2009-2010

Briefing paper

Latin America and the Caribbean in the World Economy

A crisis generated in the centre and a recovery driven by the emerging economies

UNITED NATIONS

ECLAC

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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 Natural Resources and Infrastructure Division, ECLAC subregional headquarters for the Caribbean and ECLAC subregional headquarters in Mexico assisted with the preparation of this year's edition.

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Notes

The following symbols have been used in the tables shown in the Survey:
Three dots (…) indicate that data are not available or are not separately reported.
A dash (-) indicates that the amount is nil or negligible.
A full stop (.) is used to indicate decimals.
The word "dollars" refers to United States dollars unless otherwise specified.

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INTRODUCTION

The 2009-2010 edition of *Latin America and the Caribbean in the World Economy*, which discusses the crisis generated in the developed world and the recovery driven by the emerging economies, is divided into five chapters.

Chapter I undertakes a short- and medium-term analysis of the post-crisis international economic situation, concentrating on its implications for international trade prospects in Latin America and the Caribbean. It examines the recovery of the global economy, which has centred mainly on the Asian economies (especially China) and other emerging economies, together with the role played by international trade in this recovery both globally and regionally and the heterogeneity of trade performance between different regions of the world. Some latent uncertainties that could throw the recovery off course are also identified, including: (i) the difficult task of sustaining growth and ensuring fiscal stability in the main economies by ensuring an orderly transition in the sources of global demand from public-sector stimuli to private-sector spending and from stimuli provided by economies running external deficits to stimuli generated by economies in surplus; (ii) weak final demand in the industrialized countries and the possibility of economic and financial contagion from the euro area, which could negatively affect commodity prices and demand; (iii) asymmetries in monetary policies between emerging and industrialized economies that could send destabilizing capital flows into the former, setting them up for eventual overheating and speculative bubbles that could affect macroeconomic stability; (iv) large differences in economic growth rates and interest rates between emerging and industrialized economies which, if not moderated, could progressively be reflected in currency appreciation in Latin America and the Caribbean and other emerging regions, affecting the potential for progress in diversifying exports; (v) a shift in the main sources of economic, trade and financial growth towards developing Asia and emerging countries generally, which highlights the importance of South-South trade and initiatives to strengthen it.

Chapter II reviews developments in regional trade during and after the crisis from both a long-term and a more immediate perspective, as well as the trade policy applied by the region's countries during this period. It offers a detailed analysis of the evolution of goods trade flows by origin and destination and of their sectoral composition over the past two decades, finding a high degree of heterogeneity between the region's countries: export growth has been stronger in the countries of South America than in Mexico, Central America and the Caribbean, owing to strong demand for commodities from Asia, particularly China. Consequently, while the recovery in regional trade has been substantial, particularly in South America, it has heightened an already somewhat excessive reliance on commodities that incorporate little know-how or technological progress. The challenge, then, is to find a way of taking advantage of this upsurge by strengthening the linkages between natural resources, manufactures and services, encouraging innovation in each of these links and coordinating them into clusters in which there is room for small and medium-sized enterprises, so that a vigorous export performance has greater spillover effects on the rest of the economy and so that the results of this growth are distributed more equally. This means there is a need for an integrated approach to stimulating competitiveness and innovation, as argued in the document presented at the thirty-third session of the Economic Commission for Latin America and the Caribbean (ECLAC) in Brasilia,[1] with a view to coordinating policies on export promotion and diversification, technological innovation and dissemination, inward foreign direct investment (FDI) and human resources development.

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[1] ECLAC, *Time for equality: closing gaps, opening trails* (LC/G.2432(SES.33/3)), Santiago, Chile, May 2010.

Chapter III reviews recent trade developments (particularly in the last 12 months) within the main subregional Latin American integration schemes: the Southern Common Market (MERCOSUR), the Andean Community and the Central American Common Market (CACM). It also examines progress with more recent initiatives such as the Latin American Pacific Basin Initiative and the Community of Latin American and Caribbean States. Also looked at are the most prominent recent initiatives to enhance trade ties between countries in the region belonging to different integration schemes. The chapter then briefly analyses the state of regional cooperation efforts relating to physical infrastructure, given the importance of this for integration, not least in the area of trade. Lastly, it examines the main milestones since the second half of 2009 as regards trade negotiations conducted by Latin American countries and integration schemes with partners outside the region.

Chapter IV analyses recent trends and future prospects in the Caribbean Community (CARICOM), an incomplete customs union of 15 States in the Caribbean that includes most English-speaking countries in the region plus Suriname and Haiti. It reviews: (i) progress with reforms to complete the CARICOM Single Market and Economy (CSME) by 2015, taking stock of progress towards this goal; (ii) progress with different subregional integration commitments currently being implemented, considering that integration efforts have been hit hard by the global economic and financial crisis; (iii) evaluation of progress on the Economic Partnership Agreement with the European Union now in force, which offers great opportunities both to boost trade and investment with Europe and to enhance trade integration within the Caribbean itself; and (iv) the state of initiatives, programmes and policies designed to diversify what is a highly concentrated export base.

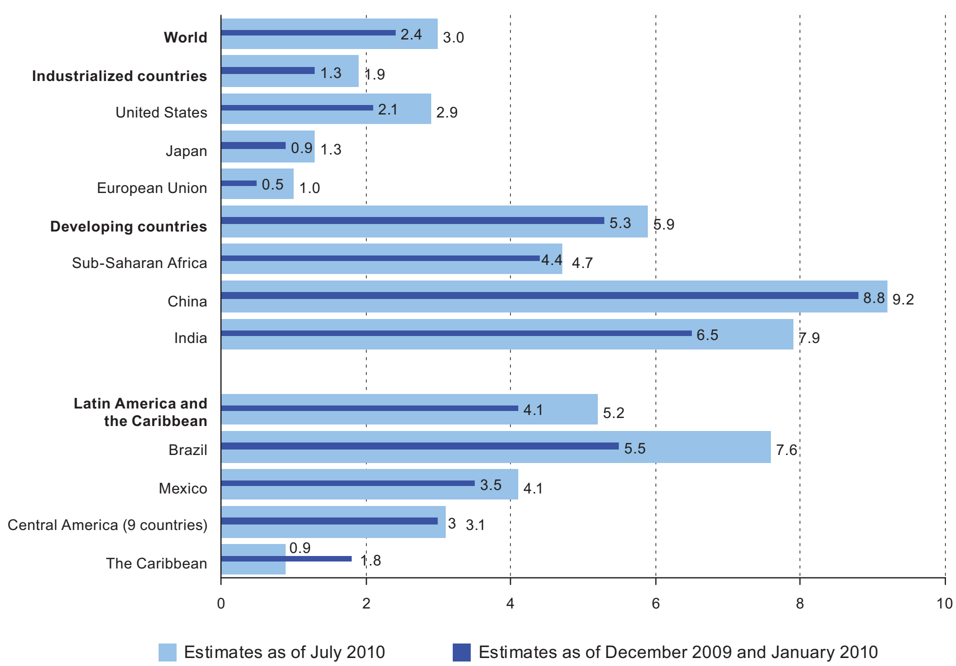
Chapter V examines the strategies recently adopted by Japan to enhance its economic relationship with Latin America and the Caribbean from the perspective of a public-private partnership that aims to take advantage of opportunities in the region not only in the area of natural and energy resources but also in respect of food security and infrastructure. The chapter also analyses Japanese economic partnership agreements (EPAs) and official development assistance (ODA), which provide substantial opportunities to enhance the region's systemic competitiveness; the former seek to supplement trade liberalization with cooperation, while the latter, following the Japanese ODA model applied in Asia, puts the emphasis on infrastructure improvements, training and participation in the regional and global value chain with a view to revitalizing the productive economy and promoting external trade and investment with the recipient country. The conclusion is that this is a good time for Japan and Latin America and the Caribbean to revisit and strengthen their economic relationship, including a reformulation of ODA.

SUMMARY

A. A CRISIS CREATED IN THE CENTRE AND A RECOVERY DRIVEN BY THE EMERGING ECONOMIES

As of mid-2010, the recovery in the global economy and trade is proving more robust than expected, but more uneven than could be desired. The world economy grew at an annualized rate of over 5% during the first quarter of 2010, essentially because of strong growth in Asia. Not only did China grow by 12% (see figure 1), but Hong Kong (Special Administrative Region of China), Malaysia and Singapore grew at even higher rates. International trade in the quarter, meanwhile, was 25% up on the same quarter in 2009. This sharp recovery in international trade, also led by the Asia-Pacific region, Japan and India, has helped to gradually restore confidence among consumers, businesses and the financial markets, reactivating consumption and investment. Notably, the buoyancy of the emerging economies has not been confined to the four countries (Brazil, the Russian Federation, China and India) known as the BRICs.

Figure 1
SELECTED COUNTRIES AND REGIONS: ESTIMATED GDP GROWTH, 2010 [a]
(Percentages)

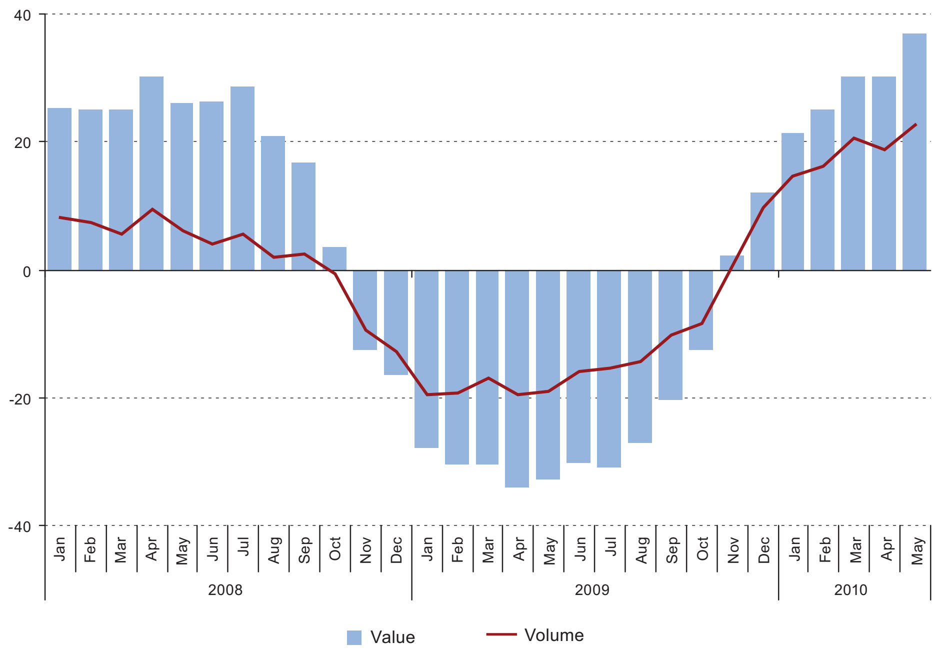


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations, *World Economic Situation and Prospects 2010*: Update as of mid-2010 (WESP2010), New York, July 2010. United Nations publication, Sales No. E.10.II.C.2; *Economic Survey of Latin America and the Caribbean 2009-2010* (LC/G.2458.P), Santiago, Chile, July 2010; and Preliminary Overview of the Economics of *Latin America and the Caribbean 2009* (LC/G.2424.P), Santiago, Chile, December 2009, Sales No. E.09.II.G.149.

[a] Aggregate GDP for countries outside the region was calculated on an exchange-rate basis.

International trade has played a vital role in the recovery of the global economy. Trade and open markets prevented the crisis from deepening further and have successfully transmitted signals of rising demand. A number of the factors that led to the decline in global trade in 2008 and early 2009 are now contributing to its recovery, with final demand in emerging countries acting as the main engine of growth (see figure 2). Other factors include the reactivation of demand for capital goods and intermediate inputs, partly thanks to the normalization of financial markets and credit and to fiscal stimulus plans. These have also supported an adjustment in inventories and a new cycle of electronic products. Growth in world trade by value has also been helped by recovering prices for a number of commodities, particularly oil. More generally, the regulations of the international trading system have helped ensure a better outcome by providing scope for crisis measures to be taken without threatening trade relations. This has helped to sustain confidence in the trading system and has allowed the Asian recovery to rapidly spread worldwide.

Figure 2
WORLD TRADE: 12-MONTH GROWTH RATES, BY VALUE AND VOLUME
(Percentages)



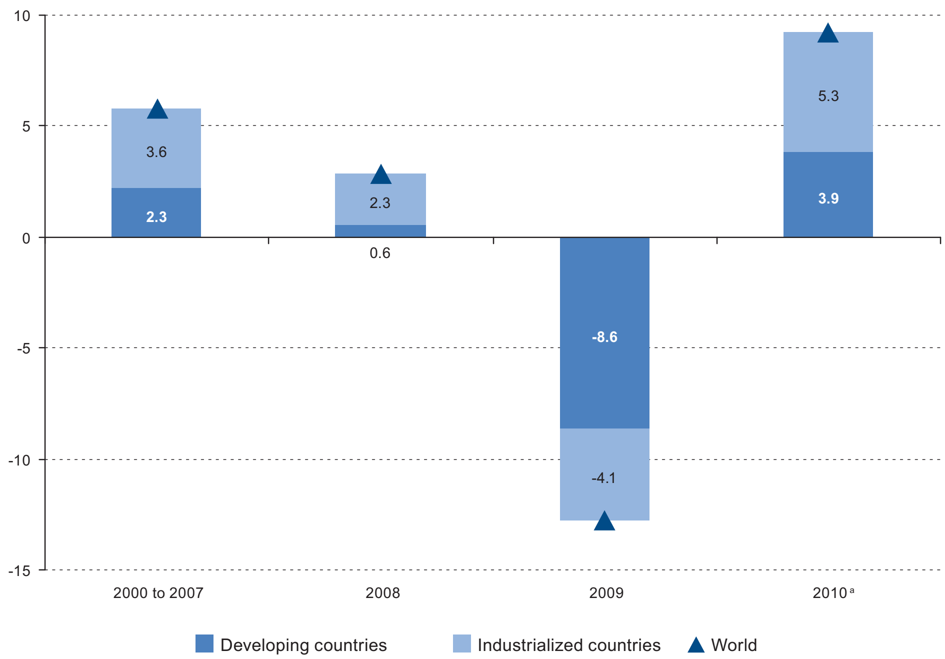
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Netherlands Bureau for Economic Policy Analysis (CPB), "World Trade Database" [online] http://www.cpb.nl/eng/research/sector2/data/trademonitor.html [date of reference: 18 June 2010].

Output and trade in Latin America and the Caribbean have also recovered more quickly than expected. This solid revival is largely based on the dynamism of domestic demand, a pick-up in investment and robust exports driven by demand from China and the rest of Asia, and by the normalization of demand in the United States. This positive overall picture, however, masks a high level of heterogeneity in the region's countries (see table 1). The best performance has been seen in commodity-exporting countries. The recovery has been slower in countries that are importers of commodities and depend on tourism and remittances, owing to the still weak performance of the industrialized countries that are the main source of these latter flows.

Figure 3

INDUSTRIALIZED AND DEVELOPING COUNTRIES: CONTRIBUTION TO REAL GROWTH OF GLOBAL EXPORTS, 2000-2010

(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Netherlands Bureau for Economic Policy Analysis (CPB), "World Trade Database" [online] http://www.cpb.nl/eng/research/sector2/data/trademonitor.html [date of reference: 18 June 2010].

[a] Projections by the World Trade Organization (WTO), *press release* 26 March 2010.

Table 1

LATIN AMERICA AND THE CARIBBEAN: ANNUAL GROWTH RATES FOR GOODS TRADE

(Percentages)

	Exports			**Imports**		
	2008	**2009**	**2010** [a]	**2008**	**2009**	**2010** [a]
Latin America and Caribbean (35)	16.2	-22.6	21.4	21.7	-24.9	17.1
Latin America (19 countries)	15.8	-21.9	22.0	21.7	-24.9	18.2
MERCOSUR	24.4	-21.9	23.4	40.3	-27.4	29.6
Andean countries	30.0	-27.8	29.5	21.9	-20.8	5.8
Central American Common Market	8.3	-9.3	10.8	14.5	-22.8	14.6
CARICOM	31.1	-43.6	23.7	20.1	-25.6	9.8
Other countries						
Chile	-2.2	-19.2	32.6	30.9	-31.0	18.5
Mexico	7.2	-21.2	16.0	9.5	-24.0	16.3
Panama	10.6	5.6	10.1	18.7	-13.0	17.8
Dominican Republic	-5.8	-19.0	12.5	17.6	-23.2	16.3

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

[a] The figures for 2010 are preliminary projections prepared by the Economic Development Division.

Large disparities in growth rates (high in emerging economies and low in industrialized ones) undermine the chances of a more sustainable recovery. The faster recovery has partly been due to the great dynamism of Asia and the emerging economies and to the remarkable countercyclical reaction in the fiscal, monetary and financial policies of most industrialized and developing economies. The recovery in the first group of countries has been weak on the whole, with the United States doing relatively well, especially in comparison with the European Union. In the latter, the recovery has been complicated by large fiscal deficits in certain countries and the additional fiscal impact of financial rescues, a situation that severely affected Greece before spreading to other Mediterranean countries and those in the east of the Union. Public-sector budgets in the largest European Union economies have also been cut sharply, setting the stage for even weaker European growth in 2011.

Other trends also point to reduced dynamism in the world economy and trade in the second half of 2010 and during 2011. First, much of the restocking of inventories carried out to meet demand in the recovery phase is complete. Second, the effect of fiscal and monetary stimulus measures is fading. Third, the massive expenditure involved in fiscal measures means that public debt has been rising to very high levels. In the Group of Seven (G-7) countries, for example, debt is expected to reach 113% of GDP in 2010. A number of countries are accordingly taking fiscal austerity measures, reducing public expenditure drastically. Yet the withdrawal of fiscal stimulus could imperil economic performance over the coming months.

Ahead lies the difficult task of sustaining growth while maintaining fiscal stability in the industrialized economies. This challenge involves not only matching the gradual withdrawal of stimulus with a recovery in private spending, but also ensuring that two necessary transitions take place in the sources of global demand. The first transition is from public-sector stimulus towards private-sector spending, and the second is from economies running external deficits to those running a surplus. This is where action is needed on fiscal sustainability, financial sector restructuring and stagnating productivity growth. Progress towards these goals requires international coordination on exit strategies, financial reform and rebalancing of the global economy.

The direct impact of the European fiscal crisis on Latin America and the Caribbean appears to be limited, but the medium-term consequences could be greater. Only a small proportion of the region's exports go to the European countries worst affected. If risk premiums spike because of a sovereign debt default, however, emerging regions, including Latin America and the Caribbean, could find it much harder to access financing. It is also possible that European firms, and Spanish ones in particular, might invest less in the region. If the fiscal crisis were to spread to the other large European countries, and if austerity measures were long-lasting, European demand would weaken yet further, and this would certainly affect Latin American exports to the continent. This is a low-probability scenario, however, given that recent data for the European economies show an increase, albeit marginal, in projected growth and financial market confidence.

Regarding emerging economies, there are doubts about the sustainability of their recovery in a context of limited economic activity in the Organisation for Economic Co-operation and Development (OECD). If the industrialized economies do not fall back into recession and are able to keep growing, even at current low rates, emerging economies will be able to sustain growth of some 6% a year in the next two to four years, giving a growth floor of 3% for the world economy. This is being made possible by the growing bonds between emerging economies themselves, notably the close trade relations among Asian economies, as well as China's stronger ties with Africa and Latin America and the Caribbean.

There are particular concerns about the future pace of growth in China. This is the variable of most interest for the external trade of South America, just as the growth of the United States economy is of greatest concern to Mexico, Central America and the Caribbean. China could continue growing at rates of some 9%, relying on domestic consumption and investment demand. Indeed, it grew by 9.1% in 2009, with private-sector consumption growth exceeding output growth for the first time in many years, while net exports deducted 4 points from GDP growth. A gradual appreciation of the renminbi would help with this by reducing the external surplus and creating demand for products from the rest of the world. Conversely, an abrupt revaluation would be risky because it could heighten the dangers of overheating in the Chinese economy by accelerating capital inflows and overstimulating asset markets.

Monetary policy shows excessive differences around the world. A number of emerging economies have already begun to gradually dismantle their stimulus packages and raise interest rates, widening the rate differential with the industrialized economies. Capital flows into emerging economies have recovered strongly following the drastic slump of 2008 and 2009. The recovery has been more marked for bonds and shares and less so for syndicated loans, which are still below pre-crisis levels. This growth disparity between industrialized and emerging economies is worrying because it is encouraging destabilizing flows of capital into the latter, potentially leading to overheating in these economies and fuelling speculative bubbles and currency appreciation that are bringing down import prices and impeding export diversification. This is why the International Monetary Fund (IMF) is taking an innovative approach in this area, having expressed a willingness to consider the possibility of controls on capital inflows.

A possible (although improbable) government debt crisis in certain countries could complicate the global economy and finances and the outlook for Latin America and the Caribbean. A European financial crisis would raise the cost of investment and trade financing. Lower growth in these industrialized countries would in turn affect emerging countries' exports. Weak final demand in the industrialized countries and possible economic and financial contagion from the euro area could adversely affect commodity prices and demand, damaging commodity exporters in Latin America and other emerging regions.

The economic and financial crisis has raised the profile of emerging economies, not only in global production and trade but also in international finance and governance. Long-term projections indicate that what are currently developing countries will probably account for 60% of global GDP by 2030. The combined GDP of the BRIC countries accounted for 15% and 22% of global output in 2008 at current prices and in purchasing power parity terms, respectively. The developing-country share of FDI was almost 40% in 2009. In 2010, international reserves held by developing countries were 1.5 times as great as those held by industrialized ones. The BRICs hold 39% of reserves, Latin America and the Caribbean 6%. This is of structural significance. The 2008-2009 financial crisis laid bare a tremendous asymmetry: the developing countries are the main sources of savings, while it is the industrialized countries that are spending them.

For all their growing importance in the global economy, the emerging economies are not yet in a position to take up all the slack from the United States, Europe and Japan. Notwithstanding the short-term uncertainties, it is safe to say that in the medium and long terms the focus of economic, trade and financial growth will shift towards developing Asia and emerging countries generally, which drives home the importance of South-South trade and initiatives to strengthen it.

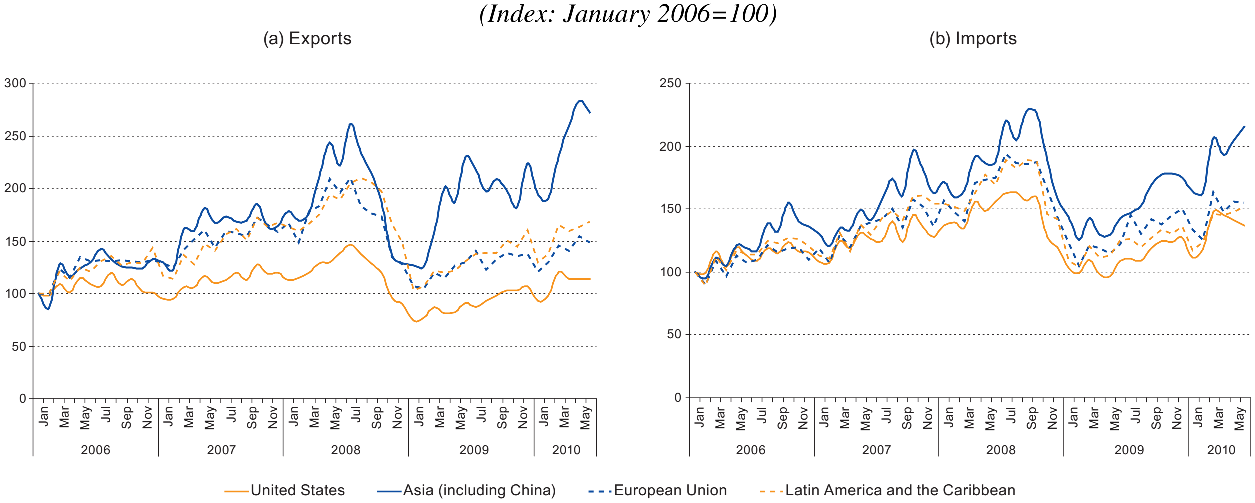
South-South trade is increasingly substantial and is now becoming one of the main engines of global goods trade, while South-South FDI is rising steadily. South-South trade grew at an annual rate of 13% between 1990 and 2008 to reach US$ 2.9 trillion in the latter year. The share of South-South trade in the global total rose from 9% to 18% over the same period; over 40% of world trade involves developing countries, and 43% of that amount is South-South trade. Although South-South FDI flows are still small, intraregional FDI in developing Asia and Latin America and the Caribbean has been dynamic and is showing signs of entering an important stage of international expansion. In the latter case, almost 10% of inward FDI flows are from the region itself, originating with so-called “trans-Latins”.

South-South trade is already a major trade segment in Latin America and the Caribbean, accounting for almost 29% of total exports. The most important developing-market export destination is the region itself, accounting for 18% of total exports, followed by developing Asia with 6%. Africa, the Middle East and central Europe are still minor destinations in the region’s export total. Trade between emerging Asia and the Middle East has continued to grow and is based mainly on oil, while intra-Asian South-South trade is known as the best example of global production complementarities.

B. OVERVIEW OF REGIONAL TRADE DURING THE PAST DECADE

Trade with leading extraregional and intraregional trading partners expanded strongly in the post-crisis period, recovering from the sharp contraction of 2009. Comparing export and import growth by value in the first half of 2010 from the levels seen in the same period of 2009 reveals that the three leading destinations experienced double-digit increases, with exports to Asia and the United States expanding more strongly than those to the European Union (see figure 4).

Figure 4
LATIN AMERICA AND THE CARIBBEAN (14 COUNTRIES): TRADE WITH SELECTED PARTNERS, BY REGION, JANUARY 2006 - JUNE 2010
(Index: January 2006=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information provided by the national statistical offices, central banks and customs departments of 14 countries: Argentina, the Bolivarian Republic of Venezuela, Brazil, Colombia, Costa Erica, Chile, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Paraguay, Peru, the Plurinational State of Bolivia and Uruguay.

In the post-crisis period, the exports of the Andean countries, MERCOSUR and Chile performed the best, while those of Mexico and the Central American countries lagged behind. This is a result of the relatively strong prices for commodity exports, which account for a larger share of total exports in South America than in Mexico and Central America.

Four main factors have been driving the recovery of regional exports and imports since the second quarter of 2009: first, the recovery in the world economy, including the strong upturn in economic activity in the region, which has also stimulated intraregional trade; second, steady demand from China and the rest of Asia for a number of the commodities exported by the region, which has kept international prices for these high; third, improved financing conditions, including trade credit; and, fourth, the stimulus of the "pro-trade" measures applied by some countries, especially Mexico and Brazil.

Breaking down sectoral growth in exports from Latin America to both the European Union and the United States shows that agricultural export values have been less volatile than those of mining products and oil, reflecting greater volatility in the prices of the latter. Again, the region's export basket is more manufacturing-intensive in the case of the United States than of the European Union.

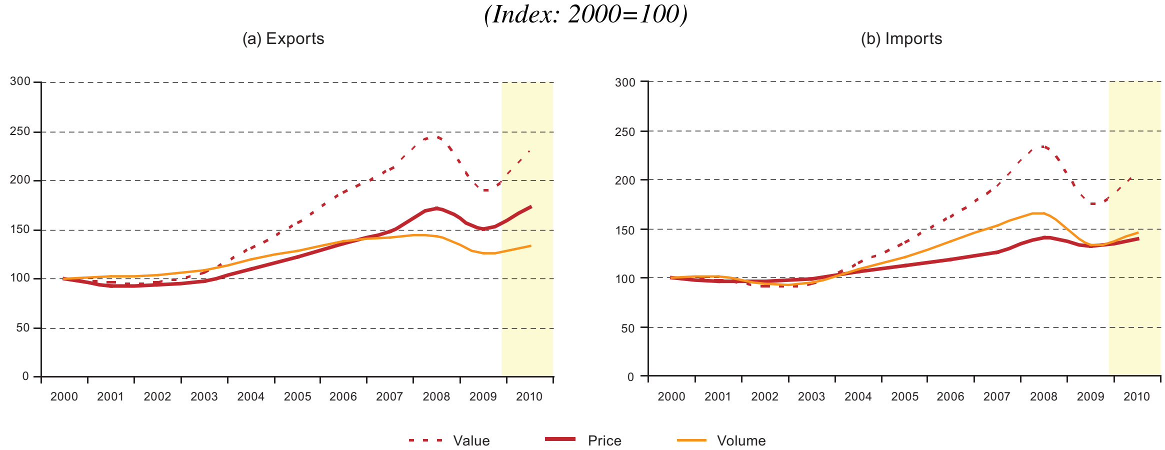
Lower demand for agricultural and mining products in the United States and the European Union during the crisis was partly offset by the strength of China's imports. A sample of volume growth rates for the most important products to the region's countries during the crisis and post-crisis periods illustrates the remarkable role played by the Chinese market in cushioning the effects of the crisis, as demand for products such as fresh fruit, vegetables, crude oil and iron ore held up strongly despite the adverse conditions.

When trade growth is broken down by value, the data show that prices increased for both the region's exports and its imports. Export prices have increased by more in 2010, which will improve the terms of trade, reversing some of the deterioration experienced by commodity exporters during the crisis in 2009 because of highly volatile fuel prices. The renewed surge in the region's export volumes during 2010 is also striking. Despite the strength of the recovery so far in 2010, the value of the region's trade has yet to return to its pre-crisis peak (see figure 5).

A preliminary overview of export performance in the past decade shows that the region's exports have grown by less than the global average and have underperformed relative to other developing regions such as Asia, Africa and the Middle East in both value and volume. The region's export growth rate has also been lower in the past decade than it was in the 1990s. The export effort of Latin America and the Caribbean is thus proving inadequate and the region is continuing to lose global trade share (see figure 6).

Two differentiated patterns can be distinguished within the region. While the export growth rate of South America has doubled, that of Mexico and Central America has fallen by more than half. Exports from all South American countries other than the Bolivarian Republic of Venezuela have grown by more than the regional average over the past decade. Conversely, export growth rates have underperformed the regional average in all Central American countries except Nicaragua. The slackening of export growth in both Mexico and Central America over the past decade has been reflected in the performance of imports, since these countries' exports include a large component of inputs imported for the maquila industry.

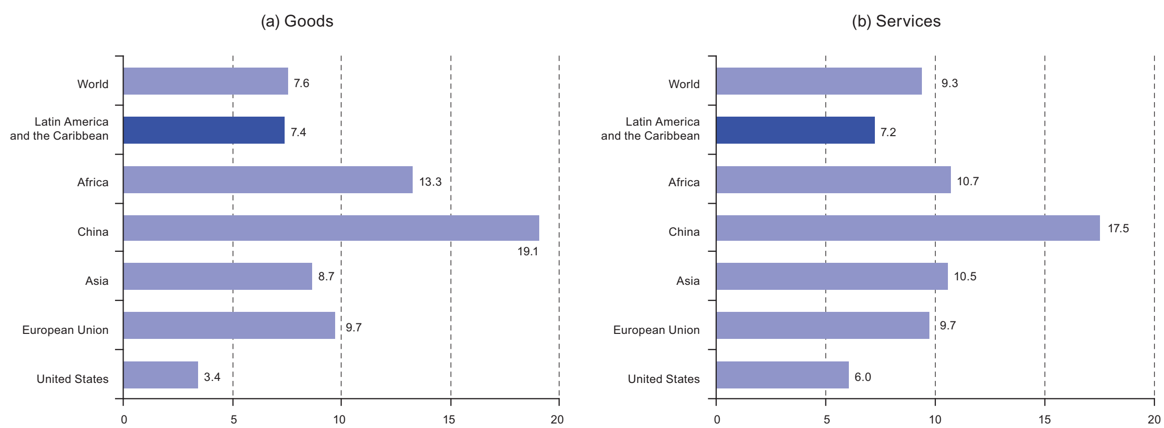
Figure 5
LATIN AMERICA AND THE CARIBBEAN: GOODS TRADE DURING THE 2000s[a] AND BREAKDOWN OF GROWTH DURING THE PRE-CRISIS, CRISIS AND POST-CRISIS PERIODS
(Index: 2000=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the balance of payments of 35 countries.

[a] Levels for 2010 and the breakdown of growth for that year correspond to projections made by ECLAC, on the basis of information available for January-May.

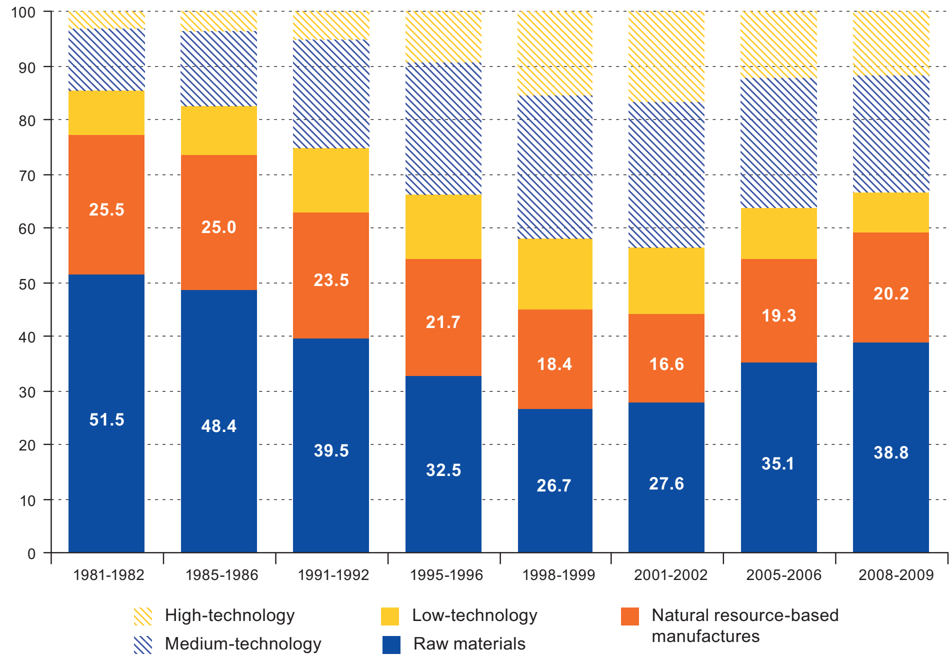
Figure 6
SELECTED WORLD REGIONS: AVERAGE ANNUAL GROWTH IN GOODS AND SERVICES EXPORTS, BY VALUE, 2000-2009
(Percentages)



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

Natural resources have been the region's most dynamic exports over the past decade, especially in South America. This pattern of growth has created the conditions for a recommodification of the regional export structure. After falling from some 52% of total exports in the early 1980s to a low of 26.7% in the late 1990s, the share of raw materials has risen over the past decade to reach almost 40% of the total in the last two-year period (2008-2009) (see figure 7). This increase in the share of raw materials has taken place at the expense of medium-, high- and low-technology manufacturing exports, all of which have grown by much less than in the 1990s. This is consistent with the reduced dynamism of engineering- and labour-intensive manufacturing exports.

Figure 7
LATIN AMERICA AND THE CARIBBEAN: STRUCTURE OF WORLDWIDE GOODS EXPORTS, BY VALUE, SINCE THE EARLY 1980s
(Percentages of the total)

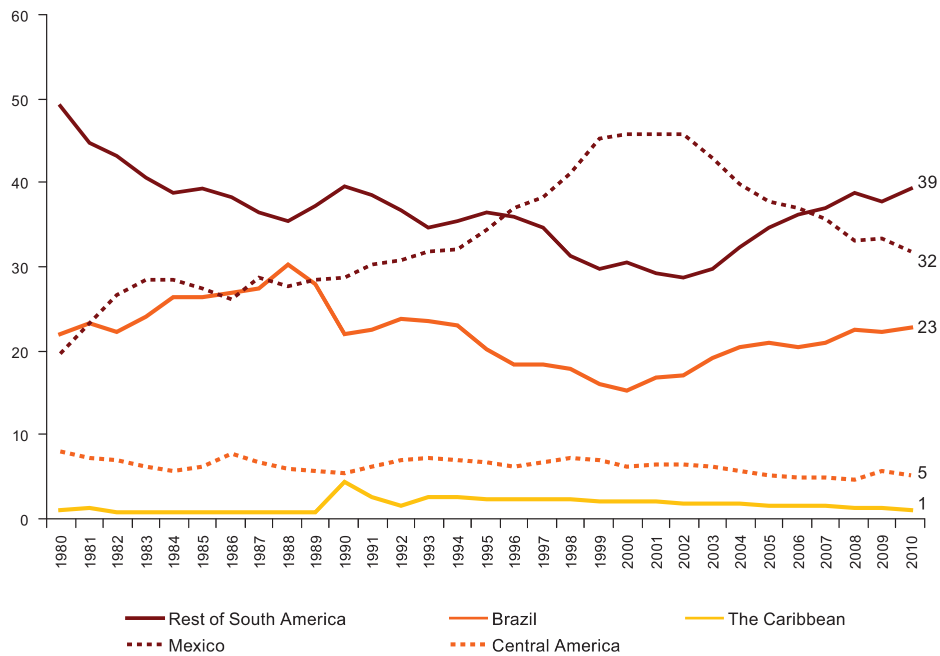


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Data Base (COMTRADE).

Differences in the growth rates of raw material and manufacturing exports have led to a readjustment of the relative shares of exports from Mexico on the one hand and South America on the other. The former's share of the region's total goods exports fell from 40% in 2000 to 30% in 2009. Meanwhile, Brazil increased its share from 13% in 2000 to about 20% in 2009, recovering the share of total exports it had in the early 1980s. Other countries in South America also increased their share of the region's goods exports, particularly Argentina, Colombia, Peru and Chile. The low growth rates of CARICOM and the Dominican Republic meant that all these countries' shares of the region's total goods exports declined (see figure 8).

By contrast with goods, services exports have expanded slightly faster in the past decade than they did in the 1990s. Nonetheless, they grew more slowly than global exports of services and than those of Africa, Asia, China and the European Union. As with goods, Mexico has significantly underperformed the region as a whole over the past decade. Also noteworthy is the weakness of export growth in the Caribbean subregion, where services constitute a large share of total exports. As for South and Central America, no well-defined pattern exists and there is a high degree of heterogeneity.

Figure 8
SELECTED SUBREGIONS AND MEXICO: SHARE IN TOTAL EXPORTS OF GOODS FROM THE LATIN AMERICAN AND CARIBBEAN REGION, 1980-2010
(Percentages of the regional total)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of balance-of-payments data.

This preliminary overview of export performance in the decade shows that the region has not succeeded in significantly improving the quality of its international trade. On the one hand, the South American countries have displayed greater export dynamism in the aggregate, but this has largely been determined by exogenous factors such as the renewed strength of international demand for raw materials and the consequent rise in their prices. On the other, Mexico and Central America, whose exports include a greater share of manufactures, have proved less dynamic in the aggregate, largely because of intense Chinese competition in their main market, the United States, especially for products whose manufacture involves intensive use of unskilled labour.

The expansion of natural resource-related sectors, driven mainly by demand from Asia, has not contributed enough to the creation of new technological capabilities in the region. Although returns in these sectors have improved, and there have actually been productivity gains, the absence of active production development policies has led to a widening of productivity gaps with countries deemed to be at the frontier, especially the United States.

The region's trade relations with Asia offer both opportunities and challenges. One major challenge is to prevent the growing trade between the two regions from reproducing and entrenching a centre-periphery trade pattern in which Asia (particularly China) emerges as a new centre and the countries of the Latin American and Caribbean region as a new periphery. What is needed, then, is progress towards trade relations that are more in keeping with the economic and social development patterns this region needs.

There is thus an urgent need for an effort to promote higher levels of innovation and endogenous development of technological capabilities, both in natural resource-related sectors and in manufacturing and services. Public policy has an irreplaceable role to play in generating such capabilities and the systemic competitiveness they bring with them. This effort requires, among other things, the coordination of a wide range of policies, including those designed to increase the competitiveness of small and medium-sized enterprises (SMEs), with programmes to improve quality certification, compliance with technical and sanitary standards and training, all necessary instruments when it comes to fostering a greater presence for SMEs in export flows, clusters and international value chains.

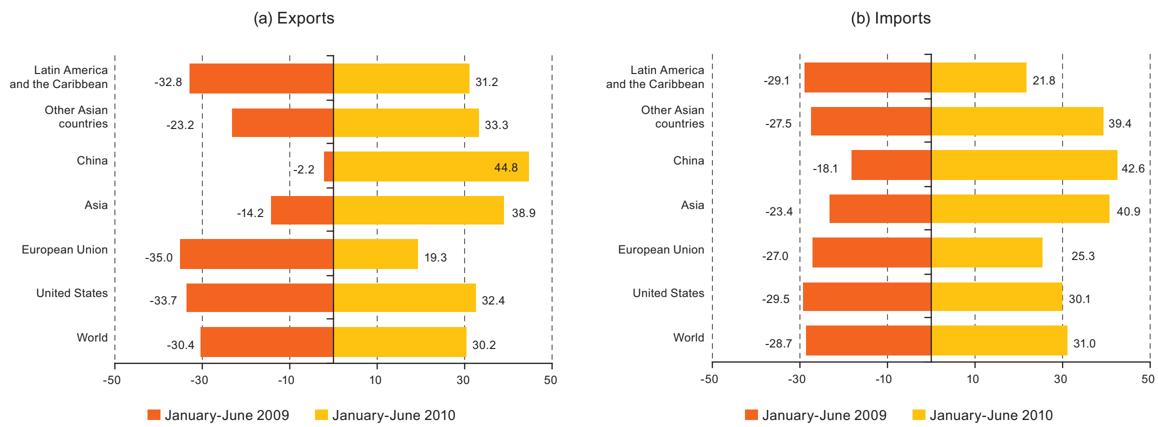
Actions to further the development of intraregional trade are also desirable given that this trade presents positive features such as greater manufacturing intensity and a greater presence of SMEs, the main drivers of high-quality job creation and social cohesion. Furthermore, intraregional markets could serve to cushion demand shocks originating outside the region, provided progress is made with financing mechanisms for intraregional trade. This is the intention of traditional organizations such as the Inter-American Development Bank (IDB), the Andean Development Corporation, the Latin American Export Bank (BLADEX) and the Latin American Reserve Fund (FLAR), to which might be added the potential contribution of the Bank of the South in this area. The data show that the potential for intraregional trade was not sufficiently exploited during the recent crisis.

C. REGIONAL INTEGRATION INITIATIVES AND NEGOTIATIONS WITH EXTRAREGIONAL PARTNERS

The crisis strongly affected intraregional trade, and recovery has been slow. The exports of Latin America and the Caribbean to all leading destinations other than China contracted during 2009. Intraregional trade fell by 28% in 2009, by much the same proportion as the region’s exports to the United States and the European Union (26% and 28%, respectively). Exports to Asia fell by just 5% and those to China actually rose 5%. The recovery in intraregional trade during the first half of 2010 compared with the same period the previous year has been slower than the recovery in trade with Asia and the United States (see figure 9).

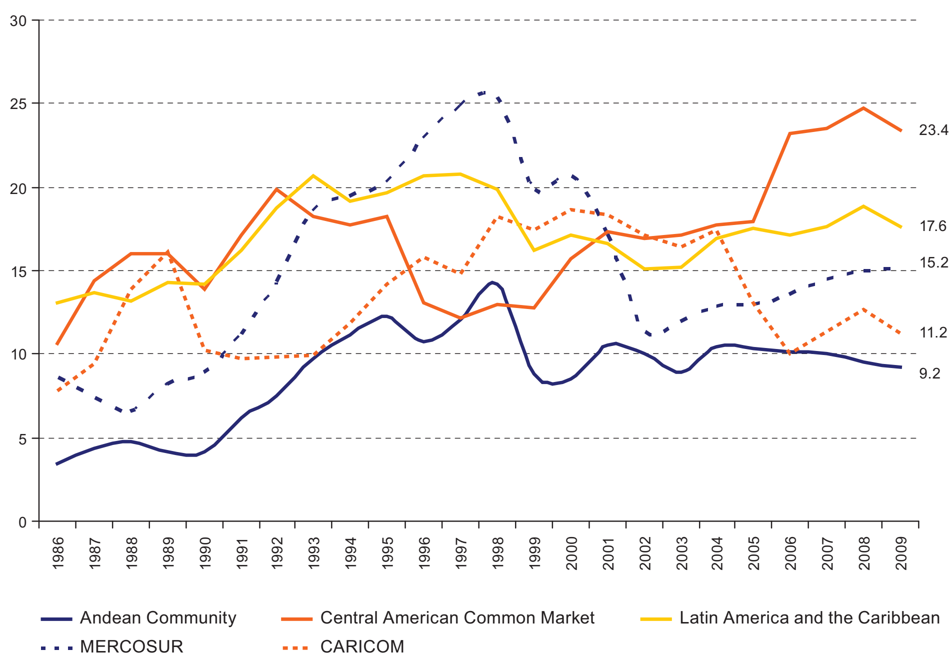
The crisis led to a drop in intraregional trade ratios, with the exception of MERCOSUR. Intraregional trade has yet to revisit its earlier highs. After rising steadily from the early 1980s onward, by the late 1990s intraregional trade accounted for a little over 20% of the total in Latin America and the Caribbean as a whole and 25% in the case of MERCOSUR and the Central American Common Market. These increases were reversed in 1999, however, when the level of intraregional trade dropped sharply as the repercussions of the Asian financial crisis struck the region. Currency upheavals in MERCOSUR and the Andean Community subsequently led to a collapse in trade between the South American countries. Although the intrasubregional trade ratio continued to rise in the Central American Common Market (CACM), the region as a whole did not see a return to the earlier peak (see figure 10).

Figure 9
LATIN AMERICA AND THE CARIBBEAN: VALUE OF TRADE BY MAIN DESTINATION, JANUARY-JUNE OF 2009 AND 2010
(Percentage growth over the same period of the preceding year)



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

Figure 10
COEFFICIENT OF INTRAREGIONAL AND INTRASUBREGIONAL TRADE, 1986-2009
(Percentages of total exports from the region and each integration scheme)



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

The state of economic and trade integration in Latin America and the Caribbean presents large variations between the different subregions or integration schemes. In particular, the more ambitious trade integration initiatives have been badly affected by differences of opinion in the region. This can be seen in the abandonment of the project of creating a South American free trade zone, which was floated in 2005 within the framework of the then South American Community of Nations (SACN). Likewise, negotiations to create a free trade area under the auspices of the Latin American Integration Association (LAIA) have progressed little since they were launched in 2004.

MERCOSUR has shown some positive developments in the last 12 months, most notably with the agreements reached at its summit in San Juan, Argentina, from 2 to 3 August 2010, dealing with a number of measures designed to improve the customs union. These agreements include the gradual abolition of double charging of the common external tariff (CET), the adoption of a mechanism for distributing customs revenue and the adoption of a common customs code. These three issues, it should be noted, were the subject of intensive negotiations from 2004 onwards. In addition to these advances, progress was made in the liberalization of trade in services and in the consolidation of the MERCOSUR Structural Convergence Fund (FOCEM) and the creation of the MERCOSUR Guarantee Fund for Micro, Small and Medium-sized Enterprises and Local-Currency Payment System. Pending challenges for MERCOSUR include making faster progress towards the goal of doing away with non-tariff restrictions on intra-zone trade, making greater use of the mechanisms provided by MERCOSUR itself for the resolution of trade disputes arising between its members, and making headway with the incorporation of community regulations into national law. Another important development during the period was the resumption of negotiations for an economic partnership agreement with the European Union. These are testing negotiations but, if they come to fruition, they could create major benefits for MERCOSUR.

The members of the Andean Community have continued to pursue further cooperation and integration in a number of areas. These efforts are embodied in the 12 agreed areas of operation of the Strategic Agenda approved by the foreign and trade ministers of the Andean Community in February 2010. The starting point for the Agenda is the recognition of the diversity of approaches and views among Andean Community members, on the basis of which it seeks to preserve the achievements built up over its four decades of existence and advance pragmatically into new areas that command consensus, including economic complementation and trade integration issues. Major efforts here include those being made to develop Andean technical standards, strengthen Andean agricultural health, food safety and quality systems, and facilitate trade.

The Central American Common Market (CACM) economic and trade integration process has been more dynamic over the past 12 months than similar processes in South America. Having achieved free trade between them years ago, with minimal exceptions, the CACM members are now working to complete their planned customs union. To this end, they are in the process of harmonizing the 4% of their tariff universe that is not yet subject to a common external tariff. Progress is continuing in areas such as modernization of the Standard Central American Tariff Code, the development of Central American technical regulations for different products, mutual recognition of sanitation records for food, drinks, medicines and hygiene and cosmetic products, and the establishment of integrated customs.

The process leading to effective Panamanian membership of the Central American Economic Integration Subsystem is also under way, with completion planned for late 2011. Deeper trade links between Panama and Central America have been accompanied by growing integration in other areas. These include energy, with Panama forming part of the Electrical Interconnection System for Central America (SIEPAC), whose purpose is to create a common Central American market for electricity. Panama is also coordinating work to develop a Central American short-distance sea transport system (cabotage).

Depending on their outcome, the contacts that have been taking place between Brazil and Mexico since August 2009 with a view to negotiating a strategic economic integration agreement may favourably influence economic and trade integration initiatives in the region. A decision to begin negotiations during 2010 could act as a catalyst for integration efforts throughout the region by tying together the leading economies of South America and Meso-America.

Since its creation in 2007, the Latin American Pacific Basin Initiative has been exploring initiatives to achieve trade convergence between its 11 members. These discussions have not as yet included the subject of tariff convergence, as the priority has been to achieve convergence via cumulation of origin. By connecting up the different bilateral agreements, this would favour the integration of production between Pacific Basin countries and reduce the transaction costs involved in trade between them. Its members have also agreed to seek progress on technical barriers to trade, sanitary and phytosanitary measures, customs procedures, services, dispute resolution and trade defence, among other topics. This forum could serve as a catalyst for convergence in terms of expanded markets and integrated production by contributing to the development of regional value chains and thereby increasing the attractiveness of Latin America and the Caribbean as an economic and trading partner for Asia-Pacific.

Most Latin American and Caribbean countries have continued to actively negotiate trade agreements with partners outside the region, particularly the European Union and, increasingly, Asian countries. This intensive activity undoubtedly owes something to the lack of movement on the Doha Round, but it could also be a response to slow progress with the main trade integration projects in the region. The list of extraregional agreements signed recently or under negotiation is long and includes: (i) the agreements recently concluded between the European Union and Central America (including Panama) and with Colombia and Peru, (ii) the free trade agreements (FTAs) signed by Costa Rica with China and Singapore, (iii) the FTA currently being negotiated between four Central American countries and Canada, (iv) the bilateral FTAs being negotiated by the Republic of Korea with Peru and Colombia, (v) the economic partnership agreement (EPA) negotiations between Peru and Japan and (vi) the FTA recently signed between MERCOSUR and Egypt. Conversely, not much progress has been made on the region’s trade relations with the United States, as demonstrated by the fact that the United States Congress has yet to ratify the FTAs signed with Colombia and Panama over three years ago.

Having concluded negotiations on a partnership agreement with CACM and a trade agreement with Peru and Colombia, the European Union continues to implement the strategy of forging closer ties to Latin America that it decided upon in the mid-1990s. Both agreements will now have to go through their respective signing and ratification processes, and are expected to come into force in early 2012, joining the agreement signed in October 2008 between the European Union and 15 Caribbean countries that are members of the Caribbean Forum of African, Caribbean and Pacific States (CARIFORUM) and the agreements in force with Chile and Mexico. Negotiations on a partnership agreement between MERCOSUR and the European Union have recently resumed and will be interesting to follow over the coming months.

Another scheme that offers some potential as a platform linking Latin America and the Caribbean to the Asia and Pacific region is the Trans-Pacific Strategic Economic Partnership Agreement (TPP), also known as the P4, which was signed in 2005 between Brunei Darussalam, Chile, New Zealand and Singapore. Negotiations to bring the United States into the TPP began in March 2010, and have now been joined by Australia, Peru and Vietnam, while other countries from both Asia and Latin America are considering joining the process. While not economically imposing now, the TPP offers the potential to build a “trans-Pacific community” that could counteract the centripetal tendencies now being seen in East Asia.

A number of countries in the region are still very actively pursuing extraregional negotiations. This could create strains within the subregional integration schemes, as has been demonstrated by the negotiations between the Andean Community countries and the United States and European Union. Commitments that countries from the region negotiate individually with extraregional partners (particularly developed countries) may present discrepancies with the obligations they have accepted in their regional or subregional scheme, with potentially large implications for the latter. Although this situation poses a major challenge to Latin American trade integration, there are no obvious solutions. Consequently, there seems to be a need to retain some scope for flexibility and even variable geometry in the different subregional schemes so that this situation can be accommodated.

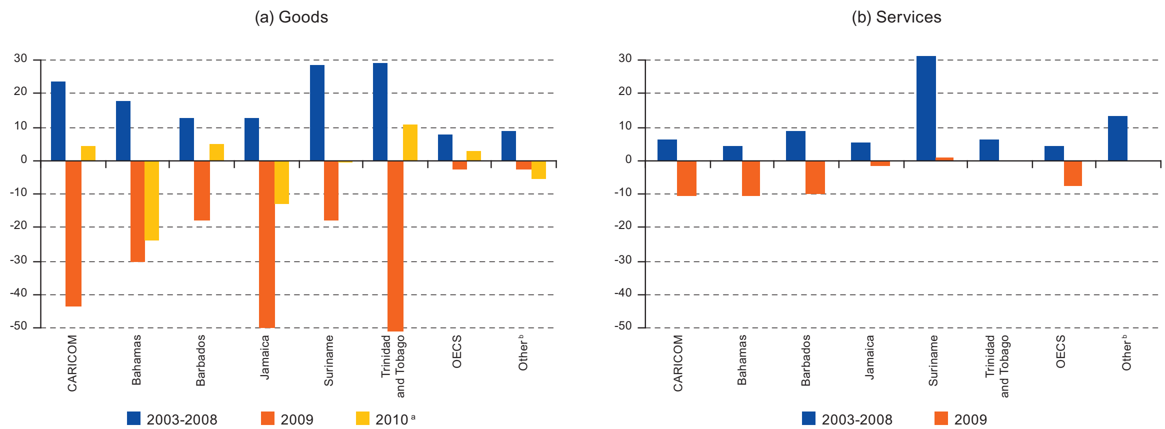
There is currently no obvious framework for implementing the ambitious South American trade convergence initiatives launched in the middle of the last decade. This limits the scope for progress towards a larger integrated economic space, even though such a space would benefit the development of intraregional trade, with all its benefits (a larger presence for manufactures and SMEs, greater potential for integrating production systems, etc.). This situation contrasts with that in Meso-America, where intensive negotiations are going on both to enhance current agreements or replace them with more comprehensive ones, and to create larger economic spaces by bringing about convergence between existing agreements.

Nonetheless, the difficulties in progressing towards liberalization of intraregional trade must not become an obstacle to enhanced regional or subregional cooperation in other areas where action is needed at least as urgently to deal with the competitiveness challenges facing Latin America and the Caribbean. Among these, ECLAC has identified eight priority areas: (i) the development of infrastructure for integration, (ii) measures to support trade (progress with the trade facilitation agenda and the provision of proper financing, especially for intraregional trade), (iii) efforts to strengthen the social component of integration, (iv) a renewed effort to deal with the asymmetries between countries and regions, (v) regional cooperation on innovation and competitiveness, (vi) a joint strategy for enhancing ties with Asia and the Pacific, (vii) regional coordination in debates about international financial system reform and (viii) regional cooperation to deal with climate change.

D. TRADE AND INTEGRATION IN THE CARIBBEAN: TRENDS AND OUTLOOK

The global financial crisis has worsened the economic difficulties of the Caribbean countries and exposed their vulnerability to external shocks. The crisis had a large impact on the trade of the Caribbean Community (CARICOM) because of its dependence on external markets. In 2009, Caribbean goods exports fell 43% by value, largely because of lower prices for the energy products and raw materials that dominate the export baskets of the largest goods exporters, such as Jamaica, Suriname and Trinidad and Tobago. External sales of services were less affected, although they also fell by 10% (see figure 11).

Figure 11
CARICOM: AVERAGE ANNUAL GROWTH RATES OF GOODS AND SERVICES EXPORTS, 2003-2008, 2009 AND 2010
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), "Balance of Payments Statistics", and "Direction of Trade Statistics" [online] http://www.imf.org/external/data.htm, and official figures from the respective countries.

[a] Refers to the period January-February 2009 and January-February 2010.
[b] Includes Belize, Guyana and Haiti.

Following record growth in 2005 and 2008, exports fell substantially in 2009, especially in Trinidad and Tobago (51%), Jamaica (50%), Bahamas (30%), Barbados (18%) and Suriname (18%). Given that Jamaica, Suriname and Trinidad and Tobago have large goods-producing sectors by the standards of the rest of the Caribbean economy, these declines were very significant. Preliminary data for 2010 show that exports have begun to recover, albeit with large variations between countries.

Services exports suffered less in the crisis. This is partly because trade in services is more crisis-resistant than trade in goods, being less dependent on trade financing, less fragmented globally and less sensitive to changes in demand. Other than Guyana, Suriname and Trinidad and Tobago, the CARICOM economies specialize in services, particularly tourism and to a lesser extent financial services. These countries have suffered from the drop in tourist arrivals from Europe and, especially, the United States. Tourist arrivals recovered slightly in the first quarter of 2010.

Goods now circulate very freely within the Caribbean, as most tariffs on merchandise originating in the countries of the common market were abolished in the 1990s. A number of non-tariff barriers have also been eliminated and a timetable has been adopted for abolishing unauthorized import duties and taxes.

CARICOM is currently implementing the CARICOM Single Market and Economy (CSME) in two phases. In the 2001 Revised Treaty of Chaguaramas, a timetable from 2006 to 2015 was agreed, with two sub-phases: the single market (2006 to 2009) and the single economy (2010 to 2015). With the single market, all barriers to trade in goods and services and to the movement of several categories of workers are to be removed. Implementation of the single market is further entrenching the integration process via harmonization of the regulatory regime and economic policies and the creation of a monetary union.

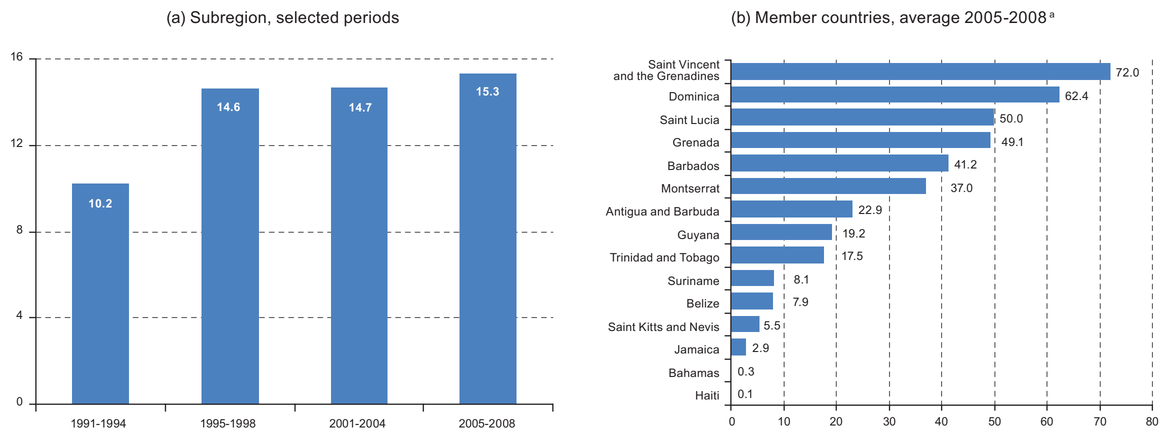
Substantial advances have been made in applying the CSME. Like other regional integration schemes, CARICOM remains an imperfect customs union. New CARICOM agreements have been signed, ratified and enacted into domestic law by most members. The exceptions are the Bahamas and Montserrat, which have decided to remain outside the CSME, and Haiti, which has postponed implementation.

Intrasubregional trade represents a large share of the total, but is skewed towards a few countries and a handful of products. Exports to CARICOM members as a share of the total grew from 10.2% in 2005 to 15.3% in 2008. Intra-Caribbean exports are increasingly dominated by Trinidad and Tobago, which accounted for 80% of the total in 2008. The country mainly sells natural gas and oil to Jamaica, Barbados and Guyana. Energy products accounted for 65% of intrasubregional exports in 2008. This trade is very important for small economies; the Organization of Eastern Caribbean States (OECS), and Grenada, Dominica and Saint Vincent and the Grenadines in particular, sell half their exports in the subregional market. Intra-Caribbean trade is also above the average for the subregion in Guyana and in Trinidad and Tobago, but represents a smaller proportion of total trade for the Bahamas, Haiti and Jamaica (see figure 12b).

Figure 12

CARICOM: INTRA-CARIBBEAN TRADE OF THE SUBREGION AND THE MEMBER COUNTRIES AS A PROPORTION OF ALL EXPORTS

(Percentages of the total)



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

[a] The information for Haiti is based on data from the International Monetary Fund (IMF) Direction of Trade Statistics. The data for Suriname should be interpreted with caution since no specific destination is attributed to most of the country's exports.

All countries other than Bahamas have adopted the Common External Tariff (CET), which has itself been substantially reduced. The weighted average import tariff was lowered from 20% in the early 1990s to 10% in 2009. CARICOM has also adopted a common trade policy towards external partners, albeit with some exceptions. For this purpose, the Caribbean Regional Negotiating Machinery (CRNM) was integrated into CARICOM in 2008 and renamed the Office of Trade Negotiations (OTN).

Progress has also been made on free intraregional trade in services, the main comparative advantage of the region. All members have adopted a negative list whereby all sectors and measures are to be liberalized unless otherwise specified. All member countries have put into place legislation to permit the free movement of highly skilled personnel, including university graduates, media workers, sportsmen, artists and musicians wishing to provide a service or set up a business.

Another important achievement has been the establishment of a Regional Development Fund to assist disadvantaged members. The Fund seeks to alleviate difficulties faced by some countries in the transition to an integrated market for goods and services.

Notwithstanding progress towards the establishment of CSME, there has been less movement in certain areas. Issues on which there is room for improvement include the following: (i) monetary and fiscal policy are uncoordinated and unharmonized, (ii) tariff suspensions and reductions and national exceptions to the CET are widely used, even though all members except Bahamas have adopted the CET, (iii) free movement of goods is still being hindered by non-tariff barriers such as phytosanitary rules and technical barriers to trade, (iv) the free movement of capital and skilled labour needed to develop service industries and their exports is still incomplete, (v) decisions by the various CARICOM bodies are non-binding, (vi) there has been a failure to develop and apply common sectoral policies, (vii) progress in harmonizing competition policies and consumer protection regulations has been slow and (viii) the technical and administrative capacity of member governments is weak.

The promotion of exports is of the utmost importance for all CARICOM countries, because in the medium term smaller economies can only build up their economic infrastructure and develop by importing capital goods and intermediate inputs, as well as technology. Over the long run, countries must maintain equilibrium in their balance of payments, as they can only grow over the long run at rates of growth compatible with their external position. This is the main reason why the performance and development patterns of small open economies have been and continue to be heavily constrained by the vicissitudes of the external sector.

Given the very limited financial resources of Caribbean countries, Aid for Trade (AfT) has a key role to play in strengthening their ability to capitalize on international trade opportunities. The ability to implement regional decisions depends heavily on external financial assistance. Financial support for regional integration also needs to be increased.

The implementation of the single economy component of the CSME, which should have started in 2009, needs to be fast-tracked. In particular, the Revised Treaty of Chaguaramas provides for the development of a common trade policy and coordination of policies to promote the development of critical economic sectors including industry, agriculture and transport. This creates opportunities for the integration of development and trade policy that will allow the region to maximize the benefits from trade agreements.

CARICOM needs to establish a mechanism to manage the implementation of decisions taken by the Heads of Government Conference. CARICOM States are still failing to enact regulations agreed on by the organization’s decision-making bodies into local law. CARICOM should take the necessary action to remove the remaining obstacles to effective functioning of the single market. These include the harmonization of sanitary and phytosanitary measures and technical standards, removal of unauthorized taxes on regional goods, implementation of the consumer protection regime, abolition of work permit requirements for service providers and implementation of licensing arrangements for service providers.

The recently created CARICOM Development Fund (CDF) may not be enough to deal with the issue of special treatment for the most disadvantaged members. Because of the lack of secure funding for the CDF, the inadequacy of its capital fund and the temporary nature of its assistance, it is possible that it will be not able to achieve its goals. Therefore, the CDF needs more secure funding and a larger pool of resources. As an alternative for supporting the less advanced members, consideration could be given to the World Bank recommendation that additional resources be sought to strengthen the role of the Caribbean Export Development Agency.

The Economic Partnership Agreement (EPA) with the European Union provides opportunities for export diversification, increased inflows of investment and financial and technical assistance to promote regional integration. Concerns about slow disbursement of European Development Fund (EDF) resources notwithstanding, those Caribbean governments that have not yet established EPA implementation units need to move quickly to do so. CARICOM should try to clarify the development cooperation components of the EPA. This issue could be addressed within the Joint CARIFORUM-EU Council. Caribbean governments should urge the European Union to speed up disbursement of the funds allocated to promote regional integration.

It is important for CARICOM and the Dominican Republic to rapidly resolve their differences over the tariff treatment of exports from the Dominican Republic to CARICOM. This is necessary to facilitate effective application of the EPA. The CARICOM member countries need to position themselves better to capitalize on the market access provided by the EPA and thereby diversify their exports. This repositioning will require that countries take full advantage of the financial and technical assistance available under the EPA with a view to developing production capacity, strengthening institutions and improving competitiveness.

To attract inflows of FDI from the European Union, CARICOM needs to improve the business climate. Required measures include promotion of macroeconomic stability, creation of a skilled workforce, provision of adequate infrastructure and development of strong, independent institutions.

Export diversification efforts under way in the Caribbean are moving in the right direction, but the process needs to be accelerated. Export diversification is critical to reduce the effects of external shocks, enhance productivity, create new comparative advantages and promote economic growth. Supply-side constraints have to be addressed if export diversification is to be successful. Significant constraints that require urgent attention include deficient physical infrastructure including roads, ports and telecommunications, weak private sectors, weak institutions and an inadequate supply of expertise.

It is important to strengthen local technical capacity to produce more sophisticated exports based on human capital development and to achieve export diversification that enhances intersectoral linkages. Foreign technologies have few spillovers without the development of local capacity to innovate. Deepening the regional integration process will not by itself solve these issues of low technical capacity and limited human capital development. In particular, tourism services need to be linked more strongly to the creative industries and domestic agriculture with a view to enhancing production and employment spill overs.

Given the limited financial resources of Caribbean countries, Aid for Trade (AfT) will have a vital role to play in relaxing supply-side constraints. AfT can help to promote export diversification by providing the financial and technical assistance needed to implement and administer the EPA, improve infrastructure, strengthen institutional capacity and improve the innovation and marketing capacities of private-sector firms. CARICOM should encourage donors to improve the implementation and effectiveness of AfT initiatives by correcting the main shortcomings identified by beneficiaries. Most importantly, the predictability of AfT funding needs to be improved to facilitate speedy and efficient implementation of export diversification programmes. Other improvements that should be considered include increased input from Caribbean countries in the design of AfT initiatives and more emphasis on the development of local capacity.

E. ECONOMIC COOPERATION AND TIES BETWEEN JAPAN AND LATIN AMERICA AND THE CARIBBEAN

This section analyses the recent strategies adopted by Japan to intensify its economic relationship with Latin America and the Caribbean. These are areas of cooperation that can be enhanced and expanded. ECLAC has emphasized the need to create opportunities for cooperation in the region. In the previous edition of *Latin America and the Caribbean in the World Economy*, and in the recent report *Opportunities for Convergence and Regional Cooperation*, ECLAC has proposed that cooperation efforts should be concentrated, as the cooperation agenda is becoming more important than the trade liberalization agenda. In this context, ECLAC has suggested promoting regional cooperation in eight areas, four of which relate to the intraregional level (intraregional trade promotion, infrastructure investment, social cohesion and the reduction of asymmetries) while the other four are important in the effort to address today's global challenges (innovation and competitiveness, the forging of joint ties with Asia and the Pacific, international financial system reform and climate change).

Asia, viewed through Japan, offers some clues as to the possible paths to promote regional cooperation. Integration and cooperation in Asia have generally been mutually reinforcing and complementary. After many years of market-led integration, the Asian economies are pursuing formal integration with an approach that goes beyond free trade to include innovative agendas such as industrial development, competitiveness and scientific and technological development. Cooperation is one of the major drivers of this integration. The proposals formulated by ECLAC to promote cooperation in Latin America and the Caribbean closely match the historical experience of the Asian economies. Accordingly, ties with Asia-Pacific do not have to be confined to trade and investment but also need to include cooperation. Latin America and the Caribbean have a great deal to learn from Asia where this agenda is concerned, and the region should also be exploring new ways of enhancing inter-regional cooperation with Asia.

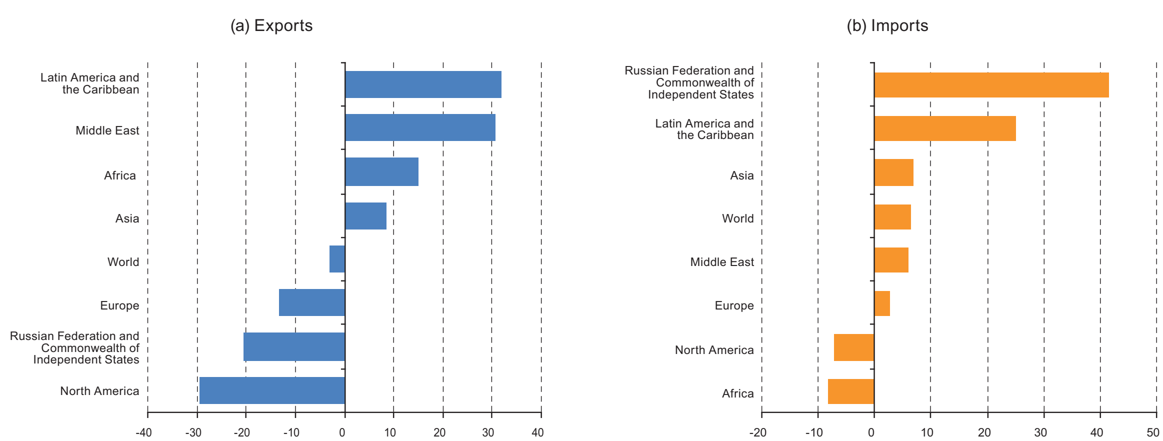
Japan is not only the largest donor in Asia, but the main Asian donor to Latin America and the Caribbean. Cooperation is one of the pillars of Japanese external economic policy. One of the main contributions made by Japan in Asia has been to promote interaction between investment, trade and official development assistance (ODA). The Japanese ODA model applied in this region has emphasized infrastructure improvements and training with a view to revitalizing the production sector and promoting trade and investment in the recipient country. Similarly, the economic partnership agreements (EPAs) offered by Japan have sought to supplement trade liberalization with a broad framework of medium- and long-term cooperation.

A number of Japanese firms now regard the region as a strategic base for their global operations. Historically, the relationship between the two parties has turned mainly on economic issues. At present, the private sector and government in Japan are coordinating their efforts in a public-private alliance set up to take advantage of opportunities in the region. In the 2010 edition of the Diplomatic Bluebook, the Japanese Government emphasizes that Latin America and the Caribbean are increasing their economic presence in the world. The basic data underlying this opinion are clear enough: a population of 560 million, regional GDP that is currently three times as great as that of the Association of Southeast Asian Nations (ASEAN) and growing rapidly, and considerable mining, energy and food resources. Japanese firms' perception of the region has improved in recent years, particularly since it became clear that Latin America and the Caribbean had been able to overcome the challenges of the global economic and financial crisis and resume growth at higher rates than expected. To strengthen economic ties with Latin America and the Caribbean, the Government of Japan is trying to provide Japanese firms with the support needed to facilitate operations in the region.

A major effort is needed from Latin America and the Caribbean so that Japan comes to regard the region as one of the hubs of its global corporate strategy. The Japanese business sector is still in shock over its experience during the "lost decade" and this experience continues to colour its perception of the region. When the crisis broke out in August 1982, Japanese banks were involved in the region's largest projects with private-sector financing operations worth over US$ 30 billion, including more than US$ 13 billion in syndicated loans. The Japanese Government had to commit large quantities of public funds to roll over private debt. Along with the banks, many Japanese firms pulled out of the region at a time when Asia was becoming a better option. A number of Japanese firms have overcome their bias, but the memories remain. Despite these experiences, however, economic relations between Japan and Latin America and the Caribbean have started to show some signs of improving.

In the last five years, the region has been the world's fastest-growing destination for Japanese exports in percentage terms, while for imports it ranks second. Latin America and the Caribbean are home to the largest accumulated stock of Japanese FDI outside Asia. Although the amounts involved do not place Latin America and the Caribbean near the top of the ranking, Japanese trade with the region is growing rapidly (between 2005 and 2009, exports increased by 34.8% and imports by 26.3%, see figure 13). This trend is expected to strengthen in the coming years as both sides' economies recover. Recent Japanese investment has concentrated on natural resources. The countries of Latin America and the Caribbean need to embark upon initiatives like those of Brazil and Mexico, the two main recipients of Japanese FDI in the region, with a view to participating in Japanese and global value chains.

Figure 13
JAPAN: TRADE GROWTH, 2005-2009
(Percentages)



Source: Japan External Trade Organization (JETRO) database [online] www.jetro.go.jp.

The Japanese public-private alliance is becoming more active as the region is rediscovered. Large general trading companies (*sogo shosha*) remain at the forefront, accompanied by other Japanese firms. During the 2010 fiscal year (April 2010-March 2011), the *sogo shosha* are expected to implement worldwide investments for what is likely to be a record total of over US$ 27.5 billion. Latin America and the Caribbean need to make an effort to attract this capital. Much of the fresh investment by the Japanese private sector is likely to go not only to natural and energy resources, but also to infrastructure and food security. EPAs and bilateral investment treaties (BITs) should help to spur business and investment by Japanese firms in the region. The Government of Japan is prepared to use the public and private advisory and assistance tools available to it to help Japanese firms (ODA, financial assistance for the Japanese private sector, insurance for commercial activities abroad, and so on). The next task for Japan is to strengthen its assistance mechanism by pledging more resources to the region. Another need is to streamline interactions between Japanese government institutions, as there is no "one-stop shop" for Japanese firms requiring assistance. Latin America and the Caribbean could help with this by seeking more and better Japanese investment in the region.

Besides liberalizing and facilitating trade and investment, the Japanese EPAs include additional measures to strengthen the economic relationship. Japan signed the first "full" EPA in its history with Mexico after agreeing to open up its farm sector. Mexico negotiated the agreement with a view to it becoming the cornerstone of the country's strategy to expand and diversify trade and investment with Asia. The effects of this EPA have been generally positive. In its first five years of operation (2004-2008), Japanese exports rose by 60%, driven by the automotive sector and steel products, while Mexican exports to Japan increased by 50%. The EPA has also enhanced the role of Mexico in Japanese and global value chains. According to a study by the Japanese Embassy in Mexico, in 2008 Mexico imported what were mainly intermediate goods from Japan (parts, components, etc.) to the value of US$ 11 billion. Mexico then used these goods to make final products and export them to the world's leading markets in a trade worth US 14.3 billion.

The Japan-Mexico EPA included a special chapter on bilateral cooperation for the first time in the history of the agreements of this type signed by Japan. The cooperation covered by the agreement encompasses nine areas: trade and investment promotion, supporting industries, SMEs, science and technology, technical and vocational education and training, intellectual property, agriculture, tourism, and the environment. Cooperation in these areas has been expanded and deepened thanks to the EPA. Technical cooperation is the common denominator of a system of cooperation in which Japanese ODA plays an important role. In Asia, cooperation has expanded into new areas such as monitoring of financial institutions and transactions and cooperation to expand electronic transactions. There is also great demand for human resources development in practically all areas.

For the first time, the EPA between Japan and Mexico also included a specific chapter on measures to improve the business environment. This is another innovative mechanism Japan later adopted in subsequent EPAs. The country's EPAs also seek to improve the business environment with a view to enhancing the bilateral economic relationship. Even in Asia, Japanese firms face a variety of difficulties that in practice turn into non-tariff barriers (continual and unexpected changes in laws and regulations affecting business, lack of transparency in administrative procedures, inadequate infrastructure, concern about citizen security, non-compliance with intellectual property rules, and so forth). Latin America and the Caribbean could become a rival to Asia if the region were to resolve these problems in the medium or long term. Under the auspices of the Japan-Mexico EPA, efforts have been made to integrate firms from the two countries more closely in the global value chain, develop scale economies and increase productivity. In practice, this mechanism also operates as a cooperation framework, in the sense of both parties cooperating to resolve some particular problem. In the years it has been operating it has produced positive results.

The concept of the public-private alliance arose in Japan as a result of successful Japanese cooperation within Asia. Japan played an important role in the construction of what is now known as "Factory Asia". In the mid-1980s, the Japanese private sector became the catalyst for an inward investment boom in Asia. Japanese ODA played a decisive role in creating an investment-friendly environment by funding infrastructure and human resources development. The next goal for Japan is to double the size of Asia's economy by 2020. Since mid-2009, Japan has been implementing an initiative whose main component is an ODA package of up to US$ 20 billion. This initiative is meant to enhance the growth capacity of Asia and increase domestic demand in the region's countries. The main goal of Japan is to grow along with Asia.

Latin America and the Caribbean also need Japanese ODA, not only to develop economically and socially but also to drive innovation and scientific and technological development with a view to improved participation in the global economy. Like Asia, Latin America and the Caribbean are now paying back more than they receive in loan assistance within the Japanese ODA framework. Given the contraction in loan demand, a large part of the ODA resources made available by Japan in Asia are now devoted to technical cooperation. Asia is the largest recipient of this type of Japanese cooperation in the world; China heads the ranking, followed by other Asian countries. In 2008, China and the members of ASEAN received US$ 265.22 million and US$ 345.72 million, respectively, while Latin America and the Caribbean received US$ 182.69 million. It is important for the region's countries to better inform Japan of their technical cooperation priorities and needs. The experience of Japan in Asia provides a number of lessons that the region should study carefully.

The region needs a revival of Japanese ODA. It is important for Japan to participate more actively in its capacity as world leader in Aid for Trade. In 1999, the region received US$ 814 million in Japanese ODA. Owing mainly to fiscal constraints, this amount was gradually reduced until, by 2008, it had fallen by more than two thirds. The picture looks completely different when Japan's Aid for Trade (AFT) ODA flows to the world are analysed. In three years, the Japanese Government delivered a promised increase in AfT that was originally scheduled to take place over five years. At the World Trade Organization (WTO) ministerial summit of 2005, the main donors increase the amounts they committed to aid of this type by 2010. In 2008, Japan exceeded its initial target and made the largest contribution at that time, US$ 13.5 billion. In July 2009, Japan announced a new strategy for the 2009-2011 period that consists of a US$ 12 billion assistance package and technical assistance for 40,000 people. This assistance has gone mainly to Africa and Asia. It is important to realize how great the demand for this type of assistance is in Latin America and the Caribbean too, particularly where infrastructure is concerned.

F. CONCLUSIONS

Over the coming years, the region will face an international economy that will be less dynamic and more uncertain than in the previous half-decade. This is a reminder that the cycle of financial instability is not over. This situation is also one in which emerging economies will play an ever-greater role in trade and finance.

A preliminary overview of export performance during the past decade shows that, at a time of greater challenges in innovation and competitiveness, the region has not significantly improved the quality of its integration with the global economy. The countries of South America have displayed greater export dynamism in the aggregate, but this is strongly associated with exogenous factors such as the renewed strength of global demand for raw materials and the consequent rise in prices. Meanwhile, Mexico and Central America, whose exports are more weighted towards manufactures, have been less dynamic overall, largely because of intense Chinese competition in unskilled-labour-intensive products in their main market, the United States.

Growth in natural resource-related sectors has not contributed enough to the creation of new technological capabilities in the region. Although returns in these sectors have risen, and there have been notable gains in productivity, the absence of active production development policies has meant that the productivity divide relative to countries considered to be at the frontier, especially the United States, has widened. This being so, the trade relationship between the region and Asia presents both opportunities and challenges. Among the latter, it is particularly important to ensure that the growing trade between the two regions does not reproduce and reinforce a centre-periphery type of trade pattern between the countries of the South, with Asia (and China in particular) becoming a new centre and the countries of the region a new periphery. There is a need to forge a trade relationship that stimulates not just growth, but also greater progress with innovation, export diversification and job quality.

An effort is urgently needed to promote greater levels of innovation and endogenous development of technological capabilities, both in natural resource-related sectors and in manufacturing and services. Production and trade tied to the strongest comparative advantages in natural resources do not necessarily represent an obstacle to higher-quality participation in the international economy, but can rather complement the development strategies of the region's countries. The hypersegmentation of global markets on the one hand, and the acceleration of technological developments in areas such as the life sciences and cognitive sciences on the other, offer a variety of opportunities to decommodify the raw materials the region exports by means of stronger differentiation and the incorporation of value added and know-how. This in turn requires the development of specialized services that allow more value to be generated and captured up and down products' value chain (product design, advertising, improved input management, logistics, transport, engineering and consultancy services, insurance and finance, among others). This provides a way of enhancing forward and backward linkages by strengthening the ties between direct and indirect export sectors and the rest of the economy, especially SMEs producing goods and services, which are the main creators of jobs in the region.

Actions to further the development of intraregional trade are also desirable given that this trade presents positive features, such as greater manufacturing intensity and a greater presence of SMEs, the main drivers of high-quality job creation and social cohesion. Furthermore, intraregional markets could serve to cushion demand shocks originating outside the region, provided progress is made with financing mechanisms for intraregional trade. The data show that the potential of intraregional trade was not adequately exploited during the recent crisis.

The region is strengthening its South-South ties, particularly in its remarkably dynamic trade with China and other Asian economies. The region's future growth will increasingly depend on its success in improving the quality of these relationships. Thus, export diversification, a stronger commitment to competitiveness and innovation and a greater effort of regional cooperation in infrastructure, logistics, intraregional trade, regulatory convergence and policy are measures that would allow Latin America and the Caribbean to improve the quality of their participation in the global economy by closing productivity divides and taking advantage of international trade opportunities to achieve growth with greater equality.