Global Production Chains in Latin America: Challenges for Inclusive and Sustainable Growth

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Whether in international tourism, natural resources extraction or manufactured goods, today Latin American countries participate in a wide array of global production chains with increasing success. Total regional exports have grown seven-fold in the last twenty years, from $112 billion in 1990 to over $886 billion in 2010, constituting over 20% of today's regional GDP (ECLAC, 2011).

Although export-oriented industries have brought important economic benefits to the region through sales abroad, they have also presented a series of policy challenges in terms of their actual contribution on the social and economic development in the countries in which they are based. Specifically, their potential contribution has often been constrained by the small number and low quality of jobs created and lack of integration with the rest of the national economy.

Therefore, this brief examines some of the latest Latin American-produced policy research on the impact of export-oriented industries and the policy responses to the challenges they pose, summarizing how these in turn can support an inclusive and sustainable growth path for the region.

The Latin American research summarized here is highly relevant to Canada's foreign economic and cooperation policies for this region, given the latter's emphasis on the development of bilateral trade and investment relationships (DFAIT 2009), and on strengthening the ability of national businesses to participate in the global economy (CIDA 2009). Accordingly, this brief underlines issues in subject areas already defined as most important to Canadian policy there.

Export-Oriented Production Chains in Latin America

Post-economic liberalization, Latin American countries have been participating in the global economy through a wide range of export-oriented economic activities. According to Eduardo Bianchi, head of the global production chains research unit at the Latin America Trade Network (LATN), the region has followed two fairly distinct export-patterns. In the North, meaning Mexico and Central America, countries have developed export-led manufacturing sectors relying on imported inputs (maquilas), large networks of touristic enclaves, and some commodities or natural resource-intensive industries. South America, on the other hand, has continued to rely primarily on natural resources for most of their internationally-oriented exports, as well as some of the capital-intensive industries inherited from the previous era of import-substitution and state-led development.

In both sub-regions, these export-oriented chains are increasingly demonstrating that they may not be, by themselves, strong drivers of inclusive and sustainable economic growth. This is due to the fact that these industries have a tendency to:

- Create low numbers of jobs, that are often of low quality;
- Have few, and even sometimes, no business linkages with the rest of the economy;
- Contribute to increases in sub-national income inequality; and,
- Increase the likelihood that countries will remain stuck in low-added value productions

The relative weight of these tendencies have naturally varied according to the types of export-driven production chains hosted in each country, as does their overall impact in the aggregate structure of each national economy. The policy responses from Latin American governments have also varied according to the specific mix of challenges faced, level of institutional capacity and political inclinations.

In order to better understand the Latin American experience with export-oriented production, it is useful to take a more detailed look at a number of specific industry/country examples.

Maquilas in Costa Rica

Manufacturing in maquilas – production that relies primarily on imported inputs and is primarily for export – has become a central component to the development strategy in Mexico, Central America and the Caribbean since the 1980s. Initially, Costa Rica was particularly successful at attracting companies to set up this type of production facility with the extensive establishment of Export Processing Zones (EPZs). During this period the country transformed its export basket; from 1980, the weight of traditional agricultural exports (coffee, banana, meat and sugar) fell from 57% to 24%, with manufactures and services now accounting for the rest. Maquila production has rapidly upgraded, moving from textiles and simple electronics to semiconductors and medical products. Most recently, call centres have become another of the county's most important exports, replicating in the export of services what was done before with maquila manufacturing (Sánchez-Ancochea 2010).

This type of production, based in EPZs and dominated by multinationals, offered the opportunity to develop new productive capacities and create abundant new employment. This was considered especially important in Central American countries such as Costa Rica, where national markets were to small to develop a policy of import substitution. Maquila production, both in manufacturing or similarly structured services such as call centers, also had the potential to facilitate the transfer of technology, allowing local industry to develop via spillovers (Sánchez-Ancochea 2010). However, this mode of export-led development has also incurred some substantial financial and developmental costs for the host-country because:

- To attract maquila and service-exporting foreign investment, Costa Rica extended tax breaks and other fiscal incentives to firms equivalent to 30% in the total income tax and 10% of total national taxes for the period 1980-2010;
- Between 1980 and 1996, maquilas imported on average 98% of their inputs, ensuring that national aggregated value and linkages with other sectors in the economy remained non-existent. Between 1997 and 2008 the percentage of inputs sourced locally increased to 11%, however the two sectors with greatest technological content created the fewest links. Finally,
- Maquila production has marginally contributed to increasing income inequality as more recent maquila and call center jobs require higher levels of education. Total maquila and service export jobs in EPZs initially made up 15% of total employment but fell to only 2.7% by 2008. (Sánchez-Ancochea, 2010).

The government has attempted to improve linkages between EPZs and the rest of the economy through a program called Costa Rica Provee, which aims to help local businesses connect with and meet the demands of the maquilas. However, the program has had negative returns (less money in generated businesses than what is invested from public funds) so far even after being designed only to meet the needs of the maquilas, and without capacity to promote local learning and technological diffusion.

Tourism in Mexico and Brazil

Tourism has a strong potential to contribute to the expansion of domestic production and employment. In 2008, tourism accounted for 17.7 million jobs in Latin America, representing 11% of the total employment. It can also potentially stimulate the local production of other services and goods, including in construction, agriculture, furniture and crafts. When the goods and services consumed by tourists are produced locally, tourism can indeed be one of the industries with the highest multiplier effect in a local economy (Ventura-Dias, 2010).

In practice, however, tourism has not always been an engine for inclusive and sustainable economic growth; when linkages with the rest of the economy cannot be adequately established, a large part of the potential economic benefits of tourism are lost. This problem is inherent in enclave tourism such as resorts, cruises and theme parks. Examples of these are most often found in the Central American and Caribbean countries accompanied by a high degree of net economic losses through the import of goods and services essential to cover the tourists' needs.

The research cited here focuses on tourism in Mexico and Brazil, two countries with very different histories in this industry. While tourism has been an important sector in both countries' economies – making up 8.7% of Mexican GDP and 3.7% of Brazilian GDP in 2009 – Mexico's history as an international tourist destination is much longer and successful (in numbers of visitors/dollars spent) than that of Brazil. In spite of this, Mexican tourist industry has been marked by the enclave problems outlined above in Cancun, Acapulco and Baja California. Eventually, the inadequately considered social and environmental costs of these developments have undermined their sustainability and success as engines for regional development.

In Brazil, the expansion and improvement of the tourism sector has been recognized since 2003 by the government as a means for the economic and social development in historically underprivileged regions. Public investment and subsidies for private initiatives have redirected tourism there from more established destinations with explicit targets in poverty and inequality reduction and the protection of cultural and environmental heritage when subsidizing investment in hotels, attraction complexes and historical restorations. A newly-independent Ministry of Tourism has been created for that specific purpose.

Mining in Peru

Traditionally, large-scale mining has been characterized as an enclave industry in Peru, with few backward or forward linkages to the local economy. Local purchasing has often been limited to low-technology goods, and processing of the raw material is often done in other countries. Employment in medium and large-scale mines is comparatively low, with the jobs requiring skilled labour traditionally reserved for foreigners although slowly these positions are being opened up to the local workforce. Furthermore, the distribution of tax revenues from mining activities often reinforce intra-regional inequality, and occasionally lead to social unrest (Fairlie 2010).

A study of three large mining companies operating in Peru finds that in the past few decades there has been an increase in local hiring and purchasing of locally produced goods. However, this has depended exclusively on the policies of private firms as opposed to any official government initiative. For example, the gold mine Yanacocha increased its local hiring from 10% in 1997 to 60% in 2007, and increased

local purchases several fold in the same period. Other firms studied, such as Antamina and Southern, did much less or almost nothing in that regard. The study also found that the nationality of the capital of the firm (domestic or foreign) had no real bearing on this behavior.

Besides, these firms did not contribute more or less through the key channels of local employment and local purchases according to the levels of benefits being provided by Peruvian legislation. The latter was systematically improved over the 1997-2007 to further gains for mining investors across the board, without linking these gains to the more or less development-friendly practices of individual firms.

Conclusions and Policy Recommendations

Though export-oriented production can be an engine for economic growth, its existence is not enough to ensure that the benefits of this growth are translated into increased employment or technological development. Instead, many export-oriented industries such as mining, maquila and tourism can be characterized as enclaves, with few linkages to the rest of the economy. The degree to which these industries can be characterized as enclaves varies, however, according to the nature of the industry, the characteristics of local firms and human resources, and the policies that frame their operations.

The main lesson derived from this research is that export-oriented production, while necessary to finance adequate levels of imports, is not enough to guarantee development. Instead of taking for granted the positive contribution exported-oriented production chains will make to regional or national development, policy responses must explicitly consider how export-oriented production chains arising from static comparative advantages (abundant labour, touristic destinations, mineral resources) will contribute to development and through what mechanisms they can best do so.

Therefore, Canadian policies seeking to support Latin America's export-driven development ought to consider the specificity of the global production chains it is encouraging there via free trade agreements or bilateral investment treaties. Given that Canadian policy will de facto contribute to promote further enclaves in mining, maquila or tourism, it should foster policy responses in the countries with which it trades or where it invests so that employment and local business contracting are maximized. That will build the link between global markets and economic and sustained prosperity in Latin America.

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