Come Together

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While nature can deliver the unexpected in devastating fashion – witness Japan's tsunami – man has equal capacity to do the same in economic terms. The linchpin of South America's economic health has been commodities but this narrow focus carries inherent risks because prices can never be constant; today's surge can be tomorrow's decline.

Mayday is a message sent out by aircraft and ships in distress and on 5 May there was a message, equally distressing, which was sent out to stock markets around the world when commodity prices fell sharply. The ensuing commotion over commodities is seen by some as being due to lax monetary policy that is fuelling speculative activity while others compare the economic recovery to a Potemkin village, a falsehood sustained by fiscal manipulation and is a precursor of worse to come. These concerns were recognised at the World Economic Forum on Latin America which was held in Rio de Janeiro in April when more than 700 regional and global leaders, representing 46 countries, met to discuss relations between the region and the European Union.

The important point was made that Latin American nations have to wean themselves off too great a dependency on commodity exports and begin to concentrate on finding ways to develop viable and long-term alternatives, such as services industries, while at the same time tackling high crime rates, corruption and political divisions. But for me one of the most important issues was raised by Mexico's Economic Secretary, Bruno Ferrari Garcia de Alba, who said that the region's economies needed to be integrated more to bolster the future economic well-being of the region. Countries need to be more united in their trade, looking inward, and not just outward, to a domestic market of some 550 million people in a region which at this time is experiencing a level of growth that is only second to Asia's. While the region's natural resources fire the engines of expansion in places such as China and India, meeting regional demands will be a powerful antidote against economic downturns beyond the region.

Figures reveal some surprising facts about Latin America's productivity (a term cynics would argue was an oxymoron). Consider, however, that between 2005 and 2008 Brazilian total factor productivity rose at an annual average rate of 2.1%, with Peru reporting practically the same, in contrast to the leading Asian economies, China and South Korea, where productivity rose 2.9%.

Perhaps unnoticed by outsiders, intra-trade has been growing steadily in the last decade and this year the inter-Oceanic highway will be completed: the first paved road to cross South America coast to coast. It will be to the pantechnicon what Panama's canal is to the container ship. The United Nations Conference on Trade and Development reports that trade flows within Latin America grew at just under 9% per year from 2000 to 2009, increasing from USD134 billion to USD290 billion. Brazil, Argentina, Mexico, Chile and Colombia had the highest volumes, but Panama, Ecuador, Paraguay, Bolivia and Peru experienced the fastest growth in their share of regional trade. Panama, in fact, saw its regional flow of trade rise by a factor of 6.2 in the decade ending 2010 – despite the Great Recession. Some commentators suggest that Brazil will start to look more closely at Panama because of its growing regional banking services.

Brazil, of course, is Latin America's Goliath, but successes can be found elsewhere. The improved situation in Paraguay following rapid growth, the surprising degree of financial recovery in Argentina, the improving security in Colombia – not to mention similar positive signals in other regional countries – all mean that Brazil is not the only horse pulling the cart.

We should not forget that beyond the rivalries of China and the United States of America, vying with each other in their bid to capture market share in Latin America, the European

Union still remains the region's second largest trading partner – although there are predictions that it will likely be overtaken by China in the next three or four years. Even so, it is a fact that the EU has provided the main source of Foreign Direct Investment (FDI) in the region during the last decade (it is the biggest investor in the region) and has enthusiastically pursued trade deals with Colombia and Peru, for example, which should not only open up markets but see substantial tariff barrier reductions. It is worth noting that trade between the EU, Colombia and Peru alone was worth EUR16 billion in 2010.

Predictably, Brazil captured the lion's share of FDI in 2010 while battling the real's rapid appreciation. In 2010 there was an incredible 87% increase over 2009 resulting in a leap from just under USD26 billion to USD48.5 billion and to put this in perspective, Mexico came next (just USD17.7 billion) with Chile in third place (USD15 billion) followed by Peru (just over USD7 billion) then Colombia (just under USD7 billion). The US accounted for 17% of the region's FDI in 2010, with China contributing 9%. The USD15 billion invested by China focused on mergers and acquisitions with Chinese companies becoming more active in the region's infrastructure and manufacturing sectors; a few years ago the extent of China's contribution was surface, being a more cash-and-carry relationship, centred on commodities rather than commitments.

Latin America trades less with the world than Asia does, but its domestic market is growing appreciably which will, as already suggested, serve as a counter to future global economic disruptions and this could give it a better chance of lasting ten rounds in the ring, despite perhaps still being bloody and bruised. Consider the case of Brazil and Mexico (the most populous countries in Latin America) which are the two largest economies, making up 74% of the region's gross domestic product; their combined population (about 300 million) comes close to that of the US. After successful business negotiations more Mexican goods are heading south to Brazil rather than remaining in the local market. And not just Brazil: according to Mexico's economy ministry, exports to South America in 2010 were 50% higher than in 2009. Last year, for the first time in more than a decade, South America overtook the EU as a destination for Mexican exports; but to get this in perspective, despite this positive development, 80% of Mexican exports still go to the US and so that market will be crucial for a long time to come meaning that Mexico will remain a hostage to the economic fate of the US.

Besides commodities, what about South America's similar reliance on those countries buying them? Already cracks in the relationship with China during the past decade have become more visible and when this is twinned with the reluctance on the part of the US to move trade discussions from talk to treaties (The Best is yet to Come, issue 215) then the case for heeding the title of the Beatles song, Come Together, by increasing intra-trade, becomes clear. Fruit and vegetables are not the basis of such trade – quite the contrary: the items available today are often "truly globally competitive products that are diversified", in the words of Chris Sabatini, senior director of policy at the New York-based Council of the Americas. The top ten traded products in Latin America in 2009 included either medium-or high-tech goods such as passenger vehicles, tractors, medicines and telecommunications equipment.

But cracks or no cracks in Chinese walls, Latin America has been placed in a quandary. The region's overall trade with China (this has grown 16-fold during the last decade) and other countries has resulted in the currency imbalances, caused by capital inflows, which led Guido Mantega, Brazil's finance minister, to remark: "This is a currency war that is turning into a trade war". His words echoed across continents and only the hike (for how long?) in international commodity prices has sheltered exporters with anti-competitive strong currencies.

Meanwhile, the Brazil China Chamber of Commerce complains that Brazil's tax system is too complicated and regressive. Those with Delaware limited liability companies might add the word oppressive to the description after developments first mentioned in this column last year (The Hissing Goose, Issue 210). Taxation in the region in general remains complex and it is a subject that I will be developing, not only at this journal's 21st Oxford Offshore Symposium in September, but with readers too in a future column.

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