2006

Latin America and the Caribbean in the World Economy

2007 TRENDS

UNITED NATIONS

ECLAC

Latin America and the Caribbean in the World Economy is an annual report prepared by the Division of International Trade and Integration of ECLAC. The Statistics and Economic Projections Division, the Economic Development Division, the Commission's subregional headquarters in Mexico City and Port of Spain and its country offices in Buenos Aires, Brasilia and Washington, D.C. assisted with the preparation of this year's edition. Osvaldo Rosales, Director of the Division of International Trade and Integration, has overseen the preparation of the report as a whole. Mikio Kuwayama, Officer–in–Charge of the International Trade Unit, has been responsible for its technical coordination.

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The statistical appendix was prepared by Jaime Contador with the assistance of Andrés Yáñez. It is appended to this document as a CD–ROM and is also available online at: http://www.eclac.org/Comercio/paninsal/Anexo2006_2007/ingles/.

Notes

The following symbols have been used in this Study:
Three dots (…) indicate that data are not available or are not separately reported.
A minus sign (-) indicates a deficit or decrease, unless otherwise indicated.
A full stop (.) is used to indicate decimals.
The word "dollars" refers to United States dollars, unless otherwise specified.

United Nations publication
ISBN: 978–92–1–121649–3
ISSN printed version: 1680–8657 ISSN online version: 1681–0295
LC/G.2341–P
Sales No: E.07.II.G.85

Printed in Santiago, Chile, United Nations

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Abstract

This year's edition of *Latin America and the Caribbean in the World Economy* is divided into six chapters.

Chapter I contains an analysis of recent trends in the economies of the United States, the European Union and Japan as well as a number of emerging Asian economies. The determinants of the imbalances existing among these economies are examined, and the role of these disequilibria as the principal risk factor in what nonetheless remains a positive global environment is considered. Factors influencing the trade performance of Latin America and the Caribbean are discussed, as are the region's trade results and outlook in 2006 and 2007. The chapter concludes with an analysis of the difficult negotiation process being pursued in the Doha Round and how it has been affected by changes in United States trade policy.

Chapter II offers an overview of the world economy's recent restructuring around the Asia–Pacific region, especially China, and the regional integration process that has been taking place in the wake of the Asian crisis. This region has become not only the world's most dynamic market, but also a major source of financing which is paving the way for the achievement of international financial equilibrium. This analysis shows that, in practice, the deepening of the regional integration process revolves around China, which is playing an increasingly central role as an extraregional export platform for its neighbours.

In chapter III, the strategic role of business services and the main trends to be observed in this sector are explored, and comparisons are drawn between the Latin American and Caribbean region and selected Asian countries. The success achieved by some Latin American firms in this niche is examined, together with the factors underlying their export performance, such as the regulatory framework, human capital endowments and the adaptation of advanced technology. Consideration is also given to the liberalization of trade in services under the various trade agreements in force in the region.

Chapter IV looks at the current status of regional integration efforts and of bilateral and plurilateral negotiations with countries outside the region that are having an impact on the progress made in this area. An overview is provided of milestone events in the integration processes of the various subregions (MERCOSUR), the Andean Community, the Central American Common Market (CACM), the Caribbean Community (CARICOM) and the South American Community of Nations) as they seek out complementarities and opportunities for the convergence of trade rules.

The Asia–Pacific region's integration process, which until recently consisted primarily of a de facto form of integration in the sphere of production, is examined in Chapter V. This process is now being complemented by de jure integration under the terms of both intraregional and extraregional trade agreements. In the light of these trends, the Latin American and Caribbean region should work to strengthen its trade and investment links with Asia and the Pacific, heighten its production complementarities with that region and

promote business and investment alliances that will provide it with broader access to those markets and help it position itself within Asian production and export chains. Trade agreements that move the region in this direction can serve as valuable tools for the application of such a strategy.

Chapter VI explores the various ways in which export development and innovation are linked and how these links are reflected in institutional strategies and institution–building. The cases of Australia, Finland, Ireland, Malaysia, New Zealand, the Republic of Korea, Singapore and Sweden —countries that attach importance to innovation and are better–placed than others to compete in the global economy— are studied within this framework. On the basis of this comparative analysis, a number of policy recommendations are formulated.

Summary

Developments in the international economy and their consequences for Latin America and the Caribbean

Developments in the international economy

The world economy has been growing at annual rates of over 4% since 2003, making 2006 the fourth consecutive year of growth at this pace. The outlook for 2007 and 2008 remains promising, although both economic and trade growth are expected to slow somewhat throughout the world, with global growth projected to drop slightly from its 2006 level to about 5.2% in 2007 and 2008. This slowdown is particularly evident in the United States economy but will be partially offset by buoyancy in Europe, Japan and other Asian countries. Commodity prices remain high, especially in the case of energy and minerals, thanks largely to the continuing strength of Asian demand. In the past few months, grain and cereal prices have been pushed up sharply by the rising demand associated with biofuel investment. The economic boom in Latin America and the Caribbean that has been triggered by these favourable international conditions represents an opportunity for the region to lay the foundations for sustained medium–term growth by making investments in infrastructure, innovation and human capital that can add greater value and knowledge to exports and help create more stable conditions for growth and progress towards greater equity.

There are latent risks, however, that could affect this positive global situation. The first such risk is the possibility of a sharper slowdown in the United States as a consequence of problems in the country's housing sector. If this were to occur, Japan, the European Union and the developing countries of Asia would be called upon to play an even more important role in maintaining the momentum of global growth. Second, there are a number of risks that have persisted over time, such as greater volatility on financial markets, inflationary surges that could lead to interest rate hikes, new threats in the oil market and, lastly, the likelihood of a disorderly adjustment in external imbalances worldwide. Given their current account surpluses, large international reserves, lower levels of external indebtedness, sounder fiscal positions and more flexible exchange–rate policies, the countries of the region are less vulnerable in all of these areas than they

were in the past. The fact that the multilateral World Trade Organization negotiations have stalled is a further cause for concern, however, since this situation may generate support for protectionist measures and lead to a proliferation of trade agreements that are not necessarily consistent with the multilateral framework.

Slower growth in the United States will probably have a greater effect on the trade of Latin America and the Caribbean than any other feature of the international environment. The country's economic growth rate is projected to drop from 3.3% in 2006 to 2.1% in 2007, which could signal a decline of nearly 2% (1.8%) in real terms in the volume of exports from the region to the United States, as compared with the 4.6% increase seen in 2006. Estimates suggest that Central America and the Caribbean may be the subregions that are most seriously affected.

The developing Asian countries are playing a key role in the current economic situation for a number of reasons. The first is that the Asia–Pacific region continues to drive the world economy's growth, accounting for almost half of the expansion of the global economy as measured in terms of purchasing power parity. China and India have been leading the way, with growth rates of 11.1% and 9.7%, respectively, in 2006. The other emerging economies of Asia, including Indonesia, Malaysia, the Philippines and Thailand, have been expanding more slowly than in the decade leading up to the 1997–1998 crisis, partly because investment rates are much lower. Second, Asia increasingly dominates international financial flows and is a vital source of financing for the United States trade deficit (the world's largest). In 2005–2006, the developing countries of Asia absorbed some 70% of gross world investment flows to other developing countries. China also stands out in this respect, since in 2006 it was the world's largest net exporter of capital, partly because of the increase in global reserves. Asia's economic, commercial and financial importance and its robust growth projections make it a market of great potential for Latin American and Caribbean trade and investment.

The external deficit of the United States deepened slightly (6.5% of GDP in 2006 compared to 6.4% in 2005) but is expected to narrow a little in 2007 thanks to lower oil prices in the second half of 2006 and first half of 2007. This country's trade balance with China and, to a lesser extent, with the rest of Asia worsened again in 2006, however. By the end of the year, Asia accounted for half the total external deficit of the United States and for two thirds of the deterioration seen between 2005 and 2006. The United States' external deficit is not expected to shrink much over the next five years, either. Furthermore, the ways in which the United States deficit is financed and the willingness of Asian countries to fund it are changing, and this could lead to a disorderly adjustment of the dollar at some point.

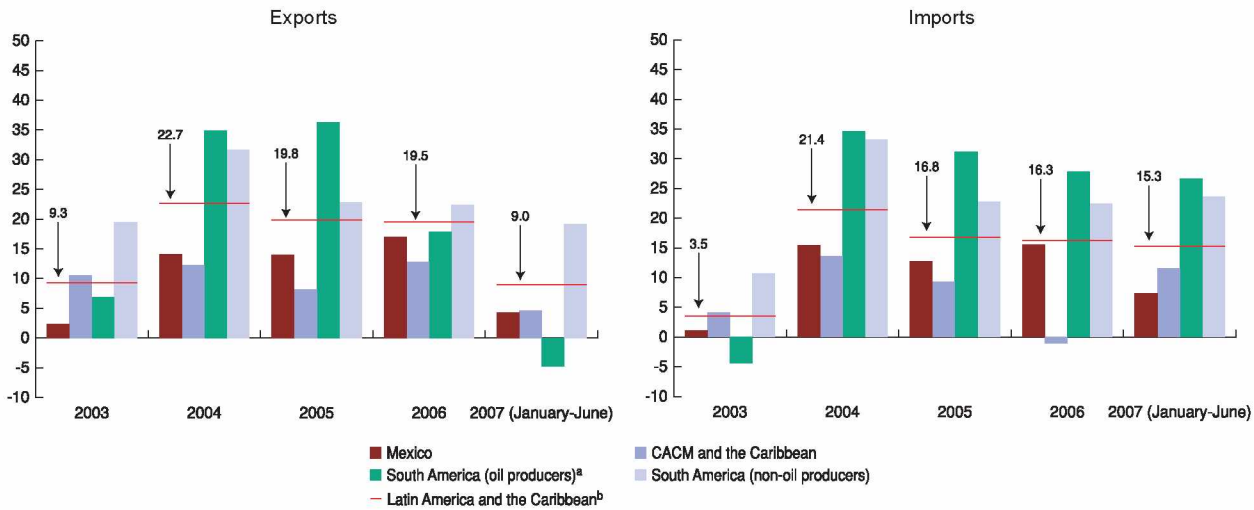
Despite some adjustments and increased volatility, financial markets have continued to strengthen in both emerging and industrial economies. In developing economies, this tendency is partly due to very positive financial results, thanks to which some stock market price indices have surpassed the record levels seen during the technology boom in the early part of the decade. The dollar fell continuously against the most widely traded currencies in 2006, with the exception of the renminbi and yen. In the first six months of 2007, the dollar's slide was gradual, but some adjustments in the currency market are still to be expected, particularly because of the large trade imbalance between the United States and some of its main trading partners and increased pessimism about growth prospects in the United States economy.

In August 2007, world stock indices fell sharply amid investors' fears of the possibility of contagion from the insolvent situation in the United States subprime mortgage market. The losses were so heavy that the gains of the entire year were wiped out in just a few days. It remains to be seen whether this drop is simply a price adjustment or if it marks the advent of a much higher–risk environment for the world economy that could trigger a credit crunch and have serious implications for production.

The rate of growth in the value of Latin American and Caribbean goods exports fell slightly to 20% from an average of 22% in 2004 and 2005. This was primarily due to the slower expansion of export volumes, as prices remained strong. In 2006, the increase in the volume of the region's exports (6%) was not only lower than the global growth rate (8%), but was also lower than it had been the year before. Meanwhile, China's exports climbed by more than 20%, while growth in the rest of the world, other than Africa and the Middle East, ranged from 7% to 11%. In the region, Mexico and the Central American countries were the best performers while South America experienced a sharp slowdown. After three and a half years of sharp increases, commodity prices began to drift downward in the second half of 2006, although the rate of decline varied considerably from one subgroup to another. After moderating in the second half of 2006, oil prices began to rise again in 2007; analysts attribute this development not so much to geopolitical circumstances as to underlying factors of supply and demand.

The region's exports were up by just 9% in value in the first half of 2007, a far cry from the 22% increase recorded for the same period in 2006. This was mainly due to a loss of dynamism in Bolivia, the Bolivarian Republic of Venezuela and Ecuador, with the latter two seeing declines of 7% and 10%, respectively, in the value of their exports. Taken as a group, Mexico, Central America and the Caribbean witnessed a slowdown in trading activity, and this was reflected in lower import growth. In contrast, the countries of South America, whether oil producers or not, have continued to see strong import growth (see figure 1). For the year as a whole, the region's goods exports and imports are expected to rise by some 13% and 17%, respectively, in value terms, which should translate into a US$ 56 billion trade surplus. In volume terms, exports are expected to grow by 6% and imports by 11%, from which it can be inferred that the unit values of exports are still being heavily influenced by high commodity prices, especially for metals and fuels.

Figure 1
LATIN AMERICA AND THE CARIBBEAN: GROWTH RATES FOR EXPORTS AND IMPORTS OF GOODS, 2003–2007
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the countries' national statistics offices, customs services and central banks.

a The oil-producing countries are the Bolivarian Republic of Venezuela, Colombia and Ecuador; non-oil-producing South America consists of Argentina, Bolivia, Brazil, Chile, Paraguay, Peru and Uruguay.

b Total of 37 countries.

The difficulties of the Doha Round and a new trade policy in the United States

The Doha Round trade negotiations, which are being conducted under the auspices of the World Trade Organization (WTO), were resumed in February 2007 after the WTO Director–General had proposed that they be suspended in July 2006 to give members time to reflect and to review the situation. During this "time–out" and when negotiations recommenced, the world's most influential countries repeatedly confirmed their commitment to achieving positive results before the end of 2007. Nonetheless, negotiations are no further forward than they were a year ago.

The chairs of the negotiating groups are drawing up new proposals on the various issues covered by the talks in an effort to move the process forward. However, failure to agree on negotiating modalities, which providing the basic parameters to guide new

liberalization commitments in the areas of agriculture, industrial products and trade in services, is still blocking the progress of the negotiations as a whole.

Following signs of possible progress in the negotiations undertaken by the United States, the European Union, Brazil and India (Group of 4), the talks suffered a new setback on 21 June 2007 when participants in the meeting held in Potsdam, Germany, failed to bring their positions closer together. The United States indicated it was willing to improve its position on domestic support for agriculture by reducing its proposed level from US$ 22.5 billion to US$ 17 billion, but Brazil and India were looking for amounts in the region of US$ 12 billion and regarded this new proposal as insufficient.[1]

Meanwhile, Brazil and India rejected the United States proposal for cuts in tariffs on non–agricultural products that would have allowed maximum tariffs of 25% for developing countries and of 10% for developed nations. The two countries believe they can accept tariffs of up to 35%.

Under these circumstances, and in response to the WTO Director–General's efforts to bring the negotiations back within the WTO framework, the chairs of the Agricultural Committee and the Market Access Negotiating Group submitted new proposals on 17 July 2007. Given the time limits imposed by the forthcoming 2008 presidential elections in the United States and the expiration of Trade Promotion Authority on 30 June, the Doha negotiations have a precarious basis on which to proceed.

In 2007, the highlights of the United States trade agenda have been the Doha Round negotiations, the ongoing negotiations with Thailand and Malaysia, the possible scrutiny in Congress of the legislation applicable to Colombia, Panama, Peru and the Republic of Korea, and the possibility of renewing Trade Promotion Authority (formerly known as fast–track negotiating authority), which expired on 1 July 2007.

In the case of trade policy, the increasing inequality observed over the last 30 years and the prolonged stagnation of average wages have aroused concern about the possible effects on the well–being of United States workers. As a number of empirical studies have shown, trade has reduced the demand for labour in a number of areas of activity where large numbers of lower–skilled workers are employed. The political platform of the Democratic Party includes the adoption of a "new trade policy for America" to raise workers' living standards and create new trade opportunities for United States goods. The suggestion is that in future agreements countries should make a commitment to adopt, maintain and enforce basic international labour standards rather than merely "enforcing their own laws"; promote sustainable development and combat global warming; and achieve a better balance between promoting access to medicines and protecting pharmaceutical innovation.

In May, the Speaker of the House of Representatives, Nancy Pelosi, and the Chairman of the Ways and Means Committee, Charles Rangel, announced a framework agreement with the United States Trade Representative, Susan Schwab, on the measures to be taken for this purpose. As it relates to accords awaiting approval by Congress, the agreement calls upon countries to incorporate the obligations set forth in the International Labour Organization (ILO) 1998 Declaration on Fundamental Principles and Rights at Work into their legislation and practices. In relation to the environment, it would ask them to undertake to sign seven agreements on the environment that are not regarded as running counter to the provisions of the free trade agreements or to the commitment to comply with the multilateral agreements each country has signed. Both issues, employment and the environment, are to be subject to the same dispute settlement mechanism as is used for all other provisions of free trade agreements. This agreement also covers issues relating to access to medicines in developing countries and the protection of drug trial data. The above has led to amendments in the texts previously agreed upon with Panama and Peru; the cases of Colombia and the Republic of Korea are still pending.

The United States Congress is expected to pass a new farm bill at some point in 2007, since most of the provisions of the 2002 Farm Security and Rural Investment Act expire this year. The debate on this legislation has very direct implications for the negotiating leeway available in the Doha Round and for the level of ambition that may be feasible, as well as for the ongoing debate regarding the government's budget deficit. The likelihood is that the new legislation will be very similar to what exists now.

[1] *Inside U.S. Trade*, vol. 25, No. 19, 22 June 2007, and *Puentes Quincenal*, vol. 4, No. 12, 26 June 2007.

Integration and dynamism in the Asia–Pacific region

Until recently, Asian regional integration was characterized by growing intraregional trade based on progressively greater production and trade complementarities in the countries' manufacturing sectors. There were substantial increases in intra–industry trade, and the different advantages of production and marketing chains were being more fully utilized. This de facto market–led integration process is now being accompanied by de jure government–led integration process whereby close production and trade links are being supplemented by free trade agreements of various kinds. Asia–Pacific has become not just the world's "factory", but also a battleground for vying preferential trade agreements.

A decade after the 1997 Asian crisis, East and South–East Asia have fully recovered and indeed greatly strengthened their already prominent position in the world economy.[2] Their dynamism can be seen in the figures for growth, international trade, FDI, technological innovation and inputs of financial resources to maintain international equilibria.

The central role being played by the Asian countries is apparent not just in world production and trade, but also in the global financial arena. The region is playing a more and more important part in preserving global economic balances, since its ample supply of low–cost goods is helping to keep demand high and inflation low in the developed countries; it supplies inexpensive credit to the United States, keeping interest rates down; and it is building up reserves[3] by purchasing United States Treasury bonds and helping to finance the current–account deficit of the United States, which remains the world's largest consumer nation. Indeed, the Asia–Pacific region has become one of the world's leading suppliers of both goods and international finance.

Two of the key factors behind developments in Asia over the last decade have been technological progress and the opportunity to "slice up" production chains, giving rise to a large increase in Asian intraregional trade. The intraregional trade ratio is higher than for the North American Trade Agreement (NAFTA) countries and is rapidly approaching that of the European Union. Trade among ASEAN members has increased and now exceeds the 18% recorded by MERCOSUR in 2005. These indicators confirm the high degree of production and thus trade complementarities existing in Asia.

This increase in intra–Asian trade is partly the result of the robust expansion of intra–firm and intra–industry trade being driven by the development of a complex transnational network of vertical supply chains, with China playing a central role as both a point of origin and a destination market. The high level of intraregional trade in Asia is both a cause and an effect of the countries' growing trade complementarities, which is manifested in high indices of intra–industry trade (i.e., cases where a country both imports and exports similar but different products).

The high degree of complementarity in production activities and trade is a clear sign of the profound changes going on in Asia's regional integration as the production process is "sliced up". The entire trade creation process in the region took place outside the scope of regional agreements, and the move to take advantage of the opportunities offered by the division of the production process is reflected in the behaviour of United States and European transnational enterprises in Asia, which differs markedly from their pattern of operation in Latin America and the Caribbean (where they have not created interlocking networks of production chains, except in Mexico and, to a lesser

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2 In this section, East Asia is taken to consist of China, Japan and the Republic of Korea, plus Hong Kong (Special Administrative Region of China) and Taiwan Province of China; South–East Asia of Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam; South Asia of India, Pakistan and Sri Lanka; and Oceania of Australia and New Zealand.

3 In December 2006, China held United States Treasury bonds worth US$ 350 billion, more than half the amount held by Japan (US$ 644 billion). At that time, China's reserves exceeded US$ 1.06 trillion, a figure much higher than Japan's US$ 875 billion. China's reserves are equivalent to over 40% of its GDP.

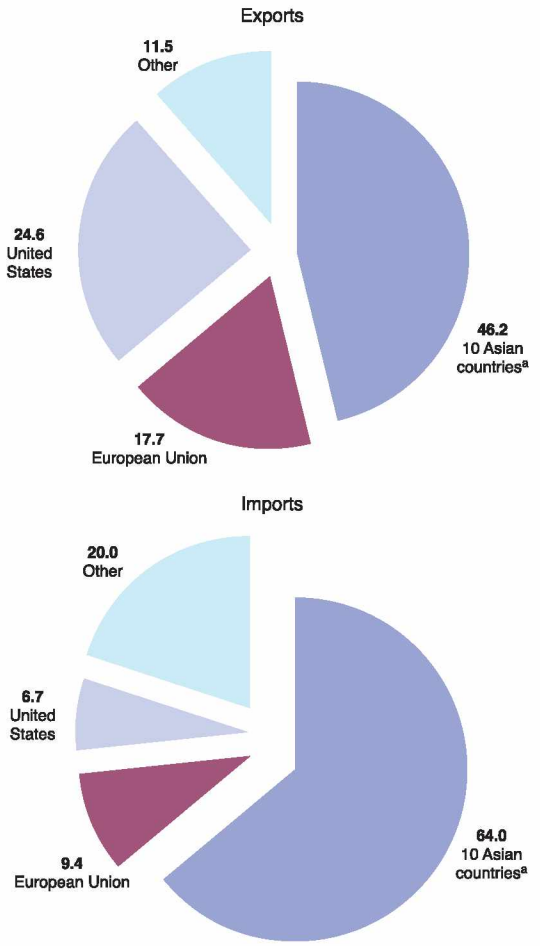
extent, Costa Rica). To attract more investment to the region, the countries of Latin America and the Caribbean should promote the development of such networks of production and marketing chains at both the regional and extraregional levels.

An important element in Asia's trade dynamism has been the rapid emergence of China as a leading actor around which a major restructuring of trade has taken place. This process is illustrated in figure 2, which highlights the importance of export and, most particularly, import flows in China generated by foreign firms based in other Asian countries. All this reflects the key role played by China in the production chains of Asian firms.

Given the size of Asia's economy and population and the level of its trading activity, as well as the high growth rates expected for the region, it offers an export market of great potential for the countries of Latin America and the Caribbean, along with tremendous opportunities for various sorts of trade and business alliances and for bi–regional free trade agreements.

The negotiation of trade agreements in Asia could give a further impetus to de facto economic and trade integration, which has been carried forward without the support of intergovernmental trade agreements. Trade agreements would provide another major incentive to deepen the integration of various industrial sectors, such as the machinery, automotive, electronics and pharmaceutical industries. Greater progress with financial and monetary cooperation would provide practical support for this process.

Figure 2
EXPORTS AND IMPORTS OF FOREIGN–OWNED FIRMS IN CHINA, 2005
(Percentages)



Source: Ministry of Commerce of the People's Republic of China, Invest in China [online] www.fdi.gov.cn.

[a] The 10 Asian economies are: Hong Kong (Special Administrative Region of China), Indonesia, Japan, Macao (Special Administrative Region of China), Malaysia, Philippines, Republic of Korea, Singapore, Taiwan Province of China and Thailand.

Trade in services in Latin America and the Caribbean: an analysis of its recent dynamism

The dynamism of business services in the region

This chapter compares the dynamism of the Latin American and Caribbean region's services trade with that of a number of Asian countries and evaluates the determinants of these trade flows before going on to propose measures for improving the region's global trading position in this area. Modern service inputs play an increasingly vital role in determining many businesses' levels of competitiveness and make a key contribution to faster economic growth and higher productivity by improving financial intermediation, infrastructure, logistics, the use of information and communication technologies (ICTs) and education. Services are accounting for a larger and larger share of the economy, employment, trade and foreign investment all over the world. Since 1990, cross–border trade in services has tripled, and the stock of FDI in services has quadrupled, while developing countries have increased their service exports more rapidly than the advanced countries.

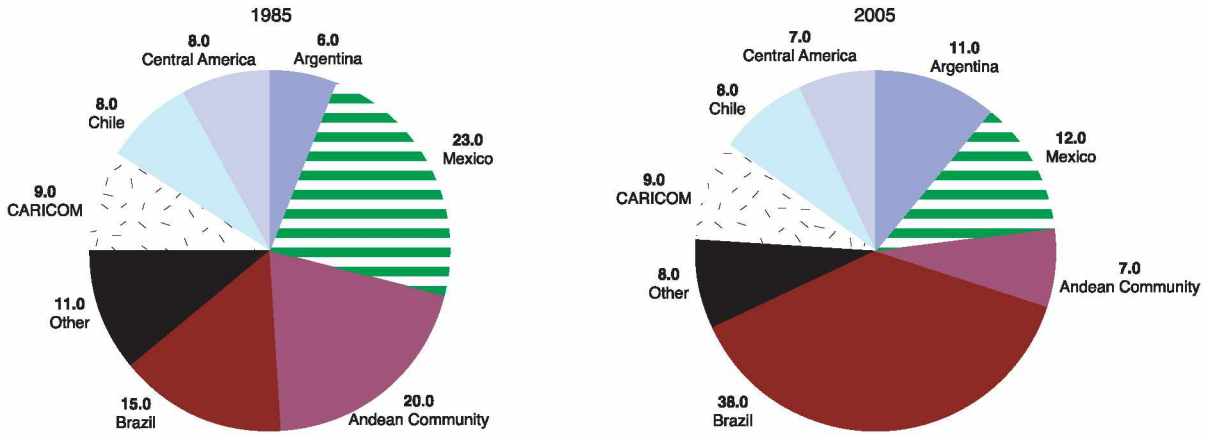
In Latin America and the Caribbean, however, these exports grew by less than the world and Asian averages between 1985 and 2005. In those two decades they expanded by a factor of 4.5 in Latin America and the Caribbean, 6.2 in the world, 8 in the Association of Southeast Asian Nations (ASEAN) and Hong Kong (Special Administrative Region of China), 14 in India and 24 in China. As a result, the share of Latin America and the Caribbean in the world's services trade has diminished, although the situation varies greatly between regions. The countries with the highest rates of growth in services are Chile, Costa Rica and Guatemala, while those with the lowest rates are the Bolivarian Republic of Venezuela, Colombia and Ecuador. Mexico remains the region's largest service exporter, although its share has shrunk considerably.

The buoyancy of the three major categories of services differs markedly. First, trade in "other services" (including communications, financial and information technology services and business services, among others) has grown more quickly than transport and travel (tourism) in both the Latin American and Caribbean and the Asia–Pacific regions as well as worldwide over the last two decades. In Latin America and the Caribbean, the share of general services classified as "other services" has remained much lower than in Asia and the rest of the world. Within the region, Argentina, Brazil, Costa Rica and Honduras are the countries where this category has expanded the most. In 1985, Mexico and the Andean Community were the region's largest exporters, but by 2005 a profound shift had taken place, with the first three places being taken by Argentina, Brazil and Mexico (see figure 3).

The analysis presented in this chapter centres on "other services", which is a category of crucial importance, especially for businesses, in an increasingly globalized world. These services allow companies to concentrate their resources on their core business and to outsource ancillary services to outside companies that are more and more frequently located in developing countries. Outsourcing affords access to higher–quality inputs than those that a company could produce itself. These inputs take on strategic importance inasmuch as they pave the way for the successful development of the other sectors (industrial, primary and tertiary alike).

The region's share of world trade in "other services" fell from 2.1% to 1.8% between 1995 and 2005. In Asia, different tendencies were seen: the shares of the ASEAN countries and Hong Kong SAR shrank, while those of China and India expanded.

Figure 3
COMPOSITION OF "OTHER SERVICES" EXPORTS, BY COUNTRY,[a] 1985 AND 2005
(Percentages)



Source: International Monetary Fund (IMF), "Balance of Payments Statistics (BOP) database" [online] http://www.imfstatistics.org/bop/.
[a] The "other services" category includes construction, financial, information technology and business services, among others.

There is also great heterogeneity across subsectors; in the communications and insurance markets, the share of Latin America and the Caribbean fell dramatically but still outweighed that of the Asian countries. The only category in which its share rose slightly was "other business services". The case of India is particularly striking, as its share of the world information technology services market increased to 14% in 2005 and was the main factor underlying the upswing in that country's stake in the "other services" category of trade. The Latin American and Caribbean region's lack of dynamism relative to that of China and India is reflected in the figures for the region's share of United States and European Union imports.

Policies needed to promote service exports

To understand why the region's growth in this area has been relatively sluggish, three key determinants are analysed: national regulatory systems, human capital, and information and communication technologies (ICTs). Although the countries of Latin America and the Caribbean tend to be less heavily regulated than Asia, the latter is more dynamic when it comes to service exports, which is the opposite of what might be expected. Because this sector was less closely regulated, Latin America and the Caribbean received larger inflows of such foreign as a share of GDP in 1995–2004 in the financial services, telecommunications and construction industries. Another factor was that State enterprises in these sectors were privatized on a larger scale.

Other important determinants of trade in services are the quality and cost of human capital and ICTs. In human capital terms, China and India have the edge over Latin America and the Caribbean and the ASEAN countries because they have a large number of highly skilled workers (including information technology experts) who are paid very competitive salaries. China and India have such a large critical economic mass that they are able to create niches of excellence, even though the educational level of the population is below the Latin American average. An added advantage for

India is that its population speaks the same language as one of its main trading partners, the United States. On a smaller scale, some countries in the region, such as Brazil, have also managed to create cores of excellence, especially in large cities. According to a study by A.T. Kearney of a subgroup of countries in the region, the availability of skilled labour is adequate in Argentina, Brazil and Mexico, intermediate in Chile and Costa Rica, and inadequate in Colombia. Another factor favouring the Asian countries is that workers have a good grasp of mathematics, an area where the region lags far behind.

Another variable affecting the performance of service exporters is the quality and cost of telecommunications and of access to the Internet and other information technologies. Different rankings suggest that the quality of infrastructure in Latin America and the Caribbean is similar to what it is in the Asian countries, although costs seem to be somewhat higher in the former. One factor that raises the cost of access to ICTs in Latin America and the Caribbean is that, by contrast with Asia, only a few countries (Costa Rica, the Dominican Republic, El Salvador, Guatemala, Nicaragua and Panama) are signatories to the WTO Information Technology Agreement (ITA), although some countries in the region, such as Chile and Mexico, do apply a zero tariff to these products in any event.

In sum, although Latin America and the Caribbean have been less successful than India and China in capturing segments of the growing international demand for high–quality services, the region does have great potential to reverse that trend. Its advantages include an ever–larger pool of skilled labour with fairly competitive pay levels, a good–quality technological infrastructure and cultural similarities with the Western countries. The region is also in the same time zone as its largest importer of such services, the United States, and benefits from geographical proximity.

In order for the region to derive greater advantage from the opportunities offered by trade in services, its public and private sectors need to make a determined effort to produce better–quality, competitively priced services. These efforts should target the main obstacles to the sector's development. Greater liberalization of services trade would seem to be a necessary first step, combined with increased mutual recognition and gradual convergence of different countries' regulatory frameworks. Liberalization of services trade under the trade agreements signed in the region has been rather slow compared to the pace of domestic reform. Services were put on the region's trade agenda in the 1990s because NAFTA and the General Agreement on Trade in Services (GATS) came into force and the region's countries decided to start negotiations on the creation of a Free Trade Area of the Americas (FTAA) in 1998, although these talks were broken off in 2003. The different subregional blocs (the Andean Community, MERCOSUR and CARICOM) reached agreements on further liberalization of trade in services between member countries, and these instruments have come into force in the last few years (2005 and 2006). Bilateral agreements signed by the region's countries with the United States, Japan and the European Union have also covered services based on either the NAFTA or the GATS model.

The approach taken to liberalization in WTO, subregional agreements such as NAFTA and the above–mentioned bilateral agreements has done no more than maintain the regulatory status quo without achieving any genuine liberalization of trade in services. None of the agreements that has been negotiated makes any substantive progress in reducing the costs of compliance with regulations governing service provision. Nor do they clearly identify the conditions under which domestic regulations would be considered "unnecessary barriers to trade", an issue that is at the heart of the debate on trade in services and trade agreements. The main obstacles to liberalizing trade in services are the regulatory changes that would be required, the economics involved and the possible practical implications for the operation of economic and development policies. Both GATS and the other agreements referred to above, including those negotiated by the United States, contain mechanisms that allow countries to determine the freedom of policymaking action that they wish to maintain in advance. The important thing is for countries to be clear about their policy goals and the instruments for attaining them.

Second, upgrading human capital is probably the most important task for Latin America and the Caribbean in this sphere. Since many services require highly skilled personnel, the public and private sectors should work together to establish ICT university courses and training programmes, especially for small and medium–sized enterprises. Governments could also conduct accreditation exercises on a regular basis in order to ensure the quality of technical education. It

is also important to encourage students to learn English, since it is the dominant language in international trade, as well as to improve instruction in mathematics and information technologies in secondary schools.

Third, an important step in opening up access to modern technologies such as telecommunications is to improve regulatory and competition policy with a view to stimulating investment and ensuring that high–quality services are provided at the lowest possible cost. Greater broadband Internet penetration makes it easier to sell more complex electronic services internationally. Broadband access can also boost companies' competitiveness and productivity. Another measure to encourage service exports is quality certification based, inter alia, on ISO 9000. Such certification enhances international credibility for service delivery and facilitates access to international business opportunities.

Economic integration in Latin America and the Caribbean: the quest for complementarity and convergence

Progress in regional integration

Intraregional trade in Latin America and the Caribbean continued to expand in 2006, although more slowly than in previous years. The share represented by intra–subregional exports increased slightly in MERCOSUR and the countries of the Latin American Integration Association (LAIA) and fell somewhat in the Andean Community and the Central American Common Market (CACM).

Integration efforts in Latin America and the Caribbean are evolving. In Central America, the Dominican Republic–Central America–United States Free Trade Agreement (CAFTA–DR) has come into force in all member countries except Costa Rica, where it is at the ratification stage. This treaty has helped to reactivate the Central American integration scheme. Meanwhile, the Caribbean Common Market has come into force with a membership of 12 English– and Dutch–speaking countries, while in mid–2007 the subgroup of eastern Caribbean countries also agreed to set up an economic union. All this stands in contrast to developments in the other subregional integration processes. The conclusion of negotiations on a free trade agreement between two members of the Andean Community and the United States led the Bolivarian Republic of Venezuela to withdraw from that integration scheme and apply for full membership in MERCOSUR, which was granted. The conditions and time limits for the country's adoption of the MERCOSUR common external tariff and trade rules should be agreed upon during 2007. The authorities who have recently assumed office in Ecuador have stated that they are not seeking any change in their trade relationship with the United States, and negotiations on a free trade agreement have thus been suspended indefinitely.

The year 2006 was a very special one in the recent history of MERCOSUR. First, it has been argued that with the creation of the MERCOSUR Parliament at the end of the year and the holding of the Social Summit, the organization is no longer just a governmental initiative but has expanded its links with civil society. Second, there is an increasing willingness to give

differential treatment to smaller partners and weaker economic agents. Enlargement has also led to new questions about the implications for the internal dynamic of MERCOSUR decision–making. There are some signs of strain among members, as well, because of the restrictions applied in the common market and problems deriving from the asymmetries existing among some countries and the way they have been addressed.

In the area of trade, intra–subregional exports grew by over 20%, producing a rise of half a point in the intra–subregional export ratio in 2006 (from 13% to 13.5%). The trend continued during the first half of 2007, with this category of exports increasing its share in the group's total by another percentage point. Much of the recovery of intra–subregional trade within MERCOSUR is attributable to expanding bilateral trade in industrial manufactures between Argentina and Brazil, the main items involved being vehicle parts, common metals and chemicals.

The Andean Community has been going through a process of adjustment and decision–making following the withdrawal of the Bolivarian Republic of Venezuela, the invitation extended to Chile to join as an associate member, and the signing of bilateral agreements by Colombia and Peru with the United States. Exports have remained buoyant despite the withdrawal of the Bolivarian Republic of Venezuela, rising by more than US$ 12.7 billion. If the Bolivarian Republic of Venezuela is removed from the calculations, the rate of growth in intra–group trade falls from 23% to 10% and the intra–subregional export ratio from 10% to 8%. The Bolivarian Republic of Venezuela thus remains a vital partner for the other Andean countries, providing a major market for a number of important regional products such as vegetable oils, medicines, motor vehicles, textiles and apparel, and fishery products. In return, the Bolivarian Republic of Venezuela will continue to supply the rest of the region with such goods as petroleum products (especially diesel fuels, liquid hydrocarbons and crude oils), iron, steel, transportation equipment, chemicals and cosmetics. The Bolivarian Republic of Venezuela and the other Andean countries have exhibited a high degree of complementarity in respect of all of these products.

For all its undoubted achievements as a subregional integration mechanism, especially with the major effort of adaptation made by its member countries over the last few years, the Andean Community has now reached a stage at which a number of issues need to be defined. The association has a solid structure of institutions and rules to regulate its members' trade, the most recent being the rules governing trade in services. The development of these rules began in June 1998 and, although full implementation was delayed a number of times, they ultimately entered into force in December 2006.

The Andean Community and its members are now preparing to begin negotiations on an association agreement with the European Union. On 19 April 2007, at the thirteenth Ministerial Meeting between the Andean Community and the European Union, the parties reaffirmed their intention to commence talks on the subject, and on 14 June 2007, those negotiations were launched at the Seventeenth Regular Meeting of the Andean Council of Presidents in Tarija, Bolivia.

On 17 July, 14 committees were set up to deal with the different aspects of the negotiations, and it was agreed that the first round would take place in Colombia between 17 and 21 September. In preparation for the negotiations, on 13 July the Andean Commission approved Decision 670 (unified customs document) and Decision 671 (harmonization of customs regimes), along with other customs rules. These two decisions were of vital importance in paving the way for these talks.

In Central America, regional integration has been given a new impetus. One milestone in this process was the Plan of Action for Central American Economic Integration, signed in 2002 by the governments of the subregion as a mechanism for transitioning from CACM to the customs union, along with a number of concrete measures designed to achieve this aim quickly. These measures included a convention on information–sharing and mutual assistance, the Standard Central American Tariff Code, a transit regime and a convention to reconcile tax systems. Other very important measures have included the creation of a regional dispute settlement mechanism and the establishment of integrated customs houses in border areas, which is expected to speed up the movement of merchandise. Major progress has also been made in eliminating barriers to trade, since of the 100 or so obstacles identified by the Secretariat for Central American Economic Integration in the early 2000s, only five remained by the end of 2006.

All these efforts have resulted in a steady rise in intra–subregional trade flows. In 2006 and thus far in 2007, sharp increases have been seen in intra–

subregional trade flows moving in practically all directions. In the case of Guatemala, Honduras and Nicaragua, growth has been strongest in the first half of 2007. If this trend continues, the intra–subregional trade ratio will soon exceed 18%, its highest level ever.

For some countries in the region, 2007 has been a landmark year in their trade relationship with the United States and the entry into force of free trade agreements with that country. In the cases of Bolivia, Colombia, Ecuador and Peru, the most important event in this area has been the renewal of the Andean Trade Promotion and Drug Eradication Act (ATPDEA), which forms part of the broader debate on extending Trade Promotion Authority (TPA) for the President of the United States.

The Bolivarian Republic of Venezuela's Bolivarian Alternative for Latin America and the Caribbean (ALBA) has also remained active. This initiative was devised as an alternative to the Free Trade Area of the Americas (FTAA), and the first step in its promotion was an agreement with the Government of Cuba in December 2004, followed by an accord with Bolivia in 2006. Nicaragua also joined the initiative at the group's fourth summit in January 2007, thus becoming the first country to do so that had a free trade agreement in force with the United States. The fifth summit, in late April, was attended not only by the Presidents of the four member countries but also by the President of Haiti and representatives of Dominica, Ecuador, Saint Kitts and Nevis, Saint Vincent and the Grenadines, and Uruguay.

The quest for convergence

At the first summit of the South American Community of Nations, held in Brasilia on 29 and 30 September 2005, the member countries instructed the secretariats of MERCOSUR, the Andean Community and LAIA to prepare studies on the convergence of the economic complementarity agreements existing among the countries of South America.

To facilitate convergence among these agreements, the texts being drafted for this purpose have included proposals regarding trade issues covered by the integration schemes, such as: the elimination of tariffs, rules of origin, customs valuation and special customs regimes, trade defence mechanisms, non–tariff measures, technical barriers to trade, sanitary and phytosanitary measures, trade in services, investment, intellectual property, competition policies, public–sector procurement and dispute settlement.

In the view of ECLAC, there is an urgent need for consensus–seeking efforts and increased political and economic cooperation to preserve the achievements of the South American integration process, especially if these advances can serve to reduce transaction costs and prevent regional fragmentation. In the last few months, unfortunately, the amount of attention being devoted by the region's governments to this undertaking, which they themselves had requested the secretariats of integration schemes to pursue, appears to have waned.

Economic restructuring in the Asia–Pacific region and its implications for Latin America and the Caribbean

The "noodle bowl" and "domino effect" in the Asia–Pacific region

The analysis in this chapter of the "noodle bowl" proliferation of trade agreements indicates that East and South–East Asia are in a second phase of economic integration that involves a search for greater synergies between de facto and de jure integration. Other regions of the world are looking to benefit from this favourable situation while protecting their interests in the region. However, the current economic integration process in East Asia, based on ever–closer de facto trade and investment ties that are now underpinned by de jure agreements, would seem to place Latin America and the Caribbean at a disadvantage. It is therefore urgent for the region's countries to adopt a strategy for engagement in Asia–Pacific. This may or may not include trade agreements between the two regions, but it should certainly embody a shared strategic vision among the countries of Latin America and the Caribbean which has as yet to take solid shape.

Abandoning their traditional reluctance to sign preferential trade agreements and join trading blocs, some large Asian economies such as China, Japan, the Republic of Korea and Taiwan Province of China have agreed to sign bilateral or multilateral trade agreements with other economies in Asia–Pacific and beyond. As a result of this proliferation, a number of Pacific Basin countries (comprising the Latin American countries that are members of APEC and North America, India, Pakistan and Sri Lanka) conduct a very large proportion of their trade within the framework of trade agreements.

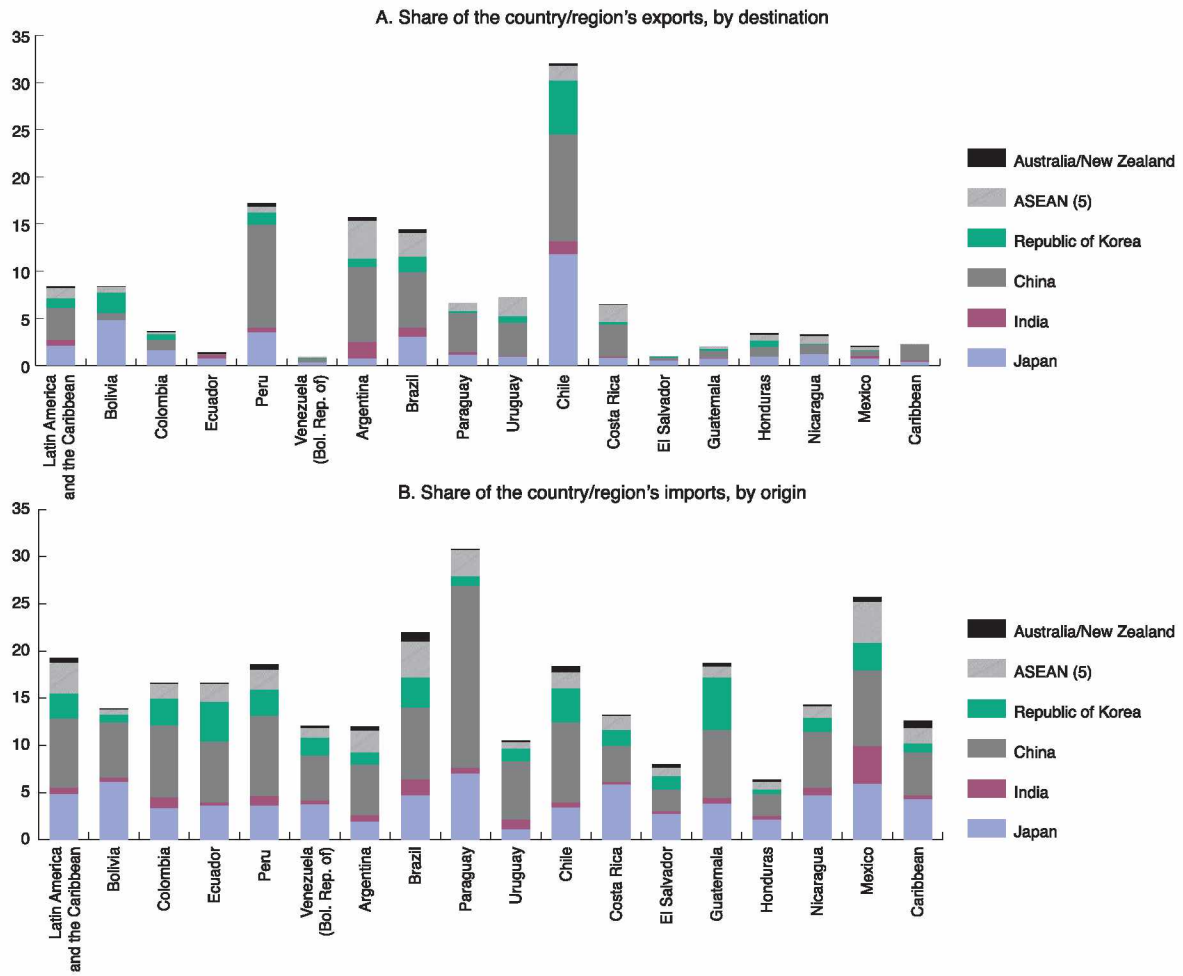
In Latin America and the Caribbean, both regional integration subgroups and those countries of the region that do not belong to subregional blocs (Chile and Mexico) have carried out activities with the aim of negotiating extraregional agreements, some of them with the countries of Asia–Pacific. Until recently, these agreements have had little impact on the growth and direction of trade flows in the region, but by late 2005 the countries of Latin America and the Caribbean had signed or negotiated more than 60 agreements covering some 60% of the region's total exports. In 1990, by contrast, there were just four trade preference schemes accounting for some 6% of the region's exports. To sum up, the recent wave of free trade agreements presents two novel features in the Asia–Pacific region: their trans–Pacific scope and the participation of the leading economies of north–eastern Asia (China, Japan and the Republic of Korea) and the United States.

Two far–reaching proposals for the creation of large–scale economic communities in Asia are now on the table. The first is for the creation of a Free Trade Area of the Asia Pacific (FTAAP) within the framework of APEC, while the second is for the establishment of an ASEAN + 3 economic community, consisting of the 10 members of ASEAN plus China, Japan and the Republic of Korea, or an ASEAN + 6, which would additionally include Australia, India and New Zealand. While the first option is backed by the United States and those members countries that are well along the road to trade liberalization, such as Australia, Canada, Japan and Mexico, the second is advocated by the member countries of ASEAN and the leading countries of North–East Asia. The countries of Latin America and the Caribbean should conduct, as a matter of urgency, a thorough analysis of the possible consequences of each proposal and should adopt joint measures in response to this situation.

Asia–Pacific as one of the Latin American and Caribbean region's principal trading partners

Trade between Latin America and the Caribbean and Asia–Pacific has recovered since the two years (1998–1999) of stagnation that followed the Asian crisis and continues to expand. More importantly still, Asia–Pacific has become one of the Latin American and Caribbean region's main trading partners, especially where imports are concerned. The Asia–Pacific region is of much greater importance for the region in terms of imports than exports, and this has resulted in a growing trade deficit since 1992 (US$ 48 billion in 2005). Unsurprisingly, given Asia–Pacific's large and growing role as a trading partner for a great many Latin American and Caribbean countries, a number of these nations have signed or are currently negotiating free trade agreements (see figure 4).

Figure 4
LATIN AMERICA AND THE CARIBBEAN: THE STRUCTURE OF TRADE WITH SELECTED ASIAN MARKETS, 2005[a]
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the Commodity Trade Database (COMTRADE).
[a] The following countries are included: Australia, China, India, Japan, New Zealand, Republic of Korea and member countries of ASEAN 5 (Indonesia, Malaysia, Philippines, Singapore and Thailand).

The robust level of trading activity taking place between the two regions is largely due to the growing role of China as both an exporter and an importer. In the early years of the present decade, China displaced Japan as the Latin American and Caribbean region's largest trading partner in Asia. Meanwhile, the ASEAN 5 countries (Indonesia, Malaysia, Philippines, Singapore and Thailand) have displaced the Republic of Korea as a source of Latin American and Caribbean imports and as a destination for the region's exports.

Latin American and Caribbean exports to the Asia–Pacific countries are concentrated in natural resources and natural resource–based manufactures. This is clearly the case in the region's exports to Japan and India and, to a lesser extent, China, the ASEAN (10) nations and the Republic of Korea. The pattern of Latin American and Caribbean imports from Asia–Pacific, in contrast, is the mirror image, in reverse, of the region's exports, albeit with substantial variations across countries and subregions. In the case of Japan and, to a lesser extent, China, the Republic of Korea and the ASEAN countries, it is high– and medium–technology–intensive manufactures that are the most important component, while in the case of India it is natural resource–based manufactures. The ASEAN countries have the highest ratio of high–technology manufactures, while commodities predominate in the export basket of the countries of Oceania.

Intra–industry trade is an increasingly important factor in trade links between the economies of East and South–East Asia. Bi–regional trade flows, in contrast, are mainly of an inter–industry nature, with the countries of the region exporting commodities and commodity–based manufactures and importing manufactures of various types. This situation may change, however, as a result of the trade agreements now operating or being negotiated within Asia–Pacific and between that region and Latin America and the Caribbean. The challenge is twofold: to capture Asian investment in any value chains that might develop around natural resources and to stimulate intra–industry trade with that region.

The high level of intra–industry trade within Asia contrasts strongly with the very low level of such trade between Latin America and the Caribbean and Asia. When the intra–industry trade ratios of Latin America and the Caribbean are compared with those of different regions around the world (the European Union, the United States and, indeed, East Asia), the level of such trade with Asia is seen to be particularly low. Latin America and the Caribbean has a high index of intra–industry trade with the MERCOSUR countries (with or without Brazil) and, to a much lesser extent, with the Andean Community and Chile. Mexico has also seen a substantial rise in this type of trade, particularly with the United States, owing to the large volume of its trade in maquila products. With the exception of Mexico, intra–industry trade with Asia is almost non–existent, which is one of the main reasons for the relative lack of dynamism in bi–regional trade.

In view of this situation, Latin America and the Caribbean need to strengthen their links with Asian countries, seek greater complementarity with them in production activities and establish not just trade agreements but trade and investment alliances as well, as this would provide them with additional access to these markets and help them to gain entry into Asian production and export chains. Latin America and the Caribbean has a number of advantages, such as skilled labour, proximity to cheaper energy sources and an abundance of natural resources, which, combined with appropriate industrial development and innovation policies, can enable them to participate more fully in production chains in Asia. All these challenges, however, require faster progress with export diversification, product and process innovation and incentives for intra–industry trade between the two regions.

Again, given the large scale of intraregional trade in natural resources within Asia–Pacific, Latin America and the Caribbean ought to be trying to compete not only in that region, in areas where they possess comparative advantages, but also in other major markets such as the European Union and the United States. The competitiveness of some countries in Asia and Oceania will be further enhanced once the different preferential agreements currently being negotiated come into force.

The disadvantage suffered by Latin America and the Caribbean in competing with the ASEAN countries to sell natural resources in Asian markets would be lessened if the countries of the region were to sign free trade agreements with the economies concerned. If there was no progress with trade negotiations, the most severe disadvantages facing the Latin American and Caribbean countries would be heightened in the commodity and commodity–based manufacturing sectors, where the ASEAN countries maintain comparative production advantages and tariffs remain high. Specifically, the tariffs applied by the ASEAN countries, China, Japan and the Republic of Korea to agricultural products, textiles and apparel and to some machinery sectors are still set at high levels, so that

reducing these under trade agreements would give the ASEAN countries an advantage over the countries of the region, leading to trade diversion that would also make it harder for Latin American firms to participate in Asian value chains.

The above indicates that Latin America and the Caribbean need to adopt a two–pronged approach that will allow them to make more efficient and coordinated use of the comparative advantages deriving from natural resources while at the same time intensifying their efforts to stimulate industrial development by improving international competitiveness in manufacturing sectors. For full advantage to be taken of the opportunities that trade agreements could open up, of course, stronger progress would have to be made domestically in meeting the challenges of competitiveness, technological innovation and export diversification. Otherwise, whatever efforts might be made to diversify markets and improve the conditions of access to the Asian market would yield nothing more than the consolidation of a commodity–based pattern of export specialization that is vulnerable to the business cycle and low in technology content.

Innovation and export development in emerging economies

Innovation as a key factor in export diversification

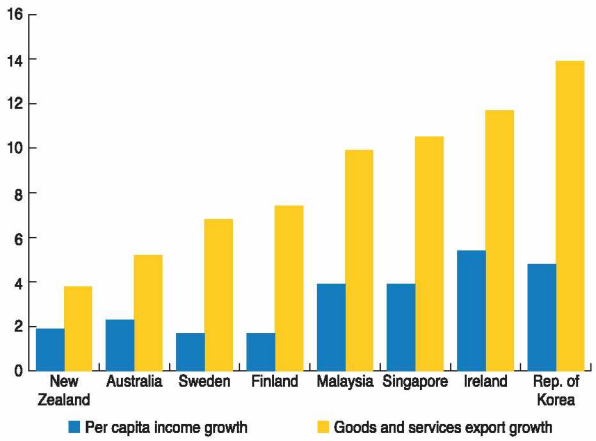
Chapter VI reviews the experience of a number of countries that have shown it is possible to diversify exports and incorporate technology and knowledge with the help of changes in the production sector and economic growth. Australia, Finland, Ireland, Malaysia, New Zealand, the Republic of Korea, Singapore and Sweden have demonstrated the value of proactive, forward–looking national and sectoral policies inspired by long–term adaptive strategies for competing in the world marketplace. As figure 5 shows, the period 1990–2005 was one of strong export growth for all these countries, while per capita income growth ranged from 2% to 4.5% a year.

These examples show that strategies are more likely to succeed when they involve a strong alliance between the public and private sectors that withstands changes in government administrations and thus makes it possible to implement those strategies on the basis of a long–term time horizon. Clearly, however, the continuous and rapid change generated by globalization and the competitive world of today makes it necessary for different actors to join forces and coordinate their efforts in pursuit of a common vision, a long–term strategy and policies to sustain that vision.

Companies are, without a doubt, the actors "on the ground" that know how the market works. Owing to the existence of market failures, however, the private sector's perspective on new opportunities is fragmented and incomplete. Collaboration or alliances between the public and private sectors can help to remedy this failing while at the same time developing a micro– and macro–institutional framework that can help the private sector to overcome a variety of obstacles.

In the countries dealt with in this chapter, innovation tends to be seen as part of the export

Figure 5
GROWTH IN PER CAPITA INCOME AND IN GOODS AND SERVICE EXPORTS, 1990–2005
(Percentages)



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

diversification and development strategy. This can be explained by the fact that countries on the technology frontier and those close to it are threatened by competition that is made all the more intense by the ICT revolution, trade liberalization and falling transport costs, in particular.

This has led governments to delineate interactive policies on competitiveness, export development and innovation to provide seamless governmental support. In some cases, strategy planning has been led by the main social actors and supported by governments through policies, instruments and financing. This has usually occurred at the national level, but sometimes at the regional or sectoral levels, as well. It is not simply a matter of increasing research and development (R&D) spending while maintaining current policies as they are, however; these policies need to be reshaped so that they are consistent with the requirements of the new strategy, which means that it is very important to decide which sectors or business areas are to be given priority.

These cases also demonstrate how some governments have sought to turn scientific and technological research and educational capacity into a pillar for high–technology industries and exports. To this end, development strategies and the national innovation systems underpinning them are being adapted to cope with these new challenges.

Public policies and an appropriate institutional structure

For all the diversity of the institutional mechanisms discussed above, the different ministries and agencies are all taking the same approach to their work in this area, thus ensuring their coordination and the increased effectiveness of policies structured around a strategy which lays down targets, deadlines and priorities and includes ongoing performance evaluations.

To avoid overlaps or duplication, the agencies involved should institute an ongoing dialogue or should create arrangements to facilitate an effort to move in this direction, such as a committee of ministers. The focus is on guiding and coordinating the decisions and policies of the different agencies, the participation of key officials in the management structure of other bodies and the creation of an agency specializing in policy coordination. Arrangements of this type are to be found in all the countries studied.

In view of the scale of the resources involved, and in order to ensure policy transparency, governments are developing a range of indicators to gauge the effectiveness and efficiency of innovation programmes and instruments. It is therefore hoped that the policy recommendations made in this report may serve to enhance the region's agenda for innovation, competitiveness and export diversification.

Chapter I

Developments in the international economy and their consequences for Latin America and the Caribbean

Introduction

2006 was a good year for growth in the world economy, and for international trade and financing as well. Most analysts likewise view the prospects for 2007 and 2008 as encouraging, although a moderate slowdown is expected in the global economy and trade. The consequences of this slowdown, which is largely confined to the United States economy at present, will be offset to some degree by the dynamism of Asia, Europe and Japan. In any event, the five years from 2003 to 2007 will have been one of the best periods for the world economy in the last 40 years. Where commodity prices are concerned, the trend has so far been favourable for the main items in the region's export basket, particularly energy and mineral commodities, largely because of higher demand from Asia.

As ECLAC has been pointing out for some years, these good economic conditions in the region represent an opportunity for Latin America and the Caribbean to lay the foundations for sustained growth in the medium term. With greater public–sector resources and access to low–cost financial markets, the region's countries could enhance their integration into the international economy by increasing infrastructure and human capital investment, encouraging efforts to add value, know–how and innovation to exports and pursuing key initiatives that can contribute to regional integration.

These considerations are particularly vital at the present time, since there are some latent risks that could affect this positive global situation. One of them is the risk of a sharper slowdown in the United States economy, which would give Japan, the European Union and the developing countries of Asia an even more important role in maintaining the dynamic of global growth. There are other risks too, such as increased financial market volatility, outbreaks of inflation pointing to higher interest rates, and a disorderly adjustment in external imbalances around

the world (United Nations, 2007). In any event, the region should prove less vulnerable than formerly, given its current–account surpluses, large reserves and lower levels of external debt (ECLAC, 2007c).

Any progress with the stalled multilateral trade negotiations will be another positive factor for the region in 2007. As of mid–year, the prospects for the Doha Round are not encouraging; the direct negotiations between Brazil, the European Union, India and the United States have not yielded results, largely owing to a failure to agree on trade liberalization in the agricultural and industrial sectors. The developed countries and the leading developing–country actors need to reach a baseline agreement on liberalization procedures. In a number of the region's countries, meanwhile, those in charge of trade policy are concluding bilateral agreements.[1]

A. The global context is still positive for the region

1. Asia as the engine of global growth

The world economy is still growing rapidly, although a modest slowdown is expected in 2007 and 2008. In 2006, the world experienced record economic growth of more than 5% in purchasing power parity (PPP) terms, or almost 4% in nominal terms (see figure I.1).[2] This was the fourth year running in which global growth exceeded 4%. This positive result was largely driven by the vigorous performance of China and India, which grew by 11% and 9%, respectively. Positive growth rates in Europe, Japan and the United States also contributed to this favourable outcome. The financial markets likewise performed very satisfactorily, in some cases hitting record highs.

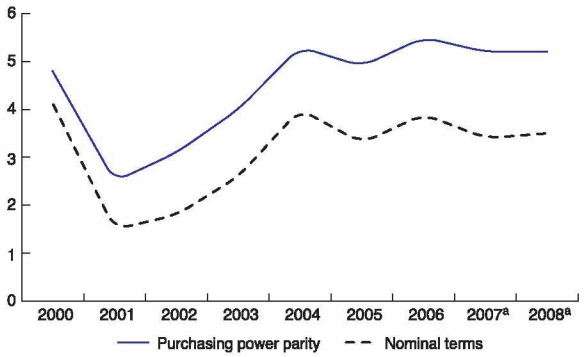
Because of their dynamism and their increasing weight in the world economy, the developing countries of Asia continue to be the engine of world economic growth. In fact, Asia accounts for almost half the growth of the world economy. China is playing the largest role, with investment and exports continuing to expand at high rates. In the last seven years, Asia has contributed more than twice as much to global economic growth in PPP terms as the European Union, Japan and the United States combined. Latin America and the Caribbean, meanwhile, contributed between 7% and 8% of global output in the period concerned (see figure I.1). In absolute terms, of course, Europe, Japan and the United States still account for almost half the world economy in PPP terms, while China and the rest of Asia account for a quarter.

In 2006 and 2007, macroeconomic divergence between the United States, on the one hand, and Japan and the European Union, on the other, slightly narrowed the external gaps and imbalances that have been a feature of the past few years (see figure I.2). Economic growth in the United States has slowed since the last quarter of 2006, while the European Union and Japan have continued to perform well.

[1] Some countries in the region have recently sought to strengthen bilateral trade links with developing countries in Asia (see chapter V).

[2] Two types of GDP weighting can be used to calculate countries' contribution to global economic growth: (i) each country's share of global GDP is calculated in terms of a common currency, usually the dollar, by converting its GDP at a nominal exchange rate, or (ii) this share is calculated by converting the country's GDP at an exchange rate adjusted for purchasing power parity. To analyse economic growth at the continental or global level, it is recommended that weightings be based on GDP calculated at purchasing power parity (Callen, 2007).

Figure I.1
WORLD GDP GROWTH AND THE MAIN CONTRIBUTORS TO IT, 2000–2008[a]
(Percentages)



Source: International Monetary Fund, *World Economic Outlook* database, April 2007.
[a] Preliminary figures.

Table I.1
CONTRIBUTION TO WORLD GDP GROWTH
(Percentages and relative weight in the world economy in 2006[a])

	2005	2006	Weight in 2006
United States	13	12	0.20
European Union	8	12	0.21
Japan	2	3	0.06
China	31	30	0.15
Other Asia	18	17	0.12
Latin America and the Caribbean	7	0.08	0.08
Rest of world	20	18	0.19
Total	100	100	1.00

Source: International Monetary Fund, *World Economic Outlook* database, April 2007.
[a] Calculated in purchasing power parity (PPP) terms.

Figure I.2
ECONOMIC INDICATORS FOR THE WORLD'S FOUR LEADING ECONOMIES

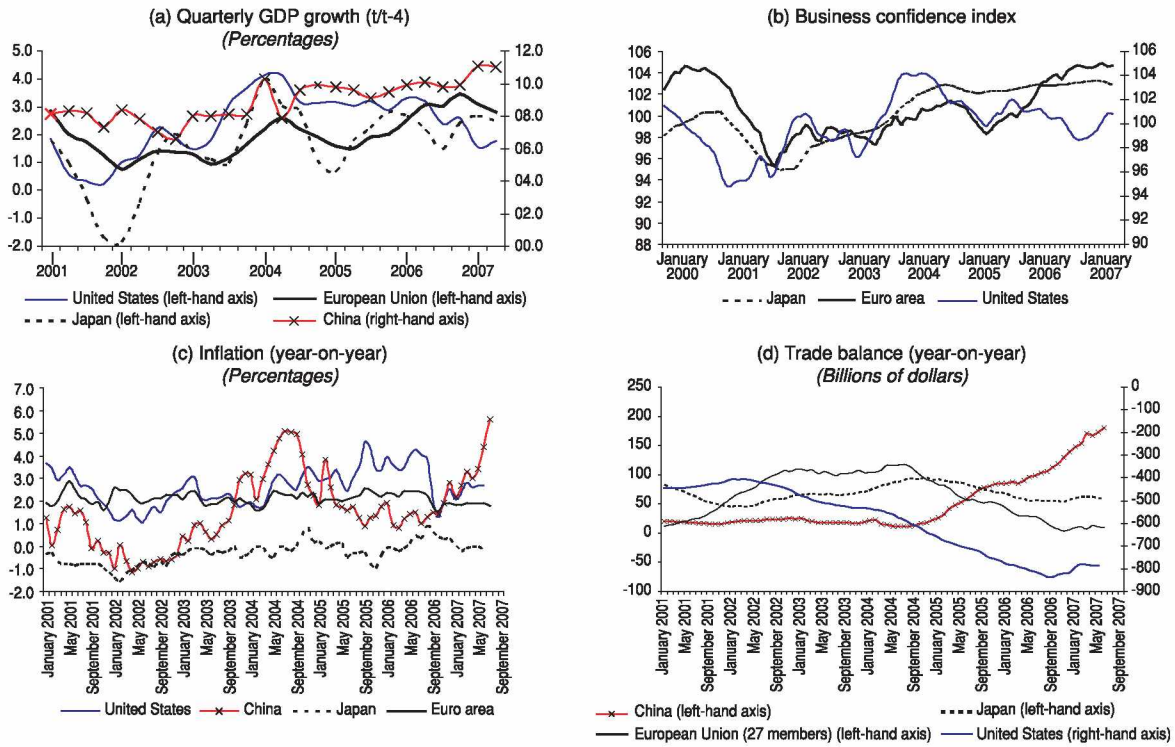
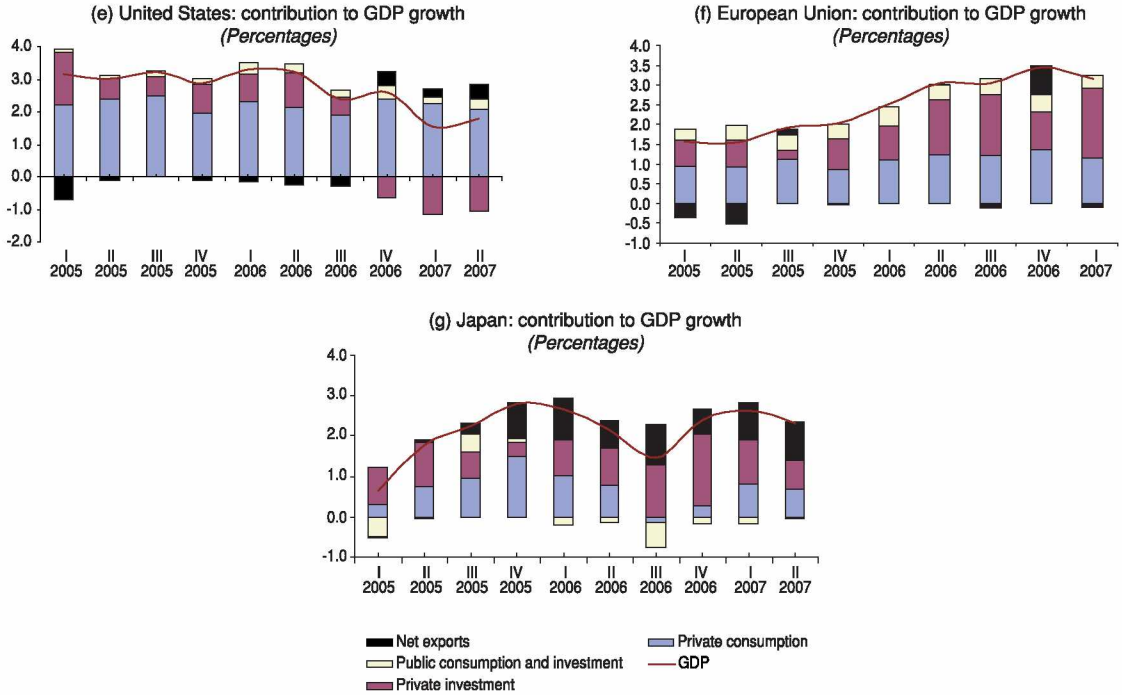


Figure I.2 (concluded)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the Bureau of Economic Analysis of the United States Department of Commerce, the Statistical Office of the European Communities (EUROSTAT), the Office of the Prime Minister of Japan, the Economist Intelligence Unit and the Organisation for Economic Co–operation and Development (OECD).

There are major differences among the three largest economies in terms of what drives their growth (see figure I.2e, f and g). In the United States, private consumption is still the main driver of the economy. Despite a very jittery property market, United States consumption has remained vigorous thanks to strong jobs growth and a substantial drop in unemployment and energy prices, in both cases to their lowest levels since August 2006. However, residential and non–residential private investment began to slow sharply in the fourth quarter of 2006, with a drop of 19% at an annualized rate in the second half of the year. The drop in corporate investment was surprising, given that companies are making large profits and borrowing costs remain low. Higher inventories also had a negative effect on growth. A new phenomenon is the positive contribution of net exports to growth since the fourth quarter of 2006, chiefly owing to a decline in the rate of import growth (see figure I.2e). These discouraging tendencies have adversely affected the export dynamism of Latin America and the Caribbean in general and Mexico, Central America and the Caribbean countries in particular, since the United States is their main market.

In the European Union, higher than expected GDP growth in 2006 and early 2007 was driven by domestic demand from both consumption and private investment. Private consumption was buoyed by the lowest unemployment rate in 15 years.[3] The most dynamic economy in the European Union was Germany's, owing to a number of reforms that have helped to improve competitiveness and export performance over recent years plus the boost to consumption from the 2006 soccer World Cup. France and Italy grew less than expected, while the United Kingdom performed more solidly.

Japan's economy remains vigorous despite a temporary slowdown in the third quarter of 2006 (chiefly in consumption). The main drivers of the economy have been exports and investment, while consumption also seemed to be picking up in early 2007. Japanese companies are still investing

[3] Strong job creation in the European Union brought the unemployment rate down to 7%.

vigorously thanks to strong profits and balance sheets. All this has resulted in a rise in new lending to the corporate sector and increased economic activity that is reacting favourably on exports. Companies are also recruiting again, and this has helped to reduce unemployment to its lowest level in nine years. This tendency should also put upward pressure on wages and consumption.

Other variables in the leading economies that deserve attention are inflation and the trade balance (see figure II.2c and d). Inflation as measured by the consumer price index fell in mid–2006, mainly as a consequence of lower oil prices. In Japan, inflation fell to zero in early 2007. Underlying inflationary pressures have been a cause for concern for the central banks of the United States and the euro area, however. Where trade balances are concerned, there are still worries about the United States balance of payments, principally because of the country's large trade deficit, especially in the consumer goods sector. By contrast, China's trade surplus with the European Union is growing at a restrained pace.

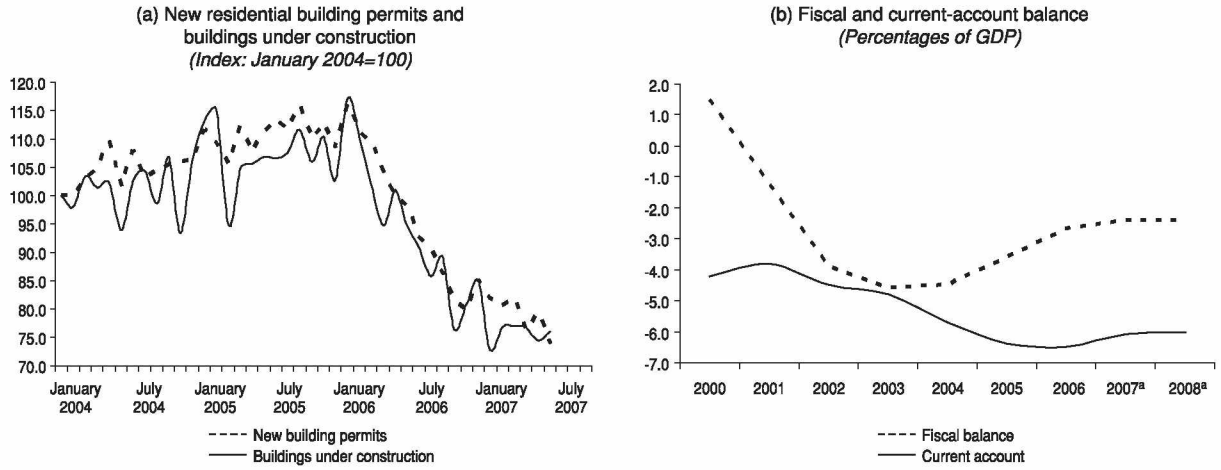
Barring upsets in global financial markets with adverse repercussions for the world economy, the international environment should remain favourable to Latin America and the Caribbean in 2007 and 2008, although it must be stressed again that slower growth in the United States will hold back imports there. For all the dynamism of the German economy, growth in the European Union is expected to slow somewhat as a consequence of higher interest rates and lower government spending. There are other latent risks that could also affect the region. First, there is the likelihood that financial markets will remain volatile as investors shun risky securities. Second, greater inflationary pressures may emerge, especially if the oil price increases, forcing central banks to raise interest rates and thereby affecting the growth outlook of the region's countries. Third, there is still the possibility of a disorderly adjustment in external disequilibria worldwide.

2. The impact of lower United States growth on Latin America and the Caribbean

The loss of dynamism in the United States will probably affect the trade of Latin America and the Caribbean more than any other international factor. Slower growth in the country in 2006 and 2007 has been due to a large drop in corporate and residential investment (owing to a downturn in the property market). Since early 2006, both the number of new residential building permits and the number of buildings under construction have dropped (see figure I.3a), and in mid–2007 there were signs of worsening instability in these two indicators. The rate of house price growth also fell in 2006. This could cause the greatest problems in the subprime mortgage segment, where arrears and default rates could increase substantially and squeeze future lending. Thus far, the consequences for the wider financial system have been limited.[4] There is still the possibility, however, that the problems in the subprime mortgage segment may restrict consumer lending and as such have undesirable consequences for consumption and economic growth.

[4] In August 2007, financial markets were, however, hurt somewhat by the worsening situation in the subprime market.

Figure I.3
UNITED STATES: THE PROPERTY MARKET AND TWIN DEFICITS, 2000–2008



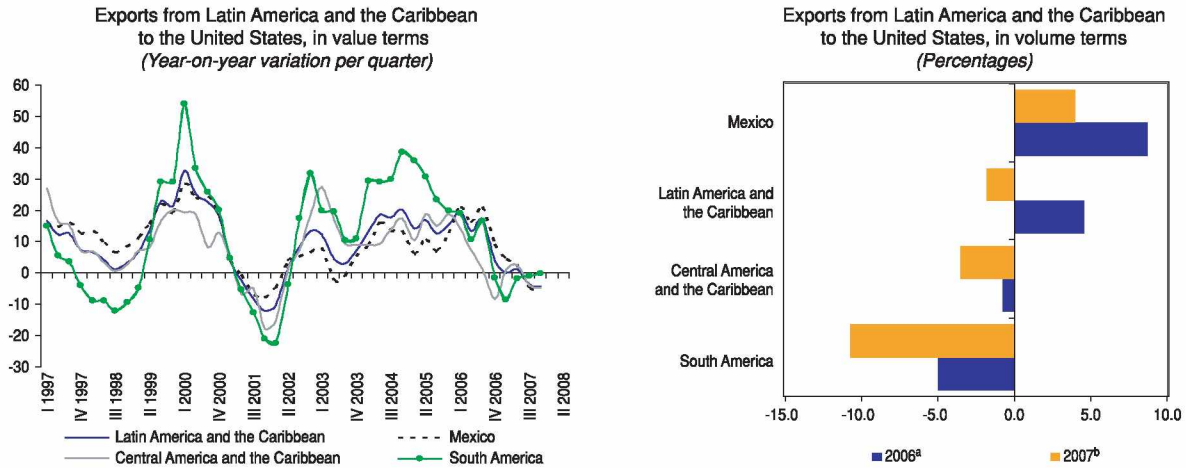
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United States Census Bureau and the International Monetary Fund (IMF).
[a] International Monetary Fund projections for 2007 and 2008.

Another major medium–term concern is the large current–account deficit, which worsened by less in 2006 than in previous years. It is expected to improve slightly in 2007 and stabilize in 2008 (see figure I.3b). This relative improvement reflects two tendencies: first, a smaller trade deficit because of the dollar's depreciation, a lower oil price and dynamic demand from trading partners and, second, a worsening in the investment income account balance. To correct this large imbalance it is essential for domestic saving in the United States to increase. In this context, it is encouraging that the federal government deficit fell to the equivalent of 2.5% of GDP in 2006.

The slowdown in economic growth in the United States is projected to have a moderate impact on Latin American and Caribbean exports to the country. ECLAC is predicting economic growth of 2% in the United States for 2007, compared to 3.4% in 2006. To ascertain the impact of this slowdown, the elasticities of Latin American export volumes were estimated in relation to real import demand in the United States.[5] The 2007 projection suggests negative real growth in the region's exports to the United States of -1.8%, compared with 4.6% in 2006. According to the estimates, South America, the Caribbean and Central America will be the worst–affected areas. Indeed, the signs of this slowdown were already there to see in the first half of 2007 and are projected to continue in the second half of the year (see figure I.4).

[5] GDP was used as a proxy for real demand, after controlling for relative prices with the real exchange rate as a proxy. Given the data available, an autoregressive model with distributed lags was estimated.

Figure I.4
LATIN AMERICAN AND CARIBBEAN EXPORTS TO THE UNITED STATES (1997–2007) AND IMPACT OF THE SLOWDOWN IN UNITED STATES GROSS DOMESTIC PRODUCT GROWTH (2007)



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

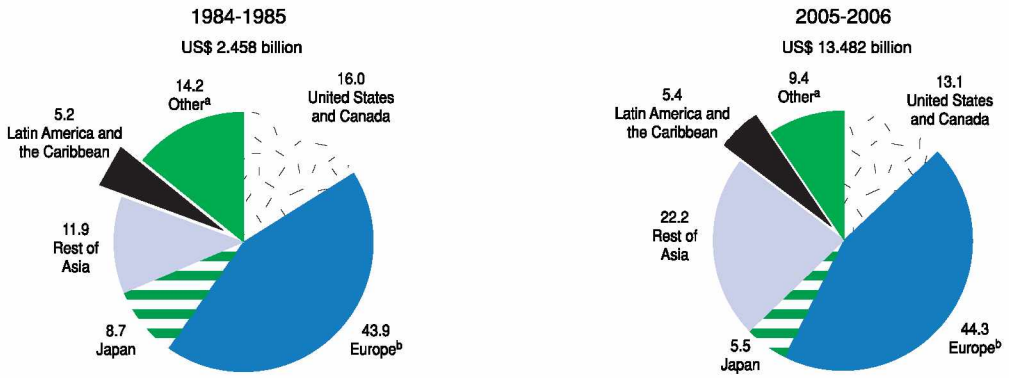
3. Asia as a key region in the current economic conjuncture[6]

Asia (and particularly its developing countries) is playing a key role in the current economic environment for a number of reasons. First, as already mentioned, it is to a great extent the engine of global economic growth. Second, Asia has the largest trade surplus of any region in the world and is the main counterbalance to the large United States deficit, accounting for more than a quarter of world trade (see figure I.5). Third, Asia occupies a strategic place in the financing of the United States deficit and is a key player in the financial markets in general. These three points will be analysed in more detail below, with particular emphasis on recent trends and the prospects they raise.

With respect to global economic growth, Asia has been the most dynamic region since 2001, despite its heterogeneity. In purchasing power parity terms, the Asia region has been contributing half of world growth, with China and India leading the way (growth of 11.1% and 9.7% in 2006, respectively). India has grown faster than it was expected to a year ago. It is important to realize that the Chinese economy is driven by investment, which accounts for half its growth, and to a lesser extent by exports, while in India private consumption is the key factor in demand. On the supply side, growth in China is dominated by manufacturing, whereas in India it is services that have been most dynamic. The other main emerging countries in Asia (Indonesia, Malaysia, Philippines and Thailand) are growing more slowly than they did in the decade prior to the 1997–1998 crisis. This lower growth is partly due to sharply reduced investment rates (see box I.1). The Asian Development Bank has argued that investment rates before the crisis were too high, by contrast with today's levels which, other than in the Republic of Korea, are among the lowest (ADB, 2007).

6 See chapter IV, which gives a more detailed account of Asia's role in the global economy and the consequences of this for Latin America and the Caribbean.

Figure I.5
SHARE OF GOODS AND SERVICES EXPORTS IN WORLD TRADE, BY REGION, 1984–1985 AND 2005–2006
(Percentages of the total)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations, Commodity Trade Statistics Database (COMTRADE), and World Trade Organization (WTO) data.
[a] Mainly Africa.
[b] Eastern and western Europe.

Box I.1
ASIA AND LATIN AMERICA: A DECADE AFTER THE CRISIS

From 1997 to 1999, numerous developing countries were badly affected by a financial crisis that broke out in Asia. Ten years ago, the world was caught unawares by a financial and currency crisis originating in Thailand, mainly because of a precipitous and unforeseen drop in confidence among foreign investors following a massive influx of foreign capital and a rapid build–up of foreign debt in the 1990–1996 period. The pressure on the Thai baht led to a large devaluation in July 1997 that not only had severe financial consequences in other countries of the region (Indonesia, Malaysia, Philippines and Republic of Korea) but also spread to the Russian Federation (August 1998), Brazil (early 1999) and several other emerging economies. The crisis in these countries resulted in large currency depreciations, a number of bank failures, higher borrowing, a drop in GDP and rising unemployment and poverty.

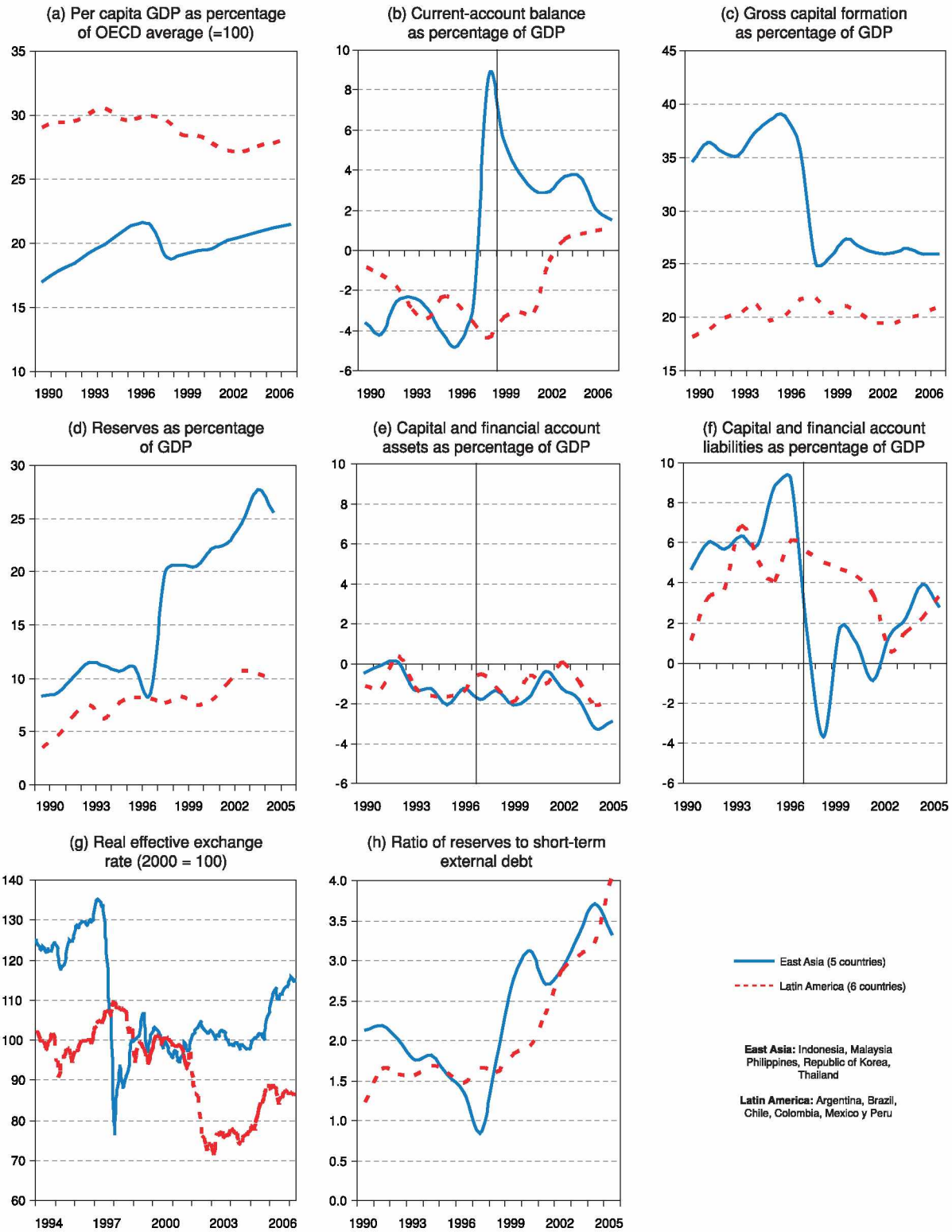
All these countries have recovered from the crisis; the recovery was faster in the worst–affected Asian countries, however, than in the leading economies of Latin America, as analysis of a set of indicators reveals (see figure I.6). The decline in per capita GDP was similar in both regions, but was shorter and sharper in Asia, while in Latin America it was protracted over five years. Pre–crisis levels of per capita GDP were regained in 2000 in the Asian countries, but not until 2004 in the Latin American ones. Furthermore, the Asian countries succeeded in reducing poverty levels, while the Latin American countries only began to see progress in this area in 2004.

A number of factors account for the rapid recovery of the Asian countries. First, the value of their currencies fell in real terms across the board, strongly boosting exports and restraining imports. Before long, the current–account balances of these countries were in surplus and they began to accumulate large quantities of reserves, which helped to make them more resilient to further turbulence, as the ratio of reserves to short–term external debt shows. Their economic growth was not interrupted by a large drop in exports in 2001 or by the moderate capital outflows that resulted from a crisis in the global information technology industry. There was a decline in gross capital formation as a share of GDP after the crisis, although a degree of dynamism was maintained and the recovery continued to be supported. Lastly, an important indicator of the strength of the recovery has been a new influx of foreign capital, plus growing investment abroad.

The recovery in Latin America was slower for several reasons; since 2004, however, the leading Latin American countries have displayed strengths similar to those of their Asian peers. First, the Latin American countries delayed the relaxation of their overvalued exchange rates; in the extreme case of Argentina, this did not happen until early 2002. Consequently, it was not until 2003 that the external sector gained momentum and supported economic growth. Reserves remained at fairly low levels, although the region did manage to reduce its vulnerability to international shocks by reducing its short–term external debt. Since 2003, gross capital formation has strengthened to some degree in the region, while net exports have risen, reserves have been built up and both capital inflows and investment abroad have increased. In a number of ways, the Latin American countries are approaching the level of dynamism seen in the developing countries of Asia.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Survey of Latin America and the Caribbean, 2006–2007* (LC/G.2338–P), Santiago, Chile, 2007, forthcoming; World Bank, *East Asia and Pacific Update*, Washington, D.C., April 2007; Asian Development Bank (ADB), *Asian Development Outlook*, 2007, Manila.

Figure I.6
COMPARATIVE INDICATORS FOR ASIAN AND LATIN AMERICAN COUNTRIES, 1990–2006



Source: World Bank, *World Development Indicators and Global Development Finance* databases, and Bank for International Settlements for real effective exchange rate data.

Asian growth is expected to remain high in the coming years, although slightly lower than in 2006. Nonetheless, some countries in the region are expected to struggle to maintain their dynamism in the medium term. The impact on Asia of the slowdown in United States growth has been fairly slight so far since the property crisis has yet to be reflected in demand for Asian electronic goods and, other than for China, the United States is a much less important trading partner now than it was in 2000. Furthermore, inflation is under control in all the countries except India (where there are price pressures), which means they have scope to apply expansionary monetary and fiscal policies of a countercyclical nature (IMF, 2007a). A somewhat more pronounced slowdown is expected in India, given the recent rise in inflation and the subsequent monetary squeeze, a large fiscal deficit (6% of GDP in the 2006–2007 period) and a considerable public debt. Furthermore, the current–account deficit has risen to 2.5% of GDP. The region's other countries will carry on expanding by 4% to 6% a year in 2007 and 2008.

China and India, the largest of the emerging economies in the Asia region, need to address a number of issues that could hold back growth in the medium term. China needs to resolve the structural problems deriving from its rapid industrialization and growth, such as income inequality between urban and rural areas and the most pressing environmental issues. Another dilemma is how quickly to revalue the currency, given China's growing trade surplus (see box I.2) and the level of unproductive investment by semi–public firms. For India, fiscal consolidation is an important issue at a time when a great deal of public investment is needed in electricity network infrastructure and highways to sustain growth (Kuwayama and Rosales, 2007).

Box I.2
WHY IS THE GOVERNMENT OF CHINA SO RELUCTANT TO REVALUE THE YUAN?

Although there has been much debate about the need to adjust the exchange rate of the Chinese currency against the dollar, there has been less discussion of the reasons behind the obvious reluctance of the Government of China to carry out a significant revaluation of its currency. This attitude is not motivated only by trade considerations, but is influenced by a number of factors. The clearest of these is that a revaluation of 15% to 40% (which some analysts see as the minimum needed to rectify the current–account imbalances between the United States and China) would result in a large decline in China's reserves.

There are other structural reasons of even greater importance, however. As an integral part of its growth strategy, China maintains restrictions on domestic savings to ensure they are placed at the service of the country's economic growth. If China were to agree to a substantial revaluation of its exchange rate (as the United States wishes), it would be difficult to maintain restrictions on local savings. By some estimates, a quarter of all the country's savings would go abroad in search of better returns. This would bring to an end the low interest rate policy that has hitherto sustained investment and growth.

A second concern is the huge divide between the country's rural and urban areas since the implementation of economic reforms in the early 1980s. The Government of China fears that competition from cheaper imported foodstuffs, combined with a substantial revaluation of the currency, might drive agricultural commodity prices down, thereby triggering even faster migration to urban areas from what is already a very weak and inefficient rural economy. This could intensify social pressures, disturbances and the risks to the country's growth.

The concern of the Chinese authorities about the risks of a rapid revaluation also seems to reflect the view that the Plaza and Louvre agreements of the 1980s caused the rise of the yen against the dollar and contributed to the serious recession in the Japanese economy in the 1990s. This makes it easier to understand why the Government of China should adopt a policy of gradual currency revaluation.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of W. Hutton, *The Writing on the Wall. China and the West in the 21st Century*, London, Little Brown, 2006; and A. Glyn, *Capitalism Unleashed*, Oxford University Press, 2006.

Asia increasingly dominates international financial flows and is an essential source of financing for the United States deficit. In the 2005–2006 period, the developing countries of Asia absorbed about 70% of gross global equity investment flows to developing countries (United Nations, 2007). China was the world's largest net capital exporter in 2006 (IMF, 2007b), partly because it possesses the world's largest reserves; by 2006 it had built up over a trillion dollars, reflecting a current–account surplus of 9% of GDP that year. China holds 21% of global reserves (in 2000 it had just 9%), while Japan has 17% and Asia as a whole 45%. Changes in the way Asia (and particularly China) invests its reserves could have marked effects on the world's financial and macroeconomic stability.

Although trade surpluses and growing reserves have made the Asian countries less vulnerable to external shocks, they could produce certain undesirable effects. Reserves become harder to sterilize as they grow, and if the money supply increases because sterilization is incomplete then bubbles could inflate in equity and property markets, inflation could accelerate and the interest rate drop below its equilibrium level (leading to overinvestment), and pressures on the exchange rate could develop. Also, these countries are chiefly accumulating low–yielding assets (in the United States) and are exposed to major losses in future. In short, it has to be asked whether these tendencies will be sustainable.

Asia and Oceania have received more FDI than developing countries anywhere else (57% and 60% of the FDI stock in 2005 and flows between 2003 and 2006, respectively, as against the 34% and 32% received by the subregions of Latin America and the Caribbean, respectively); China has been the largest developing–country recipient in recent years (UNCTAD, 2006). The relative stability of FDI flows into Latin America and the Caribbean contrasts with their growth in other regions; the result has been a decline in the region's share of FDI flows to developing countries and global flows generally. However, the Latin America and Caribbean region continues to receive more FDI as a share of GDP than Asia and Oceania (excluding the main financial centres), although this ratio has declined in the last two years (ECLAC, 2007a). Furthermore, over two thirds of developing countries' outward FDI in recent years has come from firms in emerging countries of Asia and Oceania.

Asia's growing weight in the world economy and its dynamic trade and finance make it a market of great potential importance for Latin American and Caribbean trade and investment. The Latin America and Caribbean region could make more efficient and coordinated use of the comparative advantages its derives from its natural resources and intensify efforts to boost industrial trade by improving its international competitiveness. The region could also attract more Asia–Pacific firms as a source of investment, particularly in infrastructure and energy. The region needs to identify which initiatives are most urgent and offer the highest returns and then speed up their implementation. This not only would strengthen trade and investment links with Asia–Pacific but would also generate externalities for the Latin American regional integration process (see chapter IV).

4. The growing imbalance between the United States and Asia

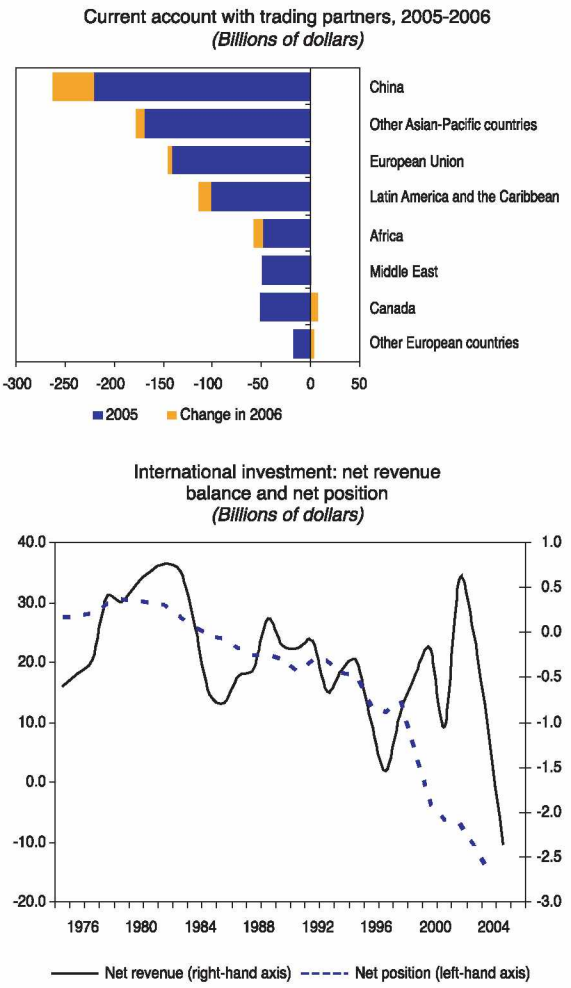
The United States external deficit widened again in 2006, although not by much, rising from 6.4% of GDP in 2005 to 6.5% in 2006.[7] In 2007 the deficit is expected to shrink slightly (United Nations, 2007). This stabilization of the country's deficit with the rest of the world is largely due to a small reversal of the negative trend in the trade deficit thanks to slightly cheaper oil imports from the second half of 2006. However, the trade balance with China and, to a lesser extent, the rest of Asia worsened again in 2006. By

[7] The United States external deficit increased from 4.8% of GDP in 2003 to 5.7% in 2004 and 6.4% in 2005.

late 2006 the trade deficit with Asia accounted for half the total external deficit of the United States and two thirds of the deterioration between 2005 and 2006 (see figure I.7).

One worrisome trend is that the international investment revenue balance of the United States turned negative for the first time in 2006 as higher interest rates made it more expensive to fund the external debt.

Figure I.7
UNITED STATES: CURRENT–ACCOUNT DEFICIT AND NET INTERNATIONAL INVESTMENT POSITION



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

In consequence, the net international investment position also continued to worsen.[8]

The United States external deficit is not expected to decrease much over the next five years, owing to two conflicting trends in the current account (IMF, 2007a). First, certain adjustments could reduce the trade deficit to some extent. These include slower GDP growth in the United States, the real effective depreciation of the dollar against the euro, the pound sterling and, to a lesser extent, the yuan (but not necessarily against the yen in the short term), slightly greater currency flexibility in the Asian economies running surpluses (see table I.2) and a lower oil price. Second, the cost of external liabilities is expected to increase, resulting in a rapid deterioration in the net international investment revenue balance that would neutralize the positive trend of the trade balance.

Asia not only accounts for the largest share of the United States trade deficit, exporting large quantities of low–priced products to the country and thereby helping to support consumption and contain inflation, but is also one of the leading sources of financing for this imbalance. Asia supplies the country with low–cost credit, helping to keep interest rates relatively low. China and Japan hold almost half of all United States Treasury bonds and Asia as a whole held over 60% as of June 2007.

However, financing rates for the United States deficit and the willingness of Asian countries to fund it are changing, and this could lead at some point to a disorderly adjustment in the dollar. Fixed–income securities have displaced variable–income ones (IMF, 2007a) and, among fixed–income instruments, Treasury bonds have given ground to riskier instruments. These shifts have increased potential exposure to market movements, especially if United States instruments yield less than other countries'. For a number of years, central banks and other agents in Asia invested in United States financial instruments because they were perceived as being more secure. However, yields have been low and the recent depreciation of the dollar makes future returns unattractive. Indeed, some investors who formerly invested in the United States are reorienting their investments towards the Asia–Pacific region (Australia and New Zealand) and Europe. There is still the risk that this process may be chaotic if there is a shift in Asian hedge fund portfolios and the Japanese yen carry

[8] The net international investment position is the overall difference between an economy's external financial assets and liabilities. It represents the resources owned and owed by a country, making it very similar to the general balance sheet of a company.

trade.[9] In addition, China is implementing a system to facilitate investment abroad with a view to obtaining higher returns on its reserves. In this it is following the lead of Temasek Holdings, operated by the Government of Singapore (*New York Times*, 21 May 2007).

What is required for a gradual adjustment are saving and investment changes plus adjustments in the real exchange rates of borrowing and lending countries. In the United States, private consumption growth is expected to slow and saving to increase. In China and the other Asian countries, consumption could increase as incomes rise and credit becomes more readily available. Another vital mechanism for adjusting imbalances are changes in real effective exchange rates, particularly a further depreciation of the dollar against leading currencies and an appreciation of the yen, combined with a greater revaluation of the yuan and other Asian currencies. The question of whether to revalue the Chinese currency is a great dilemma for the authorities, since it would entail major costs and risks in addition to certain advantages (see box I.2). Without faster revaluation of the yuan and other Asian currencies, the United States deficit with China will continue to worsen and could trigger stronger protectionist measures to contain the flow of imports from China (Mussa, 2007).

A chaotic correction in external imbalances worldwide would have a number of negative repercussions for Latin America and the Caribbean. Not only would the region's exports suffer (volumes and prices), but access to financial markets would become much more expensive as spreads on the Emerging Market Bonds Index (EMBI+) widened.

B. Financial markets

1. Increased financial market volatility

Broadly speaking, despite some adjustments during the preceding 12 months, financial markets in both emerging economies and industrial nations continued to trend upward until late July 2007, thanks to positive financial balances and an upsurge in mergers and acquisitions. In the stock market, some price indices actually rose beyond the highs registered during the technology boom of the late 1990s.

In August 2007, however, world stock markets slumped sharply amid fears of contagion from the crisis situation in the subprime mortgage market in the United States. Losses were so great that the gains of the entire year were wiped out in just a few days. It remains to be seen whether the downturn is simply a price adjustment or whether it may give rise to a much higher–risk situation for the world economy that will

[9] The carry trade is a process whereby investors sell low–yielding currencies such as the yen and buy high–yielding assets elsewhere.

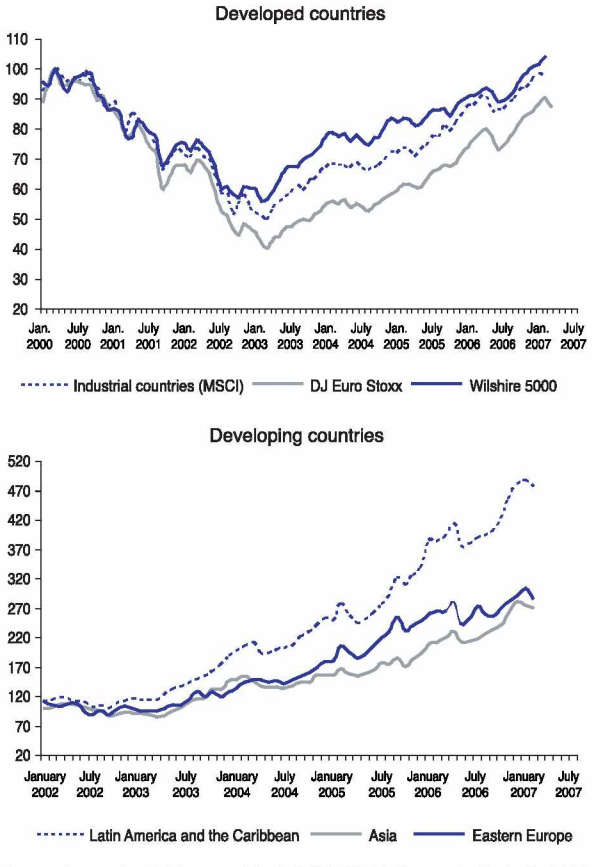
trigger a credit crunch and hurt productive sectors of the economy. As this publication went to press, the outlook was not very encouraging, since market contagion had occurred so swiftly.

Previously, there have been other signs of the greater integration of world financial markets. In late February, for example, the Shanghai index slid by nearly 9% when investors feared that Chinese authorities might step in to curb the surge in share prices. This, in turn, led to temporary downswings in stock prices on European and United States exchanges of between 2% and 3%, as well as a drop of almost 4% in the NASDAQ index. What set these indications of increased financial–market integration apart from earlier signals was the fact that, in this case, the reaction was triggered by a developing economy (see figure I.8).

Clearly, during economic booms, market integration can be a positive factor, since it helps to channel funds towards markets that offer the greatest potential gains, albeit at higher levels of risk. During times of greater volatility and uncertainty such as the present, however, deeper integration may intensify the transmission of adverse impacts. Under such conditions, the prospects for emerging markets take a turn for the worse, as demonstrated by the recent behaviour of Latin American stock markets. By the same token, the need for caution in the management of macroeconomic policy and financial variables becomes a matter of urgency is always present in the age of globalization.

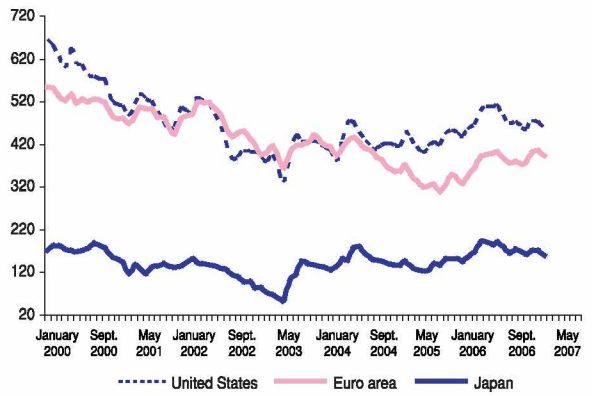
Although the situation is changing rapidly as new events unfold in the financial markets, monetary policy remains quite expansionary in both emerging markets and developed countries. Although interest rates have risen recently, in real terms they are still low by historical standards (see figure I.9). In the United States, as in some other markets (Spain), there is some concern that this rise in interest rates might lead to a slowdown in the property market that could weigh down on consumption.

Figure I.8
STOCK MARKET INDICES IN DEVELOPED AND DEVELOPING COUNTRIES (2001=100)



Source: International Monetary Fund (IMF), *World Economic Outlook, 2007*, Washington, D.C., April.

Figure I.9
LONG–TERM INTEREST RATES IN DEVELOPED COUNTRIES



Source: International Monetary Fund (IMF), *World Economic Outlook, 2007*, Washington, D.C., April.

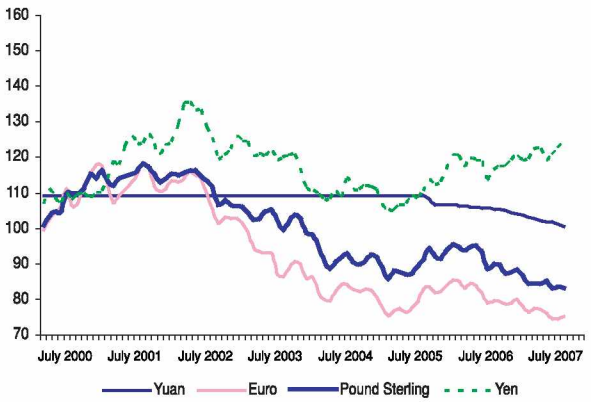
2. Limited exchange–rate adjustments

In 2006 the dollar fell steadily against the most traded currencies (other than the yen). It continued to drift down in the first six months of 2007; however, some adjustments in the currency market can still be expected, especially given the large imbalances between the United States and some of its main trading partners and increased pessimism about the growth prospects of the United States economy.

In addition to the uncertainty about the value of the dollar, the yen has been quite volatile against that currency over recent months. A policy of gradually increasing interest rates could produce a sharp revaluation of the yen against the dollar, and this would be heightened if incentives for the hitherto lucrative carry trade were reduced. The trend of the Chinese currency is harder to predict, but there are grounds for thinking that the revaluation of the yuan will be more gradual than that of the yen (see figure I.10 and box I.2). The decision by the Chinese authorities in mid–May to widen the daily trading band of the yuan from 0.3% to 0.5% was a step towards somewhat faster revaluation, allowing the currency to strengthen or weaken against the dollar.

The experience of recent years shows that emerging–market currencies are still quite vulnerable. One example of this is the increased volatility of the Thai baht following the temporary introduction of capital controls in December 2006 to prevent the currency rising further. This caused its value to fall sharply on the Thai stock market, leading the authorities to reverse the measure.

Figure I.10
NOMINAL EXCHANGE RATE: DOLLARS PER UNIT OF NATIONAL CURRENCY, 2000–2007



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

C. International trade

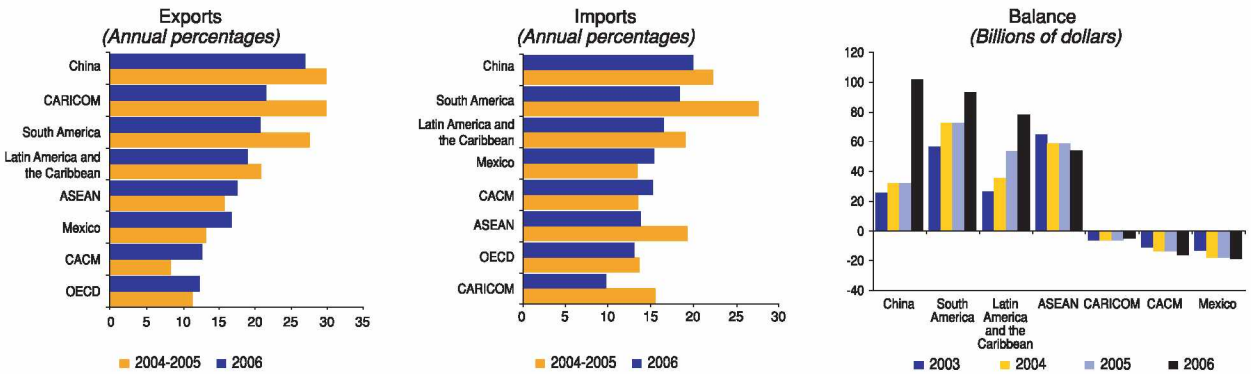
1. Latin America and the Caribbean from an international perspective

The nominal growth rate of merchandise exports in Latin America and the Caribbean dropped slightly to 20% in 2006, from an average of 22% in 2004 and 2005, which was mainly owing to in increase in export prices and only a small expansion in volume. This nominal rate was higher than the world average for 2006 (15%), but still lower than China's export growth of 27%. Within the region, CARICOM posted the

fastest growth rate. Imports slowed noticeably, especially in South America. The region's surplus continued to swell in 2006, although more slowly than China's did, while the trade deficit of the countries of the Organisation for Economic Co–operation and Development (OECD) continued to worsen (see figure I.11a).

In terms of volume, the region's exports expanded at a slower rate than the world average for 2006 (6% compared to 8%) (WTO, 2007), although more rapidly than those of the African and Middle Eastern countries. The region's export volumes also increased less in 2006 than they did in 2005. In 2006, China's exports expanded at real rates of over 20%, while those of the rest of the world (except for Africa and the Middle East) registered rates of between 7% and 11%. Within the region, Mexico and Central America recorded the highest rates, while South America saw a steep slowdown (see tables I.1 and I.2).

Figure I.11a
EXPORTS AND IMPORTS OF GOODS BY REGION, 2004–2006
(Annual growth rates and balances at current prices)



Source: World Trade Organization (WTO).

Table I.2
BREAKDOWN OF MERCHANDISE EXPORT GROWTH, 2005 AND 2006
(Growth rates in percentages)

	2005			2006		
	Price	Volume	Value	Price	Volume	Value
Latin America[a]	12.6	7.8	20.4	12.6	6.4	19.0
South America	16.9	8.9	25.8	18.3	3.3	21.6
MERCOSUR	10.1	10.8	20.9	11.1	5.3	16.3
Andean Community	28.1	6.9	35.0	22.9	-0.4	22.5
Chile	22.9	4.1	27.0	38.8	2.0	40.7
Central America	3.2	6.4	9.5	2.3	10.2	12.5
Mexico	9.0	4.9	14.0	6.8	10.0	16.8

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information.
[a] Argentina, Bolivarian Republic of Venezuela, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay.

Table I.3
BREAKDOWN OF MERCHANDISE IMPORT GROWTH, 2005 AND 2006
(Growth rates in percentages)

	2005			2006		
	Price	Volume	Value	Price	Volume	Value
Latin America[a]	9.2	15.9	25.1	6.6	17.2	23.8
South America	9.6	10.5	20.1	6.6	17.1	23.7
MERCOSUR	7.9	22.5	30.4	6.2	20.6	26.8
Andean Community	11.0	22.0	33.0	7.3	10.5	17.7
Chile	5.6	7.2	12.8	2.7	12.6	15.4
Central America	6.8	7.6	14.4	5.8	9.2	15.0
Mexico	5.4	7.3	12.7	2.3	13.2	15.5

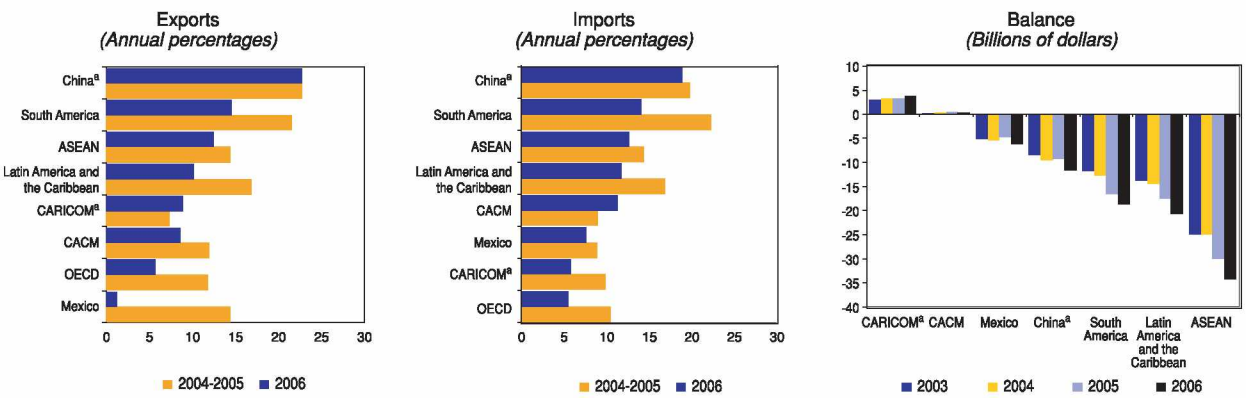
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information.
[a] Argentina, Bolivarian Republic of Venezuela, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay.

China was the fastest–growing exporter in services too, followed by South America (see chapter III for greater detail). The Latin American and Caribbean region's services exports slowed heavily in 2006, particularly Mexico's. The same occurred in the more developed OECD countries. Services trade balances posted the opposite sign to goods trade balances, especially in OECD (see figure I.11b).

In terms of main export destinations, a number of countries saw their exports to the United States slow in nominal terms, owing to the slacker rate of economic growth in that market. Among the subregions, Central American exports to the United States fell in 2006, with a negative figure of -1%. Chile was the only South American country to maintain a high rate of expansion (34.1%), which was mainly thanks to rising prices for copper, since the MERCOSUR and Andean countries saw momentum in their exports to the United States slacken, with rates equivalent to one half and one third, respectively, of those registered in 2005.

Unlike what happened in the United States, exports of merchandise to the European Union countries climbed strongly. Goods exports to the Asia and Pacific region showed a more mixed pattern, with a spectacular rise in the exports of the Andean Community, a more modest increase in those from the MERCOSUR countries and a slowdown in those from some Central American countries, especially Guatemala, Honduras and Nicaragua (see table I.3). Panama, Costa Rica and Mexico recorded the highest real growth rates in exports in 2006. The smallest expansions in real terms took place in the Bolivarian Republic of Venezuela, Peru and Haiti.

Figure I.11b
EXPORTS AND IMPORTS OF SERVICES BY REGION, 2004–2006
(Annual growth rates and balances)



Source: World Trade Organization (WTO).
[a] Data for 2006 taken from Economist Intelligence Unit.

Table I.4
LATIN AMERICA AND THE CARIBBEAN: NOMINAL GROWTH IN GOODS EXPORTS, 2005 AND 2006
(Annual rates of variation)

	Latin America and the Caribbean		United States		European Union		Asia and the Pacific	
	2005	2006	2005	2006	2005	2006	2005	2006
Latin America and the Caribbean (37 countries)	26.2	22.1	15.1	13.4	15.3	29.7	35.6	27.1
Andean Community (including Bolivarian Rep. of Venezuela)	28.6	20.2	36.0	12.7	23.3	48.7	29.6	70.0
Bolivia	34.3	38.4	22.8	1.0	5.9	50.6	36.6	93.5
Colombia	26.4	6.3	20.4	13.8	20.5	18.3	29.5	30.9
Ecuador	15.8	7.9	53.1	32.2	22.8	13.0	-43.3	138.4
Peru	48.5	33.7	46.0	4.6	-5.6	57.3	32.1	47.9
Venezuela (Bolivarian Rep. of)	27.7	24.9	36.9	10.8	64.2	75.7	49.0	124.1
MERCOSUR	24.9	20.6	11.3	5.5	8.7	15.6	42.4	12.3
Argentina	15.7	23.1	12.9	-5.0	9.4	20.3	20.4	13.9
Brazil	31.8	19.7	10.5	8.7	9.7	14.6	50.5	12.0
Paraguay	13.9	2.5	-10.1	22.6	-69.1	-51.7	6.5	-46.3
Uruguay	11.1	27.4	31.9	-31.6	9.2	4.7	17.0	32.7
Central American Common Market (CACM)	16.3	13.8	0.7	-1.3	20.0	12.2	15.1	11.5
Costa Rica	14.8	17.4	1.1	12.4	7.4	12.2	71.8	37.7
El Salvador	11.3	21.4	-4.9	-8.8	48.2	0.2	85.0	40.4
Guatemala	19.8	8.0	1.0	13.9	40.6	-24.2	160.7	-70.7
Honduras	18.5	2.7	-2.1	-25.9	46.3	44.9	64.2	-23.9
Nicaragua	16.1	24.0	22.9	10.3	14.2	-7.4	85.1	-58.3
Chile	21.4	40.4	33.7	34.1	16.6	59.3	33.1	24.6
Mexico	40.2	30.0	11.3	15.8	34.7	23.2	23.4	14.4

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

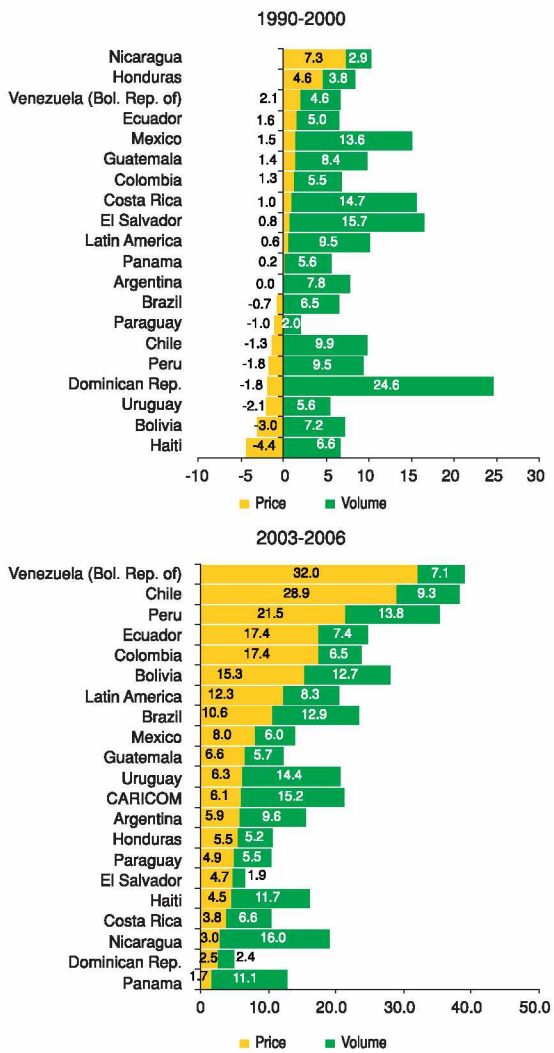
2. Commodity prices and terms of trade

Unlike what happened in the 1990s, the region's exceptional trade growth of the last few years has been driven more by good prices than by rising export volumes. During the four–year period 2003–2006, the unit value (prices) of the region's exports increased by 12.3% per year and their volume by 8.3% per year. In contrast, in the 1990s, export volumes climbed at a faster rate than prices, which rose by modest 0.6% per year (see figure I.12). After a heavy drop in 2001 and 2002, when export volumes dropped by 6.0% and prices by 1.3%, and thanks to the emergence of China and India as large buyers of commodities, the prices of certain types of merchandise began to rise steadily, especially those for copper, petroleum, tin and precious metals, as well as agricultural goods such as soybean, bananas, meat and fruit. Other products, such as sugar, cereals and grains have recently joined this positive price cycle in response both to developments in their own particular markets and to the demand exerted by biofuel projects.

After three and a half years of steep rises, commodity prices began to decrease slightly in the second half of 2006, though very unevenly across the different subgroups (see figure I.13). In the case of agricultural goods, price rises have become steadier and are fluctuating less, while the prices of mining and energy products show diverging trends. The prices of mining products remain high, but are decreasingly fractionally owing to a slight slackening in Chinese demand for certain commodities, especially steel, iron and copper. Overall demand from Asian continues to be high, however, which has impacted very positively

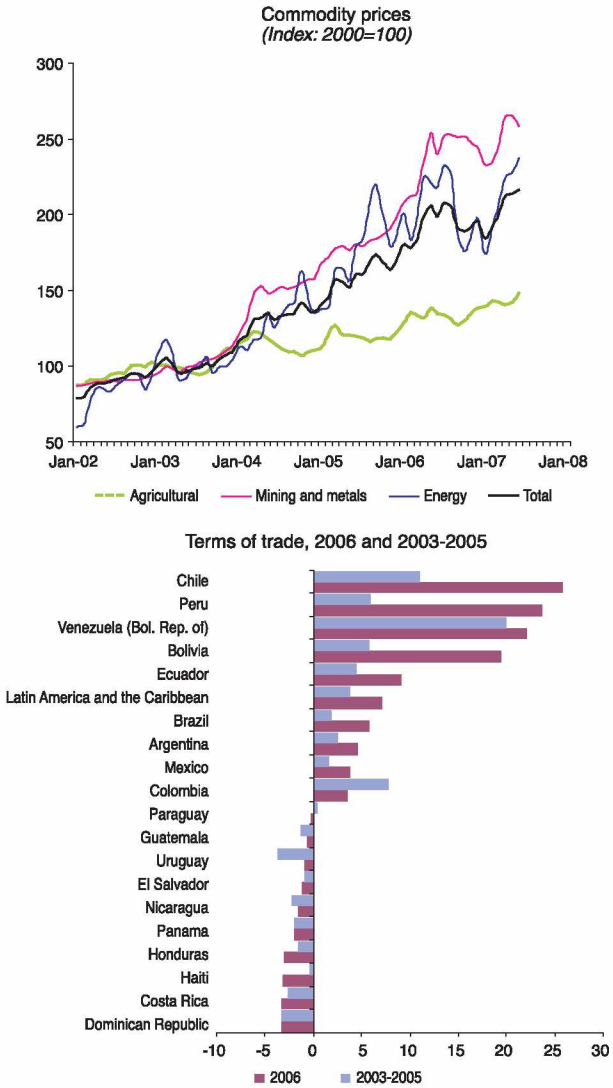
on several Latin American countries' terms of trade. After slowing in the second semester of 2006, petroleum prices began to rise again. Analysts say that this rise reflects underlying supply and demand factors rather than geopolitical considerations.

Figure I.12
LATIN AMERICA AND THE CARIBBEAN: COMPOSITION OF GROWTH IN MERCHANDISE EXPORTS, 1990–2000 AND 2003–2006
(Annual growth rates in percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from each country's balance of payments.

Figure I.13
COMMODITY PRICES AND VARIATION IN TERMS OF TRADE



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

With only a few exceptions, a slight drop in commodity prices would have a relatively limited impact on Latin American and Caribbean trade balances and economies. An exercise in which exports and imports are calculated using the terms of trade for the 1990s turns the region's current account surplus into a deficit equivalent to 2.7% of Latin America's GDP for 2005 and its trade surplus into a deficit equivalent to 0.7% that GDP figure. The number of

countries that would register a surplus would be similar to reality and deficits of the oil–importing countries of Central America and the Caribbean would become surpluses. Conversely, the natural–resource–exporting countries would return a deficit (Chile and, to a lesser extent, the Bolivarian Republic of Venezuela and Mexico). The MERCOSUR countries show little variation from the terms of trade for the 1990s (ECLAC, 2006). The region's economies are also much less vulnerable to external shocks now, thanks to more voluminous international reserves and lower levels of external borrowing.

3. Outlook

The region is likely to post a smaller surplus on the goods balance in 2007. Exports will slow slightly, owing partly to moderate price trends for a number of commodities and partly to slower growth in the exports of Mexican maquila industries. All in all, the region's exports could increase by around 12%, a rather lower rate than the 19.5% recorded in 2006. Merchandise imports could expand at a similar rate to 2006, however, which would have the effect of shrinking the surplus on the merchandise balance.

Table I.5
LATIN AMERICA AND THE CARIBBEAN: EXTERNAL TRADE IN GOODS AND SERVICES
(Real growth rates)

	2006		2007[a]	
	Exports	Imports	Exports	Imports
Argentina	7.4	15.2	8.3	18.0
Bolivia	9.6	4.2	8.6	10.0
Brazil	4.6	18.2	6.6	16.0
Chile	4.2	9.4	8.5	13.6
Colombia	7.8	21.3	6.0	18.0
Costa Rica	12.6	13.6	9.0	9.0
Ecuador	2.9	5.7	-1.5	6.1
El Salvador	7.0	9.3	5.0	8.0
Guatemala	2.5	2.3	2.7	3.5
Haiti	2.2	3.1	3.5	4.8
Honduras	4.8	13.5	4.6	9.4
Mexico	11.1	12.2	4.6	8.0
Nicaragua	10.5	6.1	8.9	8.0
Panama	12.0	15.0	10.0	12.0
Paraguay	10.0	17.0	9.5	16.1
Peru	1.0	12.4	3.8	13.7
Dominican Rep.	5.2	6.5	4.0	8.0
Uruguay	7.6	16.0	6.0	10.3
Venezuela (Bol. Rep. of)	-4.2	31.4	-2.6	21.0
Latin America	**7.5**	**14.6**	**5.4**	**12.1**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Economic Projections Centre of the Statistics and Economic Projections Division.
[a] Preliminary estimates.

Generally speaking, the outlook continues to be encouraging for Latin America and the Caribbean and for the world at large. Thus far, the boom cycle is continuing, with all the regions —including Africa— experiencing robust economic growth and, particularly, strong expansion in trade. Risks are moderate and unlikely to materialize in the short term. Commodity prices remain high. Most of the developing countries are running current account surpluses and have built up large reserves, which has made them less vulnerable to external shocks. However, the window of opportunity to address major challenges and lengthen the period of prosperity is closing. These challenges include the need to engage in coordination efforts in order to narrow the great external disequilibria and to reach some kind of accommodation in the multilateral negotiations taking place in the Doha round of trade talks. This subject is examined in greater detail below.

D. The Doha round in trouble

In February 2007 trade negotiations were resumed in the framework of the Doha Round, under the auspices of the World Trade Organization (WTO), some time after the Director–General of WTO recommended they be suspended (July 2006) to allow some serious reflection by the members. But although the main world leaders have repeatedly restated their commitment to achieving positive results before the end of 2007, the negotiations are no further forward.

The chairs of the Negotiating Groups are preparing fresh proposals in the respective areas in an effort to carry the process forward, but agreement has yet to be reached on modalities for negotiation, which are the basic parameters by which new liberalization commitments on agriculture and industrial goods are to be agreed. On 17 July, the Chairs of the Committee on Agriculture and the Negotiating Group on Market Access (NGMA) circulated among the WTO members revised blueprints on the main points under discussion (see table I.5 and box I.3).[10]

1. The balance on agriculture

On 30 April 2007, the Chairperson of the Committee on Agriculture circulated a document containing suggestions about where the members' views might converge towards a consensus on the three pillars of negotiation: (i) domestic support; (ii) export competition; and (iii) market access.[11] The impasse on domestic support had originally occurred because the reduction in support measures proposed by the United States would have enabled the country to maintain a higher level of domestic support than it currently has. This would run counter to an unwritten rule in the multilateral negotiations, under which liberalization

[10] The proposals are contained in http://www.wto.org/english/news_e/news07_e/ag_draft_modalities_july07_e.htm.

[11] See Communication from the Chairman of the Committee on Agriculture, special session [online] http://www.agtradepolicy.org/output/resource/agchairtxt_30apr07_e.pdf.

commitments must reflect the countries' current situation and "lock in" gains already made. The Chairperson of the Agriculture Committee recognizes in his paper that any new commitment on agriculture must bring the United States' multilateral commitment nearer to its existing policy on domestic support. This is in addition to the commitment to cut de minimis domestic support by at least half, while taking into account blue box agreements and the aggregate measure of support (AMS).

For the overall bound level of support, which includes all programmes of production subsidies (amber box, blue box and de minimis combined), the Chairperson argued that the additional effort needed on the part of the United States, Japan and the European Union consisted of agreeing to larger cuts in total domestic support than had hitherto been proposed.[12] One unresolved issue —specific to the United States— is the type of product–specific cap that would be feasible. The negotiations on this point have yet to proceed beyond working hypotheses. Disagreement hinges on the base period for such caps, since the United States prefers 1999–2001, which would allow higher levels of support than the proposal corresponding to 1995–2000, as the rest of the countries have considered. The Chairperson's document ultimately proposed the second of these two periods.

The Chairperson's proposal of 17 July could mean a final bound level of somewhere between US$ 13 billion and US$ 16.4 billion for the United States, which would represent a larger reduction than both the level of US$ 22 billion offered by the country in October 2005 and its latest proposal of US$ 17 billion made at the Potsdam meeting of 21 June. In the case of the European Union, the 17 July proposal would mean a cut in bound levels from € 100.3 billion to € 16.5 billion and € 27.6 billion.

With regard to subsidies covered by the amber box commitments, the Chairperson's proposal would imply a cut from US$ 19 billion to US$ 7.6 billion for the United States. In the case of the European Union, the reduction could be as much as from € 67 billion to € 20 billion.[13]

It appears to be agreed in principle that blue box programmes —which are less trade–distorting as they are not linked to levels of production or prices— should not exceed 5% of the value of production and should be reduced to 2.5% by the end of the implementation period of the Doha Development Agenda outcomes. The members are now analysing whether it is necessary to establish additional rules for achieving this and, if so, what kind. The Chairperson's document appears to favour simple disciplines and the setting of operational caps for specific products (see table I.5).

With a view to this, consideration is being given to a combination of disciplines covering domestic support (amber box) and blue box programmes, in order to control reallocations from one box to another.

To all this must be added specific and more ambitious commitments on cotton, which is a crucial sector for a number of least developed countries (LDCs). In this respect, the Chairperson has noted that, whatever general formula is agreed for domestic support and blue box programmes should include broader commitments on cotton. The United States' initial responses to such proposals have been negative, however.[14]

The Chairperson's analysis gives an assessment of the different components of export competition and, in particular, the aspiration to maintain the target date of 2013 for the elimination of export subsidies and the commitment to make substantial progress by the mid–point towards that date (see table I.5).

With respect to food aid, the Chairperson noted that: "There should be some general provisions which would apply to all food aid in all circumstances. It should be: needs driven; untied from commercial exports of goods or services; and should not be linked to market development objectives of the donor Member". He concludes that: "the only general position that will now run is that food aid is to be in fully grant form". A key aspect of the Chairperson's proposal is that WTO should not be involved in the technical aspects of defining a food emergency and food aid needs, but should leave this responsibility to agencies with recognized experience, such as the United Nations, the International Committee of the Red Cross or other humanitarian organizations. The proposal of 17 July suggests some disciplines in this respect.

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[12] Some experts note that the United States has shown a willingness to step up its commitments to reduce total domestic support from the current amount of US$ 22 billion to somewhere between US$ 15 billion and US$ 17 billion, subject to significant improvements in market access on the parts of Brazil and India and a 54% reduction in tariff barriers by the European Union. Some issues are also pending in relation to sensitive and special products (Josling (2007) and *Inside U.S. Trade* (2007a)).

[13] See *Inside U.S. Trade*, vol. 25, No. 29, July 20, 2007.

[14] Ibid.

Table I.6
PRINCIPAL PROPOSALS ON THE THREE PILLARS OF AGRICULTURE

	European Union				United States				G–20				Falconer proposal			
	Developed countries		Developing countries		Developed countries		Developing countries		Developed countries		Developing countries		Developed countries		Developing countries	
	Bands	Cuts	Bands	Cuts	Bands	Cuts	Bands	Cuts	Bands	Cuts	Bands	Cuts	Bands	Cuts	Bands	Cuts
Market access	0%–30%	30%	0%–30%	25%	0%–20%	55%–65%	0%–20%	Lower	0%–20%	45%	0%–30%	25%	0%–20%	48%–52%	0%–30%	32%–34,7%
	31%–60%	45%	31%–80%	30%	21%–40%	65%–75%	21%–40%	Lower	21%–50%	55%	31%–80%	30%	21%–50%	55%–60%	31%–80%	36,7%–40%
	61%–90%	50%	81%–130%	35%	41%–60%	75%–85%	41%–60%	Lower	51%–75%	65%	81%–130%	35%	51%–75%	62%–65%	81%–130%	41,3%–43,3%
	>90%	60%	>130%	40%	>60%	85%–90%	>60%	Lower	>75%	75%	>130%	40%	>75%	66%–73%	>130%	44%–48,7%
	Average reduction: 39%		36%		Average reduction: 66%				Average reduction:54%		36%		Average reduction: 36%		-40%	
Other access issues	Sensitive products: 8% of tariff lines. These will be subject to a maximum tariff cut of 33.3% and the quotas will be increased on the basis of their current size, adjusted for the volume of imports and domestic consumption. Special products: no position has been adopted. Special safeguards for developing countries: no proposal has been put forward. Tariff caps: 100% for developed countries – 150% for developing countries.				Sensitive products: 1% of tariff lines. Quotas with respect to domestic consumption must be substantially expanded. Special products: five tariff lines and tariff cuts below the general cut. Special safeguards: only for some tariff lines, other than sensitive and special products, transitional measures, other restrictions. Tariff caps: 75% for developed countries – 100% for developing countries.				Sensitive products: for developed countries, 1% of tariff lines; for the developing countries, 50% of additional lines compared with the number attributed to the developed country with the most lines. Tariff reductions of 70% and the quotas must be expanded on the basis of domestic consumption. Special products: no position has been set out. Tariff caps: 100% for developed countries – 150% for developing countries.				Provisions for special reductions for small, vulnerable economies. Sensitive products: 4%–6% of tariff lines for developed countries and 1/3 additional lines for developing countries. Tariff reduction for the developed countries of 1/3 to 2/3 the general formula and 2/3 for the developing countries. Quotas for developed countries should represent further access for 3% to 5% and 4% to 6% of domestic consumption, depending on the cuts. For the developing countries, the quota should be 2/3 of the access of the developed countries. Different variants of this rule were proposed. Special products and special safeguard mechanisms: no proposals were put forward, but criteria were proposed. Tariff caps: according to the text, up to 5% of the tariff lines would have a tariff of over 100%, following application of the formula. If 5% is exceeded, then the member in question will have to increase the tariff quotas by a higher percentage.			
Export competition	Elimination of subsidies in 2013: a problem related to the dismantling procedure.				Elimination of subsidies in 2013: no proposal was made.				Elimination of subsidies in 2013: a thorough–going initial dismantling is proposed.				Elimination of subsidies in 2013: a 50% cut in the value for 2010. Disciplines are added in terms of loans for export, marketing companies and food aid.			

Table I.6 (concluded)

	European Union	United States		G–20		Falconer proposal	
Total domestic support (in billions of United States dollars)	The proposal is for three bands with cuts of 70% for the highest level of subsidies, and 60% and 50% for the intermediate and lower level, respectively.	Band 0%–10% 10%–60% >60%	Cut 31% 53% 75%	Band 0%–10% 10%–60% >60%	Cut 70% 75% 80%	Band ≤ 10% 10 ≤ total domestic support ≤ 60 ≥ 60%	Cut 50%–60% 66%–73% 75%–85%
Amber box (in billions of United States dollars)	Three bands are proposed with cuts of 70% for the highest level of subsidies and 60% and 50% for the intermediate and lowest level, respectively	Band 0%–12% 12%–25% >25%	Cut 37% 60% 83%	Band 0%–15% 15%–25% >25%	Cut 60% 70% 80%	Band ≤ 15% 15 ≤ Amber box ≤40% ≥ 40%	Cut 45% 60% 70%
Blue box	Ceiling of 2.5% of the value of agricultural production on the basis of the 5% agreed. Disciplines for countercyclical payments.	Ceiling of 2,5% of the value of agricultural production on the basis of the 5% agreed. With few disciplines, so as to avoid concentration.		Ceiling of 2.5% of the value of agricultural production on the basis of the 5% agreed. Cut back further the 2.5% and better disciplines.		Additional disciplines are established with respect to the programmes. A ceiling equivalent to 2.5% of the average value of agricultural production for the base period is set. Ceilings are set for individual products.	
Green box	There are no changes in criteria or ceilings.	Changes are not favoured.		It is proposed that the criteria be reviewed and clarified.		The relevant annex was modified and further programmes and clarifications on the existing disciplines were added.	

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of proposals presented by the members of the World Trade Organization and "Draft modalities for agriculture" (JOB(07)/128), document of the Chairman of the Committee on Agriculture, 17 July 2007.

Box I.3
TARIFF REDUCTION PROPOSED BY NEGOTIATING GROUP ON NON–AGRICULTURAL MARKET ACCESS (NAMA)

Members	Formula	Elements
		Product coverage shall be comprehensive without a priori exclusions.
		Tariff reductions or elimination shall commence from the bound rates after full implementation of current concessions; however, for unbound tariff lines, a constant non–linear mark–up of 20 percentage points to the most–favoured nation (MFN) rate applied in the base year will be adopted to establish base rates for commencing tariff reductions.
		The base year for MFN applied tariff rates shall be 2001 (applicable rates on 14 November).
Developed countries	$t_1 = \frac{a \times t_0}{a + t_0}$;	All non–ad valorem duties shall be converted to ad valorem equivalents (TN/MA/20) and bound in ad valorem terms.
		The reference period for import data shall be 1999–2001.
	a= 8 - 9	The tariff reductions for developed members shall be implemented in five equal rate reductions and for developing members in nine equal rate reductions. The first reduction shall be implemented on 1 January of the year following the entry into force of the Doha Development Agenda results and each successive reduction shall be made effective on 1 January of each of the following years.
		Main flexibilities
		Developing members may apply less than formula cuts for up to 10% of non–agricultural national tariff lines provided that the cuts are no less than half the formula cuts and that these tariff lines do not exceed 10% of the total value of a member's non–agricultural imports; or
		They may keep, as an exception, tariff lines unbound, or not apply formula cuts for up to 5% of non–agricultural national tariff lines provided they do not exceed 5% of the total value of a member's non–agricultural imports.
Developing countries	$t_1 = \frac{b \times t_0}{b + t_0}$;	Developing members with a binding coverage of non–agricultural tariff lines of less than 35% will be exempt from making tariff reductions through the formula. Instead, they shall bind 90% of non–agricultural tariff lines at an average level that does not exceed 28.5%.
	b= 19-23	Members having a share of less than 0.1% of world NAMA trade for the reference period of 1999 to 2001 or best available data may apply the following modality of tariff reduction: Members with a bound tariff average of non–agricultural tariff lines (i) at or above 50% shall bind all their non–agricultural tariff lines at an average level that does not exceed an overall average of 22%; (ii) at or above 30% but below 50% shall bind all their non–agricultural tariff lines at an average level that does not exceed an overall average of 18%; and (iii) below 30% shall bind all their non–agricultural tariff lines at an average level that does not exceed an overall average of 14%. In addition, 95% of all non–agricultural tariff lines shall be subject to a minimum cut of 10%.
	Where developing members subject to the formula do not use the flexibility provided, they shall apply a coefficient of b + 3 in the formula.	Least developed countries shall be exempt from participating in the formula for tariff reduction and the sectoral approach. However, as part of their contribution to the Doha Development Agenda, those countries are expected to substantially increase their level of tariff binding commitments.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Communication from the Chairman of the Committee on Agriculture, 30 April 2007 [online] http://www.wto.org/english/tratop_e/markacc_e/namachairtxt_17july07_e.doc.
Nota: t_1= final bound rate of duty; t_0= base rate of duty; a = [8–9] = coefficient for developed members; b = [19–23] = coefficient for developing members.

The mandate for the negotiations on export credits is to ensure the elimination, by end–2013, of export credits, export credit guarantees and insurance programmes with repayment periods of more than 180 days and those not in accordance with disciplines agreed upon. In the 17 July proposal, the disciplines are meant to cover payment of interest, minimum interest rates, minimum premium requirements, and other elements which can constitute subsidies or otherwise distort trade. In addition such programmes should be self–financing, reflecting market consistency; and, "the period should be of a sufficiently short

duration so as not to effectively circumvent real commercially–oriented discipline".[15]

Market access is crucial to progress in three areas. The United States has openly stated that its offers in terms of domestic support are subject to an improvement in its products' access to European Union markets and even developing country markets. This has been a policy objective in its bilateral negotiations with Latin American and Caribbean countries as well. The Chairperson of the Committee on Agriculture bases the analysis in his proposal on the hypothesis that there are four bands of tariff cuts for developed countries and that the thresholds for those bands are those contained in the proposal of the Group of Twenty (G–20) developing countries, led by Brazil. The Chairperson is of the view that the negotiations deliver an overall cut above 50% in developed country tariffs and of two thirds of that figure for developing countries.

Sensitive products are subject to smaller tariff cuts than those contained in the general rules. The Chairperson proposed that the number of tariff lines covering such products be somewhere between 4% and 6% of all agricultural tariff lines in the case of developed countries and a third more in the case of developing countries. In addition, the developed countries will be able to lower bound tariffs by between a third and two thirds of the reduction that would otherwise be required under the tiered formula. Developing countries will be able to lower bound tariffs on sensitive products by no less than two thirds of the reduction that would otherwise have operated under the tired formula.

In the Chairperson's view, there could be a trade–off between the depth of the tariff cuts on sensitive products and access commitments in the form of tariff quotas. The proposal was that, in the case of developed countries, tariff quotas must represent new access opportunities equivalent to not less than 4% or 6% —to be determined— of domestic consumption expressed in physical units for the full two–thirds deviation. For the "minimum one–third deviation", new access opportunities would have to equal not less than 3% or 5%, to be determined. In the case of developing countries, quotas would have to equal two thirds of whatever is agreed for developed nations.

It has yet to be determined how many products developing countries may include in the category of special products; the Chairperson estimated between 5% and 8% of tariff lines. It is also necessary to agree upon the criteria for the designation of special products and their treatment. The Chairperson reasons that such products should also be subject to tariff cuts, but minimum reductions of 10% to 20% of the general cuts.[16] The 17 July proposal does not include this element although it discusses product selection criteria.

No proposals were advanced on special safeguards for agricultural products, the final item in the negotiations.

The Chairperson's analysis of 30 April was met by a reception that reflected the difficulties involved in the negotiations (*Bridges*, 2007). Among other things, the proposal to reduce the number of sensitive products to between 1% and 5% of tariff lines would pose considerable problems for Japan[17] and for the net–agricultural–importing developing countries of the G–10.[18] Private circles in the United States qualified the analysis as "unbalanced", on the basis that it omitted to mention that the domestic support modifications would in practice broaden market access in the United States. The European Union and Japan are keen for the United States to bind domestic support (amber box) measures at US$ 15 billion, which would be equivalent to a total reduction in subsidies from close to US$ 22 billion today to around US$ 17.6 billion. This has apparently been cited as a possibility, provided that market access is expanded.[19]

The G–20 argued that the document presented by the Chairperson on 30 April lacked balance, because it failed to take on board the concerns of developing countries.[20] For a balance to be struck, the Group said, effective cuts were needed in domestic support, along with disciplines to limit transfers between programmes or products. Balance in market access would have to be reflected in a combination of shallower cuts and greater flexibility for developing countries. The G–33

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15 Communication from the Chairman of the Committee on Agriculture, op. cit.

16 See April document: http://www.agtradepolicy.org/output/resource/agchairtxt_30apr07_e.pdf.

17 Japan would have 140 lines in the category of sensitive products, including rice, wheat, sugar and dairy products. The proposed 5% would reduce this number to 66 lines (*Bridges*, 2007).

18 *See Inside U.S. Trade* (2007b).

19 Some estimates place the United States' total spending on domestic support at about US$ 19 billion or less (*Inside U.S. Trade*, 2007a).

20 See declaration by the G–20 [online] http://www.tradeobservatory.org/.

also alleged an imbalance in the Chairperson's analysis. The 17 July document did refrain from addressing a number of issues that are important for developing countries, such as special safeguards, special products, the liberalization of tropical goods and preference erosion. As well, the Chairperson of the Negotiating Group on Non–Agricultural Market Access tabled proposals on the liberalization of non–agricultural products that would have a further impact on a number of developing countries (see box I.2). At meetings held in the last week of July in Geneva, the developing countries' criticisms centred on this document, which they argued was much more ambitious than the proposal on agriculture.

The Director–General of WTO, Pascal Lamy, proposed that the negotiations be resumed on 3 September 2007. The talks must now proceed under two additional conditions. First, the absence of the Trade Promotion Authority and, second, the presidential elections due to be held in the United States in 2008.

2. The scope of Doha

The substantive contents of the Doha Work Programme revolve around three main areas of negotiation: (i) trade in goods and services; (ii) development; and (iii) strengthening the multilateral trade system.

The first of these categories constitutes the core, "traditional", activity of WTO as a forum for trade negotiation. The current negotiations cover trade in services and industrial and agricultural goods, including issues relating to tariff and policy constraints that distort trade, basically domestic support and export subsidies.

The negotiations are also aimed at achieving a reduction in the significant barriers still present in world trade in non–agricultural industrial goods, especially as regards textiles, clothing and footwear. The constraints on South–South trade are a particularly relevant issue. The Latin American and Caribbean region's intraregional trade faces fewer restrictions than its trade with other regions, especially Asia and Africa.

The second focus of attention in the Doha talks today is development and, in particular, its link with trade. There are a vast number of matters of interest, which may be grouped into three subcategories: (i) implementation–related issues; (ii) special and differential treatment; and (iii) the specific problems faced by least developed countries (LDCs).

The first of these is about the problems that some developing countries have in dealing with institutional requirements, carrying out legal reforms and taking advantage of the opportunities offered by their participation in WTO. The second refers to the way the obligations contained in the agreements and the commitments undertaken by the developed countries respond to the special needs of developing countries and the particular traits that prevent those countries from engaging fully in the system. Lastly, the third aspect refers to the particular problems and needs of LDCs (those with a per capita income of less than US$ 1,000).[21]

Much work has gone into implementation–related issues, especially in the form of technical assistance aimed at improving knowledge of the agreements and institution–building activities. When the negotiations of the Doha Round began, the WTO members created the Doha Development Agenda Global Trust Fund, which has received contributions estimated at US$ 9 million. As regards special and differential treatment, worked has focused on analysing the extent to which provisions on such treatment in the WTO agreements really meet the purpose, seeking to strengthen them and make them more precise and effective. With regard to LDCs, the work is aimed at improving the integration of such countries into the multilateral trade system by broadening market access, providing support for diversification of production and exports and devising technical assistance for institutional capacity–building.

Lastly, a number of issues relating to the World Trade Organization's other traditional core activity, strengthening of the multilateral trade system, also remain to be considered. International institutions and those within individual countries must adapt to stay

[21] For greater detail, see ECLAC (2006).

relevant and fulfil the purpose for which they were created, and to adequately represent the new situations of their members. In this regard, the Organization must engage continuously in three tasks: (i) reviewing provisions in order to improve them; (ii) updating the substantive contents of the agreements, incorporating other dimensions that impact on trade or are related to it; and (iii) reducing the erosion of its relevance caused by the proliferation of regional trade agreements.

In the current negotiations, the first of these tasks has been addressed by means of a review of antidumping measures. It has been particularly important to develop provisions that are better suited to the regulation of fishing subsidies. Studies show that such subsidies represented as much as US$ 30 billion to US$ 34 billion in 2006, of which US$ 20 billion was heavily implicated in the over–exploitation of marine resources (Bridges, 2007). The review of dispute settlement procedures might also be considered under this category, although it does not form part of the final package of negotiations.

With respect to the second point, negotiations on trade facilitation are of particular interest because of the savings they could generate in commercial transactions (McLinden, 2006).

Regarding the third aspect, in the last few years a significant and growing number of regional agreements have been signed. Until recently, the multilateral trade system and regional agreements were considered to be mutually beneficial, since the multilateral system tended to build in part of the liberalization that had been negotiated in such agreements. This link appears to have weakened in recent years, however. It is necessary to ensure, therefore that provisions contained in regional agreements and obligations contracted in the framework of WTO are consistent. On 14 December 2006, the General Council of WTO provisionally adopted a new Transparency Mechanism for Regional Trade Agreements (TN/RL/18, 13 July 2006). Taking an approach similar to the trade policy reviews that WTO conducts today, the Committee on Regional Trade Agreements will examine agreements falling under Article XXIV of the General Agreement on Tariffs and Trade (GATT) of 1994 and Article V of the General Agreement on Trade in Services (GATS). The Committee on Trade and Development will review regional agreements falling under the Enabling Clause for developing countries.

3. Looking to the future

The Uruguay Round strengthened in the multilateral system from the institutional and legal point of view and helped to reinstate the agricultural liberalization process that had been suspended since the end of the Second World War. The current talks in the framework of the Doha Round may represent valuable progress in the liberalization of world trade as well as large strides for developing countries. Latin America and the Caribbean is no exception. The econometric models agree that the main benefits would come from the liberalization of agricultural trade, even if those benefits would be unevenly distributed, with South America standing to gain the most. Exception mechanisms will be needed to allow for the developing countries' shortfalls in production capacity, in order to fairly balance costs and benefits. This needs to be based on objective criteria, in the framework of proportional policies that do not undermine trade, especially the fastest growing trade of recent years: South–South trade.

It is essential to bear in mind that, although trade in agricultural products represents a considerable proportion of Latin America's exports, exports of manufactures are also significant and notable barriers to trade in these remain, especially in South–South trade.

The Doha negotiations of 2007 will also be conditioned by a new factor: the authorization of the Government of the United States to negotiate trade agreements expired on 1 July 2007 and the country's Congress, with its changed composition, has a packed trade agenda to address.[22]

[22] Evenett and Meier (2006) provide an analysis of this point.

E. The new trade policy of the United States

The trade agenda of the United States in 2007 is marked by the Doha Round negotiations, negotiations under way with Malaysia and Thailand, possible Congressional consideration of legislation applicable to Colombia, Panama, Peru and the Republic of Korea, and the possible renewal of the Trade Promotion Authority, previously known as the fast–track negotiation mechanism, which expired on 1 July 2007.

1. Renewal of the Trade Promotion Authority

The outcomes of these processes will depend to a great extent on how the relationship between Congress and the Executive branch develops, especially in light of the growing concerns about globalization and, in particular, the ways in which trade policy is updated. The purpose is to calm the debate which hinges on the question of whether global economic integration and the rules on international trade will favour the majority or the minority.

Growing economic inequality has contributed to ever–greater insecurity in that area and to pressure to change the related policies. In the case of trade policy, the increasing inequity of the past 30 years and the prolonged stagnation of average wages have awakened concern as to the various effects of world trade on the well–being of workers in the United States. Certain empirical studies have shown that trade has led to falling demand for labour in various sectors which employ large numbers of relatively unskilled workers. Apparently, subcontracting has tended to lower the wages of local unskilled workers in comparison with the rest of the work force. This has worsened fears that the labour force may become polarized, leading to demands for better sharing of the benefits of globalization (Bernanke, 2007). The debate is inconclusive, since recent studies have noted that subcontracting has had only a marginal effect on the labour markets of the United States and of the other industrialized economies (Funk Kirkegaard, 2007).

The platform of the Democratic Party includes a new trade policy for the United States, aimed at raising standards of living and creating new markets for the country's goods.[23] This would require trading partners who enter into agreements with the United States to commit themselves to adopt, maintain and enforce basic international labour standards, not merely to enforce their own laws. Those countries will also be required to promote sustainable development, combat global warming and promote a fair balance between promoting access to medicines and protecting pharmaceutical innovation.

The new policy aims to protect and increase opportunities for the country's workers, farmers and businesses through the implementation of trade agreements and to expand the role of Congress. As for workers' protection, a "strategic workers' assistance and training initiative" has been proposed. Lastly, the policy proposes to expand the diplomacy of the United States and strengthen national security through an expanded programme of trade and aid.

The treatment of labour standards is essential in enabling the executive power and the Congress to agree on and, as a result, move forward with the development of the trade agenda for 2007, especially in relation to the Trade Promotion Authority. Achieving agreement in this area will depend to a great extent on the way in which labour laws are incorporated into trade agreements and on the extent to

[23] See the document produced by the staff of the Ways and Means Committee of the House of Representatives: [online] http://waysandmeans.house.gov/media/pdf/NewTradePolicy.pdf.

which they are binding, so that there is no conflict with United States law.

In May, the Speaker of the House of Representatives, Nancy Pelosi, and the Chairman of the Ways and Means Committee, Charles Rangel, announced that they had reached a conceptual agreement with Susan Schwab, the United States Trade Representative, as to how the above goals should be achieved. The agreement, applicable to trade accords whose approval by Congress is pending, requires signatory countries to incorporate into their legislation and practices the provisions of the 1998 ILO Declaration on the Fundamental Principles and Rights at Work.[24]

Paragraph 2 of the Declaration states that "all Members, even if they have not ratified the Conventions in question, have an obligation arising from the very fact of membership in the Organization to respect, to promote and to realize, in good faith and in accordance with the Constitution, the principles concerning the fundamental rights which are the subject of those Conventions, namely:

(a) freedom of association and the effective recognition of the right to collective bargaining;

(b) the elimination of all forms of forced or compulsory labour;

(c) the effective abolition of child labour; and

(d) the elimination of discrimination in respect of employment and occupation."[25]

Under the conceptual agreement, parties must agree to the principles set out, although there is no indication of the role of ILO jurisprudence in case of any dispute on their interpretation. Only governments will be able to raise complaints for non–compliance, and only federal laws, not state laws, may be the object of disputes; these must relate to issues concerning trade or investment (*Inside U.S. Trade*, 2007a).

In the environmental field, parties are obliged to subscribe to seven agreements.[26] These are thought to be compatible with the provisions of free–trade agreements or with the commitment to implement the multilateral agreements to which each country is a party (*Inside U.S. Trade*, 2007a). Labour and environmental standards will be subject to the dispute settlement mechanism just as the other provisions of the free–trade agreements.

The consensus between the administration and the Democratic leaders in the House of Representatives also deals with issues related to access to medicine in developing countries and the protection of test data, but it does not mention the way in which these provisions would be included in free trade agreements.[27] Above all, steps would be taken to ensure that protection of test data did not impede the adoption of health policies, and the requirement to certify that no patent is in force before permission to market a generic medicine can be granted would be abolished. Lastly, consideration is being given to ending the possibility of extending the duration of a patent because of delays in the approval process, and that process is being strengthened and streamlined.

Consideration is also being given to making government procurement contracts conditional on compliance with the five main labour standards mentioned above. In the area of investment, the principle contained in the current Trade Promotion Authority, whereby foreign investors are not to be granted rights superior to those provided for in United States law, is reiterated. Lastly, as explained in the document on a new trade policy, it has been agreed that a workers' assistance and training programme will be developed.

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[24] See the text of the Declaration at http://www.ilo.org/dyn/declaris/DECLARATIONWEB.static_jump?var_language=EN&var_pagename=DECLARATIONTEXT.

[25] The Conventions referred to are those which the Declaration itself describes as having been recognized as fundamental both inside and outside the Organization.

[26] The seven agreements are the Convention on International Trade in Endangered Species of Wild Fauna and Flora; the Montreal Protocol on Substances that Deplete the Ozone Layer; the resolutions of the Inter–American Tropical Tuna Commission; the Convention on Wetlands of International Importance Especially as Waterfowl Habitat (Ramsar Convention); the International Convention for the Regulation of Whaling; and the Convention on the Conservation of Antarctic Marine Living Resources (www.tradeobservatory.org/headlines.cfm?refid=98593).

[27] Information on the content of the agreement can be found at www.tradeobservatory.org/headlines.cfm?refid=98593.

2. Food and Agriculture Act

In 2007, Congress is expected to adopt a new Food and Agriculture Act (the "2007 Farm Bill"), since most of the provisions of the Farm Security and Rural Investment Act of 2002 will expire during the current year.[28] As in the case of the previous legislation on agriculture, the main areas of disagreement will be commodity prices and the policy on income support, that is, the level of support to be provided by the United States Government to agricultural producers, and the methods used for that purpose. The limits on spending charged to federal funds, the distributive effect of agricultural aid, the influence of the Doha Round negotiations and procedures for the settlement of disputes with trade partners in the framework of WTO, as well as considerable political interest groups, will contribute to determining whether or not agricultural aid is to be radically modified.[29] It is therefore difficult to forecast the contents of the new legislation.[30]

The current legislation constituted a backward step in the country's agricultural reforms, begun in the 1980s and reflected in the position of the United States at the Uruguay Round and in the agricultural legislation of 1996 (Thompson, 2005). As a result, the new legislation will indicate the country's agricultural policy and set the limits on what can be achieved at the Doha talks.

The current situation differs in a number of ways from that which prevailed when the previous legislation was debated. First, the Doha negotiations involve further liberalization of agricultural trade, including the abolition or reduction of the distortions which affect it. Second, the persistent fiscal deficit of the United States has resulted in pressure in favour of spending cuts. The sharp price increases for certain agricultural commodities makes it hard to justify allocating additional resources to support programmes which mainly concern the production of wheat, rice, grains, cotton, soybean, milk products and sugar (Nair and others, 2007) and which include compensatory, direct and countercyclical payments (the latter introduced by the 2002 legislation), tariff barriers and, in the case of milk products and sugar, non–tariff barriers. Third, the composition of the United States Congress has changed in relation to 2001. Fourth, there is a perceived lack of equity in the distribution of the programme benefits, according to some authors (Josling, 2007) and biofuels are booming, changing the agenda of the agricultural sector.

Nonetheless, some experts believe that the legislation to be adopted in 2007 will be very similar to the current law in relation to support for commodities, perhaps with some adjustments resulting from the country's fiscal situation and the outcomes of WTO dispute settlement proceedings (Thompson, 2005 and Josling, 2007). This would restrict the United States negotiators' ability to make more concessions in the framework of Doha.

These factors —particularly the uncertainty as to the possible outcomes of Doha— are likely to lead to a trade policy based on bilateral agreements which leave aside difficult issues including agriculture. A consensus between the executive branch and the Democratic majority in Congress may give a new boost to this policy of bilateral agreements, which already includes 11 Latin American and Caribbean countries and has spread to Asia and the Middle East. That aspect is discussed in chapters IV and V of this document.

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[28] An analysis of the legislation can be found in the report of the Congressional Research Service [online] http://fpc.state.gov/documents/organization/78546.pdf. The proposal by the executive power, which serves as the basis for preparing the legislation, is available at www.usda.gov/farmbill.

[29] Dispute settlement proceedings in the framework of WTO include those relating to cotton, successfully brought by Brazil, and to wheat, initiated by Canada, as well as a possible dispute concerning rice (Josling, 2007). Thompson (2005) provides an analysis of the political significance of legislation in this sector.

[30] The agricultural legislation is extremely complex, including not only domestic support for certain crops, but also provisions relating to conservation, agricultural trade, programmes in the areas of nutrition, rural development, research, forests and energy. Although some aspects can mostly be debated separately, decisions adopted in one area may also influence the others (Thompson, 2005).

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Chapter II

Integration and dynamism in the Asia–Pacific region

Introduction

Until recently, Asian regional integration consisted of burgeoning intra–regional trade, based on the increasingly complementary production and trade components of the different countries' manufacturing sectors. Intra–industry trade (IIT) expanded significantly as the specific advantages of productive and marketing chains were exploited more effectively. This process of de facto (market–led) integration in Asia is new being supported by de jure (government–led) integration; and strong productive and trade relations are being complemented by free–trade agreements of various types that aim to consolidate those links. Nonetheless, the current wave of draft trade agreements, and the varied economic and political interests of countries both within and outside the Asia–Pacific region, have given rise to two phenomena: a proliferation of agreements (known as the "spaghetti bowl") and a chain or "domino" effect, which cause serious problems of convergence and coordination. The Asia–Pacific region has become not only "Factory Asia" for the rest of the world, but also a battleground of preferential trade agreements.

Asia's dynamism and its new ties with the Chinese economy have elicited separate strategic initiatives by the United States and the European Union to enhance their positioning in that part of the world (see chapter V). A restructuring of the East Asian economies around China could offer Latin America and the Caribbean new production and export outlets. Nonetheless, there is also growing concern at the presumption that the benefits of Asia's buoyancy may not be fully exploited by non–Asian countries, owing to the formation of an informal (de facto) trade bloc, supported by formal (de jure) integration in Asia. The latter entails an increasingly broad and complementary group in which development is disseminated in concentric circles, thanks to intra–regional foreign direct investment (FDI). In view of these trends, Latin American and

Caribbean countries need to strengthen their trade links to make their production more complementary with that of Asia, and establish trade and investment partnerships, in addition to trade agreements, which would provide new access to these markets and help them integrate into Asian production and export chains.

Ten years on from the Asian crisis of 1997, the East and South–East Asian regions have fully recovered and are greatly strengthening their already key position in the world economy.[1] This dynamism can be seen in terms of growth, international trade, FDI, technological innovation and financial resources to maintain international balances. Given the forecast high growth rates (ADB, 2007), the region is likely to remain the key source of the world boom over the next few years, and will provide an export market of major potential for Latin American and Caribbean countries, for both goods and services. This possibility has hardly been exploited thus far, except for a few commodity sectors (ECLAC, 2006). Paradoxically, at the present time Asian countries are showing unprecedented interest in forging strategic relations with Latin America and the Caribbean; but, for now, the interest and practical measures of approximation are all coming from the Asian rather than Latin American side.

A. Asia and the Pacific and Asia–Pacific economic cooperation (APEC) In the world economy

One of the most conspicuous features of Asia's emergence as a lynchpin of world economy has been China's dramatic entry on to the stage as a leading player, around which a large–scale restructuring economies and trade is unfolding. In fact in every year since 2001 the developing Asian countries, along with Japan and China, have contributed almost 50% of world GDP growth, in purchasing power parity (PPP) terms, surpassing the contribution of United States and European Union (ECLAC, 2006).

Developing Asian countries, especially China, have gained a considerably larger stake in the world economy over the last few years. In GDP terms, the economies of the 10 member countries of ASEAN, plus those of China, the Republic of Korea and Japan (the group known as ASEAN+3) represented 20% of world GDP in 2006 measured at current prices, and 31% in purchasing–power–parity (PPP) terms (see table II.1) The equivalent percentages for the broader grouping (ASEAN+6), which includes Australia, India and New Zealand, were 24% and 38%, respectively. Measured in PPP terms, the GDP of ASEAN+3 easily surpassed that of United States or the European Union (25 countries). For comparison, APEC, which consists of 21 countries of various sizes, accounted for about 60% of total world GDP measured by both indicators. The relative weight of ASEAN (10), alone, also according to both indicators, was very small at 2.3% and 4.9%. In view of this, ASEAN is attempting to establish strategic partnerships with various country groupings, and thus increase the possibility of becoming an Asian regional centre, alongside the other three hubs (China, Japan and the Republic of Korea) that are currently in the process of formation. It should be noted that in output terms, Latin America and the Caribbean outweighs ASEAN (10), although it is

[1] In this section, the term "East Asia" means China, Japan and the Republic of Korea, plus Hong Kong Special Administrative Region of China (SAR) and Taiwan province of China; South–East Asia consists of Brunei Darussalam, Philippines, Indonesia, Malaysia, Myanmar, Lao People's Democratic Republic, Singapore, Thailand and Viet Nam; South Asia refers to India, Pakistan and Sri Lanka; and Oceania consists of Australia and New Zealand.

similar in terms of population size and smaller in terms of export presence.

ASEAN+3 absorbed 23% and 19% of world exports and imports in 2005, respectively (see table II.1). The European Union (25 countries) accounted for nearly 40% of world exports and imports alike, whereas the United States' shares were smaller, at 9% and 16% respectively. APEC as a grouping represented about half of total world trade. In demographic terms, ASEAN+3 is the largest grouping, accounting for 32% of the world's population, while China and India between them represented 37%, followed by ASEAN (10), which has a total of 570 million inhabitants (9% of the world total).

The 21 APEC countries are large exporters and importers of commercial services. In 2005, they exported US$ 428 billion and imported US$ 918 billion, corresponding to 18% and 39% of the world total, respectively. Despite the heavy weight of the United States in the overall performance of the APEC grouping, the figures for exports and imports of services from ASEAN (10) countries amounted to US$ 104 billion and US$ 132 billion. These are sizeable amounts in comparison to their external merchandise trade (WTO, 2006) and they easily surpass the figures for both Mexico (US$ 16 billion and US$ 20.9 billion, respectively) and MERCOSUR (US$ 23 million and US$ 31 billion).

Table II.1
PARTICIPATION OF SELECTED ASIA–PACIFIC GROUPINGS IN THE WORLD ECONOMY
(Percentages)

Countries/groups	Area, 2006	Population, 2006	GDP, 2006 (Current prices)	GDP, 2006 (PPP)	Exports, 2005	Imports, 2005
Australia	5.7	0.3	1.7	1.1	1.0	1.1
Brunei Darussalam	0.0	0.0	0.0	0.0	0.1	0.0
Canada	7.4	0.5	2.9	1.9	3.6	3.0
Chile	0.6	0.3	0.3	0.3	00.4	00.3
China	7.1	20.3	5.8	17.2	7.5	6.3
United States	7.0	4.6	29.9	21.2	9.0	16.0
Russian Federation	12.7	2.2	2.2	2.8	2.4	0.9
Philippines	0.2	1.3	0.3	0.7	0.4	0.4
Hong Kong SAR	0.0	0.1	0.4	0.4	2.9	2.9
Indonesia	1.4	3.4	0.8	1.7	0.8	0.6
Japan	0.3	2.0	10.1	6.7	5.9	4.9
Malaysia	0.2	0.4	0.3	0.5	1.4	1.1
Mexico	1.5	1.6	1.8	1.9	2.1	2.1
New Zealand	0.2	0.1	0.2	0.2	0.2	0.2
Papua New Guinea	0.3	0.1	0.0	0.0	0.1	0.0
Peru	1.0	0.4	0.2	0.3	0.2	0.1
Republic of Korea	0.1	0.8	2.0	1.7	2.8	2.5
Singapore	0.0	0.1	0.3	0.2	2.3	1.9
Thailand	0.4	1.0	0.4	1.0	1.1	1.1
Taiwan province of China	0.0	0.4	0.8	1.1	1.9	1.7
Viet Nam	0.2	1.3	0.1	0.4	0.3	0.4
APEC	46.5	41.1	60.5	61.4	46.2	47.6
India	2.5	17.0	1.9	6.5	0.9	1.3
ASEAN (10)[a]	3.3	8.9	2.3	4.9	6.4	5.5
ASEAN+3	10.8	31.9	20.1	30.5	22.6	19.2
ASEAN+6	19.2	49.3	23.9	38.2	24.8	21.9
European Union (25)	**3.0**	**7.1**	**32.0**	**21.2**	**39.4**	**39.3**
Latin America and the Caribbean	**15.7**	**8.5**	**5.1**	**7.4**	**5.6**	**5.0**
World	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: World Bank, World Economic Indicators Database [online]; Asia–Pacific Economic Cooperation, Key Economic Indicators [online]; World Trade Organization (WTO); *Trade Profiles 2006*, Geneva, 2006.

[a] ASEAN (10) includes the following countries: Brunei Darussalam, Cambodia, Philippines, Indonesia, Malaysia, Myanmar, Lao People's Democratic Republic, Singapore, Thailand and Viet Nam. ASEAN+3 includes the 10 ASEAN countries plus China, Japan and the Republic of Korea. ASEAN+6 includes the 13 aforementioned countries plus Australia, India and New Zealand.

The Asian countries also play a major role as investors or recipients of FDI. The figures show that East and South–East Asia captured 16% of worldwide FDI flows in 2005, with China alone receiving US$ 79 billion, almost half of the total FDI inflows to Asia (JETRO, 2006a). This figure compares favourably with those of the United States, which captured 11.4% of the world total, and Latin America and the Caribbean which recorded 7%, in clear contrast to the European Union, which accounted for 51% of the global figure. As an investor, East Asia was responsible for 14% of world flows abroad, compared to 2% in the case of Latin America and the Caribbean.

The leading role being played by the Asian countries can be seen not only in the world output and trade, but also in the global financial sector. The region plays an increasingly key part in maintaining global economic balances because, with its abundant and cheap supply of goods, it helps to keep demand high but inflation low in developed countries; it provides low–cost credit to the United States, thereby helping to keep interest rates down; and it accumulates reserves by buying treasury bonds and thus helps to finance that country's current account deficit (Rosales and Kuwayama, 2007).[2] The United States remains the leading consumer, but the Asian region has become one of the world's major producers both of products and international financing.

Trade imbalances across the world continue to widen. The current account deficit in the United States reached a level of US$ 856 billion in late 2006, equivalent to 6.5% of GDP, and US$ 65.2 billion more than the 2005 figure. As much as 63% of the increase in the deficit reflects larger imports from China, and the deficit with that country widened from US$ 220.1 billion to US$ 261.7 billion. The counterpart of the huge current account deficit being maintained by the United States can bee seen in the growing surpluses recorded by emerging Asian countries, particular China; the oil exporting countries; and also Latin America and the Caribbean, which accounted for almost 14% of the United States deficit in 2005 (Rosales and Kuwayama, 2007).

As will be analysed in greater depth in chapter V despite the recent growth recovery particularly in South America, the Asia–Pacific region remains an underexploited export market. Latin American and Caribbean sales to that destination accounted for 9.0% of their total exports in 2005, compared to 11.4% in 1991; whereas its imports from Asia and Pacific were equivalent to 20.5% and 10.9%, respectively. Thus, the role of Asia Pacific as a trade partner for Latin America and the Caribbean is more important for the region's imports than its exports. As is the case with inter–regional trade, the Asian region is a relatively important source of investments for Latin America and the Caribbean (between 8% and 9%), but the phenomenon is not reciprocal.

In short, given its economic, trade and demographic size, and in view of the high growth rates forecast for the region, Asia could offer Latin American and Caribbean countries a market of great potential for their export products, and major possibilities for establishing trade and business partnerships of various types, in addition to opportunities for the signing of free–trade agreements.

[2] In December 2006 China was holding US$ 350 billion worth of United States Treasury bonds, more than half of the amount held by Japan (US$ 644 billion). China's reserves at that time exceeded US$ 1.06 billion, a figure way above that of Japan, which amounted to US$ 875 billion. China's reserves are equivalent to over 40% of its GDP.

B. High and rising level of Asian intra–regional trade

A key element in the structuring of Asia over the last decade relates to technological development and the possible fragmentation of the production chain, which triggered a sharp increase in Asian intra–regional trade. The intra–Asian trade coefficient for the countries of ASEAN+3 plus Hong Kong Special Administrative Region of China (SAR) and Taiwan province of China, has grown from 43% in the early 1990s to 56% in 2005 (see table II.2). This indicator surpasses the level of intra–regional trade attained by NAFTA, and is rapidly approaching that displayed by the European Union. Trade between members of ASEAN (10) has increased and surpasses the 18% attained by MERCOSUR in that year. In addition, indices of the intensity of intra–regional trade, which take into account the size of the markets of each grouping, show that intensity in Asia, exceeds the European indices and is similar to that of NAFTA (see table II.3). These indicators confirm the high degree of productive and hence trade complementarity that exists in Asia.

Table II.2
INTRA–REGIONAL TRADE, BY GEOGRAPHIC GROUPING[a]
(Percentages of the region's total trade)

Region	1980	1985	1990	1995	2000	2005
Within ASEAN (10)	17.9	20.3	18.8	24.0	24.7	28.1
Within ASEAN+3	30.2	30.2	29.4	37.6	37.3	39.2
Within ASEAN+3+Hong Kong SAR+ Taiwan province of China	34.1	37.1	43.1	51.9	52.1	55.6
European Union (25)	61.3	59.8	67.0	67.4	66.8	66.2
NAFTA	33.8	38.7	37.9	43.1	48.8	45.0

Source: World Trade Organization (WTO), *International Trade Statistics 2006*, Geneva 2006; Pradumna B. Rana, "Economic integration in East Asia: trends, prospects, and a possible roadmap", *ADB Working Paper Series on Regional Economic Integration*, No. 2, July 2006; and Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Asian Regional Integration Center [online] http://www.aric.adb.org/indicator.php.

[a] The share in intra–regional trade is defined as the percentage of intra–regional trade with respect to total trade of the region in question, based on export data. It is calculated as follows: $X_{ii} /\{(X_{iw} + X_{wi})/2\}$, where X_{ii} refers to exports from region 1 to the same region, X_{iw} represent exports from region i to the world, and X_{wi} represents world exports to region i. A higher percentage indicates a higher level of dependency on intra–regional trade.

Table II.3
INTENSITY INDEX OF INTRA–REGIONAL TRADE, 1990–2005, BY REGION[a]

Country/grouping	1990	1995	2000	2005
ASEAN (10)	4.4	3.7	4.0	5.0
ASEAN+3	1.9	2.0	2.0	2.0
East Asia (15)	2.2	2.1	2.2	2.3
Asia (47)	2.2	2.0	2.1	2.1
European Union (25)	1.5	1.7	1.8	1.7
NAFTA	2.1	2.4	2.2	2.6

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Asian Regional Integration Center [online] http://www.aric.adb.org/indicator.php; European Union; and Pradumna B. Rana, "Economic integration in East Asia: trends, prospects, and a possible roadmap", *ADB Working Paper Series on Regional Economic Integration*, No. 2, July 2006.

[a] The intensity index for intra–regional trade is the ratio of the share of intra–regional trade and the share of world trade in that region, based on export data. It is calculated as follows: $[X_{ii} /\{(X_{iw} + X_{wi})/2\}] / [\{(X_{iw} + X_{wi})/2\}/X_{ww}]$, where X_{ii} are exports from region i to the same region, X_{iw} are exports from region i to the world, and X_{wi} our world exports to region i. A higher coefficient indicates greater dependency on intra–regional trade.

This expansion of intra–Asian trade has been driven partly by the robust growth of intra–enterprise and intra–industry trade, thanks to the construction of a complex network of vertical supply chains by transnational corporations, in which China plays a fundamental role as both origin and destination.

At the global level, and for certain Asian groupings, the four machinery sectors in the two–digit Harmonized System (HS 84, 85, 86–89 and 90–91) all display high growth rates. These sectors have been highly dynamic, particularly in China; but, in general, export growth in all East and South–East Asian groupings far outpaced that of world trade in these products. Moreover, exports of products in HS category 84 (non–electric machinery) have accelerated sharply not only between the countries of ASEAN (5), but also between all countries of East and South–East Asia excluding Japan (ADB, 2007 and World Bank, 2007).

A detailed analysis of trade patterns among the members of ASEAN (10), especially in the case of the most important products in the grouping's trade basket, shows a heavy concentration on three product groups (at the two–digit level), both in relation to total trade and in relation to trade within or outside ASEAN. In 2005, 10 product groups represented 74% of total ASEAN trade and 80% of trade between its members.[3] The buoyancy of the machinery chapters (HS 84, 85 and 87) to some extent sustains the momentum of trade in manufactured products and, hence, trade within or outside ASEAN. The importance of the products in Chapter 85 (electronic equipment, parts and components) seems to confirm the hypothesis that "Factory Asia" has developed a manufacturing network for electronic products based on the fragmentation of the production chain.

C. Intra–industry trade and the emergence of China as the hub of the asian export platform

The highly complementary nature of production and trade is clearly indicative of the profound changes affecting regional integration in Asia, as a result of the dismantling of the production process. East Asia can be viewed as a highly integrated "factory", in which the previous national production processes have been dismantled and dispersed to the lowest–cost locations across the region (Baldwin, 2006). Thailand and China received labour–intensive processes, while Japan and the Republic of Korea were left with the engineering–intensive components. It is notable that this entire regional trade creation occurred outside the ambit of regional trade agreements.

The "Asia Factory" was established through unilateral liberalization of trade in parts and components, which are the key elements of East Asia's intra–regional trade. Although the tariff reductions were non–discriminatory, their effect was regional because of the networks of multinational enterprises from Korea, Japan and Taiwan province of China, and the very nature of the products concerned. This represented a major change in the Asian development model before China arose as an economic power. An important element of the fragmentation of manufacturing processes in the region was Japan's loss of comparative advantages in manufacturing production, which led

[3] Those product groups are: electrical machinery; fuels; non–electrical machinery; plastics; vehicles; organic chemicals; precision machinery, optical goods and medicines; iron and steel articles; iron and steel; and rubber and rubber products.

Japanese firms to slice their productive processes and outsource more labour–intensive stages to the neighbouring countries of East Asia. This "hollowing out" of the Japanese economy was replicated in Taiwan province of China, the Republic of Korea, Singapore and Hong Kong SAR, thereby deepening the process of creating the "Asia Factory." Lastly, China's entry on to the international economic stage further eroded the industrial comparative advantages enjoyed by the higher–income East Asian countries, making offshore production more attractive.

1. Growth of intra–industry trade, concentrated in the machinery sector

The high level of intra–regional trade in Asia is simultaneously a cause and effect of the increasingly complementary trade between the countries, as revealed in high indices of inter–industry trade, that is, cases where a country simultaneously both imports and exports similar but differentiated products.

East Asia, especially the ASEAN+3 economies and Taiwan province of China, form one of the most important IIT hubs worldwide. According to the most recent calculations made by the Asian Development Bank (ADB, 2007), the last decade has witnessed high and rising coefficients of IIT in natural–resource–related sectors and also among technology– and human–capital–intensive manufactures. Roughly half of the growth in IIT seen in East Asia between 1990 and 2003 is attributable to an expansion of trade in the components and machine parts sector (Ando and Kimura, 2005), which has registered the fastest growth. East and South–East Asia thus jointly assume the mantle of "Factory Asia."

It should be noted that enterprises in the United States firms and, to a lesser extent, European ones, which have a presence in the machinery sectors of East and South–East Asia are increasingly participating in the network of production chains and taking better advantage of the synergy generated in the Asian region, where numerous small and medium–sized enterprises (SMEs) participate as providers of inputs and parts (Kimura and Ando, 2004). This pattern contrasts with the behaviour of such firms in Latin America and the Caribbean, where one does not see the creation of production networks or value chains with participation by United States and European transnationals, except in Mexico and, to some extent, Costa Rica. To attract greater investments into the region itself, Latin American and Caribbean countries need to implement policies that stimulate the creation of these production and marketing chains both at the regional level and outside. Without globally competitive chains of this type, it will be very hard to attract more technology–intensive FDI into the region.

2. Intra–regional FDI, key to intra–regional and intra–industry trade

(a) The case of Japan

Japan's external trade grew significantly in 2006 in relation to the previous year's levels, with exports expanding by 8.2% and imports by 11.7%. Japan's neighbours are crucial as both destinations and origins for its foreign trade. East Asian countries supply over 40% of Japan's imports, and absorb an even larger

proportion (nearly 46%) of its exports. Among neighbouring Asian countries, China is a key trade partner, especially in terms of imports from Japan and ASEAN (10) —almost twice as large an import source as the United States or the European Union, considered separately.[4] Japan's imports from ASEAN (10) already surpass those originating from the United States or the European Union. Latin America and the Caribbean plays a relatively minor role, with barely a 5% share (JETRO, 2006a).

A large proportion of the goods that Japan trades with its Asian neighbours, both exports and imports, consists of electronic machinery, transport equipment and other manufactured products of general use. This characteristic is clearly visible not only in trade with China and the recently industrialized countries of Asia (Republic of Korea, Singapore, and Taiwan province of China), but also with the members of ASEAN. Thus, Japan's productive complementarity with the rest of Asia in the manufacturing sector is increasing and is reflected in a higher degree of IIT.

Japan's role as investor and recipient of worldwide FDI is quite small: Japanese FDI abroad represented 6% of total world FDI in 2005 (US$ 45.5 billion), while its inward FDI amounted to just 0.3% (US$ 3.2 billion). Nonetheless, East and South–East Asia are very important as destinations for this type of Japanese investment. In 2005, over 35.6% of Japan's outward FDI went to Asia, as a whole, with the following breakdown: China (14.5%), Thailand (9.4%), Indonesia (2.6%), Hong Kong SAR (3.9%), Republic of Korea (3.8%) and India (0.6%).[5] The proportion of investment corresponding to Asia outweighs that destined for the United States (26.7%) or the European Union (17.3%). Latin America and the Caribbean received US$ 6.4 billion of Japanese investment, a significant proportion of the total, which was concentrated in countries offering financial tax exemptions (JETRO, 2006a). Considering investment by individual sectors, the electronics machinery (9.6%), transport equipment (18.9%), precision machines (3.1%), and chemicals and pharmaceuticals (7.4%) were the most favoured in the manufacturing sector. The predominant position of Asia as a destination, on the one hand, and the importance of the manufacturing sectors, on the other, confirmed the role played by that sector as the key economic integration hub for Japan.

Buoyant intra–regional investments provide a counterpart to high levels of intra–regional and intra–industry trade. In the case of Japan, its outward FDI was concentrated in the ASEAN countries in the 1990s but is now shifting towards China. As shown in table II.4, the centre of gravity of Japanese FDI is focusing on three regions in China: Bohai Bay (Beijing, Hebei, Sandong and Liaoning), the Yanzi river delta (Jiangsu, Zhehing and Shanghai), and the Pearl river delta (Hong Kong SAR and Guangdong). Recently, Viet Nam has been seen as an increasingly viable alternative to FDI in Guangdong, given the rise in wages in China. In the ASEAN subregion, the number of Japanese subsidiaries has not increased much in Indonesia and the Philippines, and has actually declined in Malaysia. This stands in stark contrast to Thailand which continues to attract Japanese FDI, thanks especially to the buoyancy of the Thai motor industry. Penetration by Japanese firms in India is still very modest, but the Government is showing great interest in counterbalancing the growing presence of China in East and South–East Asia through diplomatic arrangements with India. As will be discussed below, the two countries have agreed to conduct feasibility studies with a view to signing an economic partnership agreement (Fujita and Hamaguchi, 2006).

[4] In 2006, exports to China expanded by 15.6% in relation to the previous year's level (8.8%). This dynamism originates in the electronic machine, automobile and parts and materials sector, which are exported to the United States and European markets (JETRO, 2007b).

[5] Preliminary figures for 2006 also confirm the importance of this zone, which received 34.1% (US$ 17.2 billion) of the total, which amounted to US$ 50.3 billion (JETRO, 2006a). In this year, the joint weight of ASEAN member countries as a destination was the same as that of China.

Table II.4
NUMBER OF SUBSIDIARIES OF JAPANESE FIRMS IN ASIA, 1990–2004
(Number of cases)

Country/locality	1990	1994	2000	2004
China	315	1 061	2 432	4 041
Bohai Bay	141	404	815	1 039
Yanzi River Delta	77	384	1 060	2 139
Pearl River Delta	47	152	310	525
Other	50	121	247	290
Philippines	171	234	426	453
Hong Kong SAR	793	1 022	1 112	1 121
Taiwan province of China	727	812	891	909
Republic of Korea	399	404	496	640
Singapore	743	961	1 129	1 067
Malaysia	509	709	881	805
Thailand	766	983	1 342	1 512
Indonesia	292	439	676	698
Viet Nam	1	21	174	220
India	71	81	168	193

Source: Masahisa Fujita and Nobuaki Hamaguchi, "The coming of China–plus–one: the Japanese perspective of East Asian production networks", World–Bank–IPS research project on the rise of China and India, February 2006, unpublished.

On the other hand, transnational firms consider investments in Japan itself to be fundamental for increasing their technological and innovation capacity and preventing the flight of their key technologies. Although South–East Asia has been seen to be under the shadow of rapidly growing China for the past years, their strategic geographical position between China and India may present new opportunities. In that case, it will be necessary for ASEAN to make further progress toward economic integration and to promote specialization in each country. Furthermore, the Japanese government will be able to contribute to the deepening of East Asian integration by supporting intra–ASEAN and ASEAN–India integration (Fujita and Hamaguchi, 2006).

(b) The case of China

The FDI received by China from the three leading sources —Japan, ASEAN and the Republic of Korea (see table II.5)— increased significantly especially following China's accession to the World Trade Organization (WTO) in 2001. Those three sources represent about 22% of total FDI entering in 2005, a non–negligible figure given that: (i) the shares of United States and the European Union accounted for about 6% and 7%, respectively, of the total invested in recent years; (ii) the percentage corresponding to Taiwan province of China was between 4% and 5%; and (iii) almost 60% of FDI entering China comes from Hong Kong SAR in the form of triangulation. In

Table II.5
FOREIGN DIRECT INVESTMENT IN CHINA BY JAPAN, ASEAN AND THE REPUBLIC OF KOREA, 1995 AND 2000–2005
(Millions of dollars and percentages)

	Japan		ASEAN (7)[a]		Republic of Korea	
	Amount	Percentage of total	Amount	Percentage of total	Amount	Percentage of total
1995	3 109	8.3	2 644	7.0	1 032	2.8
2000	2 916	7.2	2 837	7.0	1 490	3.7
2001	4 348	9.3	2 971	6.3	2 152	4.6
2002	4 190	7.9	3 220	6.1	2 721	5.2
2003	5 054	9.4	2 909	6.1	4 489	8.4
2004	5 452	9.0	3 010	3.0	6 248	10.3
2005	6 530	10.8	2 932	2.9	5 168	8.6

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from China.
[a] For 1995–2003, the figures refer to the following countries: Brunei Darussalam, Philippines, Indonesia, Malaysia, Singapore, Thailand and Viet Nam. For 2004 and 2005, they refer to Philippines, Indonesia, Malaysia, Singapore and Thailand.

other words, the ASEAN countries are an important source of FDI to China even though most of their FDI to China originates in Singapore (over US$ 20 billion per year). In short, China has become one of the large FDI recipients worldwide and occupies third place as a recipient of this type of investment after the United Kingdom and United States.

Foreign–owned firms operating in China are major promoters of that country's external trade. In 2005, such firms exported US$ 444 billion, equivalent to 58% of total exports, and imported US$ 388 billion (Ministry of Commerce of China (n/d)). These include goods of Asian origin which account for 46% of its total exports (see table II.6). In contrast, those of the United States or European origin accounted for 25% and 18% of China's total exports. Sales abroad by firms of Japanese origin established in China exceeded US$ 56 billion, and these were followed by US$ 19 billion from the Republic of Korea and US$ 11 billion from Taiwan province of China. Firms originating in the five countries of ASEAN (Philippines, Indonesia, Malaysia, Singapore and Thailand) were responsible for US$ 28 billion and equivalent to 13% of the total exported by China. The export orientation of the United States or European firms seems quite small compared to that of their Asian competitors.

At the same time, the presence of Asian firms is decisive for China's import orientation. Firms from the 10 selected Asian countries imported US$ 248 billion in 2005, accounting for 64% of China's total imports (see table II.6). Firms from the United States and European representing just 7% and 9% respectively. The predominant firms in China's imports are Japanese, Korean, Taiwanese, Malaysian, Singaporean, Philippine and Thai. These firms import large volumes of components and inputs from their parent companies in their countries of origin, thereby reaffirming the importance of the high level of intra–industry trade as mentioned above.

Table II.6
CHINESE EXPORTS AND IMPORTS BY FOREIGN–OWNED FIRMS, 2005
(US$ million and percentages)

	Exports		Imports	
	Amount	Percentage share	Amount	Percentage share
10 selected Asian countries	205.3	46.2	248.0	64.0
Hong Kong SAR	90.5	20.4	7.4	1.9
Japan	55.9	12.6	73.2	18.9
Republic of Korea	19.4	4.4	58.7	15.2
Singapore	11.3	2.5	11.4	2.9
Taiwan province of China	10.9	2.5	58.7	15.1
Malaysia	6.9	1.6	14.7	3.8
Thailand	3.9	0.9	9.1	2.3
Indonesia	3.2	0.7	3.7	1.0
Philippines	2.9	0.6	11.0	2.9
Macao SAR	8.7	0.2	0.1	0.0
European Union	78.8	17.7	36.4	9.4
United States	109.2	24.6	25.9	6.7
Other	51.0	11.5	77.2	20.0
Total	**444.2**	**100.0**	**387.5**	**100.0**

Source: Ministry of Commerce of China (n/d), Invest in China [online] http://www.fdi.gov.

(c) The case of the Republic of Korea

Among destinations for outward FDI from the Republic of Korea, China occupies a predominant place both in terms of the number of projects and in terms of the volume of investments carried out. Official data for the country show that by late 2006 China had absorbed roughly 16,000 projects (48% of the total), and that investment undertaken amounted to US$ 17 billion, 24% of the global amount invested (see table II.7). Given the problems with statistical data on Korean firms operating in China, these figures are thought to underestimate the large scale of operations undertaken by Korean firms in its neighbouring country (Okuda, 2006). The fact that the amount of Korean investment in China per firm is relatively small is a good indicator of the large share of Korean SMEs as investors in China.

In the 1990s, the main motivation for large Korean firms was to take advantage of the large size of the Chinese market and save on labour costs, which were beginning to rise in the Republic of Korea. In the current decade, SMEs are accompanying large firms in seeking to exploit the potential offered by the Chinese market. The manufacturing sector is the largest recipient of Korean FDI, followed by construction. Given the current idle capacity in Korean industry, the suspicion is that the boom in FDI to China may be generating an industrial vacuum in the origin country, as is happening in Japan.

Korean and Japanese firms in China display quite similar sales patterns. Surveys show (Okuda, 2006) that Korean firms are increasingly supplying themselves from local Chinese markets where almost half of the inputs they need are available. As the supply sources present in the country include foreign firms of various origins, China is increasingly in a position to offer large machine assembly operators a wide variety of cheap but high–quality inputs.

Sales by Korean and Japanese firms in China have also grown considerably, and in 2003 56.3% of their products were sold within the country (Okuda, 2006). In contrast, re–exports to the country of origin and those destined for third countries have both decreased. Japanese firms are more export–oriented then their counterparts in China.

Table II.7
STOCK OF OUTWARD FDI FROM THE REPUBLIC OF KOREA, 1980–2006
(US$ and percentages)

Country/grouping	Number of projects	Share of total (percentage)	Value of FDI undertaken	Share of total
North America	7 408	22.2	17 879 857	25.7
Europe	1 257	3.8	10 270 051	14.8
Asia	22 769	68.3	32 562 025	46.9
China	15 909	47.7	16 980 814	24.4
India	245	0.7	1 010 566	1.5
Japan	1 097	3.3	1 437 438	2.1
ASEAN (10)	3 920	110.8	8 506 784	12.2
Philippines	827	2.5	816.403	1.2
Indonesia	859	2.6	2 392 445	3.4
Malaysia	360	1.1	578.564	0.8
Singapore	237	0.7	1 467 553	2.1
Thailand	422	1.3	815.184	1.2
Viet Nam	1 023	3.1	2 176 377	3.1
Taiwan province of China	159	0.5	255.175	0.4
Oceania	884	2.7	1 459 868	2.1
Latin America and the Caribbean	669	2.0	4 740 437	6.8
Africa	199	0.6	1 159 240	1.7
Middle East	160	0.5	1 390 316	2.0
Total	**33 346**	**100.0**	**69 461 794**	**100.0**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Export–Import Bank of Korea [online] http://www.koreaexim.go.kr.

(d) The case of ASEAN

Total trade among ASEAN members in 2005 —combined imports and exports of US$ 305 billion— was almost double that of its most important trading partners, the United States (US$ 154 billion) and Japan (US$ 154 billion), who shared second place because their total trade with ASEAN represents 12.6% of the total. There is an asymmetry, however, because the United States is actually the second destination market for the exports of ASEAN countries, while the second supply source for this grouping is Japan. The same applies to the other trade partners, because while ASEAN exports to the European Union make it its third most important import market, China occupies third place as a supplier to ASEAN countries. It is also interesting to note the predominance and concentration of trade flows from ASEAN among the 10 leading trade partners, which account for over 82% of total trade.

The fourth main FDI source for ASEAN (in flow terms) are the other countries within the grouping, which even approach Japanese flows. The cumulative stock of FDI entering the grouping in 2001–2005 was US$ 118 billion, of which 27% came from the European Union, 14% from the United States, and 10% from Japan, the latter figure being surpassed by the 11% of FDI obtained from the ASEAN region itself. Apart from these countries, the Republic of Korea, Taiwan province of China, and China, represented 3.6%, 1.4%, and 1.3%, in that order, of the total amount invested during the period. It should be noted that the Cayman Islands (6.2%), Bermuda (2.7%) and other unidentified countries of Central America and America South America (2.9%) appear among the 10 leading foreign investors in ASEAN. In addition, Australia and India recorded an appreciable volume of FDI during this period, with amounts of US$ 972 million and US$ 642 million respectively. As was seen in the case of China, FDI obtained both from its neighbours (among ASEAN members) and from Japan, China and the Republic of Korea is a major source of financing for business projects (see the ASEAN website). About a quarter of the Association's FDI comes from within ASEAN+3.

Singapore and Malaysia are the leading countries in terms of FDI flows among ASEAN members, followed some way behind by Indonesia and Thailand. The first two of these countries account for about 50% of the total investment among ASEAN members in the period 1990–2003. By sector, communications equipment (23%), food and beverages (18%), and paper and paper products have been the main FDI targets among ASEAN members (Hiratsuka, 2006b). These are also sectors in which Latin American and Caribbean have some potential for investment in the ASEAN market: e.g. Argentina, Brazil, Colombia and the Central American countries in the food and beverages sector; while Mexico and Costa Rica could forge trade and investment links in the electronics sectors; and Chile, Argentina and Brazil could do the same in the paper and pulp sector.

3. China as an Asian export platform

As mentioned above, a major feature of intra–Asian trade dynamism as one of the hubs of the world economy is China's dramatic appearance as a key player, around which a major trade reorganization is unfolding in Asia. As indicated in table II.8, for many neighbouring countries in Asia, China is becoming a staging post for exports to the United States and European markets.

For example, the countries of ASEAN+2, excluding China, on average supplied 39% of China's imports in 2003 and 2005. When two–way transactions between Guangdong Province and Hong Kong SAR for processing subject to tax incentives, are added, in the percentage rises to 46% since the Chinese authorities count them as Chinese imports. China's trade with these countries (Republic of Korea, Japan and ASEAN) is in deficit, because they are its main suppliers of capital goods and intermediate inputs for its manufacturing production. This is subsequently exported to other trade partners, particularly the United

States and European Union, with which it invariably has the largest trade surpluses in both low– and high–technology manufactures. China has a deficit in medium–technology products. The ASEAN countries have a major influence as suppliers and compete shoulder to shoulder with other hubs such as Japan, the Republic of Korea and Taiwan province of China.[6]

Table II.8
CHINA: FOREIGN TRADE MATRIX AND DEFICIT/SURPLUS BREAKDOWN, ACCORDING TO THE TECHNOLOGY–INTENSITY OF TRADE, AVERAGE FOR THE PERIOD 2003–2005
(US$ million, at current prices)

	Exports Totals	Imports Totals	Balance Trade	Breakdown of the trade balance by technology–intensity					
				Products Primary	Manufactures				Other
					Natural resource–based	Low technology	Medium technology	High technology	
ASEAN+ 3	143 037	251 755	-108 718	3 980	-8 895	16 992	-42 881	-77 571	-343
ASEAN	43 064	61 763	-18 699	-4 672	-3 772	5 811	1 104	-17 172	2
China[a]	-	39 637	-39 637	-14	-1 628	-3 984	-7 077	-26 870	-65
Japan	72 301	89 628	-17 326	5 131	529	15 167	-25 000	-13 047	-107
Republic of Korea	27 671	60 728	-33 056	3 535	-4 025	-3	-11 909	-20 482	-172
United States	126 985	42 478	84 507	-4 888	420	46 645	13 556	28 711	63
Canada	8 482	6 413	2 069	-1 448	-978	3 644	139	716	-4
European Union (27 countries)	111 103	66 475	44 628	1 408	56	29 592	-10 683	24 257	-2
Latin America and the Caribbean (33 countries)	17 596	21 061	-3 465	-11 046	-2 805	5 251	3 375	1 756	4
India	6 071	7 232	-1 161	-4 014	601	291	340	1 618	2
Australia + New Zealand	9 799	12 936	-3 137	-9 123	-2 417	3 949	1 264	1 958	-116
Others	174 762	136 298	38 464	-572	-381	476	116	184	0
World	597 836	544 647	53 188	-32 121	-2 037	43 291	6 555	22 191	586

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United Nations Commodity Trade Database (COMTRADE).
[a] Refers to two–way transactions between Guangdong Province and Hong Kong SAR.

D. Conclusions

De facto economic and trade integration, which has moved forward without support from intergovernmental accords, could be encouraged yet more by the negotiation of various trade agreements. Such instruments would constitute a significant additional incentive for increased integration in a number of industrial sectors such as machinery, the auto industry, electronics and pharmaceuticals. The process would also derive tangible benefits from improved progress in the area of financial and monetary cooperation.

The countries of East and South–East Asia should continue their efforts to negotiate trade agreements and should implement the existing accords. That is not helped by the presence of tariff and non–tariff barriers

[6] China has a trade deficit with Latin American and the Caribbean, since it imports large quantities of commodities and natural–resource–based manufactures.

and the "noodle bowl" phenomenon because they increase transaction costs within and outside Asia (see chapter V). The complex negotiations for such agreements should include discussion of matters such as sanitary and phytosanitary certification, harmonization and simplification of rules of origin, and better enforcement of intellectual property and customs procedures.

Efforts must be made to ensure that the regional process of de facto productive integration in Asia extends to Latin America and the Caribbean, as is increasingly being seen in some of the region's productive sectors. With increased intra–industrial trade between the two regions, Latin America and the Caribbean would open up new routes into the Asian markets; at the same time, the incorporation of new technologies would be promoted and workers' skills and business management techniques would be improved, thanks to productive activities and the appropriate technical assistance.

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Chapter III

Trade in services in Latin America and the Caribbean: an analysis of recent trends

Introduction

The growing importance of services in the economy, employment and trade is a trend common to both advanced and developing countries. Services are essential inputs for many activities, and play a crucial role in increasing economic growth and productivity by improving financial intermediation, infrastructure, the use of information and communication technologies (ICT), education, health and the State apparatus. They currently represent approximately two thirds of the gross domestic product (GDP) of rich countries, and close to half that of developing countries, even though a clear difference exists between the types of services prevailing in each group. In terms of employment, the services sector accounts for 70% of workers in developed countries, but only one third of workers in emerging economies. Latin America and the Caribbean are positioned between the two groups. Cross–border trade in services has tripled since 1990, while foreign direct investment has quadrupled. Emerging economies have expanded their service exports at a rate exceeding that of developed countries (UNCTAD, 2004, 2005).

Business services play a strategic role in the overall arena of services. They are becoming increasingly knowledge–intensive (for example, advisory services, services related to information technology, engineering services and research and development services), and have become strategic inputs that increase the productivity and competitiveness of businesses. Moreover, thanks to advances in ICT, firms can now outsource many services to suppliers offering the best price–quality ratio, anywhere in the world. This

process has played a key role in the explosive growth of trade in services provided to businesses, as well as the internationalization of such trade. Developing countries such as India and China, as well as certain nuclei in Latin America, have shown a strong capacity to attract a considerable share of this dynamic component of global trade.

This chapter will compare the trends of trade in services (save for transportation and travel) in Latin America and the Caribbean, China, Hong Kong Special Administrative Region of China, India and the countries that comprise the Association of Southeast Asian Nations (ASEAN). It will also assess the main determining factors of such trade, and propose measures to improve international insertion in this sector. To that end, the dynamics of service exports over the last decade will be examined. The relative diversification of service exports will also be analysed and compared to the pattern of concentration found in more traditional services (transportation and tourism). The varying performance of the countries of the region in this field will then be examined —particularly with regard to the factors that have influenced trends in service exports, the progress made by regional and bilateral trade and investment agreements and the differing levels of regulation to which the sector has been subjected. Finally, policies will be proposed to improve the region's performance in terms of service exports.

These questions will be addressed in four sections. The first section deals with the strategic role of services, and sets forth the main trends in global trade. The second section compares the performance of the region in terms of trade in services with that of a group of Asian countries, both at a global level and in the main markets of the United States and the European Union. It also discusses the success of certain Latin American transnationals in this sector. The third section analyses certain factors that play a determining role in export performance, taking into account issues such as regulation, human capital and the progress achieved by countries in the field of information and communication technologies. The fourth section analyses policies that may improve the region's competitiveness in this regard by harmonizing regulatory frameworks among countries. This would be accomplished by establishing trade agreements, improving workforce quality and increasing the adoption of cutting–edge technologies.

This chapter covers all market services, with the exception of transportation and travel.[1] The annex at the end of this paper contains a list of sectors based on balance of payments and World Trade Organisation (WTO) classifications. This chapter will address not only auditing, computer, engineering and legal services provided to companies, but also construction, financial, insurance and communication services. Transportation and travel have been excluded for a variety of reasons.[2] The term "services" will hereinafter be understood to apply to all services, except for transportation and travel.

[1] The following two minor categories were also excluded: (i) personal, cultural and recreational services; (ii) government services.

[2] Firstly, travel and transportation services are usually provided directly to consumers, whereas other services are sold mainly to businesses. Since some of the determining factors of services provided to consumers differ from those offered to companies, a decision was made to focus on a single category. Secondly, while the literature on transportation and travel services is relatively abundant, trade in other services, which has become increasingly relevant in recent years, has not been extensively studied —particularly in Latin America and the Caribbean— and deserves closer attention.

A. The strategic role of services

1. Theoretical arguments

One common feature of most services is interaction between suppliers and businesses, with the general objective of increasing the productivity and competitiveness of the latter. This is true of knowledge–intensive services —advisory, auditing, computer, engineering, and research and development services, among others— as well as those which make intensive use of unskilled labour, such as cleaning and security. As production inputs, services are key to increasing competitiveness and productivity in an increasingly globalized world.

The services sector has displayed one of the highest growth levels of any sector in advanced economies and trade, primarily as a result of two phenomena (Kox and Rubalcaba, 2007)[3]. The first is the imperative to lower costs by delegating auxiliary tasks to third parties. By outsourcing such activities to service providers, companies can focus their resources on their core business. An increased supply of services also enables companies to achieve a greater degree of specialisation. This, in turn, reflects a "simple" shift whereby services move from one sector to another without undergoing any change in their nature. The second phenomenon is the ability of service providers to sell services that are different —superior in quality or more specialised— from those which the purchasing companies produced for themselves. This includes new services. Consequently, outsourcing grants companies access to inputs of greater quality than those they could have produced on their own. Services thus acquire a strategic role, as they lead to the development of other sectors, both industrial and tertiary, and attract foreign investment. Several studies of the European Union suggest that the second phenomenon is more relevant than the first in terms of explaining the massive expansion of this sector.

Another productive feature of services —particularly knowledge–intensive ones— is the key role they play in innovation in other sectors and national innovation systems (Kox, 2002; Miroudot, 2006). This occurs through three channels. Firstly, information–technology and engineering firms tend to develop technological innovations. Secondly, service companies offer their clients managerial or entrepreneurial innovations that may not be strictly technological in nature. Finally, the interaction between companies that have received innovative techniques helps disseminate best practices.

The internationalization of services is gaining importance as a result of trends supply and demand. From a demand perspective, a growing number of businesses are outsourcing or procuring their services abroad, attracted by competitive advantages. This practice, coupled with the transferral of certain internal company services overseas, is known as "off–shoring" (or "nearshoring", when services are transferred to a nearby country). Companies require such services to improve the quality of their products and processes, sell their products abroad and coordinate the activities (inventories) of their branches in different countries, among other reasons. This trend, which is a basic feature of the globalisation of economies, has its origins in advances in information and communication technologies, strong competitive pressures to reduce costs and improve productivity and increased liberalisation of trade in the aforementioned services. Technological advances have reduced transportation costs, as well as the cost of disseminating information and ideas, leading businesses to transform their processes and production structures. ICT has made it possible to digitalize many aspects of production, and has simplified the provision of services over long

[3] Such services account for half the growth of employment in the European Union since 1995.

distances. Services have thus become increasingly tradable, and the feasibility of outsourcing them or procuring them overseas has grown immensely. During the late 1980s and early 1990s, services shifted toward the client (particularly back office operations); in later years, however, they expanded to include professional services, software development, financial services and other activities that make intensive use of human capital (Mashayekhi, 2005). Off–shoring introduced a new form of entrepreneurial organization known as "extended organization", in which the parent company maintains strict control of services transferred abroad. Free trade agreements have also made it possible to exchange information in real time (Aron and Singh, 2005).

Another phenomenon which has become more relevant over the last few years is insourcing, which involves the participation of sub–contractors into their client companies. It differs from outsourcing in that the sub–contractor intervenes in the operations of the client company to redesign its productive and logistical processes. United Parcel Service (UPS), one of the world's leading companies in this field, has developed systems for the management of the entire supply chain of many of its client companies (Friedman, 2005).

Services have also become internationalized from a supply standpoint. In other words, the companies offering them are operating in more and more locations around the world. Product differentiation based on point of sale and customer–oriented services are key success factors in the successful globalisation of services. This is made possible by the exchange of personal knowledge, or through information and communication technologies. Internationalisation can be achieved by means of 3 models (Toivonen, 2004): (i) the "evolutionary model", in which companies begin by increasing their local market share, and then export their services, often by following their national clients overseas; (ii) the "born global model", in which companies offer products to clients in different countries from the very outset, relying on intensive use of ICT; and (iii) the "think globally, act locally" model, in which companies operate mainly in the local market but provide services to branches of foreign clients or national firms that are active in many countries. Companies in this category are often part of international networks made up of similar firms in other countries.

2. Trends

While the global trade in "other services" (total services minus transportation and travel) is growing faster than trade in goods, it is difficult to accurately measure its volume, given the lack of complete statistics in most countries. The only data available are estimates of cross–border trade based on the balance of payments. Such trade involves services that cross national borders while their providers and consumers do not. International phone calls and telemedicine are examples of this phenomenon. It is often the case, however, that no record is kept of operations in which a provider or client travels to provide or receive a service. In other words, many services require the physical presence of both parties, one of whom must necessarily cross a border (see box III.1 and figure A.1).

Available data show that, as a result of the above, global cross–border trade in "other services" has expanded at a faster rate than that of other goods and services over the past two decades (see figure III.2). Its share of the global trade in goods and services has increased by three percentage points, reaching 9.0% in 2006. Between 1985 and 1995, exports of such services on the part of developing countries grew faster than those of advanced countries, although this trend was surprisingly reversed during the following

decade. Developing countries lost two percentage points of their share in global trade between 1995 and 2005.

The structure of the global trade in services changed considerably between 1995 and 2005, shifting toward computer and information–technology services, as well as financial services (see figure III.2). Available data on the seven main categories show that "other services" represent half of worldwide trade in those services. In the "other services" category, services related to commerce (buying and selling), legal services and research and development deserve special attention.[4]

Box III.1
SOURCES OF DATA ON INTERNATIONAL TRADE IN SERVICES

The main difference between services and goods lies in the immediacy of the relationship between supplier and consumer. Many services are "non–transportable", and cannot be exported like goods; the consumer must go to the supplier, or the supplier must go to the consumer. To reflect this type of trade, the *Manual on Statistics of International Trade in Services* extends the definition of *international trade in services* to include the value of services provided through foreign affiliates established abroad.[a] Services are also provided by individuals located abroad, either as service suppliers themselves or employed by service suppliers. While a large part of this type of trade in services is covered by the balance of payments, the remainder requires additional information, as it would include transactions among residents. The *Manual* describes four modes through which services may be supplied:

Mode 1, or cross–border supply, takes place when both the consumer and the provider of a service remain in their respective countries, while the service crosses the border. The delivery of the service can be effected by telephone, fax, Internet, mail or courier, among other means. It is similar to the traditional notion of trade in goods. Freight transport services, correspondence courses and telediagnosis are examples of this type of trade in services.

Mode 2, or consumption abroad, takes place when a consumer moves outside his or her home territory and consumes services in another country. Overseas tourism is one example of this phenomenon.

Mode 3, or commercial presence, entails close contact with the consumer in his or her home territory in the various stages of production and delivery, as well as after delivery. Medical services provided by a foreign–owned hospital, courses in a foreign–owned school and services provided by a domestic branch or subsidiary of a foreign bank are examples of supplies through commercial presence.

Mode 4, or presence of natural persons, occurs when an individual has moved into the territory of the consumer to provide a service, whether on his or her own behalf or on behalf of his or her employer. This type of supply applies to two areas: trade in services in the *Balance of Payments Manual* sense (e.g., financial auditing services by an auditor sent by a foreign firm or provision of entertainment services by a professional who is temporarily in the host country), and employment, meaning physical presence of persons in the receiving country on a "non–permanent" basis. Short–term employment of foreign doctors or teachers, intra–corporate staff transfers, the presence of foreign staff in foreign affiliates or the employment of construction workers or paid domestic helpers are some examples.

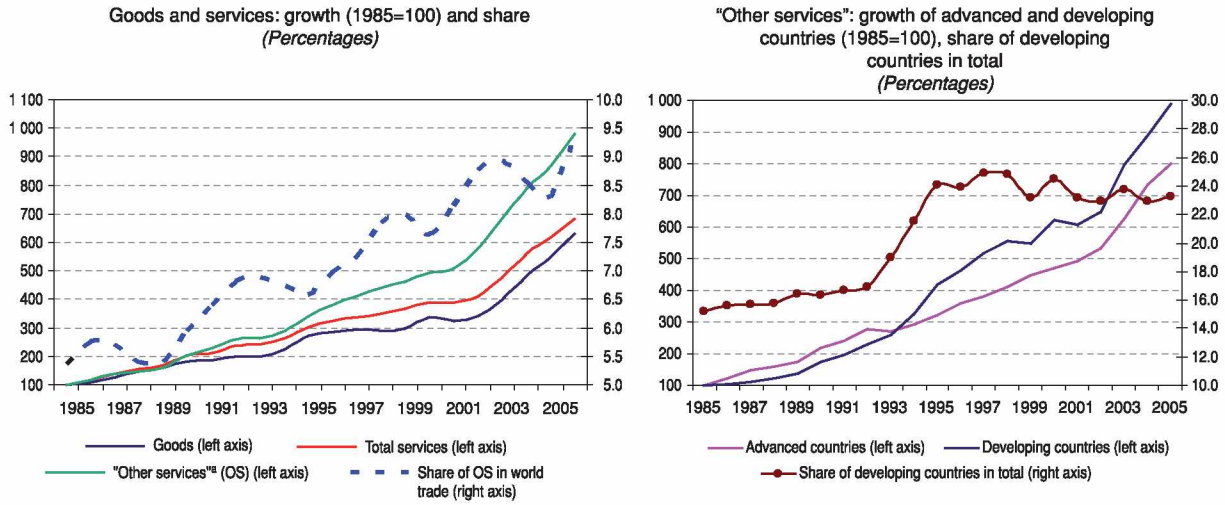
This chapter employs data recorded in the balance of payments, and adheres to the extended definition of services. The main service categories are as follows: transportation, travel, communication services, construction services, insurance services, financial services, computer and information services, royalties and license fees, other business services, personal, cultural and recreational services and government services. During recent years, the countries of the region have improved the breakdown of their service trade in accordance with the fifth edition of the *Balance of Payments Manual*. These data cover trade in modes 1 and 2, and partially cover trade arising from the temporary movement of persons (mode 4).

More efforts are needed, however, to collect data on trade in services through commercial presence. Other sources cited in this paper include national data and data obtained from the World Trade Organization and the Organisation for Economic Co–operation and Development (OECD). These sources help shed light on certain issues involving the trading partners of industrialized economies in the international service trade. This makes it possible to assess the participation of Latin America and the Caribbean in the trade of those economies. The *Investment Map* database of the International Trade Centre was also used, as were other sources related to foreign direct investment, in order to study international trade in services from the standpoint of commercial presence.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).
[a] This extended definition of international trade in services conforms with the 1993 System of National Accounts (SNA), as well as the fifth edition of the *Balance of Payments Manual* published by the International Monetary Fund. Its conceptual and methodological aspects are explained in United Nations (2002).

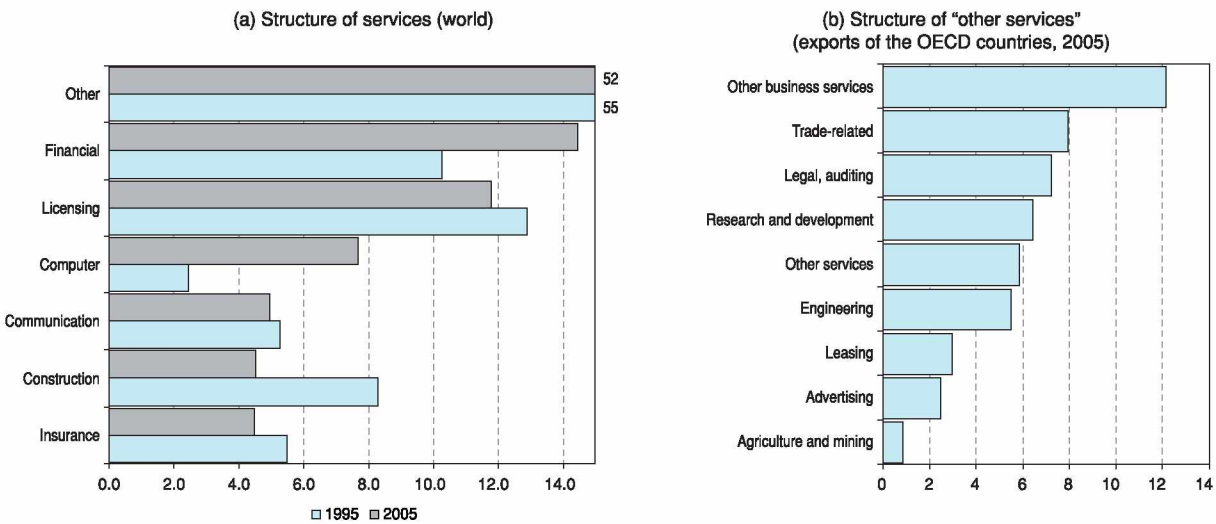
[4] It has only been in recent years that breakdowns of the category of "other services" in most of the advanced countries have been published; such services represent two thirds of the combined exports of OECD countries.

Figure III.1
GLOBAL EXPORTS OF GOODS AND SERVICES, 1985–2006



Source: World Bank, *World Development Indicators* and International Monetary Fund (IMF), "Balance of Payments Statistics (BOP) database" [online] http://www.imfstatistics.org/bop/.
Note: "Other services" refers to total services less transportation and travel.

Figure III.2
STRUCTURE OF GLOBAL TRADE IN SERVICES, 1995–2005



Source: International Monetary Fund (IMF), "Balance of Payments Statistics (BOP) database" [online] http://www.imfstatistics.org/bop/; Organisation for Economic Co-operation and Development (OECD), *OECD Statistics on International Trade in Services, Detailed Tables by Service Category*.
Note: Transportation, travel, personal and government services have been excluded.

Service exports from developing countries represent 23% of trade in that sector. Three fourths of this percentage are attributable to a small group of 15 countries. Developing countries in Asia have achieved a considerable increase in their share of world trade, from 9% in 1995 to around 17% in 2005. Latin America and the Caribbean export only 1.8% of services worldwide.

B. Export trends: a comparison between Latin America and the Caribbean and Asia

1. Export growth

The growth rate of service exports from Latin America and the Caribbean between 1985 and 2005 was lower than that of Asia and the world as a whole. Over the course of those two decades, service exports multiplied by 4.5 in Latin America and the Caribbean, 6.2 worldwide, 8 in ASEAN countries and the Hong Kong Special Administrative Region (SAR) of China, 14 in India and 24 in China. Consequently, the Latin American and Caribbean share of the world service trade fell as that of Asia rose. The growth rate of the "other services" category surpassed that of transportation and travel in those two regions and the world. Different growth rates led to a profound change in the share of trade captured by those three categories. Transactions in the "other services" category, which are the focus of this chapter, increased considerably throughout the world. While the volume of this type of services also increased in Latin America and the Caribbean, particularly between 1985 and 1995, it continued to lag far behind Asia and the world as a whole.

The lower dynamism of Latin America between 1985 and 2005 conceals a great deal of intraregional diversity (Camino, 2003 and 2005; Ventura–Días and others, 2003). Guatemala, Chile and Costa Rica displayed the highest growth rates for services in general, while the Bolivarian Republic of Venezuela, Colombia and Ecuador posted the lowest rates in this category. The greatest expansion in transportation services took place in Panama and Chile. The latter became the chief exporter of such services in the region. The strongest growth in tourism services was recorded in Guatemala, Brazil and Cuba, with annual rates exceeding 20%. Finally, Brazil, Argentina and Costa Rica posted the highest growth rates in the "other services" category. This category captured its largest share of overall exports in 2005 in Paraguay, Brazil and Argentina (see table III.1).

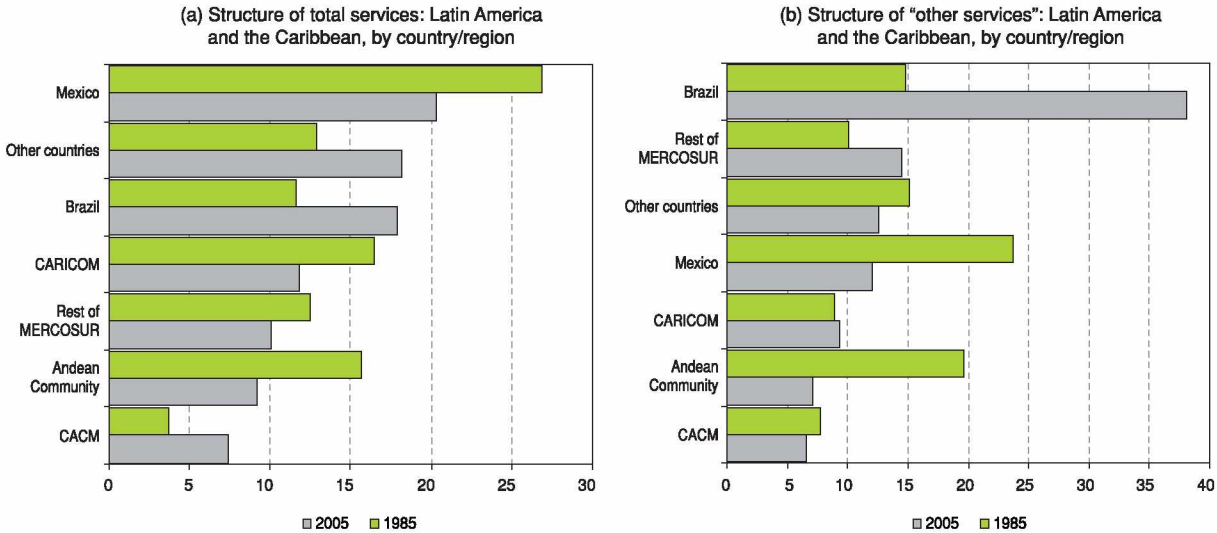
This intraregional diversity led to significants shifts in the shares of each country and subregion in the service trade between 1985 and 2005. While Mexico remains the region's largest exporter, its share dropped by seven percentage points during the period in question (see figure III.3). The Caribbean Community (CARICOM) and the Andean Community also lost ground. Conversely, service exports from "other countries" (particularly Chile) and Brazil increased considerably. The good performance of Brazil can be attributed mainly to its buoyancy in the "other services" sub–category, where its share rose from 15% to 38%. The Andean Community and Mexico were the biggest losers in this regard. The latter maintained its position only thanks to the good performance of its tourism services sector.

Table III.1
SERVICE EXPORTS, 1985–2005: LEVELS, COMPOSITION AND ANNUAL GROWTH RATES

	1985				2005				Average annual growth rate			
	Millions of dollars	Composition (percentages)			Millions of dollars	Composition (percentages)			Total	Transportation	Travel	Other
		Transportation	Travel	Other		Transportation	Travel	Other				
Latin America and the Caribbean												
Total	16 514	33	49	19	74 152	22	52	26	7	5	8	9
Andean												
Community	2 594	39	37	24	6 834	29	52	19	5	3	7	4
Bolivia	87	42	36	22	437	30	49	21	8	7	10	8
Colombia	863	43	25	31	2 388	31	48	22	5	3	9	3
Ecuador	321	39	42	18	940	36	50	14	6	5	6	4
Peru	615	37	32	31	1 926	22	60	18	6	3	9	3
Venezuela (Bol. Rep. of)	709	34	55	11	1 144	32	50	17	2	2	2	5
Central American Common Market	613	27	33	40	5 512	15	64	21	12	8	15	8
Costa Rica	257	21	47	31	2 393	11	65	24	12	8	14	10
El Salvador	175	29	21	50	1 070	33	46	21	9	10	14	5
Guatemala	56	14	22	64	1 100	8	74	18	16	13	23	9
Honduras	88	48	27	24	687	11	66	24	11	3	16	11
Nicaragua	37	26	28	46	261	12	77	12	10	6	16	3
MERCOSUR	3 988	59	22	20	20 708	22	32	46	9	3	11	13
Argentina	1 524	56	32	12	5 626	22	44	34	7	2	9	12
Brazil	1 928	73	3	24	13 258	21	27	52	10	4	22	14
Paraguay	177	3	57	40	607	15	12	73	6	16	-2	10
Uruguay	360	21	62	17	1 217	34	45	22	6	9	5	8
Mexico	4 456	13	70	17	15 035	10	75	14	6	5	7	6
CARICOM	2 727	13	76	10	8 748	12	69	19	6	5	5	9
Other countries	2 137	44	36	22	17 315	42	40	17	9	9	10	8
Chile	638	42	18	40	6 528	58	18	24	12	14	12	9
Cuba					4 245		45				20	
Panama	960	67	21	13	2 905	57	25	19	6	5	7	8
Dominican Republic	538	6	76	18	3 637	3	92	5	10	7	11	4
Asia (selected countries)												
China	2 854	45	33	22	67 983	20	40	39	17	13	18	21
Hong Kong SAR (China)	7 420	42	25	33	58 638	31	16	52	11	9	9	13
India	3 201	16	26	59	45 803	11	13	76	14	12	10	16
ASEAN	11 427	23	39	38	92 081	32	34	42	11	13	10	12
World	400	33	30	37	2 420	23	28	48	10	8	9	11

Source: International Monetary Fund (IMF), "Balance of Payments Statistics (BOP) database" [online] http://www.imfstatistics.org/bop/.

Figure III.3
LATIN AMERICAN SERVICE EXPORTS BY COUNTRY OR SUBREGION, 1985–2005
(Percentages)

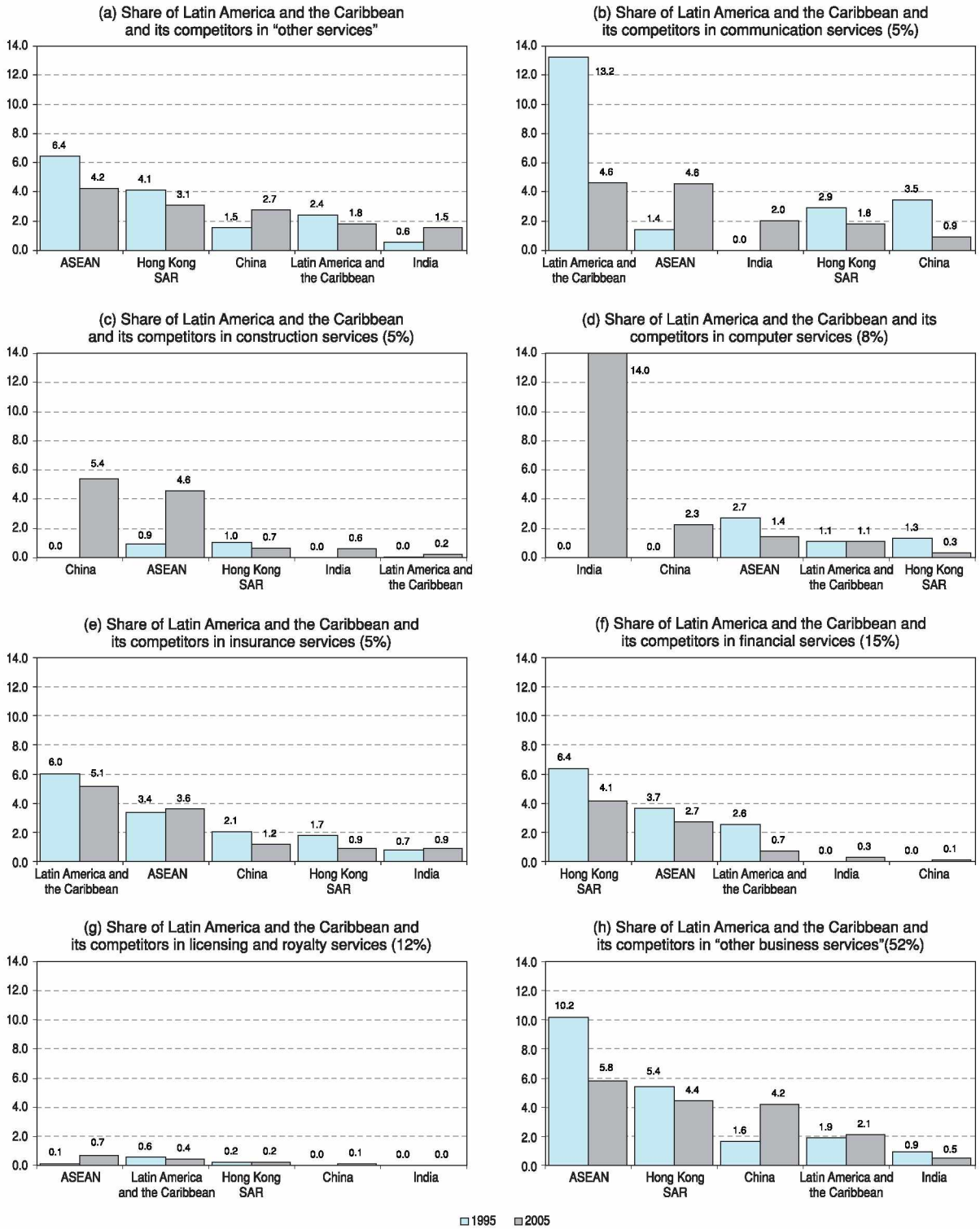


Source: International Monetary Fund (IMF), "Balance of Payments Statistics (BOP) database" [online] http://www.imfstatistics.org/bop/.
Note: "Other countries" refers to Chile, Panama and the Dominican Republic; "other services" refers to all services except for transportation and travel.

2. Participation in the global trade in "other services"

The rest of this chapter will focus exclusively on the "other services" category, also referred to simply as "services". This category includes all services except for transportation and travel. Growth of service exports in Latin America and the Caribbean has lagged behind the world average, with the region's share of this sector dropping from 2.4% to 1.8% between 1995 and 2005. The picture in Asia is mixed; while the ASEAN countries and the Hong Kong Special Administrative Region (SAR) of China suffered a drop in their share, the buoyancy of China and India led to an increase (see figure III.4). These overall results conceal a great deal of diversity among subsectors. While the share of Latin America and the Caribbean in the communication and insurance markets fell sharply, it remained above that of Asia. The only category where growth occurred was "other business services" (see annex). India warrants special attention, as its share of the global computer services market reached 14% in 2005. This goes a long way toward explaining its superior overall position in the "other services" trade. The countries of ASEAN lost overall market share, although their share of the communications and construction sectors improved.

Figure III.4
PARTICIPATION OF LATIN AMERICA AND THE CARIBBEAN AND THEIR ASIAN COMPETITORS IN THE GLOBAL TRADE IN "OTHER SERVICES", 1995–2005
(Percentages)



Source: International Monetary Fund (IMF), "Balance of Payments Statistics (BOP) database" [online] http://www.imfstatistics.org/bop/.
Note: Percentages in parenthesis refer to each category's share in total "other services" trade as of 2005. "Other services" are all services except transport and travel.

Latin America and the Caribbean succeeded in maintaining their modest share of the global computer services market, which was the category that experienced the highest amount of growth over the past decade (see box III.2). The relatively large volume of exports generated by Brazil, Argentina and Mexico should also be noted. When commercial performance is analysed as a percentage of overall sales, however, the leader is Uruguay, followed by Argentina.

Box III.2
LATIN AMERICAN SOFTWARE–RELATED SERVICE EXPORTS

The software–related service trade is an important component of computer and information services, and constitutes one of the most dynamic service categories. While its growth in the region has been low compared to that of India, Latin America and the Caribbean saw their share of world software sales increase from 1.9% to 2.7% between 2001 and 2005. Sales may reach 5% in a few short years. While Uruguay, Chile and Brazil are the largest producers of such services in relative terms (as a percentage of GDP), Uruguay and Argentina have produced the largest share of exports in terms of sales (see table). This is undoubtedly attributable to the fact that these two countries, together with Costa Rica, also lead the region in terms of human capital.

SOFTWARE–RELATED SERVICE SALES AND EXPORTS, 2004

	Sales (millions of dollars)	Exports (millions of dollars)	Sales/GDP	Exports/Sales
Argentina	1 173	192	0.77	16.3
Brazil	8 213	314	1.36	3.8
Chile	1 385	69	1.46	5.0
Colombia	340 [a]	10 [b]	0.35	3.0
Ecuador	90	11	0.28	11.9
Mexico	2 871	125	0.42	4.4
Uruguay	226	89	1.70	39.3
Total	14 298	809	0.85	5.7

Source: P. Bastos Tigre and F. Silveira Marques, "A indústria de software e serviços na América Latina: uma visão de conjunto", Santiago, Chile, 2007, unpublished.
[a] Does not include local service firms. Estimate based on the sales of 561 companies: 542 local software manufacturers (sales of 150 million dollars) and 19 transnationals (sales of 190 million dollars).
[b] Exports from 542 local software manufacturers.

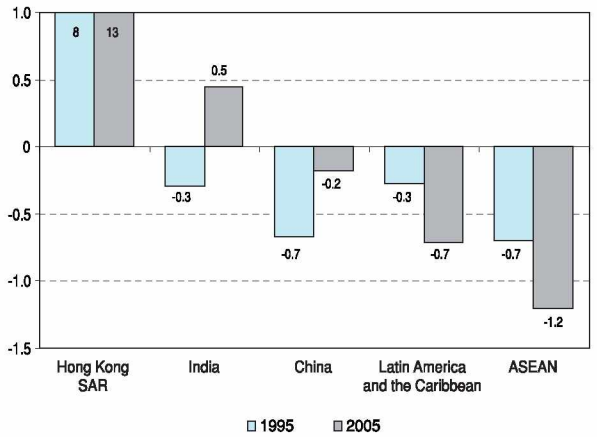
Over half the region's sales and exports proceed from the Latin American subsidiaries of only nine extraregional transnationals. These companies can be divided into three categories, depending on the type of strategy they employ. The first group of companies supplies services —particularly outsourcing— to other multinationals active in the region. The main firms in this category are EDS and Accenture, of the United States, and Tata Consultancy Services, of India. The second group is made up of equipment, software and service providers engaged in activities such as business process outsourcing (IBM, Unisys and HP). This is undoubtedly the most important group in the region in terms of sales and employment. The third group is involved in the provision of licenses, including enterprise resource planning licenses (Microsoft, Oracle and SAP).

It should be noted that, over the past few years, several computer manufacturers in the region have successfully morphed into software–related service providers. IBM in Argentina is one example of this phenomenon. In 2001, at a cost of 50 million dollars, the company transformed a printer factory into the best–equipped "technology campus" in Latin America. This transformation made IBM in Argentina a leading high–value–service supply centre, capable of competing on equal terms with centres in Brazil, China and India. Since 2002, the company has hired over 500 professionals per year for a variety of services. It currently employs 5,300 workers, and continues to expand.

Source: P. Bastos Tigre and F. Silveira Marques, "A indústria de software e serviços na América Latina: uma visão de conjunto," document prepared for the Project @LIS, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2007, unpublished; and G. Anlló, G. Lugones and F. Peirano, "La innovación en la Argentina post–devaluación, antecedentes previos y tendencias a futuro", Buenos Aires, ECLAC office in Buenos Aires, 2007, unpublished.

Service imports in Latin America and the Caribbean grew at a higher rate than exports between 1995 and 2005, leading to an increased deficit in the balance of services. While a similar trend has been observed in ASEAN countries, the opposite is true in the other three Asian countries (see figure III.5).

Figure III.5
BALANCE OF TRADE IN "OTHER SERVICES" AS A PERCENTAGE OF GDP, 1995–2005



Source: International Monetary Fund (IMF), "Balance of Payments Statistics (BOP) database" [online] http://www.imfstatistics.org/bop/.
Note: "Other services" are all services except transport and travel.

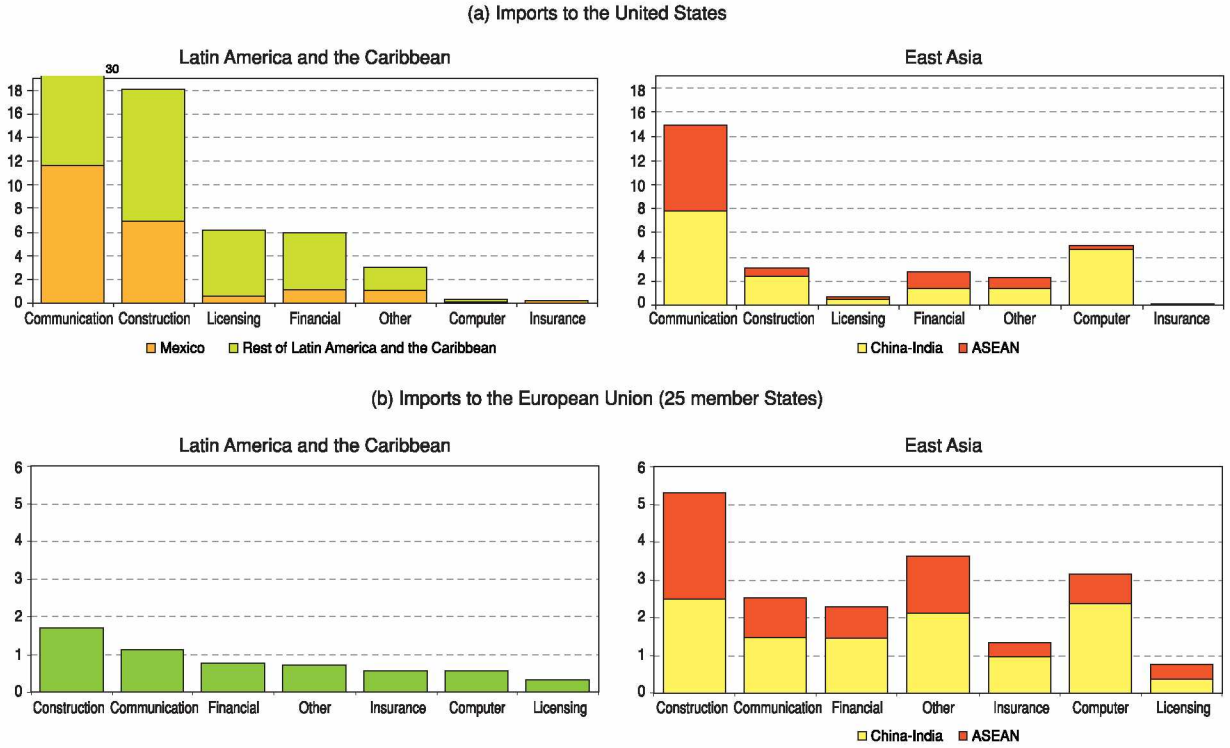
3. Share of imports to the United States and the European Union

Another way to compare trends in exports in the two regions is to analyse their share of service imports to the United States and the European Union. These two markets represent almost 60% of world services imports, and more detailed statistics, broken down by category and trading partner, are available for their study.

In the case of the United States, the share of services imported from the Latin American and Asian countries studied was 3% in 2005; significant differences exist, however, both between sub–categories and in terms of trends (BEA, 2007).[5] While Latin America and the Caribbean enjoy a strong position with regard to communication, construction and, to a lesser degree, financial services, the participation of Asian countries in computer services is relatively high (see figure III.6). Mexico is by far the largest Latin American exporter, followed by Brazil and the Caribbean.

[5] The bilateral service trade data of the Bureau of Economic Analysis are incomplete, as they exclude trade flows between parent companies headquartered in the United States and their branches abroad and between American subsidiaries and their foreign parent companies.

Figure III.6
PARTICIPATION OF LATIN AMERICA AND THE CARIBBEAN AND EAST ASIA IN SERVICE IMPORTS TO THE EUROPEAN UNION AND THE UNITED STATES, 2005



Source: Bureau of Economic Analysis of the United States and Statistical Office of the European Communities (EUROSTAT).
Note: "Other services" are all services except transport and travel.

Between 1995 and 2005, exports from India and China to the United States grew more rapidly than exports from Latin America —with the exception of the Caribbean— and the ASEAN countries. This is surprising, given the proximity of Latin America to the United States. The good performance of the Caribbean is partly attributable to offshore financial centres. During the period in question, imports to the United States from India increased by a factor of 24, whereas imports from Latin America and the Caribbean merely doubled (Engman, 2006). As of 2005, Indian exports were equivalent to over half of Latin American and Caribbean exports. The share of the region —particularly Mexico— in United States service imports has, in fact, declined. When transportation and tourism are factored in, however, the volume of Latin American exports is still seven times larger than that of China and India combined.

One World Bank study (Freund, 2006) shows that India has effectively displaced the region in terms of trade in four types of services: research and development, legal services, industrial engineering and other services. The same cannot be said, however, of the other categories.[6]

The share of imports to the European Union from Latin America and the Caribbean in 2005 was much lower than that of the sub–group of Asian countries. The only categories in which this percentage exceeded 1% were construction and communication services, while the share of the Asian countries studied surpassed that figure in almost every instance. It should be noted that the respective shares of China and India were larger than those of ASEAN countries. The European Union lacks detailed bilateral time–series data with which to study possible changes in the performance of both regions.

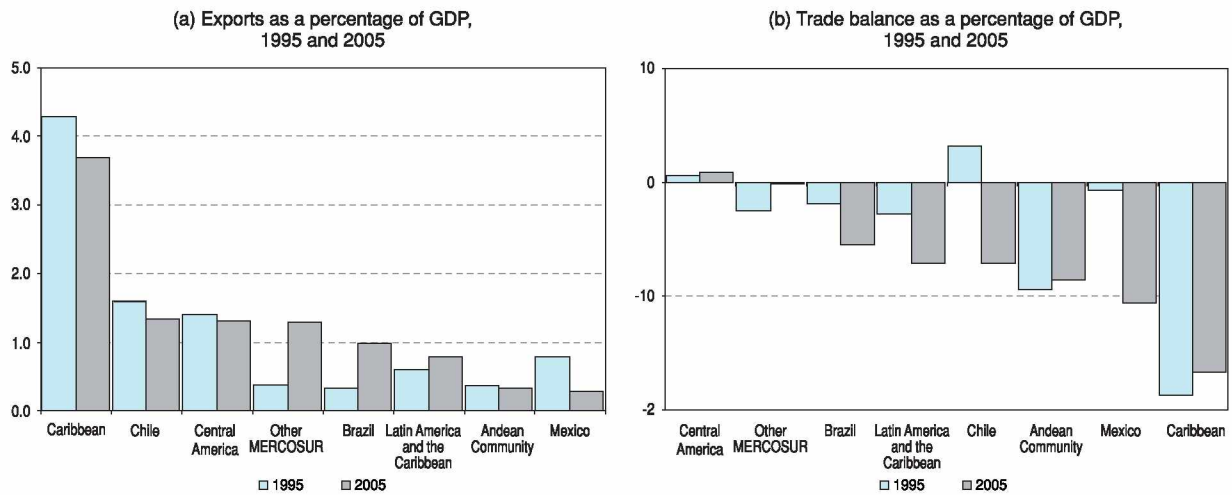
[6] Another interesting finding of this study was that database and other information service exports from the United States are shifting from the region to India. This may be a cause for concern, given the intensity of intrasectoral trade in this category. The Indian computer industry requires inputs from the United States (Freund, 2006).

4. Regional diversity

The regional average conceals a great deal of diversity in terms of the position and trends of subregions and countries. While average service exports as a percentage of GDP amount to only 1%, their relative importance is much greater for the Caribbean, whereas Mexico saw them drop to 0.3% in 2005 (see figure III.7). The dynamism of Brazil and the rest of the Southern Common Market (MERCOSUR) deserves special attention. The balance of trade in services is negative in almost every country except for Central America, Argentina, Uruguay, Paraguay and the Caribbean.[7] A larger deficit does not necessarily imply weakness, however; it may suggest an increased use of external services as a means of improving the competitiveness of the rest of the economy, particularly with regard to the export of goods.

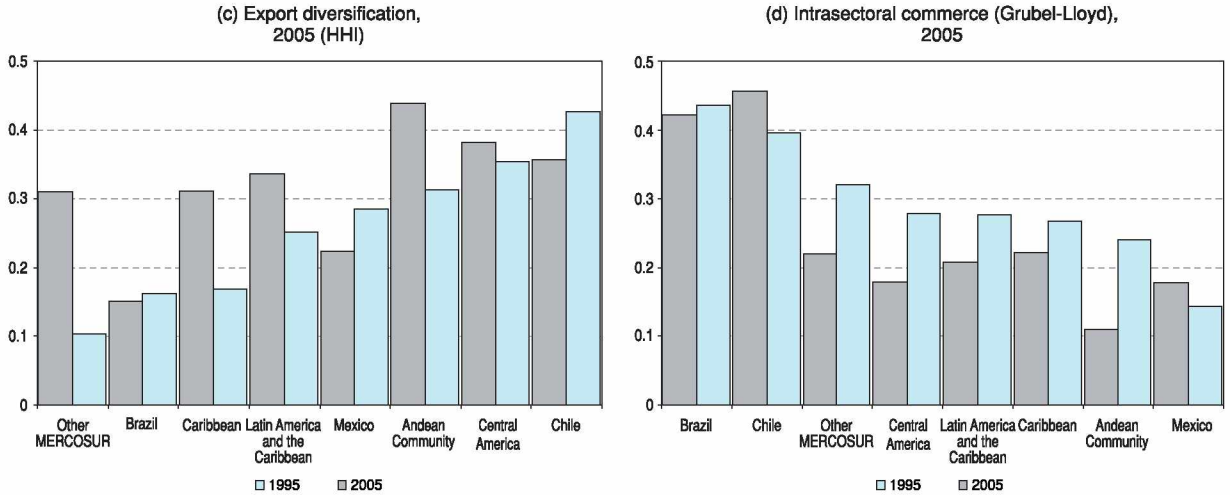
Two other indicators also display a significant degree of diversity. Firstly, the diversification of exports within the overall context of services plays an important role in evaluating the efforts of countries to penetrate other niches that hold promise in terms of learning, productivity and reducing exposure to crises in specific markets. The progress achieved by Argentina, Uruguay and the Caribbean in this regard deserves special notice. Secondly, intrasectoral trade reflects the degree to which a country participates in international networks that encourage the differentiation of services, increase productivity and generate economies of scale with regard to production. The greatest achievers in this area are Brazil and the rest of MERCOSUR, which possess the highest percentage of intrasectoral trade. While there appears to be a marked correlation between the two variables —the most diversified countries are also those which have increased their intrasectoral trade, or vice–versa— the exact causes of this phenomenon are unknown. The performance of Argentina, Brazil, the Caribbean, Costa Rica and Uruguay should be noted in this regard. Certain aspects of the Caribbean and Brazilian experience are discussed below.

Figure III.7
TRADE IN "OTHER SERVICES" BY SUBREGION AND COUNTRY OF LATIN AMERICA AND THE CARIBBEAN, 1995 AND 2005



[7] Significant contrasts exist between the islands of the Caribbean. Barbados, Saint Vincent and the Grenadines, Grenada, and Trinidad and Tobago posted surpluses in 2005, while Suriname, Antigua and Barbuda, Jamaica and the Bahamas posted deficits.

Figure III.7 (concluded)



Source: International Monetary Fund (IMF), "Balance of Payments Statistics (BOP) database" [online] http://www.imfstatistics.org/bop/.
Note: "Other services" are all services except transport and travel.

(a) The Caribbean (English–speaking and Dutch–speaking)

The economies with the highest relative volume of service exports in the region are those of the Caribbean (English–speaking and Dutch–speaking). On average, services represented almost two thirds —and in some cases almost 90%— of exports of goods and services from Caribbean countries between 2000 and 2005.[8] Tourism accounted for two thirds of service exports —a ratio which has remained steady over the last few decades. This category is followed by transportation, with a share of between 11% and 17%.[9] Business services represent around 18% of service exports, while financial and insurance services represented only 2.5%. This last category is significantly undervalued, given the exclusion of services provided by offshore companies.[10]

Several economies have been able to achieve and maintain relatively high income levels and good standards of living by focusing on the export of services. Success is neither automatic nor guaranteed, however. On the contrary, it entails a long–term process of continuous learning and feedback, in which service exports generate growth, which in turn increases productivity and the diversification of service exports. This cycle of mutually reinforcing factors requires concerted action in the public and private spheres, as well as the constant renewal of competitive strategies.

While there is no direct evidence in this regard, it is safe to say that offshore services have acquired an important role in the Caribbean in recent years. Offshoring involves the incorporation of companies on the islands without any requirements as to physical presence. The success of these services, which were pioneered by the Bahamas, can be attributed to the non–existent or very low corporate taxes to which these companies are subject. Over the last few decades —particularly in the wake of the terrorist attacks in New York and Washington, D.C., on September 11, 2001— the industry has modernized its legal framework and controls, in order to avoid abuse on the part of criminals and terrorists. In addition to low taxes, the main factor encouraging businesses to form offshore

8 Guyana, Suriname, and Trinidad and Tobago are exceptions, as their chief exports proceed from the energy, agricultural and mining sectors.
9 The World Travel and Tourism Council estimates that the direct and indirect contribution of tourism to the region in 2004 was equivalent to 15% of GDP and 16% of employment. In countries more focused on tourism, these percentages exceeded 80%.
10 The data contained in the Services section of the balance of payments is deficient with regard to the coverage of certain service areas. This applies to services supplied by consultants who travel to deliver services, and is especially true of business and professional services, as well as services delivered by offshore companies (CARICOM, 2004, p. 7).

centres in the Caribbean is the confidence generated by a modern, stable legal framework.[11] This enables companies exporting financial and insurance services to achieve high levels of productivity and sophistication, thanks to their enhanced efficiency and ability to assume risks. In several countries, offshoring dovetails neatly with tourism, as visitors can combine recreational activities with the purchase of financial and insurance services.

It is impossible to gauge the true importance of services exported by offshore companies, since Caribbean countries do not include them in their balances of payments. These balances include only the fees companies pay governments to become incorporated on the islands. A comparison of the declared value of Caribbean exports with data on imports brought into the United States from those countries (given that the United States is their most important trading partner) suggests that Caribbean exports are undervalued by a factor of at least two.[12]

Bermuda, which according to *The Economist* (2007) has the highest per capita income in the world, ranks at the top of the market for insurance and extraterritorial funds. Its exports seem to have been underestimated at least by a factor of 10.[13] The Bahamas, which has the highest number of ships registered and a well–established international services sector, is specializing, among other things, in managing the assets of the wealthiest people in the world. The British Virgin Islands have the highest number of registered offshore companies.

Offshore companies have become a significant source of tax revenues and foreign exchange in several countries and non–independent territories of the Caribbean. However, the available information on their contribution to the economy and to exports is still scanty. According to a study dealing specifically with the Bahamas, the offshore sector accounts for 15% of GDP, 13% of jobs and 19% of tax revenues (Bahamas Financial Services Board, 2006). In other countries, including the British Virgin Islands, Bermuda and the Cayman Islands, it is estimated that the sector accounts for an even higher share of the economy.

(b) Brazil

The service sector is one of the fastest growing categories in Brazilian exports. Exports of services more than tripled between 1995 and 2005, while exports of goods rose two and a half times. In 2006, services other than transportation and travel accounted for more than half of all services (including transportation and travel), a high percentage for the region. The subcategories that grew most in recent years were professional services and execution of technical projects. These activities are related to engineering and architecture, which still rank at the top in exports of services (one third of the total) and which constitute one of the main comparative advantages of Brazil (World Bank, 2004; Bom Angelo, 2004; Valls Pereira, 2002; Moreira, Alves and Kubota, 2006).

The success of services is partly a result of high demand from exporters of manufactured goods and commodities. Financial services support the marketing firms, whose business is growing in leaps and bounds. Different banks take different approaches: Banco do Brasil (a State bank) serves medium–sized firms, while the local branches of foreign banks (ABN–AMRO, HSBC and Santander) carry out large, complex transactions for multinational corporations. IT and information services are also quite successful: Brazilian (CPM, Datasul and Microsiga) and foreign companies (EDS, IBM and TATA) follow similar strategies in providing support for multinationals within and outside Latin America. The main functions they perform are: administrative control activities, payroll management, help–desk services and call centres. Although the growth of these sectors is higher than the average growth of exports, it is small in comparison with countries like India (Mantega, 2005).

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[11] The flip side of low taxation in fiscal paradises is the loss of tax revenue in other parts of the world.

[12] In 2005, the Caribbean islands recorded service exports (excluding transportation and travel) in the amount of 1.706 billion dollars, whereas the United States declared imports in the amount of 3.5 billion dollars (IMF and Bureau of Economic Analysis).

[13] Bermuda's exports of services (other than transport and travel) totalled US$ 1.3 billion, while the United States declared imports of US$ 12.478 billion in 2004. These data suggest that actual exports must be at least 9.5 times higher than the figures declared by Bermuda (IMF and Bureau of Economic Analysis).

5. The trans–Latins

To complete the analysis of exports by firms located in Latin America and the Caribbean, the preceding analysis of cross–border trade needs to be supplemented with an assessment of the volume of sales by branches set up by these companies in other countries. As noted above, around half of the world's trade in services is accounted for by sales of branches located in foreign markets (mode 3).

Although the data are still relatively scarce, some partial figures and qualitative information suggest that over the past few years, there has been an increase in the presence in foreign markets of several Latin American multinational corporations (trans–Latins). The data on sales of Latin American transnationals are incomplete, among other things because in many cases sales by subsidiaries are not published separately. Also, many subsidiaries are relatively small and are therefore not included in classifications of large corporations.[14] For example, in its 2004 and 2005 rankings of the 500 largest corporations (branches) in Latin America by volume of sales, *América Economía* only included two branches of one trans–Latin outside its country of origin, namely, Empresa Brasileira de Telecomunicaçoes (EMBRATEL) and Claro de Brasil, which belong to the Mexican firm América Móvil.[15]

Sales of services by the trans–Latins may be approximated by looking at their levels of foreign direct investment (FDI) (see box III.3). The data on Brazil, Chile and Colombia show that in the last few years, services accounted for at least half of FDI.[16] The services sector (excluding transport and travel) grew significantly, especially in engineering and construction, telecommunications and finance. Except in the case of the first segment, this is a fairly recent phenomenon.[17]

The following companies are leaders in services (other than distribution, transportation and travel):[18]

- Engineering and construction: these companies, especially in Brazil (including Odebrecht and Andrade Gutiérrez) and Argentina (including Techint and Impsa) started doing business internationally during the 1980s as a result of a decline in projects in their original markets. The competitive advantages of this group of trans–Latin companies were a combination of technological capacity, operational flexibility and low costs. The ability to operate in environments characterized by complex regulations and legal and economic constraints has given these companies an advantage over world competitors in some markets, especially in developing countries.
- Telecommunications: the Mexican firms TELMEX and América Móvil (Grupo Carso) now figure among the largest corporations in the region and the five largest in the world in terms of subscribers. Their international activity began in 1990 with the privatization of Teléfonos de México (TELMEX). The Mexican Government wanted to sell a vertically integrated corporation in

[14] There are several sources of partial information on foreign sales by branches in Latin America and the Caribbean and in developing countries in general: (i) some databases such as the *Country Reports* published by UNCTAD in its *World Investment Directory* and *the Investment Map* (based mainly on *Who Owns Whom*, by Dun and Bradstreet, London) published by the UNCTAD/WTO International Trade Centre; (ii) *América Economía* magazine, which every year publishes a database showing the characteristics (including sales) of the 500 largest companies in the region, including several in the business services sector (the main findings of this database are reported every year in *Foreign Investment in Latin America and the Caribbean*, published by ECLAC), and (iii) data on FDI abroad. Only a few countries in the region, including Brazil, Chile and Colombia, publish sectoral breakdowns of these data. Considerable caution must be exercised in comparing these data, given the multiplicity of sources and the different accounting methods used. Indeed, the main purpose of this discussion is to illustrate trends rather than make assertions about absolute levels.

[15] Another case is that of Cencosud in Chile and its branches Disco and Cencosud in Argentina.

[16] These three countries, along with Argentina, Mexico and Panama, are the largest investors in the region in absolute terms. In relative terms, the countries with the highest levels of FDI abroad in terms of GDP are Panama, Chile, Argentina, Brazil and the Bolivarian Republic of Venezuela (UNCTAD, 2007).

[17] The growth of the trans–Latins in other services sectors, including distribution and electricity, is also noteworthy.

[18] For more information on trans–Latins, see ECLAC (2006 and 2007). Other successful trans–Latins operate in retail and air transport services, see ECLAC (2006).

order to create a "national champion" that could compete with foreign firms. The two companies focused on Latin America, beginning operations in Brazil and Colombia and later expanding to Argentina, Central America (El Salvador, Guatemala, Honduras and Nicaragua) and, more recently, Chile, Paraguay and Peru.

- Financial services: the countries with the most dynamic banks abroad are Brazil, Mexico and Panama. The Brazilian bank Itaú, which already had a considerable presence in Argentina, recently expanded its activities to Chile and Uruguay. The Mexican bank Banorte expanded its activities in the United States with the purchase of INB bank and the money–transfer firm UniTeller. On the other hand, several Panamanian banks lost a substantial part of their participation in other Central American countries in 2006, as they sold their assets to HSBC, Citibank and Lloyds TSB.

Box III.3
TRANS–LATINS IN THE SERVICES SECTOR: AN OVERVIEW OF PARTIAL DATA

The partial data that are available on outward FDI from Brazil, Chile and Colombia show that services accounted for at least half of such investment during the period studied. In Brazil, services accounted for between half and two thirds of investment abroad between 2001 and 2005 (other than investment in tax havens). The main subsectors are trade (50%), construction (25%), transportation, telecommunications and real estate (which make up the remainder). In Colombia, almost half of investment abroad in 2005 was in services. Within this sector, the main subsectors were business services (40%), transportation, storage and telecommunications (31%), public services (12%) and trade (11%). In Chile, three quarters of investments between 1990 and 2006 were in the services sector, mainly in energy, trade and financial services.

The location of the main branches of the trans–Latins gives a general idea of their geographical strategy. UNCTAD data for 2002 suggest that branches of trans–Latins are set up in a number of different countries or regions (see table below). In the case of Argentina and Chile, other countries in the region are the main destinations; for other countries, the preferred destination is the United States. There has been very little development in Asia; Panama has the greatest geographic diversification.

LOCATION OF THE 50 MAIN BRANCHES OF TRANS–LATINS IN THE SERVICES SECTOR, 2002
(Percentages)

Investor	Argentina	Brazil	Chile	Colombia	Mexico	Panama	Venezuela (Bol. Rep. of)
Latin America	70	6	81	21	4	16	33
United States	15	78	19	74	92	42	56
European Union	15	11	0	5	4	37	11
Others	0	6	0	0	0	5	0
Total	100	100	100	100	100	100	100

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development (UNCTAD), *World Investment Directory*.

C. Factors determining performance abroad

1. What are they?

Several recent empirical studies suggest that performance in export of services depends on several factors.[19] The first one consists of the classic gravitational variables, such as size of markets of origin and destination, distance or proximity of markets and the effects of clustering. The second are the so–called natural barriers (differences in language, culture or institutions). Third, the rise of information and communications technologies (ICT), a key factor because it helps determine whether a service is tradable and at what cost, partly cancelling out the repercussions of distance in trade. The fourth factor is the presence, cost and productivity of skilled labour, bearing in mind that many services are labour–intensive. These last two factors have a considerable influence on operational risks (capacity to provide a steady supply of high–quality services) and structural risks (probability of customer relations not living up to expectations) (Aron and Singh, 2005). Finally, it is also important to bear in mind the impact of the regulatory systems in the different countries, including intellectual property regimes and legislation on migration.

To allow for a better understanding of the differences in the performance of Asia and of Latin America and the Caribbean with respect to the export of services, this analysis focuses on three issues: regulation, human capital and ICT.

2. Impact of regulation on trade and investment

National regulatory systems affect at least three dimensions of international trade in services (Kox and Nordas, 2007). The first has to do with the ability to engage in trade. On this point, regulation itself and the differences between regulatory systems in different countries represent a barrier or a fixed cost for trade that affects not so much the price of services provided as the level of exports needed to begin operations, and this in turn determines the average size of the export firm (Melitz, 2003).[20] The second is the direct impact of regulations on the volume of flows of trade in services, and the third has to do with the repercussions

[19] Dihel, Eschenbach and Shepherd (2006), Kox and Nordas (2007), Markusen and Strand (2007) and Piña (2005). These recent studies were undertaken with available data on bilateral trade in European Union countries and then extended to all OECD countries (Kox and Nordas, 2007). A standard model found in the literature was used, namely, a gravitational model which includes several indicators of regulation developed by OECD on the basis of the methodology used by the Australian Productivity Commission (Golub, 2003; Dihel and Shepherd, 2005) with respect to services in general and other business services and indicators developed by the International Monetary Fund and the World Bank for financial services. For a business point of view concerning the key factors for success in exporting services (e.g., subcontracting and purchase of services abroad), see Aron and Singh (2005).

[20] The purpose of regulation is to correct market failures that lead to an inefficient allocation of services. These failures occur more frequently in the services sector because of its innate characteristics. Depending on their intensity and heterogeneity, regulations —although legitimate— can considerably restrict international trade in services by preventing one market from taking advantage of the economies of scale achieved in another.

of regulatory schemes on flows of foreign direct investment in the services sector.

(a) Impact on the ability to engage in trade

Econometric models confirm that regulatory intensity has a negative impact on the ability to start operations in trade in services.[21] However, the differences between regulatory systems in different countries do not seem to affect the potential for trading in services. The size of the importing market is also important. Hence, service companies in countries with little domestic regulation and large trading partners will have a greater likelihood of becoming exporters.

(b) Impact on trade flows[22]

As regards the volume of trade flows, the evidence shows that business services are much more sensitive to regulatory restrictions than services in general.[23] This sensitivity is higher in the exporting country. While a more stringent regulatory context in the exporting country has a negative impact on trade, the regulatory intensity in the importing country does not seem to have a significant impact. The diversity of regulatory systems between countries also has a marked negative impact on flows of trade. Accordingly, policies designed to encourage harmonization of regulatory schemes could be key to increasing trade in services.[24]

The differences in the incidence of the regulatory framework between Latin America and the Caribbean and Asia are not big enough to explain the differences in performance of exports (see table III.2). Aggregate indices of regulation of different service sectors are consistently lower in the region than in Asia. However, as indicated in the preceding section, the dynamism of the Asian countries, especially China and India, in exports of services is much greater. This would appear to indicate the existence of other factors that affect this type of trade, including the availability of qualified personnel and of information and communications technologies (ICT).

(c) Impact on foreign direct investment

The regulatory system not only affects cross–border trade in services, it also affects exports of services through the direct sales of branches abroad. Given the lack of data, the volume of such trade is estimated on the basis of flows of foreign direct investment. As shown in the study of OECD countries by Kox and Nordas (2007), regulation affects both the inflow of investment to the services sector in the receiving country and the country's outward investment. Indeed, except for legal barriers, regulatory restrictions have a greater impact on investment abroad than on foreign direct investment received. As far as the other variables are concerned, there is a positive correlation between market size and FDI within the country and abroad.

Given the lack of data on foreign direct investment by sector, it is only possible to illustrate the hypotheses on incoming FDI in Latin America and Asia, which seem to confirm the overall results for OECD countries (see figure III.8). The fact that there are fewer restrictions on foreign direct investment (mode 3) in Latin America than in Asia was reflected in larger flows of foreign direct investment with respect to GDP during the period 1995–2004 in almost every sector of financial services, telecommunications and construction.[25] These flows to Latin America also reflect, to a large extent, the greater role played by privatization of state enterprises in those sectors in the region, especially during the 1990s.

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21 In this case, the model used was a Probit model based on regulation indexes and the existence of trade in services between countries.

22 In this case, a Probit model based on indices of regulation and the existence of bilateral trade in services between countries was used. As suggested by gravitational models, the impact of regulation is greater in trade in services than in trade in goods. With regard to the other determining factors, the models suggest that trade in services depends on the same variables as trade in goods, although there are differences in the relative importance of each variable in trade flows. While cultural differences have a greater impact on trade in services, geographic variables have a greater impact on trade in goods. In addition, the quality of regulation and the efficiency of governments are much more important in the case of trade in services.

23 In this case, a Poisson gravitational model of maximum verisimilitude was developed.

24 For example, the document shows that the adoption of a fully harmonized system would bring about a 60% increase in trade in services with respect to 2003. Although this exercise tends to magnify the impact, it is nevertheless relevant.

25 Unlike other regions, Asia managed to attract more investment in "other services" in business, for which there is no indicator of regulatory intensity.

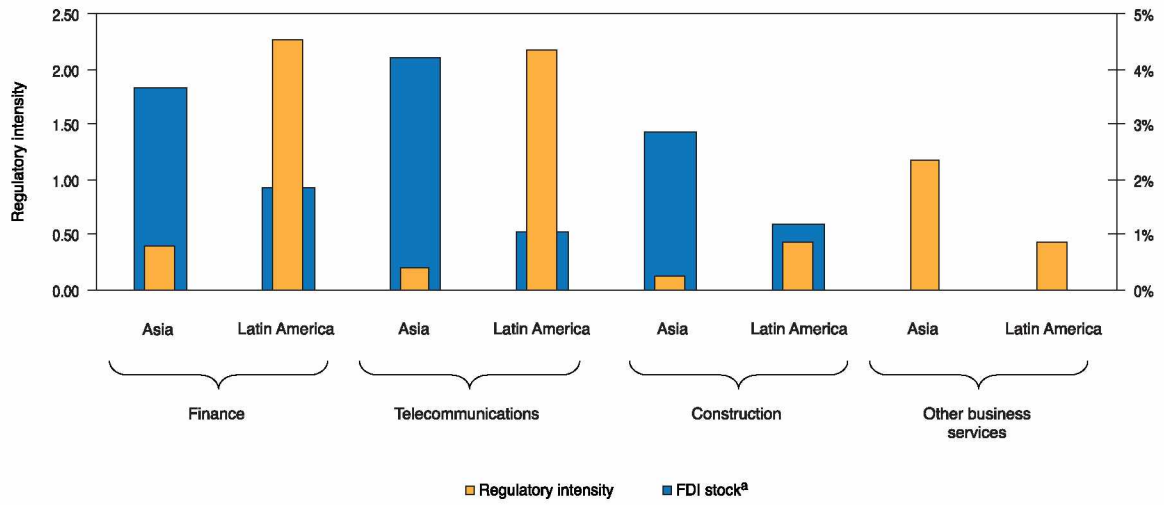
Table III.2
AGGREGATE INDEX OF REGULATORY INTENSITY[a]

Sector	Banking	Insurance	Fixed Telephone	Mobile Telephone	Engineering
Latin America					
Argentina	0.76	0.86	0.28	0.35	0.51
Bolivia	0.88	1.41	1.36	0.89	N/A
Brazil	1.09	1.36	0.4	0.94	1.42
Chile	0.85	0.85	0.37	0.36	1.04
Colombia	1.44	0.90	1.19	0.50	N/A
Ecuador	0.66	1.62	1.38	0.64	N/A
Peru	0.61	0.61	0.34	0.17	N/A
Uruguay	0.46	1.24	1.30	0.15	N/A
Venezuela (Bolivarian Republic of)	1.36	1.26	0.40	0.81	N/A
Average	0.90	1.12	0.78	0.53	0.99
Asia					
China	1.73	1.95	1.66	2.01	1.71
Philippines	N/A	N/A	N/A	N/A	0.73
Hong Kong SAR (China)	N/A	N/A	N/A	N/A	N/A
India	2.11	2.81	1.41	2.00	N/A
Indonesia	N/A	N/A	N/A	N/A	1.57
Malaysia	2.6	2.48	1.22	1.86	2.01
Singapore	N/A	N/A	N/A	N/A	0.56
Thailand	1.46	1.78	1.63	2.50	1.39
Average	1.97	2.25	1.48	2.09	1.33

Source: N. Dihel and B. Shepherd, "Modal estimates of services barriers", *OECD Trade Policy Working Paper*, No. 51, Paris, Organisation for Economic Co–operation and Development (OECD), 2005.

[a] This index was constructed on the basis of weighted aggregation using a method of factorial analysis of qualitative indicators taken from surveys of different governments conducted by the Organisation for Economic Co–operation and Development (OECD) (*Regulatory Indicators Questionnaire*). This indicator increases in intensity, where 0 corresponds to a hypothetical country that is completely liberalized, i.e., it replies 0 to all questions on the questionnaire. Regional aggregation is obtained by calculating the simple average of countries in which information on foreign direct investment is available.

Figure III.8
FOREIGN DIRECT INVESTMENT AND REGULATION IN LATIN AMERICA AND ASIA, 2004



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of UNCTAD/WTO International Trade Centre, *Investment Map* and N. Dihel and B. Shepherd, "Modal estimates of services barriers", *OECD Trade Policy Working Paper*, No. 51, Paris, Organisation for Economic Co–operation and Development (OECD), 2005.

[a] The FDI pool represents the cumulative flows between 1995 and 2004 as a percentage of GDP in 2004.

3. Other factors: human capital and information and communications technologies

Other fundamental factors in trade in services are the quality and cost of human capital and information and communications technologies (ICT). Several private consulting firms produce annual and biannual reports measuring the competitive level of a group of advanced and emerging countries for the purpose of hiring or establishing offshoring, nearshoring or outsourcing services.[26] The measurements shown in these specific reports are more useful than general indicators for measuring true competitiveness, especially that of the large countries. For example, even though at the national level China and India are behind the Latin American average with respect to the penetration of ICT and levels of human capital, the consultancies always classify them as being more competitive than the countries in the region. In fact, the national averages may mask a considerable degree of heterogeneity within a given country. Although India is still a poor country in general terms, it has managed to attract a significant share of world trade in terms of outsourcing and subcontracting abroad for information technology (IT) services, thanks to the advanced development of certain cities and regions.

In this context, the competitiveness of different countries was assessed on the basis of indicators provided in the Global Services Location Index 2007 (GSLI) by AT Kearney and of qualitative information. The Global Services Location Index consists of three categories and 13 subindexes: costs (labour, infrastructure, and taxes and regulation), business environment (country risk, quality of infrastructure, cultural adaptability and security of intellectual property) and human capital (availability of labour, training and language, experience/skills in negotiation processes and retention of employees). The final index is a weighting of the three subcategories. The type of indexes considered and the weighting were arrived at after multiple interviews with major stakeholders in the offshoring industry and in outsourcing. The indicators are "objectives" and are comparable between countries. The information is taken from different sources and hence was not obtained from surveys.

The countries that stand out most in the classification are India and China, while the others are similar to each other (see figure III.9). Each country has certain advantages that make it interesting as a destination for investment and trade. The classifications used by other consultancies also show India and China in first and second place, but the order of the Latin American countries and ASEAN countries varies from one ranking to another because they are relatively close to each other. Both groups of countries are mixed in the final classification. Thus, some Latin American countries are ranked higher than Singapore, which has a better business environment but very high costs.

(a) Human capital

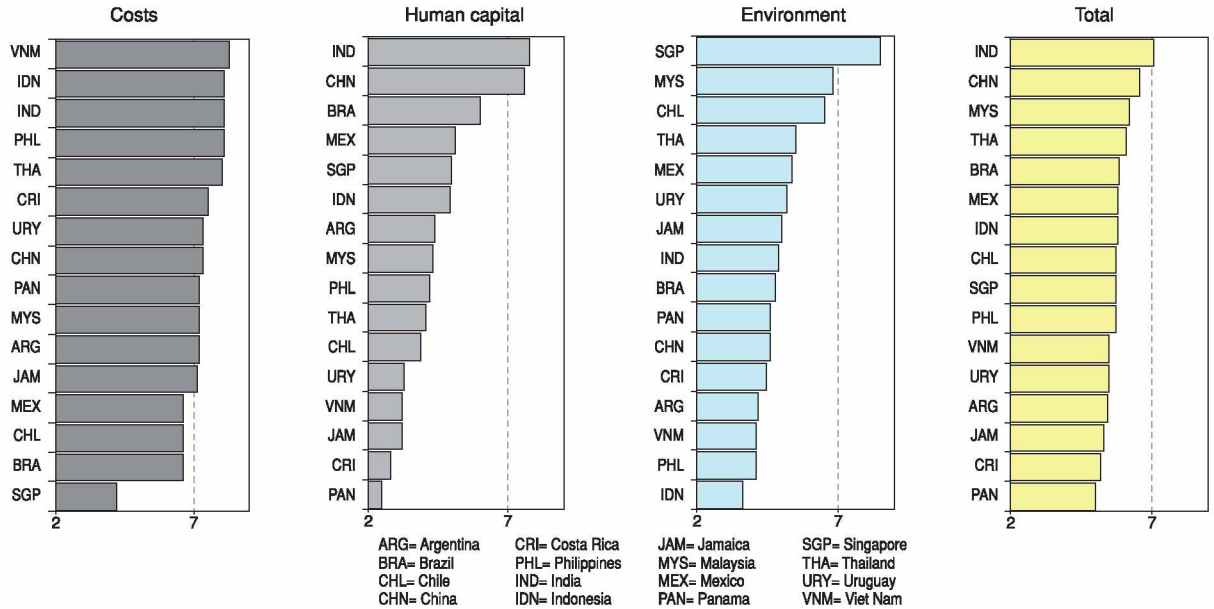
The greatest competitive advantage that India and China have over Latin America and the Caribbean and the ASEAN countries is the large number of highly skilled workers who receive very competitive wages, despite the fact that the general population has a lower level of schooling than the average in Latin America. China and India have a huge economic critical mass which enables them to create niches of excellence despite their poverty levels. Several excellent universities and technology institutes have been set up in India which turn out some 200,000 graduates per year, including 75,000 information technology engineers. China is in a similar position, with some 50,000 IT graduates per year. India has the additional advantage of a common language with the United States, its main trading partner, and this has contributed to the establishment of a large number of call centres.

Although in general terms, Latin America and the Caribbean do not match the number of university and IT graduates in India and China, some centres of excellence have been created, especially in the major cities.[27] As a result, the services industry in those

[26] These include CIO (2006), AT Kearney (2007a) and Diamond Cluster (2006).

[27] Buenos Aires and Córdoba in Argentina; Rio de Janeiro, São Paulo and other cities in southern Brazil; Santiago in Chile; Bogotá in Colombia; San José in Costa Rica; and Ciudad Juárez, Mexico City, Monterrey and Tijuana in Mexico, among others (AT Kearney, 2007b).

Figure III.9
APPEAL OF COUNTRIES FOR LOCATION AND TRADE IN SERVICES IN 2007



Source: AT Kearney, *The Global Services Location Index*, Chicago, Illinois, 2007.

countries has grown considerably. Brazil, for example, has 15,000 IT graduates per year (CIO, 2006). In addition to having gained experience in the domestic market, the region's service industry has a highly qualified work force that could increase exports. According to AT Kearney (2007b), among the eight Latin American countries that are most attractive to international business in the remote services sector, the availability of skilled labour is adequate in Argentina, Brazil and Mexico; intermediate in Chile and Costa Rica; and is inadequate in Colombia. In terms of language skills, while some countries such as Argentina, Costa Rica and Mexico have a significant number of bilingual people (Spanish–English) who can serve the United States market, language skills are scarce in other countries including Brazil, Chile and Colombia. The governments of these and other countries are paying more attention to the teaching of English. Spanish is also becoming increasingly important in cross–border services with the United States, given the growing Spanish–speaking population of that country. Mathematics is another important skill for trade in services, but in that regard, the region is way behind the Asian countries. In fact, the results of standardized mathematics tests (Trends in International Mathematics and Science Study (TIMSS 2003) and OECD Programme for International Student Assessment (PISA)) that were administered in several countries showed that Asian students (especially in Singapore, Republic of Korea, Hong Kong SAR (China) and Malaysia) scored higher than students in Argentina, Chile and Brazil.

Another problem that arises in competing with the Asian countries is the wage level, although worker productivity must also be considered. For example, wages for IT programmers or call centre operators in India and the Philippines range between one third and one half the average of the top eight Latin American countries. Taking into account differences in productivity and nominal exchange rates, Argentina and Uruguay are the most competitive countries in the region and can compete with India in certain services. Considering that wages in India are rising by two digits per year (15% in 2006), Latin America is becoming a more appealing destination, as shown by the investments made in the region by Indian companies such as TATA.

(b) Access and quality of information and communications technologies

Other variables that affect the performance of exporters of services are the quality and cost of telecommunications, internet access and other information technologies. A study by Freund and Weinhold (2002) showed that improving Internet access can enable a trading partner of the United States to increase its exports of services to the United States

market by 1.7%. Different classifications suggest that the quality of infrastructure in Latin America and Asia is similar, but costs are somewhat higher in the Latin American countries. Within the region, Chile stands out for the quality of its infrastructure and Argentina for its low costs in 2007.

One factor that has had a negative effect on the cost of access to information and communications technologies (ICT) in Latin America and the Caribbean is the fact that, unlike Asia, only a few countries (Costa Rica, El Salvador, Guatemala, Nicaragua, Panama and the Dominican Republic) have signed the WTO Information Technology Agreement (ITA). The 70 countries that signed the Agreement in 2007 account for 97% of world trade in IT products. These countries have undertaken to import those products duty free on the basis of most–favoured–nation treatment. However, no South American country has signed the Agreement, although some, such as Chile, apply a most–favoured–nation (MFN) zero tariff.[28] Consequently, enterprises in several South American countries are at a disadvantage because of the added cost of acquiring foreign technologies compared with companies in the signatory countries. Brazil, for example, applies a 13% MFN tariff on ICT products in order to protect its national industry.

Another key factor in competition is the ability to guarantee high standards of quality of the services provided by means of international certification. This is essential in overcoming cultural barriers and prejudices in advanced countries regarding standards of services provided by developing countries. Quality standards for industrial products (ISO 9000) and the Capability Maturity Model (CMM) are two certifications that are fundamental. The Capability Maturity Model, which has five levels, is a model for evaluating and improving software processes. Level 5 is the highest and refers to the most important processes that must be complied with by the company concerned (Prieto, 2003).

D. Promoting the sector

In brief, although Latin America and the Caribbean have been less successful than India and China in attracting the growing international demand for services, there is a great potential for changing this trend. The region has several advantages that make it an increasingly appealing alternative for outsourcing and nearshoring: a growing contingent of skilled labour at fairly competitive wages, a sound technological infrastructure and the same culture as other Western countries. Moreover, interest in the Spanish language has increased internationally, as have the English language skills of Latin Americans. The region is geographically close to the large importers of services —the United States and Canada— and is in the same time zones. The increasing political and macroeconomic stability of most Latin American countries is another positive trend.

Although the conditions for taking better advantage of opportunities for trade in services are relatively good, the change will not be automatic and will require a considerable effort on the part of the public and private sectors, as they must continue to improve the quality of services at competitive prices. In promoting services, the focus should be on the main obstacles hindering the sector's development. The following is a discussion of two important issues that are relevant to the preceding section: liberalization and recognition of regulatory frameworks among countries under bilateral and regional treaties, and the effort of the public and private sectors to improve the supply of

[28] Chile eliminated tariffs on all information and communications technology products after signing the free trade agreement with Canada in 1997.

skilled labour and create a legal framework that will encourage production and the use of information and communications technologies (ICT). In addition to these, there are many other ways to encourage trade in services, including by improving access to financing, granting tax incentives, promoting innovation and improving the logistical apparatus (see ECLAC, 2003 and Prieto, 2003).

1. Services in intra– and extraregional integration[29]

In some Latin American and Caribbean countries, as in other regions, the dynamism of activities and trade in services seems to have been determined and controlled by technological change and regulatory reform. Liberalization of trade in services in the context of trade agreements signed in the region has been relatively slow compared with these changes. Moreover, deregulation of this activity in most of the countries has been an independent decision made in the context of specific trade agreements.

Mexico was the first country of the region to negotiate liberalization of trade in services in the context of a trade agreement, namely, the North American Free Trade Agreement (NAFTA). These negotiations took a new approach to liberalization in that cross–border trade in services was separated from the sale of services through foreign direct investment (mode 3) and accordingly, the relevant rules and disciplines were established. At the same time as NAFTA, the General Agreement on Trade in Services (GATS) was negotiated in the context of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT).[30]

The first generation of agreements between Latin American countries, especially in the framework of the Latin American Integration Association (LAIA), included a clause allowing further negotiations on services. However, it was not until the late 1990s that this dimension of trade began to be included in agreements.

The three incentives that led to the definitive inclusion of services on the trade agenda of the region during the 1990s were the entry into force of NAFTA, GATS and the decision of the countries in the region to begin negotiations on the creation of the Free Trade Area of the Americas (FTAA); that decision was taken in April 1998. Prior to that, for almost four years, a collective analysis had been made of the implications of negotiations on services in the context of free trade agreements, and it was decided that the latter should be included in the results of negotiations on FTAA.

After Mexico, Chile was the second country of the region to actively include this dimension in its trade negotiations. Following the NAFTA model, services were included in the agreement with Canada that was signed in mid–1997.

On 11 June 1998, the Andean Community adopted Decision 439, on a General Framework of Principles and Rules and for Liberalizing Trade in Services in the Andean Community, in fulfilment of the provisions of articles 79 and 80 of the Cartagena Agreement. On 30 October 2001, the Commission of the Andean Community adopted Decision 510, which contained an inventory of measures in force at the time that restricted trade in services, and provided that such measures should be eliminated by 1 January 2006. This was achieved on 14 December 2006 with the adoption of Decision 659, on services sectors where rules would be liberalized or harmonized.[31]

The Andean Community adopted a liberalization model for the services sector which is similar to that of GATS but lays down a procedure for countries to list

[29] For a review of trade in services in the context of agreements signed in Latin America and the Caribbean, see Marconini (2005 and 2006), Sáez (2005) and Stephenson (2002).

[30] The Treaty of Rome, creating the European Community, lays down the principles governing trade in services among Member States. Such trade is governed by the provisions on the "right of establishment" and freedom for suppliers to provide services. In addition, there are other provisions and specific rules for certain sectors, such as transport and financial services. During the 1990s, this dimension of the European Common Market received priority attention, especially with regard to financial services and telecommunications. Recently, some guidelines for further liberalizing professional services have been met with considerable opposition.

[31] See Andean Community (2007), for a description of the different stages in the regional integration of services.

those measures that are incompatible with the agreed rules (negative list) and undertook to eliminate them and not to introduce new restrictions (Andean Community, 2007).

The MERCOSUR countries also followed the GATS model in liberalizing trade in services on the intraregional market, but only in the sectors specified in the schedules of commitments (positive list). The Montevideo Protocol, which lays down the regulatory framework for trade in services, was adopted in December 1997. The first commitments were annexed in July 1998, but the agreement only entered into force in December 2005, once the process of ratification by the legislatures of Member States was finalized. One of the main objectives of the Montevideo Protocol on Trade in Services in MERCOSUR is to complete, no later than ten years from the date of entry into force of the Protocol, the programme of liberalization of trade in services of MERCOSUR (article XIX). Annual negotiations are to be held to that end.

Although the Protocol entered into force in December 2005, six rounds of negotiations have been held since 1997, at which new sectors have been added to the commitments undertaken.[32] These negotiations have made it possible to move forward in consolidating the existing restrictions, but they have not led to any significant liberalization of the market within the free trade zone (Grupo de Servicios del MERCOSUR (no date)).

Progress has been made in the drafting of common regulatory instruments, especially those aimed at facilitating the temporary movement of persons. In particular, the Agreement on the creation of the MERCOSUR visa; the Mechanism for the exercise of temporary professional services and the Agreement on the facilitation of business activities. Ratification of these instruments by the legislatures of Member States is still pending.

In 1997, CARICOM adopted an approach to services integration that enshrined the right of establishment, namely, the right to carry out any commercial, industrial, agricultural, professional or artisanal activities and to create and administer any type of organization. This agreement also grants persons in Member States the freedom to provide services. In addition, there is a commitment not to establish new restrictions and to remove existing ones. The latter goal was to have been reached by 31 December 2005.

In negotiations conducted by the United States with Chile, Central America, Colombia and Peru, the NAFTA model was adopted, while European Union negotiations with Mexico and Chile used the GATS model, as will probably be the case with the Andean Community, Central America and MERCOSUR (Fereira Portela, 2001). One might ask how and to what extent these negotiations between certain countries of the region and the United States and Europe have progressed further than multilateral negotiations and negotiations within the region.

Marconini (2006) conducted a comparative study of the provisions of the World Trade Organization, NAFTA and the agreements recently negotiated by the United States with Latin American countries, the European Union and Japan. Both the GATS model, followed by the European Union, and NAFTA, used by the United States, are similar in scope with respect to the measures that affect services, and they make a distinction between trade in services and modes of supply.[33] However, they differ in regard to the depth with which each of these issues is treated.

In the GATS model, the same disciplines are applicable to all the modes of supply. In the case of NAFTA, the disciplines are developed separately, with a distinction being made between those that apply to "cross–border trade" (including modes of supply 1, 2 and 4 of GATS), investment (mode 3 of GATS) and procedures applicable for access of businesspersons in the destination market (mode 4). However, this criterion has not been uniform, especially in the agreements signed by the United States subsequent to the agreements with Chile and Singapore, which contain no provisions on "businesspersons".

According to Marconini (2006), it is not possible to determine a priori if the agreements signed by the United States, the European Union and Japan have created more liberalization than the results of WTO negotiations. In some cases, certain sectors have been excluded, such as air transport and audiovisual services, while in others the scope of application in certain areas has been limited. For example, movement of natural persons has been limited to "businesspersons", while GATS includes all categories of service suppliers. Finally, in other cases, certain sectors or activities

[32] For the Spanish text of the Protocol of Montevideo, see Foreign Trade Information Service (SICE) (undated). For an assessment of efforts carried out to date, see Services Group of MERCOSUR (no date).

[33] Modes of supply are defined as: (i) cross border; (ii) consumption abroad; (iii) commercial presence; and (iv) presence of natural persons.

have been excluded by way of negotiated reservations (maritime transport and subfederal and municipal measures).

In other regards, however, some agreements have gone beyond the WTO provisions, including in financial services or telecommunications and even some disciplines of the maritime transport sector (in the context of agreements negotiated by the European Union) (Pereira Gonçalves and Stephanou, 2007; Sáez, 2005b). Also, rules of origin applicable to service suppliers appear to be more flexible than those agreed in GATS.[34] Furthermore, agreements negotiated by the United States and Japan in the area of investment (applicable to services established through commercial presence) include stricter disciplines in terms of performance requirements and the prohibition to establish local–presence requirements as a condition for providing a service.

One of the main elements supplementing the disciplines regulating trade in services are the schedules of commitments whereby the countries define those sectors and terms that will be subject to the provisions on trade in services. The agreements negotiated by the United States and Japan include a larger number of disciplines, follow a negative–list approach (everything is included except that which is expressly excluded), and adapt the level of commitments to the regulatory status quo (consolidation); these agreements are considered more transparent and liberalizing than the GATS model followed by the European Union. As noted above, however, the actual level of liberalization is determined by the content of the schedules of commitment. In WTO, in the subregional agreements like NAFTA, and in the aforementioned bilateral agreements, liberalization has been approached from a standpoint that has simply maintained the prevailing regulatory situation without achieving true liberalization of trade in services (Marconini, 2006; Sáez, 2005b). This has also been the objective achieved in the case of MERCOSUR, whereas the Andean Community has tried to freeze the current situation, assuming a commitment to liberalization supplemented by specific disciplines in certain sectors. Since this is a very recent development, it is difficult to assess its effects.

Marconini (2006) discusses four aspects of the provisions on domestic regulation that are applicable to trade in services: transparency, good governance, requirements and recognition. The agreements negotiated by the United States and Japan seem to move towards transparency and good governance, as they establish requirements relating to the drafting and the procedure for adopting and applying rules, issues which are not addressed in the agreements signed by the European Union. As Sáez (2005b) points out, however, none of the agreements show progress specifically in terms of reducing the costs involved in rules and regulations that service suppliers must comply with in order to be able to carry out their activities. Nor do they clarify the conditions under which domestic regulations might be considered "unnecessary barriers to trade", an issue that is at the centre of the debate on trade in services and trade agreements.

The difficulties involved in addressing liberalization of trade in services are closely related to the regulatory changes that must be made, economic policy and the practical implications for managing economic and development policies (Marconini, 2006; Sáez, 2005). It is therefore advisable to keep open the possibility of creating new regulations should the existing ones prove inadequate and provided they are not challenged under the dispute settlement system as being contrary to the commitments assumed or as being unnecessary barriers to trade. Another aspect that should be considered is the degree to which the desired policies are aimed at discriminating against foreign suppliers or to give the State an advantage as a service provider. Consequently, the most direct repercussions may be seen in the type of policy instruments applied and their effect (discrimination in favour of national suppliers) and the degree of State participation in the provision of services, either as a regulator or as a direct supplier (Sáez, 2005b).

Both GATS and the aforementioned agreements, including those negotiated by the United States, contain a number of mechanisms that enable countries to define a priori the policy options they wish to keep open. In other words, sovereign decisions concerning policies and instruments are preserved, and the sectors affected, including the type of State participation in the activity, are policy decisions that can be adequately addressed in the context of international negotiations. What is important is that governments should be able to clearly identify their policy objectives and the tools to be used in achieving them.

[34] Although these might be relevant only for those countries that are not members of GATS, given that the most–favoured–nation clause requires all WTO members to receive equal treatment.

2. Human capital, technology and quality

Other areas in which exports can be promoted are the training of skilled workers and the creation of an environment in which investment and information technologies are encouraged. Cooperation between the public and private sectors is key to identifying problems and formulating policy proposals.

(a) Human capital

The improvement of human capital, a key factor in India's success, is probably the most important challenge facing Latin America and the Caribbean. Priority should be assigned to three areas. In the first place, since many services require highly skilled personnel, the public and private sectors should offer incentives for university–level ICT programmes, as well as training programmes, especially for small and medium–sized enterprises. Furthermore, governments should ensure the quality of technical education by requiring accreditation at regular intervals. And finally, citizens should be encouraged to learn English, the main language of international trade, and the teaching of mathematics and information technologies in secondary schools should be improved.

(b) Development of (information) technology and certification

An important step in promoting access to modern (information) technologies —including in the telecommunications sector— is to improve regulatory policies and competition so as to encourage investment and guarantee high–quality services at the lowest possible cost. The increased availability of broadband internet connections facilitates the sale of more complex electronic services at the international level. Broadband goes a long way towards promoting competitiveness and productivity. Public policies should encourage both the supply of and the demand for broadband, with special emphasis on small and medium–sized enterprises (Ueki, Tsuji and Cárcamo, 2005). This can be done by eliminating or reducing import taxes and value added taxes on IT equipment and related services. Another key measure will be to encourage (micro) entrepreneurs to use ICT by stepping up the development of e–government in the areas of registration and transactions with the business sector. Also, governments should strengthen programmes aimed at raising awareness and training businesses in ICT–related subjects and demonstrating the potential of ICTs for promoting innovation and competitiveness. It must be pointed out, however, that ICTs should not be considered a goal in themselves but rather a means of improving efficiency.

Exports of services can also be encouraged by promoting different types of certification, including quality standards for industrial products (ISO 9000). Such certification —which applies to the processes by which services are provided— enhances quality and international credibility. However, considerable resources are needed in order to obtain and maintain certification. Governments and trade organizations in the private sector have an important role to play in encouraging certification. Governments could set priorities for certain types of certification, maintain their requirements and prevent them from becoming a barrier to trade. Certification should be voluntary and only for a limited time. Private trade associations could carry out special activities for certifying the quality of different services and help entrepreneurs comply with the international quality standards that are applied to management techniques, rationalization of costs and quality control.

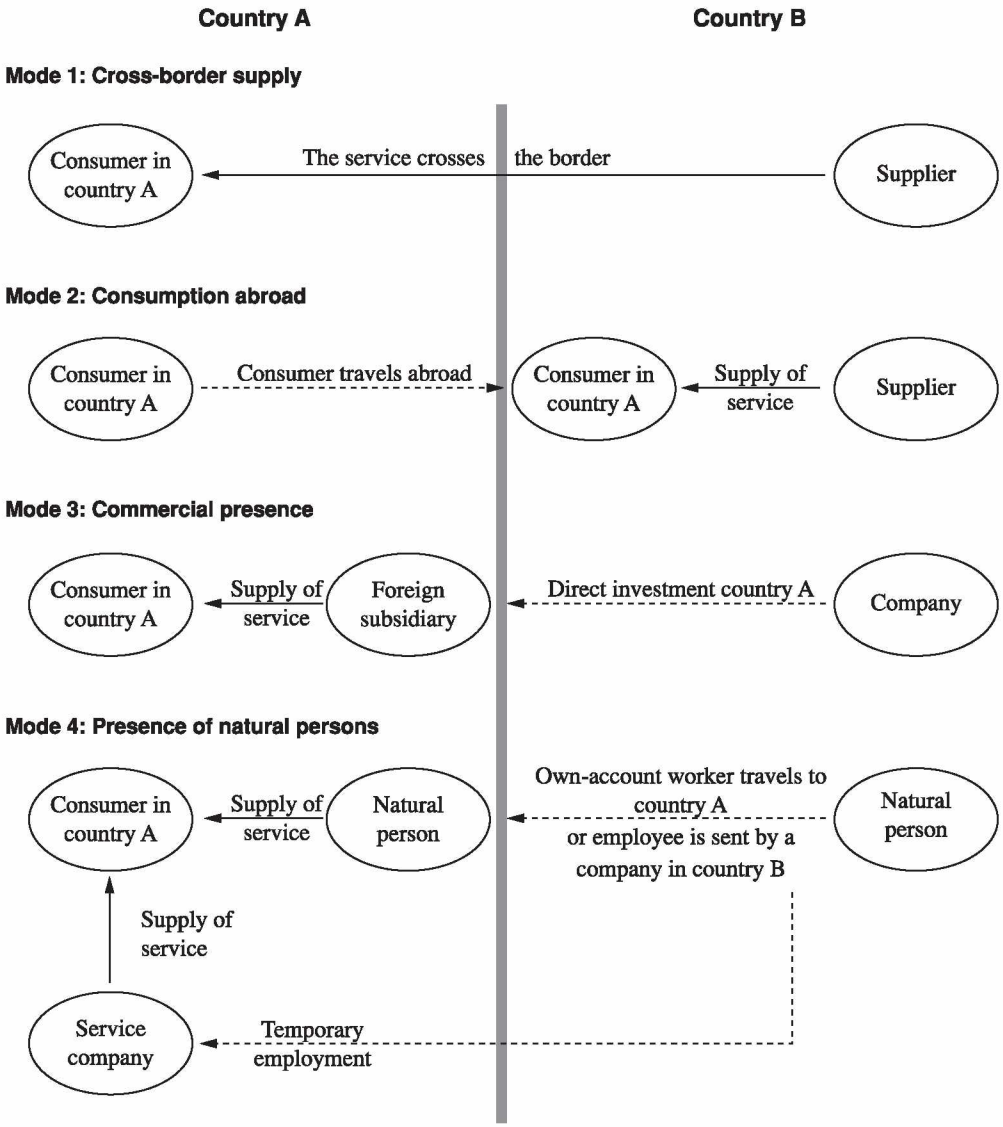
Annex

Table A.1
CLASSIFICATION OF TRADE IN SERVICES

Main category	Detail
Services:	
Communications	Post and courier activities Telecommunications
Construction	
Insurance	Life insurance and pension funding Freight insurance Other direct insurance Reinsurance Auxiliary services to insurance
Computer and information services	Computer services Information services (news agency services), other information provision services
Royalties and licence fees	Franchises and similar rights Other royalties and licence fees
Other business services	Merchanting and other trade–related services Operating leasing services Miscellaneous business, professional and technical services (including legal services, accounting, auditing; consulting, advertising, research and development, waste management and decontamination)
Excluded:	
Transportation Travel (including tourism) Personal, cultural and recreational services Government services	

Source: International Monetary Fund (IMF), *Balance of Payments Manual*, Washington, D.C., 1993.

Figure A.1
THE FOUR MODES OF SUPPLY FOR SERVICES IN INTERNATIONAL TRADE



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on information from the Organisation for Economic Co-operation and Development (OCDE).

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Chapter IV

Economic integration in Latin America and the Caribbean: the quest for complementarity and convergence

Introduction

The integration process is in a state of change in Latin America and the Caribbean. The Dominican Republic —Central America— United States Free Trade Agreement (CAFTA–DR) has come into effect in all the member countries, except in Costa Rica, where it is in the process of being ratified. This agreement's entry into force has injected vigour to the effort to renovate the Central American integration scheme. Meanwhile, the Single Caribbean Market has come into effect in 12 English– and Dutch–speaking member countries. Within that scheme, the subgroup of Eastern Caribbean countries also agreed, in mid–2007, to form an economic union. All this stands in contrast to the position in the other subregional integration schemes. The Bolivarian Republic of Venezuela withdrew from the Andean Community after two other members of the bloc concluded negotiations for a free trade agreement (FTA) with the United States. The country then requested and was granted full membership of the Southern Common Market (MERCOSUR). In 2007, the Bolivarian Republic of Venezuela negotiated time frames and conditions for implementation of the common external tariff and the incorporation of the MERCOSUR rules into its national legislation. Conversely, the new administration taking office in Ecuador indicated a wish to keep trade relations with the United States as they were, which led to the indefinite suspension of negotiations for an FTA.

The Andean Community is going through a period of adjustment and redefinition following the withdrawal of the Bolivarian Republic of Venezuela, the associate membership extended to Chile and the signature by Colombia and Peru of bilateral trade agreements with the United States.

Intraregional trade continued to expand, albeit at a more sedate pace than in the preceding years. The

proportion of intrasubregional trade, measured by exports, rose slightly in MERCOSUR and the countries of the Latin American Integration Association (LAIA), but declined somewhat in the Andean Community and the Central American Common Market (CACM) (see table IV.1).

In 2007, some of the region's countries, such as Colombia, Costa Rica, Panama and Peru, focused on trade relations with the United States and the entry into force of FTAs that had already been signed. For Bolivia, Colombia, Ecuador and Peru, the trade agenda was also marked by the extension of the Andean Trade Promotion and Drug Eradication Act (ATPDEA), in the context of wider debates on the extension of the United States President's Trade Promotion Authority (TPA) for the negotiation of trade agreements.

The Bolivarian Alternative for Latin America and the Caribbean (ALBA), an initiative of the Government of the Bolivarian Republic of Venezuela, has also remained active. ALBA was tabled as an alternative to the Free Trade Area of the Americas (FTTA) and initially, in December 2004, it was an agreement between the Venezuelan and Cuban governments, which were then joined by Bolivia in 2006. Nicaragua joined in January 2007, on the occasion of the group's fourth summit. The fifth summit, held at the end of April, was attended by the president of Haiti and representatives of Ecuador, Uruguay, Dominica, Saint Kitts and Nevis and Saint Vincent and the Grenadines, as well as the presidents of the four member countries (Carriba, 2007; Vaillant, 2007).

Table IV.1
LATIN AMERICAN AND THE CARIBBEAN: TOTAL EXPORTS BY SUBREGIONAL INTEGRATION SCHEME, 1990–2007
(Millions of current dollars and percentages)

	1990	1995	1998	2001	2002	2003	2004	2005	2006	January -March 2006	January -March 2007[d]
Latin American Integration Association (LAIA)											
Total exports (1)	112 694	204 170	251 345	316 298	319 807	346 145	427 835	506 557	614 960	141 695	152 443
Exports to LAIA (2)	13 589	35 471	43 118	41 934	36 164	40 872	56 777	72 251	89 815	19 299	22 805
Percentage intrasubregional exports (2/1)	12.1	17.4	17.2	13.3	11.3	11.8	13.3	14.3	14.6	13.6	15.0
Andean Community											
Total exports (1)	31 751	39 134	38 896	53 543	52 177	54 716	74 140	100 089	124 111	29 670	30 108
Exports to CAN (2)	1 312	4 812	5 504	5 656	5 227	4 900	7 604	10 313	12 719	2 680	2 848
Percentage intrasubregional exports (2/1)	4.1	12.3	14.2	10.6	10.0	9.0	10.5	10.3	10.2	9.0	9.5
Southern Common Market (MERCOSUR)											
Total exports (1)	46 403	70 129	80 227	89 078	89 500	106 674	134 196	162 512	190 789	40 581	46 372
Exports to Mercosur (2)	4 127	14 199	20 322	15 298	10 197	12 709	17 319	21 134	25 675	5 410	6 740
Percentage intrasubregional exports (2/1)	8.9	20.2	25.3	17.2	11.4	11.9	12.9	13.0	13.5	13.3	14.5
Central American Common Market (CACM)											
Total exports[a] (1)	4 480	8 745	14 987	16 328	17 006	18 117	19 767	21 849	24 821	5 907	6 795
Exports to MCCA (2)	624	1 451	2 754	2 829	2 871	3 110	3 506	3 912	4 429	1 062	1 243
Percentage intrasubregional exports (2/1)	13.9	16.6	18.4	17.3	16.9	17.2	17.7	17.9	17.8	18.0	18.3
Caribbean Community (CARICOM)											
Total exports (1)	4 955	5 927	5 537	7 544	7 110	8 624	10 395	14 125	18 522	...	...
Exports to CARICOM (2)	509	843	1 031	1 384	1 220	1 419	1 810	2 150	2 639	...	...
Latin America and the Caribbean											
Total exports[b] (1)	130 214	227 922	280 065	345 484	347 610	376 590	472 444	569 295	689 985	152 830	164 822
Exports to Latin America and the Caribbean[c] (2)	18 727	45 180	56 644	58 607	53 424	59 635	79 952	100 340	120 051	26 702	30 503
Percentage intrasubregional exports (2/1)	13.9	19.8	20.2	17.0	15.4	15.8	16.9	17.6	17.4	17.4	18.5

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the respective subregional grouping and the International Monetary Fund (IMF), *Direction of Trade Statistics*.
[a] Figures include maquila trade.
[b] Includes LAIA, CACM, the CARICOM countries, Panama, Cuba and the Dominican Republic.
[c] Includes intrasubregional trade in the Andean Community, MERCOSUR, CACM, CARICOM and trade between Chile and Mexico and the rest of the region, as well as trade between groups, plus exports from Cuba, Panama and the Dominican Republic to other countries in the region.
[d] Preliminary figures.

The principles of ALBA are enshrined in an instrument known as the People's Trade Agreement and basically consists of covenants of cooperation covering a broad range of issues, including energy, health and culture. Thus far, two such agreements have been signed, one by Cuba and the Bolivarian Republic of Venezuela and the other by those two countries and Bolivia. These agreements are based on the general principles of complementarity, solidarity, cooperation and respect for the sovereignty of peoples.[1] The ALBA countries recently signed up to three cooperation projects in the areas of education, culture and trade. The first two consist of literacy programmes and the creation of a development fund for culture. The third project, which is known as the ALBA Great National Fair Trade Project, consists of the creation of two large enterprises, one dealing with industrial supplies and the other undertaking exports and imports through a countertrade system based on networks of shops and storage facilities and sales of merchandise.

The second Summit of Heads of State of the Andean Community was held in Cochabamba, Bolivia in December 2006. This organ has gained some prominence in the region by tackling a broad agenda of issues including infrastructure–related matters. In addition, the first South American Energy Summit was held on Margarita Island, Bolivarian Republic of Venezuela on 16 and 17 April 2007. On this occasion, the Summit approved the Declaration of Margarita and created the South American Energy Council, which comprises the ministers of energy of each country and is mandated to prepare draft versions for the South American Energy Strategy, an Action Plan and the South American Treaty on Energy, which will be discussed at the third Summit of Heads of State of the Andean Community in Colombia in 2007.

A. The United States and the Latin American and Caribbean region[2]

In 2006 and 2007, the United States has focussed its trade agenda on multiple initiatives aimed at opening markets, both bilaterally and multilaterally, as part of a strategy of "competitive liberalization" (see table IV.2). In the rationale of this strategy, free trade agreements are a means to "establish the breadth and scope of potential multilateral agreements in years to come by setting precedents and by demonstrating the real benefits of free and fair trade" (Schwab, 2007).

In the western hemisphere, the United States signed trade promotion agreements with Peru and Colombia in 2006[3] and concluded negotiations with Panama late that year. Similarly to previous agreements, these instruments are broad in scope and cover all aspects of trade, including investment, services, intellectual property and government procurement, and they aim to eliminate tariffs and other barriers to trade in goods and services.

In late 2006 the United States Congress passed the Tax Relief and Health Care Act, whose most interesting aspect, from the perspective of the Latin American and Caribbean region, was its trade provisions. These broaden the scope of the Generalized System of Preferences (GSP) and the Andean Trade Preference Act (ATPA)/Andean Trade Promotion and Drug Eradication Act (ATPDEA) and authorize new trade preferences for textiles and clothing from Haiti. The Act also establishes normal and ongoing trade relations with Viet Nam.

1 See, for example, the declaration of 14 December 2004 signed by the Governments of Cuba and the Bolivarian Republic of Venezuela.

2 See ECLAC (2006a), which contains an outline of developments in this regard in 2006.

3 These two agreements are denominated "trade promotion agreements", unlike the arrangements with Chile, Central America and, more recently, Panama.

The GSP was also extended until 31 December 2008. This covers most of the preferences applicable to 3,400 products from 133 developing countries. The new legislation contains stricter rules regarding the use of exemptions on the grounds of "competitive need" with a view to limiting higher–income developing countries' use of the GSP. This could affect some exports from such countries as Brazil and India, which are among the largest users of GSP (see table IV.4), because the Act eliminates exemptions for all products of which a country exports more than 1.5 times the amount established for that particular calendar year —about US$ 180 million in 2006— or exceed the value of the country's imports of that product by 75%.

In the 2005–2006 biennium, the Latin American and Caribbean region's exports to the United States were worth an average of US$ 309.905 billion, of which only 1.7% came under GSP, while 7.6% corresponded to other preferential accords and over 40% were governed by FTAs. By 2006, the preferences applicable under CAFTA–DR were already on record at the United States Department of Commerce. Over 50% of exports to the United States from Chile, El Salvador, Honduras and Mexico are traded under FTAs (see table IV.3). Few of the region's countries invoked GSP in 2006, but the number of exports shipped under recently concluded FTAs increased. The main 20 GSP beneficiary countries include only four from the region: Argentina, Brazil, Colombia and Peru (see table IV.4).

Table IV.2
UNITED STATES: AGREEMENTS, PREFERENTIAL AGREEMENTS AND TRADE NEGOTIATIONS

Regional, bilateral and multilateral	Negotiations under way or beginning shortly	Negotiations concluded and pending ratification	Signed agreements in force
Multilateral	WTO (Doha Round)		
Western hemisphere	Free Trade Area of the Americas (FTAA); Ecuador	Colombia and Peru (2006); Panama (2006); Costa Rica (2004)	North American Free Trade Agreement (NAFTA) (Canada and Mexico) (1994); Caribbean Basin Trade Partnership Act (2000); Andean Trade Promotion and Drug Eradication Act (ATPDEA) (2002); Dominican Republic – Central America – United States Free Trade Agreement (CAFTA–DR) (El Salvador, Guatemala, Honduras, Nicaragua and the United States) (2006); Chile (2004)
Africa and the Middle East	South African Customs Union; United Arab Emirates		Israel (1985); Jordan (2001); Bahrain (2006); Morocco (2006); Oman (2006)
Asia and Oceania	Malaysia; Republic of Korea; Thailand		Australia, (2005); Singapore (2004)

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United States Trade Representative.

Table IV.3
UNITED STATES: PREFERENTIAL TREATMENT EXTENDED TO IMPORTS FROM WESTERN HEMISPHERE COUNTRIES
(Billions of dollars and percentages)

	Imports under GSP		Other tariff preference agreements[a]		Preferences under free trade agreements		Total imports	
	2005	2006	2005	2006	2005	2006	2005	2006
Latin America and the Caribbean	**1.8**	**1.6**	**8.1**	**7.1**	**38.1**	**41.5**	**290 671**	**329 139**
MERCOSUR	**14.6**	**14.6**	**0.0**	**0.0**	**0.0**	**0.0**	**29 781**	**30 657**
Argentina	13.3	17.0	0.0	0.0	0.0	0.0	4 648	3 925
Brazil	14.9	14.3	0.0	0.0	0.0	0.0	24 346	26 169
Paraguay	51.8	48.6	0.0	0.0	0.0	0.0	59	51
Uruguay	8.3	9.8	0.0	0.0	0.0	0.0	728	512
Chile	**0.0**	**0.0**	**0.0**	**0.0**	**54.5**	**57.7**	**6 745**	**9 551**
Andean Community	**2.2**	**2.0**	**57.1**	**59.9**	**0.0**	**0.0**	**20 060**	**22 510**
Bolivia	9.2	6.0	53.6	45.9	0.0	0.0	293	362
Colombia	2.2	2.0	53.1	51.9	0.0	0.0	8 770	9 240
Ecuador	1.0	1.0	74.4	76.0	0.0	0.0	5 874	7 011
Peru	3.4	3.0	44.5	54.3	0.0	0.0	5 123	5 897
Venezuela (Bolivarian Republic of)	**2.3**	**1.9**	**0.0**	**0.0**	**0.0**	**0.0**	**32 750**	**36 283**
Mexico	**0.0**	**0.0**	**0.0**	**0.0**	**63.3**	**64.5**	**169 216**	**197 056**
Central American Common Market (CACM)	**2.0**	**1.3**	**46.7**	**20.4**	**0.0**	**28.2**	**13 422**	**14 020**
Costa Rica	2.6	3.0	30.1	36.2	0.0	0.0	3 377	3 813
El Salvador	2.9	0.5	61.9	8.4	0.0	53.3	1 982	1 843
Guatemala	2.1	1.5	39.9	21.0	0.0	17.9	3 123	3 103
Honduras	1.5	0.3	63.1	14.9	0.0	53.6	3 758	3 735
Nicaragua	0.1	0.1	34.2	7.3	0.0	27.1	1 182	1 526
Panama	**6.2**	**7.2**	**12.5**	**9.8**	**0.0**	**0.0**	**320**	**338**
Caribbean countries	**1.0**	**1.0**	**32.1**	**37.5**	**0.0**	**0.0**	**18 377**	**18 724**
Bahamas	0.1	0.5	15.9	28.7	0.0	0.0	698	436
Barbados	2.8	0.0	12.5	15.2	0.0	0.0	32	33
Belize	1.5	4.1	56.1	49.3	0.0	0.0	98	146
Guyana	5.5	11.7	5.0	4.8	0.0	0.0	120	125
Haiti	0.4	0.3	68.0	76.4	0.0	0.0	447	496
Jamaica	2.5	2.6	44.6	52.2	0.0	0.0	341	471
Dominican Republic	3.3	2.9	54.0	54.6	0.0	0.0	4 603	4 540
Saint Kitts and Nevis	2.9	2.0	50.0	50.0	0.0	0.0	50	50
Saint Vincent and the Grenadines	0.2	1.1	6.3	0.0	0.0	0.0	16	2
Saint Lucia	1.3	1.3	9.2	18.9	0.0	0.0	65	37
Suriname	0.0	0.1	0.0	0.6	0.0	0.0	165	164
Trinidad and Tobago	0.1	0.1	35.1	43.8	0.0	0.0	7 793	8 398
Others[b]	**0.0**	**0.0**	**0.2**	**0.1**	**0.0**	**0.0**	**3 949**	**3 826**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the International Trade Commission (USITC).
[a] Includes the tariff preference agreements extended by the United States to different groups of countries in the region: the Andean Trade Preference Act (ATPA) and the Andean Trade Promotion and Drug Eradication Act (ATPDEA) with Bolivia, Colombia, Ecuador and Peru, as well as the Caribbean Basin Initiative (CBI) and the Caribbean Basin Economic Recovery Act (CBERA) with the countries of Central American and the Caribbean Basin.
[b] Includes Anguilla, Antigua and Barbuda, Aruba, the British Virgin Islands, Grenada, Montserrat, the Netherlands Antilles and the Turks and Caicos Islands.

Table IV.4
UNITED STATES: MAIN BENEFICIARIES OF GENERALIZED SYSTEM OF PREFERENCES, 2006
(Millions of dollars)

Order	Beneficiary developing country	Tax–free imports under GSP	Total imports from the country	Percentage of imports into the United States under GSP
1	Angola	5.92	11.72	50.5
2	India	5.67	21.83	26.0
3	Thailand	4.25	22.47	18.9
4	Brazil	3.72	26.39	14.1
5	Indonesia	1.89	13.40	14.1
6	Equatorial Guinea	1.34	1.73	77.3
7	Philippines	1.14	9.70	11.8
8	Turkey	1.12	5.36	21.0
9	South Africa	1.07	7.53	14.2
10	Venezuela (Bolivarian Republic of)	0.69	37.17	1.8
11	Argentina	0.67	3.97	16.8
12	Russian Federation	0.51	19.78	2.6
13	Kazakhstan	0.48	0.96	50.3
14	Chad	0.40	1.92	21.1
15	Yemen	0.34	0.45	75.5
16	Romania	0.27	1.12	24.6
17	Colombia	0.18	9.27	2.0
18	Peru	0.18	5.88	3.0
19	Croatia	0.15	0.35	41.3
20	Sri Lanka	0.14	2.14	6.7
21	Dominican Republic	0.13	4.53	2.9
24	Costa Rica	0.11	3.84	3.0
25	Ecuador	0.07	7.09	1.0
27	Guatemala	0.07	3.10	2.2
32	Uruguay	0.05	0.51	9.8
39	Paraguay	0.03	0.06	47.5
40	Panama	0.02	0.38	6.4
42	Bolivia	0.02	0.36	6.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United States International Trade Commission (USITC).

ATPDEA was extended for an additional six months in the cases of Bolivia, Colombia, Ecuador and Peru. Subsequently, another similar measure was approved for countries whose legislatures concluded the approval of a trade promotion agreement with the United States. Only Colombia and Peru are in the process of being granted a second automatic extension and the United States Congress still has to approve the respective free trade agreements. In March 2007, however, the democrat majority in the United States Congress was examining the possibility of extending the preferences for a two–year period after their expiry in June 2007. Non–renewal of ATPDEA could hurt the beneficiary countries, especially Bolivia and Ecuador, which are the less developed members of the group. Of the possible consequences of ATPDEA not being renewed, the worst are job losses, migratory pressure on the United States and drops in well–being, not only in the Andean countries but also for United States consumers (USITC, 2005; Durán, 2007).

After tough negotiations in the United States Congress and thanks to an agreement brokered by the Committee on Ways and Means, four days before its expiry ATPDEA was extended for a further eight months, with an expiry date of 29 February 2008. This extension comes as a relief for Bolivia and Ecuador, because it affords their exporters some breathing space. The time left is still quite short, however, and is causing concern in many business circles. For Peru and Colombia the additional time serves as a bridge while their respective governments await approval of the FTAs negotiated in the last two years, but if the United States Congress should fail to approve the pending agreements they will be obliged, like Bolivia and Ecuador, to request further extensions in the future.

In the first four months of 2007, among other issues on the trade agenda of the United States Congress and government was the matter of how labour and environmental provisions would be incorporated into new trade agreements signed. With respect to the agreements awaiting approval by Congress, a consensus was reached that the legislation and practices of partner countries must comply with the obligations set out in chapter I of the International Labour Organization (ILO) Declaration on the Fundamental Principles and Rights at Work, adopted in 1998. It was also made obligatory to sign seven agreements on the environment and undertake to implement any multilateral agreements signed (*Inside U.S. Trade*, 2007a).

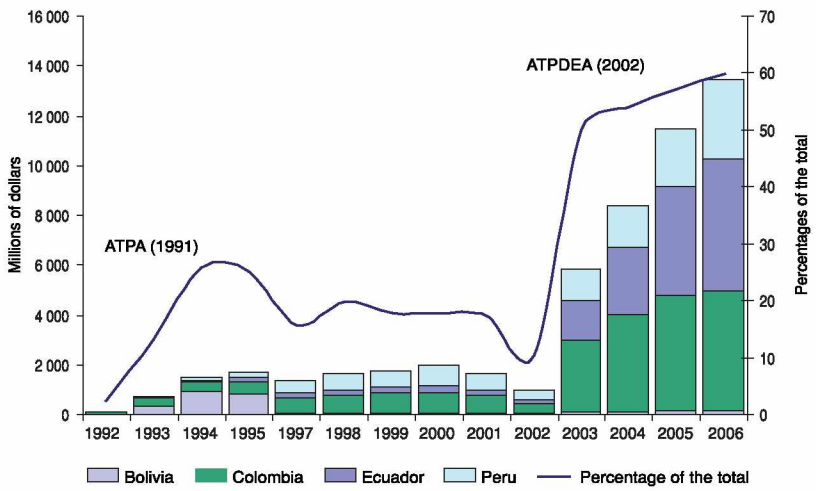
ATPDEA was enacted in 2002, substituting and broadening the Andean Trade Preference Act of 1991 (ATPA), which was designed to stimulate a more diversified type of economic growth and combat drug production and trafficking. ATPDEA allowed tax–free market access for an initial list of 700 products, which later swelled to a total of 6,300. The following products, among others, come under the Act: leather articles, petroleum and petroleum products, refined copper, fresh flowers, asparagus, textiles, made–up clothing, footwear, tuna and clothing assembled from United States fabric.

In 2006, more than half of imports into the United States from Bolivia, Colombia, Ecuador and Peru, with a value of US$ 13.5 billion, entered the market under the ATPDEA programme (see figure IV.1). Ecuador, Colombia and Peru were the main suppliers from the Andean group.

The preferences applicable to Haiti were augmented through a new provision added to the Caribbean Basin Initiative, the Haitian Hemispheric Opportunity through Partnership Encouragement Act (HOPE), which authorizes tax–free entry for new Haitian products, including electrical cable for automobiles and clothing. The Act will come into effect once the President of the United States is able to certify to Congress that Haiti has met certain requirements and stipulations regarding reshipments.

The Caribbean Basin Trade Partnership Act expires in 2008. Discussions about alternative courses of action thereafter were to take place at the Conference on the Caribbean: A 20/20 Vision in Washington, D.C. in June 2007.

Figure IV.1
UNITED STATES: IMPORTS FROM ATPDEA BENEFICIARY COUNTRIES, 1992–2006
(Millions of dollars and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United States International Trade Commission (USITC).

B. MERCOSUR: larger but weaker

The year 2006 represented a very particular period in the recent history of MERCOSUR. On the one hand, it may be argued that, with the establishment of the MERCOSUR Parliament at the end of the year and the holding of the MERCOSUR Social Summit, MERCOSUR has ceased to be a matter exclusively for governments and administrations and has broadened to include civil society. On the other hand, concern has mounted over the need to extend differential treatment to smaller partners and to weaker economic agents.

On the trade front, intrasubregional exports swelled by over 20%, generating a half–percentage–point rise in the proportion of these exports, which were up from 13% to 13.5% en 2006. This momentum continued into the first quarter of 2007 and the proportion rose a further point to 14.5% (see table IV.5). The upturn in intrasubregional trade in MERCOSUR owes much to bilateral trade between Argentina and Brazil which is becoming more stable. Trade in industrial manufactures from Argentina and Brazil climbed strongly up to March 2007, with a steep rise in sales of vehicle parts, common metals and chemicals.

Table IV.5
MERCOSUR EXPORTS, 1990–2007
(Millions of dollars and percentages)

	1990	1995	1998	2001	2002	2003	2004	2005	2006	January -March 2006	January -March 2007[a]
Total exports (1)	46 403	70 129	80 227	89 078	89 500	106 674	134 196	162 512	190 789	40 581	46 421
Percentage annual growth	-0.3	13.3	-2.9	4.0	0.5	19.2	25.8	21.1	17.4	15.9	14.4
Exports to MERCOSUR (2)	4 127	14 199	20 322	15 298	10 197	12 709	17 319	21 134	25 675	5 408	6 740
Percentage annual growth	7.6	17.8	-1.1	-13.6	-33.3	24.6	36.3	22.0	21.5	18.6	24.6
Percentage exports intra–MERCOSUR (2/1)	8.9	20.2	25.3	17.2	11.4	11.9	12.9	13.0	13.5	13.3	14.5

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

1. Differential treatment for smaller partners and agents

In the interests of providing differential treatment for smaller partners and agents, on 15 December 2006 the Minister of Finance of Brazil and the Minister for Economic Affairs of Argentina signed a protocol of intent to implement a system of payments in local currency for bilateral trade in the second half of 2007, with obvious benefits for SMEs. In January 2007, however, the governments of Uruguay and Paraguay indicated that the elimination of the United States dollar for regional transactions would not be acceptable to them. Hence, although the project has moved into a phase of technical preparation, it affects mainly trade between the two largest partners.

Also with a view to countering trade distortion, on 9 January 2007 the Government of Brazil announced its decision to eliminate the double levy of the common

external tariff (CET) on products imported by MERCOSUR. One possibility would be to use a certificate of exemption to allow products to circulate within the bloc. The political decision has been taken, but the measure still hinges on a number of feasibility studies. Uruguay is the country to have lobbied most strongly for an end to the double CET levy. Paraguay has objected, however, fearing fiscal losses, since tariff levies represent 18% of its government's total receipts.

An end to the double CET levy is also one of the European Union's requirements in negotiations between the two blocs and the matter is working its way through the technical procedures. The lack of a regional institution to administer the receipts from the tariff levy and the constitutional restrictions on the allocation of resources are the two main stumbling blocks standing in the way of a rectification of this distortion.

Also in January 2007, Brazil announced that it would facilitate the entry into its territory of Uruguay and Paraguayan products by reducing the level of national content required to qualify for tariff preferences, which is currently set at 40% for Paraguay and 50% for Uruguay. Brazil proposed that MERCOSUR should reduce those percentages to 30% for Uruguay and 25% for Paraguay. At the MERCOSUR Summit in Rio de Janeiro, held on 18 January 2007, it was agreed to postpone the decision on whether to extend those benefits. The Summit also set up a task force of deputy ministers to examine support measures for smaller partners, with proposals to be submitted to a ministerial meeting in April.[4]

The MERCOSUR Structural Convergence Fund could help to compensate smaller members for possible losses in receipts and could also, given the difficulty in making progress on other issues, represent a form of partial compensation that would benefit those members in other ways. The fund holds a capital of US$ 100 million, of which 75% corresponds to contributions from the Government of Brazil. Eleven pilot projects were approved at the Rio de Janeiro Summit, with a total cost of US$ 73 million. Of these, five are located in Paraguay, two to build up the capacities of the MERCOSUR Technical Secretariat and one to combat foot–and–mouth disease in the region.

Some less controversial initiatives refer to production complementarity among the five economies. In December 2006, the ministers approved a number of measures in this direction. Petróleo Brasileiro (Petrobras) will be at the heart of an effort to coordinate a network of enterprises to bring them up to the standards of quality, innovation and price that their suppliers require, in order to increase the share of the region's goods– and services–producing firms in petroleum and gas projects throughout the world.[5]

In early May 2007, six of the region's ministers of economic affairs (Argentina, Bolivarian Republic of Venezuela, Bolivia, Brazil, Ecuador and Paraguay) met to agree upon the creation of the Bank of the South. One of the purposes of this institution will be to finance infrastructure projects, especially those that can contribute to regional integration.

2. Enlargement of MERCOSUR

The process of enlargement has become increasingly important for the future of MERCOSUR. On 15 December 2006, the Common Market Council approved a request for entry from Bolivia. However, rather than formalizing the request in order to become a full member as the Bolivarian Republic of Venezuela had done, Bolivia asked for the establishment of an ad hoc task force to examine the costs and benefits of full

4 The proposal has generated some internal conflict. The National Confederation of Industry of Brazil opposed the proposal to make the MERCOSUR rules of origin more flexible, on the basis that industry had not been consulted by the government.

5 Measures have also been examined for the automobile sector, including the integration of assembly firms and producers of vehicle parts with locations in more than one country and, for the tourism sector, the interconnection of business between hotels and manufacturers of products the sector uses, such as bed–linen, uniforms, towels, foods and others. Similarly, Brazil and manufacture parts for tractor assembly operations. These factories now pay tariffs of between 14% and 18%, but under the proposal would pay 8%.

membership, with conclusions to be submitted in a period of 180 days, renewable for a further like period. Bolivia intends to continue as a member of the Andean Community and has made no commitment to substitute the Andean CET for that of MERCOSUR.

The new Administration in Ecuador did not request full membership of MERCOSUR at the Summit of January 2007, preferring to remain as an associate member of this group and retain the benefits of its Andean Community membership.

The protocol of adherence signed with the Bolivarian Republic of Venezuela[6] in July 2006, which formalized the country's entry as a new partner in the bloc, represented an unprecedented step in the regional integration process: this was the first time since its formation in 1991 that MERCOSUR had been enlarged and had admitted a new full member into the customs union. Up till then, relations between MERCOSUR and the Bolivarian Republic of Venezuela had taken place in the framework of interregional negotiations between MERCOSUR and the Andean Community, which had been governed since 2004 by the Economic Complementation Agreement between the States Parties of MERCOSUR and Colombia, Ecuador and the Bolivarian Republic of Venezuela, whose main purpose was to form a free trade area.

The Bolivarian Republic of Venezuela's entry to MERCOSUR signifies a 13.2% increase in the bloc's GDP and the addition of a market of 38 million inhabitants. The Venezuelan economy is the third largest in South America and the region's second–largest exporter. The country is also one of the world's biggest oil producers and possesses considerable reserves of hydrocarbons. However, the importance of the Bolivarian Republic of Venezuela's incorporation into MERCOSUR as suggested by these data stands in contrast to the magnitude of its trade relations with the bloc, which are relatively minor. The country's imports from the region are not only much smaller than the main intrasubregional flows, but also represent a small portion of its total exports and imports. It accounts for some 4.5% of intrasubregional trade and its exports to MERCOSUR countries represent only 2% of its total exports. The bulk of Venezuelan exports go to markets outside the region and the country's imports from MERCOSUR come mainly from Brazil and Argentina (see table IV.6).

Table IV.6
SOUTHERN COMMON MARKET (MERCOSUR): MATRIX OF INTRASUBREGIONAL TRADE, SUPPOSING THE INCLUSION OF THE BOLIVARIAN REPUBLIC OF VENEZUELA AS A FULL MEMBER, 2006
(Millions of dollars and percentages)

2006	Millions of dollars						Percentages						"Intra" coefficient
	Argentina	Brazil	Paraguay	Uruguay	Venezuela (Bolivarian Republic of)	**MERCOSUR**	Argentina	Brazil	Paraguay	Uruguay	Venezuela (Bolivarian Republic of)	**MERCOSUR**	
Argentina		8 152	616	1 139	793	**10 700**		27.0	2.0	3.8	2.6	**35.5**	**22.8**
Brazil	11 714		1 231	1 006	3 555	**17 506**	49.0		4.1	3.3	11.8	**58.1**	**12.6**
Paraguay	168	328		420	10	**916**	0.7	1.1		1.4	0.0	**3.0**	**21.1**
Uruguay	301	583	58		78	**1 020**	1.3	1.9	0.2		0.3	**3.4**	**22.7**
Venezuela (Bolivarian Republic of)	25	592	140	599		**1 356**	0.1	2.0	0.5	2.0		**4.5**	**2.0**
MERCOSUR	**12 208**	**9 655**	**2 045**	**3 164**	**4 436**	**30 142**	**51.1**	**32.0**	**6.8**	**10.5**	**14.7**	**100.0**	**11.4**

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

[6] In order for the protocol of adherence to enter into force, the parliaments of the five member countries must confirm it. Thus far, only the Bolivarian Republic of Venezuela, Argentina and Uruguay have ratified the entry of the new partner.

As regards trade, the Bolivarian Republic of Venezuela's entry into MERCOSUR brings two main challenges: the adoption of the CET and trade liberalization vis–à–vis the bloc's founding members. The protocol of adherence established a four–year time frame for the adoption of the CET and delegates the preparation of a timeline for its implementation to the task force.[7] The main problem arising in this process is tariff convergence. Some studies have found a degree of parity in the mid–level tariffs, but the complexity of the Venezuelan tariff scheme could give rise to a certain amount of conflict during the process of convergence.

With regard to the liberalization of trade within the bloc, the protocol of adherence stipulates a time frame within which Argentina and Brazil must open their economies to Venezuelan products, starting on 1 January 2010. The Bolivarian Republic of Venezuela will allow products from all MERCOSUR members free access to its market as of 1 January 2012. Lastly, Uruguay and Paraguay will fully open their markets to Venezuelan products as of 2013. The protocol provides for deadlines to be brought forward in the case of products covered by agreements signed previously between MERCOSUR and the Andean Community, particularly for "sensitive" products for which the establishment of zero tariffs was moved from 2018 to 2014. The greatest differences between the two timeframes affect the Bolivarian Republic of Venezuela, Paraguay and Uruguay. In any case, the activities that have the greatest potential to increase trade flows are already covered by some degree of preference, so the benefits of moving trade liberalization schedules forward should not be overestimated.

There has been discussion in the Bolivarian Republic of Venezuela over some of the possible economic effects of trade liberalization, given that it is less competitive than the MERCOSUR countries in certain branches of production. In particular, the trade deficit that the Bolivarian Republic of Venezuela has been running with the countries of the southern bloc throws some doubt on whether the country's productive fabric can reach the standards necessary within the times stipulated. Moreover, in those sectors and products that offer potential opportunities for new Venezuelan exports in general, it appears that the new partner will have to compete with one of the bloc's two largest economies. For the moment, the country has comparative advantages in a number of products, such as iron and steel, chemical and non–ferrous metals (Andean Community, 2007a), in which both Argentina and Brazil also have great potential. For those products, therefore, the Bolivarian Republic of Venezuela will probably continue to rely on demand from the Andean countries, especially Colombia and Ecuador, which entail lower transport costs than do the MERCOSUR countries (Fernández and Pineda, 2006). The withdrawal of the Bolivarian Republic of Venezuela from the Andean Community has drained momentum from Venezuelan trade with Peru, however, with Venezuelan imports into Peru down by 70% in the first two months of 2007 (Aduanas del Perú, 2007).

There is still a question mark over the role the Bolivarian Republic of Venezuela will play in the dynamics of decision–making within MERCOSUR.[8] Some see the country as a possible strategic ally for Argentina, with the two forming a counterweight to the economic power of Brazil in the region. Others see it as a potential leader uniting the smaller economies of the bloc, perhaps helping to lay to rest the separatist pressures that have arisen within the smaller partners. Too little time has elapsed to draw any conclusions, however, and, more importantly, it remains to be seen what policy measures the Bolivarian Republic of Venezuela will take to finalize its entry into MERCOSUR, including its real willingness to negotiate an association agreement with the European Union.

Two aspects have aroused some uncertainty on the political front. The first is the leverage the Government of the Bolivarian Republic of Venezuela might be able to exert on the bloc's external agenda, since the country is becoming increasingly vulnerable in sectors in which MERCOSUR is more competitive and this could generate tensions in negotiations with third parties (Peña, 2007a). The second, related, matter is the choice of main economic partners outside the region, which could become a source of conflict among the members of MERCOSUR.

The process of admitting the Bolivarian Republic of Venezuela as a full member of MERCOSUR is generating a new layout of integration in South America. An important test will be how relations between the members evolve during the transition process and how the competitiveness gaps between

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7 See MERCOSUR [online] http://www.mercosur.int/msweb/portal%20intermediario/es/index.htm.

8 Da Motta Veiga and Rios (2007) and Vaillant (2007) give an analysis of the Bolivarian Republic of Venezuela's entry into MERCOSUR.

them are addressed. At the same time, the process represents a great opportunity for MERCOSUR, since the successful incorporation of the Bolivarian Republic of Venezuela would not only make the bloc institutionally stronger, but would also help to attract other South American countries.

In its trade relations with the rest of the region, Brazil has been gradually adopting a strategy of bilateral agreements, as have the other MERCOSUR partners. Brazil has signed agreements with the Bolivarian Republic of Venezuela, Bolivia and Paraguay and is holding discussions with Argentina, Chile and Uruguay. A prominent example is the cooperation agreement on biofuels signed by Brazil and the United States.[9] Subsequently, Brazil formed a strategic partnership with the European Union, in the framework of the first Brazil–European Union Summit. Such a partnership, which the European Union has formed previously only with China, India and the Russian Federation, involves, among other things, the pursuit of an agenda of dialogue, contacts and knowledge transfer activities on a broad range of issues, including fuels, for which a mechanism known as the "Energy Dialogue" has been created.[10]

The small economies in MERCOSUR would be willing to explore new possibilities, not only as regards internal linkages but also relations with countries from outside the bloc. A number of technical experts from government agencies and academic circles are now assessing this possibility and the possible costs and benefits involved.

C. Relations within MERCOSUR

On 27 January 2007, Uruguay signed a Trade and Investment Framework Agreement (TIFA) with the United States. Argentina and Brazil have stated that the ultimate signature of an FTA with the United States by Uruguay would be incompatible with the country's continued membership in MERCOSUR. However, the prospect of the framework agreement's signature helped to attract a number of foreign investments to Uruguay, with a view to the United States market. The TIFA also reflects Uruguay's dissatisfaction with the results of MERCOSUR and its disappointment over the stance the bloc has taken on its conflict with Argentina over pulp mills in Uruguay.

A number of conflicts remain among the MERCOSUR partners. The most entrenched is between Uruguay and Argentina and concerns potential environmental damage from two pulp mills sponsored by European groups, Botnia of Finland and ENCE of Spain. In 2002, the two firms began procedures to set up operations in Fray Bentos in Uruguay's eastern region. The project involves a total investment of almost US$ 1.5 billion and could have a considerable impact on the Uruguayan economy in terms of employment, exports and tax income. The plan triggered opposition in Argentina, however, where questions were raised over the project's potentially harmful cross–border impacts, the choice of location, the production technology to be employed and the plants' waste management. The rationale for the environmental criticisms was that the plants would use a water resource shared by the two countries. The Argentine government claims that Uruguay has breached the River Uruguay Statue (ERU) a treaty between the two countries that was concluded in 1975, by failing to consult with the Administrative Commission for the River Uruguay (CARU) regarding its intention to undertake a project of this magnitude.

[9] Peña (2007b) gives an analysis of this agreement and its regional effects.
[10] See European Union website [online] http://ec.europa.eu/external_relations/brazil/intro/index.htm.

Uruguay questioned the rationale for these criticisms, noting that Argentina has allowed the establishment and operation of several pulp mills that use inferior technology on its territory. In addition, permits for the construction of the plants at the planned location had been issued following commitments that they would operate to international standards and rules. The dispute worsened when the Uruguayan government unilaterally gave the go ahead for work to begin which, in the case of Botnia, was enshrined in a bilateral investment agreement signed with Finland. The conflict become even more bitter in the early months of 2006, when inhabitants and civil society organizations of Gualeguaychú, a city in the Argentine province of Entre Ríos almost opposite Fray Bentos on the River Uruguay's other bank, blocked border crossings into Uruguay at the height of the tourist season.

In May 2006, the Government of Uruguay appealed to the MERCOSUR Dispute Settlement Mechanism under the Protocol of Olivos, alleging that the Argentine government's failure to take action over the roadblocks had caused it serious economic losses. The Argentine authorities defended their stance before the MERCOSUR arbitration tribunal, arguing that respect for the constitutional principle of freedom of expression must take primacy over free road movement as established in the Treaty of Asunción.

Seeking to keep the conflict in the terrain of a bilateral dispute and out of the regional sphere, Argentina pressed ahead with the procedure set forth in the River Uruguay Statue, filing proceedings against Uruguay in the International Court of Justice in The Hague over the alleged violation of the Statute's provisions.[11] In December 2006, ENCE informed the two governments of its decision to change its mill's location to the Uruguayan department of Colonia, while Botnia moved rapidly ahead with work at the original location. The Spanish Crown is currently engaged in a process of mediation in the matter. The protests in Argentina have continued and the roadblocks have spread to other border crossings. The Uruguayan authorities have refused to enter into any kind of official negotiation until the roadblocks are removed.

In January 2007, Argentina brought a complaint against Brazil before the World Trade Organization (WTO) over antidumping measures taken against imports of polyethylene terephthalate (PET) resin from Argentina. Argentina bases its complaint on the argument that the anti–dumping investigation conducted, the determination made and the duties imposed by Brazil are inconsistent with the GATT provisions of 1994 and the Anti–Dumping Agreement (WTO, 2007).[12]

In late 2006, Argentina imposed new restrictions on some household appliances, from Brazil by making them subject to non–automatic import licences, which slows and bureaucratizes the import procedure. Brazil accused Argentina of avoiding importing those goods from MERCOSUR countries and importing them from China and Mexico instead, thus diverting trade. Argentina argued that it needed to reach a level of production that would enable it to compete with Brazil (*Valor Econômico*, 2007).

D. The andean community: a difficult renewal

In 2006 the Bolivarian Republic of Venezuela withdrew from the Andean Community. The member countries are now concluding negotiations for the administration of the five–year period in which the benefits granted and received will continue to be valid, as provided in article 135 of the Cartagena Agreement.

11 The International Court of Justice has rejected requests for provisional measures made by Argentina and Uruguay, seeking, respectively, the suspension of works and the removal of roadblocks.

12 It is worthy of note that Argentina should have taken its complaint directly to WTO without exploring dispute settlement alternatives at the regional level. Argentina alleges that MERCOSUR does not provide harmonized rules to deal with antidumping issues, whereas the WTO rules are valid and accepted everywhere (*O Estado de S. Paulo*, 2007).

From the time of notice of withdrawal until five years have elapsed, the Bolivarian Republic of Venezuela remains committed to: (a) maintain national treatment; (b) prohibit barriers to trade proceeding from Andean countries; (c) maintain trade liberation programmes agreed upon with its former partners; and (d) extend most–favoured nation treatment until full withdrawal. The countries also agreed to continue to set specific rules to govern issues concerning safeguards, the dispute settlement mechanism, sanitary and phytosanitary measures and technical barriers to trade, as well as the goods liberalization programmes (Decision 641 of the Commission of the Andean Community). The Bolivarian Republic of Venezuela, Colombia and Ecuador agreed that the provisions contained in the Motor Vehicle Complementarity Agreement[13] and the related instruments would remain fully valid. The Secretary General of the Andean Community and the Presidents of Bolivia and Ecuador have engaged in efforts to persuade the Bolivarian Republic of Venezuela to reconsider its decision and rejoin the Andean Community (Andean Community, 2007c).

The member countries of the Andean Community signed a Memorandum of Understanding giving Chile the status of associate member and agreed to enter into negotiations on an association agreement between the two parties. A Joint Committee was set up for this purpose, comprising representatives of the Government of Chile and officials from the General Secretariat of the Andean Community (Andean Community, 2006 and 2007f).

The Joint Committee's preliminary activities concluded with the adoption of Decision 666, which contains provisions on Chile's participation in the bodies and mechanisms of the Andean Community in its capacity as an associate member. Generally speaking, the decision allowed Chile to participate with the right to speak in ordinary and extraordinary meetings of the Andean Integration System, including the Andean Presidential Council, the Andean Council of Ministers of Foreign Affairs and the Commission of the Andean Community. Trade relations will continue to be governed by the complementarity agreements signed between the bloc's member countries and Chile.

The Joint Committee, which was created in September 2006, continues to function and will meet at least once every year and hold extraordinary sessions at the request of the member countries. The Commission was mandated to address and resolve differences arising from the implementation of decision 666 (Andean Community, 2006, Decision 645).

Despite the withdrawal of the Bolivarian Republic of Venezuela from the group, intrasubregional exports continued to expand, registering a value of over US$ 12.7 billion (see table IV.7). If the Bolivarian Republic of Venezuela is excluded from the calculation, the rate of expansion of intrasubregional trade drops from 23% to 10% and the percentage of intrasubregional exports drops from 10% to 8%. The Bolivarian Republic of Venezuela therefore continues to be an important partner for the other Andean countries, since its market generates a strong demand for a number of key regional products, including vegetable oils, medicines, motor vehicles, textiles and clothing and fishery products. Conversely, the Bolivarian Republic of Venezuela continues to supply petroleum products, especially gasoil, liquid hydrocarbons and crude oils, iron and steel, transport equipment, chemicals and cosmetics to the rest of the subregion. In all these sectors, the Bolivarian Republic of Venezuela and the other Andean countries have demonstrated a high level of complementarity (Andean Community, 2007a).

In the first quarter of 2007, intrasubregional exports continued to rise, although at a lower rate than in 2006. This growth was driven mainly by Colombian exports to the Bolivarian Republic of Venezuela and faster growth in Peru's exports to all destinations, except the Bolivarian Republic of Venezuela and Ecuador. The latter two countries have seen their exports to the subregion slow by 10% and 15%, respectively.

[13] Under this arrangement, the countries apply a tariff of 35% to light vehicles and can suspend tariff payments for parts and pieces for assembly, subject to compliance with rules of origin. For heavy vehicles, the Bolivarian Republic of Venezuela and Colombia apply a CET of 15% and Ecuador of 10% (Andean Community, 2007b).

Table IV.7
ANDEAN COMMUNITY: EXPORTS INCLUDING THE BOLIVARIAN REPUBLIC OF VENEZUELA, 1990–2007
(Millions of dollars and percentages)

	1990	1995	1998	2001	2002	2003	2004	2005	2006	January -March 2006	January -March 2007[a]
Total exports (1)	31 751	39 134	38 896	53 543	52 177	54 716	74 140	100 089	124 111	29 670	30 108
Percentage annual growth	25.7	16.1	-16.5	-11.8	-2.6	4.9	35.5	35.0	24.0	32.2	1.5
Exports to the Andean Community (2)	1 312	4 812	5 504	5 656	5 227	4 900	7 604	10 313	12 719	2 680	2 848
Percentage annual growth	26.3	28.2	-2.2	9.5	-7.6	-6.3	55.2	35.6	23.3	35.2	6.3
Percentage exports intra–Andean Community (2/1)	**4.1**	**12.3**	**14.2**	**10.6**	**10.0**	**9.0**	**10.5**	**10.3**	**10.2**	**9.0**	**9.5**

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

Undeniably, the Andean Community has built up assets as a mechanism of subregional integration, particularly in the last few years, when it has engaged in considerable efforts to modernize. The group is now at a crossroads, however. As a number of authors have noted, the Andean Community has a solid institutional structure and a corpus of rules that govern its members' trade (Pineda Hoyos, 2007; Machinea and Uthoff, 2007; González Vigil, 2005), the most recent being rules on trade in services. Although the bloc began developing these rules in June 1998, there were a number of delays to their implementation and they did not come fully into force until December 2006, which makes it difficult to evaluate their operation in practice. Nevertheless, they demonstrate the will of the bloc's current members to move ahead with deepening the integration process.

The Andean Community and its members are preparing for negotiations on an association agreement with the European Union. On 19 April 2007, at the thirteenth Ministerial Meeting between the Andean Community and the European Union, the Ministers expressed their intention to begin these negotiations in the framework of the next meeting of the Joint Committee, which was to be held at the end of May in La Paz, Bolivia. As events transpired, however, the negotiations were actually launched in Tarija, Bolivia, on 14 June 2007 during the seventeenth Regular Meeting of the Andean Council of Presidents. On 17 July the 14 panels that will examine the various issues involved in the negotiations were set up, and the parties agreed to hold the first round of talks in Colombia from 17 to 21 September. In preparations for these negotiations, on 13 July the Andean Community adopted Decision 670 regarding the adoption of a consolidated customs schedule and Decision 671 on the harmonization of customs regimes, together with other provisions on customs administration. These two decisions are of vital importance in paving the way for talks between these parties.

Thus far, the members of the Andean Community have defined a common tariff reduction point, known as the "base tariff", for 75% of tariff items and for all trade with the European Union (Andean Community, 2007e). Efforts are still needed to bring their tariff lines closer together and develop an effectively unified tariff.

With the adoption of Decision 663 in January 2007, the entry into force of Decision 535, by which the group's new CET is to be approved and existing exemptions are to be extended until 31 January 2008, was postponed once again.[14] Given this postponement, the picture in the region as regards CET is as shown in table IV.8. There is a clear difference between Peru, which has brought 43% of tariff lines down to zero, and Bolivia and Ecuador, which have done so for only 6% of lines and Colombia, which has done so for just 3%. Peru applies a CET of 12% for 40% of tariff sub–items, while Colombia retains tariff peaks of up to 227% and Ecuador of 85.5%, although these peaks represent no more than 1% of the tariff universe of 6,843 lines (see table IV.8).

[14] The implementation of CET has now been postponed eight times. See Decisions 563, 569, 577, 580, 612, 620, 626 and 628, compiled and analysed in table 16 in Durán and Maldonado (2005).

Table IV.8
COMPARISON OF TARIFF STRUCTURE OF ANDEAN COMMUNITY COUNTRIES
(Number of sub–items)

Level	Bolivia		Colombia		Ecuador		Peru	
	No. lines	Percentage of the total	No. lines	Percentage of the total	No. lines	Percentage of the total	No. lines	Percentage of the total
0	395	5.8	192	2.8	418	6.1	2 975	43.5
5	1 688	24.7	2 293	33.5	2 224	32.5		
10	4 749	69.4	962	14.1	1 201	17.6		
12							2 742	40.1
15			1 633	23.9	1 283	18.7		
17							47	0.7
20			1 640	24.0	1 655	24.2	718	10.5
25							320	4.7
35			15	0.2				
45			1	0.0				
50			14	0.2				
60			9	0.1				
70			3	0.0				
80			15	0.2				
More than one level[a]	11	0.1	66	1.0	62	0.9	41	0.6

Source: Andean Community, "Estado de situación de la aplicación del arancel externo común. Al 15 de febrero de 2007", working paper (SG/DT.384), General Secretariat, 21 February 2007.

[a] Cases in which the more detailed 10–digit national schedule has two or more different tariff levels for a particular eight–digit line of the Common Tariff Nomenclature of the member States of the Cartagena Agreement Decision 381, owing to overlaps occurring at that level of detail.

In addition, "advances were made toward approving a set of Community customs provisions, leaving only those referring to customs regimes and customs offenses to be dealt with. As regards transportation, the Decision on international highway transportation of goods is being perfected in order to introduce a series of improvements that will facilitate this service" (Andean Community, 2007e). The entry into force of community commitments on services should also help to move talks with the European Union ahead in this area.

The agreements Colombia and Peru have signed with the United States have yet to come into force. In the first case, the process of approval is under way in both countries; in the second, approval is pending in the United States. Bolivia and Ecuador are seeking to extend the duration of the tariff preferences granted under ATPDEA, which expire at the end of February 2008. Colombia is also negotiating an FTA with the Northern Triangle countries (El Salvador, Guatemala and Honduras) and Peru is in talks with Thailand and Singapore.

E. Central American regional integration: renewed momentum[15]

Between 2002 and 2006, the Central American region experienced considerable activity in the area of trade agreements. Negotiations on the Dominican Republic —Central America— United States Free Trade Agreement (CAFTA–DR)[16] began in 2002; the Agreement was signed in 2004 and it was ratified by every country

[15] This section is based on Schatan and others (2007).

[16] CAFTA–RD includes Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua, which are also members of the Central American Common Market (CACM).

except Costa Rica in 2005 and 2006. In the case of Costa Rica, the Supreme Electoral Tribunal decided that it should be ratified or rejected by referendum rather than by the Legislative Assembly. The referendum will be held in August or September 2007 (*Inside U.S. Trade*, 2007b).

Almost simultaneously, the countries of the region have been renewing their efforts to achieve regional integration. The Plan of Action for Central American Economic Integration was signed by the governments of the region with a view to moving from CACM to a customs union, and other concrete steps have also been taken to expedite the process. Among other things, the Agreement on information exchange and mutual assistance, the Standard Central American Tariff Code, the community transit regime and the Agreement on compatibility of tax systems are worth mentioning. Another important step was the creation of the regional dispute settlement mechanism and the establishment of integrated and peripheral customhouses within the customs territory, a measure which will help streamline the transit of goods. Considerable progress has been made towards eliminating obstacles to trade; in 2006, only five of the 100 or so obstacles identified by the Secretariat for Central American Economic Integration (SIECA) soon after 2000 remained.

All this effort has led to a steady increase in intrasubregional trade flows. In 2006, and so far in 2007, intrasubregional trade rose significantly in practically every direction, with Nicaragua, Guatemala and Honduras showing especially strong growth during the first quarter of 2007. If this trend continues, the intrasubregional trade coefficient will be over 18%, the highest level attained to date (see table IV.9).[17]

There has been considerable discussion about the relationship between CAFTA–DR and the integration of the Central American countries. One might ask to what extent the negotiation and subsequent implementation of CAFTA–DR might undermine the Central American countries' integration efforts and their desire to take advantage of their own regional markets to stimulate their economies or, from another standpoint, to what extent the new treaty would help consolidate integration.

Actually, the interaction between activities concerning CAFTA–DR and efforts to establish a Central American customs union has been quite dynamic. There are clear synergies between the two agreements aimed at achieving institutional, legal and procedural changes in the countries and achieving greater flexibility and transparency in trade within the region and between the region and other countries. Most of these changes will benefit all stakeholders, helping to improve regional integration and boost the region's position within the global economy.

Table IV.9
EXPORTS FROM THE CENTRAL AMERICAN COMMON MARKET, 1990–2007
(Millions of dollars and percentages)

Central American Common Market (CACM)	1990	1995	1998	2001	2002	2003	2004	2005	2006	January -March 2006	January -March 2007[b]
Total exports[a] (1)	4 480	8 745	14 987	16 328	17 006	18 117	19 767	21 849	24 821	5 907	6 795
Percentage growth	25.2	17.1	17.4	-1.8	4.1	6.5	9.1	10.5	13.6	4.9	15.0
CACM exports (2)	624	1 451	2 754	2 829	2 871	3 111	3 506	3 912	4 429	1 062	1 243
Percentage growth	8.9	17.2	38.5	1.5	8.3	11.6	12.7	11.6	13.2	19.3	17.0
Percentage exports within CACM (2/1)	**13.9**	**16.6**	**18.4**	**17.3**	**16.9**	**17.2**	**17.7**	**17.9**	**17.8**	**18.0**	**18.3**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official information supplied by the Secretariat for Central American Integration (SIECA) and official information supplied by the countries concerned.
[a] Total export figures include maquila and free zones.
[b] Preliminary estimates.

[17] In these calculations, maquila and free–zone activities are included in total exports of the group. This explains why the coefficient is different from the official figures provided by the General Directorate of Informatics of the Secretariat for Central American Economic Integration (SIECA), which do not include maquila industries. See "Centroamérica Exportaciones (FOB) 2000–2006" [online] http://www.sieca.org.gt/Publico/CA_en_cifras/COMERCIO_2000_2006/04.htm).

Thanks to the initiatives generated by CAFTA–DR and by the CACM countries, with European Union support, the groundwork has been laid for an effective customs union. The region itself has developed some essential common rules, as noted above, and when no regional rules existed, they have been drawn up on the basis of CAFTA–DR. Rules based on CAFTA–DR have been developed in the following fields: government procurement; investment (although a Central American agreement on investment and trade in services already existed, it had not been ratified by any of the countries); cross–border trade in services, including financial services; telecommunications; intellectual property; labour and environmental issues; and transparency and corruption. In some cases, the rules adopted in the context of CAFTA–DR are WTO rules, so they contribute towards harmonizing regional rules with internationally agreed rules. In other areas such as intellectual property, however, the requirements laid down are considerably more stringent that those agreed in WTO or even in previous free trade agreements between the United States and other countries, including NAFTA; this has led to discussions on the potential cost of innovation and health in the region.[18]

As regards trade between the Central American countries and between these countries and the United States, concerns have been expressed in regard both to the fiscal impact of tariff reduction and to the possibility that intraregional trade might be replaced by trade with the United States. One of the main concerns has to do with different nature of intraregional and extraregional trade. Indeed, most of the products exported to the CACM countries are wholly manufactured and hence have greater value added than the products that are exported to the United States. Exports to that country are mainly maquila products, especially clothing and electronic subassemblies, and commodities with very few local production linkages and, hence, only limited economic benefits.

In 2005, the main intraregional export products were, among others, foodstuffs based on cereal or flour; milk, eggs and others; alcoholic beverages and vinegar; paper and cardboard, forged iron and steel, chemical products; pharmaceuticals, data processing machines and parts; plastics and plastic manufactures, electrical machinery and apparatus. The only commodity was meat and edible meat offal.

In considering the repercussions of CAFTA–DR on trade flows in the Central American region, the following points should be borne in mind:

(a) The United States has not been a significant supplier of goods similar to those traded among the Central American countries, at least up to the entry into force of CAFTA–DR. Even when CAFTA–DR enters into force, products from the United States are not likely to "invade" the Central American markets, since they probably will not be able to compete with regional production of similar goods.

(b) The sources of Central America's imports have become diversified and that trend is likely to continue. China plays an important role and is displacing the United States as a supplier of goods to Central America, as are the Central American countries themselves and the countries of the European Union (see table IV.10).

(c) CAFTA–DR is not expected to bring about major changes in the volume or composition of Central American exports to the United States, a large share of which are already entering the United States duty–free under preferential agreements with individual countries, i.e., through the Generalized System of Preferences (GSP) and the Caribbean Basin Initiative.[19]

(d) There could be major changes in the maquila clothing sector, since all the countries will be granted certain preferences in addition to the existing ones. Nicaragua, the poorest country of the region, will be especially favoured, as it will benefit from very flexible rules of origin during the first five years. It will be able to use the equivalent of 100 million square meters of fabrics from third countries for production of clothing and to export that production to the United States free of tariffs.

(e) The countries are expected to attract more FDI, while domestic investment would probably be directed more towards exports that can take advantage of rules of origin under CAFTA–DR. In that regard, the agreement would be attractive

[18] Díaz (2006) includes an assessment of intellectual property issues in free trade agreements. Schatan and others (2007) also provides an overview.

[19] The Caribbean Basin Initiative has been in force since 1983 and will expire in 2008 or on the date when CAFTA–DR is ratified by one of its signatories.

Table IV.10
CENTRAL AMERICA: EXPORTS AND IMPORTS BY DESTINATION, 2000-2005
(Millions of dollars and percentages)

		CACM	United States[a]	European Union	China	Hong Kong	Others	Total[a]
Exports	**Millions of dollars**							
	2000	2 617	9 640	1 943	17	19	1 924	16 168
	2005	3 912	12 290	1 916	304	489	1 428	21 871
	Percentages							
	2000	16.2	59.6	12.0	0.1	0.1	11.9	100.0
	2005	17.9	56.2	8.8	1.4	2.2	6.5	100.0
Imports	**Millions of dollars**							
	2000	2 739	7 927	1 633	208	78	4 694	18 909
	2005	2 602	9 557	2 529	1 355	135	8 448	26 758
	Percentages							
	2000	14.5	41.9	8.6	1.1	0.4	24.8	100.0
	2005	9.7	35.7	9.5	5.1	0.5	31.6	100.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the Commodity Trade Database (COMTRADE) and official information from Secretariat for Central American Economic Integration (SIECA) for intrasubregional trade, official information from Secretariat for Central American Economic Integration (SIECA).

[a] The figures include the value of maquila exports and of free zones. COMTRADE does not include these figures; in all cases, total export figures and figures for the United States were changed accordingly.

because preferential access to the United States market is now permanent rather than temporary, as it was under GSP and CBI. Moreover, inputs from throughout the region can be integrated for export to the United States market. This advantage is further enhanced by the agreement with the United States under which the benefit also extends to certain inputs originating in Mexico.

(f) The remaining challenges for regional integration are to eliminate the exceptions laid down in Annex A to the General Treaty on Central American Economic Integration and to establish a common external tariff. In 2006, 5.4% of items had yet to be harmonized, potentially opening up a window for unfair trade within the region and jeopardizing the success of the customs union.

F. The Caribbean community: beyond the point of no return

Regional integration among the English–speaking countries of the Caribbean, which have recently been joined by Dutch–speaking Suriname and French–speaking Haiti, has always been about much more than trade. Indeed, it has been argued that integration in the area of trade would not entail significant advantages for the CARICOM countries, given that intraregional trade represents a relatively small share of overall trade, especially if energy exports from Trinidad and Tobago to the other countries in the group are excluded (Mesquita Moreira and Mendoza, 2007).

In 2006, intrasubregional trade in the CARICOM area amounted to around US$ 2.7 billion and grew by around 23.6% (see IV.11). In absolute terms, the largest increase appears to have occurred in Trinidad and Tobago, which accounted for 72% of subregional exports and whose main trading partners continue to be Barbados, Belize and Jamaica.

The regional integration process has moved forward over the last two years (see box IV.1). During most of the decade, it has become evident that asymmetrical preferential agreements on access to the European market by Caribbean exporters might be incompatible with the WTO agreements. The Cotonou Agreement (2000) envisages the establishment of a symmetrical agreement between the European Union and its former colonies in the African, Caribbean and Pacific Group of States (ACP) that would be compatible with WTO rules. This new trade agreement would be drawn up in the form of an economic partnership agreement.

The economic partnership agreement calls for regional integration to be firmly established; this means that the CARICOM countries are under considerable pressure to make substantive progress. From the European standpoint, the Caribbean economic partnership agreement should include not only the members of CARICOM, but also the Dominican Republic. Accordingly, the Caribbean Forum of the African, Caribbean and Pacific Group of States (CARIFORUM) was created as a grouping of countries as well as an organization that could sign an agreement on trade and technical cooperation with the European Union.

Table IV.11
EXPORTS FROM THE CARIBBEAN COMMUNITY (CARICOM), 1990–2006
(Millions of dollars and percentages)

	1990	1995	1998	2001	2002	2003	2004	2005	2006[a]
Total exports (1)	4 955	5 927	5 537	7 544	7 110	8 624	10 395	14 125	18 522
Percentage annual growth	19.7	25.3	-6.5	-3.1	-5.8	21.3	20.5	35.9	31.1
Exports to CARICOM (2)	509	843	1 031	1 384	1 220	1 419	1 810	2 188	2 704
Percentage annual growth	8.2	26.5	5.7	12.4	-11.8	16.3	27.5	20.9	23.6
Percentage of exports within CARICOM (2/1)	**10.3**	**14.2**	**18.6**	**18.3**	**17.2**	**16.5**	**17.4**	**15.5**	**14.6**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the respective subregional schemes and the International Monetary Fund (IMF), *Direction of Trade Statistics*.
These data do not include information on The Bahamas; hence, the intraregional trade coefficient with that country would be different than the figure shown here. For the same reason, the series are different from those shown previously.
[a] Preliminary figures.

Box IV.1
STEPS TOWARD A CARIBBEAN SINGLE MARKET

In 2006, a number of significant milestones were reached and significant progress was made towards the integration of CARICOM. The Caribbean Common Market, conceived as a preliminary step towards the CARICOM Single Market and Economy (CSME), was formally established on 1 January 2006. The Common Market provides for the free movement of goods and services originating in the region, the right of establishment, free movement of skilled workers (holding the Caribbean Skills Certificate) and free movement of capital. Six countries joined from the outset: Belize, Guyana, Suriname, Trinidad and Tobago, Barbados and Jamaica; these countries have supported the common market since 2004. The Member States of the Organisation of Eastern Caribbean States (OECS) were reluctant to make a commitment to comply with the framework established, as they first had to resolve certain issues. Those countries joined once they saw that sufficient progress had been made in the process, a development fund had been established, and the regulations on foreign ownership of land had been accepted. With the addition, on 3 July 2006, of Antigua and Barbuda, Dominica, Grenada, Saint Kitts and Nevis, Saint Lucia and Saint Vincent and the Grenadines, membership of the Single Market rose to 12.

The establishment of CSME has been a two–stage process. In February 2007, the Heads of State decided to devote 2008 and 2009 to achieving harmonization in several areas of economic policy, including the broadening of monetary cooperation and establishment of a single currency, as well as unified tax and incentive systems. A full monetary union will be established between 2010 and 2015, and structural policies will be coordinated in several sectors.

Not only did the members of OECS join CSME, they also announced plans for full economic union. The signing ceremony was held in Saint Kitts and Nevis on 21 June 2006; on that occasion, the new proposal for an OECS treaty, outlining the steps to be followed in establishing an economic union, was made public. The deadline for establishment of the economic union is 1 July 2007.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), ECLAC subregional headquarters for the Caribbean, Port of Spain.

The deadline for completing negotiations on an economic partnership agreement between the European Union and CARIFORUM, at least in general terms, is July 2007. During the first few months of the year, the countries have continued negotiating those issues which up to now had represented a challenge in the effort to reach an understanding between the Caribbean Regional Negotiating Machinery and the European Union. Some of the key issues are: (a) tariff reduction; (b) trade in services and investment; (c) government procurement, as well as tools for implementing development cooperation (CRNM, 2007). At the end of 2006, some of the fundamental issues hindering consensus with Europe were yet to be resolved, including regional geometry, harmonization of sectoral policies, the nature of tariff reduction commitments, the position on sugar and bananas and the deadline for negotiations. In particular, the parties needed to reach consensus on tariff reduction schemes in the region, so as to make it possible to establish a variable geometry that would take into account the legal issues arising from the special economic characteristics of the Dominican Republic, the Bahamas, Haiti and the OECS countries. Consensus was also pending on how and when to incorporate new agreements on sugar and bananas in the economic partnership agreement and on liberalization of services.

The inclusion of Haiti in CSME came up again when CARICOM terminated its suspension of that country's membership, bearing in mind that the presidential and parliamentary elections in 2006 had been free and fair and that they clearly reflected the wishes of the citizens. Since Haiti had not been allowed to participate in any of the discussions on CSME for over two years, it can appeal for protection under the revised Treaty of Chaguaramas, which also provides a certain degree of protection for disadvantaged countries in the group through tools such as the development fund.

With respect to the harmonization of sectoral policies, energy is probably the most important issue pending in Caribbean integration efforts. Thirteen of the 15 members of CARICOM signed the PETROCARIBE Energy Cooperation Agreement with the Bolivarian Republic of Venezuela. This agreement is aimed at providing relief from high oil prices for the Caribbean States by deferring payments. The CARICOM countries welcomed the agreement, especially Jamaica, which was paying more and more for oil imports. The initiative was launched in June 2005, although many analytical problems remained to be solved in 2006.

Another important issue that must be dealt with by CSME is the formulation of an energy policy for the Caribbean. In 2006, considerable technical work was done by the CARICOM task force on regional energy policy, Trinidad and Tobago's regional energy plan and the proposed pipeline for the Caribbean Renewable Energy Development Programme (CREDP), among others. These projects are broad in scope and include legislation on conventional and renewable sources of energy, market regulation, intra– and extraregional negotiations and initiatives for the processing of raw materials.

The free movement of labour is essential in CSME and continues to be encouraged. There is some preferential treatment, as some OECS countries are not required to apply reciprocity, that is, they are not required to accept workers from the region in cases when their own workers might not be able to compete in certain places in CSME. Efforts to harmonize educational certificates, travel documents and debarkation permits have continued in the region. There are clearly many opportunities within the region for CSME workers but past experience has shown that skilled workers and college–educated professionals are likely to benefit the most from the free movement laws. Suriname, Saint Kitts and Nevis, Saint Vincent and the Grenadines and Grenada are already issuing CARICOM passports.

The CSME constitution will make it necessary to reduce or eliminate practices that curtail the movement of capital. Current laws on the right of establishment allow companies to set up operations in all CSME zones, and the promise that no new restrictions will be established is maintained. Companies will also benefit from the free movement of skilled workers, thus enabling such workers to follow their employers abroad. These measures are expected to provide impetus to the economic growth of the region.

G. The South American Community of Nations as a mechanism for convergence

At the first meeting of Heads of State and Government of the South American Community of Nations (SACN), held in Brasilia, Brazil, on 29 and 30 September 2005, the member countries of SACN requested the "[LAIA], MERCOSUR, [the Andean Community] and CARICOM Secretariats to prepare, no later than the first semester of 2006, studies on the convergence of economic complementation agreements among the countries of South America. These studies should contemplate the objective of the gradual establishment of a South American free trade zone as well as the complementation of the economies of the South American countries and the promotion of their growth and development, taking into consideration the reduction of existing asymmetries and in the case of member states of [LAIA] preserving the advances achieved in Resolution 59 of [LAIA's] Council of Ministers."[20]

To this end, the secretariats drew up a set of proposals which were transmitted to Ambassador Celso Amorim, Minister for Foreign Affairs of Brazil, on 13 July 2006.[21] The reports are divided into three categories: (a) a new treatment of asymmetries in South American integration; (b) convergence of integration agreements in South America; and (c) legal and institutional issues relating to the South American Community of Nations.

In order to facilitate convergence between South American integration agreements, the documents prepared by the secretariats include proposals on the trade issues covered by the integration schemes: tariff reduction; rules of origin; customs valuation and special customs regimes; trade remedies; non–tariff measures; technical barriers to trade; sanitary and phytosanitary measures; trade in services; investment; intellectual property; competition policies; government procurement; and dispute settlement.

As far as tariff reduction is concerned, progress in creating the South American free trade zone on the basis of the network of existing agreements has been slow. Trade between members of the Andean Community and MERCOSUR is practically liberalized, except in the sugar and automotive sectors in MERCOSUR. Trade liberalization among members of SACN, however, is moving slowly. In 2011, for example, tariff–free intracommunity trade will account for between 50% and 70% of total trade. In 2018, the figure will be between 65% and 95% (ECLAC, 2006c; SACN, 2006; Vaillant, 2007). There is room for speeding up liberalization of reciprocal trade, especially among the smaller and relatively less developed countries.

[20] See "Declaration on the Convergence of Integration Processes in South America" [online] http://www.comunidadandina.org/ingles/documentos/documents/casa_2005_1.htm.

[21] The documents in question may be found under *Documentos elaborados por las secretarías generales de la Comunidad Andina, Mercosur y LAIA para el proceso de convergencia sudamericano* [online] http://www.comunidadandina.org/csn/estudios.htm.

Table IV.12
CONVERGENCE PROPOSALS BY THE SECRETARIATS OF INTEGRATION AND COMPLEMENTARY PROPOSALS BY ECLAC

Areas	Secretariats of the Andean Community, MERCOSUR and LAIA	Complementary proposals by ECLAC
Tariffs	Speed up tariff reduction, giving priority to the smaller and relatively less developed countries.	The objective proposed by the Secretariats is important.
Rules of origin	Harmonize rules; strengthen the legal basis; certificates of origin; reduce time limits for verification and control.	Rapid progress could be made without complex negotiations, e.g., accumulating origin.
Customs valuation and special customs regimes	WTO agreements and LAIA resolution 226 of 5 March 1997 provide a common base. These issues are under discussion.	Further progress with customs procedures is needed. In particular, a greater effort should be made to automate, simplify and facilitate trade without reducing oversight.
Trade remedies	Maintain national provisions in accordance with WTO rules (antidumping and subsidies).	Eliminate antidumping measures for originating products in intrazone trade. Maintain countervailing duties in cases where subsidies are applied.
Safeguard measures	Two safeguard mechanisms: a mechanism consisting of a general safeguard (trade safeguard) and another one that would be applicable to a small group of agricultural products and would be triggered by volume and prices.	Eliminate safeguards in intracommunity trade and maintain the mechanism during transition period. With respect to third parties, maintain WTO individual mechanisms.
Non–tariff measures	Begin negotiations among members with a view to gradually eliminating NTMs. In terms of offers, these negotiations would entail setting a deadline for the elimination of all measures, including a timeline for elimination of NTMs.	Strengthen NTM disciplines, e.g., by reference to the corresponding WTO provisions, and the prohibition of NTMs along with the relevant explanations, emphasizing the impact of the measures and their possible justification in the context of the agreed rules. They could eventually be eliminated through dispute settlement procedures.
Technical barriers to trade	Move forward on substantive issues in the framework of this agreement, in particular, in areas relating to harmonization of technical rules and regulations; sign agreements on mutual recognition of national conformity assessment procedures, as well as other initiatives relating to confidence building and technical assistance.	It does not seem advisable to proceed with harmonization of technical rules and regulations. Decisive action should be taken on the issues of equivalency and mutual recognition, as well as on trade facilitation measures in connection with accreditation and conformity assessment procedures.
Sanitary and phytosanitary measures	(a) promote harmonized rules for the development of common sanitary and phytosanitary requirements for specific products; (b promote free movement of agricultural products through recognition of sanitary and phytosanitary certificates; (c) develop harmonized mechanisms and procedures for inspection tasks and quarantine control; (d) promote training activities for personnel specializing in the application and development of the principles embodied in the SPS Agreement; and (e) promote the strengthening of agricultural health institutions.	Effectively implement in the region the operating criteria of “pest– or disease–free zones”, improvements in management and decision–making, risk assessment and cooperation with responsible institutions.
Trade in services	There is a suitable framework for moving forward at the regional level in the area of services, given the common framework provided by GATS and the experience of the Andean Community and MERCOSUR,	The key is to undertake, within a short period of time, to eliminate restrictions that are incompatible with the guiding principles of trade in services. This means doing away with the current focus on holding to the status quo and establishing commitments based on a positive list.
Investment	No concrete proposal is made, merely a description of the situation prevailing at the subregional level and among members of SACN.	Convergence is hard to achieve because of the differences in approach and the network of existing bilateral agreements.
Intellectual property	There are differences of approach in the region.	It is important to first identify the objectives being pursued in this area.
Competition policies	Cooperation between agencies responsible for this issue.	Cooperation between responsible agencies is the most feasible mechanism.
Government procurement	There is ample room for convergence, using international experience as a reference point.	
Dispute settlement	Emphasis on the importance of having a dispute settlement instrument that offers legal certainty and protection to trade rules that might be developed by SACN.	This mechanism should be one option among others that are available, including in WTO.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information supplied by the Andean Community in "Documentos elaborados por las secretarías generales de la Comunidad Andina, Mercosur y ALADI para el proceso de convergencia sudamericano" [online] http://www. comunidad andina.org/csn/estudios.htm.

As far as origin is concerned, it appears that the differences between these agreements and decisions are not significant. Nevertheless, the rules should be harmonized in order to allow for full convergence of the agreements. Indeed, there should be a common legal basis because so far, each one has its own reference to responsible authorities. A free trade zone should have a common legal basis in order to ensure greater transparency in relations. Furthermore, uniform criteria should be followed so as to facilitate intracommunity trade. It would also be useful to harmonize the format of certificates of origin, bearing in mind the high cost of bureaucracy and red tape; this would make it possible to shorten time limits for verification and control.

In resolution 226 of 5 March 1997, the Committee of Representatives of LAIA adopted common customs valuation rules for the 11 member countries of the Association to supplement the relevant WTO agreement, which is also in force for members of LAIA. Resolution 226 establishes that the customs value of imported goods shall be determined in accordance with the provisions of the agreement on the application of article VII of GATT 1994.

Thus, a common base is already in place for members of SACN. Nevertheless, an additional issue that should be included in the SACN agenda and was not dealt with by the secretariats is that of the relationship between the customs procedures generally applied by the countries. In particular, a greater effort should be made to automate, simplify and facilitate trade without reducing oversight.

A key element in establishing a South American free trade zone is the elimination of non–tariff barriers that are not directly aimed at achieving legitimate trade policy objectives. In this regard, the documents prepared by the secretariats propose that members should initiate negotiations with a view to gradually eliminating non–tariff measures (NTMs). In terms of offers, these negotiations would entail setting a deadline for the elimination of all measures. This would entail identifying the measures adopted in the individual countries, so as to ensure transparency and facilitate market access. Elimination would be achieved through a "request–offer" approach. NTMs should be gradually attenuated until full reciprocal elimination of NTMs is accomplished. All this would be supplemented with the following steps: (a) a notification procedure, covering both the measure and the products affected; (b) a commitment to the status quo; and (c) special and differential treatment for relatively less developed economies by means of facilitation.

The secretariats' proposal has a number of positive features, particularly in the light of the need to significantly reduce the impact of NTMs and move towards their elimination. However, the procedure suggested does not seem entirely appropriate, since the negotiation process would unnecessarily delay achievement of the objective. At the same time, since a multilateral process is involved, elimination might depend on what concessions other countries have obtained. Moreover, each country would have to "unilaterally" recognize the measures under negotiation. This procedure had been suggested previously in connection with trade agreements between countries in the region but did not lead to the elimination of NTMs. It would seem more appropriate to approach the issue by strengthening the disciplines associated with NTMs, e.g., by reference to the corresponding WTO provisions, establishing the prohibition of NTMs along with the relevant explanations, emphasizing the impact of the measures and their possible justification in the context of the agreed rules. They could eventually be eliminated through dispute settlement procedures.

As far as technical barriers to trade are concerned, the secretariats' proposal discusses the existing agreements, including the Framework Agreement for the Promotion of Trade through overcoming technical barriers to trade. The secretariats suggest moving forward on substantive issues in the framework of this agreement, in particular, in areas relating to harmonization of technical rules and regulations, and on agreements on mutual recognition of national conformity assessment procedures, as well as other initiatives relating to confidence building and technical assistance.

In this area, it does not seem advisable to proceed with harmonization of technical rules and regulations. In the first place, the exercise is not efficient from the economic standpoint, since the rules have been developed in different circumstances. In the second place, the experience of the European Union has shown that this is a very slow way to reduce the costs associated with differences among countries. It would be wiser to take decisive action on the issues of equivalency and mutual recognition, as well as on trade facilitation measures in connection with accreditation and conformity assessment procedures.

With respect to sanitary and phytosanitary measures, the reports prepared by the secretariats

recommend "taking steps to ensure increased implementation and application of the principles laid down in the WTO Agreement on the Application of Sanitary and Phytosanitary Measures". They also suggest that the following actions should be taken:

(a) promote harmonized rules for the development of common sanitary and phytosanitary requirements for specific products;
(b) promote free movement of agricultural products through recognition of sanitary and phytosanitary measures;
(c) develop harmonized mechanisms and procedures for inspection and quarantine control;
(d) promote training activities for personnel specializing in the application and development of the principles laid down in the Agreement on the Application of Sanitary and Phytosanitary Measures; and
(e) promote the strengthening of agricultural health institutions in the signatory countries.

All these actions will facilitate trade in agricultural products. Also, in this case, the efforts of the members of the South American Community of Nations should emphasize the principle of equivalency more than harmonization. In addition, the operating criteria of "pest– or disease–free zones" should be implemented more effectively in the region; management and decision–making and risk assessment procedures should be improved, and cooperation between responsible institutions should be strengthened so as to promote the effective use of equivalency as a trade–facilitation tool.[22]

In the area of trade remedies, two safeguard mechanisms are proposed. One would be a general safeguard (trade safeguard). The other would be applied to a small group of agricultural products and would be triggered by volume and price, in a manner similar to that laid down in the WTO Agreement on Agriculture; certain provisions would be included to moderate the impact, such as a possible period of non–application. One way to maintain trade flows would be to establish volume criteria that would be kept separate from such measures. In cases of unfair competition (dumping and subsidies), the idea would be to maintain national provisions in accordance with WTO rules.

In this regard, the secretariat proposals could go even further. As far as safeguards are concerned, limits could be set on the time frame for applying them and the grounds for doing so, with a view to completely eliminating them in intracommunity trade. Likewise, in cases of unfair competition, only those measures necessary for remedying the negative impact of subsidies should be maintained. Antidumping measures should not, however; these have proliferated in the region in recent years (Finger and Nogués, 2005) and are unjustified in a free trade zone. Moreover, as they are envisaged in international agreements, they are of limited usefulness in economic terms and could potentially be used as a disguised protectionist tool.

With respect to trade in services, the Andean Community and MERCOSUR have attained the greatest level of normative development. In both cases, the model followed has been the WTO General Agreement on Trade in Services (GATS). More detailed provisions have been developed in some sectors, especially in transport, including land transport, financial services, telecommunications and professional services. The Andean Community has drawn up a list of barriers that are incompatible with the terms of the services regime which the countries undertook to liberalize in January 2007. The MERCOSUR countries have been working on identifying those sectors and services that are governed by the provisions of the common regime (positive list), along with the terms, conditions and limitations thereof. Other economic complementarity agreements signed in the region do not include disciplines and commitments in the area of services. The secretariats' reports point out that a suitable framework exists for moving ahead in this area, based on GATS and the experience of the Andean Community and MERCOSUR. Agreements on services are being negotiated between Chile and MERCOSUR and between Chile and Colombia, and Peru and Ecuador.

Although the GATS model serves as a common base for all SACN members, it is not necessarily the right model for an ambitious regional integration process, since it does not include essential rules in certain areas, such as the principles of regulation, mutual recognition, professional services and movement of persons. Moreover, this model does not make sense if the goal is to develop regional disciplines in the area of investment.[23] The key issue is to take an approach like the one followed in the Andean Community, undertaking, within a short period of time, to eliminate restrictions that are incompatible with the guiding principles of trade in services. This means doing away with the current

[22] This issue is discussed in Salles (2007).
[23] This is because there cannot be two treatments for the same issue: investment in services and other activities.

focus on holding to the status quo and establishing commitments based on a positive list. Otherwise, two levels of liberalization would be cohabiting in SACN: one within each subregional scheme and another between the subregions. In the case of services, although not only in this case, a permanent mechanism is needed for the negotiation and improvement of trade disciplines.

With regard to investment, the secretariats' reports indicate that the economic complementarity agreements signed by the member countries of the Andean Community and those of MERCOSUR show greater convergence than do the norms of the two economic blocs (Decision 291, and MERCOSUR Protocols). However, the MERCOSUR Protocols have not yet entered into force.

Convergence in the area of investment seems difficult, given the differences in approach of the members of SACN. This may be one of the aspects in which South America will find it hard to achieve convergence. In relations between SACN members and with respect to third parties, priority has been given to agreements on promotion and protection of investment under the terms of their domestic legislation. However, the questions of access to and operation of investment (treatment, performance requirements and others) have not been addressed. In their relations with countries outside the region, some SACN members have adopted models which in practice offer better treatment than that available between members. The extensive network of bilateral agreements on investment promotion and protection between South American countries and developed nations could make convergence even more difficult to achieve.

Competition policy has been regulated in Latin America only for the last 20 years. Regional agreements have dealt with it in different ways and the practical results have not been fully assessed.[24] Within SACN, the Andean Community has developed a set of disciplines and has reached a degree of institutional development that can be useful in addressing the question of competition policy. MERCOSUR has drawn up rules that have not yet entered into force (Decision 18/96), so it is not possible to assess their effectiveness. No agreements are in place among the South American countries for substantively regulating anticompetition practices.

In this regard, the best approach is to create effective mechanisms for cooperation among the agencies responsible for preventing such practices. It is not realistic to consider a substantive instrument covering practices that have cross–border effects, especially since such measures usually require the existence of a supranational institution.

Intellectual property is an important item on the contemporary trade agenda. The studies prepared by the secretariats acknowledge that the WTO Agreement on Trade–related Aspects of Intellectual Property Rights (TRIPS Agreement) is the fundamental instrument on which to base trade policy relating to intellectual property. Not all the substantive rules laid down in this multilateral instrument have been developed or treated in depth in the Andean Community and MERCOSUR regulations and, in fact, the normative and procedural treatments tend to be different. The reports add that the Andean Community rules have greater normative and procedural depth than those of MERCOSUR. This could serve as a basis for normative complementation and institutional capacity–building. The studies specify that the two subregional groupings have rules in only four of the 12 areas of protection that might be considered for an eventual common regime. However, a comparative review shows that there are differences, often substantial ones, in their scope and their content. While the Andean Community emphasizes harmonized procedures, MERCOSUR usually refers to the domestic legislation of its members. There is no question that a common set of rules would also call for the existence of an institution to deal with the settlement of disputes which are not only of general interest, but usually involve private interests and therefore lead to claims for compensation and indemnity.

In this regard, before a proposal is developed, it would seem appropriate to identify the objectives being pursued by including intellectual property in SACN, indicating what priority it would have on the agenda and in what areas protection would be provided.

The question of government procurement has often been absent from trade negotiations in Latin America and the Caribbean. On the one hand, none of the countries in the region are parties to the corresponding multilateral agreement administered by WTO. On the other hand, regional treatment has been relatively

[24] A preliminary study on this topic may be found in Brusick, Alvarez and Cernat (2005).

general in nature. Accordingly, the secretariats correctly recognize that there is ample room for convergence using international experience as a reference point. This is an area that several countries in the region have included or intend to include in their negotiations with countries outside the region, including the United States and the European Union.

Trade disputes have played an important role in recent years as a tool for giving trade agreements solidity and credibility (see box IV.1).[25] The secretariats' studies stress the importance of having an instrument of this type to give legal certainty and protection to trade rules that might be developed by SACN. Indeed, it is a very necessary tool. Nevertheless, this mechanism should be one option among others that are available, including in WTO. To the extent that there is the potential for competition between forums, there will be an incentive to make them more efficient, but disputes in one forum or the other should be dealt with in the light of the rules involved. This would help ensure that rules are carefully constructed, given that if the disciplines agreed by SACN were less developed than those available at the multilateral level, for example, SACN members could resolve their disputes by invoking the tighter rules and more secure mechanism.

The construction of SACN on the basis of trade rules should be underpinned by the engagement of all its members in the integration process. The secretariats have addressed this aspect by preparing a report on the treatment of asymmetries, with the support of ECLAC[26] and other regional organizations. This document recognizes that the instruments used to date in subregional and intraregional integration processes have not produced satisfactory results when it comes to addressing asymmetries between the countries. Many asymmetries are more acute within the countries themselves. Thus, they are structural in nature and have to do with a country's level of relative development and with its size. The report proposes a new treatment for addressing asymmetries.

This new treatment would involve three tracks: (i) market access; (ii) policies for treatment of structural asymmetries and policies for treatment of asymmetries created by public policy; and (iii) policies relating to the first track should expand on their traditional design, in terms of both the tools used and their duration. These pillars would provide the basis for a programme covering specific lines of work in the following categories: (a) special and differential treatment; (b) market access guarantees; (c) complementarity and competitive development, with emphasis on support for microenterprises, small and medium–sized enterprises and other production organizations; (d) physical infrastructure, by deepening the approach of the Regional Infrastructure Integration in South America (IIRSA); cooperation in macroeconomic policy; (e) export incentives and investment policies; and (f) other measures involving the tools to be used for addressing specific lines of action.[27]

The secretariat proposals are important, inasmuch as they recognize that the creation of a South American Community of Nations entails ensuring that all members are effective parts of the whole. As mentioned earlier, however, if this goal is to be attained, it will be necessary to mobilize substantial resources which compete with the need to address the existing asymmetries within individual members of the Community, and this hinders its viability. Be that as it may, any effort to preserve Community values through consensus and greater political and economic cooperation must be welcomed and strengthened, especially if it helps reduce transaction costs and avoid regional fragmentation.[28]

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25 In this regard, ECLAC has developed an Integrated Database on Trade Disputes (IDATD) [online] http://idatd.eclac.cl, which covers the Latin American and Caribbean countries. See also ECLAC (2007).

26 See Durán and Masi (2007) for further details and an overall analysis of this issue.

27 A full analysis of this issue may be found in "Un nuevo tratamiento de las asimetrías en la integración sudamericana" [onnline] http://www.comunidadandina.org/unasur/estudios.htm.

28 On this subject, see Rosales (2006).

Box IV.2

LATIN AMERICA AND THE CARIBBEAN IN TRADE DISPUTES: AN IDATD–BASED ANALYSIS

Between 1995, when WTO entered into force, and May 2007, the countries of the region have been involved in 86 of a total of 361 disputes, i.e., 24% of all cases. Four countries account for 64% of the cases submitted to WTO: Argentina, Brazil, Chile and Mexico. The remaining 36% are divided among other countries, and only one involves the English–speaking Caribbean. The WTO members against which most claims have been brought by countries in the region are the United States (27%) and the European Union (18%). Disputes between Latin American and Caribbean countries account for 43%. In terms of specific issues addressed in most complaints brought before WTO, the main ones are unfair competition (antidumping measures and countervailing duties), representing 36% of the total. These are followed by cases relating to the Agreement on Safeguards and the Agreement on Agriculture. Agricultural products are involved in nearly 40% of all claims submitted by countries of the region. This is to be expected, given the export patterns of many of the countries; it is also an indication of which countries are more active in the system. Disputes on agricultural products do not refer only to questions relating to the Agreement on Agriculture, but also to the application of safeguards, subsidies and countervailing duties, import licences and even services (bananas).

Since the entry into force of MERCOSUR in 1991, there have been around 542 disputes between its members, which shows a significant level of use of the system. The highest percentage of disputes in this scheme involve Argentina and Brazil, both as plaintiffs, 42% and 30.6% respectively, and as defendants, 33.6% and 41%, respectively. Disputes between Argentina and Brazil are at the top of the agenda in the system, as they account for 53% of the total. This is understandable, considering the significant level of bilateral trade. Most of the disputes occurred during the early years of MERCOSUR, between 1995 and 2001, when 85% of the cases were brought.

Three hundred and seventy–five disputes have been initiated in the Secretariat of the Andean Community, including those originated within the former Andean Pact, from 1980 onwards. The General Secretariat (the former Board of the Cartagena Agreement) has been active in bringing complaints against members of the integration scheme, given its responsibility for ensuring that members comply with their obligations. The active approach taken by the Secretariat could explain why there have been relatively fewer disputes among members; although the number is high (34%), it is much lower than the 54% of complaints brought by the General Secretariat. Complaints submitted by the private sector represent around 12.5% of the total. As respondent countries, the Bolivarian Republic of Venezuela and Ecuador account for around 45% of all complaints. (This is a further exploration of the analysis by Rosales, Durán and Sáez (2007), ECLAC (2005), chapter 3; and that contained in Durán and Maldonado, 2005).

The problems most frequently submitted to the WTO dispute settlement system have to do with unfair competition, including antidumping measures and countervailing duties in the case of subsidies. The second most common category of complaints are issues relating to the application of the Agreement on Agriculture. In third place are issues relating to safeguards and GATT.

In the case of NAFTA, most of the disputes have involved allegations of unfair competition (dumping practices or subsidies) and the means used by countries to compensate for their negative impact.

In MERCOSUR and the Andean Community there are several common issues that give rise to disagreements: (i) disputes relating to tariffs, usually associated with the formative period of the common market (the first five years) and bilateral tariff reduction programmes; (ii) disputes relating to domestic taxes and their impact in creating trade discrimination (national treatment), which coincide with the period of disputes on tariffs; (iii) in both schemes a high percentage of disputes fall within the category of "other non–tariff measures", although these are more frequent in MERCOSUR. In the Andean Community, disputes on the application of safeguards and antidumping measures account for a large share of the total.

In every instance, agricultural and food products account for a significant percentage of disputes. In NAFTA, steel products and by–products are significant. Both in WTO, and in the Andean Community and MERCOSUR, there have been frequent disputes about "trade policies", as reflected in the percentage of disputes over "broad or non–specific" issues.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), Integrated Database on Trade Disputes (IDATD) [online] http://idatd.eclac.cl.

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Chapter V

The economic restructuring of the Asia–Pacific region and its impact on Latin America and the Caribbean

Introduction

The following analysis of the proliferation of trade agreements shows that East and South–East Asia are in a second phase of economic integration and trying to extract greater synergy from de facto and de jure integration processes. For that reason, other regions of the world are interested in taking advantage of this favourable situation, while, at the same time, defending their own interests in the region. Nonetheless, the current economic integration process in East Asia, based on increasing trade and investment links, and now promoted by formal agreements, could place Latin America and the Caribbean at a disadvantage. The countries of the region urgently need to adopt a strategy for Asia–Pacific engagement that includes agreements between the two regions.

A. The "noodle bowl" phenomenon in Asia and the Pacific

In Asia over the last decade, trade–preference or free–trade agreements have proliferated both at the regional level and bilaterally, a phenomenon known as a "noodle bowl" to reflect the Asian culture rather than the "spaghetti bowl" of the western world. Although not originating in Asia, this phenomenon (Menon, 2006a) has achieved maximum expression in that region since the second half of the 1990s.[1] According

[1] The number of trade agreements in Asia and Pacific quadrupled between 2000 and 2006. According to a count made by Menon (2006a), which includes the United States and Canada, as of October 2006 there were 176 bilateral agreements; and all Asia–Pacific countries apart from Mongolia had participated in at least one agreement of this type. The most active countries in this process are India, with 22 agreements; the United States with 20; and Singapore and Pakistan with 10 each.

to data from the Asia Regional Integration Center of the Asian Development Bank, between 1976 and December 2006, there have been 192 trade agreements of various types involving Asia and the Pacific (which includes not only East Asian countries but also those of South Asia and the countries of the former Soviet Union). Of these agreements, 57 are already in force; 27 have completed negotiations; 39 are in the negotiation phase, and 18 have a framework agreement signed or being negotiated.

A clear characteristic of the new regionalism in Asia and the Pacific is the fact that several large regional economies, such as Japan, China, the Republic of Korea and Taiwan Province of China, are abandoning their traditional reluctance to sign preferential agreements and join trade blocs, and have decided to sign bilateral or plurilateral trade agreements with other economies both within and outside the Asia–Pacific region (see table V.1).

Examples of trans–Pacific agreements include the treaty between Chile and China, the first trade agreement that China has signed with a western–hemisphere country; the agreement signed by Chile with India and Japan, and the agreement between Panama and Singapore and with Taiwan Province of China. The Agreement between Japan and the United Mexican States for the Strengthening of Economic Partnership entered into force on April 2005 and is the first broad–scope agreement that Japan has signed thus far. Other initiatives between Pacific Rim and Latin American countries include: the Chile–Korea Free–Trade Agreement, which was the first ever trans–Pacific free–trade treaty; the Trans–Pacific Strategic Economic Partnership Agreement between Chile, New Zealand, Singapore and Brunei Darussalam (referred to as a P4 agreement), the Peru–Thailand Free Trade Agreement, for which negotiations concluded in 2005. Chile is also in preliminary talks (feasibility studies with a view to an FTA) with Thailand, Malaysia and Viet Nam. This set of initiatives reveals a serious intent by Latin American countries to take a long–term view in their relations with Asia and the Pacific, but it cannot yet be described as a strategic approach.

For a number of countries of the Pacific Basin (the countries of North America, Latin American States members of APEC, India, Pakistan and Sri Lanka), a large proportion of trade is already subject to preferential tariffs. As of August 2007, the network of free trade agreements in force in the Pacific Basin involved preferential tariffs applicable to 45% of total exports, most of which were grouped around the ASEAN countries (53.5%). The interests of China, Japan and the Republic of Korea, which make up the "ASEAN + 3" area, and those of Australia, India and New Zealand ("ASEAN + 6"), together with the drive and dynamism of Canada, the United States and other countries of the region (Chile and Peru), are reflected in the proposal to build a large–scale agreement on the basis of APEC, a Free Trade Area of the Asia Pacific (FTAAP). The proportion of trade subject to preferential tariffs could quickly increase to 65%, and within the ASEAN area that figure could rise to 97% of total exports (see figure V.1). The adoption of FTAAP is already supported by the business communities in Brunei, Chile, Mexico, New Zealand, Peru, Singapore and the United States.

Regional integration sub–groups and countries of the region that do not belong to subregional blocs (Chile and Mexico), have entered into agreements of this type outside the region, some of them with the Asia–Pacific region. Until recently, these bilateral agreements had a small specific weight in the growth and direction of the region's trade flows. Nonetheless, by late 2005, the countries of Latin America and the Caribbean had signed or negotiated over 60 agreements; and roughly 60% of the region's total exports took place under their auspices, in stark contrast to the situation prevailing in the early 1990s, when the four existing trade preference schemes accounted for about 6% of the region's total exports (Kuwayama, Durán and Silva, 2005).

In brief, while the conclusion of bilateral or subregional agreements between the economies of Asia and Pacific is not a new phenomenon, the recent wave of free–trade treaties displays two new features: the transpacific scope of the new agreements, and participation by the leading economies of North–East Asia (Japan, China and the Republic of Korea) and the United States.

Table V.1
NETWORK OF FREE-TRADE AGREEMENTS IN ASIA AND THE PACIFIC

Bilateral

Within East Asia

Singapore–Japan
Singapore–Republic of Korea
China–Hong Kong SAR
Japan–Thailand
Japan–Brunei Darussalam
Republic of Korea–Thailand[a]
Lao PDR–Thailand
Malaysia–Republic of Korea[c]
Taiwan province of China–Malaysia
Japan–Republic of Korea[b]
Japan–Malaysia
Japan–Philippines
Japan–Indonesia
Thailand–China
China–Macao SAR
Japan–Viet Nam[a]
China–Republic of Korea[c]
China–Singapore[a]

Trans-Pacific

Australia–United States
Singapore–United States
Singapore–Panama
Chile–Republic of Korea
United States–Viet Nam
United States–Indonesia[c]
United States–Philippines[c]
Peru–Thailand[a]
Mexico–Japan
Republic of Korea–Mexico[a]
United States–Republic of Korea
United States–Thailand[a]
Singapore–Peru[a]
Chile–Thailand[c]
United States–Malaysia[a]
United States–Taiwan province of China[c]
Singapore–Mexico[a]
Singapore–Canada[a]
Chile–China
Chile–Japan
Taiwan province of China–Panama
Taiwan province of China–Guatemala
Taiwan province of China–Dominican Rep.[c]
Taiwan province of China–El Salvador[a]
Taiwan province of China–Honduras
Taiwan province of China–Nicaragua
Taiwan province of China–Paraguay[a]
Chile–Malaysia[a]
Peru–China[a]
Chile–Australia[c]

East Asia–Australasia

Singapore–New Zealand
Singapore–Australia
Thailand–Australia
Thailand–New Zealand
Australia–China[a]
Australia–Malaysia[a]
New Zealand–China[a]
New Zealand–Malaysia[a]
Japan–Australia[a]

Outside East Asia

Singapore–European Free Trade Association (EFTA)
Republic of Korea–EFTA
Singapore–India
India–Thailand[a]
India–Republic of Korea[a]
Pakistan–Singapore[a]
China–India[c]
Malaysia–India[c]
Pakistan–Thailand[c]
Thailand–Bahrain[a]
Singapore–Jordan
China–Pakistan
Malaysia–Pakistan[a]
Pakistan–Indonesia[a]
Japan–India[c]
Pakistan–Philippines[c]
Singapore–Sri Lanka[c]
Thailand–Egypt

Plurilateral

Within East Asia

ASEAN Free Trade Area
ASEAN–China
ASEAN–Republic of Korea
ASEAN–Japan[a]
Latin America and the Caribbean–China–Japan–Republic of Korea[c]

Trans-Pacific

Chile–New Zealand–Singapore–Brunei Darussalam (P4)
Thailand–MERCOSUR[c]
Republic of Korea–MERCOSUR[c]

East Asia–Australasia

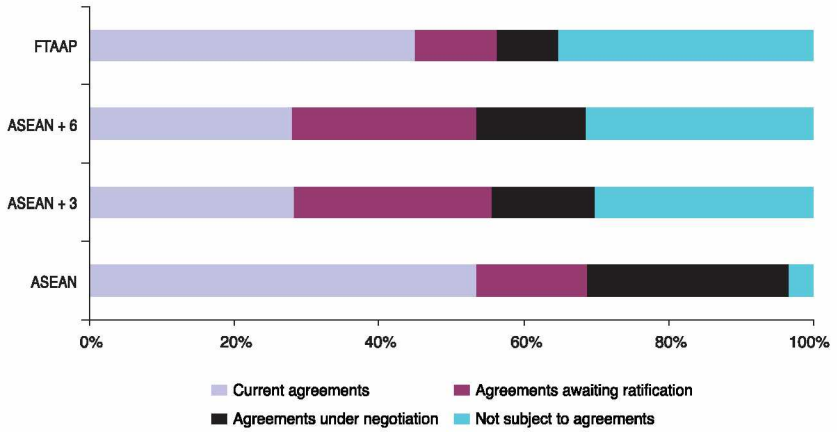
Trade Agreement for Closer Economic Relations of Australia and New Zealand (ASEAN–CER)[a]
EAFTA[c]

Outside The Asia–Pacific region

ASEAN–India[a]
Bay of Bengal Initiative for Multisectoral, Technical and Economic Cooperation (BIMSTEC) [a]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the World Trade Organization, Asian Development Bank (ADB) and the press.
[a] In negotiation.
[b] Negotiations suspended.
[c] Proposed.

Figure V.1
INITIATIVES ON FREE TRADE AGREEMENTS IN THE PACIFIC BASIN, AUGUST 2007
(Percentages of exports covered by preferential tariffs)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United Nations Commodity Trade Database (COMTRADE) and agreements currently in force, signed, or under negotiation in Pacific Basin countries (expanded to India, Pakistan and Sri Lanka).

B. The causes of the "noodle bowl" phenomenon: the asian crisis, the stagnation of the Doha round and the domino effect

This multitude of agreements stems from three specific circumstances in the current world economic situation: firstly, a certain disenchantment with the multilateral negotiation process within WTO, especially the relative stagnation of the negotiations. Nonetheless, while multilateral negotiations are making little progress, the other regions (mainly the American and European continents) are negotiating bilateral or plurilateral trade agreements that move towards the formation of discriminatory trade blocs. Asia is also learning in that direction.

The second decisive factor in the change of direction towards bilateral or plurilateral trade agreements in that region was the Asian crisis of 1997, which showed that APEC was unable to serve as the assistance forum that the Asian countries needed. The third key element was that the crisis endangered fulfilment of the Bogor Goals, which had been agreed under different circumstances; and this led to a number of countries attempting to form a trade bloc of an free–trade area (FTA) or economic union type.[2] The 1997 crisis thus changed the way in which the Asia–Pacific economies conducted regional integration: it henceforth ceased to be an exclusively market–oriented process driven by the private sector —de facto integration— and began to incorporate a number of government initiatives —de jure integration— which were not only trade–oriented, but also included

[2] In the Meeting held in Bogor (Indonesia) in 1994, the APEC member countries undertook to liberalize trade and investments in the Asia–Pacific region in 2010 for developed countries and 2020 in the case of developing countries. This liberalization was to take place on the basis of an open regionalism process, in which concessions would be granted unilaterally (i.e., not reciprocally) to all WTO members.

measures in the monetary and financial areas (Rana, 2006; Lamberte, 2005).[3]

The proliferation of bilateral preferential agreements apparently also reflects the need to move faster on the liberalization path, since neither the WTO negotiations nor those within APEC have progressed at a pace that satisfies the needs of the region's economies. Moreover, the consolidation of other regional agreements elsewhere threatens to undermine the competitiveness of the Asian economies. Lastly, a backdrop to the multiplication of agreements has seen an intensification of intra–regional production and trade links, which need greater depth and the creation of more "formal" local cooperation mechanisms in view of the growing interdependence (see chapter II).

As in other regions of the world, bilateral agreements, whether already in place or under negotiation, can produce a domino effect mainly among the smaller trading partners, whose fear of losing comparative advantages and market share prompts them to pursue bilateral agreements with trade partners that have already signed agreements (Baldwin, 2006). This multiplication of agreements ends up generating strongly intertwined commitments, and considerable lack of coordination, not to mention higher operating costs in terms of both the negotiation and its implementation, especially in the case of multiple bilateral agreements.

Preferential agreements among the Asia–Pacific countries, especially those signed with developed countries, have generated controversy as to whether they are more or less complete than the more traditional free–trade agreements. Generally, the trade agreements prevailing in Asia are less wide–ranging: although they involve commitments on "behind–the–border" measures, they are mainly confined to tariff reduction on goods, and they also exclude a large number of products that are considered sensitive. Although such measures feature in most agreements, the breadth of coverage of their areas and the depth of their commitments seem limited. More specifically, the agreements that already exist, or are under negotiation, vary greatly in terms of the liberalization timetable, lists of exceptions, the different systems of rules of origin applied, and implementation modalities (Baldwin, 2006; Evenett, Venables and Winters, 2004; and Dent, 2006).

This domino effect is clearly visible in the case of China's proposal to sign an agreement with ASEAN, since it was followed by similar offers of wide–ranging economic partnerships by Japan, the Republic of Korea, India, Australia and New Zealand. The signing of a bilateral agreement between two of North–East Asia's three main trading partners is expected to trigger this broad–scope phenomenon in Asia and Pacific (Evenett, Venables and Winters 2004). This is due to the fact that the risk incurred by giving preference to bilateral agreements among the large players (the advantages resulting from hub–and–spoke integration schemes) tends to be concentrated in the large "hub" economies.

Moreover, any agreement that involves one of the three large players (Japan, China and the Republic of Korea) will alter the relative competitiveness of firms that export to the signatory countries. Changes in the competitiveness of Asia's manufacturing sectors, induced by the signing of such an agreement, would encourage exporters from countries that are not members of the treaty to pressure their governments to join the free–trade treaty race; firms in the United States or Europe would do the same, thus fuelling the "domino effect".

[3] Recently, the countries of East Asia have achieved greater integration by creating processes of regional surveillance, dialogue (such as the ASEAN+3 Economic Review and Policy Dialogue), coordination (the Chiang Mai Initiative) and the Asian Bond Market Initiative. The members of ASEAN+3 decided to create a multilateral extension of the Chiang Mai initiative to manage funds, called the "Self–Managed Pooling Reserve", which would allow for additional regional interdependence thanks to investments in infrastructure projects in the region.

C. Proposals on the future economic integration of the Asia–Pacific region

The economic integration process in the Asia–Pacific region has not been homogeneous, but has followed various paths with different speeds of implementation. Diversity among the sizes and development levels of the different Asian countries is the main obstacle to establishing the long–desired Asian free market.

At the present time there are two broad–scope proposals to create large economic communities in Asia. The first relates to the creation of an Asia–Pacific free trade zone within APEC; while the second concerns the formation of an ASEAN+3 Economic Community, consisting of the 10 members of ASEAN, along with China, Japan and the Republic of Korea, or with ASEAN+6, which additionally encompasses Australia, India and New Zealand. The first alternative is supported by the United States and member countries that have moved forward along the road to trade liberalization, such as Australia, Japan, Canada and Mexico. The second originated from the ASEAN member countries and the leading countries in North–East Asia.

1. Challenges facing APEC

For many APEC members (including Australia, Canada and the United States) the objectives of this institution are both economic and strategic: to avoid the polarization of Asia and Pacific. Nonetheless, the variety of political and economic situations prevailing among its members makes it hard to obtain a unified stance on all political and economic topics of the varied agenda.

Furthermore, the non–binding (voluntary) nature of the commitments assumed in APEC does not give its participants incentives to move forward, nor does it exert pressure in this direction; so the process tends to stagnate and members spend their time signing preferential bilateral and subregional agreements. The fact that these commitments do not satisfactorily respect the Bogor Goals is causing confusion as to the function of APEC. There are also institutional weaknesses that are probably undermining the efficacy of the APEC discourse: confused objectives, too many members, too long an agenda, the dysfunctional structure of the Secretariat, and now new regional competitors (ASEAN+3 and the East Asian Summit, consisting of ASEAN+6 (Gyngell and Cook 2005).

With this problem as a backdrop, the participants at a symposium held during the meeting of the APEC Committee on Trade and Investment (25–26 May 2006, Ho Chi Minh City, Viet Nam) agreed that the Bogor Goals should be interpreted dynamically, to go beyond the original objectives, since members perceived them ambiguously.[4] Participants felt that APEC should from now on: (i) seek greater regulatory transparency and consistency; (ii) promote mutual recognition of standards; (iii) apply fewer restrictions on movements of people, businesses and capital; and (iv) use better practices in terms of logistics, including paperless trade and other emerging applications arising from information and communication technologies (ITCs).

[4] See the report of the APEC International Symposium, 2006.

The trade ministers of the 21 APEC countries, meeting in July 2007 in Cairns, Australia, reiterated their call for progress in the WTO negotiations, but also considered ways of boosting trade among the member countries. The options they examined, aside from a multilateral agreement (which is seen as the most important), included the creation of an Asia–Pacific free trade zone, which would however be a long–term goal. At the same time, in light of the growing complications resulting from the multiplication of regional agreements and the danger raised by some critics of a trade diversion, the ministers decided to look into a possible rationalization of preferences and the other provisions of such agreements. They also approved a new trade facilitation plan which should lead to a 5% drop in transaction costs (*Bridges Weekly Trade News Digest*, 11 July 2007).

2. Growing United States interest in promoting trade with the Asia–Pacific region

The United States has been showing increasing interest in signing free–trade agreements with Asia–Pacific countries; it has agreements currently in force with Australia, Canada, Chile, Mexico and Singapore; and it is negotiating with Malaysia and Thailand separately, and with India and Nepal jointly. It has also proposed an agreement with Brunei Darussalam, Indonesia, Pakistan, the Philippines, Sri Lanka and Taiwan Province of China, among others.[5] The ASEAN–United States Trade and Investment Framework Agreement (TIFA) was also signed in August 2006 with the ASEAN countries, since this type of agreement is considered a precursor of a free trade agreement.

From the standpoint of the United States, free–trade treaties with Asia–Pacific countries have the following aims: they promote its trade and political interests both tactically and strategically; they support local democratic institutions and economic reforms in the signatory countries; strengthen security in the zone; they establish a benchmark for future negotiations with other countries with a deep integration approach that includes non–transboundary trade issues; and they speed up regional–scope trade liberalization by forging alliances with the region's political leaders (Feinberg, 2006).

The "domino effect" observed in the Asia–Pacific region is viewed as the outcome of a geopolitical and economic game being played out on a global stage. The United States is aware of the tremendous progress made by the European Union in terms of signing global trade treaties, and of China's growing influence and its consequent rivalry with Japan for leadership in the region. It also perceives the need to strengthen its presence in various parts of the world, including Asia and the Pacific.[6]

For the United States, boosting merchandise exports is less important for the promotion of free trade agreements than expanding services and investments, protecting intellectual property, and taking labour and environmental issues into account. The agreements signed by the United States have broader coverage and are deeper than those signed by the European Union; as a result they are harder to propagate. As the trade agreements that are emerging in different parts of the world incorporate behind–border issues, bilateral agreements are an effective instrument enabling the United States to safeguard its commercial interests.

A noteworthy recent event was the signing of a free trade agreement with the Republic of Korea —the world's tenth largest economy, whose per capita

[5] In addition to these agreements, the United States has a free–trade or preferential trade agreement at the implementation stage with the following countries: Federated States of Micronesia, Israel, Jordan, Marshall Islands, Morocco and Palau; it has also signed a free–trade agreement with Bahrain (Menon, 2006a).

[6] In late 2005, the European Union had signed at least one type of preferential trade agreement with every country in the world apart from Australia, Canada, Hong Kong Special Administrative Region of China, Japan, New Zealand, the Republic of Korea, Singapore, Taiwan Province of China and the United States.

income measured in current dollars is currently US$ 16,000. This country is a very important trade partner for the United States, and the agreement is considered the most important since NAFTA. It is estimated that bilateral flows between the two countries could grow by more than US$ 26 billion, raising the current level of US$ 74 billion to US$ 100 billion (*Bridges Weekly Trade News Digest*, 2007a and 2007b). Apart from tariff reductions on merchandise trade, the agreement also includes chapters on services, investments, sanitary and phytosanitary measures, contingency measures, technical barriers to trade, intellectual property, dispute settlement mechanisms, and others.[7] There can be little doubt that ratification of the agreement by the United States Congress could change the course of the negotiations of these agreements in Asia and Pacific.

3. Japan in pursuit of leadership in Asia–Pacific economic integration

Japan has three free trade agreements currently in force (with Malaysia, Mexico and Singapore), and it has signed four others (Brunei Darussalam, Chile, Philippines and Thailand). Apart from these seven agreements, it is negotiating with Indonesia, Switzerland, Viet Nam and the Gulf Cooperation Council. Looking further into the future, there are possible agreements with Australia and India, and also with the Republic of Korea and the ASEAN countries. These agreements are crucial for making headway in spreading economic partnership agreements throughout Asia.

The stance adopted by Japan, previously based on the multilateral principle, began to shift towards bilateral and plurilateral trade agreements, within the Asian region and elsewhere, in 2002 when former Prime Minister Junichiro Koizumi proposed the Initiative for Japan–ASEAN Comprehensive Economic Partnership. This change of approach occurred in response to China's growing leadership in the Asian economy, and to contain that country's influence on the direction being taken by regional integration centred on ASEAN. The latter is a key subregion for Japan, not only as a supplier of natural resources and manufactures (especially parts and components), but also as an important industrial base for Japanese transnationals. In other words, ASEAN is a fundamental area for the country's international competitiveness, owing to the growing links between trade and investment. Japan has made enormous investments in the ASEAN economies and has provided them with a great deal of economic assistance. It feels threatened by the growing presence of China in this subregion, and has responded by proposing a regional–scope free–trade treaty.

[7] Both parties agreed to eliminate 94% of their tariffs within three years from the entry into force of the agreement, and the remainder during the established period. In the case of the automotive industry, tariffs will immediately eliminated on vehicles with engines of less than 3,000 cc. and their parts, while those larger than 3,000 cc will be eliminated over a three–year period. The current tax regime applied to automobiles will be adjusted. The United States will immediately eliminate 64% of its tariffs on textiles, apart from a number of ready–to–wear garments. In the case of agricultural products, the Asian country will maintain the current level of tariffs on oranges, beans, powdered milk, and other products of the agriculture sector. Rice will be excluded from the tariff reduction schedule, while the 40% tariff on beef will be eliminated within 15 years.

Box V.1
PROSPECTS FOR A FREE–TRADE AGREEMENT IN APEC

At the 2006 annual APEC summit held in Viet Nam, the leaders of this grouping decided to form a study group with a view to creating the world's largest economic and trade grouping, the Free Trade Area of the Asia–Pacific (FTAAP), a proposal originally put forward by the APEC Business Advisory Council (ABAC) at the summit held in Chile in 2004 (see ABAC, 2004). This initiative reflects two fundamental features of the international setting: First, it is a tacit recognition of the virtual stagnation of multilateral trade negotiations; and second, it reflects the search for new internal dynamism in APEC, which has been affected by the proliferation of agreements both within the Asia–Pacific region and on the American continent. It also aims to promote fulfilment of the Bogor Goals and the Osaka Agenda for Action (Bergsten, 2007b). Other elements of this initiative concern the possibility that the new intra–regional agreements may increase discrimination against non–Asian countries, which would allow for the emergence of an Asian bloc with a strong presence in international policy and economic forums, polarizing the Pacific region into two blocs and the world into three.

The initiative to create the study group was originally suggested by the United States, with support from Australia, Canada, Japan and Mexico. Coincidentally, these are countries which (except for Australia and Japan) are outside the main trend of bilateral trade agreements in Asia, although there are also agreements between, among others, Australia and the United States and Singapore, Japan and Mexico, and Thailand and Australia, in addition to recently concluded agreements between the Republic of Korea and the United States, and between Chile and China, Chile and Japan, and the 2005 agreement with the Republic of Korea. In fact, some of these countries would have much to lose if an integration scheme were established between Asian countries. Nonetheless, apart from keeping this threat at bay, the proponents of the agreement are linking the formation of this free trade area to the possible advantages that all APEC economies would enjoy.

Among the expected benefits of the agreement's implementation, it should be remembered that the relative importance of APEC members in world trade and the global economy would make it hard for multilateral negotiations to surpass the advantages produced by a free–trade agreement, even if some exceptions to total liberalization were adopted. Moreover, the prospect of this agreement could lead non–APEC countries to resist continuing with multilateral negotiations and reconsider their position, given the repercussions that trade in these countries would suffer as a result of greater trade deviation and a reduction in their market shares. The agreement could act as a brake on the proliferation of regional and bilateral agreements, it could reduce the risks of polarization between East Asia and the Western Hemisphere, and attenuate the economic conflicts affecting China's relations with the United States. It would also strengthen APEC in moments of tension arising from trade disputes being faced by certain members and would maintain the interest (and commitment) of the United States in trade with the Asia–Pacific region and also in world trade, since the agreement would provide a basis for renewing the mandate of the Trade Promotion Authority, which runs out in mid–2007 (Bergsten, 2007a).

There is no consensus on the feasibility of implementing this broad–scope initiative. Morrison (2006), for example, considers the agreement to be politically unviable for various reasons, including the fact that the conditions do not exist to embark upon the negotiations, since APEC would have to call a halt to all other negotiating activities; and, given the complexity and scope of the agreement, it would have to maintain strong support throughout the negotiation period, which it is estimated would last about five years. This negotiation would only be feasible if one of the main APEC economies promoted the process. In addition, a full free–trade agreement in APEC means, in United States pubic opinion, a trade agreement with China and all Asian economies that follow its competitive steps —something that seems unviable today in the legislative climate prevailing in the United States. Moreover, negotiation of the agreement would require changes in APEC, which was never conceived as a negotiation mechanism, but as an organization to establish a community for socioeconomic cooperation, although the strengthening of trade ties was always present on its agenda. Nonetheless, the Bogor Vision assumed that liberalization would be achieved through a voluntary and consensus–based process rather than by binding commitments. To establish a free–trade agreement, it would be necessary to consider not only binding commitments but also the adoption of rules of origin that discriminated against non–members, in contradiction to the principle declared in 2005 at Busan, Republic of Korea, that APEC should not be an inward–looking trade bloc, but should pursue global free trade.

Some leading APEC countries, such as China, stress aspects such as open and voluntary regional cooperation. For Japan, agricultural liberalization is still a very difficult topic domestically. Like China, Japan is very interested in strengthening regionalism in East Asia, as can be seen from a proposal to create the East Asia free–trade area, which would unite ASEAN and another seven countries of Asia and Pacific (ASEAN+6). Some ASEAN countries might not be ready to cope with such a large–scale agreement, however, as was the case with the Free Trade Area of the Americas (FTAA).

Lastly, it should be recalled that individual APEC members have different approaches to trade treaties. China prefers more strictly defined agreements, whereas the North American countries prefer broader and deeper agreements (Bin, 2006). These differences, together with the preference displayed by some Asian countries for forming an East Asian FTA, could end up exacerbating trends towards polarization between the Asia–Pacific countries (Bergsten, 2007b).

Box V.1 (concluded)

The Trans–Pacific Strategic Economic Partnership Agreement between Brunei Darussalam, Chile, New Zealand and Singapore (P–4) has broad coverage and includes trade in goods, services and investments, as well as government procurement and intellectual property. What is probably unique is the "big bang" approach to trade in goods liberalization – Singapore has achieved MFN zero tariffs; for New Zealand, all tariffs would be eliminated with immediate effect; for Chile, tariffs on 89.3% of products would be eliminated immediately, 9.57% within three years and the remaining 1.13% in six years. There are breakthroughs in agricultural trade liberalization, particularly as Chile and New Zealand are both southern hemisphere countries with similar climates and seasons and compete in a range of agricultural exports

The agreement takes into consideration the most up–to–date manufacturing methods, with rules of origin that allow for the use of subcontracting. In the area of trade facilitation, it provides for self–certification in seeking preferential tariffs; risk management in the area of customs; and advance rulings. There is also a section on cooperation in five fields: economics, education, primary industry, culture and science, and research and technology, for example, the sending of trade missions, the strengthening of cooperation in the area of education, increases in the number of working visas issued, strategic alliances for investment incentives and collaboration on sanitary and phytosanitary matters. There is also a memorandum of understanding on labour regulations and an environmental cooperation agreement.

The P4 agreement is intended as a model for various types of integration schemes, both by being open to new members (provided they accept the existing conditions without additional negotiation) and in terms of the initial effect of its liberalization. Nonetheless, despite the interest already shown by a number of countries in joining the agreement (including Malaysia, Mexico, Peru and Thailand), two obstacles arise that will make broader dispersion difficult: (i) the political and economic cost of applying such rigid rules at the outset; and (ii) the large physical distances that separate the main partners, which requires a level of logistics and transport management that would be hard for all APEC members to achieve (Yue and Soesastro, 2006). For these reasons, although the P–4 agreement could increase the number of members, it does not seem, *ceteris paribus*, to offer the chance of achieving convergence between integration processes in Asia, although its architecture could be very useful for countries that want to achieve fast liberalization, by joining that agreement.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Fred C. Bergsten, "China and economic integration in East Asia: implications for the United States", *Policy Briefs in International Economics*, Institute for International Economics, March 2007 and "Toward a Free Trade Area of the Asia Pacific", *Policy Briefs in International Economics*, Washington, D.C., Institute for International Economics, February 2007; Chia Siow Yue and Hadi Soesastro, "ASEAN perspectives on promoting regional and global freer trade", *An APEC Trade Agenda? The Political Economy of a Free Trade Area of the Asia Pacific*, The Pacific Economic Cooperation Council/The APEC Business Advisory Council, 2006; C Morrison, "An APEC trade agenda," *An APEC Trade Agenda? The Political Economy of a Free Trade Area of the Asia Pacific*, The APEC Business Advisory Council, 2006; S. Bin, "The political economy of an Asia Pacific Trade Area: a China Perspective," *An APEC Trade Agenda? The Political Economy of a Free Trade Area of the Asia Pacific*, The APEC Business Advisory Council, 2006.

Japan has four opportunities to exercise leadership in the region. First, it should promote its EPA with ASEAN as a model, since the other countries' agreements are likely to be incomplete in certain areas. Second, the Japanese government should continue offering economic and technical cooperation, including human resources development, to help improve infrastructure in the region. Third, it should work toward further liberalization of its own market, by adopting the policy of protectionism as required but compromise whenever possible. (JETRO 2005). Fourth, it must accept the increased immigration of skilled workers. Many countries compete for immigrants in professional and technical fields, and Japan should do the same by accepting people from specific countries when FTA/EPA negotiations are concluded. (JETRO 2005, Kimura 2006).[8]

From Japan's viewpoint, South–East Asia still has major barriers to trade and investments, a general framework that is unsuitable for business, compounded by weak infrastructure and supplier industries. The country should try to make cross–border logistics more efficient and provide incentives for support industries in the ASEAN region. In this regard, the Economic

[8] If this is the case, Japan would be the first G–7 country to relax these criteria, which would technically be reflected in a broader negotiation on Mode 4 service provision.

Partnership Agreement (EPA) that Japan is negotiating with ASEAN could be a good model allowing for legal integration because of its comprehensive nature, which includes liberalization along with trade facilitation and investments (encompassing topics such as regulations on investment, competition, certification and intellectual property protection), and economic partnerships and cooperation.

The first stage of market liberalization in South–East Asia should be completed in 2007, while in 2008 negotiations are expected to be completed between China and the Republic of Korea for a FTA with ASEAN, and to create conditions for an even deeper liberalization process. If the negotiations for the agreement between these two countries and ASEAN really are completed before 2010, the process of establishing a South–East Asia free–trade area will have ended ahead of schedule (JETRO, 2005). According to the most realistic expectations, agreements with ASEAN will be completed in 2009 in the case of the Republic of Korea, 2010 in the case of China, and 2012 in the case of Japan.

The signing of the free–trade agreement between the Republic of Korea and the United States could encourage Japan to resume the suspended negotiations for a similar agreement with the Republic of Korea and move towards an eventual bilateral agreement with the United States. If substantive headway is made towards these types of trans–Pacific initiative between the major players, the balance of economic and trade power between China and Japan would be altered not only in the Asia–Pacific domain, but also between China and the United States, thereby substantially changing the integration panorama in the Asia–Pacific region.[9]

4. Agreements involving China as an integral part of trade diplomacy and strategic partnerships

China began to speed up the establishment of its network of trade agreements in 2001, when it signed the first agreement with other members of the Bangkok Agreement, thereby notifying the world that it was abandoning the trade policy based on the multilateral system to embrace the policy of nonalignment. By late 2006 it had completed agreements, or had held negotiations for that purpose, with 32 countries or country groupings in Africa, Asia, Latin America and the southern Pacific. The volume of trade with these countries amounted to US$ 345 billion, a quarter of the country's total trade in 2005 (Bin, 2006). It has also embarked on feasibility studies for free–trade agreements with India and Iceland (Rosales and Kuwayama, 2007), and it is studying the feasibility of a similar treaty with Japan and the Republic of Korea.

Several features distinguish the treaties signed by China from those signed by other Asian and non–Asian countries (Bin, 2006). Firstly, China adopts a very pragmatic strategy that takes the different interests of its trade partners into account; there is no single model for all agreements. For example, its agreements with Hong Kong Special Administrative Region of China (SAR) and Macau Special Administrative Region of China (SAR) —Closer Economic Partnership Agreements (CEPAs)— include specific disciplines and rules, while those with Australia and New Zealand are more declarations of intent with general commitments on cooperation issues. Secondly, the implementation process is staged, for example starting with the "early harvest" program, and, in later phases, the possible incorporation of other disciplines such as services, investments and trade facilitation measures, as happens in the agreement with ASEAN (Kwei, 2006) or with

[9] An application of the general computable equilibrium model (CGE) by Lee, Roland–Holst and van der Mensbrugghe (2004), for the United States, Japan and China, shows that the option of a trilateral treaty would generate greater advantages, whereas bilateral agreements with ASEAN, such as between ASEAN and China, tend to divert Chinese trade. The advantages are greater when they include substantial liberalization of the agriculture sector.

Chile.[10] Lastly, several Chinese agreements exclude sensitive products and sectors such as intellectual property protection, sector liberalization and labour and environment issues.

China uses these agreements as tools of its trade policy, like the "one country, two systems" model applied in the cases of Hong Kong SAR and Macau SAR. The ASEAN–China agreement is seen as a tool of diplomacy to mitigate the growing trade and investment competition between ASEAN countries and China. Other agreements, such as those signed with Chile, India, Pakistan and South Africa are seen as diplomatic efforts to initiate or consolidate strategic partnerships and a guarantee the supply of natural resources. Another important objective is to ensure recognition of market–economy status by the countries signing trade agreements (ECLAC, 2005).

Given these peculiarities, if a free–trade area like the one proposed for APEC is achieved, the Chinese authorities would not abandon ongoing negotiations or those of future agreements. China would prefer to maintain agreements that offer a degree of flexibility in terms of preferential and differential treatment. Even more importantly, it would not be in China's interests to submit the bilateral disputes that exist with the United States —such as the latter's burgeoning trade deficit, China's rigid exchange–rate regime, new measures applied by the United States to Chinese products, prohibition of foreign investment in strategic United States sectors— to as broad a regional forum as a free–trade area. In other words, it would not be in its interest to allow the United States to use that area as the only forum for addressing bilateral disputes and try to "fence in" or "contain" China (Bin 2006). It is more likely that China would pursue the path of different types of trade agreements to maximize its economic and political power in its negotiations (Kwei, 2006).

5. ASEAN: achievements and challenges in creating the ASEAN Economic Community

ASEAN countries have made major efforts to create the ASEAN Economic Community (AEC), with a view to forming a single market and productive base in which goods, services, investments, capital and skilled workers can all circulate freely.[11] This initiative possibly also needs a single currency and common financial institutions to be successful (Rajan, 2005; Ferguson, 2004), and it has an implementation horizon that extends to 2020, in view of the challenges it involves.

An initial step towards creation of the Community was the establishment in January 1992 of the ASEAN Free Trade Area (AFTA). This aimed to eliminate tariff and non–tariff barriers between member countries and move towards integration of the ASEAN economies on a single productive base, creating a single market of over 570 million people, by applying the Common Effective Preferential Tariff Scheme (CEPT). The tariff reduction program has proceeded satisfactorily, and in fact the initially agreed upon date of 2008 has been brought forward to 2002 (see box V.2) In addition, to reduce trade diversion with third countries, ASEAN members are continuing to lower their tariffs with third countries, while at the same time reducing their intra–zone duties.

[10] An example of such flexibility is provided in the ASEAN–China agreement, which allows ASEAN member countries to negotiate individual treaties with China. Thailand has also completed an agreement with China on various sensitive products such as fruit and vegetables; it is more feasible to address the interests of small countries, such as Thailand, separately, rather than including them in a broader agreement.

[11] Historically, ASEAN was Asia's first attempt to create a regional community. Its beginnings date back to 1967 when it was founded with the aim of promoting regional cooperation, well–being and peace in Southeast Asia. The founding members were the Philippines, Indonesia, Malaysia, Singapore and Thailand; Brunei Darussalam joined in 1984, Viet Nam in 1995, Lao People's Democratic Republic and Myanmar in 1997, and lastly Cambodia in 1999.

Some countries of that region are major promoters of a deep integration of ASEAN, such as Singapore which has become a regional financial services, transport, telecommunications and education hub. The commitments assumed by Singapore in the agreements' chapters on services, generally go beyond those assumed in the General Agreement on Trade in Services (GATS). It is therefore considered that this grouping professes and at the same time practices the concept of open regionalism and serves as an element for unification of the multilateral system (Zhai, 2006, Menon, 2006b).

In addition to the rapid implementation of the free–trade area, ASEAN has reached agreements to forge Closer Economic Partnerships with its most important trading partners (Australia, China, India, Japan, New Zealand and the Republic of Korea).[12] It has also signed a number of agreements with these

Box V.2
PROGRESS OF THE ASEAN COMMON EFFECTIVE PREFERENTIAL TARIFF SCHEME

The various instruments designed to achieve this objective include the Common Effective Preferential Tariff (CEPT) scheme for the establishment of the free–trade area. This scheme established that tariffs on a wide range of products traded in the region should be lowered to no more than 5% by 2003 for the six founding countries of ASEAN (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand), while the tariff reduction program would subsequently include Viet Nam in 2006, Lao People's Democratic Republic and Myanmar in 2008 and Cambodia in 2010. In addition, in 2010, the six original members of ASEAN should eliminate all tariffs on intra–regional imports, while the four newer members would have until 2015 to do this.

At the present time, the CEPT scheme has been applied by the six countries mentioned. According to data from the ASEAN Secretariat and other studies (Tongzon, 2005), 99% of the products on the inclusion list (which encompasses 65,080 out of a total of 65,743 tariff lines) submitted by the six ASEAN founder countries have had their tariff rates lowered to a range of 0–5%. The main exceptions have been products in the automotive sector and auto parts. The new members (Cambodia, Lao People's Democratic Republic, Myanmar and Viet Nam) have managed to put almost 80% of their products on the respective lists and about 66% of their tariffs are now in the 0–5% range. Nonetheless, the private sector has apparently been using the scheme less than expected (a use level of about 10%), as a result of complicated bureaucratic procedures on rules of origin which cause companies to prefer paying the most favoured nation (MFN) tariffs (Langhammer, 2007). In fact, only Malaysia and Thailand publish statistics on the use made of this scheme; and these show that intra–regional exports in which the preferential tariff scheme is being applied are increasing, with exports from Thailand and Malaysia recording the highest and most rapidly increasing levels of use. Exports from Thailand alone use this scheme 20% of the time, while participation in Malaysia is still at the one–digit level (JETRO, 2006). This low rate of use reflects the fact that tariffs levels are already low, and the procedures entailed in using the scheme are burdensome.

In a recent survey, Japanese firms were asked which preferential tariff schemes they were using. Of the replies received, the ASEAN Free Trade Area was mentioned most frequently (24 times), followed by the Japan–Malaysia agreement (cited by 15 firms) and the agreement between Thailand and Australia (mentioned by eight firms). In the opinion of those responsible for the survey, the results highlight the following: (1) the free trade area scheme is the most widely used because it covers the whole ASEAN region, where Japanese firms have established procurement and production networks; (2) despite recent events, firms have made intensive use of the Japan–Malaysia agreement; and (3) Thailand, which is now a major production base for Japanese firms, is also becoming an export platform for certain companies to send their products to markets outside ASEAN, by exploiting its FTAs with countries such as Australia and India.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Association of South–East Asian Nations (ASEAN) and the Japan External Trade Organization (JETRO), *2006 JETRO White Paper on International Trade and Foreign Direct Investment (Summary). Japanese Corporate Activity in New Growth Markets and the Emerging East Asian Free Trade Zone*, Tokyo, 2006; J. L. Tongzon, "Role of AFTA in an ASEAN economic community," *Roadmap to an ASEAN Economic Community*, Denis Hew (ed.), Singapore, Institute of Southeast Asian Studies, 2005; R. Langhammer, "The Asian way of regional integration: are there lessons from Europe?", *Kiel Economic Policy Papers*, No. 7, January 2007.

[12] For further details on the preferential agreements signed or in the process of negotiation, see Rosales and Kuwayama (2007). On possible repercussions of the India–ASEAN agreement, see Bhattacharya and Bhattacharyay (2006). The Republic of Korea has signed a free trade–agreement with ASEAN, Chile, the European Free Trade Association (EFTA), the United States and Singapore; it is negotiating a free–trade agreement with Japan (currently suspended) and Canada; and it is studying the feasibility of a free–trade agreement with China, India, MERCOSUR, Mexico and possibly Israel. The Korea–ASEAN agreement, which excludes Thailand following its refusal to include rice in the tariff reduction timetable, was signed in May 2006 and entered into force in July that year.

countries giving rise to various free trade areas, such as the Closer Economic Partnership agreements with China, India, Japan and the Republic of Korea. In addition, the South Asian Free Trade Area was established in January 2004 and is expected to be fully operational in 2016; and in Central Asia the Central Asia Regional Economic Cooperation CAREC has been established since 1997. Lastly, an Asia–Pacific trade–preference agreement is being negotiated, to replace the 1975 Bangkok Agreement (Asia–Pacific Trade Agreement–APTA).[13] In this regard, the new ASEAN agreements involving a number of trade partners outside their own groupings, such as the ASEAN+3 or ASEAN+6 agreements, are seen as a second wave of preferential trade treaties (Bhattacharyay, 2006).

(a) ASEAN+3

Viewing ASEAN as a hub seems an appropriate defence strategy to prevent other country groupings from exploiting their natural predominance. Nonetheless, this stance poses major challenges for a grouping of the size and characteristics of ASEAN. In the first place, the diversity of its members is reflected in non–convergent criteria concerning their roles in the development of regionalism in the wider region; and, secondly, this diversity is also reflected in different capacities for adapting to pressures from "natural hubs".

The formation stage of the ASEAN Economic Community poses the challenge of establishing points of convergence between bilateral agreements already signed or currently under negotiation, mainly between the largest economies of North–East Asia and members of ASEAN. Apart from the bilateral agreements that are being negotiated between ASEAN members and China, Japan and the Republic of Korea (ASEAN+3), ASEAN also has agreements with China and the Republic of Korea and is negotiating an agreement with Japan. This second group of agreements is referred to as ASEAN+1. Although it might be thought that having one agreement with three countries is the same as three separate agreements, the final effect would be very different, because an agreement with three countries produces synergies; and, in this case, the North–East Asia region would be liberalized as a whole.

Moreover, the fact that, of all the countries that belong to the East Asia Free–Trade Area, only Cambodia, the Lao People's Democratic Republic and Myanmar are not members of APEC, raises the problem of coordination and overlapping preferences between this area and the project to form a free–trade area based on the Asia–Pacific Free–Trade Treaty within APEC. There is also the risk that APEC could polarize around two large countries (China and Japan), resulting in serious losses for non–Asian nations. The creation of the East Asia Free–Trade Area could bring major benefits to China, although less than what would be offered by constructing a system of agreements centred on that country. China would benefit from additional intra–regional trade and investment, and its integration in the regional production network would be enhanced through the elimination of trade barriers and lower transport costs (Yue and Soesastro, 2006).

(b) Alternatives for the future East Asia Free Trade Area

There are various ways in which this free–trade area can be consolidated at the present time, including the following (Yue and Soesastro, 2006):

- Consolidation of agreements with South–East and North–East Asia. This seems unlikely as it would leave ASEAN at a disadvantage, since the North–East Asian countries would outweigh those of ASEAN;
- Consolidation of the various ASEAN+1 agreements. These agreements could serve as an initial framework for establishing the East Asia Free–Trade Area. A positive factor is that there would already be a common framework agreed upon with a broad liberalization programme, thereby minimizing potential conflicts; and

[13] Also known as the first agreement on trade negotiations among developing member countries of the Economic and Social Commission for Asia and the Pacific; this was initially negotiated by seven developing countries, but only four ratified and implemented it: Bangladesh, India, the Republic of Korea and Sri Lanka. The aims of the agreement are to promote and sustain reciprocal trade and to develop economic cooperation between the contracting parties.

– ASEAN+3 deepening. A free–trade area could also be achieved through the existing ASEAN+3 agreements. This option had already been considered when the Joint Expert Group for Feasibility Study on East Asia Free Trade Area (EAFTA) was created at the ASEAN+3 ministerial meeting. Nonetheless, a point that remains to be resolved is whether ASEAN will negotiate as a group or whether the 13 economies will negotiate separately.

In any event, an East Asia Free Trade Area would have advantages for ASEAN, particularly in the form of economies of scale and scope. It would also provide an incentive for member countries to adopt reforms and restructure their economies to face the challenges of globalization, allowing for the removal of trade and investment barriers and freer circulation of capital and people, which would have direct effects on regional production networks and supply chains. It would also be necessary to harmonize and standardize rules of origin and other technical requirements, thereby overcoming the disadvantages caused by the web of agreements that only serve to raise costs and scare away FDI (Menon, 2006b).

In addition, the diversity of the economies and their different development levels could harm countries or sectors that fail to match the efficiency level of the other members, thereby leading governments to refuse to liberalize certain sectors without safeguards and guarantees of assistance.

Nonetheless, the various challenges include strengthening mutual trust between Asian countries, so that they become convinced of sharing a common destiny; but at the same time they should continue to promote their international engagement. The East Asia Free Trade Area should complement and not substitute for multilateralism, so it would need to offer broader concessions than those established in WTO agreements, with exclusions and limitations kept to the minimum.

6. The European Union and the Asia–Pacific region: a necessary approach for the new Asian regionalism

The European Union has shown growing interest in signing free trade agreements with Asia. In late 2006, the European Commission officially requested mandates from its member countries to negotiate free–trade agreements bilaterally with India, the Republic of Korea and ASEAN. The Commission granted the mandate as requested in April 2007, with instructions that the agreements be broad–based and include the liberalization of goods, services and investments. These negotiations are set in the new trade–policy orientation of the Community, as notified by the European Commission in October 2006, which aims to achieve bilateral free trade agreements to guarantee new markets for the European Union. The agreement that the European Union is preparing to negotiate with ASEAN, India and the Republic of Korea is justified, according to the European Commission, because these markets combine a high level of protection with high market potential. These new free trade treaties are expected to enable the European Union to increase its exports by US$ 40 billion, thereby raising GDP of the European Union by the equivalent of 0.13%. These estimates are based on expectations of additional manufactured exports to India, along with commercial services supplied to ASEAN and the Republic of Korea. Overall, if the expected objectives of the liberalization are achieved, exports from the European Union to these three trade partners could increase by 3.7%, while ASEAN exports to Europe would grow by 18.5% and those to India and the Republic of Korea by 18.7% and 36.0%, respectively (*Bridges Weekly Trade News Digest*, 2007b).

The European Union has also been engaging in more active and energetic trade diplomacy towards China, in response to the drastic increase in its trade deficit with that country. In 2006, China was the European Union's second largest trade partner, displacing the United States as its largest export market. Exports from the European Union to China amounted to ¤63 billion, while imports from that country totalled ¤191 billion, with a deficit of ¤128 billion. According to official data published by China, the European Union remains its largest export market, surpassing the United States and Japan.

With the aim of correcting the trade imbalance and addressing outstanding issues between the two parties, the European Union has been deploying a more active policy in its relations with China since 2006, while also pursuing deliberations in the WTO, the mechanism through which the European Union has traditionally managed trade policy with that country.[14] The Partnership and Co–operation Agreement signed in late 2006, which replaces the earlier 1985 agreement, provides the framework for this cooperation.

D. The proliferation of trade agreements in the Asia–Pacific region: consequences for Latin America and the Caribbean

1. The Asia–Pacific region is one of Latin America and the Caribbean's main trade partners

Trade between Latin America and the Caribbean and the Asia–Pacific region has recovered after two years of stagnation (1998–1999) following the Asian crisis, and it continues to expand.[15] The Asia–Pacific region has also become a very important trading partner for Latin America and the Caribbean, particularly in terms of the latter's imports. In 2005, exports to the Asia–Pacific region from Latin America and the Caribbean amounted to US$ 48.5 billion (9.0% of the region's total exports); while Asia–Pacific imports totalled US$ 97.1 billion (a 20.5% share). In the same year, the United States share of exports from Latin America and the Caribbean was 50.2%, while the European Union (27 member States) accounted for 12.1%. On the other side of the equation, the United States and the European Union provided 36.3% and 14.3% respectively of the region's imports (see figures 2A and 2B). The importance of the Asia–Pacific region

[14] Issues of dispute between China and the European Union include the fulfilment of commitments assumed in WTO with respect to market access, services, investments and public procurement; forced technology transfer; export requirements; intellectual property protection, lack of transparency in the sector subsidy regime, and the slow progress of banking reforms in the country.

[15] Unless indicated otherwise, in this section the Asia–Pacific region encompasses the group of 12 countries and territories consisting of Australia, China, Philippines, Hong Kong SAR, Indonesia, Japan, Malaysia, New Zealand, Taiwan Province of China, the Republic of Korea, Singapore and Thailand. The other members of ASEAN (Brunei Darussalam, Cambodia, Lao People's Democratic Republic, Myanmar and Viet Nam) are not included in the analysis for statistical reasons.

as a trade partner is thus much greater in terms of imports than exports, and this has generated a growing trade deficit with that region since 1992, amounting to US$ 48 billion in 2005. Given the important and increasing role of the Asia–Pacific region as a trade partner for many Latin American and Caribbean countries, it is not surprising that several of them have signed or are in the process of negotiating free–trade agreements.

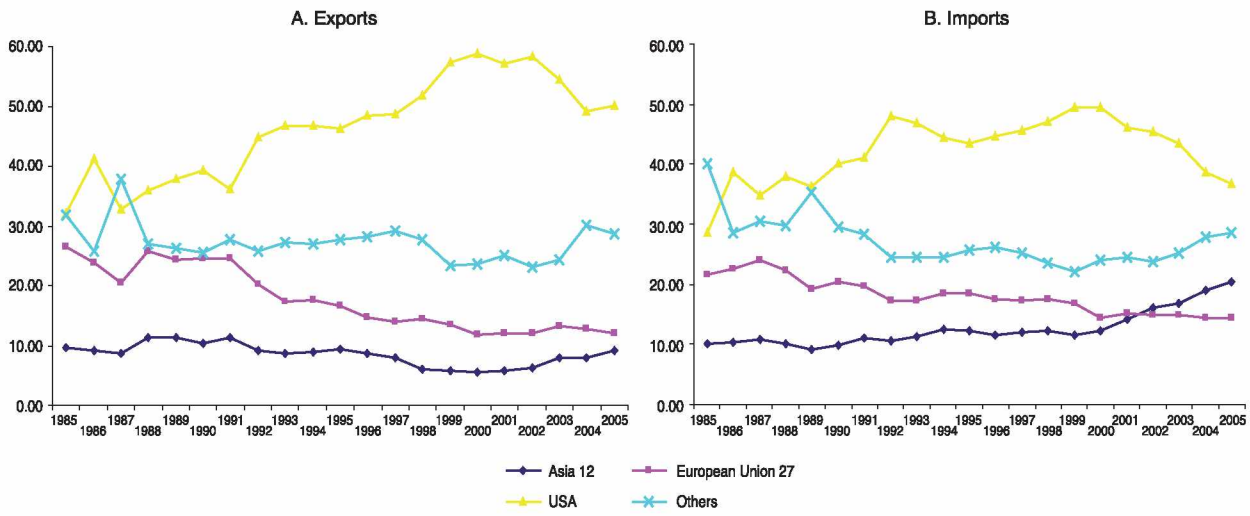
It is interesting to note that the countries of the region give justified priority to negotiations with the European Union, whose relative importance as one of the region's main trading partners is gradually diminishing; whereas in Latin America and the Caribbean there is insufficient awareness of the importance of the Asia–Pacific region, let alone a coordinated strategy between countries or country groupings to seek closer trade and investment links with that region, whose importance as a trade partner is growing significantly. Approaches to the Asia–Pacific region by Latin American countries have thus far been somewhat sporadic and individual, involving the signing of bilateral free trade agreements by countries on an individual basis.

Behind this dynamic trade between the two regions, China is playing an increasing role in both exports and imports, displacing Japan as the largest trade partner in Asia at the start of the decade (see figures 3A and 3B). In addition, the ASEAN (5) grouping has overtaken the Republic of Korea as a source of imports from Latin America and the Caribbean and as a destination for its exports.

(a) Trade flows between Latin America and the Asia–Pacific region

Countries comprising the ASEAN+6 grouping in 2005 accounted for 8.2% and 19.3%, respectively, of Latin America and the Caribbean's exports and imports.[16] Bi–regional exports are concentrated in South America, while Central America and Mexico are relatively minor players (see tables V.2 and V.3). Nonetheless, Mexico is a major importer from ASEAN+6, especially from China and Japan, which

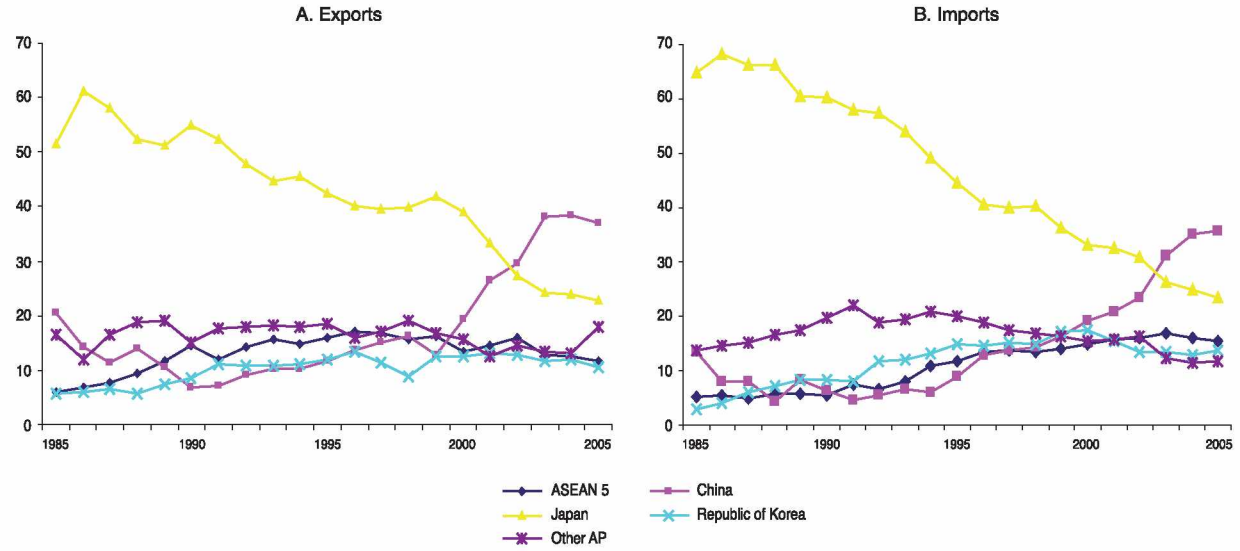
Figure V.2
LATIN AMERICA AND THE CARIBBEAN: SHARE OF THE UNITED STATES, EUROPEAN UNION (27 MEMBER STATES) AND THE ASIA–PACIFIC REGION IN THE REGION'S EXPORTS AND IMPORTS
(Percentages)



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

16 The countries considered in tables V.2 and V.3 are the countries of ASEAN (5), plus Australia, China, India, Japan, New Zealand and the Republic of Korea.

Figure V.3
LATIN AMERICA AND THE CARIBBEAN: SHARE OF SELECTED COUNTRIES AND GROUPINGS OF THE ASIA–PACIFIC REGION IN EXPORTS AND IMPORTS
(Percentages)



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

provide 8% and 6% of its total imports, respectively. ASEAN+6 absorbs about 15% of the total exports of MERCOSUR countries, but only about 4% of the exports of other subregional groupings, and just 2% in the case of Caribbean countries.

The trade flows between the two regions reveal the growing importance of China as a buyer and supplier. This country absorbed 3.4% of the region's total exports and was the source of 7.3% of its imports in 2005, rapidly overtaking other trade partners such as Japan and the Republic of Korea. China, Japan and the Republic of Korea, in that order, are the leading trade partners for each of the subregions of Latin America and the Caribbean (MERCOSUR, Andean Community, Central American Common Market and the Caribbean Community). In the case of Mexico, the weight of ASEAN+6, its second largest import source, is high and rising, with 22% of its imports coming from that grouping (ECLAC, 2006). India is also playing an increasingly important role as a destination for Latin American and Caribbean exports, drawing ever closer to the level of the Republic of Korea. ASEAN countries are emerging as another hub of bi–regional trade in Asia, surpassing the Republic of Korea as a destination and origin of products. The Oceania region, defined as Australia and New Zealand for the purposes of this study, occupies a small but increasingly important space.

Table V.2

LATIN AMERICA AND THE CARIBBEAN: EXPORTS TO CERTAIN MARKETS, 2005

(Millions of current dollars and percentages)

	Total exports by destinaton								Percentage of total of Latin America and the Caribbean							Percentage of total of each destination							Balance
	Japan	India	China	Rep. of Korea	ASEAN	Australia +New Zealand	Asia-Pacific total[b]	World	Japan	India	China	Rep. of Korea	ASEAN	Australia +New Zealand	Asia-Pacific total	Japan	India	China	Rep. of Korea	ASEAN	Australia +New Zealand	Total	incl. Asia-Pacific
Latin America and the Caribbean	**11 348**	**3 094**	**18 601**	**5 262**	**6 197**	**1 283**	**45 785**	**553 072**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**2.1**	**0.6**	**3.4**	**1.0**	**1.1**	**0.2**	**8.3**	**-48 406**
Andean community	**1 331**	**142**	**2 327**	**488**	**222**	**101**	**4 612**	**106 459**	**11.7**	**4.6**	**12.5**	**9.3**	**3.6**	**7.9**	**10.1**	**1.3**	**0.1**	**2.2**	**0.5**	**0.2**	**0.1**	**4.3**	**-5 779**
Bolivia	134	1	20	60	18	3	**236**	2 797	1.2	0.0	0.1	1.1	0.3	0.2	**0.5**	4.8	0.0	0.7	2.2	0.6	0.1	8.4	-90
Colombia	330	5	237	136	49	21	**778**	21 190	2.9	0.2	1.3	2.6	0.8	1.6	**1.7**	1.6	0.0	1.1	0.6	0.2	0.1	3.7	-2 755
Ecuador	72	36	7	3	5	15	**139**	9 869	0.6	1.2	0.0	0.1	0.1	1.2	**0.3**	0.7	0.4	0.1	0.0	0.0	0.2	1.4	-1 455
Peru	604	79	1 861	227	111	60	**2 943**	17 114	5.3	2.6	10.0	4.3	1.8	4.7	**6.4**	3.5	0.5	10.9	1.3	0.6	0.4	17.2	630
Venezuela (Bol. Rep. of)	190	21	203	61	39	1	**516**	55 487	1.7	0.7	1.1	1.2	0.6	0.1	**1.1**	0.3	0.0	0.4	0.1	0.1	0.0	0.9	-2 110
MERCOSUR	**3 808**	**1 868**	**10 174**	**2 266**	**4 632**	**677**	**23 426**	**161 328**	**33.6**	**60.4**	**54.7**	**43.1**	**74.7**	**52.8**	**51.2**	**2.4**	**1.2**	**6.3**	**1.4**	**2.9**	**0.4**	**14.5**	**1 604**
Argentina	285	723	3 154	345	1 603	160	**6 269**	40 106	2.5	23.4	17.0	6.5	25.9	12.5	**13.7**	0.7	1.8	7.9	0.9	4.0	0.4	15.6	2 800
Brazil	3 473	1 137	6 831	1 896	2 944	516	**16 796**	116 129	30.6	36.7	36.7	36.0	47.5	40.2	**36.7**	3.0	1.0	5.9	1.6	2.5	0.4	14.5	-4
Paraguay	18	4	70	3	15	0	**111**	1 688	0.2	0.1	0.4	0.1	0.2	0.0	**0.2**	1.1	0.3	4.1	0.2	0.9	0.0	6.6	-1 032
Uruguay	32	4	120	23	69	2	**249**	3 405	0.3	0.1	0.6	0.4	1.1	0.1	**0.5**	0.9	0.1	3.5	0.7	2.0	0.0	7.3	-159
Chile	4 536	493	4 390	2 214	569	121	**12 323**	38 596	40.0	15.9	23.6	42.1	9.2	9.4	**26.9**	11.8	1.3	11.4	5.7	1.5	0.3	31.9	6 829
CACM	**133**	**12**	**307**	**44**	**171**	**14**	**682**	**16 755**	**1.2**	**0.4**	**1.7**	**0.8**	**2.8**	**1.1**	**1.5**	**0.8**	**0.1**	**1.8**	**0.3**	**1.0**	**0.1**	**4.1**	**-3 535**
Costa Rica	60	8	241	21	132	6	**468**	7 151	0.5	0.2	1.3	0.4	2.1	0.5	**1.0**	0.8	0.1	3.4	0.3	1.8	0.1	6.5	-737
El Salvador[a]	8	1	4	1	2	0	**15**	1 475	0.1	0.0	0.0	0.0	0.0	0.0	**0.0**	0.5	0.1	0.2	0.1	0.1	0.0	1.0	-377
Guatemala	38	3	37	8	18	3	**107**	5 381	0.3	0.1	0.2	0.2	0.3	0.2	**0.2**	0.7	0.1	0.7	0.2	0.3	0.0	2.0	-1857
Honduras	17	0	18	13	12	3	**64**	1 883	0.1	0.0	0.1	0.3	0.2	0.3	**0.1**	0.9	0.0	1.0	0.7	0.6	0.2	3.4	-232
Nicaragua	10	0	8	1	7	2	**29**	866	0.1	0.0	0.0	0.0	0.1	0.1	**0.1**	1.2	0.0	1.0	0.1	0.8	0.2	3.3	-332
Mexico	1 470	561	1 136	242	595	362	**4 365**	214 207	13.0	18.1	6.1	4.6	9.6	28.2	**9.5**	0.7	0.3	0.5	0.1	0.3	0.2	2.0	-44 760
Caribbean and other Latin American countries	**71**	**19**	**266**	**7**	**9**	**7**	**378**	**15 727**	**0.6**	**0.6**	**1.4**	**0.1**	**0.1**	**0.5**	**0.8**	**0.4**	**0.1**	**1.7**	**0.0**	**0.1**	**0.0**	**2.4**	**-2 765**
Antigua and Barbuda	0	0	0	0	0	0	**0**	121	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0	0.0	0.1	-31
Barbados	0	0	1	0	1	0	**2**	361	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.2	0.0	0.2	0.0	0.5	-232
Belize	4	0	0	0	0	0	**4**	208	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**	1.8	0.0	0.0	0.0	0.0	0.0	1.9	-21
Dominica	0	0	0	0	0	0	**0**	42	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-13
Guyana	2	5	5	1	4	1	**18**	539	0.0	0.2	0.0	0.0	0.1	0.1	**0.0**	0.3	1.0	0.9	0.2	0.7	0.2	3.3	-5
Jamaica[a]	35	4	166	0	0	3	**208**	1 412	0.3	0.1	0.9	0.0	0.0	0.2	**0.5**	2.5	0.3	11.8	0.0	0.0	0.2	14.7	124
Saint Kitts and Nevis	0	0	0	0	0	0	**0**	34	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**	0.2	0.0	0.0	0.0	0.0	0.0	0.2	-400
Santa Lucia	0	0	0	0	0	0	**0**	64	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.2	0.0	0.1	0.1	0.5	-11
Saint Vincent and the Grenadines	0	0	0	0	0	0	**0**	40	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.1	0.0	0.0	0.0	0.2	-45
Trinidad and Tobago	1	2	4	1	1	2	**11**	9 611	0.0	0.1	0.0	0.0	0.0	0.2	**0.0**	0.0	0.0	0.0	0.0	0.0	0.0	0.1	-14
Panama	3	7	10	2	2	0	**24**	964	0.0	0.2	0.1	0.0	0.0	0.0	**0.1**	0.4	0.7	1.1	0.2	0.2	0.0	2.5	-123
Cuba[a]	26	1	80	3	0	1	**111**	2 332	0.2	0.0	0.4	0.1	0.0	0.0	**0.2**	1.1	0.0	3.4	0.1	0.0	0.0	4.8	-476

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

[a] Figures for Cuba, El Salvador and Jamaica related to 2004.

[b] Asia–Pacific total in the sum of the previous columns.

Table V.3

LATIN AMERICA AND THE CARIBBEAN: IMPORTS FROM SELECTED COUNTRIES, 2005

(Millions of current dollars and percentages)

	Total imports by origin								Percentage of Latin America and Caribbean Total							Percentage of total of each origin						
	Japan	India	China	Rep. of Korea	ASEAN	Australia +New Zealand	Asia-Pacific total[b]	World	Japan	India	China	Rep. of Korea	ASEAN	Australia +New Zealand	Asia-Pacific total[b]	Japan	India	China	Rep. of Korea	ASEAN	Australia +New Zealand	Total
Latin America and the Caribbean	**23 324**	**3 369**	**35 616**	**13 386**	**15 706**	**2 790**	**94 191**	**488 323**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**4.8**	**0.7**	**7.3**	**2.7**	**3.2**	**0.6**	**19.3**
Andean community	**2 447**	**505**	**4 474**	**1 769**	**1 024**	**171**	**10 391**	**67 506**	**10.5**	**15.0**	**12.6**	**13.2**	**6.5**	**6.1**	**11.0**	**3.6**	**0.7**	**6.6**	**2.6**	**1.5**	**0.3**	**15.4**
Bolivia	143	12	136	18	15	2	**326**	2 343	0.6	0.3	0.4	0.1	0.1	0.1	**0.3**	6.1	0.5	5.8	0.8	0.6	0.1	13.9
Colombia	705	248	1 617	594	344	25	**3 533**	21 204	3.0	7.4	4.5	4.4	2.2	0.9	**3.8**	3.3	1.2	7.6	2.8	1.6	0.1	16.7
Ecuador	347	33	622	400	184	7	**1 594**	9 609	1.5	1.0	1.7	3.0	1.2	0.3	**1.7**	3.6	0.3	6.5	4.2	1.9	0.1	16.6
Peru	446	122	1 058	348	259	81	**2 313**	12 502	1.9	3.6	3.0	2.6	1.6	2.9	**2.5**	3.6	1.0	8.5	2.8	2.1	0.6	18.5
Venezuela (Bol. Rep. of)	806	90	1 041	410	223	56	**2 626**	21 848	3.5	2.7	2.9	3.1	1.4	2.0	**2.8**	3.7	0.4	4.8	1.9	1.0	0.3	12.0
MERCOSUR	**4 427**	**1 523**	**8 312**	**2 928**	**3 694**	**938**	**21 821**	**112 718**	**19.0**	**45.2**	**23.3**	**21.9**	**23.5**	**33.6**	**23.2**	**3.9**	**1.4**	**7.4**	**2.6**	**3.3**	**0.8**	**19.4**
Argentina	557	201	1 529	378	651	154	**3 469**	28 689	2.4	6.0	4.3	2.8	4.1	5.5	**3.7**	1.9	0.7	5.3	1.3	2.3	0.5	12.1
Brazil	3 567	1 264	5 825	2 462	2 909	774	**16 800**	76 436	15.3	37.5	16.4	18.4	18.5	27.7	**17.8**	4.7	1.7	7.6	3.2	3.8	1.0	22.0
Paraguay	260	21	716	39	106	2	**1 144**	3 715	1.1	0.6	2.0	0.3	0.7	0.1	**1.2**	7.0	0.6	19.3	1.0	2.8	0.1	30.8
Uruguay	43	37	242	49	28	9	**408**	3 879	0.2	1.1	0.7	0.4	0.2	0.3	**0.4**	1.1	1.0	6.2	1.3	0.7	0.2	10.5
Chile	1 017	135	2 541	1 076	520	205	**5 494**	29 857	4.4	4.0	7.1	8.0	3.3	7.4	**5.8**	3.4	0.5	8.5	3.6	1.7	0.7	18.4
CACM	**1 280**	**141**	**1 469**	**864**	**372**	**90**	**4 217**	**31 649**	**5.5**	**4.2**	**4.1**	**6.5**	**2.4**	**3.2**	**4.5**	**4.0**	**0.4**	**4.6**	**2.7**	**1.2**	**0.3**	**13.3**
Costa Rica	532	27	350	151	140	6	**1 205**	9 173	2.3	0.8	1.0	1.1	0.9	0.2	**1.3**	5.8	0.3	3.8	1.7	1.5	0.1	13.1
El Salvador[a]	134	13	114	67	44	21	**392**	4 891	0.6	0.4	0.3	0.5	0.3	0.7	**0.4**	2.7	0.3	2.3	1.4	0.9	0.4	8.0
Guatemala	398	63	752	584	120	46	**1 964**	10 500	1.7	1.9	2.1	4.4	0.8	1.6	**2.1**	3.8	0.6	7.2	5.6	1.1	0.4	18.7
Honduras	98	19	103	25	37	13	**295**	4 565	0.4	0.6	0.3	0.2	0.2	0.5	**0.3**	2.1	0.4	2.3	0.5	0.8	0.3	6.5
Nicaragua	118	20	150	37	31	5	**361**	2 520	0.5	0.6	0.4	0.3	0.2	0.2	**0.4**	4.7	0.8	5.9	1.5	1.2	0.2	14.3
Mexico	13 078	959	17 696	6 496	9 708	1 188	**49 125**	221 819	56.1	28.5	49.7	48.5	61.8	42.6	**52.2**	5.9	0.4	8.0	2.9	4.4	0.5	22.1
Caribbean and other Latin American countries	**1 075**	**106**	**1 125**	**253**	**387**	**197**	**3 143**	**24 774**	**4.6**	**3.1**	**3.2**	**1.9**	**2.5**	**7.0**	**3.3**	**4.3**	**0.4**	**4.5**	**1.0**	**1.6**	**0.8**	**12.7**
Antigua and Barbuda	15	1	5	2	2	7	**31**	525	0.1	0.0	0.0	0.0	0.0	0.2	**0.0**	2.8	0.1	0.9	0.4	0.5	1.3	5.9
Barbados	128	3	49	18	18	17	**234**	1 672	0.5	0.1	0.1	0.1	0.1	0.6	**0.2**	7.6	0.2	2.9	1.1	1.1	1.0	14.0
Belize	8	1	10	3	3	0	**24**	439	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**	1.9	0.1	2.2	0.6	0.6	0.1	5.6
Dominica	8	0	4	0	1	0	**13**	165	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**	4.6	0.3	2.2	0.1	0.5	0.1	7.8
Grenada[a]	12	0	4	1	2	3	**23**	250	0.1	0.0	0.0	0.0	0.0	0.1	**0.0**	4.9	0.2	1.7	0.5	0.6	1.4	9.2
Guyana	24	12	32	2	7	9	**84**	778	0.1	0.3	0.1	0.0	0.0	0.3	**0.1**	3.0	1.5	4.1	0.2	0.9	1.1	10.8
Jamaica[a]	173	16	115	18	40	39	**400**	3 817	0.7	0.5	0.3	0.1	0.3	1.4	**0.4**	4.5	0.4	3.0	0.5	1.0	1.0	10.5
Saint Kitts and Nevis	8	0	2	1	1	0	**12**	210	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**	3.8	0.2	0.8	0.2	0.4	0.2	5.6
Santa Lucia	22	1	10	2	6	4	**45**	475	0.1	0.0	0.0	0.0	0.0	0.1	**0.0**	4.6	0.2	2.1	0.5	1.3	0.7	9.5
Saint Vincent and the Grenadines	10	2	7	1	2	3	**24**	240	0.0	0.1	0.0	0.0	0.0	0.1	**0.0**	4.2	1.0	2.7	0.5	0.7	1.1	10.2
Suriname[a]	97	9	32	0	9	1	**148**	742	0.4	0.3	0.1	0.0	0.1	0.0	**0.2**	13.0	1.3	4.3	0.0	1.2	0.1	19.9
Trinidad and Tobago	225	37	168	40	85	33	**587**	5 694	1.0	1.1	0.5	0.3	0.5	1.2	**0.6**	3.9	0.6	3.0	0.7	1.5	0.6	10.3
Panama	188	7	99	103	16	27	**440**	4 155	0.8	0.2	0.3	0.8	0.1	1.0	**0.5**	4.5	0.2	2.4	2.5	0.4	0.6	10.6
Cuba[a]	159	15	590	63	196	55	**1 078**	5 610	0.7	0.5	1.7	0.5	1.2	2.0	**1.1**	2.8	0.3	10.5	1.1	3.5	1.0	19.2

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

[a] Figures for Cuba, El Salvador, Grenada, Jamaica and Suriname refer to 2004.

[b] Asia–Pacific total in the sum of the previous columns.

(b) Structure of trade between Latin America and the Caribbean and the Asia–Pacific region

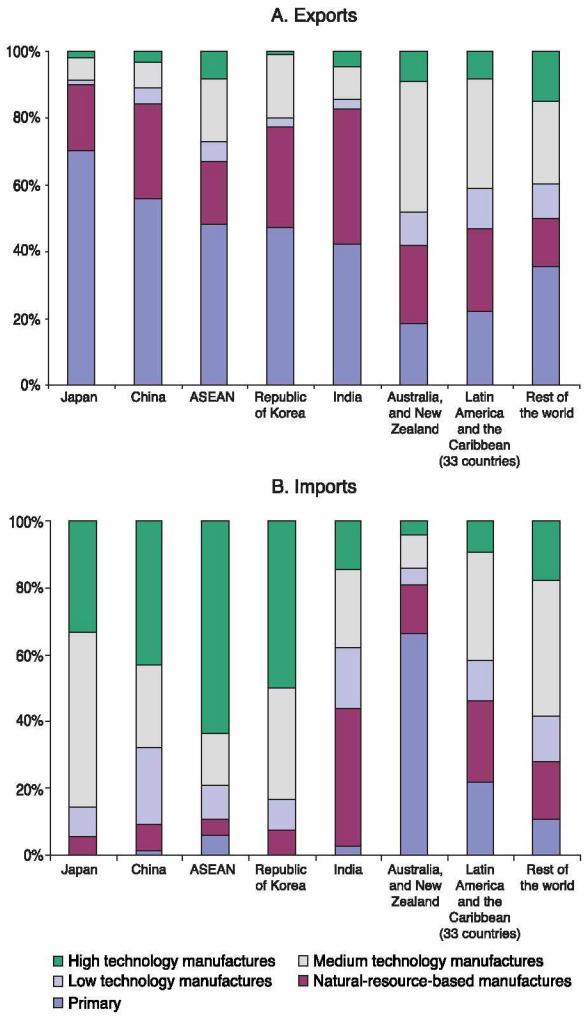
The structure of Latin American and Caribbean exports destined for the Asia–Pacific region is concentrated on the natural resource sector and manufactured goods based on them (see figure V.4). This can clearly be seen in the cases of India and Japan, and to lesser extent China, ASEAN (10) and the Republic of Korea. In general, the share of manufactures of differing technological intensity (low, medium or high) is very small and contrasts starkly with the structure of Latin American intra–regional trade, which includes a high component of products of medium–technology intensity. ASEAN has an export basket in which manufactured products, including those in the medium– or high–technology categories, take more than a negligible share. The countries of Oceania overall report a large component of medium–technology manufactures, which largely reflects the Latin American intra–regional trade structure.

In contrast, the structure of Latin American and Caribbean imports from the Asia–Pacific region is the reverse of its export structure, but with sharp variations between countries and subregions. In the case of Japan and, to a lesser extent, China, the Republic of Korea and ASEAN, the most important components are high– and medium–technology–intensive manufactures, while natural resource–based manufactures are the leading category in India. The largest coefficient of high–technology manufactures occurs in the ASEAN group. In contrast, the export basket of the countries of Oceania is concentrated in primary products.

As the analysis of the previous section shows, intra–industry trade (IIT) is a growing feature of the trade links that exist between the economies of East and South–East Asia. Nonetheless, bi–regional trade flows strongly feature inter–industry trade, while the countries of the region export primary and processed primary products, but import different types of manufactures. It remains to be seen whether trade agreements currently in force or in the negotiation stage in the Asia–Pacific region, or between the two regions, will be able to change these structures.

The 30 product categories exported by Latin America and the Caribbean to ASEAN (5)+3 (Japan, China and the Republic of Korea) with the highest export values in 2005 are highly concentrated in natural resources and processed products based thereon (see table V.4, which also shows the value of trade in these products worldwide). These categories account for about 86% of the region's total exports to the Asia–Pacific region; table V.4 also shows the five largest providers of each of the 30 products exported to the Asia–Pacific region in 2005, with their respective market shares. The list includes a number of new commodities, such as fresh fruit, along with high–technology manufactures, including telecommunications equipment and data–processing machinery.

Figure V.4
LATIN AMERICA AND THE CARIBBEAN: STRUCTURE OF TRADE TOWARDS CERTAIN MARKETS, 2005
(Percentages)



Source: Economic commission for Latin America and the Caribbean (ECLAC) on the basis of official data from the statistical database on merchandise trade (COMTRADE).

The presence of a number of Latin American and Caribbean countries should also be noted among the main suppliers of these 30 products. ASEAN (5)+3 obtained more than 40% of its total imports of refined copper from Chile in 2005; in that year over 64% of Asia–Pacific imports of oilseed products came from Brazil and Argentina, and more than 46% of the coffee imported by this region was supplied by Brazil, Colombia and Guatemala. Nonetheless, despite the region's high concentration in a few products, ASEAN (5)+3 has achieved a high level of diversification of supply sources, sufficient to prevent Latin America and the Caribbean having strong bargaining power with respect to these products. There is significant competition with several developed economies, such as Australia, Canada, New Zealand and the United States, and with neighbouring developing Asian countries, such as China, Indonesia, the Republic of Korea, Taiwan Province of China and Thailand, among others, in mining, agriculture, fishery and forestry products, where Latin America and the Caribbean traditionally enjoy comparative advantages.

This shows that the challenge facing the Latin American and Caribbean region is to exploit the comparative advantages it enjoys from its natural resource endowments, on a more efficient and coordinated basis, and attempt to move up the value chains that may arise around them. In view of these challenges, efforts should be made to attract Asian investment into those value chains and stimulate IIT with that region.

Table V.4

ASEAN+3: 30 LEADING IMPORTED PRODUCTS FROM LATIN AMERICA AND THE CARIBBEAN AND THEIR COMPETITORS

(US$ million and percentages)

	Code	Product description[a]	2005 Latin America and the Caribbean (33 countries)					Leading supplier countries and import percentages[g]										Total[h]
			b	c	d	e	f											
	Total	**All products**	**55 718**	**100.0**	**2.8**	**1 977 041**		**CHN**	**13.0**	**JPN**	**11.4**	**USA**	**10.4**	**OAN[i]**	**6.6**	**KOR**	**6.3**	**47.6**
1	287	Ores and concentrates of base metals, nes	8 448	15.2	34.8	24 301	16	CHL	23.0	AUS	20.8	IDN	12.6	PER	6.1	USA	4.7	67.1
2	281	Iron ore and concentrates	7 290	13.1	27.7	26 366	15	AUS	38.7	BRA	23.4	IND	21.7	ZAF	4.1	CAN	1.7	89.6
3	222	Seeds and oleaginous fruit, whole or broken, for "soft" fixed oil	5 447	9.8	45.6	11 947	35	USA	40.8	BRA	24.0	ARG	20.4	CAN	7.1	CHN	2.1	94.4
4	682	Copper	3 633	6.5	21.5	16 883	25	CHL	19.8	JPN	13.1	OAN	10.7	KOR	7.7	CHN	7.6	58.8
5	081	Feeding stuff for animals (not including unmilled cereals)	2 822	5.1	38.4	7 352	59	USA	24.1	ARG	12.8	PER	11.8	BRA	8.7	IND	6.7	64.1
6	776	Thermionic, microcircuits, transistors, valves, etc.	2 145	3.8	0.9	236 445	1	OAN	18.1	USA	13.9	JPN	13.1	KOR	11.4	MYS	10.3	66.8
7	011	Meat and edible meat offal, fresh, chilled or frozen	1 805	3.2	16.7	10 818	43	AUS	27.4	USA	18.3	DNK	11.9	CAN	10.6	BRA	10.5	78.6
8	333	Crude petroleum and oils obtained from bituminous minerals	1 453	2.6	0.7	219 602	2	SAU	27.8	ARE	16.8	IRN	9.3	QAT	6.2	KWT	6.1	66.1
9	251	Pulp and waste paper	1 320	2.4	12.8	10 333	45	USA	25.0	CAN	19.4	IDN	10.3	BRA	6.7	RUS	5.9	67.3
10	671	Pig and sponge iron, spiegeleisen, etc., and ferro-alloys	1 223	2.2	17.2	7 114	61	CHN	26.0	ZAF	13.8	KAZ	7.5	RUS	7.3	JPN	5.9	60.5
11	672	Ingots and other primary forms, of iron or steel	1 209	2.2	5.8	20 873	18	JPN	22.3	CHN	15.3	KOR	11.8	RUS	10.4	OAN	8.2	68.0
12	423	Fixed vegetable oils, soft, crude refined or purified	1 113	2.0	60.8	1 832	148	ARG	49.6	BRA	11.1	CAN	9.0	ESP	8.7	ITA	6.9	85.3
13	034	Fish, fresh, chilled or frozen	1 044	1.9	8.3	12 631	32	RUS	14.3	USA	13.0	CHN	12.5	OAN	8.9	CHL	6.4	55.1
14	071	Coffee and coffee substitutes	870	1.6	56.7	1 536	159	BRA	23.2	COL	18.6	IDN	9.7	VNM	6.8	GTM	6.0	64.3
15	611	Leather	867	1.6	18.2	4 764	87	CHN	12.7	KOR	12.3	OAN	12.2	ITA	11.9	BRA	11.1	60.2
16	684	Aluminium	712	1.3	4.4	16 198	27	AUS	16.3	CHN	15.9	RUS	14.1	JPN	7.1	KOR	6.2	59.6
17	334	Petroleum products, refined	641	1.2	0.9	67 973	3	SGP	20.9	KOR	12.0	SAU	8.7	KWT	7.7	ARE	6.6	55.9
18	278	Other crude minerals	637	1.1	20.6	3 089	121	CHN	20.1	USA	13.2	AUS	11.6	VEN	10.4	MEX	6.5	61.9
19	512	Alcohols, phenols etc, and their derivatives	566	1.0	4.3	13 065	31	SAU	22.4	USA	9.6	OAN	9.6	JPN	8.7	CAN	8.0	58.4
20	759	Parts, nes of and accessories for machines of headings 751 or 752	525	0.9	0.9	56 571	5	CHN	30.7	JPN	12.6	MYS	9.4	USA	9.1	KOR	6.8	68.7
21	793	Ships, boats and floating structures	464	0.8	11.2	4 132	100	JPN	33.8	CHN	13.4	PAN	9.6	KOR	6.5	SGP	5.4	68.7
22	764	Telecommunication equipment, nes; parts and accessories, nes	458	0.8	0.7	63 751	4	CHN	34.9	KOR	13.7	JPN	10.6	MYS	6.2	USA	6.1	71.4
23	061	Sugar and honey	431	0.8	16.4	2 626	125	AUS	26.6	THA	25.1	GTM	6.0	ZAF	5.3	CUB	4.6	67.6
24	246	Pulpwood (including chips and wood waste)	418	0.7	18.3	2 278	135	AUS	34.2	ZAF	21.1	CHL	11.2	VNM	6.5	USA	6.3	79.3
25	248	Wood, simply worked, and railway sleepers of wood	395	0.7	6.9	5 761	74	CAN	20.1	MYS	11.6	IDN	9.0	USA	8.9	RUS	7.3	56.9
26	674	Universals, plates, and sheets, of iron or steel	381	0.7	1.4	26 712	14	JPN	35.4	KOR	16.9	OAN	14.7	CHN	5.8	RUS	4.6	77.4
27	752	Automatic data processing machines and units thereof	354	0.6	0.7	51 961	6	CHN	39.6	THA	9.9	USA	8.7	SGP	7.2	PHL	6.2	71.7
28	044	Maize, unmilled	349	0.6	8.2	4 232	98	USA	64.8	CHN	24.0	ARG	7.1	BRA	1.1	SGP	0.7	97.6
29	121	Tobacco unmanufactured; tobacco refuse	347	0.6	31.7	1 096	172	BRA	30.8	USA	16.6	ZWE	12.3	CHN	11.6	TUR	4.1	75.3
30	057	Fruit and nuts, fresh, dried	334	0.6	8.3	4 007	102	USA	30.7	PHL	21.8	CHN	9.0	THA	6.4	NZL	5.9	73.8

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

[a] 30 leading products imported from Latin America and the Caribbean by ASEAN+3 countries, based on their import value in 2005, with their ISIC Rev.2. codes.

[b] The order reflects the import value of these products.

[c] Share of the product in the total imports of ASEAN+3 from Latin America and the Caribbean in 2005.

[d] Share of the product imported from Latin America and the Caribbean in the total value of the product imported worldwide.

[e] Total value of imports of the product worldwide.

[f] Ranking by the value of the product in relation to total imports worldwide.

[g] Five leading countries as suppliers of this product, and their share in imports worldwide.

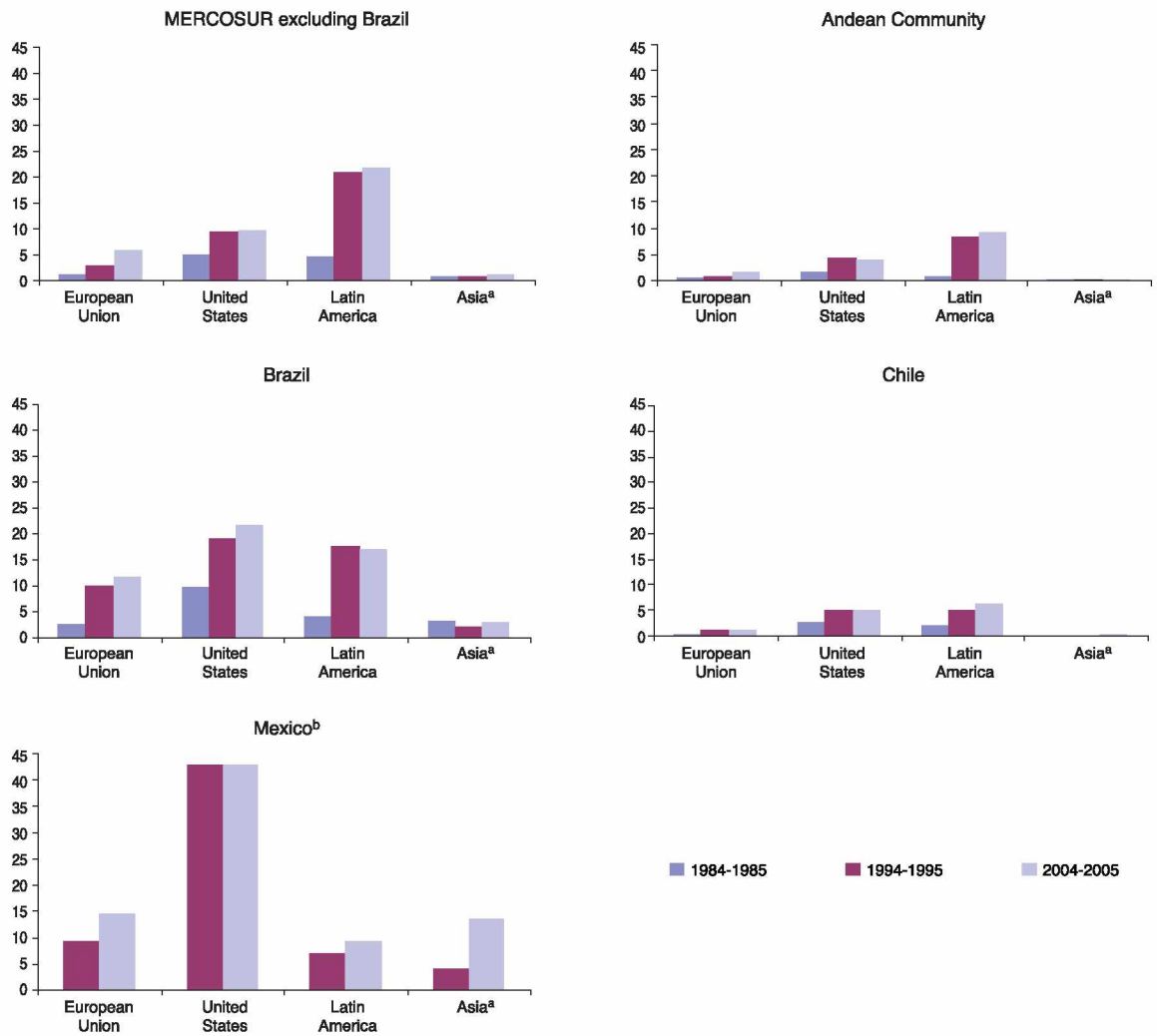
[h] Sum of the shares of the five leading suppliers of the product in its total imported value.

[i] Other unspecified Asian countries and territories.

(c) Low level of intra–industry trade between Latin America and the Caribbean and Asia

The level of IIT in Asia contrasts starkly with the very low level prevailing between Latin America and the Caribbean and Asia. If one compares the IIT coefficients of Latin America and the Caribbean with those of other regions of the world (United States, European Union and even East Asia), the amount of this type of trade with Asia is very small (see figure V.5). Latin America and the Caribbean shows a high index of intra–industry trade with the MERCOSUR countries (whether or not including Brazil) and, to much smaller extent, with the Andean Community and Chile. This type of trade has increased considerably in the case of Mexico, especially with the United States, as a result of the maquila trade. Apart from Mexico, IIT with Asia is almost non–existent, and this is one of the main reasons for the relative stagnation of bi–regional trade generally.

Figure V.5
LATIN AMERICA AND THE CARIBBEAN: TREND OF THE INTRA–INDUSTRY TRADE INDEX 1984–1985, 1994–1995 AND 2004–2005
(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] Asia includes China, the Philippines, Indonesia, Japan, Malaysia and the Republic of Korea.

[b] Figures for Mexico which cover 1994–1995 and 2004–2005 only.

2. Tariffs in Asia: a headache for Latin America and the Caribbean?

The following table gives an overview of trade weighted average tariffs as applied to imports by the leading countries of Asia and India. Although the average tariff applied to all products by these 10 countries was around 8%, the average on agricultural products was above 23%, while the average on industrial products was 6%. These figures help to explain the structuring of production systems in Asia, since the tariff system is clearly biased towards protecting agricultural products, and there is an apparent lowering of tariffs on industrial products. In this regard, of the 10 countries considered here, only the Philippines would be the exception, since the average of its industrial tariffs is almost twice that levied on agricultural products. Nonetheless, the highest average tariff on industrial products is actually applied by Thailand and not the Philippines (see table V.5).

After Singapore, which has a free market, the country with the lowest average tariffs is Japan, followed by Indonesia and Malaysia; the latter applies an average tariff of over 26% on plastic and plastic products, rubber and rubber products, the highest of the group for these articles.

In Asia, the highest tariffs are applied to agricultural products and a number of natural–resource–based manufactured goods —precisely the product lines in which the Latin American and Caribbean region has most comparative advantages. The challenge facing the region is to engage in the Asian production and distribution scheme with exports that face the highest levels of protection. From that standpoint, future negotiations between Latin American and Caribbean countries and Asian countries will be complex, and to be able to conduct them successfully the region will need to offer additional new attractions. The priorities of the ASEAN economies are negotiations with China, Japan and the Republic of Korea. Competing even on a minor scale would need broader and unified markets with similar standards and disciplines. Only in this way would it be possible to attract trade and investment interest from the ASEAN countries with respect to the business opportunities that arise in the region. In other words, to accept the challenge of participating in "Factory Asia", Latin America and the Caribbean need to develop their own "Industry America", focus on incorporating knowledge into their exports, and develop regional negotiation schemes offering greater access advantages than would arise from a strictly bilateral negotiation process.

Advantages such as skilled labour, proximity to lower–cost energy sources, abundance of natural resources and appropriate industrial development and innovation policies can help Latin America and the Caribbean to participate more intensively in Asian production chains. Nonetheless, all this assumes making faster progress in export diversification, product and process innovation, and promotion of IIT between Asia and Latin America and the Caribbean.

Table V.5
AVERAGE TARIFFS APPLIED TO PRODUCT GROUPS IN ASIA, WEIGHTED BY TRADE VALUE, 2006[a]
(Ad valorem percentage rates)

		Japan	China	Rep. of Korea	Philippines	Thailand	Malaysia	Singapore	Indonesia	Viet Nam	India
Average tariff applied to all products		1.12	4.27	6.89	11.89	35.77	3.64	0	3.57	6.78	9.32
Average tariff applied to agricultural products		2.61	19.57	31.11	6.86	58.66	2.48	0.04	10.73	69.07	30.29
Average tariff applied to industrial products		1.09	4.19	6.14	12.85	13.71	3.67	0	3.54	6.46	9.21
1	Live animals; Animal products	6.47	6.69	19.24	5.85	30.00	1.50	0	1.67	6.37	30.25
2	Vegetable products	2.21	12.58	66.33	11.40	10.14	3.22	0	5.88	5.20	25.09
3	Animal or vegetable fats and oils	23.22	13.35	9.00	8.27	9.25	2.55	0	1.11	20.07	72.67
4	Prepared foodstuffs; Beverages, spirits and vinegar; Tobacco and manufactured tobacco substitutes	0.77	24.92	31.52	11.80	59.67	2.61	0.06	14.66	98.76	30.42
5	Mineral products	34.74	0.57	3.93	4.73	4.08	1.78	0	0.49	3.76	3.40
6	Products of the chemical or allied industries	0.24	11.25	6.76	3.29	5.52	1.79	0	3.75	6.05	14.78
7	Plastics and articles thereof; Rubber and articles thereof	0.24	7.73	7.74	9.72	10.82	26.11	0	12.86	24.17	14.59
8	Raw hides and skins, and articles thereof; Travel goods	10.03	12.22	7.94	6.89	5.00	3.01	0	11.10	36.47	14.25
9	Wood and articles of wood; Wood charcoal; Cork and articles of cork	1.08	3.33	6.93	7.18	5.92	11.39	0	4.54	12.13	12.06
10	Pulp of wood or of other fibrous cellulosic material; Recovered (waste and scrap) paper or paperboard; Paper and paperboard and articles thereof	0.02	3.73	0	5.60	9.66	1.21	0	3.73	15.66	12.97
11	Textiles and textile articles	7.14	14.24	12.33	10.02	34.94	17.43	0	13.97	43.92	15.19
12	Footwear, Headgear, umbrellas, sun umbrellas, etc.	14.86	16.67	11.99	13.21	39.14	16.63	0	12.13	47.02	14.78
13	Articles of stone, plaster, cement, asbestos, mica or similar materials; Ceramic products; Glass and glassware	0.48	13.15	7.79	6.37	28.04	4.71	0	5.04	45.91	14.81
14	Natural or cultured pearls, precious or semi–precious stones, precious metals, metals clad with precious metal, and articles thereof; Imitation jewellery; Coin	0	0.03	2.54	2.89	0	0.01	0	4.52	1.28	14.94
15	Base metals and articles of base metal	0.29	11.47	6.31	4.45	9.94	7.61	0	9.29	20.59	15.62
16	Machinery and mechanical appliances; Electrical equipment; Parts thereof; Sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles	0	2.98	4.44	2.32	11.70	2.08	0	2.14	4.56	6.32
17	Vehicles, aircraft, vessels and associated transport equipment	0	11.76	6.57	22.54	0	13.39	0	13.59	22.53	32.81
18	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; Clocks and watches; Musical instruments; Parts and accessories thereof	0.14	5.66	6.44	2.58	5.00	0.30	0	3.92	0.73	9.45
19	Arms and munitions, parts and spares	2.12	12.91	0.26	14.49	0	11.85	0	0.47	1.15	14.94
20	Miscellaneous manufactured articles	0.37	7.71	2.46	8.62	5.92	7.40	0	11.47	29.55	14.83
21	Works of art, collectors' pieces and antiques	0	8.49	0	0	0	0	0	8.42	0	14.94

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the International Trade Centre, Market Access Map (MAcMap) [database], United Nations Conference on Trade and Development (UNCTAD)/World Trade Organization (WTO).
[a] Data refer to 2006, except India (2005).

3. Competition between Latin America and the Caribbean and the Asia–Pacific region, in the agricultural and extractive products sector

In addition to the importance of the Asia–Pacific region in worldwide exports of manufactured goods, that region is also one of the main exporters and importers of agricultural products. In fact, the Asia–Pacific region, as a whole, is the second largest agricultural exporter after the European Union, with an 18% share of world exports in 2005, compared to the 13% of Latin America and the Caribbean. As an importer its share was somewhat larger, close to 21% (see table V.6). The world's 15 leading exporters of agricultural products include the following seven Asia–Pacific countries: China (US$ 29 billion in 2005); Australia (US$ 21 billion); Thailand (US$ 18 billion); Indonesia (US$ 14 billion); Malaysia (US$ 13 million); New Zealand (US$ 13 billion) and India (US$ 10 billion). The Latin American and Caribbean countries that compete in agricultural exports are: Brazil (US$ 35 billion); Argentina (US$ 19 billion); Mexico (US$ 13 billion) and Chile (US$ 10 billion). The 15 largest importers of these products in the world include Japan, China, the Republic of Korea, Hong Kong SAR and Taiwan Province of China, India and Malaysia, in order of importance.

The Asia–Pacific region also outweighs Latin America and the Caribbean in its share of global exports and imports of fuels and extractive industry products, with over 14% of global sales and 32% of global purchases of these products. As an exporter, it easily surpasses the Latin American share.

According to WTO data (2006), intra–regional flows of agricultural products in the Asia–Pacific region, which totalled US$ 89 billion in 2005, represented 49% of the total amount imported by the region in this category. This indicates a significant level of productive and trade complementarity within the region, even in non–manufacturing sectors. The Asia–Pacific region also supplies these products to Europe and North America, markets to which it exported a total of US$ 28 billion and US$ 22 billion, respectively, in 2005. The intra–regional trade index is also high in the case of extractive products (fuels and minerals); nearly 37% of the sector's total imports (US$ 560 billion) came from the region itself.

In view of the high level of intra–regional trade in natural resources in the Asia–Pacific region, the Latin American and Caribbean region would have to compete in that region not only in the areas in which it has comparative advantages, but also in third markets of major importance such as the European Union and the United States. Competitiveness in some countries of Asia and Oceania will be further strengthened when the various preferential agreements currently being negotiated are completed.

Table V.6
THE ASIA–PACIFIC REGION: EXPORTS AND IMPORTS OF PRIMARY PRODUCTS WORLDWIDE, BY REGIONS, 2005
(Percentages)

Regions of the world/product groups	Agricultural		Fuels and minerals	
	Exports	Imports	Exports	Imports
Europe	46.5	47.2	23.2	37.0
Asia	18.1	20.8	14.4	32.0
North America	14.5	16.1	8.9	19.4
Africa	3.8	3.8	11.1	1.9
Community of Independent States	3.1	3.4	11.7	1.5
Middle East	1.5	3.7	21.8	1.4
Latin America and the Caribbean	12.5	4.9	8.8	3.7
World	**100.0**	**100.0**	**100.0**	**100.0**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the World Trade Organization (WTO), *International Trade Statistics* 2006, Geneva, 2006.

4. Consequences for Latin America and the Caribbean of a regional–scope free–trade treaty

The establishment of an Asian free–trade area that includes China, Japan, the Republic of Korea, and possibly India also, poses a major challenge for Latin America and the Caribbean, because integration in Asia has an intra–regional emphasis, with a larger share of intra–regional exports in the tariff preferences scheme. As indicated above, Asian imports from the Latin American region remain concentrated in primary products and natural resources, while the composition of imports to Latin America and the Caribbean from ASEAN is strongly biased towards product areas such as information and communication technology, on which tariffs have fallen substantially in the last few years.

Accordingly, Latin America and the Caribbean's disadvantage in Asian markets in these product lines, given competition from ASEAN, would be eased if the countries of the region were to sign free–trade agreements with the ASEAN countries. In the absence of trade negotiations, the most serious disadvantages for Latin American and Caribbean countries would be aggravated in the primary product and commodity–based manufacturing sectors, where the ASEAN countries have comparative advantages in terms of production and where effective tariff rates are high, as shown in table V.5. The tariffs applied by the ASEAN countries, China, Japan and the Republic of Korea remain high on agricultural products, textiles and apparel, and certain machinery sectors. Thus within the ASEAN+3 agreement, or the ASEAN agreement with each of the three countries, or even the China–ASEAN agreement (see box V.3) or the ASEAN–India agreement, a reduction in these tariffs would favour ASEAN members at the expense of Latin American and Caribbean countries. This would generate trade diversion which would also make it harder for Latin American enterprises to participate in Asian value chains.

In terms of the trade and well–being of the Latin American and Caribbean region, there is little information on the potential effects of trans–Pacific free trade agreements either in force or under negotiation between the two regions. A study that analyses the effects of the free–trade agreements signed by Chile with Asia (4) (China, India, Japan and the Republic of Korea), finds that the trade impact for Chile is considerable, especially in terms of the expansion of their exports to China and Japan. The study also found that trade creation dominates (Schuschny, Durán and de Miguel, 2007),[17] while trade diversion is very small and only affects Argentina, Brazil and Peru. These countries have considerable trade with China and Japan, competing with Chile in exports of certain natural resources and agribusiness products. The different export patterns among the other countries of the region means that there is virtually no trade diversion.

[17] The study makes simulations of several hypotheses of trade liberalization using the database and general computable equilibrium model of the Global Trade Analysis Project (GTAP). All hypotheses take as a reference point a base centred on 2004 (also calibrated by the authors), either with full employment or with unemployment, as the case may be. The agreements simulated were those of Chile–Japan, Chile–China and Chile–Asia (4). All cases have assumed both full liberalization and liberalization excluding sensitive products. The free trade agreement with Japan has also been represented in a dynamic exercise that incorporates capital accumulation.

Box V.3

CHINA AND THE FREE–TRADE AGREEMENT WITH ASEAN

The China–ASEAN Free Trade Agreement was signed in November 2002, and seeks to improve economic cooperation in trade in goods, services and investments. The coverage of the agreement was recently expanded by the signing of an merchandise trade agreement between ASEAN and China which involves effective tariff savings in goods trade. This agreement has been applied as from 1 July 2005. The tariff preferences apply to imports from ASEAN to China and vice–versa, and the basic elements are as follows:

Liberalization timetable and product coverage: as part of the commitment established in the agreement, tariffs applicable to nearly 7,000 types of industrial goods would be reduced by between 0% and 5% between July 2005 and 2015. The tariffs applicable to the six most advanced countries of the group (Brunei Darussalam, Philippines, Indonesia, Malaysia, Singapore and Thailand) for the products included on the normal list, which represent about 400 tariff lines and 10% of total value imported in 2001, will be eliminated before 2010. Those applicable to the other four countries (Cambodia, Myanmar, Lao People's Democratic Republic and Viet Nam) will be eliminated before 2015. A deadline of 2018 has been set for tariff reductions on sensitive products (such as rice, cement and automobiles); and tariffs for highly sensitive products will be reduced by up to 50%. This round of tariff liberalization has been preceded by the application of an "early harvest" programme for the agriculture sector, which has been in force since early 2004. With the implementation of these measures, ASEAN countries are expected to increase their natural–resource exports to China and their imports of manufactured products from China. Preferences between the countries participating in this agreement (China and the six member countries) in the framework of the agreement on merchandise trade, are as follows:

	ACFTA tariff rate			
Most Favoured Nation tariff rates	2005	2007	2009	2010
Up to 20%	20%	12%	5%	0%
Between 15% (inclusive) and 20%	15%	8%	5%	0%
Between 10% (inclusive) and 15%	10%	8%	5%	0%
5%–10%	5%	5%	0%	0%
No more than 5%	unchanged		0%	0%

Early harvest program: (i) has been applied since 1 January 2004; (ii) only covers selected agricultural products, included in chapters 1–8 of the Harmonized System (roughly 600 products defined at the eight– or nine–digit level); and (iii) does not apply to most manufacturers established in China. The preferences between China and ASEAN in the framework of this program are as follows:

	Agreement tariff rate	
Most Favoured Nation tariff rates	2005	2006
More than 15%	5%	0%
Between 5% (inclusive) and 15%	0%	0%
Less than 5%	0%	0%

Recent expansion towards industrial products and consumer goods: reductions in tariffs and non–tariff barriers will be applied to trade in products contained in HS chapters 9 and 97. Firms must fulfil certain requirements to be able to use this scheme.

Rules of origin: in general terms, the aim is that the "manufacturing value–added" by China or an ASEAN country should amount to 40%. Nonetheless, to obtain certification requires analysis of the business model or production chain.

Deadline: implementation should be completed by 2010.

Scope of application: the agreement covers not only merchandise trade, but also trade in services and investments, although the two latter on a relatively small scale.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Association of South–East Asian Nations (ASEAN).

E. Conclusions and recommendations

To promote trade and investment flows between Latin America and the Caribbean and the Asia–Pacific region in such a way as to improve competitiveness, the following constraints need to be addressed: (i) the fact that trade flows by country and the composition of traded products are highly concentrated; (ii) the nature of these flows is almost exclusively inter–industry, and Asia–Pacific exports mainly manufactured goods while Latin America and the Caribbean mainly exports raw materials; and (iii) this characteristic makes it harder for the region's countries to engage more effectively in the productive chains of the Asia–Pacific region, which are increasingly intra–industry. The Latin American and Caribbean region should therefore adopt a two–pronged approach: first, more efficient and coordinated exploitation of natural–resource–based comparative advantages; and, secondly, greater efforts to promote industrial development by improving the corresponding international competitiveness in manufacturing sectors.

Concerning the more efficient and coordinated exploitation of comparative advantages, a number of recent experiences show that value can be added to commodity exports and knowledge can also be incorporated. Although more difficult than in manufacturing sectors, it is also possible to integrate commodities into production and marketing chains in Asia and the Pacific; this calls for a systemic approach including the production process, trade logistics, sea and air transport, and the marketing and distribution in the final consumption market. To the extent that this is based on alliances with Asian investors, the initial export of commodities will become a complex of activities involving goods, services, investments and financing. It remains for Latin America and the Caribbean to motivate its enterprises to successfully link themselves to the success of Asian companies, engaging with production unit supply chains with more highly processed inputs and contributing technology and knowledge. This includes involvement in those supply chains on the basis of natural–resource–based products which are more highly processed than those currently exported to Asia and the Pacific. It is important to make the most of natural resources by promoting long–term contracts, investment agreements and technology partnerships in this sector, and by establishing strategic clusters between countries, firms and certain geographical areas within the Asia–Pacific region. Strategic partnerships are needed that allow for greater value–added throughout the production and marketing chain; and technological partnerships need to be managed for mutual benefit, incorporating progress in biotechnology and agribusiness, mining, forestry and fishery production among other things. All these areas offer considerable room for working together with Asian allies. The likelihood of this taking place, however, will depend on whether the countries of Latin America and the Caribbean can present joint initiatives to achieve progress in various areas with public– and private–sector actors in Asia. Only when the region's producers can attain higher levels of productivity and efficiency will there be opportunities to integrate into value chains, not only in Asia but also in Europe and North America. In this case, Asian cooperation will be needed, in the shape of investments and the construction of technical and technological capacity in areas which can improve efficiency in exports and the incorporation of knowledge in raw materials.

As for the intensification of efforts to promote industrial development, it is important to support intra–industry trade between Latin America and the Caribbean and Asia and the Pacific. Although it has grown, it is still at an incipient stage, particularly in medium– and high–technology sectors. If such manufacturing activities are to become high value–added ones, policies must be promoted to support conversion to value–added exports with knowledge incorporated, the benefits of which are reflected in the rest of the economy through the creation of forward and backward linkages. The industries must improve the productivity and competitiveness of local producers of inputs and components, and there must also be a pro–innovation approach on the part of the region's governments, with a view to competing with Asian products in high–quality markets.

In both cases there is an urgent need for the countries of the region to strengthen trade links, seek greater opportunities for productive complementarity opportunities with Asia and the Pacific and enter into

trade agreements and trade and investment alliances, which would offer new access to that region's markets and promote integration into Asian production and export chains. The quality and quantity of domestic products must be improved to match the scales of Asian demand, and appropriate institutions must be set up to deal with issues of sanitary and phytosanitary barriers, as well as trade–related techniques.

Until recently, the Asian regional integration process was characterized by growing intra–regional trade and was mainly market driven. Today, this de facto integration process is being accompanied by de jure integration. To intensify the production and trade links induced by the first type of integration, these need to be complemented by free trade agreements of a different type, together with another type of economic and technological cooperation. Nonetheless, there is also growing concern about the presumption that the benefits arising from East and South–East Asia's vigorous growth are not being felt to the full by non–Asian countries. This is because an informal and formal trade bloc is forming around those areas, forging an increasingly broad and more complementary grouping in which development is disseminated in concentric circles, thanks to intra–regional FDI. It is thus becoming increasingly important to establish closer trade and business links with the Asia–Pacific countries, China in particular.

The de jure economic integration progress in the Asia–Pacific region has not been uniform, but has followed various channels with different speeds of implementation. The diversity of sizes and development levels among the Asian countries is the main obstacle to establishing the long–desired Asian free market. This chapter's analysis of the proliferation of trade agreements shows that East and South–East Asia are in a second stage of economic integration and are aiming to achieve greater synergy between de facto and de jure integration. For that reason, other regions of the world are interested in taking advantage of this favourable situation, while also defending their own interests. Nonetheless, the current process of economic integration in East Asia, based on growing commercial and investment linkages, thus far promoted by agreements, would put Latin America and the Caribbean at a clear disadvantage. The countries of the region urgently need to adopt a strategy for engaging with the Asia–Pacific region, including inter–regional agreements between the two.

Undeniably, taking full advantage of the opportunities offered by such agreements will require, on the domestic level, more determined advances to face the challenges of competitiveness, technological innovation and export diversification. Otherwise, efforts to diversify markets and improve access to the Asian market would be limited to consolidating commodity–based export specialization, vulnerable to the business cycle and involving the incorporation of little technology.

The effects for Latin America and the Caribbean of the proliferation of trade agreements in the Asia–Pacific region are hard to forecast, however, and will depend largely on the different settings of liberalization in the Asia–Pacific countries, the Asia–Pacific free trade treaty in the APEC framework, ASEAN+3 or ASEAN+6, and even possible combinations between the countries of Asia, Oceania and trans–Pacific agreements some of which involve certain Latin American countries. The various forecasts tend to confirm the assumption that the economic effects of a regional–scope Asian free–trade agreement would grow with its area of coverage. Thus, a free–trade agreement in East and South–East Asia would generate more economic benefits for its members than one between China, Japan and the Republic of Korea. Moreover, the magnitude of the economic effects would vary from one member to another and, in general, would tend to be greater among countries that are more trade reliant or have greater import protection. In any event, the Governments of Latin America urgently need to analyse the available options and take the corresponding decisions swiftly, effectively and on a coordinated basis.

The reduction of tariffs and other barriers being undertaken within the various types of free–trade agreements in the Asia–Pacific region, not only with respect to industrial products but also agricultural goods, could have significant consequences for the future of Latin American trade with the Asian region. It is therefore increasingly important for Latin America and the Caribbean to engage more effectively in the production and business networks that are being formed in the Asia–Pacific region, the hub of which is China. The recent trend toward the consolidation of trade relations through the signing of trans–Pacific agreements tends to facilitate that engagement, although it needs to be supported by significant progress both in export diversification and in regional integration. Regional integration is not only fully complementary with more energetic engagement in Asian markets, but is also a condition for success.

A specific working agenda thus arises for Latin American Governments, business organizations and regional banks, to agree upon an integrated set of

initiatives that encompasses various countries and stimulates IIT and reciprocal investments between Asian and Latin American economies.

The countries of the region also urgently need to make the most of the current dynamism in the Asia–Pacific region and develop new linkages to move forward in the innovation and competitiveness area (a weak link in the Latin American regional experience), strengthen links between trade and investment, and consolidate productive and technological linkages. The Asia–Pacific region offers investments that could provide complementary financing for major initiatives, especially in the infrastructure and energy areas. An interesting challenge is to identify the infrastructure and energy projects where that Asian investment might be most needed, to speed up works implementation, which not only would make it possible to strengthen the trade facilitation and investments link with Asia Pacific but also would generate externalities for Latin America's own regional integration process. It would thus be advisable to link the strategic partnership with that region with an updating of regional integration, to achieve unified markets supporting increasingly common standards and providing greater legal certainty.

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Chapter VI

Innovation and export development in emerging economies

Introduction

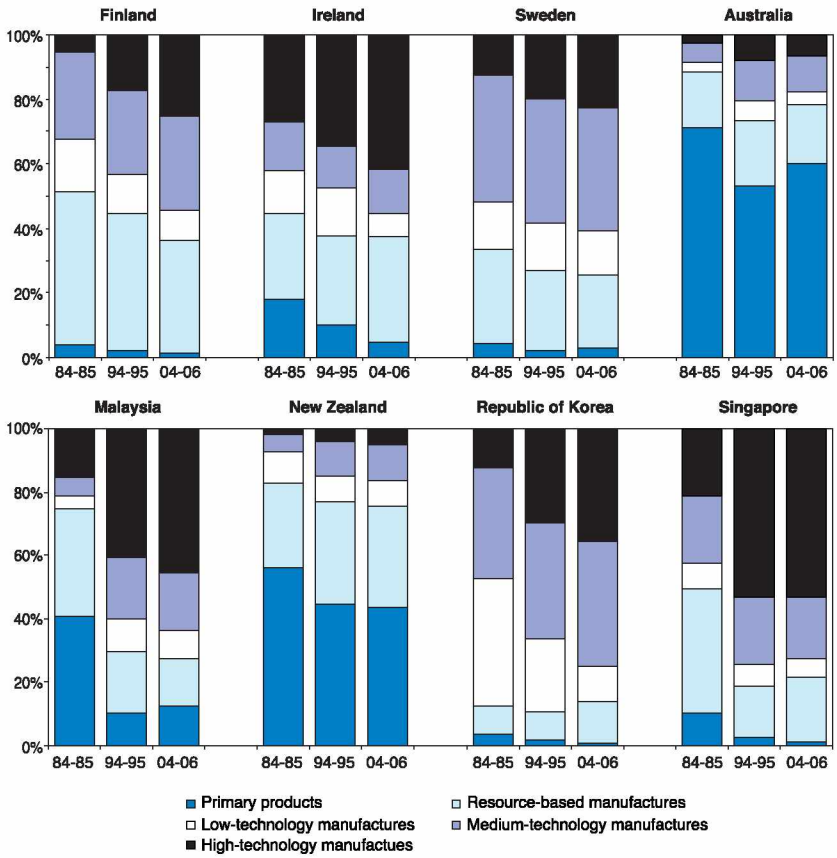
A study on the competitiveness of Latin American countries, contained in *Latin America and the Caribbean in the World Economy, 2005–2006*, states that despite the sound export performance recorded in the preceding years, these countries had continued to lose ground on leading markets. Furthermore, export growth did not usher in any substantive improvement in per capita income or in the quality of life of the population. One of the causes of this phenomenon was said to reside in the low value added and incorporated knowledge of the region's exports, an issue which has to do with the export–based development strategy and the role of innovation in that strategy.

The relationship between export development and innovation is not usually analysed; rather, these two subjects tend to be dealt with separately, possibly because of the difference in their theoretic or policy base. However, since the information and communications technology (ICT) revolution, the creation of knowledge and its use to strengthen the international integration of different economies are becoming more and more important. In this increasingly globalized world, the ability to invent, design and produce new products and services is more vital for the future than it was in the past. Industries and countries that make considerable investments in innovation may compete in better conditions in the global market; this generates growth that is more robust and, apparently, more equitable than the average, given the strong link between innovation, improved productivity and the quality of human resources.

Thus, the present report includes an analysis of the linkage between export development and innovation and its translation into strategies and institution–building. To illustrate this trend, it examines the different experiences of countries with varying degrees of advancement in this area: Australia, Finland, Ireland, Malaysia, New Zealand, Republic of Korea, Singapore and Sweden. Of this list, Finland, Ireland, Republic of Korea and Singapore are recognized as leading manufacturers and exporters of high–technology products (see figure VI.1). They are interesting examples since, until recently, their production structure, like that of many Latin American countries, was based on traditional branches or on natural

resources; however, unlike the Latin American economies, their production path veered off in a different direction in just a matter of years. Driven in almost all cases by the export sector, the growth of these countries (except Malaysia) has raised per capita income to a level equivalent to, or higher than, the average of the Organisation for Economic Co–operation and Development (OECD) (see table VI.1).

Figure VI.1
DEVELOPMENT OF THE EXPORT STRUCTURE BY TECHNOLOGICAL CONTENT (SELECTED COUNTRIES), 1984–1985, 1994–1995, 2004–2006



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

Table VI.1
GROWTH IN PER CAPITA GDP AND EXPORTS IN SELECTED COUNTRIES, 1975–2005

Countries	Per capita GDP in 2000 prices Annual growth rate (percentages)		Per capita GDP at constant 2000 prices (dollars)	Exports of goods and services at constant prices (percentages)		Per capita exports at constant prices
	1975–1990	1990–2005	2005	1975–1990	1990–2005	2005
Australia	1.6	2.3	23 039	5.6	5.2	4 326
Finland	2.6	1.7	25 713	5.2	7.4	17 132
Ireland	3.3	5.4	29 991	8.8	11.7	34 496
Malaysia	4.2	3.9	4 437	10.5	9.9	5 353
New Zealand	0.3	1.9	15 298	4.0	3.8	5 135
Republic of Korea	6.8	4.8	13 210	12.6	13.9	10 814
Singapore	5.7	3.9	25 845	9.2	10.5	69 926
Sweden	1.6	1.7	29 954	4.1	6.8	21 303

Source: For per capita GDP, World Bank, World Development Indicators [online database] http://devdata.worldbank.org/dataonline/; for exports, United Nations Statistics Division, National Accounts Main Aggregates database [on line] http://unstats.un.org/unsd/snaama/selectionbasicFast.asp.

Ireland, the Republic of Korea and Singapore experienced more spectacular export growth in volume terms with average rates for the past 15 years attaining double digits. They are followed by Malaysia, which moved from the status of a natural resource exporter in the mid–1980s to a stage where in the mid–1990s, 60% of its total exports were manufactures, with high–technology products accounting for 40% of that total. Sweden, whose per capita income is the highest in the group, shows a higher degree of specialization in the export of medium–technology exports, although the increase in exports of high–technology products in the past decade has been significant. Australia and New Zealand continued to specialize in the export of resource–based products and have diversified these same product chains. It is interesting to note that they have been able to incorporate value in these resources, linking exports and innovation.

The rest of the chapter is divided into two sections. The first considers the concept of innovation, the phases of this process and its indicators. The second examines the role of innovation in international integration and export development strategies, how this translates into institution–building and the importance of establishing effective programmes and policies. All of this underscores the need for coordination among the organizations involved, complementarity of programmes and policies and collaboration between the public and the private sector. The selected countries whose experiences are used as examples are all from outside the region. The conclusions are presented in the final section.

A. Innovation in the global economy

Currently, innovation is conceived as a social process in which different stakeholders participate and which involves different levels of competition, although the focus is on the business company. This is so, because innovation is not just limited to the creation of scientific projects, but implies adding commercial value to the successful exploitation of new knowledge and technological developments. Innovation can refer to the sphere of the company, the industry or the economy as a whole and, as Schumpeter pointed out at an early stage, it can be related to the manufacture of new products, the provision of services, the development of processes or the domain of new markets.[1] It may also be expressed in new business, marketing or logistical models or in new formulas for market conquest, processes that are vital for export development. The conception of innovation is much broader than that linked only to technological development and scientific research, since it also has to do with business management and the multiple possibilities that it generates.[2] Nevertheless, it should be recognized that without basic and applied research and without technological development, innovation would rapidly lose strength.

Different stages may be identified in the development of the capacity for technological innovation, and countries may be placed in terms of the stage they are at (see diagram VI.1).

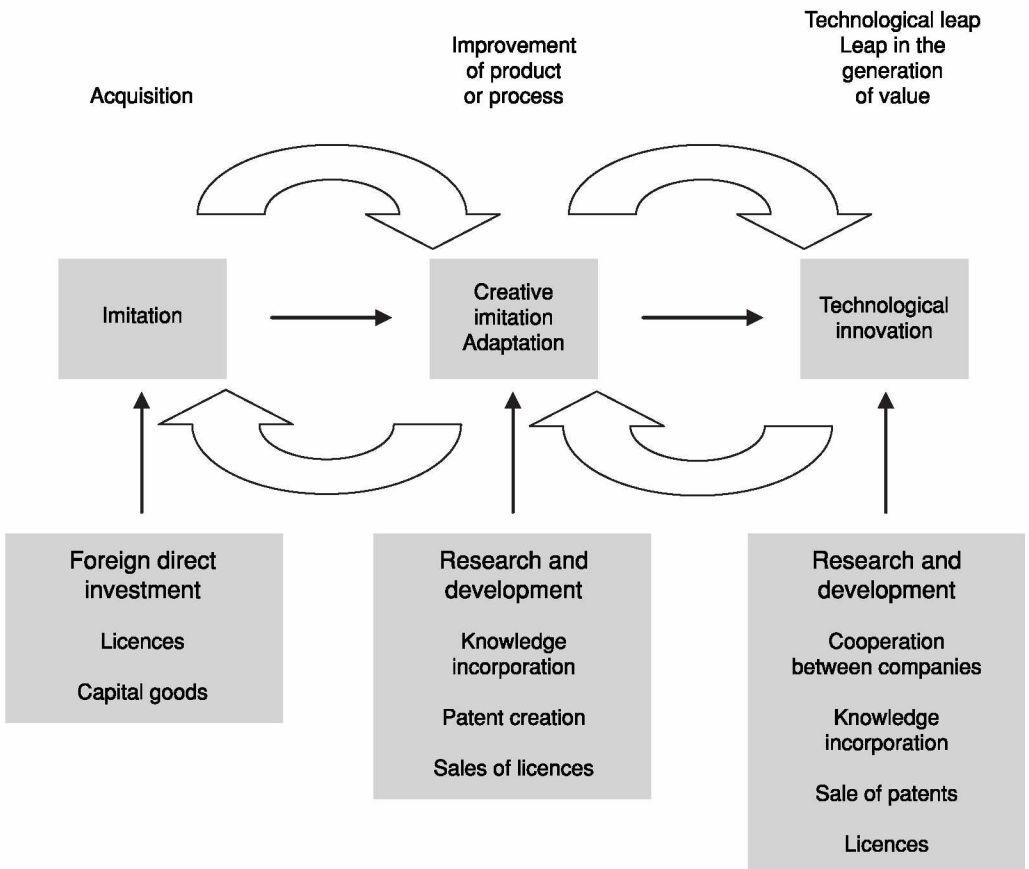
A company may acquire technology, machinery or equipment abroad to develop a new product locally or penetrate a new market, as well as to incorporate an already established process. If this leads to an increase in the business or industry's competitiveness and profitability, it is an innovation. However, companies that rely on the incorporation of existing technology are usually at a disadvantage in the global market compared with companies that are capable of developing technology for themselves.

1 See Schumpeter (1934).
2 For the incorporation of new elements into the traditional definition of innovation, see OECD (1997) and (2005).

A country may remain in this phase for a period, but if it wishes to improve its competitiveness and gain a foothold in the global market, it must pass through the following phases.[3] Technology may be acquired by purchasing machinery and equipment, by purchasing licences or through investment by a transnational corporation in a new plant that manufactures a product that did not exist before. Several countries have made tremendous strides in terms of diversification and export development, thanks to this last type of innovation. The prime example is Ireland, which became a platform for entry into the European market following the rapid pace of transnational investments in the 1980s and early 1990s. The same is now occurring in Asia with Malaysia and Singapore.

Time is of the essence in overcoming the imitation phase; companies eventually incorporate knowledge for improving and distinguishing their products and services and the phase of creative imitation starts. Thus, in the innovative process, on–the–job learning is irreplaceable. This activity is linked to research and development (R&D) and may take place within the firm itself or with the collaboration of other companies, universities, centres of excellence or institutes of technology. Among the countries studied, this phase prevails currently in various sectors in Ireland and Singapore, in various branches of agribusiness, manufacture and services in Australia, and in activities relating to agribusiness in New Zealand (see diagram VI.2).

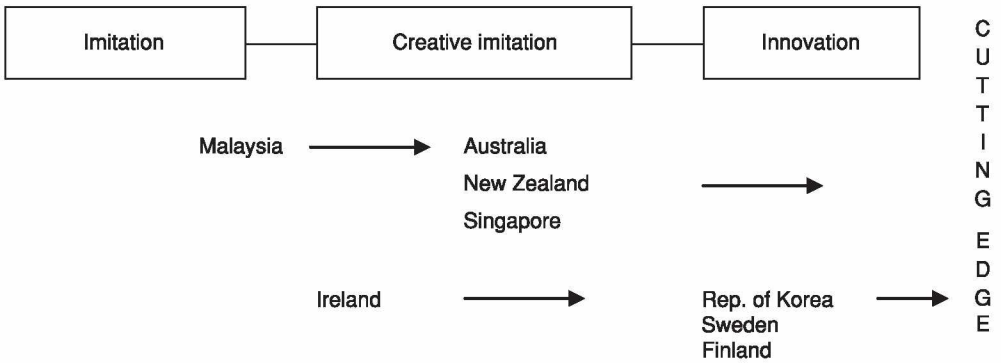
Diagram VI.1
THE PROCESS OF TECHNOLOGICAL INNOVATION



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

[3] For more in–depth studies on this issue, see Nelson (1993), Lundval (1992), Katz (1998) and Cimoli, Ferraz and Primi (2005).

Diagram VI.2
STAGES IN THE DEVELOPMENT OF TECHNOLOGICAL INNOVATION IN SELECTED COUNTRIES



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organisation for Economic Co–operation and Development (OECD), *OECD in Figures 2006–2007 and Main Science* and *Technology Indicators*, Paris, 2006; and Innometrics, "European Innovation Scoreboard 2006. Comparative Analysis of Innovation Performance", 2006 [online] http://www.proinno-europe.eu/doc/EIS2006_final.pdf.

The final phase of development consists in innovation in the true sense of the term. To achieve this phase, R&D must be considered as a central process not only for the company, but also for the country. This is due to the fact that innovation is not an individual act and requires not only the broadest possible collaboration between companies but also a sufficiently wide research base in order to boost the process. In this regard, coordination of the companies with R&D centres and university centres of excellence within and outside the country is essential; by the same token, financing for basic science, which is usually provided by the State, is vital. The closer–knit these knowledge networks, the greater the potential success of the invention. The subsequent phase, marketing, encompasses various stages, so that governments design policies and incentives that strengthen this dimension.

These phases are not linear and may coexist within a country and even within an industry or firm. There are countries that are technologically at the cutting edge in one or two sectors and others that are in this position in most sectors. Among the countries studied, the Republic of Korea can claim this distinction especially in the area of electronics, notably in semi–conductors. Finland and Sweden are at the forefront in their main export sectors. These countries are considered leaders in innovations at the global level, even compared with countries of the European Union, the United States and Japan. This leadership is demonstrated by the fact that they rank at the top of the category in multiple indicators. For example, with respect to their capabilities in science and technology, OECD places them in the leading position on account of their expenditure on R&D as a percentage of GDP, the share of this expenditure financed by the companies and the number of patents registered in the United States, Japan and Europe per thousand inhabitants (see table VI.2).

The European Union is preparing a series of indicators to reflect the capacity for innovation in all its complexity and in its various dimensions. "Innovation drivers" are used to measure the structural conditions that enable a country to develop its innovation potential; knowledge creation indicators measure investments in R&D activities; and innovation indicators and entrepreneurship refer to the company's efforts to market the new products, services or technologies; the applications refer to the value added of activities linked to the most innovative sectors, and intellectual property indicators measure the results of registering patents in the United States, Europe and Japan and of creating new brands and designs at the global level. By using these indicators, it is possible to present graphically the averages of sets of countries, in this case the members of the European Union, which are in phases of imitation (trailers), creative imitation (followers) and innovation (leaders) (see figure VI,2). In line with these statistics, what differentiates countries that have a high capacity for innovation from those that display creative imitation is the magnitude

Table VI.2
SCIENCE AND TECHNOLOGY INDICATORS

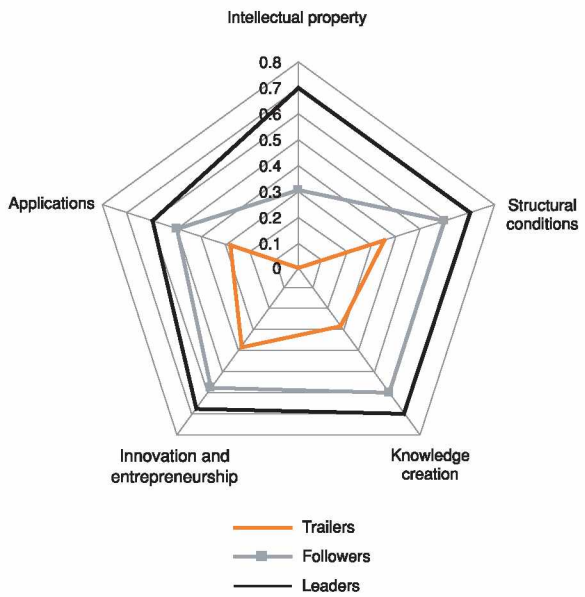
Country	Expenditure on R&D /GDP (percentages)	Percentage of expenditure incurred by firms	Percentage of expenditure incurred by high-technology industries	Patents registered in the United States, Europe and Japan per 1,000 inhabitants
Australia	1.6	51.2	12.1	0.021
Finland	3.5	70.1	55.2	0.120
Ireland	1.2	64.6	38.2	0.014
Republic of Korea	2.8	76.7	53.0	0.015
New Zealand	1.1	42.5	-	-
Sweden	4.0	74.1	51.4	0.089
United States	2.7	70.1	40.3	-
OECD	2.3	67.9	-	-

Source: Organisation for Economic Co-operation and Development (OECD), *OECD in Figures 2006–2007*, Paris, 2006; and *Main Science and Technology Indicators*, Paris, December 2006.

of innovations that are patented and marketed. Countries in the imitation phase show deficiencies in all indicators.

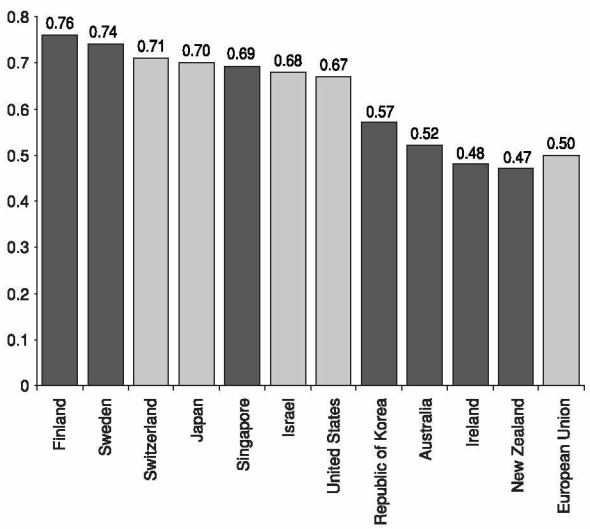
This set of indicators also facilitates the generation of a summary indicator, which presents figures for almost all of the countries in this study. On the basis of this indicator, Finland and Sweden again lead the process at the global level, together with Switzerland, Japan, Singapore, Israel and the United States (see figure VI.3).

Figure VI.2
PERFORMANCE BY PHASE IN THE INNOVATION PROCESS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Innometrics, "European Innovation Scoreboard 2006. Comparative Analysis of Innovation Performance", 2006 [online] http://www.proinno-europe.eu/doc/EIS2006_final.pdf.

Figure VI.3
GLOBAL SUMMARY INNOVATION INDEX[a]



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Innometrics, "European Innovation Scoreboard 2006. Comparative Analysis of Innovation Performance", 2006 [online] http://www.proinno-europe.eu/doc/EIS2006_final.pdf.

[a] Black bars are used to highlight the figures of the countries selected for this study.

B. Innovation and export development

In the selected countries, innovation tends to be conceived as part of the diversification and export development strategy. This is due to the fact that countries that are technological leaders and their close followers are threatened by competition, heightened essentially by the information and communications technology (ICT) revolution, trade liberalization and the reduction in transport costs.

Trade liberalization has enabled countries that produce at very low cost and which, historically have been marginalized from world trade, to become integrated into the global market. Companies that wish to continue competing on markets where those new countries are positioned are forced to move up in the value chain and shift from competing on a low–cost basis to competing on the basis of new, high–quality products, in which the role of innovation is vital.

On the other hand, technology and scientific knowledge are changing the world at unprecedented speed. ICTs, nanotechnology, biotechnology and even new fuels are generating a new wave of innovations and creating other business opportunities for obtaining competitive advantages. The winners in this race are the countries that are usually first, but nothing is guaranteed, because in today's world, given the speed with which knowledge is transmitted, they can easily be displaced.

Communications also have an impact on consumers. Knowledge in real time of what is happening in the rest of the world rapidly influences tastes; new fashions, ideas and products emerge and are disseminated almost instantaneously. Being constantly aware of consumer demand and of the market niches that open up and being capable of satisfying demand with new and better products imply a mastery of the innovation process and the ability to keep up to date with changes in international supply and demand.

In recent years, these determinants have weighed heavily on countries' strategies for international integration; this has generated flexibility amid changing objectives and has placed innovation at the centre of strategy redefinition. This has led governments to design mutually inter–linking policies for competitiveness, export development and innovation in order to provide comprehensive government support. In some cases, the strategies have been spearheaded by leading stakeholders and supported by governments through policies, instruments and financing. This phenomenon has occurred at the national level and also at the regional or sectoral level, as in the example presented in box VI.1.

Box VI.1
AUSTRALIA: NATIONAL FOOD INDUSTRY STRATEGY

In 2002–2007, the National Food Industry Advisory Committee, in association with the Government of Australia, launched the initial stage of the National Food Industry Strategy (Australia, Department of Agriculture, Fisheries and Forestry, 2002). This was based on a 23–point action agenda and its aim is to ensure that Australia's food industry will be a significant player in the global market. The approach has been to increase the export opportunities and profitability of companies by raising investment in innovation, improving supply chain practices, increasing efficiency and competitiveness and skills development as well as promoting clean and safe food through sustainable environmental management practices. Programmes have been developed around four key themes:

(i) innovation: leveraging Australia's science and technology, and education and training by making the country a recognised centre for innovation in food product, process and systems development, anticipating and meeting consumer needs, and attracting investment;

(ii) market development: developing an international food market entry strategy that increases Australian exports of food products to enable companies to optimize profitability, investment and employment;

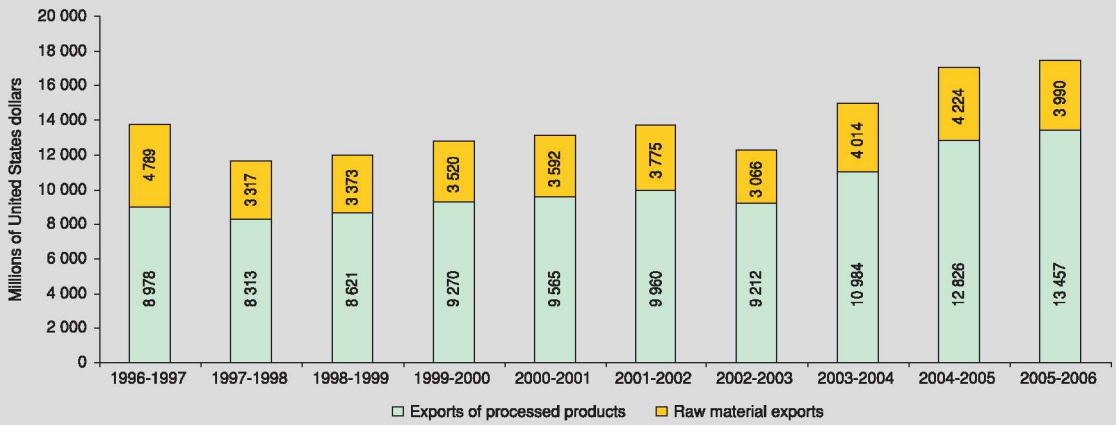
Box VI.1 (concluded)

(iii) business environment: building a globally competitive business–operating environment to improve food industry investment; and

(iv) environmental sustainability: ensuring long–term resource availability and responsible management of environment, energy and waste to support industry growth.

AUSTRALIA: EXPORTS OF FOOD AND BEVERAGES, RAW MATERIALS AND PROCESSED PRODUCTS, 1996–2006

(In millions of dollars)



Source: South Australian Food Industry ScoreCard team, *National Food Industry Scorecard 1996–97 to 2005–06*, Adelaide.

In 2006, commodities and processed food exports accounted for 11.4% of total exports from Australia; of that figure approximately 70% were processed goods. The steady growth of exports was due in part to high commodity prices. Currently, innovation is the key to profitability and competitiveness in the food industry. The real opportunities on the global market will come from value added throughout the product chain. This is why food processing and production is being promoted through innovation; the aim is to move from diversification of commodities to value added in the sector. To this end, the national strategies include the following programmes and projects, which are designed to reduce innovation risk:

(i) subsidy programmes for innovation in foods for those projects that envisage commercial results from R&D relating to products, processes or technologies;

(ii) the creation of centres of excellence to provide the basis for scientific research and practice, creating an environment that will benefit the sector;

(iii) a specialists' management programme in food science and technology;

(iv) the increase in the level of the labour force and its skills through capacity–building and skills training.

In 2005, an external consultant assessed the implementation of this strategy and the progress of the programmes (Ridge Partners Consultants and Advisers, 2005). The assessment revealed the following:

(i) the programmes responded to the needs of the sector;

(ii) government subsidies were essential when deciding on the implementation of projects;

(iii) the programmes effectively provided benefits in terms of marketing, improvement of the capacity of enterprises and building networks;

(iv) the participation of small and medium–sized enterprises was limited; and

(v) programme administration was efficient and effective.

At the end of the period, consultations were held throughout the country and it was concluded that a national strategy was needed. In addition, strengthening collaboration between the public and private sectors stood out as a more acute need when the initiative was taking shape. The current objective is to create international competitive advantages for the industry through innovation throughout the value chain, solve problems shared by the sectors of which it is comprised and increase the returns on the investment. There is a proposal for promoting the culture of innovation throughout the sector, which is facilitated by the successful results of programmes implemented in the previous five–year period. Lastly, the establishment of close coordination and collaboration between the sector and the multiple government entities at the federal and State levels is considered to be another important success of the strategy.

1. Innovation in the face of future challenges

The future outlook for a country seeking to improve its position on the international market and the need to adapt to changing conditions leads some countries which formerly had performed satisfactorily to reaffirm their strategies and the place occupied by the different factors of competitiveness and growth. In most of the countries examined, innovation is considered to be the key element for future success. However, it is not just a matter of increasing expenditure on R&D and maintaining the current design of policies: the latter must be redefined to match the requirements of the new strategy. The most important definitions concern the sectors or activities to which priority will be given.

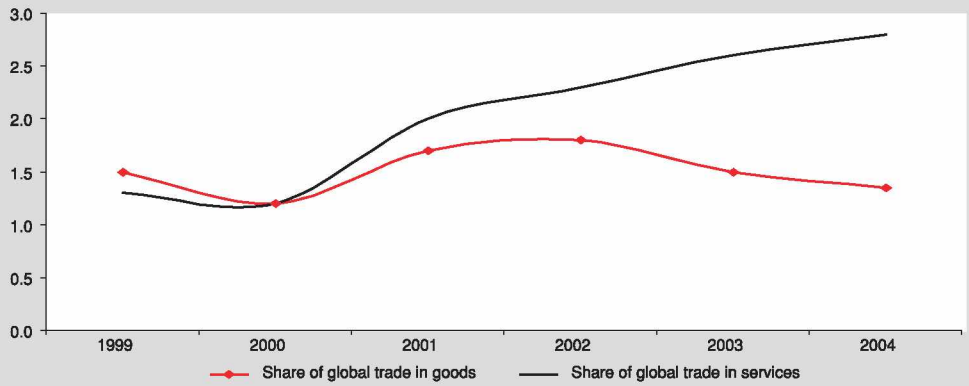
Ireland is a case in point: in the 1990s, its exports of high–technology products increased exponentially, but it now has to compete with the low wage bill of Chinese and some Eastern European manufacturers of computers and other electronic equipment. Undaunted by these new challenges, the government and entrepreneurs set up in 2004 a special analytical group –the Enterprise Strategy Group– to assess the situation and outlook. This Group's report and recommendations were taken into account in the government's subsequent programme and policy designs (Enterprise Strategy Group, 2004 and Martin, 2006). The recommendations highlighted the need to improve the capacity to apply technology for producing goods and services of higher value in the country, that is, to move up as far as possible in the value chain and evolve towards the knowledge economy (see box VI.2). These recommendations led the government to gear its policies towards market intelligence, innovation and deepening of the development of business networks, which, in turn, resulted in a shift in the definition and priorities of the development agencies.

Box VI.2

IRELAND: A COMPREHENSIVE STRATEGY FOR INTERNATIONALIZATION

Ireland's strategy for export diversification was based on attracting foreign direct investment. Its success was overwhelming, since more than 1,000 transnational corporations set up operations in a country of some four million inhabitants. The Industrial Development Agency (IDA) of Ireland was responsible for implementing programmes and policies to attract this investment. Nevertheless, international trade conditions are changing and affect these platforms and the government and principal stakeholders are therefore developing new strategies in anticipation of the future evolution of trade in their country. Ireland is losing its market share in sales of manufactures globally, while, at the same time, it has a great potential in high value–added services. This loss of participation is due to the fact that some transnational corporations that produce high technology equipment have transferred their operations to Asia.

IRELAND: SHARE OF GOODS AND SERVICES IN THE WORLD MARKET

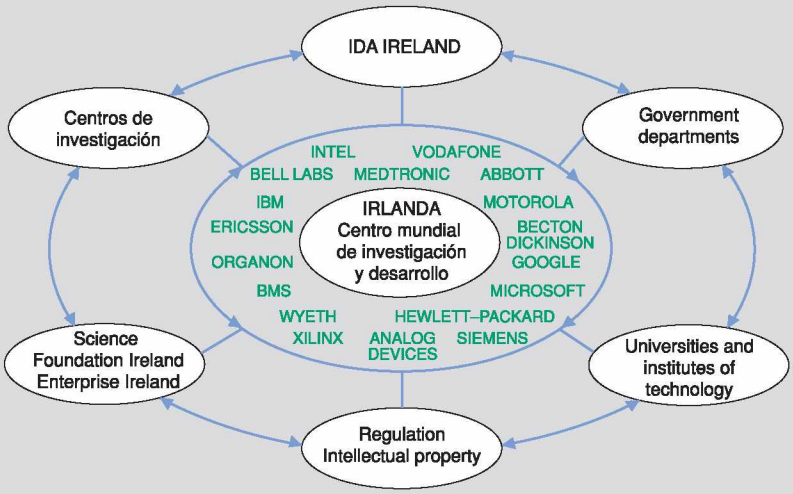


Source: Enterprise Ireland [online] http://www.enterprise-ireland.com/

Box VI.2 (continued)

In order to address this situation, companies have geared their resources towards the highest part of the value chain with respect to services and even the production of high–technology goods linked to electronics, life sciences, future foods and the pharmaceutical industry. This orientation, which allows the payment of high wages, combined with high profitability, forces companies to pursue intense development in terms of innovation.

INNOVATION PROMOTION ENTITIES



Source: Industrial Development Agency (IDA Ireland) [online] http://www.idaireland.com/.

In order to facilitate this reorientation, the Government of Ireland has carefully planned a comprehensive strategy for science, technology and innovation (Ireland, Department of Enterprise, Trade and Employment, 2006), through which it will coordinate the activities of all the public entities involved.

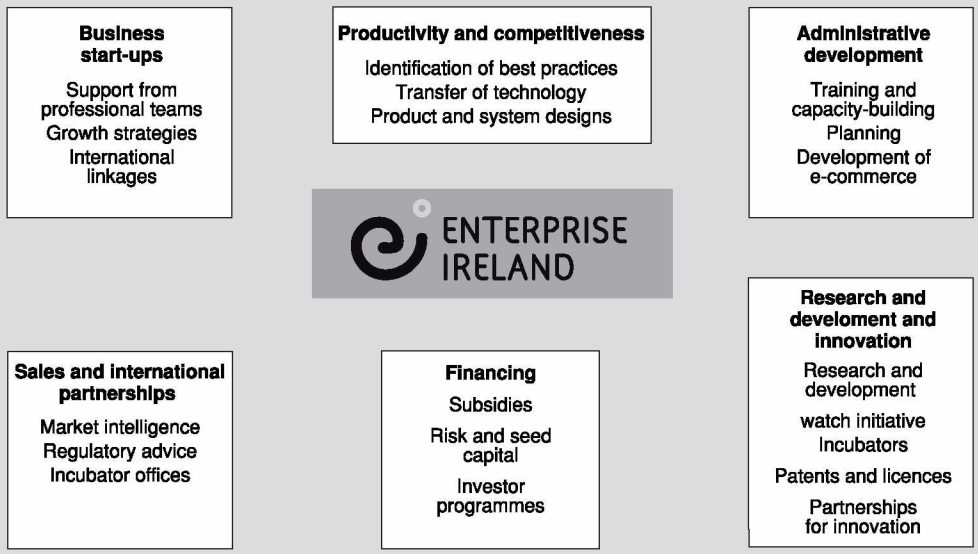
Transnational corporations receive tax incentives to prepare R&D activities through IDA Ireland, but, in addition, they benefit from programmes implemented by other bodies, such as Science Foundation Ireland, which encourages scientific research in key areas for the economy through the coordination of businesses, universities and centres of excellence. Furthermore, the strategy sets out a commitment to double the number of graduates with doctorates and to attract new generations to education, by ensuring the necessary infrastructure.

At the same time, Irish companies cannot afford to fall behind and the government has, therefore, prepared a strategy for their internationalization. According to this new strategy, the future of Ireland depends on research, marketing and the production and sale of products and services with high value added on the global market. According to the business development organization, Enterprise Ireland, in order to obtain success in such a competitive context, there is need for a new business model, under which foreign trade will be increasingly dependent on market knowledge and innovation. But the government does not expect this reorientation of economic activity to be market–led and, thus, it has proposed a set of policies. The programmes and policies are aimed at raising the productivity and competitiveness of businesses, boosting trading on the global market of goods and services, improving management, providing financing and promoting innovation.

In terms of exports, government support helps to provide flexible solutions to the needs of businesses. Enterprise Ireland is associated both with businesses that are already established and new entities and helps to identify new opportunities and to build knowledge and understanding of markets and marketing capacity.

Box VI.2 (concluded)

ENTERPRISE IRELAND: POLICIES AND PROGRAMMES



Source: Enterprise Ireland [online] http://www.enterprise-ireland.com/.

This promotion activity forces Enterprise Ireland to develop and maintain market contacts, conduct research and compile information for clients through its network of offices in Ireland and throughout the world. It acts in six areas: business improvement and productivity specially adapted to the needs of companies; R&D within the company; R&D in collaboration with other companies; research into marketing; collaboration in R&D at the international level; and acquisition of technology. Companies are urged to focus on potential technological R&D, promote business incubators, develop patents and licences and promote partnerships.

The Republic of Korea, notwithstanding the very different context, also serves as an example. Convinced that science, technology and innovation can play a decisive role in promoting national competitiveness, the Government of Korea has been restructuring the national innovation system since 2004, moving from a strategy based on imitation towards one based on innovation. This strategy consists in establishing systematic cycles of creation and dissemination of products resulting from R&D, which promote growth, job creation and an improvement in the quality of life. This has led the government to address a series of new approaches in terms of policies geared to the following objectives:

i) improving the creative capacity of agents and promoting greater coordination between government technological research institutes, businesses and universities. Basic science will be strengthened and further support provided to academic institutions, whose development had been previously weakened. Reorienting funding for R&D towards socio–economic demands and overcoming the gap between supply and demand for technology, by expanding infrastructure;
ii) promoting innovations at all phases of creation and industrialization;
iii) promoting knowledge–sharing, an environment of collaboration and increasing the efficiency of the national system for innovation.

Consequently, the government is promoting training for a large number of professionals in scientific fields, strengthening the capacity for innovation of small and medium–sized enterprises (SMEs) and promoting the marketing of the products of technological innovation. In order to make this policy of science and technology effective and efficient, the government has created a new system of administration to finance, coordinate and evaluate existing programmes and instruments (Kee Yol Yu, 2005 and Deok Soon Yim, 2006). Currently, the Korean Institute of Industrial Technology

(KITECH) provides special support to SMEs in innovation planning and management, information and evaluation of technology, training of engineers and holding of consultancy workshops on the development of innovation. These are some of the activities for development and transfer of technology to manufacturing. There are 12 technological development centres throughout the country, which encompass the main industrial sectors. The thematic areas are: future generation manufacturing systems, innovations in processes, and advanced products and materials. The institute has a budget of US$ 187 million and 921 professionals. This technological support is complemented with the support of the government–run Small and Medium Business Administration (SMBA, n.d.), which develops a set of programmes to encourage the capacity for innovation and entrepreneurship, geared to boosting new start–ups, thereby providing an effective financial service geared, among other things, to improving human resource skills and servicing micro–enterprises.

Few countries are better placed than Sweden to take advantage of the process of globalization and emergence of the knowledge economy. However, this has not prevented it from looking towards the future and analysing the changes that it will need to make in order to keep on growing and raising the standard of living of the people. The Ministry of Industry, Employment and Communication, in conjunction with the Ministry of Education of Sweden, canvassed the views of the business sector and the trade–union movement, as well as representatives of the research and education community and came up with the analysis from which the strategy *The Innovative Sweden* has been drawn up. This strategy focuses on four aims: strengthening the knowledge base for innovation; boosting innovation in trade and industry, public investment in innovation, and capacity–building for individuals in the area of innovation. As regards the second of these focuses, the government recognizes that competition is exerting increasing pressure in the business world and that the competitiveness enjoyed by large firms is not sufficient to survive in this context (Parker, 1999); survival depends also on SMEs and the way they interact within integrated production systems. If Swedish SMEs do not succeed in becoming competitive, the major transnational corporations will transfer their operations outside of the country; the challenge is to avoid this situation and success in this regard will have an impact in terms of stable employment and development of the regions. These companies must compete with the technological platforms of low–cost countries in terms of quality and knowledge relating to high–technology products. To this end, policies are being geared towards:

- strengthening cooperation between company networks, higher education institutions and research institutes;
- developing support for product development and design;
- developing production technologies and new production systems;
- encouraging SMEs to invest in R&D, providing seed capital and other types of financing until risk capital recognizes that the projects are viable; and
- promoting the capacity of SMEs to operate internationally.

These examples show how the Governments of Ireland, the Republic of Korea and Sweden have sought to convert scientific and technological research and educational capacity into an industrial and export strength in high–technology areas; this has implied reviewing development strategies and national innovation systems that support them in order to face up to new challenges.

2. Institution–building

Institution–building is an important factor for the success of policies and a number of different issues come into play. In this analysis, the focus will be on elements that have been particularly important for the success of export development and innovation policies: (i) coordination between the executing

agencies or entities; (ii) complementarity of the programmes and targeting of specific sectors; and (iii) cooperation between the public sector, companies and academia.

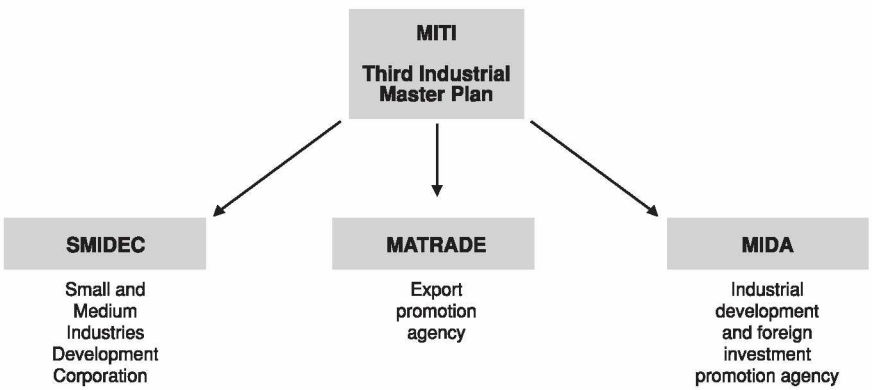
a) Coordination between agencies

Irrespective of the different national institutional agreements and their varying complexity, coordination between agencies may be well or poorly implemented. Clearly, this will depend on whether there is evidence, at the highest level of government, of the will to link global strategy with sectoral or regional strategies and the policies that emerge from them. In the case of export development, industrial development and innovation, coordination requires dialogue between ministries and agencies in each sector. It is interesting to study the institutions that countries that are advanced in these practices have built in order to ensure policy effectiveness.

Malaysia affords an interesting example. This country made a giant leap in its international integration, bringing its exports of manufactures to remarkable levels thanks to an industrialization strategy based on proactively attracting foreign direct investment. Nevertheless, new challenges to its competitiveness have since emerged: China's growing competitiveness internationally and nationally; intense competition for foreign direct investment (FDI); a major gap between demand for and supply of skilled workers; a workforce with little training in information technology; and the need to build knowledge and experience in terms of the design and brands of manufactures.

In the light of these challenges, the Ministry of International Trade and Industry coordinates a set of policies implemented by three agencies: the Malaysia External Trade Development Corporation (MATRADE); the Malaysian Industrial Development Authority (MIDA), which also seeks to attract foreign investment; and the Small and Medium Industries Development Corporation (SMIDEC). Each of these bodies started out with specific programmes geared to the objectives and goals defined by the ministry and governed by the ninth national development plan (Ninth Malaysian Plan) and the Third Industrial Master Plan, which are provided with the necessary financial resources. The ministry is the focal point and holds periodic meetings with representatives of the three entities. Moreover, meetings are usually held to discuss new initiatives with the stakeholders involved. This practice is consistent with the plans and strategies formulated for Malaysia's development. The ministry's policies are also coordinated with those of the Ministry of Science, Technology and Innovation (Ministry of Science, Technology and Innovation, 2006).

Diagram VI.3
MALAYSIA: THE MINISTRY OF INDUSTRY AND ITS DEVELOPMENT AGENCIES

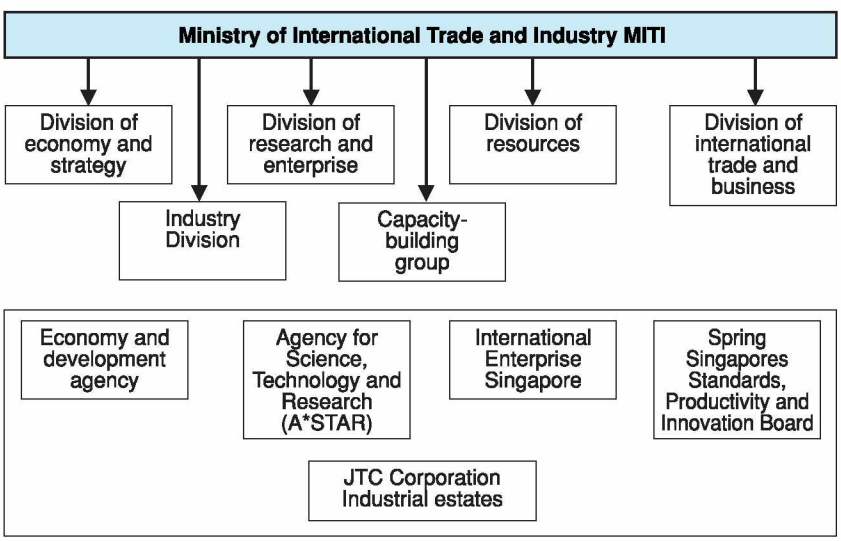


Source: Economic Commission for Latin America and the Caribbean (ECLAC).

These challenges do not differ from those faced by a country like Singapore, notwithstanding its higher degree of development. In the 1990s, the economic development strategy was geared towards the manufacturing and services sectors. The economic strategic plan presented in 1991 placed emphasis on education and human resources in a bid to enhance the country's competitiveness. In the operational programme, the focus was on development of the services sector, and companies were encouraged to use Singapore as a regional platform or as the parent company's distribution centre. Investments in the services sector were based on the film industry, multimedia products, publications, art and entertainment, textiles, fashion and design in different sectors. The globalization strategy seeks to transform Singapore from a production–based economy to one driven by innovation. The Ministry of International Trade and Industry (see diagram VI.4) is the entity responsible for formulating strategies for international integration, competitiveness, entrepreneurship and development of the two sectoral pillars of Singapore: high–technology manufacturing and global services. It has six divisions, which structure their policies around industrial and corporate development, international trade, and innovation. All the divisions work closely with the agencies, which are autonomous bodies responsible for programme execution.

Ireland is the third example. The Ministry of Enterprise, Trade and Employment of this country is responsible for policies relating to competitiveness, export development and innovation. Its coordination and advisory body, Forfás, is in charge of the areas of enterprise, trade, science, technology and innovation. In other words, Forfás is a multidisciplinary body that is in charge of coordination, conducting studies and proposing policies for each of these areas; at the same time, it acts as advisor to the ministry, providing a comprehensive vision. In order to be able to fulfil these functions, it participates on the boards of directors of the bodies that implement policy. IDA Ireland, the government body in charge of industrial development, which is responsible for attracting foreign investment; Enterprise Ireland, which deals with development of national industry; and Science Foundation Ireland, the organization that promotes scientific and technological research in the areas of biotechnology and ICT (Forfás, n.d). Forfás was, and in some cases still is, part of the secretariat of other State agencies and of ad hoc groups formed at the Prime Minister's request. Since it is not an executive body, it does not take part in analyses or play a role in the economy in the short term; as such, it is able to have a longer–term vision which is highly prized when discussing strategic issues.

Diagram VI.4
SINGAPORE: STRUCTURE OF THE MINISTRY OF INTERNATIONAL TRADE AND INDUSTRY AND THE AGENCIES THAT SUPPORT DEVELOPMENT STRATEGY



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

For example, when the government was focusing on training human resources for the future development of Ireland, which was to be based on the knowledge economy, Forfás worked with an ad hoc group of experts, the Ministry of Education and other agencies to prepare a vision for appropriate systems of education and capacity–building to train the human resources for the economy of the future, helping to design a national strategy for skills–training (Forfás, 2007) and to identify future needs. Special emphasis was placed on ICTs, medical equipment and international marketing services, which are the production and services areas to which the country is committed in terms of its niche in the world market. This example demonstrates that a country such as Ireland can, first of all, have a vision of the future, second, steer the work of the different ministries and agencies in the same direction and, third, create institutions to ensure that the course taken is in line with the agreed objective, in order to strengthen policies and enhance their effectiveness.

b) Complementarity of programmes, evaluation and orientation towards specific sectors

The effectiveness of programmes and policies depends unequivocally on the efficient coordination of government ministries and agencies. The task is easier if there is a strategy that sets goals, deadlines and priorities and whose execution is actually evaluated. In the countries examined, there is usually a wide variety and complementarity of programmes and policies, although, in some cases, there may be areas of overlap or duplication. These may be avoided through constant dialogue with the agencies in question. Such dialogue is ensured when the existing institutions include bodies, such as ministerial committees, which are set up for this purpose and which direct and coordinate the decisions and policies adopted by the different entities, when directors that hold decision–making positions participate on the boards of directors of the other agencies or provided there is an agency specialized in policy coordination and other functions. This type of mechanism exists in all of the countries under consideration.

For example, one of Singapore's strengths is the fact that its policies have been effectively integrated and implemented by a number of institutions (see box VI.3). Integration has been facilitated by a political and administrative system that depends on a relatively small group of decision–makers. Singapore is now exporting some of its experience in this area to other countries: China, India, Viet Nam and countries of the Middle East are working with Singapore's development agencies on the creation of industrial estates, airports, the construction of water treatment plants and capacity–building of civil servants and teachers.

The countries under consideration have priorities that orient the main policies and objectives of each agency. For example, in Malaysia, one of the objectives of the Third Industrial Master Plan is to achieve closer coordination between SMEs and the production chains led by the transnational corporations, or their internationalization. The Small and Medium Industries Development Corporation (SMIDEC) is the agency responsible for the development of programmes for promoting the achievement of these objectives (SMIDEC, 2006) and six programmes are currently being implemented: the industrial coordination programme, the global supplier training programme, the skills generation programmes, the advisory programme for SMEs, the development of technological infrastructure and the enterprise development programme. These encompass a set of issues for enterprises which must be improved if they are to become exporters or suppliers for transnationals.

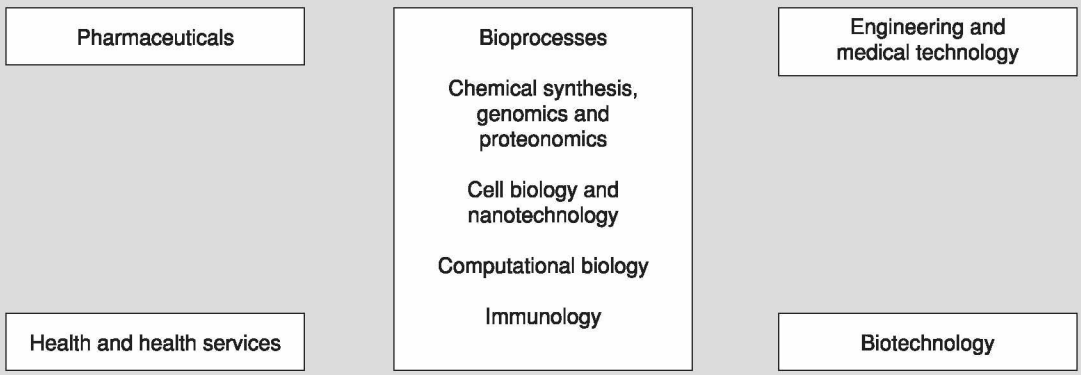
In addition, in the area of innovation, the Strategic Business Intelligence Centre, a government enterprise dependent on the Ministry of Science, Technology and Innovation (SIRIM, 2005), supports the national industry through multidisciplinary technological programmes. Its R&D programmes seek to introduce new know–how which will place companies at the cutting edge technologically, transforming them into world players. The programmes provide services especially designed for SMEs, including strategic planning, business intelligence, technological development and quality. This set of actions complements those developed by SMIDEC giving it comprehensive assistance.[4]

[4] Not all countries choose sectors or stakeholders as the central focus of their strategies. When the economy has become specialized and the main production sectors are at the leading edge of their field, innovation becomes the focus in order to advance in the knowledge economy, but in all spheres. Finland opted for this course with its horizontal innovation policy, which is implemented through close cooperation between the government, businesses and academia. Cooperation is the central element of policy implementation. One of the principal instruments for consolidation of horizontal connections is network densification, which seeks to create synergies of all kinds among actors. See The Science and Technology Council of Finland (2006).

Box VI.3
SINGAPORE: THE BIOMEDICAL SCIENCES CLUSTER

The Singapore Biomedical Sciences (BMS) initiative was launched in June 2000 to develop the biomedical sciences cluster as one of the key pillars of Singapore's economy, alongside electronics, engineering and chemicals. Three key agencies work in close coordination to develop the BMS cluster: the Biomedical Research Council (BMRC) of the Agency for Science, Technology and Research (A*STAR), which funds and supports scientific research initiatives; the Biomedical Sciences Group (BMSG), which comes under the Economic Development Board (EDB), which promotes industrial development and innovation in manufacturing; and Bio*One Capital, which functions as an investment arm. These agencies are responsible for establishing research infrastructure, supporting the industry, providing venture capital support and strengthening manpower capabilities.

THE BIOMEDICAL SCIENCES CLUSTER IN SINGAPORE



The first phase of development (2000–2005) of the BMS initiative was focused on establishing a firm foundation for basic biomedical research in Singapore. Five research institutes developed research capacity in the areas of bioprocesses, chemical synthesis, genomics and proteonomics, molecular and cell biology, biotechnology and nanotechnology and computational biology. The Science and Engineering Research Council and the Institute of Chemical and Engineering Sciences have provided support for training in four basic sectors: pharmaceuticals, biotechnology, medical technology and health services.

In the following development phase (2006–2010), the focus is on deepening the research capabilities of the different national stakeholders and on establishing networks abroad, which is fundamental for translating basic discoveries into clinical applications geared to improving human health.

In order to bring the project to fruition, the country has in the past few years attracted an impressive number of prominent international scientists to head and develop research in biomedical sciences. A*STAR of Singapore is providing financing for young researchers from all over the world to join the cluster and contribute with their own research to its development.

Singapore's position at the forefront of biomedical sciences was validated when a group of 25 laboratories, including the most reputable in the world, set up operations in Biópolis, the name adopted for the cluster formed with the investments for the initial project. It has recently been announced that Lilly Singapore Centre will invest US$ 150 million in a centre for the study of cancer and metabolic diseases, which will employ 150 researchers. The company Glaxo SmithKline (GSK) recently invested US$ 13 million in a new medicinal chemistry laboratory, geared to degenerative diseases, and the Novartis Institute for tropical diseases has expanded its biomedical research to include dengue, tuberculosis and malaria.

International firms coexist and collaborate with national firms and research service providers as well as with Singapore's seven R&D institutes in Biópolis, which has a campus that is specially designed for research into biomedical sciences (Biomedical Sciences Group, n.d.).

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

Since the resources involved are considerable, governments, in their determination to ensure policy transparency, have prepared a series of effectiveness and efficiency indicators for the programmes and instruments to facilitate their evaluation. A mid–term evaluation may be carried out in order to correct the problems and inefficiencies that arise during or following implementation, with a view to determining whether the programme should be rescheduled or eliminated. The consultancy group's recommendations are essential for improving programmes. Countries have adopted these indicators as a systematic and indispensable practice for ensuring that their management is effective and transparent. Currently, rather than measuring the activity in itself, its effect and results are assessed. These evaluations are done by groups of external international or national consultants; they are usually public and generally disseminated via the Internet.

c) Interaction between the public and private sectors

The effectiveness of the programmes and public policies in the area of competitiveness, export development and innovation depends to a large extent on the degree of participation of the different stakeholders. For some countries, the public/private sector partnership for strategy implementation is vital and is usually reflected at the level of the different policy–making bodies. In Ireland, for example, the business sector, including the representatives of transnationals, unions and non–governmental organizations, participates with government representatives in the National Economic and Social Council (NESC), which draws up the country's medium–term strategy. Representatives of national firms and transnational corporations also participate on the boards of directors of the main development agencies, in regional bodies and in ad hoc consultancy groups set up at the government's request. In this regard, there is a high degree of trust between the public and private sectors and the will to move forward together to improve the standard of living of the society.

In other countries, the private sector's participation in decision–making is less clear–cut. But even in those cases, governments are making serious efforts to listen to the views of entrepreneurs, maintaining links through regular consultations and meetings. Discussion groups or groups for implementation of specific projects are set up from time to time with the participation of the different stakeholders.

Collaboration between the academic sphere, companies and government is vital in the area of innovation and this is recognized in all the countries under consideration. The Nordic countries attach special importance to cooperation among the three basic stakeholders in the national innovation system; this approach has been disseminated as the triple helix model. In Finland, this model has proved itself, not only in big cities, but also in regions where there are no universities but where businesses do have needs in areas such as technological development and modernization; for example, in one region in the south of the country, a programme for building networks has been applied.

The regional government, together with entrepreneurs and five universities in different regions, devised a plan for applying information technology, innovation in management and upgrading of processes and products through a cooperative planning method. Groups of researchers set up a new research community combining many disciplines and universities. The programme was appraised in 2004 (Alarinta, 2005) and it was concluded that the network organization for development of innovation had been rapidly consolidated. New fields of research, such as ICT, have been hooked up with traditional sectors (wood, food and metals), incorporating new value and better processes in businesses.

Another example is the development of the biotechnology industry in New Zealand. The government recognized its strategic importance, both for its potential participation in the world market and for the preparation of new products and the contribution of new knowledge to the country's traditional export industries. This initiative was undertaken with the close collaboration of the development agency New Zealand Trade & Enterprise (NZTE), the Ministry of Research, Science and Technology and the industry. The industry is now enjoying rapid growth and is participating in projects internationally. This has given rise to a growing number of joint trade ventures, in particular with Australia. This resulted in an expansion in the quantities of products traded in 2006, the existence of about a dozen pharmaceuticals at an advanced stage of clinical development and progress with projects linked to the agricultural sector, medical equipment, and industrial biochemical and diagnostic products (LEK Consulting, 2006).

Some countries have developed special agencies to form partnerships between universities and business. This is the case of collaborative research centres (CRC) of Australia (Australia, Department of Education, Science and Training, n.d.). These agencies have been created from companies and research institutes or centres which have taken the initiative of moving forward in an area of innovation geared to marketing. The participant group may include national and transnational corporations. In 2006, there were 158 CRCs which allowed the direct coordination between companies and academia in the different production sectors in Australia. In the evaluation carried out on this initiative (Insight Economics Pty Ltda., 2006), the following issues emerged: (i) the benefits brought about by the innovations, which translate into licences or new companies that prepare the products and processes that have been developed; (ii) access to international networks through the participation of foreign researchers in CRC projects and the participation of their members in international standard–setting bodies; (iii) the increase in the skills of researchers and, above all, the creation of a critical mass of young researchers who participate in CRC; and (iv) the benefits of interaction between the industry and the academic sector, which learn to dialogue with each other, thereby enhancing the productivity of innovation.

C. Conclusions

Innovation has emerged as a central element in the export development and competition strategy of those countries that have made leaps towards a stronger position in the international market. Factors such as trade liberalization, the fall in transport costs, advances in ICT, globalization and constant shifts in consumer demand have a strong impact on the strategy for international integration, placing innovation at the heart of this strategy. One way of illustrating this phenomenon is to look at the way stakeholders, governments, businesses and the academic sphere organize in order to achieve coordination between export development and innovation.

The analysis focused on the experience of eight countries: Australia, Finland, Ireland, Malaysia, New Zealand, Republic of Korea, Singapore and Sweden. Notwithstanding their differences in terms of their stage of technological development and degree of export diversification, they have, overall, experienced significant export expansion in recent decades and this has been reflected in growth and in a substantial increase in their per capita income. In all cases, innovation has been part of the solution to the future challenges. What these countries show, however, is that it is not just a matter of increasing spending on R&D: policies must be redefined to bring them in line with new requirements. Scientific and technological research and educational capacity must be transformed into industrial and export strength; this implies changing not only the national innovation system but also the export development agencies and industrial development or business promotion agencies.

Moreover, in this highly competitive world, a new business model is needed in which market knowledge and innovation are crucial for success in external trade. The experience of these countries is that the market is not sufficient in itself to push forward this process. Explicit programmes and active policies geared to raising the productivity, competitiveness and innovation of enterprises, and to developing linkages between enterprises, the academic sphere and government must be created to promote trade in the world market, improve management and secure financing.

Institution–building has proven to be a significant factor for the success of policies. To deal with this very broad issue, this study has focused on central areas in which export development ties in with innovation, for example, coordination between entities, complementarity

of programmes, targeting, appraisal and, lastly, the interaction of stakeholders. These questions have been examined using the selected countries as examples and this has revealed the salient trends and provides sufficient motivation to study them in greater depth.

The fact that marketing is an indispensable step in the area of innovation and the fact that the countries examined are for the most part small economies which are dependent on foreign trade for their development mean that innovation and export development strategies tend to be complementary. Hence the importance of coordination between development agencies to harmonize their policies and increase their effectiveness. This dialogue is ensured provided the existing institutions include forums designed for this purpose, such as ministerial committees, which guide and coordinate the decision– and policy–making of the different agencies, provided that directors that hold crucial positions on decision–making bodies of the different agencies participate in those of other agencies, and provided that there is an agency that specializes in policy–coordination, among other possible mechanisms. This type of agreement may be observed in all the countries examined.

Countries that are at a more advanced stage of industrialization tend to have a horizontal strategy, which to a great extent, is due to the fact that they have to deal with deeper and more integrated markets, where sectoral policies are not so effective. This is why the focus of the programmes is on stakeholders. in Finland, Ireland, Republic of Korea and Sweden, and SMEs linked to chains of major national firms and transnationals are the target of many of the innovation and export development policies. In other countries which are still in the process of diversification, such as Australia, Malaysia and New Zealand, the strategy also incorporates sector targeting.

Cooperation between the government, companies and the academic sphere, such as it occurs in the Nordic countries or in the Economic and Social Council of Ireland, or also at a lower level through dialogue between the public and private sectors in the agencies and through participation on their boards of directors, is recognized as a fundamental element: it generates mutual trust among stakeholders, and, at the same time, creates a collective commitment to the success of programmes and policies. Lastly, an important element for the effectiveness of these is evaluation and transparency. This practice is usually conducted through national or international consultants that are external to the agency, and through the systematic construction of indicators of policy efficacy, which are related to the effect and actual results and are usually accessible to the public.

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