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## TRADE DEVELOPMENTS IN LATIN AMERICA AND THE CARIBBEAN

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# TRADE DEVELOPMENTS IN LATIN AMERICA AND THE CARIBBEAN<sup>1</sup>

*Trade has slowed in the LAC region over the past several years, mostly reflecting global economic developments—including sluggish output growth, lower commodity prices, and weak investment. Structural factors—such as a slower pace of trade liberalization and transportation cost reductions, and an increase in trade protection and trade costs—have also contributed to lower trade growth in LAC and other countries. Given a weak outlook for economic growth, LAC’s prospects for better trade performance will require reinvigorating its trade policy agenda and making progress on trade barriers and other trade costs.*

## A. LAC Trade in the Global Context

### 1. In the post crisis period, global trade growth slowed in both nominal and real terms.

Global trade in values has declined sharply since 2011, posting an 11 percent drop in 2015, the second largest fall since 1950 (after the 23 percent contraction during the Global Financial Crisis (GFC)). A large part of the decline reflects valuation effects, with fuel and metals prices falling by 44 percent and 23 percent, respectively (Figure 2, panel d) in 2015. In addition, trade in volumes has also decelerated. Real global trade growth slowed to 3 percent on average between 2012-2015, half of its average annual growth rate in the pre-crisis period (2002-2007) (Figure 2, panel a), mostly due to sluggish global GDP growth (IMF 2016a). Among other reasons, changing consumption patterns, due to the growing aging populations, have increased the relative demand for nontradable goods.

**2. Trade patterns in Latin America and the Caribbean (LAC) have closely mirrored those in the rest of the world.** Growth in trade values and volumes in LAC have significantly declined in the last several years. Real trade in LAC contracted in the last three years at an annual average growth rate of 2.7 percent, driven by very weak imports, in contrast to other regions, which eked out broadly stable import volumes. LAC’s contraction in real imports is partly a consequence of the region’s economic underperformance relative to other developing economies, as the LAC region has been adjusting to the slump in commodity prices, the correspondingly wealth effect through currency depreciation, and recessions or below potential growth in Brazil, Argentina and Venezuela, which represent slightly more than 50 percent of the region’s economy. The pass-through of the exchange rate on inflation has resulted in higher levels of inflation through increased import prices. This, combined with subdued economic growth, negatively affected investment, and hence, import demand has been flat or negative.

### 3. In recent years, the fast pace of global trade growth relative to GDP growth has ended.

The ratio of import growth to GDP growth fell from an average of 2.3 during 2002-2011 to an

<sup>1</sup> Prepared by Daniela Estrella Morgan. I would like to thank Ana Ahijado for useful inputs and Valerie Cerra for helpful suggestions. This paper was prepared as a background study for the Western Hemisphere Department’s Cluster Report on Trade Integration in Latin America and the Caribbean. This paper describes research in progress by the author and is published to elicit comments and to encourage debate. The views expressed in this paper is that of the author and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

average ratio of 1.2 during 2012-2016. Although this ratio has declined for all regions, trade volumes grew significantly less than real GDP in Emerging Asia during 2013-2015, a dramatic shift in behavior relative to the period 1980-2012. In LAC, both real GDP and real imports contracted during the last two years; however, imports contracted at a higher rate. In contrast, in Advanced Economies, trade volumes still slightly outpaced real GDP. Even so, the contribution to global trade growth from emerging and developing countries has dropped from around 40 percent before the global financial crisis (2002-2007) to 30 percent in the recent years (2012-2016).

**4. Sluggish private investment in many advanced and emerging market economies contributed to the decline in the growth of trade relative to GDP (IMF, 2016a).** Private investment is more trade-intensive compared with other expenditure components of demand, especially public spending, which is directed more toward non-tradable goods (ECB, 2016). Investment is highly pro-cyclical whereas public expenditure may be countercyclical in countries that have fiscal space to stimulate the economy when growth falls below potential. Consistent with slow investment growth since the GFC, trade in capital and intermediate goods have slowed more than trade in consumption goods (IMF, 2016a). China's process of rebalancing from investment to consumption-led growth has also played a role in this trend, as well as the fall in commodity prices. Investment and its related import demand in LAC have been suppressed in response to the drop in commodity prices and economic recessions in major economies of LAC.

**5. The creation of global value chains (GVCs) boosted trade during the last two decades, but may have run its course in recent years (IMF, 2016a).** Global value chains (GVC) describe the fragmentation of production processes in which intermediate goods are shipped across borders multiple times, with each exporting country adding value along the production chain to final consumption (ECB, 2016). During the 2000s, intermediate goods from emerging economies joined global production processes at a faster pace than those from advanced economies. However, GVC creation has stalled since 2011 (ECB, 2016), especially in China, in which imports of parts and components in total exports decreased from 60 percent in the mid-1990s to 35 percent in 2015 as Chinese firms substituted from foreign inputs to domestic inputs (Constantinescu et. al, 2015). This trend reflected a sharp reduction of transport and communication costs in the interior of China relative to the rest of the world, leading China's coastal regions to source relatively more inputs from the Chinese interior (Kee and Tang, 2014). The pace of production fragmentation also matured due to increasing labor costs in key emerging markets. LAC's participation in GVCs has lagged behind other emerging regions and has stalled in countries like Argentina, Bolivia, Uruguay and Venezuela (Figure 5). Thus, LAC may still have room to enhance participation in GVCs.

**6. Foreign direct investment flows have also been strongly linked to trade in LAC.** FDI rose sharply in most regions of the world, including LAC, from the late 1990s until the GFC. FDI has been linked in part to GVC creation and international vertical specialization, spurred by the information and communication technology shock. FDI in LAC has also reflected investment in natural resource sectors, especially during the commodity boom. FDI is still growing in Emerging Asia, but has tapered off in LAC as the commodity cycle has reversed and economic growth weakened (Figure 4).

**7. In the Caribbean and Central America, service sector exports have significantly increased in importance, with the share approaching nearly half of total exports.** In comparison, the share only increased from 18 percent in 1975 to 26 percent in 2015 in advanced economies, and has not surpassed 16 percent in South America, emerging and developing Asia, MENA, and SSA. Services trade in Caribbean and Central America mainly reflects tourism (Figure 6). While these exports depend somewhat on economic cycles in the U.S., Canada, and some other advanced economies, they are less volatile than commodity exports or manufacturing sector goods (IMF, 2016a). Thus, the global trade slowdown has been less severe for services than goods exports.

## B. Trade Links and Spillovers

**8. Globalization has increased the importance of analyzing economic spillovers, including the transmission of shocks through trade linkages across countries.** Advanced economies have represented a large share of import demand. However, since 2000, developing and emerging economies, mainly those from developing Asia, increased their share in global trade. In fact, China's share of world imports in real terms increased from 2 percent in 1998 to more than a quarter (27 percent) of total imports in 2015.

**9. The United States and China are key trading partners for many countries in LAC.** The United States is an important trading partner for South America as it imports oil from Ecuador, Venezuela and Colombia, and manufactured goods from Peru, Chile and Brazil. China is also an important export destination for several countries in the region, especially since China has represented more than half of global demand for major base metals in recent years. For example, Chile and Peru are the world's largest and third largest copper producers, respectively, while Brazil is third largest in iron ore production. In 2015, exports to China from Chile, Peru, and Brazil represented 8 percent, 5 percent, and 2½ percent of each country's GDP, respectively. Therefore, China's economic transition to a more sustainable growth path, based on consumption rather than investment, is likely to have a significant effect on mineral-exporting countries like Chile, Peru and Brazil, through its impact on commodity prices and lower demand.

**10. The largest economies in LAC, Brazil, Argentina and Mexico, have not played the same role as regional trade hubs as China has done for developing Asia.** Brazil and Mexico are top-five trading partners for no more than 12 regional partners (IMF, 2015a). For Mexico, this mostly reflects its very strong trade relationship with the United States. The countries from the Southern Cone (Paraguay, Uruguay, Argentina and Bolivia) have significant trade linkages with Brazil, but the exchange of goods and services from the rest of the region with Brazil is weak.

**11. Intra-regional trade could also imply additional indirect exposures to China and the U.S.** Indirect exposures reflect trade links of other countries in the region with China and the U.S. Adler and Sosa (2012) measure country *i*'s indirect exposure to China as the weighted average of country *i*'s trading partners' direct exposures to China, multiplied by the share of each trading partner in country *i*'s total exports. According to this measure, overall exposure to China and US almost double for the Southern Cone countries while the effect is minimum for the Andean Countries (Chile, Peru, Colombia, Ecuador and Venezuela).

## C. Trade Barriers Developments

**12. Structural factors have also contributed to global trade developments, including the recent trade slowdown.** According to Constantinescu et. al (2015), nearly half of the trade slowdown relative to GDP growth can be accounted for by structural factors that raise barriers or costs of trade. These trade barriers include policy barriers, transportation costs, and trade and transaction costs.

**13. LAC and emerging Asia engaged in strong trade liberalization in the 1990s, focused on the reduction of tariffs, through either unilateral actions or trade agreements.** Consequently, the weighted average tariff in the world fell from around 12 percent in 1994 to 5 percent twenty years later. Although tariff reduction has been a trend within LAC, there has also been heterogeneity. For example, Peru reduced its weighted average tariff to less than 2 percent in 2015, but Brazil has maintained its tariffs at a weighted average around 8 percent during the last 10 years. Tariffs reductions have stalled since the global financial crisis.

**14. Recent trade agreements have been deeper and include more trading partners.** The number of regional trade agreements (RTAs) increased until the global financial crisis. The average number of physical RTAs that entered into force during the last two decades was approximately 12 per year. LAC broadly maintained its pace of new trade agreements before and after the crisis. Between 2000 and 2007, LAC signed almost 3 RTAs on average per year while between 2010-2016, it signed an average of 4 RTAs per year.

**15. However, non-tariffs barriers (NTBs) have been increasing.** Sanitary and phytosanitary (SPS) and technical barriers to trade (TBTs) have become the most common non-tariff measures. SPS measures are those applied to protect humans, animals, and plants from diseases, pests and contaminants or measures to protect biodiversity. TBTs include technical regulations such as labelling requirements, standards on technical specification, certification, and quality standards, as well as environmental protection. SPS and TBT measures often have objectives other than creating explicit trade barriers. They contrast with past trade barriers such as import quotas, which had been used to protect domestic industries, and domestic subsidies and antidumping laws imposed to enhance domestic production. SPS and TBTs are the most common NTBs in South America. Brazil has the highest number of NTBs in place, around 1800 non-tariff measures, which together with the highest weighted average tariff of the region may contribute to Brazil's low openness.

**16. The decline in transportation costs, which also spurred trade during the previous two decades, appears to have faded since the global financial crisis.** Costs to export and import have both marginally increased from 2011 to 2014 in most of the regions, including in LAC, where costs to trade (in US\$ per container) have increased 8 percent on average. The number of documents and days needed to trade in LAC is much higher than in North America, although LAC's costs are in line with other emerging regions.

**17. Trade may be constrained by domestic factors such as the quality of trade and transport infrastructure, efficiency of customs management and quality of logistic services.**

The World Bank has developed the Logistic Performance Index (LPI) in order to identify the challenges and opportunities countries face in their performance on trade logistics. The index ranks 160 countries on six different components: customs, infrastructure, ease of arranging shipments, quality of logistics services, tracking and tracing, and timeliness.

**18. LAC ranks poorly on some LPI indicators, but there is heterogeneity in the region.** LAC is particularly weak in its customs efficiency compared to other regions with Venezuela, Argentina and Brazil having the lowest scores. The quality of port infrastructure is below the world average, although Chile, Ecuador and Uruguay score reasonably well on this indicator. South America and Panama are perceived as better than the Caribbean and Central America in facilitating trade through domestic factors.

**19. Chile and Panama perform well in some components of the World Economic Forum's Enabling Trade Index.** Chile has the second highest score in market access, implying that the level of tariff protection Chile imposes and the tariff barriers it faces are amongst the lowest in the world. Peru follows closely in the fourth position. Chile also stands out in the region in terms of efficiency and transparency of customs, although it ranks lower than some developed economies like Singapore, Japan, Hong Kong, United States and Germany. Panama is the highest ranked country in availability and quality of transport infrastructure, mainly reflecting the importance of the Panama Canal, although it would need to improve the movement of goods within the country and across the border and offer better trade-related services.

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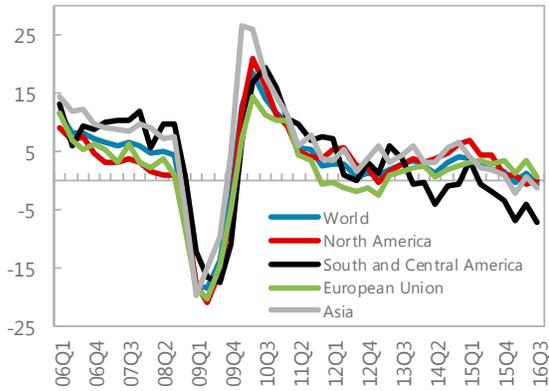
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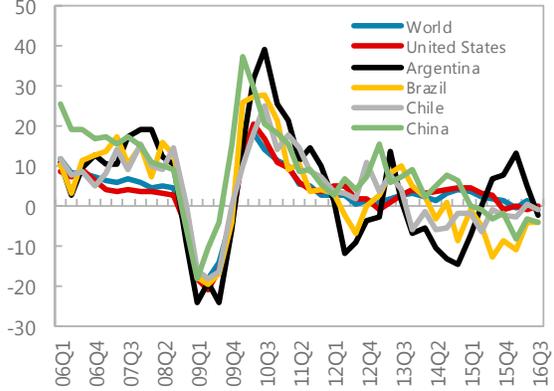
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**Figure 1. Real Growth of Trade by Region and Selected Countries**

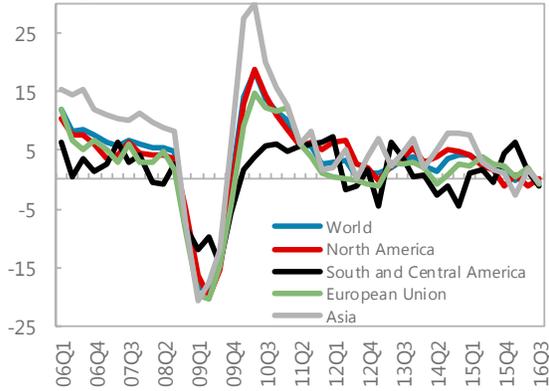
**Trade volume by region**  
(annual growth rate)



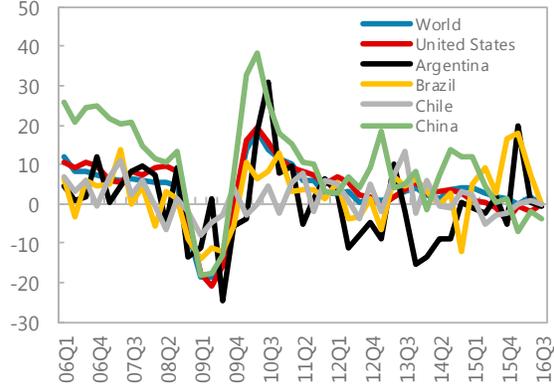
**Trade volume by country**  
(annual growth rate)



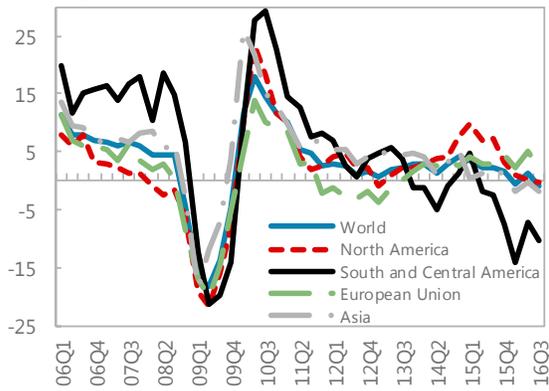
**Exports volume by region**  
(annual growth rate)



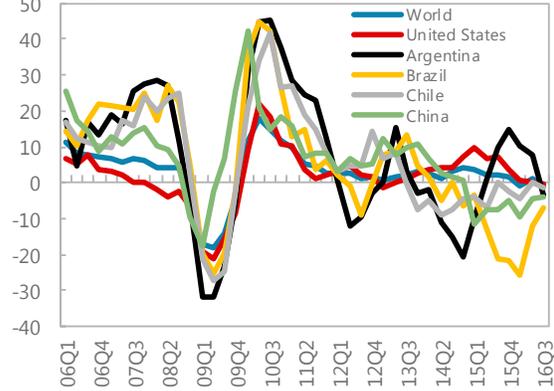
**Exports volume by country**  
(annual growth rate)



**Imports volume by region**  
(annual growth rate)



**Imports volume by country**  
(annual growth rate)

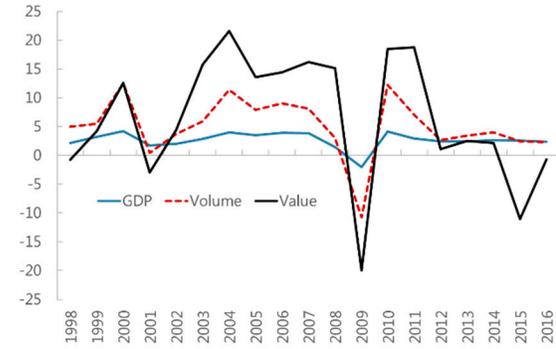


Source: World Trade Organization (WTO) and Fund Staff calculations.

**Figure 2. GDP Growth Rate, Contribution and Commodity Prices**

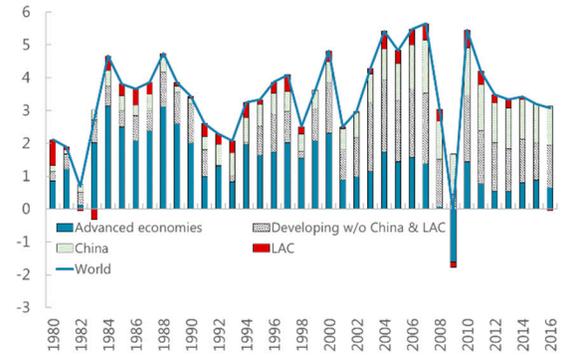
**World GDP and global import growth**

(annual percentage change)



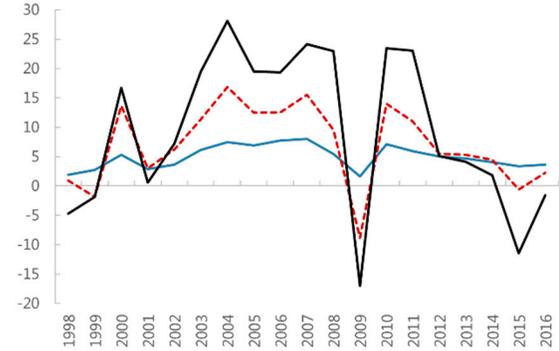
**Contribution to World GDP growth**

(percentage points)



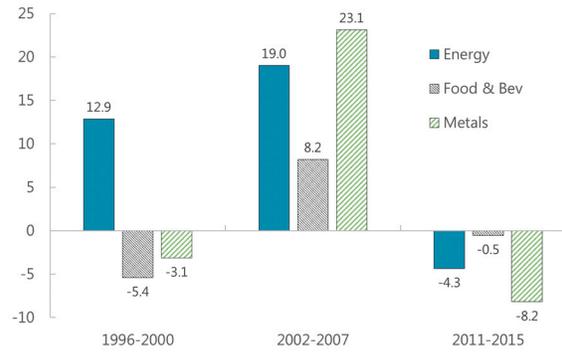
**Developing Economies GDP and import growth**

(annual percentage change)



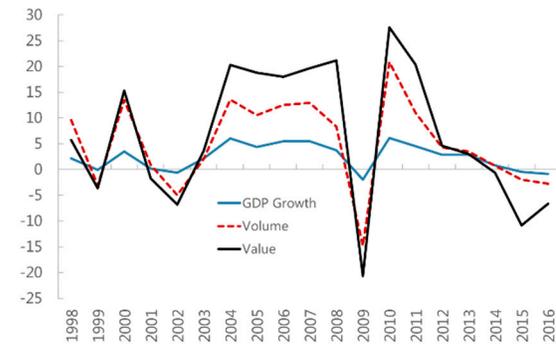
**Commodity price indexes**

(average annual growth rate)



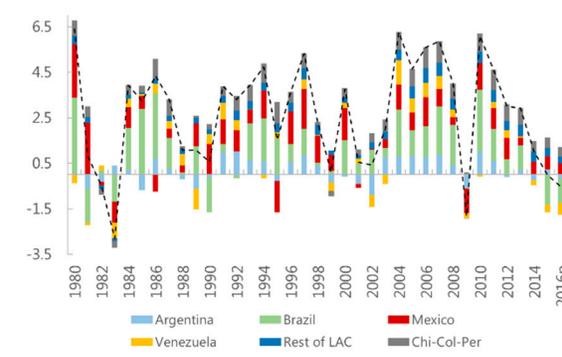
**LAC GDP and import growth**

(annual percentage change)



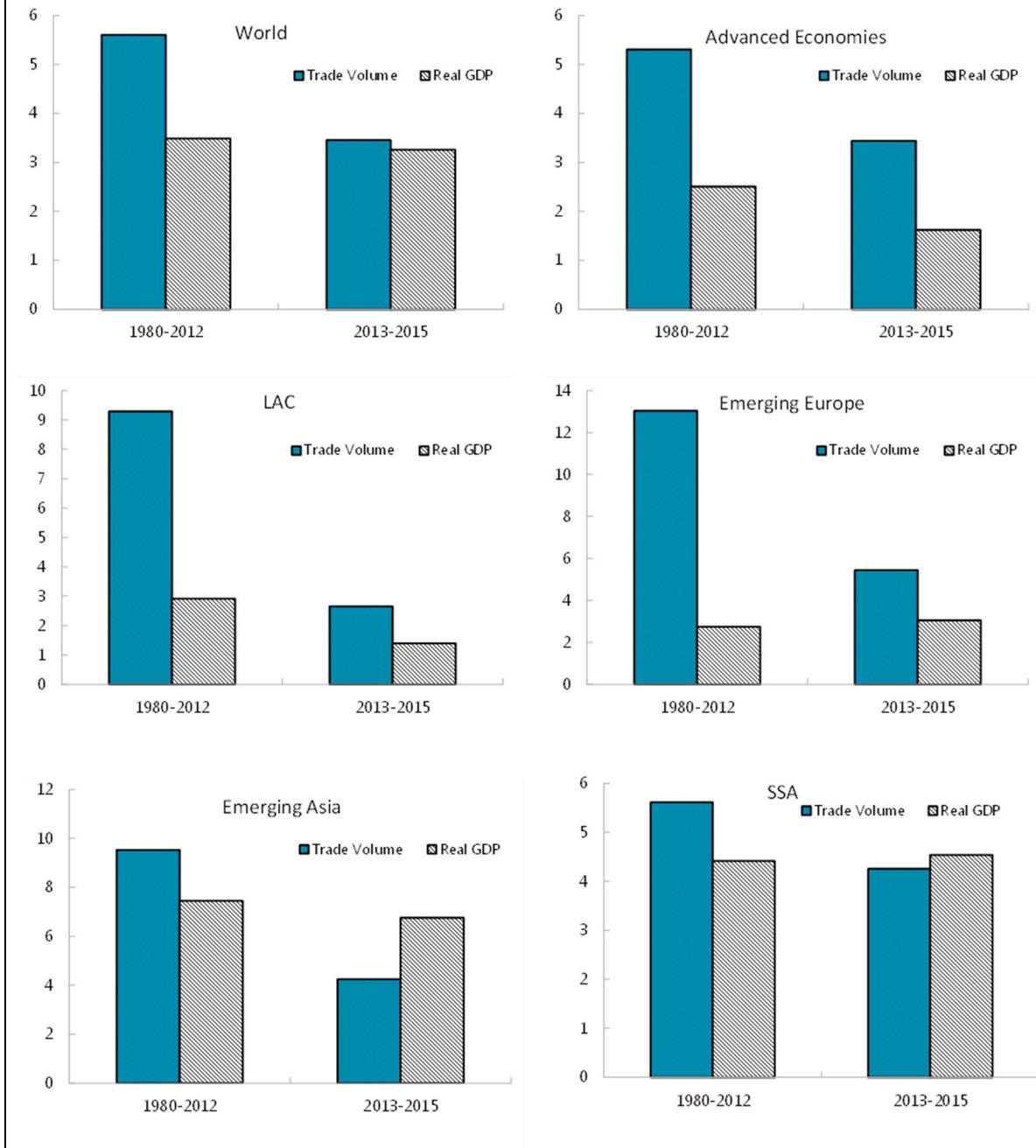
**Contribution to LAC GDP growth**

(percentage points)



Source: WEO database and Fund Staff calculations

**Figure 3. Real Trade and Output Growth**  
(Year on Year percent change)

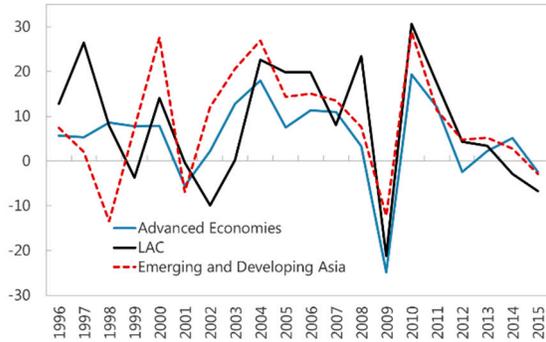


Source: WEO database and Fund Staff calculations.

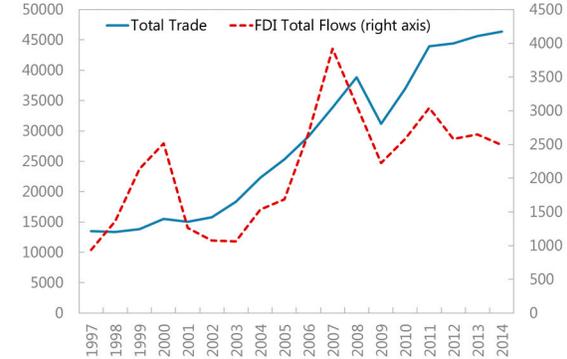
\* Trade of Goods and Services.

**Figure 4. Trade Relationship with Investment and FDI**

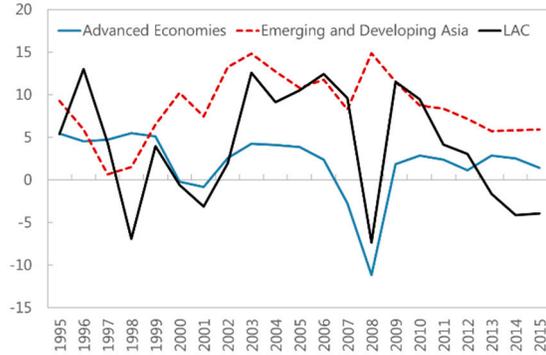
**Machinery and equipment imports**  
(nominal annual growth rate)



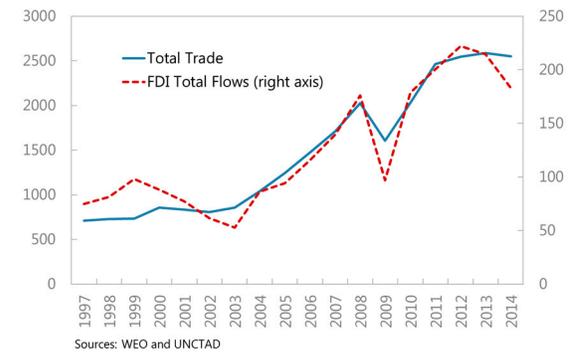
**World: Total trade vs Total FDI**  
(Billions USD)



**Gross fixed capital formation**  
(real annual growth rate)

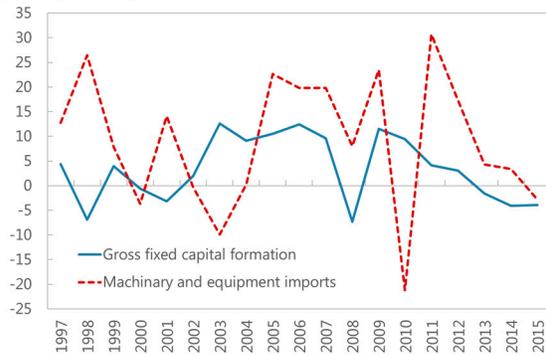


**LAC: Total Trade vs Total FDI**  
(Billions USD)

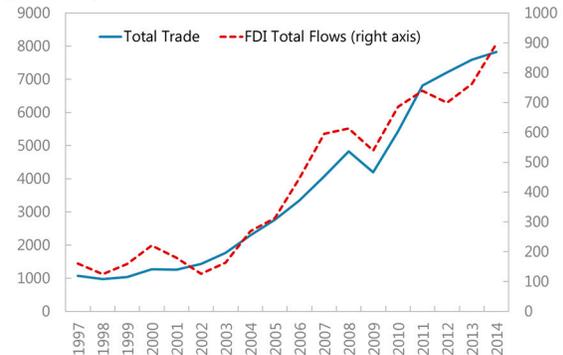


Sources: WEO and UNCTAD

**LAC: Real investment vs mach. and eq. nominal imports**  
(annual growth rate)



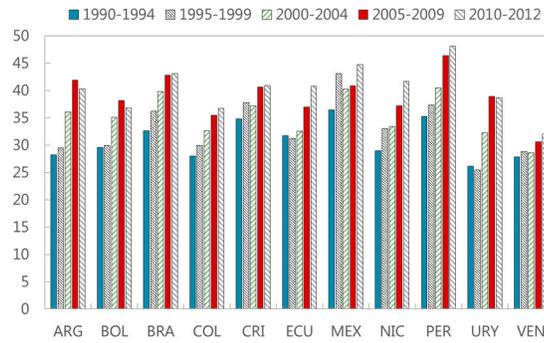
**Emerging Asia: Total Trade vs Total FDI**  
(Billions USD)



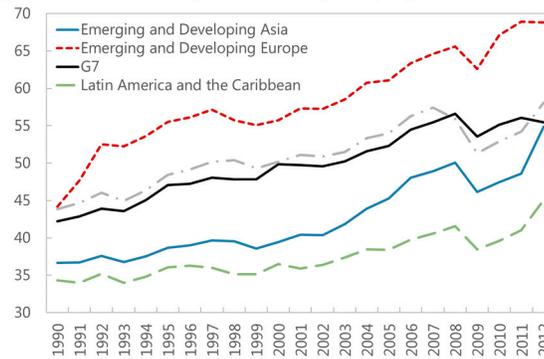
Source: WEO database, UNCTAD and Fund Staff calculations.

**Figure 5. Global Value Chain's Indicators**

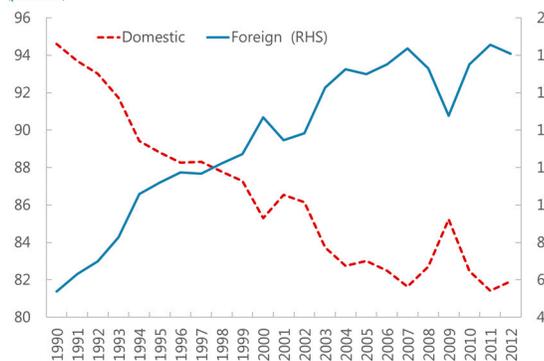
**Global value chain participation index by country**  
(share of domestic and foreign value added in gross exports)



**Global value chain participation index by region**  
(share of domestic and foreign value added in gross exports)

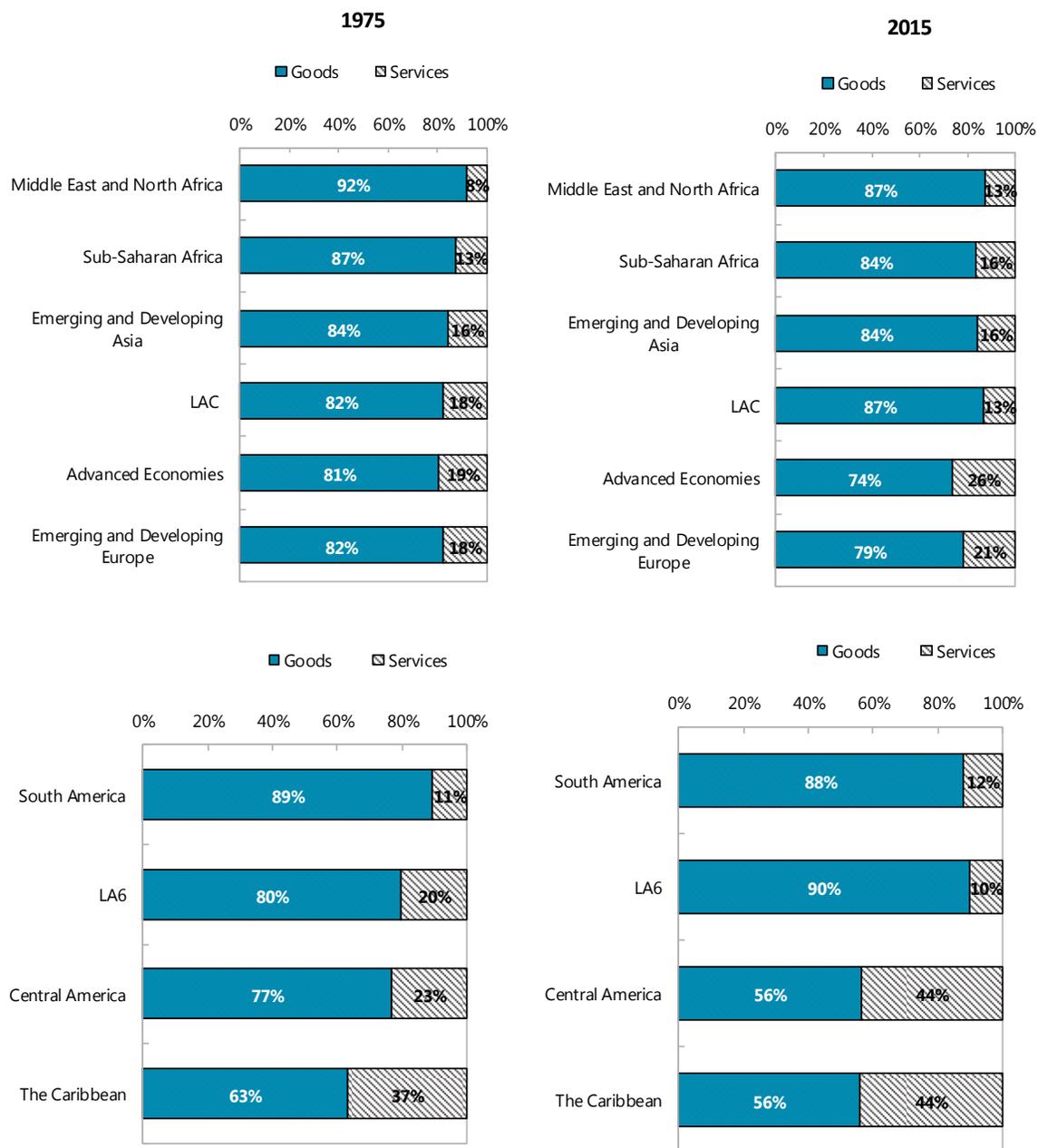


**China: Global value chain participation by source of input**  
(percent)



Source: Novta and Rodrigues Bastos (2016) and Fund Staff

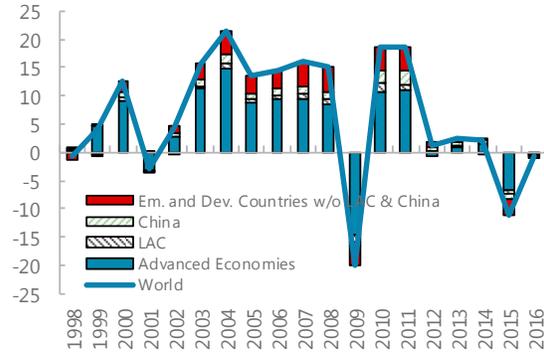
**Figure 6. Goods and Services Share of Exports**  
(In percent)



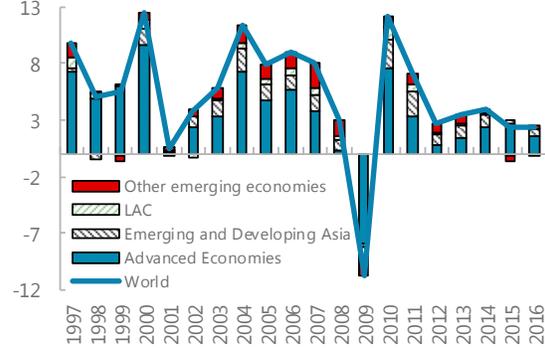
Source: WEO database and Fund Staff calculations.

**Figure 7. Contribution to Trade by Region and China's Importance in Global Trade**

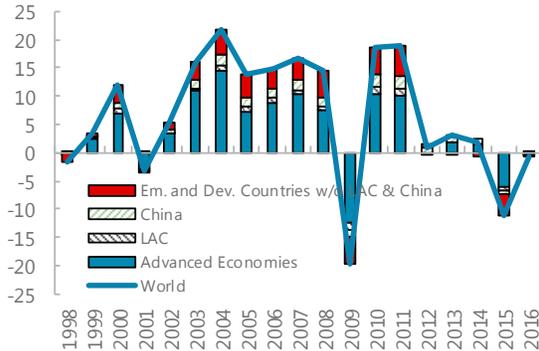
**Contribution to nominal imports growth**  
(percentage points)



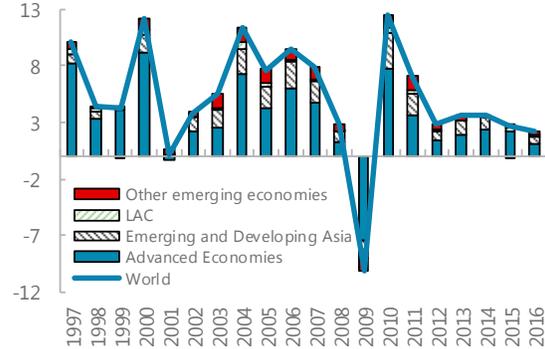
**Contribution to real imports growth**  
(percentage points)



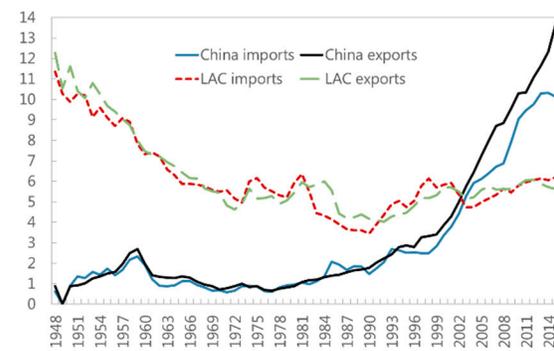
**Contribution to nominal exports growth**  
(percentage points)



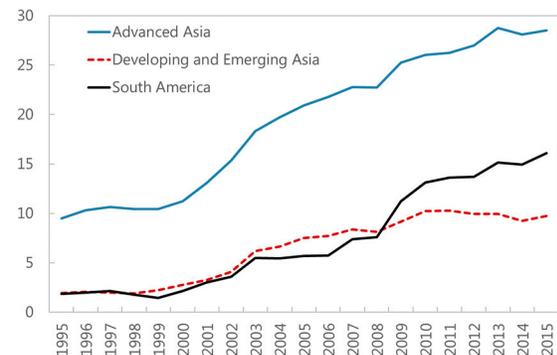
**Contribution to real export growth**  
(percentage points)



**Share of nominal world imports/exports**  
(percentage of total imports/exports)



**Export to China as a share of total exports**  
(percentage)

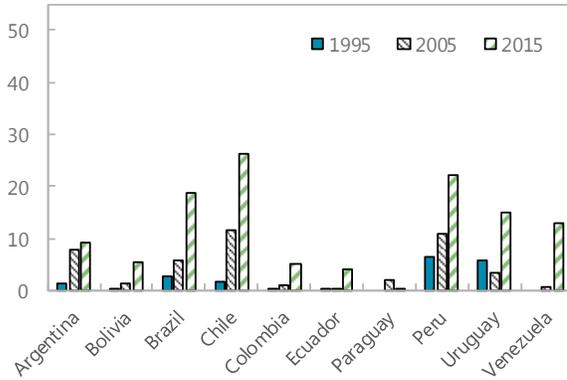


Source: WEO database, UNCTAD and Fund Staff calculations.

**Figure 8. South America's Exports: Direct Exposure**

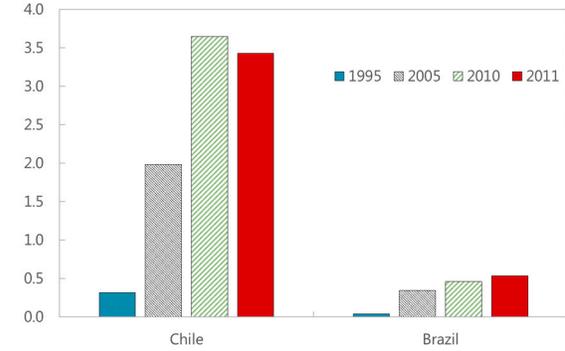
**Direct trade exposure to China**

(exports to China as a percentage of total exports by country)



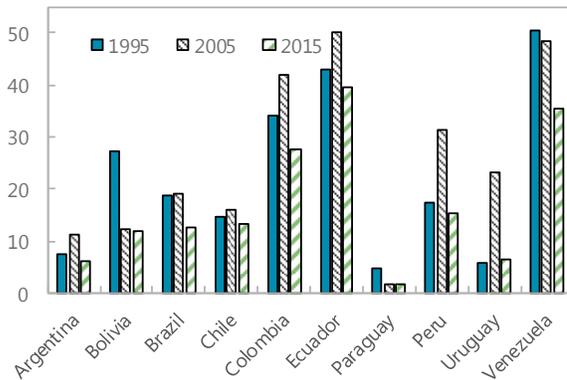
**Value-added embedded in China's exports**

(percent of GDP)



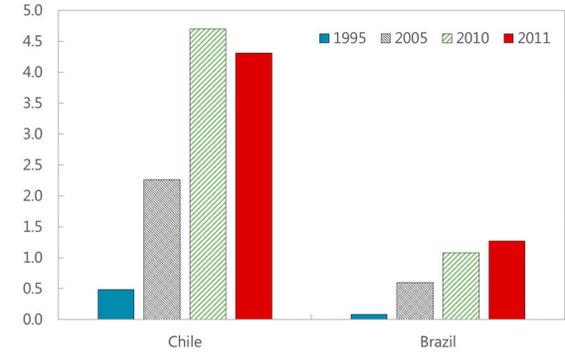
**Direct trade exposure to United States**

(exports to USA as a percentage of total exports by country)



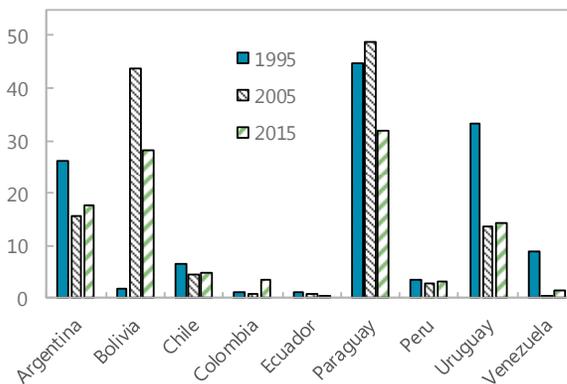
**Value-added embedded in China's domestic demand**

(percent of GDP)



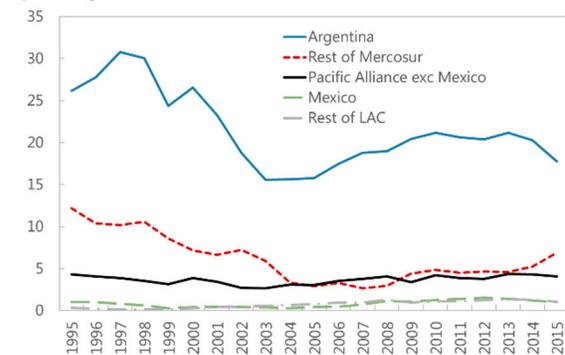
**Direct trade exposure to Brazil**

(exports to Brazil as a percentage of total exports by country)



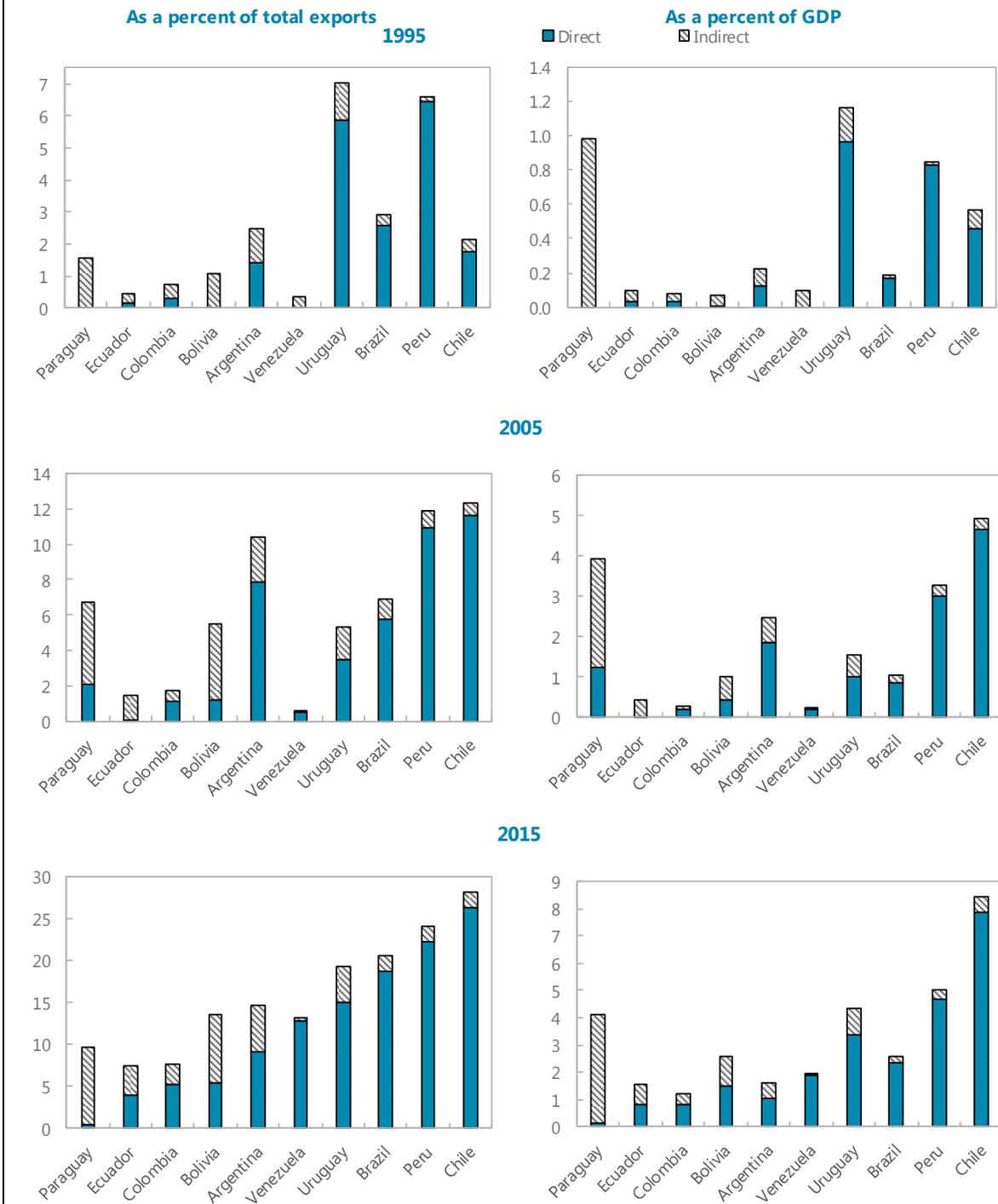
**Exports to Brazil as a share of total exports**

(percentage)



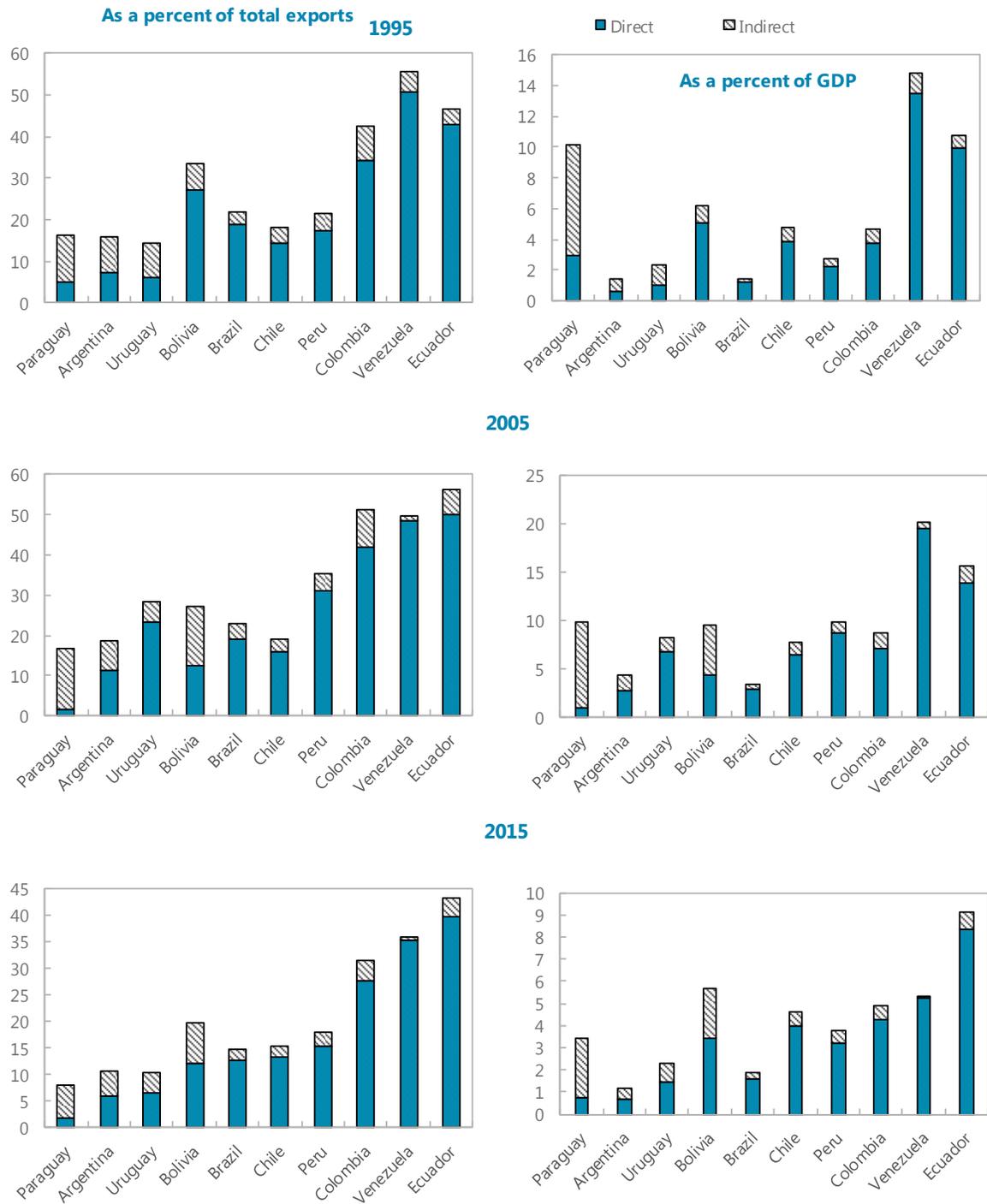
Source: IMF DOTS, WEO database, OECD TiVA database and Fund Staff calculations.

**Figure 9. South America's Exports: Exposure to China**



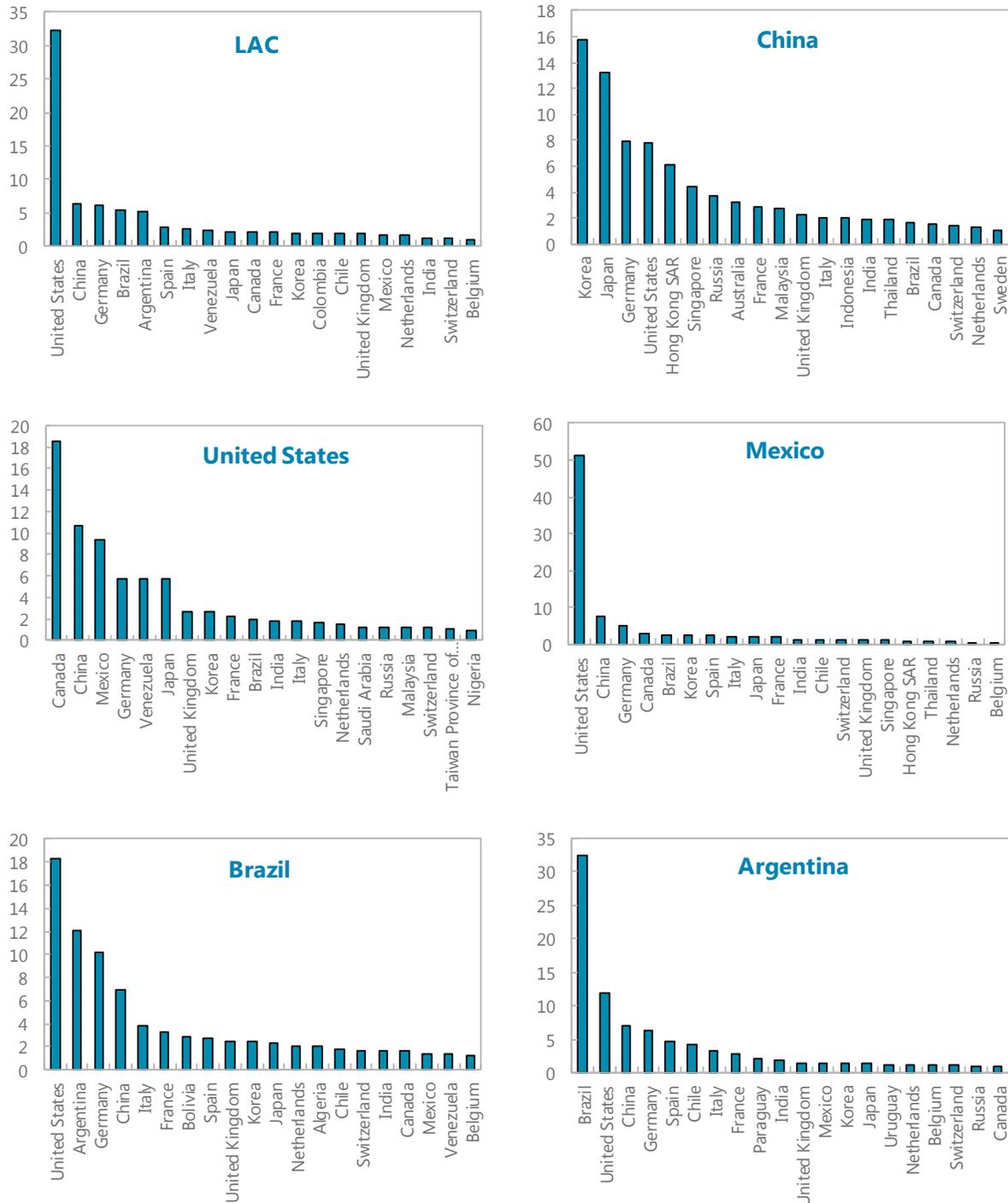
Source: IMF DOTS, WEO database and Fud Staff calculations.

**Figure 10. South America's Exports: Exposure to USA**



Source: IMF DOTS, WEO database and Fund Staff calculations.

**Figure 11. Top 20 Import Origins of Intermediate Goods in 2012**  
(Percent of total imports)

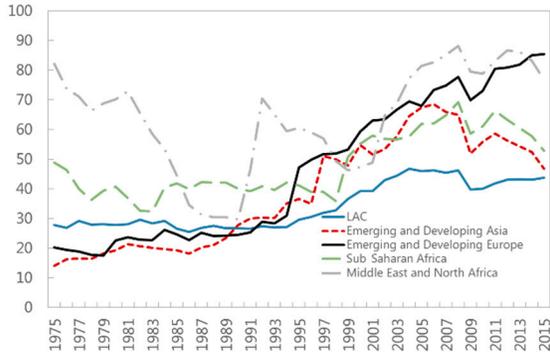


Source: EORA database and Fund Staff calculations.

**Figure 12. Trade Openness and Structural Factors Behind Trade Slowdown**

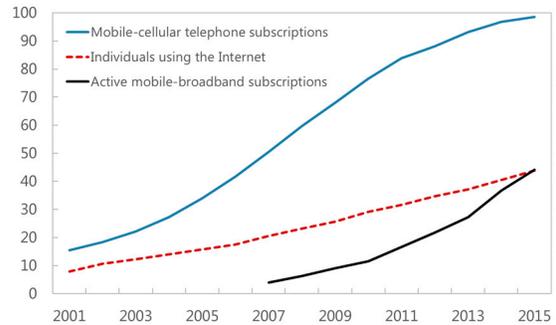
**Trade Openness**

(as a percent of GDP)



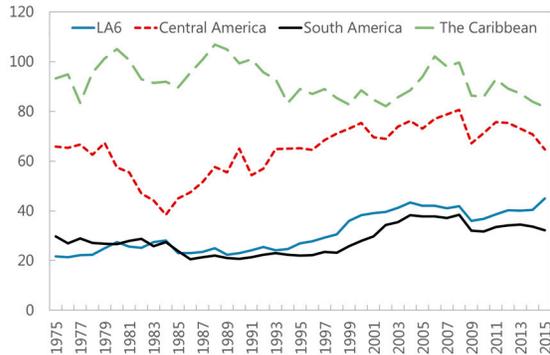
**Global ICT developments**

(per 100 inhabitants)



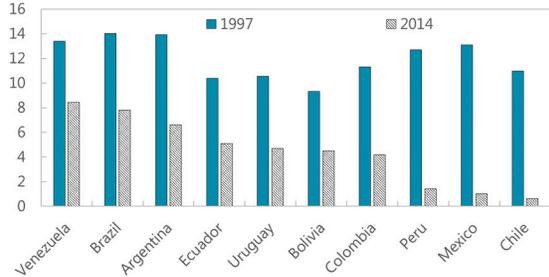
**LAC: Trade Openness**

(as a percent of GDP)



**Weighted average tariff**

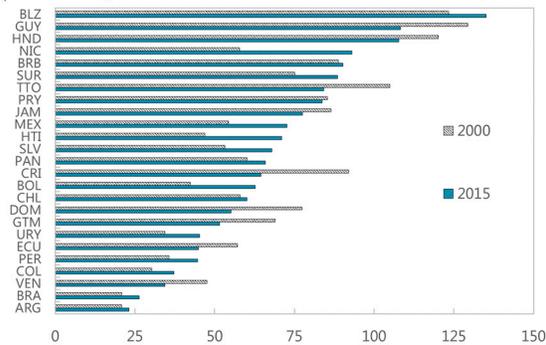
(percent)



Sources: World Bank's WITS database and Fund Staff calculations.  
1/ Effectively Applied Weighted Average tariff (%): The average of tariffs weighted by their corresponding trade value figures.

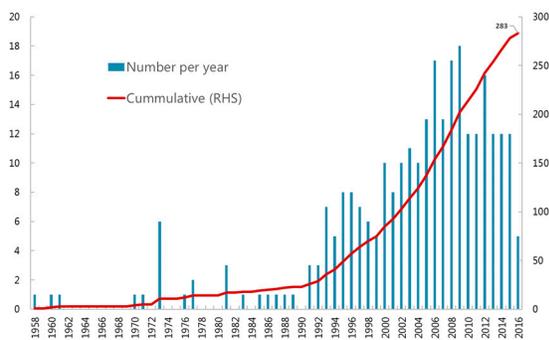
**LAC: Trade Openness**

(percent of GDP)



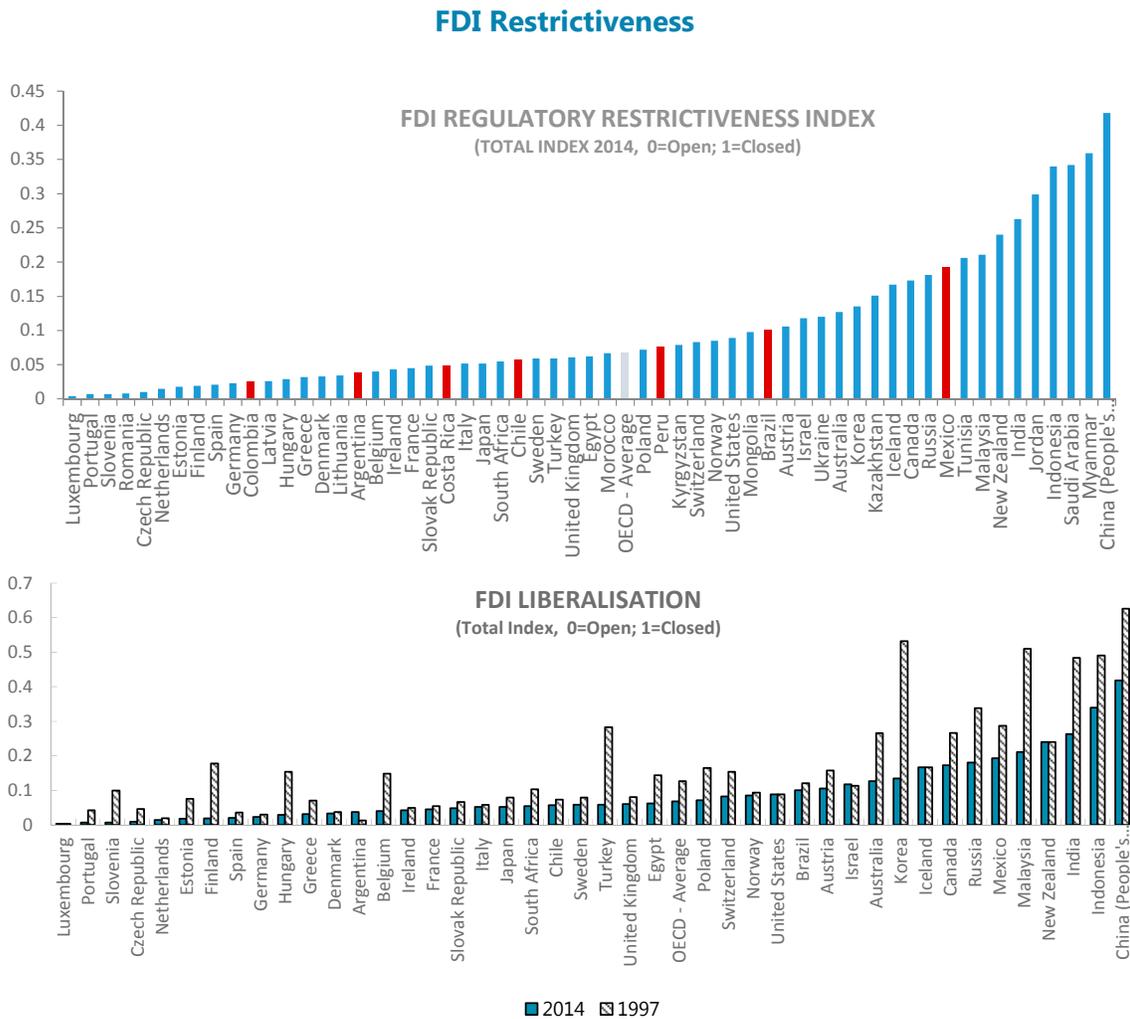
**Global Regional Trade Agreements (RTAs) by date of entry in force**

(number)



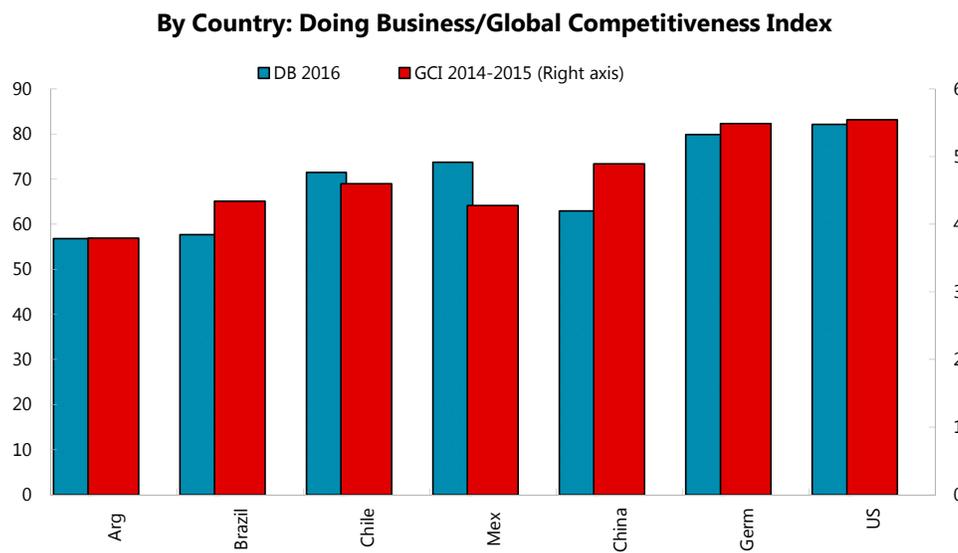
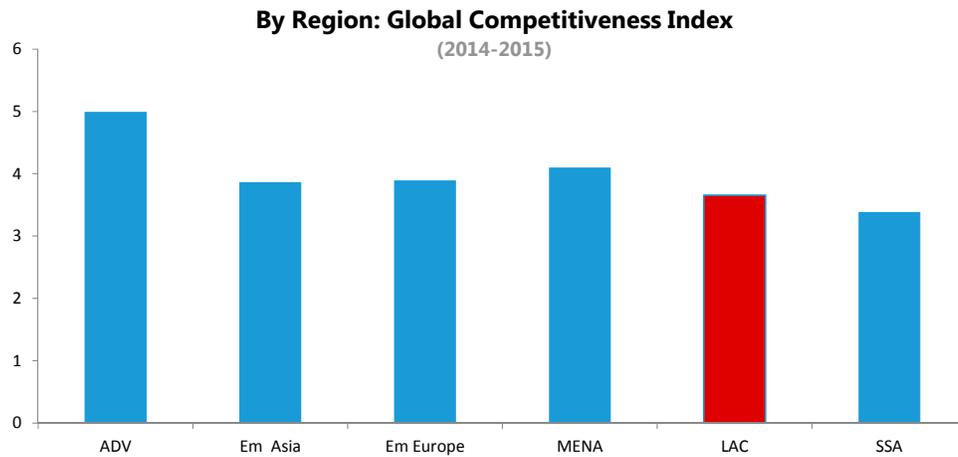
Source: WEO database, World Bank's WITS database, ITU World Telecommunication/ICT indicators database, WTO and Fund Staff calculations.

Figure 13. FDI Restrictiveness



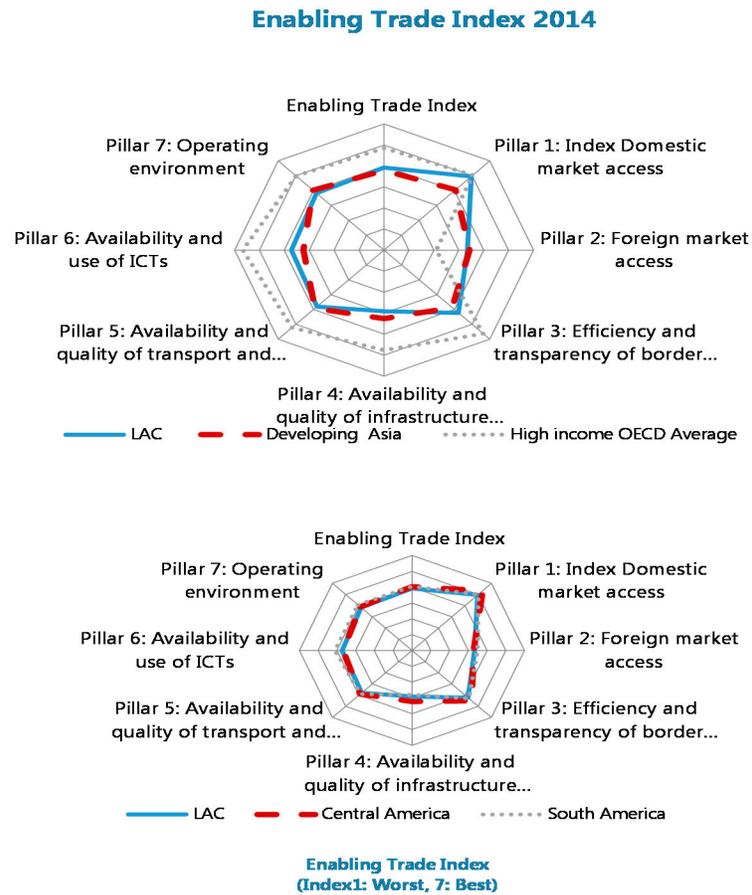
Source: OECD FDI Restrictiveness Index and Fund Staff calculations.

**Figure 14. Competitiveness and Doing Business Ranks**



Source: World Bank Doing Business 2016 and World Economic Forum Global Competitiveness Index 2014-2015.

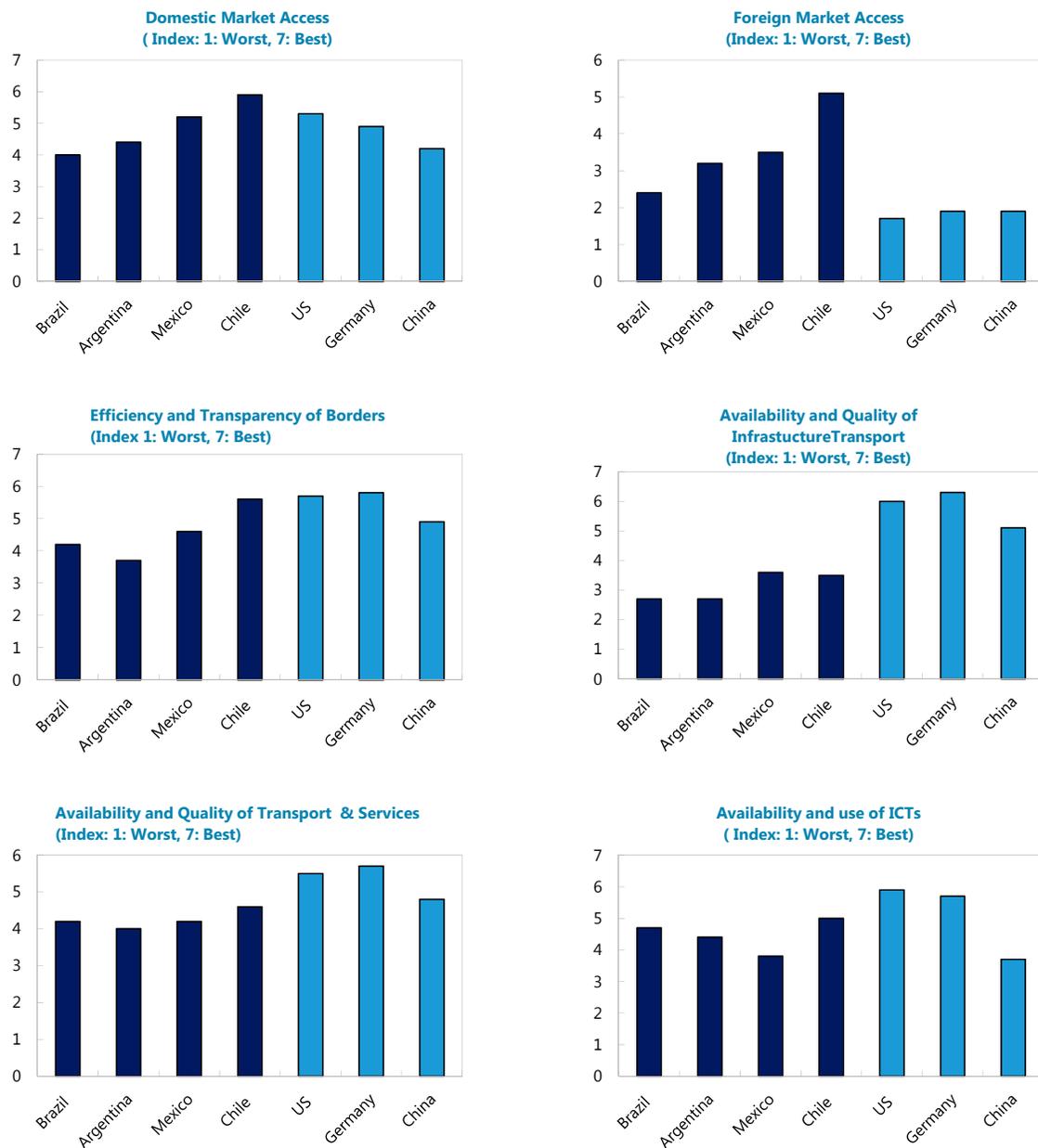
**Figure 15. Enabling Trade Index 2014**



Source: WEF Enabling Trade Report 2014

Source: WEF Enabling Trade Report 2014.

**Figure 16. Enabling Trade Index Pillars for Hub Countries**



Source: WEF Enabling Trade Index Report 2014.