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MADE IN THE AMERICAS: PROMOTING VALUE CHAINS IN OUR HEMISPHERE

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IDB
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KEY STATISTICS

- With the increasing importance of global value chains, trade in intermediate inputs has become a driving force of international trade. **Today, intermediate inputs consti-tute 60% of global trade.**
- Imports of intermediate inputs are increasingly used in the production of other goods. **In Europe and Asia-Pa-cific, the average import content of exports is 33% and 29%, respectively. In Latin America, the average is 18%.**
- In Europe, 50% of the imports used to produce exports come from within the same region. In Asia-Pacific coun-tries, 42% of the imports used to produce exports come from the Asia-Pacific countries. **Latin America has sig-nificantly fewer intra-regional supply chains, with only 15% of the imports used to produce exports originating within the region.**

INTRODUCTION

Production processes have grown increasingly fragmented worldwide. In industries as diverse as electronics, transport equipment, garments, and food, goods are manufactured in a multi-stage production process with each stage carried out in a different country across the globe. Frequently cited examples include the iPhone and Boeing's 787 Dreamliner. Even less technologically-intensive goods, such as the Barbie doll, now involve production stages in multiple countries.

Today many countries, including some in the developing world, are manufacturing and trading components of goods that they never before produced. By entering global supply chains, they are increasing their portfolio of exports. **Thus, in the last three decades, the fragmentation of production has been a driving factor behind current unprecedented lev-els of international trade as a share of world GDP.**

Participation in global supply chains is also an opportunity for export diversification, an issue of great importance to those Latin American and Caribbean countries with highly concentrated export bases, particularly those dominated by natural resource-intensive sectors. In sum, for these countries, joining supply chains for goods that were previously out of reach means increased participation in trade, greater diversification of their product offer, as well as exposure to the latest market intelligence and production technologies.

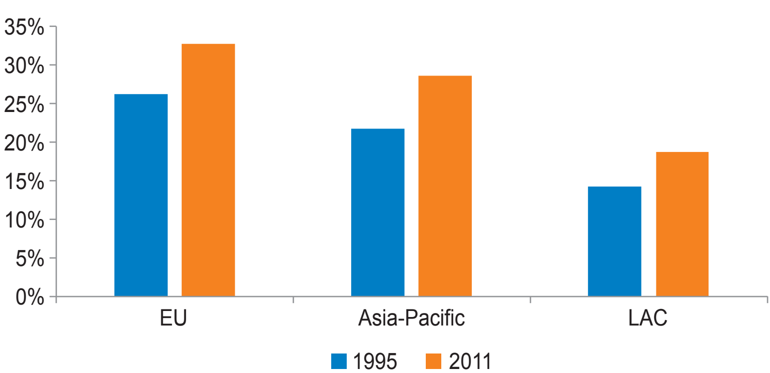
DIAGNOSTICS AND TRENDS

A variety of economic indicators point to the same conclusion—**that Latin America has so far lagged behind other regions in its participation in global value chains (GVCs).**

One measure is based on intra-industry trade indexes. Since global supply chains involve sequential trading of intermediate goods within a particular industry, intra-industry trade is a suitable proxy for GVCs. IDB research has shown that between 1985 and 2010 the index of intra-industry trade of manufactured goods increased by 35% on average for Latin American countries. However, it doubled for Asia-Pacific countries over the same period (IDB, 2014).

Another useful measure of GVC participation is the share of foreign value added (imports) used in a country's exports. Figure 1 shows this measure for the average country in the

Figure 1. Share of foreign value added used in total exports



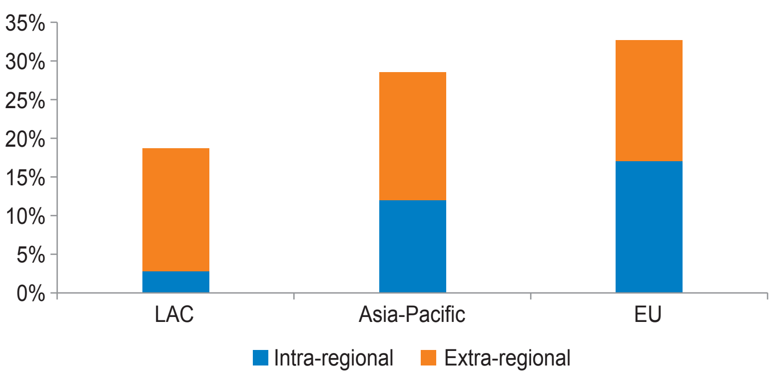
Source: IDB with data from TiVA database (WTO-OECD).

European Union, Asia-Pacific and Latin America.[1] While the share has been increasing in all three regions, **Latin American participation in GVCs is clearly under performing the comparator regions.**

Even more striking is the very low level of production linkages within Latin America. This can be observed in Figure 2, which breaks down the same measure shown in Figure 1 by the origin of value added. Note that in Europe, around 50% of the foreign value added used to produce exports comes from countries within the same region. In the Asia-Pacific countries, this share is 42% and in Latin America only 15%. Thus, the data indicates that not only is Latin American participation in GVCs comparatively low relative to other regions, but particularly so with respect to production linkages within its own hemisphere.

Three key factors are contributing to this situation in Latin America: 1) **the state of regional integration**—with multi-ple and overlapping trade agreements—is not

Figure 2. Share of foreign value added in total exports, by origin



Source: IDB with data from TiVA database (WTO-OECD).

[1] Latin America's share is approximated by the average of the countries from the region available in the TiVA database: Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico and Peru.

conducive to the formation of region-wide supply chains; 2) **the quality of transportation and logistics infrastructure** may be inade-quate for modern supply chain practices; and 3) t**he existence of information frictions** that keep potential suppliers on the sidelines. While the public sector has an important role to play in remediating these factors, there are opportunities for the private sector to take an active role in addressing each of these issues, as argued below.

THE ROLE OF THE PRIVATE SECTOR

1. Regional Integration

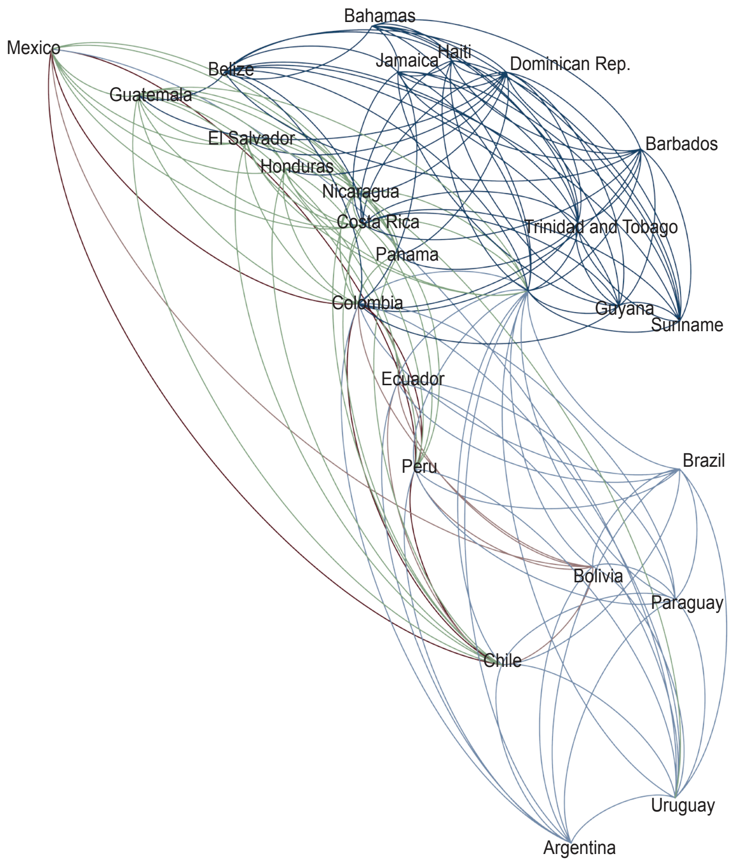
The current state of integration in LAC—many separate preferential trade agreements (PTAs) without interconnections among them and with several countries holding bilateral agreements on their own—is not very conducive to the emergence of region-wide supply chains. Figure 3 shows how labyrinthine is the state of regional integration in Latin America; the so called "spaghetti bowl" of trade agreements.

The spaghetti bowl might encourage production linkages amongst the members of each agreement, but it limits the emergence of supply chains between countries across agreements by making it too costly to use foreign inputs from outside the blocs due to the combination of tariff rates and rules of origin. This problem is more prominent in Latin America than in other regions. For example, for the average Latin American country, around 35% of exports are covered by trade agreements in which partner countries from the same region do not participate. This percentage is less than half in Asia (15.2%), and zero for countries in the EU.

Fostering regional integration in Latin America is not an easy task. The IDB has put forward an initiative based on the convergence and rationalization of existing agreements, filling in the missing links (signing agreements between countries and trade blocs within the region where they do not exist today), and working under a structure that is flexible and minimalistic by avoiding supranational institutions (IDB, 2017).

The private sector in Latin America indeed has some experience taking an active role in trade agreements. One example is the Pacific Alliance (PA). From the beginning,

Figure 3. PTAs in Latin America



Source: IDB.

this trade agreement encouraged the creation of the **Pacific Alliance Business Council** (CEAP for its acronym in Span-ish), a corresponding private sector group with a chapter in each PA member country. The CEAP participates directly in the work of the Alliance, serving important advisory roles on trade integration and other economic cooperation initia-tives, as well as presenting recommendations to the member countries' business associations and coordinating joint ac-tion to engage with third party markets.

A private sector initiative like the CEAP could be replicated at a larger scale to support a region-wide integration process. Note that a strong business council could also be effective to minimize the potential risk of capture.

2. Logistics Infrastructure and Trade Facilitation

Firms utilizing globally fragmented production processes must necessarily reduce the risk of delay in the production of each individual component in order to prevent disruption of the production of the final goods. Accordingly, these firms seek to work with suppliers in countries with adequate transport and logistics infrastructure. Similarly, modern supply chain practices, such as just-in-time delivery or postponement (the practice of delaying the final customization of a semi-finished good), require that suppliers commit to swift deliveries with minimum disruptions, which in turn depends on reliable transportation and logistics systems. While the efficiency of ports and airports is clearly an important issue for international trade (IDB, 2008), the transport-related agenda should also address roads; improving the quality of the domestic road network can have a significant impact on trade flows, as reported in IDB (2013).

Investing in transportation and logistics infrastructure **should not be an activity exclusively in the realm of the public sector.** Public-private partnerships can greatly increase the impact of public infrastructure investment. Moreover, the quality of transport and logistics infrastructure depends not only on the physical infrastructure but also a whole array of services with ample space for the private sector. Indeed, auxiliary port and airport services, such as storage and warehousing, provisioning, repairing, and fueling, can be provided more efficiently if the private sector is enabled to enter and compete.

Well-functioning GVCs also require that countries work on all aspects of trade facilitation—the elimination of nontariff or regulatory barriers to trade. For instance, substantial costs can arise when firms engaging in international trade are confronted with cumbersome customs procedures and a lack of appropriate, state-of-the-art processing technol-ogies to complete them. When formalities and procedures are poorly designed, crossing borders may take significant time. Trade facilitation policies such as the introduction of adequate risk management systems, authorized economic operator programs and single window arrangements speed up the movement of goods across borders and have been shown to favor trade expansion (see IDB, 2016).

3. Information Frictions

Information barriers are at the root of many failed attempts to export final goods, as potential exporters lack international market knowledge and likewise international buyers find it challenging to locate trusted suppliers. In the context of regional value chains, where intermediate goods are more specific and buyers more demanding, **information frictions can be particularly problematic**.

The most direct strategy for overcoming information friction is instruction, such as trainings, workshops, or coaching. This is an important area for public-private collaboration; while the public sector may be willing to support such services, the required expertise lies within the business community. **Coaching or mentorship** programs, for instance, could bring together potential exporters with firms that have already achieved success in international supply chains; or with current or retired international procurement professionals.

Knowledge transfer also occurs in the regular course of networking and business, so increasing the volume of interactions with potential business partners can also overcome information friction. Face-to-face business rounds are an important source of such networking. In addition, virtual business rounds could help generate a much higher volume of interactions, such as on the ConnectAmericas platform by the IDB, the first social network for businesses in the Americas.

Overcoming information frictions also requires improving international buyers' awareness of the export offer. Certifications are an important visibility tool to help overcome these information gaps. Global firms use certifications to screen potential suppliers for compliance with relevant standards in their respective supply chains (see Humphrey and Schmitz, 2008; Morrison, Pietrobelli, and Rabellotti, 2008). Strong collaboration between the public and private sectors is important to help achieve compliance, particularly in those industries where certifications are mandatory. Where industry-specific certifications are not required, quality certifications can signal the ability to serve a demanding global market (González, et al., 2012). The private sector could work with government and local firms to determine where certifications could have the greatest impact, as well as to design and manage certification and/or regional branding to increase market visibility and signal competence.

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