighted against negotiations on non-agricultural products and services, where other major difficulties are in play, albeit

less problematic than those in agriculture. The United States, the European Union and Japan have of course made the scale of their agricultural liberalization conditional on the level of openness that developing countries can offer on trade in non-agricultural products and services. This is one of the aspects that held up progress in the Doha negotiations, because the developed countries have insisted that Brazil and India, in particular, should accept significant liberalization on non-agricultural market access (NAMA) and services.

The Hong Kong Ministerial Declaration maintains a development rhetoric, which is crucial for involving the majority of developing countries in the negotiation process. Nonetheless, the recommendations and decisions are increasingly focused on LDCs, a category in which the only Latin American and Caribbean member is Haiti. Relatively more attention is also being paid to the Work Programme on Small Economies, which could bring benefits to a larger number of the countries in the region, especially in the Caribbean.

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## 2. Key issues for furthering the negotiations

Few results have been achieved in the first half of 2006, since the Hong Kong Ministerial Conference. Neither the established deadlines nor the objectives initially proposed on modalities have been met,<sup>9</sup> nor has the aim of concluding the Doha Round in 2006. Nonetheless, progress on technical aspects aroused expectations that major decisions could be adopted in the negotiations.<sup>10</sup> Apart from the lack of consensus to address the development dimension, however, differences also remained between developing countries and within their groupings, raising doubts about the latter's representativeness in some cases. A new form of coordination among WTO members also emerged in the form of G-6, but this mode of work has been called into question by developing countries, including some in the region, in relation to its inclusiveness and representativeness.<sup>11</sup> In response to this criticism, the

WTO Director-General stated that the progress made in the deliberations did not constitute adopted decisions, and all delegations were being kept informed to ensure transparency.

### (a) Organization of the negotiations

As the negotiations in 2006 were split between establishing modalities no later than 30 April, and submitting global schedules of undertakings on trade in goods (both agricultural and non-agricultural) and services by 31 July, this meant that the latter indirectly became the critical date for determining whether the negotiations would be brought to a successful conclusion by the end of the year. The sequence of negotiations on access for agricultural and non-agricultural products actually shows that the first stage focused on the

<sup>8</sup> In addition, supervision mechanisms needed to be improved to oversee the fulfillment of commitments and minimize the potential for transfer between the amber, blue and green boxes. This had already been curtailed in the July package, by reducing the overall base level of support, which incorporates the amber and blue boxes at least (see WTO, 2004a, annex A, paragraph 7).

<sup>9</sup> The initial deadline established for this task in Doha was March 2003.

<sup>10</sup> In the first half of 2006, the General Council met three times and the Trade Negotiations Committee met on four occasions. There were also informal ministerial meetings (Davos, Paris), meetings of G-6 and between Brazil, the United States and the European Union (Rio de Janeiro).

<sup>11</sup> Cuba and the Bolivarian Republic of Venezuela have expressed their disagreement with the procedures for preparation and running of the conference, and also with the subsequent work.

tariff reduction mechanism (use of the global negotiation formula or traditional procedure for exchanging petitions and offers by product). Once a liberalization methodology had been agreed upon, the subsequent discussion had to focus on the parameters to be fed into the formula, and hence the possibility of obtaining an approximate outcome to the negotiations. The value of the results and the details, which are very important, centre on the verification of schedules, the negotiation of exceptions to the formulas, their trade importance and their treatment.

That stage was fundamental for evaluating the outcome in the case of agriculture, especially the treatment of tariff quotas. Although no formula was agreed upon in this sector of the negotiations, the basic methodological parameters were defined as follows: (i) cuts based on bound tariffs; (ii) classification of agricultural products into four tariff bands; (iii) proportionately larger reductions for the highest tariffs; (iv) the existence of sensitive and special product categories that would receive different treatment, and other elements relating to market access, such as special safeguards and specific issues for developing countries. In agriculture, the modalities also include formulas for reducing domestic support. Table III.2 summarizes the main proposals presented.

Work in the first half of 2006 focused on the three key issues where differences were greatest and the level of ambition also defined the scope of the remaining issues on the agenda, namely domestic support in agriculture, and market access in both agriculture and non-agricultural goods. The level of ambition stems from a combination of reductions with trade significance, and the flexibility to be defined by the parameters for a set of instruments, such as the new blue box, sensitive and special products, the special safeguard mechanism for developing countries, and others. The chairperson of the agriculture negotiations decided to prepare reference papers addressing the three pillars of the agreement in the sector (WTO, 2006a).<sup>12</sup>

### **(b) Domestic support in agriculture**

This involves defining cuts in the amber box (subsidies that most distort trade), disciplines for the

green box (permitted subsidies) and various instruments in relation to cotton.<sup>13</sup> Nonetheless the greatest debate arose in relation to the blue box (subsidies not linked to production levels) —in particular, cuts in average expenses; caps applicable to specific products as part of the value of production; and new disciplines for those subsidies. The new blue box, which does not impose limits on production, is an issue on which the main stakeholders hold divergent positions. For example, the European Union would accept spending caps on certain products if the United States would stop opposing new rules on the blue box.

### **(c) Market access for agricultural products**

In addition to work to agree upon thresholds and tariff cuts in the sector,<sup>14</sup> the largest gaps emerged in the treatment to be received by sensitive products. For these, the proposals on the percentage of tariff lines ranged between 1% and 15% before the Hong Kong conference, and this issue was not clarified in 2006. Another debate revolved around criteria for quotas to ensure a substantive improvement in market access for products subject to this type of measure.<sup>15</sup> Exporting countries have lobbied to restrict sensitive products, deepen the proposed cuts and curb the use of the special safeguard mechanism by developing countries that have adopted a defensive stance on this subject (G-33). Some developing countries fear protectionist effects from this mechanism in South-South trade. A similar debate arose on special products, especially regarding the definition of criteria, the treatment to which they would be entitled, and acceptable deviation from the formula. Positions on the number of tariff lines that could be designated as special products varied between five lines and 20% of them.

The gap between positions in the sector is clearly reflected in the extensive final draft of possible agricultural modalities, submitted by the chairperson of the respective negotiating committee on 12 July, which stresses that “this document is not, [...] agreed by Members, even as a draft” (TN/AG/W/3).

<sup>12</sup> The reference papers, which were the responsibility of the chairperson, initially consisted of drafts on issues that were not priorities and contained text rather than figures.

<sup>13</sup> Some analysts highlight the overestimates of support given to the agriculture sector and the limited real effects of the suggested reductions, in addition to the costs involved for those who apply them, given the gaps that exist between bound and applied rates (see Panagariya, 2005).

<sup>14</sup> The report that the chairperson of this negotiation took to Hong Kong stated that there was greater consensus on thresholds than on the cuts, and that work needed to be done on tariff caps.

<sup>15</sup> The criteria include the basis on which the increase in quotas would be calculated, either linked with domestic demand or with imports and current quota commitments.

Table III.2  
**COMPARISON OF PROPOSALS SUBMITTED FOR THE AGRICULTURE SECTOR BEFORE THE HONG KONG MINISTERIAL CONFERENCE**  
*(Distributed October 2005)*

	Proposal made by the United States	Proposal made by the European Union	Proposal made by G-20
Tariff measures	Five-year reduction period	No deadlines specified	No deadlines specified
Tariff reduction	Four bands involving cuts of between 55% and 90% for developed countries Smaller reductions and longer periods in the case of developing countries	Based on the G-20 proposal. Establish four bands with larger reductions for higher bands and flexibility for linear reductions in each band. Bands: 0%-30%; 30%-60%; 60%-90%; more than 90%	Defines four bands of 0%-20%, 20%-50%, 50%-75%; more than 75%. Bands for developing countries of 0%-30%, 30%-80%, 80%-130%, and over 130%. Linear reduction averaging 54% for developed countries and 36% for developing countries
Export subsidies	Total elimination in 2010 and new disciplines	Total elimination in a period to have been agreed upon at Hong Kong and new disciplines	Elimination of all export subsidies in 2010 and immediate standstill <sup>a</sup>
Domestic support	Five-year reduction period in the framework of elimination of trade distorting measures within five years, following a five-year phase of reduction and evaluation in each case	No period specified	No period specified
Amber	60% reduction in the Aggregate Measurement of Support (AMS) and caps for products according to 1999-2001 data	70% reduction, proportional reductions by others. Creation of three groups of countries organized in three AMS tiers: with reductions of 60% and 50%. Caps for specific products	Defines three bands: countries with US\$ 25 billion of assistance should reduce by 80%; countries with between US\$ 15 billion and US\$ 25 billion assistance should reduce by 70%, and those between 0 and US\$ 15 billion should reduce by 60%
Blue	Harmonization of amounts of assistance to reduce differences between the United States and the European Union	Principle of harmonization, with proportionality	
Green	Cap of 2.5% on the value of agricultural production from the 5% agreed upon	The 5% cap is considered too tight, and no caps should be considered. Establish more disciplines and agree upon a limit for price gaps	Upper limits per product
Other issues	No changes in criteria or upper limits Establish a peace clause	Review criteria contained in this category, without greater specification Geographical indications for all agricultural products, including a multilateral notification system. Protection of existing trademarks	Review and clarify criteria Liberalization of tropical products Special and differential treatment as an integral part of the negotiations, including special products and special safeguard measures

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

<sup>a</sup> The proposals on export subsidies arise from the New Delhi Declarations, 18 and 19 March 2005, and the Bhurban Declaration, 9 and 10 September 2005.

**(d) Non-agricultural market access (NAMA)**

The debate on the parameters of the tariff reduction formula, flexibility for developing countries (including the possibility of exempting some of their goods from the reduction) and the treatment of unbound tariffs has been particularly difficult. Two opposing groups have emerged: those supporting an agreement without full reciprocity, and those who proposed real market access by liberalizing applied tariffs instead of bound tariffs (a position rejected by developing countries). The divergence between the two positions is also apparent in the gap between the coefficients proposed by the developing countries (25) and the developed countries (5) (WTO documents JOB(06)200/rev.1 and TN/MA/W/79). An additional front of discussion also opened up with the arrival of proposals on export restrictions in the framework of non-tariff barriers (WTO, 2006c).

The NAMA-11 group of developing countries<sup>16</sup> supported the following principles: flexibility to ensure policy spaces, results that are fair and balanced with other areas of negotiation, and recognition that development concerns will be addressed in the modalities (see WTO, 2006d and 2006e). The group also supports the concerns of least developed countries and other small, vulnerable economies, without creating a new subcategory of members. In addition, NAMA-11 insists on maintaining its option of recourse to flexibility and differential coefficients in the formula, in keeping with its interpretation of the July package (see paragraph 8 of the annex on NAMA).

While the developed countries stressed differential coefficients as the main flexibility mechanism, developing countries evaluated the asymmetries existing between the offers made by the developed countries on agriculture and their demands in terms of non-agricultural market access. They are also demanding the comparability envisaged in the Hong Kong Declaration, which ensures a relatively high level of ambition in market access

for agriculture and NAMA (see paragraph 24 of the Ministerial Declaration of Hong Kong and *Inside US Trade*, 13 January 2006).

Argentina prepared criteria for that comparison and proposed work on four elements: reduction formulas, flexibilities and sensitive products, tariff caps and the relation between bound and applied tariffs, and tariff simplification. Its arguments highlight the methodological differences on tariff reduction between the two sectors —bands or formula— and specifically consider the equivalency of the proposals, in terms of what their application in each case would mean in the other sector. This exercise reveals a sharp inter-sectoral asymmetry.<sup>17</sup> Another point highlighted is the need to evaluate not only proposals for designating tariff lines for sensitive agricultural products but also their significance in trade-value terms and the imports affected.

The final document presented by the group chairman on NAMA, dated 26th June, reflects the distances between the positions, and laments the fact that the report is “at best a step in the direction of full modalities”. The annexes on the most contentious issues firstly contain the structure and coefficients of the formula and flexibilities of paragraph 8. It is also claimed that the negotiation work has been constrained and conditioned by the agricultural sector (JOB(06)200/rev.1). Nonetheless, the outline content of the possible agreement in this sector is relatively well-defined, with the following general constituent parts: the formula, the treatment of unbound tariffs, deadlines for developing countries and other flexibilities (see box III.1).

In fact, regarding the agriculture and non-agricultural negotiations alike, the widespread opinion is that because of the flexibilities contained in the different negotiating modalities, a large group of developing countries, in addition to LDCs, would not have to make significant liberalization commitments. Moreover, in terms of rules there is a limited negotiation on new substantive disciplines, one of the main difficulties that developing countries have faced as a result of the Uruguay Round obligations.

<sup>16</sup> Argentina, the Bolivarian Republic of Venezuela, Brazil, Egypt, India, Indonesia, Namibia, the Philippines, South Africa and Tunisia.

<sup>17</sup> One of the examples, illustrated in the document for an original tariff of 35%, states that the coefficient of 10 proposed by the European Union and the United States for access to markets for non-agricultural products would result in a tariff of 7.8%, equivalent to a linear cut of 77.8%; whereas the proposal made by the bloc to reduce the same original tariff in agriculture would be 42.8%, reaching a tariff of 19.3% (rounded to one decimal place). See the communication from Argentina dated 9 March (TN/MA/W/67; TN/AG/GEN/14).

## Box III.1

## CONSTITUENT ELEMENTS OF A POTENTIAL NAMA AGREEMENT

1. A Swiss Formula applied on a line-by-line basis for bound tariffs and different coefficients for developed and developing countries.

2. Treatment of unbound tariffs:<sup>a</sup> a non-linear mark-up, with a constant amount in terms of percentage points to be defined, to determine the basis for applying the formula; the base rate (focus of discussion) would be defined as:  $T_b = T_a + \text{mark-up}$ , where  $T_a$  is the applied tariff and  $T_b$  is the base rate from which the reduction would occur. This already formed part of the Hong Kong Ministerial Declaration (paragraph 17), so the centre of discussion has been the level of mark-up (which would be fixed). Its impact therefore depends on the level of the applied tariff. This is potentially a

very important result giving countries certainty regarding tariffs in force in the destination market for their exports.

3. Apart from longer implementation periods for developing countries, the negotiation focused on flexibilities for these countries in adopting the general formulas. For example, up to a certain percentage of tariff lines (10% has been mentioned) could apply a smaller reduction, but not less than half of the general formula. Other more specific exceptions would be in terms of unbound tariff lines or without applying the formula.

4. Other flexibilities for exemption from the formula would be applied to countries

whose binding coverage of non-agricultural tariff lines is less than 35% (Cuba and Suriname in the region), provided they bind the majority of their tariff universe (100% has been suggested) at an average level no greater than the overall average of tariffs committed to by developing countries in the Uruguay Round. This provision was set out in paragraph 6 of the annex on NAMA in the July package, with numbers to be confirmed.

5. The negotiations also considered the potential sectoral agreements that are being promoted, and there is additional flexibility for small, vulnerable economies.

<sup>a</sup> This is exclusively a NAMA issue, since one of the obligations on members in the Uruguay Round was to bind all their agricultural tariffs. The majority of unbound tariffs correspond to developing countries.

### 3. Other developments of interest

#### (a) Trade facilitation

Progress has been made in improving mechanisms relating to merchandise movements and reducing the degree of discretion with which this is managed. The use of information and communication technologies (ICTs) and the introduction of international standards play a very important role here. The proposals presented in the last few months are evidence of an intent to find mechanisms to implement the measures agreed upon and coordinate them with technical assistance instruments, capacity building and special and differential treatment. These have generated broad interest in the region, emphasizing the importance of S&D treatment and presenting alternatives for making it operational (particularly WTO documents TN/TF/W/41 and TN/TF/W/81). Other proposals relate to the functioning of agreements on customs unions, particularly the relevance of regional coordination on rules, standards and border procedures;<sup>18</sup> conditionality of the degree of compliance with commitments, based on

the provision of technical assistance, support for capacity building and financing for developing countries and LDCs, among others.

#### (b) Development dimension and other issues

Differences and backlogs have systematically persisted on implementation issues<sup>19</sup> and special and differential treatment; and since the Hong Kong conference, considerable work has also been done on aid for trade. Outstanding issues in the negotiations since December 2005 include the following:<sup>20</sup> (i) plurilateral negotiations on services (while also persevering with bilateral negotiations) and progress in terms of their internal regulation; (ii) within the work on standards, the decision adopted on a transparency mechanism for regional trade agreements (JOB(06)/59/Rev.5), while less headway was made on new disciplines in relation to fishing subsidies, and proposals on anti-dumping continued to proliferate; and (iii) diverging views persisted on geographical indications on intellectual property.<sup>21</sup>

<sup>18</sup> Needs raised in the proposals made by India (WTO documents TN/TF/W/77 and 78) and other countries, including Peru (WTO document TN/TF/W/30).

<sup>19</sup> This includes issues relating among others to the following: investment standards, balance of payments, geographical indications, intellectual property and biodiversity.

<sup>20</sup> For further background on this, see the WTO documents on: (i) services (TN/S/25 to 28); (ii) standards (TN/RL/16 - 19); and (iii) intellectual property (TN/IP/15 and 16). See also CINPE/ICTSD (2006) and ICTSD (2006).

<sup>21</sup> This debate includes the voluntary nature of the system and freedom for countries to define their own implementation provisions within their legal framework, a line adopted by the United States, Australia and 10 Latin American and Caribbean countries, among others (see TN/IP/W/10 and addendum of April 2005).

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#### 4. The region and other stakeholders: their participation in the process

The region's countries have continued to participate actively in various interest groups, especially on agriculture; and Brazil in particular has played a very important role, both in this and in other areas of negotiation, through its participation in key groups such as the current G-6. Nonetheless, given their inherent characteristics and the priorities they give to international engagement, countries adopt different positions on individual subjects, as shown in several debates in the developing country groups. Latin American and Caribbean countries have also played an active role and given leadership in groupings addressing specific topics, such as NAMA, anti-dumping and fishing subsidies; and, in the period following the conference in Hong Kong, they have played a key part in trade facilitation, formulating specific proposals on mechanisms for S&D treatment and the interrelationship with commitments arising from the negotiations.<sup>22</sup> Four Latin American and Caribbean countries that have signed free trade agreements (Chile, Colombia, Mexico and Peru) expressed their concern about the difficulties in moving forward in a letter sent to the Director-General of the WTO at the end of April, in which they pointed out that individual agreements are no substitute for an ambitious multilateral round, since there are issues such as agricultural subsidies and trade rules that need to be addressed at this broad level of negotiation.

Latin American and Caribbean countries also continue to adopt both "offensive" and "defensive" positions on different topics within the agriculture negotiations. For example, whereas G-20, in particular Brazil and Argentina, are putting forward ambitious proposals on tariff cuts,<sup>23</sup> limitation of sensitive products and application of disciplines on the green and blue boxes, some members of that group support the more defensive proposals of the G-33 on special products and the special safeguard mechanism (several Latin American and Caribbean countries also participate in that group). Developing countries, including several from the region, notably Costa Rica, have shown special interest in liberalizing tropical products, e.g., by proposing to exclude them from the sensitive products that would receive differential treatment in terms of market access. These proposals have been strongly questioned by the Group of African,

Caribbean and Pacific States (ACP), because the Caribbean countries have preferential access for several of these products, such as sugar or bananas, and an exclusion of this type would erode that preference.

Latin American and Caribbean countries have also put forward joint proposals in conjunction with other developing nations, such as China, India and South Africa (with whom they participate in G-20 and G-33), both for the agriculture negotiation and NAMA-11, among others. India, whose growth and export performance have been very impressive over the last few years, has often coincided with interests and proposals made by Latin American and Caribbean countries, e.g., in the groups and topics mentioned above, and in the proposal to move forward on mode 4 service provision, trade facilitation, intellectual property and public health, and special and differential treatment, among others. India has a vested interest in the NAMA negotiations, since manufactures dominate its export structure and it faces tariff peaks for key exports (textiles, clothing and leather products), and in several service subsectors (engineering, architecture, health, information technology and mode 4). It also has offensive and defensive interests in the agriculture sector, as a net exporter of food products; and it seeks protection for its fragile rural population through its membership of the G-20 and G-33 (WTO, 2006b).

The position of China appears to be different, as it might be thought not to require further concessions following the commitments it assumed when joining the WTO in 2001. This country would have much to lose from a failure of Doha, since it has relatively low tariffs (compared to other large developing countries), and progress in the multilateral system would strengthen the current growth effect of its exports. A strengthening of the multilateral system would also act as a defence against protectionist pressures from developed countries. Moreover, in view of the likely failure of those negotiations, the country is stepping up its efforts to negotiate preferential agreements, particularly in its own region (Hufbauer and Schott, 2006). This raises genuine risks for Latin American and Caribbean countries, which may find themselves lagging behind, although China has also pursued agreements with some of these countries (see chapter II).

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<sup>22</sup> The topics of interest to these countries are shown in ECLAC (2005a), table II.1.

<sup>23</sup> Tariffs in these countries have lower averages than in developed countries and other developing countries (particularly in Asia).

Meanwhile, developed countries stood firm on the proposals made before Hong Kong, insisting that they would only be adjusted once better offers were received from other countries, both developed and developing alike. Whereas the European Union has adopted proactive positions on NAMA and services, but more defensive positions on several aspects of the agriculture negotiation, the United States is defensive on aspects of export competition—particularly food assistance—but clearly offensive in terms of market access. The European Union has also expressed interest in resuming work on the Singapore issues within the WTO and in other forums, which, except for trade facilitation, dropped off the agenda as a result of the July package. Nonetheless, the priority for the two leading players, the European Union and the United States, was to conclude the Doha Round in 2006; and they stressed the risk of failing to achieve its internal processing by the expiry of Trade Promotion Authority in the United States (European Commission, 2006; USTR, 2006).<sup>24</sup> The latter is persevering with an active policy of bilateral preferential agreements, encompassing several countries in the region (negotiations with Peru and Colombia are the latest to have been concluded). These agreements often trail disciplines that have not yet been developed in the multilateral system.

As in earlier phases, variable geometry has been designed to coordinate the interests of these large stakeholders and cuts across the North-South axis,<sup>25</sup> although signs of differentiation and pressure on the larger developing countries to make further concessions also persist. Moreover, specific demands by small economies or LDCs—which are increasingly active participants on the issues of interest to them—to address their particular situations, have been rejected by other developing countries, and no agreement has been reached to establish new country categories.

Unlike what happened in the Uruguay Round, these negotiations have not elicited active support from industry in either the United States or Europe, or in the other leading developed countries. In contrast, private-sector and civil-society groups that are critical of the WTO negotiations have organized to promote their arguments (Hufbauer and Schott, 2006). In Latin America and the Caribbean, negotiations in the multilateral system framework are also failing to attract interest from the private sector, which is more focused on bilateral negotiations and the corresponding approval and implementation processes. This panorama is further complicated by the proximity of elections in several of the countries that are key actors in the process.

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## C. Critical task: how to empower the development dimension?<sup>26</sup>

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### 1. General issues of the development dimension

The development dimension is not a new concern in the multilateral system, but over time its conceptualization and treatment have changed. At the present time, more attention is being paid to technical assistance needs, institutional capacity-building and, more recently, aid

for trade to address adjustment costs and develop export supply capacity. From the inception of the Generalized System of Preferences to the introduction of special and differential treatment (as defined and implemented since the Uruguay Round) the emphasis has shifted from

<sup>24</sup> There are several views on the difficulties in renewing Trade Promotion Authority, compounded by the conclusion of the Farm Security and Rural Investment Act (known as the Farm Bill) in late 2007 (see Hufbauer and Schott, 2006).

<sup>25</sup> This has been emphasised by the Government of the United States, for example, in its coordination with G-20 to eliminate agricultural export subsidies, or joint proposals with India and Chile on services (USTR, 2006).

<sup>26</sup> For further background on this issue see ECLAC (2006c).



demand conditions to the supply restrictions faced by the developing countries (WTO, 1999). The current version of special and differential treatment basically includes some flexibility and differentiated levels for the developing countries in terms of their commitments, as well as longer implementation periods in various agreements and the right to invoke special provisions (enabling clause, balance-of-payments provisions, etc.). LDCs form a special category

of developing countries for which the special treatment is expanded or made more flexible.

Aid for trade arises in this context as a useful and innovative approach, by focusing on eliminating export-supply constraints in developing countries. It therefore complements efforts to position the development dimension as a key objective of the Doha Round (see WTO, 2001a, 2001b and 2005a).

## 2. Towards a new approach: aid for trade (A4T)

The aid-for-trade perspective sees trade and aid as complementary elements, rather than substitutes as they have traditionally been viewed. Its implementation as a WTO discussion topic is largely aimed at supporting developing countries in adjustment processes and overcoming their supply-side constraints, to improve their international engagement, while strengthening technical assistance and initiatives for institutional capacity-building.<sup>27</sup> The objectives, grouped together in two large categories of assistance, correspond to costs and requirements that also differ in terms of their nature and time horizon, as shown in table III.3.

Opinions differ as to the orientation, scope and modalities of the assistance. There are also differences concerning the institutional framework that would be responsible for management, coordination and provision of the aid, and in particular the appropriate role for WTO in this task; and there is debate as to whether these decisions should be part of the single undertaking of the Round.

Establishing aid for trade raises considerable challenges, firstly because of the variety of constraints and the impact of trade reform on the different countries. Moreover, donors and lending organizations do not want to consolidate their aid commitments with a mechanism that is binding under WTO, so new institutional mechanisms are required to ensure that the funds needed by the developing countries are used effectively, especially funds for development. Lastly, while financial assistance can be made available rapidly, it may not be sufficient in view of existing needs (see Evenett, 2005; Stiglitz and Charlton, 2006). The negotiation on trade facilitation illustrates these challenges, by prioritizing the technical assistance and institutional

capacity-building dimensions, and giving the proposals a high level of detail (see box III.2).

Table III.3  
AID-FOR-TRADE CATEGORIES: ORIENTATION  
AND CHARACTERISTICS

Category and orientation	Basic characteristics
Type 1: Aims to strengthen trade capacity for competitiveness and development	Responds to long-term needs, to some extent independent of the negotiations and similar to those dealt with by official development assistance (ODA), but with additional resource requirements that can take the form of concessional loans or subsidies for the requesting countries.
Type 2: Aims to address the implementation costs of trade agreements	Responds to short-term needs and is aimed at "losers" (not always LDCs) in the negotiations. Among other things, this category involves the effects of liberalization on fiscal revenues, erosion of preferences, the effects of the required adjustments (including labour-market adjustments induced by restructuring) and agreement implementation costs, particularly in areas such as trade facilitation, intellectual property, standards and rules on services.  This slightly newer concept of aid is for a situation in which costs are imposed on some countries as a result of reform, while there are gains for other countries or overall gains. It is therefore argued that the additional resources needed to meet such costs, unlike the first type of aid, should be granted through subsidies.

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Lauren Phillips and others, "Aid for Trade: What does it mean? Why should aid be part of WTO negotiations? And how much might it cost?", *Opinions*, No. 61, London, Overseas Development Institute, 2005 and United Nations Development Programme (UNDP), "Concept Note on Aid for Trade: Context, Content, Concerns and a Way Forward", New York, Poverty Group, Bureau for Development Policy, January 2006.

<sup>27</sup> See the Technical Assistance and Training Plan 2006 (WT/COMTD/W/142) formulated in this regard for 2006 in the WTO. Lengyel (2005) estimates the costs in Latin America of responding to adjustment needs and applying the Uruguay Round agreements.

## Box III.2

## TECHNICAL ASSISTANCE IN THE NEGOTIATIONS ON TRADE FACILITATION

The aim of the negotiations on trade facilitation is to clarify GATT articles V, VIII and X, relating respectively to: freedom of transit; fees and formalities connected with importation and exportation; and publication and administration of trade regulations. The Negotiating Group on Trade Facilitation focused on these issues alone, having faced resistance from developing countries and LDCs when it began to address the "Singapore issues".<sup>a</sup>

Technical assistance in this area is hugely important and extremely complex, given the different degrees of implementation of trade facilitation measures that exist among developing countries, and because the issue is often not among their development priorities. In this context, the measures proposed for the negotiation can be divided into two types: those that do not require costly infrastructure but mainly administrative provisions (e.g., publication of trade regulations); and those that require sustained efforts, both

with regard to resources and in terms of implementation capacity (e.g., installation of computerized systems to reduce or eliminate discretionality). The various similar proposals include a joint proposal made by 11 of the region's countries to implement technical assistance, involving various stages and implementation periods (see WTO document TN/TF/W/81).<sup>b</sup>

From the numerous contributions made by countries to the negotiations on trade facilitation in the areas of technical assistance, capacity building and special and differential treatment, it can be concluded that: (i) there is broad consensus among developing countries and LDCs on the importance of the technical-assistance dimension of the negotiations to achieve real progress on trade facilitation; (ii) although other international agencies must continue playing an important role, a coordinating and centralizing body needs to be created within the WTO, with responsibility for areas relating to technical assistance,

capacity building, financing and the needs of countries, in the broadest sense of trade facilitation (which goes beyond the three negotiating articles mentioned above); and (iii) developing countries and LDCs should intervene actively to make appropriate diagnoses, obtain the necessary assistance and thereby make progress on trade facilitation to take advantage of the expansion of international trade. Against this backdrop, ECLAC held a seminar-workshop in November 2005 attended by 20 experts drawn from Ibero-American countries, for the purpose of exchanging ideas, opinions and proposals for efficient implementation of trade facilitation instruments. The conclusions of this event stressed the need to deepen regional coordination efforts in the framework of trade facilitation, taking advantage for this purpose of the electronic forum Knowledge Network on Information Technologies Applied to Trade Facilitation (RECTIFAC) made available by ECLAC for these purposes.<sup>c</sup>

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), "The Role of Technical Assistance in World Trade Organization (WTO) Trade Facilitation Negotiations", *FAL Bulletin*, No. 238, Santiago, Chile, June 2006.

<sup>a</sup> Trade facilitation issues are addressed in several other WTO agreements (customs valuation, and rules of origin, and others).

<sup>b</sup> The proposal comes from Chile, Dominican Republic, Ecuador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay.

<sup>c</sup> Conclusions in ECLAC (2006e) and reference to the forum: <http://stnt01.eclac.cl/WBE/?boardID=rectifac>.

Stiglitz and Charlton (2006) state that aid for trade should focus on three aspects: (i) strengthening of national and regional institutions responsible for applying development-oriented trade policies and regulations; (ii) helping firms to become more competitive, with support from governments; and (iii) dealing with domestic infrastructure barriers (trade facilitation). In this proposal, it is important to stress the linkages needed between the public and private sectors, and the key role of regional institutions. ECLAC is working on proposals for coordinating technical assistance on this issue at the regional level.

### Experience and recommendations

The discussion on aid for trade draws on acquired experience, the debates that have been held and recommendations made by international organizations, including the World Bank, the International Monetary Fund (IMF), and the United Nations Conference on Trade and Development (UNCTAD).<sup>28</sup> Various organizations

are facing challenges to contribute to the design and implementation of trade-complementary policies, and more effectively articulating the set of policies around the development strategy. These complementary policies include macroeconomic and financial, regulatory and competition policies, in addition to policies on infrastructure, among other areas (see WTO, 2004b and UNCTAD, 2004). Although market opening has been facilitated, strategies that take a narrow view of the key factors that enable trade to contribute to growth have not proven as effective in preventing the erosion of competitiveness and stimulating export diversification, with a view to strengthening linkages between exports and the rest of the economy.

These organizations also point to the effect of the "conditionality" of loans and assistance on the limited domestic ownership of reform, which makes it more difficult to implement. Together with institutional and physical infrastructure to strengthen supply-side capacity and competitiveness, they also include investments and South-South technology transfer, among other things; and they suggest a more important role for regional banks in

<sup>28</sup> References include: UNCTAD, 2006; IMF/World Bank, 2005; UNDP, 2006b; IDB, 2006; and World Bank, 2006b.

supporting trade capacity.<sup>29</sup> As a complement, various organizations stress the need to provide assistance to developing countries in trade negotiations and to more effectively combine openness with institution building and measures to mitigate the possible adverse effects, which requires evaluations of consequences and needs linked to trade reform and agreements.

In aid for trade, such as that currently being proposed in several international organizations, trade and trade policies are seen as part of development strategies. This perspective is consistent with arguments repeatedly made by ECLAC, both in the past and more recently (see ECLAC, 2002 and 2004).<sup>30</sup> The tasks undertaken by

ECLAC in support of administration and implementation functions, arising from the signing of preferential and free trade agreements, start from the basis that exploitation of those agreements requires countries to review their policies, strategies and institutional framework (see [www.cepal.org/comercio](http://www.cepal.org/comercio)). Consonant with emerging views, it has also been proposing the coordination of rules in various domains—origin, standards and trade facilitation, among others—in addition to regional-scale investment and financing efforts that would stimulate and facilitate trade between countries. Regional trade usually contains a higher value-added and technology content, which can provide greater stimulus to economies at large.

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### 3. The mandate of the Hong Kong Ministerial Conference and the current debate

The aid for trade envisaged in paragraph 57 of the Declaration issued by the Hong Kong Ministerial Conference aims to help developing countries, particularly LDCs, to build the supply-side capacity and trade-related infrastructure they need to implement and benefit from WTO agreements, and to expand their trade. As such it is a valuable complement to the Doha Agenda. This conference also decided to deepen work on LDCs, prioritize technical assistance and capacity building, and strengthen the integrated framework.

The Aid for Trade Task Force, created in February and consisting of 13 members drawn from developed and developing countries,<sup>31</sup> is expected to make recommendations to the General Council on how to make assistance more operational and functional to the Doha Round development dimension. Through direct consultations with the WTO Director-General, a second line of work has made it possible to reaffirm the commitment to contribute additional resources (which have grown considerably) for aid for trade.

Regional views can be seen in recent communications from various countries: (i) the Group of African, Caribbean and Pacific (ACP) States, which includes Caribbean countries; (ii) Brazil; (iii) three Andean Community countries:

Colombia, Ecuador and Peru; (iv) Barbados, with proposals from small, vulnerable economies; and (v) a group of six developing countries, including Guyana, Honduras and Nicaragua. Under various categories, the groups address the following four issues: general guiding framework, domains or scope of the aid, application and resources. Their views and proposals are described in box III.3.

Lastly, the countries suggest addressing the issue of aid through regional mechanisms and institutions (including regional integration schemes and United Nations commissions); and most consider that the integrated framework is a model platform for preparing the guidelines that should govern aid for trade in this new phase. The opinions expressed in the contributions reviewed are framed by a broader set of developing country concerns and issues, such as the low level of participation in the conceptualization and design of aid for trade, and the type and degree of conditionality that the loans will have, among other issues (UNDP, 2006a).<sup>32</sup> An innovative proposal from the LDC group suggests using value-chain analysis to identify measures to strengthen supply-side capacity in developing countries (WT/AFT/W1).

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<sup>29</sup> To address the complexity of the multiple agreements in the region, the Inter-American Development Bank (IDB) has proposed creating cooperation forums or networks between countries, and coordinated projects on trade facilitation and investments, to contribute to SME participation in the international arena, infrastructure initiatives (Initiative for the Integration of South American Regional Infrastructure (IIRSA) and the Puebla-Panama Plan), and private-sector strengthening (IDB, 2006).

<sup>30</sup> Its work also highlights the scant share of the trade component in the ever-smaller amounts of official development assistance received by the region (United Nations, 2005).

<sup>31</sup> This includes coordinators from LDCs and the Group of African, Caribbean and Pacific States, together with three countries from the region: Barbados, Brazil and Colombia.

<sup>32</sup> A group of six developing countries, including Guyana, Honduras and Nicaragua, claim that some of the more vulnerable countries have been excluded from these deliberations (WT/AFT/20).

## Box III.3

## ORIENTATION AND RECOMMENDATION OF THE REGION'S COUNTRIES ON AID FOR TRADE

In the **general framework** the countries address the orientations of assistance and its relation with the development dimension in the current Round. For some countries, aid for trade is neither a topic nor a tool of negotiation, but an instrument for promoting the development dimension; and they propose widening the scope of the Hong Kong Ministerial Declaration to address new needs. They also call for special attention for a certain category of developing country, namely small, vulnerable economies (the group of six developing countries).

In terms of the **domains or scope** of aid, the countries basically consider the following: (i) assistance for adjustment, e.g., social costs (unemployment) and more specifically those arising from the ending of the agreement on textiles or higher food prices (Barbados); (ii) fulfilment of rules and trade capacity-building, including the institutional framework for trade policy (Brazil) and a legal advice centre (Andean Community); and (iii) development of supply and infrastructure for trade (e.g.,

trade facilitation), aiming to address the entry to new markets (African, Caribbean and Pacific States) providing services to SMEs (Barbados), mobilizing resources for migrant or temporary workers (Brazil) and developing business capacities (Andean Community). Brazil envisages a coordinating role for the WTO in the tasks listed in (ii). Some countries believe the system should target not only the results of this Round but also existing agreements (six developing countries) and the opportunities arising from regional agreements. In addition, it is considered difficult to establish the scope of assistance without knowing the implications of the Doha Round (Barbados).

As regards the **application** of assistance, the countries propose mechanisms for management, coordination and administration, the forms, supply deadlines and links with transition periods, and supervision of implementation, among other things. The debate includes the role of the WTO in these tasks and the incorporation or otherwise of these agreements in the Round's "single

undertaking". Non-inclusion would arise from opening assistance to other WTO agreements. The Andean Community countries stress that demands should be adapted to development policies, and the majority assign a coordination role to WTO, in the framework of an inter-agency consultative group, for example, to strengthen efficiency and consistency.

On the issue of **resources**, reference is made to additionality, the nature and form of delivery (grant or loan), non-conditionality (Barbados) and the timeliness of the assistance, among other points. The Andean Community countries stress the small share of official development assistance allocated to aid for trade and the small share of total ODA that the region receives; Brazil stresses the need for additional resources to offset the dwindling trend of ODA, and the Group of African, Caribbean and Pacific States proposed multilateralizing the assistance, strengthening bilateral support, and making arrangements for extended assistance (multi-year projects), in a timetable that can be adjusted to the transition periods.

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Trade Organization (WTO), country communications WT/AFT/W/8, 10, 12, 18 and 20, 2006.

The recommendations of the Aid for Trade Task Force formulated in late July state that effective aid for trade will enhance growth prospects and reduce poverty, complementing multilateral trade reforms and distributing their benefits more fairly. It thus complements the Doha Round but does not depend on its success. The assistance would include activities identified as trade-related development priorities within the strategies of the recipient countries and basically distinguish the following categories: trade policy and regulation, trade development, trade-related infrastructure, productive capacity-building and trade-related adjustment. To make this operational, the Task Force adopts the principles of the Paris Declaration on Aid Effectiveness, which include national ownership and accountability between the parties (World Bank, 2005). It also provides guidelines to strengthen the formulation of the demand and the response of donors, together with their coordination at the national, regional and global levels. Lastly, it stresses the need for monitoring and evaluation, among other issues and specific recommendations (see WTO document WT/AFT/W1).

In synthesis, there is a broad consensus on the importance of aid for trade in the Doha Round, as a complement to other elements of the development dimension, and with the necessary interaction between trade, aid and deeper reforms in the countries. This in turn requires greater coordination between the public and private sectors in the individual economies, and better evaluations of developing countries' needs in the context of their growth strategies. It is also agreed that more resources and deeper coordination between donors are needed; but there is less consensus on the binding nature of the commitments assumed by donors and the institutional framework required to carry them out (including the role of WTO). Nor is there a clear relation between aid for trade and the capacity and conditionality for complying with commitments by developing countries. Nonetheless, the regional perspective is increasingly present in diagnostic studies and initiatives in this field, which increases the chances of regional organizations of various types, including ECLAC, playing an important role.

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#### 4. The future of the Doha Round and developing countries

Negotiations in the Doha Round were suspended in late July. Under the Hong Kong Ministerial Declaration, the political decisions needed for its conclusion had been postponed, but the political climate for producing those decisions did not alter during the first half of 2006. Basically, there are problems concerning the conditions that the negotiations need to fulfil to be acceptable to the main stakeholders. On the one hand, the United States is seeking better market access for its agricultural exports, both in the European Union and in the markets of a number of developing countries; it is also interested in other aspects of market access for non-agricultural goods and services. The European Union, on the other hand, needs results on market access for non-agricultural goods and services—to turn its internal reform of agricultural policy into a multilateral commitment. For the leading developing countries in the negotiation, the profile of results that would make it possible to conclude the Round remains unclear. At the present time, while they are on the offensive in agriculture, particularly against the European position, they are on the defensive on non-agricultural market access and services. Thus, the equation that would be satisfactory to them thus appears to be unviable.

It was always known that the negotiations would not conclude in December 2006, unless a package could be put together in July to resolve postponed decisions; and this ultimately did not happen. It should be noted that although pessimistic views of the Round and its results are expressed regularly, the outcome did not seem negative for developing countries. In terms of liberalization, while specific results have not been achieved, it is recognized that most developing countries, including all LDCs, could be exempted from liberalization commitments through one or more mechanisms. The negotiations are focused on a certain number of target developing countries, which represent the critical mass in terms of market access for goods (agricultural and non-agricultural) and services.

Since the Hong Kong conference, LDCs have had a non-reciprocal commitment on access to the markets not only of developed countries but also several developing countries, which still has to be materialized. The least developed countries will be exempted from practically all the new Doha commitments; moreover, apart from trade facilitation, there are virtually no new disciplines requiring implementation efforts from developing countries, which was the major criticism of the results of the Uruguay Round. Although instruments remain that raise doubts as to the real market access that can be achieved when

the modalities are defined, there is genuine willingness to address the problems of developing countries through the aid-for-trade mechanism (evaluated as one of the key issues among elements available on the negotiation table since the Hong Kong conference) and particularly as regards trade facilitation measures. Other important items for developing countries included having a date for ending export subsidies, together with a possible substantive cut and disciplines in domestic agricultural assistance, strengthening of rules offering more balanced conditions for their interests, or safeguards against protectionist temptations among developed country partners, and new mechanisms of special and differential treatment, among others.

Consequently, there was a set of elements on the table which could have led to an acceptable outcome for various developing countries. The dust cloud raised by major discussions among the leading WTO members has overshadowed this progress, and is eclipsing the more permanent importance of WTO as an anchor for the multilateral trading system. As mentioned on other occasions, the multilateral system offers a number of possibilities that are not available in regional, bilateral or other preferential agreements. Its importance lies in the potential for building a reliable system based on rules that have been agreed upon by its participants, offering a framework of negotiations between very different parties; and thus also a framework for addressing the asymmetries in capacities and requirements, and providing a robust system for settling disputes, which allows LDCs real access.

The recent suspension of negotiations is generating great uncertainty as to the future of the agreements reached or the progress achieved in the process, several of which are very important for developing countries, including the recommendations on aid for trade.

Lastly, in addition to the issues raised above, there is another more structural one. To what extent will the agreements arising from this Round make it possible to address the problems and challenges of the twenty-first century? These include anti-competitive practices with increasingly cross-border features, electronic commerce and information technologies, and domestic regulations and their effects on trade, including measures relating to security, health or the environment. On these issues, the multilateral system is increasingly out of step with the bilateral rules agreed upon in other international forums by a large number of its own members, developing countries included.

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## Chapter IV

# Regional integration and trade-agreement convergence

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### Introduction

Recent experience in Latin America and the Caribbean indicates that intraregional trade is more conducive to export diversification, provides a friendlier environment for small and medium-sized enterprises (SMEs) and is more intensive in value-added than trade with the rest of the world. Regional and subregional integration has been slow to gather momentum, however, and the political will to promote these processes has not been fully reflected in the steps taken to put them into practice. Intraregional trade has gained some ground since the 1990s, and a number of rules and institutions have been created, particularly in Central America and the Andean Community, but these advances have not measured up to the magnitude of the challenges involved. Nor has significant progress yet been made in terms of competitiveness, technological innovation and export diversification. Since the chances for making headway in all these areas hinge on the development of suitable national policies, the weakness of the region's integration processes can be attributed to shortcomings in those policies.

Some important assets have been built up within the framework of these integration schemes, including a number of institutional advances, the Andean Community's recently created social development programmes, the MERCOSUR Structural Convergence Fund, and the efforts devoted to devising uniform customs codes and

fully applying the common external tariff. The challenges to be met in order to place the region in a competitive position within the international economy are of such a pressing nature, however, that the regional debate tends to focus on the weaknesses and shortfalls of its integration processes.



It is important to ensure that regional integration does not remain in its present embryonic state for much longer, given the trends and developments being observed in the international arena, including the strong emergence of China and other Asian economies on the global stage and the bilateral trade agreements being reached between various Latin American countries and the United States, the European Union and, lately, Asian countries. All of this poses major challenges in terms of the region's competitiveness and the current relevance of its integration schemes. Bilateral agreements entail a number of difficulties in relation to trade diversion, areas in which they may be at cross-purposes with multilateralism, an emphasis on matters that are of more interest to developed economies and certain types of institutional demands that not all developing economies are in a position to meet. They also afford a variety of benefits, however, such as improved access to the markets of major trading partners. Such arrangements can enable countries to consolidate positions and preferences that used to be subject to conditionalities and discretionary concessions. They also make it possible to do away with tariff escalation and thus promote export diversification. In addition, bilateral agreements can give rise to broader and deeper commitments on important matters than is usually the case with other integration accords, as well as more binding mechanisms and greater legal certainty (Rosales, 2005). The region's governments must therefore weigh the costs and benefits of bilateral negotiations and of the other mechanisms available to them with a view to determining which option—or combination of options—will be most effective in strengthening their countries' competitiveness and improving their position in the international economy.

The immediate challenge is to bring about a rapid adjustment in the region's integration schemes in order to avert an asymmetrical situation in which the commitments contained in agreements with developed-country trading partners are more demanding than those included in subregional schemes. Commitment asymmetry of this sort would undermine incentives for regional integration and pave the way for differentiated treatment. Greater efforts should also be made to standardize the different integration schemes' rules and disciplines in order to avoid creating a network of "hub-and-spoke" agreements.

The fact that progress towards Latin American and Caribbean integration has stalled cannot, however, be attributed to the attention being paid by the countries of the region to concluding free trade agreements (FTAs) with third parties. Instead, it has more to do with the scant amount of headway that has been made and with integration bloc leaders' lack of sufficient political will to drive the process forward. This state of affairs jeopardizes the achievements made so far and dilutes the identity of each of the regional integration schemes. Since the Latin American and Caribbean region is currently enjoying a favourable international economic environment and higher GDP growth, while at the same time exhibiting fiscal responsibility and low levels of inflation, it may be missing the promising opportunity offered by a favourable business cycle to increase trade convergence and to step up the pace of integration.

Existing subregional schemes should be deepened as a means of paving the way for the creation of a common market in the long term.<sup>1</sup> To this end, steps need to be taken in several directions. To start with, commitments should be extended to areas now excluded or only partially covered, such as services, investment and public procurement, and convergence of the rules and disciplines established by the region's various trade agreements. Headway also needs to be made in institutional bridge-building among the different integration schemes with a view to creating an expanded market in which goods and factors can move freely, achieving macroeconomic cooperation, setting up binding dispute settlement mechanisms, dealing with existing asymmetries appropriately, creating structural funds designed to yield balanced benefits, and coordinating social policies and bold initiatives in the fields of energy and infrastructure (ECLAC, 2005). The most pressing task of all, however, is to re-establish a climate for dialogue in which no party is excluded or disparaged. This stage in the process calls for tolerance of the diversity of national interests and trade strategies. The validity of existing mechanisms should be respected and used as a basis for identifying areas and instruments that can serve as a platform for progress, first, in carrying forward regional cooperation initiatives and, later, in devising means of fostering convergence in the areas of trade and integration.

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<sup>1</sup> A common market with policy convergence and a community-wide institutional structure is probably the most demanding of the many and varied ways to deepen integration. The establishment of gradual, realistic objectives may lead in this direction, but the challenge today is much more modest: to hold on to the ground gained, meet the existing commitments and pave the way for convergence among the different subregional groupings.

## A. Integration under a new set of conditions

### 1. Trends in intraregional and extraregional trade

For the third consecutive year, in 2005 intraregional trade—defined as the proportion of the region's total exports represented by the total sum of intraregional exports—continued to win back some of the ground lost during the downswing that followed the Asian crisis and continued into 2001 and 2002, although it has not yet regained its record high of 1997 (see table IV.1).<sup>2</sup> This pattern was repeated in all the subregions, with growth rates in the Andean Community and MERCOSUR (23% and 23.6%, respectively) outstripping those of the Central American Common Market (CACM) and the Caribbean Community (CARICOM). Intraregional

trade also expanded for the second year running, though slightly less strongly than in 2004, in the Latin American Integration Association (LAIA) countries.

Despite this momentum, intraregional trade has yet to return to the record level of 1997. This is mainly because of the trade patterns of the Andean subgroup and MERCOSUR, which together represented almost 50% of all Latin American and Caribbean trade and 74% of intraregional trade in 2005. These integration schemes have seen a significant increase in their extraregional trade flows in the last few years.

Table IV.1  
LATIN AMERICA AND THE CARIBBEAN: TOTAL EXPORTS BY SUBREGIONAL INTEGRATION SCHEME, 1990-2006  
(Millions of current dollars and percentages)

	1990	1995	1998	2000	2001	2002	2003	2004	2005	January- June 2005	January- June 2006 <sup>d</sup>
<b>Latin American Integration Association (LAIA)</b>											
Total exports (1)	112 694	204 170	251 345	328 274	316 298	319 807	346 145	427 835	506 557	242 825	293 252
Exports to LAIA (2)	13 589	35 471	43 118	42 887	41 934	36 164	40 872	56 511	70 153	31 307	31 731
Percentage intrasubregional exports (2/1)	12.1	17.4	17.2	13.1	13.3	11.3	11.8	13.2	13.8	12.9	10.8
<b>Andean Community</b>											
Total exports (1)	31 751	39 134	38 896	60 709	53 543	52 177	54 716	74 140	94 751	48 005	59 970
Exports to Andean Community (2)	1 312	4 812	5 504	5 167	5 656	5 227	4 900	7 361	9 056	4 132	4 552
Percentage intrasubregional exports (2/1)	4.1	12.3	14.2	8.5	10.6	10.0	9.0	10.5	9.6	8.6	7.6
<b>MERCOSUR</b>											
Total exports (1)	46 403	70 129	80 227	85 692	89 078	89 500	106 674	134 196	162 512	75 177	84 772
Exports to MERCOSUR (2)	4 127	14 199	20 322	17 710	15 298	10 197	12 709	17 319	21 406	9 859	11 468
Percentage intrasubregional exports (2/1)	8.9	20.2	25.3	20.7	17.2	11.4	11.9	12.9	13.2	13.1	9.5
<b>Central American Common Market (CACM)</b>											
Total exports <sup>a</sup> (1)	4 480	8 745	14 987	16 624	16 328	17 006	18 117	19 767	21 849	10 690	11 650
Exports to CACM (2)	624	1 451	2 754	2 616	2 829	2 871	3 110	3 506	3 911	1 865	2 089
Percentage intrasubregional exports (2/1)	13.9	16.6	18.4	15.7	17.3	16.9	17.2	17.6	18.0	17.4	17.9
<b>Caribbean Community (CARICOM)</b>											
Total exports (1)	4 118	5 598	4 790	6 358	6 072	5 732	6 712	7 880	8 274	...	...
Exports to CARICOM (2)	509	843	1 031	1 230	1 384	1 220	1 419	1 810	2 329	...	...
<b>Latin America and the Caribbean</b>											
Total exports <sup>b</sup> (1)	130 214	227 922	280 065	359 396	345 484	347 610	376 590	461 323	548 975	263 209	314 690
Exports to Latin America and the Caribbean <sup>c</sup> (2)	18 727	45 180	56 644	62 552	58 607	53 424	59 635	79 484	100 016	44 543	55 856
Percentage intrasubregional exports (2/1)	13.9	19.8	20.2	17.4	17.0	15.4	15.8	17.2	18.2	16.9	17.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the respective subregional scheme and the International Monetary Fund (IMF), *Direction of Trade Statistics*.

<sup>a</sup> Figures include maquila trade.

<sup>b</sup> Includes LAIA, CACM, the CARICOM countries, Panama, Cuba and the Dominican Republic.

<sup>c</sup> Includes intrasubregional trade in the Andean Community, MERCOSUR, CACM, CARICOM and trade between Chile and Mexico and the rest of the region, as well as trade between groups, plus exports from Cuba, Panama and the Dominican Republic to other countries in the region.

<sup>d</sup> Preliminary figures.

<sup>2</sup> Examination of intraregional and extraregional trade flow patterns shows that the intraregional market accounted for a considerable proportion of the blocs' total exports between 1990 and 1998. Exports to Latin America and the Caribbean by MERCOSUR, the Andean Community and CARICOM expanded rapidly and accounted for a larger share of total exports than those going to extraregional markets. Intragroup trade in MERCOSUR and the Andean Community accounted for much of the high proportion of intraregional trade in that period.

In 2000-2005, extraregional trade was a decisive factor for the region as a whole and for each of the subregional integration blocs. The United States and Asia have been Latin America's most dynamic extraregional trading partners during the last five years (see table IV.2). The United States market is particularly important for the Andean Community, CACM and CARICOM, as is Asia for MERCOSUR.

Briefly, then, regional integration in Latin America and the Caribbean is being affected by a new phenomenon

that has to do mainly with the direction of the region's export flows. With or without North-South FTAs, the region's integration schemes and individual countries have been looking to extraregional markets as the main driving force for trade creation over the last five years. This pattern is clearer in the cases of the Andean Community, MERCOSUR and Chile, whereas CACM and Mexico have continued to rely heavily on the United States market.

Table IV.2  
EXPORT GROWTH IN THE LATIN AMERICAN AND CARIBBEAN SUBREGIONS,  
BY COUNTRIES AND BLOCS, 1990-1998 AND 2000-2005  
(Contribution to total export growth)<sup>a</sup>

	Andean Community		MERCOSUR		CACM		CARICOM	
	1990-1998	2000-2005	1990-1998	2000-2005	1990-1998	2000-2005	1990-1998	2000-2005
<b>Latin America and the Caribbean</b>	<b>2.0</b>	<b>2.5</b>	<b>4.7</b>	<b>3.3</b>	<b>4.6</b>	<b>2.1</b>	<b>2.0</b>	<b>2.3</b>
LAIA	2.0	1.7	4.7	2.6	4.3	1.7	1.4	2.1
MERCOSUR	0.3	0.0	<b>3.7</b>	<b>0.5</b>	0.0	0.0	0.0	0.1
Andean Community	<b>1.7</b>	<b>1.1</b>	0.5	0.8	0.3	0.1	0.1	0.3
Chile	0.1	0.3	0.4	0.8	0.1	0.0	0.2	0.0
Mexico	0.1	0.5	0.1	0.9	0.2	0.4	0.1	0.5
CACM	0.0	0.2	0.0	0.3	<b>3.7</b>	<b>1.3</b>	0.2	0.0
CARICOM	0.0	1.3	0.0	0.8	0.1	0.1	<b>1.1</b>	<b>1.4</b>
Other <sup>b</sup>	0.0	-0.2	0.0	0.0	0.3	0.2	0.2	0.3
<b>Rest of the world</b>	<b>0.7</b>	<b>9.6</b>	<b>2.7</b>	<b>10.9</b>	<b>11.8</b>	<b>6.1</b>	<b>-0.8</b>	<b>15.9</b>
United States	0.7	5.9	0.6	1.7	10.1	4.9	-0.2	13.6
European Union	0.1	1.3	1.2	2.2	1.3	0.1	-0.1	1.8
Japan	-0.1	0.1	0.0	0.1	0.1	0.0	0.0	0.0
Asia	0.1	1.0	0.3	3.9	0.6	1.8	0.0	0.9
Other	0.0	1.3	0.4	4.0	0.3	0.0	-0.4	1.1
<b>World<sup>c</sup></b>	<b>2.7</b>	<b>12.0</b>	<b>7.3</b>	<b>14.1</b>	<b>16.3</b>	<b>8.2</b>	<b>1.2</b>	<b>18.0</b>

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the Commodity Trade Database (COMTRADE), statistical departments of the customs unions, statistical institutes and central banks of the member countries, and the International Monetary Fund (IMF), *Direction of Trade Statistics*, for the CARICOM countries.

<sup>a</sup> Contribution is calculated as growth in exports to each trading partner, weighted by exports to that market as a proportion of the country's/group's total exports.

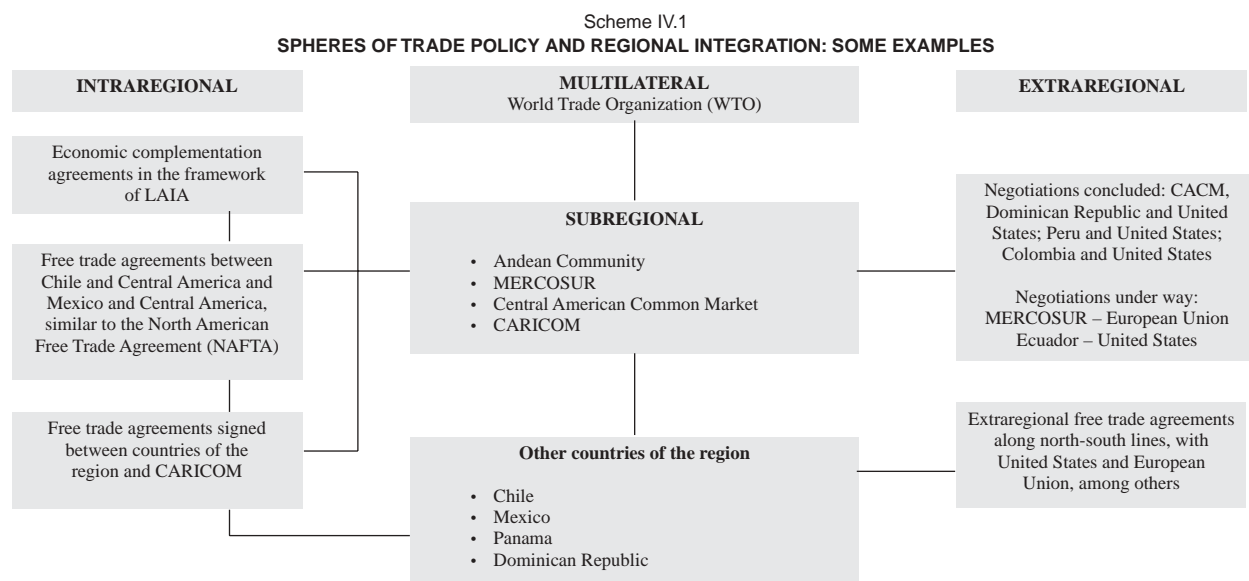
<sup>b</sup> Refers to Latin American and Caribbean countries (Cuba, Dominican Republic and Panama).

<sup>c</sup> Small differences in the sums reflect the rounding of decimals.

## B. Proliferation of intraregional and extraregional agreements

In the 1990s, regional integration in Latin America and the Caribbean gained fresh impetus from the creation of new blocs and the reactivation of existing schemes. Now a new modality has emerged, in which integration is being driven mainly by bilateral agreements, both with other countries in the region and with nations in other regions of the world. The integration schemes in the region and countries not affiliated with any of the subregional

blocs (e.g., Chile and Mexico) have taken steps to forge extraregional accords. Until recently, bilateral agreements had relatively little bearing on the volume or direction of the region's trade flows. In the last few years, however, the proliferation of accords being negotiated by countries or groups of countries with extraregional trading partners has become a factor to be reckoned with at the regional level (see scheme IV.1).



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

Up to December 2000, 61 agreements extending intraregional tariff preferences had been signed, most of them negotiated in the framework of LAIA. Only five FTAs had been signed with developed countries, four of them by Mexico—the North American Free Trade Agreement (NAFTA) in 1994 and accords with the European Union in 1997, Israel in 2000 and the European Free Trade Association (EFTA) in 2001—and one by Chile, with Canada in 1997. Since then, and particularly in the last five years (2001-2006), the number of extraregional agreements negotiated in the region has outnumbered new intraregional accords. As a result, of a total of 68 agreements in force or in the process of coming into effect as of May 2006, 51 are intraregional trade preference agreements and 17 are extraregional arrangements.<sup>3</sup>

Until 1991, the only types of subregional preferential agreements in existence were customs union arrangements, which covered only 6% of the region's exports. This situation changed dramatically towards the end of the 1990s and even more rapid changes have taken place in the last five years. By the end of 2005, 64% of the region's exports came under some type of intraregional or extraregional preferential agreement, whether bilateral or plurilateral. In particular, Mexico, the Central American subregion and Chile shipped 94.4%, 84.8% and 73.7% of their exports, respectively, under preferential trade arrangements (see table IV.3). Given the other extraregional accords now being negotiated, the proportion of exports covered by tariff preferences is likely to rise from 64% to 72% by the end of 2007.

Table IV.4 shows the proportion of external trade (measured by exports) that has been covered by tariff preferences negotiated in intraregional and extraregional agreements in the last 15 years. In the first half of the 1990s, intraregional trade was liberalized under agreements signed in the framework of LAIA. The second half of the decade marked a new phase in Latin American and Caribbean trade policy, as a flurry of agreements were struck with non-regional trading partners such as Canada, the United States, Japan and the European Union. This process is now leading to an adjustment of integration schemes to encompass the different trade structures of the countries in the region.

Even in the absence of more thorough-going subregional integration schemes, member countries have entered into FTAs with blocs or countries outside the region, either individually or in groups. As a group, MERCOSUR has concluded preferential agreements with developing nations (e.g., India) and is negotiating accords with the Russian Federation, the European Union and a number of African countries. Central America, as a bloc, has signed an FTA with the United States and is preparing another with the European Union.

Two Andean Community countries (Colombia and Peru) have concluded free trade negotiations with the United States, and Ecuador is in the process of negotiating a similar accord. The efforts of these three countries, and of Bolivia, to secure more permanent preferential access to the United States market have been driven by the end of the unilateral preferences extended under

<sup>3</sup> The most recent agreements either signed or in the process of being approved include those concluded by Peru and Thailand in 2005, Peru and the United States in 2006 and Colombia and the United States in 2006. An FTA between Chile and China will come into effect on 1 October 2006. The 68 agreements mentioned above do not include accords that have been abrogated or subsumed into new agreements.

the Andean Trade Promotion and Drug Eradication Act (ATPDEA), which expires in December 2006. The extension of ATPDEA is vital for the four beneficiary countries, 50% of whose exports to the United States

are eligible for the regime. Bolivia and Ecuador in particular, as relatively less developed countries, stand to lose out with the end of ATPDEA (Durán, de Miguel and Schushny, 2006).

Table IV.3  
LATIN AMERICA AND THE CARIBBEAN: TYPES OF AGREEMENT AND SHARES OF EXPORTS <sup>a</sup>  
(As of May 2006)

Subregional agreements/ Countries (Intragroup preferences) <sup>b</sup>		Other intraregional agreements (tariff preferences extended) <sup>b</sup> (percentages of total exports)		Extraregional agreements (tariff preferences extended) <sup>b</sup> (percentages of total exports)	
Southern Common Market (MERCOSUR) Economic Complementarity Agreement (ACE) 18 (1991)	12.9%	MERCOSUR–Chile (Economic Complementarity Agreement (ACE 35–1996)); MERCOSUR–Bolivia (ACE 36–1996); MERCOSUR–Peru (ACE 58–2003); MERCOSUR–Colombia, Ecuador and Venezuela (Bolivarian Rep. of) (ACE 59–2004); Uruguay–Mexico (FTA–2004)	9.6%	MERCOSUR–India (2004), covers 450 products; MERCOSUR–Southern African Customs Union (SACU) <sup>c</sup> (2004) MERCOSUR–European Union (being negotiated)	...
Andean Community (1969)	8.8%	Venezuela (Bolivarian Rep. of)–CARICOM (1992); Chile–Bolivia (ACE 22–1992); Colombia–CARICOM (1994); Chile–Colombia (ACE 24–1992); Bolivia–Mexico (ACE 31–1994); Chile–Ecuador (ACE 32–1994); Colombia–Venezuela (Bolivarian Rep. of)–Mexico (G3) (ACE 34–1994); Chile–Peru (ACE 38–1998); Peru–MERCOSUR (ACE 58–2003); MERCOSUR–Colombia, Ecuador and Venezuela (Bolivarian Rep. of) (ACE 59–2004)	9.7%	Colombia–United States (2006); Peru–Thailand (2005) Peru–United States (2005); Ecuador–United States (being negotiated)	14.5%
Central American Common Market (CACM) (1960)	18.6%	Costa Rica–Mexico (1994); CACM–Dominican Republic (1998); CACM–Chile (1999); Costa Rica–Trinidad and Tobago (2002); Costa Rica–CARICOM (2003); Nicaragua–Mexico (1998); Northern Triangle (El Salvador, Guatemala and Honduras)–Mexico (2000); Guatemala, El Salvador and Honduras–Andean Community (being negotiated by the Andean Community Secretariat and the Secretariat for Central American Economic Integration (SIECA))	4.6%	Costa Rica–Canada (2001); CACM–United States (2005); CACM–European Union (start of negotiations announced)	61.6%
Caribbean Community (CARICOM) (1973)	12.2%	CARICOM–Venezuela (Bolivarian Rep. of) (1992); CARICOM–Dominican Republic (2001); Trinidad and Tobago–Costa Rica (2002); CARICOM–Costa Rica (2003); CARICOM–MERCOSUR	2.3%	CARICOM–Canada (being negotiated) CARICOM–European Union (negotiations begun in July 2004)	...
Chile		Chile–Bolivia (1993); Chile–Venezuela (1993); Chile–Colombia (1994); Chile–Mexico (1998); Chile–Ecuador (1995); Chile–MERCOSUR (1996); Chile–Peru (1998); Chile–Central America (1999); Chile–Cuba (2002)	15.1%	Chile–Canada (1997); Chile–United States (2003); Chile–European Union (2002); Chile–Republic of Korea (2003); Chile–European Free Trade Association (2004); Chile–New Zealand, Singapore and Brunei Darussalam (2005); Chile–China (2005)	58.6%
Mexico		Mexico–Chile (1992); Mexico–Venezuela and Colombia (G3) (1995); Mexico–Costa Rica (1995); Mexico–Bolivia (1995); Mexico–Nicaragua (1998); Mexico–Uruguay (2003); Mexico–Northern Triangle (El Salvador, Guatemala and Honduras) (2001); Mexico–Panama (1986)	2.2%	Mexico, United States and Canada (NAFTA) (1994); Mexico–European Union (2000); Mexico–Israel (2000); Mexico–European Free Trade Association (2001); Mexico–Japan (2005)	92.2%
Latin America and the Caribbean		51 agreements <sup>d</sup> in effect covering 12.5% of total exports		17 agreements covering 51.5% of total exports	

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

<sup>a</sup> The agreements shown include economic complementarity agreements (ECAs) and free trade agreements (FTAs).

<sup>b</sup> Percentage of total exports.

<sup>c</sup> The Southern African Customs Union (SACU) comprises South Africa, Botswana, Lesotho, Namibia and Swaziland.

<sup>d</sup> Includes all the economic complementarity agreements in effect in the framework of the Latin American Integration Association (LAIA).

Table IV.4  
LATIN AMERICA AND THE CARIBBEAN: PROPORTION OF TOTAL EXPORTS COVERED BY PREFERENTIAL AGREEMENTS <sup>a</sup>

		Intraregional	Extraregional	Total
1991	Distribution of total trade (A)	13.9	86.1	100.0
	With tariff preferences extended (B)	8.4	0.0	8.4
	<b>Free trade (C=(B/A)*100)</b>	<b>60.4</b>	<b>0.0</b>	<b>8.4</b>
1995	Distribution of total trade (A)	19.8	80.2	100.0
	With tariff preferences extended (B)	11.2	31.6	42.8
	<b>Free trade (C=(B/A)*100)</b>	<b>56.6</b>	<b>39.4</b>	<b>42.8</b>
2000	Distribution of total trade (A)	17.4	82.6	100.0
	With tariff preferences extended (B)	11.7	45.6	57.3
	<b>Free trade (C=(B/A)*100)</b>	<b>61.5</b>	<b>55.2</b>	<b>57.3</b>
2005	Distribution of total trade (A)	18.2	81.8	100.0
	With tariff preferences extended (B)	12.0	51.0	63.0
	<b>Free trade (C=(B/A)*100)</b>	<b>65.9</b>	<b>62.3</b>	<b>63.0</b>

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of M. Kuwayama, J. Durán and V. Silva, "Bilateralism and regionalism: re-establishing the primacy of multilateralism: a Latin American and Caribbean perspective", *Comercio internacional series*, No. 58 (LC/L.2441-P/E), Santiago, Chile, December 2005, and official figures.

<sup>a</sup> Does not include trade conducted under non-reciprocal tariff preferences, such as the Generalized System of Preferences (GSP).

MERCOSUR and the Andean Community have set up an FTA between their members and, together with Chile, Guyana and Suriname, are working on an intraregional initiative known as the South American Community of Nations. A number of Central American countries have concluded FTAs with CARICOM countries and with the Dominican Republic, and several are negotiating an agreement with the Andean Community. In turn, CARICOM has approached Central America and has announced the start of free trade negotiations with MERCOSUR.

In the second quarter of 2006, the Bolivarian Republic of Venezuela withdrew from the Andean Community and the Group of Three (G-3) when its Ministry of Foreign Affairs officially renounced both pacts, arguing that the conclusion of negotiations by Colombia and Peru with the United States would change the nature of the Andean

Community. With notable celerity, the Bolivarian Republic of Venezuela then requested and negotiated full membership in MERCOSUR. This, too, was quickly settled, and in July 2006 the country signed a protocol of adherence with its new trading partners, with which it now has a trade agreement and corresponding tariff reduction schedule (Economic Complementarity Agreement No. 59). The process will conclude when the countries' Congresses approve the protocol and the Bolivarian Republic of Venezuela meets all the respective commitments by incorporating the group's rules into its national legislation and implementing the common external tariff, by the end of 2010 at the latest. In addition, together with Cuba and Bolivia, the Bolivarian Republic of Venezuela has announced the signature of what it calls a "people's trade agreement" (see box IV.1).

Box IV.1

## THE PEOPLE'S TRADE AGREEMENT

The Bolivarian Republic of Venezuela, Bolivia and Cuba signed the People's Trade Agreement (TLCP) in Havana on 1 May 2006. The ground for this agreement was prepared by the Bolivarian Alternative for Latin America and the Caribbean, a joint initiative by the Bolivarian Republic of Venezuela and Cuba in response to the (now stalled) Free Trade Area of the Americas (FTAA). The aim of the accord is to build on the signatories' complementarities by trading products over a barter platform based

on the comparative advantages of each member. Hence, the Bolivarian Republic of Venezuela has offered to assist with the development of Bolivia's mining and energy sector and to export fuels to meet Bolivia's domestic demand. In turn, Bolivia will export mining and agricultural products, especially soybeans, to the Bolivarian Republic of Venezuela and to Cuba. The key Venezuelan contribution lies in the energy sector, in which relations are being strengthened between *Petróleos de Venezuela (PDVSA)*

and *Yacimientos Petrolíferos y Fiscales de Bolivia (YPFB)*.

Only 13% of the three countries' total exports go to Latin American and Caribbean markets, and their reciprocal trade flows amount to less than US\$ 800 million, which is less than 1% of the three economies' combined exports. Initially, Bolivia stands to gain the most from the agreement, since the Venezuelan market accounts for just over a fifth of its total exports (see tables A and B).

Table A  
PEOPLE'S TRADE AGREEMENT COUNTRIES: SELECTED GEOGRAPHICAL  
AND SOCIO-ECONOMIC INDICATORS, 2004

Country	Area (millions of km <sup>2</sup> )	Population (millions)	GDP (millions of US\$)	Per capita GDP (thousands of US\$)	Percentage of total exports going to Latin America
Bolivia	1 098 580	9 227	8 773	951	65.0
Cuba	10 860	11 338	34 973	3 085	11.0
Venezuela (Bolivarian Rep. of)	912 050	26 125	109 764	4 201	11.5
<b>Total</b>	<b>2 021 490</b>	<b>46 690</b>	<b>153 510</b>	<b>3 288</b>	<b>12.9</b>

Table B  
PEOPLE'S TRADE AGREEMENT COUNTRIES: MATRIX OF RECIPROCAL EXPORTS, 2004  
(Millions of dollars)

Origin \ Destination						Percentage intragroup trade
	Bolivia	Cuba	Venezuela (Bolivarian Rep. of)	Total for the three countries	World	
Bolivia		0	489	489	2 254	21.7
Cuba	1		96	96	2 200	4.4
Venezuela (Bolivarian Rep. of)	9	170		179	76 002	0.2
<b>Total</b>	<b>9</b>	<b>170</b>	<b>585</b>	<b>764</b>	<b>81 480</b>	<b>0.9</b>

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

In 2005, Bolivia's main export markets were MERCOSUR (46%), the Andean Community (17%) and the United States (14%). The largest market for Venezuelan exports was the United States (59%). Cuban

exports go mainly to the European Union and Eastern European countries (70%).

The figures suggest that the trade impact of this agreement will be very limited. An innovative aspect of the arrangement is its

pronounced emphasis on social cooperation initiatives; although such programmes fall outside the usual scope of trade agreements, they may warrant closer consideration in the context of other integration agreements.

Chile has accepted an invitation to join the Andean Community as an associate member, after having withdrawn from the group in 1976 over Decision No. 24 on the Common Regime of Treatment of Foreign Capital and Trademarks, Patents, Licences, and Royalties. Several countries along the Pacific coast<sup>4</sup> are advocating the idea of forming an association in order to take advantage of their coastal location (*El Mercurio*, 28 July 2006). This includes the possibility of closer trade ties with Asian countries on the Pacific coast. Chile has already invited Peru to join the FTA known as P4, signed by Chile, New Zealand, Singapore and Brunei Darussalam. The idea of a Latin American Pacific free trade area comprising the Andean Community countries and Chile began to emerge in the first half of 2006 (FEDESARROLLO, 2006). Meanwhile, in September

2006 Chile signed the agreement which makes it an associate member of the Andean Community.

Within MERCOSUR, consideration is being given to some sort of mechanism for trade negotiations with third countries. The groups' smaller countries have lobbied for more freedom to enter into agreements with States outside the bloc and, in particular, Uruguay is keen to explore the possibility of negotiations with the United States. It has been argued that an imperfect customs union may be compatible, to some extent, with commitments involving key components of trade with third countries. The WTO provisions on the enabling clause negotiated during the Tokyo Round (1979) and article XXIV of GATT—which are binding on the members of MERCOSUR—may offer a way forward in this regard (Peña, 2006).<sup>5</sup>

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## C. Assets and liabilities of regional integration

A brief overview of the assets and liabilities of the different regional integration processes may afford an understanding of the stage each has reached, the quality of integration achieved and prospects for deepening it. To this end, this

section looks at trade policy, institutional development, macroeconomic harmonization and common policies, including the treatment of asymmetries. Each of the subregional groups' trading patterns are also examined.

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### 1. Southern Common Market (MERCOSUR)

One of the main achievements of MERCOSUR in its first 15 years was to form a free trade area, even though some important sectors, such as motor vehicles and sugar, are still excluded from it. Another achievement was the establishment of a common external tariff for 85% of the tariff universe four years after the Asunción Treaty was signed in 1991. Basically, MERCOSUR functions as an incomplete free trade area and an imperfect customs union, with an average common external tariff of 12%.

Although important exceptions to the common external tariff remain, provision was made recently for the free movement of goods within MERCOSUR by eliminating

the double tariff as of 2008. The association has decided to set up a single customs area, without rules of origin, by instituting mechanisms to distribute customs revenues, using a common customs code and computerizing customs facilities. A regime has also been approved for integrating production processes in some of the member States using goods originating outside the subregion.

Institutionally speaking, MERCOSUR has an intergovernmental decision-making structure backed up by technical and consultative bodies. The most prominent advances in this regard are the recent creation of the Permanent Court of Review as a community forum for

<sup>4</sup> Mexico is apparently proposing a new partnership along these lines (see statements by Mexico's Secretary for Foreign Affairs, Luis Ernesto Derbez, at [http://www.sre.gob.mx/comunicados/conferencias/2006/confe\\_37.htm](http://www.sre.gob.mx/comunicados/conferencias/2006/confe_37.htm)).

<sup>5</sup> A number of authors propose a straightforward two-speed model for MERCOSUR, deepening bilateral relations between Brazil and Argentina and creating wider degrees of freedom for the other partners. This would imply enhancing the free trade area and abandoning the idea of a customs union (Giambiagi and Barenboim, 2005).

the resolution of trade disputes and the establishment of the MERCOSUR Parliament.<sup>6</sup>

MERCOSUR is one of the region's most uneven integration schemes in terms of the size and competitiveness of its members' economies. One of the first steps taken to deal with its acknowledged structural asymmetries was the creation of a US\$ 100 million structural convergence fund in 2005, which will bring greater benefits for the smaller countries (MERCOSUR, 2005).

The lack of a common trade policy is a major weakness: MERCOSUR has no community rules on trade protection (such as safeguards or antidumping measures), quality or technical standards, or sanitary and phytosanitary regulations. Moreover, efforts to develop a consensus on such rules have yielded little real progress. The countries are still discussing how to adopt a definitive common external tariff and have extended the duration of preferential tariffs and exception regimes for certain goods. This does little to help lift the main non-tariff barriers within the group and allows new constraints on free trade to develop.

With regard to complementary trade policy, MERCOSUR is only just beginning to implement the provisions of a protocol that was adopted in 1998 to facilitate the free movement of a certain number of services. Its competition and public investment protocols have not been implemented, and the public procurement protocol has yet to be incorporated into national legislation in the member countries. There is no common standard on intellectual property.

Little headway has been made on macroeconomic harmonization. Work is in progress to standardize fiscal and monetary indicators, but little has been achieved in terms of meeting specific macroeconomic targets (Sánchez-Gómez, 2006). No steps have been taken to harmonize fiscal or other

types of measures that generate non-structural asymmetries, such as those arising from subsidies and investment and export incentives.

The institutional structure of MERCOSUR is limited in some quite significant ways. Apart from the main body, the Common Market Council, MERCOSUR lacks solid, well-established executive bodies. The limited powers of the Secretariat are juxtaposed with those of the Committee of Permanent Representatives but neither body acts as an executive arm. In addition, only 50% of the standards or resolutions adopted by the group have been written into the members' national legislation and entered into effect. This is acting as a severe drag on the integration process (Durán and Maldonado, 2005).

Despite these constraints, MERCOSUR has developed more dynamic intragroup trade than any of the other integration schemes. From only 9% of total exports in 1990, intragroup exports came to account for 25% in 1998, representing no less than US\$ 20.3 billion. In 2005, intrasubregional trade amounted to US\$ 21.4 billion, or 13% of all the bloc's exports (see table IV.3). Although intrasubregional exports now account for a smaller percentage of the total than they did a decade ago, they have expanded steadily for the last few years and have reached much higher absolute values than in 1998, at US\$ 21.4 billion in 2005 (see table IV.5). Buoyant intragroup trade has helped each of the countries to diversify its exports and has allowed for a greater interchange of value-added within essentially inter-industry trade flows, especially in mid-level technology manufactures. The smallest countries have suffered the most in the wake of the macroeconomic crises of 1999 and 2002, however, in terms of both the volume exported to other group members and the quality of those exports.<sup>7</sup>

Table IV.5  
MERCOSUR: TRENDS IN EXPORTS  
(Millions of dollars and percentages)

	1990	1995	1998	2000	2001	2002	2003	2004	2005	January- June 2005	January- June 2006 <sup>a</sup>
Total exports (1)	46 403	70 129	80 227	85 692	89 078	89 500	106 674	134 196	162 512	75 177	84 772
Percentage annual growth	-0.3	13.3	-2.9	12.3	4.0	0.5	19.2	25.8	21.1	21.0	12.8
Exports to MERCOSUR (2)	4 127	14 199	20 322	17 710	15 298	10 197	12 709	17 319	21 406	9 859	11 468
Percentage annual growth	7.6	17.8	-1.1	16.8	-13.6	-33.3	24.6	36.3	23.6	25.6	16.3
<b>Percentage exports within MERCOSUR (2/1)</b>	<b>8.9</b>	<b>20.2</b>	<b>25.3</b>	<b>20.7</b>	<b>17.2</b>	<b>11.4</b>	<b>11.9</b>	<b>12.9</b>	<b>13.2</b>	<b>13.1</b>	<b>13.5</b>

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the MERCOSUR Secretariat and official country information (Secretariat of Foreign Trade of Brazil (SECEX), National Institute of Statistics and Censuses of Argentina (INDEC), Central Bank of Uruguay and Central Bank of Paraguay).

<sup>a</sup> Preliminary estimates.

<sup>6</sup> Through the Common Market Council, the countries set up the Joint Parliamentary Commission to monitor progress towards the establishment of the MERCOSUR Parliament in December 2005. According to the Commission's latest report, as of July 2006, Paraguay was the only member to have approved the founding protocol; the Congresses of Argentina, Brazil and Uruguay had yet to ratify it (<http://www.mercosurabc.com.ar/nota.asp?IdNota=834&IdSeccion=2>).

<sup>7</sup> According to the MERCOSUR countries' external trade figures, between 2000 and 2005 Uruguay's and Paraguay's exports to MERCOSUR partners lagged behind those of Brazil and Argentina, losing ground in low- and mid-level technology goods and in resource-based manufactures (Durán and Masi, 2006).



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## 2. Andean Community

The Andean Community is the most advanced of the integration schemes in terms of setting up a free trade area, even though Peru was later in entering the system.<sup>8</sup> First, there are no exclusions from the Andean free trade area. Second, it has common rules on trade protection (antidumping and safeguards) and community procedures for the regulation and quality certification of goods. In addition, an Andean Agricultural Health System has been created to harmonize provisions on sanitary matters.

The Andean Community also has common standards for trade in services and for the treatment of investment and intellectual property. These standards will now have to be carefully adjusted in order to reconcile them with the contents of Peru's and Colombia's FTAs with the United States. In 1991, the Andean Community approved a protocol on intra-community competition policy which was then improved and updated in 2005. Although it lacks community regulations on government procurement as such, the public procurement of services is already covered.

A first step has been taken towards macroeconomic harmonization with what are known as "convergence action programmes", which are used to set monetary and fiscal targets. The Andean Community has also adopted decisions aimed at harmonizing the VAT and excise taxes. Substantial work has also been carried out on financial integration with the creation of the Andean Committee of Stock Exchange Regulatory Authorities.

The Andean Community's greatest asset is its institutional structure, which is the most comprehensive of all the region's integration schemes and has become a key tool for deepening Andean integration. The Andean Community General Secretariat has a well established and acknowledged executive function, and it works directly with presidential and ministerial decision-making organs. The Andean Community Court of Justice is a supranational tribunal with the power to deal with nullity proceedings against the decisions of the executive bodies, infringement of community rules, interpretation of those rules and arbitration proceedings. More recently, the Community established the Andean Parliament, which consists of directly elected representatives. The majority

of the executive bodies' decisions are written into the countries' national legislation.

A prominent part of the Andean Community's institutional framework is the Andean Development Corporation, which is viewed as the leading development bank in Latin America and the Caribbean. Its members include not only the Andean Community countries, but also the MERCOSUR, Central American and CARICOM countries and Spain. The Corporation's total loan portfolio started out at just US\$ 20 million when the institution was created in 1975 and grew to US\$ 574 million by 1990. Between 1990 and 2005 it increased more than 10-fold and is worth over US\$ 8 billion today. The institution has consolidated its position as the highest-rated Latin American issuer (it was the first to be awarded an investment-grade rating by the main international rating agencies) and has become a very important alternative to multilateral financial institutions for the region.

With regard to the treatment of structural asymmetries, the Integral Plan for Social Development (IPSD) was created recently to address problems of poverty, exclusion and inequality in the Andean Community and to mobilize funding for social cohesion programmes.

Despite its solid framework of Community institutions and significant progress towards the formation of a common trade policy, the Andean Community has made less headway than MERCOSUR in consolidating a common external tariff and building a customs union. A common external tariff was established in 1994, covering 60% of the tariff universe with an average tariff of 11%. Since then, efforts to broaden its coverage have repeatedly been deferred, and Peru remained outside the tariff scheme for 12 years.<sup>9</sup> The Andean countries have lodged multiple complaints and called for consultations over common external tariff violations, and there are still special customs regimes that act as tariff loopholes.

A number of trade-related difficulties remain as well. First, rules of origin are not fully standardized, and the safeguard system suffers from limitations with respect to certain types of products and the treatment of exchange rates. Second, price bands for agricultural goods act as a form of protectionism in trade within and outside the Andean Community. The countries have submitted numerous

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<sup>8</sup> Peru did not join the free trade area until the first half of 2006.

<sup>9</sup> Peru did not apply the common external tariff until January 2006.

complaints in which they charge that the improper use of trade protection measures and technical and quantitative restrictions constitute barriers to intrasubregional trade. In fact, the constant infringement of rules agreed upon by the member countries is one of the most serious obstacles to the Andean Community's operation as a free trade area (Durán, Maldonado and Meneses, 2006).

The Andean Community conducts less intrasubregional trade than MERCOSUR does. Its intragroup trade expanded very strongly in the 1990s, but has been relatively slack in the last five years, amounting to about US\$ 9 billion and representing only 10% of the group's total trade (see table IV.6).<sup>10</sup> In the last few years, export growth has been more robust in

external than in intragroup markets. Particularly sharp upswings have been seen in external sales to the United States and Europe and, more recently, to other Latin American markets (see table IV.2). The structure of the Andean Community has helped its member countries to diversify their exports and form a platform from which to access new markets (SGCAN, 2004).<sup>11</sup> In the 1990s, intragroup trade expanded mainly on the back of exports of resource-based manufactures and of low- and mid-level technology goods. Since 2000, however, growth in these categories of exports has tailed off sharply, shifting instead to commodities.<sup>12</sup> Colombia and Peru, however, have been able to improve their position with regard to higher-tech manufactured goods.

Table IV.6  
ANDEAN COMMUNITY: TRENDS IN EXPORTS  
(Millions of dollars and percentages)

	1990	1995	1998	2000	2001	2002	2003	2004	2005	January- June 2005	January- June 2006 <sup>a</sup>
Total exports (1)	31 751	39 134	38 896	60 709	53 543	52 177	54 716	74 140	94 751	48 005	59 970
Percentage annual growth	25.7	16.1	-16.5	36.1	-11.8	-2.6	4.9	35.5	27.8	34.9	24.9
Exports to the Andean Community (2)	1 312	4 812	5 504	5 167	5 656	5 227	4 900	7 361	9 056	4 132	4 552
Percentage annual growth	26.3	28.2	-2.2	31.1	9.5	-7.6	-6.3	50.2	23.0	29.3	10.2
<b>Percentage intra-Community exports (2/1)</b>	<b>4.1</b>	<b>12.3</b>	<b>14.2</b>	<b>8.5</b>	<b>10.6</b>	<b>10.0</b>	<b>9.0</b>	<b>10.5</b>	<b>9.6</b>	<b>8.6</b>	<b>7.6</b>

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

<sup>a</sup> Preliminary estimates.

### 3. Central American Common Market (CACM)

CACM also became a free trade area at the start of this decade, although a number of (mainly agricultural) products are excluded from it. Apart from rules of origin, CACM has no community rules on trade protection or technical, sanitary or quality standards, but has instead adopted the WTO rules on these matters. Barriers to intraregional trade have come down significantly, and the obstacles that

remain (mainly in the agricultural sector) have little effect on intraregional trade. The CACM members have been working on a Central American agreement on services and investment since 2001. There are no subregional rules on intellectual property or government procurement.

One of the main achievements of CACM has been to set up a customs union. The CACM common external

<sup>10</sup> According to data calculated by ECLAC on the basis of official statistics, trade within the Andean Community peaked at 14% at the end of the 1990s.

<sup>11</sup> In 2002, exports of Andean products using the subregional market as a platform to third markets represented US\$ 1.2 billion. Between 1993 and 2002, the proportion of products taking this route climbed from 12% to 63% (SGCAN, 2004).

<sup>12</sup> Data from ECLAC, on the basis of official statistics.

tariff covers 95% of the tariff universe and maintains a low level of effective protection, at only 6%, on average. CACM has a single customs procedures manual, a standard Central American tariff code and a customs union plan of action, which was approved in 2004 and is designed to eliminate the double tariff regime, distribute customs revenue and manage the common customs. In terms of macroeconomic harmonization, CACM has set convergence parameters for GDP variation, monetary and fiscal indicators, international reserves and external debt.

CACM also has a more advanced institutional structure than MERCOSUR does, and its achievements are much more similar to those of the Andean Community in this respect. The Central American Integration System encompasses an executive system, a parliament and a court of justice. The CACM dispute settlement mechanism, which is procedurally similar to the MERCOSUR system, is designed to avert infringements of the rules and establish the consequent compensation for damages. CACM also has a General Secretariat, to which a number of technical secretariats report. These secretariats have proven to be highly effective providers of support to the different member countries and their ministries in bilateral and multilateral negotiations, as well as serving as a channel for international financial cooperation.

Through their FTAs with Mexico, the Central American countries have benefited from the Puebla-Panama Plan (to which Colombia recently acceded), which includes projects to facilitate energy, transport and telecommunications interconnection on the isthmus, as well as legal harmonization. The Puebla-Panama Plan encompasses projects to reduce structural asymmetries in competitiveness and human development. With respect to

initiatives to tie in with social cohesion policies, CACM has a programme known as the Alliance for the Sustainable Development of Central America and a Secretariat for Social Integration, which was created in 2001 to assist with efforts towards achievement of the Millennium Development Goals in the subregion. In addition, the Central American Bank for Economic Integration (CABEI) has financing programmes aimed at improving competitiveness, combating poverty and developing border areas.

The Central American countries have adopted a very dynamic and flexible approach to signing FTAs with Canada, Chile, Mexico, the United States and the CARICOM countries and are now negotiating another such accord with the European Union. Within CACM, 77% of trade comes under preferential agreements. The Dominican Republic—Central America—United States Free Trade Agreement (CAFTA-DR) functions particularly well for the subregion and should help to deepen common trade policy in Central America, since it has more comprehensive rules on each of the basic standards and on trade in services, investment, intellectual property, public procurement, the environment and labour matters (Jaramillo and Lederman, 2006).

Generally speaking, the bulk of Central American exports have always gone to the United States market, which has absorbed between 50% and 60% of Central American exports over the last 15 years. Intrasubregional trade reached a high of 18% of total exports in 2005 and has been holding at that level. Since 2003, however, intraregional exports have expanded at a higher average annual rate than overall exports (see table IV.7).<sup>13</sup> One of the advantages of this intraregional trade pattern has been an increase in exports of mid-level and high technology industrial goods and of resource-based manufactures.

Table IV.7  
CENTRAL AMERICAN COMMON MARKET: TRENDS IN EXPORTS  
(Millions of dollars and percentages)

Central American Common Market (CACM)	1990	1995	1998	2000	2001	2002	2003	2004	2005	January-June 2005	January-June 2006 <sup>b</sup>
Total exports <sup>a</sup> (1)	4 480	8 745	14 987	16 624	16 328	17 006	18 117	19 767	21 849	10 690	11 650
Percentage annual growth	25.2	17.1	17.4	5.3	-1.8	4.1	6.5	9.1	10.5	10.4	9.0
Exports to CACM (2)	624	1 451	2 754	2 617	2 829	2 871	3 111	3 506	3 911	1 865	2 089
Percentage annual growth	8.9	17.2	38.5	8.1	1.5	8.3	11.6	13.1	8.1	11.6	12.0
<b>Percentage intra-CACM (2/1)</b>	<b>13.9</b>	<b>16.6</b>	<b>18.4</b>	<b>15.7</b>	<b>17.3</b>	<b>16.9</b>	<b>17.2</b>	<b>17.6</b>	<b>18.0</b>	<b>17.4</b>	<b>17.9</b>

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the Secretariat for Central American Economic Integration (SIECA) (<http://www.sieca.org.gt/SIECA.htm>), and official figures from the relevant countries.

<sup>a</sup> Total export figures include maquila and duty-free zones. The intraregional trade series shown therefore differs from series published in previous editions of the *Latin America and the Caribbean in the World Economy*, which do not include these areas of activity.

<sup>b</sup> Preliminary estimates, on the basis of official figures for January-April.

<sup>13</sup> ECLAC data, on the basis of official figures. Starting with this publication, total export figures include maquila and export processing zones; hence, the intrasubregional trade figure differs from that shown in previous years' publications.

Table IV.8  
REGIONAL INTEGRATION: ASSETS AND LIABILITIES

	MERCOSUR	Andean Community	Central American Common Market	CARICOM
Free trade area	Exceptions for motor vehicles and sugar	No exceptions	Exceptions for some agricultural goods and for beverages	No exceptions
	Many non-tariff barriers to intraregional trade	Numerous complaints over use of non-tariff barriers		Many barriers to intraregional trade
Common trade policy	Protocols for services, investment and public procurement	Common rules on trade protection, quality, agricultural health, services, investment, intellectual property and competition policy	Agreement on services and investment. Other rules adopted since the expansion of CAFTA-DR (trade protection, public procurement, intellectual property and so forth)	Legislation exists on trade protection, technical and sanitary rules, customs procedures, services, intellectual property and competition policy
	Protocols on competition, investment and public procurement not applied. No common rules on intellectual property. Lack of consensus on common standards regarding trade protection and technical and sanitary rules	Price band for agricultural goods creates protectionism. Limitations imposed by differentiated rules of origin, by safeguards and by lack of technical rules	Process of reconciling trade protection rules with CAFTA may create new forms of protectionism within the free trade area	Rules written into national legislation in a few countries only. Barriers to trade in services
Customs union	Common external tariff covering 85% of goods at an average of 12%. Double tariff regime eliminated and single customs area to be created by 2008	Common external tariff covering 60% of goods, at an average of 11.2%	Common external tariff covering 95% of goods at an average rate of 6%. Customs code. Plan of action approved for single customs area	Average common external tariff of 15%. Single market and economy (CSME) proposed for 2008. Free movement of skilled labour and capital
	Deadline for winding down special regimes and eliminating list of products exempt from common external tariff has been extended	Peru late in applying common external tariff. Successive postponements of new levels of coverage for common external tariff. Special customs regimes. Complaints over repeated violations of common external tariff	CAFTA-DR rules may enter into conflict with elimination of rules of origin in customs union and may create differentiation and dispersion of common external tariff	Most group decisions on the customs union remain to be written into national legislation
Macroeconomic harmonization	Macroeconomic targets set and indicators standardized	Macroeconomic targets set. Tax and financial harmonization efforts	Macroeconomic targets set and indicators harmonized	
	Lack of political will to work towards fiscal and monetary harmonization		No efforts known apart from convergence parameters set for economic growth indicators and macroeconomic stability	No progress
Institutional development	Intergovernmental structure with Council of Ministers as decision-making body. Permanent Court of Review and Parliament	Highly advanced institutional structure with General Secretariat and executive bodies, parliament and supranational judicial system. Andean Development Corporation is the leading development bank in Latin America and the Caribbean	General Secretariat and executive, parliamentary and judicial bodies. Dispute settlement tribunal. Central American Bank for Economic Integration (CABEI)	Executive bodies with Secretariat. Court of Justice recently created to settle disputes. Caribbean Development Bank
	Pronounced weakness due to absence of solid and established executive bodies. Community decisions not well incorporated into national legislation	Demonstrated weakness in implementing resolutions and compliance with community rules even though they are well incorporated into national legislations		
Structural asymmetries	Structural Convergence Fund (2005)	Integrated Plan for Social Development (PIDS)	Sustainable development programmes, (ALIDES), social integration (SISCA), Puebla-Panama Plan	Development fund created
	Plans recently begun	Plans recently begun		Recent initiative
Intensity and quality of trade	Unprecedented growth (the highest in the region) in intraregional trade. Export diversification, largely inter-industry	Strong growth in the 1990s. Intraregional exports have broader manufacturing base	Trade oriented towards countries outside the subregion. Intrasubregional exports growing faster than extraregional exports. Intrasubregional trade is manufactures-based	Intraregional goods trade represents a high proportion of exports and is growing faster than extraregional trade
	Intraregional exports have declined as a proportion of total trade, with smaller countries losing ground in market access	Weakened intraregional export performance since 2000. Stronger growth in trade with the United States, Europe and, recently, with countries and blocs in Latin America and the Caribbean	Intraregional trade can be maintained only insofar as intragroup linkages strengthen exports outside the subregion.	Constraints on the negotiation of FTAs with countries and blocs. Services trade little developed
Other matters	Amount of intraregional exports today is slightly higher than in 1998	Andean Development Corporation portfolio expanded more than 10-fold between 1990 and 2005	77% of exports covered by preferential trade agreements. Dynamic approach to FTAs	Comparative advantages greater in services trade than in goods

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

## 4. Caribbean Community (CARICOM)

After a number of attempts to plot a course towards regional integration in the Caribbean, the members of CARICOM signed a treaty on the Caribbean Single Market and Economy (CSME), which will come fully into effect in 2008. A number of obstacles and limitations have to be overcome before that happens, however, since only 7 of the 12 members of CARICOM are signatories to CSME.

Although free movement of capital and of skilled labour has now been instituted among the 12 members of CARICOM, merchandise trade is still hampered by many non-tariff barriers and domestic barriers in the member countries. In 2002, legislation was drawn up on trade protection; technical, sanitary and customs harmonization rules; the free movement of services; intellectual property; and competition policy. Trinidad and Tobago is the only country to have written these Community decisions into its national legislation, however. Many obstacles remain to the free movement of services, too, and this is perhaps an even more important issue for the Caribbean than the movement of goods. With most of the Community's decisions on the formation of a customs union yet to be incorporated into national legislation, the integration

process is lagging far behind the other subregional integration schemes.

The decision-making bodies in the institutional structure of CARICOM are the Conference of Heads of Government and the Community Council of Ministers, and the CARICOM Secretariat is the principal administrative organ. The decision-making organs are backstopped by a large group of technical, social, educational, legal and other types of institutions, as well as consultative institutions and councils, including the Caribbean Development Bank (CDB). More recently, the Caribbean Court of Justice, whose main job is to settle disputes, was created. CARICOM has unfinished business in matters of macroeconomic coordination and treatment of asymmetries, although a development fund was set up recently to assist the countries that are lagging behind with a view to the establishment of the Caribbean Single Market and Economy.

Of all the subregional groups, CARICOM exhibits the highest percentage of intragroup trade, which has increased from 12% in the 1990s to 23% today (see table IV.9). Intraregional trade has, moreover, expanded much more quickly than exports outside CARICOM.

Table IV.9  
CARICOM: TRENDS IN EXPORTS  
(Millions of dollars and percentages)

	1990	1995	1998	2000	2001	2002	2003	2004	2005 <sup>a</sup>
Total exports (1)	4 118	5 598	4 790	6 358	6 072	5 732	6 712	7 880	8 274
Percentage annual growth	11.6	25.2	-18.3	23	-4.5	-5.6	17.1	17.4	5.0
Exports to CARICOM (2)	509	843	1 031	1 230	1 384	1 220	1 419	1 810	2 329
Percentage annual growth	2.9	26.5	5.7	12.3	12.4	-11.8	16.3	27.5	28.7
<b>Percentage intra-CARICOM exports (2/1)</b>	<b>12.4</b>	<b>15.1</b>	<b>21.5</b>	<b>19.4</b>	<b>22.8</b>	<b>21.3</b>	<b>21.1</b>	<b>23.0</b>	<b>28.1</b>

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the respective subregional grouping and the International Monetary Fund (IMF), *Direction of Trade Statistics*.

<sup>a</sup> These data do not include information for Bahamas, Haiti or Suriname. Hence, the intraregional trade ratios shown here would vary if these countries were included.

Since merchandise trade in CARICOM is dominated by a small number of countries and its members enjoy greater comparative advantages in services than in merchandise, the challenges posed by integration are different in some respects than they are for other subregional schemes in the region. First, any deepening of the CARICOM integration process must be based mainly on the liberalization of trade in services. Second,

as far as its trade in goods is concerned, CARICOM would probably be better off maintaining the non-reciprocal tariff treatment it now receives from the United States and Europe<sup>14</sup> than if it were to sign FTAs with them, given its members' lack of competitiveness in this area. It appears that these options are, however, no longer available. This being the case, the challenge is to determine how to take advantage of negotiations

<sup>14</sup> Caribbean goods receive preferential treatment in the United States under the Caribbean Basin Initiative and enter Europe tariff-free under the Lomé Convention and the Cotonou Agreement. These preferential arrangements are in place for a limited period of time, however.

with the European Union to strengthen the CARICOM institutional structure and incorporate a suitable sort of special and differential treatment that is also consistent with the Doha Round's emerging core issues in relation to trade facilitation and, particularly, aid for trade. Third, preferential agreements with Latin American countries have

been secured by the more competitive Caribbean nations, but not by CARICOM as a whole. Be that as it may, any agreements CARICOM negotiates, whether with developed countries or with other blocs in the region, must take into account the very particular traits of the type of trade that takes place within this subregional group.

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## D. The need for FTA convergence

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### 1. Scope of the different agreements' rules and disciplines

The multiplicity of bilateral, plurilateral and regional trade agreements in force in Latin America and the Caribbean could give rise to discriminatory practices among countries and regional sub-groups, given the variety of provisions relating to coverage, types of treatment and the depth of commitment entailed by their various disciplines and rules. Moreover, this unwieldy set of agreements makes trade facilitation in the region an arduous and complicated undertaking. Unless urgent steps are taken to achieve convergence among the different types of agreements, the region, instead of creating trade, runs the risk of triggering major trade diversions and bolstering development areas or enclaves with very different, or even conflicting, trade agendas, to the detriment of regional integration.

Countries and integration blocs in the region have signed no fewer than 68 bilateral and plurilateral trade agreements; these arrangements vary considerably both in terms of the coverage of disciplines and rules and as regards the level of commitment they command within and outside the region. Significant progress has been made in reducing tariffs, especially in intraregional agreements. Among the LAIA member countries, for example, approximately 85% of all tariff items and 70% of bilateral trade operations are already fully liberalized (LAIA, 2005 and 2006).

In seeking to promote convergence towards free trade, the MERCOSUR and Andean Community secretariats, in conjunction with LAIA, have produced a study in which they measure the proportion of trade among the

countries of the South American Community of Nations (SACN) that should be free of tariff barriers as of 2006, 2010, 2014 and 2018 (see table IV.10 and SACN, 2006). The results point to a slow convergence towards free trade, since in 2006, between 35% and 60% of trade was reported to be free of tariffs, depending on how it is measured, whereas by 2014, between 60% and 70% of trade is expected to be completely free and, by 2018, the figure ought to be between 65% and 95%. Only Chile and Bolivia are expected to achieve market conditions approximating actual free trade by 2010, when more than 85% of their exports will be entitled to preferential market access in the subregion. Bilateral liberalization between the two countries will be shallower, however, because the asymmetrical treatment resulting from the negotiations will work in Bolivia's favour.

As of 2006, the greatest achievements in terms of trade liberalization were recorded in the countries of the Andean Community, where, in theory, liberalization applies to all tariff categories. The situation in MERCOSUR is different, since exceptions to free trade are maintained in the sugar and motor vehicle industries, where no major changes are expected for the time being. Projections prepared by the Working Group on Integration Secretariats indicate that in 2010 and 2014 there will still be a significant percentage of products that do not benefit from trade liberalization, with many cases in which the degree of trade liberalization will still fall far short of 90%; these lags are greatest in trade between the Andean Community and MERCOSUR and in Chilean exports to Bolivia (see table IV.10).

Table IV.10  
**CHANGING PATTERNS OF FREE TRADE IN SOUTH AMERICA, SEVERAL YEARS <sup>a</sup>**  
*(Percentages of the beneficiary's exports, weighted by preferential tariffs)*

Beneficiary \ Granting authority										
	Argentina	Brazil	Paraguay	Uruguay	Chile	Bolivia	Colombia	Ecuador	Peru	Venezuela (Bolivarian Republic of)
<b>Estimate for 2006</b>										
Argentina		76	85	82	72	58	3	4	7	13
Brazil	62		72	70	89	65	9	7	2	8
Paraguay	96	97		98	68	18	1	0	0	53
Uruguay	92	92	93		72	62	3	8	17	5
Chile	85	83	84	84		0	96	96	81	94
Bolivia	81	83	89	80	99		100	100	100	100
Colombia	15	14	1	21	97	100		100	100	100
Ecuador	69	75	18	32	46	100	100		100	100
Peru	64	69	7	58	86	100	100	100		100
Venezuela (Bolivarian Rep. of )	2	27	18	22	100	100	100	100	100	
<b>Projections for 2014</b>										
Argentina		76	85	82	96	100	24	17	65	27
Brazil	62		72	70	100	100	24	10	57	26
Paraguay	96	97		98	98	100	16	8	48	79
Uruguay	92	92	93		100	100	13	25	40	9
Chile	100	100	100	100		0	100	96	99	100
Bolivia	100	100	100	100	99		100	100	100	100
Colombia	56	64	1	49	100	100		100	100	100
Ecuador	86	91	41	65	46	100	100		100	100
Peru	100	100	7	71	100	100	100	100		100
Venezuela (Bolivarian Rep. of )	53	83	26	22	100	100	100	100	100	

Source: Secretariats of the Andean Community, MERCOSUR and LAIA, on the basis of the South American trade convergence data bank.

<sup>a</sup> The darker the shading the less free trade takes place between the two countries. Bilateral relations with a degree of trade openness of over 90% are shown against a white background.

This outlook is scarcely encouraging for the region's exporters and investors, since, on the one hand, the remoteness of the prospect of liberalization could discourage them from taking business decisions, and, on the other, several countries in the region could be parties to faster-paced export and import tariff reduction processes as part of agreements with the United States and probably with the European Union as well. In order to get around this difficulty and move forward towards deeper tariff reductions, the secretariats of these integration schemes have proposed speeding up their timetables in order to extend tariff-free status to at least 90% of regional trade in the short term.

Tariff reduction does, however, require the concurrence of other fundamental rules and disciplines to guarantee its effectiveness. Not all of these rules have been fully incorporated into intraregional agreements, and—unlike the provisions of extraregional agreements signed with

such countries and associations as the United States and European Union—even those that have been are no more comprehensive than WTO rules are.<sup>15</sup>

There are substantive differences in terms of the coverage of rules and disciplines provided for by each type or group of agreements. Intraregional agreements tend to incorporate rules relating primarily to trade protection so as to expedite the tariff reduction schedule and avoid the introduction of non-tariff barriers to trade. Such agreements do not, however, offer broad-based coverage for other types of rules which, when not fully harmonized, turn into non-tariff barriers, as in the case of sanitary and phytosanitary rules and technical standards. At the same time, with respect to disciplines on non-trade matters, albeit trade-related, disciplines (services, investments, public procurement and intellectual property), intraregional agreements definitely have more limited coverage than extraregional agreements.

<sup>15</sup> In particular, issues such as competition policies, public procurement, services, investment, intellectual property and technical rules appear to be treated very sketchily.

In any event, intraregional agreements vary as regards the coverage of their trade disciplines. For example, South American customs union agreements and bilateral agreements deriving therefrom cover a broad range of trade protection and dispute settlement measures, but are less thorough when it comes to sanitary and phytosanitary measures and technical standards. By contrast, the FTAs signed between Chile and Mexico and by these countries with Central American nations cover these disciplines more comprehensively. In this regard, these agreements have more in common with the region's FTAs with North America than with intraregional bilateral or plurilateral

agreements. Admittedly, this is a sensitive issue, but it is one that should now be addressed if the aim is to gradually advance towards a unified regional market.

The large number and diversity of bilateral and plurilateral agreements signed among countries of Latin America and between this group and countries outside the region could pose obstacles, especially to intraregional trade, in the form of non-tariff barriers. The problems of non-fulfilment that have arisen in some regional agreements could also account for the low degree of interconnection exhibited by intraregional trade flows (ECLAC, 2005; Durán and Maldonado, 2005).

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## 2. Convergence modalities

The problems arising from the multiplicity of agreements and rules in the region fall within three categories. The first involves operational matters, such as rules and procedures relating to customs, transit and storage of goods, where unfamiliarity with the necessary formalities or confusion over methods of application become disguised barriers to trade. The second has more to do with the rules and disciplines established in different agreements. Such rules and disciplines may exist in some accords but be absent from others (provisions on investment, services and intellectual property, for example). At the same time, they represent areas in which intraregional agreements lag behind those signed with countries outside the region. These agreements may contain different provisions regarding similar issues (national treatment) or may mandate different treatments for identical issues (negotiation or commitment models).

Lastly, cases of discrimination may occur between trading partners (less favourable treatment), as a result of differences in terms of regulations, policies and the degree of liberalization between intraregional and extraregional agreements. In the latter case, differences of this sort tend to be greater.

Recently, some countries in the region seem to be placing greater emphasis on trade relations with third countries. A very sharp asymmetry has also been observed between bilateral and plurilateral agreements within

the region and those concluded with nations outside the region (especially countries of the North) because the extraregional agreements contain more demanding obligations, provide for more binding mechanisms and afford greater legal certainty than those existing at the subregional level. The latter, on the other hand, appear to be limited to less stringent trade and non-trade disciplines and rules.

Above and beyond the predominant course being followed by integration strategies in the region, this situation draws attention to the need to facilitate higher levels of intraregional trade. Efforts must be made to ensure closer ties among members of subregional integration schemes and between the latter and their peer organizations (Andean Community/MERCOSUR/CACM/CARICOM), as well as to strengthen trade linkages between individual members of the region.

These efforts must be geared towards generating a level of convergence that promotes greater compatibility between the different integration processes with a view to creating an integrated Latin American market. The term "convergence" refers to the process whereby the agreements concluded by countries of the region adopt more or less similar rules and disciplines. Convergence may be based on three approaches: voluntary, semi-voluntary and involuntary (Stephanou, 2003) (see box IV.2).



## Box IV.2

## CONVERGENCE MODALITIES

**Voluntary:** This modality is widely applied in a number of economic activities. The simplest form of voluntary convergence is that used in financial markets. Several countries built into their own regulations the capital requirements for internationally active banks drawn up by the Basle Committee on Banking Supervision. In 1997, this Committee, which operates under the Bank of Basle, also developed the 25 Core Principles for Effective Banking Supervision. These principles are not incorporated in any type of binding international legal instrument, but are adopted unilaterally by countries. The main incentive for adopting these Principles is that a country's financial market is evaluated on the basis of the level of compliance therewith. This has been an effective mechanism for improving international banking supervision and reducing the risk of financial crises and their contagions. This voluntary international convergence modality is also used in the securities and insurance market and in standardization procedures. As a way of reducing technical barriers to trade, countries are advised to adopt on a unilateral basis standards formulated by international organizations, such as the International Organization for Standardization (ISO) in the area of non-agricultural products and the International Electrotechnical Commission (IEC) for electrical and electronic products. In the case of agricultural products, the international organizations are the Codex Alimentarius Commission for food safety, established by the Food and Agriculture Organization of the United Nations (FAO) and the World Health Organization (WHO),

the International Epizootic Bureau for animal health and the Secretariat for the International Plant Protection Convention. Countries adopt the rules, guidelines and recommendations of these organizations voluntarily, thus providing a common scheme of regulation and basis for comparison. In adopting recommendations, countries may adapt them to their particular situations, but are expected to provide a rationale for such departures. Lastly, still in the interests of standardization, many countries adopt unilaterally a given rule applied in one country because it may be deemed the most appropriate. This occurs in many cases in fields such as electricity.

Cooperation between government agencies responsible for the management of trade through the establishment of formal arrangements (memorandum of understanding) and informal arrangements (exchange of information) is often sufficient to encourage voluntary convergence. These types of arrangements are used in different spheres of action ranging from questions relating to trade in goods to cooperation in terms of competition policies.

**Semi-voluntary:** in these cases, convergence is prompted by a country's interest in securing a benefit from another which, in turn, makes the extension of the desired benefit subject to compliance with specific requirements. The most obvious example of semi-voluntary convergence is the conditionality linked to protection of the environment or certain labour rules that some countries have adopted in order to accede to the benefits of the Generalized System of Preferences.

Again in the sphere of international finances, countries increasingly have to adopt domestic measures to comply with international recommendations on money-laundering in order to participate effectively in the international market. For example, the free trade agreements signed recently by various countries of the region with the United States and Europe have included commitments on the signing of certain intellectual property agreements. In addition, with respect to sanitary and phytosanitary measures, the negotiation of mutual recognition and equivalency mechanisms depends on compliance with specific requirements on either side; not usually on unilateral compliance.

**Non-voluntary:** although a country's accession to a given international agreement is by definition voluntary, in many cases, it calls for the adoption of a significant number of rules which require modification of its domestic legislation. This is the case of countries which, in applying for membership of the World Trade Organization, must bring their trade policies in line with the principles and obligations contained in the different agreements. This is a lengthy process that calls for a great effort in terms of regulatory changes. This is also the case of countries that join the European Union, which must introduce into their laws the *acquis communautaire*, in other words the entire set of laws and regulations governing the trade relations of its members. In both of the above cases, countries do not have the leeway to decide which obligations they wish to espouse and which they wish to reject.

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

Convergence can be encouraged and achieved in various ways, and the possible options should be examined in the light of the specific topics involved. A flexible approach that is conducive to creative solutions is called for. In the case of operational issues, convergence may be achieved through informal or formal arrangements for exchanging customs information, cutting red tape and reducing technical obstacles, ensuring unilateral recognition of security and safety measures, and harmonizing trade facilitation rules relating to transport and border or immigration inspections.

The relevant countries could also try to come to an agreement on common interpretations of rules and disciplines. In cases where agreements contain the same provisions but with different wordings, their members could agree upon a particular way of interpreting the provision, in accordance, for example, with the interpretations used

by WTO. This would help to ensure legal consistency between whatever provisions different bilateral and subregional agreements may have in common. If a given agreement does not include certain disciplines and rules, they should be adopted through negotiation, bearing in mind that different approaches may exist for their treatment and application. If intraregional integration agreements lag behind bilateral agreements with countries outside the region in adopting certain disciplines, then the tendency will be towards voluntary convergence, since there would be no economic or political justification for members of a subregional integration scheme to grant more favourable treatment to extraregional partners, or, for that matter, different treatment for the same issues. Thus, countries would be well advised to adopt a common approach and to grant each other the most favourable treatment possible in order to achieve more balanced regional integration.

Institution-building is a policy matter that must be decided by countries and integration subgroups. A modernizing approach to convergence support might perhaps be developed on the basis of existing institutions, in particular, to help countries to create trade facilitation mechanisms, establish facilities for information and analysis, and provide technical support for interpreting provisions, implementing agreements and settling disputes.

One of the first intraregional convergence initiatives was adopted by the South American Community of Nations (SACN) in September 2005 by means of a mandate instructing the LAIA, MERCOSUR, the Andean Community and CARICOM<sup>16</sup> secretariats to prepare studies on the convergence of agreements among South American countries in three specific areas: trade-related and complementary rules and disciplines; institutional rules; and treatment of asymmetries. The SACN mandate was based primarily on a 2004 LAIA resolution<sup>17</sup> recommending the adoption of measures for the gradual establishment of a free trade area for the members of this association. In this resolution, LAIA stressed the importance of harmonizing rules and disciplines contained in such agreements that are designed to promote greater market access, support for relatively less developed countries (RLDCs) and the promotion of other areas of integration, including physical and digital matters, trade financing and links with the business, labour and academic sectors of member countries.

As regards the convergence of rules and disciplines observed by South American countries, work on trade-related issues has focussed on rules of origin, trade protection, customs valuation and special trade regimes and non-tariff measures. The countries have also decided to work on convergence issues in agreements relating to investment, services, intellectual property, public procurement and competition policy. In order to promote institutional convergence, efforts should be directed towards reconciling and streamlining the consultative and decision-making structures of the Andean Community and MERCOSUR, as well as improving dispute settlement mechanisms. In dealing with the existing asymmetries, the emphasis is on ensuring that the relatively less developed countries in South America converge towards common patterns of economic growth and trade integration based on provisions covering special and differential treatment, guaranteed access to intraregional markets and complementarity and competitive development.

The SACN and LAIA initiative for promoting convergence among regional integration agreements is not confined to existing rules and institutions as set forth in each of the South American intraregional agreements, as it also encompasses agreements signed between South American countries and nations outside the region. This is particularly important because the coverage of extraregional agreements is greater in terms of commitments and includes disciplines that are underdeveloped or simply non-existent within the Andean Community and MERCOSUR.

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## E. Conclusions

The proliferation of FTAs in Latin America and the Caribbean in recent years may be attributed to a number of economic factors, the foremost being uncertainty regarding WTO negotiations (see chapter III of this report), stagnation of the regional integration process and the quest for opportunities for market and product diversification in bilateral negotiations with third parties. None of these trends can justifiably be interpreted as indicative of a lack of interest in regional integration, however. The future challenge in Latin America and the Caribbean, and especially in South America, is to agree on a common diagnostic analysis of the shortcomings of existing integration schemes and to put forward proposals

for modernizing them while accepting the diversity of trade strategies, preserving the gains achieved and facilitating the gradual convergence of the many agreements in existence. The work to be done in this area must be based on a realistic timetable and programme of work that reflect a recognition of the urgent need for a renewed regional integration process.

Regional integration is necessary and must be pursued as a matter of urgency. It is justified not only for the traditional reasons, but also because of the exigencies of the current phase of globalization, and in particular the need to forge strategic international partnerships in the areas of production, logistics, marketing, investment

<sup>16</sup> With the participation of Chile, Guyana and Suriname.

<sup>17</sup> Resolution 59(XIII) of 18 October 2004 of the Council of Ministers of LAIA.

and technology. The demand for competitiveness and technological innovation is mounting (chapter V), while China's and India's competitive leapfrogging has redrawn the global map of trade flows and comparative advantages (see chapter II). Expanded markets, legal certainty and convergence in rules and disciplines, together with advances in infrastructure, energy and connectivity, are prerequisites for growth with equity.

In addition to the benefits to be derived from free trade, integration entails a gradual increase in cooperation in connection with macroeconomic variables and with policies and rules in non-trade areas, the most important being infrastructure, energy and regulatory spheres, as well as migration, social security, health, education and the environment. Europe provides examples of policies aimed at reducing economic asymmetries among its members, encouraging social cohesion in their societies and building community institutions that reflect the balanced interests of all its members.

The present results of regional integration efforts are too far removed from the situation described above, and a pervasive climate of dissatisfaction seems to prevail. This dissatisfaction is more marked in South America, where what are at times repeated cases of non-compliance with agreed provisions erode the political credibility of integration efforts and legal certainty, deflecting would-be investors away from integration schemes. In the absence of effective means of dealing with existing asymmetries, the smaller countries do not feel that current integration arrangements offer the best framework for their economic growth and export diversification.

Existing integration schemes do not satisfactorily address key competitiveness issues in such areas as services, investments, e-commerce, technological innovation, trade facilitation, logistics, and air and maritime transport. This is reflected in the positions that the countries of the region hold in international rankings in this area. Thus, these integration schemes are not fulfilling the roles that they were expected to perform at the outset, when it was thought that they would develop into effective learning platforms for exporting to third markets and serve as tools for negotiating important matters with the region's main trading partners.

By contrast, the debate in Central America is quite different. Here a shifting geometric configuration prevails, with the integration process progressing at varying speeds and with countries willing to accept negotiations by member countries with third parties. In negotiating the Central American Free Trade Area (CAFTA), the Central American countries decided to apply the provisions that each had established with the United States among themselves; in so doing, they are seeking to modernize their own integration scheme, incorporating new commitments in

services, investments and other spheres. Thus, they have been laying the groundwork for an expanded economic area, with common disciplines and with prospects for the formation of trade alliances to take advantage of the expansion of the Central American market and of access to the United States market. Central America has used its trade negotiations with the United States and, more recently, with the European Union to renew its integration process, persevering in its effort to forge better international linkages. The Caribbean, for its part, is strengthening its integration institutions in preparation for negotiations with the European Union.

In the absence of good news at the multilateral level or in the sphere of regional integration, it should come as no surprise that small and medium-sized countries are seeking free trade negotiations with industrialized economies such as the United States or the European Union in order to gain access to major markets. Within the region, 11 Latin American countries and 14 Caribbean economies ship 40% or more of their exports to the United States market, and it therefore makes economic and commercial sense for these countries to attempt to lock in and deepen stable access to that market. The debate in the United States Congress on foreign investment, Chinese manufactures and outsourcing reveals signs of protectionism; in this regard, bilateral agreements serve as a sort of insurance against the possible emergence of trade-averse situations.

While accepting the existing differences in size and trade orientation, the achievements of the region's integration processes must be preserved by promoting convergence in trade and non-trade issues (Rosales, 2006a). At the same time, of course, each integration scheme must take stock of its contributions to the growth and competitiveness of its member countries.

Integration schemes must provide for closer ties with the private sector and strive to achieve greater congruence between that sector and public integration initiatives. This does not reduce the scope for action for public policies. On the contrary, it focuses policy measures on grappling with market and government failures and in building the necessary public-private partnerships, both of which are crucial to successful integration outcomes.

In pursuing the creation of common areas of endeavour and the adoption of more flexible operating rules for integration schemes, the best option would be to promote policy convergence in the fields of energy and infrastructure before moving on to such areas as the environment, tourism, connectivity, information and communications technologies, e-commerce and regulatory practices. Given this plurality of options, bridges can be built among the different intraregional trade agreements so as to define a basic core of shared obligations based on flexible timetables, particularly for the smaller economies, in conjunction with

special infrastructure, trade facilitation and connectivity programmes that include the dimension of special and differential treatment.

In order to achieve these objectives, maintaining the quality of the integration process is of crucial importance (Rosales, 2006b). This entails respecting differences, observing established procedures, incorporating flexibilities, understanding the interests of each country and their diversity in terms of economic and trade conditions, placing priority

on consensus-building in areas where agreement will be the most meaningful, while bearing in mind the relevance of integration efforts and the need to bring them into line with the demands of today's world. A joint assessment of the costs and of possible reciprocal concessions that could minimize them and help ensure their acceptance by the respective societies is a fundamental task for consensus-building and for improving the quality of the region's integration processes.

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## Chapter V

# Competitiveness, technological innovation and natural resources: the experiences of Australia and New Zealand

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### Introduction

Despite Latin America's export boom and greater access to destination markets in recent years, the region has made limited progress in terms of competitiveness. In the long term, competitiveness is vital for ensuring the growth capacity of its economies, and in the short term it is crucial for taking advantage of the opportunities offered by free-trade agreements that facilitate the launch of additional products and ones with higher value-added in new markets. Increasing competitiveness is also a way of protecting the region's position in the world market and coping with new global players and competitors such as China and India.

There is no single way of measuring competitiveness. The most direct way is to measure export performance on the basis of variables such as market share, per capita exports or technological content of export products. These variables, or indicators, show gains or losses in terms of positioning and foreign exchange, based on a country's level of competitiveness. The World Economic Forum publishes another type of indicator related to factors that determine competitiveness: the latest *Global Competitiveness Report 2005-2006* gives the Growth Competitiveness Index for 117 countries. The index is made up of technological indicators (linked

to the capacity for innovation, technology transfer and adoption of free-trade agreements (FTAs)); strength of public institutions (formulation of laws and contracts, level of corruption and public spending efficiency); and indicators of macroeconomic stability and country risk. This set of variables is more comprehensive and integral than results-based indicators, and both sets are therefore used for the purposes of the analyses in this chapter.

Although all Latin American countries export raw materials to some extent, there were three identifiable export models during the 1990s: South American countries that were clearly oriented towards exports of raw materials

and natural-resource-based processed products; Mexico and Central America exporting assembled manufactures or maquila in electronics, automobiles, clothing and/or footwear; and lastly Caribbean countries that focused on service exports. This chapter concentrates on analysing competitiveness in countries that export natural resources, and its conclusions are therefore especially relevant for those that fit the first export model (i.e., South American countries).

The first section compares competitiveness indices for Latin America with the following six countries of the Organisation for Economic Co-operation and Development (OECD): Australia, Finland, Ireland, New Zealand, Norway and Sweden. These countries have been selected on the basis of their current or recent status as major exporters of natural resources.

A long-term view of trends in the region's market share is not particularly encouraging. Latin America's share of world imports plummeted dramatically during the second half of the last century, followed by a slow recovery from 1990 onward. The basic pillars underlying performance, as measured by the Growth Competitiveness Index of the World Economic Forum, show that all Latin American countries (except Chile)

are in the bottom half of the international ranking of 117 countries.

The same analysis, when applied to the six selected OECD countries, shows that they suffered less of a decline in the long term, while the Asian countries were the overall winners during the period. However, this phenomenon belies the fact that the selected countries have a much higher value of exports per capita than Latin American countries do, and that they are in a better position to face competition in the global market. Innovation strategies were vital for their growth and competitiveness.

The second section of the chapter therefore describes the strategies of Australia and New Zealand, whose productive and export structures are similar to many South American countries'. Innovation has been the lynchpin of both countries' development strategies and positioning in the world economy. This is because the innovation process is designed at the highest levels of government, brings together all stakeholders and benefits from financing at the local, regional and national levels. Their experiences can be of great use to Latin America, particularly at a time when many of its economies are experiencing significant booms in terms of trade, amidst discussions of how best to use these extra resources.

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## A. Competitiveness indicators

One of the challenges facing Latin American countries is recovering the position they occupied in world trade in the middle of the last century. At that time, over 10% of world imports came from Latin America (see table V.1). By 1990, when economic reforms were being implemented throughout the region, the region's share had fallen to 3.6%. This was because the region failed to jump on the bandwagon in terms of higher technology products, and was also unable to cope with the rise of Asian countries, led by China, as they gained ground in the world market by stages.

By 2005, the region had recovered just over one percentage point, but a closer look reveals that this was largely thanks to Mexico and its rapid development of the assembly industry (electronics, automotive, clothing, footwear) for the United States market following the signing of the North American Free Trade Agreement (NAFTA). Some of the other countries (mainly Brazil and Chile) increased their participation during the 1990s, while the

remainder recorded very moderate progress. Over the entire 1948-2005 period, the subregion that fared the worst was MERCOSUR, as its initially agricultural member countries were models of truncated industrialization throughout the previous century (Fajnzylber, 1983), with no significant advances in competitiveness. The same indicator of world market share shows that the Andean Community and the Central American Common Market registered a slight increase between 1990 and 2005, although this was not the case for Caribbean countries. These patterns can be explained by determinants of competitiveness described in the report of the World Economic Forum.

The indicator shows that, between 1948 and 2005, the selected OECD countries also lost world market share: a fall of 26% compared with the 52% lost by Latin America. The former group lost out despite some countries' major efforts to diversify into technology-intensive products (Finland, Ireland and Sweden) and add value to natural resources (Australia and New Zealand).

Table V.1  
LATIN AMERICA AND THE CARIBBEAN PLUS SELECTED OECD COUNTRIES: INDICATORS OF EXPORT COMPETITIVENESS

	Market share of world imports <sup>a</sup> (percentages)			Per capita exports of goods and services (dollars)			Proportion of raw and processed materials in export total <sup>c</sup> (percentages)			Herfindhal concentration index	Composite index 8=(6*7)/100 (percentages)	Proportion of other manufactures in export total (percentages)			National per capita income 2004 <sup>d</sup>	
	1	2	3	4	5	6	7	8	9			10	11	12	2004 dollars <sup>e</sup>	Current dollars
	1948	1990	2005 <sup>c</sup>	1990	2005 <sup>b</sup>	2002-2004	2004	2004	1990			2004	2004	2004	2004	2004
<b>Latin America and the Caribbean</b>	<b>10.25</b>	<b>3.84</b>	<b>5.28</b>	<b>415</b>	<b>1 197</b>	<b>44.7</b>	<b>0.157</b>	<b>0.07</b>	<b>32.1</b>	<b>52.9</b>	<b>6 151</b>	<b>2 471</b>				
<b>Andean Community</b>	<b>2.67</b>	<b>0.90</b>	<b>1.02</b>	<b>385</b>	<b>921</b>	<b>81.8</b>	<b>0.433</b>	<b>0.35</b>	<b>13.4</b>	<b>17.3</b>	<b>4 948</b>	<b>2 316</b>				
Bolivia	0.15	0.03	0.03	146	317	85.1	0.152	0.13	4.7	13.4	2 800	960				
Colombia	0.44	0.19	0.20	248	535	63.6	0.312	0.20	25.1	37.0	6 940	2 020				
Ecuador	0.08	0.08	0.10	318	783	91.2	0.188	0.17	2.3	7.3	3 770	2 210				
Peru	0.25	0.09	0.16	189	681	83.4	0.080	0.07	18.4	16.0	5 400	2 360				
Venezuela (Bolivarian Republic of)	1.64	0.51	0.53	964	2 132	87.8	0.887	0.78	10.2	11.3	5 830	4 030				
<b>MERCOSUR</b>	<b>4.65</b>	<b>1.31</b>	<b>1.57</b>	<b>291</b>	<b>817</b>	<b>54.8</b>	<b>0.051</b>	<b>0.03</b>	<b>44.5</b>	<b>46.2</b>	<b>8 580</b>	<b>2 928</b>				
Argentina	2.56	0.35	0.38	455	1 183	71.1	0.076	0.05	29.3	29.0	12 530	3 580				
Brazil	1.84	0.89	1.13	238	737	47.7	0.054	0.03	51.8	53.3	7 940	3 000				
Paraguay	0.04	0.03	0.03	596	548	86.4	0.239	0.21	9.9	12.7	4 820	1 140				
Uruguay	0.28	0.05	0.03	695	1 371	61.9	0.124	0.08	38.5	34.2	9 030	3 990				
<b>CACM</b>	<b>0.37</b>	<b>0.12</b>	<b>0.22</b>	<b>231</b>	<b>660</b>	<b>49.2</b>	<b>0.078</b>	<b>0.04</b>	<b>23.1</b>	<b>51.2</b>	<b>4 926</b>	<b>2 170</b>				
Costa Rica	0.07	0.04	0.07	638	2 255	36.2	0.120	0.04	26.8	62.7	9 220	4 470				
El Salvador	0.07	0.02	0.03	190	676	41.4	0.095	0.04	37.7	60.0	4 890	2 320				
Guatemala	0.11	0.03	0.05	179	392	61.7	0.104	0.06	24.5	41.8	4 260	2 190				
Honduras	0.08	0.02	0.04	212	443	71.0	0.130	0.09	9.3	26.1	2 780	1 040				
Nicaragua	0.03	0.01	0.02	103	324	86.8	0.107	0.09	7.9	10.4	3 480	830				
<b>CARICOM</b>	<b>0</b>	<b>0.22</b>	<b>0.17</b>	<b>452</b>	<b>709</b>	<b>71.3</b>	<b>0.650</b>	<b>0.46</b>	<b>21.7</b>	<b>29.1</b>	<b>...</b>	<b>...</b>				
Chile	0.52	0.24	0.38	780	2 908	85.4	0.170	0.15	9.8	12.9	10 610	5 220				
Mexico	0.73	1.15	2.04	586	2 126	18.3	0.405	0.07	43.3	79.9	9 640	6 790				
Panama	0.03	0.09	0.06	1 842	2 982	87.6	...	...	20.4	10.0	6 730	4 210				
<b>6 OECD countries</b>	<b>6.87</b>	<b>5.27</b>	<b>5.08</b>	<b>5 057</b>	<b>14 675</b>	<b>40.6</b>	<b>0.130</b>	<b>0.05</b>	<b>56.0</b>	<b>57.5</b>	<b>30 482</b>	<b>33 650</b>				
Australia	2.59	1.10	1.01	2 905	6 443	77.4	0.064	0.05	18.6	20.1	29 340	27 070				
Finland	0.79	0.75	0.61	6 267	14 055	16.0	0.113	0.02	82.8	83.2	29 800	32 880				
Ireland	0.31	0.67	1.04	7 750	40 280	13.8	0.056	0.01	69.0	85.4	32 930	34 310				
New Zealand	0.78	0.29	0.20	3 440	6 911	69.2	0.060	0.04	25.2	30.7	22 260	19 990				
Norway	0.65	0.96	0.99	8 027	28 063	79.7	0.406	0.32	32.4	18.8	38 680	51 810				
Sweden	1.74	1.50	1.24	6 707	18 738	19.0	0.083	0.02	82.6	80.4	29 880	35 840				

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

<sup>a</sup> Indicator corresponds to the proportion of exports in total world imports declared by the World Trade Organization (WTO).

<sup>b</sup> Preliminary figures.

<sup>c</sup> Corresponds to all raw materials and manufactures based on natural resources.

<sup>d</sup> Figures from the World Bank, World Economic Indicators Database [online], April 2006. The figures for groups of countries are simple averages.

<sup>e</sup> Corresponds to per capita national income at constant prices, deflated by the purchasing power index.



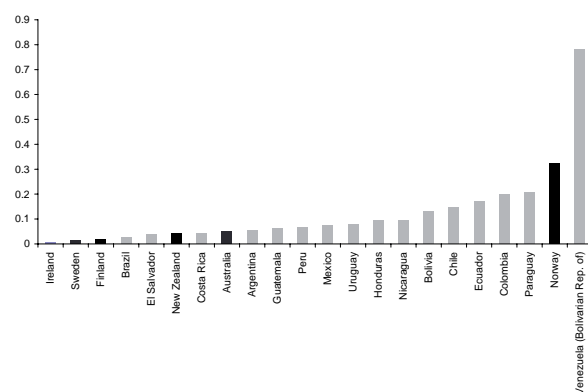
Per capita export value indicates what a country receives in current dollars in relation to its population, which in some way serves to correct the export indicator in accordance with country size. In Latin America, per capita exports in 2005 represented US\$ 1,100, which is almost triple the amount recorded in 1990, following a pattern similar to that of the six OECD countries (table V.1, columns 4 and 5). Although this growth has not been enough to recover the market share lost up until 1990, the improvement is considerable given that all the region's countries posted increases (with the largest rises recorded in Brazil, Chile, Costa Rica, El Salvador and Mexico). It should, however, be borne in mind that performance was influenced by petroleum and copper prices in 2005. The case of Brazil is especially noteworthy as the country managed to revert the marked domestic-oriented approach that had prevailed until the 1980s.

These results seem less positive when compared with those for the six OECD countries, whose average per capita export value is almost 12 times higher than for Latin America (reaching US\$ 14,600 in 2005). Those countries with greater technological content and diversification in their exports (such as Finland, Ireland and Sweden) have particularly high figures. The performance of Ireland is particularly interesting, as it multiplied its export value by a factor of five. Also, the per capita exports of Australia and New Zealand are five and six times higher (respectively) than in Latin America. This leads to the conclusion that, although specializing in natural resources may have limited these countries' positioning on the world market, their performance was nonetheless far superior to that of Latin American economies based on such resources. The same is true of oil-rich Norway, compared with a country such as the Bolivarian Republic of Venezuela. This suggests that Latin America does have development potential, and that it is linked to the incorporation of knowledge, innovation and value-added.

Table V.1 also includes an indicator of the level of commodity concentration of countries' exports. This indicator is the result of multiplying the Herfindahl index by the proportion of exports represented by raw materials and processed products based on natural resources (see column 8 of table V.1 and figure V.1). This shows how vulnerable countries are to the volatile nature of international prices. A high value for the indicator points to a greater impact of volatility. Given the distribution of values in the sample, an index of 0.10 or above indicates high vulnerability.<sup>1</sup> This high vulnerability affects countries of the Andean Community and CARICOM, and others such as the Bolivarian Republic of Venezuela, Chile, Colombia,

Ecuador and Paraguay. As for OECD countries, Norway is the most vulnerable, while Australia and New Zealand, despite the high proportion of raw materials in their exports, have a high level of diversification so they do not depend so heavily on a single product (like copper in Chile or oil for the Bolivarian Republic of Venezuela).

Figure V.1  
INDICATOR OF VULNERABILITY TO COMMODITY PRICE SHOCKS



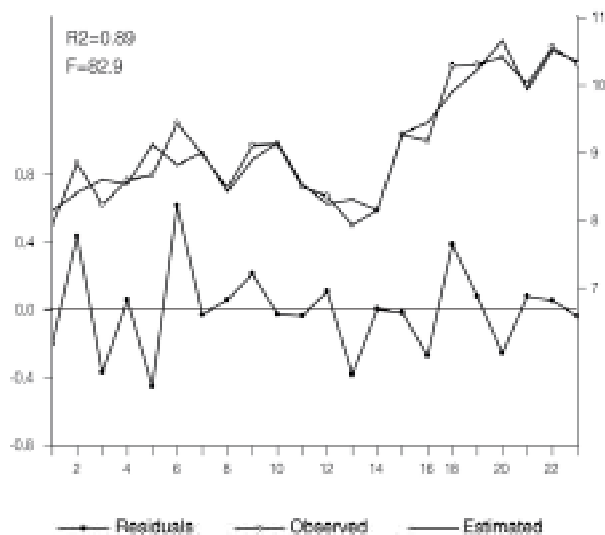
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United Nations Commodity Trade Database (COMTRADE) and official country information.

Indicators of the proportion of manufactures within total exports (table V.1, columns 9 and 10) show the different patterns of manufacturing exports from the Southern Cone compared with those from Mexico and Central America (where manufacturing linked to the maquila industry has mushroomed in the last 15 years). Mexico turned in the best performance, with almost 80% of its exports coming from non-natural-resource-based manufactures. Among the OECD countries, Ireland has become an almost exclusive exporter of high-technology manufactures, and Australia and New Zealand have made slower progress while specializing in processed raw materials.

A couple of simple regressions were carried out in order to illustrate the effects of export development on a fundamental economic variable such as per capita income. The sole aim of the exercise is to ascertain the level of correlation between the variables. The first regression is between the logarithm of per capita income and the logarithm of per capita exports, with the constant and the slope corrected by a fictitious variable representing the degree of industrialization. Heteroscedasticity was corrected using White's method, and the coefficients of per capita exports and degree of industrialization are highly significant, while the resulting correlation is 0.89 (0.88 for adjusted  $R^2$ )—which is considered fairly high for cross-sectional data.

<sup>1</sup> For Latin America, the indicator ranges from 0.02 to 0.78, with an average of 0.13. For the OECD countries, the indicator ranges from 0 to 0.32, with an average of 0.07.

Figure V.2  
**RESULT OF REGRESSION BETWEEN PER CAPITA EXPORTS AND PER CAPITA INCOME**



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

Lastly, the same exercise was carried out using the participation of each country's exports within world imports (i.e., its market share) as the independent variable. The results were less compelling ( $R^2 = 0.54$ ), but the result is positive considering that only two variables are correlated. The conclusion drawn from these exercises is that the degree of integration into the world economy, as measured by the per capita export value or participation in world trade, helps to explain the variance of per capita income in a cross-sectional sample. This implies that it constitutes a significant component of income differentiation.

So far, we have analysed variables that are a result of the competitiveness achieved by the countries of the region. However, this in itself is a complex phenomenon determined by a number of different elements. One of the indices that encompasses the largest number of institutional, technological and economic factors is the index calculated by the World Economic Forum. The *Global Competitiveness Report 2005-2006* gives the Growth Competitiveness Index for 117 countries (see table V.2).

This exercise is interesting because it groups together determinants of national productivity linked to the business

Table V.2  
**COMPOSITION OF THE GROWTH COMPETITIVENESS INDEX**

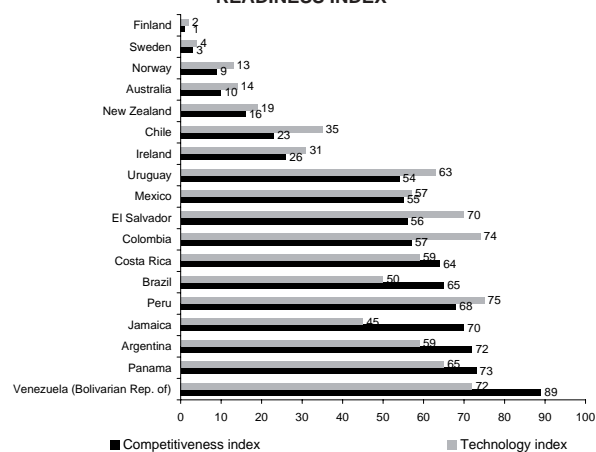
Growth Competitiveness Index	Subindices	Source of information
Technology index	Innovation	Survey Patents in United States University enrolment rate
	Technology transfer	Survey
	Information and communication technology (ICT)	Survey Hard data
Public institutions index	Contracts and law	Survey
	Corruption	Survey
	Government waste variable	Survey
Macroeconomic environment index	Macroeconomic stability	Government surplus/deficit
		National savings rate
		Inflation
		Real effective exchange rate
		Interest rate spread
		Government debt
	Country risk	Hard data

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Economic Forum, *Global Competitiveness Report 2005-2006*, New York, Oxford University Press, 2006.

environment and technological factors. Also worthy of note is the fact that the indices are not weighted in the same way for all countries. The innovation index is more heavily weighted for Finland than for any of the Latin American countries, which in turn have a higher weighting for technology transfer. It should be borne in mind that the indicators do not provide rankings that are truly comparable over time, since the methodology is revised every year.

The growth competitiveness index for 2005 shows that almost all Latin American countries rank below 54th position (see figure V.3), i.e., among the least competitive of the 117 countries in question. Chile constitutes the exception, as it stands at number 23, above Ireland (best export performance between 1990 and 2005 among the selected OECD countries). Figure V.3 also shows technological readiness, which is the index of countries' position in terms of their technological advances and innovation capacity. Finland is in first position among the selected OECD countries (ranking second in the world as a whole), followed by Sweden and Norway. Australia and New Zealand rank 14th and 18th, while Chile stands at number 35.

Figure V.3  
GROWTH COMPETITIVENESS INDEX AND TECHNOLOGY  
READINESS INDEX<sup>a</sup>



Source: World Economic Forum, *Global Competitiveness Report 2005-2006*, New York, Oxford University Press, 2006.

<sup>a</sup> The indices show each country's position in the world ranking of 117 countries. Finland ranks first overall.

The indicators analysed definitely lead to the conclusion that Latin America is performing well below its potential. Countries such as Australia and New Zealand with similar productive structures achieve per capita exports and income five or six times higher than the regional average in Latin America. The positive performance of countries like Australia and New Zealand is linked to, inter alia, their institutional stability, good quality policies and the competitiveness and international integration strategies that are analysed below. Finland, Ireland and Sweden have come even further, and their situation is fairly different from that of Latin American countries. Their experiences will be studied in more detail in the next edition of *Latin America and the Caribbean in the World Economy*.

## B. Australia and New Zealand: innovation strategies aimed at increasing competitiveness

Australia and New Zealand are small open economies with high levels of per capita income and low inequality indices. As two of the world's most developed countries, they are both incorporated into the world economy thanks to exports based on natural resources (mineral, forestry,

agricultural, agro-industrial and fish). In the case of these two countries, specializing in natural resources has served growth and development, partly thanks to the way in which the export sector is linked to the rest of the economy and a strategy based around innovation.

Table V.3  
BASIC INDICATORS FOR AUSTRALIA, NEW ZEALAND AND SELECTED LATIN AMERICAN ECONOMIES

	Km <sup>2</sup>	Population 2005 (thousands)	Per capita income 2004 (US\$)	Gini coefficient <sup>a</sup> (percentages)	Inflation 2005 (percentages)	Exports 2005 (US\$ billions)	Average growth 1990-2005 (percentages)
Australia	7 686 850	20 264	27 070	35.2	2.7	103	3.3
New Zealand	268 680	4 076	19 990	36.2	3.0	22	2.9
Argentina	2 766 890	38 592	3 580	52.2	12.3	40	3.6
Brazil	8 511 965	187 597	3 000	62.1	5.7	118	2.5
Costa Rica	51 100	4 322	4 470	49.3	14.1	7	4.7
Colombia	1 138 910	46 039	2 020	53.8	4.9	22	2.9
Chile	756 950	16 267	5 220	55.6	3.7	41	5.7
Mexico	1 972 550	106 147	6 790	52.4	3.3	214	3.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures provided by the countries' statistical institutes; ECLAC databases; Organisation for Economic Co-operation and Development (OECD), Main Economic Indicators Database [online]; and World Bank, World Economic Indicators Database [online].

<sup>a</sup> Coefficient calculated by countries in different years. Calculations based on most recent figures available.

Innovation strategies are closely linked to the strengthening of international trade and the integration of businesses into the world market. This is due to the small size of the local markets, and manifests itself in outward-looking government programmes and private-sector activities. Innovation is considered a more complex process than scientific and technological research. Inventions become innovations when they are commercialized and acquire value. Private enterprise is therefore the key to transforming invention into innovation, hence the importance of the partnership between academia and the business world.

Innovation is not always synonymous with invention, and companies depend initially on the imitation and adaptation of technology. However, there comes a stage in countries' development when they must rely heavily on research and development to defend their place in the international market and increase their competitiveness. This is a time of productivity and competitiveness advances, which in turn generate considerable increases in R&D spending as a proportion of GDP and in innovation incentives.

Australia and New Zealand appear to be in this stage of development and therefore benefit from the joint efforts of their public officials, scientists, public and private research centres, universities, technology institutes and business associations. The work of all these stakeholders is guided by a vision that establishes targets, policies and

programmes with concrete incentives that are constantly assessed to avoid distortions and the generation of income not associated with productivity increases. There is also an across-the-board commitment to use policies and other instruments to develop partnerships between the public, private and academic sectors to ensure that cooperation between these various actors and organizations serves to boost innovation efforts.

This proactive attitude manifests itself in public sector investment in R&D infrastructure and research platforms, as well as in incentives for participation in international networks and specific incentives targeted at the private sector and academia. For the private sector, incentives are aimed at creating innovation capacity within firms and establishing institutions that support the dissemination of technology. Companies therefore benefit from tax incentives for research and development and subsidies for entrepreneurial, commercialization and international marketing activities. Countries that have gone beyond imitating foreign technology and that therefore need to boost R&D to speed up the innovation process—such as Australia and New Zealand—then increase government funding of research carried out by public and private centres of excellence. Private centres of excellence receive grants and subsidies, which are also awarded to universities. Incentives have also been created to link scientific research with the needs of industry, as discussed below.

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## 1. Strategy of innovation for competitiveness

One of the main features of Australia's and New Zealand's innovation strategies is that they are devised as part of a general strategy of growth and improving the standard of living of their inhabitants. They are not isolated strategies with no link to the competitiveness policies implemented by sectoral ministries, and the resulting programmes commit the government as a whole, involve all ministries and are formulated in commissions chaired by the most senior public authorities.

Australia's current strategy is called "Backing Australia's Ability – Building Our Future through Science and Innovation",<sup>2</sup> which is based on the recognition of ideas, scientific and technical knowledge and skills as the cornerstones of economic and social progress. Since 2002, New Zealand has been implementing the "Growth and Innovation Framework" (GIF) strategy,<sup>3</sup> also known as

"Growth Through Innovation". The strategy is designed to achieve sustainable growth and improve the population's standard of living in the long term.

Although Australia and New Zealand do not have the same institutions or organizations, their strategies share some features. First, efforts to encourage public and private collaboration with academia by means of special programmes and policies are common to both. Second, the strategies of both countries include incentives (in the form of substantial public resources) for increasing private spending on innovation and bringing academia and industry closer together. Research and development is a fundamental element of the strategies (albeit not the only one), and innovation is understood as a multidimensional process that plays out across a variety of systems, business models and strategies, markets, clients and value networks.

<sup>2</sup> For further information on this strategy, see website <http://backingaus.innovation.gov.au/>.

<sup>3</sup> New Zealand, Ministry of Economic Development (2005).

The strategy “Backing Australia’s Ability”, for instance, is based on the premise that innovation does not occur in a vacuum, but rather requires support and a structure of incentives to facilitate the dissemination of ideas and the development, creation and successful commercialization of the final product. The strategy is therefore implemented through a series of grants for the generation of new ideas, commercialization, skill-building and training. The funding amounts to AU\$ 5.3 billion for 2006-2011, which is the equivalent of US\$ 4 billion, or total government expenditure on science and innovation in 2005 (1.7% of GDP) (Government of Australia, 2004b).<sup>4</sup> This follows on from the AU\$ 3 billion strategy implemented between 2001 and 2004. Combined with other science and innovation programmes, the Government is demonstrating its commitment to this policy by increasing innovation funding by 25% a year.

Both countries’ strategies recognize that business innovation is the core factor in productivity growth and improved economic performance, hence the importance of strengthening the networks that link businesses with the scientific community. In New Zealand, where private-sector participation in innovation expenditure is considerably lower than the OECD average, there is a special stimulus programme within firms, in addition to efforts to strengthen international connections and networks. According to the most recently published statistics, New Zealand invested US\$ 1.0 billion on such purposes in 2005 (about 1.16% of GDP): 61.5% was public funding and 38.5% private-sector finance. Although private spending has been below the OECD average, it nonetheless increased by 29% between 2002 and 2004 (Statistics New Zealand, 2004). Total expenditure was supplemented by contributions in the context of the “Growth Through Innovation” strategy, which amounted to NZ\$ 169 million (US\$ 108 million) (New Zealand, Ministry of Research, Science and Technology, 2005). These funds were mainly used to strengthen networks between firms and link firms with international value chains and innovation in models for business, learning and training in commercialization and marketing.

The pace of technological change and market dynamics have forced Australia and New Zealand to devise policies aimed at developing new industries and activities. In this sense, innovation strategies not only support mature natural-resource-based sectors but also attempt to develop new areas. There are two sectors that are “up and coming” in both countries: information technology and biotechnology. Both types of activity boost and add value to natural resources while also seeking out new areas. Australia currently has the advantage in terms of biotechnology advances in agro-industry and mining, and intends to achieve similar progress in pharmaceuticals, health and the environmental industry. New Zealand is more involved with developing creative industries on the basis of the potential of an existing group of enterprises, with positive results achieved to date. Support for such industries is crucial, especially given their growing importance at the international level.

Growth and innovation strategies also have their regional and sectoral expressions, like the National Food Industry Strategy in Australia, which aims to help processed food exports tap into top markets worldwide.<sup>5</sup> Australia has developed special programmes to generate value added in wool, meat, cereals, manufacturing niches, the food and beverage industry, life sciences, textiles, clothing and footwear. Both countries have also launched programmes to create new biotechnology and IT industries (particularly in creative industries in New Zealand).

In Latin America, by contrast, most countries lack a national innovation strategy to link industry, sector and cluster needs with academia by means of programmes, policies and incentives. However, the more agriculturally developed countries are strengthening their sectoral innovation systems in response to demand and the need to reduce costs. This has forced them to incorporate their own technological advances driven by the private sector, the public sector or more recently specific public-private partnerships. Brazil provides a good example of such cases (see box V.1).

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<sup>4</sup> The exchange rate at the time of publication was one Australian dollar to 0.756 United States dollars.

<sup>5</sup> See <http://www.nfis.com.au/>.

## Box V.1

## INCORPORATING TECHNOLOGY INTO AGRICULTURAL EXPORTS: THE CASE OF BRAZIL

According to figures from the Food and Agriculture Organization of the United Nations (FAO), Brazil is the world's third largest exporter of agro-food products after the United States and the European Union. Over the last 15 years, the value of Brazilian agro-food exports has tripled. This production and export boom was made possible thanks to a series of factors, including the expansion of the agricultural land area and the incorporation of significant technological advances in terms of inputs, primary production and the processing of agricultural products.

The agro-food sector is increasingly turning to science and technology in all areas, from input production to the marketing of final products, including agricultural and livestock production, industrial processing, services included with products, industrial organization, packaging, transport and logistics. The technologies used, whether they were developed internally or externally, have diversified considerably in recent years (Rodrigues, 2002). This process has included internal innovations but also the incorporation of technologies developed in other sectors, particularly chemical and mechanical industries and, more recently, microelectronics and biotechnology.

The computerization of all stages of the agro-food production chain, including satellite positioning and tracking, has resulted in significant increases in productivity. Other major advances in agricultural inputs include biotechnology development of transgenic plant varieties that are most resistant and/or produce greater yields, the use of biodiesel and biological pest and disease control. Progress in food processing has included research into ingredient fractionation and food reconstitution, new techniques for preserving fresh foods and developing "nutraceutical" products that benefit health by combating or preventing disease.

These advances in input and agricultural production and agro-industrial processing are integrated and have required the implementation of a series of innovations at the distribution and commercialization stages. Many innovations in various stages of the agro-food production chain are therefore interdependent.

The large-scale use of external technologies and the coming together of different scientific disciplines to generate technical advances make the agro-food sector a catalyst for interaction between industries and services that develop cutting-edge technology. This interaction

is constantly being strengthened through a complex network of functional links between agriculture, services of input production, agro-industrial processing, services and other technology-generating industries (Ribeiro, 2000). The network involves both public and private agents that develop agro-food technologies, and the participation of the private sector in particular has increased considerably in recent years.

Public-private agreements usually arise in specific areas of work or, in the case of more general issues, if and when national research institutes have reached a standard of international excellence. Brazil is probably Latin America's best example of recent growth in the area of public-private alliances for agro-food sector research. In the soybean sector, for instance, the Brazilian Agricultural Research Enterprise (EMBRAPA) and Monsanto have an agreement on the latter's "Roundup Ready" genes and technology for transforming soya from EMBRAPA-owned germplasm assets. The partnership has resulted in a variety of "Roundup Ready" soya adapted to the local market. Monsanto intends to sell the modified soya through its distributor network, while EMBRAPA will receive royalties from sales (Silveira and Borges, 2005).

The scientific community in Brazil has also become internationally renowned in the last decade for its significant contributions to biotechnology, such as the genome project of the State of São Paulo Research Foundation (FAPESP). One of the main outcomes of the project was the identification of the genetic code for *xylella fastidiosa* bacteria that cause disease in the country's citrus production industry (Pray, 2001). The private sector was also involved through the Fund for Citrus Plant Protection (FUNDECITRUS), an organization representing citrus companies, although its financial contribution to the project was minimal.

Following the successful sequencing of the *xylella* bacteria, the genome project went on to research the genetic code of sugar cane, this time with the participation of the Cooperative of Sugar Cane, Sugar and Alcohol Producers of the State of São Paulo (Coopersucar) (Silveira and Borges, 2005). This project marked a turning point in the technological development of sugar and ethanol production in Brazil, as it revealed 90% of sugarcane genes to researchers. This has enabled them to

develop transgenic varieties resistant to disease and drought, with greater yields, adapted to the conditions of certain producer regions or even with special characteristics such as higher sucrose content. The latter development results in greater ethanol yields per cultivated area of sugarcane, and was achieved in response to the current trend of seeking alternative and renewable energy sources in the face of soaring oil prices (FAPESP, 2006).

The genome project and biotechnology research in Brazil have tended to focus on the country's main agricultural export products: oranges, sugar, ethanol, soybean, tropical fruits and, more recently, beef. The need to compete on international markets that are subject to a series of price distortions and trade barriers puts pressure on research institutes and companies to achieve greater yields and reduce production costs. Furthermore, new patterns of demand are dictating a series of innovations in terms of the quality, presentation and special processing characteristics of agricultural raw materials and final products.

In the sugar and ethanol chain, for instance, innovations are not limited to primary production but include various stages of industrial processing and the extension of the use of ethanol in the automobile industry through the development of flex fuel cars (Dias and Galina, 2000; Quadros, Consoni and Quintão, 2005). This has placed Brazil at the forefront of research in this sector, with the generation of totally national technologies patented internationally. The public sector clearly dominates this process, while the private sector collaborates in specific stages, more in terms of the dissemination of new technologies than in financing research.

Despite these impressive advances, the dissemination of technology throughout all parts of the agro-food production chain and, even more so, among the various agents involved in these stages continues to be an issue (FAO, 2004). The access that small-scale producers have to technology developed by and/or for corporate agriculture is restricted by the following factors: limited resources, technology ill-adapted to the needs of these producers, low levels of education and information, etc. The limited dissemination of available technology obviously has a strong impact on levels of productivity in developing countries, which tend to be far below the average in developed countries.

**(a) Institutions**

The innovation systems in Australia and New Zealand involve the ministries of education, science and technology, agriculture, industry, health, economic development and tourism. The ministries have departments, corporations and centres of excellence responsible for researching and implementing innovation policies and programmes, in addition to centralized and regional fund administration.

As far as academia is concerned, universities, their research centres and independent institutes are actively involved. Companies participate through technological centres linked to trade associations and corporate research departments. In addition to those people directly involved in science and innovation, there are a large number of governmental and non-governmental organizations that facilitate the processes involved by means of policy coordination, fund administration and regulation of intellectual property rights and the system in general.

In these systems, companies are important but academia is even more vital as its capacity to create new knowledge and transfer it to companies enables it to sow the very seeds of change. The State therefore makes serious efforts to establish links for research- and innovation-oriented cooperation between scientists of various universities, independent research centres and companies, productive sectors or clusters. This tends to build trust and create incentives for collaboration.

The density of the networks and the close links forged between those involved make for a national innovation system with a dynamic structure in which new entities appear while others are eliminated, institutions are strengthened

by experience and learning and networks are strengthened and modified in keeping with the challenges and priorities of the national innovation strategy. While Australia has recently placed much emphasis on sectoral entities such as Cooperative Research Centres (CRCs) and Research and Development Corporations (RDCs), New Zealand has prioritized the stimulation of innovation in public research centres and consortia linking industry and universities.

**(b) Research and development (R&D)**

R&D performance can be measured in relation to spending by those involved, but also on the basis of its results. Spending on R&D and its implementation in Australia and New Zealand is below the OECD average, which is partly due to the fact that the production structure is closely linked to primary sectors and partly attributable to innovating consisting of imitation and adaptation of technology. However, they seem to be catching up in terms of all indicators, including private-sector spending and implementation. Data from 2003 suggests that this has reduced the involvement of public institutions in investment, a trend in keeping with the OECD average. Indeed, in the last 12 years, private-sector financing of research and development has grown by 7.7 percentage points in Australia and almost 10 percentage points in New Zealand. Private-sector involvement has increased in response to government incentives and a greater awareness of the importance of innovation for maintaining competitiveness in the increasingly fierce battle for market share. The quest for “novelty” as part of diversification implies ever increasing expenditure on innovation.

Table V.4  
AUSTRALIA, NEW ZEALAND AND OECD: RESEARCH AND DEVELOPMENT INDICATORS

	Australia		New Zealand		OECD Total		
	1990	2002	1990	2003	1990	2002	2003
R&D expenditure as percentage of GDP	1.3	1.7	1.0	1.2	2.3	2.2	2.3
Total number of researchers per 1,000 employees	5.5	7.8	4.1	10.2	5.9	8.3	..
Percentage of R&D expenditure financed by companies	41.1	48.8	29.3	38.5	57.8	62.5	61.8
Percentage of R&D expenditure financed by Government	54.9	42.4	60.3	45.1	36.8	29.6	30.4
Percentage of expenditure implemented by companies	40.2	51.2	28.2	42.5	68.6	67.8	67.7
Percentage of expenditure implemented by universities	25.5	26.7	27.9	28.5	14.4	17.3	17.4
Percentage of expenditure implemented by public institutions	32.6	19.3	43.9	28.9	14.7	12.3	12.3
R&D expenditure in higher education as percentage of GDP	0.3	0.5	0.3	0.3	0.3	0.4	0.4

Source: Organisation for Economic Co-operation and Development (OECD), OECD Main Science and Technology Indicators, 2006 [on-line] [http://www.sourceoecd.org/tpsv/statistic/s20\\_about.htm?jnlissn=16081242](http://www.sourceoecd.org/tpsv/statistic/s20_about.htm?jnlissn=16081242).

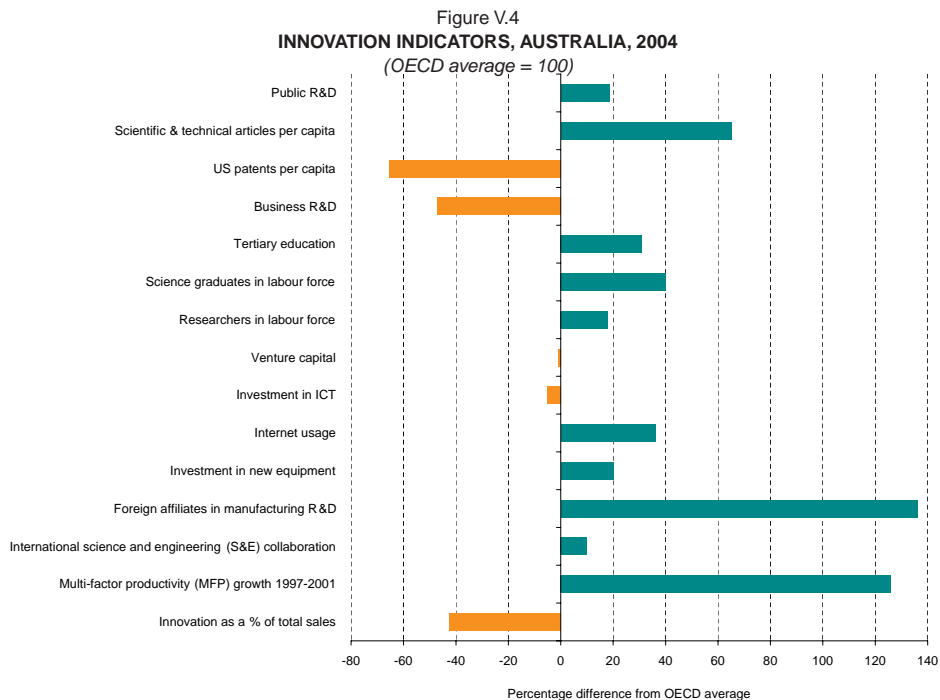
In terms of analysis of the indicator results, figure V.4 shows that Australia is above the OECD average in 10 out of 15 indicators, including publication of scientific and technical articles, higher education, number of science graduates in the work force and number of researchers in the labour force, foreign affiliates in R&D, Internet

usage, investment in new equipment and international scientific collaboration.<sup>6</sup> Although Australia is below the OECD average in terms of patents, the cost of each patent (reflecting effectiveness of dollars spent) is lower than in Sweden, Finland and Norway. The same applies to New Zealand (see Machinea and Vera (2006)).

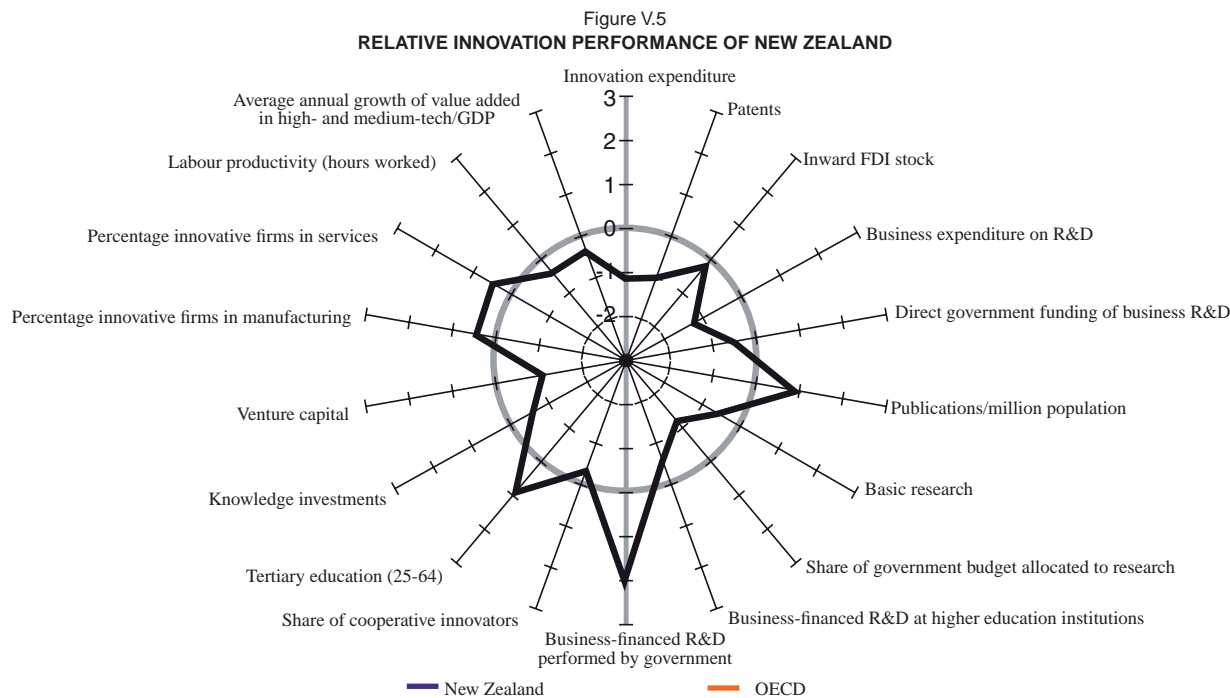
<sup>6</sup> For further information, see <http://backingaus.innovation.gov.au/>.

Figure V.5 shows a set of indicators that enables us to compare New Zealand’s innovation capacity with the OECD average. For indicators such as level of patenting, R&D expenditure, private financing and availability of risk capital, New Zealand is below the OECD average.

On the other hand, the country is above average in terms of the number of scientific and technical publications, implementation of projects financed by the private sector, higher education and innovation in services and manufacturing (Williams, 2005).



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Government of Australia, "Backing Australia's Ability - Building Our Future Through Science and Innovation", 2004.



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Julian Williams, "Frameworks for horizontal innovation policy in New Zealand", *Governance of Innovation Systems: Case Studies in Innovation Policy*, Organisation for Economic Co-operation and Development (OECD), vol. 2, Paris, 2005.



### (c) Centres of excellence

Much of the R&D in Australia and New Zealand is carried out by public-sector centres of excellence, which house a critical mass of scientists, train new professionals and provide industry with knowledge and services through their increasingly sophisticated departments of applied research.

One of the main examples in Australia is the Commonwealth Scientific and Industrial Research Organisation (CSIRO), one of the world's top research agencies with subject area coverage including all primary sectors and industry.<sup>7</sup> CSIRO has 6,500 scientists and ranks in the top one per cent of world scientific institutions in 12 of 22 research fields. It is also ranked sixth for animal, plant and agricultural sciences and eighth in environmental sciences. The work of CSIRO is based on the six national research priorities: light metals, preventive

health, wealth from oceans, water for a healthy country, food futures and energy transformed.

New Zealand has the Crown Research Institutes (CRIs)<sup>8</sup> that implement a third of R&D investment, much of which is intended to add value to natural resources. CRIs carry out basic research and applied science and technology research and development for commercial purposes. Their clients include central and local government and private sector markets in New Zealand and abroad.

A common feature of these organizations is that their researchers work closely with businessmen (in small-scale farming, manufacturing and mining) and forge scientific research partnerships with universities. They are grouped by science and technology subject areas, which change according to sectoral demands. The current missions of such centres are to ensure the sustainability and profitability of production chains and to establish a biotechnology system to add value by creating biotechnology products for export.

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## 2. Entities that facilitate collaboration between companies and academia

In Australia, much of the innovation system is made up of entities that facilitate collaboration between business stakeholders, public research institutes and academia.<sup>9</sup> They are known as Cooperative Research Centres (CRCs) and Research and Development Corporations (RDCs). New Zealand has recently established a similar, albeit less advanced, initiative which is being implemented by a number of research consortia.

Australia's Research and Development Corporations (RDCs)<sup>10</sup> were created by the public sector in the 1990s to facilitate innovation in rural areas, which were

considered a priority for the country's development. Although RDCs are public bodies attached to sector ministries, farmers also participate in their management and financing through associations and the formation of R&D companies. An important part of the funding is provided by a levy collected from companies in each industry.<sup>11</sup> The State matches the contribution it levies from companies, and the funds are then invested by the RDCs. Public-private collaboration is therefore clearly an important requirement for the effective functioning of RDCs (see box V.2).

<sup>7</sup> See <http://www.csiro.au/files/files/p2jh.pdf>.

<sup>8</sup> See <http://www.acri.cri.nz/>.

<sup>9</sup> See Christensen, Schibany Vinding (2000).

<sup>10</sup> See [www.rirdc.gov.au](http://www.rirdc.gov.au).

<sup>11</sup> The sectors in which the private sector makes contributions to innovation are: forestry and wood, fishing, grape and wine industry, crops and cereals, new rural industries, as well as a public initiative for the sustainable use of land and water.

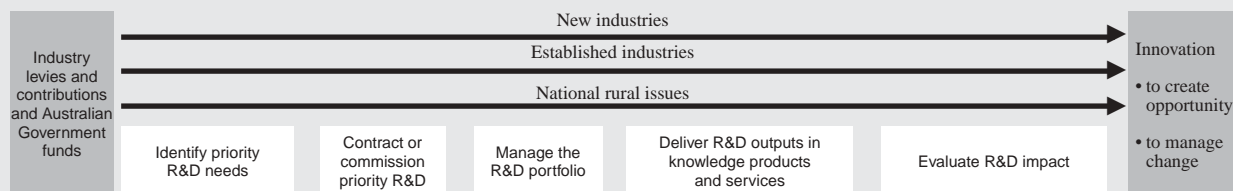
Box V.2  
**ORGANIZATIONS FOSTERING PUBLIC-PRIVATE COLLABORATION FOR INNOVATION**

Rural Industries Research and Development Corporations include members from businesses big and small (RIRDC, 2005). Their administrators and committees of advisors identify R&D priorities, contract or commission researchers, manage the portfolio of projects and then deliver the results to industry, communities

and the government in the form of publications, products and services. To guarantee a return on innovation, these corporations have paid special attention to managing intellectual property rights while disseminating technological advances and new processes. In this sense, RDCs act as innovation transfer centres, hence their

interest in communication strategies as a means of bringing new developments to industry, thereby immediately reducing costs. They achieve this through workshops, field tests, websites, publications, reviews, newsletters, and formal and informal communication networks in each industry.

**BUSINESS MODEL OF RESEARCH AND DEVELOPMENT CORPORATIONS IN RURAL INDUSTRIES**



Source: Rural Industries Research and Development Corporation ([www.rirdc.gov.au](http://www.rirdc.gov.au)).

As for the Cooperative Research Centres (CRCs) in Australia, their programmes have a renewable duration of seven years. CRCs are limited liability companies run by a council of representatives from member organizations (companies, trade associations, universities and centres of excellence). In order to determine the State's contribution to the centre, CRCs are supervised at the governmental level by a council that assesses whether the programme will be continued, on the basis of indicators

such as number of patents applied for, income from research or consultancy carried out for industry, and income from companies established as a result of projects. In newer centres or those with unquantifiable impact, this assessment is carried out by external consultants (Allen Consulting Group Pty Ltd., 2005).

In New Zealand, Research Consortia were created in 2002 in the same vein as the Australian Cooperative Research Centres (CRCs) to link industry with academia through the implementation

of research projects of mutual interest. The State cofinances 50% of investment for five years, a period that be extended if the assessment proves positive. The areas covered by cofinancing are: quality control in primary production, sustainable production systems, biological services and product niches, food innovation, high-value manufacturing processes, knowledge-intensive services, optimization of physical use of infrastructure and the sustainability of technological development in New Zealand.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of G. Muguillansky, "Australia y Nueva Zelandia, dos ejemplos de competitividad con innovación", Comercio Internacional series, No. 72 (LC/L.2564-P), Santiago, Chile. Economic Commission for Latin America and the Caribbean (ECLAC), June 2006.

In Australia, Cooperative Research Centres (CRCs) were also set up in the 1990s to increase the effectiveness of public contributions to research and development by providing linkages between businesses and researchers. Unlike Research and Development Corporations (RDCs), CRCs cover all economic activities and sectors but only those research institutions and groups of companies that take the initiative to make progress in an area of innovation. Another difference is that CRCs provide for a direct link between companies and academia (see box V.2). In 2004, there were 72 programmes in the following 6 sectors: environment, agriculture, information and communications, mining, medical science and technology and manufacturing. One of the main achievements of CRCs is the boost they provide to the usage, commercialization and transfer of technology.

New Zealand currently has 10 Research Consortia, which are associated with many more companies and research centres (such as Crown Research Institutes (CRIs)), universities and even foreign organizations. Their

aim is to increase the critical mass of research capability, which will in turn increase the chances of success at the commercialization stage. The Government assesses how the project is developing after one year to see whether it needs to provide assistance.

For Latin American countries, the experiences of Australia and New Zealand in this area can be most valuable. The idea is not to copy their models, but discover how they work and their advantages, while learning from the various forms of association. It is well known that participation in networks linking efforts, knowledge and initiatives is vital for innovation, especially for small and medium-sized enterprises that can accomplish little in isolation. Let us take the example of agricultural innovation: although a public institute or university can carry out the basic scientific research, businesses are more likely to need applied research. One company does not have the critical mass necessary to negotiate with universities or public institutes. These R&D corporations are therefore exceptionally useful in successfully linking

and coordinating the requirements of large corporate groups to constitute a critical mass for innovation, in addition to disseminating innovation among all those involved in a way that either generates across-the-board modernization (for innovative productive processes) or contributes to commercialization on the world market

(in the case of new products). It should be borne in mind that, as far as R&D corporations are concerned, innovation, as such, does not actually take place until the product is sold on the market, hence the importance of commercialization and marketing within innovation policy (see box V.3).

Box V.3

### INNOVATION IN THE AUSTRALIAN WINE INDUSTRY

Australia ranks fourth in the world wine market and first among the so-called New World countries (Chile being second). The figure below shows the options analysed by the Australian

wine industry during the 1990s, when it quickly chose to focus on high-value segments of the world market. This called for an innovation strategy incorporating production, R&D and

marketing policies to establish the Australia brand and improve distribution channels, prices, sales, promotion and industry communication (see WFA, 2000).

Table  
SHARE OF WINE EXPORT CATEGORIES, 2003-2004<sup>a</sup>  
(Percentages)

	Price US\$/Litre	Australia	Chile
Basic wines	Less than 2	17	44
Table and Premium wines	2 to 3.5	45	47
Super Premium, Ultra Premium and Icon wines	Over 3.5	38	9

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of *Compendio vitivinícola de Chile*, Santiago, Chile, Nuevos Mundos, 2004; and Australian Wine and Brandy Corporation, "Australia at a Glance Sales", 2004.

<sup>a</sup> Chilean price categories are standardized on the basis of sales per litre to wholesale distributors.

The results of the strategy can be seen in the above table. Between 2003 and 2004, Chile sold almost half of its wine at less than US\$ 2 per litre, compared to only 17% for Australia, which sold more in higher price categories. To achieve this result, the Australian wine industry devised a long-term strategy that was disseminated and implemented by regional associations linked by the Winemakers' Federation of Australia (WFA).

The Winemakers' Federation is responsible for the industry's strategic development, international positioning and R&D and training policies. Technology

and innovation strategy is defined by the Federation's own Australian Wine Research Institute. This long-term vision within the industry is linked to the Government's sectoral policy making.

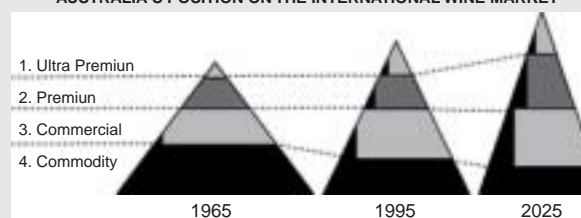
In this model, the public sector provides considerable leverage for sectoral development by providing services to producers and exporters, industry information and market analysis through the Grape and Wine Research and Development Corporation and the Australian Wine and Brandy Corporation, the latter being the industry regulator responsible for establishing and monitoring wine standards, quality and

integrity. The private sector provides an equitable contribution to financing scientific and technological development by means of the proportional levy applied to the company's production and paid to the Research and Development Corporation.

These institutions have provided the Australian wine industry with a strong network linking enologists, company executives, researchers, academics and public officials. Such a network has been made possible thanks to a common vision and close alliance among all stakeholders: a fundamental factor in a successful innovation process.

**Source:** Graciela Moguillansky, "Innovación en la cadena del vino", document prepared for project on determinants and impact of innovation in Chilean export industries, Economic Commission for Latin America and the Caribbean (ECLAC), the Chilean Production Development Corporation (CORFO) and the Universidad Adolfo Ibañez (UAI), April 2006.

Figure  
AUSTRALIA'S POSITION ON THE INTERNATIONAL WINE MARKET



**Source:** Winemakers' Federation of Australia.

## 3. Funds for business innovation

The innovation systems in Australia and New Zealand include programmes and funds used for the various requirements of companies: R&D, start-up, commercialization of products, technology and services, innovation development in small and medium-sized enterprises (SMEs) and incentives to join international networks.

### (a) Financing for companies

Both countries' innovation budgets are significantly increasing the funds available for encouraging company research and innovation. In New Zealand, for instance, 40% of the innovation budget is targeted at directly productive

activity.<sup>12</sup> Out of this percentage, 70% accounts for applied scientific research and 21% is used to guide knowledge flows to and from industry. The main programme is Technology New Zealand,<sup>13</sup> which aims to increase companies' in-house skills for adopting new technologies and applying new knowledge for business growth. This is achieved by raising awareness about new cutting-edge technological developments through promotion and information services, motivating businessmen to help finance basic technological research, hiring specialized professionals, researchers and scientists to work in companies or business research organization projects and creating networks to increase understanding of technological innovation.<sup>14</sup>

The Government of Australia has been focusing its attention on innovation commercialization, since it is vital if innovation is to be relevant and the appropriate value generated. As is the case in New Zealand, the funds help with start-up, production and commercialization of the product.<sup>15</sup> For instance, the new "Commercial Ready" programme encourages the growth of innovative Australian companies in emerging and high-technology industries. More than 1,700 small and medium-sized firms are supported to undertake research and development, proof-of-concept, technology diffusion and early-stage commercialization. Participation is competitive, and applicants are selected on the basis of a detailed business plan for all stages, commercial potential of the project, capacity for product development and the commercialization plan. The programme values collaboration among firms and between firms and Australian and international research centres, as such cooperation is a key feature of successful experiences. The programme also encourages firms to employ new graduates in the area of company innovation. In short, the policy not only aims to make innovation viable, but also to close existing productivity and competitiveness gaps.

### **(b) Risk capital and seed capital for financing innovation**

Although innovation in Australia and New Zealand is mainly funded publicly, capital risk funds are playing an increasingly important role, especially in Australia where there is a growing market for such financing. The Australian Private Equity & Venture Capital Association Limited (AVCAL), which was set up in 1992 as a private entity consisting of around 60 investor members, aims to create an environment that assures capital inflows for business ventures. Membership comprises venture capital firms, banks, incubators, angels,<sup>16</sup> academic institutions and other industry service providers. Also involved are specialist consultancy firms that assist companies in the early stages in order to make their ventures suitable for subsequent risk capital investment. In 2005, these funds had AU\$ 3.5 billion (US\$ 2.6 billion) invested in 912 companies.<sup>17</sup>

Australia also has companies specialized in granting seed capital for innovation, especially in the area of information and communications technologies. Foundation Capital, which is the country's main risk capital company, targets technological investment and has a special innovation investment fund that constitutes a joint venture with the Federal Government.

In New Zealand, where risk capital for innovation is much less developed, the Government joined forces with private investment funds to form the New Zealand Venture Investment Fund (NZVIF), which channels its resources into joint investments in various sectors, especially new businesses based on technology and products with value added. The Fund grants seed capital and resources for investment in new ventures. New Zealand is attempting to develop its risk capital market based on the models of Israel and Singapore, while stepping up capacity-building for businessmen in terms of skills and experience in risk capital investment.

<sup>12</sup> See Ministry of Research, Science and Technology (2005).

<sup>13</sup> The other industry-oriented programme is Grants for Private Sector Research and Development (GPSR&D), which provides grants to small and medium-sized enterprises to assist them with the costs of investing in R&D. It is a kind of cofinancing system to encourage firms to absorb and exploit new technology that they would otherwise be unable to use due to lack of resources and the huge financial risks involved.

<sup>14</sup> In addition, New Zealand Trade and Enterprise has a series of support programmes to assist companies in developing new products and services from pre-start-up, through development, market launch and globalization, when companies are helped to join the international value chain.

<sup>15</sup> See <http://backingaus.innovation.gov.au/>.

<sup>16</sup> An angel investor is a person who invests in a business venture at start-up, in exchange for a higher rate of return.

<sup>17</sup> See Australian Bureau of Statistics (ABS) (2005).

## C. Conclusions

Although this chapter only presents partial indicators, they nonetheless show how the competitiveness of Latin America has deteriorated over time. Although economic reform, market liberalization, trade agreements and greater economic stability have enabled the region to recover some of its market share, much remains to be done, especially if per capita income variance among countries is as strongly influenced by export development as suggested by the exercise in section 1.

Countries such as Australia and New Zealand give the lie to the idea that natural resources are a curse for growth (Sachs and Warner, 1995): with a production structure similar to that of Latin America, their per capita exports are five or six times higher than in this region. Much can be learned from this kind of strategy, both to reduce the volatility of growth in the short term and (see chapter I) and in terms of long-term innovation strategies.

Australia and New Zealand based their development on natural resources and, unlike Latin America, they have achieved high per capita income, maintained stable growth and eradicated poverty. This is not only due to effective macroeconomic management, but also to a growth and international insertion strategy based around innovation. Given their level of development, the only way companies in these countries could improve their positions in global value chains, remain competitive and continue to raise income is through diversification (new industries or adding value to products and services). All of the above encourages the private sector to increase its innovation spending and motivates the public sector to support that effort with investment and incentives.

For these governments, the concept of innovation goes beyond research and development to cover technology imitation and adaptation, research into products and processes, new business and marketing models —any measure that adds new value to the market.

Their national innovation and competitiveness strategies are in keeping with the emergence of sectoral and regional strategies. Australia's hopes to soon become a major global player in the food production chain, for instance, have prompted the country to complement policies stemming from the national innovation strategy with a national food industry strategy. Including such coherent linkages in their policies and programmes poses another major challenge to governments in Latin America.

In Australia and New Zealand, programmes that include an innovation strategy for competitiveness involve more

than large amounts of resources: more importantly, these programmes have precise aims and targets, in addition to result assessment indicators. In some cases, their results are assessed by external agencies. The decision to reinvest money or extend the timeframe and budget depends on performance. Measuring performance on the basis of market indicators is therefore another cornerstone of implementing their innovation strategies.

The authorities of both countries acknowledge that a lack of close cooperation between businesses, the public sector and scientists can seriously hamper policy implementation. Even if policies are well defined, the results will not be positive unless there is smooth communication between those involved. National innovation systems are therefore viewed as a complex network of relations and interdependencies, rather than a disperse collection of organizations and actors. In the two countries, programmes receive support from various entities by supplementing research areas or joint efforts to form a critical mass for research, or in the form of resources.

The link between business and academia is one-to-one, in the sense that some scientific development must be applicable in companies. Incentive programmes therefore emphasize commercialization, while companies have a need for scientific knowledge. The link between enterprises and the academic world is one of the most difficult relationships to strengthen in Latin America.

In Australia and New Zealand alike, policy priority is given to developing innovation in natural-resource-processing industries and in new industries, especially biotechnology and information and communications technologies. This is not a chance occurrence, but is in response to the cross-cutting needs and demands of a range of activities. Biotechnology forms the basis for new knowledge, provides much value added to natural resources and enables new products to be commercialized in agro-industry, forestry, aquaculture and mining. Information technology is in turn fundamental for integrated management systems and for the data sources that make innovation possible.

Although education and training have not been mentioned in this chapter, they are nonetheless an important part of both countries' innovation strategies. The innovation process grinds to a halt unless an ever-increasing number of professionals receive training in basic sciences. This requirement has led to syllabus reforms and incentives to encourage students to opt for sciences, persuade expatriated experts to return home and motivate teachers to constantly

update their skills. Such programmes are developed in conjunction with others aimed at stimulating innovation in companies and promoting R&D in universities.

In conclusion, innovation systems in Australia and New Zealand benefit from considerable incentives (tax breaks, subsidies, grants, awards and investments) administered by programmes and funds that target the various requirements of companies throughout the innovation process: R&D, start-up, commercialization of products,

technologies or services, innovation development in SMEs and incentives to join international networks. Herein lies another difference between these and Latin American innovation systems —innovation support is not limited to increasing resources, but includes integral support to sectoral clusters (especially natural resources) and a comprehensive concept of innovation for competitiveness that goes beyond simple R&D to reflect the complexity of achieving competitive success.

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## Chapter VI

# Bird flu and foot-and-mouth disease: impacts and regional cooperation

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### Introduction

International trade in animals and foods of animal origin, especially meat, is governed by strict quality requirements that, to a large extent, determine the volume of such trade and the price of commodities. The effect of quality criteria on trade has increased with the emergence of new risk factors associated with outbreaks of diseases that have the potential to impact strongly on the economy and on human health. One such disease is avian influenza, avian flu or bird flu, which is now a serious threat to health and to the global economy and has forced governments to take measures to prevent, detect and control contagious diseases that may represent public health and safety problems.

This chapter describes the main economic losses caused by avian flu and foot-and-mouth disease (FMD), two transboundary diseases that together represent one of the global meat trade's main challenges today. Bird flu cut world poultry trade by 8% in 2004 and altered projections for this year. FMD is now one of the main sanitary problems affecting South American livestock and has played a part in redistributing market shares in the region. The disease has jeopardized the position of Brazil, which is facing trade embargoes in dozens of importing markets and risks losing its status as the world's largest beef exporter.

This chapter will examine specialized studies on the financial, economic and social costs of recent outbreaks

of these diseases. It discusses the repercussions on international trade and the regional and international policy response to the fallout. The last section looks at trends and future challenges for global meat markets and warns of the urgent need for governments to take coordinated preventive measures as the most efficient way to control bird flu and FMD. Joint efforts to conduct surveillance, prevention and control, together with political, technical and financial commitment to undertake coordinated sanitary measures in response to the existing global zoosanitary and public health risk, are not only essential to preserve trade competitiveness but also serve greater regional integration in a real and significant way.



## A. Overview of the global meat market

Since the early 1980s, the world's production, consumption and trade of meat, particularly poultry, have expanded considerably. In 2002, the Food and Agriculture Organization of the United Nations (FAO) estimated that global meat consumption would increase

by 2% annually up to 2015 (FAO, 2002). Most of this increase was expected to occur in developing countries, where total meat consumption was to grow by 2.7% per year, compared with 0.6% in the developed world (see table VI.1).

Table VI.1  
WORLD MEAT CONSUMPTION

	Consumption					
	1997-1999	1969-1999 Thousands of tons	1979-1999	1989-1999	1997/1999-2015 Growth rates (annual percentages)	2015-2030
<b>World</b>						
Bovine	57 888	1.4	1.2	0.7	1.4	1.2
Ovine	10 706	1.9	2.2	1.4	2.1	1.8
Pig	86 392	3.2	2.9	2.7	1.4	0.8
Poultry	60 809	5.2	5	5.2	2.9	2.4
Total meat consumption	215 795	2.9	2.8	2.7	1.9	1.5
<b>Developing countries</b>						
Bovine	28 074	3.4	3.5	4.1	2.3	2.0
Ovine	7 625	3.5	3.8	3.7	2.7	2.2
Pig	49 522	6.1	6	5.8	2.1	1.2
Not including China	11 393	3.6	3.2	3.7	2.7	2.4
Poultry	31 920	7.8	8	9.4	3.9	3.1
Total meat consumption	117 141	5.3	5.6	6.1	2.7	2.1

**Source:** Food and Agriculture Organization of the United Nations (FAO), "Animal diseases: implications for international meat trade", Committee on Commodity Problems, nineteenth session, Rome 27-29 August 2002; and *World Agriculture: Towards 2015/230*, Rome, 2002.

This projection of world meat consumption was based on two trends: the expansion of demand and the gradual reduction of trade barriers. But these two trends, specifically, have begun to change direction in the last few years, either because of recent outbreaks of animal disease or because of the resulting imposition of tougher sanitary barriers by non-infected countries. FAO has revised its 2006 projections for poultry, assuming a drop of 3 million tons in world consumption and 6% in world exports, with respect to the estimates made in 2005 before avian flu broke out on several continents (FAO, 2006f).

Any straightforward assessment of the potential global impact of avian influenza is, however, complicated

by the recent outbreaks of FMD in Brazil, which is a major world meat exporter. This will also influence world meat markets over the short term, especially since chicken and beef are normally used as substitutes for each other. FAO estimates that the adverse impact of poultry shortages in international markets (because of avian flu) will be heightened by reduced exportable beef supplies from Brazil (because of foot-and-mouth disease), putting considerable upward pressure on all meat prices, similar to the situation in 2004 when the absence of North American beef due to concerns over bovine spongiform encephalopathy (BSE) pushed up all meat prices.

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## B. Avian influenza

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### 1. Socio-economic impacts of the disease

Avian influenza, avian flu or bird flu is an infectious disease of birds caused by the influenza virus. It can be transmitted to humans who enter into close contact with infected birds.<sup>1</sup> The danger of the virus lies in its resistance, ability to mutate and ease of propagation. The first known case of human infection with avian flu occurred in Hong Kong Special Administrative Region of China (Hong Kong SAR) in 1997. Previously, avian flu had been detected only in South-East Asia, but in the last few years outbreaks have occurred in Africa, Europe, the Middle East and the Americas (FAO, 2005a). Up until July 2006, the highly pathogenic H5N1 strain of the virus had not been found in Latin America and the Caribbean, although a number of countries have reported other, less pathogenic varieties.

The socio-economic impacts of bird flu take the form of deaths, medical costs (medicines, hospitalization and treatment), loss of working days and reduced employment performance and the effects on trade and on the services sector. As well as being an important source of work and income for rural communities, poultry provides high quality proteins for human consumption. The magnitude of these impacts depends on a range of factors, from the biological characteristics of the disease to the country's domestic structural features. The scientific aspect refers to the pathological traits of the disease, which determine the lethality of the pathogen and how it is spread, i.e., bird to bird, bird

to human or human to human (as yet there is no record of the last of these).

The first two forms of contagion have already occurred and are known to have caused economic losses mainly through poultry culls, and the destruction of poultry farms to avoid propagation, the decline in poultry trade, the disappearance of income sources, medical costs and expenditure on infrastructure investments and prevention programmes. The financial losses of the poultry farming sector in Asia were estimated at some US\$ 10 billion (FAO, 2005b).

The third form of contagion, from one human to another, could unleash a pandemic. This scenario remains hypothetical, although some experts have said that it is simply a matter of time until it occurs. The economic losses in such a situation are difficult to quantify because the entire global production system would be affected. The international community has begun to venture some projections, however, based on the two major human pandemics experienced in the past: severe acute respiratory syndrome (SARS) and Spanish flu (see table VI.2). Significantly, though SARS affected a limited geographical area and spread relatively little (with 8,000 people infected and 700-800 deaths), it strongly impacted on the world economy, with US\$ 30 billion to US\$ 50 billion in losses and a 2% contraction in East Asia's regional GDP in the second quarter of 2003 (Newcomb, 2005).

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<sup>1</sup> The avian flu virus is transmitted from birds to humans through contact with virus-containing bird excreta that enter the human body through the mouth or nose. The disease is not passed on through consumption of poultry, eggs or derived products.

Table VI.2  
ESTIMATED ECONOMIC COSTS OF A POSSIBLE PANDEMIC

Source	Observation	Cost
Lowy Institute for International Policy	Estimate of economic losses in four impact scenarios (mild, moderate, severe and ultra), based on the historical experience of major pandemics <sup>a</sup>	“Ultra” scenario: over 142 million deaths and world GDP loss of US\$ 4.4 trillion Mild scenario: 1.4 million deaths and world economic output loss of around 0.8% (about US\$ 330 billion)
International Monetary Fund	Estimate based on the socio-economic impact of Spanish flu (1918-1919) <sup>b</sup>	Loss of 2% in world GDP, only through the loss in human productivity (drop of some 20 million in the labour force in the first 6 weeks)
World Bank	Estimate based on impacts on the labour force through deaths, absenteeism and low productivity	Loss of 2% in world GDP (a annual loss of some US\$ 800 billion)
Centers for Disease Control and Prevention	Estimate of economic impacts on the United States	Loss of some US\$ 166.5 billion, taking into account only the social impacts (death, work days and productivity lost and medical expenses)
Asian Development Bank	Estimate of economic impacts in Asia, based on mild and severe scenarios	Mild scenario: losses of US\$ 99 billion through drop in consumption; US\$ 14 billion through deaths and productivity decline; and loss of the equivalent of 2.6% of Asian GDP Severe scenario: losses of US\$ 279 billion in the short term (6.8% of Asian GDP)

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of W. Mckbbin and A. Sidorenko, *Global Macroeconomic Consequences of Pandemic Influenza*, Lowy Institute for International Policy, February 2006; International Monetary Fund (IMF), *World Economic Outlook, Globalization and Inflation*, Washington, D.C., 2006; M. Brahmhatt, *Avian Influenza: Economic and Social Impacts*, Washington, D.C., World Bank, September 2005; M. Meltzer, N. Cox and K. Fukuda, *The Economic Impact of Pandemic Influenza in the United States: Priorities for Intervention*, Atlanta, Centers for Disease Control and Prevention, September-October 1999; J. Newcomb, *Economic Risks Associated with an Influenza Pandemic*, Bio Economic Research Associates, November 2005.

<sup>a</sup> Each of the scenarios was based on a different pandemic depending on gravity: the mild scenario took as a basis the 1968-1969 pandemic in Hong Kong; the moderate scenario the Asian flu of 1957; the severe scenario Spanish flu; and the ultra scenario would be one worse than that caused by Spanish flu.

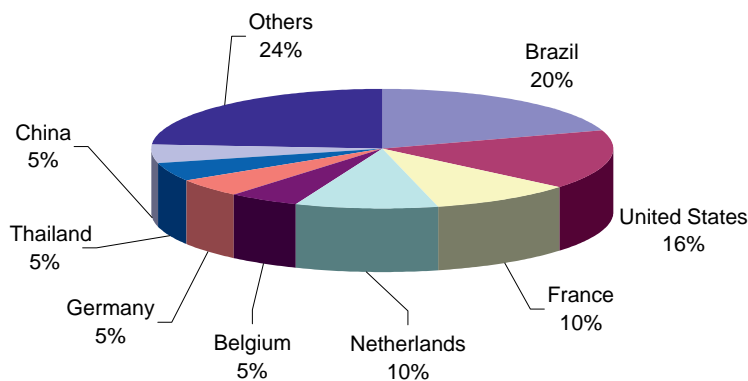
<sup>b</sup> Spanish flu infected a quarter of the world's population and claimed the lives of 40-50 million people worldwide. Its mortality rate varied from one country to another, from 0.6% in the United States to 5% in India and 20% in some Pacific islands. India is thought to have experienced a contraction of 3.3% in agricultural production and an 8% drop in the labour force (IMF, 2006).

## 2. Repercussions for the global poultry trade

In the last decade, world trade in chicken has expanded at an average annual rate of 10% in volume terms and 6% in value. Prices for chicken have dropped in this period. The largest world exporters of poultry meat in 2004 were Brazil, United States, Netherlands and France (see figure VI.1). The continued expansion of the poultry

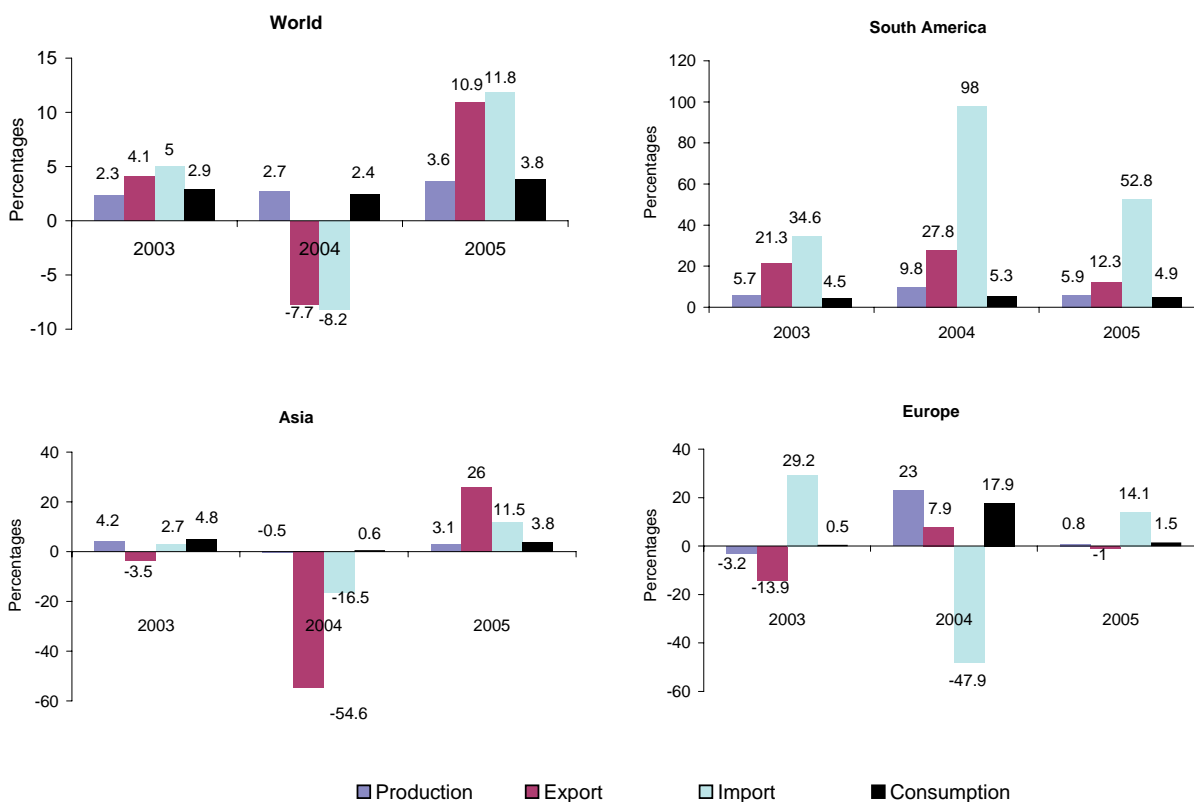
sector has been threatened, however, by the worsening of bird flu in the last few years, especially in Asia and Europe, whose exports have dropped considerably. In addition, world imports, which used to come from the regions now infected, are now coming mainly from the Americas (see figure VI.2).

Figure VI.1  
WORLD TRADE IN POULTRY PRODUCTS, 2004  
(Thousands of dollars)



Source: FAO Statistical Databases (FAOSTAT), 2006.

Figure VI.2  
POULTRY MARKET DURING THE SPREAD OF AVIAN FLU, 2003-2005  
(Growth rates in percentages)



Source: Food and Agriculture Organization of the United Nations (FAO), Meat Market Assessment, June 2006.

Notes: Up to 2003, Europe had 15 member countries; after 2004 it had 25 member countries.  
Growth rate in percentages by variation in volume (100 metric tons).  
2004: estimate; 2005: projection.

As the outbreaks of the disease move towards the West, restrictions on imports of poultry products from affected countries have increased. In the last year and a half, the main trade impacts on the world market have been: (i) a decline in world poultry trade; (ii) an increase in chicken meat stocks in infected producer countries; (iii) a drop in prices in infected countries; (iv) falling consumption of poultry in infected countries; (v) diversion of trade, with more imports coming from disease-free countries; (vi) toughening of sanitary requirements.

#### (a) Downswing in poultry trade

Asia and Europe are the regions whose trade has suffered the most from avian flu (see table VI.3). The impact of these trade losses has been very bad in

Asia, where the poultry business is crucial to several countries' economies. In the Philippines, the poultry trade represents 2% of GDP, which is one of the highest rates in the world. The World Bank reports that in Thailand, Viet Nam and China and the countries that sustained the heaviest financial losses during the avian flu outbreaks of 2003-2004, poultry trade accounts for 0.5%, 0.6% and 1.3% of GDP, respectively (Brahmbhatt, 2005). In the event of a pandemic, GDP in South-East Asia would shrink by an estimated 1.5%. Avian flu was responsible for almost halving Thailand's chicken exports between 2003 and 2004 and losing the country its place as the world's fifth largest exporter. From there it slipped to seventh place and avoided losing further ground by investing in the export of processed chicken meat (FAO, 2005b).

Table VI.3  
**MAIN POULTRY EXPORTERS**  
*(Millions of dollars)*

	2003	2004	Variation
Brazil	1 953	2 813	44%
United States	1 934	2 211	14%
France	1 357	1 346	-1%
Netherlands	1 357	1 336	-2%
Belgium	626	757	21%
Germany	639	713	12%
Thailand	1 138	675	-41%
China	796	625	-21%

Source: FAO Statistical Databases (FAOSTAT), 2006.

Europe's poultry trade, too, has been affected by avian flu. Many of the European countries are prominent in the world poultry trade: Belgium, France, Germany and the Netherlands together accounted for 30% of all poultry exports in 2004 (see figure VI.1). The largest exporters are France and the Netherlands, though their exports have declined since 2003. Conversely, there has been a rise in exports from European countries, including Belgium (where no H5N1 was reported in 2003) and Germany (where less was detected), which appear to have gained the market share of the others.

#### (b) Impacts on prices and consumption

In 2003-2004 outbreaks of bird flu initially pushed the international prices of poultry meat up by 20% or 30%, since the sanitary embargoes placed on exports from China and Thailand, which are among the world's main suppliers, reduced the volume available on the international market.<sup>2</sup> The detection of bovine spongiform encephalopathy (BSE), also known as "mad cow disease", in North America also helped to push up the price of chicken, which was used to substitute beef. Rising world prices contrasted with those dropping in the countries affected, as the exportable supply was channelled into domestic markets and local demand shrank owing to food safety and health concerns on the part of consumers.<sup>3</sup> In late 2005, poultry consumption was down by an annual 1% on average in 15 European Union countries. This drop has been uneven, however, and has steepened in 2006, varying from 70% in Italy to 20% in France and 10% in northern European (FAO, 2006c).

#### (c) Diversion of trade flows

Avian flu has also altered the flows of international poultry trade. In the last few years the exports of the main Asian suppliers have gradually declined, while those of

South America (mainly Brazil) and the United States, where the H5N1 virus has not yet been found, have climbed. Those countries have become the largest world suppliers of poultry meat, substituting the Asian supply (see table VI.3). Japan, which imports 70% of the poultry it consumes (three quarters of which used to come from China and Thailand), is now importing much more chicken from Brazil. In 2004 Japan was the largest consumer of Brazilian poultry, accounting for 18.9% of Brazil's chicken exports that year.<sup>4</sup>

#### (d) Prospects

Food safety issues will continue to divert trade flows in the global meat markets and South American shares in the world poultry trade are expected to keep growing in the short and medium terms. The long-term outlook for countries that are traditionally exporters (Brazil, among others), as well as the maintenance of their market share, hinges basically on two factors: (i) the countries remaining free from avian flu; and (ii) the ability to adapt to stricter sanitary requirements in importing markets.

In the long term, it is expected that traditional importers will continue to dominate the poultry trade and that Brazil and the United States will continue to supply the bulk of exports. Interestingly enough, Chile is gaining a growing foothold in the global poultry trade and should continue to supply major regional markets, such as Mexico. Projections show that poultry consumption will increase in the OECD countries, which will account for 37% of all meat consumed in 2014. The developing countries will become net importers of poultry meat once world prices come down and as local industries strive to compete with sales of low-price imports of chicken cuts. World trade rules are likely to hasten a shift towards consumption of more processed poultry products, because of sanitary barriers on unprocessed poultry (OECD/FAO, 2005).

Be this as it may, the question of how long the impacts of avian flu on trade will last is complicated by the growing complexity of the global markets, the uncertainties of consumer demand and the prolonged imposition of sanitary barriers. Moreover, the emergence of a virus that could be spread among humans could cause unprecedented losses, not only in the global poultry trade, but across the board.

In the light of recent bird flu developments around the world, FAO projections for poultry consumption for 2006 are currently 3 million tons lower, with a downward revision of 6% in world exports, than previous estimates based on outbreaks that intensified in 2005.

<sup>2</sup> The price of frozen chicken rose by 45% in Japan and by 20% in Singapore (FAO, 2006d).

<sup>3</sup> Apprehension among consumers causes avian flu to impact on products derived from poultry meat, processed products (whole chickens, refrigerated or frozen) and eggs, even though the disease is not transmitted through consumption of these products.

<sup>4</sup> According to data from the Commodity Trade Database (COMTRADE).

### 3. Trade impacts in Latin America and the Caribbean

Latin America has experienced outbreaks of different types of avian flu in the last 10 years, though none have been highly pathological: Mexico (1995), Chile (2002), Central America (2003) and Colombia (October, 2005). The disease caused Chilean exports to drop heavily in 2002, with a loss of US\$ 21 million in comparison with the previous year (see table VI.4). A trade quarantine was imposed on Colombia by the other Andean countries (Bolivarian Republic of Venezuela, Bolivia, Ecuador and Peru), leading Colombia to lodge a complaint against Ecuador with the Andean Community's dispute settlement body.<sup>5</sup> Given that no incidences of the H5N1 virus have been encountered on the American Continent as yet, the flow of world imports from Latin American countries has increased and they have gained market niches previously occupied by Asian countries.

Table VI.4  
**LATIN AMERICA AND THE CARIBBEAN: MAIN POULTRY EXPORTERS**  
(Millions of dollars)

	2000	2001	2002	2003	2004	Variation 2003-2004	Variation 2000-2004
Brazil	904	1 439	1 498	1 953	2 813	44%	33%
Chile	37	57	36	54	116	113%	33%
Argentina	14	18	22	40	65	63%	47%
Latin America and the Caribbean	986	1 541	1 576	2 057	3 017	47%	32%

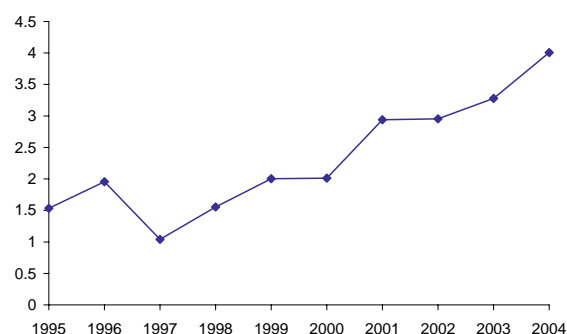
Source: FAO Statistical Databases (FAOSTAT), 2006.

One consequence of these developments is that between 2003 and 2004, the period that coincided with the outbreaks of avian flu in Asia, poultry came to account for a higher share of the region's total agricultural exports (see figure VI.3). In 2004 Latin American and Caribbean poultry exports expanded by 47% with respect to 2003 and accounted for 4% of agricultural exports that year (see table VI.4 and figure VI.3). Brazil is the region's largest poultry exporter, accounting for 20% of this market. Its exports increased by 44% in volume between 2003 and 2004. Argentina and Chile are the other two large exporters in the region.

A breakdown of poultry exports reveals uneven growth patterns across the different components. Exports of chicken meat have expanded steadily, especially in 2003-2004 (48%), as a result of avian flu in Asia. Turkey

exports have also moved upwards fairly constantly, except in 2002, when avian flu broke out in Chile, which is the region's second largest exporter of turkey (its exports dropped from US\$ 12 million in 2001 to US\$ 4 million in 2002). Exports of eggs also rose, except in 2002, as a result of the same outbreak (see table VI.5).

Figure VI.3  
**LATIN AMERICA AND THE CARIBBEAN: POULTRY EXPORTS AS A PROPORTION OF TOTAL AGRICULTURAL EXPORTS**  
(Percentages)



Source: FAO Statistical Databases (FAOSTAT), 2006.

Table VI.5  
**LATIN AMERICA AND THE CARIBBEAN: POULTRY EXPORTS**  
(Millions of dollars)

	2000	2001	2002	2003	2004	Variation 2003-2004	LAC share in 2004 world exports
Chicken meat	848	1 344	1 381	1 776	2 637	48%	31%
Turkey meat	90	124	116	159	231	45%	5%
Tinned chicken meat	48	73	78	122	148	21%	2.4%
Eggs	33	43	29	19	33	74%	14%

Source: FAO Statistical Databases (FAOSTAT), 2006.

The Latin American and Caribbean countries export no goose meat and very little duck meat, though duck exports expanded sharply from US\$ 95,000 in 2003 to US\$ 940,000 in 2004. This increase may be attributable to the global supply shock caused by the sudden drop in exports of duck meat from Thailand, Hong Kong SAR and China between 2003 and 2004.<sup>6</sup>

<sup>5</sup> The General Secretariat of the Andean Community ruled that there was no proper justification or technical grounds for Ecuador's ban on all poultry products from Colombia. Accordingly, Ecuador was required to amend its resolution No. 024 by including an article allowing the sale of poultry products treated to inactivate the avian influenza virus (see resolution 982 of the General Secretariat of the Andean Community).

<sup>6</sup> According to FAO statistics, Thai duck meat exports plunged from US\$ 39 million to US\$ 3 million. Those of Hong Kong SAR dropped from US\$ 21 million to US\$ 5 million and those of China fell from US\$ 26.5 million to US\$ 20 million.

Poultry farming for export is highly mechanized in the region, as may be seen in Argentina, Brazil and Chile. This means that there is less contact between humans and birds in poultry farms and producers are in a position to respond quickly to disease prevention and control plans. In several countries, however, a good deal of chicken meat is also produced in small and medium-sized rural farms for the domestic market. These farms are at higher risk of catching and spreading avian flu.

Lastly, an important point is that financial losses are not confined to the poultry trade, but spill over to the production of maize and soybean, on which poultry feed is based. Argentina and Brazil would be the region's worst affected countries in this regard, since they are the largest exporters of cereal and vegetable oil (maize and soy, respectively) for use in feed for the world poultry industry. Much of this feed goes to the domestic market, however. In Brazil, the domestic poultry sector alone absorbs 49.5% of maize production and 27% of powdered soybean production.<sup>7</sup>

#### 4. International agency response and mobilization in the region

Responding to the urgency of the situation, international agencies mobilized and joined forces to provide technical assistance to the countries. They have conducted a series of activities individually and jointly, led by the World Health Organization (WHO), the Food and Agriculture Organization of the United Nations (FAO)<sup>8</sup> and the World Organisation for Animal Health (OIE).<sup>9</sup> Among other efforts, they have organized seminars, workshops and technical assistance, including support for national authorities in investigating outbreaks, stepping up surveillance in affected regions and coordinating regional programmes to tie in with international directives.

In the framework of global mobilization around this issue, FAO, OIE, WHO and the World Bank convened the Meeting on Avian Influenza and Human Pandemic Influenza in Geneva in November 2005. At the meeting, the organizations looked at the FAO proposal for a global programme of avian influenza control and eradication and examined the countries' main short-, medium- and long-term financial needs. It was agreed that FAO would coordinate the global programme with regional initiatives, which would cost an estimated US\$ 476 million (see table VI.6). Significantly, this estimate does not include the costs of financing the regional initiatives.<sup>10</sup>

Despite the socio-economic importance of the poultry sector in the region, the countries' response to bird flu has been very uneven (see table VI.8). As well as regional

meetings of governments and animal health agencies, once the existence of the H5N1 virus was known, the regional agencies spurred on the preparation of a regional avian flu pandemic preparedness plan, under the guidance of WHO, OIE and FAO. Domestic mobilization in the countries has been led by ministries of health and of agriculture and livestock, in coordination with public and private bodies. The Pan-American Health Organization (PAHO) is also working with the Latin American and Caribbean countries to develop national pandemic preparedness plans and has stipulated that all members must have their preparedness plans finalized by July, 2006.<sup>11</sup>

Table VI.6  
ESTIMATED COSTS TO FAO OF COORDINATING GLOBAL  
CONTROL AND ERADICATION EFFORTS  
(Millions of dollars)

FAO activity	First 6 months	First full year	Second year	Third year	Total
Coordination	9 838	18 500	15 892	15 337	49 711
Infected countries	22 220	56 129	24 637	23 652	104 418
Countries at risk	16 197	21 007	29 123	27 492	77 622
Newly infected countries	16 100	44 000	62 700	137 500	244 200
Total	64 355	139 636	132 352	203 981	475 969
<b>Estimated prevention costs</b>					
Americas	3 239	4 201	5 825	5 498	15 524

Source: Food and Agriculture Organization of the United Nations (FAO), *Avian Influenza Control and Eradication. FAO's Proposal for a Global Programme*, January 2006.

<sup>7</sup> Data from the Ministry of Agriculture, Fisheries and Supply (MAPA) of Brazil.

<sup>8</sup> Information from FAO is available at on its website: [http://www.fao.org/ag/againfo/subjects/es/health/diseases-cards/special\\_avian.html](http://www.fao.org/ag/againfo/subjects/es/health/diseases-cards/special_avian.html).

<sup>9</sup> Information from OIE is available at: [http://www.oie.int/eng/avian\\_influenza/guidelines.htm#AIEurope](http://www.oie.int/eng/avian_influenza/guidelines.htm#AIEurope).

<sup>10</sup> Regional programmes include the Global Early Warning and Response System for Major Animal Diseases (GLEWS) for transboundary animal diseases (estimated cost of US\$ 3 million) and those run by the Emergency Centre for Transboundary Animal Diseases (ECTAD) in Bangkok (the cost of activities in the Asian region is estimated to be US\$ 5.6 million) (FAO, 2006e).

<sup>11</sup> For further details see: "Influenza pandémica". <http://www.col.ops-oms.org/repositorio/vertema.asp?id=20&idrepositorio=1>.

## C. Foot-and-mouth disease

Foot-and-mouth disease (FMD) does not infect humans, but it is one of the most contagious diseases of mammals and has great potential for causing severe economic loss because of the ease with which it spreads, the significant deterioration of the animals affected and its ability to spread through the sale of the meat. It is therefore an issue of great concern in the international beef trade. An intensive cooperation effort between health and

agriculture sectors has achieved significant progress in controlling and eradicating the disease in several countries, almost exclusively highly economically developed nations, while South America has yet to reach this point. According to the Secretariat of the World Trade Organization (WTO), FMD heads the list of animal health concerns, together with BSE (mad cow disease).<sup>12</sup>

### 1. Impacts on the international beef trade

FMD affects trade because it reduces livestock productivity (meat, milk and derivatives), forces sanitary restrictions on exports and pushes up production costs through compliance with international sanitary standards and the provisions of public control and eradication programmes. In addition to deaths caused by the disease and the necessary cull of livestock,<sup>13</sup> it causes spontaneous abortion, loss of reproductive capacity, gestation problems, increased secondary conditions (such as mastitis) and heightened vulnerability to other infections. Another indirect economic effect is the impact on tourism. The losses to tourism and recreational activities caused by the restriction on access to rural areas during the FMD outbreak in the United Kingdom in 2001 amounted to US\$ 4.9 billion, which represented half the total cost of the disease (DEFRA, 2005).

These outbreaks of FMD impacted immediately on world trade in beef and cattle, which declined by 4%. Trade losses in Uruguay and Argentina, which were also hit in this period, are estimated at US\$ 178 million and

US\$ 440 million, respectively. Outbreaks of BSE in the European Union and of FMD in Argentina, the Republic of Korea, the United Kingdom and Uruguay slowed world trade in beef in 2000 and 2001 and triggered a shift in consumption trends that pushed up the prices of all meat other than beef. Trade flows were also diverted, much like what happened in the world poultry trade in response to the spread of avian flu. The FMD outbreak in the Republic of Korea in 2000 hurt the country's trade with Japan, which was worth US\$ 300 million, and enabled other major exporters to gain a larger share of the Japanese market (FAO, 2004).

In sum, the short-term trade impacts of FMD outbreaks in 2000-2001 in the main exporting countries were reduced availability of FMD-free meat in the international markets; a drop of almost 3% in global beef trade and a consequent 3.5% increase in world prices; and an increase in the prices of other meats, such as pork, poultry and lamb or mutton, which were used as substitutes (FAO, 2004).

<sup>12</sup> Bovine spongiform encephalopathy (BSE) is the scientific name given to the condition commonly known as "mad cow disease", which was first diagnosed in the United Kingdom in the 1980s.

<sup>13</sup> Outbreaks of foot-and-mouth led to the culling of 4.03 million animals in Taiwan Province of China in 1997 and 6.24 million in the United Kingdom in 2001 (FAO, 2004b).



## 2. Foot-and-mouth disease in South America

Two changes in the international rules have contributed to the growth of regional beef exports in the last few years: the recognition of zones classified as FMD-free with vaccination and the regionalization concept. Previously, the international market recognized only FMD-infectious areas and FMD-free areas, which placed South America at a disadvantage, since this classification did not distinguish countries that were free of the disease through vaccination (as in the cases of Argentina, Brazil, Paraguay and Uruguay), but only whether FMD had been eradicated in the region or not. This had two implications for trade. First, meats from FMD-free areas were in greater demand, attracted higher prices and enjoyed access to the markets of countries in the FMD-infectious areas. Second, countries that had not eradicated FMD could sell only to other countries within the same FMD classification, or market processed (cooked or salted) meat at a lower market value (PAHO, 2005). In this regard, beef from Argentina and Brazil, though of high quality, did not attain the high market value of meat from Australia, the European Union or United States, which were FMD-free.

In the 1990s, OIE devised the sanitary category of “FMD free zone with vaccination” in its International Animal Health Code. This is the first disease for which OIE has established an official list of countries and areas that are disease free with and without vaccination. This category provides for the trading of beef under conditions that are advantageous to countries of South America, which has the world’s largest beef herd and where, with vast stretches of land devoted to livestock farming, it is difficult to completely eradicate the disease throughout the continent.

The great majority of the developed countries are classified as FMD-free without vaccination. All the Central American and Caribbean countries and Chile have attained this category too. A number of South American countries, including Paraguay and Uruguay, have been classified as FMD-free through an efficient system of herd vaccination. Argentina and some States in Brazil, having gained FMD-free with vaccination status, then had it suspended.<sup>14</sup> In terms of trade, this suspension strips a country of one of the main entry requirements laid down by the world’s largest beef importers.

### (a) The challenge of overcoming resistance to regionalization

Another important development that broadened the export prospects of countries where FMD had not been eradicated was the introduction of the regionalization principle enshrined in article 6 of the Agreement on the Application of Sanitary and Phytosanitary Measures (the SPS Agreement),<sup>15</sup> and its subsequent regulation by the international organizations, namely OIE and the International Plant Protection Convention (IPPC).<sup>16</sup> This principle is crucial for large countries reporting outbreaks of disease that are restricted to a particular geographical area.<sup>17</sup> Argentina and Brazil have benefited from the regionalization principle, since it enables them to export beef from FMD-free regions and avoid beef embargoes on the whole country as a result of isolated outbreaks. These two changes in the international rules had much to do with the considerable increase in the region’s beef exports in 1994-2004. In 2000-2004, Brazil led export growth (33%), followed by Paraguay (22%) and Uruguay (14%) (see table VI.7).

<sup>14</sup> The outbreak in Mato Grosso do Sul triggered the suspension of that State’s FMD-free with vaccination status, together with that of Tocantins, Minas Gerais, Rio de Janeiro, Espirito Santo, Bahia and Sergipe (from 30 September 2005). The outbreak in Paraná led the suspension of FMD-free with vaccination status there and in the States of Sao Paulo, Goias, Mato Grosso and the Federal District of Brazil (from 21 October 2005). Argentina’s FMD-free with vaccination status was suspended as of 8 February 2006 following a report of an outbreak of FMD in the province of Corrientes that month.

<sup>15</sup> Article 6 of the Agreement on the Application of Sanitary and Phytosanitary Measures (the “SPS Agreement”) requires governments to recognize areas within other countries as safe sources for imports of food and animal and plant products, instead of taking measures based solely on national boundaries.

<sup>16</sup> The International Plant Protection Convention (IPPC) has three rules dealing with regionalization: International Standard for Phytosanitary Measures (ISPM) No. 4 on requirements for the establishment of pest-free areas; ISPM No. 10 on requirements for the establishment of pest-free places of production and pest-free production sites; and ISPM No. 22 on requirements for the establishment of areas of low pest prevalence. The OIE Terrestrial Animal Health Code sets out requirements for certification of freedom from diseases.

<sup>17</sup> The purpose of the regionalization principle is to allow part of a country to be declared FMD-free, even if outbreaks have occurred in other parts of the country. This avoids the need for a country-wide embargo on meat exports.

Table VI.7  
**LATIN AMERICA AND THE CARIBBEAN: MAIN BEEF EXPORTERS**  
*(Millions of dollars)*

	2000	2001	2002	2003	2004	Variation 2000-2004
Brazil	783	1 009	1 090	1 508	2 429	33%
Argentina	662	249	475	595	1 020	11%
Uruguay	376	229	272	383	629	14%
Paraguay	70	76	20	60	158	22%

Source: FAO Statistical Databases (FAOSTAT), 2006.

Paraguay and Uruguay attained unprecedented growth in their beef exports thanks to their FMD-free status. Both growth rates outstripped that of Argentina, which has a much larger herd and volume of beef than either Paraguay

or Uruguay. Although both these countries are working at full capacity, the combined volume they export (349,000 metric tons in 2004) is not enough to cover all the market supplied by the exports of Brazil and Argentina, which ship almost five times as much.<sup>18</sup>

Although it has certainly had a positive impact on regional beef trade, the regionalization principle would yield much greater benefits if all the WTO member countries were to respect it. Of all the Latin American and Caribbean countries, Argentina lodged the largest number of WTO notifications under the regionalization principle, followed by Brazil (WTO, 2005b), between 1995 and 2004 (WTO, 2005b).

## D. Trends and future challenges for the global meat market

South America is an unusual region in that is prominent in global trade of both chicken and beef and both are crucial to its agricultural sector. The region has the largest commercial beef herd in the world and it is the world's second largest exporter of beef and largest exporter of chicken. The production and sale of these products are not only important sources of employment and income for rural communities: they also contribute heavily to human well-being by supplying high-quality proteins that are essential for good health.

As new sanitary barriers are imposed, governments and producers must continually take preventive measures if they are to maintain their exports of livestock products, since it takes some time to regain access to destination markets and recoup consumer confidence after a sanitary problem has occurred.

### (a) The three main weaknesses

These "sanitary shocks" have revealed issues that, though not new, point up three main difficulties for the countries of the region: (i) lack of effective public inspection procedures; (ii) weakness of public-private partnership; and (iii) lack of legal provisions designed, at least, to standardize sanitary protection, even if they are not identical in content.

Recent outbreaks of FMD call into question the capacity of the region's countries to deploy a rapid and effective response to transboundary diseases, which heightens concerns over the potential spread of avian flu to the American continent. What is more, it shows up the institutional weakness of many countries, i.e., the lack of inspection agencies properly prepared to undertake sanitary surveillance, prevention and control. The spread of these diseases also demonstrates on the ground that public-private collaboration is essential for any satisfactory sanitary programme. On the one hand, it is the responsibility of the public sector to formulate and produce instruments for achieving clear objectives in disease control and eradication, since only the public sector has the authority to define epidemiological profiles and interact with productive units in the best possible way. On the other hand, the private sector is responsible for implementing the sanitary measures set out in government programmes, not only when a disease worsens, but at all times.

Another difficulty is that, typically, farming methods vary widely in Latin America and the Caribbean, for both beef and poultry. Large industries with advanced, high-tech production methods exist alongside medium-sized and small producers using traditional techniques of animal husbandry. The broad variety of types of meat production in the region places limits on the efficiency of public plans of sanitary inspection and

<sup>18</sup> According to FAOSTAT data, Brazil and Argentina combined reported a volume of 1.664 million tons in 2004.

coordination with the plans of neighbouring countries. This, together with Latin America's ecological diversity, makes it difficult to put the discourse on harmonization of sanitary rules into practice in the region.

Despite these difficulties, if the spread of avian flu in the Americas is to be avoided, a common regional strategy must be formulated as a matter of urgency and coordinated with the respective international strategies. In the case of FMD, given that several regional plans have started up in the last few years, the main obstacle now is the region's institutional heterogeneity, which prevents more effective surveillance by the responsible bodies in each country. Effective FMD eradication plans need closer coordination between public authorities and rural producers. Better investment in municipal or provincial surveillance systems would represent a step in this direction.

Short-term initiatives in response to transboundary disease focus on prevention and control within production units, but in the long term what is needed is an effective institutional structure conducting surveillance at all times, not only when the international alarm is raised over an outbreak that is already spreading. It is therefore necessary to strengthen services of surveillance, prevention and control within the countries and to establish a joint, standard strategic system based on sanitary rules that offer a common level of protection, thereby creating "sanitary armour-plating" that can safeguard the stability of the region's livestock trade.

The countries of the region have made some headway in putting their respective national avian flu prevention plans in place. However, the only effective way to deal with a disease that spreads rapidly across geographical boundaries is to devise a coordinated response by all the countries, lest trade barriers compromise access to export markets. Efforts should therefore be focused on coordinated activities, of which examples are the creation of the Ad hoc Group on Avian Influenza<sup>19</sup> by the Southern Cone countries and the preparation of the Regional Strategy on Avian Influenza Prevention aimed at standardizing sanitary measures in the region.

The containment of FMD, too, is vital for the international positioning of the livestock sector and must therefore be dealt with by the governments. For example, Brazil's national FMD eradication programme drastically reduced the

incidence of the disease and eradicated it altogether in several states.<sup>20</sup> Bolivia has implemented a similar programme and has managed to have the area of Chiquitania recognized as FMD-free with vaccination.<sup>21</sup> Although several eradication programmes have achieved positive results, however, the latest outbreaks in Argentina and Brazil show that the countries still have a long way to go to eradicate the disease in Latin America. In this regard, proposals for joint action by institutions such as the Southern Agricultural Council (CAS) and the Agricultural Policy Coordination Network (REDPA)<sup>22</sup> are crucially important for the countries that form one of the world's largest beef producing areas.

#### **(b) Investment in traceability, regionalization and mutual recognition agreements**

The diseases discussed here spark consumer concerns over human health impacts and this has heightened the need to implement methods to verify the origin of foods consumed. Food traceability or trackability lets consumers know where food comes from, offers guarantees of food safety, improves quality management and risk assessment to increase consumer confidence and provides a basis for timely measures to be taken in response to risk-inherent problems.<sup>23</sup> In order to enter markets such as the European Union, the United States and Japan, meat exporters must provide accurate information on the history of the imported food from its point of origin to the consumer's table. This is why it is important to have traceability systems in place permanently.

With regard to the regionalization principle, since the approval or rejection of requests calls for technical and legal evidence, efforts must be made to minimize the political factors that are sometimes involved in consultations undertaken in the framework of WTO. The countries should be represented at the main WTO and OIE meetings addressing the issue, in order to engage the international community in the problems the countries face in securing recognition of the regionalization principle.

Mutual recognition agreements arise out of assessment processes in which two or more countries agree that the systems they employ can permit the goods traded in one country to be traded freely in any other country party to

<sup>19</sup> This working group is an initiative of the Permanent Veterinary Committee of the Southern Cone.

<sup>20</sup> Brazil recorded 2,000 outbreaks of FMD in 1994, compared to just 2 in 2004 (Lima and others, 2005).

<sup>21</sup> Further details available from PANAFTOSA and the National Agricultural Health and Food Safety Service of Bolivia (SENASAG).

<sup>22</sup> CAS was established in 2003 by the member and associate countries of MERCOSUR and comprises the ministers for agriculture of Argentina, Bolivia, Brazil, Chile, Paraguay and Uruguay. Its main tasks are to harmonize agricultural policies in the region, exchange information on the agricultural matters in the member countries, coordinate sanitary defence, adopt common positions on international trade negotiations and promote regional integration. REDPA is a mechanism of regional coordination on agricultural policy implementation. Further details are available at: <http://www.iica.org.uy/casonline/inicial.asp> and <http://www.redpa.org>.

<sup>23</sup> The traceability system applies to foods, feed and animals from which food products derive. Monitoring encompasses all operations along the production chain, industry, transport, distribution and retail.

the agreement. The purpose of such agreements is to allow goods to flow more freely among countries and avoid impediments to trade caused by differences in the trading partners' national rules, on the condition that each country maintains a proper level of sanitary protection —which does not require the rules to be identical. In practice, a mutual recognition agreement facilitates trade and reduces or eliminates the need for inspection of goods at the point of entry, on the basis that the importer trusts the effectiveness of control systems in the exporting country.

Mutual recognition agreements are based on the notion that different rules can result in an acceptable

degree of assurance of food safety, even if the contents of the legislation are different. Among countries with such varied sanitary situations as those of the region, this is essential. Such agreements merit a place on the Latin American countries' trade policy agendas, because they would represent substantial progress towards improving regional trade flows, in view of shared sanitary problems such as FMD. Unquestionably, the countries need to inject urgency into the joint initiatives that have been developed over the last few years to even out sanitary policies in their agricultural sectors, since this would represent a first step towards forging mutual recognition agreements.

Table VI.8  
REGIONAL ACTIVITIES AIMED AT AVIAN FLU CONTROL AND PREVENTION

Institutions		
<ul style="list-style-type: none"> <li>• Pan American Health Organization (PAHO)</li> <li>• FAO Regional Office for Latin America and the Caribbean (RLAC)</li> <li>• OIE Regional Representations</li> <li>• Permanent Veterinary Committee of the Southern Cone</li> <li>• Inter-American Institute for Cooperation on Agriculture (IICA)</li> <li>• International Regional Organization for Plant and Animal Health</li> <li>• Inter-American Committee on Avian Health</li> <li>• OIE regional commission on avian health</li> </ul>		
Activities		
<ul style="list-style-type: none"> <li>• Technical assistance for training and institution-building of veterinary services and national laboratories</li> <li>• Organization of information seminars and workshops</li> <li>• Guidance on scientific research and risk assessments</li> <li>• Capacity building</li> <li>• Guidance on national prevention plans</li> <li>• Meetings to improve regional coordination</li> <li>• Financing of national and regional activities</li> </ul>		
Forums and instruments		
<ul style="list-style-type: none"> <li>• Global Framework for Transboundary Animal Diseases on the American Continent <sup>a</sup></li> <li>• Regional strategy of avian flu prevention</li> <li>• Hemispheric Conference on the Surveillance and Prevention of Avian Influenza (Brasilia, 2005)</li> <li>• Technical cooperation projects for detection of avian flu in Central America, the Caribbean, the Andean region and the Southern Cone (FAO)</li> <li>• Guide to prevention and control of avian flu in small-scale poultry farming in Latin America and the Caribbean</li> <li>• Ad hoc Group on Avian Influenza created by the Permanent Veterinary Committee of the Southern Cone</li> </ul>		
By country		
Brazil	Costa Rica	Bolivia
<ul style="list-style-type: none"> <li>• Avian flu prevention plan</li> <li>• National poultry health programme</li> <li>• Inter-agency working group on avian influenza</li> <li>• Inter-ministerial executive group on potential avian influenza pandemic</li> <li>• Contingency plans and operational manuals</li> </ul>	<ul style="list-style-type: none"> <li>• National commission on influenza pandemic preparedness</li> <li>• Influenza pandemic preparedness and response plan</li> <li>• National influenza virus surveillance system</li> <li>• Guide to integral patient treatment</li> </ul>	<ul style="list-style-type: none"> <li>• National plan for avian influenza</li> <li>• National avian health programme</li> <li>• National programme of control and eradication of Newcastle disease and avian influenza surveillance</li> </ul>
Chile	Peru	Argentina
<ul style="list-style-type: none"> <li>• Influenza pandemic preparedness plan</li> <li>• National programme of epidemiological surveillance in avian diseases</li> <li>• Livestock emergency plan and contingency plan for avian influenza (SAG)</li> <li>• Avian influenza prevention system (SAG)</li> <li>• National outbreak response and sanitary emergency commission</li> </ul>	<ul style="list-style-type: none"> <li>• National avian health programme</li> <li>• Sanitary regulations for the rearing and slaughter of poultry for consumption</li> <li>• National preparedness and response for a potential outbreak of avian influenza</li> <li>• Registration and operation of farms and incubation plants</li> </ul>	<ul style="list-style-type: none"> <li>• SENASA Resolution No. 1078/ 99 on avian influenza</li> <li>• Epidemiological surveillance programme</li> <li>• National poultry health plan</li> <li>• National poultry health commission</li> </ul>

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

<sup>a</sup> The Global Framework for Transboundary Animal Diseases (GF-TADs) is a joint FAO/OIE initiative, which combines the strengths of both organizations to facilitate alliances among countries to combat transboundary animal diseases and assist with the establishment and development of programmes to control such diseases, including FMD and avian flu. Asia was the first region to implement GF-TADs and in 2005 it was introduced on the American continent with the support of a number of regional organizations.

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