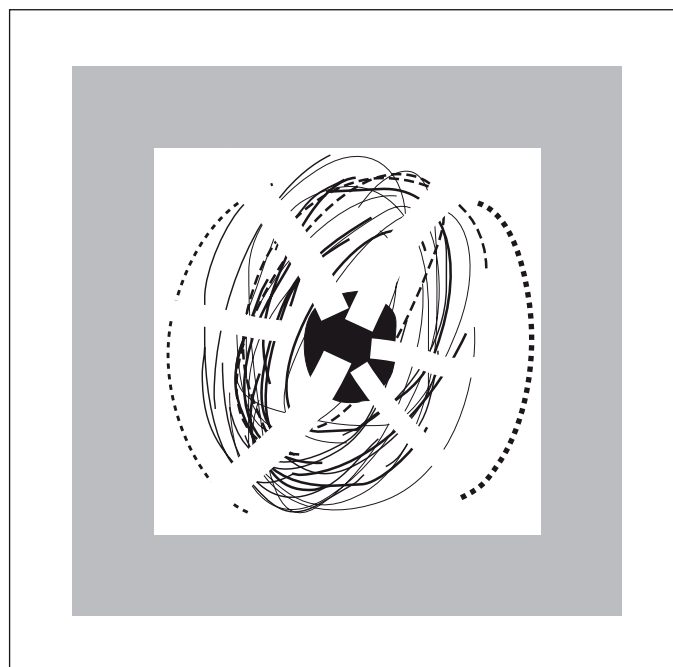


2007

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Latin America and the Caribbean in the World Economy

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ABSTRACT

This year's edition of *Latin America and the Caribbean in the World Economy* is divided into seven chapters.

Chapter I contains an analysis of recent trends in the main industrialized and emerging economies and reviews the possible impact of the financial crisis that began in the United States on the world economy and on the economic and trade performance of Latin America and the Caribbean. The effect of the crisis on the prices of commodities (especially food and oil) and the implications for growth, inflation and the region's external sector are also examined. Lastly, the chapter looks at the region's trade figures for 2007 and projections for 2008.

Chapter II describes recent developments in the Doha Round, including documents disseminated in July 2008 on negotiations relating to agriculture and non-agricultural market access. It also provides a summary of the main advances and obstacles emerging from those negotiations, with emphasis on the repercussions for Latin America and the Caribbean.

Chapter III discusses some new trade-related topics: (i) new security requirements for freight transport; (ii) the development and legal status of private quality standards; (iii) the state of play in discussions on trade and labour rules; and (iv) the debate on the links between climate change, trade and the multilateral trading system. It is argued that these and other issues will be on the international agenda for the next few years and that the region must begin to form unified positions on such topics.

Chapter IV examines recent progress in regional integration and the main initiatives under way in the region's integration schemes (the Southern Common Market (MERCOSUR), the Andean Community, the Central American Common Market (CACM) and the Caribbean Community (CARICOM)). The chapter also analyses: (i) Mexico's active policy aimed at strengthening its trade and infrastructure links with Central America; (ii) the Latin American Pacific Basin Initiative; (iii) the South American Community of Nations (UNASUR); and (iv) the hosting by Brazil in December 2008 of a Summit of Heads of State and Government of Latin America and the Caribbean on the subject of regional integration schemes. The chapter concludes with an analysis of the links between investment and services as an instrument of de facto integration.

Chapter V reports on the status of negotiations for the adoption of an association agreement between the European Union and each of the above-mentioned subregional integration schemes. In each case, there is a description of the negotiation process, controversial issues and the main challenges. It is noted that, since there is a similar framework for all these negotiations (covering Caribbean and Central American countries, the Andean Community, MERCOSUR, Mexico and Chile), they may generate important synergies for the subsequent convergence of trade and investment rules among the region's integration schemes.

Chapter VI presents an in-depth analysis of trade and investment relations between the Latin American and Caribbean region and the Asia-Pacific region, as well as within the latter. It is established that: (i) biregional trade remains inter-industrial in nature, despite the emergence of some new export commodities and high-technology manufactures; (ii) so far, efforts to forge closer links between the Latin America and Caribbean and the Asia-Pacific regions have been undertaken by individual countries on a somewhat sporadic basis; and (iii) there needs to be a more coordinated strategy among countries, so as to

strengthen the nexus between trade and investment and to reinforce production and trade linkages through various types of public-private alliances (including free trade agreements).

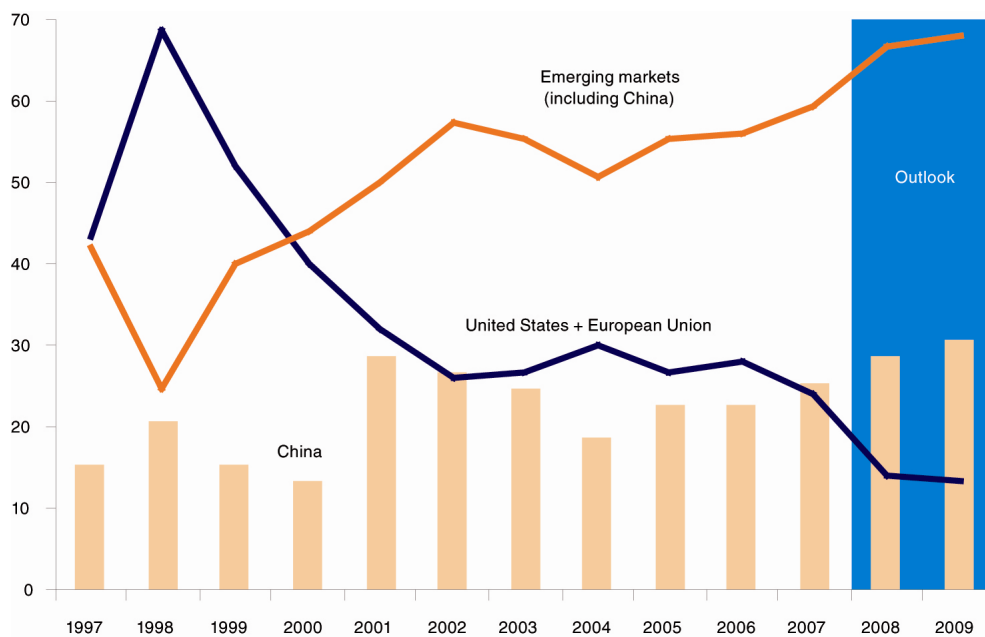
The subject of chapter VII is the foresight analyses carried out by some countries of the Organisation for Economic Co-operation and Development (OECD) with a view to strengthening innovation, competitiveness and export diversification. Despite the importance of such exercises for building consensus around strategic development guidelines, they are not frequently used in Latin America and the Caribbean. Advances achieved in other parts of the world could therefore encourage the countries of the region to use such exercises as an effective tool for promoting competitiveness, innovation and export development.

EXECUTIVE SUMMARY

GLOBAL ECONOMIC TRENDS AND LATIN AMERICAN AND CARIBBEAN TRADE FLOWS

In 2003-2007, world economic activity was at its most vibrant in 40 years, with high growth rates, low inflation, low interest rates, fluid financing and buoyant international trade. The major emerging countries (Brazil, the Russian Federation, India and China —the so-called “BRIC” group) accounted for almost half of world economic growth. This favourable international context, combined with improvements in the region’s macroeconomic policies, enabled the Latin American and Caribbean region to achieve its best economic performance in 40 years. An important factor in this positive regional performance was high world demand for energy, food and other commodities, which boosted the region’s exports.

Figure 1
CONTRIBUTION OF SELECTED REGIONS TO WORLD GROWTH
(Percentages of annual world growth)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), World Economic Outlook (WEO) database.

Note: Gross domestic product (GDP) based on purchasing power parity (PPP).

The year 2008 will be a landmark in the economic history of globalization.¹ This year has broken the upward phase of the cycle with powerful interrelated shocks, which have their origins in the five years running up to 2008: (i) the subprime mortgage crisis, which started in the United States in 2007 and threatens to throw that country and the world economy into recession; (ii) the weakening dollar during the first half of the year and steady demand from emerging economies, which have caused oil and food prices to soar and increased speculative movements and volatility in those markets, thereby putting inflation back on the agenda of global concerns; and (iii) the domino effect of the subprime mortgage crisis, which has triggered a series of bankruptcies and shake-ups in the financial industry in the United States and Europe. In late September, these repercussions toppled the United States investment banking sector, which had led the way in engineering the recent financial innovations of the global economy, and the threat of an international financial crisis loomed. Fears of recession have since led to a fall in raw material prices, especially those of oil, copper and other commodities of interest to the region.

In short, the subprime mortgage crisis is the aftermath of a real estate bubble in the United States which, when it burst, sent ripples through financial institutions that had large quantities of assets backed by such mortgages. The losses incurred by these operations raised these institutions' levels of indebtedness and reduced their capital, thereby limiting their capacity to meet the credit needs of the economy. Faced with this situation, they proceeded to sell off assets, intensifying the fall in the price of such assets and consequently exacerbating their own debt and capital problems. This downward spiral triggered a loss of confidence among the banks themselves, which sparked a credit crunch and set the stage for the failure of financial giants that had imprudently saddled themselves with excessively risky operations and short-term financing. At this point, it became absolutely indispensable for the State to step in to restore confidence and normalize financial flows.

The crisis has reverberated through financial markets in the United States and Europe, creating solvency and liquidity problems and causing turmoil in credit markets worldwide. Authorities in industrialized economies have responded—with varying degrees of timeliness and coverage—by providing liquidity and recapitalizing financial institutions in need of assistance. Notwithstanding the enormous efforts that have been made, volatility remains high, fuelled, on the one hand, by uncertainty about the duration and intensity of the financial crisis, and, on the other, by questions as to how the measures will be implemented and how the costs will be divided up among the different stakeholders.

Regardless of exactly how the crisis is eventually resolved, it is already having a serious impact on the real economy in the industrialized countries, and lower growth and job-creation figures are being forecast for the rest of 2008 and for 2009 in those economies. This situation, whose duration and intensity are still impossible to predict, has started to filter through to the Latin American economies and will have deeper repercussions in 2009. In particular, a fall in external demand and in unilateral current transfers is to be expected, which would reduce inflows to the region. This drastic change in external conditions will have an adverse effect on growth and employment in the region and, thus, on the number of people living in poverty in Latin America and the Caribbean.

¹ The world financial debacle triggered by the subprime crisis in the United States, following decades in which emphasis had been placed on deregulation, has, once again, set off the debate on the deficiencies of the regulatory framework for international finance (just as occurred after the “Asian crisis”). Having led the bail-out of European banks by deciding that his government would assume an active role as a shareholder, the Prime Minister of the United Kingdom, Gordon Brown, stated that it seemed that the time had come to rethink the world's financial system in the global era.

According to information available as of early October 2008, the European banking system has also suffered. This has further undermined confidence in the financial and stock markets and, in some cases, has generated panic situations to which some of the major emerging economies are exposed to as well. Despite massive injections of liquidity in the United States and Europe, interbank interest rates remain at a record high, and there is a serious danger of defaults along the payment chain in the United States. If this unfortunate situation were to arise, the economies of the United States and the European Union would face a much more dramatic slowdown and perhaps even a recession in late 2008 and for much of 2009. This would drive down growth projections sharply for 2009 and 2010 for the world economy, including developing economies.

Current events are therefore interlinked, and they are increasing the level of uncertainty and volatility in financial systems, sapping confidence and shrinking credit in the major economies. The effects on production, investment, employment and trade will be felt more keenly in 2009. The present financial crisis is the most serious event of its kind to take place in the United States since the Great Depression, and although the world is now better prepared to cope with its effects, it will nonetheless leave a deep mark on the global economy, as is only to be expected when such a severe crisis occurs in what is not only the most dynamic sector of the world's largest economy but also the one that has the most far-reaching ramifications for other economic activities in the United States and the wider world economy. With the bailout of Bear Stearns by JP Morgan Chase, the acquisition of Merrill Lynch by Bank of America, the bankruptcy of Lehman Brothers and the change of status of Goldman Sachs and Morgan Stanley to regulated bank holding companies, in the space of just six months the five leading investment banks in the United States have disappeared. These events, in addition to the bailout of Fannie Mae and Freddie Mac (the country's main mortgage lenders) by the United States Treasury and the rescue of the nation's biggest insurance company, American International Group Inc. (AIG), and Washington Mutual (a major commercial bank), demonstrate that this is a systemic crisis with serious ramifications not only for world finance but also for the real economy.

Given the off-balance-sheet operations conducted by these investment banks, it is still difficult to predict the depth and duration of the crisis. The bursting of the real estate bubble therefore needs to come full circle, so that the prices of all "toxic" assets can return to sustainable levels. Only then will the scale of the losses be known, and the financial sector can begin to put its accounts in order and recapitalize. These processes will take time, and this is why the rescue package proposed by the United States authorities to restore confidence in the system amounts to some US\$ 700 billion. As of mid-October 2008, implementation of the financial "megaplan" was a matter of urgency, as was an announcement of the plan's operational details so that "toxic" assets could be isolated and liquidity could be provided to distressed financial institutions in order to restore confidence among banks and normalize financial flows. In early October, the main financial challenge in the United States was to ensure continuity in the chain of payments in order to enable well-managed financial agencies and enterprises to avoid bankruptcy and thus avert severe impacts on employment and production activity.

The massive rescue package finally approved by the United States Congress did not succeed in restoring confidence in the world's financial and stock markets. Whether this was due to design failings or problems of implementation, the inadequacy of this response became evident when the United Kingdom announced its own rescue package. The overall matrix of that package was endorsed a few days later by the other European governments, which coordinated their operations to lower interest rates and throw a lifeline to the European financial system. The impact of the coordinated European action, following a few weeks of vacillation, was dramatic, reviving financial and stock markets and reducing interbank rates. The markets rewarded the idea of a coordinated global effort to deal with a global, systemic problem.

In essence, the rescue package proposed by Prime Minister Brown was broader, deeper and swifter than that of the United States Treasury and Federal Reserve. Its main components were: (i) an injection of liquidity into the financial system; (ii) an equity injection consisting of the recapitalization of weakened financial institutions in exchange for a government stake; (iii) guarantees for interbank debt; (iv) insurance for bank deposits; and (v) public purchase of subprime assets.

Table 1 shows the breakdown of the total amount of liquidity —some US\$ 3.1 trillion— which central banks and other government agencies have recently injected into the banking system. By mid-October, the US\$ 700 billion rescue package announced by the United States and the European countries' firm resolution to take decisive, coordinated action on the basis of the matrix proposed by the Government of the United Kingdom, had generated commitments totalling US\$ 2 trillion. The markets responded positively and many stock markets recovered ground lost since the start of the crisis.

Table 1
LIQUIDITY INJECTIONS AND RESCUE PACKAGES ANNOUNCED UP TO 20 OCTOBER 2008
(Trillions of dollars)

Countries	Liquidity used ^a (as at 20 October)	Rescue packages (as at 14 October)	Rescue packages (as at 20 October)
United States	1.38	0.7 ^b	4.3 ^e
European Union	1.62	2.41 ^c	2.42 ^f
15 euro zone countries	1.16	1.54 ^c	1.56 ^f
United Kingdom	0.46	0.87 ^c	0.87 ^c
Japan	0.11
Other	0.05 ^d
Total	3.17	3.11	6.72

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), *Global Financial Stability Report*, October 2008; and international financial press reports (*New York Times*, *ABC*, *The Guardian*, *Estrategia*, *BBC News*, among others).

^a Refers to the liquidity supplied by the United States Federal Reserve, the European Central Bank and other central banks through repurchase agreements (repos) and short-term (less than 90-day) loans. The amounts spent by governments to purchase equity in banks are also included.

^b First United States rescue package.

^c Includes guarantee commitments for inter-bank loans, bank deposit insurance and public purchase of subprime assets by the Governments of France, Germany, Ireland, the Netherlands and Spain.

^d Includes injections of liquidity in Australia and Sweden.

^e Includes the announcement by the United States Federal Deposit Insurance Corporation that it would insure the deposits of subordinate banks up to US\$ 1.5 trillion, non-interest-bearing deposits up to US\$ 500 billion and commercial paper up to US\$ 1.6 trillion. The three commitments add up to US\$ 3.6 trillion.

^f Includes the intervention by the Government of the Netherlands in the bailout of ING.

In adopting their rescue model, the United States authorities had rejected the idea of having the State acquire equity in the banking system, probably for ideological reasons, and had instead placed emphasis on government purchase of “toxic” assets through mortgage securitization. This, however, did not manage to restore confidence in financial markets. Given the success of the European rescue programme and the coordinated interest-rate measure, the United States followed suit, reinforcing the improvement in financial expectations worldwide. The United States authorities announced that US\$ 250 billion of the rescue package approved by Congress would be used to purchase equity in large and small

banks. In the days that followed, the Federal Deposit Insurance Corporation announced that it would guarantee deposits in subordinate banks, non-interest-bearing current accounts and commercial paper amounting to approximately US\$ 3.6 trillion. These guarantees, plus the US\$ 700 billion bailout package, bring the total United States rescue programme to US\$ 4.3 trillion (see table 1).

It is not yet possible to ascertain whether these measures will be sufficient to resolve the crisis. They are certainly a step in the right direction, however, and the more alarming problems that were looming at the beginning of October, that is, widespread panic on financial markets and the threat of a break in the payment chain, seem to have abated.

It is precisely the positive characteristics of the cycle (high growth, low interest rates and low inflation) that increased risk-seeking and made financial innovation, securitization and off-balance-sheet operations seem more attractive. Overconfidence in the market and deregulation were responsible for the rest, creating a climate that encouraged fraud and set off the worst financial crisis since the 1930s. Just as the external debt crisis in Latin America and the Caribbean led to more sensible economies policies (following the lost decade and some painful adjustments), the current financial crisis in the United States could result in a rethinking of financial regulation in terms of risk management and levels of capitalization and leverage, as well as stronger economic policy incentives for saving (to deter excessive public and private borrowing in that country's economy).

The repercussions of the financial crisis will be even more keenly felt in 2009, as they manifest themselves in economic activity and employment levels. The world economy will therefore grow less in 2009 than in 2008. Depending on the results of the financial rescue package in the United States and the effectiveness of the support measures introduced in Europe, the situation could even give rise to a significant recession, unless the crisis is prevented from spreading to real economic activity via a serious credit crunch. For the time being, the slowdown is concentrated in the main advanced economies, although Asian and other emerging economies will also be affected, albeit to a lesser degree. The United States economy has been grappling with strong recessionary pressures since late 2007, but buoyant net exports, which have been boosted by the weak dollar, have averted a worse slump in the economy as a whole. Japan and the European Union are being severely hurt by the crisis in the United States, and their performance, in terms of both domestic and external demand, has taken a considerable turn for the worse as they seem to be headed towards a virtual recession in late 2008.

Up to mid-2008, emerging economies were maintaining high levels of growth despite the slowdown in advanced economies, which suggested that there was some degree of decoupling between the two groups. In the second quarter of 2008, new signs pointed to a more nuanced outlook, as the trading partners of developed countries began to be affected by the sharp drop in demand in the latter. Furthermore, the financial crisis has aggravated the liquidity squeeze in international markets, which has pushed up interest rates. This will have a further negative impact on growth in developing economies. So long as the financial crisis does not continue to worsen, most emerging countries will be better prepared than previously to weather external shocks, thanks to their substantial international reserves, orderly fiscal accounts and low external debt. Nevertheless, the scale of the crisis is so great that the entire global economy, including the emerging economies, will feel its impact.

The financial crisis and the slowdown in world growth have halted the upward trend in food and oil prices. These prices rose until mid-July 2008, in a context of growing demand for such commodities from China, India and other Asian countries, combined with tight and inelastic supply. In real terms, the price of oil was higher than it had been during the 1979 energy crisis, while metal prices have tripled or quadrupled since 2003. Food prices have also shot up since 2006. In the second half of 2008, commodity

prices started to fall as a result of the financial panic, the threat of a global recession and the sharp slowdown in industrialized economies. Between July and mid-October, wheat and maize prices fell by 70%, oil prices by 55% and aluminium, copper, nickel and platinum prices by nearly 50%. Long-term trends still place these prices at relatively high levels and they will probably remain high as long as China and the other emerging economies remain buoyant. The financial shock has watered down the speculative component in price volatility, but structural supply and demand factors continue to push up the prices for these products, especially energy, minerals and metals. Everything points to these prices remaining relatively high but ceasing to exert inflationary pressure.

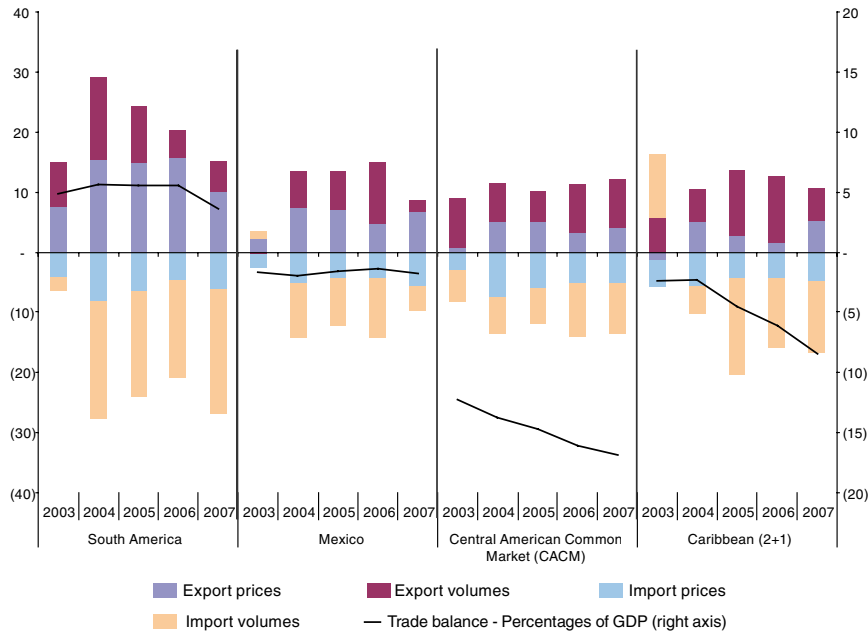
The improvement in the trade balances of Mexico, South America and the region as a whole between 2004 and 2006 is due mainly to high and rising commodity prices. In 2007, these trade balance worsened slightly, owing to the strong increase in import volumes and prices. In contrast, the rise in commodity prices had the opposite effect on Central America and the Caribbean, as they are net importers of oil and food.

The projected fall in commodity prices in the final quarter of 2008 and in 2009 is bad news for developing countries that export raw materials, such as those of Latin America and the Caribbean. As already mentioned, however, those prices will probably remain above 2006 and 2007 levels, which should bring some relief in terms of inflation and will be of benefit to the net oil-importing countries of Central America and the Caribbean (with the exception of Trinidad and Tobago). The years 2008 and 2009 are expected to see a decline in export volumes, while imports will continue to rise. As a result of the worsening terms of trade and a drop in trade volumes, the trade and current account balances will deteriorate in all subregions except Central America and the Caribbean. In 2009, the external sector will therefore no longer be a growth factor for the region.

Given this complex world scenario, the Latin American and Caribbean region has to deal with both immediate and long-term challenges. In the short run, the region's governments must find a way to cope with international financial and economic turmoil at a time when they have less access to external financing, they must pay higher interest rates, local stock exchanges have been hit hard by world trends, capital is being shifted to safer destinations and into less risky assets, exports are lower, migrant remittances from industrialized countries in recession are declining and foreign direct investment is down. As a result, credit lines for exports and investment plans will be tighter, thereby limiting growth.

If the crisis were to deepen beyond the situation observed in early October (when this summary went to press), then the avoidance of contagion from the financial crisis in industrialized economies would clearly become the highest priority. In that case, the region's governments would have to ensure liquidity in the financial system (particularly credit lines in United States dollars) and reinforce prudent supervision of the soundness of the banks and financial institutions with the most (direct and indirect) links to international financing and risky operations. If such a negative scenario were to become more likely, with recession in the United States and the European Union and a severe liquidity squeeze, then a less stringent monetary policy would be justified.

Figure 2
EXPORTS, IMPORTS AND TRADE BALANCE
(Annual growth rates and percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Note: The increase in prices refers to the annual variation in the unit values of imports and exports. Growth in volume refers to the annual variation in the quantities exported. The trade balance is the weighted net result of growth rates. Caribbean "2 + 1" refers to Panama, Haiti and the Dominican Republic.

The higher cost of capital and the restriction of global financial and investment flows will continue for the rest of 2008 and 2009 and will be coupled with stronger inflationary pressures, and this situation, for the time being, calls for somewhat more monetary policies. Given these conditions, such pressures have to be eased through the use of appropriate monetary and fiscal policies, along with other social and production measures to support low-income groups. In any event, the world economic slowdown can be expected to reduce demand for commodities, especially food and energy, thereby gradually easing the disturbing inflationary pressures observed since the beginning of 2008. Curbing inflation should continue to be the aim as long as this remains the most pressing challenge. Achieving this objective may entail adapting policies to the scale of the inflationary pressure generated by external factors. As stated previously, all indications are that the international situation will cease to be a source of inflationary pressure in the rest of 2008 and in 2009.

In order to deal with the foreseeable external shocks, governments should strengthen their countercyclical macroeconomic policies, maintain sound fiscal accounts and monitor external account trends in order to prevent the emergence of unsustainable disequilibria. Depending on how the financial crisis evolves, fast-acting expansionary policies will probably have to be devised, as a matter of urgency, in order to support liquidity in the financial system. This will call for financing and appropriate policy arrangements to avoid the creation of new disequilibria. In the medium term, the governments of countries that maintain favourable terms of trade should improve the management and use of additional

income from above-trend commodity prices by promoting activities that boost medium-term competitiveness, human resource development and export diversification.

Although 2009 will be a tighter year for all the economies in Latin America and the Caribbean, the extent of the constraints will vary in each case, depending on each economy's specific circumstances. The opportunities or constraints influencing each economy's performance in 2009 will be determined by a number of variables, including: (i) the solvency of its financial system; (ii) whether it is a net debtor or net creditor vis-à-vis the rest of the world; (iii) the sustainability of its fiscal accounts and the level of its public debt; (iv) the level of inflation and inflationary expectations; (v) the balance-of-payments current account balance; (vi) the relative importance of remittances and FDI as stable sources of current account financing; (vii) the degree of export diversification in terms of destination markets; and (viii) whether the country is a net exporter or net importer of food and energy. Beyond any national differences, the global situation is one that recommends fiscal caution, exchange-rate flexibility and prudent supervision of the financial system's performance in order to ensure its liquidity and to make sure that the terms, currencies and types of risk involved in financial operations match up.

The current global financial crisis and the threat of recession in 2009 pose an enormous challenge in terms of the soundness of the economic reforms that the region's countries have been making considerable efforts to implement in recent decades. Thanks essentially to these reforms, and notwithstanding the need to determine whether these reforms have effectively contributed to growth, equity and competitiveness, there is no doubt that the region is now better prepared to face this adverse situation. Although this crisis may well have a considerable impact, there is no doubt that, without such reforms, that impact would have been much greater. Now is the time to keep the reforms that are enabling countries to weather the financial storm with relatively limited damage firmly on track, with emphasis on: fiscal responsibility and control of inflation; trade openness and market diversification; and debt reduction and the build-up of international reserves. These are the assets that have prevented Latin America and the Caribbean from falling into a recession such as the one towards which the United States and the European Union appear to be heading. These same assets will also stimulate a rapid recovery once global financial flows return to normal.

To sum up, it is difficult to see how the world economy could remain the same after 2008. Changes need to be made in terms of financial regulation, energy efficiency, the search for renewable energy sources and the provision of international funds to reduce hunger and increase the food supply in the poorest countries. In the first half of 2008, the combined effect of the energy crisis and soaring food prices not only triggered inflation in a number of countries within the region and elsewhere, but also posed serious threats to democratic governance in some developing nations. These concerns were expressed at many international summits, which highlighted the urgency of tackling the issues of governance associated with the globalization process.

Indeed, once efforts to resolve the financial crisis are on the right track, the governance of globalization, with emphasis on redefining the modalities for regulation and prudential supervision of the financial system, should be the main item on the international agenda. In this regard, and against the backdrop of the current financial crisis, the main European leaders —Prime Minister Brown of the United Kingdom, Chancellor Merkel of Germany and President Sarkozy of France— are calling for an international summit to address the urgent reforms needed in the international financial system, including rules on greater transparency, the definition of global standards for cross-border regulation and supervision, and the establishment of crisis early warning systems. In a similar vein, proposals are being made to update institutions such as the International Monetary Fund, the World Bank and even the World Trade Organization in order to bring them into line with the new state of the global economy in the

twenty-first century. The United Nations has expressed its full willingness to make its Headquarters in New York available for such a summit to facilitate this increasingly urgent process. Decades of economic reform are now threatened by volatility and a lack of governance in financial markets, as well as by shocks in energy and food prices that have been exacerbated by speculative operations. An international recession in 2009 would seriously jeopardize the achievement of the Millennium Development Goals. This seems to be the right time for Latin American and Caribbean countries to adopt a unified position on these issues, to speak with one voice in various international forums and to formulate proposals that will help to shape the global agenda. The Summit of Heads of State and Government of Latin America and the Caribbean on Integration and Development, due to be hosted by Brazil on 16 and 17 December 2008 in Salvador, Bahía, will be an excellent opportunity to do so.

The Doha Round: failure or temporary setback?

In 2008, the climate at the Doha Round deteriorated from reasonable optimism to a state of pervasive uncertainty, following the failure of the “mini-ministerial meeting” convened by the Director-General of the World Trade Organization (WTO), Pascal Lamy, in the final week of July. This round of negotiations is especially important because it is the first to take place in 15 years, i.e., since the end of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) in December 1993. For developing countries, the Doha Round represents the possibility of reinstating the development dimension on the international trade agenda; hence the term “Doha Development Agenda”.

The Doha Development Agenda originated out of a recognition that, although advances made in the new multilateral system were significant, they had not benefited all members in an equitable way. One of the problems was that developing countries needed support tools to deal with the complexity of World Trade Organization (WTO) agreements, which is why there was interest in identifying problems of application in each agreement and assessing special and differential treatment for the developing countries concerned. The second aim of the Doha Round was negotiation in the traditional areas of market access for agricultural and non-agricultural products and trade in services, which would capture part of the liberalization process that members have been implementing since the close of the Uruguay Round. A third aim was to continue the process of reforming agricultural trade by creating effective access opportunities, reducing the subsidies that distorted trade the most and agreeing to eliminate export subsidies applied by developed countries. Lastly, the Doha Round provides for improvements in the trade rules on antidumping duties, fishing subsidies and the link between trade rules and environmental agreements with a view to improving consistency between the former and the goals of sustainable development.

The purpose of the “mini-ministerial meeting” was to consolidate the informal progress made on various negotiation topics during 2007 and 2008 and to provide a new political impetus to the most sensitive issues in relation to trade in agricultural and non-agricultural products. With regard to market access, for instance, the proposal was for a minimum average tariff reduction of 54% for developed countries and 36% for developing countries. Countries could designate a percentage of tariff lines as “sensitive products”, and developing countries could, in addition, designate “special products” and apply safeguards. Sensitive and special products were to be subject to smaller reductions, and certain special products would have been completely exempt.

In terms of total domestic support (production subsidies),² the proposal on the table would oblige the European Union to reduce total subsidies by between 75% and 85%. For the European Union (15 members), the estimated reduction would be from the existing level of € 110.3 billion to € 27.6 billion. The United States and Japan would have to reduce their subsidies by between 66% and 73%. For the United States, this would mean a reduction from the current consolidated figure of US\$ 48.2 billion to between US\$ 16.4 billion and US\$ 13 billion. In the case of the most trade-distorting (amber box) subsidies, the proposals would translate into a reduction of 70% for the European Union, i.e., a drop from the current ceiling of € 67.16 billion to a new maximum of € 20.1 billion. For the United States, the reduction would be 60%, from the current ceiling of US\$ 19.1 billion to around US\$ 7.6 billion. Although the objection raised to these proposals is that the United States would retain some margin for raising subsidies above current levels, these would nonetheless be lower than those applied in four of the last seven years.³ Following the collapse of the negotiations in July 2008, if the current situation (no agreement) is compared with the commitments undertaken in the Uruguay Round (the status quo), the European Union could now triple the most trade-distorting subsidies it applies without breaching its international commitments. Similarly, the United States could double its subsidies.

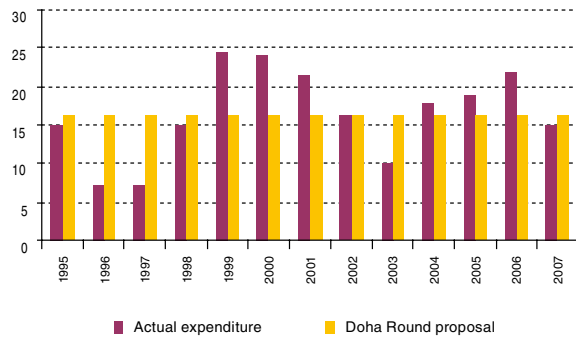
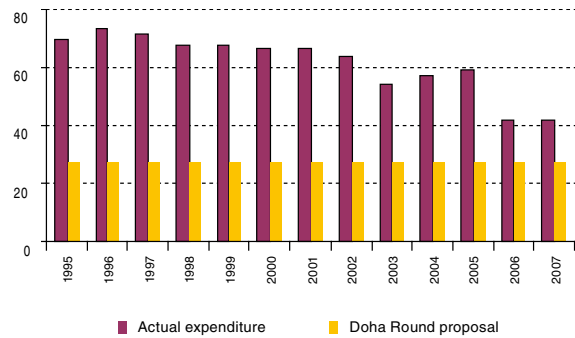
In terms of non-agricultural market access, it was suggested that bound tariff reductions should be introduced using a formula that distinguished between developed and developing countries. For developing countries, there would be three different rates, based on the degree of flexibility chosen. The larger the reductions (and the lower the rate), the greater degree of flexibility there would be (and vice versa). There would also be additional flexibility that could be used to exempt certain products or apply smaller reductions to them. There were also provisions for special modalities for the 32 least developed countries (which would be exempt from tariff reductions) and special arrangements for 31 small and vulnerable economies and for 12 developing countries with a low percentage of bound tariff lines.

The failure of the “mini-ministerial meeting” in July 2008, which was marked by disagreements between China, India and the United States as well as less visible conflicts of interest among developing countries, is creating uncertainty about the capacity of the protagonists of the negotiations (beneficiaries of the process of globalization) to make the multilateral trading system more governable. This latest failure could be seen as a justification for regional policies and bilateral negotiations undertaken in a context where the positive complementarity between multilateralism and regionalism appears weaker than in the past. Multilateral trade rules are lagging behind regional ones, endangering the relevance of the multilateral system for its members and weakening its ability to tackle the challenges of an expanding membership. Once again, questions are being raised about the ability of WTO to handle the international agenda of the future, and unless negotiations are reopened very soon, the Doha Round and its pro-development agenda will be delayed until late 2009 or 2010 at the earliest.

² This includes the most trade-distorting subsidies (amber box), subsidies not decoupled from production (blue box) and *de minimis* (or minimum) subsidies.

³ *The Economist*, 2 to 8 August, 2008.

Figure 3
TRADE-DISTORTING AGRICULTURAL SUBSIDIES, 1995-2007
(Billions of dollars and billions of euros)

(a) United States**(b) European Union**

Source: Sébastien Jean, Tim Josling and David Laborde, “Implications for the European Union of the May 2008 Draft Agricultural Modalities”, International Centre for Trade and Sustainable Development (ICTSD), June 2008; David Blandford, David Laborde and Will Martin, “Implications for the United States of the May 2008 Draft Agricultural Modalities”, International Centre for Trade and Sustainable Development (ICTSD), June 2008; Kimberly Ann Elliott, “Last Gasp for Doha? [online] http://blogs.cgdev.org/globaldevelopment/2008/07/last_gasp_for_doha.php; and World Trade Organization (WTO), “Unofficial guide to the 10 July 2008 ‘revised draft modalities’”, 2008

Note: The figures compare actual expenditure in 1995-2007 with the proposed new limits on expenditure. Includes the most trade-distorting subsidies (those directly linked to prices and production), which are officially called Aggregate Measurement of Support (AMS) and are also known as “amber box” subsidies. Also includes blue box subsidies, which are not linked to prices or production, and the *de minimis* category, which includes amber box support but in smaller quantities or the minimum allowed in relative terms (currently 5% of production for developed countries and 10% for developing countries). The three programmes together are equivalent to the concept of Overall Distorting Domestic Support (ODDS), as shown in the figures. The reforms proposed in the Doha Round include limiting blue box subsidies to 2.5% of the value of production for the period 1995-2000 and reducing *de minimis* subsidies to 2.5% of the value of production. The Doha Round proposal also seeks to amend the Agriculture Agreement to include disciplines in these categories and to define a new concept of trade-distorting subsidies. Both figures use the most conservative estimates of the possible results of the Doha Round according to current proposals. For the United States, results range from US\$ 13 billion to US\$ 16.4 billion. For the European Union, estimates vary between €16.5 billion and €27.6 billion.

In Latin America and the Caribbean, there are many viewpoints on developments in the Doha Round. There is consensus that industrialized nations have the scope to be more generous in their proposals regarding agricultural trade in terms of both access and reductions in distortions. No such consensus exists, however, about how the region can shape its proposals concerning non-agricultural and services market access in order to contribute to a good agreement in the Doha Round. There are also differences of opinion on the urgency of concluding the Round. Some countries would prefer no agreement to an unsatisfactory one. For others, what is on the table constitutes significant progress, particularly in view of the protectionist tendencies that may be triggered by the current financial crisis in industrialized economies.

It is in light of the above that the quality of the agreement and the urgency of concluding it must be assessed. Assuming a tight schedule and adopting an optimistic outlook, if the Doha Round is postponed, it could still be completed in 2010 and approved by national parliaments in 2011, but even then its first benefits would not be felt until 2012. In this scenario, however, the Doha Development Agenda could easily

be sidetracked by the impact of either the financial crisis in the United States and the European Union or new global problems such as energy or food crises or climate change. It is said that negotiations never fail, but are only postponed. However, it is also true that their political relevance is not eternal.

Although the July 2008 agreement was far from fully satisfactory to developing countries, it was nonetheless a step in the right direction: improved access to the agricultural markets of developed countries, elimination of subsidies for agricultural exports by 2013 and a reduction in bound levels of domestic support for agriculture. These bound commitments were almost double the effective levels, but this was because of the high prices of agricultural products in July 2008, which means that the support was less necessary. The idea is to bind domestic support at a ceiling rate so that, when prices fall, a glut in supply can be avoided. The level at which such support would be bound would be lower than that applied by the United States in four of the last seven years, and this restriction would be permanent. This remains pending while a detailed study is made of the costs, benefits and opportunities of the Doha Round. In this process, the Latin American and Caribbean region could strengthen its internal consensus so that it would be in a position to play a more prominent role in the Doha Round without losing sight of the synergic and facilitating effect these negotiations could have on other trade talks (such as those with the European Union) if the Doha Round were to be concluded soon.

Globalization and new trends in international trade

In recent decades, the international economy has undergone sweeping changes, mainly in the form of advancing globalization, dramatic technological change and the emergence of strong new competitors such as China, India and the Asia-Pacific region in general. The implications of these three developments are varied and complex. For instance, there have been drastic changes in the world map of trade flows and competitive advantages, with new winners and losers emerging in terms of economic areas, countries, production sectors and enterprises. The most striking element is the stronger competitive presence of China, India and the Asia-Pacific region, as well as of emerging economies in general. Even though they have coincided with a strong upswing in the business cycle (2003-2007), this complex reconfiguration of the world economy has not banished the dangers of traditional protectionism. At the same time, the uncertainty associated with the new world economic order is hampering progress in multilateral negotiations (see chapter I). If the world economy slows in 2009 and 2010 as suggested by the available evidence, not only will the Doha Round become more problematic but, against the backdrop of an economic slowdown and a credit crunch in industrialized economies, the competitive challenges posed by emerging economies may trigger pressure for new forms of protectionism.

In analysing these new trends in international trade, care must be taken to distinguish those that stem from technological change and new ways of organizing business activities from those that are based on efforts to preserve market share by establishing rules that, although not formally binding, do in practice influence the competitiveness of products and companies. In production, for instance, advances in information and communications technologies (ICT), telecommunications and transport are increasingly shifting the dividing line between tradable and non-tradable goods and between manufactures and services. This facilitates the management of global value chains based on a twenty-first century template for the organization of production. Although this template of industrial organization may not represent more than 15% or 20% of existing business enterprises, these are the leading companies that are setting international business standards and that are managing to have some of them incorporated into international trade rules. Innovations such as bar codes, online connections with suppliers and distributors, and new forms of online information sharing have facilitated flexible mechanisms for matching demand, thanks to processes such as outsourcing, offshoring and insourcing. This value chain incorporates logistics into the production function so that, in addition to production per se, the chain also

encompasses research and development, design, distribution, marketing, financing, after-sales service and product recycling or disposal. These processes can now be regarded as structural trends in international trade, and innovation and competitiveness policies therefore need to adapt to that fact.

Growing awareness of environmental issues and the importance of climate change and the increasing political influence of consumer groups (particularly in Europe) are also establishing new parameters in international trade. Energy conservation and environmental protection are becoming higher profile issues in corporate discussions concerning innovation and competitiveness. Furthermore, industrialized countries are introducing an increasing number of safety and traceability requirements for the production and international trade of foodstuffs.

The issues of security and trade have become extremely important to the international community since the attacks of 11 September 2001. This has resulted in the establishment of new requirements for freight transport, some of which have emerged from cooperation among countries via the World Customs Organization (WCO), while others have been created unilaterally. This will lead to a significant increase in trade costs as requirements for the inspection of all containers and certification of security methods throughout the export chain are introduced. Although meeting these requirements could bring benefits such as greater delivery speed and predictability, considerable investments would also be required, and there are doubts about how smaller countries and small and medium-sized exporters would be able to finance their implementation.

The top private corporations have recently been playing a regulatory role in terms of product quality and the establishment of private-sector trade standards, which, although voluntary, can nonetheless influence countries' competitiveness. These private standards include Good Agricultural Practices (GAP), safety certificates, the criteria of the International Standards Organization (ISO) and quality certification. The chapter on this topic goes on to discuss the current public-policy debate in the United States and the European Union regarding the links between trade and employment and between trade and climate change. The issue of climate change will definitely be prominent on the international agenda. The link between trade and measures to mitigate or remedy climate trends will become increasingly important, and the discussion therefore turns to the proposals made by Europe and the United States concerning trade measures designed to limit greenhouse gas emissions and border taxes aimed at levelling internal and external competitiveness. The analysis is not exhaustive, but instead focuses on those aspects that may have the most impact on the external trade of Latin America and the Caribbean. Attention is also devoted to the link between trade-related measures and WTO trade rules, with emphasis on the most relevant provisions and some potential conflicts.

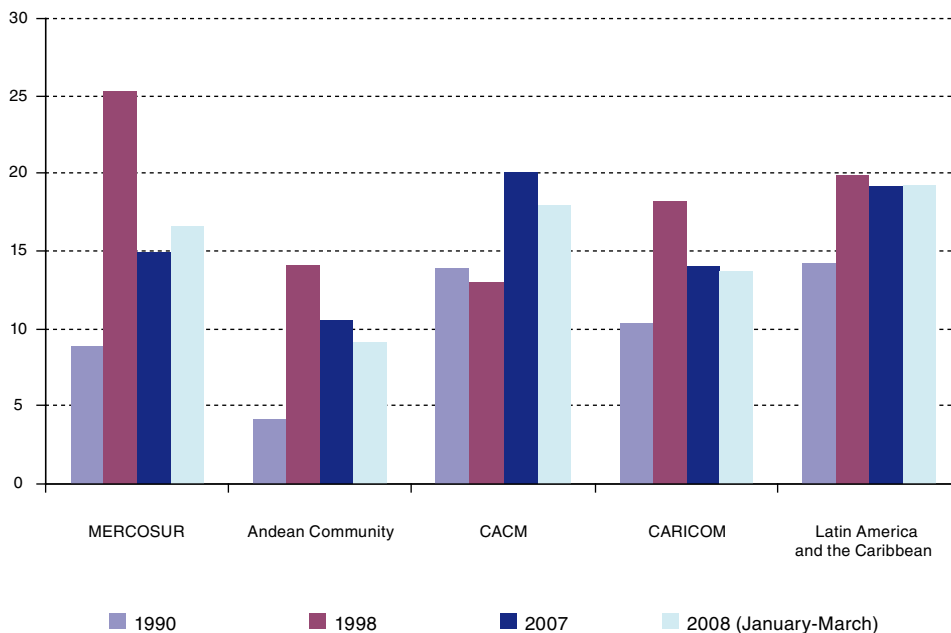
All of these events may generate additional pressure in terms of the competitiveness of the region's countries and may lead to the emergence of barriers that are not regulated by international trade disciplines. These trends do not necessarily translate into precise multilateral rules that define the playing field for the international economy of the twenty-first century. Here again, the multilateral trading system is failing to keep up with the rapid pace of technological change and the evolving structure of business stakeholders that are often more relevant to and hold more sway over trade issues than the governments of industrialized countries. This interaction, which could be described as encompassing technological and business developments, on the one hand, and, on the other, new issues and institutions, is highly complex as it combines requirements arising from technological advances (such as quality certification) with business models that use technological change to attempt to limit competition and protect private business (as is the case with certain certification requirements linked to specific laboratories and enterprises).

There is a fine line between technological progress, the creation of new agencies and institutions, and protectionism, and it is one that can easily be crossed, particularly if developing countries do not focus on creating the technical capacity to distinguish between changes that they will have to adapt to and those that are merely new forms of private business that may limit competition or encourage protectionism.

Integration and trade initiatives

In 2007, intraregional trade once again posted double-digit growth, although the rate of expansion (around 19%) was slower than in previous years. During 2008, intraregional exports continued to climb, thereby offsetting poor sales to the United States. All groups show an upward trend when compared with the first quarter of 2007 (see figure 4).

Figure 4
INTRAREGIONAL AND INTRA-SUBREGIONAL TRADE IN EXPORTS, 1990, 1998, 2007
AND JANUARY-MARCH 2008^a
(Percentage of total exports)



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

^a Total exports used to calculate the ratio include exports from the maquila sector and free-trade zones.

With considerable uncertainty prevailing in the international economy, especially with regard to exports to the United States by members of integration schemes, strenuous efforts were being made in 2007 and the first half of 2008 to move forward with community commitments on trade facilitation. One example is the adoption of a unified customs document and the harmonization of customs regimes within the Andean Community. Similarly, the Central American Common Market (CACM) approved and updated a series of technical regulations on standardization measures, metrology and authorization

processes, as well as sanitary and phytosanitary measures and procedures. Similar advances have been made in the context of MERCOSUR.

Efforts are also being made to promote trade strategies aimed at increasing regional interdependencies. Examples include the re-launch of the South American Community of Nations (UNASUR) and the Meso-American Integration and Development Project (Meso-America Project), formerly the Puebla-Panama Plan (PPP), as well as efforts by countries that make up the Latin American Pacific Basin Initiative to generate synergies in trade relations with countries of the Asia-Pacific region (especially China, India and members of the Association of Southeast Asian Nations (ASEAN)). Lastly, countries of the Caribbean (in 2007) and of Central America and the Andean Community (in 2008) have been involved in trade negotiations with the European Union.

In recent years, the international expansion of certain companies has resulted in an increase in foreign investment, especially from Brazil, Chile and Mexico. Trans-Latins have become an increasingly significant phenomenon and currently account for around 8% of inflows of FDI to Latin America and the Caribbean, especially in the sectors of natural resources and natural-resource-based manufactures, food and beverages, commerce and services (with this last sector representing approximately half of the total). However, for Central America and the Dominican Republic, trans-Latins represent 20% of total FDI, or almost 40% if United States investment is removed from the equation. It is interesting to note that, in the case of services, FDI is the principal means for suppliers to offer services abroad. América Móvil (Telmex) and the retailer Cencosud of Chile are two examples.

Although this growing internationalization is one of the most noteworthy features of economic events in the region, unfortunately it has not been linked with integration decisions. Any effort to deepen integration should seek to strengthen links with the regional actors in the internationalization process; this would reinforce both the expansion of the companies involved and the relevance and effectiveness of the integration process. Generally speaking, this process has not resulted from specific public policies or measures arising from integration commitments. Initiatives could be undertaken within the framework of trade agreements and trade facilitation measures to strengthen this vital *de facto* integration process. In addition to increasing the credibility of dispute settlement mechanisms, steps could be taken to promote the convergence of regulatory frameworks in the services sector and perhaps to update trade agreements in order to deepen their coverage of trade in services. Trade facilitation measures include investment in logistics and infrastructure and the harmonization of regulations, as well as mobility of technical and professional workers and the gradual harmonization of tax and financial procedures.

In many countries, the current integration process is coupled with more ambitious, broader and deeper approaches to liberalization than in the past. This is reflected in aspects of trade that either featured only partially in previous integration models (as with investment) or not at all (as in the case of services). One of the most radical changes in approaches to integration is that several Latin American and Caribbean countries have sought to conclude trade agreements with their main trading partners (especially the United States, the European Union and, more recently, the Asia-Pacific region).

It is well known that the past decade has seen rapid changes in technology and in the world economy, as well as the emergence of new competitors and markets (China and India, along with the rest of the Asia-Pacific region). This has dramatically altered the world map of trade flows, comparative advantages and investment location decisions, and it will no doubt continue to do so. It is in this global context of new opportunities and challenges that the progress made in terms of integration falls short of the mark, particularly in South America. Indeed, integration schemes do not figure in major business decisions, and integration is not high up on the countries' political agendas; when it does appear, it

amounts to little more than statements of intention. Against that backdrop, it should come as no surprise that the range of possible avenues for integration into the world economy are increasing. By the same token, sharp structural and policy differences are to be found across the countries of the region. Structural differences exist in terms of size, production structures, export capacities, comparative advantages, structure of main destination markets and degree of complementarity with or substitution of the main agricultural products of industrialized economies that heavily subsidize exports or support domestic producers. Policy differences have to do with the role that each country aspires to play in the regional and world economy, the strength of its economy and institutions and, hence, its bargaining power and alliance structure—all of which is reflected in trade policy and trade negotiations.

The different visions that have emerged therefore need to be acknowledge and reconciled in order to preserve the objective of integration. Integration has to be built up from these diverse realities with a view to making an expanded regional market more attractive. The time is ripe to update the notion of “open regionalism” by reinforcing the complementarity between integration into the world economy and subregional or regional integration schemes. This would not only broaden access to the main markets for labour- and natural-resource-intensive products, but would also encourage the development of technology- and knowledge-intensive activities, including the incorporation of value added in natural-resource-based products.

Integration schemes involve elements of development and policy coordination that are not present in free trade agreements concluded with partners outside the region. Therein lies the superiority of integration, but the serious political and technical efforts that this process requires have thus far not materialized. Of course, integration is about more than just trade, and more attention must indeed be paid to the social dimension (especially in a continent blighted by social inequality). However, this must not be done at the cost of delaying or compromising the economic and trade aspects of integration, but should rather reinforce the complementary nature of its commercial and social dimensions. With this in mind, efforts should be redoubled to build subregional value chains that enable members to export to third markets, and measures should be introduced to encourage the inclusion of less developed countries in those chains. This would represent an appropriate form of “open regionalism” that combines growth, the quest for third markets and social cohesion and in which structural support for reducing inequality among member countries promotes the development of competitive export supply in the less developed nations.

Viewed from this perspective, the summit meeting of heads of State and government on regional integration which will be hosted by Brazil in December 2008 offers an ideal opportunity to discuss these issues and agree upon an agenda for renewing and deepening regional integration.

Association agreements between the European Union and Latin America and the Caribbean: from preferences to reciprocity

Forging stronger economic and commercial ties with the European Union is an item of key importance on the regional agenda. This chapter focuses on the fact that Europe’s importance as a trading partner of Latin America and the Caribbean has declined as the region’s trade with the United States has expanded and as the Asia-Pacific region has become an increasingly significant export market and source of imports for the region.

These negotiations are important for the Latin American and Caribbean region, especially in view, on the one hand, of the recent failure of the Doha Round and, on the other, of the need to deepen its own regional integration. A possible association agreement between the European Union and each regional integration scheme (MERCOSUR, the Andean Community, the Central American Common

Market (CACM) and the Caribbean Community (CARICOM)) could act as a catalyst for the convergence of the various trade agreements that exist among Latin American and Caribbean countries. The European Union promotes agreements that cover the three pillars of trade, cooperation and political dialogue. The aim of all the ongoing negotiations is the creation of a free trade area supplemented by a series of trade clauses and cooperation initiatives. The accompanying political dialogue tends to focus on aspects relating to democracy, human rights and efforts to combat corruption and drugs.

In late 2007, the Caribbean countries successfully completed negotiations for an association agreement with the European Union, while the Central American and the member of the Andean Community each embarked upon negotiations for similar agreements. The negotiation process with MERCOSUR, which began eight years ago, is at a standstill. In mid-2008, the European Commission announced its intention to negotiate a strategic partnership with Mexico that could take economic relations to a new level. This is in addition to the strategic partnership agreement that the European Union signed with Brazil at the first European Union-Brazil Summit, held in Lisbon in July 2007.

If and when all these negotiation processes are brought to a successful conclusion, 13 economies of Latin America will have association agreements with the European Union (the number could rise to 18 if MERCOSUR reaches an agreement which includes the Bolivarian Republic of Venezuela). The agreements between the European Union and Mexico (2000) and Chile (2002) are in full swing. While Chile has managed to increase and diversify its exports as a result, the trade benefits for Mexico are less obvious (given its large and widening trade deficit with the European Union). The opportunity for reconfiguring its relations with the European Union through a strategic partnership could provide Mexico with a promising avenue for diversifying trade and attracting investment.

Caribbean exports to the European Union are concentrated in services and a few agricultural products (sugar and bananas). Until now, trade relations have been based on the preferences granted by the European Union to the African, Caribbean and Pacific (ACP) countries. The economic association agreement that was concluded in December 2007 (although not yet officially approved by the Caribbean countries) is a comprehensive accord that provides for the gradual removal of tariffs and the liberalization of services. The commitments of the Caribbean Forum of African, Caribbean and Pacific States (CARIFORUM) in the areas of services and investment go much further than the offers made by developing countries under the General Agreement on Trade in Services (GATS). However, the European Union has offered limited concessions in terms of what is contained in GATS. The total benefits for CARIFORUM countries will become clearer once the crucial provisions (such as the one concerning temporary work permits for professionals in European Union countries) have been implemented. Putting an agreement of such depth and scope into operation will not be easy in countries with limited institutional capacity. Furthermore, participating countries will have to face the fiscal impact of tariff reduction. The main challenge, however, will be to diversify from sugar and bananas to other production and service sectors.

Central America, for its part, receives the lion's share of the assistance which the European Union provides to the region. This aid is mainly focused on rural development, disaster prevention and reconstruction, social cohesion and regional integration, as well as on various programmes aimed at strengthening democracy and human rights. Agricultural products constitute the subregion's main exports to the European Union, and it is in this area that the negotiations will be most difficult (especially with regard to bananas). The challenge for Central America is to convert and expand the current Generalized System of Preferences, plus unilateral preferences, into more permanent market access for strategic goods. The parties have agreed that negotiations should be completed by mid-2009, and the trade talks are

on schedule. These negotiations will nonetheless be difficult in areas that are important to Central America, such as exports of banana and other tropical fruit.

In the Andean Community, the effort to combat illegal drugs is one of the main topics of the dialogue on politics and cooperation. The Andean Community exports mainly agricultural and mining products to the European market. The European Union has suspended negotiations, citing the lack of a common position within the Andean Community as the main reason. There are significant differences between the negotiating positions of Peru and Colombia, on the one hand, and Bolivia and Ecuador, on the other. Bolivia has stated that it will exclude itself from certain sections of any free trade agreement. The position of the European Union is that negotiations should be carried out at the level of groupings and that agreements should be as comprehensive as possible. It would appear that, in order for these negotiations to move forward, a greater degree of flexibility needs to be introduced so that countries in differing situations can choose different coverage options. In terms of merchandise trade, the long-standing dispute about bananas also poses a major challenge in these negotiations.

Although it has been eight years since negotiations between MERCOSUR and the European Union were formally opened, there is no sign of an agreement being reached in the next few years. Talks have been hampered by disagreements on the European Union's agricultural subsidies and access to MERCOSUR markets for manufactures and services. There is every indication that the deadlock could be broken once an overall agreement is reached on agricultural subsidies in the Doha Round.

There are several quite complex issues under discussion. For Central America, the sticking point is market access for the subregion's textiles and agricultural products, as well as the European demand for ratification of the Statutes of Rome of the International Criminal Court. The Andean Community needs to arrive at a common negotiating position, at least on the main issues being considered. If this is not achieved, bilateral negotiations (as requested by Colombia and Peru) cannot be ruled out as a way of overcoming the current standstill. Another requirement is the solution of the long-running controversy with the European Union over banana exports, a crucial issue for Central America (and Colombia and Ecuador). In this respect, the agreement on bananas that the European Union had accepted in Geneva in order to unblock negotiations in Doha in late June 2008 paved the way for more rapid progress in negotiations with Central America and the Andean Community. In contrast, the way in which the European Union is tying that agreement to a final agreement in Doha is an obstacle to those same negotiations. For MERCOSUR, agricultural market access and the Singapore issues are the main stumbling blocks.

The association with the European Union could act as a catalyst for regional integration. Indeed, the European Union prefers to negotiate with subregional or regional groups and offers cooperation to strengthen integration schemes. No less importantly, the fact that a large number of Latin American and Caribbean countries will probably have a similar and wide-ranging trade agreement with the European Union offers a real opportunity for the convergence of intraregional trade agreements, thereby facilitating the standardization of regional rules and disciplines in various chapters of those agreements. There will be intense negotiations between the European Union and Central America throughout 2008 and 2009, and an agreement does appear to be in sight. Negotiations with the countries of the Andean Community will be more difficult unless a more flexible approach is adopted. Progress with MERCOSUR will depend on the outcome of the Doha Round. Agricultural market access is the top priority in the negotiations being pursued with these three subregional integration schemes.

The Latin American and Caribbean and Asia-Pacific regions in search of closer trade and investment relations

In the last seven years, the Asia-Pacific region has increased its share of the world economy. In terms of output measured in constant prices and purchasing power parity (PPP), the economy of the region as a whole represented 20.5% and 28.0% of world GDP, respectively, in 2007, compared with 6.4% and 8.3% for Latin America and the Caribbean. The Asia-Pacific region accounted for just over 36% of the 4.9% growth in the world economy during 2007.

The Asia-Pacific region plays a major and growing role in world trade, representing 28% of world merchandise exports and 23% of commercial service exports (compared with 5.7% and 3.3%, respectively, for Latin America and the Caribbean). The merchandise exports of ASEAN amounted to US\$ 863 billion, exceeding the total for all of Latin America and the Caribbean. In terms of services, China, India and Singapore have become major exporters, especially of “other services” (i.e., services other than the traditional sectors of transport and travel).

In 1980-2006, the stock of FDI received by Asian countries amounted to US\$ 1.2 billion (10% of worldwide stocks). Latin America and the Caribbean, on the other hand, received just under 8% of world FDI. Thus, among developing regions, Asia has outpaced Latin America and the Caribbean in this respect.

The Asia-Pacific region plays an increasingly important part in maintaining global economic equilibria. In terms of the world current account, the combined US\$ 727 billion surplus of China, Japan, the newly industrialized Asian economies and ASEAN practically covered the US\$ 740 billion deficit of the United States. What is more, emerging Asian economies and Japan have almost 60% of the world’s international reserves. It is estimated that the Asia-Pacific region holds 53% of United States Treasury bonds. As a result, any indication of what Asia-Pacific (and China in particular) may do with its huge reserves has immediate repercussions on global financial markets.

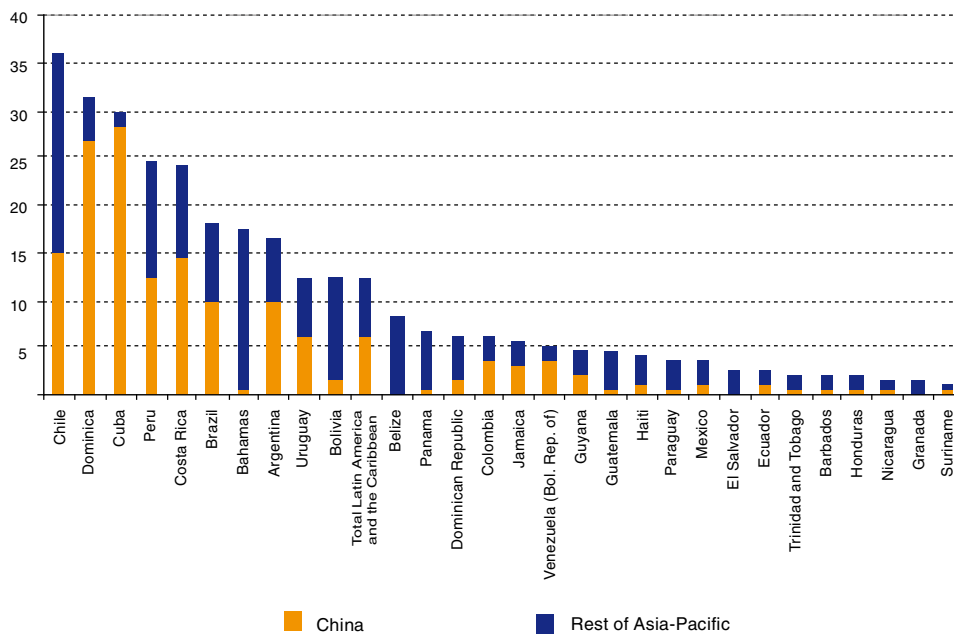
For some countries of Latin America and the Caribbean, the Asia-Pacific region represents a massive market: nearly 36% of Chile’s exports go to that region; the figure for Dominica is 31%; for Cuba, 29%; Peru, 24%; Costa Rica, 24%; Brazil, 18%; Bahamas, 17%; Argentina, 16%; Uruguay, 12%; and Bolivia, 12%. Most of these exports are from South America, while Central America and Mexico account for a smaller proportion. For many Latin American and Caribbean countries, the Asia-Pacific region remains a relatively untapped market.

The Asia-Pacific region is a much more important trading partner in imports than in exports, which means that the Latin American and Caribbean region has a growing trade deficit with it. Of total Latin American and Caribbean imports, a larger proportion originates from the Asia-Pacific region than from the European Union, with China displacing Japan as the main destination and origin. For some countries, such as Argentina, Brazil, Costa Rica and Uruguay, ASEAN has become a major trading partner. However, for China, Japan, the Republic of Korea and ASEAN, the Latin American and Caribbean region accounts for no more than 4% of imports and exports.

As pointed out in recent editions of *Latin America and the Caribbean in the World Economy*, the region’s exports to the Asia-Pacific region are largely in the form of inter-industry trade, contrasting with the intra-industry focus in Asia, which is embarking on a considerable de facto vertical and horizontal integration process. In recent years, however, the inter-industrial trade structure has been taking on certain aspects of intra-industry trade associated not only with new commodities but also some high-technology manufactures. The Grubel-Lloyd index shows that Mexico is increasing its level of trade with the Asia-

Pacific region, while Brazil and Costa Rica are beginning to engage in trade of a more intra-industrial nature with the region. Nonetheless, the low level of vertical and horizontal intra-industry trade continues to act as a major limitation on biregional trade and mutual investment.

Figure 5
LATIN AMERICA AND THE CARIBBEAN: SHARE OF THE ASIA-PACIFIC REGION IN TOTAL EXPORTS, BY COUNTRY, 2007
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), estimates based on official national figures.

To promote biregional trade, a two-pronged strategy is called for that would be directed towards: (i) making the most of the present surge in demand from Asia for commodities by incorporating knowledge, technology and value added; and (ii) becoming better integrated into Asian production and marketing networks for intra-industry trade and investment.

Intra-Asian trade and FDI are both concentrated in manufactures. An analysis by destination and origin of the trade and FDI of China, Japan, the Republic of Korea and ASEAN shows that their own region is becoming increasingly important. It is vital for the Latin American and Caribbean countries to become part of the regional process of productive integration that is under way in Asia.

This is confirmed by the high values of the Grubel-Lloyd index for Asian countries. The Latin American and Caribbean region has not been a preferred destination for FDI from China, Japan and the Republic of Korea. Much of what investment there is goes to tax havens such as the British Virgin Islands and the Cayman Islands. The Latin American and Caribbean region receives little investment in manufacturing, with most of the inflows being concentrated in various service sectors. Even in natural resource sectors (except mining), the Latin American and Caribbean region has not been a favoured destination for Asian investment.

De facto integration in Asia has been further intensified by intra-industrial and intra-firm trade. This can be observed in the fragmentation (slicing up) of value chains, especially in machinery sectors. This creates an increasingly close trade-investment nexus in which China serves as an export platform for neighbouring countries.

The proliferation of trade agreements in Asia-Pacific indicates that the region has entered a second stage of economic integration in which it is seeking a greater synergy between the de facto and de jure dimensions of this process. A network of trade agreements is being created around ASEAN which includes ASEAN+3 (ASEAN plus China, the Republic of Korea and Japan) and ASEAN+6 (ASEAN+3 plus Australia, India and New Zealand). This de jure integration process may place Latin America and the Caribbean at a disadvantage.

Approaches to the Asia-Pacific region have thus far been undertaken by individual countries on a somewhat sporadic basis by means of bilateral free trade agreements (FTAs). A more coordinated strategy is needed among countries or country groupings for the establishment of closer ties with this region. Such a strategy should focus on reinforcing the nexus between trade and investment and on strengthening production and technological linkages through various types of public-private alliances (including FTAs when such an option is deemed feasible and recommendable). It is important to link this strategic partnership with regional integration, to seek greater externalities and to move forward with enhanced legal certainty and macroeconomic stability, as well as forging more unified markets by streamlining and/or harmonizing trade rules (dispute settlement mechanisms, sanitary and phytosanitary measures, technical barriers to trade, accumulation of origin). Such advances in the regional integration agenda can be expected to increase the region's negotiating capacity vis-à-vis Asia-Pacific and broaden the scale and variety of business ties between Latin American and Caribbean firms and their Asia-Pacific counterparts.

Prospective analysis: a tool for strengthening international integration

Foresight studies have become an important consensus-building tool, particularly as regards the core components of strategies for strengthening countries' positions within the international economy and promoting export development. This kind of exercise is not common today in Latin America and the Caribbean, and progress made in this area by other countries and continents may thus serve as a stimulus for studies of this sort in the region.

Numerous analytical approaches to the preparation of prospective studies can be found in the literature. The scope of such studies has been growing in complexity over the last few decades, however, and the focus has shifted to decision-making in the present. The participation of multiple stakeholders (scientists, business people, other professionals, public authorities) helps create conditions conducive to planning and to well thought-out, systematic and participatory approaches to the creation of long-term development strategies geared towards improving a country's position in the international economy.

In a number of OECD countries, this type of long-term perspective is embodied in export development strategies having four strategic pillars around which programmes and policies are structured: attraction of foreign investment; export promotion and diversification; linkage and internationalization of SMEs; and innovation. These foresight exercises have helped to build consensus in priority-setting and in decision-making around these strategic pillars.

Although at first prospective studies focused on technology, they have since been expanding in scope to include other fields, such as sectoral strategies, and even broader development issues, such as sustainable growth. Prospective analysis is evolving through the convergence of trends in public policy analysis, strategic planning and future studies. This process therefore brings together the main agents of change in order to develop a strategic outlook based on advance intelligence.

Between the late 1940s, when future studies were first undertaken, and the present day, when prospective exercises have become a public policy instrument, the methodology used for this purpose has expanded enormously. Prospective studies are now conducted in many different ways depending, for the most part, on the characteristics of each country and each exercise, but the available methodologies are the same.

One key element in the latest studies has been the high degree of participation by stakeholders. Experience indicates that a policy's effectiveness depends on the involvement of the widest possible range of stakeholders, and that this is just as important as the expertise of those in charge of its implementation. The form that stakeholder participation takes depends on the type of exercise involved and the type of methodology used. An analysis of experiences in this regard points up the existence of distinct phases, each of which elicits differing degrees of interest and participation. If the exercise is at a diagnostic or exploratory stage, the level of participation may be lower owing to the specificity of the issues that are being addressed. During the decision-making stage, the range of stakeholders involved will tend to be wider. In contrast, at the implementation and coordination stage, the number of participating stakeholders will decrease considerably.

Although there are numerous research institutes and centres in the world that undertake future analysis exercises, governments are the ones that have taken the initiative in the use of prospective analyses as a decision-making and strategy-definition tool.

Foresight analysis is also being conducted in Latin America and the Caribbean, but, except in a few countries, governments have not systematically applied this practice at the national, subnational or sectoral level. In most cases, these exercises have been carried out only sporadically, and the capacity to adapt them in a creative way to the conditions found in the countries of the region has yet to be developed sufficiently.

Prospective studies help to build consensus and to determine strategic courses of action for overcoming obstacles to competitiveness. Energy policy provides one example. Such analyses are not widespread in Latin America and the Caribbean, but some interesting cases can be found in Brazil and the Bolivarian Republic of Venezuela. The study carried out by the Latin American Energy Organization (OLADE) is also a point of reference in this respect.

The United Nations Industrial Development Organization (UNIDO) has been promoting a sectoral form of prospective analysis in the region. In 2005, an analysis of the future of the South American fishing industry was carried out which covered Chile, Colombia, Ecuador and Peru. The corresponding chapter describes foresight analyses at the sectoral level that may help to detect potentials in new sectors as well as to define the future of an industry in crisis and to identify possible options.

The types of prospective exercises outlined in this chapter can be used to help strengthen public-private partnerships. Experience shows that such studies, by identifying the priorities and strategic guidelines that need to be taken into account in the present, are useful in building consensus as to how to construct a desirable future that is achievable in the long run.

Some foresight studies have been undertaken in Latin America and the Caribbean, but they have not influenced policy. Changes in administrations also reduce the continuity of recommended actions. A consensus as to how obstacles to competitiveness or future challenges should be addressed greatly reinforces support for the policies that are adopted and increases their sustainability and ability to withstand changes in government administrations. This is of fundamental importance for the implementation of State policies underpinned by long-term strategies. Prospective studies are a useful tool for countries striving to meet this challenge.