

Summary of Discussion of OECD Seminar on:
Trade and Competitiveness in Argentina, Brazil and Chile
(22 November 2004, Paris)

Within its cooperation framework with non-member countries, the OECD organised this seminar on “*Trade and Competitiveness in Argentina, Brazil and Chile*” (A-B-C). It aimed to discuss how market mechanisms and policy choices need to interact to support the strengthening and diversification of the tradable sector in these countries. The seminar started with a presentation of conclusions of an OECD study¹ on this topic launched on the same day, followed by presentations of policymakers from A-B-C giving their government's views on how to support the expansion and diversification of the tradable sector. At the end, there was a discussion with the floor, opened by introductory interventions from representatives of the Spanish and US delegations to the OECD and two experts (see Annex for detailed programme).

The main issues of the presentations and discussions were structured along the five chapters of the OECD study:

(a) In line with the first chapter, the presentations of government officials and discussion emphasised the *need for the exchange rate to be flexible to avoid distortions of the relative price* of nontradables to tradables (i.e. real exchange rate). Today A-B-C have flexible rates, but this was not the case in the 1990s, when Argentina and Brazil adopted more or less fixed exchange rates which distorted relative prices and factor allocation. It was argued that, in addition to exchange rates regimes, more attention needs to be paid on the impact of sudden shifts in capital flows which have accompanied large fluctuations in the real exchange rate in these countries. An important observation was that the distinction between tradables and nontradables is increasingly blurred, for two reasons: First, various services, typically referred to as nontradables, are in fact internationally traded, and for Chile in particular service exports are increasing rapidly. Second, the production of tradables is increasingly intensive in service inputs, underscoring the need for competitive nontradable sectors such as logistics and financing to enable tradable sectors to develop.

(b) A key issue is *whether A-B-C need to change their trade specialisation to catch up with OECD countries in terms of per capita income levels*. Chapter 2 of the book contrasts A-B-C with Ireland, Korea and Mexico, and argues that the latter group developed much faster economically in part because they succeeded to change their specialisation from primary products to manufactures, for which international demand grows faster, technological spillovers are larger, and prices are more stable, attenuating swings in the trade balance. In the presentations and discussion, some argued that being specialised in primary and low value-added products is not necessarily a drag on a country's development, as long as production is constantly upgraded in terms of human and technological skills, as for example Australia and Finland have demonstrated. Foreign direct investment plays a major role in this process. Moreover, representatives from Brazil and Chile argued that their trade specialisation has changed more than is often perceived. Others argued that countries should not push the transformation of trade specialisation too far, as there is an arbitrage between the diversification of the “product portfolio” and higher rates of return on a country's key (“traditional”) comparative advantages. It was noted that Product diversification and economic development follow a U-shaped pattern, with diversification first increasing, but subsequently falling. Whatever view is taken on the importance of diversification, it was not obvious what policy levers are appropriate to achieve it. The benefits of industrial policy are unclear, though trade integration and FDI play key roles in overcoming

¹ OECD (2004), *Trade and Competitiveness in Argentina, Brazil and Chile: Not as Easy as A-B-C*, Paris.

barriers to entering markets for differentiated goods. In general, trade integration in A-B-C remains weak, though it has been strengthening markedly for Chile recently.

(c) With regard to *foreign investment*, A-B-C have a relatively friendly environment for FDI, as highlighted by Chapter 3. They received large inflows during the second half of the 1990s, mostly linked to privatisation of state enterprises in services. Since the early 2000s, FDI flows have fallen strongly, in tandem with other emerging markets, and are now mostly green-field investments. FDI policies are mostly “neutral”, although Chile mentioned that recently it has introduced grants for co-financing investment in high-tech sectors and tax exemptions for multinationals choosing Chile as their Latin American headquarters. In the discussion, it was pointed out that a disadvantageous geographical location is one of the reasons why A-B-C receive little investment from multinationals to become part of international production networks. Moreover, deficient regulatory frameworks in A-B-C and breach of contracts in Argentina also explain why investment in infrastructure sector has been timid in recent years. A new phenomenon is that A-B-C not only receive FDI, but since a few years are also investing abroad (e.g. neighbouring countries, China and United States).

(d) There is wide agreement that *agriculture and food industry have been the cornerstone of the recent external adjustment of A-B-C and will continue to be a pillar of export growth*, as illustrated by Chapter 4. Although this sector still has an enormous growth potential, its share in employment is likely to continue to fall substantially as most of the expansion will occur at capital-intensive and export-oriented farms. In this respect, A-B-C face a major challenge to absorb excess labour in other sectors of the economy. It was noticed several times that entry barriers to the European and US markets for commodities and foodstuffs hinder exports of A-B-C in general and the upgrading the export basket in particular. Model simulations indicate that more than half of the benefits of global trade liberalisation in agriculture will accrue to A-B-C.

(e) The non-tradable sector also needs to be competitive for the tradable sector to perform well. *Competition policy plays a key role to promote competition in nontradables*, as shown in Chapter 5. The discussion stressed that the benefits from privatisation of state enterprises in infrastructure sectors were less than expected due to deficient regulatory frameworks. Only in the late 1990s, competition advocacy has become an integral part of regulatory reform, in particular in Argentina. A test case is the telecom market, which is becoming increasingly concentrated.

(f) *Other issues:*

- *Impact of China on A-B-C?* The trade balance between both is highly in favour of A-B-C, being suppliers of raw materials and semi-manufactures to China. Since a few years, exports to China have increased at a high pace, and are likely to continue to grow at high levels despite China’s growth deceleration, because A-B-C’s share in Chinese imports is still very low. To prevent the interruption of supplies, China will invest in A-B-C, in particular in logistics.
- *Shifting resources across sectors* in A-B-C may be hindered by insufficient flexibility in the formal labour market. In Brazil, the high cost of capital limits new investments.
- *The high concentration of firms in the export sector contributes to persistent income inequality in A-B-C:* the book does not address this link.
- Efforts to *improve the overall business environment* remain key. Brazil and Chile have adopted “pro-growth agendas”, which include reforms of bankruptcy law and capital market, facilitation of business start-ups, and improvement of technology policy.

- Annex: Detailed programme Seminar

Trade and Competitiveness in Argentina, Brazil and Chile

Chair: Mr. Val Koromzay

- 15:00-15:05 **Opening**
- 15:05-15:30 ***Presentation of the study : “Trade and Competitiveness in Argentina, Brazil and Chile”*** by MM. Joaquim Oliveira Martins and Nanno Mulder (OECD)
- 15:30-16:30 ***Promoting Competitiveness in the Tradable Sector: National Perspectives***
 Argentina: Mr. Roberto Villambrosa (Ministry of Economy)
 Brazil: Mr. Pablo Fonseca (Ministry of Finance)
 Chile: Mr. Raul Saez (Ministry of Finance)
- 16:30-17:45 ***Discussion from the Floor***
 Introductory interventions:
- Mrs. Inmaculada Lopez (Spanish delegation) and Mr. Peter Barlerin (US delegation)
 - Mr. Jérôme Sgard (CEPII) and Mr. Carlos Quenan (IHEAL)
- 17:45-18:00 **Concluding remarks** by the Chairman