Comment on "Financial Flows for Regional Integration," by Stephany Griffith-Jones

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I like Stephany Griffith-Jones' paper because it provides a good deal of information on an important aspect of hemispheric integration we don't know very much about. Finance and investment are generally acknowledged to be the most important aspects of hemispheric integration. That is why Latin American countries are interested in negotiating integration mechanisms with the United States. On the other hand, in terms of intra-Latin American integration, there is more of an emphasis on the importance of trade. This may be a distinction between hemispheric vs. intra-Latin American integration that we want to keep in mind.

There are three different types of trade and financial links discussed in this paper. First, we have finance directly promoting trade and investment via the current payment mechanisms and trade finance. Second, finance indirectly promotes trade and integration via foreign direct investment among countries. And, third – the opposite of the second item – trade and integration promote finance and investment via increasing the integration process and leading to increased capital flows.

The first of these mechanisms – finance directly promoting trade and integration – has been present in all the processes of hemispheric integration, going back to the ALALC-LAFTA days in the earlier post-war period. Until now, these mechanisms have been limited to the intra-Latin American aspect of hemispheric integration and they have not reached the United States; the US has not participated in these kinds of mechanisms. In part, these mechanisms began early in the post-war period because of balance of payments problems, and Stephany talked about the fact that their importance declined in the 1990s. But this type of finance also increased during the debt crisis of the 1980s. I think there is some clear evidence of the link between availability of international finance and these mechanisms becoming more important in financing trade. Even now, however, they remain at a very high level: according to the data in Stephany's paper nearly 70 per cent of intra-Latin American imports are financed by these mechanisms.

The second process that Stephany talks about – finance indirectly promot-

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ing trade and integration via foreign direct investment – is a newer process in so far as we are talking about investment among Latin American countries, basically a phenomenon of the 1990s. But, of course, if we look at hemispheric integration, US investment in Latin America is really a very old story. There are two different processes here: one is addressed in the paper and the other is not. The one that is not addressed is investment increasing trade via intra-firm transactions, whereby firms engaging in foreign investment import inputs and capital goods into the host country and thereafter export the goods they produce back to their home country. The mechanism that Stephany does talk about in the paper vis-à-vis this topic is a different one. That is: increased investment is likely to lead to de facto integration, which in turn, at least in some cases, will lead to de jure integration. If we are looking at the Mexican-US example, this is exactly what happened. There was de facto integration across the border at a variety of levels, which eventually led to the agreement to formalise this in the NAFTA agreement. There are some observers who have discussed the Chile-Argentina relationship in the same way, that it was the spontaneous Chilean investment in Argentina which later led the Chilean government to begin to approach Mercosur to try to negotiate a more formal kind of relationship. So there is at least some evidence that the second process indeed does work.

The third process discussed by Stephany – that trade and integration may increasingly promote investment itself – is the opposite of the second point. This is an argument that has been made, but I think the situation is less clear than may be implied by some of the discussion we have heard. It seems true that greater security about rules for foreign investment will lead to greater amounts of investments. But on the other hand, if we ask whether firms are trying to increase their sales by investing in other countries – for example, is the United States trying to increase its sales in Latin America by investing there? – then the situation becomes a bit less clear. It was certainly true in the import-substitution industrialisation period, when there were barriers to trade, that if you wanted to sell in the domestic market, you had to invest there. But in the current period of more open markets, the situation may even operate in the opposite way. For example, a number of Japanese industrial firms that were operating in Latin America have decided to close down their local operations and export from Japan to Latin America because it is cheaper and they can make higher profits. So it is not totally clear that greater integration will necessarily lead to greater investment.

Dynamics of Other Regions

There have been a number of comments, both in Stephany's paper and in the previous discussion this morning, about a qualitative distinction between

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integration processes in different regions, but I think it is also important to talk about a quantitative distinction. In this quantitative distinction, Latin America, and the Western Hemisphere more generally, are far behind Europe and Asia. If we look at trade among European Union countries, more than 60 per cent of those countries' trade is now with each other. In terms of the Asian region nearly half of the trade of the Asian countries is now among themselves and the share has been rising very rapidly. In the Western Hemisphere, by contrast, only 22 per cent of total trade occurs among hemispheric countries.

An interesting aspect of what has been going on in Asia is the different types of symmetry in the Asian region and in the Latin American region. With respect to export markets, developing Asian countries – the NICs and ASEAN – are more important to Japan than Japan is to them. That is, only 17 per cent of developing Asian countries' exports are sold in Japan, while 34 per cent of Japanese exports are sold in developing Asian countries. In the Western Hemisphere the symmetry is the opposite of what you find in Asia: 15 per cent of US exports are sold in Latin America while 43 per cent of Latin American exports are being sold in the United States.

There is a similar situation if you look at investment, the topic of Stephany's paper. Investment flows among EU countries now reach about 63 per cent, i.e. 63 per cent of EU investment is in other EU countries. In the case of Asia, we've got a quite different situation than we saw in the case of trade; 16 per cent of Japanese investment goes to developing Asian countries and about 80 per cent of developing Asian countries' investments are in other developing Asian countries. Those amounts are becoming quite large although, as Stephany said, our data are not really good in terms of investment flows; best estimates are of at least 5 billions dollars a year of investments among developing Asian countries in the 1990s.

In the Western Hemisphere, the figures that Stephany reports are a good deal less than a billion dollars, though she says that these may be underestimated. So, let us say, a billion dollars in Latin American countries' investment goes elsewhere in the hemisphere compared to 5 billion dollars for the developing Asian countries. Brazil, Mexico and Venezuela, by far the largest investors, send most of their money in the United States, whereas only the medium-sized countries, Chile, Colombia and Peru, invest heavily within the region. So there is quite a different dynamic going on in Latin America compared to Asia.

While all these figures seem to indicate a fairly strong relationship between trade and finance within regions, the causality is somewhat unclear. There seems to be an interactive process of some sort going on, probably a mutually reinforcing one. We must understand this causality better if we are to answer the question that Stephany's paper poses: what role can finance play in the future in increasing trade flows within the Western Hemisphere or among the Latin American countries themselves?

Compensation and Trade Finance

Let me finish by coming back to some of the compensatory mechanisms that are discussed in the paper. Most of the mechanisms that Stephany talks about are intra-Latin American; the exception is NAFTA in possibly promoting US investment in Mexico. The important analytical and policy question, once we move to discuss hemispheric integration as opposed to intra-Latin American integration, is to what extent the United States will begin to participate in these mechanisms. It seems clear that, at least at this point in time, unlike the situation in Europe, the US government has no interest in providing compensatory financial flows to the Latin American region. There is indeed a lot of discussion and some action in terms of providing compensatory relationships within the United States itself. Firms and workers who supposedly are being hurt by the NAFTA agreement can get access to training funds and other kinds of compensation. But this will not work between the United States and Latin America. For example, when US Commerce Secretary Ron Brown was here last year I asked him if there are going to be any kind of mechanisms set up such as the European structural funds for Mexico or for other Latin American countries. His answer was: "Absolutely none. If Latin America wants to join NAFTA or some hemispherical organisation, they must have other reasons than trying to get compensation". Thus, the moral hazard issue is unlikely to arise in this particular context.

Trade finance is somewhat different because there is the Export-Import Bank financing available, but this is a very one-sided kind of relationship as well. The Exim Bank exists to promote US exports to Latin America (and elsewhere), not to promote any kind of common goals within the hemisphere. Therefore, some questions arise: Can we find mechanisms that might promote common goals within the hemisphere? Could some kind of intra-regional organisation like the IDB play a positive role? Could private trade finance play a role in changing the situation? These are some of the policy issues that this paper suggests.

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