# Chapter 4. Trade for Development

## China, India, and the challenge of specialization

The rise of China and India in the global economy has had important effects on Latin America and been the subject of passionate public debate. Both these Asian giants have outperformed Latin America since the mid-1990s in terms of growth, exports, FDI attraction and innovation, giving rise to considerable prehension in the region. While there are many examples of business co-operation between Latin America and the Asian giants, and trade agreements are being signed between their governments, public opinion has at times seen Asia's increased presence as a threat to national industries. A closer look at the real impact in Latin America of the world's rapidly growing trade with China and India nevertheless offers a much more encouraging assessment.

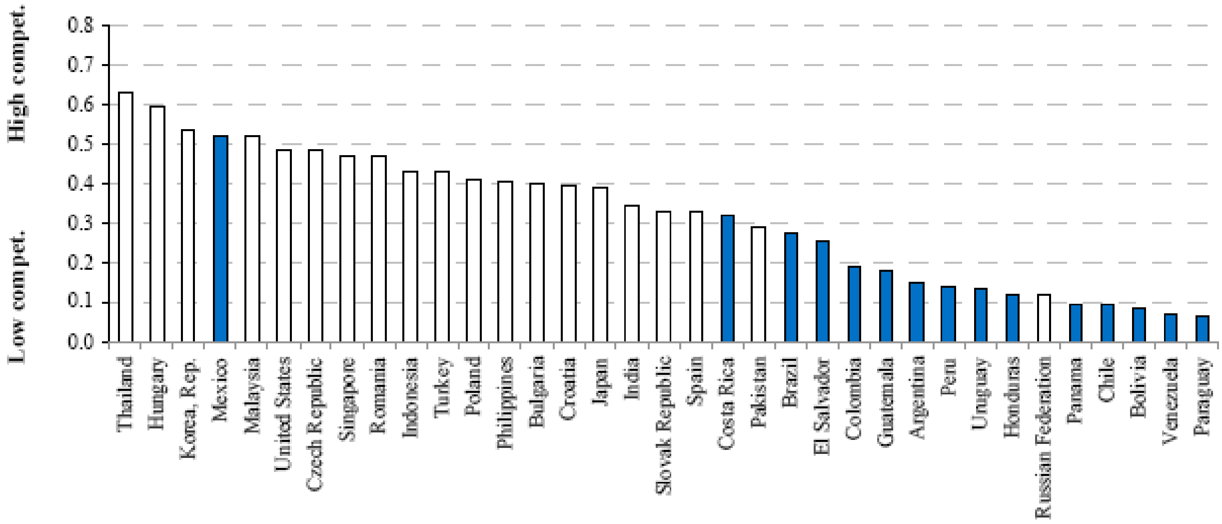
## Trade competition between Latin America and the Asian giants

The United States, the European Union and Japan are where most third-market competition takes place between Latin America and the Asian giants. That competition is fiercest in the United States, which alone received 57 per cent of Latin American exports in 2006. China and India have been increasing their market shares in the United States — and, in the case of China, have already overtaken Mexico's share, for example.

Closer inspection shows, however, that only a few countries in Latin America face much trade competition with China and India, and that the latter do not constitute a significant threat to Latin America as a whole. Figures 6 and 7 provide indicators of export competition between China and India and selected countries. The competition is measured by comparing the trade structure of each country with that of China, in Figure 6, and with that of India, in Figure 7. A high score indicates similarity in export structures, which suggests more thirdmarket
competition.

The data show that the export structures of most Latin American countries are very different from Chinese and Indian export structures, implying that they have little to fear from China's and India's export dynamism. Other emerging economies such as Thailand, Hungary and Malaysia are facing substantially tougher competition from Chinese exports. Mexico and Central America are the exceptions to this general pattern in Latin America of non-competition with China. Latin America's competition with India is similarly low, with El Salvador, Brazil and Argentina apparently facing the most exposure to competition, and emerging economies in other regions — notably Pakistan, Romania, Turkey and Bulgaria — facing much tougher competition with India. Not surprisingly, Latin American countries that export mainly commodities face the least trade competition with China and India, as the latter are net importers of these products. Paraguay, Venezuela, Bolivia and Chile thus suffer the least from Chinese and Indian trade competition.

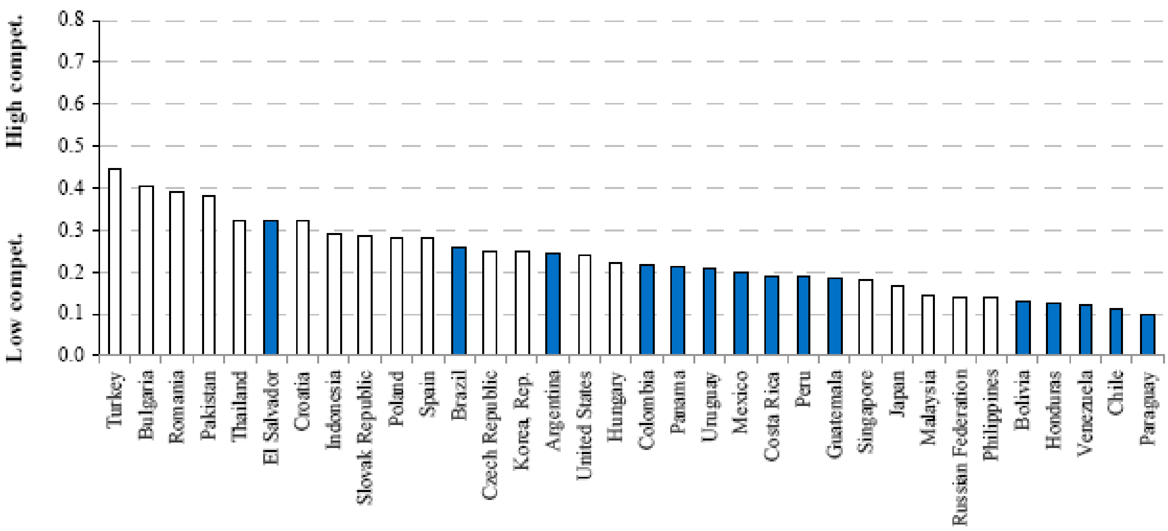
Figure 6. **China's Export Competition with Latin American and Other Selected Countries**




*Note:* Measured by Average Coefficients of Specialisation and Coefficients of Conformity.
*Source:* OECD Development Centre (2007); based on World Integrated Trade Solution (WITS) and Comtrade (2007) data.

StatLink http://dx.doi.org/10.1787/121447200442

Figure 7. **India's Export Competition with Latin American and Other Selected Countries**




*Notes:*
Measured by Average Coefficients of Specialisation and Coefficients of Conformity.
For more details, see Statistical Annex table 4.A5a and 4.A5b.
*Source:* OECD Development Centre (2007); based on WITS and Comtrade (2007) data.

StatLink http://dx.doi.org/10.1787/121480464125

## Export bonanza in commodities

Equally significant is the fact that rapid growth in China and India is opening important export opportunities for Latin American countries. Thus, while Mexico's export structure suggests it is the most vulnerable amongst Latin America's large countries to Asian competition in third markets, especially in manufactures, Mexico is also one of the Latin American countries, together with Colombia and Venezuela, that stands to gain the most from increased commodities exports to China and India. Indeed, of the 19 biggest Latin American and Caribbean exporters, 11 are specialised in commodities, and both China and India are prime importers of these products. Their heightened demand for oil and minerals has already substantially increased Latin America's export earnings, which have benefited both directly, from the increased volume of the region's commodities exports to China and India, and indirectly, from the increase in world prices for the region's commodities exports to Asia and elsewhere induced by strong Asian demand. Few countries in Latin America, in contrast to Southeast Asian developing countries for example, appear likely to benefit from potential intra-industry trade growth with China and India, however. Mexico and Brazil may be partial exceptions in this regard, as they may have some potential to benefit from intra-industry trade in manufactures with the Asian giants.

## Dutch disease, or the natural-resource curse

While China's and India's growth dynamism thus offers major benefits for Latin American exporters of primary goods, including oil, minerals and agricultural products, the principal risk is that as commodity exports become more valuable and commodity exporters see their incomes rise, they will rely on commodity exports to the detriment of other sectors. As is well-documented in the literature on the so-called Dutch disease, surges in commodityexport income, while increasing both growth and government revenues, can have substantial adverse effects if they are not managed responsibly. Surging commodity exports can easily drive up a country's exchange rate, which induces a long-term decline in non-commodity exports, notably manufactures, to the detriment of economic development.

Recent data on trade patterns in Latin America are partially consistent with the need for concern about Dutch disease in the region. The terms of trade have notably risen in Colombia, Chile and Uruguay, for example, indicating that the prices of their main exports are increasing faster than those of their imports. Specialisation has also increased, with most Latin American countries showing a higher degree of export concentration in commodities than at the beginning of this century. The trend towards greater specialization in commodities is most marked in Venezuela, Ecuador, Bolivia and Chile; the exceptions are Costa Rica and Argentina.

More reassuring is the fact that real exchange rates have not appreciated as much as could be feared. Macroeconomic stability has also been maintained, with inflation contained. Fiscal reform is in part to be credited for these successes, especially recently established oil and stabilisation funds. New transparency rules, such as freedom-of-information laws, should further stimulate responsible and accountable policies.

## Enhancing competitiveness

The current commodities boom also intensifies the need for both governments and firms in Latin America to redirect windfall revenues towards strategic growth-enhancing activities in order to maintain growth beyond the natural-resource bonanza. These activities include building up capabilities in innovation, education and physical infrastructure. They are needed to strengthen the competitive position of the economy's non-commodity exporters, including those involved in intra-industry trade, and to offset the negative impact of any exchange-rate appreciation. Diversifying the economy and taking advantage of noncommodity export opportunities also require a sound business environment, and it is important that

Latin American countries be attractive destinations for FDI and for cooperation on innovation. Yet spending on innovation remains insufficient, and what is spent goes largely to basic research with little private-sector participation. Education, too, remains a major challenge, even for the region's best performers.

Moreover, for those parts of Latin America's economy that do compete against Chinese and Indian exports, including much of Mexico's and Costa Rica's manufacturing export industries, as well as labour-intensive sectors in other parts of Latin America and the Caribbean, proximity to the United States offers a major potential competitive advantage in goods where fast delivery or short turn-around times are crucial. These goods include clothing whose fashions change frequently and rapidly, for example, and intermediate automotive and electronic products in lean production systems that rely on just-in-time delivery of manufactured inputs. To take competitive advantage of proximity to the United States nevertheless requires well-performing infrastructure, in transportation as well as in telecommunications. Yet current infrastructure investment levels in Latin America remain substantially below those of Asian countries, and many countries need to rethink their infrastructure-investment strategies.

Infrastructure thus constitutes a potentially critical part of Latin America's response to increased competition from Asia. Mexico needs to exploit its geographical position fully by improving infrastructure, and Latin America as a whole needs to invest more and better in infrastructure. Such investment is also likely to help reduce inequality and poverty. It requires a well-organised public sector capable of managing infrastructure projects while maintaining fiscal discipline and engaging the private sector.

## Looking Forward

Latin America benefits today from stable macroeconomic environments and pragmatic policy making. Democracy is widespread, and is gaining strength from improving fiscal policies. Pension reform is promoting financial development, if not raising savings. Foreign direct investment is strong, and the region has become an important home, as well as host, to multinational corporations. Rapid development of telecommunications, to which foreign investors are major contributors, should help raise the productivity and living standards of many people. And trade with Asia, contrary to widespread fears, constitutes more of a bonanza than a competitive threat for the region as a whole. Indeed, the preservation of macroeconomic stability in the context of such a bonanza is itself an important achievement.

The challenges Latin America faces today are no less impressive. Continuing high levels of poverty and inequality top the list. Together with policies to sustain growth, they call for less regressive and more efficient social and public expenditures that help build fiscal and democratic legitimacy. They call for pension reforms that, in addition to deepening capital markets, provide reliable sources of retirement income for much broader segments of the population. They call for regulatory systems in key public services (including telecommunications) that are carefully designed to complement market incentives while effectively lowering inequality of access between the rich and the poor. They call for governments and firms to redirect more of their windfall commodity export earnings to strategic long-term growth-enhancing activities, including more and better spending on education, innovation capabilities and infrastructure. Above all, they require efficient and responsive public sectors that benefit from fiscal legitimacy and are capable of providing strategic vision while maintaining fiscal discipline and fully engaging the private sector.