Comparative Perspectives on Trans-Pacific Trade, Integration, and Development

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Comparative Perspectives on Trans-Pacific Trade, Integration, and Development

This document was prepared jointly by the Inter-American Development Bank (IDB) and the Asian Development Bank (ADB) for the 50th IDB Anniversary Conference "Strengthening the Economic and Cooperation Linkages between Latin America and the Caribbean and Asia" (Tokyo, Japan, November 2009). The views and opinions expressed in this publication are those of the authors and do not necessarily reflect the official position of the IDB or the ADB.

Table of Contents

Prologue

Latin America and the Caribbean (LAC for short) and Asia and the Pacific (Asia for short) are dynamic and diverse emerging markets in the global economy. Collectively, they constitute a quarter of the global GDP. Both regions hold immense potential for growth, trade, and development; both are also under the pressures of global competition and vulnerable to external shocks such as global economic downturns and volatile capital flows. Both regions are also undertaking the hard work of reducing poverty and inequality, streamlining institutions, fostering private sector competitiveness, and nurturing regional cooperation and integration. Much of the future of LAC and Asia depends on how they carve their destinies today.

A key opportunity in this process lies in trans-Pacific relations. The two regions provide many lessons for each other. What is more, several complementarities of the two regions have only begun to be exploited. Indeed, trade and capital flows between Latin America and Asia are growing and diversifying amid the rise of new common economic and political cooperation initiatives. Smartly executed expansion of bi-regional trade, investment, and political relations can thus be conducive to the growth, development, and global competitiveness of the economies across the Pacific basin.

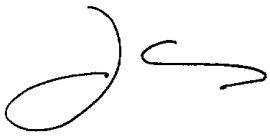
Perhaps the key opportunity in LAC-Asia relations lies in the immense diversity of the trans-Pacific space. After all, the region consists of economies of varying levels of development, divergent historical paths, and a rich assortment of cultural and institutional combinations. This diversity is an asset. What could be called "scale economies of regional knowledge"—the vast issue-specific expertise carried by the diverse set of countries surrounding the Pacific basin—provides rich reflections on the best ways to harness new bilateral opportunities as well as to respond to the pressing external challenges. It allows for building further complementarities between the two regions, and helps in devising multifaceted approaches to the common management of the challenges and opportunities engendered by globalization.

A particularly promising agenda for LAC and Asia would be to develop a synergistic approach to bi-regional cooperation—integrate the mutual objectives of trade and investment liberalization, financial and macroeconomic stability, growth and competitiveness, and broader, non-economic

cooperation. Such a range of shared policy interventions will enhance the supply of various trans-regional public goods, as well as help combat common public "bads", such as climate change, other types of environmental degradation, financial crises, and communicable diseases. The opportunities for pooling bi-regional resources, for the benefit of all, are there waiting to be tapped.

Multilateral support from the Inter-American Development Bank (IDB) and the Asian Development Bank (ADB) is critical for promoting economic integration and trade and investment facilitation between LAC and Asia. Since 1999, inter-regional institutional cooperation between IDB and ADB has deepened to include trade facilitation, technical capacity building, and shared lessons learned on a variety of development-oriented cooperation initiatives. Joint initiatives include the Regional Public Goods Conference (2002), and ongoing participation in the Latin America/Asia Economics and Business Association (LAEBA). Most recently, in June 2009, IDB and ADB agreed to expand their respective trade finance facilitation programs to US$1 billion in response to the recent credit crunch, and share access to their trade finance programs, linking more than 100 financial institutions to support trade between companies in LAC and Asia.

Looking forward, there is much work to be done to continue to exploit the complementarities and opportunities of our two regions. In the increasingly globalized world we cannot limit ourselves to approaches that consider our countries, or even our regions, in isolation. As we continue our efforts to better the lives of the people in LAC and Asia, we must take advantage of all of the opportunities that exist across these combined regions. This is our ongoing commitment.



Luís Alberto Moreno
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Executive Summary

Over the past decade, a proliferation of trade agreements and a surge in bilateral investment have expanded economic links between Latin America and the Caribbean (LAC) and Asia. In 2008, total inter-regional trade exceeded $300 billion. Bilateral trade has surged as a result of numerous bilateral free trade agreements (FTAs) as well as the membership of Chile, Mexico, and Peru in the Asia-Pacific Economic Cooperation (APEC) forum, an association of 21 Pacific Rim countries that promotes liberal trade and economic policies. Another avenue for bi-regional collaboration is the Forum for East Asia Latin America Cooperation (FEALAC), which promotes education, science and technology coordination among its 30 East Asian and Latin American members.

However, despite the recovery of investment and trade ties since the 1997 Asian financial crisis, bi-regional economic links remain relatively weak and show little diversification. One of the key reasons for limited bi-regional trade and investment flows is the predominance of inter-industry trade and the paucity of intra-industry trade between the two regions. Although there is significant intra-industry trade within each region, intra-industry trade across regions is still nascent. This fact is important because intra-industry trade is associated more with technology transfer and foreign direct investment (FDI) than is inter-industry trade. Similarly, bilateral investment flows, albeit growing and diversifying, are still low compared to the two regions' investment ties with the developed country markets, and have a great deal of room for growth.

Given the considerable uncertainty in the world economy, especially following the 2008 global financial crisis and the rather slow progress of multilateral trade talks, regionalism has regained significance. Against this backdrop, intra-regional trade in Latin America has been robust, increasing by 8 percent since 1990 to reach 19 percent of the region's total trade. Intraregional trade in Asia has also expanded as global production networks in key industries develop regional roots and suppliers. In East Asia alone intraregional trade now accounts for half of total trade. Furthermore, trade facilitation and strategies that promote regional integration are also receiving attention. Countries in both regions are looking for policy mechanisms to ameliorate their respective "spaghetti bowls[1]" of agreements while at the same time continuing to negotiate cross-regional agreements.

[1] "Spaghetti Bowls" refer to collections of overlapping and crisscrossing free trade agreements that apply only to members, and have provisions such as rules of origin that limit the participation of non-members in the benefits of the agreements.

The purpose of this report, which consists of chapters by the Inter-American Development Bank and the Asian Development Bank, is threefold: (1) to examine the state of trade and investment flows and integration between the LAC region and Asia; (2) to explore some of the results of a recent spree of intra-regional regional integration initiatives in Asia-Pacific and compare and contrast it with integration in the LAC region; and (3) to propose a future bi-regional agenda for LAC and Asia to further trans-Pacific scale economies. Such an agenda would need to be comprehensive, consisting of tighter integration of bi-regional production and marketing networks, harmonization of overlapping trade agreements crisscrossing the Pacific basin, and strengthening of economic, political, and cultural ties to foster bi-regional business alliances that help consolidate production and technological linkages.

Trans-Pacific Trade, Integration, and Development: The Perspective from Latin America and the Caribbean

By the Inter-American Development Bank[2]

[2] This chapter was prepared by the Integration and Trade Sector, Vice Presidency for Sectors and Knowledge, of the IDB, under the supervision of Antoni Estevadeordal (Manager), by Jeremy Harris, Kati Suominen, Yee Wong (consultant) and Ariel Mecikousky (research assistant).

Introduction

Trade and investment ties between Latin America and the Caribbean (LAC) and Asia-Pacific (Asia-Pacific) have recovered since the Asian financial crisis, and are continuing to expand rapidly, thanks largely to the recent surge in trade with China. The Asia-Pacific region has become an important trading partner for Latin America and the Caribbean. In 2008, total trade with Asia reached $229 billion, accounting for about 9 percent of total LAC exports and 23 percent of total LAC imports. By comparison, in the same year, the share of US exports was 44 percent/ and US imports reached 32 percent, while the European Union (EU) accounted for 13 percent of LAC exports and 14 percent of imports. Thus, as a trading partner, the Asia-Pacific region is far more important as a source of imports to LAC than a destination for exports, which has created a trade deficit with the region that ballooned to $98 billion in 2008.

Asia-Pacific remains a relatively untapped market for most LAC countries, with several important exceptions. In the past five years, Brazil, Chile, Argentina, Mexico, and Peru have accounted for more than 90 percent of all exports to Asia-Pacific. . About 36 percent of Chile's exports go to Asia, and Peru's share totals roughly 24 percent. In South America, Brazil is the largest exporter to the Asia-Pacific region in absolute terms, and while Mexican and Central American exports are relatively low, Costa Rica ships more than 20 percent of its total exports to Asia.

Trade between the two regions is largely characterized by inter-industry trade. LAC generally exports primary products to Asia-Pacific which, in turn, exports largely manufacturing goods, especially medium and high technology. Recently, however, some changes in intra-industry trade have emerged in high-technology manufactures. For example, LAC exports have become more diversified to include fishery products, pork, and some high technology manufactures, which suggests that Latin America may be slowly gaining a foothold in supply chain networks in the Asia-Pacific region.

Compared with sources of FDI from the United States or Spain, investment flows between the two regions remain relatively low. Asian FDI to LAC increased by about 164 percent since 1994, but Latin America accounts for just 3 percent of total Asian outward FDI. Most FDI is concentrated in natural resources rather than manufacturing sectors, with most inflows focused

in a few services sectors (e.g. finance and insurance). Except for mining, Latin America has faced stiff competition from other regions, especially Africa, for Asian FDI in natural resource sectors. LAC's share of outward Asian FDI has also declined as investors flock to ASEAN and China. For example, LAC's share of Japanese FDI has declined in recent years (from 15 percent in the 1980s to 1 percent in 2007), while ASEAN was the largest recipient, with about an 11 percent share.[3] Most Japanese FDI in Latin America is not directed at natural resource sectors, but instead is concentrated in finance and insurance, which absorb about 47 percent of FDI, followed by transportation (about 25 percent). Chinese FDI in Latin America has fallen short of initial expectations and has been directed primarily to tax havens in the Cayman Islands and the British Virgin Islands (accounting for about 48 percent of total outward Chinese foreign investment). The Cayman Islands and British Virgin Islands are also major recipients of outward Korean FDI to LAC. Brazil, Mexico, and Peru are also key recipients. Korean FDI to LAC, on the other hand, has shifted away from natural resources to manufacturing (about 24 percent of total Korean FDI flows), mining (20 percent) and services (44 percent).

As major Latin American firms expand abroad, outward LAC FDI has gained a presence in Asia. For example, the Mexican construction conglomerate Nemak recently established a new production plant in China. The company has also purchased the operations of the Chinese high-technology aluminum manufacturer Tk Aluminum. The Brazilian auto company Marcopolo also launched a project with Tata Motors to supply the Indian market.

Part of the reason for relatively low investment flows is due to inter-industry trade patterns, lack of knowledge of corporate strategies in both regions and still feeble infrastructure and port network systems linking them together. There are also few well-established networks or strategic alliances among companies, which suggests high sunk costs and barriers to entry for investors.

Closer Regional Integration

The uncertainty and stalled WTO Doha Round has led to a re-emergence of regionalism in both Latin America and Asia Pacific. The OECD estimates that the number of preferential regional and bilateral trade agreements in the world could soon approach 400, and Asia and Latin America have been very active in this regard. Historically, LAC has a long record of government-led

[3] See Vodusek (1996).

support for regional preferential trade agreements dating back to the Latin American Free Trade Association in 1960 and Andean Pact in 1969. Since 2005, trans-Pacific FTAs have gained particular significance, and at least 27 FTAs have been implemented, signed, or proposed; nearly one-third of these have been in partnership with Mexico or Chile. In contrast, while most Asia Pacific countries were initially hesitant to embark on FTAs, large economies such as China, India, Japan, and Korea have now joined regional trade blocs and PTAs. In fact, the number of FTAs in force East Asia has jumped from about three in 2000 to at least 43.

The benefits of regional FTAs and trans-Pacific FTAs are significant. For example, survey results of private firms suggest that nearly all LAC firms used FTA preferences, as do a significant and increasing percentage of Asian firms. Also, trans-Pacific FTAs are comprehensive and rapid in their tariff reduction schedules, where on average nearly three-quarters of tariff lines are eliminated upon entry into force.

While both regions are converging to address overlapping FTAs and "spaghetti bowl" problems of different standards and rules of origin requirements, their different approaches to regionalism offer complementary insights. For example, while about 60 percent of trade in machinery and transport equipment and parts and component exports takes place intra-regionally in Asia Pacific, just 44 percent of intra-regional trade in parts and components takes place in Latin America.[4] Dense production networks that created a "factory Asia" for the rest of the world, together with robust growth of intra-firm and intra-industry trade were key vehicles for fostering high intra-regional trade in Asia. By 2008, the share of intra-regional trade in Asia Pacific reached 42 percent, representing a 10 percent increase since 1990. By contrast, production and trade networks were less dynamic in LAC, where the share of intra-regional trade was about 19 percent in 2008, increasing 8 percent/ since 1990.

The two approaches to regional integration suggest significant benefits in pursuing dynamic effects of integration beyond trade in goods and services. Cooperation in harmonization of norms, strengthening of infrastructure, and resolving different procedures and rules of origin in regional FTAs, is important for strengthening bi-regional trade relations.

[4] United Nations ECLAC (2007).

Evolution of LAC Trade and Investment with Asia

Overview

Trade and investment relations between Latin America and Asia have expanded substantially, notwithstanding the medium-term impact of the 1997 East Asian financial crisis. While the role of Asia as a LAC trade partner is more prominent in imports than in exports, Latin American food exports to Asia have jumped significantly as a share of total exports, reflecting LAC's comparative advantage and very high demand elasticity. By 2008, Asia accounted for about 15 percent of total two-way LAC exports and imports, making Asia Latin America's second largest regional trading partner, after the United States. In fact, the voracious appetite of Asian countries for natural resources has contributed to the exponential growth in LAC exports of ores, metals, and soybeans, which jumped by 700 percent during the period 1990–2008, to about $26 billion.

There are, however, intra-regional variations. While South America's Asia Pacific-bound exports are dominated by raw materials, Mexico and Central America are increasingly exchanging manufactured goods with their Asian partners. The asymmetry between Asia's market share in Latin American trade is mirrored in the diversified Asian exports to LAC. Asian countries are the main suppliers of at least 13 key products—such as toys, games, footwear, electronics, textiles, and automobile parts, which account/ for about 5 percent of total LAC imports. As a result, the share of Latin American imports from Asia skyrocketed from nearly 9 percent in 1990 to 22 percent in 2008.

On the investment side, there is relatively little foreign direct investment (FDI) between the two regions. Although FDI to Latin America increased by 164 percent since 1994, Latin America accounted for a small share of Asian outward FDI flows (about 3 percent). The bulk of Asian outward FDI continues to go to Southeast Asia, North America, and the EU. The lack of intra-industry trade has been a significant factor for the low level of FDI, although some countries, such as Korea, have gradually increased investment in higher value-added products, such as manufacturing, electronics, IT cooperation centers, apparel production, and trading.

Overall, while the investment relationship between both regions has widened beyond Japan, to include Korea, China, Thailand, and Singapore,

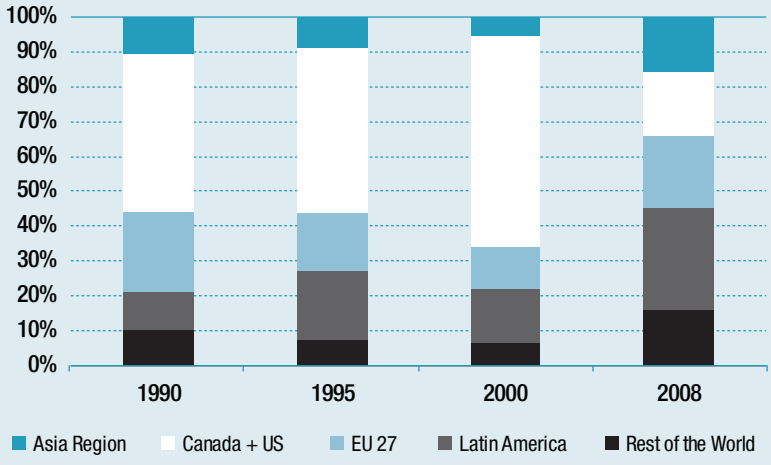
inter-regional FDI remains relatively low. In 2008, inter-regional trade reached about $325 billion, which accounts for just 1 percent of world merchandise flows. Clearly, there are vast opportunities as well as the challenges for deepening bi-regional cooperation in trade and investment.

Dynamics of Latin American Trade with Asia

Trade Flows

Latin American trade with Asia has evolved through a process of market diversification. For a long period, Japan had been the leading destination for Latin American exports. However, between 1980 and 1990, Japan's share of LAC exports declined from about 80 percent to 53 percent. Meanwhile, by 1995, Korea increased its share of LAC exports to 12 percent. Even more, in 2002, China overtook Japan as the most important Asian destination, and by 2008 that country received over 7 percent of all LAC exports to Asia.

FIGURE 1.1/
Geographical Distribution of Latin American Exports



Following the 1980s debt crisis, imports from Asia met the growing domestic demand and liberalization in Latin American economies. Since 1990, Asia has become an increasingly important trading partner for LAC despite the latter's low share in total Asia-Pacific exports and imports. Imports from Asia overtook the United States, reaching about $204 billion as imports from the European Union declined.

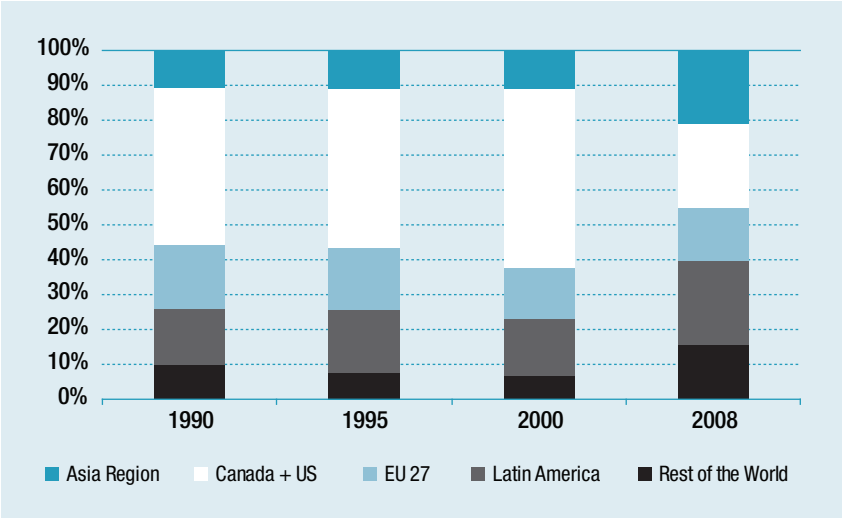


FIGURE 1.2/
Geographical Distribution of Latin American Imports

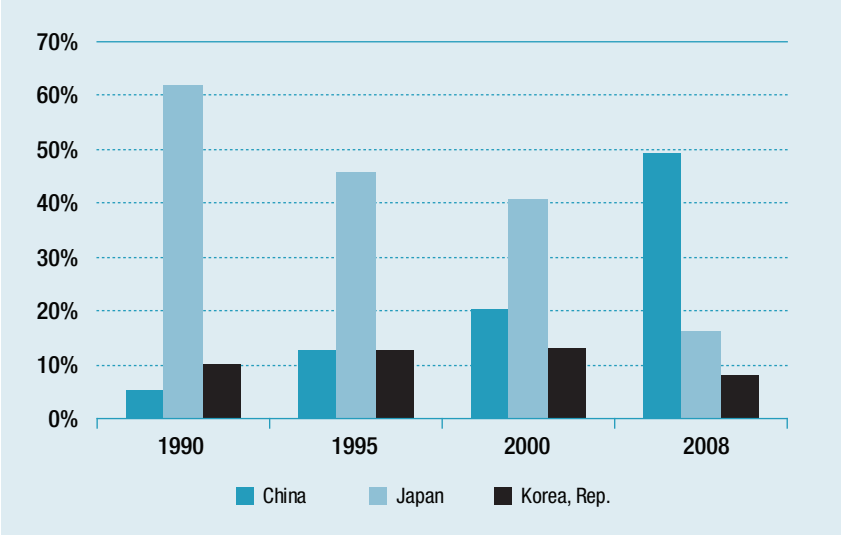
While Latin America's trade in most regions has increased over the past decade, its trade with Asia has been particularly vibrant. The importance of Asia-Pacific as an export destination differs significantly among LAC subregions and countries. For example, Asia became a significant MERCOSUR export market in the early 1990s (about 130 percent of total exports), reaching 17 percent in 2008. Central America's exports have been relatively stagnant but increased significantly to China, Korea, and ASEAN. While the relative importance of Asia has declined in Mexico (from nearly 7 percent of total Mexican exports in 1990 to less than 3 percent in 2008), Peru and Brazil both rely heavily on exports to Asia. The region accounted for a growing share of Peru's exports (20 percent in 2008) and Brazilian exports (18 percent in 2008).

The relatively low level and moderate growth of trade flows between the two regions can be explained through two interrelated problems: country concentration and product composition. Just two LAC countries account for the bulk (81 percent) of exports to Asia: Brazil (62 percent) and Argentina (19 percent/). In terms of imports, Brazil and Argentina account for over 75 percent of imports from Asia.

Product Composition of Trade

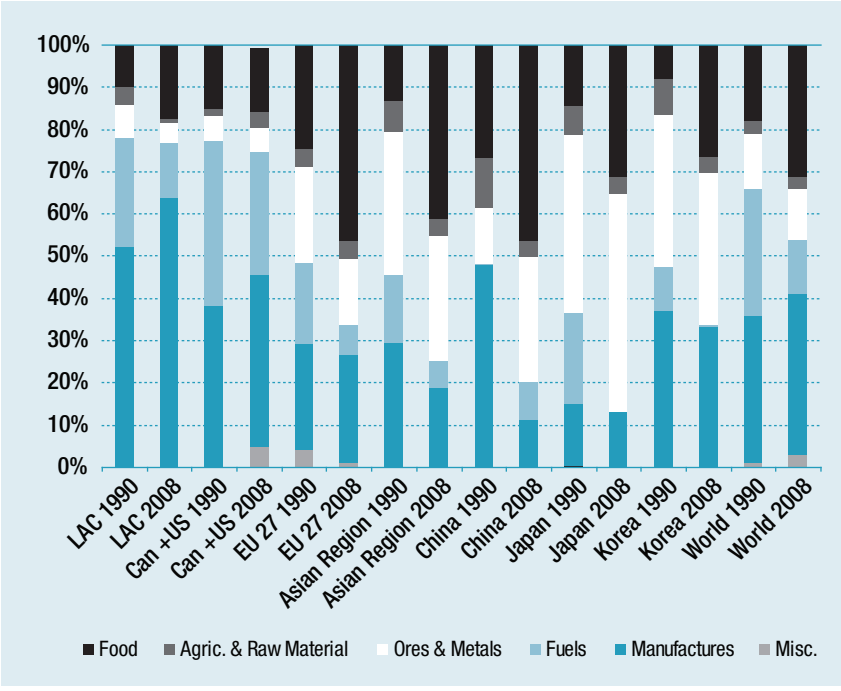
Just as LAC exports to Asia are highly concentrated in a few countries, the product composition of LAC exports show a similar lack of diversity. Food products account for a growing share of total exports (41 percent), followed

FIGURE 1.3/ Share of Total Latin American Exports to Asia by Destination



by the predominance of primary and semi-manufactured products. Food, minerals, and metals—such as copper, iron, and zinc,—wood, and soybeans, comprise more about 80 percent of total LAC exports to Asia.

FIGURE 1.4/ Latin American Export Structure 1990–2008 by Destination and Commodity Group



By contrast, LAC imports from Asia are more diversified, ranging from toys, footwear, apparel, and manufactured goods. However, LAC's trade with Asia shows the same limitations that the region has in international trade in general: Exports are mostly concentrated in primary and semi-manufactured goods. LAC needs to increase the processing of natural resource-based export products and seek new outlets for more value-added differentiated products.[5]

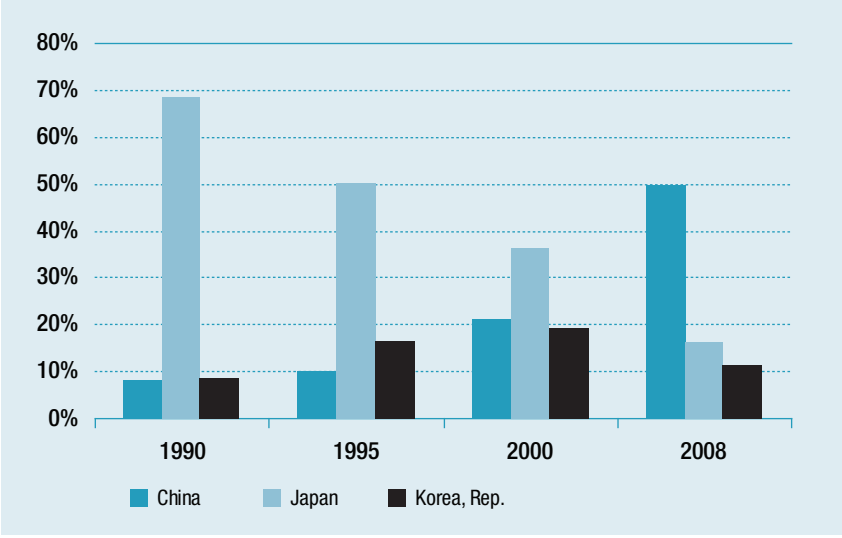


FIGURE 1.5/ Share of Total Latin American Imports from Asia, by Origin

Trends in LAC-Asia Investment Flows

In Asia, investment flows are considered to be the essence of the Asian "flying geese" model for regional integration.[6] Asian countries provided several incentives to attract FDI: liberalization of external trade, usually on a unilateral basis; liberalization of capital flows, especially FDI; improvement of conditions for greater participation of private firms through privatization, concessions and build-operate-transfer; deregulation and structural reforms; and export promotion policies and export processing zones.

While pursuing similar measures as Asia, LAC economies did not follow the flying geese pattern. Instead, Latin America launched new processes of regional and subregional integration through various regional trade agreements (RTAs), such as NAFTA, Mercosur, the Andean Community, CACM, and CARICOM. Also, new Latin American multinational corporations) were

[5] Kuwayama (2001)

[6] The "flying geese" analogy refers to the well coordinated V-formation of migrating geese. In Asia, this phenomenon of regional integration is based on the assumption that trade patterns created by FDI flows tend to develop simultaneously and sequentially, according to inter-industry specialization with each country reaching a higher level by continuously improving its productivity and competitiveness. Japan leads, followed by the four Asian newly industrialized economies, and then the new NIEs and China. By contrast, the dynamic market-led intraregional trade, FDI, and flying geese pattern were not observed in Latin America, where interindustrial trade is higher in subregional groups (e.g. automobile industries of Brazil and Argentina in the case of Mercosur). See United Nations ESCAP (2000).

competitive in industrial commodities and some financial sectors, but not in manufacturing, where the most dynamic Asian trade and FDI integration took place.

In the 1990s, however, Latin America's rapid privatization of state-owned enterprises attracted FDI in such key sectors as electricity, telecommunication, public services, banking and transportation. FDI related directly to privatization corresponded to about 38 percent of total FDI inflows to LAC in 1991.[7] When Latin American economies opened traditionally protected sectors, they attracted significant foreign capital from North American and European investors. In contrast, Asia remained rather closed to FDI inflows, especially in services sectors, until after the Asian financial crisis.

Asian Investment in Latin America

FDI flows between Asia and Latin America are rather incipient. Asian firms hardly participated in LAC's privatization processes, and Asian FDI to Latin America still represents only a small share of Latin America's total FDI. In 2003–2006, the period for which detailed bi-regional figures are available, they composed only 3 percent of total Latin American FDI flows, slightly below the 4 percent in 1998–2002. The European Union and North America continue to be the main sources of FDI for Latin America, together comprising 75 percent of all FDI flows to the region.

Asia-Pacific FDI in Latin America is in part driven by growing Asian demand for natural resources. Some examples include Australian mining corporation BHP Billiton's investment in Chile's copper mining sector, Japanese industrial conglomerate Mitsui's investment in Brazil's ethanol production operations, and investments by Chinese energy company CNPC in the exploration and development of Venezuela's oil capabilities. But Asian manufacturers are also seeking to use Latin America as a production and exporting platform to the regional and North American market. In particular, Mexico's manufacturing sector continues to attract Japanese and Korean automakers.

Japan is among the leading sources of Asian FDI in Latin America. Except for a brief pause during the debt crisis in the 1980s, the share of Japanese FDI to Latin America has increased by 357 percent since 1996, reaching $55 billion in 2008. Compared with its Asian trading partners, Japan has adopted a different investment strategy that has allowed it to build strategic alliances with LAC partners since the 1960s. While participating in the mining sector, Japanese investors developed alliances to participate in Latin Ameri-

[7] Hosono (2001)

ca's industrialization in the 1960s and 1970s. Japanese investments were also critical for the development of Brazilian and Venezuelan exports to Asia, including the relocation of aluminum factories.[8]

Most Japanese investment has recently diversified away from natural resources (mining, forestry and fishery projects) to include energy (especially ethanol) and electronics, although the relative importance of Latin America's manufacturing sector in total Japanese FDI has declined. Japanese firms have also participated in energy-related projects in Mexico and Colombia, to name two. In March 2007, a Japan-Brazil ethanol project was announced that will be financed by the Japanese National Development Bank and Mitsui & Co. Ltd will cost an estimated $8 billion. Japanese outward FDI to Latin America has also increased in finance and insurance sectors, comprising the vast majority (71.2 percent) of total outflows to the region in 1998 and reaching $4.6 billion. This high level of investment is concentrated in the tax haven of the Cayman Islands.[9]

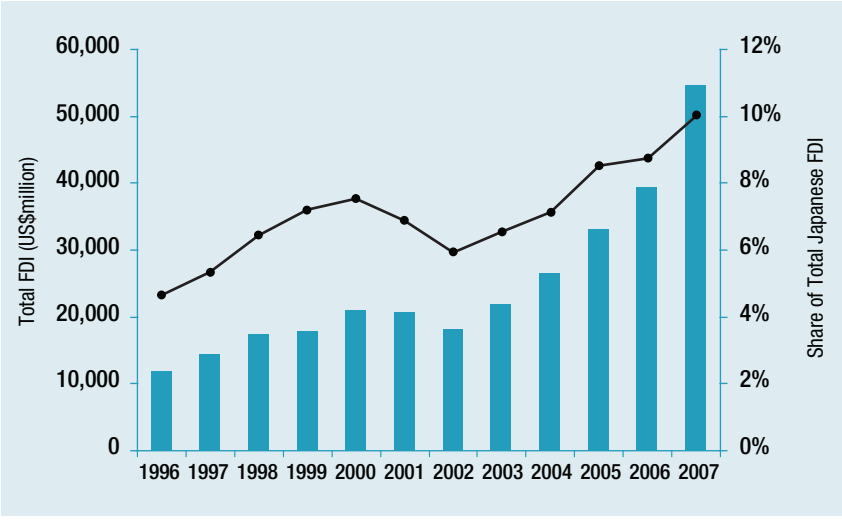


FIGURE 1.6/ Japanese Foreign Investment in Latin America 1996–2007

Like Japan, China also invests heavily in Latin American primary resources, such as iron mining in Peru and Brazil and copper mining in Chile. Though comprehensive data on Chinese FDI in Latin America is not available, China has increased its investments in LAC to satisfy its tremendous needs for raw materials. More than 200 Chinese firms are reported to have invested more than $14 billion in more than 20 LAC countries. Some recent

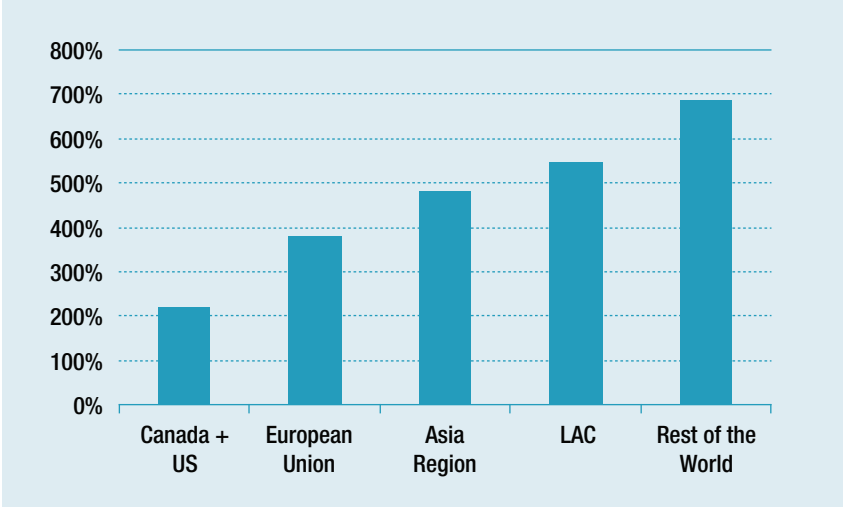
[8] Pizaro (2001).

[9] JETRO (2000).

and notable examples include Chinese mining giant's MIMETAL's $2 billion joint venture with Chilean mining company CODELCO in 2006; acquisition of Hierro Peru by China's Shougang Company for $122 million in 1992 (accounting for about 2 percent of FDI inflows to Peru that year); and Chinese state-owned oil companies providing $10 billion in financing for Petrobras.

Investment relations between Latin America and Korea have been particularly dynamic and Korea has been the most prominent runner-up to Japan in consolidating economic relations between the two economies since the 1990s. Unlike Japan and China, whose investments are predominantly focused on natural resource development, Korea has made substantial investment in apparel and higher value-added manufacturing and electronics. By 1998, more than half of Korean FDI in Latin America was concentrated in the manufacturing sector. Korean FDI in the apparel industry in Central American economies was also significant, totaling about $120 million annually in Guatemala, where it represented about 5 percent of total exports. While Korean investors were initially focused on a cost-driven corporate strategy that used Latin America as a platform to target the North American market, they gradually shifted to tapping the growing domestic market potential of Latin America's large middle income class. Over the following decade, Korean FDI in South America, and especially Brazil, witnessed an unprecedented increase by more than 600 percent since 1995, to $134 billion in 2008.

FIGURE 1.7/ Growth of South Korean FDI 1996–2008 by Destination Region



Latin American Outward FDI to Asia

Latin American investment in Asia is rising, albeit from a relatively low base. Chile has developed strong investment ties to Asia, as evidenced by the robust growth in Chilean FDI outflows to Asia (increased by 617 percent since 1990). But these levels remain low, accounting for just 5.3 percent of total outflows in 2008 (about $42 million).[10] Agro-industry is one subsector where Latin American companies are strongly competitive in regional and world markets. Processed foods have similar characteristics to other industrial commodities, and several Latin American beer companies such as AmBev have made inroads in intra-industry investments, increasing their exports to the United States and Japan. One of the largest beverage companies in Brazil also started bottling and marketing Guarana in Shanghai, China. There has also been a significant expansion of exports of LAC coffee and wine to Asia.

LAC infrastructure investment in Asia is also on the rise. For example, Brazilian firms, such as Alstom Energia, Voith Siemens and GEC Alsthom, have signed contracts worth over $220 million and established offices in China to participate in dam construction projects. A Mexican construction company has indicated it would participate in a dam construction project in Malaysia. Brazilian aircraft manufacturer Embraer produced its first airplane outside Brazil, in China, in 2003, and signed a $2.7 billion contract with that country's Hainan Airlines.[11]

[10] See Government of Chile, Foreign Investment Statistics, available at: http://www.cinver.cl/english/estadisticas/estadisticas.asp

[11] The global financial crisis has led the plant in Harbin, China, to lose contracts and fail to attract new clients. As a result, without new orders, Embraer is considering closing its Chinese plant in mid-2010. See AE Brazil Newswire, "Brazil Jet Maker Embraer Considers Closing Plant in China," July 6, 2009.

Toward Trans-Pacific Ties: Bi-Regional Integration and Cooperation

Regionalism in LAC and Asia

Both LAC and Asia have a long history of regional integration schemes. An early wave of import substitution-inspired integration initiatives in the Americas included the Central American Common Market (CACM), the Andean Pact (later renamed the Andean Community of Nations), and the Latin American Free Trade Association (LAFTA), which later became the Latin American Integration Association (LAIA)[12]. In Asia the Association of South East Asian Nations (ASEAN) dates from approximately the same time and involved similarly thin levels of trade liberalization and integration.

Beginning in the early 1990s, the Americas experienced a surge in regionalism with the creation of NAFTA and MERCOSUR and the reinvigoration and deepening of both CACM and the Andean Community. This was followed, especially by Mexico and Chile, with a rapid expansion of FTAs within the region.

In contrast, in Asia, this surge was not seen until the aftermath of the financial crisis, starting early in the new millennium. However, integration processes were extremely rapid and several in number. Whereas in December 2000 there were only three FTAs in force in East Asia and one under negotiation, by late 2008 there were 43 in force and over 60 at some stage of discussion.[13]

These different experiences can and should serve as comparative laboratories for policy design. The slightly longer history of "new" regionalism in the Americas can provide insights for Asia as agreements within the Western Hemisphere mature and face new issues. Meanwhile, the Asian experience can also provide valuable insights for the Americas regarding the promotion and development of integrated transnational supply chains.

The growing importance of trans-Pacific FTAs

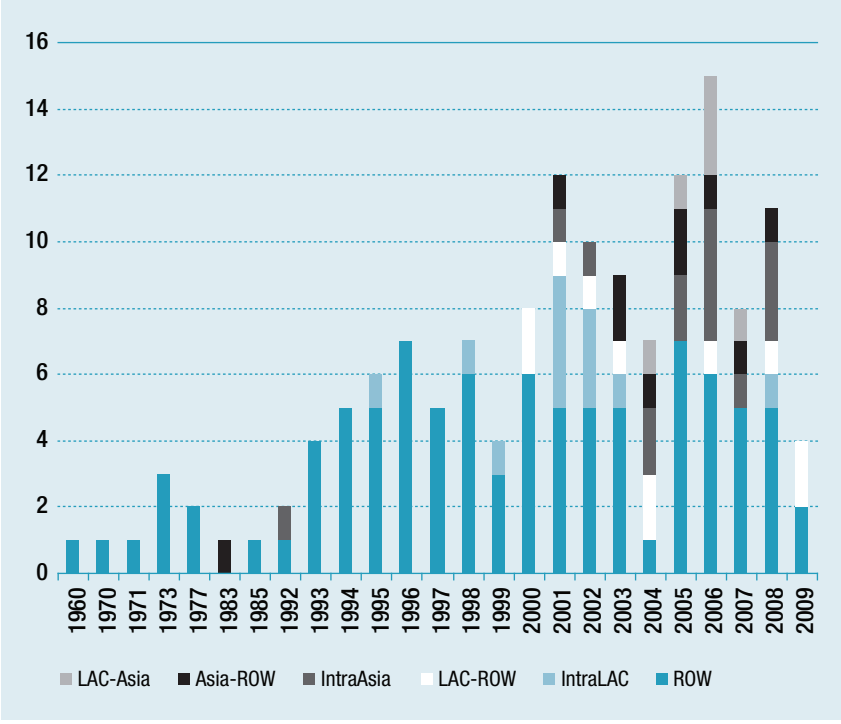
In addition to the value of lessons to be shared from the experiences of each region separately, a fast-developing set of trans-Pacific preferential trade agreements have been signed, and more are under negotiation. For example, Chile has signed agreements with Korea, Japan, China, and Singapore (plus Brunei and New Zealand). Mexico has an agreement in place with Japan,

[12] See Devlin and Estevadeordal (2001)

[13] Kawai and Wignaraja (2009b)

and Peru has agreements with Singapore, Thailand, and now China. Additionally, negotiations are under way between Chile and India; Peru and Korea; and Costa Rica and Singapore. To date, an estimated 27 trans-Pacific PTAs have been signed, proposed, or implemented. Over 70 percent of trans-Pacific PTA activity happened at a rapid clip post-2005 (see appendix 1). Figure 1.8 illustrates the rapid growth of integration in and between LAC and Asia. LAC and/or Asian countries belong to over on third of all agreements notified to the WTO.

FIGURE 1.8/
New RTAs Notified to the WTO around the World, 1960-2008



Source: IDB calculations based on WTO data.

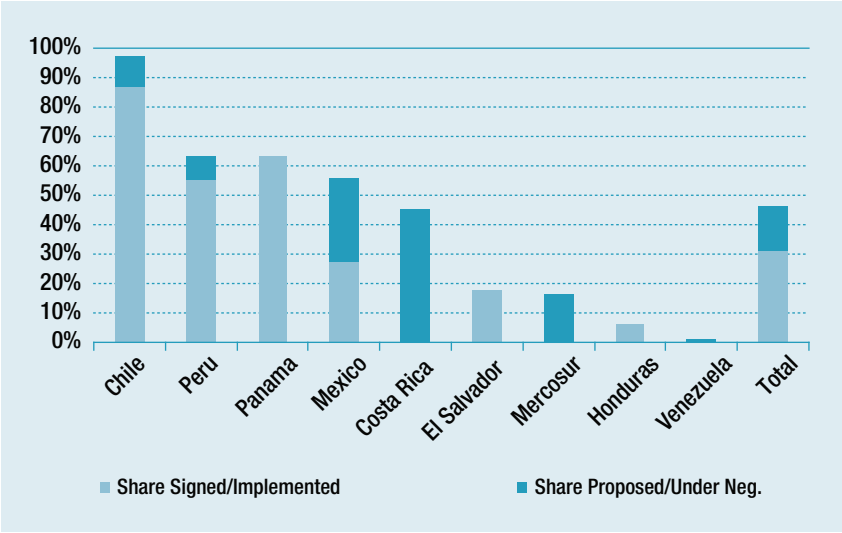
As can be seen in the figure, which is based solely on official notifications to the WTO, LAC and Asia are playing a very large part in the formation of new RTAs, especially since the year 2000. While these data are not the most complete representation of facts on the ground, the global picture is clear: The two regions account for most of the new preferential trading schemes. This means that these are the most active laboratories for the design and implementation of such agreements and the development of best practices in this respect.

TABLE 1.1/
Trans-Pacific PTAs: Implemented, Negotiated and Proposed

LAC Partner or Regional Grouping	Asian Partner or Regional Grouping	Type of FTA	Status
Chile	India	Bilateral	Under Negotiations
Chile	China	Bilateral	Implemented
Chile	Japan	Bilateral	Implemented
Chile	Korea	Bilateral	Implemented
Chile	P4: New Zealand, Singapore and Brunei	Regional	Implemented
Chile	Malaysia	Bilateral	Under Negotiations
Chile	Vietnam	Bilateral	Proposed
Chile	Thailand	Bilateral	Proposed
Costa Rica	Singapore	Bilateral	Under Negotiations
Costa Rica	China	Bilateral	Under Negotiations
El Salvador, Honduras	Taipei, China	Regional	Implemented
Mercosur	India	Regional	Negotiated but not implemented
Mercosur	Korea	Regional	Proposed
Mercosur	Thailand	Regional	Proposed
Mexico	India	Bilateral	Proposed
Mexico	Japan	Bilateral	Implemented
Mexico	Korea	Bilateral	Under Negotiations
Mexico	New Zealand	Bilateral	Proposed
Panama	Singapore	Bilateral	Implemented
Panama	Taipei, China	Bilateral	Implemented
Peru	China	Bilateral	Signed but not yet implemented
Peru	Korea	Bilateral	Under Negotiations
Peru	Singapore	Bilateral	Signed but not yet implemented
Peru	Thailand	Bilateral	Signed but not yet implemented
Venezuela	India	Bilateral	Proposed
GRAND TOTAL Trans-Pacific PTAs			25
Subtotal Implemented PTAs			7
Subtotal Under Negotiations PTAs			8
Subtotal Signed but not Implemented			3
Subtotal Proposed PTAs			7

Sources: WTO (2009), Asian Development Bank ARIC (2009), and Organization of American States SICE (2009).

FIGURE 1.9/
Percentage of Exports to Asia under RTAs Implemented/Signed and Under Negotiation/ Proposed (Select Countries, based on 2007 data)



Source: IDB calculations based on COMTRADE data.

As regards the importance of these agreements, and their potential impact on trans-Pacific trade, Figure 1.9 shows that four countries of the Americas send over half of their exports to Asian countries with which they have a FTA or where an FTA is proposed. For LAC exports as a whole to Asia, this figure is nearly 50 percent. These agreements are already important, and there is still much room for growth.

The IDB has studied these and other agreements in detail, in particular the tariff elimination schedules (figure 1.10).[14] The trans-Pacific agreements stand out as being quite comprehensive and quite rapid in their tariff reduction schedules: On average, they eliminate tariffs on nearly three quarters of tariff lines upon entry into force, achieve liberalization of over 90 percent. of lines by year 10, and eventually free trade on over 97 percent/ of tariff lines.

This pattern is similar when the data are broken down into agriculture and industry. For industrial goods, trans-Pacific agreements are faster than intra-Americas accords, and equally as comprehensive (Figure 1.11). In agricultural goods, trans-Pacific agreements are less encompassing than their intra-Americas equivalents, but far more liberalizing than their trans-Atlantic counterparts. After the tenth year of implementation, essentially all industrial tariff lines, and over 80 percent of agricultural lines are fully liberalized. Additional market access is provided for agricultural tariff lines through tariff rate quotas (TRQs).

As a reflection of the regional integration processes, both LAC and Asia have seen a sharp rise in intra-regional trade, in particular. In Latin

[14] See, for example, Estevadeordal et.al. 2009.

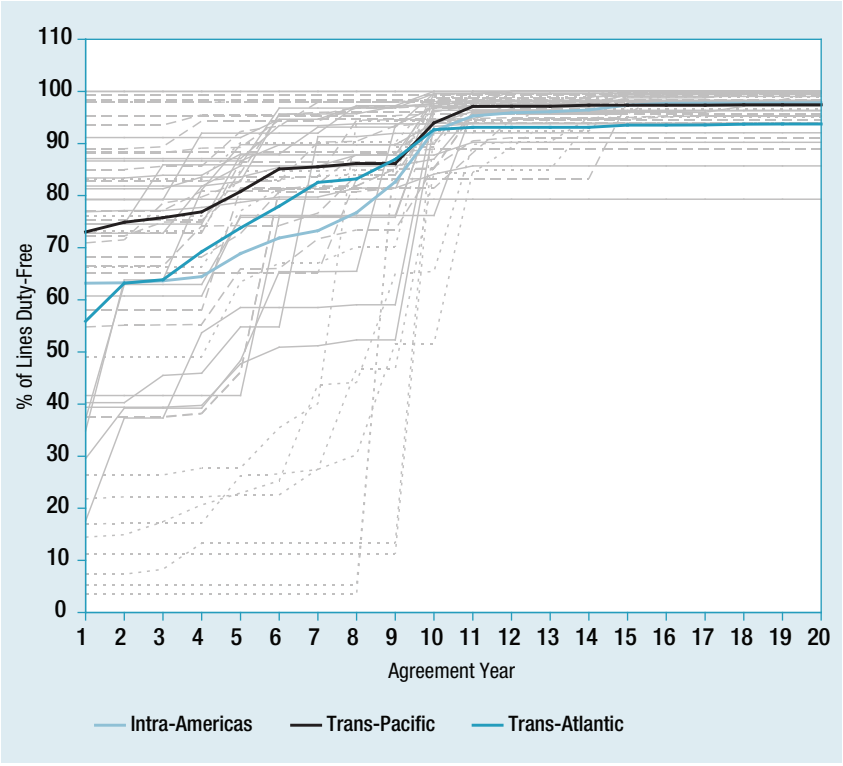


FIGURE 1.10/
Evolution of Duty-Free Treatment in Selected FTAs

Source: IDB calculations.

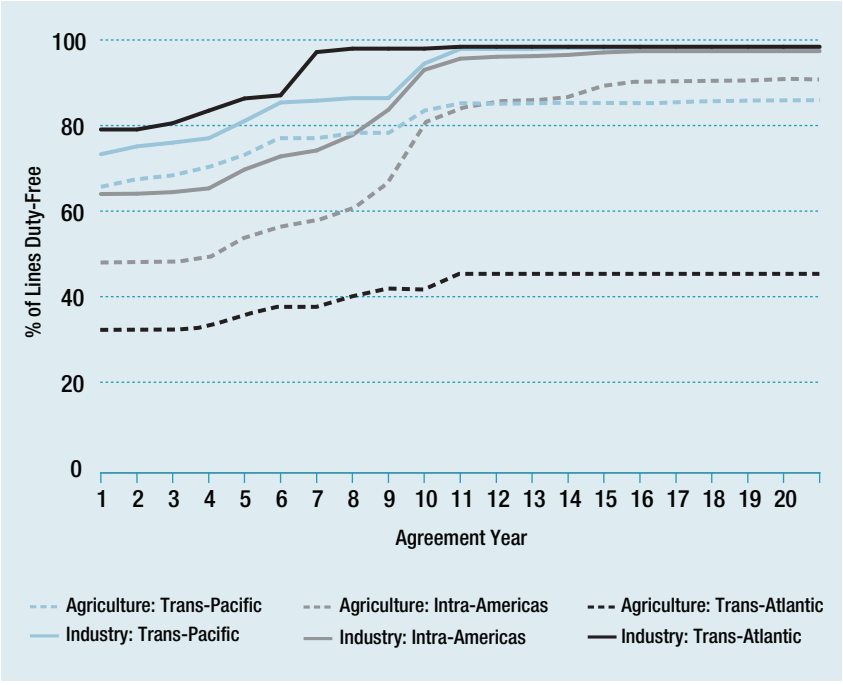


FIGURE 1.11/
Evolution of Sectoral Duty-Free Treatment in Selected FTAs

Source: IDB calculations.

America, the ratio of intra-regional exports increased by 8 percent to reach 19 percent in 2008. The intra-Asian trade ratio grew by 10 percent to 42 percent. Although the robust growth of intra-firm and intra-industry trade helped boost the expansion of intra-Asian trade, LAC subregional intra-regional trade ratios have recently surpassed Asia. For example, during 2008, intra-regional trade among Mercosur countries amounted to 25 percent and CACM reached 28 percent, which exceeded ASEAN's ratio of 23 percent (Table 1.2).

The current agendas in both regions point to a desire to reduce the complexities of the overlapping system of FTAs. The 11 so-called Arco del Pacifico countries of the west coast of Latin America are exploring ways to better integrate the dozen agreements among them. The Mesoamerica Project countries, from Mexico to Colombia, are a subset of the above, and include regional infrastructure issues in discussions on trade reform. The US and Canada are also participating in the "Pathways to Prosperity in the Americas" initiative, which aims at building synergies among the agree-

TABLE 1.2/
Intra-regional Trade (share of exports), 2008
changes from 1990 in italics; shaded cells are intra-regional trade flows

Exporting Region	LAC	Mercosur	Nafta	Caricom	Direction CACM	US & Canada	EU	Asia	ASEAN
LAC	19%	12%	47%	1%	2%	47%	14%	10%	2%
	8%	*5%*	*1%*	*0%*	*1%*	*2%*	*–9%*	*–1%*	*0%*
Mercosur	36%	25%	24%	2%	1%	–13%	22%	17%	4%
	23%	*15%*	*–3%*	*2%*	*0%*	*13%*	*–11%*	*1%*	*1%*
Nafta	15%	5%	49%	1%	1%	42%	16%	16%	4%
	5%	*3%*	*8%*	*0%*	*1%*	*6%*	*–6%*	*–4%*	*0%*
Caricom	20%	2%	47%	17%	2%	44%	16%	3%	0%
	20%	*2%*	*–39%*	*17%*	*2%*	*–41%*	*4%*	*1%*	*–5%*
CACM	38%	2%	41%	1%	28%	37%	13%	8%	1%
	7%	*1%*	*–8%*	*0%*	*3%*	*–9%*	*–4%*	*6%*	*1%*
US & Canada	16%	5%	43%	1%	1%	35%	18%	18%	4%
	6%	*2%*	*3%*	*0%*	*1%*	*0%*	*–4%*	*–3%*	*0%*
EU	2%	1%	8%	0%	0%	8%	64%	7%	2%
	1%	*0%*	*0%*	*0%*	*0%*	*0%*	*–3%*	*1%*	*0%*
Asia	4%	2%	17%	0%	1%	16%	18%	42%	13%
	2%	*1%*	*–13%*	*0%*	*0%*	*–13%*	*–1%*	*10%*	*0%*
ASEAN	3%	1%	12%		1%	12%	13%	56%	23%
	2%	*1%*	*–8%*		*1%*	*–8%*	*–4%*	*7%*	*3%*

Source: UN Comtrade (2009)

ments among the Arco countries and these North American partners as well as building technical capacity for small businesses, investments in clean energy, and development.

In Asia, the conclusion of the ASEAN-Japan Closer Economic Partnership (AJCEP), which coexists with three bilateral Japanese FTAs—with ASEAN members Malaysia, Philippines, and Thailand—provides a comprehensive framework for fragmentation of production processes across these countries, moving past the limitations that had been encountered under the more piecemeal approach of bilateral FTAs. The China-ASEAN and Korea-ASEAN agreements have similar functions. Discussions of ASEAN+3 and ASEAN+6 possibilities are still more hypothetical, but they point in the same direction: convergence of many bilateral agreements can provide benefits that exceed the sum of the individual agreements, especially if product coverage can embrace the sum of the existing agreements and not just the least common denominator.

Strengthening LAC-Asia ties is all the more relevant during the ongoing recovery from the global economic crisis. By deepening regional ties, LAC and Asia can weather the financial crisis and diversify their export partners. Besides stoking trade and investment flows, FTAs help nourish the long-term development of cooperative relations with partner nations. This is precisely what has happened in the trans-Pacific arena. The bi-regional relationship has matured and broadened from FTAs to political cooperation and exchange of ideas through a network of think tanks and educational hubs. Today, IDB non-regional members include Japan, Korea, and China. Fifteen of the largest Asian economies are also members of the Forum for Latin America-East Asia Cooperation (FEALAC), established in 2001 as the most comprehensive bi-regional forum composed of 32 Latin American and East Asian nations.

Conclusion: Toward Closer Inter-Regional Economic Integration

Bi-regional economic relations between Latin America and Asia-Pacific have shown growing dynamism in recent years. Trans-Pacific trade flows continue to be driven by Asian demand for Latin American exports of natural resources. FDI to Latin America from Asia-Pacific, primarily from Japan and China, is concentrated in the mining and energy sectors. Korean FDI has increasingly flowed to Latin America's manufacturing sectors.

However, there is also a trend toward some diversification in bi-regional trade, and even an incipient increase in bi-regional intra-industry trade. Furthermore, while Asian firms have long used Latin American markets as launching pads to the North American markets in such sectors as automobile, telephone, and machinery, today they are forging partnerships and joint ventures with Latin American companies and tapping into local supply chains in Latin American host nations. And the bi-regional investment ties are increasingly two-way, with major Latin American companies setting up production and services facilities in Asia-Pacific.

There are several conscious efforts fueling these positive trends, such as bi-regional trade agreements, export promotion activities, business matchmaking efforts, and general cooperation between the two regions. However, more work lies ahead for truly harnessing the potential for trans-Pacific integration. The numerous trade agreements need to be complemented by common efforts to foster productive business links and strategic alliances that facilitate trade and investment promotion. In addition to building a joint agenda for technical cooperation on trade and investment facilitation, both regions should focus on removing bottlenecks in transport infrastructure.

One step towards facilitating integration between the two regions is by working with existing ASEAN programs to implement transport facilitation, trade, investment, harmonization of customs procedures, and SPS control. The Trade Facilitation Action Plan (TFAP) of the Asia-Europe Meeting (ASEM) process could also provide an example for how to address trade issues between Asia and Latin America. For example, a TFAP could follow the ASEM model by including concrete goals in key areas such as customs procedures, testing, certification and accreditation; public procurement; quarantine and SPS procedures; intellectual property rights; and labor mobility.

Finally, food security presents an opportunity to promote economic integration between the two regions. Some areas for technical cooperation include measures related to food security and handling, agro-industrial technologies used in downstream processing of higher value-added products, and training of SPS certification. Mutual interests are readily apparent given the high population density in Asian economies, voracious domestic demand for agricultural products to meet the demands of rising middle income households, and Latin America's vast agricultural land resources. Economic integration in the food sector would facilitate transition from basic grains and commodities to higher value-added trade.

The case for deepening and broadening bilateral economic ties is all the more compelling now in light of the global economic downturn, which is rattling economies on both sides of the Pacific. Economic growth in both LAC and Asia is driven in good part by these regions' hard-won integration in the global economy. The best antidote against the global turbulence is for both regions to step up their regional and global trade and investment liberalization and integration and cooperation. The trans-Pacific arena provides both regions with perhaps more untapped opportunities than any other realm for integration and safeguarding growth and prosperity in the months and years ahead.

Trans-Pacific Trade, Integration, and Development: The Perspective from Asia

By the Asian Development Bank[15]

[15] This chapter was prepared by Masahiro Kawai (Dean, Asian Development Bank Institute) and Ganeshan Wignaraja (Principal Economist, Office of Regional Economic Integration, Asian Development Bank).

Introduction

Overview

The onset of the global economic crisis has fueled renewed interest in the links between the processes of global and regional economic integration in the developing world, and particularly Latin American and the Caribbean (hereafter, "Latin America"). A sharp contraction in manufacturing capacity in many developing countries following a fall in external demand along with the related risk of protectionism have fashioned at least three alternative economic paths: First, the exclusive pursuit of global economic integration as the means to continue the unprecedented economic prosperity it generated in the postwar period; second, carrying out both processes goes hand in hand, since harnessing regional markets can help to sustain economic prosperity in turbulent global economic times; and third, de-linking from the world economy and promoting inward-orientation to protect declining manufacturing sectors. These multiple alternatives present policy makers with stark choices on economic integration's way forward, globally or regionally.

This chapter analyses East Asia's integration experience and offers policy lessons for Latin America economies. East Asia provides a fascinating case of sequenced economic integration, with a strong initial focus on global integration since the 1960s followed by more recent emphasis on regional integration. The merit of sequenced integration is borne out by the results. For instance, the region has the world's largest number of newly industrializing economies (NIEs) and has thus far maintained positive growth during the global economic crisis, albeit at a reduced rate.

East Asia's spectacular rise since the 1960s to become the world's factory through outward-oriented development strategies is well known in the literature on trade and development (see Wade, 1990; Stiglitz, 1996; Amsdem 2001; Lall, 2001; and Baldwin, 2006) Less known perhaps is that since the late-1990s, a shift has occurred in East Asia's outward-oriented development strategies in which the region's economies emphasized regional integration alongside global integration. Global production networks and supply chains have become increasingly regionalized in East Asia. Formal economic integration through the spread of free trade agreements (FTAs) and regional organizations has followed suit.

The chapter undertakes three inter-related tasks. First, it provides an overview of global and regional integration processes in East Asia, focusing on the emergence of the global factory, the spread of FTAs, and the evolving regional institutional framework. Second, it charts some spillovers from these processes for Latin American economies in terms of increasing economic trade between East Asia and Latin America and assesses the impact of East Asian regionalism on Latin American economies using the results of a recent computable general equilibrium model exercise. Third, it draws on East Asia's integration experience with global and regional integration, offering policy lessons for Latin America. The remainder of the paper is arranged according to these three subject areas, with a concluding section.

An Overview of East Asia's Global and Regional Integration

Emergence of the Global Factory

The story of East Asia's spectacular rise over 50 years or so from a poor underdeveloped agricultural backwater to become the global factory it is today is regarded as an economic miracle (Stiglitz, 1996). Particularly remarkable is the emergence of multiple NIEs within a relatively short historic time span. The Republic of Korea (hereafter, "Korea") and Taipei, China were the earliest NIEs in the 1960s and 1970s, while the giant People's Republic of China (PRC) and Vietnamare more recent NIEs.

In the 1960s, developing Asian economies lacked natural resources and had high levels of poverty. There seemed little prospect of economic advancement. Nonetheless, East Asian economies had ample supplies of cheap, productive manpower. They were also geographically close to expanding high-income Japan, whose efficient multinational corporations (MNCs) were seeking to relocate production to cheaper locations in East Asia. Multilateralism—through the World Trade Organization (WTO) framework and its predecessor, the General Agreement on Trade and Tariffs (GATT), and open regionalism centered on Asia-Pacific Economic Cooperation (APEC)—underpinned Asia's approach to international trade policy for several decades. FTAs were absent internationally and in Asia.

International trade policy at the national level was centered on outward-oriented development strategies, high domestic savings rates, creation of world class infrastructure, and investment in human capital and strong public-private sector partnerships. Outward-oriented growth in Asia was fueled by a booming world economy hungry for labor-intensive imports, falling tariffs in developed country markets, inflows of trade related foreign direct investment (FDI), and generous foreign aid flows.

A long period of market-driven expansion of trade and FDI followed during which East Asia increasingly became the global factory. Table 2.1 shows shares of world exports for various groupings in the world during the years 1980–2008 and charts East Asia's rise in world trade. East Asia's share of world exports nearly doubled from 14 percent to 27 percent between 1980 and 2008, driven particularly by Northeast Asian economies. By comparison, North America Free Trade Agreement's (NAFTA) exports fell

from 17 percent to 13 percent between 1980 and 2008 while MERCOSUR's exports somewhat stagnated at around 3 percent. FDI inflows into East Asia (including Japan) rose from 7 percent of the world total in 1980 to 13 percent in 2006, while East Asian FDI outflows increased from 5 percent to 12 percent over the same period.

TABLE 2.1/ World and Intra-Regional Trade Shares of East Asia 1980, 1990, 2000 and 2008

	Share of Total World Exports [a] (%)				Intra-Regional Trade Share[b] (%)			
Region	1980	1990	2000	2008	1980	1990	2000	2008
ASEAN (10)[c]	3.9	4.3	6.7	6.4	17.9	18.8	24.7	27.1
ASEAN+3[d] + Hong Kong+ Taipei,China (15)	14.0	20.6	25.9	26.6	34.6	43.1	50.2	52.5
ASEAN+6 (16)[e]	14.9	18.6	22.6	25.7	34.6	33.7	40.5	43.6
NAFTA (3)	16.6	16.2	19.0	12.7	33.8	37.9	48.8	41.9
MERCOSUR[f]	3.5	2.6	2.6	3.5	15.4	14.6	23.7	20.7
New EU (27)[g]	39.6	41.5	38.0	36.2	53.6	59.7	67.3	65.1

Sources: IMF Direction of Trade Statistics CD-ROM (data as of June 2009). Data for Taipei,China for the period 1989–2007 sourced from the Bureau of Foreign Trade website, and for the period 1980–1988 sourced from the Statistical Yearbook published by the Directorate-General of Budget, Accounting and Statistics.

Notes:

[a] Share of world export is the computed as the value of total exports of the region to the world as share of total world exports.

[b] Intra-regional trade share is computed as $X_{ii} / [(X_{iw} + X_{wi}) / 2]$, where X_{ii} is the value of intraregional exports, X_{iw} is the value of total exports of the region to the world, and X_{wi} is the value of total exports of the world to the region.

[c] ASEAN = Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam.

[d] ASEAN+3 = ASEAN countries, PRC, Japan, and Republic of Korea.

[e] ASEAN+6 = ASEAN+3 countries, Australia, New Zealand, and India.

[f] MERCOSUR =Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay and Venezuela

[g] New EU = Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxemburg, Malta, the Netherlands, Poland, Portugal, Romania, Slovak, Slovenia, Spain, Sweden, United Kingdom.

Through strategies of innovation and learning, East Asian firms acquired the technological capabilities needed to compete internationally or become suppliers to MNCs (Hobday, 1995; Lall, 2001; Kimura, 2006; Wignaraja, 2008). They developed production engineering skills they needed to efficiently use imported technologies and successfully pluginto advanced global production networks formed by MNCs and local suppliers. Over time, as systematic innovation and learning took place at the firm-level, a shift from labor-intensive exports (e.g. textiles, garments and footwear) to

more technology-intensive exports (e.g. chemicals, ship building, electronics and automotives) occurred in Asia. Some Asian firms also created deep innovative capabilities based on investments in research and development, often emerging as leading actors in production networks and supply chains (Hiratsuka, 2006 ed). Rising economic prosperity in East Asia followed in the wake of rapid export-led industrialization. Three of the world's richest economies are now in East Asia—Japan, Singapore, and Korea. With varying outcomes, aspects of East Asian-style outward-oriented development strategies were adopted elsewhere in the developing world.

Furthermore, intra-regional concentration of trade and FDI activities rose as production networks involving Asian firms deepened regionally (ADB, 2008). Rising factor costs in core production locations were a prime impetus. Falling regional trade barriers and logistics costs as well as technological progress spurred decentralization and dispersed production networks into the most cost-effective locations. Accordingly, intra-regional trade shares in Asia have increased significantly, particularly in parts and components.

Table 2.1 also summarizes changes in the share of intra-regional trade for various groupings in the world during 1980–2008. It shows that intra-regional trade as a share of East Asia's total trade rose from 35% in 1980 to 53% in 2008 (including Japan) or from 23% to 44% (excluding Japan). The intra-regional trade share within East Asia remains below that of the European Union (EU) (which peaked at 67% in 2000), but exceeds that of NAFTA (which peaked at 49% in 2000). Towards the turn of the 20th century, this simple story of outward-orientation and export success was punctuated by a change in the nature of Asia's international trade policy towards FTAs.

Spread of FTAs

Alongside multilateralism, East Asia began emphasizing FTAs as trade policy instruments since the late 1990s and is today at the forefront of world FTA activity (Gilbert, Scollay, and Bora, 2004; Fiorentino, Verdeja, and Toqueboeuf, 2007). Table 2.2 shows information on the status of FTAs in East Asia since 1980: (i) FTAs in effect and (ii) future FTAs (those that are signed but not yet in effect, under negotiation and proposed). There was little FTA activity in East Asia until the late 1990s. Thereafter, a burst of FTA activity occurred, the number of FTAs increasing fifteen-fold from only 3 to 47 between 2000 and 2009. The spread of FTAs in East Asia is likely to continue

as another 64 FTAs are in different stages of preparation. Today East Asia is ahead of the Americas in signing FTAs per country—on average Asia has 3 concluded FTAs per country compared with 2.2 for the Americas.[16]

TABLE 2.2/ Growth of East Asian FTAs with Latin America, 1980–2009

	Cumulative number of FTAs					
	East Asian FTAs with Latin America			All East Asian FTAs		
Year	Total	FTAs in Effect	Future FTAs	Total	FTAs in Effect	Future FTAs
1980	0	0	0	1	1	0
1990	0	0	0	1	1	0
2000	2	0	2	7	3	4
2005	17	4	13	67	21	46
2009	24	9	15	111	47	64

Source: ADB FTA Database, Asia Regional Integration Center (www.aric.adb.org)

Notes:
1. Future FTAs include those signed but not yet in effect; FTAs under negotiation or proposed FTAs.
2. Data as of July 2009.

Furthermore, the high degree of extra-regional orientation of East Asian FTAs is also striking; about two-thirds of FTAs are with countries or groups outside East Asia. The extra-regional orientation of future East Asian FTAs is even higher, in which over 80 percent is with countries or groups outside East Asia. Thus, East Asian economies have a strong preference for maintaining open trading relations with the rest of the world rather than looking inward.

Drivers of FTAs

Four main factors underlie recent spread of FTA initiatives in Asia (see Kawai, 2005 and 2007): deepening market-driven economic integration, European and North American economic integration,) the 1997–98 Asian financial crisis, and slow progress in the WTO Doha negotiations.

First and foremost among these is market-driven economic integration through trade and FDI and the formation of East Asian production networks and supply chains. Market-driven economic integration has begun to require further liberalization of trade and FDI and harmonization of policies, rules, and standards governing trade and FDI. East Asia's policymakers

[16] SICE- Foreign Trade Information System (www.sice.oas.org). For a more detailed analysis of East Asian FTAs, see Baldwin (2006) and Kawai and Wignaraja (2008 and 2009a).

are increasingly maintain that FTAs, if given wide scope, can support expanding trade and FDI activities through further elimination of cross-border impediments, facilitation of trade and FDI, and harmonization. Thus, FTAs can be regarded as part of a supporting policy framework for deepening production networks and supply chains formed by global MNCs and emerging Asian firms.

Second, the FTA process in East Asia has been spurred by European and North American economic regionalism, including EU expansion into central Europe, a monetary union in the Euro area, and the success of the North American Free Trade Agreement (NAFTA) and its incipient move to the Free Trade Area of the Americas (FTAA). Governments fear the two giant blocs might dominate rule-setting in the global trading system, marginalizing Asia. Increasingly, they have realized the need for stepping up integration to improve international competitiveness through exploitation of scale economies, strengthen their bargaining power, and have their voice heard in global trade issues. FTAs can help insure against the periodic difficulties of multilateral trade liberalization, such as recent slow progress in the WTO Doha negotiations and a perceived loss of steam in the APEC process.

Third, the 1997–98 Asian financial crisis made it clear that East Asian economies in particular needed to work together in the area of trade and investment in order to sustain growth and stability by addressing common challenges. This need has not yet been fully met by either regional initiatives to strengthen the international economic system, or by national efforts to strengthen fundamentals, both of which take time to bear fruit. Once FTA initiatives began, countries started to join the bandwagon out of fear of exclusion.

Fourth, slow progress in the WTO Doha negotiations encouraged countries to consider FTAs as alternatives. Hailed as an initiative that would promote trade-led growth in poor countries, the WTO Doha Development Round began in November 2001. The talks have largely focused on liberalization in two key areas—agriculture and non-agricultural market access (NAMA). In essence, developed countries were being asked to reduce agricultural tariffs and subsidies, and developing countries to reduce tariffs for industrial goods, faster and further. Seven years of formal negotiations eventually stalled in mid-2008 over concerns in developing countries over safeguard measures to protect poor farmers from rising food and oil prices. But behind the scenes discussions have continued. As prospects of an early deal diminished with time, pro-business East Asian countries emphasized

FTAs for continued liberalization of trade in goods and services as well as the adoption of the Singapore issues, which are beyond the scope of the WTO.

Role of Key Players

Much of the increase in FTA activity can be traced to five of East Asia's richer and larger economies—Singapore, Japan, Korea, PRC, and Thailand—suggesting a link between FTA growth and economic prosperity. For instance, these five economies were party to more than 80 percent of the FTAs in effect in East Asia in early 2009.

Japan implemented bilateral economic partnership agreements (EPAs) with Singapore, Mexico, Malaysia, Chile, Philippines, Thailand, Brunei Darussalam, and Indonesia. In addition, Japan signed FTAs with Vietnam and Switzerland and implemented a comprehensive agreement with ASEAN. It is now negotiating agreements with Korea, India, and Australia. PRC implemented an FTA on goods with ASEAN and is now negotiating agreements on services and investment. Korea has also implemented an FTA with Chile and an FTA on goods with ASEAN and has reached an agreement on an FTA with the US. ASEAN is even more aggressive: While enacting FTAs with PRC and Korea, ASEAN has signed an FTA with Australia-New Zealand, is negotiating with India, and is considering negotiating with the EU. Some ASEAN members, such as Singapore and Thailand, are y pursuing bilateral FTAs. Recently, Australia, New Zealand, and India have got on this bandwagon. The liberalization schedules of East Asian economies indicate that most liberalization measures will be fully implemented by 2020.

PRC has proposed a Northeast Asian trilateral FTA with Japan and Korea, as well as an East Asian Free Trade Agreement (EAFTA) for the ASEAN+3 countries (10 ASEAN members plus PRC, Japan, and Korea). Japan has proposed an even bigger regional EPA for the ASEAN+6 countries (ASEAN+3 plus Australia, New Zealand, and India), and called for a Comprehensive Economic Partnership Agreement (CEPEA). Official feasibility studies have been conducted on these two region-wide FTAs, but no time frame has been proposed for negotiations. The economic effects from alternative East Asian FTA scenarios are assessed in section 3.

For Northeast Asian economies, these FTA initiatives mark a shift away from the long-standing WTO/APEC framework. These countries decided to pursue a trade policy using a three-track approach based on:) global (WTO-based) cum trans-regional (APEC-based), regional (ASEAN+3 or ASEAN+6), and bilateral liberalization. Regional and bilateral liberalization

could achieve deeper integration with trading partners on a formal basis, going beyond reductions in border restrictions to pursue investment liberalization, promote greater competition in the domestic market, and harmonize regulations, standards, and procedures. The challenge is to balance the regional and bilateral approach with the still-important WTO liberalization framework.

With some exceptions, the region's poorer economies (notably, Cambodia, Lao PDR, Vietnam, Philippines, and Indonesia) have tended to rely on ASEAN for concluding FTAs with the region's larger economies. This may reflect weak institutional capacity, resources, and leverage to undertake FTA negotiations in poorer economies. The ASEAN framework offers the possibility of pooling scarce capacity and resources.

Use of FTA Preferences and Rules of Origin (ROOs)

Although FTAs are a relatively new phenomenon in East Asia, East Asian exporting firms tend to utilize FTA preferences more intensively than conventionally thought[17] and may even increase the utilization rate. Some interesting new evidence is provided by surveys conducted by ADB and its partners in Japan, Singapore, Korea, PRC, Thailand and the Philippines (for an overview, see Kawai and Wignaraja, 2009b) on 841 sample firms. Of the 835 responding East Asian firms, 28% use FTA preferences. When plans for using FTA preferences are also factored in, 53% of responding firms use or plan to use FTA preferences, which is double the figure for FTA use. This is encouraging but room for improvement exists in FTA preference use at firm-level.

The survey also found that most firms see more benefits than costs from the agreements. Those benefits include wider market access and preferential tariffs that make it easier to import intermediate materials needed for finished goods. The main impediments for non-use include a lack of information on FTAs, low margins of preference, use of other schemes (such as export processing zones and the Information Technology Agreement) for exporters) and non-tariff measures in partner countries.

Interestingly, multiple country ROOs—which determine where goods originate from for a variety of purposes including quotas and labeling—add some costs but were not a significant hindrance to business activity. Only 20 percent of responding firms claim that multiple rules of origin add to business costs. As the number of FTAs increase, it is possible that multiple ROOs may increasingly become a future problem. Accordingly, several measures are needed to mitigate negative effects, notably encouraging rationalization

[17] Previous studies of ASEAN Free Trade Agreement (AFTA), for instance, suggested that FTA utilization rates were low. Baldwin (2006) reports an overall AFTA utilization rate of under 3% for the late-1990s. He further suggests a small increase of 4% for Malaysia and 11% for Thailand by 2002.

of rules of origin and upgrading ROO administration, simplifying the approach to ROOs in East Asia involving harmonized ROOs, promoting co-equality of ROOs and cumulation of value contents, and adopting international good practices in ROO administration.[18]

Regional Institutional Framework

Several key groupings have developed in Asia over the last two decades, including ASEAN, ASEAN+3, East Asia Summit, APEC, and Asia-Europe Meeting. Each of these is summarized below.

ASEAN

The 40-year-old ASEAN until recently was the main focus of regional economic integration in East Asia. It launched the ASEAN Free Trade Area (AFTA) in January 1992 as its lynchpin of economic integration, aiming for a free trade area within 15 years. AFTA has been in effect among the six original signatories—Brunei Darussalam, Indonesia, Malaysia, Singapore, Thailand, and the Philippines—since January 2002 and has successfully reduced tariffs on almost all products in the Inclusion List (in the Common Effective Preferential Tariff [CEPT] Scheme) to the 0–5 percent range. These six countries are expected to eliminate tariffs altogether by 2010 and the four ASEAN latecomers are expected to do so by 2015.

The ASEAN Framework Agreement on Services (AFAS), signed in 1995, aims to substantially reduce restrictions to trade in services among ASEAN members by progressively improving market access and ensuring equal national treatment and improving the efficiency and competitiveness of ASEAN services suppliers. The ASEAN Investment Area (AIA), adopted in 1998, aims to make ASEAN a competitive and freer investment area through liberalizing investment rules and policies in protected sectors and promoting greater flows of capital, skilled labor, professional expertise, and technology within the region. There has been some progress on AFAS liberalization but only limited progress on AIA.

The ASEAN Economic Community is expected to make ASEAN a single market and production base by 2015 with a free flow of goods, services, and investment; a freer flow of capital; equitable economic development; and reduced poverty and socio-economic disparities. In moving in this direction, it is critical to strengthen the implementation of its existing economic initiatives (AFTA, AFAS, and AIA); accelerate regional integra-

[18] This may include introduction of a "trusted trader program" that would allow successful applicants to self-certify their own certificates of origin, a switch to business associations issuing certificates of origin for a fee, increased use of IT-based systems of ROO administration, and training programs for SMEs.

tion in priority sectors; facilitate movement of business people, skilled labor, and talent; and improve the existing ASEAN Dispute Settlement Mechanism (Hew and Soesastro, 2003; Hew, 2007). In the Singapore Summit in November 2007, the leaders signed the ASEAN Charter to establish the group as a rules-based legal personality, improve the decision-making process, and accelerate economic integration.

ASEAN+3

The leaders of Japan, PRC, and Korea were invited to the informal ASEAN leaders' meeting in December 1997 in the midst of the Asian financial crisis, which de facto initiated the ASEAN+3 process. Many ministerial processes have been created within the ASEAN+3 framework, including processes for foreign affairs; economy and trade; macroeconomics and finance; environment, energy, health, labor, science, and technology; and social welfare. PRC regards ASEAN+3 as a natural grouping for East Asia's trade and investment cooperation and has proposed an EAFTA.

The ASEAN+3 leaders agreed in 2004 that the establishment of an East Asian Community is a long-term objective and affirmed the role of ASEAN+3 as the main vehicle for this eventual establishment. The East Asia Study Group (EASG, 2002) identified 17 concrete short-term measures and nine medium- to long-term measures to move East Asian cooperation forward. The leaders in 2003 endorsed the implementation strategy of the short-term measures—to be realized by 2007—and in 2004 encouraged a speedy implementation of the short- and long-term measures. Some key long-term measures relating to economic, trade, and investment integration include:

- Formation of an East Asian Free Trade Area (EAFTA);
- Establishment of an East Asia Investment Area by expanding the AIA; and
- Promotion of investment by small- and medium-sized enterprises (SMEs).

East Asia Summit (EAS, or ASEAN+6)

The ASEAN agreement in Vientiane (in November 2004) to convene an EAS was a significant development. ASEAN+6 (13 ASEAN+3 members and Australia, India, and New Zealand) has met three times since December 2005 to focus on wider issues including avian flu, education, energy, finance, and natural disasters. Japan regards ASEAN+6 as an appropriate group for East

Asia's trade and investment cooperation and has proposed a comprehensive economic partnership agreement (CEPEA).

Future economic cooperation in East Asia, leading to an East Asian Economic Community, is likely to evolve around the multiple groupings under ASEAN, ASEAN+1's, ASEAN+3, and EAS (or ASEAN+6). It is likely that the ASEAN Economic Community, to be created by 2015, will be the hub of East Asian economic integration, thereby ensuring ASEAN's role as the driving force, ASEAN+3 as the main vehicle for an eventual East Asian Economic Community, and the EAS as an integral part of the overall evolving regional architecture (Kawai, 2007).

APEC and ASEM as Trans-Regional Forums

Established in 1989, APEC has encouraged trade and investment liberalization in a voluntary and unilateral fashion within an Asia-Pacific context. Australia played a major role in promoting APEC as a trans-regional forum with the basic principle of "open regionalism." One of APEC's most important achievements was to promote unilateral, voluntary trade liberalization among the then non-WTO members, such as PRC and Taipei, China. But APEC's prominence appears to have declined since the Asian financial crisis due to its inability to effectively respond to the crisis and its members' have pursuit of bilateral and sub-regional FTAs. Open regionalism can remain important, nonetheless, if APEC members view APEC and WTO principles as a liberalization infrastructure for their FTAs and attempt to go beyond them.

The Asia-Europe Meeting (ASEM), created in 1996 as a forum for Asia-EU economic cooperation, has not been active as a forum for trade and investment liberalization, but has the potential to serve as a vehicle connecting East Asia with Europe.

Spillovers for Latin American and the Caribbean

There is little doubt that the process of East Asian global and regional integration is beginning to have a variety of spillover effects on other developing regions including Latin America. Growing linkages between East Asia and Latin American economies are perhaps remarkable in view of the relatively few historical or cultural ties and geographical distance between the two regions. This underlines the fact that international trade, investment, and other forms of economic integration are powerful forces for change across borders, and that countries need to adapt to reap the benefits.

What is less clear from the few available studies on the subject is the size of spillover effects from East Asian integration on Latin American economies, both present and anticipated for the future.[19] It has been observed that East Asian economies such as PRC offer a huge potential market, but also act as a potent new competitor in markets for Latin American goods and services (Devlin, Estevadeordal and Rodriguez-Clare, 2005). This is a technically complex issue that requires detailed economic analysis of different transmission channels (e.g., trade, FDI, technology transfer, and migration), which are difficult to address in this short chapter due to space and data constraints. Nonetheless, using available information, some light can be shed on highlight spillover patterns to assist in the identification of policy lessons for Latin American economies. In this vein, three issues are briefly discussed below: economic effects for Latin America from FTA consolidation in East Asia, increasing FTAs with Latin America, and trade growth with Latin American economies. The first issue deals with indirect effects of East Asian integration while others consider more direct effects.

Negligible Losses for Latin America

A process of FTA consolidation has been taking place in East Asia with ASEAN emerging as the regional FTA hub. FTAs between ASEAN and the three major Northeast Asian economies are in effect and two large region-wide FTAs (EAFTA and CEPEA) have been proposed. Computable General Equilibrium (CGE) model analysis is a convenient means to evaluate the economic effects of alternative FTA scenarios. The income effects for various regions from a recent CGE exercise are shown in Table 2.3.[20] The results are reported relative to a 2017 baseline simulation (in $ billion and as a % change) to reflect the fact that the formation of region-wide FTAs is likely to take time. Scenarios 1–3 are concluded FTAs between ASEAN and each of the major Northeast Asian economies (PRC, Japan and Korea). Scenarios 4 and 5 represent on-going discussions among policymakers on region-wide FTAs. Based on bridging ASEAN and the region's Northeast Asian neighbors, scenario 4 (EAFTA) was an early attempt by PRC at an East Asia-wide FTA. Scenario 5 (CEPEA), spearheaded by Japan, has created the realization that the synergies could be gained by linking Australia-New Zealand and India with ASEAN+3 economies.

The two East Asia-wide FTA scenarios—CEPEA and EAFTA—offer larger gains to world income than the three scenarios involving ASEAN and any of the major Northeast Asian economies. Typically, the gains to members

[19] Insightful studies include Devlin, Estevadeordal, and Rodriguez-Clare (2005) and IDB (2006).

[20] These estimates are from a CGE model developed in Francois and Wignaraja (2008) with the following features: (i) strong micro-foundations and detailed interactions among industries, consumers and governments, across the global economy; (ii) medium to long run investment effects by allowing for trade to affect capital stocks through investment activities; (iii) projection of the GTAP dataset (version 6.3) through to 2017 trade and production patterns to represent a post-Uruguay Round world by including the phase out of the Agreement of Textiles and Clothing, the remaining WTO commitments under the Doha Round and EU enlargement to 27 members; and (iv) a stylized FTA that includes goods, services and some aspects of trade cost reduction.

TABLE 2.3/ Income Effects of Alternative Scenarios Compared to a 2017 Baseline *(At Constant 2001 US Dollars)*

	ASEAN + PRC FTA		ASEAN + Japan FTA		ASEAN + Korea FTA		EAFTA (ASEAN + 3)[a]		CEPEA (ASEAN + 6)[b]	
Region	Value (US$ Mn)	% change	Value (US$ Mn)	% change	Value (US$ Mn)	% change	Value (US$ Mn)	% change	Value (US$ Mn)	% change
Northeast Asia[c]	9,756	0.11	18,624	0.21	7,256	0.08	165,720	1.85	172,087	1.93
ASEAN	44,211	3.72	28,831	2.43	8,088	0.68	62,186	5.23	67,206	5.66
NAFTA	9,985	0.06	–214	0.00	273	0.00	–235	0.00	–4,474	–0.03
US	7,713	0.05	–782	-0.01	287	0.00	–4,966	–0.03	–8,917	–0.06
Canada	1,211	0.12	363	0.04	155	0.02	1,796	0.18	1,546	0.15
Mexico	1,062	0.11	205	0.02	–169	–0.02	2,935	0.31	2,897	0.30
Latin America	2,667	0.13	–109	–0.01	–303	–0.01	–2,082	–0.10	–2,958	–0.14
EU27	12,921	0.11	867	0.01	253	0.00	6,786	0.06	1,806	0.02
World	81,998	0.17	45,134	0.09	14,173	0.03	213,919	0.45	259,837	0.54

Source: ADB estimates. For details of the CGE model used, see Francois and Wignaraja (2008).

Notes:
[a] ASEAN+3 includes the 10 ASEAN members (Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam) and PRC, Japan, and Republic of Korea.
[b] ASEAN+6 includes the ASEAN+3 countries, Australia, India, and New Zealand.
[c] Northeast Asia includes Japan, Republic of Korea, and People's Republic of China.

of these five FTAs (e.g. Northeast Asia or ASEAN) are significant while the losses to non-members are relatively small.

Latin America as a whole—which is outside these FTA scenarios—experiences negligible losses of less than $3 billion under CEPEA or EAFTA and a few hundred million dollars at most under the ASEAN-Korea FTA or the ASEAN-Japan FTA.[21] Unexpectedly, Latin America sees gains of $2.7 billion under the ASEAN-PRC FTA. Furthermore, Mexico (a NAFTA member) sees notable gains under four of the FTA scenarios. Thus, simulation analysis suggests early fears about the negative impact of East Asian integration on other regions may be misplaced.

Increasing FTAs with Latin America and Deep Integration

Alongside the rapid spread of cross-regional FTAs involving East Asia economies, FTA activity with Latin American economies began in the early 2000s. The Chile-Korea FTA and the Taipei, China-Panama FTA were the earliest East Asia-Latin America FTAs to take effect in 2004. They were closely followed in 2005 by the Japan-Mexico FTA and in 2006 by the PRC-Chile FTA.

[21] The direction of our CGE estimates confirm those of previous studies which looked at the economic effects of tariff reduction in alternative FTA scenarios in East Asia (see, for instance, Gibert, Scollay and Bora, 2004).

Table 2.2 shows that the number of East Asian FTAs in effect with Latin American countries doubled from four to nine between 2005 and 2009. Interestingly, Tapei, China has been the most active, with four FTAs in effect with Central American economies (Panama, Guatemala, and Nicaragua). The major Northeast Asian economies have also been quite active. Japan has two FTAs in effect (with Mexico and Chile) while PRC and Korea have one each. Singapore has one bilateral FTA with Panama and one regional FTA with Chile through the Transpacific Strategic Economic Partnership Agreement. With another 15 FTAs in different stages of preparation (including two signed FTAs, Singapore-Peru FTA and Taipei-Nicaragua FTA), FTA activity between the two regions seems set to intensify somewhat. Both Korea and Singapore are in the process of negotiating FTAs with Mexico, Malaysia with Chile, and Thailand with Peru.

East Asia-Latin American FTAs have typically resulted in increased market access in goods and improved bilateral trade flows. The Korea-Chile FTA is a case in point. Under this FTA, Korea undertook to eliminate tariffs on 96.3 percent of its tariff lines (HS96), equivalent to 99 percent of its imports from Chile in 2003, within ten years (WTO 2005 and 2008). Korea's tariff elimination schedule saw the immediate liberalization of virtually all industrial products. This contributed to a 220 percent increase in Korea's imports from Chile. Similarly, upon entry into force of the Japan-Mexico FTA, some 3,367 tariff lines (37 percent of Japan's tariff lines) became duty-free for imports from Mexico (WTO, 2009). Remaining tariffs are progressively eliminated, and by 2015, 87 percent of Japan's tariff lines (86.1 percent in terms of import value) for Mexican exports will be duty-free. In 2007 alone, exports from Japan to Mexico increased by 10.5 percent, while Japan's imports from Mexico increased by 11.8 percent.

Encouragingly, most East Asia-Latin American FTAs appear to have reasonable coverage beyond goods, including services, the four Singapore issues, and cooperation enhancement provisions. Table 2.4 maps the coverage of seven FTAs in effect between East Asia and Latin America. The PRC-Chile FTA presently focuses on goods but may expand to other areas in the future. Five of the agreements cover key services chapters on telecommunications and financial services, while six agreements provide for entry of business persons and labor mobility. Strikingly, six agreements have provisions on most of the Singapore issues as well as some coverage of cooperation enhancement provisions. This underlines the point that the main motivation behind East Asia-Latin America FTAs is deep integration, i.e., ensuring market access in distant markets in areas beyond goods.

TABLE 2.4/
Coverage of Selected East Asian FTAs

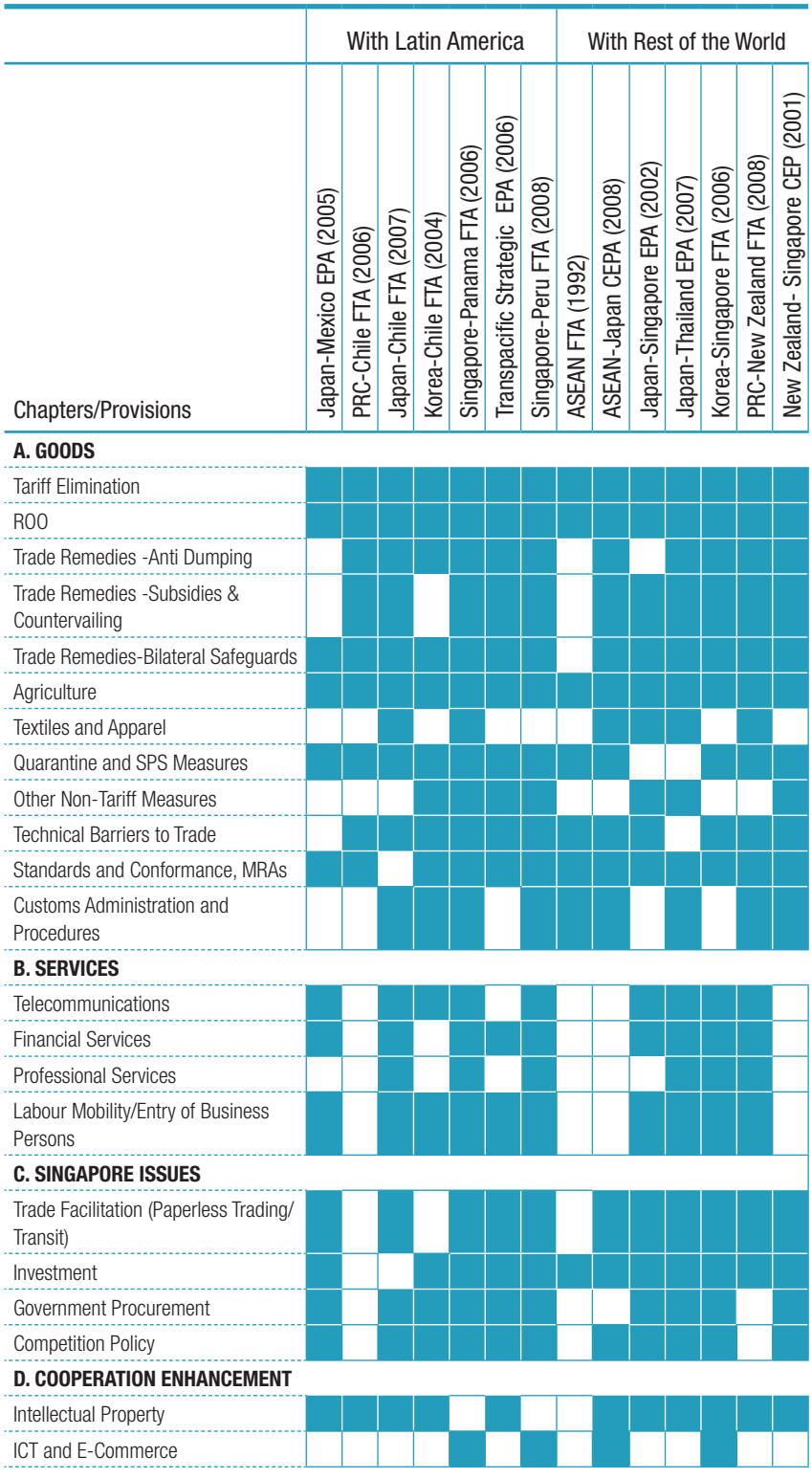


TABLE 2.4/
Coverage of Selected East Asian FTAs
(continued)

	With Latin America							With Rest of the World						
Chapters/Provisions	Japan-Mexico EPA (2005)	PRC-Chile FTA (2006)	Japan-Chile FTA (2007)	Korea-Chile FTA (2004)	Singapore-Panama FTA (2006)	Transpacific Strategic EPA (2006)	Singapore-Peru FTA (2008)	ASEAN FTA (1992)	ASEAN-Japan CEPA (2008)	Japan-Singapore EPA (2002)	Japan-Thailand EPA (2007)	Korea-Singapore FTA (2006)	PRC-New Zealand FTA (2008)	New Zealand- Singapore CEP (2001)
Labor Standards/Movement of Natural Persons					■	■	■			■	■		■	■
Environment	■	■	■		■	■			■		■	■		
Economic & Technical Cooperation	■	■				■				■	■	■		
Information Exchange		■			■						■		■	
Energy					■				■		■	■		
Transport and Communications	■				■				■	■	■	■		
SME		■			■				■	■	■		■	
Trade and Investment Promotion		■			■				■		■		■	
Transparency		■		■	■	■	■				■	■	■	■
Dispute Settlement	■	■	■	■	■	■	■	■	■	■	■	■	■	■

Sources: Compiled from ADB FTA database and official documents (data as of 1 April 2009).

Rapid Trade Growth from a Low Base

The last two decades have seen rapid growth in trade between the economies of East Asia and Latin America, albeit from a relatively low base. This is linked to falling trade barriers and transport costs, increased inward investment by East Asian firms in Latin America and, most recently, the spread of FTAs. According to estimates from the IMF Direction of Trade Statistics, the dollar value of East Asia's total trade with Latin America increased fifteen-fold, from $20.5 billion to $303 billion, between 1987 and 2008 (or equivalently from 2.3 percent to 3.6 percent of East Asia's total trade). Table 2.5 provides data on the trade of East Asia with Latin America between 1987 and 2008. Interestingly, East Asia's imports from Latin America grew faster than its exports to Latin America during 1997–2008, which reverses the trend of the previous decade. By 2008, East Asia's imports from Latin America amounted to $134.9 billion while its exports to Latin America reached $168.1 billion,

indicating that the trade balance is still somewhat in favor of East Asia. Studies suggest that the bilateral trade balance may be related to weak industrial efficiency and competitiveness in Latin America relative to East Asia.[22] As expected, the large Northeast Asian economies, with their large dynamic export-oriented manufacturing sectors, remain the major players in East Asia's trade with Latin America.

Kawai and Zhai (2009) argue that the PRC (and more generally economies in East Asia) and Latin American countries need to move beyond their traditional focus on resource complementarity to more dynamic, FDI-based intra-industry trade. Policies that encourage deeper economic integration between the two regions would help Latin American firms integrate into the value chains of global production, and enable East Asian firms to have greater and more stable access to markets, in addition to resources. Further liberalization of trade, FDI regimes, and regulatory policies should be of high priority for most Latin American countries, while the East Asian economies could make a great contribution to trade ties by investing in manufacturing sectors and infrastructure in Latin America.

[22] A detailed study by Weiss and Jalilian (2003) on industrialization in East Asia and Latin America concludes that "there is little evidence of LA catch-up with ESEA in efficiency terms once Mexico is treated as a special case and the improvement in export performance in the 1990s for LA appears much less impressive," (Weiss and Jalilian, 2003, p. 36). Weiss and Jalilian suggest that the gap in Latin America's performance may be related to the investment climate, weak educational and technical base, and weak and unreformed institutions. Similar conclusions are reached by Wignaraja and Taylor (2003), who benchmark manufacturing export competitiveness across a sample of 80 developing countries. Seven East Asian economies are present in the top ten list and only one in Latin America.

TABLE 2.5/
East Asia's Trade with Latin America, 1987, 1997 and 2008

Exports to Latin America	Value ($Mn)			Growth Rate[a]		Share of Total Exports (%)[b]		
	1987	1997	2008	1987–1997	1997–2008	1987	1997	2008
East Asia (15)	**10,776**	**45,585**	**168,098**	**15.5**	**12.6**	**2.1**	**3.2**	**3.9**
China, People's Republic	394	4,425	69,183	27.4	28.4	1.0	2.4	4.7
Japan	7,861	19,655	38,855	9.6	6.4	3.4	4.7	5.0
Korea, Republic of	1,148	8,238	26,473	21.8	11.2	2.4	5.7	6.3
Singapore	428	2,096	11,242	17.2	16.5	1.5	1.7	3.3
Taipei,China	0	2,999	5,439	—	5.6	0	2.5	2.2
Hong Kong, China	635	5,135	5,874	23.3	1.23	1.3	2.7	1.7
Thailand	79	651	4,621	23.5	19.5	0.7	1.1	2.7
Malaysia	137	1,258	3,137	24.8	8.7	0.8	1.6	1.4
Indonesia	52	888	2,501	32.8	9.9	0.3	1.7	1.6
Philippines	41	174	469	15.6	9.4	0.7	0.7	0.7

Imports to Latin America	Value ($Mn)			Growth Rate[a]		Share of Total Imports (%)[b]		
	1987	1997	2008	1987–1997	1997–2008	1987	1997	2008
East Asia (15)	**9,689**	**27,667**	**134,853**	**11.1**	**15.5**	**2.4**	**2.1**	**3.3**
China, People's Republic	1,158	3,654	71,797	12.2	31.1	2.7	2.6	6.0
Japan	6,076	11,090	25,991	6.2	8.1	4.0	3.3	3.4
Korea, Republic of	1,181	3,940	12,608	12.8	11.2	2.9	2.7	2.9
Singapore	193	1,368	5,826	21.6	14.1	0.6	1.0	1.8
Taipei, China	0	2,325	4,807	—	6.8	0	2.0	1.9
Hong Kong, China	376	1,636	3,501	15.8	7.2	0.8	0.8	0.9
Thailand	211	1,150	3,527	18.5	10.7	1.6	1.8	2.0
Malaysia	168	1,141	2,869	21.1	8.7	1.3	1.4	1.5
Indonesia	214	883	1,924	15.2	7.3	1.7	2.1	1.4
Philippines	111	464	1,202	15.4	9.0	1.6	1.2	1.6

Sources: IMF Direction of Trade Statistics (data as of June 2009); Taipei, China data is from the CEIC database (December 2008).

Notes:
East Asia (15) includes ASEAN, PRC, Hong Kong, Taipei, China, Japan, and Republic of Korea; Latin America refers to all Organization of American States (OAS) members except the US and Canada.

[a] Growth rate is computed using annual growth rate = $(FV/PV)^{1/n} - 1$.

[b] Shares of total exports or imports is computed as the value of total exports to Latin America as a share of total world exports from the East Asia (15) economy or region

Lessons for Latin America and the Caribbean

What lessons for Latin America can be drawn from East Asia's experience of sequenced economic integration, namely strong initial focus on global integration since the 1960s, followed by greater and more recent emphasis on regional integration? These lessons may help forge an effective policy response for Latin America to take full advantage of its growing economic relations with East Asia. There is a broad consensus that outward-oriented development strategies, prudent macroeconomic management, and investment in human capital are linked to successful globalization. It is increasingly recognized that the process of "regionalism is too complex and sui generis to generate universal operational rules."[23] Nonetheless, rules of thumb or lessons of experience can be drawn from the analysis of the East Asian case that might be relevant to the development of regional integration strategies in most circumstances.

Six broad lessons can be identified as follows:

1. *Develop internationally competitive manufacturing sectors.* Historically, a shift from subsistence agriculture to export-oriented manufacturing has been associated with rising economic prosperity and a flexible skill base. This requires significant investment in innovation and learning activities by individual firms as well as the development of geographically dispersed production networks driven by transnational corporations. Over time, production networks can acquire regional roots with the emergence of regional suppliers able to produce goods to world-class price, delivery, and quality standards.
2. *Emphasize domestic structural reforms and market orientation in regional strategy.* A general emphasis on markets for resource allocation and promotion of greater competition in domestic markets encourages efficiency. Where market imperfections arise, however, intervention may be required. As the present global economic crisis and the earlier Asian financial crisis indicate, financial markets in particular require adequate regulation to avert market failures. Likewise, regional policy instruments such as FTAs should be designed to liberalize trade rather than grant prolonged protection to inefficient production behind high tariff walls.

[23] Schiff and Winters (2003) p. 25. Also see Petri (2008), Francois, Rana and Wignaraja (2009 eds.) and Kawai and Wignaraja (2009a).

3. *Tailor policy mix to national circumstances.* There is no one-size-fits-all strategy. Key ingredients of regional strategy—investment in infrastructure, improvement of logistics, open trade and investment policies, measures to improve export competitiveness, and public-private sector partnerships—need to be modified and sequenced to suit individual country needs and priorities.
4. *Emphasize cross-regional linkages with East Asia.* Not all trading partners are equal. Integration into dynamic production networks of economies such as those in East Asia can bring numerous externalities to Latin American economies and their enterprises (e.g. capital, marketing linkages, scale economies, and technology transfer). To maximize benefits, such cross-regional FTAs should be comprehensive in scope, covering services, the Singapore issues, and cooperation provisions.[24]
5. *Involve the private sector in developing regional strategy.* The behavior of foreign and domestic firms influences the formation and deepening of regional production networks in different industries. Accordingly, close involvement of the private sector in discussions of regional strategy and FTA negotiations is critical.
6. *Mitigate development gaps.* To sustain the consensus for greater integration in formal regional arrangements it is imperative to accelerate economic development in smaller, low-income countries that may be at risk from short-term adjustments within regional arrangements. Low-income economies need to put in place economic strategies emphasizing market-orientation, inward investment, and skill creation. Larger and richer economies o need to support them through technical assistance and experience sharing.

[24] See Plummer (2007) for review of provisions in East Asian FTAs and suggestions for best practices.

Conclusion

This chapter dealt with East Asia's fascinating experience of sequenced integration, the spillovers, and lessons for Latin American economies.

East Asia is internationally reputed for having successfully integrated into the global economy over the last five decades through sustained outward-oriented development strategies. One highlight was the evolution of East Asia as the global factory though the engineering of a series of industrial revolutions in several economies. The most recent of these are the giant PRC economy and Vietnam.

Less known perhaps is that East Asia commenced a process of regional economic integration in the wake of the Asian financial crisis of the late-1990s. Over the last decade or so, economic regionalism has taken firm root in East Asia, alongside progressive globalization. The region is becoming highly integrated through market-driven trade and FDI activities as well as policy-driven initiatives such as FTAs. ASEAN is increasingly emerging as a production and FTA hub. Moves are underway to establish an ASEAN Economic Community by 2015 alongside proposals for an East Asian FTA and a broader CEPEA. Accordingly, a more complex regional economic architecture is expected to evolve in East Asia in the future. There is also emphasis on economic links between East Asia and the United States and Europe through the APEC and ASEM trans-regional forums.

East Asia's emergence on the world economy has begun to impact other regions and economies within them. CGE results presented here suggest that the two region-wide FTA scenarios (EAFTA and CEPEA) offer large gains to world income and limited losses to Latin American economies and others outside these arrangements. Hence, early worries in some quarters about the global impact of East Asian regionalism seem misplaced.

There are growing economic links between East Asia and Latin America though FTAs and trade flows. Some nine FTAs, mostly comprehensive in coverage of provisions beyond goods, are in effect among economies in the two regions. This underlines the point that the main motivation behind East Asia-Latin America FTAs is deep economic integration. Encouragingly, such FTAs seem to have resulted in increased market access in goods and improved bilateral trade flows. FTAs and more bilateral trade with East Asia offer an engine of growth for Latin American economies in the future.

The global economic crisis is likely to exert a dampening effect on the pace of East Asia- Latin American economic relations in the short term. For instance, there may be reduced demand for goods and inputs produced in production networks spanning East Asia and Latin America. Faced with a credit crunch, multinationals may reduce foreign investment in projects involving activity in both subregions. Pressures from powerful industrial lobbies may result in some protectionist measures being imposed. In the medium term, however, there are grounds for optimism and a return to pre-2008 levels of integration activity across East Asia and Latin America. These include:) a global recovery that is expected to start sometime in 2010; growing regional markets in East Asia, led by PRC, which offer opportunities to take up slack demand and capacity; and more intense diplomatic activity on the APEC front[25], which is expected to lead to more liberalization between East Asia and Latin America.

However, benefits from deep economic integration with East Asia may not automatically trickle down to Latin American economies. Latin American economies and the region as a whole may need to develop coherent approaches to maximize the benefits of deep economic integration with East Asia while minimizing costs. In this regard, six lessons might be drawn from East Asia's experience of sequenced integration: develop internationally competitive manufacturing sector, emphasize domestic structural reforms and market-orientation in regional strategy,) tailor policy mix to national circumstances, emphasize cross-regional linkages with East Asia, involve the private sector in developing regional strategy, and) mitigate development gaps.

[25] As agreed by APEC Leaders in Bogor, Indonesia, in 1994, the Bogor Goals set the target of free and open trade and investment in the Asia-Pacific region to be achieved by 2010 for industrialized economies and 2020 for developing economies.

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