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COMMENTARY

Focus on competitiveness not just trade

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Although the Republican Party was soundly trounced in the November mid-term elections, an even bigger loser was free trade.

For trade-dependent communities like South Florida and its hemisphere trading partners, the outlook for further liberalization of commerce appears bleak. The Doha Round of the World Trade Organization is stalled, the Free Trade Area of the Americas is comatose, congressional ratification of U.S. free-trade agreements with Peru and Colombia is unlikely and renewal of the Trade Promotion Authority is highly doubtful.

Does this mean a predicted decline in the economic and commercial fortunes of our neighbors to the south, yearning to expand their exports? Not at all.

In our forthcoming book *Can Latin America Compete?*, John Price, president of InfoAmericas, and I document a mixed picture of the region's competitive landscape. We argue that, irrespective of the course of trade liberalization, Latin America countries will fall further behind in the global marketplace unless they reform their institutions, infrastructure and human capital.

- **Infrastructure.** Since 1980, the region's investment in roads, electricity, water and telecommunications (\$47 billion) has declined precipitously. A paltry 2 percent of GDP, its infrastructure investment is now one-third that of Asia and Eastern Europe. Energy rates are expensive (Mexico's is three times that of China), and logistics costs are among the world's highest (10 percent to 30 percent of costs of goods sold compared to 5 percent in the United States and Europe). It takes companies in El Salvador 43 days to ship goods out of the country, 17 days in the Dominican Republic, but only six days in Germany.

On the bright side, telecom expansion has grown significantly; and multinationals such as América Móvil, BellSouth and Telefónica are bullish on the region, as small and medium businesses plan to invest more than \$10 billion to beef up their mobile equipment and infrastructure next year.

- **Institutions.** Latin America's are inefficient, ineffective and inadequate. Bank lending to small businesses is minimal. Courts are backlogged and often corrupt, and property rights are not enforced. Tax burdens are higher than in Asia, Brazil being the worst culprit. Mexico, on the other hand, does not collect enough revenue. Taxes collected

represent only 11 percent of the GDP, lower than any country in the Organization for Economic Co-operation and Development.

However, it is business regulation that is the biggest obstacle to competitiveness. The World Bank's Doing Business 2007 report documents the Kafkaesque web of regulations that choke businesses and stifle small entrepreneurs. This includes the 152 steps and five months it takes to set up a business in Brazil versus less than a month in Russia. In Argentina, the total costs of regulations and state intervention exceed \$4 billion. Corruption is another serious problem, shaving more than half a percentage point from GDPs.

Fortunately things are improving. As regulatory-improvement agencies like Mexico's COFEME institute sweeping changes, innovative banks engage in consumer lending (Banco Azteca, Lemon Bank) and reforms in capital markets, corporate governance and the judiciary begin to yield results.

- **Human capital.** Latin America has made great strides in primary education and university expansion (not so in secondary education, however). Schools of business and engineering proliferate, and innovation clusters such as those in Campinas (Brazil), Monterrey (Mexico) and San José (Costa Rica) are strengthening the region's competitiveness. India's Tata Consultancy Services is using Uruguay as an outsourcing hub, as is IBM in Argentina, Mexico and Brazil. Nevertheless, except for Chile, no Latin American country is ranked among the top 50 in the World Economic Forum's Global Competitiveness Index.

Whereas research-and-development expenditures account for 2.5 percent of GDP in South Korea, Latin America's outlays are less than 0.5 percent. (Last year my alma mater, Columbia University, registered more patents than the entire region.) Ironically, at a time when the region requires more engineers, computer scientists and technicians to compete globally, Latin America's universities overwhelmingly graduate lawyers, psychologists and sociologists. In the workplace, rigid, restrictive, cumbersome and costly labor rules undermine efficiency and productivity, eroding firm-level (and national) competitiveness.

The prospects for further trade liberation are grim -- unless a nation does so unilaterally. Free-trade agreements are neither a panacea nor an apocalypse. They are but one necessary yet insufficient arrow in the quiver of a nation's economic growth and development. It is competitiveness that will shape a nation's economic destiny.

Instead of blaming its long-standing problems on China, protectionist policies in industrial countries and insufficient foreign aid, Latin America should focus on internal transformation of institutions, infrastructure and human capital -- changes that will produce wider impacts and greater benefits in strengthening competitiveness and improving the daily lives of ordinary citizens.

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