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South American Regional Trade: Economic, Geographic, and Policy Constraints

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A Research Paper

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South American Regional Trade: Economic, Geographic, and Policy Constraints [redacted]

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A Research Paper

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This paper was prepared by [redacted] with a contribution from [redacted] Office of Global Issues. It was coordinated with the Department of Commerce. [redacted]

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Comments and queries are welcome and may be directed to the Chief, Economic Division, OGI, on [redacted]

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South American Regional Trade: Economic, Geographic, and Policy Constraints

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Summary

Information available as of 3 June 1986 was used in this report.

Economic progress in South America has been adversely affected by the decline in regional trade in the 1980s. Since the advent of the debt crisis, South American regional trade has decreased by more than one-fourth, despite the relatively successful efforts to expand exports to markets outside the continent. Regional exports now account for only 10 percent of total exports from South American countries. We believe the lack of regional trade has created economic inefficiencies and has retarded regional political cohesion by constraining economic linkages. 25X1

Although the decline in regional trade ended in 1983, a resurgence is unlikely in the near term because:
- Debt-related trade strategies target exports to developed-country markets and restrict imports, including those from other South American countries.
- Protection of emerging domestic industries—for example, computers, pharmaceuticals, and automobiles—limits imports of these items from neighbors.
- Commodity-based trade probably will continue to experience low and/or falling prices; fuel exports are the most recent example.
- Regional trade organizations are weak and relatively ineffective.
- Geographic barriers—the high Andes and the Amazon Basin, for example—and poor infrastructure pose difficulties for developing an adequate highway and rail network. In addition, ports and airports were developed for trade with non–South American markets. 25X1

Although there are considerable constraints, South American leaders are showing more interest in reviving regional trade and becoming less dependent on developed-country markets. This move toward self-reliance in trade is being influenced by the growing threat of protectionism from Western countries and demands by international financial institutions to implement economic structural reform as prerequisites for additional lending. In addition, South America's economic decision makers are realizing the benefit of reduced trade barriers for economic growth. 25X1

In the short term, US exports to South America could be hurt by regional trade cooperation, for example, market sharing in pharmaceuticals and chemicals. In the long run, however, we believe expanded regional trade would be beneficial for US interests. In particular, opportunities for US exports to the region should improve if South America's efforts to increase

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regional trade are successful in stimulating economic growth and development. Some of the pressure on access to US markets could be reduced if regional markets were expanded for South American goods. Moreover, increased regional trade would improve chances for economic growth and stability in the recently elected governments of South America, such as Argentina, Brazil, and Uruguay. Increased integration, however, would increase the risk, although small, that instability in one area could spill over to other countries in the region, as was the case in Central America.

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To expand regional trade, South America has to develop further products suited for the continent's markets. Some sectors for potential expansion might include processing of raw materials, for example, food and agricultural materials, and exporting semifinished goods, like metals, for further processing in neighboring countries. In our view, however, the outlook for expanded regional trade is unfavorable for goods that are protected by import substitution programs aimed at industrial development, such as electronics and automobiles. We believe chances are slim that South American countries will substantially open their domestic markets to regional imports in the near term, given the concern for protecting domestic economic sectors and the continued need to restrict imports to conserve foreign exchange. Moreover, concern over who receives the most benefit from expanded regional trade could hamper enthusiasm for and progress in the drive to increase trade in South America. 25X1

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South American Regional Trade: Economic, Geographic, and Policy Constraints

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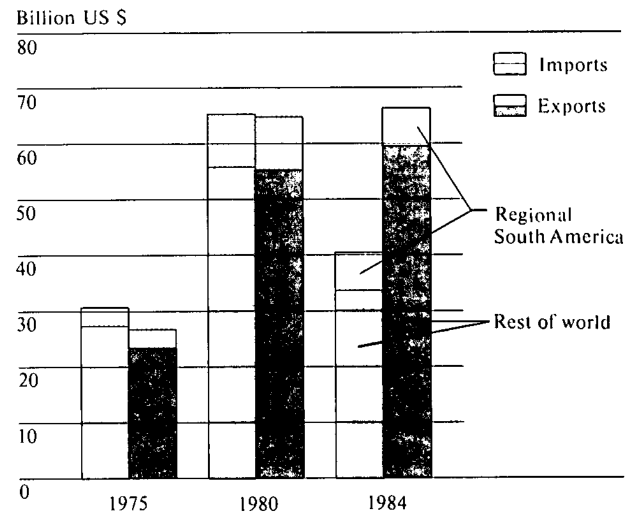
Trade Patterns

During the mid-to-late 1970s, South American regional trade enjoyed significant growth—almost tripling to $9.5 billion between 1975 and 1980.[1] This growth in regional trade far surpassed the growth of South American trade with the rest of the world, which only slightly more than doubled. 25X1

With the onset of the debt crisis, however, regional trade contracted to $6.2 billion in 1983. The decline in regional trade mirrored the overall decline in South American imports as austerity programs forced down imports of South American nations from their neighbors as well as the rest of the world. In contrast, exports to the rest of the world continued to expand, growing by almost 8 percent between 1980 and 1984. Since 1983 the decline in regional trade has been arrested and the decline in South America's economies has been slowed. Regional exports grew slightly in 1984 to $6.8 billion and, according to our estimates, to perhaps $7 billion last year. 25X1

Trade shares are not evenly spread throughout the region. In 1984 the major exporters—Brazil, Venezuela, and Argentina—accounted for almost three-quarters of total exports within South America, while the medium-size exporters—Chile, Colombia, Peru, and Uruguay—provided about one-fifth of the total. The smallest exporters—Bolivia, Ecuador, and Paraguay—contributed less than 10 percent to regional exports for the same year. 25X1

Figure 1
South America: Trade Patterns, 1975, 1980, and 1984



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Brazil: South America's Trading Hub. With a diversified manufacturing sector to complement its existing natural resource base, Brazil has become by far the largest player in South American trade. Regional exports nonetheless accounted for only 9 percent of Brazil's total exports in 1984, down from almost 15 percent in 1980. Although Argentina is Brazil's main regional trading partner, Brazil also has significant trade relations with many of its neighbors in the region. 25X1

Brazil's exports to South America are concentrated in manufactured goods, accounting for almost two-thirds of total regional exports in 1983. Moreover, Brazil's manufactures' exports cover a variety of goods, including metals manufactures to all of its South American neighbors except Peru and Colombia; automobiles to Chile, Colombia, Peru, and Venezuela; and 25X1

[1] For the purpose of this research, South America includes Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay, and Venezuela. In addition, this research paper does not address narcotics trade. 25X1

South American Trade Patterns, 1984

Million US $

Importers	Exporters Argentina	Bolivia	Brazil	Chile	Colombia	Ecuador	Paraguay	Peru	Uruguay	Venezuela
Total	**1,204.9**	**310.6**	**2,545.0**	**528.0**	**319.1**	**118.3**	**116.8**	**279.7**	**227.2**	**1,109.0**
Argentina	0	271.1	853.0	116.7	24.2	4.0	40.8	31.1	85.6	7.0
Bolivia	88.4	0	141.0	14.7	0.4	0.1	0	12.4	1.8	0
Brazil	469.9	14.7	0	227.5	5.3	1.6	62.0	46.6	113.8	534.0
Chile	155.6	6.0	281.0	0	19.6	40.1	8.0	44.7	8.5	229.0
Colombia	59.3	3.8	171.0	43.0	0	66.0	0	74.9	3.6	276.0
Ecuador	15.2	0	141.0	27.8	46.8	0	0	28.1	1.1	2.0
Paraguay	91.5	0	333.0	4.5	0	0	0	0	5.6	0
Peru	130.5	14.8	124.0	44.9	23.6	3.5	0	0	5.0	18.0
Uruguay	86.4	0	136.0	8.7	0.2	0.1	6.0	1.8	0	43.0
Venezuela	108.1	0.2	365.0	40.2	199.0	2.9	0	40.1	2.2	0

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machinery to Argentina, Colombia, Ecuador, Paraguay, Uruguay, and Peru. Brazil also exports food and agricultural products, including coffee, fruits and vegetables, vegetable oil, and sugar to Argentina, Chile, and Venezuela. Brazilian imports from its neighbors are primarily commodities, including food and agricultural products from Argentina, Paraguay, and Uruguay; metals from Chile and Peru; and fuel from Ecuador and Venezuela.

Brazil's success in 1983 and 1984 in achieving a trade surplus with its South American neighbors, excluding Venezuela, has led to trade tensions in the region. In response to their trade deficits, Brazil's neighbors have been calling for balanced trade with Brazil. Although Brasilia has responded to its neighbors' complaints with bilateral trade agreements, it is unlikely that Brazil is willing to give up its trade surplus.

Argentina and Venezuela: Also Major Exporters. Argentina and Venezuela are the other leading South American traders, each with annual exports within the continent of more than $1 billion. Argentina has a more regionally oriented economy than Venezuela and exports more than 14 percent of its total exports to South America, compared with only 7 percent for Venezuela. Argentina's exports to South America are concentrated in grains, fruits, vegetables, vegetable oils, and semifinished metals. Especially hard hit by the contraction in South American trade, Argentina's exports to the region fell by more than $500 million between 1980 and 1984, the largest decline in the region. While Argentina's primary regional trading partner is Brazil, it also is the major customer for Bolivian natural gas exports. Argentina, however, has just reduced the price it pays for natural gas purchased from Bolivia, according to press reports. Under its agreement with the International Monetary Fund, Argentina is required to substantially reduce its government deficits and specifically to eliminate the deficit for Gas del Estado, a state-run gas enterprise that purchases natural gas from Bolivia, according to diplomatic reporting.

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On the other hand, Venezuela exports mostly crude petroleum to the region, with nearly 50 percent going to Brazil. Venezuela's exports declined by more than $250 million, or about one-fifth, between 1980 and

Brazil: Tensions From Its Regional Trade Surplus

Brazil's current trade goal is to maximize its trade surplus, according to diplomatic reporting. It is achieving part of this goal through its trade with South America, recording a surplus with all of its neighbors except Venezuela during 1983 and 1984. In response to their trade deficits, Brazil's neighbors are calling for more balanced trade with Brazil. [redacted]

[redacted]

Brazil has responded to these complaints with bilateral trade agreements outside the Latin American Integration Association (LAIA), the region's trade organization. During the past year, Brazil agreed to:

- *Increase wheat and oil imports from Argentina.*

[redacted]

- *Increase imports of rice, beans, and metallurgical coal from Colombia.*
- *Make a $600 million countertrade deal with Peru—a fourfold increase in bilateral trade from the 1984 level—to import Peruvian oil and minerals, while exporting food and manufactured products.* 25X1 25X1
- *Increase beef and rice imports from Uruguay.*

These trade agreements, however, will probably have a more political than economic effect because Brazil most likely is unwilling to give up its trade surplus position. Brazil's 1985 drought, however, should also contribute to increased imports of foodstuffs, including grains, livestock, and dairy products. [redacted] 25X1

[redacted] 25X1

Brazil probably will take a leadership role in LAIA efforts to increase regional trade. Some countries, however, may feel that Brazil is merely trying to increase its regional trade surplus and might resent Brazilian leadership in the trade effort. [redacted] 25X1

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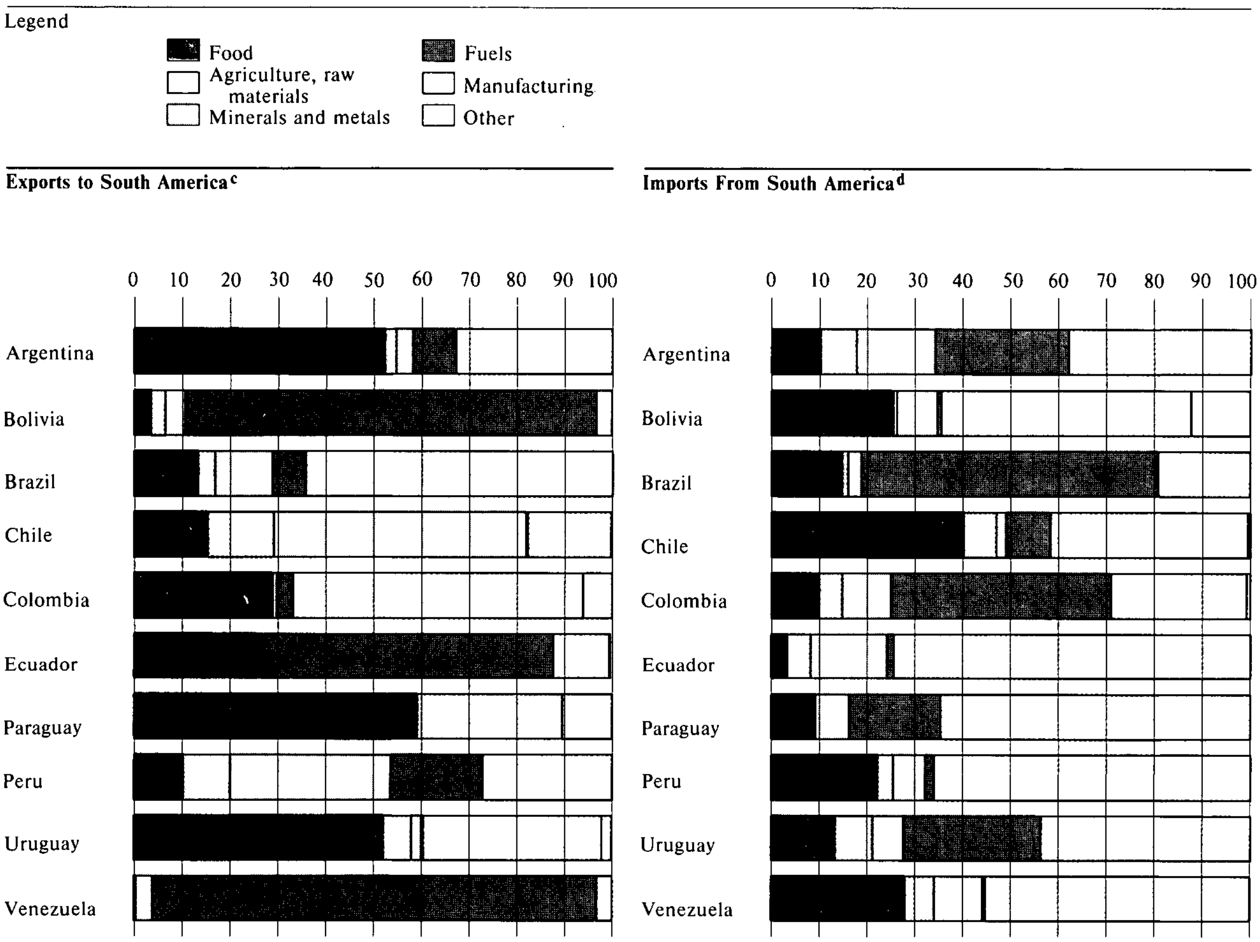
1984. One of its smallest regional trade partners is Ecuador, with which Caracas signed a $2.4 million trade agreement last year in an effort to stimulate trade. According to press reports, Venezuela will export steel and aluminum byproducts, while Ecuador will sell marine, chemical, and technical products. [redacted]

Other Exporters. Slightly more regionally oriented than the major exporters, South America's medium-size exporters (Chile, Colombia, Peru, and Uruguay) also suffered major losses in regional sales between 1980 and 1984:

- *Chile* exports metals, mostly copper, to Brazil and Argentina. Its exports suffered the region's second-largest drop over the period, falling by more than $500 million.
- *Colombia*'s regional exports decreased by more than $200 million between 1980 and 1984, as Venezuela—its main trading partner—cut manufacturing imports from its neighbor. 25X1
- *Peru* also exports mostly copper to Brazil and Argentina. Its exports fell from $500 million to $280 million.

Figure 2
South America: Distribution of Trade, by Country[a] and Commodity, 1983[b]



[a] Including Mexico.
[b] Or latest available year.
[c] 1982 data for Bolivia, Paraguay, and Peru.
[d] 1979 data for Bolivia and Paraguay; 1982 data for Ecuador and Peru.

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- *Uruguay* sells grains, meat, semifinished goods, and chemicals to Argentina and Brazil. Among the medium-size exporters, Uruguay's share of its total exports destined for South America is the largest—about 15 percent. Its regional exports fell by more than $160 million to $227 million.

South America's smallest exporters (Bolivia, Ecuador, and Paraguay), with the most regionally oriented economies in the region, experienced varying losses in exports during the same period:

- *Bolivia* is the most dependent of the South American countries on sales to its neighbors—more than 50 percent of total exports. It experienced an 18-percent loss in regional exports, sheltered by its natural gas sales contract with Argentina.

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Smuggling: The Underground Regional Trade

The restrictive trade policies of South American governments have fostered widespread smuggling of crops, minerals, and consumer goods throughout the region, according to US Embassy reporting. Illegal exports to neighboring countries are encouraged by high export taxes, overvalued exchange rates, and low producer prices paid by government parastatals to commodity producers. Contraband imports are the result of severe import restrictions—particularly on luxury goods—levied in an effort to halt the outflow of foreign exchange.

Although precise estimates of such underground trade in South America are difficult to make, the evidence indicates that the value involved is several billion dollars each year and is an important element in the local economies:

- ***Paraguay****'s smuggling network accounts for half of the country's foreign trade and employs 15 percent of the labor force, according to an Embassy study. Illegal imports of Argentine wheat and flour—around 150,000 metric tons per year—have sabotaged the government's food self-sufficiency program. Most of the motor vehicles on Paraguayan roads were originally stolen in Brazil or Argentina, and much of the packaged food sold is contraband. On the export side, $350-700 million of cotton and soybeans go unrecorded to Brazil each year, along with large amounts of timber, cattle, meat, and leather.*

- ***Argentina****'s total illegal trade in 1984 was about $1.7 billion, according to Embassy reporting. Although more than $1 billion is believed to be from unreported exports to the world market, much of the rest is consumer goods trade with Paraguay, Brazil, and Uruguay. A crackdown in December 1984 in a town bordering Paraguay netted $40,000 in contraband in two days.*

- ***Brazil****'s biggest contraband export to neighboring countries is coffee—we estimate around 800,000 bags in 1985. Most of the gold mined in Brazil is smuggled out and usually shipped directly to Europe or the United States. In past years, much of the soybean crop went out through Paraguay, but pricing policy shifts have reversed the flow. In the Brazilian states along the border with Bolivia and Paraguay, consumer goods smuggling is a major industry. Embassy sources claim a significant amount of contraband consumer electronics trade is shipped in trucks and airplanes along with narcotics.* 25X1

- *In* ***Colombia*** *academic studies estimate that illegal exports of manufactured goods to Brazil, Venezuela, Ecuador, and Peru have ranged from $100-200 million annually in recent years. Banned consumer goods, including everything from Brazilian cigarettes to Venezuelan televisions, are plentiful in Colombian cities. Experts there believe retail goods smuggling employs 100,000 workers in Colombia's largest cities.* 25X1

Although we believe widespread contraband trade has boosted the underlying health of South American economies, smuggling undermines government efforts to service the foreign public debt. By ignoring official export channels, smugglers keep hard currency foreign exchange for themselves rather than channeling it through the central bank. 25X1

In the longer run, perhaps the most damaging effect of smuggling is that it promotes the status quo among vested interests: many powerful individuals and officials—particularly in Bolivia and Paraguay—are heavily involved in smuggling and would view economic liberalization as a threat to their business. In addition, black markets defuse civil unrest over economic matters by supplying more and better goods—reducing public pressure for policy reform.

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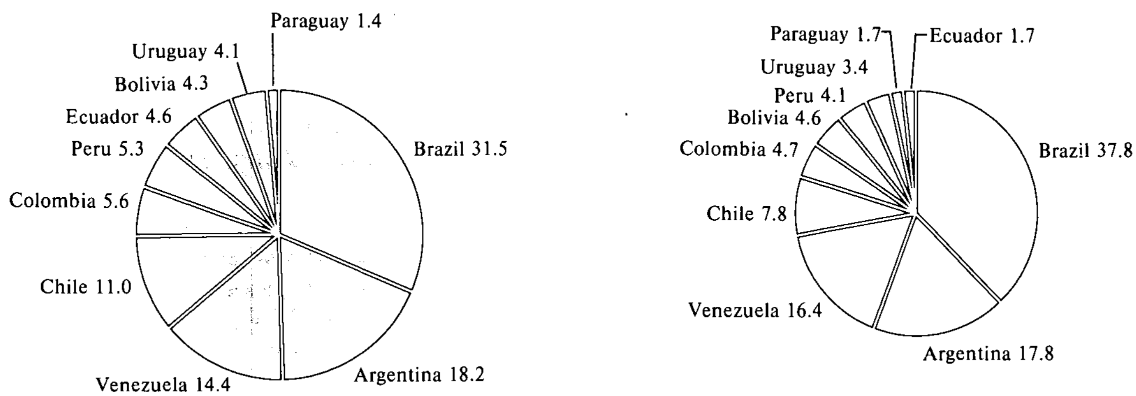
Figure 3
South America: Regional Exports, 1980 and 1984

Percent

Total 1980=9.5 billion US $ | **Total 1984=6.8 billion US $**



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- *Ecuador* exports mostly fuel to Brazil, Chile, and Colombia. Its exports fell by almost three-fourths, the largest percentage decline in the region.

- *Paraguay* relies upon food exports—mostly grains—to Brazil. Its exports to South America fell by only about 15 percent. [redacted]

The Key Constraints: Economics, Trade Policy, and Geography

In our view, the problems of South American regional trade have their roots in three broad areas: economics, trade policy, and the geography of the South American continent. [redacted]

Economics. A key constraint to South American trade is the lack of economic diversification in the region. Although endowed with a wide variety of natural resources, South America's economies, except Brazil's, are not well developed and usually concentrate on only a few types of commodities, many of which are suffering low prices. Moreover, in several cases, countries are competing with each other to sell the same product. Both Colombia and Brazil are large coffee exporters, while Venezuela and Ecuador export fuel to the region. Argentina and Paraguay both export soybeans to Brazil. [redacted] 25X1

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The debt crisis has played a major role in the contraction of regional trade in the 1980s and has further shifted the relative orientation of South American trade from the region to the rest of the world. With an external debt that increased more than 50 percent to $248 billion between 1980 and 1984, South America was forced to adopt austerity measures: it cut imports, including those from the region, and targeted exports to developed countries to earn foreign exchange. While imports from outside South America dropped by almost 40 percent to $33.7 billion between 1980 and 1984, South American exports to the rest of the world increased 8 percent to $59.6 billion. The United States absorbed much of the increase in the region's exports to non–South American markets; the US share of OECD imports from South America rose from about one-third to one-half between 1980 and 1984. [redacted] 25X1

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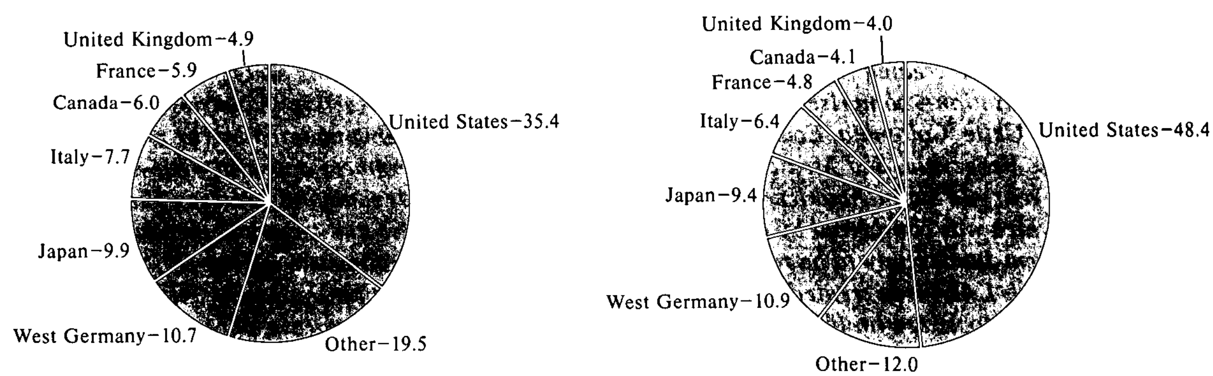
Figure 4
South America: Exports to OECD, 1980 and 1984

Percent

Total 1980=42.6 billion US $ | **Total 1984=45.0 billion US $**



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Trade Policy. In our view, South American trade policy has been a more serious constraint than economics to regional trade. In large part as a result of import substitution-based development policies, South America's trade policies have been intended to develop and protect domestic markets, especially in manufacturing, as well as to conserve foreign exchange. Although South America has organizations to promote regional trade, individual country trade restrictions, including tariff and nontariff barriers, usually apply to all trading partners.

We believe that, because of the region's product mix, these policies have had a particularly adverse impact on regional trade. In our judgment, Colombia's high tariffs on automobiles and textiles, for example, have helped limit exports from other automobile producers—like Brazil—and textile producers—like Peru—in the region. Brazil's high tariffs on automobiles, textiles, and paper have likewise restricted exports from producers of these goods in the region.

South American countries extend some tariff preferences to neighboring countries, but the preferences are generally too small to produce a significant increase in regional trade. A 1984 regional tariff preference agreement, produced under the auspices of the Latin American Integration Association, the region's trade association, reduced tariffs a maximum of only 7 percent below those on goods imported from outside South America. Moreover, regional tariff preferences are relatively meaningless if the country provides exemptions from import tariffs for exporters from outside the region, as the LAIA found to be the case in Brazil, Argentina, and Colombia. Finally, regional tariff preferences are sometimes withdrawn if a country wishes to protect a domestic industry. Argentina, for example, recently suspended its tariff preference for electronics imports from Brazil, Chile, Mexico, and Uruguay to shelter its emerging electronics industry, according to press reports. Argentina will now charge tariffs of up to 90 percent on electronics imports from these countries.

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Failure of South American Trade Organizations

In an attempt to counter the generally protectionist trade regimes of the continent, South American countries have set up regional trading organizations. On balance, however, they have done little to liberalize policies that affect regional trade. [redacted]

Latin American Integration Association. *The 1980 Treaty of Montevideo created the Latin American Integration Association—comprised of Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay, Venezuela, and Mexico—that replaced the 20-year-old Latin American Free Trade Association, which was considered by an Inter-American Development Bank study to be relatively unsuccessful. Although LAIA was created to promote regional trade, its tools are limited mainly to tariff preferences. In 1984 LAIA members reduced tariffs among themselves compared with those charged countries outside the region. The agreement reduced regional import tariffs by 5 to 7 percent for the less developed South American nations of Bolivia, Ecuador, and Paraguay; 3 to 7 percent for Chile, Colombia, Peru, Uruguay, and Venezuela; and 2 to 5 percent for Argentina, Brazil, and Mexico. The tariff revisions probably will not meet with much success, however, because of the small size of the decrease. Moreover, tariff preferences often are given to non–South American trading partners to attain development goals. As much as 74 percent of Brazil's imports from outside the continent are not subject to tariffs, and slightly less than half of Argentina's and Colombia's non–South American imports are exempted from tariffs, according to a 1984 LAIA study.* [redacted]

LAIA recognizes that further trade integration is dependent on the political will of the group's members to negotiate effective trade agreements. Under LAIA, Argentina and Brazil now have bilateral tariff preference agreements with all of their regional neighbors, while the rest of South America has agreements with at least three other LAIA members. In addition, agreements among LAIA members that reduce tariffs for certain industries have been developed and are being updated by the private sector—subject to government approval—providing the potential for more dynamic integration. These agreements cover electronics and electrical communications, office equipment, domestic appliances, refrigeration and air conditioning equipment, pharmaceuticals, chemicals, petrochemicals, photography, and paramedical equipment. [redacted]

Andean Pact. *The Andean Pact is a subregional economic integration organization—including Venezuela, Colombia, Ecuador, Peru, and Bolivia—established in 1969 to promote economic and trade cooperation and development. The members promised to eliminate by 1980 duties and other restrictions on trade among themselves, but they failed to reach their goal because of continued domestic protectionist pressures. The group has also been unable to agree to a common external tariff and a coordinated economic policy. Furthermore, sectoral programs and assistance for the less developed countries of Bolivia and Ecuador have not met with much success.* [redacted]

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South America's nontariff barriers, established as part of austerity programs or to protect domestic economic sectors, have also negatively affected regional trade. Peru, for example, banned 200 types of "nonessential" imports last year, including textiles, garments, shoes, domestic appliances, paints, tires, and office equipment, to conserve foreign exchange. [redacted] South American auto producers, such as Argentina, Brazil, Colombia, Uruguay, and Venezuela, have restricted imports of autos and auto parts through prohibition, local content requirements, and licensing to protect their domestic markets. The local content regulations have almost certainly reduced the production efficiency of all the region's auto manufacturers. In addition, several of the region's textile and apparel producers, such as Brazil, Ecuador, and Venezuela, limit imports of these goods and, therefore, regional trade through licensing, prohibition, and other import substitution measures. In newly developing industries, such as

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electronics, nontariff barriers have restricted the development of regional trade: Brazil bans mini- and micro-computer imports, and Argentina limits electronics imports through licensing measures.

Finally, many South American countries have devalued their currencies as part of their debt-related austerity measures, provoking retaliatory trade measures within the region. As a result of currency devaluations in Venezuela, Ecuador, and Peru, Colombia recently announced that it would impose restrictions—primarily prior licensing requirements—on selected imports from these countries, according to Embassy reporting. Colombia is attempting to protect its domestic industry in the face of more price-competitive regional imports. Neighbors' exports that will be affected by Colombia's action include petroleum, chemical petroleum byproducts, asphalts, auto parts, resins, and lumber and sea products. Venezuela is concerned that restrictions on these products would set a precedent for restrictions on more important products, especially steel and aluminum, according to the US Embassy in Caracas.

Geography. Even if trade policies were to shift more in favor of the region, trade would remain constrained by many elements of South America's physical and cultural geography. The high Andes, the river-laced Amazon Basin, and other inhospitable terrain present formidable natural obstacles to movement and commerce. Moreover, great distances separate most of the major national core areas, and the overall transportation network is woefully inadequate. Since the colonial period, ports, roads, and railroads have been built primarily for the collection and shipment of goods overseas, not to facilitate trade among neighboring countries. We believe that limited financial resources and burdensome foreign debts will continue to limit construction of new roads and other infrastructure that could help overcome isolation and stimulate regional trade.

The elongated shape of South America and its settlement patterns do not favor regional trade. The continent extends nearly 7,500 kilometers north-south, and about 5,000 kilometers east-west at its widest part. The core area of each country developed in relative isolation—a pattern deliberately enforced during the colonial period to promote dependence on the mother country. Gradually, road and rail links were formed over the last century, but most new construction still 25X1
serves local needs.

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The massive Cordillera de los Andes, the most obvious physical barrier to commerce, is a rugged range of high mountains that extends along the entire length of western South America and defines political boundaries for several nations, especially Argentina, Bolivia, and Chile. Generally, its crest is more than 3,000 meters high, and elevations in excess of 6,000 meters are common. Few all-weather roads cross the range, and those that do are closed periodically by winter snows, high winds, fogs, falling rocks, and landslides. Within the region, roads are confined to north-south trending valleys or parallel the Pacific coast. Although paved, most of the roads include switchback turns, rutted surfaces, and potholes that substantially reduce driving speeds. 25X1

The vast forest-covered Amazon Basin, extending across the broadest portion of the continent, isolates northern countries from the rest of South America. 25X1
Roadbuilding and maintenance are difficult and expensive because of rough terrain, dense tropical forest, endemic disease—especially malaria—and erosion from torrential tropical rains. Building materials are often unavailable locally and, along with fuel and equipment, must be hauled hundreds of kilometers.

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At present, existing transportation links are barely adequate to support current trade, and considerable new capacity would have to be added to promote any substantial increase. *Water transport* carries most regional trade—both by weight and value—partly because the major ports are located in economic core areas and partly because overland routes are poorly developed. The most important commodity is Venezuelan oil sent to Brazil. Timber, agricultural products, ore, and manufactured goods are also shipped by sea 25X1
to trading partners in South America. All countries except landlocked Bolivia and Paraguay have one or more ports for oceangoing vessels. Riverboats serve Paraguayan ports, but navigation is difficult because of constantly changing river beds and sandbars, and most cargo is now moved by truck. 25X1

Figure 5
South America: Primary Transportation Network

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South America: Surface Transportation by Region

The Developed Southeast. *Road and rail links between core areas of Argentina and Brazil—the most developed portion of the continent—and also Paraguay and Uruguay carry much of the trade among those countries. There are no significant physical barriers, other than the major rivers—the Rio de la Plata, Parana, and Uruguay—that are crossed at several key locations by bridges and elsewhere by ferry. Argentina and Brazil are likely to continue to improve transportation links to projects like the bridge over the Parana near Foz do Iguacu, scheduled for completion in 1987. Increased integration of the road network would reduce overland transportation costs and help foster regional trade in the southeastern portion of the continent.*

Northern Andes. *The Pan American Highway system and several other all-weather roads are the primary overland trade links between Venezuela, Colombia, Ecuador, and Peru; railroads play no direct role in regional trade. Two important all-weather roads connect Colombia and Venezuela—one along the Caribbean coastal lowlands, the other one, the PAH, crosses farther inland. The PAH follows intermountain valleys and is the only paved highway linking Colombia, Ecuador, and Peru. Although considered all-weather, driving conditions are physically difficult in some areas and congested in others. There are no overland links along the Colombia and Peru border, which lies east of the Andes in the Amazon. A pipeline transports oil from Venezuela to Colombia.*

Central Andes. *The Pan American Highway system, the only land link between Peru and Chile, is a two-lane paved road in good condition. It remains unpaved across the desert of southern Peru and through much of Bolivia. Rugged mountains make roadbuilding exceedingly difficult and expensive; consequently, most trade between Chile and Peru moves by coastal freighter. Landlocked Bolivia is dependent on rail lines traversing high Andean passes from the Altiplano to the Chilean ports of Arica and Antofagasta. The former route is complicated by a gauge change and steep slopes requiring rack and pinion tracks. In the south, Bolivian rail lines cross into Argentina, a primary source of grain. Pipelines carry Bolivian oil and gas to Chile and Argentina. During the 1980s, assisted by development banks, Bolivia has added bridges and paved portions to its part of the PAH and built some 400 kilometers of new rail in the Amazon, an ambitious undertaking for an impoverished nation. These efforts do not extend to the borders and are not, therefore, a factor in regional trade.* 25X1

Southern Andes. *The Argentine-Chilean border follows the crest of the Andes and, although 5,300 kilometers long, is crossed by only one paved road, the Pan American Highway, and two rail lines. Several unpaved roads are used seasonally, but snows, high winds, and landslides preclude use much of the year, especially in the southern portions of the border. Ship transport around the southern tip of the continent is the primary trade link.* 25X1 25X1

The Amazon. *Transportation in the Amazon Basin is underdeveloped because of great distances and sparse settlement. The Amazon River and its tributaries are primary avenues for commerce, but planners are pushing for speedier means of transport. A number of pioneer roads are being built, and Bolivia is extending a rail line in the southern portion of the basin. However, the Carretera Marginal de la Selva, a highway in Bolivia, Colombia, Ecuador, and Peru on the drawing board for more than 20 years, is largely incomplete. In Brazil, construction of the Trans-Amazonas has been abandoned and the Perimetral Norte begun in only a few places. By contrast, the Perimetral Sur has been paved as far as Porto Velho and work is progressing westward into Acre state, promoting rapid settlement. However, the highway will do little to expand regional trade until it is opened to the Pacific through Peru.* 25X1 25X1

Land routes link all South American countries to at least one or more paved roads except for Guyana, Suriname, and French Guiana, which are virtually isolated from the rest of the continent. The Pan American Highway (PAH) system, several other important roads, and a few rail lines are the primary overland trade routes. The PAH links most of the capitals of South America, but not all of the major ports. Much of the rail equipment and tracks are antiquated. The best developed regional transportation network links the economic core areas of Argentina, Brazil, Uruguay, and Paraguay. But even among these countries, the links are tenuous.

Air transport is important to the tourist trade and communications among distant cities—especially in the Amazon Basin, where there are few roads. Air cargo service is generally limited to high-value, low-weight cargoes, such as electronics products, precious metals, and illegal narcotics. Increasingly, smuggling involves the use of small aircraft and clandestine airfields in remote locations beyond government control.

Expanding and integrating the transportation infrastructure is widely regarded as a means of stimulating regional trade. For example, the Brazilian Minister for Transportation renewed calls in early 1986 for the construction of a road through Acre state to the Peruvian port of Callao, and another through Roraima territory to Venezuelan ports on the Rio Orinoco, to expand Brazil's trade with Peru and Venezuela and to provide access to the Pacific and the Caribbean. Construction of transcontinental rail lines has also been proposed: one would traverse southern Brazil, Bolivia, and Chile; another line, also through Bolivia, would link Lima to Buenos Aires. A 45-kilometer section of track along Lago Titicaca would have to be built, but, even if it is, required gauge changes between countries would limit the usefulness of these lines. Progress will be slow. Lack of money and large foreign debts will discourage lenders who might otherwise finance construction, and transcontinental rail lines and Amazonian links to the Pacific and the Caribbean will not be completed during this decade.

Policy Shifts Considered

Because of the plunge in regional trade during the 1980s, South America's leaders are focusing increased attention on their ability and need to expand regional trade. Bilateral agreements are being increasingly used as a way to achieve balanced trade between trading partners and to expand regional market potential; these trade agreements are often easier to negotiate than multilateral ones. 25X1

Despite the failure of LAIA and the Andean Pact to accomplish much in the way of trade liberalization, Latin leaders are again talking about using the two organizations to boost regional commerce. The LAIA, for example, has outlined the following goals to strengthen regional trade integration: 25X1

- Promote and establish new sources of goods and services in the region to replace those currently being imported from outside South America.
- Correct trade imbalances.
- Improve trade finance mechanisms.
- Establish programs to increase production of noncompeting products. 25X1
- Assist less developed member countries—Bolivia, Ecuador, and Paraguay.
- Eliminate obstacles to regional trade.
- Increase cooperation in regional transportation and communication. 25X1

Much of this is rhetoric. South America's leaders, several of whom were recently elected to office, are acutely aware of the demands of their constituents and would be reluctant to undertake measures that could damage sectors of their own economies for the sake of potential region-wide gains. We believe the best chance for action lies in improving the region's trade finance system—the Reciprocal Payments and Credits Agreement (RCPA). The RCPA facilitates regional trade through a trade credit clearinghouse mechanism that allows LAIA members to trade using domestic currency. The outlook is favorable for improving the trade finance mechanism because it allows trading partners to conserve foreign exchange. Opportunities for shifting the sources of goods and

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The Latin American Integration Association's Trade Finance Program

The Latin American Integration Association facilitates regional trade through the use of a trade credit clearinghouse and a liquidity support facility. LAIA's Reciprocal Payments and Credits Agreement (RPCA) allows its members, as well as the Dominican Republic, to trade using domestic currency, thereby conserving scarce foreign exchange. The central banks of participating countries act as agents for the agreement. In an Argentine-Brazilian transaction, for example, the Argentine exporter would be paid by the Argentine Central Bank in australs, and the Brazilian importer would pay the Brazilian Central Bank for the goods in cruzados. [redacted]

Daily bilateral transactions between South America's central banks are covered by a bilateral credit line that operates over a four-month period. When the debits exceed the credit line, the creditor Central Bank may ask the debtor Central Bank for immediate payment of the excess debt in advance of the settlement deadline. At the end of the period, debits between central banks must be settled with a convertible currency. [redacted]

Transactions channeled through the RPCA peaked at $9.3 billion in 1981. As a result of the contraction in regional trade, the flow of funds dropped to only $6.0 billion in 1983. During January–August 1985, however, clearing transactions amounted to $4.7 billion, compared with $4.1 billion for the same period in 1983. Foreign currency was required in only 20 percent of the total transactions during this period, and only 1 percent of total transactions required advance payments. [redacted]

Under the Santo Domingo Agreement, LAIA members and the Dominican Republic provide reciprocal support and assist member banks in coping with temporary liquidity problems. The agreement provides for three types of financing:

- *Financing for clearing of RPCA balances.*
- *Financing for overall balance-of-payments deficits.*
- *Financing for liquidity shortfalls caused by natural disasters.*

A central bank must have posted either a deficit or a reduction in its surplus in clearing transactions through the RPCA to qualify for support under the Santo Domingo Agreement. In addition, credits granted under the support mechanism are for a term of four months and can be renewed three times. As of mid-1983 the support facility had been used 24 times, for a total of $419 million, based on an initial capital of $263 million. [redacted] 25X1

The Andean Pact's Andean Reserve Fund (FAR), established in 1976, provides support for member countries experiencing balance-of-payments problems. FAR's capital was increased to $500 million in October 1986, doubling its initial capital outlay. FAR has provided assistance to Bolivia, Ecuador, Colombia, and Peru on several occasions, according to press reports. [redacted] 25X1 25X1

Plans for future trade finance development include LAIA's consideration of an RPCA expansion, although we doubt whether LAIA members will be able to develop a working regional currency in the near future. The Andean Pact, however, has introduced a regional currency—the Andean peso—which was used to cancel Andean Pact trade obligations for the first time in September 1985. Moreover, Peru has proposed a Latin America Monetary Fund (FML) to partially replace the IMF. The FML reportedly would be based on the Andean Reserve Fund. Peru's proposal, however, has elicited no support from other South American governments. [redacted] 25X1 25X1 25X1 services from non–South American to regional trading partners are also favorable as long as the countries concerned do not perceive unequal benefits resulting from the trade shifts.

The Andean Pact has been meeting since 1985 to try to revive subregional trade integration, but the group has not made much progress because individual members insist on keeping existing trade restrictions, according to diplomatic reporting. During the Andean Pact's 12–16 May 1986 meeting on trade, members were only able to agree informally on:

- Requiring limited importation of 30 to 50 products, formerly banned for protection of domestic producers.
- Permitting temporary protection of domestic production if disrupted by competing imports from other Pact members subject to review by the Pact.
- Eliminating nontariff barriers and lowering import duties applied to Bolivian and Ecuadorean exports to Pact countries.
- Requiring Pact countries, except Bolivia and Ecuador, to apply the most-favored-nation clause to fellow members if the clause is extended to non-Pact trading partners.

Pact leaders, however, have yet to agree formally on these proposals. Pact countries will find it politically difficult to repeal trade restrictions in view of their countries' high unemployment and economic difficulties, according to diplomatic reporting. Although the group's restrictive investment policy most likely will be revised in the future, we believe investment in the Andean countries will still be unattractive because of government policies and small national markets reinforced by high tariff barriers.

There is some evidence of greater trade cooperation among the more developed countries in the region. Argentina, Brazil, and Venezuela agreed last year to cooperate in the steel market with the support of the Latin American Economic System (SELA)—a Latin American organization of 26 countries established in 1975 to promote regional industrial cooperation—to expand regional steel trade and increase their access to developed country markets. We have seen nothing yet, however, to indicate what specific actions are being taken. Another example of cooperation involves Brazilian and Venezuelan steel companies working together to circumvent the US-Brazilian voluntary restraint agreement on steel exports to the United States. The Brazilian steel firm plans to ship slab to 25X1 Venezuelan steel companies that would then sell the slab to the United States. US steel imports from the three countries amounted to 6 percent of total US steel imports in 1984. 25X1

Regional trading partners have also been cooperating in the area of chemicals and pharmaceuticals. In 1984, Brazil, Argentina, and Mexico's health ministers agreed to combine production and share markets in pharmaceuticals and chemicals under the auspices of the Pan American Health Organization (PAHO), according to diplomatic reporting. The ministers indicated that some self-sufficiency has been achieved in these industries and that they could cooperate to obtain quality drugs at lower prices. Although PAHO's director stated that his organization had no interest in excluding non-Latin companies from Latin American markets, this type of program could adversely affect foreign pharmaceutical companies operating in the region. 25X1

Issues Ahead

Despite domestic political pressures, South American leaders are likely to view invigorating regional trade as being increasingly in their interest. We believe this drive will be strongly influenced by a growing cadre of economic decision makers in many of the new governments who view economic growth and self-reliance as the cornerstone of their economic policy. In our judgment, this desire to become less dependent on access to developed-country markets is likely to be reinforced by: 25X1

- The increasing threat of protectionism in Western countries, especially the United States.
- The need of debtor countries to at least match increasing debt servicing burdens with like increases in export earnings.

- The increasing demand for economic structural reform as a prerequisite to enhanced financing by international financial institutions. Export expansion and diversification have been cited as key elements of such a reform effort by the World Bank and as part of the US initiative on debt.[2]

South American success in expanding exports to each other will also be in the long-term interest of the United States:

- Expansion of regional trade would, in our judgment, promote economic growth and stability for recently established democratic governments like Argentina, Brazil, and Uruguay.

- Moreover, enhanced exports to regional markets could relieve some pressure for greater access to the US market and increase the capabilities of South American debtor countries to make debt payments to US institutions.

More regional trade integration in South America is not without its risks, however. In the short run, US exports could suffer as South American countries strive to expand trade with each other. For example, cooperation among South American countries to share regional markets for specific products, such as pharmaceuticals and chemicals, could hurt US exports of these items to the region. In the long run, however, if trade expansion stimulates economic growth and development, opportunities for US exports to the region should increase.

Expanding regional trade will not be easy. To expand regional trade, South American countries need to develop further new product lines; these lines might include processing the raw goods that they now export, such as food and raw agricultural materials. In addition, producers of semifinished goods, for example, metals, could expand exports of these goods to other South American countries for further processing. However, for industries considered key to national interests—such as electronics and automobiles—we believe chances are slim that producing countries will substantially open their domestic markets to regional imports in the near future. Efforts toward greater trade integration could particularly be stymied if countries perceive that a dominant partner—say Brazil—is benefiting at their expense.

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[2] US Treasury Secretary James Baker proposed a new program for sustained growth in debtor countries on 8 October 1985 at the joint IMF–World Bank meeting in Seoul, South Korea. The US initiative on debt called for further economic structural reforms by debtor countries to promote economic growth, hold down inflation, and improve balance of payments. Debtor countries that adopt such reforms would be eligible for up to $29 billion in new lending over the next three years—$9 billion from the World Bank and other multilateral development banks and $20 billion from commercial banks.

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Appendix A

Direction of South American Regional Trade

Million US $

	Exports			Imports		
	1975	1980	1984	1975	1980	1984
Argentina	**580.3**	**1,729.2**	**1,204.9**	**851.9**	**2,066.5**	**1,588.2**
Argentina	0	0	0	0	0	0
Bolivia	63.8	133.4	88.4	130.7	252.4	395.4
Brazil	213.5	765.1	469.9	358.9	1,072.4	862.7
Chile	130.6	217.6	155.6	162.2	254.7	122.7
Colombia	16.3	39.0	59.3	27.2	52.1	26.7
Ecuador	11.4	17.5	15.2	11.1	61.1	6.2
Paraguay	37.3	189.4	91.5	50.2	84.6	41.1
Peru	29.6	116.8	130.5	41.5	69.6	34.2
Uruguay	40.8	185.3	86.4	22.1	148.1	91.2
Venezuela	37.0	65.1	108.1	48.0	71.5	8.0
Bolivia	**186.0**	**377.5**	**310.6**	**190.6**	**226.9**	**284.1**
Argentina	135.0	245.2	271.1	80.3	89.6	97.2
Bolivia	0	0	0	0	0	0
Brazil	18.5	36.3	14.7	79.9	53.5	154.6
Chile	5.8	46.9	6.0	10.6	30.9	16.2
Colombia	1.4	9.8	3.8	9.8	3.3	0.3
Ecuador	13.3	1.6	0	0.4	1.0	0.1
Paraguay	0.5	0	0	0.4	2.6	0
Peru	7.4	32.3	14.8	8.7	44.4	13.6
Uruguay	4.1	0.6	0	0.5	1.1	2.0
Venezuela	0	4.8	0.2	0	0.5	0.1
Brazil	**1,071.0**	**2,989.0**	**2,545.0**	**637.0**	**2,426.0**	**1,607.0**
Argentina	381.0	1,092.0	853.0	252.0	841.0	539.0
Bolivia	122.0	180.0	141.0	17.0	47.0	16.0
Brazil	0	0	0	0	0	0
Chile	100.0	451.0	281.0	112.0	462.0	240.0
Colombia	29.0	136.0	171.0	13.0	10.0	6.0
Ecuador	27.0	50.0	141.0	6.0	36.0	2.0
Paraguay	118.0	409.0	333.0	28.0	99.0	41.0
Peru	93.0	130.0	124.0	47.0	130.0	51.0
Uruguay	88.0	311.0	136.0	67.0	203.0	125.0
Venezuela	113.0	230.0	365.0	95.0	598.0	587.0

Direction of South American Regional Trade (continued) *Million US $*

	Exports			Imports		
	1975	1980	1984	1975	1980	1984
Chile	**377.6**	**1,040.4**	**528.0**	**385.1**	**1,133.1**	**878.2**
Argentina	166.4	280.6	116.7	107.9	157.4	160.9
Bolivia	13.4	26.4	14.7	10.9	26.3	6.6
Brazil	98.0	448.6	227.5	82.2	394.8	296.4
Chile	0	0	0	0	0	0
Colombia	25.0	76.8	43.0	9.9	17.8	21.5
Ecuador	19.1	21.6	27.8	91.3	210.2	46.0
Paraguay	1.4	7.7	4.5	1.9	7.3	36.5
Peru	25.0	70.7	44.9	46.3	40.6	49.2
Uruguay	7.3	29.6	8.7	4.7	21.6	9.3
Venezuela	22.0	78.4	40.2	30.0	257.1	251.8
Colombia	**220.5**	**531.4**	**319.1**	**135.8**	**635.7**	**844.2**
Argentina	27.8	68.7	24.2	18.6	42.8	65.2
Bolivia	6.5	2.2	0.4	1.1	7.4	1.4
Brazil	8.6	9.0	5.3	22.3	127.1	188.0
Chile	23.9	64.3	19.6	29.1	82.5	47.3
Colombia	0	0	0	0	0	0
Ecuador	36.1	77.3	46.8	21.4	77.5	152.5
Paraguay	0.3	0.6	0	0.2	0.4	0
Peru	33.7	29.2	23.6	18.0	97.0	82.4
Uruguay	0.6	0.9	0.2	3.1	4.0	3.9
Venezuela	83.0	279.2	199.0	22.0	197.0	303.5
Ecuador	**224.2**	**435.8**	**118.3**	**101.0**	**232.8**	**302.1**
Argentina	9.3	31.1	4.0	12.9	13.5	21.9
Bolivia	0.3	0.6	0.1	0	11.6	0.1
Brazil	5.8	34.7	1.6	24.8	49.8	162.5
Chile	78.0	220.4	40.1	12.0	24.4	31.2
Colombia	26.3	93.3	66.0	37.2	52.4	51.3
Ecuador	0	0	0	0	0	0
Paraguay	0.1	0.3	0	0.1	0	0.4
Peru	103.3	12.9	3.5	5.7	56.8	30.0
Uruguay	0.1	1.6	0.1	0.3	0.9	1.2
Venezuela	1.0	40.9	2.9	8.0	23.4	2.6

Direction of South American Regional Trade (continued) *Million US $*

	Exports			Imports		
	1975	1980	1984	1975	1980	1984
Paraguay	**63.9**	**136.6**	**116.8**	**76.0**	**266.9**	**309.3**
Argentina	49.7	74.2	40.8	33.2	106.4	90.5
Bolivia	0	0.6	0	0.3	0.1	0
Brazil	6.2	40.2	62.0	37.2	140.5	211.2
Chile	1.0	11.3	8.0	1.3	4.3	1.4
Colombia	0.2	0.1	0	0.3	0.2	0
Ecuador	0.1	0	0	0.1	0.3	0
Paraguay	0	0	0	0	0	0
Peru	0.4	0	0	0.1	0.1	0
Uruguay	2.3	10.2	6.0	3.5	15.0	6.2
Venezuela	4.0	0	0	0	0	0
Peru	**198.2**	**500.2**	**279.7**	**375.6**	**262.5**	**370.9**
Argentina	34.9	59.4	31.1	27.9	71.6	130.5
Bolivia	5.5	69.2	12.4	5.4	11.4	14.8
Brazil	35.6	124.2	46.6	76.3	81.3	124.3
Chile	82.8	45.0	44.7	26.2	34.0	44.9
Colombia	15.9	55.9	74.9	32.5	22.6	23.5
Ecuador	10.1	83.8	28.1	118.2	5.5	3.5
Paraguay	0	0.5	0	1.4	0.2	0
Peru	0	0	0	0	0	0
Uruguay	1.4	10.2	1.8	0.7	7.5	5.0
Venezuela	12.0	52.0	40.1	87.0	28.4	24.4
Uruguay	**110.4**	**388.3**	**227.2**	**149.8**	**590.5**	**303.0**
Argentina	29.6	142.3	85.6	47.3	174.1	85.8
Bolivia	2.8	1.7	1.8	0.2	1.9	0.1
Brazil	65.5	191.0	113.8	71.9	284.0	149.4
Chile	2.2	23.3	8.5	7.9	19.6	9.6
Colombia	3.0	3.6	3.6	0.5	1.5	0.3
Ecuador	0.4	0.8	1.1	0.2	6.3	0.1
Paraguay	3.7	14.6	5.6	3.8	19.5	7.9
Peru	2.2	8.0	5.0	2.0	10.8	2.0
Uruguay	0	0	0	0	0	0
Venezuela	1.0	3.0	2.2	16.0	72.8	47.8
Venezuela	**306.0**	**1,372.0**	**1,109.0**	**273.0**	**636.0**	**770.0**
Argentina	48.0	56.0	7.0	37.0	85.0	108.0
Bolivia	0	0	0	0	3.0	0
Brazil	95.0	678.0	534.0	113.0	186.0	365.0
Chile	30.0	242.0	229.0	22.0	81.0	40.0
Colombia	22.0	273.0	276.0	83.0	183.0	199.0
Ecuador	8.0	17.0	2.0	1.0	38.0	3.0

Direction of South American Regional Trade (continued) *Million US $*

	Exports			Imports		
	1975	1980	1984	1975	1980	1984
Paraguay	0	0	0	4.0	0	0
Peru	87.0	26.0	18.0	12.0	57.0	53.0
Uruguay	16.0	80.0	43.0	1.0	3.0	2.0
Venezuela	0	0	0	0	0	0

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