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Expanding Trade Opportunities in Latin America and the Caribbean

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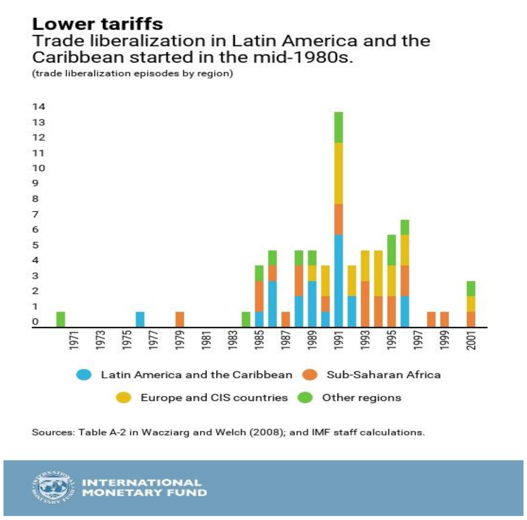
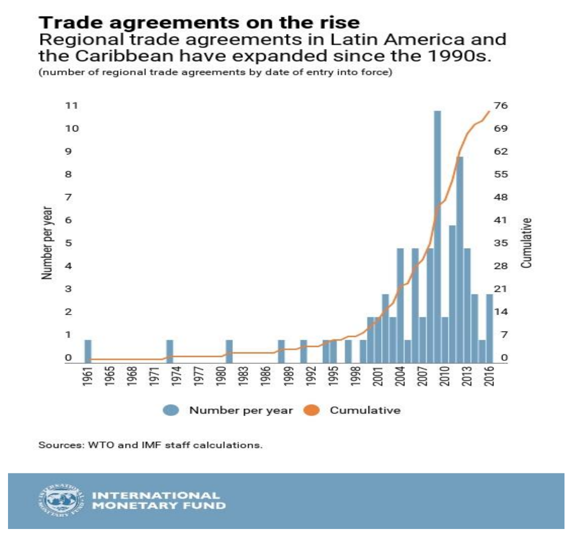
Trade has helped drive economic growth in advanced and developing economies. But not all regions have taken advantage of this opportunity. Latin America and the Caribbean trade less among countries within the region as well as with other countries. The region is therefore losing out on a critical ingredient to reinvigorate its growth.

A new IMF report looks at trade integration in Latin America and the Caribbean. It draws on a large set of analytical studies, as well as a survey of officials from the region on trade policies and strategies. The report finds that further trade integration can help stimulate growth in Latin America, especially given the lackluster regional and global economic outlook. The report also recommends policies to strengthen Latin America's trade ties while ensuring that the benefits of trade are spread equitably.

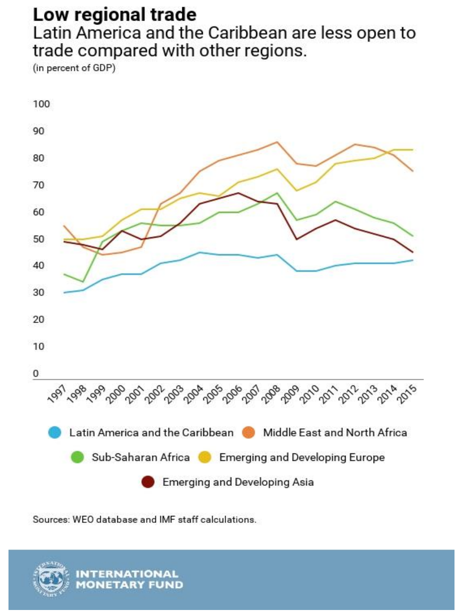
Lagging behind other regions

Latin America and the Caribbean underwent a trade liberalization wave starting in the late 1980s and sharply expanded its network of regional trade agreements since the 1990s. Import tariffs declined from a weighted average of around 12 percent in the late 1990s to about 6 percent in recent years





Despite this progress trade represents only about 44 percent of regional GDP, well below many other emerging market regions. In addition, only about 15 percent of Latin America and the Caribbean's exports are destined to countries within the region, compared with over 50 percent of total exports in developed Europe and Asia.



To some extent, this performance reflects the dominance of commodity exports for many countries in the region, the presence of significant geographical barriers, and the region's relatively limited participation in global value chains, in which trade is associated with multicountry production operations. In addition, the large economies in South America, particularly the Mercosur countries, are significantly less open to trade compared to countries in Central America and the Caribbean, have higher import tariffs, including for capital and intermediate products, and are not as well-linked via agreements with the rest of the region. Thus, none of the large countries in Latin America have emerged as a trading hub, in contrast to China and South Africa in their respective regions.

Boosting growth with regional integration

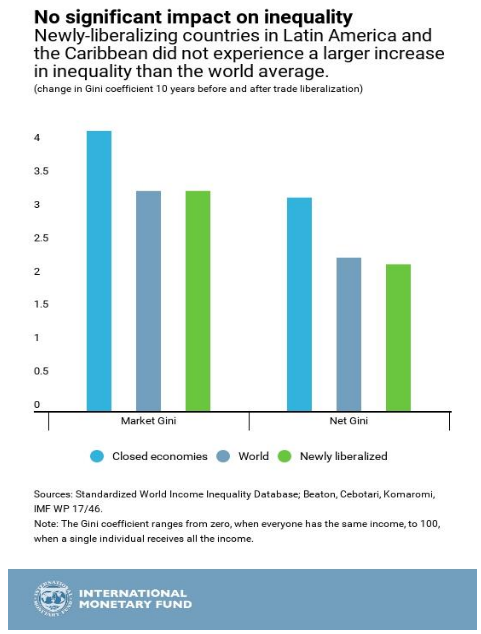
IMF research finds that trade integration can spur economic activity. While enhancing trade with advanced economies may offer the greatest potential for Latin America and the Caribbean to benefit from knowledge and technology spillovers, regional integration may provide a greater opportunity to reap the growth benefits of trade given the current juncture. In fact, our estimates show that bringing Latin America and the Caribbean's regional integration and participation in global value chains in line with that of the highly integrated Asian region can each have the potential to increase the region's average per capita growth by about 1 percentage point.

The current downturn in commodity prices has also highlighted the importance of export diversification. Estimates suggest that diversifying the region's export basket by 25 percent, for example, could potentially increase real per capita growth by 1 percentage point.

Impact on income inequality

As income inequality in Latin America and the Caribbean, as measured by the Gini coefficient, is already among the highest across regions, can the region pursue stronger trade integration without adversely affecting its income distribution? Our analysis for countries across the world consistently suggest that trade openness does not adversely impact aggregate income inequality.

Following trade liberalization events, the changes in income inequality experienced by newly-liberalizing countries in the region have mirrored global trends. In other words, more open trade was not the primary driver of rising aggregate inequality. Even so, trade openness may have different impacts across industries that lead to winners and losers within an economy even if an economy benefits from enhanced trade at the aggregate level.



Trade and worker-friendly policies

Our report identifies a number of policies to foster trade and help workers adjust to economic change.

Regional integration. The time is ripe for a renewed emphasis on regional integration in Latin America and the Caribbean and efforts to create regional value chains. These would provide technological spillovers and broaden the participation of smaller firms in trade. In recent years, the region has focused on pursuing additional bilateral trade agreements rather than on untangling its complex "spaghetti bowl" system of bilateral and multilateral trade agreements, each with distinct rules. With the eventual objective of a regional trade agreement in mind, countries could work to harmonize existing trade rules, strengthen linkages between regional blocs, and remove the remaining tariff and non-tariff barriers to intra-regional trade.

Non-tariff trade policies. The Asian experience demonstrates the importance of private sector-led regional integration and the linkages between regional trade and investment. Agreements between countries in Latin America and the Caribbean, which address issues such as investment rules and competition policy, would therefore be important in facilitating cross-border investment and production chains. Beyond trade agreements, strengthened cooperation on regulatory issues and standards, trade facilitation, and improvements in the region's connectivity, are initiatives where progress could be made outside the traditional trade negotiation arena.

Unilateral liberalization. Greater regional integration is not incompatible with a push to increase trade integration with the rest of the world. There is scope for countries in the region to liberalize trade on a unilateral basis, particularly in countries where tariff barriers on intermediate goods are high and non-tariff barriers have proliferated in recent years.

Infrastructure and human capital development. In our survey, country authorities frequently mentioned these two areas as major constraints on exporting. Empirical evidence also bears this out; upgrading infrastructure would reduce trade costs, facilitate production chains, and stimulate exports from industries with high value added, as would investing in improvements in the skills base.

Support for workers. Managing the distributional effects of trade through labor market policies and social safety nets is critical to ensuring that the gains from trade benefit all. Country officials in the region suggest a lack of adequate attention to this issue in the past. Moreover, future trade liberalization can proceed under less favorable global growth prospects, which may bring more attention to the human and economic downsides by a more skeptical public. Smoothing the adjustment process for those workers and industries negatively affected by trade liberalization will also help reinforce support for free trade in the region.

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