Better Neighbors

Toward a Renewal of Economic Integration in Latin America

Chad P. Bown, Daniel Lederman, Samuel Pienknagura, and Raymond Robertson
The benefits of international integration: Is a global approach superior?

➢ Three criteria to assess the benefits of integration:

1. Similarity of structural factors (HO, Ricardo)


3. **Diversification** of risks (Caselli et al. 2015)

➢ LAC neighbors are structurally similar, invest little in R&D, are less integrated in global markets.

➢ Then, why pursue regional integration?
Then, why pursue regional economic integration?

Because our neighborhood cannot be ignored

- Geography shapes trade in goods and services, migration decisions, and, to a lesser extent, capital flows
- It also affects knowledge diffusion (Keller 2002)
- And economic performance is geographically clustered (even after controlling for terms of trade fluctuations)
This implies that the benefits of global and regional integration are intertwined

- A country’s neighborhood affects its global competitiveness
  - Example: Regionally traded goods and services, such as land transport and electricity

- And global integration affects the potential benefits from regional economic ties (e.g., learning about our neighbors’ export markets)

- How? An agenda for the renewal of integration in LAC...
1. Renew MFN tariff liberalization to enhance efficiency

**Evolution of applied MFN tariffs**

- **LAC countries**
- **Other countries**

- **Pacific Alliance**
- **CAFTA-DR**
- **Mercosur**
- **G-7**
- **Selected Asian economies**

**In percent**

- **Applied MFN tariffs, 2014**
- **Applied MFN tariffs, 1995**
1. Renew MFN tariff liberalization to boost investment

Applied MFN tariffs and WTO binding commitments

- LAC countries
  - Pacific Alliance
  - CAFTA-DR
  - Mercosur
- Other countries
  - G-7
  - Selected Asian economies

- Applied MFN tariffs, 2014
- Overhang
2. Deepen integration between LAC sub-regions

Trade similarity with regional and extra-regional partners (rank correlations)
2. Deepen integration between LAC sub-regions

<table>
<thead>
<tr>
<th>Region</th>
<th>Other Subregional Countries</th>
<th>Other Regional Countries</th>
<th>Rest of the World</th>
</tr>
</thead>
<tbody>
<tr>
<td>South America</td>
<td>Contiguous</td>
<td>Other Subregional Countries</td>
<td>Rest of the World</td>
</tr>
<tr>
<td>Central America + MEX</td>
<td>Contiguous</td>
<td>Other Subregional Countries</td>
<td>Rest of the World</td>
</tr>
<tr>
<td>Caribbean</td>
<td>Contiguous</td>
<td>Other Subregional Countries</td>
<td>Rest of the World</td>
</tr>
</tbody>
</table>

Trade similarity with regional and extra-regional partners

- 2. Deepen integration between LAC sub-regions
3. Harmonize rules to enhance global competitiveness

- Non-tariff barriers affect trade flows and efficiency

- Two examples:

  1. Rules of Origin (RoO)
3. Harmonize rules to enhance global competitiveness

- Non-tariff barriers affect trade flows and efficiency

- Two examples:
  
  1. Rules of Origin (RoO)
  
  2. Regulatory frameworks: Critical for RTGs
     - Example: transmission of electricity
4. Reduce LAC’s trade costs

Elasticities of trade flows with respect to distance by region and partner type

Note: SSA=Sub-saharan Africa, MENA= Middle East and North Africa, EUR=Europe, ECA=Eastern Europe and Central Asia, EAP=East Asia and the Pacific
5. Deepen labor market integration

- Three indicators of labor-market integration:
  - Short-term comovement of wages of similar workers (synthetic cohorts) across countries
  - Long-term wage differentials across countries
  - Speed of adjustment to equilibrium wage gaps
- All these compared with what is observed within countries (Mexico and the U.S.)
Short-term co-movement of wages: Across LAC vs. Mexico and the U.S.

Elasticity of wages in one country (region) with respect to changes in wages in other countries (regions)
Wage differentials and speed of adjustment: Across LAC vs. Mexico and the U.S.

Average wage gaps

<table>
<thead>
<tr>
<th>Region</th>
<th>LAC</th>
<th>Mexico</th>
<th>United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>50%</td>
<td>27%</td>
<td>-0.35</td>
</tr>
</tbody>
</table>

Speed of adjustment toward equilibrium gaps

<table>
<thead>
<tr>
<th>Region</th>
<th>Latin America</th>
<th>Mexico</th>
<th>United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>-0.35</td>
<td>-0.3</td>
<td>-0.25</td>
</tr>
</tbody>
</table>
5. Deepen labor market integration to enhance efficiency

- Interpretation of the evidence: potential efficiency gains from deeper labor-market integration

- But, two challenges ahead [graphs]
5. Deepen capital market integration to improve the regional investment climate

- Evidence suggests that geography exerts a weaker pull on capital flows.
- Nevertheless, concerted regional efforts can foster capital inflows into the region.
  - Example: The Pacific Alliance’s MILA
- If the regional investment climate improves, the region as a whole becomes more efficient.
Link to the report: bit.ly/mejores-vecinos

Thanks!
Learning about your neighbors’ export markets

Determinants of entry and survival in new export markets

- **Determinants of Entry**
  - Network Effect Elasticity

- **Determinants of Survival**
  - Established Partners' GDP per capita Elasticity
Regional trade integration and diversification of risks

Effects of changes on intra-LAC and global trade on export volatility

Note: Changes in export variance are calculated under two counterfactual exercises. The first assumes that for each country, intra-LAC export shares double compared to the observed share. The second assumes that the rest of the world share (the non-LAC share) halves compared to the observed shares. See the main text for more details on the exercise. LAC = Latin America and the Caribbean. See annex 1A for a list of countries in this region.
Economic performance and geographic distance

Structural breaks and distance

Short-run economic cycles and distance [back]
Challenges to labor market integration in LAC: Actual vs intended intra-regional emigration rates
Challenges to labor market integration in LAC: More immigration, more resistance

Immigration rates and anti-immigration views

Note: Immigration rates are calculated as the stock of immigrants over total population. Immigration views come from the World Value Surveys.