

CONNECTING THE DOTS

A ROAD MAP FOR A BETTER INTEGRATION OF LATIN AMERICA AND THE CARIBBEAN



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More than half a century of integration

What is the motivation?

“The progressive realization of the

common market will gradually transform it...”

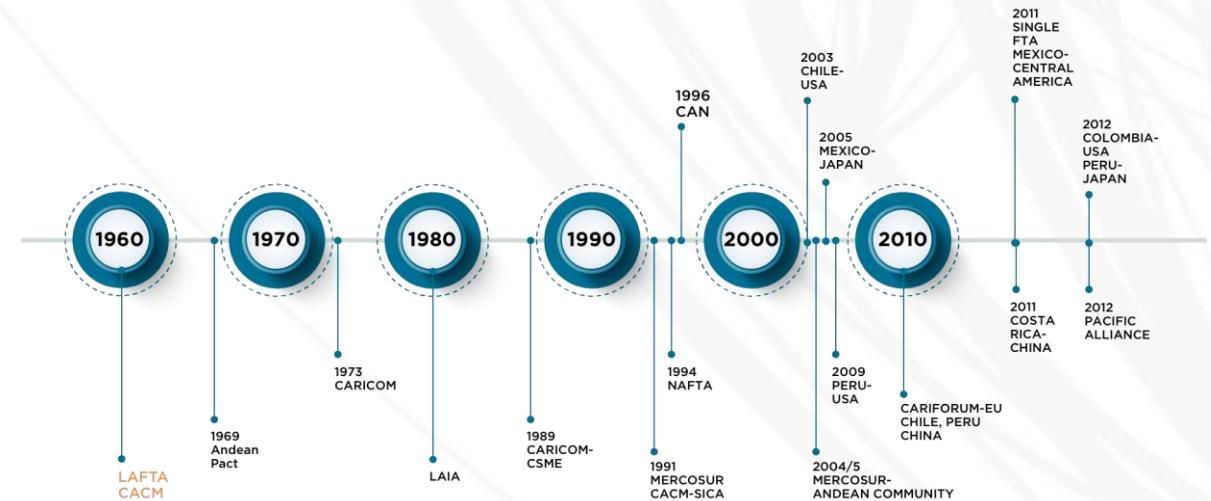
... “breaching the narrow limits of the national market, acquiring more economic

dimensions and, due to its greater productivity,

can increase its already significant contribution to the Latin American standard of living.”

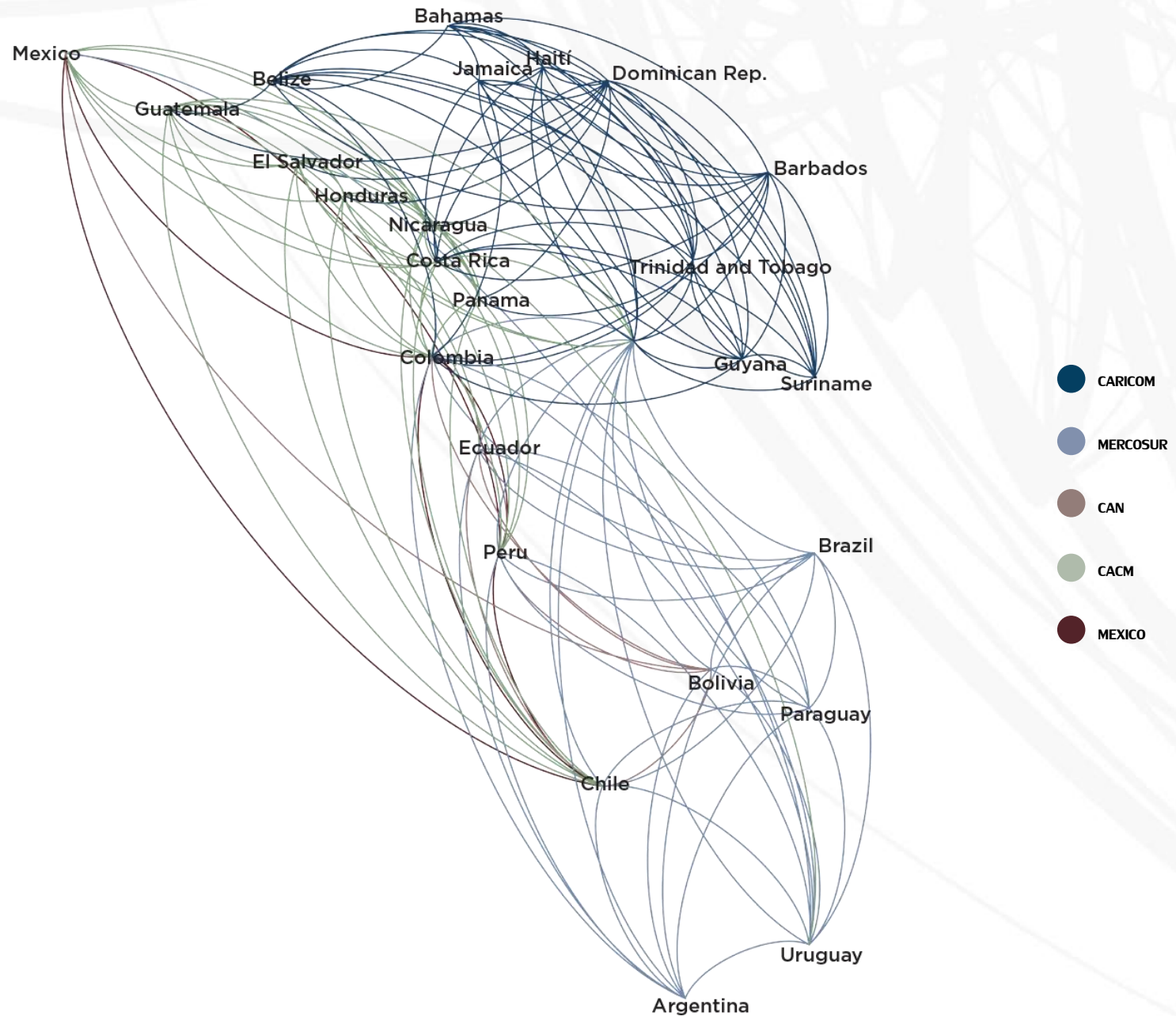
“The development of manufacturing exports to the rest of the world may be one

of the consequences of the common market.”



Source » Raul Prebisch *“El Mercado Común Latinoamericano”* Naciones Unidas, México, 1959. p.4

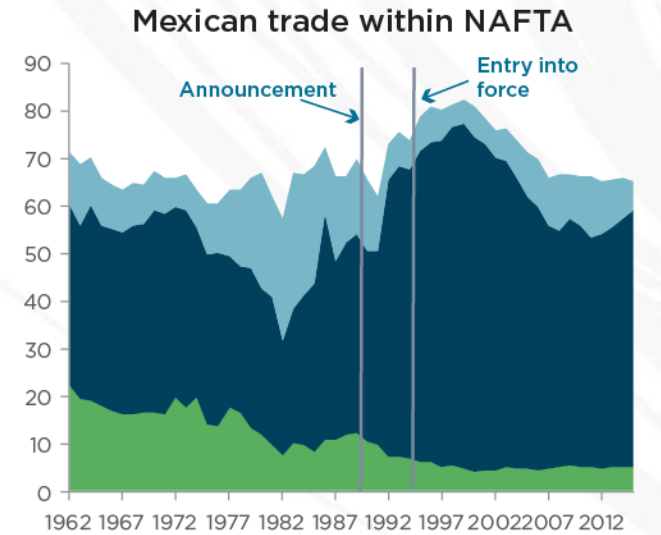
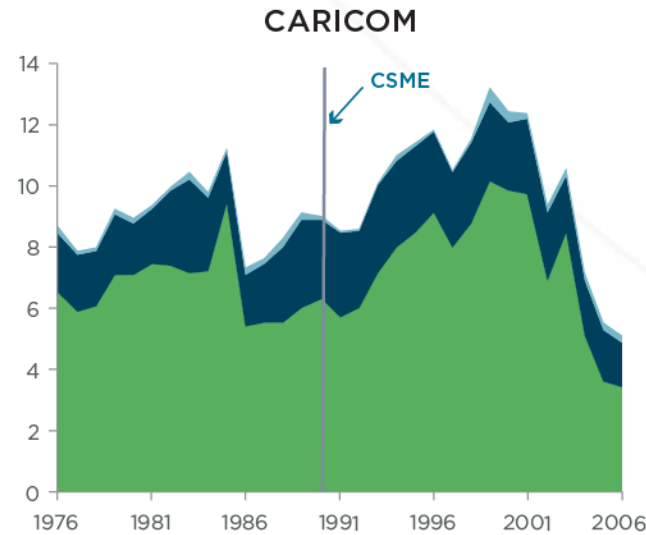
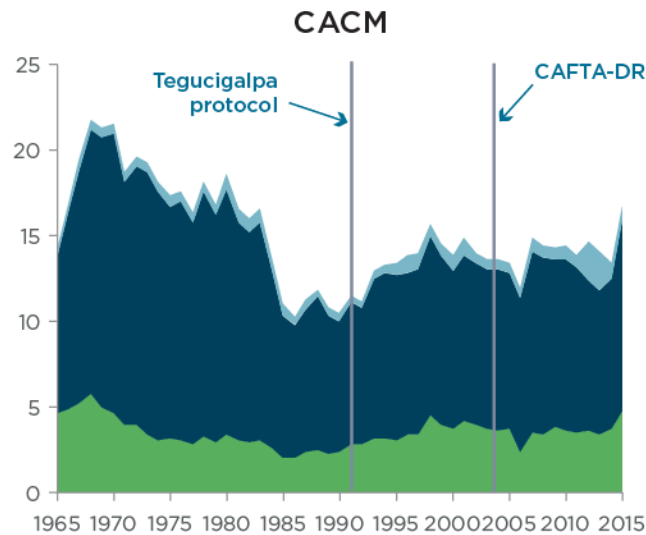
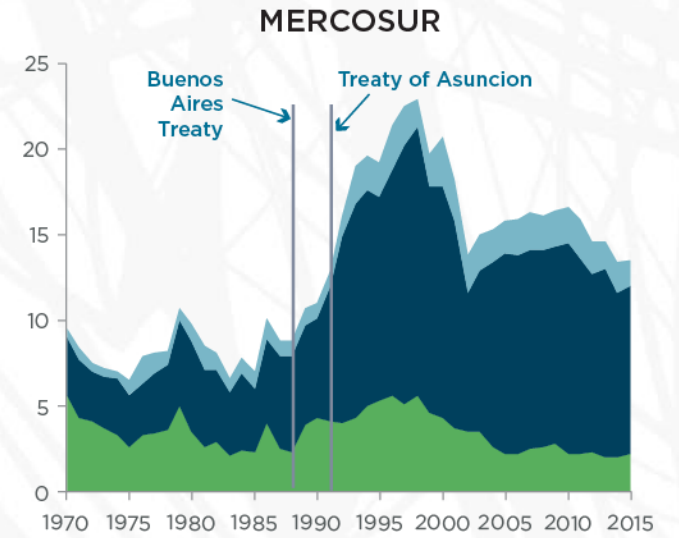
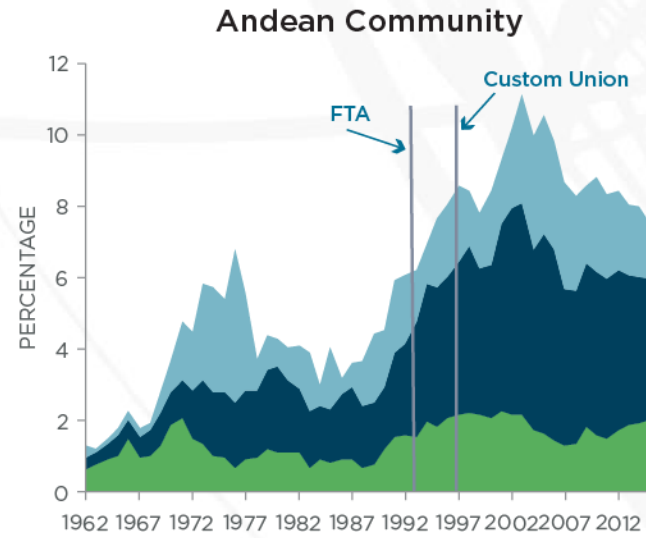
○ This motivation has created a vast network of preferential trade agreements (PTAs)



Source » IDB estimates with INTrade data

The PTAs seem to have boosted intra-regional trade...

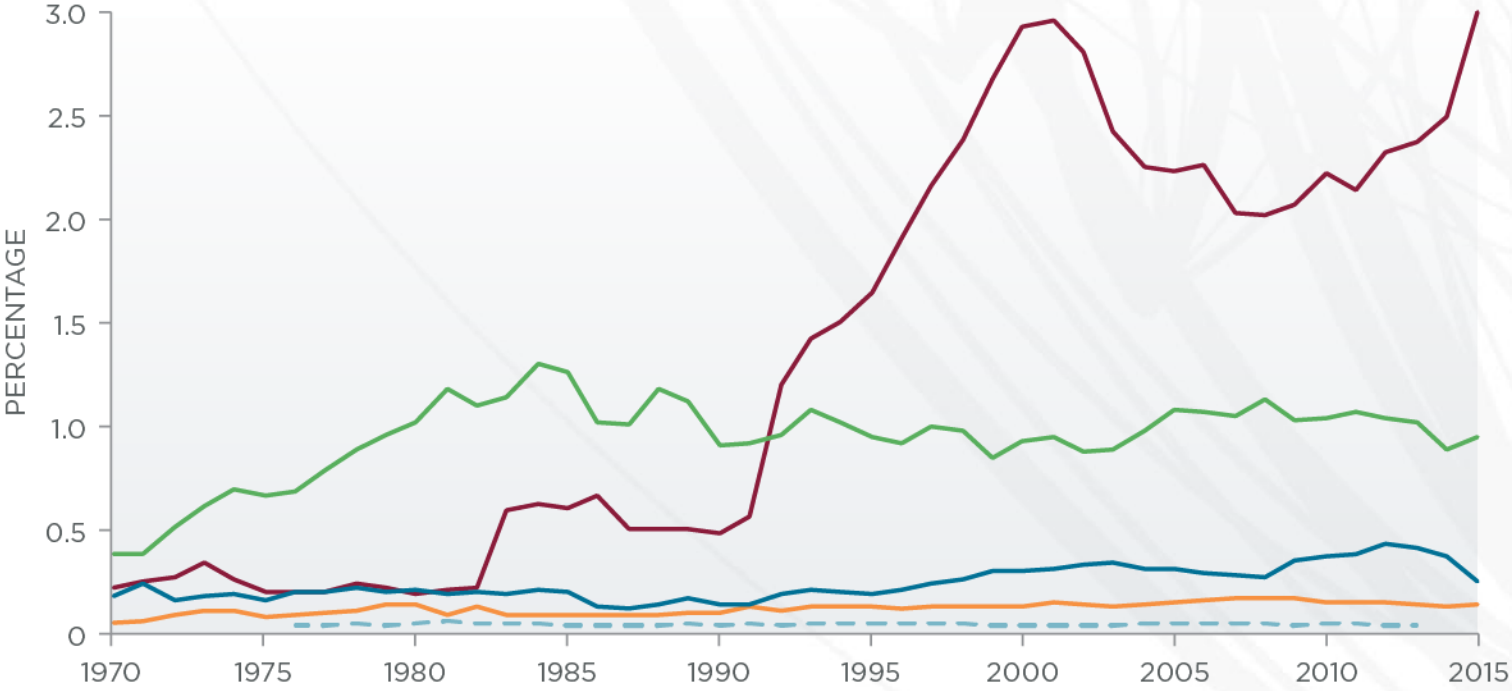
- Mining
- Manufacturing
- Agriculture



Source » IDB estimates

**but they did not boost export
diversification
to the world**

- MEXICO
- AC
- MERCOSUR
- CARICOM
- CACM



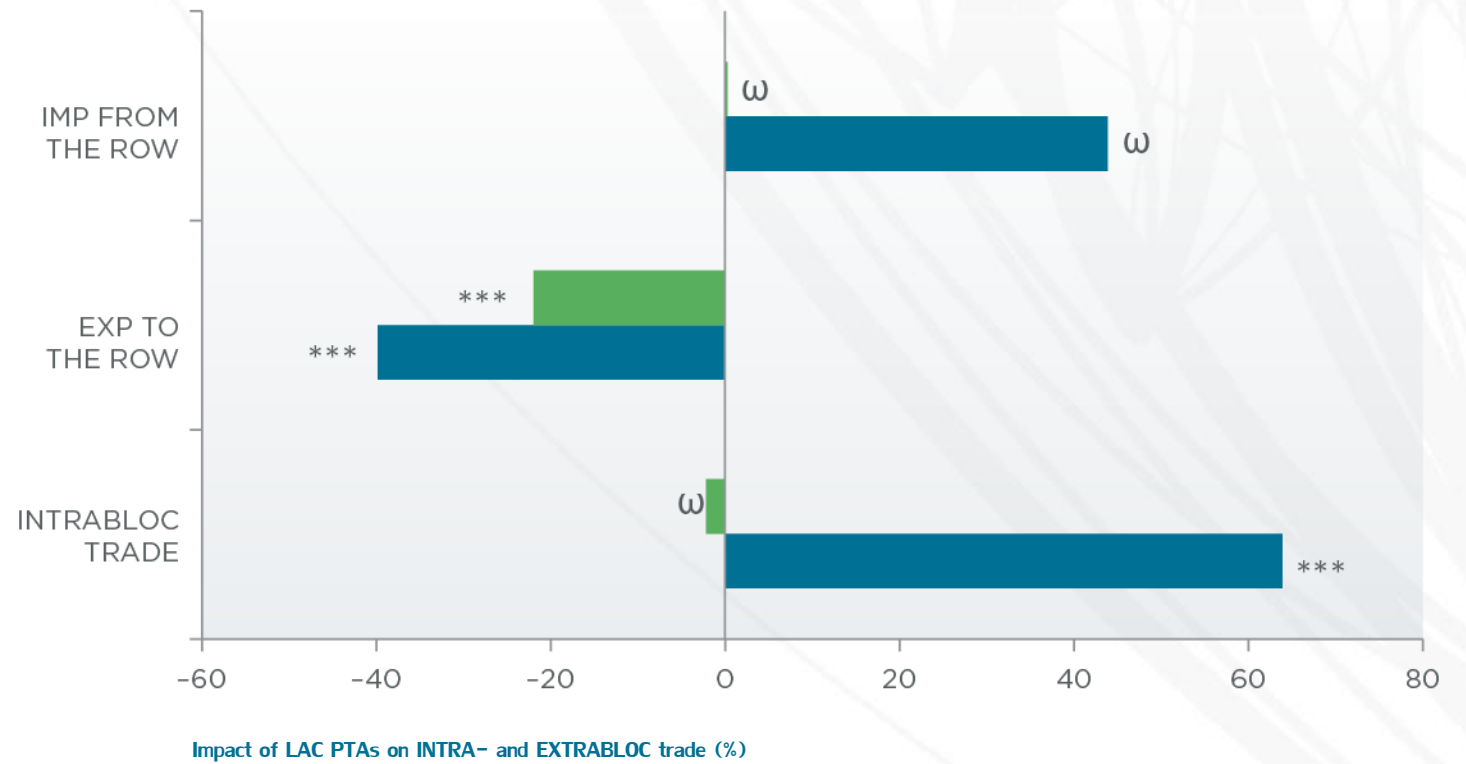
Mexico within NAFTA and selected PTAs: Share of world manufacturing exports

Source » IDB estimates with UN Comtrade data

Results

confirmed by econometrics

- Intra-LAC PTAs
- LAC-ROW PTAs



Source » IDB estimates

The problem has been the proliferation and fragmentation of PTAs

33

AGREEMENTS among the 26 regional members of the IDB





**Fragmentation
will be increasingly dysfunctional**

- **Whatever trade scenario prevails
in the world economy...**

- Will the US and Europe eventually resume the march towards mega-PTAs?
- Will China lead a new (lighter) regionalism?
- Will there be escalating trade frictions?

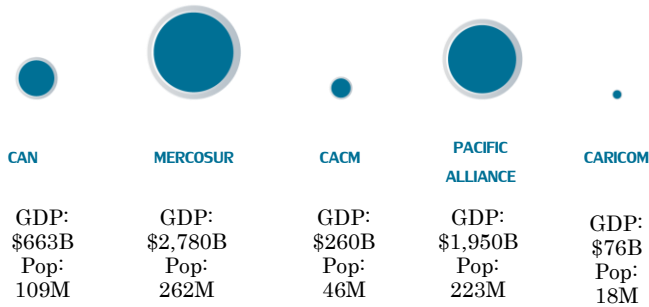
- **...small scale PTAs tend to be increasingly ineffective and lose relevance**

How to fix it?

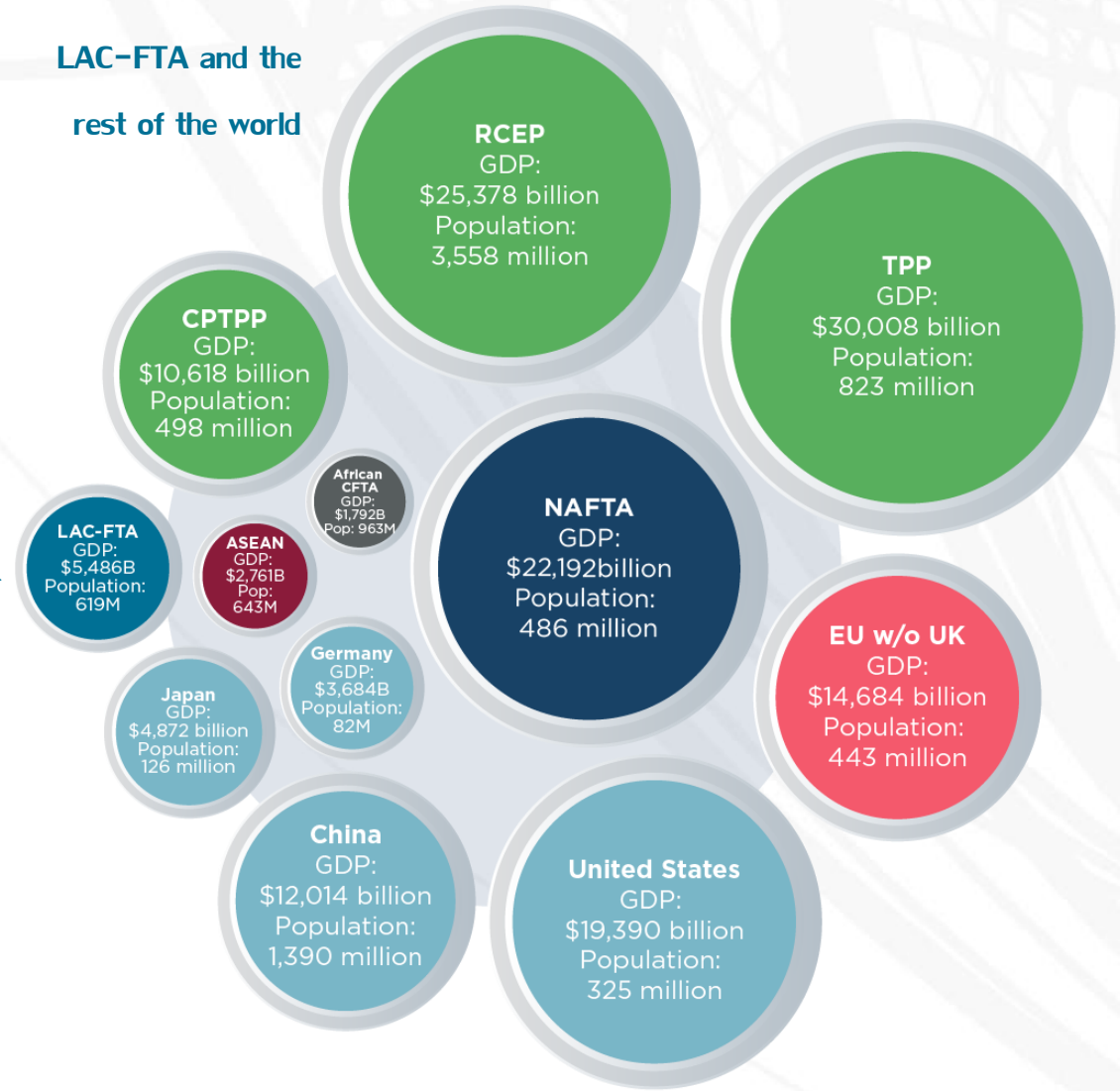
From a multitude of small agreements...

...to a stronger, larger agreement

Redemption would come through convergence among existing PTAs, leading eventually to a regionwide Free Trade Agreement or LAC-FTA



LAC-FTA and the rest of the world



Integration suffers from an original sin: fragmentation. There are just too many small Preferential Trade Agreements (PTAs)



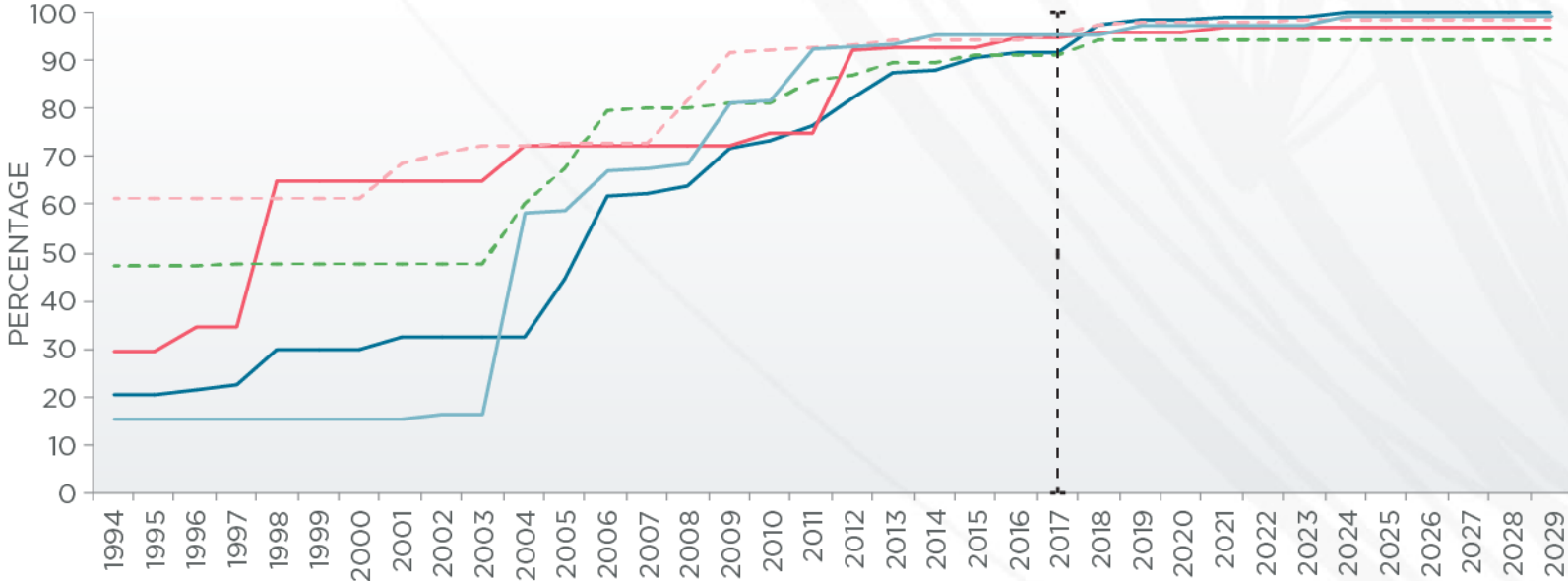
How to do it?

Building upon the existing PTAs

90%

OF ACTUAL
TRADE
IS DUTY FREE

- ANDEAN
- MEXICO
- MERCOSUR
- CENTRAL AMERICA
- CHILE



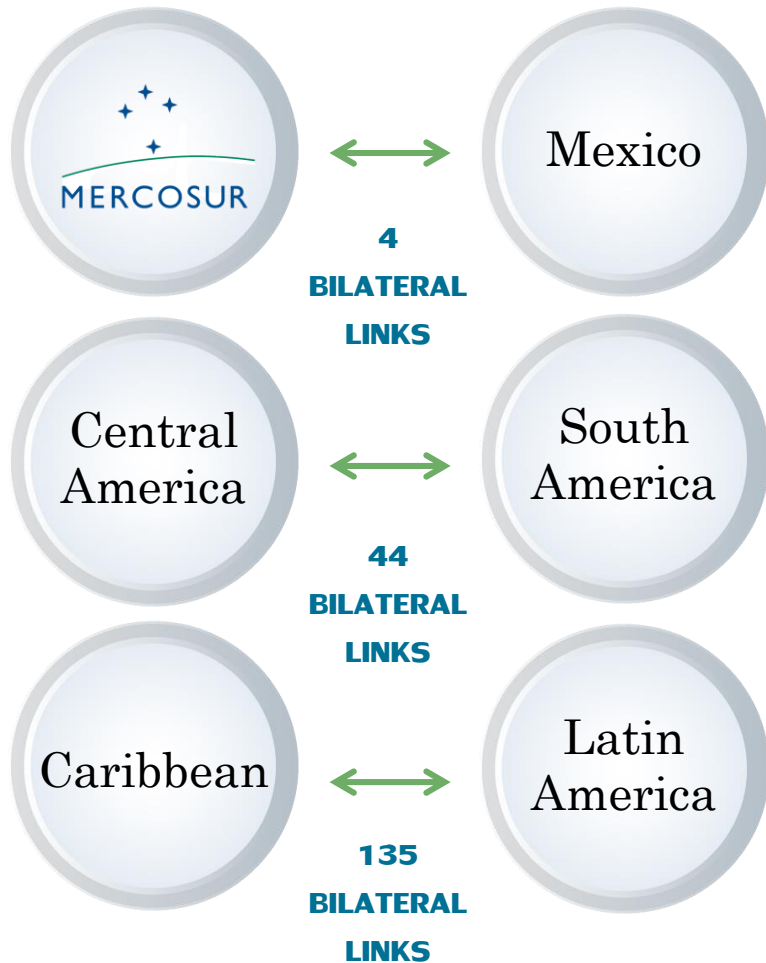
Negotiated tariff reduction schedules (percentage of duty-free intraregional trade base on 2014 trade values)

Source » IDB estimates with INTrade data.



**There are two main obstacles
for a better integration**

Critical missing links



(between IDB regional members)

Many rules of origin (RoOs)

47 sets of product-specific RoOs
under 33 PTAs

COSTS OF COMPLIANCE

Estimates range from 2% to 15%
ad valorem equivalent

- Limits on sourcing, more costly or less efficient providers
- Administrative costs, documenting compliance

VALUE CHAINS

- Different rules require separate inventories
- Limit value chains and diversification of markets

○ Different options for different political ambitions

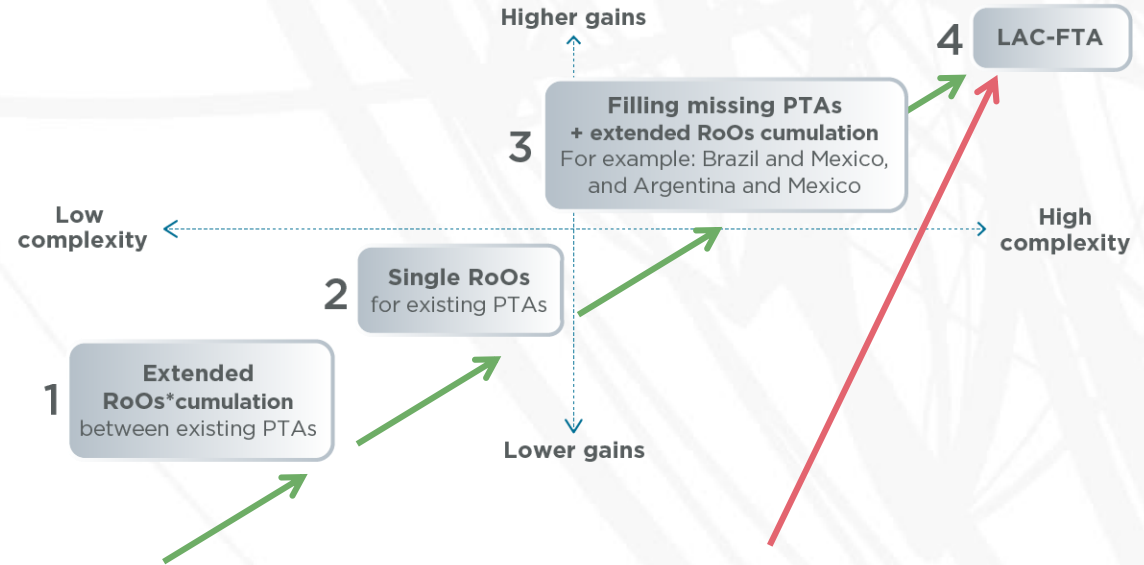
There is more than one route to reach a free trade area. Governments can take a more cautious, step-by-step approach or travel non-stop toward establishing a regionwide Free Trade Agreement or LAC-FTA

Option A » Step by Step

PROS » Easier to implement because it relies on existing architecture and carries the lowest political risk

CONS » Implementation may be easier but –given the number of players involved– it may take too long, and the gains are bound to be limited, falling short of the urgent demands of the current trade environment

*RoOs: Rules of origin in preferential trade agreements (PTAs) are the criteria that establish the degree to which materials imported from non-member countries can be incorporated into a product and still qualify for duty-free treatment under the agreement



Option B » Direct implementation

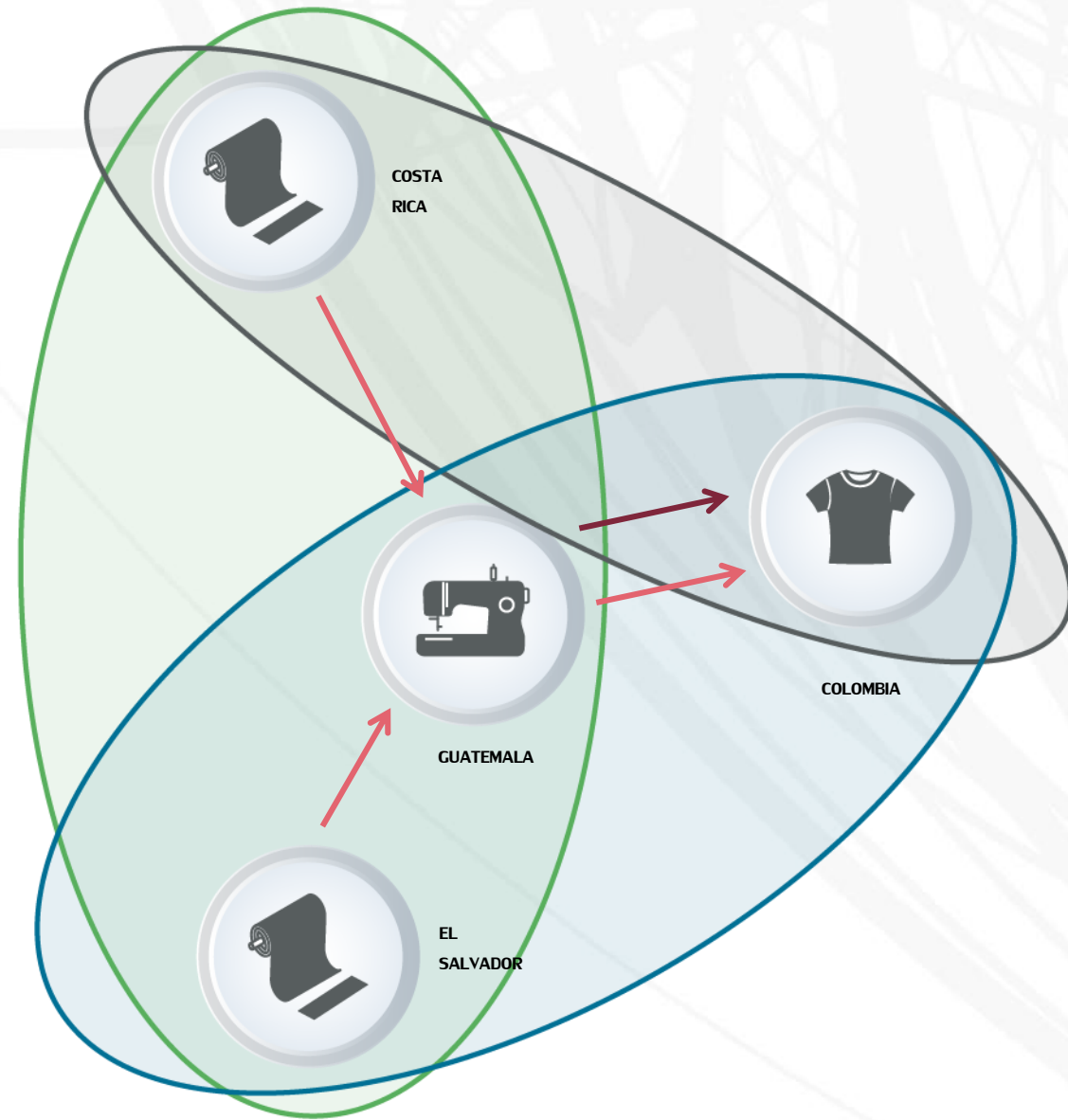
PROS » Coordinating is more likely to speed up implementation and allow for the maximization of integration gains

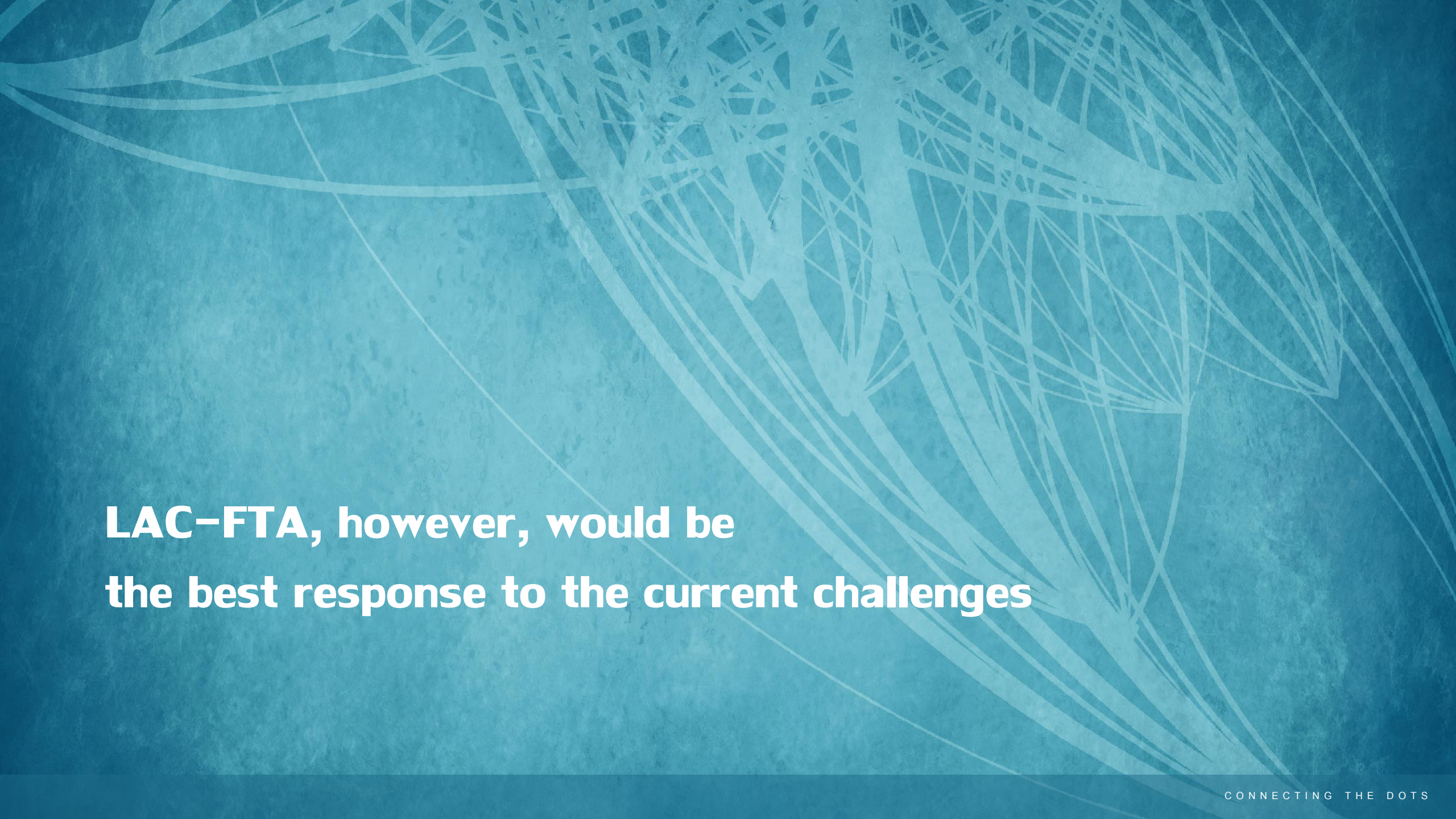
CONS » It carries the highest political risks and it is up against a credibility gap caused by past attempts that fell short of expectations

Extended cumulation of rules of origin (across existing network of PTAs)

Extended cumulation will allow Guatemala to use fabric from Costa Rica to export t-shirts to Colombia under preferences

- COLOMBIA-COSTA RICA**
Guatemalan apparel made with Costa Rican fabric pays tariffs in Colombia because there is NO cumulation among agreements
- CENTRAL AMERICAN COMMON MARKET (CACM)**
Guatemala imports fabric from Costa Rica and El Salvador duty-free under CACM
- COLOMBIA-NORTHERN TRIANGLE**
Guatemalan apparel made with Salvadorian fabric pays NO tariffs in Colombia because the agreement allows cumulation





**LAC-FTA, however, would be
the best response to the current challenges**

Key steps

Heads of State and Presidents' Summit

With a declaration outlining goals, mechanisms and timetable

Closing the relationship and product gaps

Aspiring members required to be linked by regional or bilateral PTAs

Only a critical mass of countries required
(e.g. Pacific Alliance + MERCOSUR) for the kick-off

Key steps

Setting up a minimal institutional framework

Intergovernmental principle. A council of trade ministers and chief negotiators, which would supervise technical working groups.

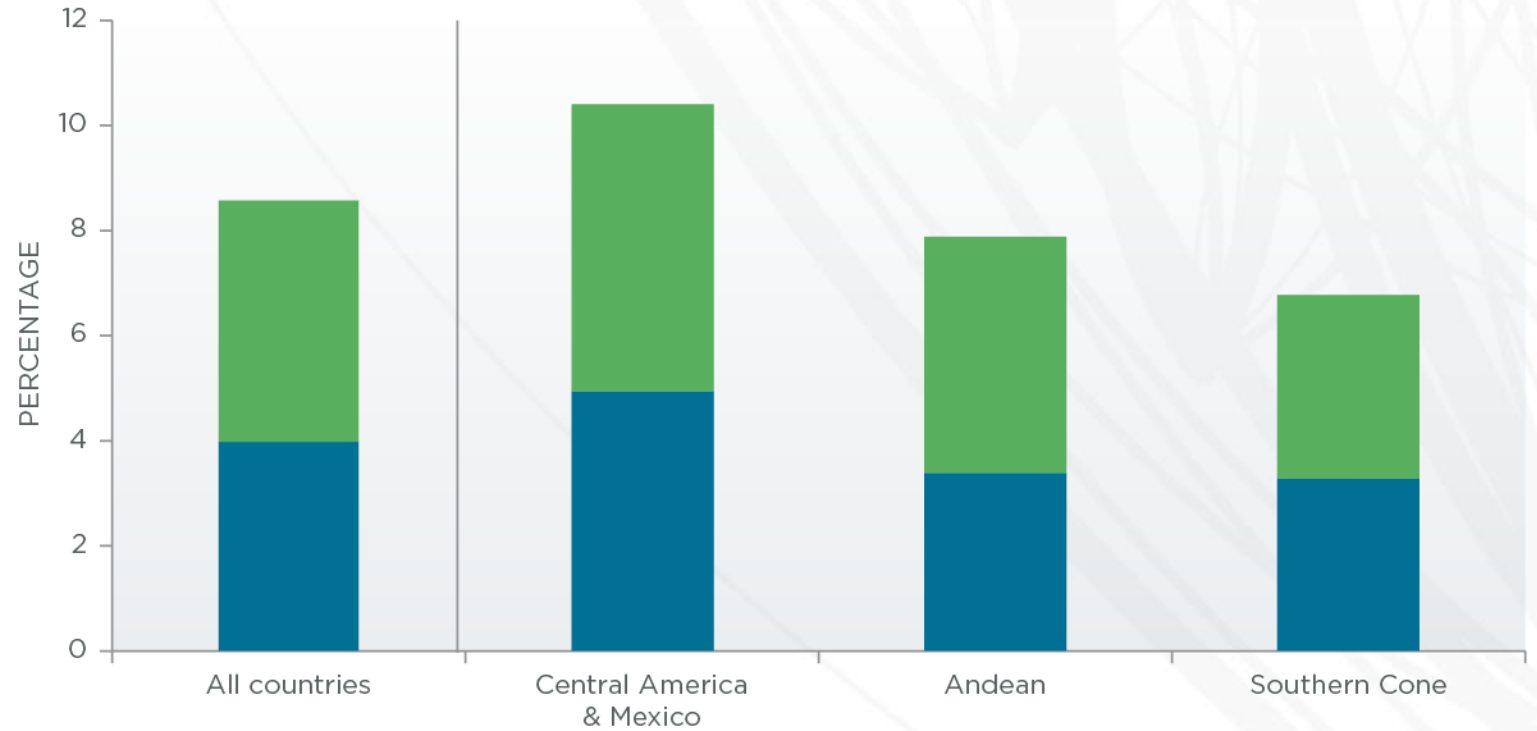
“Living agreement”, open to new members and issues

Negotiating tariffs, NTBs, unified RoO, and trade facilitation

Consolidation of preferences and RoOs across trade partners, with a phase-in schedule to accommodate sensitivities. Exceptions kept to a minimum

These actions can boost regional value chains...

- PTA
- RoOs

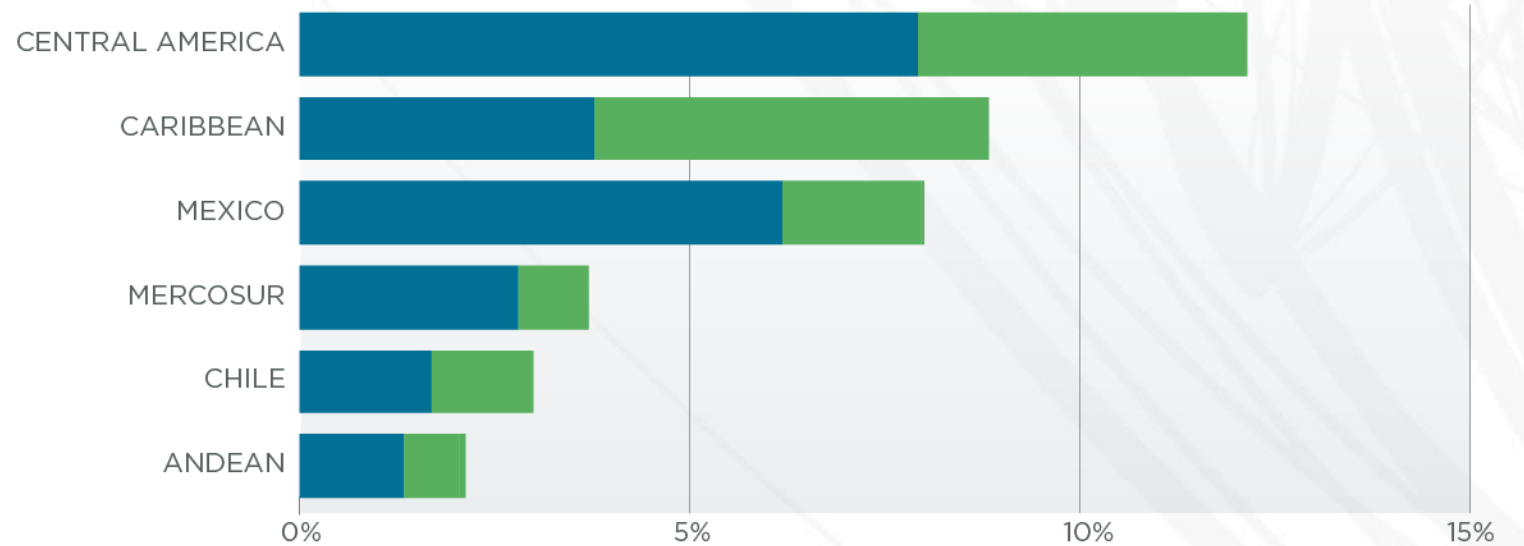


Change in exports of value-added from LAC countries that are subsequently used as inputs in other LAC countries' exports

Source » IDB estimates.

...and boost overall intraregional trade

- Tariff
- Other effects*

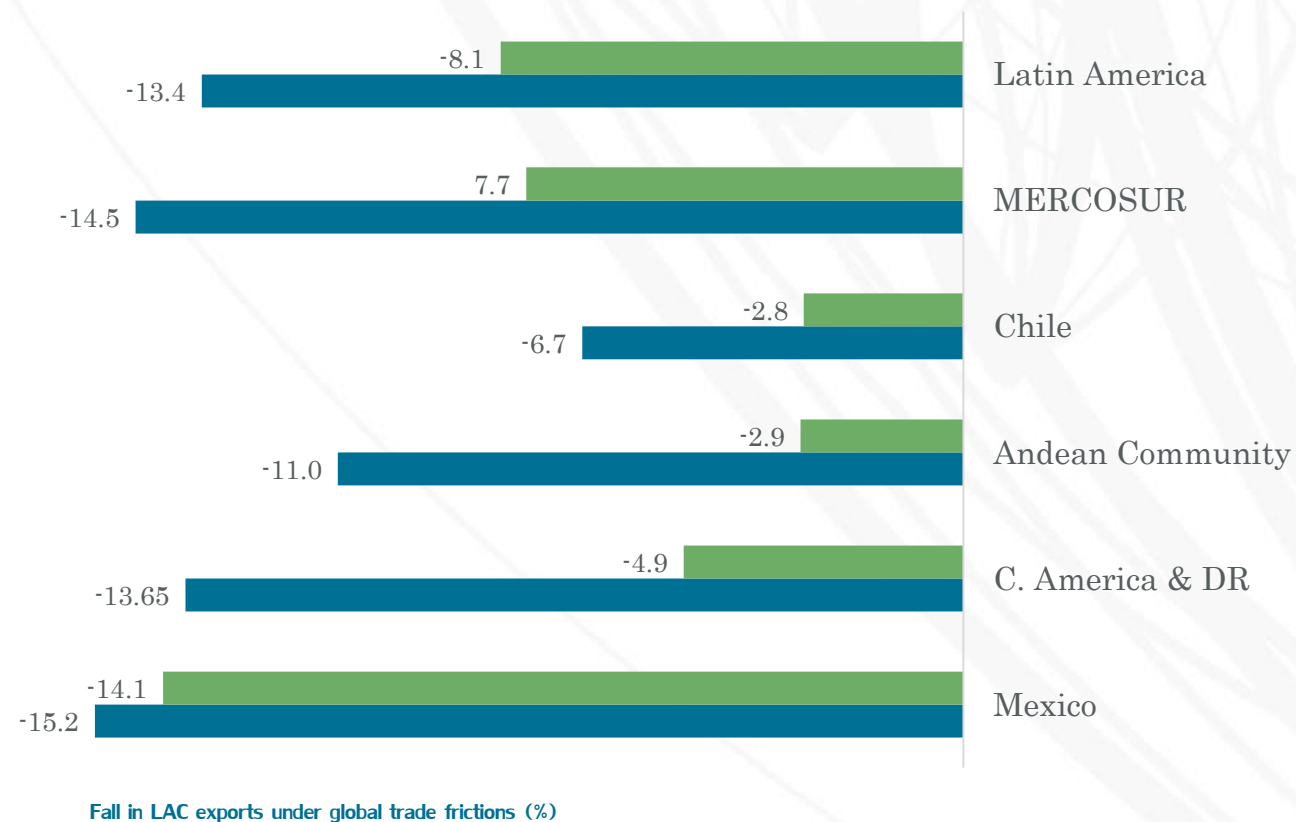


What could the region gain from a fully integrated market?
Gains in exports to other subregions in a simulated zero-tariff scenario

Source » IDB estimates.

*Non/tariff barriers, FDI and policy stability.

A LAC-FTA would also be important insurance policy in an uncertain trade environment



Without LAC integration

With LAC integration

Source » IDB estimates.

Conclusions

○ Conclusions

○ The “New Regionalism” PTAs were a powerful tool to boost interregional trade, but ineffective in improving the region’s stance in the world market.
Fragmentation took a toll

○ Convergence is the most rational solution and can take many forms according to the political constraints. A LAC-FTA, though, would be more effective in harnessing the scale gains of the regional market

○ Conclusions

- The initial goal should be a plain FTA for goods and services, with a light, intergovernmental architecture. Following the PA model, aspiring members should all have PTAs with all the other members
- The trade gains of convergence are no panacea, but they are a low hanging fruit that can provide a meaningful boost to regional value chains, as well as add further dynamism to overall intraregional trade
- Equally important, it can provide an effective insurance policy in a trade environment growing more challenging and uncertain

Thank you!



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