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# Integration in Latin America: Time to take firmer steps

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**Valparaíso Port, Chile (photo: Julio Etchart/robertharding/Newscom)**

Compared with Europe or Asia, intraregional trade south of the Rio Grande is strikingly low. Even in Africa the figures are higher. In a period of very slow growth in global trade—1.9 percent a year during 2012–2016 compared with 7.5 percent over 2003–2007—many are questioning whether we are missing an opportunity. Given the current anti-globalization sentiment in many developed countries, this question takes on even greater significance.

There are various reasons for the low level of integration in the region. More vibrant trade is hampered by the existence of tariffs on trade in some major countries, fragmented trade agreements, deficient infrastructure, and similar productive structures, including the significant share of commodities. However, there are ways in which regional integration can be both increased and improved.

**Heading in the right direction**

The IMF's Western Hemisphere Department held a very useful conference on economic integration earlier this month. The three multilaterals: the IMF, the World Bank, and the Inter-American Development Bank (IDB) have recently been undertaking very valuable research, which fed through to excellent presentations during the conference. This is one of those conferences that I have had the privilege of attending in which I felt that I had learned a lot.

Integration is a step in the right direction. There is robust evidence that both global and regional trade integration support growth and have not worsened the income distribution in countries that have opened up. Moving from the 25$^{th}$ to the 75$^{th}$ percentile in terms of integration boosts per capita growth by 1 percent to 2 percent over the ensuing 5 years. Although the Gini coefficient (which goes from 0 to 1, with lower numbers reflecting higher levels of equality) has improved virtually across the board, the lowest improvement was seen in the countries that only recently opened up.

We have several problems. The region has a "spaghetti bowl" structure of agreements, with different rules that make it difficult to export to several countries. Mercosur has relatively high tariffs that are at similar levels to those from 20 years ago. In addition, generally speaking, the difference between the applied tariffs and the highest tariffs that could potentially be applied in the region is much higher than in the rest of the world. Moreover, although exports have increased, it appears that they are less human capital-intensive than in the past.

**Opportunities and bottlenecks**

Countries in the region stand to gain a lot by opening further. The regional strategy is one step in this process but should not be a substitute for the ultimate objective: globalization of the region. There are great opportunities to be derived from harmonization and from reducing the costs of trade.

This brings me to five points that I tried to make in my own presentation at the conference and which, based on my own practical experience, point to where I think there are opportunities and bottlenecks.

**First**, we need to take advantage of less traditional forms of integration that go beyond trade. There are nontradable industries in which a country may be much more efficient than others. Direct investment in these areas could be very beneficial and the good news is that it is happening. The retail industry in my country (Chile) is a good example of this. Brazilian banks are another. We also need to see immigration as a great opportunity. The movement of factors of production is better than trade.

**Second**, the Pacific Alliance agenda shows that it not so easy to make progress, even in the case of a group of countries with a relatively homogenous viewpoint on globalization. Nevertheless, it can be done, step by step. Case in point, the countries agreed to step up their commitment to bilateral tariff reductions in 2015, as well as to eliminate exemptions. Today, only sugar remains highly protected in two countries. Also, in the past two years, we have succeeded, among other things, in getting the four countries to recognize issuances in the other countries of both securities yielding a variable return and fixed-income securities, we simplified the tax treatment for cross-border pension fund investments and agreed on an architecture to create a "passport" for these funds.

**Third**, we need to be better prepared and to dedicate more human resources in the region to these areas, especially in ministries of finance. If for one reason or another, the leaders are able to reach a serious agreement on integration, my fear is that we may not be able to implement it. Multilateral institutions could help us a great deal in this area.

**Fourth**, a statement that is politically incorrect but rooted in realism. If, Brazil, our regional giant, is not committed to and willing to lead this process, we cannot hope for much. In South America, the relative weight of Brazil is more significant than the combined weight of Germany, France, and Italy in Europe. Any serious change will require the convergence of Mercosur and the Pacific Alliance. I fear, however, that Brazil is still not yet deeply convinced about the merits of an open economy. There are political considerations, a long track record of success with an "inward looking" growth strategy, and a powerful protectionist lobby. I hope that Brazil's leaders will have an opportunity to see the papers presented at the conference.

And **fifth**, we have spent far too many years searching for a Big Bang. We have a plethora of free trade agreements and country groupings. We do not need any more clubs. What we need is political leadership and simplification. Let us start by merging the clubs whose mandates are most similar with respect to the 33 existing agreements among the 26 regional members of the IDB.

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