

Regional integration

Towards an inclusive value chain strategy



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ECLAC

Regional integration: towards an inclusive value chain strategy



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FOREWORD

This document is a contribution of the Economic Commission for Latin America and the Caribbean (ECLAC) to the deliberations of its thirty-fifth session, which will be held in Lima from 5 to 9 May 2014.

Regional integration is a multidimensional process which may take the form of coordination, cooperation, convergence and deep integration initiatives and whose scope extends not only to economic and trade issues but to political, social, cultural and environmental ones as well. The present document focuses on the productive dimension of integration and the way this can contribute to the strategy of structural change for equality that ECLAC has been advocating since 2010. This is a return, then, to a subject that has traditionally been at the centre of ECLAC thinking about integration and development. Another aim is to contribute to the current debate about the role of integration in Latin America and the Caribbean in the light of the significant shifts taking place in the global economy. These include rapid technological change, the growing economic weight of Asia and emerging economies generally, the rise of global value chains and the trend towards the creation of integrated macroregions.

If inequality is one of the region's hallmarks, promoting equality ought to be a hallmark of its regional integration strategy. Because this is a systemic challenge, it does not seem practicable to address it exclusively through social policies. A first obvious link is with the sphere of production. Achieving a production transformation that helps to reduce inequalities requires more and better-quality productive employment and a greater presence of small and medium-sized enterprises (SMEs), manufactures and services in exports. These are better represented in intraregional trade than in any other kind of trade. Consequently, there is a direct link between a strategy of growth with equality and the strengthening of the regional economic space. Similarly, renewing the impetus of industrialization by diversifying exports and increasing the knowledge and value added embedded in them should lead rapidly to a greater commitment to regional integration.

The basic proposition of this document, which is that production integration should become a strategic cornerstone of regional integration, is fully consistent with the goal of giving this integration a more markedly social character. The key role for SMEs in this proposal means that what is being advocated is the promotion of inclusive value chains, in line with recent ECLAC arguments.¹ This approach is consistent with the traditional concerns of Latin American structuralism, which places the production structure, labour market characteristics, productivity differences and access to technological progress at the heart of its thinking on development and income distribution.

If national strategies for growth with equality are to be pursued successfully, it is vital for them to be complemented by real regionwide progress on infrastructure, production chain integration, convergence in regulatory policies and support for intraregional trade. Bringing together national and regional efforts would enhance the region's attractiveness and economic prospects. These new emphases in regional integration would also help Latin America and the Caribbean speak with a single voice when addressing the main issues on the global agenda.

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¹ See ECLAC, *Comercio internacional y desarrollo inclusivo. Construyendo sinergias*, Santiago, Chile, 2013.

INTRODUCTION: TIME FOR PRODUCTION INTEGRATION

Regional integration is a multidimensional process encompassing not just economic and trade issues but political, social, cultural and environmental ones as well. The production dimension in particular was central to the earliest ECLAC thinking about integration, when it was argued that national markets had to be transcended in order to reap the economies of scale and learning advantages the regional market had to offer. This in turn would help the region's economies to move towards more sophisticated forms of productive specialization with greater technology content. The aim was to move forward with an industrialization underpinned by productive complementarity that would increase intraregional trade in manufactured products. By expanding and diversifying the supply of foreign exchange and reducing dependence on an export structure that was overreliant on raw materials, this shift in the production matrix would help to deal with the classic external constraint that has characterized the region's development.

For a variety of political and economic reasons, this prospect fell some way short of being realized. Excessive and continued protection of national markets, weak policies on innovation and technological progress and the low priority given to creating linkages between natural resources and manufacturing and service activities resulted in an increased dependency on foreign-exchange earnings from commodity exports and in a form of industrial development that was too dependent on the decisions of transnational enterprises. In turn, the actions of the latter were generally aimed at reaping the benefits of protected markets, without enhancing local learning and technology diffusion capacities. Thus, economic activity as a whole ultimately became reliant on the fluctuating external financing capacity provided by the primary sector. Taking advantage of favourable external financing conditions from the mid-1970s onward, the region's countries, often under military regimes, sought to supplement this financing with rising and often irresponsible external borrowing. The rest is a familiar story: the external debt crisis, painful adjustments, large net transfers of resources abroad, growing poverty and, in short, the "lost decade".

In the 1990s, as democracy was restored, the region's economies reoriented their development by scaling back protection levels, taking steps to modernize their integration schemes and establishing various types of trade agreements with one another. The issues of industrialization and production transformation tended to drop down government agendas, while the echoes of advice from the international organizations promoting structural adjustment in the late 1980s continued to set the tone on macroeconomic balance, deregulation, trade and financial opening and the withdrawal of the State from production activities. At the same time, a number of the region's countries entered into free trade agreements with industrialized economies, seeking to enter larger markets and so find substitutes for the wider regional markets that integration schemes did not seem to be providing.

The rise of China in world trade, driven by its membership of the World Trade Organization (WTO) since 2001, has had major regionwide repercussions. The great dynamism of the Chinese economy has produced considerable demand for natural resources, raising their prices and significantly boosting a number of South American economies. The interaction between China's trade surplus with the United States (stemming from a massive flow of low-cost manufacturing exports) and its counterpart in the capital account (Treasury bond purchases) resulted in the remarkable period of world economic growth between 2003 and 2008. The United States economy was able to grow above potential with low inflation and interest rates and with ample external financing to fund its imbalances. Chinese growth in this period was in double digits, while that of the United States was close to 4% in some years.

While the main trading partners of Latin America and the Caribbean were achieving high rates of growth, the region itself was surmounting the most restrictive external debt constraints (although this was true only to a lesser extent of the Caribbean) and making substantial progress with macroeconomic management.

The convergence of domestic economic reforms and the favourable international situation between 2003 and 2008 resulted in the region's best economic performance in 40 years: average growth rose to 4.7% a year, the unemployment rate fell from 10.7% to 7.3%, and there were even years when the fiscal account and the balance-of-payments current account were both in surplus. Exports grew by 18% a year, boosted by the terms-of-trade improvements deriving from high commodity prices. In the social sphere, the poverty rate fell from 43.9% to 33.5% and income distribution even improved slightly. In this favourable context, worries about production and export diversification and about the region's innovation and competitiveness deficits were once again left behind.

When the subprime crisis broke out, the region was able to respond with firm countercyclical policies thanks to the soundness of its fiscal and external accounts, its high level of international reserves and its low inflation. This response was bolstered by similar expansionary policies in a number of the world's leading economies, particularly the United States and China. The region thus returned quickly (in 2010) to high levels of growth in economic activity and exports. The eurozone crisis affected the region less, owing to the gradually diminishing importance of its trade and investment links with Europe. However, the slowdown in the Chinese economy, where growth dropped from an average of 11% a year between 2003 and 2010 to 7.7% between 2011 and 2013, seriously affected the region's exports and terms of trade. Accordingly, as 2014 begins, the region's growth prospects between now and 2018 look clearly less auspicious than they were in 2003-2008: exports and growth are slowing sharply, the current account deficit is re-emerging just as external financing is expected to become dearer, fiscal leeway is lessening and, in a number of cases, pressure for devaluation could translate into higher inflation.

This rapid overview of the last few decades in the region's economies confirms that Latin America and the Caribbean has not succeeded in overcoming its external constraint, i.e. has not done enough to develop endogenous drivers of growth, but remains heavily dependent on external cycles. When international financing and trade conditions are favourable, the region grows at above 4%; when they deteriorate, it returns to growth levels closer to 3%.

This seems a good time, then, to reflect more deeply on the quality of the Latin American and Caribbean economies' international position and the part regional integration can play in this. Conditions now are very different from what they were when regional integration began: the economies of the region are more open and are interconnected by a number of trade agreements, much has been learned about macroeconomic management, and a degree of technological capacity has been developed in several activities and sectors. A number of countries have also taken significant steps forward in the governance of natural resources, and in general the technical capacity of governments has grown substantially.

As well as being more mature economically, Latin America and the Caribbean has been consolidating its democratic progress. The combination of these elements has been documented in a number of international reports that show favourable medium-term prospects for the region, given its economic achievements, its growth prospects, its plentiful natural resource endowment and the growth of its domestic markets and middle classes. These are also the factors underlying its increased economic autonomy in interactions with its main trading partners, and this in turn underpins the argument that the conditions are in place for fresh integration that is more sophisticated than earlier efforts.

The traditional arguments for integration still hold: increased productive efficiency, economies of scale, larger markets and greater scope for economic complementation and the provision of regional public goods. Also still valid are the benefits of integration in terms of a lessening of conflict situations, greater resilience to external shocks and joint exploitation of opportunities in the global economy. Much the same holds regarding the need for collective action to deal with the challenges of climate change and the governance of shared natural resources.

The rise of value chains in the global economy has brought renewed attention to the centrality of the regional space. The fact is that the main global production networks are structured around specific regions, and this is largely because of the importance of geographical proximity when it comes to organizing production processes that are fragmented between a number of countries. Nonetheless, the experience of North America, East Asia and Europe reveals that proximity is a necessary but not sufficient condition for the development of modern production networks. These are characterized by complex flows of goods, investment, services, information and people. This means that there is a need to move towards common legal frameworks that encourage firms from each country to link up their operations with those of others beyond their borders. Just as important are explicit policies to support productive integration and an adequate transport, logistics, energy and telecommunications infrastructure. In the absence of these things, productive integration becomes an aspiration rather than a reality.

The present document has been prepared in the light of these considerations and is intended to stimulate thinking about regional integration. The aim is not to cover all spheres of integration or to take stock of the various efforts made in this area. The document focuses specifically on the need for greater regional production linkages at a moment in history when technological innovation has been accelerating, the relative weights of the different actors in the world economy have been reconfigured and there has been a trend towards the formation of enlarged regional markets.

It is in this context that the importance and topicality of the integrationist challenge is being reasserted. It is unlikely that the region can achieve sustainable growth, while reducing poverty and inequality and progressing with innovation, without diversifying its production and export structure. This will obviously require improvements in the quality of its position in the international economy, which in turn will mean a major commitment to education and training quality. This will unquestionably be a complex and drawn-out effort, but it is even harder to imagine that any country could manage it in isolation, particularly given the trend towards the creation of megamarkets and value chains with a wide geographical reach.

In summary, the current outlook makes integration more topical than ever as a basic component of production transformation and strategies for growth with equality, since the structural change that production transformation entails is closely tied to the opportunities offered by regional integration. In fact, the figures show that the potential for manufacturing trade, intra-industry trade, SME internationalization and increases in the number of exporting firms and the quantity of goods exported is closely linked to the prospects for the regional market. If these prospects were enhanced by explicit policies to support this type of trade, with subregional and regional value chain options being explored, the possibilities described could become promising realities. In the light of these considerations, the present document places the emphasis on the scope for implementing joint actions on innovation, technology diffusion and measures to close the digital divide; on support for the development of clusters and internationally competitive and environmentally sustainable value chains; and on regional or subregional initiatives to increase the presence of firms and technology centres from the region in global knowledge and technology networks. All this with the goal of constructing dynamic comparative advantages that can enable the region to renew its position in a global economy that is undergoing profound restructuring and is increasingly centred around the activity of the Pacific countries.

Production transformation is bound up, first, with an education for the twenty-first century and, second, with smart international integration. Such an education would enable more knowledge to be embedded in the production structure, increasing the scope for it to become more integrated via export diversification. In this context, enlarged regional markets, legal certainty and gradual convergence of regulatory standards and disciplines, combined with progress in creating regional public goods such as infrastructure, energy and connectivity, are now prerequisites for growth with greater equality.

Integration would benefit from a closer relationship with the business sector, involving coordination mechanisms in specific spheres. This does not reduce the scope of public policies. Rather, it means that market and government failures can be better addressed by enhancing coordination, dealing with information asymmetries and putting the conditions in place for the necessary public-private partnership, all decisive factors in the most advanced integration efforts.

In the mid-2010s, having reconnected with democracy, the region can point to a considerable macroeconomic learning process, a remarkable reduction in poverty (as a result of higher growth, greater access to consumption for large sections of society and a deeper commitment to targeted social policies), better wages and employment quality and even, in a number of cases, improved income distribution. Nonetheless, these substantial achievements are quickly translating into political pressure, since the millions of Latin Americans exiting poverty are rapidly, and quite legitimately, raising their aspirations. This is manifested in greater demand for public goods (education, health services, public transport, urban security), in intolerance of corruption and in growing demands for transparency and greater representativeness and inclusiveness in the political system. These demands, together with the importance of preserving high economic growth and macroeconomic stability, highlight the need to improve income distribution and reduce inequalities.

Once this point is reached, targeted social policies start to show their limitations as a tool for addressing the demands of middle-income sectors. These demands quickly lead to efforts being focused on the quality of the production and employment structure and the evolution of productivity, since they relate to wage trends, productivity dispersion and, ultimately, functional income distribution. Hence the importance of the link with integration since, as will be explained later, this transformation of the employment structure can hardly be attempted without the impetus the regional market can give to production and export diversification.

These strains on the political and institutional fabric, which are not far removed from those seen in industrialized economies, have not, however, prevented the region from being perceived as more self-confident, with greater autonomy to decide on its strategic orientation and its main international partnerships. It is true that, in the short term, these expectations are threatened by a slight deterioration in external factors. Nonetheless, the region is in a position to cope with them without jeopardizing its favourable medium-term prospects. Thus, it is unsurprising that in an international situation where growth in the industrialized economies will remain below its long-term trend, there should be renewed interest from the United States, the European Union and China in initiatives to improve economic, trade and investment ties with Latin America and the Caribbean or particular countries in the region.

The important thing is for the region to be able to develop its own diagnosis and vision for the future, with a shared narrative that interweaves the role it aspires to play on the world stage, the type of dialogue it wishes to have with the United States, the European Union, China and the rest of Asia, and the input it wishes to bring to the debate about the main issues on the global agenda. This narrative obviously needs to assign a substantive role to regional integration, and marked shortcomings in this area will continue to constrain the region's scope for concerted action over issues on the global agenda.

This document is organized into seven chapters. Chapter I summarizes some of the main changes in the political economy of regional integration in Latin America and the Caribbean over the past decade. The next two chapters analyse the international economic context that will provide the setting for the region's integration efforts, both in the immediate future (chapter II) and in the medium term (chapter III). Chapter IV argues that the shifts now under way in the world economy are reinforcing the relevance of regional integration in Latin America and the Caribbean. Chapter V presents recommendations for different areas of integration, structured in each case around the goal of increasing production linkages. Chapter VI addresses the specific challenges to integration in the Caribbean, given the peculiarities of that subregion. Lastly, chapter VII concludes by offering ten recommendations for regional integration.

Chapter I

THE EVOLVING POLITICAL ECONOMY OF REGIONAL INTEGRATION

The dynamics and emphasis of regional integration in Latin America and the Caribbean (understood as the formal, i.e. government-led type) have changed greatly in the past decade. A number of factors have been involved. First, the social discontent that the results of the liberal-leaning reforms of the 1990s gave rise to in several of the region's countries led to the arrival in power of political coalitions with different priorities from those that had preceded them. These priorities were transferred to ideas about integration. While there are obviously shades of opinion, a number of the governments that have come to power in the region in the past few years share a critical attitude to the trade opening undertaken since the 1980s and to the emphasis on trade that they consider to have characterized integration projects in the 1990s. These governments have sought to extend the integration agenda to other areas, laying particular stress, at least in their public positions, on the political and social dimensions.

A second factor influencing the evolution of regional integration in recent years has been the global financial crisis that began in September 2008, the repercussions of which are still being strongly felt, especially in the industrialized economies. The scale of the crisis —the greatest since the 1930s— has been such that serious doubt has been cast over a number of conceptions characterizing the globalization process since the 1980s, such as the primacy of financial markets, self-regulation and the pared-down State. As a result, the intellectual influence of these ideas has been sharply reduced. At the same time, there has been a revival of more heterodox approaches that give a prominent role to the State, not just as regulator but also as coordinator of active industrial policies. The impressive economic achievements of China and other Asian economies, arrived at by policies that bear no resemblance to the orthodoxy, have also contributed to this renewal of thinking about development and integration.

The third factor is the rise of China in the world economy, which has not only altered the region's traditional trade patterns greatly, but has also exerted an indirect influence on its integration efforts. Whereas at the start of this century China took 1% of the region's exports and was the source of less than 2% of its imports, by 2012 these shares had reached 9% and 14%, respectively. At the same time, although the United States is still the region's main trading partner, this position has been eroded. Between 2000 and 2012, its share of the region's exports dropped from 60% to 40% and its share of the region's imports from 50% to 31%. China has been particularly important as a trading partner for the raw material-exporting countries of South America, and is now the largest or second-largest export market for some. The improved terms of trade and reserves build-ups resulting from high raw material prices during most of the period from 2003 to 2011 reduced the external vulnerability of the South American countries. For some of them, China has also become one of the main sources of external funding. The reduction in external vulnerability and in trade and financial dependence on the United States has given South America increasing political autonomy, and this extends to the formulation of its integration strategies.

The combination of these and other factors has meant that in the past decade the region has enjoyed considerable and almost unprecedented autonomy to explore new political, economic and social approaches. The good economic and social outcomes of the period from 2003 to 2011 strengthened this trend. This has naturally been reflected in the sphere of integration. For one thing, the regional integration architecture has become considerably denser and more complex with the creation of the Community of Latin American and Caribbean States (CELAC), the Union of South American Nations (UNASUR), the Bolivarian Alliance for the Peoples of Our America - Peoples' Trade Treaty (ALBA-TCP) and the Pacific Alliance. For another,

the region's traditional integration schemes, which were established in a different historical context and are heavily skewed towards trade, are facing major challenges and in some cases transformations whose outcome it is not yet possible to predict. In this constantly evolving context, membership of multiple blocs is becoming increasingly common, while the new groupings that have arisen over the past decade are still trying to define their respective spheres of action.

These processes have not operated equally strongly everywhere in the region. In particular, the dynamic in Mexico, Central America and the Caribbean differs sharply from those in South America. For obvious geographical reasons, countries in the first group retain strong links to the United States economy, not only through trade but also through flows of foreign direct investment (FDI), migrants, tourists and remittances. In particular, the Mesoamerican subregion and some Caribbean countries are an integral part of manufacturing value chains centred on the United States. These links are given institutional expression in the North American Free Trade Agreement (NAFTA) and the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR), recently joined by the Mexico-Central America Free Trade Agreement, which is heavily influenced by the NAFTA model. In short, the course followed by economic integration in this subregion has been heavily determined by geography, and in particular the strong pull exerted by the United States.

South America is less economically dependent on the United States than are the Central American and Caribbean countries, and has strengthening links with China and other developing countries and regions. Another difference from the Mesoamerica area is that South America has lower levels of intraregional trade and productive integration between its economies. This is the outcome of numerous factors, such as its export specialization in natural resources (most of which go to markets outside the region), its great geographical extent, its inadequate transport infrastructure and the fragmentation of its economic integration schemes. Recognition of these and other specific features of the South America subregion underlay the 2004 creation of the South American Community of Nations, which has now become UNASUR.

Notwithstanding the differences between the processes described, some integration groupings created in the last decade are seeking to move beyond the subregional logic, defining membership by other criteria. This is the case with ALBA-TCP and the Pacific Alliance. In both initiatives, the main forces for cohesion are the similar policy stances of the member countries' governments, a criterion supplemented in the case of the Pacific Alliance by the possession of a Pacific seaboard. CELAC, meanwhile, is trying to position itself as the main coordinating forum for an agenda of regionwide relevance. In the few years that have passed since its creation, CELAC has received strong backing from major actors beyond the region, specifically China and the European Union. In fact, CELAC was identified by the then Chinese Premier Wen Jiabao as the natural partner for progress on the wide-ranging cooperation agenda he proposed to the region in June 2012. Similarly, the first Summit of Heads of State and Government of CELAC and the European Union was held in Santiago, Chile in January 2013 and approved a biregional plan for the period from 2013 to 2015.

The region's financial architecture has also become more complex over the last decade, with the creation of new initiatives such as the Bank of the South and ALBA Bank, which have joined existing institutions such as the Development Bank of Latin America (CAF), the Central American Bank for Economic Integration (CABEI), the Caribbean Development Bank (CARIBANK), the Financial Fund for the Development of the River Plate Basin (FONPLATA) and the Latin American Reserve Fund (FLAR). New functional cooperation bodies have also arisen, including PETROCARIBE in the area of energy security, and the Initiative for the Integration of Regional Infrastructure in South America (IIRSA) and the Mesoamerican Integration and Development Project in the area of infrastructure development. The purpose of all these cooperation and integration mechanisms is to provide important regional public goods such as financial stability and appropriate regional transport and energy infrastructure.

In short, integration appears to be on the upsurge in the region at present, at least if the proliferation of new initiatives is the yardstick. Paralleling this is growing de facto integration, reflected in increasing investment, migration and tourist flows. Rarely have the concepts of regional integration and cooperation come up as often in public speeches as in the last few years. However, it must be recognized that the gap between words and deeds does not seem to have narrowed much. For one thing, there must be a risk that the constant creation of new initiatives, some of them institutionally fragile, will result in a dispersal of efforts. For another, some alignments are being driven by political affinities (by definition transitory) and divisions between the region's Atlantic and Pacific seaboard. None of these situations accords with the exigencies of today's world or the character that integration should have as a policy of State.

Where production integration is specifically concerned, there is also a large gap between discourse and reality. All the region's governments have identified the strengthening of production linkages between the economies of Latin America and the Caribbean as a priority goal of regional integration. Consequently, all economic integration mechanisms have placed this high on their working agendas. While this is positive, the region (and particularly South America) remains largely outside the global trend towards rising trade through multinational value chains. The reasons for this are numerous and complex, and include, among others, factors such as the lack of production diversification in some economies and the region's well-known shortcomings in transport, logistics, communications and energy infrastructure. It would therefore be unfair to attribute this failing solely to deficiencies in the region's current economic integration mechanisms and agreements. Nonetheless, as the following chapters argue, a renewed integration agenda can help both to create a more propitious environment for the emergence of intraregional production linkages and to gradually deal with the infrastructure deficiencies that make it hard for such linkages to be established.

Chapter II

A COMPLEX GLOBAL ECONOMIC ENVIRONMENT

The current debate on the trends and outlook for the integration processes under way in Latin America and the Caribbean is taking place amid major transformations in the world economy, whose main implications cannot be ignored. For example, all prospective studies suggest that within the next two decades China will become the leading world economy, followed by the United States and by major developing economies such as India, Brazil, Mexico and Indonesia. Japan and the European economies will relinquish their position of economic dominance to the new actors from the developing world. This unprecedented process of convergence will take no more than 20 or 30 years so that those now entering the workforce will experience it first-hand. This process coincides with astounding technological changes and with the urgent need to address the threat of climate change, notably through measures to promote non-conventional renewable energies and energy efficiency. These determining features of the global scenario in the coming decades will coincide with new challenges linked to the demographic shift, increasing urbanization and the expansion of the middle class in the developing world. Prior to an analysis of some of these structural transformations, this chapter looks at the global economic context in which the region will evolve during the remainder of the current decade.

Six years after the outbreak of the 2008-2009 financial crisis, there is confirmation of new international trends: slower growth in the emerging economies, rising interest rates, flat commodity prices and more volatile economic variables. In 2008, when the fast-paced global growth of the previous five years (of around 5% per year) proved unsustainable, a financial crisis was unleashed in the United States and subsequently in the eurozone. The latter then entered a prolonged recession from which it is only just emerging. As a result, Europe's integration has been called into question and its post-war social compact has been undermined. While United States looks healthier in terms of its economic scenario, it continues to perform below potential and its unemployment rate remains relatively high. In addition, its Congress is facing difficulties in finding long-term solutions to the fiscal deficit and the high public debt, which will hamper growth in the United States economy for the rest of the decade. Although the fiscal deficits have been declining, population ageing, coupled with rising interest rates, over the rest of the decade will exert upward pressure on the national debt-to-GDP ratio (Feldstein, 2013).

The advanced countries and the emerging economies performed very differently in the immediate aftermath of the crisis. While the advanced countries recorded flat or sluggish growth, the emerging economies managed to maintain significant growth in 2010 and 2011. In both groups, authorities deployed monetary fiscal stimulus measures to mitigate the impact of the crisis. By contrast, in 2012, the emerging markets experienced a slowdown amid heightened volatility, while the advanced economies started to pick up. This new pattern will probably continue through to the end of the decade.

A. MODEST GROWTH IN THE DEVELOPED COUNTRIES

By mid-2013, four years after recovery from the financial and economic crisis began, most of the developed countries were showing stronger growth. Nevertheless, the world's three largest developed economies are traversing a period of major structural changes, such that their performance has yet to regain pre-crisis levels. What is more, these transformations require complex, fine-tuned policies whose outcomes are uncertain and will have ramifications for other countries given the interdependence of global actors.

In the case of the United States, much of the economic recovery is attributable to the Federal Reserve's quantitative easing policy, under which assets were purchased to stimulate private activity by reducing interest rates and offering loan incentives. Various trends point to a consolidation of this recovery in 2014. Consumption should increase as the housing price rally and stock exchange gains leave households better off. Moreover, the fall in unemployment and broader credit access, together with the Federal Reserve's announcement that it will maintain the interbank interest rate at close to zero at least until 2015, will help to encourage consumption and private investment. On the external front, exports will continue to be a major driver of growth, outpacing imports.

Growth in the United States is projected to rise from 1.9% in 2013 to 2.8% in 2014, largely thanks to the budget deal reached at the end of 2013, which eased fiscal pressures. The corollary of this is that fiscal policy will tighten in 2015, since most of the fiscal cuts will be carried over into that year (as, contrary to earlier projections, they will not be reversed).

Slowly and at differential rates depending on the country, the eurozone has been moving out of negative growth towards modest expansion. In the course of 2013, the region emerged from a recession that had lasted six quarters, but growth remains lacklustre. According to preliminary estimates, eurozone GDP contracted by 0.4% in 2013, while output for the European Union as a whole grew by 0.1% (EUROSTAT, 2014). The main reasons for these paltry results are the fiscal austerity programmes and high unemployment, which have stifled domestic demand.

In 2014, growth in the eurozone could average 1.2%, with France, Italy and Spain performing below this rate and with only Cyprus still in recession. The slightly brighter growth outlook in 2014 may be attributed to a number of factors. The lower pressure from fiscal cuts, following the agreement between the European Commission and some member States to extend the fiscal adjustment period, is a good sign. Similarly, the introduction of the Outright Monetary Transactions Programme (OMT)¹ has reduced the risk premiums on default swaps and the outflow of capital from the peripheral countries in the monetary bloc. In these economies, the situation is improving thanks to deleveraging of the private sector and expanding exports.

Recovery in the European countries is slow, uneven and unbalanced, with unemployment at socially unsustainable levels. Of the 17 economies that made up the eurozone in 2013, only Germany, France, Belgium, Austria, Latvia, Luxembourg, Slovakia, Estonia and Malta managed to avoid recession that year and only the last five produced growth of more than 0.5%. The environment in Europe shows the after-effects of a long and deep recession, which has constrained growth potential and hampered efforts to solve the financial weaknesses. The cumulative effects of an extraordinary and prolonged monetary stimulus programme, which had little impact in terms of economic growth, places further constraints on the recovery, in addition to the threat of a rise in inflation and, hence, greater difficulties in servicing the heavy debt burden.

The weakness of the eurozone banking sector remains a major threat. An Asset Quality Review (AQR) and stress tests should be implemented rigorously along with recapitalization of banks, where necessary. Without far-reaching and complex reforms in this direction, the financial situation will remain fragile and monetary policy will be hard placed to revive credit and investment.

Japan, for its part, is emerging from two decades of deflation and stagnation. Its recovery gained momentum in 2013, thanks to a rise in exports, following a massive depreciation of the yen and an upturn in consumption and private investment, as household and business confidence strengthened. This economic upswing has a markedly Keynesian bias, as it was preceded by strong fiscal and monetary stimulus (the latter consisting of a doubling of the money supply) and the announcement of a series of structural reforms, which include incentives for investment, privatization of part of the country's infrastructure, restructuring of the energy sector and measures to facilitate business start-ups. In any event, most of these reforms are yet to be implemented.

¹ This programme allows the European Central Bank to purchase debt from countries facing financial constraints through transactions in secondary markets.

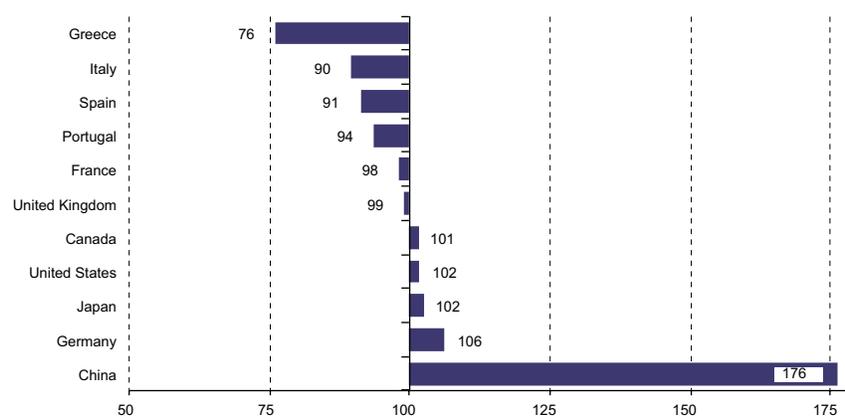
The advanced economies have not yet consolidated their recovery. In the case of the United States, one of the challenges is how to synchronize the winding down of the quantitative easing programme. A premature exit could hamper economic recovery, while a late exit could cause major financial losses and turmoil on international financial markets. Another challenge is fiscal consolidation to stabilize the public debt ratio at a time when public health and education costs are climbing relentlessly.

In the eurozone, although the fiscal consolidation has largely been achieved, the adjustment must be maintained in order to bring down the high levels of public debt in several countries. Consumption will remain depressed by high unemployment, low income growth and credit constraints in some economies. The future scenario could also be complicated by the failure to consolidate a banking union (indispensable for reducing States' exposure to banking crises), by tight credit access owing to insufficient liquidity, and by the lack of growth-boosting reforms and initiatives. In addition, the sharp slowing of inflation towards the end of 2013 is proof that, amid sluggish economic activity, deflation is a real risk.

In the case of Japan, while the substantial depreciation of the yen has shored up exports, it has also made imports more expensive—and Japan is heavily reliant on energy imports. This explains at least in part the increase in the trade deficit in 2013. There is a gaping fiscal deficit and, in GDP terms, public debt—the highest in the developed world—is continuing to grow. A tightening of fiscal policy in 2014 (with the scheduled increase in the consumption tax rate) could again cool the economy. Implementing the planned structural reforms needed to consolidate growth and counteract deflationary pressure poses a further challenge.

The weakness of the recovery in the three largest developed economies is reflected in the labour market. At the end of 2013, none of them had regained the employment levels of 2008, the year when the crisis broke out. Unemployment rates both in the United States and in the European Union are above pre-crisis levels. According to forecasts by the International Monetary Fund (IMF), in 2014 per capita GDP (measured in constant national currency) will be even lower than in 2007 in several of the southern European economies, and only slightly higher than the 2007 figure in Canada, Germany, Japan and the United States. This contrasts sharply with the almost 80% expansion in per capita GDP predicted for China for the same period (see figure II.1).

Figure II.1
UNITED STATES, CHINA, JAPAN, CANADA AND THE EUROPEAN UNION (SELECTED COUNTRIES): VARIATION IN PER CAPITA GDP, 2007-2014^a
(Index: 2007 = 100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), World Economic Outlook. An Update of the Key WEO Projections, Washington, D.C., 9 July 2013 [online] <https://www.imf.org/external/pubs/ft/weo/2013/update/02/pdf/0713.pdf>.

^a The data for 2014 are projections.

B. SLOWDOWN IN THE EMERGING ECONOMIES

Up to 2011, growth in the emerging economies far exceeded that of the advanced countries. Although the emerging economies are still growing faster, their lead has shortened and their relative contribution to global economic growth has accordingly fallen. This situation is expected to continue for the next five years or so, with the emerging economies growing by about 5.3% and the developed countries by around 2.3% (see table II.1).

Table II.1
WORLD, REGIONS AND SELECTED COUNTRIES: GDP GROWTH, ANNUAL AVERAGES
ON THE BASIS OF CONSTANT VALUES, 2003-2007, 2008-2009, 2010-2013, 2014-2019
(Percentages)

| Country/Region | 2003-2007 | 2008-2009 | 2010-2013 | 2014-2019 ^a |
|---|-----------|-----------|-----------|------------------------|
| World | 4.8 | 1.1 | 3.8 | 3.9 |
| Developed economies | 2.7 | -1.7 | 1.9 | 2.3 |
| United States | 2.9 | -1.5 | 2.3 | 2.7 |
| Japan | 1.8 | -3.3 | 1.8 | 1.0 |
| Eurozone | 2.2 | -2.0 | 0.6 | 1.5 |
| Emerging and other developing countries | 7.7 | 4.4 | 5.9 | 5.3 |
| Latin America and the Caribbean | 4.8 | 1.4 | 4.1 | 3.2 |
| Developing Asia | 9.7 | 7.4 | 7.7 | 6.6 |
| Middle East and North Africa | 6.9 | 4.1 | 3.9 | 4.3 |
| Sub-Saharan Africa | 6.3 | 4.2 | 5.2 | 5.5 |

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the International Monetary Fund (IMF), World Economic Outlook Database, April 2014.

^a Average annual growth forecast for the period.

The developing countries' growth figure for 2013 was 3 percentage points down on 2010, with three quarters of this reduction due to a slowdown in the BRICS (Brazil, the Russian Federation, India, China and the Republic of South Africa), especially in China and India. The slowdown is attributable to both cyclical and structural factors. The cyclical factors include flagging international demand, flat commodity prices, the withdrawal of fiscal and monetary stimulus measures (both in the United States and in the developing countries themselves) and rising interest rates. The structural factors, which are of particular relevance for China and the Russian Federation, are linked to the exhaustion of the existing growth model (IMF, 2013). In the case of China, these factors include overcapacity and low returns on investment—arising from extraordinarily high capital accumulation rates—and demographic trends which will produce a decline in the labour force as of 2014. In the Russian Federation, growth potential is constrained by bottlenecks in infrastructure and in use of idle capacity.

After cruising at close to or over 10% for several years, growth in the Chinese economy moderated in 2012 to stand at around 7.7% in the past biennium. Essentially, this reflected slacker growth in investment in infrastructure, real estate and installations and manufacturing machinery. The slowdown in gross fixed capital formation, which normally accounts for close to half of GDP, is dragging down the pace of economic growth. Underlying the more sluggish investment growth are the loss of momentum in exports—due to weak external demand—overcapacity and a more modest increase in extrabudgetary credits granted to local governments for miscellaneous investments.

With the loss of momentum in investment and in the export sector, the greatest challenge for China is to redirect the growth model towards private consumption. The objective of the authorities is to achieve more

balanced and sustainable growth and to reverse the trend of recent years, which consisted in reducing the share of consumption in GDP and in increasing the contribution of investment (thanks mainly to the strong public stimulus following the financial crisis). Increasing domestic consumption will be an unprecedented challenge for the Chinese economy, which has traditionally been investment- and export-driven. In particular, higher consumption requires workers to save less. In the absence of a properly constituted social protection network, this is a difficult proposition, inasmuch as saving is crucial for financing expenditure on education, health and pensions, areas in which coverage by the public system is inadequate. Other challenges for China have to do with its high public debt (mainly at the local government level) and reducing the impact of economic growth on the environment.

First quarter signs in 2014 point to slowing growth in the emerging economies. Underlying these symptoms are the United States Federal Reserve's announcement of the gradual withdrawal of quantitative easing² and the expected impact of this on interest rates; the great threat to the global economy of the United States' legislative disputes relating to the public debt ceiling; China's cooling in and the resulting softening of commodity prices; and concerns over certain weaknesses in the emerging economies. The situation in the first quarter of 2014 was compounded by political upheaval in the Bolivarian Republic of Venezuela, Thailand, Turkey and Ukraine as well as by the heavy devaluation in Argentina.

Tighter external financial conditions in terms of amounts and rates and more sluggish international trade flows than in the past will lead to closer monitoring of the evolution of external disequilibria in emerging and developing economies. The general conclusion is that in the aftermath of the crisis, the high growth recorded by several of these economies was over-reliant on the favourable external climate. Now, the slowdown in China and the Federal Reserve's announcement have complicated emerging economies' access to external flows and laid bare certain vulnerabilities resulting from over-expansionary cycles of credit and monetary and fiscal stances. Be that as it may, none of these emerging economies faces a serious risk with respect to its balance of payments, banking system or sovereign debt. Their international reserves are relatively high, their banking systems sound, their debt showing low insolvency risk and their exchange rates flexible; all of these factors act as a buffer against harsher external conditions.

In short, developing countries are facing a less favourable international context than during much of the past decade, when commodity prices were high, interest rates low, and external financing readily available. Nevertheless, these economies are a very mixed group and the type of difficulty they face differs depending on variables such as their production structure, export mix and external account vulnerability.

C. SLUGGISH WORLD TRADE

World trade was particularly muted in 2012 and 2013. After rebounding strongly from the crisis, growth in global trade volumes slowed to 5.4% in 2011, to just 2.3% in 2012 and to 2.1% in 2013 (WTO, 2014). Thus, 2013 was the second year in a row in which global trade and GDP (measured in current dollars) grew at much the same rate, breaking the pattern observed since the start of the 1990s, when growth in world trade almost doubled that of GDP.

² The Federal Reserve's initial announcement in May 2013 that it would be scaling back its asset purchases triggered significant devaluations in all the BRICS (except China), as well as in Indonesia, Mexico and Turkey. Following this announcement, the Federal Reserve has been reducing the stimulus by US\$ 20 billion per month, which has pushed up long-term interest rates in the United States. This effect, together with stronger growth in the United States and the emergence from recession by a number of countries in the European Union, detracts from the relative appeal of the emerging economies, undermining their chances of receiving external financing.

The recent sluggishness in world trade largely reflects lacklustre demand for imports in most of the advanced economies, particularly in the eurozone. In a world increasingly integrated into value chains, feeble demand from Europe undermined the exports and imports of several of the developing countries; these fell by about 2% between the second and fourth quarter of 2013. Against this backdrop, China overtook the United States to become the country with the highest level of trade (goods exports plus imports) in 2013.

Revised World Trade Organization (WTO) forecasts point to a recovery of momentum in world trade in 2014, with a predicted expansion of 4.7%. Nevertheless, this figure is still short of the 5.3% annual average posted between 1993 and 2013. According to WTO, some risk factors for world trade have receded somewhat in recent months, including the sovereign debt crisis in Europe and uncertainty over debt-ceiling negotiations in the United States. Conversely, there are some risks associated with the developing economies, including large current account deficits in countries such as India and Turkey, foreign-exchange problems in Argentina, and China's overinvestment in production capacity and over-reliance on external demand. Overall, WTO predicts a slight uptick in global trade to 5.3% in 2015 (WTO, 2014).

D. IMPACT OF THE GLOBAL SITUATION ON LATIN AMERICA AND THE CARIBBEAN

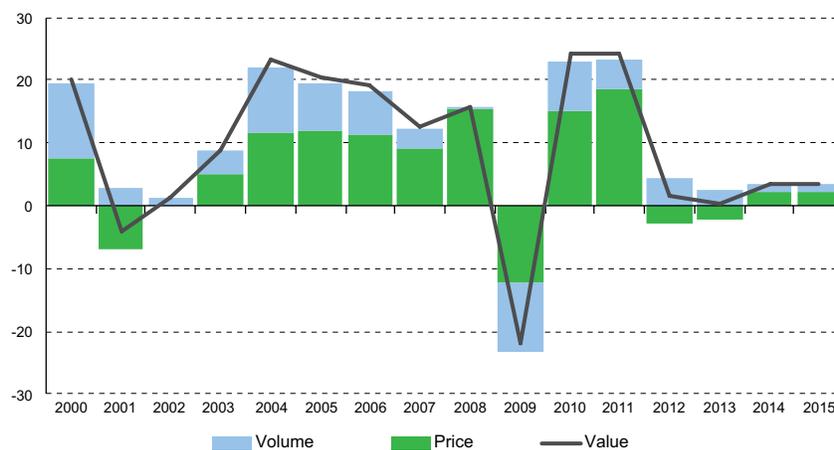
In 2013, GDP growth slowed for the second year running in Latin America and the Caribbean, to just 2.5%, down from 3.1% in 2012 and over 4% per year between 2003 and 2007 and again in the biennium 2010-2011. Regardless, in decade of the 2000s, the region has shown a persistently lower growth rate than the rest of the developing economies (see table II.1).

Regional growth in 2013 was driven mainly by sustained domestic demand and above all by consumption, which contributed 2.8 percentage points to GDP growth, compared with 0.9 percentage points from investment. Exports made a negative contribution (-0.8 percentage points). With only a modest upturn in demand in the main developed economies, the value of exports from the region stagnated in 2013. This came after low growth (1.6%) in regional exports in 2012 (see figure II.2). In 2013, the fall in prices (-2.1%) had a negative impact on the value of exports, while the volume increased (by 1.9%). In the same year, the value of imports was up by 3.5%, mainly as a result of higher volumes. The slowdown in exports, coupled with robust domestic demand in most of the countries of the region, has been reflected in recent years in imports rising faster than exports in value terms. Consequently, the regional surplus on the merchandise trade balance contracted significantly, from 0.9% of GDP in 2012 to 0.3% in 2013 (ECLAC, 2014).

The less buoyant economic activity heralds the end of an extremely favourable trade and financial cycle in the region, particularly where South America is concerned. This cycle was characterized by high commodity prices, trade surpluses, low interest rates and a period of reserves build-up in most of the countries, especially in South America. Thus, between 2004 and 2011, terms-of-trade gains driven by high raw material prices accounted for a substantial part of the expansion in gross national income (see figure II.3).

The external situation now appears less favourable for the region, with several latent risks. One of these the slowdown in the consumption of commodities, especially by China, in view of its cooling economy and the expected shift in its growth pattern, which will likely be reflected in a gradual change in its import basket. This lower demand will affect the region's commodity exports, which, though they will remain high in the coming years, will not regain their 2008-2010 peaks (especially in the case of minerals and metals). Accordingly, the current account position has deteriorated in the great majority of the region's economies, in some cases quite drastically (see figure II.4).

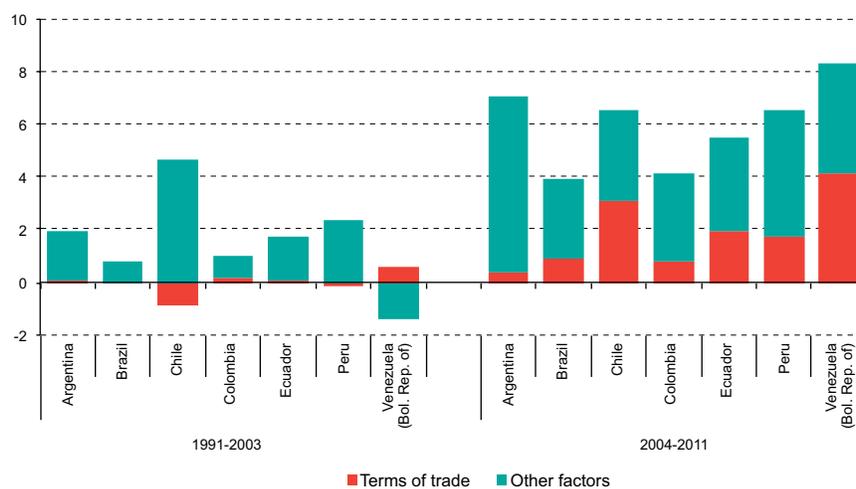
Figure II.2
LATIN AMERICA AND THE CARIBBEAN: ANNUAL VARIATION IN GOODS EXPORTS, 2000-2015^a
(Percentages)



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

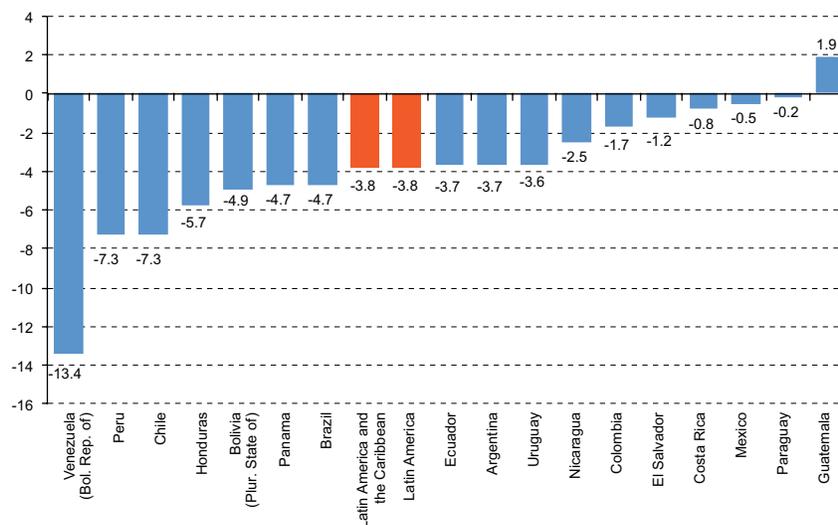
^a The figures for 2014 and 2015 are projections.

Figure II.3
LATIN AMERICA (SELECTED COUNTRIES): BREAKDOWN OF AVERAGE VARIATION IN GROSS NATIONAL INCOME, 1991-2003 AND 2004-2011
(Percentage points)



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

Figure II.4
LATIN AMERICA AND THE CARIBBEAN AND SELECTED COUNTRIES: VARIATION IN THE AVERAGE BALANCE-OF-PAYMENTS CURRENT ACCOUNT DEFICIT, 2005-2006 TO 2013-2014^a
(Percentage points of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of the International Monetary Fund, *World Economic Outlook Database*, October 2013 [online] <http://www.imf.org/external/pubs/ft/weo/2013/02/weodata/index.aspx>.

^a The average for 2013-2014 is an estimate.

In the medium term, the upturn in the industrialized economies should boost exports of goods and services and the inflow of remittances. However, strong domestic demand in the region, associated mainly with consumption expenditure, could mean that imports could grow faster than exports (this is already occurring in the case of goods), which would steadily erode the region's trade balance and current account. This pattern is an indicator of external vulnerability, worsened by the probability that a rise in global interest rates—triggered by the withdrawal of monetary stimulus in the United States—will push up the financial cost of covering the gap.³

Another pattern evident in the region is that reserves accumulation has flatlined. Following a decade of double-digit growth, international reserves in the region as a whole remained virtually unchanged in 2013. At the same time, net FDI flows are forecast to hold steady or slow down slightly, mainly on the expectation of slacker global commodities demand. At the same time, lower international liquidity following phased monetary stimulus withdrawal in the United States starting in 2014, could bring down portfolio investment flows and trigger fresh capital outflows. The likely higher cost of external resources, coupled with currency depreciation and exchange-rate volatility, could deter some private agents in the region from seeking financing on international markets.

³ In fact, as expectations concerning interest rates in the United States between May and July 2013 changed, the spread between the yield of the region's external bonds and that of United States Treasury bonds—a proxy for country risk—widened.

E. SUMMARY

World growth is projected to stand at 3.6% in 2014, above the 2013 level of 3%. Activity picked up in the second half of 2013 on the back of demand in the industrialized economies, and this spurred exports from the emerging economies. Financial conditions also improved in the advanced economies insofar as the multiplier effect of fiscal consolidation seems to have largely taken hold.

Nevertheless, global growth remains lacklustre and expectations subdued. The industrialized economies will continue to perform beneath their potential: the deleveraging of households, banks and most non-financial enterprises will continue, while the high fiscal deficits and steep public debt burdens will continue to hamper growth. The risk of a prolonged stagnation in the advanced economies, which could damage productivity through disinvestment in physical and human capital, is thus a further concern (Roubini, 2014). The fragility of the emerging economies hinges to a great extent on China's progress with its economic reforms. To date, the figures appear to indicate that it is not easy to change China's growth pattern and that the task will take several years. Furthermore, China is carrying worrisome levels of public and private debt, as reflected in its large shadow banking sector and difficulties in deflating the real estate bubble in the main cities.

The general picture in the global economy in 2014 is thus one of modest, gradual upturn in the advanced economies and fragilities in the emerging economies, which could bring some surprises if they are not duly addressed. The emerging countries most at risk are likely to be those that have relied most on short-term capital flows or where credit and consumption have overexpanded in relation to the economy's potential. These countries will face harsher external financing conditions, smaller capital inflows and narrower room for growth. Currency devaluations could help to cushion the impact of these external shocks, promoting competitiveness and equilibrium on the external accounts, as long as the potential inflationary effect of devaluation is countered by an appropriate monetary and fiscal policy mix. Nevertheless, the final outcome will depend on macroeconomic conditions in each economy. It is increasingly necessary, as well, to back up these policies with measures to support the financial system stability and strengthen macroprudential regulation.

The precise mix of policies in each economy will depend on the GDP-expenditure gap, inflationary pressures, the fiscal and public debt margin and the external balance, as well as on each economy's institutional memory. In any event, 2014 should not be too complicated a year for emerging and developing economies. The United States and the European Union will post more robust growth than in 2013; Japan, China and the rest of Asia will maintain or increase their growth rate; international trade will gather strength; and systemic or major risks should diminish.

Economic policymakers in the region in 2014 should therefore exert particular caution, in view of increased financial volatility and the complexity of certain geopolitical events. To this should be added the tapering-off of quantitative easing and the fiscal cuts in the United States and the need to maintain a watching brief regarding the economic reforms under way in China, in particular with respect to the public debt and shadow banking⁴ and the effects these factors combined may have on the main emerging economies.

In this new, more restrictive context, the next five years will place greater demands on the countries of Latin America and the Caribbean in terms of macroeconomic management, with less leeway in the fiscal and current accounts and more tenuous growth. The new scenario poses a threefold challenge for the region: maintaining levels of saving, increasing investment and, above all, boosting productivity. Without greater efforts to increase innovation and productivity and to modernize industrial policy, growth in the region will

⁴ The relevant data for January 2014 are worrying. They show the largest credit expansion in four years, almost triple the level of December 2013. Given the lag with which monetary policy takes effect, growth is likely to remain strong in 2014 and to remain over-reliant on borrowing. In fact, levels of public and private debt grew from 130% of GDP in 2008 to 210% in 2013 (Rabinovitch, 2014).

hover at around 3% or 4%, which is clearly too little to support progress regarding the challenges at hand. If it is to achieve greater equality, the region must increase its productivity, close its infrastructure gaps and afford more importance to developing the regional market. It also needs to become more integrated and to put in place public policies on trade facilitation and on support for SMEs. This point will be examined further in chapters IV and V.

F. A MEDIUM-TERM PERSPECTIVE ON THE INTERNATIONAL ECONOMIC SITUATION

Almost six years after the international financial crisis broke out, it has not yet been fully overcome nor its underlying causes effectively addressed. The future scenario is thus marked by much uncertainty and high financial volatility, and fresh episodes that could damage industrialized and emerging economies alike cannot be ruled out. The persistence of this climate of uncertainty in the global economy is due to a number of factors, the most important of which are discussed below.

1. High public indebtedness in the industrialized economies

After the outbreak of the subprime crisis in September 2008, the recession in the United States spread to the eurozone, Japan, the United Kingdom, Canada, Latin America and the Caribbean, Central and Eastern Europe and the Commonwealth of Independent States, sparing only the economies of developing Asia and most of the African countries. Thanks to their coordinated action, consisting of massive countercyclical programmes and a collective commitment to avoid protectionist measures, the Group of Twenty (G-20) succeeded in warding off a great depression such as that of the 1930s. Nevertheless, as the United States economy started to recover and China managed to maintain growth rates of the order of 10% in 2009 and 2010, proposals for more ambitious financial regulation and reforms to the international monetary system were gradually shelved. The fallout from the financial crisis hit the eurozone harder from 2012, although the recession lasted from 2009 to almost 2013 in Spain and Greece and from 2009 to 2010 in Ireland.

The eurozone has since experienced a costly lapse in its fiscal orthodoxy, with procyclical tendencies that have worsened unemployment and stifled growth. The “treatment” is still a matter of discussion, inasmuch as those economies are still carrying high levels of public debt and in several cases huge deficits.⁵ The consolidated public debt in the eurozone jumped from 70% of GDP in 2008 to 90% in 2012. However, levels in Greece, Ireland, Italy and Portugal exceeded 100% of GDP.⁶ This heavy fiscal burden, compounded by the absence of a clear debt consolidation programme and the serious social security challenges in the medium term, will continue to undermine growth in the eurozone in the coming years. In the case of the United States, the fiscal agreement reached in early 2014 has pushed the major burden of the adjustment back to 2015. Nevertheless, the United States still faced some issues similar to those facing the European countries, albeit not so severe. Lastly, the case of Japan’s public debt is even more problematic. With the economic outlook less auspicious than in 2004-2008 and without credible fiscal consolidation efforts by the main industrialized economies, these factors pose not inconsiderable risks for the global economy for the rest of the decade.

⁵ In 2012, the eurozone’s average fiscal deficit was 3.7% of GDP, down from 6.4% of GDP in 2009. However, of the 17 countries that made up the eurozone in 2012, five were running public deficits in excess of 6% of GDP and five others deficits of between 4% and 5% (EUROSTAT, 2013).

⁶ Towards the end of the third quarter of 2013, the public debt in the eurozone stood at 93% of GDP (EUROSTAT, 22 January 2014).

2. Non-governability of financial flows

The dynamics of financial flows have already been identified as one of the main causes of the recent crisis and its long duration. Gore (2013) goes further describing the current era as dominated by financial globalization with its attendant features: high volatility, recurrent crises and concentration of wealth.

Online transmission of financial transactions, highly complex operations with financial derivatives,⁷ the increase in off-balance-sheet banking and the expansion of tax haven operations, among other things, make it increasingly difficult to achieve proper financial regulation. The emergence of a virtual currency on the Internet—the bitcoin—has opened up a debate on the implications of using an electronic currency that works online, without a central issuing bank, hence without the backing of any government or regulation by International Monetary Fund (IMF) standards.⁸ An additional fear is that these virtually anonymous purchases may encourage transactions involving drugs or other illegal merchandise, money laundering and tax evasion.

The rating agencies have been showing a marked procyclical behaviour, which ultimately validates *ex post* the dynamics of short-term flows. With abundant liquidity supplied by the central banks of Europe, Japan and the United States, sudden, massive movements in investment portfolios not only accentuate the decoupling between stock exchange values and the real economy but also trigger sudden shifts in investor sentiment. This had led to radical changes in assessments of the relative strength of the emerging economies, for example. In the space of just a few months, perceptions of these economies shifted from the engine of the world economy to the worst concern and principal obstacle to global growth. Both views were exaggerated. For one thing, the contribution to world growth by the emerging economies excluding China remains much smaller than that of the main industrialized economies and, for another, the medium- and long-term prospects for the emerging economies are still good, bearing in mind trends relating to urbanization, industrialization and emergence of the middle classes (Roubini, 2014). True, the short-term difficulties faced by several emerging economies should not be underestimated, but this should not cloud their favourable outlook over the medium and long terms.⁹

Concern over the potentially destabilizing impacts of the financial dynamics of globalization is spreading fast. In a statement delivered in February 2014, Christine Lagarde, Managing Director of IMF, drew attention to the future scenario of increasing tensions in economic interconnections. Lagarde warned that the financial crisis had not ended and that “a sustained and coordinated effort” was needed “to deal with problems that still linger—a legacy of high private and public debt, weak banking systems and structural impediments to competitiveness and growth—which have left us with unacceptably high levels of unemployment.” She added that “financial integration can make crises more frequent and more damaging” and that if the challenges referred to were not addressed, “the global economy can become even more prone to instability” (Lagarde, 2014). Hence the importance of Lagarde’s appeal for the management of an increasingly complex

⁷ The European Securities and Market Authority recently requested the European Commission to provide a clear definition of the term “financial derivative”, since there is no common definition. Establishing a single definition is a necessary step for moving towards a convergent regulation. At present, however, there are as many definitions as there are members (28) of the European Union (Bloomberg, 2014).

⁸ The bitcoin was created in 2009 and its initial value was set at US\$ 10. It is a currency that can be used for person-to-person transactions (exchange of information between equals) without intermediaries, using alphanumeric codes through which payments can be made in any part of the world to users who have an electronic portfolio. Some 12.5 million bitcoins were estimated to be in circulation in February 2014. The value of the bitcoin fell from US\$ 850 to US\$ 600 in mid-February 2014, after use of the bitcoin was suspended by one of its main platforms owing to technical problems. For precautionary financial reasons, China and the Russian Federation recently forbade the use of the bitcoin on their territory (El País, 2014).

⁹ The problem is that this overshooting produces real impacts on economies, affecting key relative prices, such as the exchange rate and interest rates and, hence, investment and growth prospects.

international monetary system and for the construction of a post-crisis global financial system that serves the productive economy rather than its own purposes (Lagarde, 2014).¹⁰

3. Mounting difficulties with economic projections

A recent report by the Organization for Economic Cooperation and Development (OECD) points out that extreme volatility during the financial crisis made it difficult to make economic forecasts. As a result, OECD forecasts are believed to have underestimated the extent of the slump in activity in 2008 and 2009 and to have overestimated the rate of recovery in more recent years (OECD, 2014).¹¹ The main underestimate has to do with the link between banking system weakness and sovereign debt. Globalization appears to have heightened exposure to external shocks by tightening the links between economies, particularly through financial interconnectedness.

These reflections bear out the concerns raised some time ago by Latin American structuralist thinking (Ocampo and Uthoff, 2004). What is striking is that today, these concerns are being expressed by specialists in the economic mainstream. In recent studies, Olivier Blanchard, Chief Economist of IMF, draws attention to serious limitations in the battery of macroeconomic tools. The macroeconomy, he suggests, by integrating finances has also incorporated finances' weak microeconomic fundamentals, increasing the margin for error in forecasts made during financial crises (Blanchard, 2011).

The broad consensus is that macroeconomics has underestimated the impact of financial factors on economic fluctuations. However, the state of the research does not yet indicate whether there is a credit and financial cycle that operates independently of the economic cycle. There is a lack of clarity on a number of other important points, as well: (i) whether or not central banks ought to incorporate financial stability and macroeconomic stability in their mandates; (ii) the extent to which regulatory, microprudential and macroprudential activities are coordinated; (iii) the level of indebtedness that can be considered sustainable; (iv) whether capital controls are effective; and (v) the respective space for financial regulation and self-regulation (Blanchard, 2013). Macroeconomics should be redefined both at the domestic and at the global level. Blanchard adds, with good reason, that without significant advances in this research, economic policy decisions relating to financial openness, regulations and controls in this sphere should be guided by caution, gradualism and pragmatism. With a great degree of intellectual honesty, he adds that "We have to keep our hopes in check. There are going to be new crises that we have not anticipated. And, despite our best efforts, we could have old-type crises again" (Blanchard, 2011).

To sum up, in a highly uncertain economic scenario and one determined to a great extent by financial flows, it is clear that, without the proper tools for understanding their behaviour, the constraints of economic thinking in current conditions of globalization will become a further disruptive factor. This is another major issue that should encourage more concerted regional activity, be it through academic interaction, permanent representations of the countries of the region to international financial agencies, the G-20 or the dynamics of regional financial integration.

¹⁰ Naked credit default swaps (CDS) are a case in point. They enable investors to contract insurance against non-payment of a sovereign public debt bond, even if they do not own any of the bond. If the institution contracting the default insurance is a major investment fund or a rating agency with influence in the public debt market, it is in its interest for the country to founder and for the default to occur (Caldera and others, 2010).

¹¹ The report adds that forecasting errors were greater in economies that were more open to trade and finance and had more regulated goods and labour markets, and in economies with weaker banking systems.

4. Deficiencies in governance of globalization

Reference has been made to some of the main constraints on the governance of financial globalization without alluding to reform of the international monetary system, which is increasingly out of sync with the economic and financial realities of the twenty-first century. The gaps are wider and more varied, however. They include the crucial issue of climate change, rising inequalities, the advent of megaregional trade agreements, which are being negotiated outside the framework of the World Trade Organization and could rewrite the rules of trade, and the weakness of governments and policy vis-à-vis powerful financial institutions.

Clearly, the magnitude of these challenges underscores the urgent need for an overall approach to rethinking development. This debate should ideally take place in a multilateral forum. So, multilateralism needs to be renewed and strengthened—even specialized financial agencies share this concern. The Managing Director of IMF recently launched an appeal for a new multilateralism for the twenty-first century, in order to face up to the challenges of a world that is more diverse than in the post-war era, in which power is more dispersed. In the economic and social sphere, major challenges are demographic dynamics (population ageing in the advanced economies and the “youth bulge” in many emerging and developing countries), environmental degradation and income inequality, all of which undermine sustainable growth (Lagarde, 2014).

A detailed examination of these issues would exceed the scope of this document. Nevertheless, this complex and pressing global agenda provides an increasingly powerful argument for developing unified regional stances and building regional consensus that can be defended in major international forums. It is, thus, another powerful reason for pressing ahead with regional integration efforts.

Chapter III

A SUMMARY OF THE MAIN TRANSFORMATIONS TAKING PLACE IN THE GLOBAL ECONOMY

A. THE CHALLENGE OF TECHNOLOGICAL CHANGE

Over the last few decades, information and communication technologies (ICTs) have developed and spread as never before, transforming economic and social processes along the way. Almost 40% of the world's population now use the Internet. Mobile technologies are driving the new advances, with some 2 billion people subscribing to mobile broadband (ITU, 2013). Access improvements have come with remarkable increases in processing power, making it possible to develop a wide range of electronic applications covering all economic sectors. The cost-performance ratio of processing power, storage and broadband have been falling exponentially, driving down prices¹ and thus ensuring that these technologies spread more quickly than earlier paradigms such as electricity. Today's potential for convergence between different Internet-based devices, applications, networks and platforms explains why they have become vital tools for economic growth and competitiveness, to such an extent that it is no longer possible to separate digitalization from development.

In the coming years, scientific innovation and technological change will accelerate, driven by converging and mutually reinforcing advances in information technology, ICTs, biotechnology, nanotechnologies and neurosciences or cognitive sciences. The conjunction of these advances has even led to the emergence of new fields of knowledge.² These changes are radical in themselves, but the most novel aspect is the growing speed at which new knowledge is being applied to production, shortening the development cycle for products and corporate strategies. This technological convergence will be further-reaching than the digital convergence that has taken place in the past 25 years and will greatly alter the outlook for societies and cultures, considerably affecting international trade and production in the process. The explosiveness of this convergence of innovations is well captured by the expression “technological big bang”.

Four groups of technologies are expected to have a particularly strong influence on the world's economy and society by 2030: ICTs, advanced manufacturing and automation technologies, energy and natural resource technologies and health-care technologies (see box III.1). Firms in China and the rest of Asia already have the skills to dominate many of the new markets associated with these, which means that competitiveness issues will be at the heart of trade, investment and intellectual property debates in the coming years.³

The processes described are affecting not only production but also logistics, transport, security and goods traceability, and thence international trade. Thus, technological changes, along with the liberalization of financial movements and the gradual opening up of markets to trade and investment, have hastened the dynamic of innovation, the convergence of international standards and corporate strategies and the tendency

¹ For example, a gigaflop of processing power cost US\$ 42,000 in 1997 but only US\$ 1.8 in 2011. A gigabyte of storage cost about US\$ 200,000 in 1980, whereas a terabyte (1,024 gigabytes) cost US\$ 100 in 2011 (Jordán, Galperin and Peres, 2013).

² These include bioinformatics (the use and organization of information of biological interest, particularly that relating to the organization of biomolecular databases, and especially DNA sequences, which requires computers for its analysis and incorporates information from various biological sources), proteomics (an approach in molecular biology that seeks to identify and characterize complete series of proteins and their interactions in a given species) (FAO, 2004) and biomimicry (a discipline based on the study of models, systems, processes and natural elements with a view to imitating them and thereby finding sustainable practical solutions to human needs) (Rocha, 2012).

³ See *The Wall Street Journal* (2014).

for production to be organized around global value chains or networks (see section C of chapter III). These are giving rise to geographical fragmentation of production processes, made easier by the growing digitalization of many activities, greater internationalization of services and falling transport and logistics costs.

A brief review of the effects of this innovation synergy on the production structure unsurprisingly reveals the importance of innovation as a cornerstone of policies to improve competitiveness. In the scenario described, the sectors most reliant on natural resources or low-skilled labour may face two major risks: (i) a tendency to fall behind the rapid march of technology, and (ii) greater exposure to traditional or new forms of protectionism in industrialized economies and in medium-sized emerging ones, owing to greater competition in natural-resource-intensive or medium-technology manufacturing sectors. It is thus important for these sectors to make significant efforts to incorporate more knowledge, technology and innovation into their production processes. Those countries that are quickest to grasp the implications of the profound technological transformation under way and respond with suitable policies are likely to cope most successfully in the international economy.

Box III.1

THE LIKELY IMPACTS OF NEW TECHNOLOGIES BY 2030

Global Trends 2030: Alternative Worlds, a publication produced by the United States National Intelligence Council, identifies four technology arenas that are expected to shape the world's economies and societies by 2030. They are:

Information technologies

These technologies will enter the big data era. Processing power and data storage will be almost free; networks and the cloud will provide global access and pervasive services. Social media and cybersecurity will be large new markets. The coming together of social networks with big data will allow the emergence of “smart cities” that maximize productivity and quality of life while minimizing the consumption of resources and damage to the environment.

Automation and advanced manufacturing technologies

These technologies will transform the mass production model. Additive manufacturing or 3D printing and robotics will change working patterns, although the transition may be slow. By raising productivity in the industrialized countries, these technologies will reduce the need to offshore production in cases where the benefits are not obvious. This displacement of labour will heighten distributional inequality and may result in adverse social movements. About 1.2 million robots are currently in use, mainly in the automotive industry, homes and hospitals and in military applications. A new generation is now being brought out for service applications, particularly cleaning, maintenance and public relations. In health care, there will be increased demand for robots to provide basic services and support for the elderly as their ability to interact with people improves.

Autonomous or remote-controlled vehicles are already being used in the armed forces and mining to improve safety, cut costs, increase effectiveness and mitigate labour shortages. Unmanned aerial vehicles (drones) are being used for both military and civilian purposes, with the latter including geopropecting, precision agriculture, inspection of power lines and traceability. Driverless vehicles could help cut traffic congestion, reduce accidents and increase people's productivity, as they would be able to read or work on the road.

3D printing is already being used to produce plastic consumer items and vehicle and aerospace components. It is also starting to be used in medicine, with the copying of bones and internal organs. The combination of low-cost 3D printers and online provision of 3D software could democratize manufacturing, boosting the creation of latest-generation SMEs. The emphasis of this new technology will probably be on products for which transport costs are high or lead times long, so that supply chains are shortened and simplified. Developing countries could benefit most, as additive manufacturing requires less industrial infrastructure than conventional manufacturing.

Energy and resource technologies

An essential role will be played by technologies that enhance water management and desalination and irrigation efficiencies, along with energy efficiency generally. Genetically modified crops and the foods derived from them will also be prominent (although highly controversial), as will precision agriculture, irrigation techniques, solar energy and hydraulic fracturing (or “fracking”) technologies for oil and natural gas extraction. Fracking technologies are already having a positive impact on United States industrial competitiveness. Progress is also expected on the cost-benefit ratios of energies produced from non-food biomass and second-generation biofuels.

Box III.1 (concluded)

Health technologies

These will continue to raise the average age of the world's population, improving people's physical and mental condition and quality of life. The expectation is that the interface between biology, nanosciences and information sciences will be at the core of innovation in the next 50 years, with multiple manifestations: disease detection and diagnostic techniques based on molecular biology and genetic information will provide more effective control and treatment of communicable and non-communicable diseases; progress with theranostics (diagnosis and therapy in a single treatment) will cut hospital care costs and recovery times; advances in regenerative medicine will facilitate access to replacement organs (prostheses, motorized exoskeletons); and the expansion of neuromedicines will benefit from the convergence between advances in biology and neurosciences. The high cost of these advances suggests that for some decades they will only be affordable for a limited portion of the world's population, with major implications for future debates about social cohesion.

Manyika and others (2013) identify 12 "disruptive technologies" that could spearhead massive economic change in the coming years. These are: (i) mobile Internet; (ii) automation of knowledge work; (iii) the Internet of Things (IoT); (iv) cloud technology; (v) advanced robotics; (vi) autonomous and near-autonomous vehicles; (vii) next-generation genomics; (viii) advanced energy storage technologies; (ix) 3D printing; (x) advanced materials such as graphene; (xi) advanced oil and gas exploration and recovery; (xii) renewable energy. These 12 technologies largely coincide with the four technology groups identified in the United States National Intelligence Council report.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of National Intelligence Council, *Global Trends 2030: Alternative Worlds*, Washington, D.C., December 2012 [online] www.dni.gov/nic/globaltrends, and James Manyika and others, *Disruptive Technologies: Advances that Will Transform Life, Business, and the Global Economy*, McKinsey Global Institute, May 2013 [online] http://www.mckinsey.com/insights/business_technology/disruptive_technologies.

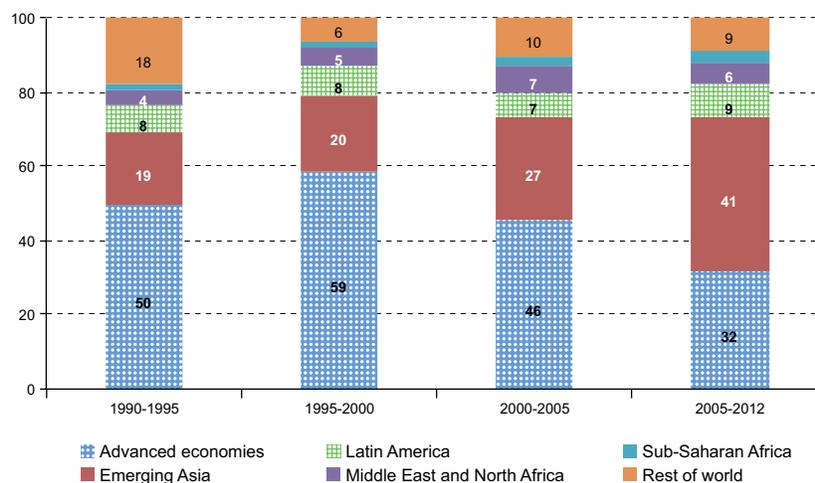
B. THE GROWING WEIGHT OF CHINA AND EMERGING COUNTRIES IN THE WORLD ECONOMY

The current economic context is characterized by a shift of global wealth towards emerging economies, which have become the main drivers of global growth (CAF/ECLAC/OECD, 2013). This structural trend has been heightened by the combination of low growth, high unemployment and fiscal vulnerability that has affected most of the industrialized countries since the economic and financial crisis broke out in 2008. The developed economies' contribution to world economic growth fell from 50% in 1990-1995 to just over 30% between 2005 and 2012 (see figure III.1). Some projections put this share no higher than 20% between 2012 and 2022.⁴

There is a great deal of heterogeneity between developing regions where economic growth is concerned, with emerging Asia standing out as the most dynamic. Emerging Asia's contribution to world GDP growth more than doubled from 19% to 41% between 1990-1995 and 2005-2012, the contribution of Latin America held virtually steady, just edging up from 8% to 9%. The remarkable performance of Asia is directly due to the rise of China, which has become the world's second-largest economy, its main exporter of goods and a coming technological power. Its record of 10% annual growth for more than three decades is historically unprecedented, particularly for such a populous nation. The opening up of the Chinese economy since the late 1970s and of India's since the early 1990s has been tantamount to adding a second floor to the world economy, expanding the size of markets, more than doubling the global workforce and multiplying the demand for natural resources. This dynamic performance is reflected in the significant changes expected in the distribution of global output over the coming decades (see figure III.2).

⁴ The contribution of the industrialized countries to global growth breaks down as follows: North America (United States and Canada), 10.9%; Western Europe, 6.4%; Japan, 1.7%; Australia and New Zealand, 1%. The projected contribution of Latin America and the Caribbean is 7.5%, putting it ahead not only of Western Europe but also of Eastern Europe (6.8%), Africa (4.9%) and the Middle East (4.5%). See BBVA Research (2013).

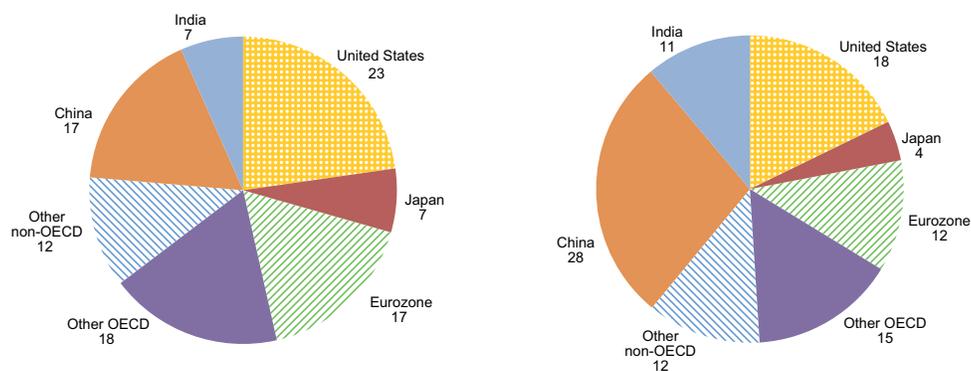
Figure III.1
SELECTED COUNTRY GROUPINGS: CONTRIBUTION TO WORLD GDP GROWTH, 1990-2012^a
(Percentages)



Source: Development Bank of Latin America/Economic Commission for Latin America and the Caribbean/Organization for Economic Cooperation and Development (CAF/ECLAC/OECD), *Latin American Economic Outlook 2014: Logistics and Competitiveness for Development* (LC/G.2575), Paris, 2013.

^a GDP is calculated in purchasing power parity (PPP) terms. The contributions are measured as the share of world GDP growth represented by each region's GDP growth.

Figure III.2
DISTRIBUTION OF GLOBAL GDP AMONG SELECTED COUNTRIES AND GROUPINGS, 2011 AND 2030^a
(Percentages)



Source: Åsa Johansson and others, "Looking to 2060: Long-term global growth prospects", *OECD Economic Policy Papers*, No. 3, November 2012 [online] <http://www.oecd.org/eo/outlook/2060%20policy%20paper%20FINAL.pdf>.

^a Calculated in purchasing power parity (PPP) terms. Global GDP is defined as the sum of the GDP of the 34 member States of the Organization for Economic Cooperation and Development (OECD) and the 8 developing economies that are members of the Group of 20 but not the OECD (Argentina, Brazil, China, India, Indonesia, the Russian Federation, Saudi Arabia and South Africa). The 2030 figures are projections.

The growing ties between China and the rest of Asia, Africa and Latin America have transmitted economic dynamism to those regions, as China has become an increasingly important market for their exports. China's spillover effect on other developing economies largely explains an unprecedented historical development: the gradual closing of per capita income gaps between economies that are currently developed and the rest of the world. Whereas in the 1990s just 12 developing countries succeeded in growing twice as fast per capita as the high-income members of OECD, 65 did so in the 2000s (OECD, 2010). This phenomenon is what Mahbubani (2013) calls the great convergence and Wolf (2011) the sign of the new times.

The rise of China in the world economy is largely explained by its incorporation into Asian value chains. Every product that comes out of Chinese factories bound for the West incorporates intermediate goods, services and technologies from economies such as Japan, the Republic of Korea, Hong Kong Special Administrative Region of China, Taiwan Province of China, Singapore, Malaysia, Thailand and Indonesia, among others, whence the term "factory Asia". Thus, while China runs large trade surpluses with the United States and the European Union, it has deficits with Japan, the Republic of Korea and the 10-nation grouping of the Association of Southeast Asian Nations (ASEAN). These deficits are largely due to medium- and high-technology manufactures. Thus, when China grows by 8% or 10%, it transmits growth and export diversification to these economies.

At the same time, the strength of industrialization and urbanization in Asia has resulted in what has become known as a supercycle in the prices of raw materials, particularly minerals. This has cast doubt, at least for the past couple of decades, on pessimistic theories about the evolution of the terms of trade for countries exporting these commodities. The slowdown in the Chinese economy since 2012 has triggered a fierce debate about the ending of this supercycle. Predictions to this effect seem rather hasty, however. The target set by the Chinese authorities is for 7.5% annual growth until 2015 and 5% from 2020. This needs to be set in perspective. For China to aspire to trend growth of 5% in 2020 (by which time, on a number of projections, it is expected to be the world's largest economy) is remarkable. China is also responsible for the largest share of global demand for copper, oil and soybean, among other commodities. Consequently, demand for mineral and metal commodities can be expected to remain high, and their prices, even if below their 2008 peaks, will remain above trend.

China and other Asian economies are showing that rapid income convergence with the industrialized economies is possible. They have achieved this precisely by increasing the density of their production and technology bases, coming to play an important role as exporters of certain manufactures and services of increasing technological complexity. It certainly seems that centre-periphery approaches need to adapt to this new reality (Rosales, 2009). At present, two categories of economies may be said to coexist on the "periphery". There is the traditional category of economies involved in inter-industry trade (exporting commodities and importing manufactures) and presenting major deficits in endogenous innovation and technology dynamics. Then there is another category, mainly in Asia, of more innovative economies that have greater industrial density, strong intra-industry trade links and a large presence in value chains, and that compete in advanced technology sectors.

Alongside their rapid growth, developing countries have been increasing their economic presence in other ways. Thus, this group's share of world goods and services trade increased substantially between 2000 and 2012. Although all developing regions made progress in this area, it was much more marked in Asia. This is accounted for mainly by the remarkable performance of China. In contrast, Latin America and the Caribbean stagnated, with a small increase in its share of world goods exports and a small decrease in its share of world services exports. The other developing regions, Africa and the Middle East, have also performed more dynamically than Latin America and the Caribbean (see table III.1).

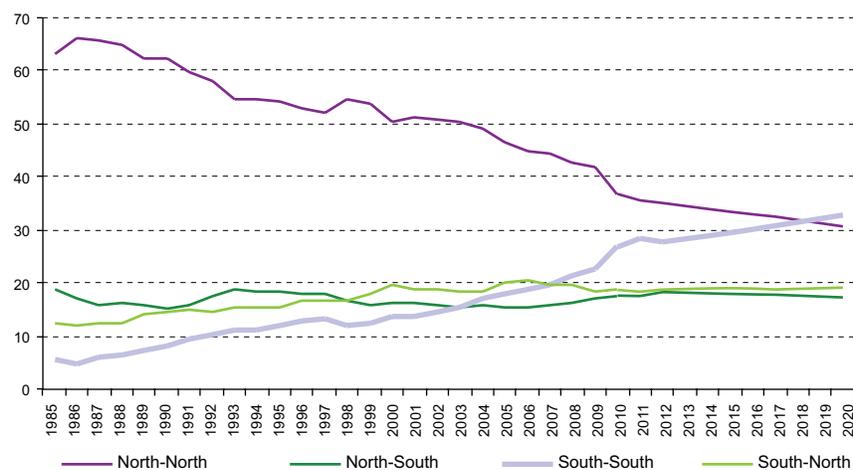
Table III.1
**SELECTED GROUPINGS AND COUNTRIES: SHARE OF WORLD GOODS
 AND SERVICES TRADE, 2000 AND 2012**
 (Percentages)

| | Goods | | | | Services | | | |
|-----------------------------|---------|-------|---------|-------|----------|-------|---------|-------|
| | Exports | | Imports | | Exports | | Imports | |
| | 2000 | 2012 | 2000 | 2012 | 2000 | 2012 | 2000 | 2012 |
| World | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Developed economies | 65.7 | 50.8 | 69.7 | 55.1 | 75.3 | 66.7 | 70.7 | 58.8 |
| Developing economies | 31.9 | 44.6 | 28.8 | 41.4 | 23.1 | 30.4 | 27.4 | 37.3 |
| Asia | 20.2 | 27.8 | 18.3 | 27.3 | 14.3 | 21.4 | 15.7 | 22.3 |
| China | 3.9 | 11.1 | 3.4 | 9.8 | 2.0 | 4.3 | 2.4 | 6.6 |
| Latin America and Caribbean | 5.7 | 6.1 | 5.8 | 6.1 | 4.1 | 3.6 | 4.9 | 5.1 |
| Brazil | 0.9 | 1.3 | 0.9 | 1.3 | 0.6 | 0.9 | 1.1 | 1.9 |
| Mexico | 2.6 | 2.0 | 2.7 | 2.1 | 0.9 | 0.4 | 1.1 | 0.7 |
| Africa | 2.3 | 3.4 | 2.0 | 3.3 | 2.2 | 2.2 | 2.7 | 4.0 |
| Middle East | 3.6 | 7.3 | 2.6 | 4.6 | 2.6 | 3.1 | 4.0 | 5.8 |
| Transition economies | 2.4 | 4.6 | 1.6 | 3.4 | 1.6 | 2.9 | 1.9 | 3.9 |

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development (UNCTAD), *Handbook of Statistics 2013*. United Nations publication, Sales No. B.13.II.D.4.

Trade between developing countries (South-South) has grown particularly strongly, more than tripling its share of world goods trade from 8% in 1990 to 28% in 2012. ECLAC projections suggest that South-South trade could outstrip trade between developed countries (North-North) before the end of this decade (see figure III.3). Developing Asia, with China at the forefront, is easily the main driver of South-South trade, accounting for 83% in 2012 (WTO, 2013b).

Figure III.3
**DISTRIBUTION OF WORLD GOODS EXPORTS BY ORIGIN
 AND DESTINATION GROUPING, 1985-2020^a**
 (Percentages)

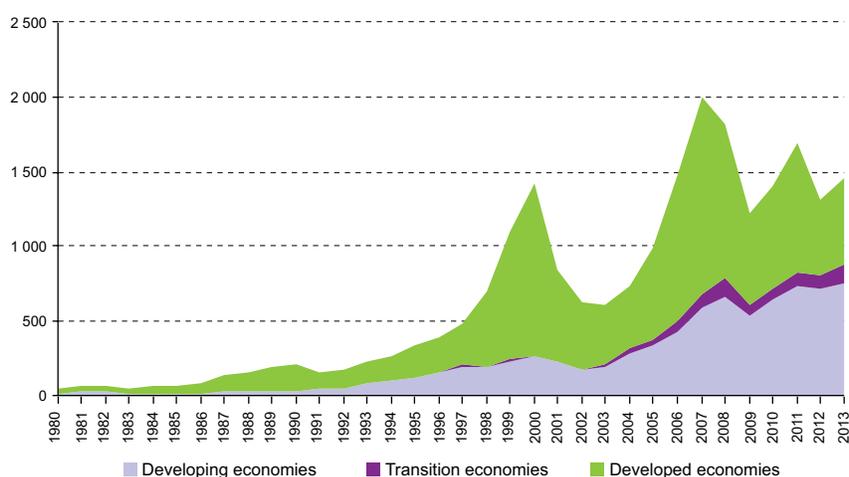


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United Nations Commodity Trade Database (COMTRADE).

^a The shares from 2013 onward are projections.

Developing countries have also been strongly increasing their share of world foreign direct investment (FDI) flows, both as recipients and as investors abroad. According to preliminary estimates by the United Nations Conference on Trade and Development (UNCTAD), FDI flows to this group of countries reached an all-time high of US\$ 759 billion in 2013, equivalent to 52% of worldwide FDI inflows (see figure III.4). Again, developing countries were the source for 31% of worldwide outward FDI in 2012, likewise their highest share ever. As with trade flows, the prominence of developing countries in FDI flows is largely due to Asia, and China in particular. In any event, Latin America and the Caribbean ranks second among developing regions as a recipient and source of FDI (see table III.2).

Figure III.4
WORLDWIDE FLOWS OF INWARD FOREIGN DIRECT INVESTMENT, 1980-2013
(Billions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development (UNCTAD), UNCTADSTAT database [online] <http://unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=88> [date of reference: 4 December 2013] and UNCTAD, *Global Investment Trends Monitor*, No. 15, 28 January 2014 [online] http://unctad.org/en/PublicationsLibrary/webdiaeia2014d1_en.pdf, for 2011, 2012 and 2013 figures.

Table III.2
DISTRIBUTION OF WORLDWIDE FDI FLOWS TO AND FROM DEVELOPING COUNTRIES, 2012
(Percentages)

| Region or country | Distribution of FDI flows from the world to developing countries | Distribution of FDI flows from developing countries to the world |
|--|--|--|
| Africa | 8 | 4 |
| Latin America and the Caribbean ^a | 28 | 14 |
| China | 19 | 22 |
| Other Asia | 45 | 60 |
| Oceania | 0 | 0 |
| Total developing countries | 100 | 100 |

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of the United Nations Conference on Trade and Development (UNCTAD), UNCTADSTAT database [online] <http://unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=88> [date of reference: 4 December 2013].

^a Excludes financial centres in the Caribbean.

Another key aspect of the closing of divides between industrialized and developing countries is technological capability. Between 1990 and 2012, the share of patent applications accounted for by Europe, the United States and Japan between them fell dramatically, from 87% to 52%. Offsetting this, the share of patents applied for in the major developing Asian economies increased sharply. The performance of China is particularly remarkable, since its share of worldwide patent applications rose 28-fold over the period. Thus, in 2011 it displaced the United States from its leading position on this variable, and in 2012 it accounted for almost twice as many patent applications as the whole of Europe. The share of Latin America and the Caribbean, on the other hand, is low, having actually fallen between 2000 and 2012, and is largely accounted for by the region's two biggest economies, Brazil and Mexico. The share of the Republic of Korea is more than three times that of the whole region, even though the latter's population is 12 times as large (see table III.3).

Table III.3
SELECTED GROUPINGS AND COUNTRIES: PATENT APPLICATIONS, 1990, 2000 AND 2012^a
(Numbers and percentages)

| | 1990 | | 2000 | | 2012 | | Change 1990-2012 |
|------------------------------------|----------------|--------------|------------------|--------------|------------------|--------------|---------------------|
| | Number | Percentage | Number | Percentage | Number | Percentage | Percentage |
| High-income countries ^b | 870 979 | 87.3 | 1 036 233 | 75.2 | 1 230 589 | 52.4 | 41 |
| Europe | 339 112 | 34.0 | 320 795 | 23.3 | 344 978 | 14.7 | 2 |
| United States | 171 163 | 17.2 | 295 895 | 21.5 | 542 815 | 23.1 | 217 |
| Japan | 360 704 | 36.2 | 419 543 | 30.5 | 342 796 | 14.6 | -5 |
| China | 10 137 | 1.0 | 51 906 | 3.8 | 652 777 | 27.8 | 6 340 |
| India | 3 820 | 0.4 | 8 538 | 0.6 | 43 955 | 1.9 | 1 051 |
| Republic of Korea | 25 820 | 2.6 | 102 010 | 7.4 | 188 915 | 8.0 | 632 |
| Latin America and the Caribbean | 18 468 | 1.9 | 47 687 | 3.5 | 59 314 | 2.5 | 221 |
| Brazil | 7 537 | 0.8 | 17 283 | 1.3 | 30 116 | 1.3 | 300 |
| Mexico | 5 061 | 0.5 | 13 061 | 0.9 | 15 314 | 0.7 | 203 |
| World | 997 501 | 100.0 | 1 377 800 | 100.0 | 2 347 700 | 100.0 | 135 |

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Intellectual Property Organization (WIPO), WIPO Statistics Database [online] <http://ipstatsdb.wipo.org/ipstatv2/ipstats/patentsSearch> [date of reference: 11 January 2014].

^a Includes applications by residents and non-residents.

^b Includes Europe, the United States and Japan.

Lastly, an OECD study (Kharas, 2010) projects that by 2030, almost 80% of the world's middle-class population will be living in countries currently defined as developing. Asia alone will be home to two thirds of the world's middle-class population and a similar percentage of world consumer spending, thanks to its strong economic and demographic growth. For its part, the middle-class population of Latin America and the Caribbean is predicted to grow by 73% in absolute terms between 2009 and 2030. Nonetheless, the region's share of the world's middle-class population will gradually decline, as economic growth there is expected to be lower than in Asia (see table III.4).

Table III.4
WORLD AND SELECTED REGIONS: MIDDLE-CLASS POPULATION, 2009, 2020 AND 2030^a
(Millions of people and percentages)

| | 2009 | | 2020 | | 2030 | |
|------------------------------|--------------------|------------|--------------------|------------|--------------------|------------|
| | Millions of people | Percentage | Millions of people | Percentage | Millions of people | Percentage |
| North America | 338 | 18 | 333 | 10 | 322 | 7 |
| Europe | 664 | 36 | 703 | 22 | 680 | 14 |
| South and Central America | 181 | 10 | 251 | 8 | 313 | 6 |
| Asia and the Pacific | 525 | 28 | 1 740 | 54 | 3 228 | 66 |
| Sub-Saharan Africa | 32 | 2 | 57 | 2 | 107 | 2 |
| Middle East and North Africa | 105 | 6 | 165 | 5 | 234 | 5 |
| World | 1 845 | 100 | 3 249 | 100 | 4 884 | 100 |

Source: Homi Kharas, “The emerging middle class in developing countries”, *OECD Development Centre Working Paper*, No. 285, Paris, OECD Development Centre, January 2010 [online] <http://www.oecd.org/dataoecd/12/52/44457738.pdf>.

^a Households with daily per capita expenditure of between US\$ 10 and US\$ 100 in PPP terms are deemed to be middle class. The 2020 and 2030 figures are projections.

C. THE RISE OF VALUE CHAINS AND MEGAREGIONAL TRADE AND INVESTMENT AGREEMENTS

Much of the world’s trade and production now takes place within what are known as value chains, be they regional or global. According to UNCTAD estimates, about 80% of worldwide goods and services exports (measured in gross terms) consist of trade within value chains involving multinational enterprises (UNCTAD, 2013b). This reflects the far-reaching geographical fragmentation of production in the world, especially since the mid-1980s. This has been made possible by the conjunction of lower barriers to trade and FDI, lower transport costs and improvements in ICTs.

In industries characterized by value chains (such as the automotive, electronics, aerospace and apparel industries), increasingly, final goods are no longer produced in a single country. Activities ranging from research and development (R&D) to product recycling and including production, support services, distribution, marketing, finance and after-sales services are carried out in a number of countries via interactions between subsidiaries of a single multinational or transactions between these and outside suppliers. Consequently, the countries participating in these chains specialize not so much in the complete production of final goods or services as in particular tasks or segments of the production process.

Trade within value chains has a number of distinctive features. The first is its close relationship with FDI. There is a strong positive correlation between countries’ FDI stock and their participation in value chains. This correlation has become more marked over the past two decades, especially in less developed countries (UNCTAD, 2013b). Secondly, this type of trade is characterized by heavy movements of intermediate goods, which accounted for between 50% and 55% of global non-oil goods exports in every year from 2000 to 2011 (WTO, 2013c). A third feature is the rise in the imported content of exports: about 28% of the gross value of world goods and services exports was accounted for by imported content in 2010 (UNCTAD, 2013b).

A fourth distinctive feature of trade within value chains is the fundamental role played by a wide range of services (financial, legal, logistical, design, communications, and so on), many of which are incorporated as inputs into the final goods. Thus, the services share of world exports in 2008, measured by value added, was 42%, i.e. almost twice the gross measurement (WTO, 2013c). Many services that support value chains have in turn been fragmented into different tasks and outsourced to countries with the respective competitive

advantages. This development has been facilitated by advances in ICTs that have enabled the provision and consumption of these services to be geographically separated.

Within value chains, the greatest value added lies in knowledge-intensive activities such as design and R&D, with assembly activities and the supply of raw materials lying at the opposite end of the scale. In this context, international competitiveness is increasingly linked to intangible aspects such as quality, timeliness, connectivity, innovation, patentability and trademark registration, traceability, safety, environmental conservation, carbon footprints and energy efficiency. All these attributes are what enable products and services to be differentiated, opening up access to the most lucrative sectors of demand.

For developing countries, integration into value chains, and especially their most knowledge-intensive segments, can bring a variety of benefits. Chief among them is the opportunity to gain access to new technologies, business know-how and networks that in turn yield gains in productivity, employment quality and wages (Lim and Kimura, 2010; UNCTAD, 2013b). Participation in value chains can also be a powerful tool for the internationalization of SMEs, either as direct exporters or indirectly as suppliers of goods or services to larger export firms. Nonetheless, participation in value chains has some risks, including the following:

- (i) The contribution to GDP can be limited if countries capture only a small part of the value added created in chains.
- (ii) Much of the value of global value chains in developing countries is generated in the subsidiaries of multinational enterprises, and the result can be low “value capture” because of transfer prices or repatriation of revenues.
- (iii) Dissemination of technologies, capacity-building and upgrading are not automatic, and developing countries risk being left behind in activities with relatively low value added.
- (iv) Environmental and social impacts, including the effects on employment conditions, occupational security and health, can be negative.
- (v) Activities in global value chains are potentially footloose and more vulnerable to external shocks, which also represents risks.

It is thus not just a matter of joining value chains. The challenge is to increase the share of value added generated locally and to move up the chain hierarchy from simple to more complex activities. This process is neither straightforward nor spontaneous. It depends critically on public policies that engage with this objective. For example, there needs to be a critical mass of skilled human resources, high-quality logistics and telecommunications infrastructure and an appropriate business environment, including proper protection for intellectual property. Ultimately, for small and medium-sized economies far from the dynamic centres of world trade, the challenge is to construct factors of differentiation that transcend natural resource endowments or low labour costs.

The best way of maximizing the benefits and minimizing the risks associated with value chains is through policies to: (i) enhance the synergy between trade and investment policies by pursuing both in tandem and by including measures to stimulate these chains in industrial development policies; (ii) deal with infrastructure bottlenecks that limit the potential of these chains; (iii) foment the production capabilities of local firms; and (iv) help the local workforce to acquire specialized knowledge. The sustainability risks that can be entailed by participation in value chains need to be mitigated by adopting a sounder environmental, social and governance framework that includes an enhanced regulation mechanism together with assistance for capacity-building. In these tasks, regional cooperation and policies shared by a number of the region’s countries will always be a better prospect than isolated national policies that are narrower in scope or, worse, too heterogeneous (see diagram III.1).

Diagram III.1
**A DEVELOPMENT-ORIENTED POLICY FRAMEWORK FOR REGIONAL
OR GLOBAL VALUE CHAINS**

| Goal | Recommended actions |
|---|---|
| Incorporation of regional value chains into development strategies | <ul style="list-style-type: none"> Incorporate regional value chains into industrial development policies. Establish policy goals consistent with development trajectories driven by regional or global value chains. |
| Support for participation in regional or global value chains | <ul style="list-style-type: none"> Create and maintain an environment conducive to trade and investment. Establish infrastructure prerequisites for participating in regional or global value chains. |
| Capacity-building in national production | <ul style="list-style-type: none"> Support business development and improve the negotiating power of local firms. Reinforce the specialized knowledge of the workforce. |
| Establishment of a sound environmental, social and governance framework | <ul style="list-style-type: none"> Minimize the negative effects and risks associated with global value chains. Help local firms meet international standards. |
| Establishment of synergies between trade and investment policies and institutions | <ul style="list-style-type: none"> Ensure consistency between trade and investment policies. Establish synergies between trade and investment promotion and facilitation. Create "regional industrial development compacts". |

Source: United Nations Conference on Trade and Development (UNCTAD), *World Investment Report 2013*, Geneva [online] http://unctad.org/en/publicationslibrary/wir2013_en.pdf.

Despite falling transport, communication and data processing costs, coordinating production processes across a number of countries is still a complex task, especially when they are far apart. Trade within value chains, where a product may cross borders several times at different phases of production, is particularly sensitive to the costs deriving from distance. This is why the main value chains have a clear regional dimension (WTO, 2011; Lim and Kimura, 2010).⁵ Three major production networks (“factories”) can be identified in the world: “factory Europe” (Germany being the hub), “factory North America” (based in the United States) and “factory Asia” (centred originally on Japan and more recently on China) (Baldwin, 2012). The three world “factories” present high levels of intraregional trade (see table III.5), of which intermediate goods (parts and components) are an important component, especially in the case of “factory Asia”. This reflects the vertical trade patterns that characterize today’s international production networks (see figure III.5).

Table III.5
SELECTED GROUPINGS: INTRA-GROUP EXPORTS AS A SHARE OF TOTAL EXPORTS, 2008-2012
(Percentages)

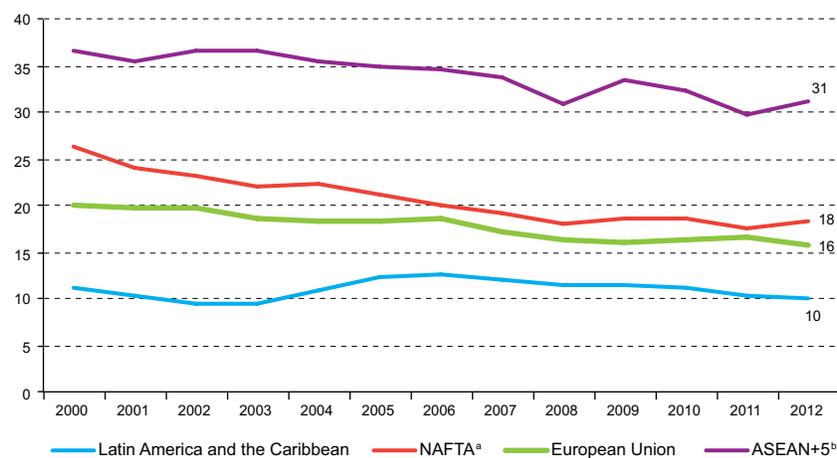
| Grouping | 2008 | 2009 | 2010 | 2011 | 2012 | 2008-2012 average |
|-------------------------------------|------|------|------|------|------|----------------------|
| European Union | 66.3 | 65.9 | 64.4 | 63.4 | 62.2 | 64.4 |
| North American Free Trade Agreement | 49.3 | 47.6 | 48.3 | 48.0 | 48.4 | 48.3 |
| ASEAN+5 ^a | 47.0 | 48.4 | 49.4 | 49.7 | 50.5 | 49.0 |

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

^a Includes the 10 member countries of the Association of Southeast Asian Nations (ASEAN) and China, Japan, the Republic of Korea, Hong Kong Special Administrative Region of China and Taiwan Province of China.

⁵ A distinction should be drawn between production and supply networks. While the former tend to be mainly regional, the latter are often global in scale. For example, countries such as Brazil, Chile and Peru are major suppliers of the iron and copper employed in various Asian industrial chains, but they do not usually participate in the processes whereby these minerals are transformed into manufactured products.

Figure III.5
**SELECTED GROUPINGS: PARTS AND COMPONENTS AS A SHARE
 OF INTRA-GROUP EXPORTS, 2000-2012**
(Percentages)



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

^a North American Free Trade Agreement.

^b Includes China, Japan, the Republic of Korea, the 10 member countries of the Association of Southeast Asian Nations (ASEAN), Hong Kong Special Administrative Region of China and Taiwan Province of China.

An important factor in the formation of the great world “factories” have been far-reaching regional integration processes centring on megamarkets. A leading example is “factory Asia”, a space comprising China, Japan, the Republic of Korea, Hong Kong Special Administrative Region of China, Taiwan Province of China and the 10 economies of the Association of Southeast Asian Nations (ASEAN). All these economies in practice form a single integrated region by virtue of its flows of trade and FDI, especially in the manufacturing sector. This de facto market integration has been strengthened in recent years by a process of de jure formal integration via a network of trade agreements established around ASEAN. The next stage in the process is expected to be the creation of a vast free trade area also taking in Australia, India and New Zealand via the project known as the Regional Comprehensive Economic Partnership (RCEP), on which negotiations began in May 2013.

In Europe, the development of value chains was facilitated by the entry of a number of Central and Eastern European countries into the European Union (and its single market) from 2004. This production macroregion is completed by a number of economies in North Africa, the Middle East and the former Soviet Union with which the European Union has signed deep trade and investment agreements.⁶ For its part, “factory North America” has been operating since the 1960s between the United States and Canada, particularly through binational production networks in the automotive sector. However, its scope was substantially increased with the 1994 implementation of the North American Free Trade Agreement (NAFTA), between these two economies and Mexico. This spurred the development of production linkages between Mexico and the United States, chiefly in the form of assembly plants or maquiladoras in sectors such as automobiles, wearing apparel and electronics. Also part of this economic space are the countries of Central America,

⁶ “Deep” agreements are those whose scope extends beyond the elimination of tariffs and other border obstacles to goods trade, taking in a range of behind-the-border regulatory barriers to the workings of value chains. Among them are the treatment of foreign investment, trade in services, intellectual property rights and technical norms and standards.

which are linked to Mexico and the United States by separate free trade agreements (with the United States agreement also including the Dominican Republic).

Deep integration initiatives in Asia, Europe and North America have been supplemented more recently by transregional initiatives of vast scope, known as “megaregional” initiatives. This is the case in particular with the current negotiations over the Trans-Pacific Partnership (TPP), the Transatlantic Trade and Investment Partnership (TTIP) between the United States and the European Union, and the free trade agreement between the European Union and Japan. Also in this category is the Regional Comprehensive Economic Partnership (RCEP) initiative referred to above, which may be seen as competing with the TPP as a model to set the “ground rules” in Asia for the coming years. All these processes aim to harmonize or at least render compatible the rules under which the different world “factories” operate.⁷ Megaregional negotiations can also be interpreted as a response by the industrialized economies to the growing weight of emerging ones, particularly China and the rest of East Asia, in world production and trade.

The prolonged impasse in the WTO Doha Round negotiations⁸ is one of the factors accounting for the raft of megaregional negotiations. These will probably have a strong impact on the geographical distribution and governance of global trade and investment flows in the coming years. The scale of these initiatives, in terms both of the economic heft of the participants and the ambitiousness of their agendas, could mean in practice that by about 2020 the rules of international trade will have been renegotiated to adapt them to the reality of value chains. By contrast with the last major renegotiation of this type at the global level, the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), however, it appears that this time the new rules will be set outside WTO and by a limited number of countries, basically those most heavily involved in value chain trade. This in itself should be a cause for concern for the countries of Latin America and the Caribbean, which, with some exceptions, are little involved either in production networks or in megaregional negotiations.

The current megaregional negotiations have a variety of complex implications for Latin America and the Caribbean. The countries engaged in these negotiations account between them for about 70% of the region’s goods trade, whether measured by exports or imports. In addition, they are the main foreign investors in Latin America and the Caribbean. Consequently, if these processes are brought to a successful conclusion, the scale, composition and direction of trade and FDI flows for the region’s countries will certainly be affected. These effects will be felt differently in each country, depending on the composition and geographical structure of its trade, its degree of participation in regional or global value chains and its network of trade agreements, among other factors.

Given that megaregional negotiations tend to have strong regulatory emphasis, any results they achieve in this area will likely have a larger impact on the region’s trade than any tariff measures agreed. In particular, the TTIP may set new rules for emerging international trade issues, given the economic weight and regulatory influence of the United States and European Union. In this context, there is a risk that this forum or the TPP will negotiate new rules and requirements (on the environment, quality and traceability, among other things) that are hard for the region’s exporters to comply with. For example, the outcome of discussions between the United States and European Union on matters such as the commercialization of genetically modified crops, the use of hormones in stockbreeding or the regulation of biofuels will have major consequences for a number of countries in the region that export these products.

⁷ Further details of these negotiations can be found in ECLAC (2013b) and Rosales and Herreros (2014).

⁸ The importance of WTO as a trade negotiating forum was strengthened by the agreements on trade facilitation and other issues struck at its Ninth Ministerial Conference in Bali (Indonesia) in December 2013. However, it is not clear that this success in Bali will open the way to rapid reactivation of the whole Doha agenda.

Besides their impact on the region's trade and investment flows, megaregional negotiations will probably affect the scope the countries of Latin America and the Caribbean now have to design and implement public policies in a variety of areas. The new rules currently being negotiated on intellectual property, capital flows, the handling of personal information on the Internet, State-owned enterprises and labour and environmental issues are just a few examples. Thus, among other things, the region's governments could have less leeway to apply capital controls for prudential purposes, independently determine their levels of environmental protection or ensure access to the Internet for educational purposes and to stimulate innovation. Latin American countries participating in megaregional negotiations will directly experience the impact of these new rules. Those that are not participants will probably be exposed to them indirectly, as the results of these negotiations may ultimately provide the basis for future multilateral agreements at WTO.

The possibility of a wide-ranging trade agreement between the United States and the European Union via the TTIP raises major challenges for the region. Mexico has openly stated its interest in participating in these negotiations, as has Canada. A likely medium-term scenario is thus the completion of a new-generation agreement between the European Union and the three members of NAFTA. In such an eventuality, it is also reasonable to assume that other countries in the region that have free trade agreements with Europe and the United States will seek mechanisms to prevent trade and investment diversion that would reduce the usefulness of their own agreements. This prospect could lead these countries to consider becoming part of this great integrated space centring on the Atlantic. The rationale of the TPP raises similar concerns. The countries of the region that are currently participating are Chile, Mexico and Peru. However, considering that the largest partner, the United States, also has free trade agreements with Colombia, Central America, the Dominican Republic and Panama, the same possibility arises as with the TTIP, namely that some of these countries might seek to involve themselves in the TPP to prevent their agreements with the United States becoming a dead letter. In fact, Colombia and Costa Rica have on a number of occasions expressed an interest in joining the TPP.

This analysis assumes full convergence between TPP and TTIP in the issues covered and the way these are treated, which is far from assured. In fact, on a number of important issues (consumer protection, genetically modified foods, trade-related labour and environmental standards, capital flows, State-owned enterprises and privacy protection for Internet users, among others), the most likely outcome is that large differences will persist between the two agreements. This confirms that the best scenario is still convergence in these rules at the multilateral level. In fact, the megaregional negotiations now under way could well increase the transaction costs associated with trade, resulting in trade and investment diversion and creating duplication or overlap in rules that are not necessarily convergent. This situation would create particular difficulties for smaller exporting economies and firms. Nor can the possibility be ruled out that demanding standards negotiated in these forums may conceal protectionist temptations in new guises.

As is well known, the TPP and TTIP negotiations are taking place outside WTO. Again, none of the economies in the grouping known as BRICS is present at these negotiations. This opens up the possibility that three levels of international trade governance might develop in future, with WTO regulating traditional subjects and the megaregional agreements dealing with the "new issues" associated with value chains, plus a third space dominated by regional integration efforts in Asia, Africa and Latin America, led by the BRICS countries in their respective areas of influence (Baldwin, 2012). In this scenario, if the megaregional agreements are perceived as potentially prejudicial to the countries not participating in them, defensive responses could well develop along the lines of regional trade blocs. This could hasten trends towards economic fragmentation between geographical areas, or between the countries that participate in these mega-agreements and those that do not. This would not be good news, especially in the context of lacklustre international trade such as that expected for the rest of this decade.

Finally, megaregional negotiations are meant to establish governance mechanisms that respond to the shifting nature of world production, trade and investment. The international production networks based in North America, Europe and East Asia are among the most visible examples of these transformations. However, there is much less production integration between the countries of Latin America and the Caribbean, and the economic integration agreements between them are usually less far-reaching than those in these other regions, and thus less well suited to managing modern value chains (see section A of chapter V). Consequently, megaregionalism poses a challenge to Latin America and the Caribbean to deepen its own integration process as a tool for improving its participation in the world economy.

Chapter IV

THE NEED FOR REGIONAL INTEGRATION IN LATIN AMERICA AND THE CARIBBEAN IN RESPONSE TO THE ONGOING GLOBAL TRANSFORMATIONS

A. THE REGION'S STRENGTHS AND WEAKNESSES AS AN INTERNATIONAL ECONOMIC ACTOR

At this point, it will be helpful to provide a brief summary of the main strengths and weaknesses of Latin America and the Caribbean as it grapples with the profound changes under way in the global economy. In 2012, the region accounted for about 9% of the world's population and output. That same year, it was the destination for 13% of worldwide inward FDI (excluding financial centres in the Caribbean). This reflects the region's attractiveness to foreign investors, whether because of its fast-growing domestic markets, the abundance of its natural resources or its advantages as a platform for exporting to outside markets. Conversely, the region's share of worldwide outward FDI in 2012 was less than 4%. Its share of international trade is also lower than its share of population and output, since in 2012 it accounted for 6% of world goods exports and 4% of service exports. The gap is even wider when it comes to the creation of patentable knowledge: in 2012, Latin America and the Caribbean accounted for less than 3% of worldwide patent applications (see table IV.1). This poor showing can be linked directly to the low level of R&D spending in the region. According to World Bank figures, R&D spending averaged 0.83% of regional GDP between 2005 and 2010, and this figure was strongly influenced by Brazil (1.1% of GDP). In all the other countries of the region, R&D spending is below 0.7% of GDP. These numbers contrast with an average of 2.5% of GDP in high-income countries and 1.7% of GDP in the developing economies of Asia-Pacific.

Table IV.1
**LATIN AMERICA AND THE CARIBBEAN AND THE WORLD: SELECTED
ECONOMIC VARIABLES, 2012**

| | Population (millions of inhabitants) | GDP (trillions of dollars) ^a | Exports (billions of dollars) | | Foreign direct investment (billions of dollars) ^b | | Patent applications (number) |
|--|--|---|----------------------------------|---------------------|--|----------|------------------------------------|
| | | | Goods exports | Services exports | Inflows | Outflows | |
| Latin America and the Caribbean | 610 | 7.3 | 1 120 | 157 | 175 | 51 | 59 314 |
| World | 7 080 | 83.2 | 18 401 | 4 350 | 1 351 | 1 391 | 2 347 700 |
| Share of Latin America and the Caribbean (percentages) | 8.6 | 8.8 | 6.2 | 3.6 | 12.9 | 3.6 | 2.5 |

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations, *World Population Prospects. The 2012 Revision* [online] <http://esa.un.org/wpp/Documentation/publications.htm>, for population; International Monetary Fund (IMF), *World Economic Outlook Database*, Washington, D.C., October 2013, for GDP; World Trade Organization (WTO), *Statistics Database*, for goods and services exports; United Nations Conference on Trade and Development (UNCTAD), *UNCTADSTAT Database* [online] <http://unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=88>, for foreign direct investment; and World Intellectual Property Organization (WIPO), *WIPO Statistics Database*, for patent applications.

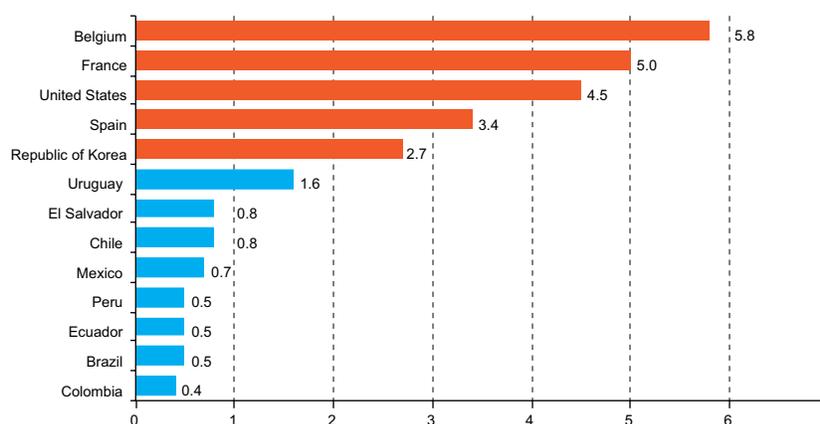
^a In purchasing power parity (PPP) terms.

^b The figures for Latin America and the Caribbean exclude financial centres in the Caribbean.

The region presents a number of shortcomings in its export performance, reflecting its hallmark structural heterogeneity. First, the proportion of firms that export is very low, at less than 1% in most of the countries for which information is available (see figure IV.1). Second, exports are heavily concentrated among a small number of highly internationalized large firms, usually associated with natural resources (see table IV.2). The top percentile of exporting firms account for over 70% of all shipments in Argentina, the Bolivarian Republic of Venezuela, Chile, Colombia, Mexico, Paraguay, Peru and the Plurinational State of Bolivia (see figure IV.2). Turnover among the region's exporting firms is high, one reason being their heavy reliance on a small number of products and destination markets (see figure IV.3).

The picture is very mixed in Latin America and the Caribbean where participation in global value chains is concerned. This can be measured by the share of imported inputs in exports. A comparison between the world's regions shows that Central America and Mexico, along with East and South-East Asia, are among the developing regions most heavily involved in value chains. This finding is largely due to the way in which Mexico and the Central American countries are positioned in the international economy, with a strong presence of processing industries (*maquila*) whose exports incorporate a large share of imported intermediate goods. These countries are in fact heavily integrated into “factory North America”, participating actively in value chains in the electronics, automotive, medical inputs and apparel sectors, among others. By contrast, South America has one of the lowest degrees of participation in global value chains, while the Caribbean is in an intermediate position (see figure IV.4).

Figure IV.1
SELECTED COUNTRIES: EXPORTING FIRMS AS A PROPORTION OF ALL FIRMS, AROUND 2010
(Percentages)



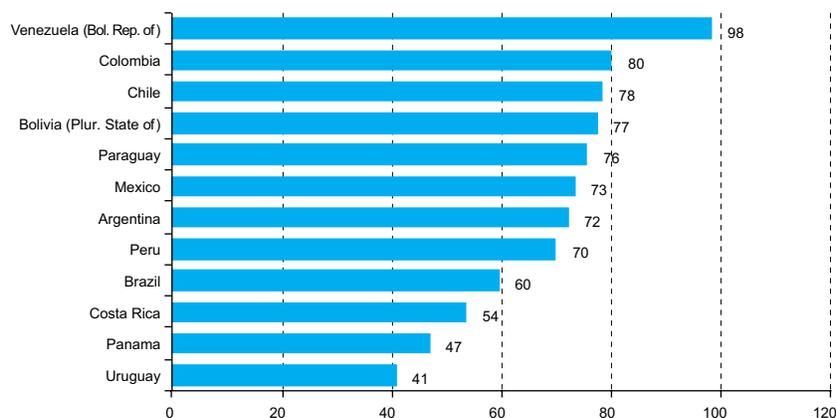
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the customs services of the respective countries; Organization for Economic Cooperation and Development (OECD); World Bank; specialized studies.

Table IV.2
LATIN AMERICA AND THE CARIBBEAN: TOP 20 EXPORTERS, 2012

| Ranking among the top 20 exporters | Ranking among the 500 largest companies | Company | Country | Sector | Exports (millions of dollars) | Exports (percentage of total sales) |
|------------------------------------|---|----------------------|------------------------------------|----------------|-------------------------------|-------------------------------------|
| 1 | 3 | PDVSA | Venezuela (Bolivarian Republic of) | Oil/Gas | 121 480 | 97.6 |
| 2 | 2 | PEMEX | Mexico | Oil/Gas | 50 370 | 39.8 |
| 3 | 5 | VALE | Brazil | Mining | 25 580 | 55.9 |
| 4 | 1 | PETROBRAS | Brazil | Oil/Gas | 22 169 | 16.1 |
| 5 | 7 | ECOPETROL | Colombia | Oil/Gas | 15 269 | 40.5 |
| 6 | 25 | CODELCO | Chile | Mining | 13 878 | 87.5 |
| 7 | 30 | CEMEX | Mexico | Cement | 10 820 | 71.2 |
| 8 | 32 | Norberto Odebrecht | Brazil | Construction | 9 260 | 65.9 |
| 9 | 22 | FEMSA | Mexico | Drinks/Spirits | 7 293 | 39.7 |
| 10 | 28 | Grupo Alfa | Mexico | Multisector | 6 847 | 44.4 |
| 11 | 45 | Volkswagen de México | Mexico | Automotive | 6 826 | 58.7 |
| 12 | 63 | Escondida | Chile | Mining | 6 588 | 74.7 |
| 13 | 20 | Bunge Alimentos | Brazil | Agroindustry | 6 321 | 33.6 |
| 14 | 55 | Grupo México | Mexico | Mining | 5 756 | 56.5 |
| 15 | 36 | Grupo Bimbo | Mexico | Food | 5 228 | 39.2 |
| 16 | 72 | Industrias Peñoles | Mexico | Mining | 5 158 | 68.4 |
| 17 | 89 | Embraer | Brazil | Aerospace | 4 951 | 82.9 |
| 18 | 58 | Chrysler | Mexico | Automotive | 4 756 | 50.0 |
| 19 | 42 | Cargill | Brazil | Agroindustry | 4 154 | 35.1 |
| 20 | 144 | Minera Antamina | Peru | Mining | 3 824 | 100.0 |

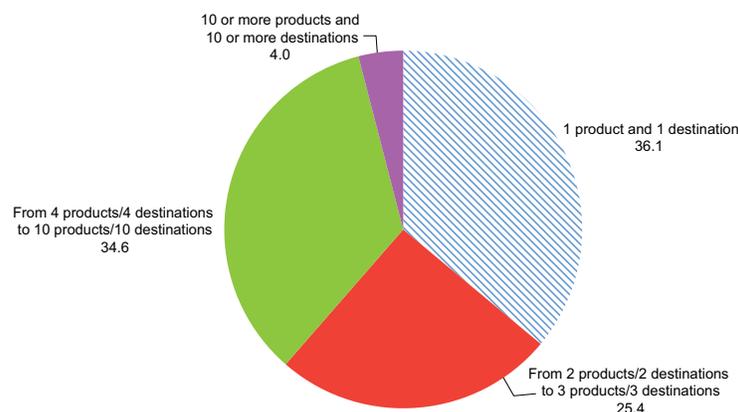
Source: *Revista América Economía* [online] http://rankings.americaeconomia.com/2013/ranking_500_latinoamerica_2013/las-100-mayores-exportadoras.php.

Figure IV.2
LATIN AMERICA (SELECTED COUNTRIES): EXPORT SHARE OF THE TOP PERCENTILE OF EXPORTING FIRMS, BY VALUE, AROUND 2010
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the customs services of the respective countries; Organization for Economic Cooperation and Development (OECD); World Bank; specialized studies.

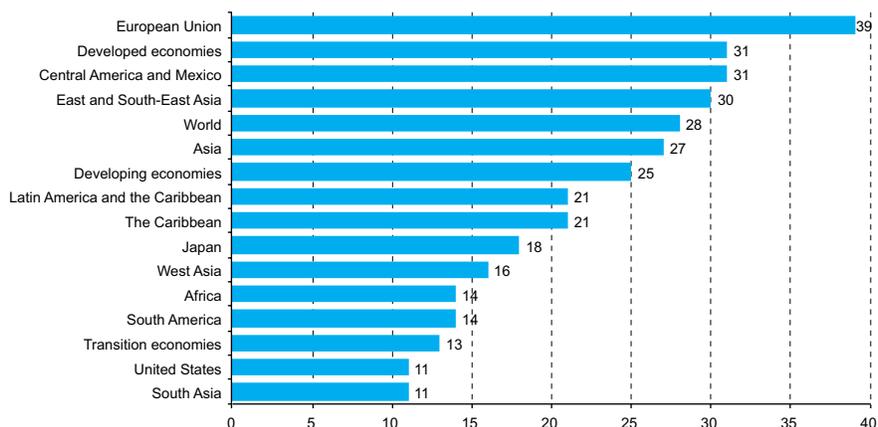
Figure IV.3
**LATIN AMERICA (10 COUNTRIES): DISTRIBUTION OF EXPORTING FIRMS
 BY NUMBER OF MARKETS AND PRODUCTS, AROUND 2010^a**
 (Percentages)



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

^a Includes information for Argentina, the Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Mexico, Panama, Paraguay, Peru and Uruguay.

Figure IV.4
SELECTED COUNTRIES AND REGIONS: SHARE OF IMPORTED VALUE ADDED IN EXPORTS, 2010
 (Percentages)



Source: United Nations Conference on Trade and Development (UNCTAD), *Global Value Chains and Development. Investment and Value Added Trade in the Global Economy*, Geneva [online] http://unctad.org/en/publicationslibrary/diae2013d1_en.pdf.

Albeit tardily in comparison with other emerging regions such as Asia and Eastern Europe, Latin America and the Caribbean entered a number of global services chains during the last decade. In particular, the region is strategically positioned to serve the North American market, owing to its geographical proximity, location in the same time zone and competitive pay levels. In this context, the region has received a large volume of domestic and foreign investment in business process outsourcing (BPO), health services, creative industries, information technology outsourcing (ITO) and other services, such as education and knowledge

process outsourcing (KPO). The BPO-ITO sector in the region generated sales of US\$ 8 billion in 2010, compared to US\$ 5 billion for Eastern Europe (Tucci, 2011). A number of countries in the region have succeeded in positioning themselves in the different global services markets (see table IV.3). These include large economies (Argentina, Brazil and Mexico), medium-sized ones (Chile, Colombia and Peru and small ones (the Central American countries, Cuba, the Dominican Republic and Jamaica). A number of cities in these countries are ranked among the world's 50 most attractive outsourcing destinations.¹

Table IV.3
COUNTRIES OF LATIN AMERICA AND THE CARIBBEAN: PARTICIPATION
IN GLOBAL SERVICE CHAINS

| Business process outsourcing | Health services | Creative industries | Information technology | Other services |
|---|--|---|---|---|
| Accounting and finance Argentina, Brazil, Chile, Costa Rica, Mexico, Uruguay | Health tourism Brazil, Cuba, Colombia, Chile, Costa Rica, Panama | Audiovisual industry Argentina, Brazil, Chile, Mexico | Software development Argentina, Brazil, Chile, Colombia, Costa Rica, Uruguay | Education Argentina, Brazil, Chile |
| Process management and development Argentina, Brazil, Chile, Costa Rica, Mexico, Uruguay | Clinical trials Argentina, Brazil, Chile, Colombia, Mexico, Peru | Advertising Argentina, Brazil, Chile, Mexico | Consulting and information technology services Argentina, Brazil, Chile, Costa Rica, Uruguay | Research, development and innovation Brazil, Mexico, Chile |
| Human resources Argentina, Brazil, Chile, Costa Rica, Uruguay | Telemedicine Argentina, Brazil, Colombia, Mexico | Content industries Argentina, Brazil, Mexico | Management, integration and application maintenance Argentina, Brazil, Chile, Colombia, Costa Rica, Uruguay | Engineering and construction Argentina, Brazil, Chile, Mexico |
| Call, contact and customer service centres Central American countries, Chile, Colombia, Dominican Republic, Peru, Uruguay | Telediagnostics Brazil, Mexico | Architecture Argentina, Brazil, Chile, Mexico | Infrastructure and networks Argentina, Brazil, Chile, Costa Rica, Jamaica, Uruguay | Outsourcing of knowledge-intensive services (legal services, financial and market research) Brazil, Chile, Costa Rica, Mexico |
| Back office services Argentina, Chile, Brazil, Colombia, Costa Rica, Mexico, Uruguay | Analysis and interpretation of medical results Brazil, Uruguay, Mexico | Design Argentina, Brazil, Mexico | Video games, animation and simulation Argentina, Chile | Financial services Brazil, Chile, Costa Rica, Mexico |
| Shared service centres Argentina, Chile, Brazil, Colombia, Costa Rica, Mexico, Uruguay | | | | |

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Andrés López, Andrés Niembro and Daniela Ramos, "Promotion policies for services offshoring: global analysis and lessons for Latin America", *Latin America's Emergence in Global Services. A New Driver of Structural Change in the Region?*, René Hernández and others (eds.), *Libros de la CEPAL* series, No. 121 (LC/G.2599-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), March 2014.

There are three business models for global services chains in Latin America and the Caribbean. The first are shared service centres, these being subsidiaries of multinationals that bring together key services such as information technologies, human resources and accounting. These centres are mainly located in Argentina, Brazil, Chile, Costa Rica and Mexico. The second business model is that of multinational global service firms selling services around the world. These firms set up in the region some time ago but formerly made most of their sales in domestic markets. This group has recently been joined by global service providers from India. Lastly, there are Latin American firms that once sold only information-technology-related services but branched out into BPO services (Hernández and others, 2014). The region's progress in entering global service

¹ They include San José, Costa Rica (ranked 13), São Paulo, Brazil (18), Santiago, Chile (21), Buenos Aires, Argentina (24), Curitiba, Brazil (27), Montevideo, Uruguay (37), Rio de Janeiro, Brazil (38), Mexico City, Mexico (40), Monterrey, Mexico (42), Brasilia, Brazil (43), Guadalajara, Mexico (48) and Bogota, Colombia (49) (Tholons, 2013).

chains is partly explained by the combination of a variety of public policies and public-private partnerships whose aims have included attracting multinationals and internationalizing local firms.

The economic and social benefits of participation in global value chains depend not only on the degree of participation, but also on its quality. A high level of participation is positive insofar as a country succeeds in: (i) improving its international competitiveness by incorporating the best inputs available internationally, together with technical know-how and business practices present in the chain concerned, and (ii) passing on this knowledge and productivity to the other sectors of the economy. Conversely, if a country has a high level of participation in value chains but this consists mainly in activities such as enclave assembly of manufactures, the benefits will tend to be confined to the creation of low-productivity jobs. Meanwhile, a low level of participation in value chains can be negative if export competitiveness is affected by difficulty in obtaining inputs of international quality or access to the knowledge and networks in these chains. Then again, if these inputs, knowledge and networks are available within the country, the negative effects on international competitiveness will be lessened.

The Latin America and the Caribbean has a strategic asset in the form of its internal market, as the good growth performance of the region over most of the past decade brought a steady rise in per capita income from 2003 onward. Additionally, a favourable international business cycle and national policies geared towards greater social inclusion brought substantial advances in reducing poverty and indigence in the region (although progress has been slower since 2011). Thus, poverty fell from 43.9% to 27.9% of the population between 2002 and 2013, while indigence fell from 19.3% to 11.5% (ECLAC, 2013c). Over the past decade, the region has also achieved an improvement in income distribution, with the regional Gini coefficient dropping from 0.547 in 2002 to 0.496 in 2012 (ECLAC, 2014),² although inequality has remained very high in comparison with other regions. Meanwhile, urban unemployment has been declining since 2004, ending 2013 at a reported rate of between 6.2% and 6.3%, a historic low (ECLAC/ILO, 2013).

The conjunction of the factors set out above has led to the regional consumer market expanding along with the middle-income population which, according to a recent World Bank study, rose from 103 million people in 2003 to 152 million (29% of the region's population) in 2009. This expansion is expected to continue in the next two decades, albeit more slowly than in the period that began in 2003. Thus, the middle class is expected to represent 42% of the population in the region by 2030 (Ferreira and others, 2013).³

The region's large endowment of natural resources is another strategic asset. In mining, for example, Chile is the world's largest copper producer and Brazil the third largest iron producer. Mexico is the leading producer of silver and the fifth largest producer of molybdenum and lead ore. Peru is among the leading world producers of silver, copper, gold and lead. The Plurinational State of Bolivia is the fourth largest producer of tin and the sixth largest producer of silver. Colombia is the seventh largest producer of refined nickel, Cuba the eighth largest producer of nickel ore and Jamaica the seventh largest producer of bauxite. Between 1990 and 2012, the region strongly increased its share of world output of gold, molybdenum ore and copper ore, and to a lesser degree of refined copper (see table IV.4). Where energy is concerned, in 2012 Latin America and the Caribbean had the largest proven oil reserves of any region in the world except the Middle East, with 20% of the total. This was heavily concentrated in the Bolivarian Republic of Venezuela, which had 88% of the region's proven reserves as of late 2012 (BP, 2013).

² In both years, the Gini coefficient is a simple average for 18 countries of Latin America.

³ Under the methodology employed in this study, households with a daily per capita income of between US\$ 10 and US\$ 50 in PPP terms are deemed middle-class. Poor households are those with incomes of between US\$ 0 and US\$ 4 and vulnerable households those with incomes of between US\$ 4 and US\$ 10.

Table IV.4
**LATIN AMERICA AND THE CARIBBEAN: MINING OUTPUT AS A SHARE
 OF THE WORLD TOTAL, 1990 AND 2012**
(Percentages)

| Ore or metal | 1990 | 2012 | Top three producers in the region in 2012 |
|---------------------|-------------|-------------|---|
| Bauxite | 22.9 | 19.6 | Brazil, Jamaica and Suriname |
| Copper ore | 24.9 | 44.6 | Chile, Peru and Mexico |
| Refined copper | 15.7 | 19.0 | Chile, Mexico and Peru |
| Gold | 10.3 | 21.4 | Peru, Mexico and Colombia |
| Silver | 34.2 | 47.7 | Mexico, Peru and Chile |
| Tin ore | 28.3 | 20.5 | Peru, Plurinational State of Bolivia and Brazil |
| Iron | 22.6 | 21.1 | Brazil, Bolivarian Republic of Venezuela and Mexico |
| Molybdenum ore | 15.8 | 23.8 | Chile, Peru and Mexico |
| Zinc ore | 16.8 | 19.4 | Peru, Mexico and Plurinational State of Bolivia |

Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Natural Resources: Status and Trends towards a Regional Development Agenda in Latin America and the Caribbean* (LC/L.3748), Santiago, Chile, December 2013.

Latin America and the Caribbean is also a major agricultural power, accounting for 52% of the world's production of soybean, 16% of beef and maize and 11% of milk (see table IV.5). It also possesses a third of the world's reserves of fresh water (see figure IV.5) and 15% of the world's farmland (see table IV.6). The region has a great reserve of biodiversity, mainly in Amazonia. Six of the 17 countries in the world that have been identified as megadiverse are in the region: the Bolivarian Republic of Venezuela, Brazil, Colombia, Ecuador, Mexico and Peru.

The combination of all these factors means that the region, and South America in particular, is destined to play a strategic role in world food security over the coming decades. The world's population is projected to number in excess of 9.5 billion by 2050, an increase of 2.6 billion over 2010 (United Nations, 2012a). Almost the whole of this increase will take place in what are now developing countries, particularly Sub-Saharan Africa and South Asia. FAO predicts that to feed this population, which will be not only more numerous but also more urbanized⁴ and wealthier, food production (excluding crops employed in the production of biofuels) will have to rise by 70%. Rapid urbanization and the emergence of middle classes in Asia and the rest of the developing world will mean major changes in eating habits owing to greater demand for meat, dairy products, vegetables, fruit and fish (FAO, 2009). This presents the region with a historic opportunity, but taking full advantage of it will require the adoption of consistent long-term policies in a great variety of areas, including climate change adaptation and mitigation, proper management of water resources and biodiversity, the provision of an adequate regional transport and energy infrastructure and the development of new agricultural and energy efficiency technologies.

In summary, from the point of view of its position in the world economy, the region's main strengths include an attractive domestic market and an abundant endowment of natural resources, both renewable and non-renewable. Its main weaknesses include its participation in the knowledge economy and in international trade, neither of which are sufficiently dynamic. These latter two aspects are closely related, as is shown by the prevalence of raw materials and manufactures based on low labour costs in the regional export basket.

⁴ Over 70% of the world's population is expected to be urban by 2050, compared to about 50% now (FAO, 2009).

Table IV.5
**LATIN AMERICA AND THE CARIBBEAN: SHARE IN WORLD OUTPUT
 OF SELECTED AGRICULTURAL PRODUCTS, 2012**
(Percentages)

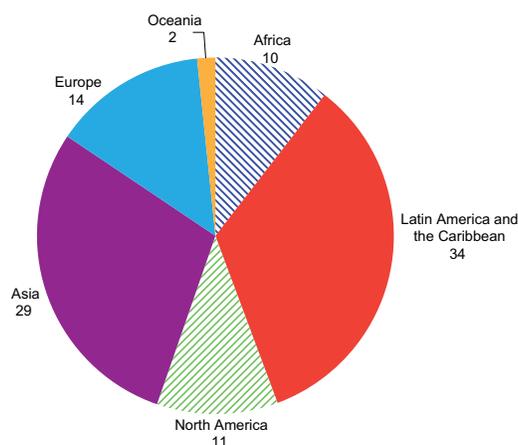
| | Rice | Maize | Soybean | Wheat | Beef ^a | Milk ^a |
|--|------------|-------------|-------------|------------|-------------------|-------------------|
| Central America and the Caribbean ^b | 0.4 | 3.0 | 0.1 | 0.3 | 2.9 | 2.2 |
| South America | 3.3 | 12.7 | 51.8 | 2.9 | 12.9 | 8.9 |
| Latin America and the Caribbean | 3.7 | 15.7 | 51.9 | 3.2 | 15.8 | 11.1 |

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Food and Agriculture Organization of the United Nations (FAO), FAOSTAT database [online] www.faostat.fao.org [date of reference: 6 January 2014].

^a Data refer to 2011.

^b Includes Mexico.

Figure IV.5
DISTRIBUTION OF GLOBAL WATER RESERVES BY REGION, 2011^a
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Food and Agriculture Organization of the United Nations (FAO), Information System on Water and Agriculture (AQUASTAT) [online] <http://www.fao.org/nr/water/aquastat/main/index.stm> [date of reference: 6 January 2014].

^a Total renewable water resources.

Table IV.6
DISTRIBUTION OF WORLD FARMLAND, BY REGION, 2011
(Millions of hectares and percentages)

| Region | Arable land and permanent crops | Permanent grasslands | Total farmland | Percentage of world farmland |
|---------------------------------|---------------------------------|----------------------|----------------|------------------------------|
| Africa | 258.3 | 911.4 | 1 169.7 | 23.8 |
| Asia | 553.6 | 1 079.9 | 1 633.5 | 33.3 |
| Latin America and the Caribbean | 188.0 | 553.0 | 741.0 | 15.1 |
| North America | 210.7 | 263.4 | 474.1 | 9.7 |
| Europe | 292.1 | 177.8 | 469.9 | 9.6 |
| Oceania | 50.3 | 373.1 | 423.4 | 8.6 |
| World | 1 553.0 | 3 358.6 | 4 911.6 | 100.0 |

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Food and Agriculture Organization of the United Nations (FAO), FAOSTAT database [online] www.faostat.fao.org [date of reference: 6 January 2014].

B. THE CRITICAL IMPORTANCE OF THE REGIONAL SPACE

Although it may seem paradoxical at first sight, the current global economic context, marked by the shift of wealth to emerging economies, particularly those of Asia, presents obstacles to progress with structural transformation in Latin America. This is because it has encouraged trade specialization that has not been conducive to the accumulation of production capabilities in the region. The resulting context tends to hold the region back in the so-called “middle-income trap” (CAF/ECLAC/OECD, 2013).

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

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

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

In the light of these considerations, deepening the regional market is an indispensable strategy if Latin America and the Caribbean is to move towards an international role that is more conducive to structural change. The fact is that, for most of the region’s countries, intraregional trade has characteristics that make it qualitatively superior to exporting to other markets. For the great majority of them, the Latin American market is the most conducive to export diversification, absorbing by far the greatest number of export products (see table IV.7).⁵

Another striking feature of the regional market is that it is the main outlet for the medium- and high-technology manufacturing exports of most of the region’s countries, often taking over 70% of these

⁵ The great exception here is Mexico, since its strong production ties to the United States mean that it exports more products to that country than to the region.

(see figure IV.6).⁶ Regional markets are very important in the formation of manufacturing value chains, especially in textiles, wearing apparel, alcoholic beverages, cleaning products, medicines, chemicals and petrochemicals, electronics, and vehicle parts and accessories, among other sectors. In all of these sectors, although there are no fully fledged value chains, there is evidence of considerable potential, especially in intermediate products.⁷ This potential is greatest for countries that are geographically close to one another and form part of the same subregional integration scheme. Thus, there are strong intra-industry trade links between Colombia, Ecuador and Peru within the Andean Community, between Costa Rica, Guatemala, El Salvador and Honduras within the Central American Common Market, and between Mexico and Central America. Among the countries of the Caribbean Community (CARICOM), although goods trade is markedly inter-industrial, the potential exists to create Caribbean value chains in some service segments, especially tourism and financial services.

Table IV.7
**LATIN AMERICA AND THE CARIBBEAN (SELECTED COUNTRIES): NUMBER OF PRODUCTS
 EXPORTED TO SELECTED DESTINATIONS, 2012^a**
(Units)

| Country | Latin America and the Caribbean | United States | European Union | China | Japan |
|---|------------------------------------|---------------|----------------|-------|-------|
| Argentina | 3 591 | 1465 | 1 712 | 407 | 388 |
| Belize | 92 | 87 | 26 | 23 | 8 |
| Bolivia (Plurinational State of) | 679 | 323 | 264 | 51 | 74 |
| Brazil | 3 929 | 2 762 | 2 991 | 1 389 | 1 247 |
| Chile | 3 014 | 1 275 | 1 296 | 362 | 313 |
| Colombia | 3 239 | 1 708 | 1 250 | 253 | 201 |
| Costa Rica ^b | 2 811 | 1 716 | 1 037 | 166 | 142 |
| Dominica | 201 | 291 | 225 | 4 | 0 |
| Dominican Republic ^b | 1 289 | 1 219 | 540 | 106 | 69 |
| Ecuador ^b | 1 916 | 1 018 | 763 | 90 | 105 |
| El Salvador | 2 522 | 1 004 | 396 | 45 | 35 |
| Guatemala | 3 274 | 1 321 | 721 | 142 | 155 |
| Jamaica | 607 | 888 | 467 | 73 | 44 |
| Mexico | 3 857 | 4 164 | 2 803 | 1 367 | 1 272 |
| Nicaragua | 1 815 | 797 | 159 | 29 | 30 |
| Panama ^b | 3 023 | 1 277 | 744 | 103 | 43 |
| Paraguay | 922 | 243 | 332 | 63 | 22 |
| Peru ^b | 3 005 | 1 804 | 1 524 | 316 | 571 |
| Uruguay | 1 428 | 429 | 659 | 129 | 45 |
| Venezuela (Bolivarian Republic of) ^b | 1 312 | 701 | 443 | 31 | 27 |

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

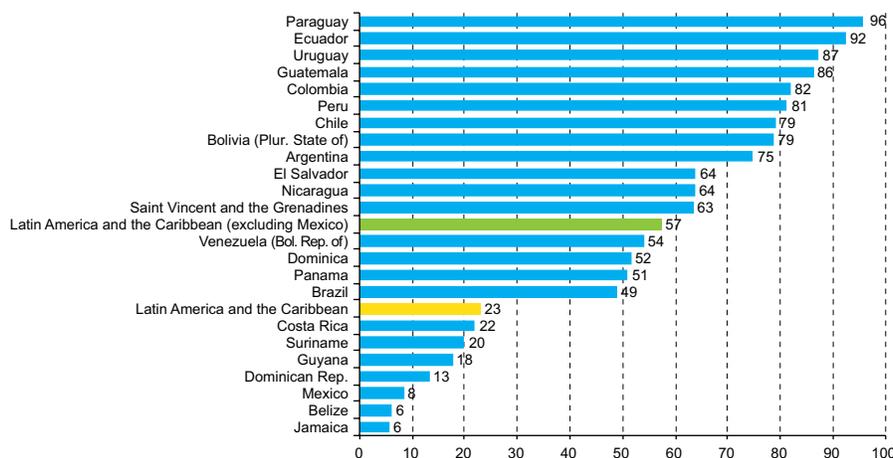
^a Products at the six-digit level of the Harmonized Commodity Description and Coding System.

^b Figures are for 2011.

⁶ As in the previous case, the exception is Mexico, which in 2012 sent just 8% of its medium- and high-technology manufacturing exports to the regional market. Some other countries, particularly in the Caribbean, are in a similar situation, with exports heavily oriented towards the United States market.

⁷ See Durán and Zacliecer (2013) for further sectoral details and a fuller analysis.

Figure IV.6
LATIN AMERICA AND THE CARIBBEAN (SELECTED COUNTRIES): SHARE OF MEDIUM- AND HIGH-TECHNOLOGY MANUFACTURES EXPORTED WITHIN THE REGION, 2012^a
(Percentages)



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

^a The figures for the Bolivarian Republic of Venezuela, Panama and Suriname are from 2011.

The regional market is hugely important for Latin American export firms. Among the firms exporting to the region's main export destinations a greater proportion export to Latin America and the Caribbean than to any other market. This is true of all the countries for which information is presented in table IV.8 other than Mexico (where 74% of firms that export do so to the United States). The concentration of exporting firms tends to be particularly great in subregional markets. Thus, in all the member countries of MERCOSUR other than the Bolivarian Republic of Venezuela, a higher proportion of firms export within MERCOSUR than to the rest of the region. The same is true of Costa Rica and Guatemala in Central America. In the Andean Community, conversely, exporting firms do not concentrate particularly on the subregional market. In Colombia, this is explained by the large number of firms exporting to the Bolivarian Republic of Venezuela (about 25% of the total), Brazil and Mexico. In the case of Peru, it is due to the many firms exporting to the Bolivarian Republic of Venezuela (15% of the total) and Chile (15%). In the case of the Plurinational State of Bolivia, lastly, it is due to the large number of firms exporting to Brazil (12% of the total) and Argentina (10%).

The regional market is especially important for small and medium-sized exporters (SMEX). These represent over 70% of all export firms in the region, although their share of the total value exported is very small. Excluding Mexico, the share of total SMEX exports going to the regional market for a group of 13 countries in the region is 55%, more than twice the figure for large firms (see table IV.9).

Table IV.8
**LATIN AMERICA (SELECTED COUNTRIES): SHARE OF ALL EXPORTING FIRMS
 THAT EXPORT TO SELECTED DESTINATIONS, AROUND 2011**
(Percentages)

| Grouping | Country | Same grouping ^a | Rest of Latin America and the Caribbean | United States | European Union | China | Rest of world |
|------------------|------------------------------------|----------------------------|---|---------------|----------------|-------|---------------|
| MERCOSUR | Argentina | 62.8 | 52.4 | 20.2 | 28.5 | 4.8 | 24.5 |
| | Brazil | 45.7 | 43.3 | 29.6 | 39.4 | 10.1 | 41.2 |
| | Paraguay | 67.1 | 26.3 | 12.3 | 21.2 | 7.4 | 21.3 |
| | Uruguay | 47.7 | 25.8 | 19.3 | 22.3 | 10.8 | 45.7 |
| | Venezuela (Bolivarian Republic of) | 9.3 | 50.2 | 25.6 | 19.8 | 2.1 | 12.9 |
| Andean Community | Bolivia (Plurinational State of) | 19.7 | 54.0 | 27.0 | 21.0 | 8.7 | 18.8 |
| | Colombia | 25.5 | 54.5 | 30.8 | 15.4 | 1.5 | 24.1 |
| | Peru | 30.5 | 43.2 | 33.9 | 25.9 | 5.6 | 23.0 |
| Central America | Costa Rica | 50.5 | 26.2 | 39.9 | 20.7 | 3.2 | 22.0 |
| | Guatemala | 57.5 | 27.6 | 32.6 | 12.2 | 2.3 | 20.7 |
| | Panama | 35.8 | 36.1 | 28.5 | 13.4 | 3.5 | 19.3 |
| Ungrouped | Chile ^b | N/A | 68.7 | 29.0 | 29.2 | 12.3 | 30.4 |
| | Mexico ^b | N/A | 29.0 | 73.8 | 15.4 | 4.4 | 18.4 |

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

^a Percentage of exporting firms in each country that export to the grouping to which the country belongs.

^b Because Mexico and Chile are classified as ungrouped, exports to the “rest of Latin America and the Caribbean” are exports to the whole region.

Table IV.9
**LATIN AMERICA (14 COUNTRIES): EXPORT ORIENTATION BY TYPE OF FIRM
 AND SHARE OF THE TOTAL, AROUND 2011^a**
(Percentages)

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

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

^a The countries are Argentina, the Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Mexico, Panama, Paraguay, Peru, the Plurinational State of Bolivia and Uruguay.

The regional market is also increasingly important from the perspective of foreign investment flows. Intra-regional FDI (i.e. direct cross-border investment between Latin American and Caribbean countries) rose from just 4% of inward FDI in the region between 2000 and 2004 to 14% in 2012. The weight of intraregional FDI is much greater in some economies, especially smaller ones. In the latest year for which figures are available, FDI from other countries in the region represented 41% of the total in Uruguay, 35% in Ecuador, 34% in Costa Rica, 32% in Guatemala, 31% in Paraguay and 28% in Argentina.

Although there are no comparable official data on the destination of FDI originating in the region, an analysis of the main trans-Latins' investment strategies shows that most of their investments go to other countries in the region, and particularly those closest to the firm's home country. Thus, Chilean firms have targeted their investments on Argentina and Peru and, more recently, Brazil and Colombia. Colombian firms that invest abroad started by opening subsidiaries in the Bolivarian Republic of Venezuela and now invest mainly in Central America and Peru. Mexican firms divide their investments between other Latin American countries and the United States. Brazilian firms also invest mainly in the region, although, being larger, they have a greater presence outside it, particularly in the United States.

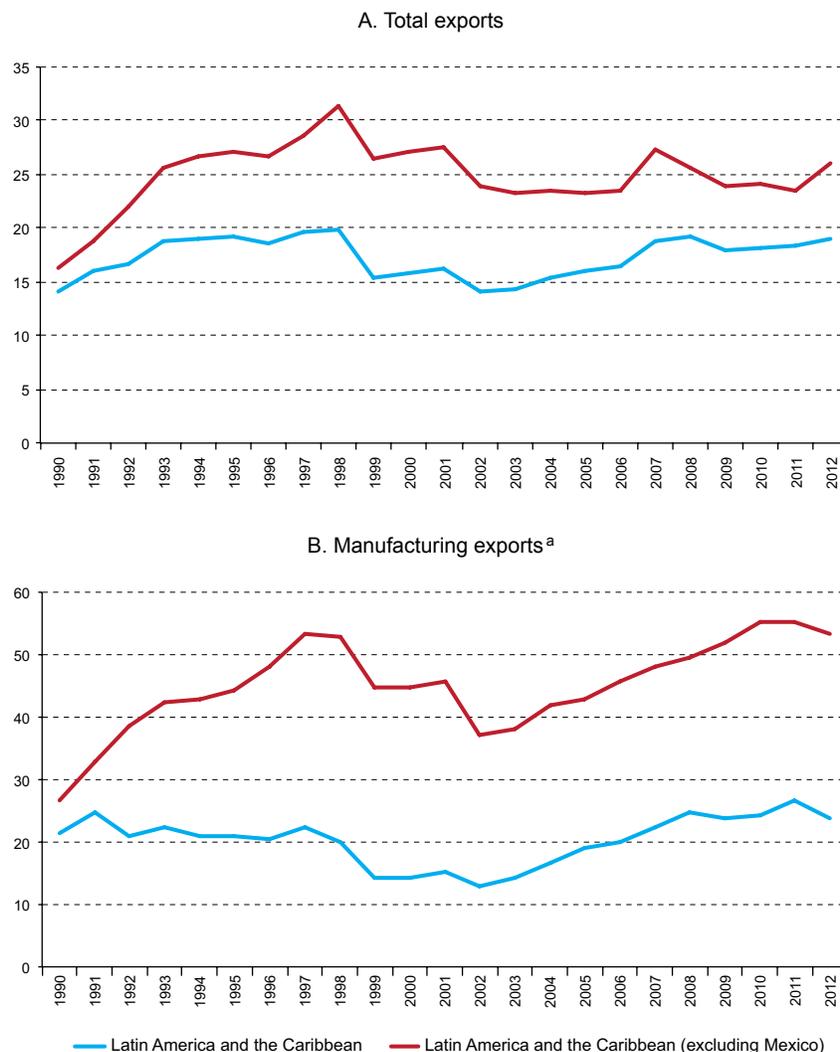
It can be said, then, that Latin America forms a corporate integration space where the most successful firms from each country find their natural outlet for expansion. Thus, large regional groups have been formed and become leaders in particular markets, such as América Móvil in mobile telephony, Sura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

The region does not seem to be taking full advantage of the potential of its own market. In 2012, just 19% of regional exports stayed within the region, a share that has been essentially unchanged since 2007.⁸ The total export share of the intraregional market rises to 26% if Mexico is excluded, since that country, the region's largest exporter, sends almost 80% of its shipments to the United States (see figure IV.7 A). Even excluding Mexico, however, the intraregional share of total Latin American and Caribbean exports is far below levels in the main regions of the world economy, as mentioned in chapter III (see table III.5).

Given the large share of raw materials in the region's export basket (especially where South America is concerned) and the fact that these go mainly to extraregional markets, it is useful to calculate the share of Latin American and Caribbean manufacturing exports going to the regional market. When this exercise is carried out, the share of the regional market proves to be considerably larger than for total exports. This increase is particularly marked when Mexico is excluded, as then it transpires that over 50% of the manufacturing exports of all the region's other countries taken together go to the regional market (see figure IV.7 B). Furthermore, the regional market's share of Latin American and Caribbean manufacturing exports has increased greatly in the last decade, from 13% in 2002 to 24% in 2012 (and from 37% to 53% if Mexico is excluded). The share of total exports going to the regional market rose by much less over the same period. In short, the regional market is now crucial to the industrial exports of Latin America and the Caribbean, and especially South America.

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

Figure IV.7
**LATIN AMERICA AND THE CARIBBEAN: INTRAREGIONAL EXPORTS
 AS A SHARE OF WORLDWIDE EXPORTS, 1990-2012**
(Percentages)



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

^a Includes high-, medium- and low-technology manufactures. Excludes natural resource-based manufactures.

Despite the high manufacturing density of Latin American intraregional trade, most of it consists of finished products, as the small share of intermediate goods (parts and components) reveals. Intermediate goods account for over 30% of trade between the countries of “factory Asia” and for 20% between the member countries of NAFTA, but for only 10% between the countries of Latin America and the Caribbean (see figure III.5). This is evidence for a low degree of production integration between the Latin American and Caribbean economies, which, with some exceptions, have made only limited progress in constructing regional or subregional value chains. This not only restricts the potential for corporate alliances and intra-industry trade but leaves greater scope for protectionist temptations of various kinds.

For most of the region's countries, the most immediate opportunities for engaging with the dynamic of value chains lie within the regional market, given its centrality to industrial exports. At the same time, integration has become indispensable in a world economy that is being increasingly structured around macroregions. A solid link can thus be identified here between a strategy of growth with equality and enhancement of the regional economic space. A production transformation capable of reducing inequalities requires more and better productive employment and a greater presence of SMEs, manufactures and services in exports. These characteristics are better represented in intraregional trade than in any other kind. There is thus a need to establish an environment conducive to greater productive integration between the region's economies. This will require action on several fronts. In the next chapter, some proposals for the role that regional integration can play in this will be outlined.

Chapter V

THE LINK BETWEEN INTEGRATION AND INDUSTRIALIZATION

A. PRODUCTIVE AND TRADE INTEGRATION

Economically speaking, the decade from 2001 to 2010 was the region's best for 40 years. This was reflected in positive indicators for growth, macroeconomic stability, poverty reduction and even income distribution. In addition, both its exports and its international reserves grew substantially. However, as was briefly illustrated in section A of chapter IV, this good news did not translate into equivalent progress in innovation and international competitiveness, or in any diminution of the substantial shortcomings in the region's physical and logistical infrastructure. In this context, the present chapter addresses the issue of how regional integration can promote greater production linkages between the countries of Latin America and the Caribbean while at the same time contributing to the diversification of production and exports and to the region's international competitiveness.

1. The role of an integrated regional market in fostering production linkages

The Latin American and Caribbean region has made substantial progress in reducing barriers to intraregional goods trade, particularly as regards tariffs. This is the result of efforts within the different subregional integration schemes, the signing of a large network of agreements connecting countries and groupings in different subregions, and the unilateral opening undertaken in many countries since the second half of the 1980s. The liberalization achieved is an asset that should be valued and preserved. Nonetheless, the limitations of this process also need to be recognized. First, there are large "missing links", i.e. intraregional relationships that have not been liberalized. The most glaring of these is trade between Mexico and MERCOSUR,¹ and between the latter and the Central American countries. Progress in liberalizing trade between the Caribbean and the rest of the region is still very incipient too (see chapter VI).

Second, the dense architecture of trade agreements within the region has resulted in a situation of increasing fragmentation. This is because the content of the different agreements varies widely, in terms of both the scope and the depth of the commitments negotiated. The rise of value chains has reduced the importance of tariff issues and increased that of non-tariff ones, such as trade facilitation, personal and corporate mobility, technical standards applicable to products and services and the treatment of foreign investment and intellectual property, among other matters. This explains the strong regulatory emphasis (also known as deep integration) of the megaregional agreements currently being negotiated in Asia, Europe and North America. Nonetheless, the thematic coverage of many of the trade agreements between countries in the region does not yet reflect these global trends (see table V.1). Consequently, the lowering of tariff barriers aside, progress towards the establishment of an integrated regional space characterized by common trade and investment regulations is still very limited. This in turn has disincentivized the development of regional or subregional value chains.

¹ Two exceptions are the automotive industry (where trade between Mexico and MERCOSUR has been partially liberalized by a number of bilateral protocols) and the relationship between Mexico and Uruguay, which is governed by a bilateral free trade treaty.

Table V.1

**THEMATIC COVERAGE OF TRADE AGREEMENTS BETWEEN LATIN AMERICAN AND CARIBBEAN COUNTRIES
AS OF MARCH 2014**

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

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

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

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

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

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

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

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

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

^h It is indicated that the parties will be governed by the WTO Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) and by the 1992 Convention on Biological Diversity.

ⁱ It is also noted that the parties will seek to develop standards and disciplines for the protection of traditional knowledge.

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

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

A number of the region's countries use public procurement as a mechanism for industrial policy and the promotion of SMEs.² This explains the reluctance of some governments to commit themselves to opening it up as part of trade and integration agreements. Nonetheless, given sufficient flexibility, it seems perfectly possible to reconcile the benefits of greater regional or subregional opening (in terms of scale and a better cost-quality ratio for the goods and services purchased) with the preservation of scope for promoting different public policy goals. Thus, for example, any agreements could include different forms of preferences for local SMEs or for firms that meet particular environmental objectives, such as the use of green technologies or unconventional renewable energy sources.

Given the information set out, the goal of moving towards an integrated regional space via gradual convergence between existing agreements remains fully applicable. Nonetheless, efforts to move in this direction over the past decade have not prospered, and this reflects profound differences over trade issues within the region.³ Consequently, a large dose of flexibility and pragmatism will be required to accommodate any advances that are made among smaller groups of countries, always ensuring that the door is left open to subsequent convergence between these initiatives at the regional level.

Since one goal shared by the governments of the region is to promote the creation and development of multinational production linkages, it would be advisable to explore options for progressing gradually towards full regional cumulation of origin.⁴ It would also be desirable for there to be greater regional or subregional coordination of the trade facilitation actions being implemented by a number of governments (such as single windows for external trade) and gradual harmonization or mutual recognition of each country's technical, sanitary and phytosanitary standards. All this would be particularly beneficial to exporting SMEs, as these are less well equipped than large firms to cope with administrative or regulatory obstacles to trade.

The development of stronger trade and investment links between South America, Central America and Mexico should also be a core objective of efforts to foment greater productive integration in Latin America. This being so, a permanent challenge is to move towards greater formal integration between Brazil and Mexico, the region's largest and most sophisticated economies.

² This is also the case in developed countries such as the United States and Japan.

³ This was the case with the initiatives aimed at creating free trade areas between the members of the Latin American Integration Association (ALADI) and the then South American Community of Nations (now UNASUR).

⁴ This concept refers to the possibility that inputs from any country in the region, incorporated into an end product to be exported by another country in the region to a third country also within the region, may be considered to be from the country exporting the end product. This would increase the range of regional suppliers to which Latin American and Caribbean export firms have access, without losing the tariff preferences negotiated as part of integration agreements.

The pursuit of intraregional trade should not be taken as a call for protectionism against the rest of the world. The new methods of organizing production in value chains are driving segmentation, stimulating trade in intermediate goods and intra-industry trade as typical features of productive complementarity. Accordingly, the net effect of measures that limit access to imports should be assessed with the greatest care. Specifically, the analysis should include the adverse impact they might have on the competitiveness of a country's production processes by excessively raising the cost of imported capital goods, inputs, services or technologies or depriving companies of timely access to them.⁵

It is true that the most recently industrialized Asian countries resorted at various times to a range of temporary protection practices, and that this helped them to shift their production structure towards light and medium manufactures in the first instance, before moving into more sophisticated sectors. From the outset, however, and albeit with national differences and specificities, there was a very strong emphasis on directing this production towards the most demanding international markets rather than domestic ones, and substantial market shares were achieved there thanks to advances in productivity, competitiveness and innovation. Such advances are surely harder to achieve when priority is given to the domestic market or a regional market protected from extraregional competition. In short, the new import substitution must be genuine, i.e. based on improvements in innovation and competitiveness and not on administrative barriers or on economies with closed borders.

Lastly, a key challenge is to reduce the high logistical costs that characterize intraregional trade, as these often exceed not only the cost represented by tariffs, but even the logistical costs of exporting to far-off destinations beyond the region. This means making gradual inroads into the transport infrastructure gaps that famously characterize the region, something that will involve substantial investments which can only be fully implemented over long periods. Nonetheless, large gains can be made in the short term with "soft" logistical solutions such as the provision of modern storage services and greater efficiency in customs and certification processes, among others (CAF/ECLAC/OECD, 2013).

2. The centrality of industrial policy

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

Industrial policy, broadly understood, comprises a very diverse array of instruments (see table V.2). These include instruments designed to improve companies' access to financing, those whose purpose is to generate and diffuse new technologies and know-how, training instruments, incentives for SME partnership and internationalization, quality certification programmes and production cluster policies. To deal with its large deficits in these areas, the region needs to break the grip of neoliberal dogmas which still preach that

⁵ For instance, about 85% of Brazilian imports of manufactures from China are intermediate and capital goods purchased by Brazilian industry to manufacture finished goods that are then exported or sold in the local market (Pedro da Motta Veiga, presentation at the WTO Public Forum in September 2012). Recent studies also bear out the crucial role played by access to modern services in the evolution of competitiveness and in adding value to exports (WTO, 2013a).

the best industrial policy is none at all, and that the market is the most appropriate instrument for allocating resources for the medium and long term.⁶

Table V.2
TYPES OF INDUSTRIAL POLICY

| Policy type | Goals | Instruments |
|---|---|---|
| Horizontal and passive | Non-discrimination among activities | <ul style="list-style-type: none"> • Competitiveness policies: <ul style="list-style-type: none"> - Stable macroeconomy - Contract enforcement - Ease of new business start-up - Investment protection and building of infrastructure • Trade and inward FDI policies: <ul style="list-style-type: none"> - General unilateral opening initiatives - Signing of bilateral or multilateral agreements that do not distinguish between or protect specific sectors - Opening up to foreign capital |
| Horizontal and active | Correct market failures | <ul style="list-style-type: none"> • Policies to foster scientific and technological development and innovation: <ul style="list-style-type: none"> - Direct support for private-sector R&D activities - Promotion of joint R&D projects to internalize externalities • Policies for human resource training and the development of business skills: <ul style="list-style-type: none"> - Funding for specialized human resource training and intellectual property protection • Policies to support SMEs and microenterprises: <ul style="list-style-type: none"> - Credit support policies • Policies to correct problems resulting from imperfect information: <ul style="list-style-type: none"> - Organization of events, fairs and congresses, preparation of business directories - Seminars and conferences |
| Policies for structural change without challenging comparative advantages | Development strategies based on existing comparative advantages | <ul style="list-style-type: none"> • Direct State action policies: <ul style="list-style-type: none"> - Provision of information on new industries consistent with comparative advantages - Coordination of investment in related industries and infrastructure improvements - Direct fiscal subsidies - Untargeted tax exemptions - Targeted lending with subsidized interest rates - The use of incubators or inward FDI promotion measures to catalyse the development of new industries - Tariffs on external trade |
| Policies for structural change that create new competitive advantages | Altering and challenging comparative advantages | <ul style="list-style-type: none"> • The industrial policy instruments used with this approach combine all the foregoing with direct State intervention instruments in the areas of financing, fiscal stimuli, public investment and public procurement, among others. With this approach, industrial policy needs to be coordinated with macroeconomic, social and labour market policies if structural change is to be achieved. |

Source: Ramón Padilla and Jennifer Alvarado, “El resurgimiento de la política industrial”, Ramón Padilla (ed.), “Fortalecimiento de cadenas de valor como instrumento de política industrial. Metodología y experiencia de la CEPAL en Centroamérica”, Mexico City, ECLAC subregional headquarters in Mexico, in press, 2014.

Industrial policy is a central element in the proposal for structural change that ECLAC has been advocating to the region in recent years. What it is meant to do is encourage the transition to activities characterized by higher levels of productivity and greater knowledge-intensity, whether in the manufacturing, natural-resource or services sector. This can be done either through policies to strengthen existing comparative advantages (by incorporating more technology into natural resource exports, for instance) or through policies to create new competitive advantages. Certainly, modern industrial policy needs to be responsive to the

⁶ These claims are not borne out by any real experience. All successful cases of development (the United States, Europe, Japan, the newly industrialized economies of Asia and now China and India) are quickly converging on industrialization paths where the role of industrial policy and State intervention have been decisive. It is no doubt very necessary to discuss the limits and specificities of such intervention in each context. Yet to deny the evidence and think that only the market was responsible for building competitiveness in these cases is pure ideology.

globalized context the region is operating in, characterized by greater openness to trade and FDI and by the constraints some trade and investment agreements place on the use of certain instruments. In other words, what is being pursued is an industrial policy that serves to improve the quality of the region's participation in the international economy.

Undoubtedly, industrial policy is mainly formulated and implemented from a national level. Nonetheless, if the aim is to promote the development of multinational production linkages, action at this level alone is not enough. This is why ECLAC has suggested the possibility of taking the first steps in the development of industrial policies with some components that are multinational, i.e. shared by a number of countries. By using studies to detect production sectors or activities with the potential to compete in intra-industry trade or multinational value chains, it would be possible to implement a range of convergent initiatives in different critical areas at the firms involved. These will depend on the specificities of each sector, but could include quality certification programmes, sanitary and phytosanitary aspects, technical standards, traceability, measurement and reduction of carbon and water footprints, and training policies closely linked to production needs (see box V.1 for two examples in Central America). As these productive convergences are gradually achieved, movements of professional and technical workers and skilled labour between different segments of the chain will gradually be induced. Consequently, these policies and instruments should be complemented by others to facilitate such movement.

Box V.1

SPACES FOR THE COORDINATION OF INDUSTRIAL POLICIES IN CENTRAL AMERICA

Some recent studies of Central American value chains have cast light on the potential for coordinating industrial policies between the countries participating in these chains. For example, Zúñiga (2011) analyses the case of the dairy industry in Costa Rica, El Salvador and Nicaragua. By studying a set of factors that influence the creation of value chains, the author determines that for the three countries to be able to take advantage of the sector's potential in their national markets, and then in the subregional market and outside markets, they need to make better use of their respective advantages.^a Thus, El Salvador could transfer information on high-impact production technology to Costa Rica and Nicaragua, as it is the country with the highest automation levels and yields of the three, despite being a net importer. It could also make greater investments in the other countries, especially Nicaragua, and this can be done by taking advantage of the existing openness to trade and FDI flows in the subregion. In turn, El Salvador and Nicaragua could benefit from Costa Rica's experience with partnership programmes to deal with the problem of atomized production and increase product quality. In Costa Rica, the Dos Pinos milk producers' cooperative controls 80% of the milk stock, thereby ensuring that producers fetch good prices, something that is not achieved in Nicaragua or El Salvador. The subregional market accounts for almost two thirds of dairy exports from the Central American countries as a group (see table).

Table

COUNTRIES OF CENTRAL AMERICA: DISTRIBUTION OF DAIRY EXPORTS (MILK, BUTTER AND CHEESE), BY EXPORTING COUNTRY AND DESTINATION MARKET, 2012^a (Percentages)

| Country | Central America | Other Latin America | United States | European Union | Rest of world | World |
|------------------------|-----------------|---------------------|---------------|----------------|---------------|--------------|
| Costa Rica | 67.8 | 22.3 | 7.1 | 1.8 | 0.9 | 100.0 |
| El Salvador | 71.6 | 0.4 | 8.6 | 2.3 | 17.1 | 100.0 |
| Guatemala | 63.8 | 8.4 | 12.9 | 1.5 | 13.5 | 100.0 |
| Honduras | 59.7 | 0.9 | 26.6 | 4.2 | 8.7 | 100.0 |
| Nicaragua | 73.9 | 12.3 | 10.1 | 0.5 | 3.2 | 100.0 |
| Panama ^b | 23.4 | 1.6 | 44.9 | 6.8 | 23.3 | 100.0 |
| Central America | 64.3 | 8.6 | 14.7 | 2.2 | 10.2 | 100.0 |

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

^a Includes groups 022, 023 and 024 of the Standard International Trade Classification (SITC) Rev. 3.

^b 2011 data.

Box V.1 (concluded)

What emerges from Zúñiga's study is that there is scope in Central America for the application of regional industrial policies that could foster the development of the dairy sector. The recommendations for this include: unifying production processes so that health and safety rules can be standardized, establishing regionally recognized certification mechanisms, expanding development banking, and investing in the creation and consolidation of the infrastructure and institutions the sector needs. In short, planning the development of this activity from a subregional perspective is important for the sector's competitiveness.

Another study is that by Antunes and Monge (2013), who conduct a diagnosis of the synthetic fibres and sports clothing chain in El Salvador. The three links in this chain account for a large share of local textile employment: it is responsible for 49% of the country's yarn-making employment, 70% of employment in fabrics and 20% of employment in clothing. SMEs make up 91% of all firms in the synthetic fibres cluster, with 503 small firms out of a total of 610 in 2011.

Among the study's main conclusions, mention is made of some factors that are crucial to the sector's competitiveness. These include the electricity price (energy consumption represents 60% of total costs for fabrics, 14% for yarns and 12% for clothing); the availability of financing mechanisms for the industrial sector (e.g. guarantees for production activities in areas such as working capital and capital formation); innovation, technological development, environmental retrofitting and certification, and affordable prices in the distribution process. This last factor largely depends on the quality of transport infrastructure (land transport in the case of sales to the Central American market and sea transport for exportation to the United States) and the associated logistical services, including management of foreign trade formalities. Here the employment of information and communication technologies, such as the use of single windows for foreign trade, has been among the factors greatly impacting export competitiveness.

In this sector, like the dairy sector, there is great potential to generate subregional value chains, this time associated with the United States market, the main buyer of apparel of different types (underwear, knitted outerwear, children's clothes, clothing accessories, etc.). In this context, it is shown that there is scope for industrial policies coordinated at the subregional level to improve the competitiveness of the sector's firms as a whole, including the following: (i) coordinating innovation efforts by firms, governments and academia with a view to moving up the chain; (ii) strengthening the sector's endowment of specialized technical workers, not qualified to tertiary level but with experience in the sector, by creating comparable profiles at universities and technical training centres in Central America; (iii) promoting the implementation of strategies to automate and harmonize customs procedures, such as the use of authorized economic operator certification; (iv) encouraging economic agents to enter into partnerships so that subregional shared service centres can be used; and (v) improving the single window mechanisms for external trade available in the Central American Common Market.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Bruno Antunes and Claudia Monge, *Diagnóstico de la cadena de fibras sintéticas-ropa deportiva en El Salvador* (LC/MEX/L.1119), Mexico City, ECLAC subregional headquarters in Mexico, 2013, and Guillermo Zúñiga Arias, "El desarrollo de cadenas de valor agroindustriales en Costa Rica, El Salvador y Nicaragua. El caso de estudio de la agroindustria láctea", *Estudios y perspectivas series*, No. 126 (LC/MEX/L.996.Rev.1), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), May 2011.

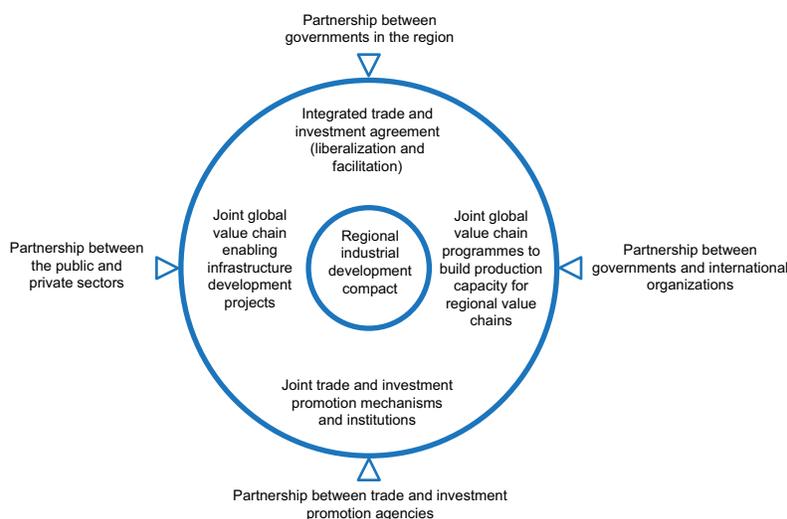
^a The factors studied include: (i) market structure; (ii) potential domestic demand; (iii) the level of aggregation of national content; (iv) the greater or lesser degree of partnership between producers; (v) the existence or otherwise of a national industrial policy; (vi) the availability of infrastructure appropriate to the sector.

Similarly, regional industrial development compacts could support the emergence of regional value chains. These collective accords could also include trade and investment facilitation agreements, joint mechanisms to promote trade and attract investment, and support for the formation of cross-border industrial clusters via joint financing of the requisite infrastructure (see diagram V.1).

A concrete example of the potential offered by regional or subregional cooperation for industrial policy implementation concerns the internationalization of SMEs. In the region, exporting SMEs are usually less productive and more likely to be informal than their counterparts in developed countries, and they usually have greater difficulty in obtaining credit. These firms experience serious human capital constraints, strategic management problems and higher fixed costs when they enter external markets. In addition, they are less well equipped than larger firms to meet the requirements applied in destination markets, such as technical,

quality, sanitary, phytosanitary and environmental sustainability standards. For all these reasons, regional SMEs generally have great difficulty exporting, whether directly or indirectly (i.e. through linkages with larger exporting firms). In fact, micro and small enterprises in Latin America hardly export at all, in stark contrast to the situation in the industrialized economies (see table V.3).

Diagram V.1
REGIONAL INDUSTRIAL DEVELOPMENT COMPACTS FOR VALUE CHAINS



Source: United Nations Conference on Trade and Development (UNCTAD), World Investment Report 2013, Geneva [online] http://unctad.org/en/publicationslibrary/wir2013_en.pdf.

Table V.3
SELECTED COUNTRIES: TOTAL EXPORT SHARES BY COMPANY SIZE, AROUND 2010^a
(Percentages)

| | Argentina | Brazil | Chile | Spain | Italy | Germany | France |
|--------------|-----------|--------|-------|-------|-------|---------|--------|
| Micro | 0.3 | 0.1 | - | 11.1 | 9 | 8 | 17 |
| Small | 1.6 | 0.9 | 0.4 | 13.3 | 19 | 12 | 10 |
| Medium-sized | 6.5 | 9.5 | 1.5 | 22.6 | 28 | 18 | 15 |
| Large | 91.6 | 82.9 | 97.9 | 47.1 | 44 | 62 | 58 |

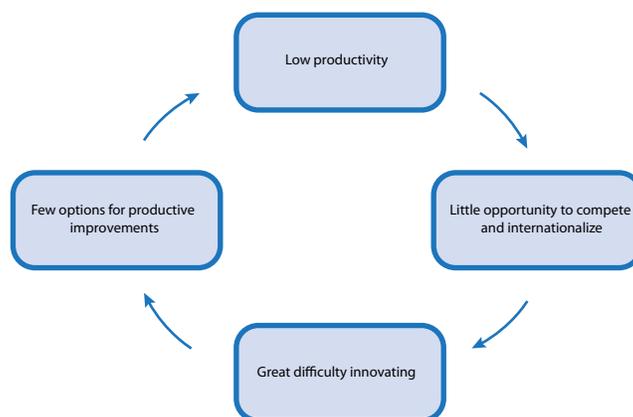
Source: Organization for Economic Cooperation and Development/Economic Commission for Latin America and the Caribbean (OECD/ECLAC), *Latin American Economic Outlook 2013: Structural Policies for SME Development* (LC/G.2545), Santiago, Chile.

^a The figures for Brazil do not include special micro and small enterprises, which account for 6.6% of total exports. In the case of Chile, the figure for small enterprises includes microenterprises. In Spain, 5.9% of exports are made by companies whose size is unknown and so are not included here. The figures for Germany only cover exports within Europe.

As already indicated, the dynamic of value chains results in many activities formerly located in a single country being shifted to different locations throughout the world. In this context, large firms are increasingly externalizing production processes to specialized SMEs. This is creating unprecedented opportunities for the region's SMEs to act as suppliers of goods and services to larger firms. To take advantage of these opportunities, however, it is necessary to break the vicious circle that constrains and limits the internationalization of the region's SMEs (see diagram V.2). For this, it is essential for them to narrow productivity divides by incorporating

technology, innovations and knowledge into their products, and to improve their management. In short, an industrial policy is needed. It would be advisable to focus efforts on the specific sectors and value chains that offer the greatest potential for these firms to participate, identifying bottlenecks and barriers to entry. Specifically, it is important to move forward on four interrelated areas of support policy: (i) innovation to enhance production and management capabilities; (ii) market access; (iii) production linkages and business cooperation; and (iv) access to financing.⁷

Diagram V.2
THE VICIOUS CIRCLE OF SME INTERNATIONALIZATION



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

Secondly, it is necessary to exploit the virtuous relationship between competitiveness and internationalization. Improving competitiveness enables SMEs to internationalize and reach new markets. In turn, internationalization stimulates the competitiveness of SMEs by making them operate in more complex markets and giving them access to new technologies, business practices, networks and market information, among other resources. Benefiting from this virtuous relationship requires action in two major policy areas: (i) training and awareness-raising among SMEs with the goal of internationalization; and (ii) the promotion of production linkages and the identification of business opportunities with multinationals (including trans-Latins). This is particularly fertile ground for regional or subregional cooperation via programmes to match demand for suppliers on the part of the largest internationalized firms operating in the region with the supply available from SMEs. These programmes could also support SMEs with potential as suppliers to enable them to meet the requirements (of quality, design or safety, for example) laid down by the larger firms in the same chain. A number of the region's countries already have successful supplier development programmes, although not all of them are explicitly export-oriented.⁸ The challenge now is to take the next step, i.e. link up these national programmes with a view to promoting multinational production linkages in the region.

Industrial policy is also vital for penetrating and moving up global service chains, as the experience of some of the region's countries shows. There are two possible ways of entering these chains: attracting multinationals, and internationalizing local firms. The region's governments have concentrated on the former, using a combination of policies. These have often included the creation of export processing zones, where multinationals enjoy a favourable fiscal regime and other benefits (in the areas of logistics and trade

⁷ On this last point, see section 1 of part B, entitled "Regional financial cooperation".

⁸ Among these, special mention should be made of the production linkages programme run by the Foreign Trade Corporation of Costa Rica (PROCOMER). There are also public-private initiatives aimed at specific sectors, such as the world-class suppliers to the mining industry programme implemented in Chile by BHP Billiton and the Chilean National Copper Corporation (CODELCO).

formalities, for example). Given that several of the region's countries now have export processing zones, the mere fact of their being there is tending to lose its value as an incentive to attract multinationals.

Another essential set of policies concerns human resource training. They include teaching English to workers at call centres oriented towards the United States market and strengthening specific skills for specialized services such as accounting, different types of engineering, and information technologies.⁹ This specific know-how is increasingly important in an international context where there is a need to scale towards more complex tasks, and where it is consequently become ever harder to compete on the basis of low labour costs alone.

In some countries, such as Chile in the 2000s and Uruguay, governments have also provided other incentives, such as partial funding of set-up costs, office rental and technological infrastructure. Again, a number of countries in the region offer incentives for innovation, research and development. These include not just tax breaks but also incentives to patent new services and measures to provide better protection for intellectual property. It is also vital to promote cooperation between the private sector and universities (Hernández and others, 2014).

A number of governments in the region are also providing local firms with specific support to help them internationalize. These efforts ought to be directed both at firms that have the potential to sell their services to other exporting firms in the country (indirect internationalization) and to those that have the potential to commercialize their services in foreign markets (direct internationalization). Many firms in the region have good technical capabilities, but lack the specific management and marketing know-how required to sell their services abroad. Public-sector support could be designed to overcome these weaknesses, for example by preparing firms to obtain the kinds of certification required internationally for the selling of services.¹⁰

Regional cooperation in science, technology and innovation is another promising field for the development of new industrial policies with multinational components. This was recognized at the ministerial meeting entitled "Innovation and structural change in Latin America and the Caribbean: strategies for inclusive regional development" held in Rio de Janeiro (Brazil) in June 2013. There, ministers and high-level science, technology and innovation authorities from the region resolved to pursue policies of investment in and expansion of new production capabilities based on scientific and technological knowledge and innovation. They also resolved to promote industrial policies oriented towards the creation of new sectors, over and above the enhancement of competitiveness of existing sectors, thereby contributing to progress with an environmentally sustainable technology paradigm. In summary, the conclusion of the meeting was that science, technology and innovation policies formed part of a new phase of industrial policies that were indispensable to promote a structural shift in Latin America and the Caribbean towards knowledge-intensive sectors. This is essential, both because of the rapid technological change the world is undergoing and because of the central role played by these policies in constructing development oriented towards equality.

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

⁹ Because higher education curricula are not necessarily designed specifically to meet the needs of firms, some countries such as Colombia and Costa Rica have created courses lasting between six months and two years to provide this knowledge ("finishing schools").

¹⁰ For example, ISO 9000, Capability Maturity Model Integration (CMMI) and Information Technology Infrastructure Library (ITIL).

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

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

B. DIMENSIONS THAT COMPLEMENT REGIONAL PRODUCTIVE INTEGRATION

1. Regional financial cooperation

The regional financial architecture is organized around three pillars: the provision of countercyclical financing to meet balance-of-payments funding needs and promote financial stability; the mobilization of investment and productive development resources; and support for intraregional trade. The first pillar is largely the preserve of the Latin American Reserve Fund (FLAR). The second is the goal of the region's development banks, including CAF-Development Bank of Latin America, the Central American Bank for Economic Integration (CABEI), the Caribbean Development Bank (CARIBANK) and the Financial Fund for the Development of the River Plate Basin (FONPLATA). As for the third pillar, support for intraregional trade is mainly provided through the payments system. In the last decade, the development banks have also been involved in providing countercyclical financing and financing intraregional trade. Some proposals for enhancing regional financial cooperation around each of the three pillars will now be put forward.

The first proposal is the creation of a regional reserve fund, based on the successful experience of FLAR. Established in 1978, this has a membership of eight countries: the Bolivarian Republic of Venezuela, Colombia, Costa Rica, Ecuador, Paraguay, Peru, the Plurinational State of Bolivia and Uruguay. FLAR has three functions: (i) to provide balance-of-payments support via loans or guarantees; (ii) to improve conditions for the investment of member countries' reserves; and (iii) to help harmonize these countries' exchange-rate, monetary and financial policies. In practice, the first function has been the most important. The subscribed capital of FLAR currently totals US\$ 3.282 billion, with paid-up capital of about US\$ 2.4 billion. The latter figure represents an average of 0.2% of the GDP and 1.6% of the international reserves of the member countries. To provide liquidity, FLAR operates as a credit cooperative where the member countries' central banks can obtain loans in proportion to the capital contributed by them to the Fund and in accordance with the lending facility chosen.

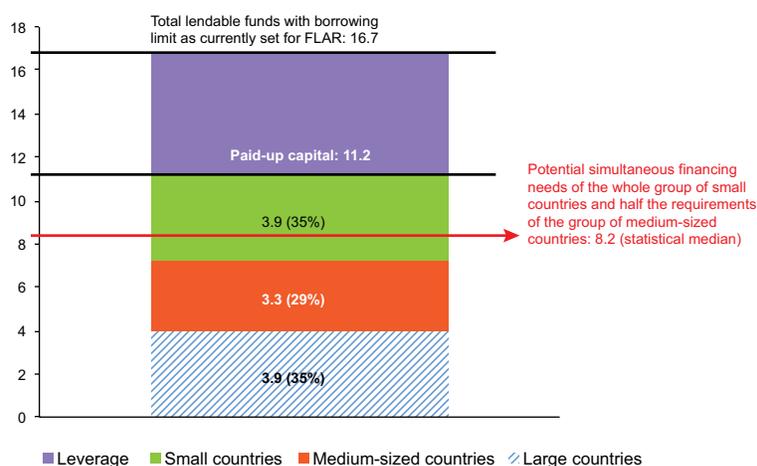
Of the different forms of credit offered by FLAR, those most often used are balance-of-payments and liquidity credit. The balance-of-payments credit line provides financing with a three-year term and an access limit equivalent to 2.5 times paid-up capital. The liquidity line offers financing for up to a year with an access limit equivalent to 1.0 times paid-up capital. All member countries except Uruguay, which joined only in 2009, have used the credit facilities of FLAR, which has provided swift and timely funding when

its member countries have applied for it. FLAR credit lines have mainly been used at times of crisis, and in particular during the external debt crisis of the 1980s. In all subsequent crises, however, only a minority of member countries have sought liquidity support simultaneously.

A regional reserve fund with a wider remit would make an important contribution to the provision of the regional and global public good that is financial stability. This option is feasible because balance-of-payments problems and crises do not usually affect the countries simultaneously. The empirical evidence shows that systemic crises and widespread contagion do not seem to be the norm (Titelman and others, 2013). In addition, experience indicates that when there is some degree of simultaneity in the crises affecting countries, it usually occurs among small ones; it is unusual for large and medium-sized economies to experience crises simultaneously. To deal with extreme cases such as a systemic crisis or widespread contagion, and even with intermediate scenarios where the capital of the Fund is not sufficient to cope with the demands of member countries, the Fund should have the capacity to “broaden its shoulders”. This can be done by leveraging its capital (that is, by issuing debt to mobilize a larger amount of resources) or by acting in coordination with other parts of the regional financial architecture.

In view of the above, it is estimated that in a scenario involving 19 countries of the region, for example, with capital contributions by the countries following the logic currently applied at FLAR, the regional fund would attain a total size of over US\$ 11 billion (equivalent to 1.7% of the 19 countries’ stock of international reserves). A fund of this size, without any leveraging, would be enough to cover the potential demand from the whole group of small countries simultaneously, along with half the needs of the group of medium-sized countries, for a total of US\$ 8.2 billion (statistical median). If the fund leveraged its capital with medium and long-term borrowing amounting to 65% of the paid-up capital, which is the maximum authorized at FLAR, lendable resources of up to US\$ 16.7 billion would be generated (see figure V.1).

Figure V.1
SIZE OF A REGIONAL RESERVE FUND FOR 19 COUNTRIES OF LATIN AMERICA^a
(Billions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Daniel Titelman and others, “Un fondo de reservas regional para América Latina”, *MPRA Paper*, No. 42614, University Library of Munich, 2012 [online] http://mpra.ub.uni-muenchen.de/42614/1/MPRA_paper_42614.pdf.

^a Based on their GDP, the large countries are Brazil and Mexico, the medium-sized countries are Argentina, Bolivarian Republic of Venezuela, Colombia, Peru, Chile and the small countries are Ecuador, Costa Rica, Uruguay, Plurinational State of Bolivia, Paraguay, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Dominican Republic and Belize. It is assumed that the current members of FLAR maintain their contributions at present levels and the rest contribute in accordance with their relative size. It is also assumed that all subscribed capital is paid-up capital.

A second area of work in regional financial cooperation is an enhanced role for subregional banks as suppliers of credit for productive development. Subregional banking has gradually taken on a more prominent role in the financial development of the region's countries. In addition, the subregional development banks have incorporated non-founder members and even members from outside the region. Since the early 2000s, subregional banks have also substantially increased both the volume of resources committed and their share of all lending by multilateral development banks to Latin America and the Caribbean. In 2011, in fact, subregional banks made loans to the region totalling almost US\$ 12 billion. This figure represents 36% of all credits granted that year by multilateral development banks to Latin America and the Caribbean, exceeding the share of the Inter-American Development Bank (IDB) (34%) and the World Bank (30%). This stands in sharp contrast to the distribution of such lending in 1990, when the shares were 10%, 35% and 55%, respectively.

The increasingly prominent role of the subregional banking system has also been reflected in the greater sectoral diversification of the loans granted and in its emphasis on the financing of infrastructure, the production sector and financial intermediation. As well as becoming a major source of funding for productive development in the region and deeper trade and financial integration, development banks have been a source of stable, countercyclical financing. They thus not only open up access to external financing sources but enable business cycle fluctuations to be smoothed, complementing the role of regional financial institutions such as FLAR.

A third pillar of regional financial cooperation is the intraregional trade promotion role of payment systems and local and subregional banks. Regarding payment systems, the region currently has the LAIA Agreement on Reciprocal Payments and Credits (CPCR), created in 1965 and reformed in 1982, plus the Local-currency Payment System (SML) between Argentina and Brazil (2008) and the Unified Regional Payment Clearing System (SUCRE), set up as part of the ALBA-TCP initiative (2009). Regional payment systems have focused their efforts, first, on measures to save currency in intraregional trade transactions and, second, on reducing the transaction costs associated with intraregional trade. For this, they employ a variety of instruments such as multilateral clearing systems, the use of local currencies and the use of common units of account.

Payment systems have enabled their member countries to make more efficient use of the currency available for intraregional trade, while also enhancing cooperation between central banks. Nonetheless, there is scope to strengthen the role of these systems as promoters of intraregional trade. A major challenge for them is to dynamize intraregional trade in a context of greater international openness and integration and greater availability of currency in the region. A second challenge is to enhance the role of SMEs in intraregional trade.

To address these challenges, in the case of the CPCR, there is a need to reduce the opportunity costs (including interest rates) incurred by central banks, financial institutions and private operators when using the Agreement. There will also be a need for yet stronger cooperation between central banks and between financial systems to reduce the financial costs of trade operations. Greater homogeneity in the regulations of central banks and financial systems as they relate to the CPCR would also be helpful. In the case of the SML, active measures are needed to reduce costs and barriers that might discourage trade between Argentina and Brazil and the participation of SMEs. In the case of SUCRE, what this needs to do, it is suggested, is consolidate financial integration between the States parties via stronger networks of interdependency between authorized operating banks (BOA) and position the common unit of account, the "sucre", as a reference standard with a view to the possible establishment of a regional currency in Latin America and the Caribbean.

The focus on SMEs is very important for the countries of Latin America and the Caribbean, as they are a vital part of the production and employment fabric. Nonetheless, they have less access to financing

than larger firms. In addition, when they can obtain bank financing, this is substantially more expensive, maturities are shorter and collateral requirements are more onerous than for larger firms (Avendaño, Daude and Perea, 2013). The effort to incorporate SMEs through payment systems can be supplemented by the development banks.

Intraregional trade financing can also be supported via national development banks and their linkages with the subregional banking system. The former have played an important role in supporting trade, mainly by providing funding. Although at present, according to data from the Latin American Association of Development Financing Institutions (ALIDE), external trade credits represent only a small percentage of the total portfolio of national development banking systems (an average of 5% for a total of 24 development banks selected in 2011), there is a great deal of variation between banks, with much higher percentages for those specializing in external trade, such as the National Foreign Trade Bank (BANCOMEXT) in Mexico.

National development banks can join forces with the subregional banking system in promoting intraregional trade. In fact, multilateral institutions such as IDB and the World Bank channel trade financing through the countries' national development banks and foreign trade agencies. National development banks need to carry on taking advantage of these opportunities, given the importance of subregional development banks to intraregional trade financing. The Central American Bank for Economic Integration (CABEI) has identified support for intraregional production and trade as one of its strategic orientations. The Andean Development Corporation (CAF) has also emphasized trade support and put this into practice by providing firms with direct funding for foreign trade operations, working capital and investment. It also operates as a second-tier bank, supplying credit lines to financial institutions, which then channel resources to the production sector. Foreign trade operations can be financed with these resources. The Caribbean Development Bank (CARIBANK), in conjunction with the United Nations Conference on Trade and Development (UNCTAD), has also launched programmes of training in the use of trade financing instruments such as factoring, with a view to extending their use at the subregional level.¹¹ Lastly, in 2012 the Bank of the South was set up with subscribed capital of US\$ 7 billion. Its general purpose is to operate as a development bank for its members in UNASUR, promoting the areas of infrastructure, energy, food sovereignty, social conditions, human talent and science and technology, among others.

Where national development banks are concerned, there is still the challenge of reconciling commercial profitability criteria with a greater role for economic development criteria in the international trade financing process. From this perspective, there seems to be a need to orient financial instruments towards the creation of an export basket with greater value added and to foster SME participation in the export effort, production linkages and the adoption of new technologies by the export sector, among other criteria of importance to economic development.

Capital market integration is another way of creating scope for regional cooperation. A regional or subregional capital market would generate scale economies that would make it possible to provide medium- and long-term financing at lower cost. Capital market integration could also reduce the risk of inadequate liquidity and moderate the instability of asset prices and rates of return. This in turn would have positive effects on investor confidence and improve the chances of obtaining higher rates of return by lowering transaction costs.

Where efforts to create a capital market at the regional level have materialized so far is in the establishment of the Latin American Integrated Market (MILA), which began operating in May 2011. This

¹¹ See [online] [http://www.unctad.info/upload/SUC/Success%20Stories/English/06_SuccessStory\(SCF_Caribbean\).pdf](http://www.unctad.info/upload/SUC/Success%20Stories/English/06_SuccessStory(SCF_Caribbean).pdf).

is an agreement between the stock exchanges of Chile, Colombia and Peru.¹² MILA is currently the largest stock market in the region by the number of companies listed, the second-largest in market capitalization and the third-largest by trading volume. In 2012, the market capitalization of MILA averaged US\$ 695 billion, a figure exceeded only by the Brazilian stock exchange (US\$ 1.5 trillion). That same year, its average monthly trading volume was US\$ 7.5 billion. The Mexican stock exchange is expected to join MILA in 2014. One of the main challenges that still lie ahead for MILA is to move towards greater regulatory harmonization and an integrated dialogue between regulators with a view to improving information disclosure requirements and market standards. In the longer term, the aim should be to incorporate fixed-income transactions into MILA.

2. Towards a regionwide digital cooperation agenda

Progress on structural change for development and the reduction of inequity in the region means formulating and implementing a new phase of strategies in information and communication technologies (ICTs). The cornerstone must be all-round development of the digital economy, meaning the area of the economy constituted by the different sectors of the ICT industry (telecommunications, hardware, software and ICT services) and the network of economic and social activities facilitated by the Internet. The digital economy is a source of higher productivity, economic growth and sustainable development. What is required to harness this potential are institutions and policies that can generate synergies between the spread of new technologies and a shift in the production structure towards sectors that are more intensive in digitalization and knowledge.

The digital economy is part of a new development vision that can act as a catalyst for structural change by fostering long-term investment, diversification of the production structure and convergence in productivity levels across the whole economy. Strategies for the digital economy in the region must be multipurpose, so as to increase the impact on growth and social inclusion in countries where ICTs are more developed and to narrow the digital divides affecting the least advanced countries. Again, promoting a digital economy for structural change requires simultaneous action on complementary supply factors (such as broadband infrastructure and the ICT industry) and demand factors (access, affordability, usage capabilities).

After two decades of digital strategy implementation, the evidence shows the digital economy commanding a large share of GDP in the region, averaging at least 3.2% for Argentina, Brazil, Chile and Mexico, a significant figure considering that the share is 5% in the European Union countries (ECLAC, 2013). Nonetheless, the digital economy has not progressed homogeneously in what is in fact a two-speed region where the implementation of digital strategies is concerned. While the three best-performing countries present an ICT development index value equivalent to 75% of that in the OECD countries, the level in the three worst-performing is just 38%. Critical infrastructure development is also highly asymmetrical between countries; for example, the mobile broadband penetration ratio between the three most advanced countries and the three least advanced is 15.

Three notable regional cooperation initiatives will now be briefly presented; all of them should be reinforced over the coming years. The first is the Plan of Action for the Information Society in Latin America and the Caribbean (eLAC), which has consolidated as the standard-setter for ICT policies and as a platform for political dialogue and cooperation between the region's countries, and between the region and Europe.

¹² Another subregional capital market integration initiative is the Alliance of Central American Markets (AMERCA), launched in 2008. However, the integration of the stock markets of Costa Rica, El Salvador and Panama, the countries leading the alliance, is currently on hold owing to a lack of agreement on regulatory issues that are hindering standardization of stock market rules (Capital, 2012).

Since its inception in 2005, this initiative has brought together political authorities and leading actors from the telecommunications and ICT industry and academia, representatives of international organizations and civil society and institutions specializing in a variety of digital development initiatives. The process is supported by a technical secretariat operated by ECLAC. Since the creation of eLAC, the region's countries have agreed three action plans, which are adjusted as the targets set are achieved and goals redefined in the light of technological advances and needs in the region's countries. They have been approved at four ministerial conferences on the information society in Latin America and the Caribbean.

The second initiative is the Regional Broadband Dialogue. Created in 2010, this currently brings together 11 countries of the region (Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru, the Plurinational State of Bolivia and Uruguay). It is a forum for debate and the pooling of experiences, approaches and proposals regarding the costs of international links. ECLAC acts as the technical secretariat. At the request of the member countries, the Regional Broadband Observatory (ORBA) was set up in May 2011. This is a source of relevant and timely information that helps the region's countries to develop and follow up on public policies for the universalization of broadband. The activities of ORBA consist in preparing service indicators, compiling, systematizing and disseminating information on policies for large-scale roll-out, and preparing periodic reports on broadband in the region.

There have been seven meetings of the Regional Broadband Dialogue so far. It has thus become a forum for pooling experiences in a context of South-South cooperation while also fostering technical and political dialogue informed by specific technical studies and statistical indicators, as well as facilitating contacts between public- and private-sector actors. The coordination of governments alone has had some effects on the market. For example, there has been a continuous improvement in service affordability (measured as the percentage of per capita GDP required to acquire a broadband connection) and an increase in connection speeds. Between the creation of the Regional Dialogue in 2010 and 2013, the price of broadband in nine of the region's countries has fallen by an average of 68%. Meanwhile, data download speeds have risen by an average of 319%, while upload speeds have increased by 364% (see figure V.2).

Figure V.2
**LATIN AMERICA (SELECTED COUNTRIES): SELECTED BROADBAND INDICATORS,
 2010 AND 2013**
(Percentages of monthly per capita GDP and kilobits per second)

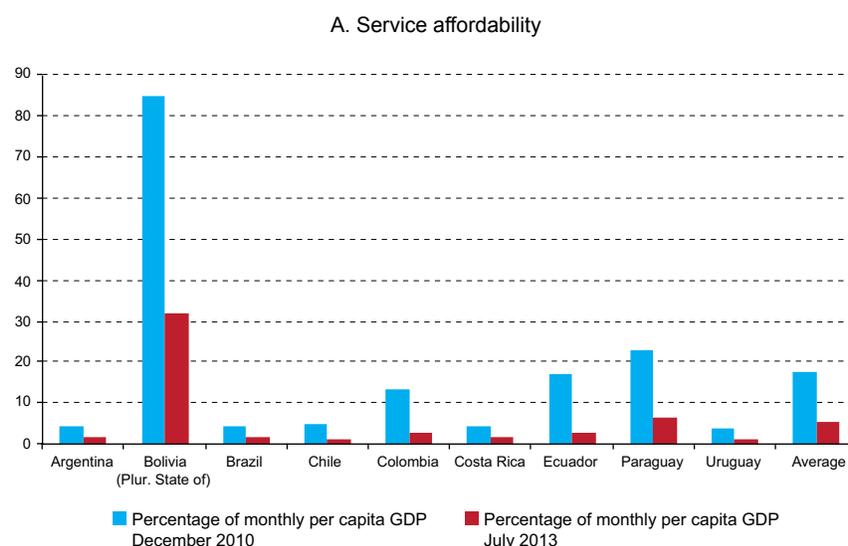
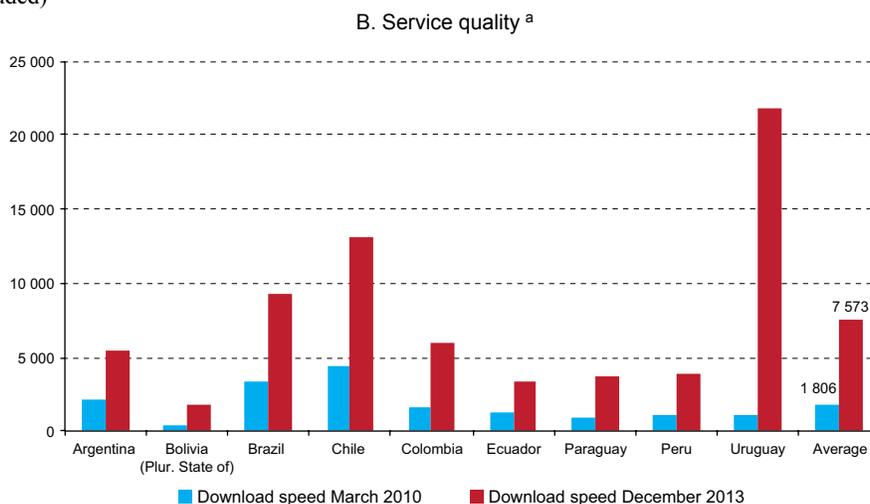


Figure V.2 (concluded)



Source: Regional Broadband Observatory (ORBA), on the basis of Ookla [online] <https://www.ookla.com/>.

^a Speeds in kilobits per second.

The lack of information on ICTs in most of the region's countries led to the creation in 2003 of the Observatory for the Information Society in Latin America and the Caribbean (OSILAC). This has played an important role in the harmonized measurement of ICTs across the region. For example, OSILAC contributes to the dissemination of ICT access and usage indicators via its online ICT statistical information system. This allows ICT data and indicators from household surveys in 18 countries of the region to be compared in order to quantify divides in ICT access and use with reference to socioeconomic factors.¹³ With this system, it is possible to cross ICT connectivity variables (place of access, type, online activities, etc.) with socioeconomic variables such as users' income level, education, gender, age and geographical location (urban or rural) so that the different dimensions of the divide can be identified. In addition, OSILAC has contributed to capacity-building for ICT measurement, holding training workshops for officials from national statistics offices and government agencies responsible for policies in this area.

3. Physical transport and logistics infrastructure

Logistics infrastructure and services are a core element in the integration of a country's economic and territorial system, making transactions possible within a particular geographical and economic space. These networks are also concrete mechanisms for linking national economies to the rest of the world by making trade flows and value chains physically possible. Consequently, infrastructure integration is a vital factor in development and productive integration within the region.

The inadequacy of the sums Latin America and the Caribbean spends on its economic infrastructure becomes obvious when its needs over the coming years are projected.¹⁴ ECLAC has estimated that the region ought to be investing about 5.2% of its GDP every year between 2006 and 2020 to meet the needs deriving from its projected economic growth.¹⁵ If the goal is to have succeeded by 2020 in closing the divide in the

¹³ See [online] <http://www.eclac.cl/tic/flash/default.asp?idioma=IN>.

¹⁴ The concept of economic infrastructure is broader than that of physical transport and logistics infrastructure, being defined as "all the permanent engineering structures, equipment and physical facilities that are the basis for providing energy, transport, telecommunications, water and sanitation services to productive sectors and households." (ECLAC, 2011a).

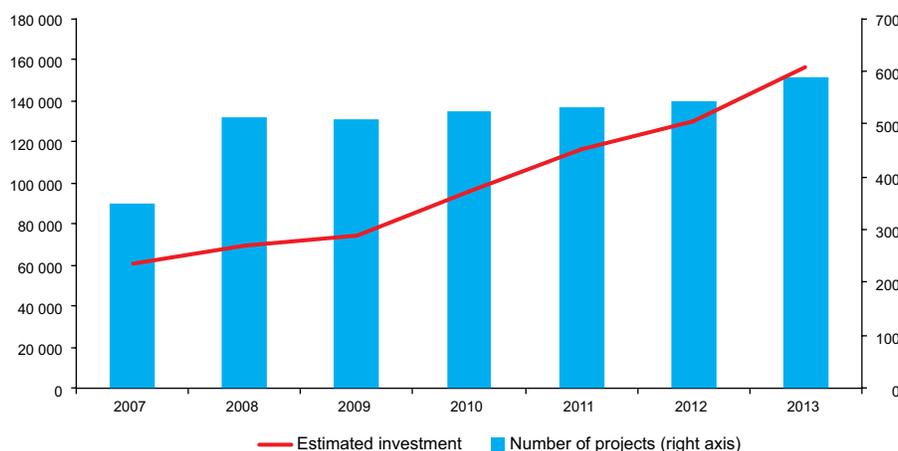
¹⁵ Estimate based on regional GDP growth of 3.9% a year and population growth of 1%.

per capita infrastructure stock that existed in 2005 between the region and a group of high-growth economies in East Asia,¹⁶ then the annual investment required is 7.9% of GDP in the same period, i.e. four times the average spent in the 2007-2008 period (ECLAC, 2011a).

In South America, a key milestone in the regional infrastructure integration process was the creation of the South American Regional Infrastructure Integration Initiative (IIRSA) in 2000. The purpose of this is to promote transport, energy and communications infrastructure integration projects with a shared regional approach. Recently, IIRSA has become an essential forum for infrastructure planning in South America and is the UNASUR technical forum for issues related to the planning of regionwide physical integration within the framework of the South American Infrastructure and Planning Council (COSIPLAN). One of the main strengths of IIRSA has been the construction of a project portfolio that organizes, prioritizes and promotes infrastructure investment by the 12 member countries. This has allowed the process to move forward independently of the political and economic vicissitudes faced by the region in the last decade.

As of September 2013, the IIRSA portfolio comprised 589 projects, equivalent to over US\$ 156 billion (see figure V.3). Of these, 67% are transport projects and 33% energy projects, while communications projects represent just 0.1% of the total. Of the transport infrastructure projects, highway investment represents 55% of the total, railways 27%, seaports 10%, river ports 4% and airports 3%. Border crossing projects and multimodal transport projects have shares of less than 1%. This share-out reflects a marked preference for building roads over other types of transport infrastructure, border crossing improvements and progress with convergence in sectoral regulations and standards.

Figure V.3
EVOLUTION OF THE IIRSA PROJECT PORTFOLIO, 2007-2013^a
(Millions of dollars and number of projects)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information provided by the Initiative for the Integration of Regional Infrastructure in South America (IIRSA).

^a Information updated using project specifications as of September 2013.

In Mesoamerica, the Puebla-Panama Plan (PPP) was established in 2001 with the goal of helping to improve the quality of life of the inhabitants of Central America and Mexico. This process gave rise in 2008 to the Mesoamerica Integration and Development Project or Mesoamerica Project, which Colombia and, more recently, the Dominican Republic have now joined. The integration of electricity, telecommunications and

¹⁶ Hong Kong Special Administrative Region of China, Malaysia, the Republic of Korea and Singapore.

transport infrastructure has played a fundamental role at both stages in the process. The transport infrastructure project portfolio of the Mesoamerica Project includes 17 initiatives (3 completed, 4 in progress and 10 approved) with total investment of some US\$ 1.9 billion. One of the most important transport infrastructure projects is the Central American Roads Network (RICAM). This is meant to improve the internal and external connectivity of the region's economies via the construction, rehabilitation and maintenance of 13,132 kilometres of highway. Some US\$ 7.2 billion are estimated to have been invested in constructing and modernizing over 6,600 kilometres of highway. The project is now 50% complete (Mesoamerica Project, 2013).

The challenges for regional infrastructure today are similar to those encountered at the national level. Quantitatively and qualitatively inadequate infrastructure and service provision is the most obvious element. However, other factors, such as those associated with institutional governance, financing and most particularly the multiplicity of visions regarding the conception, implementation and oversight of economic infrastructure and its services are also throwing up major obstacles, with considerable repercussions for the region's economic and social development (ECLAC, 2011a). Accordingly, the new integration initiatives such as UNASUR and CELAC, in addition to recognizing the subregional integration processes already begun, are seeking to advance with regional political coordination, grounded in a strategic vision of certain sectors of structural importance for endogenous development. Of these, the transport and particularly the energy sector are regarded as cornerstones of the new integrationist paradigm, creating the basis for coordinated regional standards conducive to full logistical integration that can foster sustainable economic and social development for the whole region.

Although strategic transnational investments have been identified in the areas of transport and logistics infrastructure and services, with the potential to enhance the region's integration, their implementation could be speeded up if certain institutional, financial, regulatory and operational obstacles were overcome. These include inefficiencies in market organization, regulatory failings, the absence of sustainability criteria and the persistence of historical problems connected to the lack of network investment and maintenance. These factors are a constraint on regional integration and on the wider competitiveness of each of the region's economies. What is required, then, is convergence on concrete actions that not only remove trade or physical barriers, but promote the coordination of common policies to regulate and distribute benefits in an egalitarian manner in pursuit of sustainable and equitable economic and social development for the whole region.

Where the planning and implementation of integration projects are concerned, for example, there is still a long way to go before the proposed objectives are achieved, since the investment dynamic is inadequate to cover the needs and demands of the economy. Accordingly, there is a need to put in place a regional integration strategy that, by recognizing and valuing different ideas about the model of society to be aimed at, is capable of coordinating the different initiatives, encouraging convergence in regulations and standards and a medium-term shift towards common policies.

In the sphere of economic infrastructure and the services provided, there is a need for a number of measures that the different integration initiatives should give high priority to. They include the following:

- (i) Move towards common national and subregional policies that meet criteria of comprehensiveness and sustainability. This strategy should consider the formalization of regulatory structures and public-sector action (based on the components of common policies) in a supranational framework that allows for more efficient coordination of infrastructure projects between the different countries, process facilitation and regulatory convergence.
- (ii) Consider the creation of a cohesion fund to deal with asymmetries and/or regional investment funds for the construction, maintenance or upgrading of economic infrastructure, mainly in the areas of transport, energy and telecommunications.

- (iii) Coordinate infrastructure works and harmonize procedures for infrastructure that is eminently supranational and particularly subregional in nature, with an approach that favours complementarity between the different economies, thereby reducing operating costs and negative externalities for the environment and society.

In short, there is an urgent need to improve public policies on infrastructure provision, with a focus not just on project design and construction but also on quality of service (both nationally and regionally). For this, it is vital to arrive at a shared long-term vision and work out and implement an investment plan in which the development of infrastructure services constitutes a competitive tool for the region's countries. This means that the conception, design, execution and follow-up, oversight and evaluation of infrastructure policies and related services need to be pursued in a way that maximizes the development effects, resting on foundations and criteria that are common to the countries, via an integrated and sustainable logistics and transport policy (Cipoletta Tomassian, Pérez-Salas and Sánchez, 2010).

An experience along these lines outside the region is the 2010 Master Plan on ASEAN Connectivity. Currently being implemented, it is notable for addressing the concept of connectivity from a comprehensive, strategic standpoint that encompasses its physical, institutional and people-to-people dimensions (see box V.2). Studying this initiative could provide the governments of Latin America and the Caribbean with valuable pointers to the planning of the regional infrastructure investments required in the coming years.

Box V.2

THE 2010 MASTER PLAN ON ASEAN CONNECTIVITY

In October 2010, the Heads of State and Government of the Association of Southeast Asian Nations (ASEAN) adopted the Master Plan on Connectivity. This is an integral part of the actions being taken to realize an ASEAN community by 2015. The Master Plan provides for actions in the 2011-2015 period in three areas: (i) physical infrastructure development (physical connectivity); (ii) institutions, mechanisms and processes (institutional connectivity); and (iii) empowered people (people-to-people connectivity). Key strategies and actions are laid down in each area, as are priority projects, with the aim of enhancing the international competitiveness of ASEAN, strengthening its centrality to the Asian regional integration architecture and reducing development disparities between member countries and between regions within them.

With regard to physical connectivity, the Master Plan includes actions on transport infrastructure (highways, railways, ports and airports), information and communication technologies and energy. The projects prioritized in this area include completing the ASEAN highway network and establishing an ASEAN broadband corridor. In the area of institutional connectivity, the Master Plan includes actions across a wide range of areas in which there are still impediments to the cross-border movement of vehicles, goods, services and skilled labour. Among these areas are trade facilitation (with a commitment for all member countries to fully implement single windows for external trade by 2015), harmonization and mutual recognition of standards, and agreements on transport facilitation, including multimodal transportation. Where people-to-people connectivity is concerned, gradual relaxation of visa requirements between the ASEAN countries is envisaged.

The Master Plan provides for a number of sources of financing. These include the possible establishment of an ASEAN infrastructure development fund, public-private partnerships and the development of local and regional capital markets. Partnership with multilateral development banks, international organizations and other major actors will also be strengthened. A Connectivity Coordinating Committee is responsible for monitoring progress and difficulties in the implementation of the Master Plan. A variety of actions are also being taken to communicate the goals and importance of the Master Plan to people in the member countries.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of ASEAN Secretariat, *Master Plan on ASEAN Connectivity*, Jakarta, January 2011 [online] <http://www.aseansec.org/wp-content/uploads/2013/06/MPAC.pdf>.

4. Enhanced energy integration¹⁷

Latin America and the Caribbean possesses ample energy resources, but these are not distributed evenly among the countries. As a result, the potential benefits of full energy integration are significant. A number of studies have indicated that the scale and structures of energy supply and demand in the region present major strategic complementarities, particularly in certain subregions.

Throughout history, energy integration in the region has followed different methods and patterns, reflecting a variety of political, economic and regulatory paradigms. Although some important results have been achieved, particularly in the area of electrical interconnection, there are still barriers of different types that have prevented integration from being treated as a beneficial option in the broadest sense. The greatest barrier may well be the contradiction between the goals of self-sufficiency and integration that is seen in most of the countries' expansion plans and/or energy policies. Security of supply and reduction of energy dependency is the core concern for governments. There is also a marked tendency for countries that have energy resources to protect them, as they are now perceived as scarce and dear, so that there is less willingness to share them with other countries. What is lacking is a vision of a "common energy region".

In the case of electricity, while there has been substantial progress in interconnecting the region and a number of projects are expected to come to fruition in the coming years, energy exchanges are still only modest (just 5% of the energy produced).¹⁸ As noted in the previous section, energy projects represent a third of the total portfolio of IIRSA/COSIPLAN/UNASUR projects, with investment put at about US\$ 51 billion, spread over 59 projects. Of these, 42 are national projects accounting for 68% of investment, with the other 32% going to 17 binational projects. Three quarters of the investment is going to power generation (mainly hydroelectric plants), while the rest is for interconnection projects.

The Central American countries have been developing the Electrical Interconnection System for Central America (SIEPAC) for over 25 years. The purpose of this is to create a competitive regional electricity market that respects the principles of gradualism and reciprocity. The system envisages the construction of a 1,790 kilometre-long 300 megawatt power transmission line connecting Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica and Panama. This is now almost ready, with only 36 kilometres in Costa Rica remaining to be completed. Energy trading between the countries began in June 2013, and with it the operation of the Regional Electricity Market (MER) between the member governments of SIPAC.

Where gas integration is concerned, this too benefits from the unequal distribution of natural gas in the region, which makes it necessary to optimize energy complementarity and security of supply. There are a number of gas pipelines, which were built in the 1990s in a context of major reforms to the energy sector in some countries. In recent years, however, some negative experiences with external suppliers have strengthened the hand of those favouring self-sufficiency or diversification of supply. For example, in virtually all parts of the region there has been a proliferation of projects for liquefied natural gas (LNG) regasification plants or solutions to guarantee security of supply, to the detriment of regional energy integration.

Many potential gas pipeline interconnections in the region are only feasible if new gas reserves are found or brought on stream. Accordingly, while there is potential to develop conventional resources in unexploited areas, as well as unconventional resources (such as shale gas in Argentina and Mexico and pre-salt reserves in Brazil), substantial venture capital investment is required. Simultaneously, the infrastructure to exploit

¹⁷ This section is based on chapter 11 (Regional integration) of *Challenges and Opportunities for Latin America's Sustainable Energy Development* (CAF and others, 2013).

¹⁸ With the operationalization of the Guatemala-Mexico line in 2009, the possible construction of the Panama-Colombia interconnection and the Andean Electrical Interconnection System (SINEA) project, which will interconnect the Andean countries of the Pacific with Chile, all the countries of Latin America will be interconnected. At the same time, SIEPAC will increase its installed electricity transport capacity for transfers.

these resources needs to be developed. Uncertainty about regional development of gas reserves is one of the main obstacles to the implementation of energy integration projects.¹⁹

Energy integration in Latin America and the Caribbean should take account, first, of common and general goals in the broader regional process (CELAC) and, second, of the specificities of subregional processes (CARICOM, SICA and UNASUR, among others) and of conditions and realities in the countries of these subregions. Different energy actions pursued within these regional and subregional processes in accordance with specific strategies are being complemented by the efforts of the many hemispheric and extraregional initiatives. Mexico is faced with two different realities in energy integration: first, its relationship with the United States, to which it has close ties where natural gas is concerned (Mexico is a net importer, and may become a still larger one) and, second, its relationship with Central America, to which it exports electricity.

The case of South America is peculiar owing, among other things, to its abundance of renewable and non-renewable energy sources, distributed heterogeneously over its territory, and to today's structural conditions. Since the 1990s, the 1980 ALADI Treaty of Montevideo has provided a legal framework for a number of partial scope agreements on energy integration. These agreements, and bilateral treaties on hydroelectric facilities in the River Plate basin, marked the beginning of South American energy integration. These binational initiatives could be made the most of if there were progress in implementing a regional market, with existing infrastructure being used and new projects implemented to enable natural gas and hydropower usage to be better coordinated. Finalizing the South American Energy Treaty, still under discussion within UNASUR, could be a major step forward.

For all the progress made, especially with regard to electrical interconnection, there are a number of factors impeding greater energy integration in Latin America and the Caribbean. This means there is a need to study innovative ways of sharing energy that respect each country's own policies, do not require far-reaching regulatory harmonization in the domestic markets of the nations involved and make it possible to maximize benefits, prevent abuse of market power and establish mechanisms to cover risks and solve conflicts. Under these conditions, it is essential to apply models that can adapt to different situations and operate under conditions of greater interdependency between countries and in multinational systems, on the basis of values that allow for convergence towards greater efficiency, sustainability and security of service.

5. Social integration

In Latin America and the Caribbean, the social dimension has traditionally not been a priority in policy coordination processes and regional agreements, which have rather stressed trade and production. Of the attempts at social integration that have been made in the region, mention may be made of the Andean Community conventions, the Andrés Bello convention on education, and the Hipólito Unanue convention on health care, which have provided frameworks for agreement, harmonization of standards, cooperation and validation of certificates. Another two relevant experiences in this area are MERCOSUR Social and the Central American Social Integration Secretariat (SISCA). The first of these is intended to coordinate joint policies and actions by member States dealing with childhood and adolescence, youth, older adults, food security and the social economy. The second has the function of strengthening the institutional platform for social integration between the member countries of the Central American Integration System (SICA), and is the Technical Secretariat of the Social Integration Council (CIS), which brings together the Central American ministers responsible.

CELAC has now acquired a central role at the highest political level, with discussion spaces dealing with the region's social challenges and the effort to achieve convergence in the objectives and plans of

¹⁹ Unless this assumption is based on growing extraregional LNG trade, or potential shale gas and pre-salt oil exploitation projects are implemented in the next few years, radically altering future gas supply prospects.

action decided on. Specifically, the declaration of the First CELAC Meeting of Ministers and Authorities in Charge of Social Development and the Eradication of Hunger and Poverty proposes the joint development of a strategic regional coordination agenda for social issues “oriented towards complementarity of efforts on social issues...contributing to a restructuring of their role in the region and with a view to achieving greater consistency in working agendas” (CELAC, 2013).

A noteworthy advance with integration is the social policy convergence and cooperation between the region’s countries in relation to certain objectives, management models and underlying principles, particularly as regards social protection and anti-poverty efforts. In this process, an important energizing role has been played by certain countries’ national cooperation agencies, ECLAC and specialized agencies of the United Nations, the Organization of American States (OAS), the Inter-American Development Bank (IDB) and the World Bank. Examples of these processes are social investment funds and co-responsibility transfer programmes. Because of their common characteristics, these programmes provided the basis for a South-South collaboration network involving the relevant institutions in each country. Among these, an important role has been played by social development ministries, which have been expanded in the last decade to take institutional responsibility for non-contributory social protection needs, and by national cooperation agencies.

The experiences touched on above have gradually shaped a certain technical and managerial ethos of a regional hue, and one that in fact is now being replicated in other regions of the world. The current challenge is to move towards the development of inclusive social protection systems, entrenching a rights-oriented (and thus citizen-oriented) approach in line with the idea of a social protection floor promoted by the United Nations. This challenge, to which some countries are already responding, allows for a transition from one-off programmes to comprehensive policies, with co-responsibility transfer programmes potentially providing a gateway for large sections of the population (Cecchini and Martínez, 2011).

Growing intraregional migration (see box V.3) entails opportunities and challenges for regional integration in the social area. It is important to move towards a consensual approach to migration governance that fosters protection for people’s rights regardless of their migration status. In particular, one challenge is to make migrants’ rights and benefits portable. Current restrictions in this area limit mobility and generate problems of integration between peoples, either because it is not possible to migrate to a second country in the region with the rights acquired in the first, or because foreigners cannot participate fully in the social protection system. This is clearly the case with resources contributed individually to social security systems and rights of access to health care and pensions, but it also holds for the non-contributory component and acquired rights (when someone is receiving a social pension for physical disability and migrates with his or her family to another country, for example).

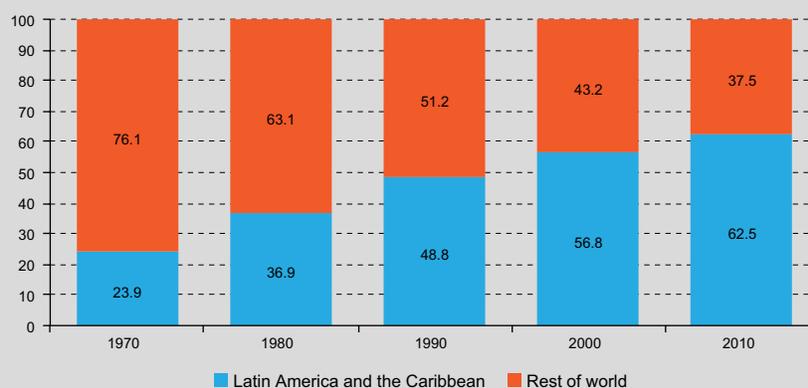
A specific instance of this is what happens in border areas, where there is a constant flow of population. This specificity creates further complications and challenges for social policy, the issue being how to enhance the quality and coverage of equivalent social services whilst maintaining national specificities, a situation that particularly affects some indigenous peoples with populations in such cross-border areas.

Besides the portability of social protection rights, there is the portability of academic credentials and skills certification. One integration challenge is to facilitate the validation of one country’s professional and technical qualifications in another without thereby constraining the scope of national legislation. Spaces like those created in the framework of the Andrés Bello Convention provide an example, but there is a need to go further in defining standards that are comparable between countries in order to facilitate the certification of credentials and skills. The region is better placed now than in the last century to make progress on these challenges, as the system of visas and movement across borders has been facilitated considerably. Nonetheless, the situation is not as favourable where the right to work, education and social protection is concerned.

Box V.3
**SOME RECENT INTERNATIONAL MIGRATION TRENDS IN LATIN AMERICA
 AND THE CARIBBEAN**

Elements of both continuity and change can be seen in the region's current international migration situation. About 30 million regional migrants are estimated to be living in countries other than those of their birth, a higher figure than 10 years ago. Migrants from within the region, clearly a minority in the early 1970s, have since increased their share steadily. Thus, in 2010 over 60% of the immigrant population came from within the region (see figure).

Figure
**LATIN AMERICA AND THE CARIBBEAN: DISTRIBUTION OF IMMIGRANT POPULATION
 BY ORIGIN, 1970-2010**
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the database of the Investigation of International Migration in Latin America (IMILA) research project.

Latin America and the Caribbean is also the second-largest destination for regional emigration after the United States. Two factors largely account for the consolidation of intraregional migration dynamics in the last decade. First, the economic crisis in the industrialized countries since 2008, the consequent hardening of migration conditions (dating in the United States to the attacks of September 2001) and the anti-immigrant climate have led to a drop in emigration to these destinations. At the same time, the regional economic integration processes that began to develop during the 1990s turned some subregions of Latin America and the Caribbean into spaces of free movement for individuals during the first decade of the twenty-first century. This is the case with the Southern Common Market (MERCOSUR), the Andean Community, the Caribbean Community (CARICOM) and the Central American Integration System (SICA). South America in particular has been moving towards a regime of unrestricted regional movement (IOM, 2012).

The 2010 census round put the number of intraregional migrants at about 4 million. The countries with the largest numbers of migrants from within the region are Argentina (1.5 million, mostly Paraguayans and Bolivians), the Bolivarian Republic of Venezuela (mainly Colombians), Costa Rica (essentially Nicaraguans) and the Dominican Republic (mostly Haitians). Intraregional emigration represents a substantial fraction of total emigration for a number of countries, most particularly Paraguay and Nicaragua. In 2010, 68% of Paraguayan emigrants living outside the country were in another country of the region, and the figure for Nicaragua was 56%. Intraregional migration is strongly subregional in character: the seven main intraregional “migration corridors” in 2010 were between countries sharing a border (IOM, 2012).^a

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the database of the Investigation of International Migration in Latin America (IMILA) research project and International Organization for Migration (IOM) (2012), *Migratory Routes and Dynamics between Latin American and Caribbean (LAC) Countries and between LAC and the European Union*, Brussels, 2012 [online] <http://www.migracion-ue-alc.eu/index.php/en-GB/data-on-migration/study-on-migratory-routes-and-dynamics>.

^a They are (in descending order of migrant numbers): from Colombia to the Bolivarian Republic of Venezuela, from Nicaragua to Costa Rica, from Paraguay to Argentina, from Haiti to the Dominican Republic, from the Plurinational State of Bolivia to Argentina, from Chile to Argentina and from Colombia to Ecuador.

In few areas of social policy is there so much consensus and homogeneity in the region as on the need to move forward with the inclusion of the gender perspective in plans and policies, gender equality and the economic empowerment of women. Besides the legal statutes deriving from national constitutions, there are multilateral and regional institutions that underpin many of these initiatives: the Convention on the Elimination of All Forms of Discrimination against Women and its Optional Protocol, the Inter-American Convention on the Prevention, Punishment, and Eradication of Violence Against Women, and the Beijing Declaration and Platform for Action (Fourth World Conference on Women, 1995). These instruments are supplemented by the regional consensuses reached by governments every three years at the Regional Conference on Women in Latin America and the Caribbean, among other things.

Although the region made greater progress than any other in narrowing the gender divide in 2013, most of its countries still rank poorly on international indicators for this gaps, particularly where economic participation and opportunities are concerned (World Economic Forum, 2013). Dealing with these gaps is a public policy goal in a number of countries, and success will depend heavily on the dynamism of the economy and employment, which often relies in turn on the export sector.

Many developing countries that have adopted an export-led model have specialized in the production of light manufactures, services and agricultural and agro-industrial products. Throughout the world, a large share of workers in these sectors are women. Consequently, if their exports increase, so will female employment. According to some research into countries in Africa, the Americas and Asia, female employment rises and the income gap between women and men narrows when international trade increases (Kyvik Nordas, 2003). According to other research, women's employment, opportunities and quality of life increase, but it is questionable whether there is any narrowing of the pay divide (Joeckes, 1995).

In Central America, for example, women's participation in global value chains is often via maquila, institutionalized in export processing zone regimes. Different case studies carried out from a value chain perspective in clusters prioritized by national competitiveness agendas (textiles, dairy products, agroindustry, fishing and fish farming, forestry, tourism, telecommunications) reveal a mixed picture. On the one hand, women's participation in value chains has enabled them to attain a degree of employment and income stability while increasing their independence and their knowledge of production and commercialization processes. On the other, firms seek competitiveness by transferring some costs to their female workers via low wages, harder and longer working days and poor working conditions (Renzi, 2004).

Public policies aimed at closing divides and empowering women economically in the region's countries are often associated with integrationist initiatives. These include programmes seeking to improve women's ability to participate in the most advanced links of value chains (see box V.4) and others whose aim is to upgrade statistical information systems in order to identify the special features of women's participation or characterize care economies and thereby set an economic value on the different spheres of human activity, highlighting the role of women in particular.

A regional proposal recently launched by ECLAC concerns the place of women in the information society and the potential for increasing their autonomy as the new technological paradigm becomes established (ECLAC, 2013g). These technologies can be brought together to achieve equality and help reduce gender inequities, which entail a social divide as well as the digital gender divide itself. Greater access to ICTs enables women, and particularly those from more vulnerable sectors, to improve their productivity and their chances of gaining access to higher-skilled jobs. This is just one example of how determined measures by the different integration mechanisms can simultaneously promote the gradual narrowing of gender divides, economic empowerment for women and the competitiveness of regional and subregional value chains.

Box V.4

TRAINING IN INFORMATION AND COMMUNICATION TECHNOLOGIES (ICTs) FOR WOMEN OWNERS AND ENTREPRENEURS OPERATING MSMEs IN CENTRAL AMERICA

The ICT training programme provided for businesswomen and women entrepreneurs at MSME assistance centres is being implemented within the framework of the Central American Integration System (SICA) and has the goal of improving the competitiveness of businesses run by women in the subregion via the promotion of access to and the introduction and use of ICTs in business processes. The programme gives continuity to the work done by the Information and Communication Technology Centre (CTIC) Foundation and the Centre for the Promotion of Micro and Small Enterprises in Central America (CENPROMYPE) from 2008, involving a number of pilot schemes whereby an ICT adviser is made available at business support centres in the Central America region.

The module was taught using a mixed training methodology with an initial phase of distance learning being supplemented by face-to-face sessions, totalling 76 hours of study time. The countries participating were Belize, El Salvador, Guatemala, Honduras, Nicaragua and Panama. Thanks to the training module, there is now a body of advisers capable of providing specialized services through MSME support centres.

All participating institutions are ready to replicate the training via the provision of business consultancy services and to emphasize the key points of the project in their institutional strategies:

- The importance of providing a special service for women in SMSEs.
- Business consultancy as a technical assistance service to incorporate ICTs into business development.
- The role of new technologies in SMSE business development.

Source: Central American Integration System (SICA), 2013 [online] <http://www.sica.int/cenpromype/>.

6. Natural resources and the environment

The countries of Latin America and the Caribbean have played an active role in developing the international framework of sustainable development principles and agreements. Three major world summits have been held in the region, and their results have guided the development agenda and underpin its values and priorities: the United Nations Conference on Environment and Development (Rio de Janeiro, 1992), the International Conference on Financing for Development (Monterrey, 2002) and the United Nations Conference on Sustainable Development (Rio de Janeiro, 2012, known as Rio+20). The common principle behind the region's approach in the current negotiations to set a post-2015 international development agenda has been to ensure that the agreements contribute to the common goal, formalized decades ago by the international community, of integrating the economic, social and environmental pillars of development without undermining the principles of international law, and international trade law in particular. One achievement has been to ensure that, sustainable development and environmental conferences and agreements aside, a key objective of the post-2015 global development agenda will be a set of sustainable development goals, currently under negotiation, informed by this comprehensive approach (see box V.5).

The region has also been very active in bringing up principles and commitments already approved at international summits but not enforced, including: application of principle 7 of the Rio Declaration on common but differentiated responsibilities; fulfilment of promises on contributions of official development assistance (ODA) and the additionality of funds for global climate protection; and the need to ensure that the resources for implementing the sustainable development agenda are commensurate with the scale of the effort.

The document that came out of Rio+20, "The future we want" (United Nations, 2012b), makes explicit the idea that international cooperation is necessary, even at the regional level. Furthermore, the strengthening

of the regional level as a vital nexus between local priorities and global realities and as a suitable sphere for mobilizing cooperation and pooling experiences is already happening in existing integration processes. One example of this is the leadership of the Caribbean countries in determining the basic guidelines for sustainable development in small island States, as set forth in the Programme of Action for the Sustainable Development of Small Island Developing States and the Mauritius Strategy for the Further Implementation of the Programme of Action for the Sustainable Development of Small Island Developing States. Thus, too, environmental and sustainable development cooperation has been an issue on integration agendas in MERCOSUR, the Andean Community, CARICOM and SICA, and more recently in CELAC, among other forums. The environment has also been a subject in free trade treaties between countries in the region and extraregional countries and groupings. In summary, and as in other parts of the world, environmental and sustainable development-related issues have been gaining ground on regional agendas, becoming a goal in themselves instead of one concern among others on the trade or health agenda. However, there are still many opportunities to step up regional cooperation in this area.

Box V.5

THE CRITICAL ROLE OF THE REGIONAL SPACE IN ATTAINING THE SUSTAINABLE DEVELOPMENT GOALS

Preparation of the sustainable development goals by the international community is part of an enhanced vision for post-2015 development. Another vital part is the design and operationalization of institutional structures to drive and monitor progress with and attainment of these goals.

Valid for all countries but adapted to reflect national differences, clear in their formulation and their metrics, the sustainable development goals are intended to call forth a global effort to make development more sustainable in all its aspects—economic, social and environmental.

Proximity and the similarity of the challenges to be met make the regional space a suitable level for gradual policy harmonization and for the pooling of experiences to shorten learning curves and protect legitimate economic competitiveness, while at the same time ensuring that there is social progress and that economic activity is better matched to its natural base.

Implementation of the Post-2015 Development Agenda requires an improved system of governance within the United Nations, ranking high enough to ensure that international institutions align themselves with the orientation it provides. The regional role will be vital in the construction of agreements on direction, progress monitoring and generation of the information needed for decision-making. By the countries' own decision, this will take place outward from the regions to the global level.

Coordination of actions to implement the development agenda will foster the creation of complementarities between international and regional institutions, which could facilitate progress even for the most vulnerable countries. In the context of a heterogeneous international community, regional action generates positive effects such as a greater sense of belonging to regional and subregional institutions. Goals relating to health, urban sustainability, gender equality, global climate stabilization and other issues require changes on a civilizational scale.

Change of this level cannot just be the sum of national contributions. In a world that is interdependent but made up of autonomous nations, collective action is indispensable for generating favourable environments based on public goods that may be global or, perhaps more simply, regional in scope, such as trade certainty, peace, financial and economic stability and untrammelled circulation of advances in technical knowledge and public policies. A coordinated regional effort capable of overcoming the centrifugal tendencies of globalization will be a better approach for dealing with the huge task of bringing about a structural shift in the direction of development to make it sustainable.

The sustainable development goals are meant to be defined in time for the sixty-eighth session of the General Assembly in 2014 and agreed upon after negotiation in time for the sixty-ninth session in 2015. How well they match the needs and specific situation of Latin America and the Caribbean will depend on the ability of the region's countries to attain common visions and agreements. The region is better placed now to exercise its relative independence than at other times when the concept of development was redefined, such as in 1992 (United Nations Conference on Environment and Development) and 2002 (World Summit on Sustainable Development). Consequently, proper use of the regional space to share outlooks and agree on common positions will ensure that the future agenda is a better match for the development of the countries of Latin America and the Caribbean.

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

For all their diversity, the countries of Latin America and the Caribbean face similar environmental challenges that are closely linked to common characteristics in their development pattern. This has been based on a production structure whose comparative advantages are static and rely on the abundance of natural resources. Despite progress in recent years, these resources have usually been exploited in a way that is detrimental to the environment, with irreversible expansion of the agricultural frontier, constant pressure on woodland, coastal areas and other critical and biodiverse ecosystems, air and water pollution and an increased risk of accidents and socioenvironmental conflicts.

The region has not sufficiently implemented governance mechanisms to channel resources from the exploitation of non-renewable natural resources into the generation of well-being and equality, or into the creation of new income sources and drivers of growth. The same development pattern that has been socially and economically inadequate has been environmentally devastating. Regional economic integration should move towards an environmentally sustainable development pattern. However, experience has shown that sustainability is not an automatic result of economic development and cannot be considered a “second stage” in that process. Furthermore, on a global scale, the poor results of efforts to solve the global environmental challenges, climate change, desertification and loss of biodiversity addressed by the conventions that came out of the 1992 United Nations Conference on Environment and Development demonstrate the unsustainability of the global production and consumption pattern the region is part of, which is unlikely to change without strong regional and global collaboration.

A change of model will not be brought about by the action of the market or by public initiatives that are confined to promoting incremental improvements in isolated variables. Systemic change is required, and here regional cooperation is crucial. A first step is to consolidate institutional integration in order to move beyond the model of reactive environmental policies that do not send out appropriate price signals or internalize environmental externalities. Incentive systems, broadly defined, need to change. Regional collective action can yield effective progress in the generation of information for decision-making (such as the preparation of integrated asset accounts) or in the implementation of measures such as the abolition of fossil fuel subsidies, fiscal covenants that incorporate environmental incentives or disincentives or the establishment of governance frameworks for the distribution and investment of rents from extraction activities. It can also nurture a network of goods, service and technology suppliers capable of acting in accordance with a logic of long-term integrated, planned development that takes account of the externalities, both positive and negative, of the solutions adopted.

A second group of opportunities for regionwide environmental cooperation relates to the need to adapt to a global market in which the environment is more highly valued, whether because consumers demand it or because of national policies, regional initiatives in leading markets such as the European Union, or as a result of international agreements. The relationship between environmental protection measures and trade is particularly important when climate change is at issue. The measures proposed or implemented to mitigate it (such as border carbon adjustment, fuel regulations and labelling) have had or may have major consequences for trade. The adoption of methods to measure the carbon footprint of traded products presents a significant opportunity for joint action by the countries of Latin America and the Caribbean (see box V.6).

A third set of opportunities for regionwide environmental cooperation is the management of cross-border areas and shared ecosystems. Thus, environmental concerns have triggered major processes of collaboration that have also contributed to integration, such as the Mesoamerican Biological Corridor and the Amazon Cooperation Treaty. An example of the greatest significance is the struggle against deforestation in Amazonia. Brazil has implemented a wide-ranging and effective programme to this end, the Action Plan for the Prevention and Control of Deforestation in the Legal Amazon (PPCDAm) (ECLAC/GIZ/IPEA, 2011). This action plan has involved different areas and levels of government, with a combination of actions ranging from satellite monitoring and police action to the creation of alternative economic activities and restrictions on lending for

certain activities. As well as achieving substantial results, the plan has been a learning experience in Amazon management for the public sector that could prove an important benchmark not only for the other Amazon countries but also for the management of other sensitive areas in the region where environmental damage calls for complex inter-institutional coordination. Furthermore, since natural boundaries do not match political ones, regional collaboration in these areas is necessary to ensure the effectiveness of national initiatives and the shared management of resources, while at the same time forestalling supranational socioenvironmental conflicts.

Box V.6

THE MEASUREMENT AND REDUCTION OF CARBON FOOTPRINTS AS A FACTOR IN EXPORT COMPETITIVENESS

Measuring and reporting the carbon footprint of internationally traded products may have a protectionist effect or may represent an opportunity to improve the energy efficiency and competitiveness of these products. The effect will depend on how the methodologies concerned are designed and how governments and firms prepare themselves to apply them. There is an opportunity here for collaboration between the region's countries, to ensure that the methodologies adopted are the most effective at combating climate change without distorting international trade, and to school government officials and company employees in the cost-effective application of the methodologies that are adopted. The same applies to other exercises in evaluating environmental "footprints", such as water, transport and ecological footprints (Frohmann and others, 2012).

In this context, since 2012 ECLAC has been carrying out a project designed to strengthen the ability of governments and food producers in Latin America to meet the increasingly stringent carbon footprint requirements their products are being held to in outside markets, especially in industrialized countries. From the start, it was seen that there was a need to promote public-private partnerships to attain this objective. The project originally covered four countries (Colombia, the Dominican Republic, Ecuador and Nicaragua), subsequently joined by Honduras, Peru and Uruguay. In six of these seven countries, trade promotion bodies were selected as partners, owing to their public-private character.

At the start of the project, a public-private committee was set up in each of the countries, coordinated by the relevant trade promotion agency, for the purpose of: (i) sharing information on current climate change and trade initiatives; (ii) receiving expressions of interest about the orientation of the project; (iii) promoting continuity in the work beyond the end of the project in late 2014. The public-private committee is involved in all project activities and decisions (workshops, presentation of its own good practices, selection of products and firms for case studies).

One of the main components of the project has been case studies measuring the carbon footprint of selected export products. Studies were carried out on six products (including coffee, cacao, prawns and uchuva) in a total of 45 firms, distributed between five countries (Colombia, the Dominican Republic, Ecuador, Honduras and Nicaragua). In two countries (Peru and Uruguay), the partners have raised resources of their own or from third parties to carry out a further 10 studies.

Implementation of the project has had positive effects for both the private sector and governments in the participating countries. In the case of the private sector, the project has succeeded in training exporters to cope better with carbon footprint and climate change adaptation requirements. The 55 firms participating in the case studies now know the carbon footprint of their respective export products, and this will enable them to adapt their production processes to reduce it and compete better in international markets. The project has also increased the ability of exporters' organizations to work together to cope with climate change challenges. In the case of the public sector, the project has made it possible to: (i) position the issue and prepare a State body to work on it; (ii) have a benchmark for the greenhouse gas emissions of its main export products; (iii) identify the structural problems (energy grid, transport infrastructure, etc.) that most affect the carbon footprint of the products exported by each country; (iv) improve collaboration with the private sector; (v) obtain inputs for formulating public policies on trade and climate change. The impact of initiatives of this kind would be increased if they could be scaled up from the national level to the subregional or even regional one over the coming years, for example by promoting partnership between sectors in different countries that export the same product (Central American coffee exporters, for example).

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

Chapter VI

THE SPECIAL CHALLENGES OF INTEGRATION IN THE CARIBBEAN

A. A BRIEF DIAGNOSIS

In the past 25 years, the member countries of the Caribbean Community (CARICOM) have made efforts to consolidate their integration through a subregional mechanism known as the Caribbean Single Market and Economy (CSME). Although restrictions on the movement of goods, services, capital and people have gradually been rolled back, it has been difficult to implement the legislative changes needed to put all the agreements reached into effect. The deadlines originally set for full implementation of CSME have therefore had to be extended. The CARICOM Secretariat announced in January 2012 that CSME was 64% on the way to completion (CARICOM, 2012).¹ The greatest progress with respect to the deepening of economic integration has been reflected in the establishment of the Economic Union of the Organisation of Eastern Caribbean States (OECS). The Dominican Republic and the members of the Caribbean Community (CARICOM) form the Forum of the Caribbean Group of African, Caribbean and Pacific (ACP) States (CARIFORUM), an intergovernmental mechanism that coordinates interregional political dialogue with the European Union.²

Caribbean countries are characterized by a number of peculiarities and constraints that raise special challenges for their integration processes. These include geography, heterogeneity in respect of income and population, the small scale of production and exports, dependence on external markets, and macroeconomic and environmental vulnerability, with a high degree of exposure to extreme natural disasters.

Geographically, 12 of the 15 CARIFORUM member States are islands, with an area of some 60,000 km². Just three CARICOM member countries are on the continent: Guyana and Suriname in South America, and Belize in Central America. This island geography increases the cost of integration. For example, it is faster, easier and cheaper to transport cargo overland from Mexico to Belize than to move it to any other destination in the Caribbean (Stoneman, Pollard and Inness, 2012).

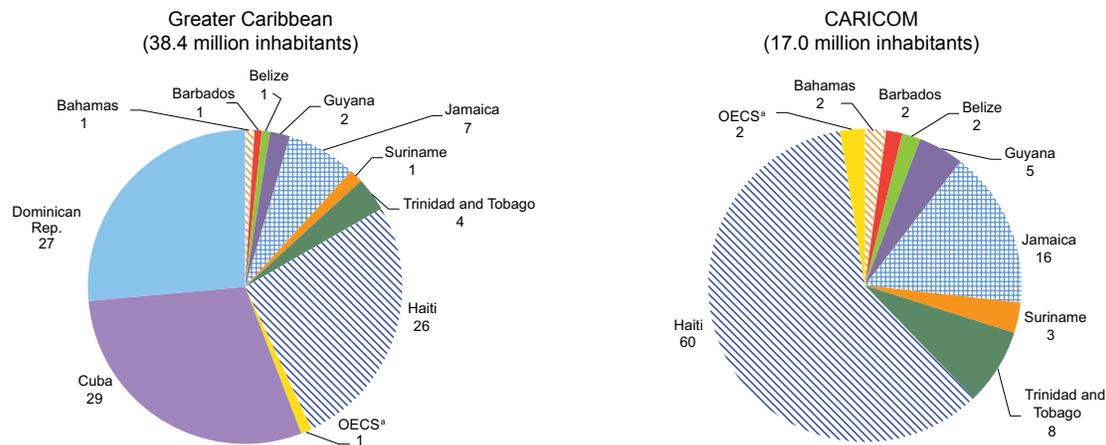
Secondly, the incomes and population of CARICOM members are very heterogeneous. This is illustrated by the broad dispersion of per capita GDP, which is over US\$ 21,000 in the Bahamas and less than US\$ 800 in Haiti. Annual GDP growth in the CARICOM member countries as a group in 2000-2012 was 2.4%, well below the regional average of 3.3% for the same period. Where population is concerned, two countries, Haiti and Jamaica, account for 75% of all inhabitants (10 million and 2.8 million, respectively), whereas the seven countries of OECS have just over half a million inhabitants between them (see figure VI.1). These income and population data confirm the Caribbean's position as the most heterogeneous subregion in Latin America and the Caribbean (see table VI.1).

Another noteworthy characteristic is the small scale of the Caribbean countries' production and exports. Although they are open, export-oriented economies, they account for only a small share of global and regional trade (less than 0.2% and 1.2%, respectively, in 2013). The exports of the subregion go in large proportion to extraregional markets such as the United States, where unilateral tariff preferences are on offer. Likewise, acting through CARIFORUM, in 2008 the Caribbean countries signed an Economic Partnership Agreement with the European Union with the object of promoting regional integration and greater participation in the world economy. These advances have not been enough to improve the export position of the CARICOM countries, as the take-up of preferences is still very low (McLean and Yoshida, 2014). Lastly, the financial crisis in Europe has depressed demand for Caribbean products as well as services, particularly tourism.

¹ The degree of compliance or implementation of commitments was estimated for different spheres of integration: free movement of skilled labour (66%), free movement of goods (80%), free movement of capital (72%), right of establishment (64%) and free movement of services (37%).

² Cuba is part of neither CARIFORUM nor the Economic Partnership Agreement signed in 2008 between the Forum and the European Union.

Figure VI.1
GREATER CARIBBEAN AND CARICOM, POPULATION DISTRIBUTION, 2013
(Percentages)



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

^a The OECS group includes information from Antigua and Barbuda, Dominica, Grenada, Montserrat, Saint Kitts and Nevis, Saint Lucia and Saint Vincent and the Grenadines.

Table VI.1
THE CARIBBEAN: SELECTED GDP AND EXPORT INDICATORS, 2012^a
(Dollars and percentages)

| Country/Subregion | GDP indicators | | | | | Exports (2012) <i>(percentages of total exports)</i> | |
|----------------------------------|---------------------------------------|--|--|---|---|---|------------------------------------|
| | Per capita GDP <i>(Dollars)</i> | Services <i>(percentage of GDP)</i> | Current account <i>(percentage of GDP)</i> | Public debt <i>(percentage of GDP)</i> | Official development assistance <i>(percentage of GDP)</i> | To Latin America and the Caribbean | Top three products ^b |
| Caribbean countries | 4 860 | 52.5 | -6.1 | 52.5 | 2.1 | 39.0 | 32.5 |
| CARICOM | 4 307 | 56.8 | -5.2 | 67.8 | 3.0 | 25.7 | 45.0 |
| Bahamas | 21 908 | 76.5 | -17.5 | 54.5 | ... | 3.1 | 91.3 |
| Barbados | 16 203 | 81.7 | 0.0 | 87.3 | ... | 31.1 | 41.0 |
| Belize | 4 858 | 58.7 | -2.2 | 72.8 | 2.7 | 13.7 | 62.6 |
| Guyana | 3 585 | 47.8 | -14.4 | 62.0 | 4.5 | 31.0 | 58.3 |
| Haiti | 776 | ... | -4.6 | 28.2 | 20.1 | 2.8 | 89.0 |
| Jamaica | 5 374 | 66.3 | -12.8 | 134.1 | 0.6 | 7.8 | 64.1 |
| Suriname | 9 182 | 52.7 | 4.9 | 28.6 | 2.6 | 14.6 | 95.5 |
| Trinidad and Tobago | 17 899 | 37.2 | 4.0 | 45.0 | ... | 31.6 | 63.6 |
| OECS | 8 405 | 75.6 | -17.1 | 82.90 | 4.8 | 49.5 | 69.6 |
| Antigua and Barbuda | 13 405 | 80.4 | -14.0 | 89.4 | 0.2 | 29.1 | 69.7 |
| Dominica | 6 919 | 70.7 | -11.1 | 72.7 | 12.0 | 78.4 | 69.2 |
| Grenada | 7 598 | 77.8 | -24.1 | 88.6 | 4.5 | 58.7 | 42.8 |
| Montserrat | 13 104 | ... | -33.1 | ... | 72.1 | ... | ... |
| Saint Kitts and Nevis | 13 659 | 74.2 | -11.4 | 129.3 | 4.3 | 13.8 | 82.7 |
| Saint Lucia | 6 558 | 73.2 | -14.2 | 71.0 | 4.0 | 44.9 | 58.6 |
| Saint Vincent and the Grenadines | 6 349 | 73.5 | -27.8 | 67.0 | 3.2 | 90.9 | 54.8 |
| Cuba | 6 288 | ... | ... | ... | ... | 5.0 | 77.3 |
| Dominican Republic | 5 795 | 54.7 | -7.2 | 33.3 | 1.0 | 25.0 | 22.4 |
| Latin America and the Caribbean | 9 510 | 53.5 | -1.9 | 46.3 | 0.5 | 19.8 | 19.6 |
| Andean Community | 6 616 | 52.6 | -2.5 | 30.3 | 0.8 | 28.9 | 45.0 |
| MERCOSUR | 11 397 | 53.8 | -1.4 | 52.8 | 0.4 | 23.8 | 20.7 |
| Central American Common Market | 4 233 | 55.9 | -6.1 | 36.1 | 2.1 | 44.3 | 20.7 |

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

^a The indicators calculated for the different subregions and the whole region are averages weighted by GDP or exports as appropriate.

^b According to the four-digit International Standard Industrial Classification (ISIC), Revision 2.

Only a few of the CARICOM member countries can be categorized as goods producers, and in such cases, production is invariably confined to a very small range of commodities, light manufacturing and petroleum products. Guyana depends on agriculture (especially sugar and rice) and mining (gold, bauxite and aluminium); and Belize on sugar, citrus and bananas, as well as petroleum. Oil, natural gas and chemicals dominate economic activity in Trinidad and Tobago; mining (aluminium and bauxite) and tourism in Jamaica; and mining (gold and aluminium), petroleum and light manufacturing in Suriname. In the other CARICOM countries, services account for a large share of GDP, often in excess of 70%. This is especially the case among OECS members (see table VI.1).

Given their trade openness, Caribbean countries are generally vulnerable to negative external shocks, particularly changes in commodity prices. All the CARICOM countries, with the exception of Trinidad and Tobago and Suriname, regularly generate large balance-of-payments current account deficits. For the subregion, this was of the order of 5.1% of GDP in 2013, or more than twice the current account deficit of Latin America and the Caribbean as a whole (1.9% of GDP). This is compounded by the heavy burden of public debt, which exceeds 100% of GDP in several countries, consuming resources that could otherwise go to production activities: during 2008-2009, debt interest payments were 14% of GDP in Jamaica, 9% in Saint Kitts and Nevis and 4% in Saint Lucia (ECLAC, 2010). Another factor contributing to the precarious macroeconomic circumstances of the Caribbean has been the fiscal deficit, which was estimated to be over 3% of output in 2010-2013 for the group as a whole (ECLAC, 2013c). The weakness of the public finances is particularly apparent in the smallest economies, with fiscal deficits of 10% of GDP in Dominica and 20% in Montserrat (Alleyne and others, 2013).

Another notable feature of the structure of CARICOM trade is the small proportion of total exports going to Latin America. Although the Latin American and the Caribbean market accounts for 26% of the group's total exports, there are economies for which extraregional markets (especially the United States, Canada, the United Kingdom and the rest of the European Union) are more important than the intraregional one. The Bahamas, Haiti and Jamaica are the extreme cases, with the region accounting for less than 10% of their exports. Trade between CARICOM members, meanwhile, is dominated by the more developed countries.³ The merchandise exports of the Caribbean countries are highly concentrated, with the top three export products usually accounting for between 40% and 90% of the total. These are generally commodities (bauxite, gold, aluminium, gas, oil, sugar, bananas and rice, among others) (see table VI.1). Only in a very few cases do exports consist of manufactured products, and even then they tend to be confined to just a few goods. Examples include polymers from the Bahamas (46%), apparel from Haiti (89%), medicines from Barbados (15%) and electrical equipment and telecommunications appliances from Saint Kitts and Nevis (73%).

Unlike the commodities exported by the CARICOM countries, which are transported in tankers, the subregion's imports of manufactures and consumer goods are shipped in containers. Because cargo volumes are small, shipping services are irregular. In general, the highest-volume international liner routes in the area are those connecting North America to South America and the European countries to North America. Of the 17 most important ports in CARICOM, only three are global and regional trans-shipment hubs (Kingston in Jamaica, Freeport in the Bahamas and Port of Spain in Trinidad and Tobago) (Sánchez and Wilmsmeier, 2009). The other islands are not served by international shippers, so this service is provided by small feeder vessels that trans-ship cargo between the small ports of the eastern Caribbean (Cordero, 2014).

The high shipping costs experienced by CARICOM countries adversely affect their competitiveness and options for tapping into regional or global value chains. In particular, the fact that only Guyana and Suriname share a border highlights the importance of efficient maritime transport infrastructure. In this context, the CARICOM countries have included among the five "anchor" projects of their 2013-2015 Regional Aid for

³ The countries in this group are the Bahamas, Barbados, Guyana, Jamaica, Suriname and Trinidad and Tobago.

Trade Strategy the creation of a rapid transshipment service in the southern Caribbean and the modernization of regional port infrastructure. It is hoped that international resources will be mobilized to put these projects into effect (McLean and Yoshida, 2014).

Air transport between the CARICOM countries has a number of similarities to sea transport. In 2009, the number of direct services between its member countries averaged just four (CARICOM, 2009, Annex B). Because of the lack of direct routes, several islands have to connect via Central America (including Panama) or the United States (Miami or Puerto Rico), which complicates connectivity and the flow of business between the members of the grouping.

Less developed countries in CARICOM depend heavily on imports of intermediate and energy supplies for local production, especially fuels (oil and gas), the main suppliers of these being Trinidad and Tobago and the Bolivarian Republic of Venezuela. In the latter case, the PETROCARIBE initiative⁴ has provided the CARICOM countries with financing for oil purchases worth about 3.5% of subregional GDP and about 6% of GDP for the small islands of OECS.⁵ Mention should be made of the regional energy policy formulated by CARICOM and approved by its member States in March 2013. Its objectives include: attaining a more sustainable pattern of renewable energy supply and use, reducing regional dependency on fossil fuels, achieving greater energy conservation and efficiency, and adopting a low-carbon development path (McLean and Yoshida, 2014).

Another special feature of the Caribbean is its high level of exposure to, and the occurrence of, natural disasters such as hurricanes, tropical storms and even earthquakes, like the one that struck Haiti in January 2010. These phenomena usually have direct effects on infrastructure and coastal ecosystems and indirectly discourage tourism and agriculture, thereby reducing economic growth.⁶ In Grenada and Jamaica, for example, GDP fell by about 10 and 2.5 percentage points, respectively, as a consequence of Hurricane Ivan in 2004; and in Belize GDP fell by 4% after the passage of Hurricane Dean in 2007. The region has suffered 187 extreme events in the past 60 years (Fraser, 2013).

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

The situations described do not exist in isolation but rather constitute a set of interrelated factors that have shaped the development of the countries in the subregion. For example, debt conditions can be expected to worsen after some extreme event or natural disaster because of the associated costs, which necessitate successive loans for unbudgeted expenditure, worsening the fiscal deficit. This dynamic becomes worse at times when international demand is contracting, such as in 2009 and during the recent period of reduced

⁴ The PETROCARIBE Energy Cooperation Agreement was formally constituted on 29 June 2005 and signed by 14 countries: Antigua and Barbuda, the Bahamas, Belize, the Bolivarian Republic of Venezuela, Cuba, Dominica, the Dominican Republic, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines and Suriname.

⁵ Estimates based on information for the quotas provided by Petróleos de Venezuela S.A. (PDVSA) and PETROCARIBE to the Caribbean countries, the percentage of long-term financing (SELA, 2013) and official prices for the Venezuelan oil basket obtained from the Venezuelan Ministry of Oil and Mining for 2008-2012.

⁶ By way of example, the earthquake of 2010 in Haiti caused losses in excess of the country's annual GDP (equivalent to 113% of output). That same year, Tropical Storm Tomas caused losses equivalent to 36% of GDP in Saint Lucia. Between 1970 and 2008, the average annual cost attributable to natural disasters in the Caribbean was 3.7% of GDP (ECLAC, 2010).

economic activity in the United States and European Union. In these circumstances, efforts to promote greater regional integration and improve the competitiveness of the countries in the subregion are constantly restricted by budgetary constraints. As a result, the subregion's trade-related infrastructure, logistics and connectivity have remained weak.

In CARICOM, ODA has declined over time as countries have been graduated from concessional development assistance upon achieving middle-income status. The exceptions to this include Haiti, the only low-income country in the region, Montserrat, which has received substantial assistance to cope with the fallout from the volcanic disaster, and Dominica, which has garnered considerable assistance under cooperation arrangements with China in particular (see table VI.1). These resources fall woefully short of what the subregion requires and there should be greater congruence between the Aid-for-Trade resources provided and the priorities of the subregion. In this regard, Aid for Trade should increasingly seek to redress urgent supply constraints, and structural rigidities which have reduced export competitiveness and have emerged as the principal barriers to subregional development and integration.

B. TOWARDS GREATER LATIN AMERICAN COOPERATION WITH THE CARIBBEAN

The small size of the CARICOM market and the low degree of trade complementarity between its economies imply a clear need for enhanced integration with other countries that are geographically close to the subregion and are its natural trading partners, particularly Cuba, the Dominican Republic and the Central American countries, including Panama (McLean and Yoshida, 2014). In view of this and of the small scale of trade relations with South America, rather than recommending the integration of the Caribbean countries into a process of convergence with the rest of the region's economies, ECLAC is promoting greater coordination among the Latin American countries to use innovative cooperation mechanisms to support the development of the CARICOM economies and their connection with Cuba, the Dominican Republic and Central America. This group of countries is naturally complementary, given their relative import and export structures. Central America is a major source of industrial and consumer goods and the Caribbean of tourism services and energy resources that Central America needs, while Panama specifically is a logistical and financial services centre that complements the needs of the Caribbean countries (see box VI.1).

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

- Technical assistance for capacity-building in areas where the region's countries have a successful track record. A practical way of supporting this capacity-building process is by establishing technical assistance missions to collaborate on some particular programmes, such as:
 - Enhancement of tax collection and public spending management capacities.
 - Establishment of public procurement management mechanisms.
 - Development of civil registry schemes.

- Establishment of single windows and interoperability of customs information technology systems.
- Harmonization of sanitary and phytosanitary standards.
- Development of service provider coalitions.
- Specific actions to promote, coordinate and assist with the financing of policies to develop sea and air transportation between CARICOM members and between these and the rest of the region. There is great scope for cooperation in this area, especially as regards improvement of transport links between the CARICOM countries and Panama, given that the latter has maritime links with Grenada, Guyana, Haiti, Saint Lucia, Saint Vincent and the Grenadines and Suriname. It also has good connections with Central and South America, so that it could act as a platform connecting these subregions with the Caribbean.

Box VI.1

SOME RECENT EXAMPLES OF INTEGRATION AND COOPERATION BETWEEN THE CARIBBEAN AND CENTRAL AMERICA

A variety of recent experiences have revealed a strengthening of integration and cooperation ties between the countries of the Caribbean and Central America. The main ones include the following:

- In March 2012, Panama signed a Partial Scope Agreement (PSA) with Trinidad and Tobago. As part of the agreement, Panama can buy butane gas from Trinidad and Tobago without intermediaries and sell it on to other countries in Central America.
- Salvador and Trinidad and Tobago have signed a tourism agreement as part of the negotiations for a PSA, and Guatemala has a culture and tourism cooperation agreement in force with Trinidad and Tobago.
- In the business sphere, there has been cross-investment between the two subregions, with firms based in Central American countries expanding their operations to the Caribbean and vice versa. Examples include the Panamanian firms Del Monte Panamerican, Carnes de Coclé and Conservas Panameñas Selectas S.A., all in the food sector. The Bermúdez Group, also in the food industry and based in Trinidad and Tobago, has been investing in Costa Rica since 2010. From that country it re-exports prepared banana products to Trinidad and Tobago and the rest of the Caribbean. Again, a financial services firm that already had a presence in Panama, Sagicor Life Jamaica, entered the Costa Rican market in 2013. In 2012, Sur Electrica Holding of the Bahamas bought 100% of the equity of three Guatemalan firms, TPS Guatemala One, TPS San José International and TECO Guatemala Services.
- Close links are maintained between the Central American Integration System (SICA) and CARICOM. Since 1992, there have been a number of ministerial meetings and summits of heads of State. The main topics dealt with have been trade and investment, climate change, risk management, security, cooperation, air transport, poverty reduction, foreign policy coordination and tourism.
- Both groups of countries, along with the Bolivarian Republic of Venezuela, Colombia, Cuba, the Dominican Republic and Mexico, are members of the Association of Caribbean States (ACS). This initiative has been the channel for cooperation initiatives such as the Plan of Action of Pétion Ville, agreed in Haiti in April 2013 during the fifth Summit of Heads of State and Government of ACS. The plan includes actions in the fields of sustainable tourism, trade, transport, natural disasters, education, culture, science and technology. In late April 2014, the first public assessment of the results of the Plan of Action of Pétion Ville will be carried out during the sixth Summit of the Heads of State and Government of ACS in Mérida (Mexico).

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

Chapter VII

TEN RECOMMENDATIONS FOR REGIONAL INTEGRATION

A. THE INTEGRATION PROCESS MUST BE REGIONAL IN SCOPE

Integration of all the subregions of Latin America and the Caribbean should be the guiding principle for the efforts of the various integration groupings and forums over the coming years. With over 600 million inhabitants, united by strong historical, cultural and, to a large extent, linguistic ties, where better to leverage the traditional benefits of integration, such as the greater scale of the enlarged market and the use of national complementarities? The region is also the most promising space for developing multinational value chains structured around the two largest economies, Brazil and Mexico. Moreover, and notwithstanding the particular features of nations and subregions, the triple problem of external vulnerability, high inequality and structural heterogeneity is common to the region as a whole. Decisive action, pursued collectively at the regional level, can contribute significantly to addressing these challenges.

The objective of regional integration is driven by the demands of the international economic environment, which, as noted earlier, is increasingly shaped by integrated macroregions with enlarged markets and shared trade and investment policies. The explanation for this lies in the growing role of value chains in the organization of global production. The development of mega-regional agreements such as the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP) between the European Union and the United States, is precisely one reaction to these trends. The parties to these agreements seek to accelerate policy and regulatory convergence in the largest markets, and to afford their companies a greater competitive presence in value chain segments with higher value added.

In the international situation foreseeable for the rest of this decade, an integrated regional market could help to boost demand and thereby growth, by absorbing the impacts of slacker growth in other parts of the world. Furthermore, integration is made more attractive by the expansion of the regional market with the growth of Latin America's middle class. Reasons of scale and profitability, the actions of multilateral and development banks, the experience of trans-Latin firms and the continued growth of foreign investment from within the region, all point towards enlarged markets and gradual policy convergence.

The above-mentioned global economic trends make it clear that the best option for Latin America and the Caribbean is to move forward in its regional integration and cooperation efforts, jointly addressing some of its main weaknesses (for example, in infrastructure, education and innovation). This would dramatically increase the region's trade and investment appeal and open up new opportunities for the creation of production and enterprise partnerships, which in turn would enlarge the map of international partnerships and the scale of business. Concerted regional action would also help strengthen the voice of Latin America and the Caribbean in major global forums, and in the region's discussions with other relevant actors in the international system (see section 7).

The creation of broad, unified spaces is also the best way which to take advantage of the externalities associated with the production of regional public goods. Convergence in respect of a limited yet critical set of regional or subregional public goods (for example in infrastructure, transport, logistics and trade facilitation), would help revitalize intraregional trade and investment flows, thereby encouraging greater production integration. Setting up a regional reserve fund would reinforce the position of Latin America and the Caribbean against balance-of-payments shocks and help provide a fundamental public good, which

is regional financial stability. Such an additional “line of defence” is particularly important considering the uncertain economic environment for the region in the second half of this decade.

Also in relation to regional public goods, national efforts (which at present are often too limited in scale) need to be combined to develop joint technology hubs in areas of shared interest, such as climate change, energy efficiency, renewable energies and biotechnology applied to agriculture and mining. Cooperation should also be encouraged to develop the region’s forecasting capabilities, so that it is better prepared to respond to rapid global changes. As such, it could be highly useful for governments and integration schemes to set up a Latin American and Caribbean global analysis network, linking together the various national institutions, whether governmental, academic or commercial, that are engaged in prospective analysis.¹ Social inclusiveness provides a further rationale for integration, since efforts in supporting SMEs, dealing with migration issues and achieving convergence on social policy issues, can be coordinated to better effect in a regional context that forms the framework for gradual and persistent approaches by the various subregional integration schemes.

At the same time, cooperation is increasingly necessary to take advantage of the huge opportunities afforded to the region by the rapid growth of the middle classes in Asia and the rest of the developing world. Given the scale of the challenges and the magnitude of the current and future potential related to this demand, the most significant initiatives will likely be those that bring together the largest number of the region’s public and private actors. This is an area in which scale is important, and therefore regional or at least subregional initiatives are required.

In short, both the demands of the global environment and the inherent dynamics of regional events point to the logic of constructing broad, unified spheres for regional cooperation, creating critical masses in financing, technology and human resources, and achieving convergence in key aspects of public policy. The objective of integration cannot be other than regional. These are signs of the times and of the demands that structural change for equality has placed on Latin America and the Caribbean.

B. INTEGRATION MUST BE CONSTRUCTED ON THE BASIS OF SUBREGIONAL AND LOCAL COMPONENTS

Integration must not exclude any country or geographical area of Latin America and the Caribbean, but this is not to deny that many of the steps towards integration have strong subregional or even local components. Matters related to infrastructure, transport and logistics, and cross-border integration programmes, by definition tend to be framed by the closest territorial space. This is the case with the Initiative for the Integration of Regional Infrastructure in South America (IIRSA/COSIPLAN) and the Mesoamerica Project on transport, energy and communications infrastructure.² Intraregional flows of people, goods and investment, as well as the creation of value chains, are also shaped to a great extent by geographical proximity.

Other promising local or subregional initiatives include the electrical grid interconnection projects in Central America and the Andean region. The members of the Caribbean Community (CARICOM) are preparing a regulatory framework to support the exchange of electricity and gas within the subregion. CARICOM is also the platform for efforts to create a Caribbean shipping lane and an integrated space in information and communications technologies (ICT). Significant steps have been taken in the environmental

¹ See Bitar (2014).

² One prominent example is the entry into operation in October 2013 of the 358-kilometre high-voltage transmission line connecting the Itaipú binational hydropower plant with Villa Hayes in the Asunción metropolitan area. The project was financed by the MERCOSUR Structural Convergence Fund (FOCEM) at a cost of almost US\$ 320 million, and will increase the capacity of the electricity supply to Asunción by 50%.

sphere, as well, including the Meso-American Biological Corridor and the Treaty for Amazonian Cooperation. In social affairs, the Hipolito Unanue Agreement on health and the Andrés Bello Agreement on education were both signed by the Andean Community, while progress was made by MERCOSUR Social and the Central American Social Integration Secretariat (SISCA). MERCOSUR Social is aimed at the coordination of joint social policies and actions among the countries of the Common Market of the South, in areas such as childhood, adolescence, youth, older adults, food security and the social economy. Meanwhile SISCA has worked efficiently to strengthen relations and coordination between the ministers who oversee social issues in Central America.

ECLAC, too, has advanced proposals for the gradual creation of shared industrial policy spaces in specific sectors (see section 6). Its proposal is to identify production sectors with the potential to form competitive value chains, to study their strengths and weaknesses, and to apply a set of public policies to leverage this potential. This is a specific example of how a regional integration approach may be grown out of border or subregional initiatives while building the commercial, technical and institutional capacities to spread these practices throughout the rest of the region.

C. NECESSARY CONVERGENCE BETWEEN INTEGRATION SCHEMES WILL BE A GRADUAL, NON-LINEAR PROCESS

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

For example, the Regional Broadband Dialogue, established in 2010 with ECLAC as technical secretariat, contributed to the agreement between the sectoral authorities of 10 countries to form the Regional Broadband Observatory in 2011. These authorities supply timely, up-to-date information on broadband matters and facilitate dialogue between public and private stakeholders. Better coordination between the region's governments, combined with various policies and sector reforms implemented at national level, have helped make the service more affordable and increase connection speeds. The digital economy is a core component of the structural change that the region needs, given that it favours production structure diversification and fosters higher productivity and productivity convergence. The advances made in terms of policy approaches and regulations in this field, are a concrete example of the contribution that regional cooperation can make towards major development challenges.

Intraregional trade facilitation is another area that should be prioritized in promoting convergence. To a greater or lesser extent, all the integration schemes have made headway in areas such as the digitalization of trade procedures, single windows for foreign trade, and authorized economic operator programmes. The logical next step will be to build bridges between these developments (see section 7).

These and other achievements could serve to make convergence between subregional integration schemes a smoother process. But this is not a linear process, because the time frames and characteristics of the various integration schemes are highly dissimilar. It would be unrealistic, then, to suggest that they should operate at the same speed and in the same sequence. In the meantime, as noted earlier, it might be possible to regionalize some less controversial issues, so as to create an underlying asset for potential future developments.

The re-engineering process currently under way in the Andean Community exemplifies the complexities and challenges of the convergence process.³ The four Andean Community member States also belong to other economic integration schemes, with differing policy slants. Colombia and Peru are full members of the Pacific Alliance, in which Ecuador holds observer status. Ecuador and the Plurinational State of Bolivia are currently in the process of acceding to MERCOSUR (with the latter at a more advanced stage). Both countries are also members of the Bolivarian Alliance for the Peoples of Our America – Peoples’ Trade Agreement (ALBA-TCP). The Andean nations will in all likelihood continue to belong to multiple integration schemes in the coming years. This creates complexities of various kinds, such as might arise if there were inconsistencies between any of the commitments (whether tariff- or policy-related) undertaken within each group. Another complex issue is how a transition might be effected from the present situation towards the goal of South American convergence, the importance of which was highlighted by Andean presidents at the beginning of the re-engineering process in the Extraordinary Meeting of the Andean Presidential Council.⁴

The member States of the Andean Community explicitly stated their intention to seize the opportunity presented by re-engineering to assess whether there are items currently on the Community’s agenda that could be more effectively addressed under the auspices of the Union of South American Nations (UNASUR) or even the Community of Latin American and Caribbean States (CELAC). Should this be the case, duplication of efforts and inconsistencies could be reduced, freeing up human and financial resources for areas defined as part of the “hard core” of Andean integration. This approach shows how bridges can be built between different integration mechanisms, minimizing redundancy while simultaneously promoting the future convergence of efforts.

It cannot be denied that multiple memberships add to the complexity of achieving convergence, already a challenging proposition in its own right. Nevertheless, the fact remains that moving towards a comprehensive regional agenda is the crucial objective. Keeping this in mind, and working around the creation of value chains, it should be possible to apply those policies that are most functional to convergence in a pragmatic manner. The immediate priority is to make progress in developing the aforementioned regional public goods (transport, logistics, telecommunications, financing and trade facilitation) so as to create the conditions for coordinated industrial policy initiatives to operate on a more realistic footing. In these two key dynamics, the complexities arising from multiple memberships do not present an insurmountable obstacle, so long as the commitment to integration is reinforced and expressed in the form of regional public goods and in the launch of a multinational industrial policy.

The development of regional public goods and the dismantling of barriers to intraregional trade and investment need not necessarily advance at the same speed or in a predetermined order. It is more important that steps are taken pragmatically, favouring those that generate the most support and accepting that different groups of countries may progress at different speeds.

Lastly, and notwithstanding the importance of institutional convergence between the different integration mechanisms, the existence of a certain minimum level of macroeconomic convergence is also crucial. The targets and mechanisms of this convergence may be set out explicitly in binding integration agreements (as with the Maastricht criteria in the European Union), although this is not essential. The most important thing is to be clear in that large gaps in inflation, fiscal balances and current accounts will inevitably hurt trade and investment flows between the member countries of integration schemes.

³ Although the Andean Community is mentioned as an example in this instance, many of these conclusions also apply to other subregional integration schemes. To these must be added the superimposition of different commitments given under intraregional and extraregional trade agreements, such as those between some of the region’s countries and China, the European Union, Japan, the Republic of Korea and the United States, to name some of the most important.

⁴ “Request the acting Andean Community Secretary-General to identify jointly with the General Secretariat of MERCOSUR and the General Secretariat of UNASUR, common and complementary elements and differences, with a view toward the future convergence of the three processes” (Declaration of Bogota, 8 November 2011).

D. THERE IS NO SINGLE OR BEST MODEL OF INTEGRATION, SO PLENTY OF FLEXIBILITY IS NEEDED IN DESIGNING AND MANAGING THE EMERGING REGIONAL SPACE

Governments throughout the region, regardless of their political stripe, share several far-reaching goals. These include the transformation of the production structure, social inclusion, regional integration and cooperation, and the struggle against climate change and its consequences. While integration is an aim in itself, in practice it also contributes to achieving the other goals. In any case, the objective of transforming production is increasingly associated with production complementarities between countries.⁵ Achieving this set of goals must therefore be the centrepiece of regional integration efforts over the coming years.

Without prejudice to the common objectives described above, the wide diversity of the region's economies, integration mechanisms and government policy orientations means that a large dose of flexibility and pragmatism is needed to establish criteria regarding several core aspects of integration, notably:

- The adoption of commitments by countries or associations at different speeds or in variable-geometry formats.
- The modes of differential treatment for smaller or less developed economies.
- The modes of convergence of existing subregional agreements.
- Consideration of the trade agreements maintained by Latin American and Caribbean countries with extraregional partners.

In the context described, it is clear that preference should be afforded to consensus-building, focusing the integration agenda on the areas where there is most agreement and where the benefits are most evident. There are also certain basic requirements that all of the region's integration mechanisms should attempt to meet, irrespective of their policy orientations. These include setting realistic and gradual objectives, preserving past achievements, fulfilling commitments, and strengthening ties with other integration mechanisms in the region. It is also essential to define more clearly the sphere of action of the various integration mechanisms, especially CELAC and UNASUR (see section 5), in order to minimize the dispersal of efforts.

All these considerations should be included in the design of a new regional institutional framework, so as to minimize its weaknesses and prevent the erosion of its credibility. The region's governments should be open to looking at successful cooperation and integration experiences in other regions, especially East and South-East Asia. In particular, an example should be made of the strong pragmatism that characterized Asian integration, which prevented the substantial differences between political regimes from becoming an insurmountable obstacle to the design and implementation of a regional cooperation and integration agenda.

E. THE COMMITMENT AND POLITICAL WILL TO CONVERGE TOWARDS A REGIONAL SPACE SHOULD BE AN ESSENTIAL REQUISITE

The movement towards an integrated regional space through the convergence of the many existing agreements and integration schemes, while highly desirable, is politically complex in the current situation. In this context, the region's countries should make the following commitments: (i) that the core medium-term objective

⁵ For example, in the MERCOSUR area, the complementarity of production is being promoted in the aeronautical and shipbuilding industries, as well as in wind power, information and communications technologies and oil and gas. The aim is to undertake common regional projects in science, technological development, innovation and production integration (Joint Communiqué of the Presidents of the Member States of MERCOSUR, 29 June 2012).

must be regional integration, i.e. between South America, Central America, the Caribbean and Mexico; (ii) that the pursuit of this objective should not be detrimental to the advances currently being made within each subregion or association; and (iii) that possible difficulties arising on the path towards future convergence will be dealt with flexibly and with commitment to the integration process. In other words, the main challenge at present is to build bridges between the existing associations and initiatives, in order to facilitate their future convergence.

Over the coming years, and in their capacity as bodies that represent the entire region and South America respectively, CELAC and UNASUR will play a central role in aligning the various integration efforts. Accordingly, both schemes must have clear agendas (avoiding the duplication of functions) as well as the technical, financial and institutional means to pursue those agendas effectively. In principle, CELAC and UNASUR are the most appropriate forums in which to coordinate regional (or subregional) positions in major global debates, as well as in relations with extraregional partners (see section 7).

One key challenge is to prevent further fragmentation of the region, whether in terms of political allegiance (by definition temporary) or geographical alignments that do not reflect the realities of the modern world. In particular, it is imperative to prevent the construction of an artificial Atlantic-Pacific division in the region.⁶ Consolidating links with Asia is not of interest exclusively to Latin American countries with a Pacific coastline, nor is it something that they can achieve alone; rather it is an undertaking with a regional dimension. Moreover, the effectiveness of such an approach will be dependent not just on the quality of policies and proposals, but also on the (economic, demographic and resource-related) critical mass that the region has to offer. It is therefore obvious that neither the Atlantic nor the Pacific coast can do without the other. Both sides of the continent have specific advantages and should coordinate to maximize the rewards that these entail.⁷

Current differences in trade policy, and in development strategies in general, are a hindrance to more coordinated action between Atlantic and Pacific countries. However, these circumstances should not be allowed to develop into a permanent restriction. In other words, efforts must be made to reduce these differences, always leaving the door open for such time as there is greater convergence. Care must also be taken to ensure that extraregional trade negotiations or initiatives involving the region's countries do not obstruct future convergence processes.

F. VALUE CHAINS AND PUBLIC POLICIES TO PROMOTE THEM CAN BE A POWERFUL INSTRUMENT FOR REGIONAL INTEGRATION

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

⁶ "Our continent has the fortune of standing between two oceans. The future of Latin America depends on our ability to bring these seas together" (President Dilma Rousseff at the first regional meeting of the Clinton Global Initiative, 9 December 2013, Rio de Janeiro).

⁷ The Latin America-Asia Pacific Observatory is worthy of note in this regard. It was set up in March 2012 by the Latin American Integration Association (LAIA), the Andean Development Corporation (CAF) and ECLAC, as a forum for information-sharing, analysis and discussion on the economic relations between the two regions, through an Internet platform [online] (www.observatorioasiapacifico.org), seminars and publications.

Escaping the “middle-income trap” requires innovation, increased productivity, production diversification and investment in infrastructure and human capital. It is therefore crucial to start with a modern understanding of integration, based on the competitive creation of value chains. Such an understanding has helped shape the region’s growing consensus to give a more prominent role to production integration, promoting regional or subregional value chains. To be consistent with this approach, it will be necessary to raise the profile of national industrial policies and to make production integration a central component of regional integration and cooperation activities.

For value chains to be competitive, industrial policies must be developed to support productivity and innovation. This is the critical link between national policies and integration policies. If the desired outcome is to favour the development of multinational production linkages, then action solely at national level is not enough. Logic dictates that certain industrial policy instruments must include multinational or subregional components, in areas such as worker training, quality certification, measuring and reducing the carbon footprint of exports, and generally in all fields relating to promoting the (direct and indirect) internationalization of companies, especially SMEs. The coordination of national industrial policies presents a number of political, technical and even budgetary challenges, which is why these initiatives must be gradual and progressive, advancing through trial and error in those activities that have a bigger impact on intra-industrial trade and subregional value chains.

While it is true that trade may consolidate or even widen the productivity differences between economies, the fact that some economies are rooted in low-productivity categories and others in more dynamic and productive segments means that one of the major challenges of regional integration is capacity-building in the least advanced economies. This may be achieved through recourse to structural funds, multilateral and development bank financing and partnerships with foreign investors that facilitate access to training, technology and production and distribution networks. It is important to ensure that the least advanced economies can access external support to enable their companies to enter and climb value chains. Special and differential treatment for less developed countries should therefore be reformulated and slanted in favour of productive and technological capacity-building.

Industrial and trade policies must be closely aligned if strategies designed to promote regional and subregional value chains are to be successful. Trade policies should focus on gradually eliminating non-tariff barriers that hamper the functioning of value chains, and which usually derive from differences between national regulations in such areas as technical standards, the treatment of foreign investment and services, and the protection of intellectual property. Such measures often impede the development of value chains to an even greater extent than tariffs, an area in which the region has made significant progress. Greater regulatory convergence between the region’s countries would also facilitate the move towards shared industrial policies, for example by reducing competition between countries to attract FDI through tax benefits or regulatory concessions.

In short, industrial policy seems to be a key vector in renewing the integration process. The challenge is to jointly build up production and technological capacities where they do not exist at present. Intraregional and especially intra-industrial trade, which is most directly associated with value chains, could be revitalized on this basis.

G. A COMMON AGENDA FOR THE NEAR TERM IS A GOOD STARTING POINT

On the basis of the various themes addressed in this document, a potential shared agenda may be envisaged for near-term regional integration and cooperation. This should include aspects related to the goal of further integrating regional production, and that of improving the external relations of Latin America and the

Caribbean, including increasing regional participation in major international debates. Some preliminary ideas in this regard are set out below.

1. Regional agenda

Insofar as the governments of the region share the objective of promoting multinational production linkages, it is advisable to explore options for a gradual move towards full regional cumulation of origin. Provisions of this kind already exist in the different subregional integration mechanisms, as well as in some agreements that connect integration mechanisms with each other (for example, the economic complementarity agreements between MERCOSUR and the members of the Andean Community) or with individual countries (such as the free trade agreement between five Central American countries and Mexico). However, the impact on regional production integration would be greater if progress could be made towards a single large cumulation system, which would include all of the region's countries and which would have more SME-friendly rules.

Another crucial aspect of this agenda is continued impetus for the region's main infrastructure investment initiatives. A selective approach, designed to identify the principal bottlenecks and the synergies with the biggest impact, along with the preparation of a specific timetable for financing, investment and implementation, would help renew the momentum behind regional integration. For example, the Interoceanic Highway, which runs through Brazil and Peru, has stimulated trade, tourism and employment in the Brazilian states of Acre, Rondônia and Mato Grosso and the Peruvian departments of Arequipa, Cuzco and Madre de Dios. Initiatives of this kind are still much needed throughout the region, and especially so in the Caribbean, given its specific logistical and infrastructure issues.

Governments and integration schemes should also take steps towards better coordination of trade facilitation; for example through a gradual harmonization of the procedures and documents required of companies. This would be a specific way to help value chains work better, not only within each subregional space, but in the whole region. Another line of work that might deliver tangible results in a relatively short period is the gradual harmonization or mutual recognition of the countries' technical, sanitary and phytosanitary standards. Finally, progress is needed on mechanisms for adequate financing of intraregional trade, involving national and regional development banks in this effort, and on extending the use of payment systems in local currency. All of these advances would benefit export SMEs in particular and therefore respond to the objective of making trade more inclusive.

2. Links with China and the Asia-Pacific region

One of the defining issues of the decade will be the region's approach to the Asia-Pacific region in general, and China in particular. For all of the region's economies, and especially those of South America, the trade link with China has become a major factor in their potential for growth, employment and macroeconomic stability. China's ongoing economic reforms could make its investment in Latin America and the Caribbean even more important. The region has the opportunity to participate in the design of this new relationship, insofar as it has the right vision and policies and to the extent that it tackles this challenge in a coordinated manner. National initiatives, while necessary, are clearly insufficient.

If a regional response is required, CELAC seems the most appropriate setting in which to prepare it. The recent establishment of the China-CELAC Forum during the second Summit of CELAC, held at Havana in January 2014, was a welcome development. This opens up the possibility that the region will have an agreed regional position and specific proposals to take into dialogue with the Chinese authorities over the future cooperation agenda. This dialogue must aim to better exploit the opportunities offered by increasing economic links between the region and China, and to find solutions to the weaknesses in the relationship, especially in the composition of trade flows.

There are strong ties between China and the economies of the Association of Southeast Asian Nations (ASEAN), several of which are competitive in goods that Latin America and the Caribbean exports or could export to China and the rest of Asia. As a result, the region's relationship with China cannot be considered in isolation from its relationship with Asia-Pacific as a whole, or at least with ASEAN. The relationship between CELAC and ASEAN will probably become a priority in the coming years. The deepening of this dialogue is needed not only to improve the quality of trade and investment, but also for the two regions to set about agreeing joint positions on major global issues.

3. Strengthening dialogue and cooperation with the European Union

At the first CELAC-European Union Summit, held in January 2013 in Santiago, the parties agreed on an action plan for 2013-2015 that includes biregional cooperation initiatives in various spheres (such as science, education, migration and sustainable development). Renewed momentum in the talks on an Association Agreement between the European Union and MERCOSUR also offers a promising window of opportunity for regional integration. A successful outcome to the negotiations would mean that the Caribbean and Central American subregions, the MERCOSUR bloc and the countries of Chile, Colombia, the Dominican Republic, Mexico, Panama and Peru, would have similar agreements in place with the European Union. Working from this common ground, options could be pragmatically explored for the possible application of these commitments among the region's countries. This would enable the deepening of the regional economic space through the gradual application of common trade and investment policies.

4. Projecting the region in debates on global governance

The membership of Argentina, Brazil and Mexico in the Group of 20 (G20) presents a strategic opportunity for CELAC to prepare joint positions that would give the region a much stronger voice in important global governance debates.⁸ For example, at the G20 Meeting of Finance Ministers and Central Bank Governors held in Sydney, Australia, in February 2014, it was highlighted that, “despite recent improvements, the global economy remains far from achieving strong, sustainable and balanced growth” and that significant vulnerabilities remain, such as “recent volatility in the financial markets, high levels of public debt and continuing global imbalances”.⁹ In this regard the G20 finance ministers and central bank governors committed to lifting their collective GDP by 2% above its expected trajectory, over the coming five years. To achieve this, it was agreed that steps would be taken to increase investment, lift employment and participation, enhance trade and promote competition. Particular emphasis was laid on developing infrastructure and supporting SMEs.

The three Latin American countries in the G20 now have a major opportunity to transfer the Sydney agenda to the regional sphere, in other words, to set about invigorating growth throughout Latin America and the Caribbean by boosting investment in infrastructure and increasing support for SMEs. Regional multilateral banks, national development banks, the IIRSA/COSIPLAN initiative, the Mesoamerica Project and other government efforts could form part of this stimulus package. In general terms, Latin American participation in the G20 could favour the prior discussion of the agenda with the countries of the region, as well as efforts to regionalize said agenda through collaboration with the different integration mechanisms.

The G20 agenda is not the only sphere in which greater regional coordination affords opportunities by which to strengthen the participation of Latin America and the Caribbean in major global debates.

⁸ Depending on the issues at stake in these meetings, specialized regional agencies such as ECLAC and the Development Bank of Latin America (CAF) could make technical contributions that would help enrich the debate and the proposals submitted.

⁹ See the press release of the G20 Meeting of Finance Ministers and Central Bank Governors [online] https://www.g20.org/sites/default/files/g20_resources/library/Communique%20of%20G20%20Finance%20Ministers%20and%20Central%20Bank%20Governors%20Sydney%2022-23%20February%202014_0.pdf.

Other relevant areas for concerted regional action include the negotiation of a new multilateral framework for addressing climate change, the formulation of the post-2015 development agenda, the reform of the international financial architecture, and the global governance of migration.

H. INTEGRATION MUST RELY MORE ON CIVIL SOCIETY

Renewing the integration process requires a closer relationship with civil society organizations. For example, integration schemes would doubly benefit from a solid and permanent connection with the region's universities. First, the universities could contribute studies on key aspects of regional cooperation and integration; inputs that secretariats and governments are not always in a position to produce in due time or with sufficient depth. Second, such links would reinforce the legitimacy of the regional integration process as a whole.

Similarly, labour organizations already maintain a dialogue with subregional integration mechanisms. Issues such as labour mobility, the portability of pension rights, the certification of technical skills, training needs and other topics of a more sector-specific nature, could enrich the regional integration agenda, insofar as its scope provides for an enhanced dialogue with labour organizations.

The decisions taken by the region's main corporate actors have little connection, at present, with those taken by regional and subregional integration institutions. This has to change, and there are responsibilities on both sides: both integration schemes and business organizations should update their respective agendas to improve dialogue, setting specific tasks and goals within definite time frames.¹⁰ In particular, the promotion of competitive regional or subregional value chains requires a fluid dialogue with the business and labour sectors that are the main actors in these chains. A well-informed and modernized dialogue would increase the relevance of domestic and integration policies on foreign trade and investment, industry, innovation and competitiveness, bolstering their contribution to the creation of value chains.

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

I. EQUALITY MUST BE A HALLMARK OF REGIONAL INTEGRATION

If inequality is one of the region's hallmarks, then promoting equality should be a hallmark of the regional integration strategy. Inequality is a systemic issue and therefore can hardly be addressed solely through social policies. To begin with, there is an evident connection between inequality and production. Transforming production to help reduce inequality will require more numerous and more productive jobs, while SMEs on the one hand, and manufacturing and services on the other, will have to acquire a greater presence in exports. These characteristics are more frequently found in intraregional trade than in other types of trade,

¹⁰ For example, the last congress of the Latin American Steel Association (ALACERO), held in Lima in November 2013, focused precisely on the links between industrialization, production diversification and regional integration.

and there is thus a direct link between a strategy of growth with equality and the deepening of the regional economic space.

The central thesis of this document, which is that production integration is a strategic vector for regional integration, is consistent with the goal of imprinting a stronger social emphasis on integration. Indeed, assigning a central role to SMEs means promoting inclusive value chains, in keeping with recent ECLAC proposals.¹¹ This approach is aligned with the traditional concerns of Latin American structuralism, which treats the production structure, labour-market characteristics, productivity differences and access to technological advances as crucial areas with respect to development and income distribution.

The spectrum of regional actions to combat inequality also includes narrowing the digital divide. Integration policies in this area must favour access to ICTs for the most vulnerable population segments, as well as access for isolated areas. Measures taken in this area should strengthen the positive impact of ICTs on public health, education, labour training activities and SME productivity.

Social policy also offers plenty of opportunities for regional cooperation, several of which are already included on the agendas of CELAC and the subregional integration schemes. Policies and measures may be coordinated on issues relating to childhood and adolescence, youth, older persons, food security, poverty reduction, migration, gender equality and the care economy, for example. Together, these topics make up a broad programme of work on social objectives, which when fully integrated with the agenda on the transformation of production, could boost confidence in the relevance of regional integration efforts and their close connection to national strategies for growth with equality.

Another significant achievement of regional cooperation on social affairs relates to the design and management of programmes for combating extreme poverty, notably social investment funds and co-responsibility transfer programmes.¹² A regional cooperation network has gradually taken shape around these programmes, engaging the competent authorities and institutions from each country. The impact of these programmes has thus transcended the region's borders, and has become an asset for the region to export. Indeed, the technical capacities of design and management inherent to this type of programme are beginning to be replicated in other parts of the developing world, illustrating the impact of the Latin American framework and contributing to South-South cooperation.

J. INTEGRATION NEEDS TO BE REGARDED AS A STATE POLICY

The debate on Latin American and Caribbean integration is usually centred on shortcomings in intraregional trade, infrastructure and policy coordination, and the superimposition and limitations of existing integration mechanisms. A more optimistic view would be to focus on past accomplishments, based on the de facto integration that is quietly taking place as a result of integrationist advances and market incentives.

As this document has highlighted, the Latin America and Caribbean region has achieved historic levels of interdependence over the past decade, and not only in the sphere of trade, but also with regard to flows of investment, goods and services, communications and people (migrants and tourists).¹³ This trend is reflected in attitudes towards integration. For the most part, Latin Americans have a positive perception

¹¹ See ECLAC (2013a).

¹² Also worth highlighting is the exchange of experiences between Brazil and Peru in relation to the Popular Pharmacy programme and cooperation in producing antimalarial and anti-tuberculosis drugs (statement by President Dilma Rousseff at the business forum "10 Years of the Strategic Alliance Brazil-Peru", Lima, 11 November 2013).

¹³ According to data from the World Tourism Organization (UNWTO), in 2010 some 55% of tourist arrivals in Chile and the MERCOSUR countries (with the exception of the Bolivarian Republic of Venezuela) originated in the countries comprising this bloc, while 21% of tourists arriving in the Andean Community had come from within the Andean subregional space (Catalano, 2013).

of their regional partners and of integration. A study produced by the Latinobarómetro Corporation, based on surveys carried out in 2009 in 18 of the region's countries, found that 71% of Latin Americans support economic integration and 59% support political cooperation (Latinobarómetro, 2010).

This picture is no excuse for complacency, however. The dynamism of de facto integration often seems to respond more to economic incentives than to the action of specialized institutions. Indeed, the latter still have unfinished business in a number of areas, some of which have been described in this document. Today's growing interdependence is an important asset that should be used, sooner rather than later, to underpin a formal integration that is deeper and broader in scope. The challenges are therefore to adapt the institutional framework of integration to the advances in de facto integration, in accordance with the demands of the international situation, the past experience and the potential of each subregional scheme, as well as to secure the political momentum that helps spur convergences between these processes.

In international relations, including those of integration, elements of cooperation and competition always exist side by side. Successful integration is that which allows cooperation to prevail, seeking convergences and trying to make differences manageable rather than eliminate them. Integration is a highly complex process, both technically and politically, and its success is critically dependent on building the trust and the institutional arrangements to ensure that past efforts will be sustained over time. In practical terms, this means accepting the principle of diversity, learning to coexist with different models and always seeking areas for possible convergence. It also means paying attention to the challenges presented to the region by the global situation.

The gradual accumulation of small advances is evidently preferable to sudden changes of direction and the constant temptation of radical transformation. Hence the importance that regional integration efforts rely increasingly on a range of civil society actors and organizations, not only to make integration more legitimate and representative, but also to ensure that it transcends changes in government administrations and allegiances. In short, integration must be understood as a State policy. In a region as diverse and Latin America and the Caribbean, this is perhaps the main challenge in achieving the integration for structural change that the region needs.

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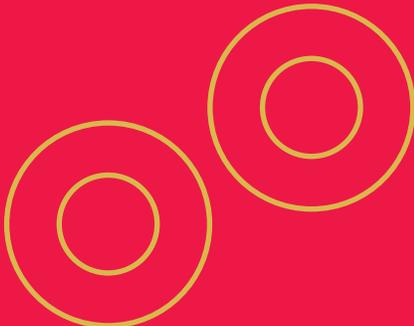
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Regional integration is a multidimensional process which may take the form of initiatives for coordination, cooperation, convergence and deep integration. Its scope ranges from economic and trade issues to political, social, cultural and environmental matters.

This document focuses on the production dimension of integration and how it can contribute to the structural change for equality strategy advocated by the Economic Commission for Latin America and the Caribbean (ECLAC) in the region since 2010. This document thus reprises a subject that has long been at the heart of the Commission's thinking on integration and development.

It also seeks to contribute to the current debate on the role of integration in Latin America and the Caribbean, in light of the significant changes occurring in the global economy. These include the rapid pace of technological development, the growing economic influence of Asia and of the emerging economies in general, the appearance of global value chains, and the trend towards the formation of integrated macroregions.

