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TRADE AND TRADE REFORM IN LATIN AMERICA AND THE CARIBBEAN IN THE 1990s

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For many decades, trade policy in Latin America and the Caribbean (LAC) had involved very high levels of protection and of government intervention. The active pursuit of import substitution policies reduced the openness and efficiency of the region's economies. It also increased their external vulnerability, as they became dependent on a narrow range of export products, with little ability to absorb external shocks. This state of affairs changed markedly in the 1980s and 1990s, when most countries of the region moved to liberalize their trade regime. Trade policy reform in LAC in the 1990s has been both widespread and extensive, and the region now shows a fairly open trade regime. Such a sharp policy reversal clearly had an impact on trade flows, and those effectively underwent significant changes in the past decade. They also coincided with a number of other important changes in the LAC economies, including major structural reforms (with the privatization of many public enterprises and the deregulation of most domestic markets), a surge in investment (itself partly linked to the lower relative prices for capital goods resulting from higher openness), higher capital flows, and a more careful pursuit of macroeconomic policy aimed at preserving financial stability to foster sustainable growth. This paper seeks to assess the magnitude of the changes in trade flows in the past decade in the context of changes in the underlying policy framework. Section I summarizes the main trends observed in LAC trade over the 1990-97 period. Section II summarizes trade

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liberalization in the region since the mid-1980s. Section III attempts to assess how trade liberalization has affected the volume and structure of trade flows. Section IV concludes with some policy recommendations in the area of trade, particularly in the context of the present global financial crisis.

I. The evolution of Latin American and Caribbean trade in the 1990s: five stylized facts

The 1990s have witnessed significant, wide-ranging changes in LAC's trade flows. For the sake of brevity, these changes will be roughly summarized into the following five "stylized facts":

• **The importance of trade for the economies of Latin American and the Caribbean has increased markedly in the 1990s.** Latin America and the Caribbean's share in world *trade (*imports plus exports) declined sharply in the early 1980s, from about 5 percent to 3½ percent, in a context marked by declining terms of trade and the unfolding of the debt crisis, and then stayed at about that level through the end of the decade (Table 1 and Figure 1). From 1990, however, it has resumed an upward trend and by 1997 it had returned to close to its pre-crisis level.

The region's ratio o*f trade to GDP* had changed little through the 1980s and early 1990s, with the increase in exports compensating for the decline in imports in the first part of that period, and the rebound in imports offsetting a fall in exports in the second part. But in recent years the trade ratio has picked up, and by 1997 LAC's total trade was equivalent to about 32 of its GDP, its highest level of at least 20 years and an increase of 3½ percentage points with respect to 1990 (Figure 2). The increase in the region's trade-to-GDP ratio over the 1990s is more impressive when measured in volume terms: after declining in the early 1980s, the trade ratio measured at constant 1990 prices almost doubled between 1986 and 1997, increasing from 23 to 45 percent of GDP.

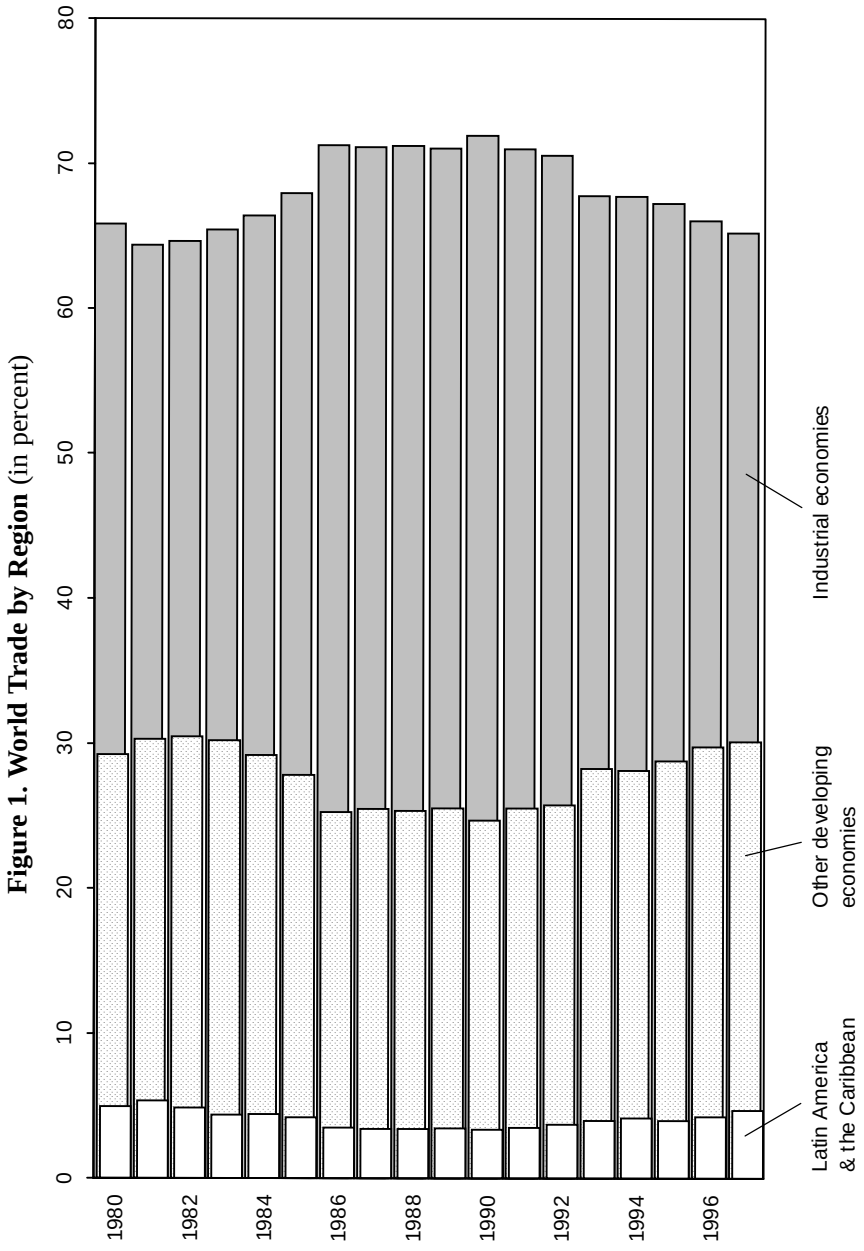


Figure 1. World Trade by Region (in percent)

Table 1. Latin America and the Caribbean: Trade Indicators

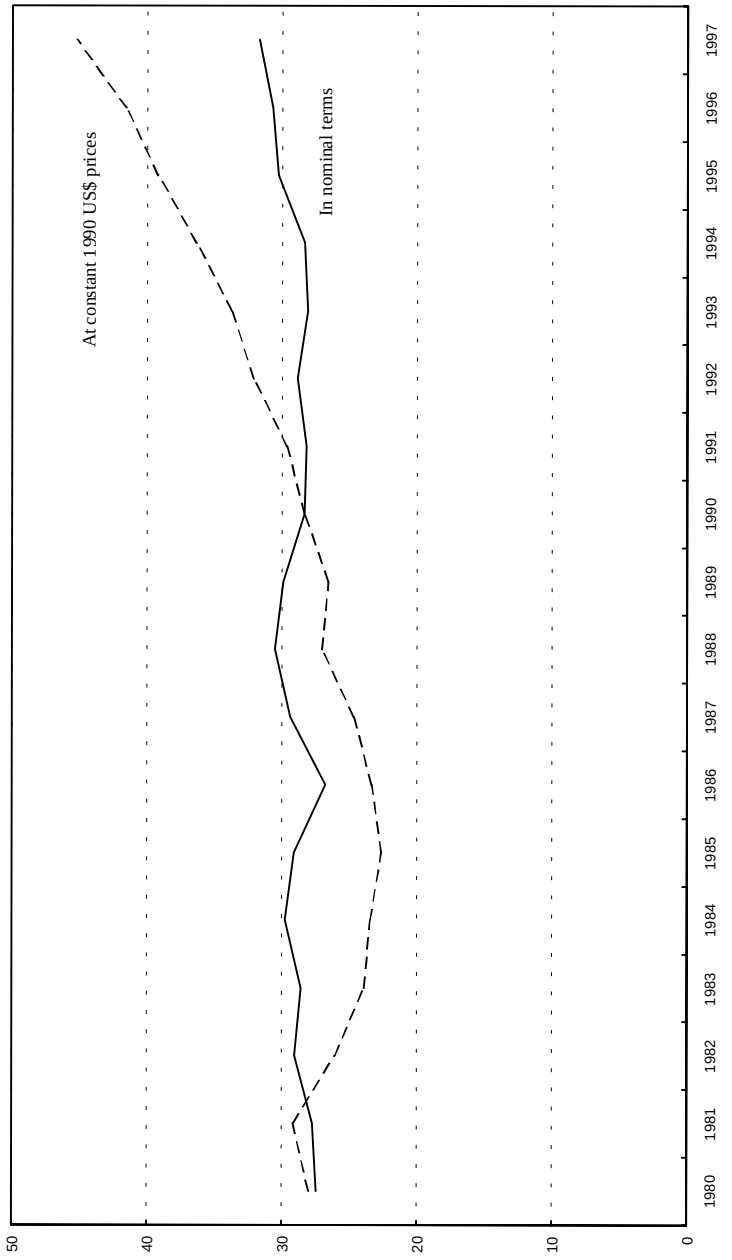
	1980	1990	1997
Share in world trade (in percent)			
Total trade	5.0	3.7	4.7
Exports	4.8	3.9	4.4
Imports	5.1	3.4	5.0
Trade-to-GDP ratio			
In nominal terms			
Total trade	27.4	28.3	31.7
Exports	13.2	15.1	14.9
Imports	14.2	13.3	16.8
In real terms 1/			
Total trade	28.0	28.3	45.3
Exports	11.5	15.1	21.5
Imports	16.4	13.3	23.8
Memorandum items:			
Industrial economies: trade-to GDP ratio			
In nominal terms	42.4	39.8	44.9
In real terms	31.7	39.8	52.9
Other developing countries: trade-to-GDP ratio			
In nominal terms	51.3	48.1	50.5

Source: International Monetary Fund.

1/ At constant 1990 U.S. dollar prices.

• **The trade-to-GDP ratio increased in nearly all countries of the region in the 1990s, but it continued to vary widely across countries** (Table 2). When measured in volume terms, the trade-to-GDP ratio increased in the 1990s in all of the countries of the region except four (Haiti, Honduras, Panama and Trinidad and Tobago); in all of the countries where it increased, except Jamaica and Venezuela, it went well over its level of the early 1980s.

Figure 2. Latin America and the Caribbean: Trade-to-GDP Ratio
(in percent)



The picture is more complex when the ratio is measured in nominal terms, mostly because of strong differences in the movements of the GDP deflators and of export prices. However, the nominal trade-to-GDP ratio increased in about half of the countries of the region, reaching record or close to record levels in Argentina, Costa Rica, Ecuador and Mexico. Haiti is the only country where both the nominal and real ratios declined in the 1990s.[2]

Table 2. Latin America and the Caribbean: Ratio of trade to GDP

	In nominal terms		In volume terms	
	1990	1997	1990	1997
Regional average	28.3	31.7	28.3	45.3
Argentina	15.6	19.8	15.6	27.8
Bolivia	43.8	41.4	43.8	48.3
Brazil	13.2	16.5	13.2	22.8
Chile	66.0	56.1	66.0	86.3
Colombia	39.2	36.1	39.2	57.2
Costa Rica	79.9	96.5	79.9	103.4
Ecuador	52.1	58.4	52.1	85.2
El Salvador	48.9	58.5	48.9	73.9
Guatemala	45.9	43.1	45.9	71.3
Haiti	41.6	23.1	41.6	36.0
Honduras	73.0	87.4	73.0	69.3
Jamaica	92.7	105.2	92.7	145.4
Mexico	37.7	49.1	37.7	71.2
Nicaragua	63.7	59.8	63.7	74.8
Panama	73.8	76.4	73.8	71.6
Paraguay	52.6	50.1	52.6	65.9
Peru	25.5	29.6	25.5	38.3
Trinidad & Tobago	83.1	95.0	83.1	83.3
Uruguay	46.0	43.4	46.0	73.1
Venezuela	59.0	49.5	59.0	78.9

Source: International Monetary Fund.

[2] Differences in the GDP deflators reflect both different levels of domestic inflation and the different degree of currency appreciation with respect to the U.S. dollar. Because of these two elements, a number of countries registered increases, some of them quite large, in volume terms, but flat or even declining ratios in nominal terms; this group includes Bolivia, Chile, Colombia, Guatemala, Nicaragua, Paraguay, Uruguay and Venezuela. This pattern is reversed in Honduras, Panama and Trinidad, where the nominal ratio increased while the real ratio declined or remained stable.

By 1997 the trade-to-GDP ratio continued to show a large level of dispersion across countries of the region. As expected, its level was generally related to the size of the economy (Figure 3). The Caribbean economies tended to have a trade coefficient of close to 100 percent of GDP or more, while the Central American economies fell in the 60-80 percent range, the medium-sized South American economies in the 40-50 percent range, and the larger economies usually displayed trade coefficients below 20 percent. The only noticeable exceptions are, on the upper side, Costa Rica, with a trade coefficient of close to 100 percent of GDP, and Mexico, with a coefficient of 50 percent; and on the lower side Peru and Haiti (with trade at under 30 percent of GDP).

• **Import growth was faster than export growth in the 1990s, both in nominal and in volume terms (Table 3 and Figure 4).** LAC imports declined sharply in the early 1980s in the wake of the debt crisis, and only grew modestly in 1984-86. Since 1987, however, with a rebound in capital inflows, imports have been growing at an average rate of 13 percent per year for the region as a whole (12 percent in volume terms). With it, the region's imports-to-GDP ratio increased from 13 percent in 1990 to 17 percent in 1997 (from 13 to 24 percent in volume terms). Import growth was particularly rapid in Argentina and Brazil, and much slower than the average in Bolivia, Honduras, Jamaica and Nicaragua. In volume terms, the imports-to-GDP ratio increased in all economies except Honduras, reaching record levels in several of them by the end of the period.

Exports, in turn, have expanded at an annual rate of about 9 percent in the 1990s, both in nominal and in volume terms. Their path has been more irregular, with only modest growth in 1990-93, and a sharp rebound in the following four years. The dispersion of countries around the mean was lesser than for imports, with over half of the LAC countries displaying a rate of export growth close to the regional average. Foreign sales expanded at a higher-than average rate in Argentina, Costa Rica, El Salvador, and Mexico, but only at 5-6 percent in Bolivia, Brazil, Honduras, Jamaica, and Nicaragua. For the region as a whole, the exports-to-GDP ratio remained roughly stable

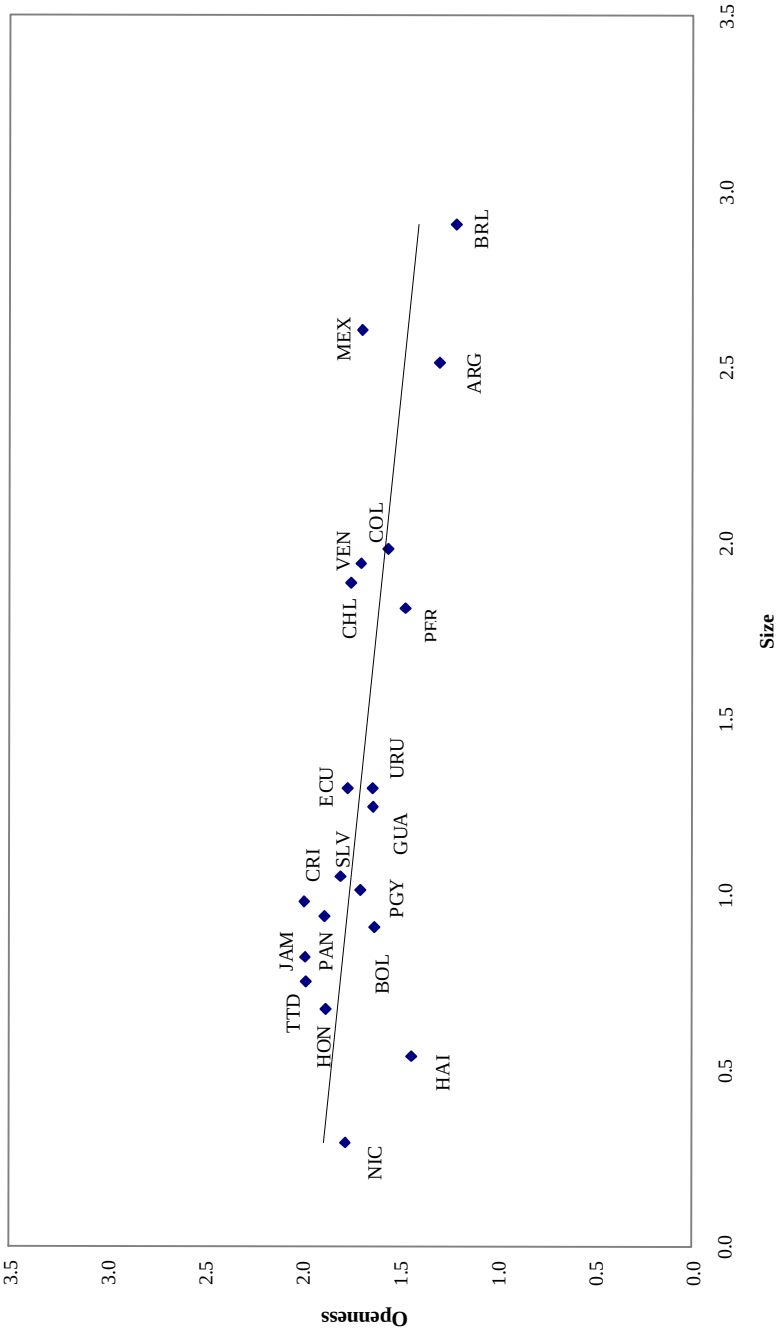


Figure 3. Latin America and the Caribbean: Trade Openness and Country Size (trade in goods and services, 1997)

Table 3. Latin America and the Caribbean: Evolution of Exports and Imports

	In nominal terms						At constant 1990 U.S. dollar prices					
	Export	Exports/GDP		Import	Imports/GDP		Export	Exports/GDP		Import	Imports/GDP	
	growth 1/	1990	1997	growth 1/	1990	1997	growth 1/	1990	1997	growth 1/	1990	1997
Regional average	9.2	15.1	14.9	12.6	13.3	16.8	8.8	15.1	21.5	12.4	13.3	23.8
Argentina	12.4	10.6	9.0	24.8	5.0	10.7	12.2	10.6	12.7	23.4	5.0	15.1
Bolivia	6.1	20.6	16.9	8.6	23.2	24.5	6.1	20.6	22.1	6.7	23.2	26.2
Brazil	5.8	7.5	7.1	16.9	5.8	9.3	5.4	7.5	9.7	16.2	5.8	13.2
Chile	10.2	34.6	26.9	13.1	31.4	29.2	10.1	34.6	39.5	13.7	31.4	46.8
Colombia	10.3	21.6	16.6	15.1	17.6	19.5	9.2	21.6	27.3	13.2	17.6	29.9
Costa Rica	11.7	36.5	47.0	11.0	43.4	49.5	8.6	36.5	49.1	8.0	43.4	54.3
Ecuador	9.8	30.0	29.9	12.8	22.2	28.5	9.3	30.0	47.1	10.7	22.2	38.2
El Salvador	16.9	18.4	24.0	14.4	30.5	34.5	13.9	18.4	28.8	15.1	30.5	45.1
Guatemala	11.2	21.0	18.8	11.8	24.8	24.3	9.7	21.0	30.1	10.9	24.8	41.2
Haiti	5.0	14.7	5.7	22.9	26.9	17.4	1.9	14.7	8.3	20.3	26.9	27.7
Honduras	7.9	34.7	39.3	9.2	38.3	48.0	2.2	34.7	31.2	2.9	38.3	38.1
Jamaica	5.6	48.3	47.8	8.1	44.3	57.4	4.5	48.3	64.7	7.3	44.3	80.7
Mexico	12.1	17.4	23.6	11.7	20.2	25.5	12.8	17.4	35.0	13.4	20.2	36.1
Nicaragua	5.2	21.1	20.5	3.2	42.5	39.3	3.3	21.1	18.7	5.6	42.5	56.1
Panama	8.4	40.2	37.6	12.4	33.7	38.8	5.3	40.2	36.2	8.4	33.7	35.4
Paraguay	10.2	23.8	22.2	15.6	28.8	27.9	8.5	23.8	30.8	10.7	28.8	35.0
Peru	7.8	12.8	12.8	10.4	12.7	16.8	5.7	12.8	15.6	9.1	12.7	22.7
Trinidad & Tobago	2.1	46.0	36.9	13.5	37.2	58.1	-0.1	46.0	30.0	15.7	37.2	53.3
Uruguay	9.8	25.9	21.2	14.1	20.1	22.2	8.8	25.9	33.7	13.1	20.1	39.4
Venezuela	8.5	39.5	29.3	10.3	19.5	20.2	7.4	39.5	49.0	9.4	19.5	29.9

Source: International Monetary fund. 1/ Average 1990-97.

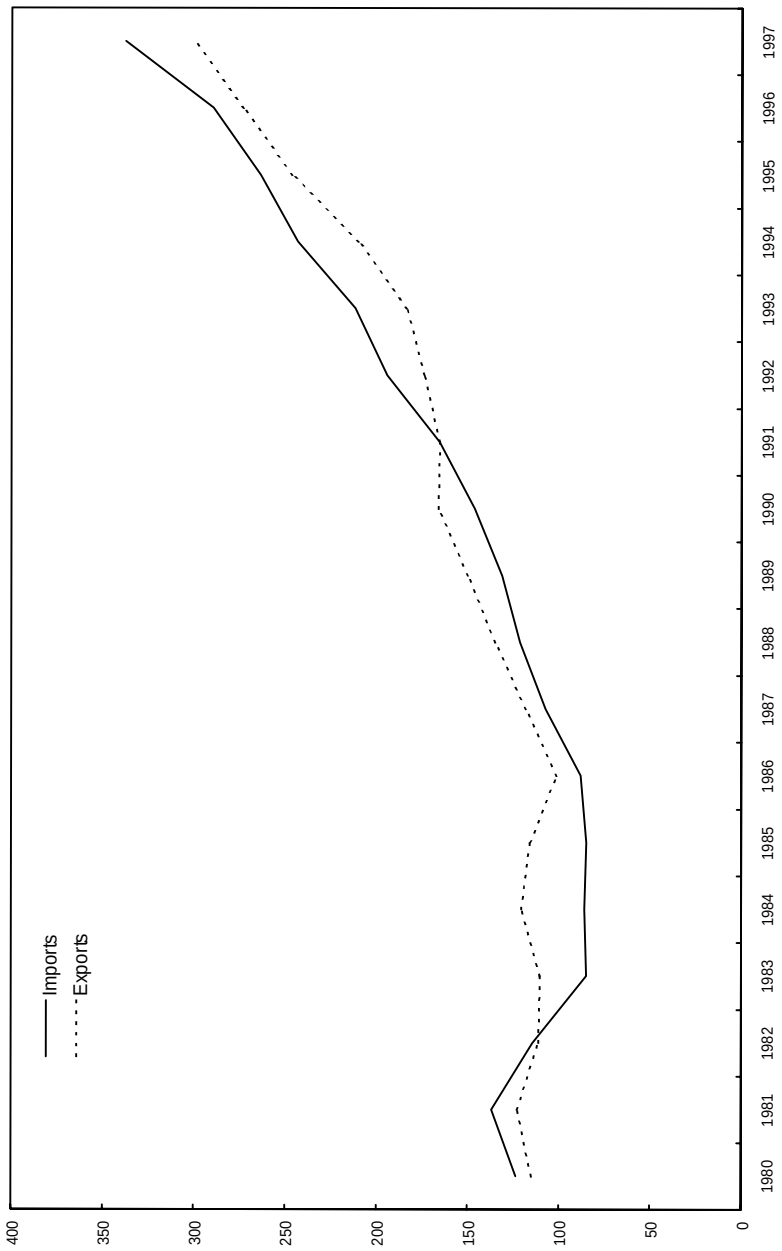


Figure 4. Latin American and the Caribbean Trade
(in billions of U.S. dollars)

in nominal terms, but increased from 15 to 22 percent of GDP in volume terms; that latter increase was, however, equivalent to only two thirds of that in the imports-to-GDP ratio over the same period.

With imports growing faster than exports, there has been a shift in the trade position, from a trade surplus of over 1½ percent of GDP in the late 1980s to a trade deficit of about the same magnitude over 1992-97 (Figure 5). Nearly all of the LAC countries saw their trade position deteriorate between the late 1980s and the late 1990s, and often by a significant margin. The only exceptions were Honduras and Venezuela, where the trade position improved; and Mexico and Costa Rica, where the widening of the trade deficit in the early 1990s was partly reversed in latter years. In 1990, over half of the countries of the region registered trade surpluses; in 1996-97, this group included only Ecuador and Venezuela (Mexico had a surplus for merchandise trade only).

• **Merchandise exports in most countries of the region remain heavily concentrated on commodities and semi-commodities.** At the regional level, the share of primary products in total exports has declined markedly, from 82 percent in 1980 to less than 50 percent in 1996, while the share of manufactures increased accordingly (Table 4 and Figure 6).[3] However, most of this trend is accounted for by Mexico. Excluding Mexico, the decline in the share of commodity exports is much less pronounced, particularly in the 1990s. Moreover, about half of this decline is accounted for by an increase in the share of semi-manufactures, or homogeneous products that are generally traded as commodities. Thus, in 1996 Mexico was the only country of the region where commodities and semi-commodities accounted for less than half of exports; their share was about 70 percent in Brazil, Honduras and Nicaragua, and over 80 percent in all other countries.

Additionally, exports have remained heavily concentrated on a few products (Table 5). In 1996 the major export product[4] accounted for less

[3] Data on the composition of merchandise exports and imports is available only up to 1996, and only for the 20 largest economies.

[4] Measured at the four-digit level of the standard international trade classification (SITC).

Figure 5. Latin America and the Caribbean: Evolution of the Trade Balance
(in percent of GDP)

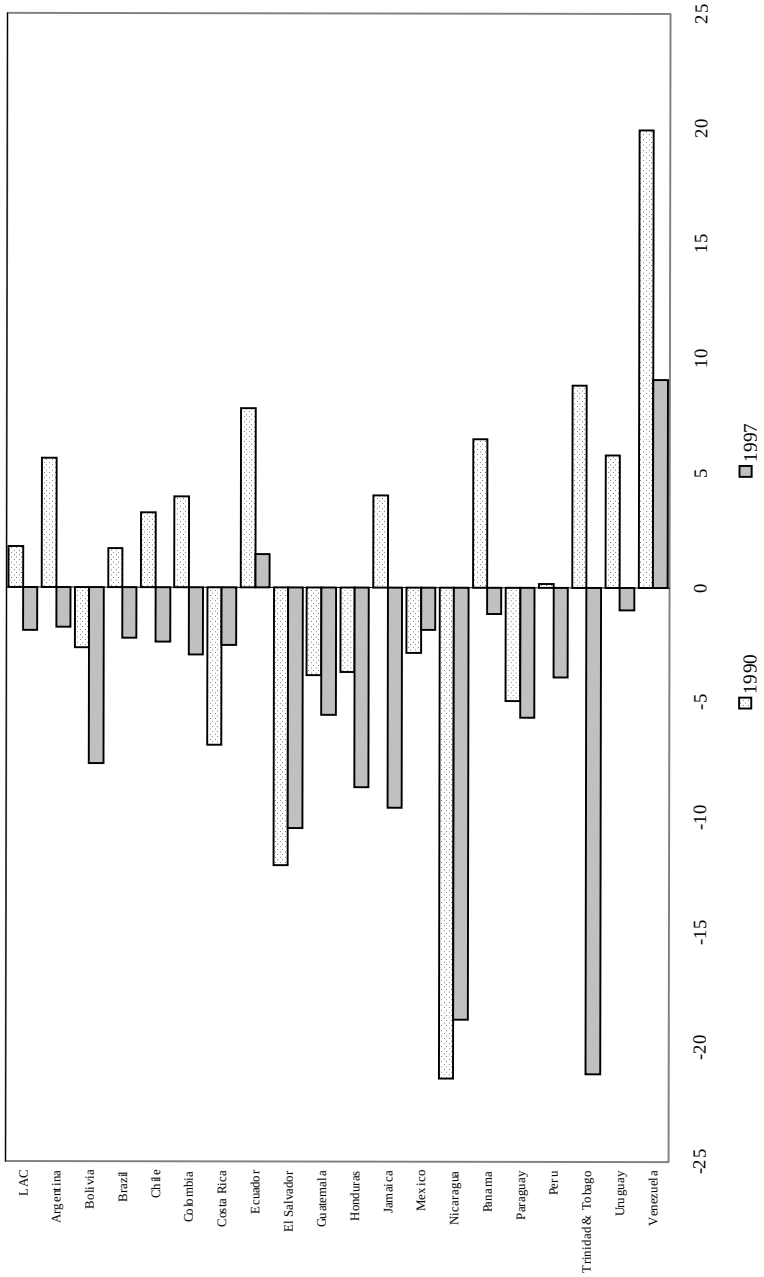


Table 4. Latin America and the Caribbean: Composition of Exports
(in percent)

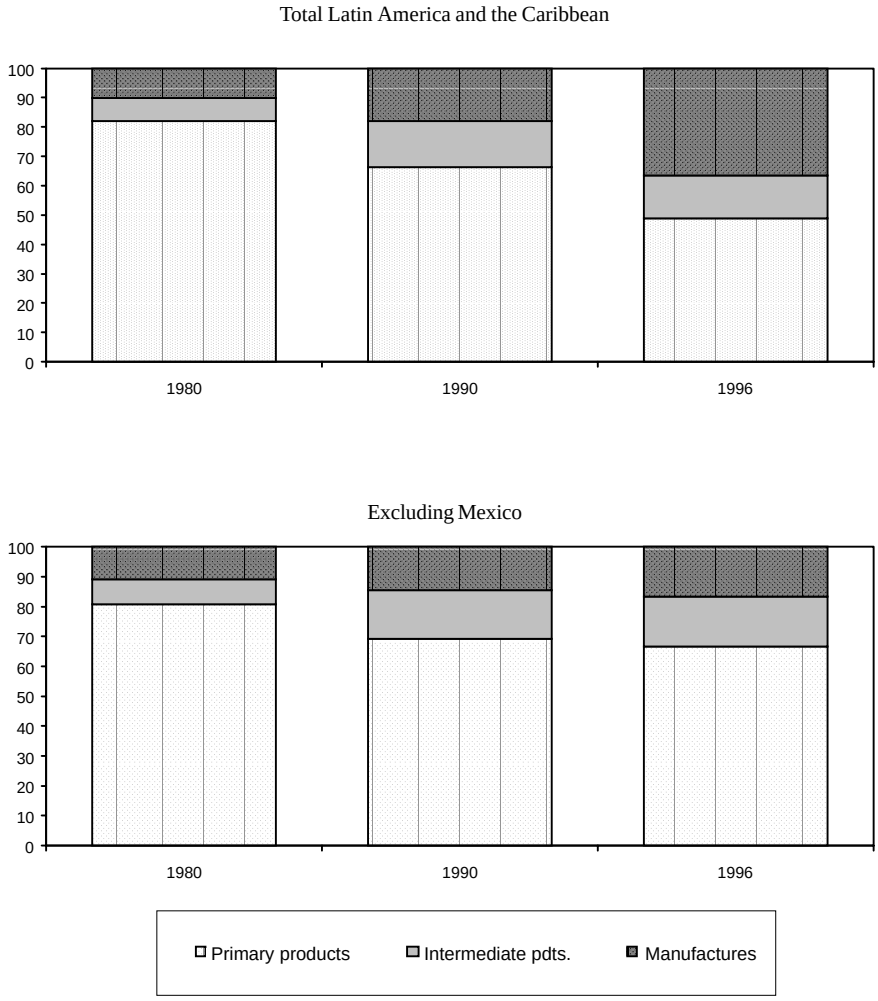
	20 largest economies			20 largest economies, excluding Mexico		
	1980	1990	1996	1980	1990	1996
Primary products	82	66	49	81	69	67
Intermediate products	8	16	15	8	16	17
Manufactures	10	18	37	11	15	17

Source: Own calculations, with data from the United Nations trade database.

than 10 percent of total exports in only one country, Brazil. It accounted for over 20 percent of total exports in over half of the countries for which data is available, reaching a record 75 percent in Venezuela. In all cases, including Brazil, the leading export product was a commodity.

There has been however some export diversification during the 1990s. The changes in the composition of Mexican exports were particularly noticeable, with the share of its leading export product, oil, falling from 32 percent in 1989 to 11 percent in 1996. Of Mexico's 20 leading export products in 1989, only 8 remained in that category in 1996, with most of the newcomers from the manufacturing sector. There was also some export diversification, although more modest, in other LAC economies, and particularly among those that initially showed very high levels of export concentration -including Ecuador, Chile, Trinidad and Tobago, Bolivia, Paraguay and Jamaica, and to a lesser extent Peru and Venezuela. In most cases, the new leading exports belonged to the commodity sector, although in Jamaica, and to a lesser extent Chile, some manufactured products also increased their relative presence. Countries such as Argentina, Colombia or Uruguay, in contrast, registered little changes in the 1990s with respect to the relative weight or the composition of their main exports.

Figure 6. Composition of Latin American Exports
(In percent)



Source: Own calculations, from data from the United Nations Trade Database.

Table 5. Latin America and the Caribbean: Export Concentration

	Share of the first leading export product in total exports (in percent)		Share of the five leading export products in total exports (in percent)		Share of the ten leading export products in total exports (in percent)	
	early 1990s	1996	early 1990s	1996	early 1990s	1996
Argentina	11	10	32	33	48	48
Bolivia	23	13	63	49	79	70
Brazil	6	6	21	19	35	31
Chile	41	28	59	51	68	62
Colombia	18	22	52	52	62	62
Costa Rica	...	23	...	47	...	55
Ecuador	49	31	88	71	...	81
El Salvador	...	33	...	45	...	54
Guatemala	20	23	43	47	51	55
Jamaica	51	45	77	73	83	83
Mexico	32	11	48	33	55	43
Nicaragua	...	19	...	48	...	69
Panama	...	32	...	56	...	67
Paraguay	38	31	82	66	90	77
Peru	20	16	52	49	64	63
Uruguay	10	10	34	36	46	46
Trinidad & Tobago	31	18	67	60	85	79
Venezuela	80	75	87	82	89	85

Source: Own calculations, with data from the United Nations trade database.

Argentina, Brazil, Colombia, Jamaica and Trinidad and Tobago: the earliest year for which data is available is 1991.
Bolivia and Peru: the earliest year for which data is available is 1992.
Guatemala and Uruguay: the earliest year for which data is available is 1993.

• **On the import side, there has been a marked decline in the share of primary products in total imports, with a matching increase in the share of manufactures.** Primary products, which accounted for 30 percent of the region's imports in 1990, accounted for only 21 percent in 1996, while the share of manufactures grew accordingly (Table 6). The trend is somewhat less pronounced, but still significant, if Mexico is excluded from the regional total (the share of primary products falls from 32 to 25 percent of total imports). The only countries where the share of primary products actually increased over that period are Costa Rica, Paraguay and Venezuela, mostly because of sharp increases in the share of food products in total imports. (The share of food products in total imports also increased in most of the other economies of the region, but it did not offset the decline in the share of nonfood primary imports.)

Table 6. Latin America and the Caribbean: Composition of Imports

(in percent)

	20 largest economies		20 largest economies, excluding Mexico		Memorandum item: World	
	1990	1996	1990	1996	1990	1996
Primary products	30	21	32	25	27	23
of which: Food	11	10	10	11	9	9
Intermediate products	25	25	27	26	20	20
Manufactures	46	55	42	49	51	54
of which: Machinery	27	31	25	27	26	30

Source: Own calculations, with data from the United Nations trade database and the World Trade Organization.

The share of machinery in LAC's total imports increased markedly between 1990 and 1996, from 27 to 31 percent of total imports, or from 50 to 56 percent of imports of manufactures. However, here again most of this trend is accounted for by Mexico, where machinery imports expanded by 29 percent per year between 1990 and 1996, to a record 38 percent of total imports. The share of machinery in total imports also increased in Argentina

and Brazil, and to a lesser extent in El Salvador, Nicaragua and Peru, although in those five countries the expansion was less than that in other (non machinery) manufactured imports. In the other countries of the region, the share of machinery imports has remained stable or declined between 1990 and 1996.

II. Trade liberalization in LAC in the 1990s

As mentioned above, the reform of trade policy has been one of the main items on the region's policy agenda over the past decade. The widespread, extensive character of trade policy reform in LAC has been documented in a large number of papers.[5] This section briefly summarizes the main measures of trade liberalization in the region from the late 1980s. It also presents for the main countries of the region an index of trade restrictiveness that allows to measure the extent of trade reform across countries in a broadly comparable form.

Up to the mid-1980s, one of the main characteristics of policy management in Latin America was the use of a relatively restrictive trade policy. Most countries in the region displayed high, staggered tariffs with a high level of dispersion, often supplemented by an extensive array of nontariff barriers and by heavily regulated foreign exchange markets. The use of quantitative restrictions to foreign exchange and foreign trade operations increased even more in the early 1980s, as a response to acute balance-of-payments difficulties following the external debt crisis. All these measures resulted in an even wider disparity of effective protection for traded goods.

In the period ranging from the mid-1980s to the early 1990s, however, most countries in the region opted for more open and transparent trade arrangements, combining relatively low and broadly uniform tariffs with little use of paratariff measures and mostly unregulated foreign exchange markets. Trade reform generally encompassed three main sets of action:

[5] See for instance Edwards (1995); Inter-American Development Bank (1996), Part II, chapter 2; Loayza and Palacios (1997); and Estevadeordal (1999).

• A significant reduction in both average and maximum tariffs. Average tariffs fell from close to 45 percent in 1986 to 14 percent in 1998, and maximum rates declined from an average of over 80 percent to about 30 percent over the same period. As a result, by 1998 the Bahamas was the only country of the region with an average tariff over 20 percent, and of the other countries, only two (the Dominican Republic and Nicaragua) had an average tariff above 15 percent.

• The dismantling of most quantitative and other nontariff restrictions. Most countries eliminated the previously pervasive lists of exception, and nontariff barriers, which had been estimated to affect close to 40 percent of imports in the mid-1980s, affected only 11 percent in 1997.

• The liberalization of currency markets in the region. Multiple exchange rate systems, that were common in the 1980s, are now the exception,[6] and foreign exchange controls on international payments have been eliminated or greatly reduced throughout the region.

Trade policy reform was quite widespread in the region, and all but a few economies have implemented a significant program of trade liberalization over the past decade, with the objective of reducing effective protection and enhancing efficiency. Nonetheless, trade liberalization policies were not implemented at the same pace and with the same intensity in all countries. The intensity of policy reform in general, and of trade policy reform in particular, is notoriously difficult to quantify and date, especially in a form that can be comparable across countries.[7] To attempt to measure the timing and intensity of trade policy reform across countries, as well as the present

[6] The Bahamas use a different exchange rate for some investment transactions; the Dominican Republic maintained an official exchange rate, distinct from the interbank exchange rate, up to July 1998; Chile legally has an informal exchange market, separate from the official exchange market, but the rates on both markets are freely determined and the difference between them is minimal.

[7] Particularly difficult methodological issues include the quantification of the impact of nontariff barriers, the appropriate calculation of average tariffs, and the relative weight to attach to different policy actions (i.e., decreases in tariff rates compared to a reduction in tariff dispersion or a reduction in the coverage of nontariff barriers).

degree of trade opening of the economies of the region, an index of trade restrictiveness has been constructed for the major economies of the region. This index, based on a methodology developed in the IMF, assesses the degree of trade restrictiveness along a 10-point scale (a rating of 1 represents the most open trade regime, and a rating of 10 the most restrictive) that takes into account the extent of both tariff and nontariff measures.[8]

The result of this exercise, presented in Table 7, illustrates how widespread and profound the drive to trade liberalization has been in the region. By the mid-1980s, most countries registered an index of 10, indicating a very restrictive trade regime. Of all the countries for which detailed information was available, only Chile had a somewhat less restricted trade regime, mainly because of the lesser scope of nontariff barriers following earlier efforts to liberalize trade in the late 1970s. By the end-1990s, in contrast, only one country displayed an index higher than 5 (a level that can be considered as only moderately restrictive), while six countries displayed a level of 2 or less, indicating a relatively high level of trade openness. In all, for the region as a whole, there was a movement of about 6 points on the index 10-point scale during the past decade or so.

The index also allows to separate the countries in different groups, according to the timing and intensity of the trade liberalization programs. There is a group of "early reformers" that started their reform effort in 1985-87, comprising Bolivia, Chile, Jamaica and Mexico. Of these, only Chile pursued a very extensive liberalization, ending the period with a restrictiveness index of 2. In a second group, the largest both by number of countries and by relative weight, trade liberalization was only initiated in the early 1990s. Colombia and Peru were the countries that undertook the most radical reforms in this group. The other countries of the group, including larger economies such as Brazil and Argentina, opted for more gradual liberalization efforts, and end the period with a trade restrictiveness index in the 4-5 range. Finally, Panama appears as the lone late reformer, but its radical reform efforts resulted in one of the most open trade regime in the region.

[8] For details on the methodology see Appendix and International Monetary Fund (1998).

Table 7. Latin America and the Caribbean: Index of Trade Restrictiveness

	1984	1990	1995	1998
Argentina	10	7	5	5
Bolivia	10	4	4	4
Brazil	10	9	5	5
Chile	8	3	2	2
Colombia	10	8	2	2
Costa Rica	...	...	...	5
Ecuador	10	8	5	5
El Salvador	...	...	...	4
Guatemala	...	...	...	5
Haiti	...	...	...	2
Honduras	...	...	...	5
Jamaica	10	6	5	5
Mexico	10	5	5	5
Nicaragua	10	...	...	6
Panama	10	10	6	1
Paraguay	...	...	...	4
Peru	10	8	3	2
Trinidad & Tobago	...	...	5	4
Uruguay	...	...	...	2
Venezuela	10	10	5	5
Memorandum item:				
United States	...	...	...	4

Source: own calculations, and International Monetary Fund.

The global financial crisis that started in late 1997 has not led to a noticeable return to restrictive trade practices in the region.[9] A few countries (including Ecuador, Mexico and the MERCOSUR economies) have raised import tariffs in an attempt to limit both the widening of their trade balance and the weakening of their fiscal position, but these increases were announced as temporary measures. A wider group of countries have introduced targeted

[9] For a detailed analysis of the impact of the financial crisis on LAC's trade and trade policy see Inter-American Development Bank (1999).

mechanisms to limit the growth of specific imports. The most frequently used have been contingent protection measures such as antidumping actions, countervailing duties, and safeguards, generally aimed at the protection of certain sensitive industries. Often, import standards, certification requirements, and administrative procedures also have been tightened. None of this, however, has led to a significant increase in trade restrictiveness in LAC. In fact, some countries such as Argentina, Chile and the Central American economies have even proceeded with unilateral or multilateral tariff reductions. This stands in stark contrast to LAC's reaction to the debt crisis of the early 1980s, when barriers to trade and exchange controls were among the most commonly used instrument to address balance-of-payments pressures.

III. The impact of trade liberalization on the volume and composition of trade flows

Trade liberalization is expected to encourage larger and less distorted volumes of trade. This section attempts to assess the impact of trade liberalization on the volume and structure of LAC's trade flows.

The impact of trade reform on the volume of trade

There is no doubt that trade liberalization in LAC has been associated with a significant increase in the volume of trade, both in absolute terms and relative to GDP. As mentioned above, for the region as a whole as well as for the majority of countries, the trade-to-GDP ratio increased to well over its pre-debt crisis level in real terms, and often also in nominal terms. In most cases, import growth both preceded and was larger than export growth. This is consistent with the way trade reform is expected to work its way through the economy, since its impact on supply (that relevant for export growth) will generally take longer to manifest itself because of lags associated with the investment process and the reallocation of resources; the demand response

(relevant for import growth), in contrast, can be expected to be much faster. In the latter part of the 1990s most LAC countries have registered higher export volume growth, which could indicate an effective export response to trade policy reform.

Factors others than trade reform, however, are likely to have also contributed to higher trade growth. These include, first, external factors, and particularly the sharp rebound in foreign direct investment and other capital flows, that considerably eased the external financial constraint that had affected the region over the previous decade. Policy-related developments, such as broadly successful stabilization policies and wide-ranging structural reforms also are likely to have played a role, both directly (through stronger reliance on market forces for the allocation of productive resources) and indirectly (through increased confidence in the sustainability of trade policy). The outcomes of these two sets of factors -namely, higher output growth, higher investment levels, higher income growth, and last but not least, the significant appreciation of most of the region's currencies -also likely contributed to higher trade growth. The impact of currency appreciation may however have been ambiguous, since it may have fostered import growth but may also have hampered export growth and export diversification.

The relatively short time span under consideration (at most a decade, in many countries barely seven years), together with difficulties in quantifying policy-related factors, and the excessively large number of potential causal variables, severely restrict the use of traditional regression analysis or other standard econometrical tools to disentangle the relative contribution of each of these elements. The following analysis will thus be limited to the comparison over time of the evolution of the potentially most relevant indicators. There are many methodological problems associated with this type of exercise, including potential sample bias, spurious processes, and collinearity. It is thus clear that the results of this exercise will not lead to any definite conclusions on the impact of trade reform; they may, however, help shed some light on the issue.

Figure 7 compares the evolution of an inverse index of trade restrictiveness with that of the real effective exchange rate on the one hand, and the import and export ratios, on the other, for a number of LAC countries.[10] The chart suggests six main observations:

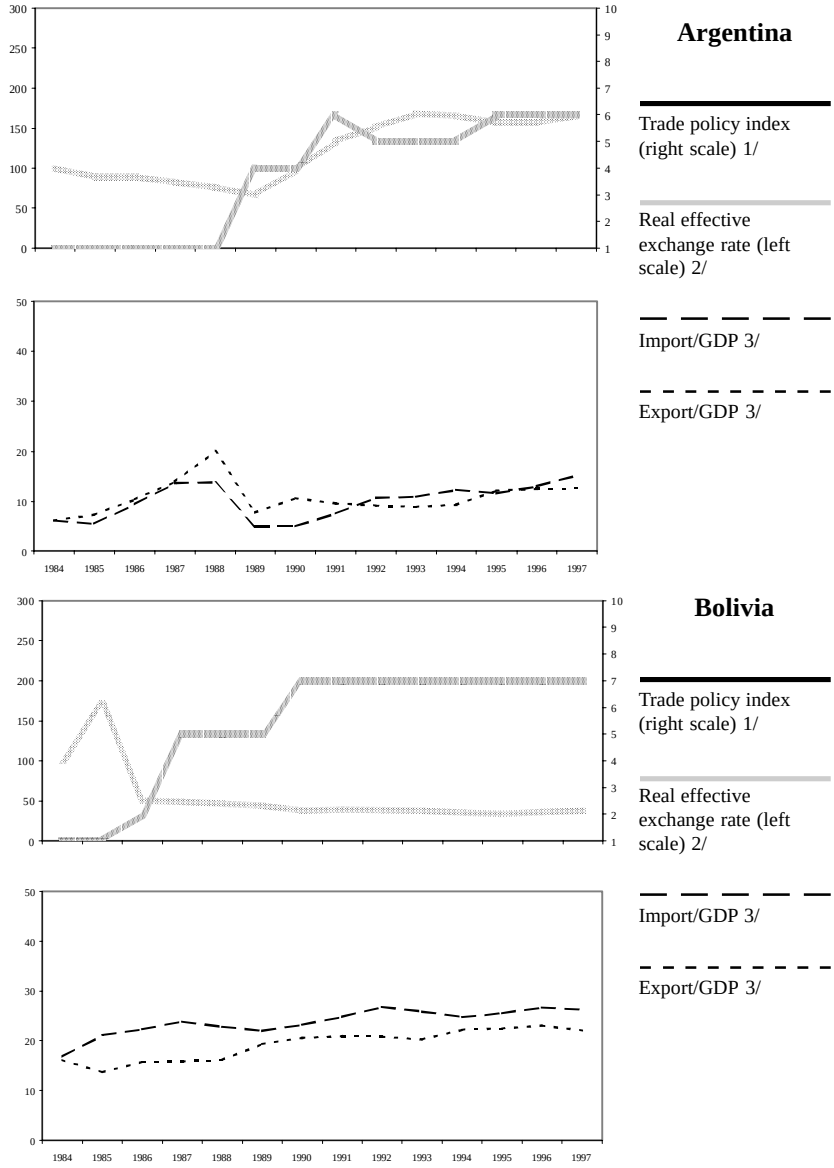
• First, it confirms that trade liberalization was both significant and rapid in the countries represented.

• Second, it shows that trade policy reform broadly coincided with currency appreciation in all of the countries represented except Bolivia. However, the magnitude and pace of the appreciation varied widely among countries: it was large and relatively abrupt in Argentina and Brazil; more gradual but still significant in Mexico, Colombia and Venezuela; and somewhat more moderate in Chile and Ecuador. Also, it is worth noticing that the general trend of currency appreciation sometimes coexisted with periods of currency depreciation; so Mexico, and to a lesser extent Bolivia and Venezuela, did experience a period of significant currency depreciation at some moment posterior to their trade liberalization efforts.

• In the aftermath of trade reform the import ratio increased markedly (an average of five percentage points) in all countries of the group, and with only a short lag (2-3 years) after the initiation of the trade liberalization program. However, both the magnitude and the speed of the increase differ significantly across countries, and there seems to be no strong, unequivocal relation between the timing or intensity of trade reform and the increase in import volumes. For instance, the increase is somewhat larger in Argentina, a "late" reformer, than in Bolivia, an "early" reformer. It is of about the same magnitude in Colombia, a "radical" reformer, as in Ecuador, a more moderate one.

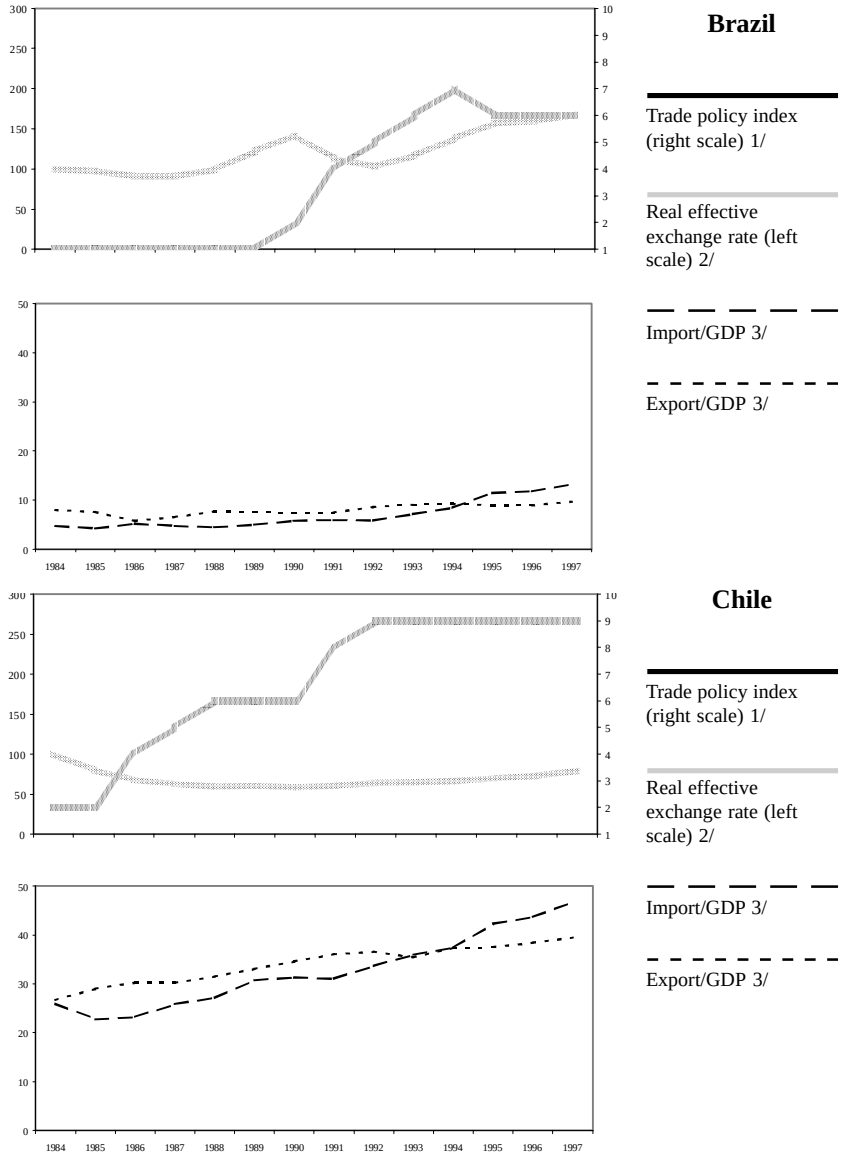
[10] The information necessary for calculating relatively reliable time series for the index restrictiveness was only available for eight Latin American countries. To facilitate the visual interpretation, the charts show the evolution of the inverse of the index of trade restrictiveness (so that both the index and trade flows are expected to move in the same direction). The real effective exchange rate index is computed so that an increase in the index denotes an appreciation of the currency. Exports and imports are measured as a share of GDP, at constant 1990 U.S. dollar prices.

Figure 7. Trade Liberalization, Currency Appreciation and Trade Volumes



Source: own calculations, and International Monetary Fund.
1/ On a 10 point scale, with 1 indicating the most restrictive trade regime, and 10 the most open.
2/ Index, 1984 = 100
3/ At constant 1990 U.S. dollar prices.

Figure 7. Trade Liberalization, Currency Appreciation and Trade Volumes



Source: own calculations, and International Monetary Fund.
1/ On a 10 point scale, with 1 indicating the most restrictive trade regime, and 10 the most open.
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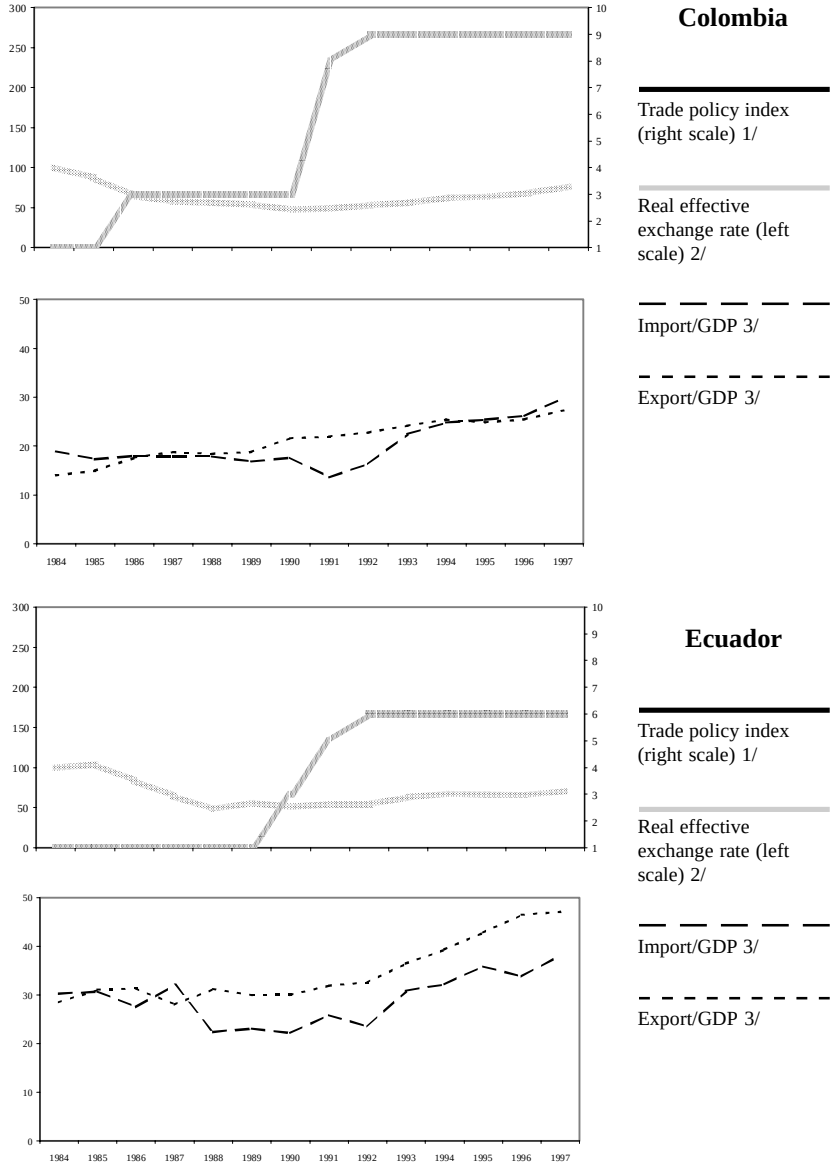

Source: own calculations, and International Monetary Fund.
1/ On a 10 point scale, with 1 indicating the most restrictive trade regime, and 10 the most open.
2/ Index, 1984 = 100
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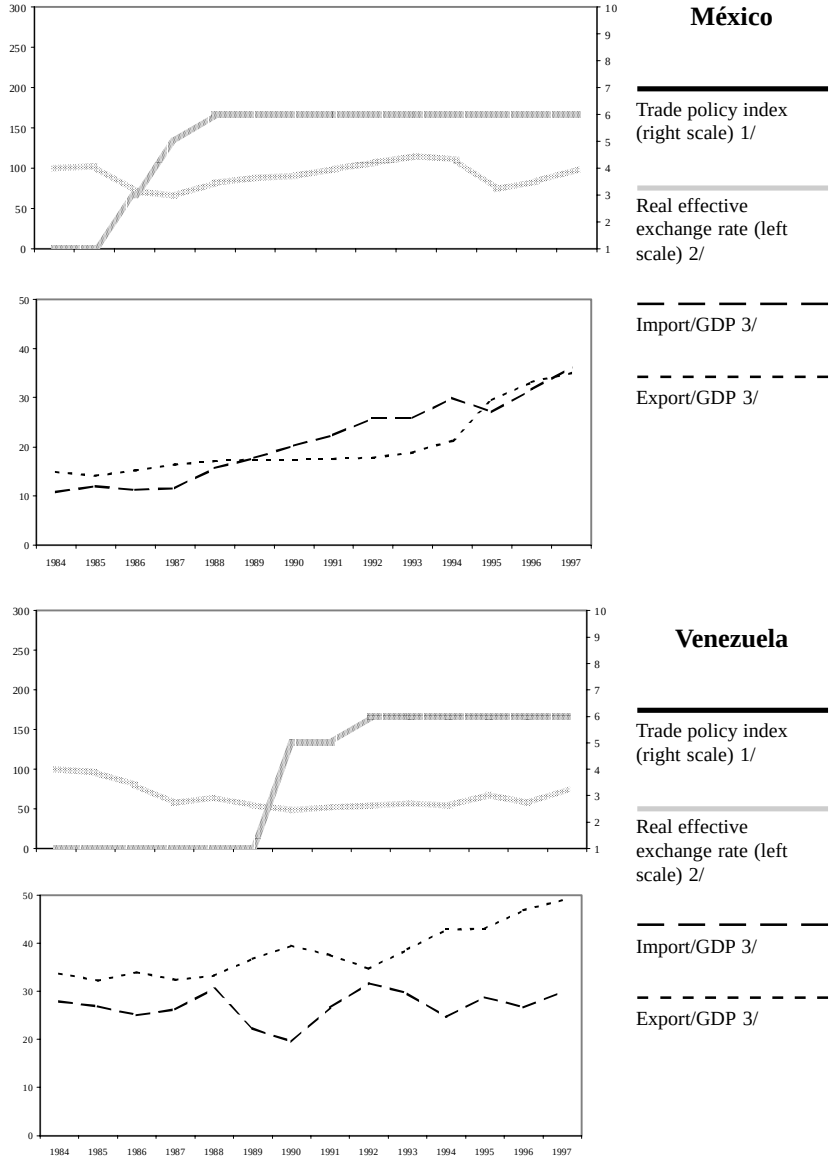

Source: own calculations, and International Monetary Fund.
1/ On a 10 point scale, with 1 indicating the most restrictive trade regime, and 10 the most open.
2/ Index, 1984 = 100
3/ At constant 1990 U.S. dollar prices.

• In most countries, the import ratio also seemed to respond to changes in the value of the currency, increasing faster when the currency appreciates and growing at a slower pace or decreasing when the currency stabilizes or depreciates. This pattern is particularly noticeable in Argentina, Brazil, Mexico and Venezuela. Across countries, however, the different degree of currency appreciation does not seem to explain the differences in the increase in the import ratio: for instance, with broadly the same degree of trade liberalization, the import ratio increased as much in Venezuela as in Argentina, and even more in Ecuador than in Argentina, although currency appreciation was much more pronounced in Argentina.

• The reaction of the export ratio to trade reform appears somewhat smaller and more delayed (an average of four points after a six year lag). There is also more diversity across countries, with the largest response in Ecuador (16 points) and the smallest in Bolivia (1½ point).

• The export ratio also appears responsive to changes in the value of the currency. For instance, the strong increase in export volume in Mexico from 1995 suggests that the earlier currency appreciation may have hampered export growth. In Venezuela also, export growth seems faster in periods when the currency depreciates or remains stable, and appears to slow down in periods of currency appreciation. In all countries, however, export volumes display a noticeable upward trend, even in a context of currency appreciation, thus suggesting that the impact of the liberalization process outweighed that of currency appreciation.

In sum, trade liberalization seems to have had a noticeable impact on the import and export ratios of the countries included in Figure 7, independently of changes in the value of the domestic currencies. Currency appreciation likely amplified the impact of trade liberalization on imports, and dampened its impact on exports. Neither trade liberalization nor currency appreciation had, however, an impact on trade flows that can be described as homogeneous across countries. This latter element would suggest that other policies also played an important role in either enhancing or dampening the impact of trade policy reform. Factors that may have limited the impact of trade

liberalization include remaining market rigidities, such as restrictions to labor mobility, the existence of monopoly positions and other restrictions to competition, and restrictions in the access to financial markets; all of these tend to increase costs and limit the scope for productivity gains and more generally for the efficient reallocation of factors. Inversely, policies aiming at the removal of these restrictions help enhance the impact of trade liberalization, and indirectly contribute to higher trade volumes. Although tracking the impact of such policies clearly exceeds the scope of this paper, it is important to recognize their bearing on the degree of openness on an economy in general, and of the LAC economies in particular.

The impact of trade liberalization on the composition of trade

Trade liberalization is expected to affect not only the volume but also the structure of trade flows, with countries specializing in the production of goods and services more attuned to their resource endowment. Trade policy reform appears to have contributed to a significant change in the composition of LAC trade flows, although here again the impact is mostly noticeable on the import side.

As mentioned above, the composition of LAC imports changed in the 1990s, with a reduction in the share of primary products and an increase in that of manufactures. Trade policy reform in LAC involved an often radical simplification of the tariff structure. Before the 1990s, tariffs in Latin America used to display a large degree of dispersion. They were usually staggered according to the degree of processing, with the highest tariffs levied on consumer durables and the lowest on inputs and capital goods (there were also numerous tariff exemptions). Additionally, with the extensive use of quantitative import controls, tariffs, although very high, were often not the binding constraint on imports.

The use of differentiated tariffs, with higher effective protection for manufactured goods and lower, sometimes even negative protection for inputs, tended to tilt the import structure toward a heavier participation of

primary and intermediate goods, and a lesser share of manufactures, particularly consumer goods. As a result, the share of primary products in LAC imports was significantly higher than that observed in world trade in general, which was somewhat paradoxical given that the region had a relatively large endowment in natural resources. With trade liberalization, this situation has changed, and, as mentioned above, the share of primary products in LAC imports has declined by about one third (from 30 to 21 percent), while that of manufactures has increased from 46 to 55 percent.

Again, factors others than trade reform may have come to play. One could be a long-term decline in the price of primary goods with respect to that of manufactured goods, which appears to have been accelerating in the 1990s.[11] Changes in the underlying pattern of demand, associated with a long-term trend increase in the share of manufactured goods in total demand, also could explain part of this change in the composition of LAC imports. Such effects would likely be reflected in changes in the structure of world trade over the same period. However, Table 6 shows that both the decline in the share of primary products in world trade (from 27 to 23 percent) and the matching increase in the share of manufactured goods (from 51 to 54 percent) are much smaller than those observed in the composition of LAC imports. This would indicate that a significant part of the changes in the structure of LAC imports in the 1990s can be effectively ascribed to trade policy reform.

The composition of LAC exports also has changed over the 1990s, although to a much lesser degree. This is partly attributable to the above-mentioned lags associated with the supply response, but a number of additional reasons may contribute to this result:

- first, there may have been less initial distortions with respect to exports than with respect to imports. As mentioned earlier, the traditional Latin American trade policy regime, relying on high, staggered tariffs and pervasive import controls, was mostly aimed at protecting domestic producers from import competition. High protection against imports did discriminate against

[11] See Reinhart and Wickham (1994).

export activity, but this was partly compensated by a range of direct and indirect subsidies;

- second, the volume of "traditional" exports such as commodities, in which LAC has a clear comparative advantage, did increase significantly. This suggests that there was an output response to the reduction in the implicit discrimination against these products that was embedded in the previous trade regime;
- third, because of the large economies of scale often associated with the exploitation of natural resources, the increase in commodity output may, paradoxically, also obscure the expansion of other, smaller export activities that, in spite of significant growth, still only represent a very small share of total exports;
- finally, export diversification may also have been hampered by rigidities in factor markets, just as those may have limited the growth of trade volumes. Even when structural reforms aimed at eliminating these rigidities have been initiated together with trade policy reform, they often require long implementation processes, thus compounding the lags with which supply changes tend to manifest themselves.

IV. Concluding remarks: the trade policy agenda for Latin America and the Caribbean

This paper has shown that, after a long period of profound structural reforms, most LAC countries now have a fairly open trade regime, and that significant changes have taken place in recent years in the volume and structure of their trade flows. Further liberalization-related changes are likely to manifest themselves in the coming years, as the effects of trade policy reform continue to work their way through the economies, particularly with respect to the export sector. Trade flows are also likely to be strongly affected by the resolution of the ongoing global financial crisis. What should be, in this context, the objectives of trade policy in the region?

The most important recommendation is one of omission -what trade policy should not attempt to do. It is a recommendation grounded in many countries' painful past experiences, and it is well worth repeating at this time of financial turmoil: trade policy should not be used as a substitute for macroeconomic stabilization policies, and tariff increases or other import control mechanisms should not be used to control domestic demand nor to address balance-of-payments problems. There are recognized economic benefits to the stability of trade arrangements, and changes in the trade regime for purposes of demand management would certainly have negative consequences on both productive efficiency and confidence.

A second important task is the necessary strengthening of policies that are complements to trade policy and that will enhance its impact on trade flows. As mentioned earlier, the impact of trade reform on the volume of trade has not always been as swift and sizeable as expected. As a result, notwithstanding the increases registered in the 1990s, the trade intensity of the LAC economies remains lower than that of most other regions: in 1997 merchandise trade accounted for 32 percent of the GDP of LAC, but 45 percent of the GDP of industrial countries, and 51 percent of the GDP of other developing countries. This indicates that there is still ample scope for structural reforms that would facilitate a more efficient use of resources, particularly in the area of competition policies, bank reform, and labor market reform.

It is important also to limit the proliferation of administrative, and potentially discretionary trade measures. Although, as mentioned earlier, trade regimes in LAC have remained fairly open, even in the context of the current global financial crisis. the use of administrative, largely discretionary measures aimed at controlling trade in specific products has expanded markedly. The use of such measures partly predated the financial crisis -the industrial economies have made an increasingly liberal use of such mechanisms over the past two decades-, but the buildup of currency pressures probably further stimulated its spread in the region. Most of these measures fall within the WTO allowances. However, they are also prone to abuse, and

can lead to significant trade distortions, as their coverage and application is not really transparent, and they may end up difficult to remove. For these reasons, they should only be applied as a last resource, and with strict adherence to WTO guidelines.

The significant trade liberalization that took place in the region over the last decade or so has contributed to a deep transformation of the LAC economies. However, the gains from a faster integration in the world economy need to be preserved through the sustained pursuit of appropriate macroeconomic policies. These include disciplined fiscal management and transparent monetary and exchange rate policies. Without them, there will be growing financial instability, and this in turn may create an unwarranted backlash towards restrictive trade practices, reversing a move that has helped modernize the region and unleash the process of sustained growth that has for so many years eluded that region.

Appendix. Index of Trade Restrictiveness

The index of trade restrictiveness, defined in IMF (1998), measures the overall degree of restrictiveness of a country's trade regime on a 10-point scale, with 1 assigned to the most open regime, and 10 to the most restrictive.

The calculation of the index takes into account both the level of average import tariffs and the use of nontariff barriers (NTBs). Tariffs are classified into five categories, with the lowest range (0 to 10 percent) being the least restrictive and the highest range (over 25 percent) the most restrictive. Three categories are specified for NTBs (open, moderate and restrictive), based on the number of sectors covered by NTBs, on the coverage of NTBs within each sector, and on their restrictiveness. Each cell of the resulting 15-cell matrix is assigned a number, from 1 to 10, representing the relative overall restrictiveness of the trade regime (Table A).

Table A. Classification Scheme for the Trade Restrictiveness Index

	Nontariff Barriers		
	Open	Moderate	Restrictive
Tariffs			
Open (0-10 percent)	1	4	7
Relatively open (10-15 percent)	2	5	8
Moderate (15-20 percent)	3	6	9
Relatively restrictive (20-25 percent)	4	7	10
Restrictive (25 percent and more)	5	8	10

Source: IMF (1998).

With respect to tariffs, countries were assigned to one of the five categories on the basis of their unweighted average tariff rate. With respect to NTBs, the assessment was more qualitative, considering the use of standard NTBs (quantitative restrictions, export and import quotas, bans, restrictive licensing,

and restrictive allocation of foreign exchange) within the following broad criteria:

- open: NTBs are absent or minor, and cover less than one percent of production or trade;
- moderate: NTBs are significant but not pervasive, and cover between one to 25 percent of production or trade;
- restrictive: many sectors or entire stages of production are subject to NTBs, that cover more than 25 percent of production or trade.

Because of its simplicity, the index of trade restrictiveness can be calculated relatively easily for a large number of countries, and for different points in time. However, the calculation does ignore certain aspects of trade restrictiveness such as the degree of dispersion of tariffs, the number of tariff bands, or the use of discretionary tariff exemptions or "exceptional" tariff rates; the information required to compute these factors in a form that would be comparable across countries is rarely available. Overall, the index tends to give more weight to nontariff barriers, under the assumption that they generally result in larger economic distortions and less transparent trade regimes than high tariff rates.

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