

Making the Most of Connectivity

Unlocking the Trade Potential of
Latin America and the Caribbean in Asia



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Executive Summary

Since the turn of the century, economic ties between Latin America and the Caribbean (LAC) and Asia have deepened to unprecedented levels. Due to high and growing complementarity, trade has been the anchor of the relationship. However, governments and firms cannot take the trade relationship for granted. This report presents an overview of how the LAC-Asia trade links have evolved over time and how policymakers and the private sector can make the most of the manifold opportunities on the horizon.

Trade between LAC and Asia is a business nearing US\$600 billion. In less than two decades Asia's share of the region's total trade in goods tripled, reaching 26% in 2018 up from 9% in 2000. However, while trade in commodities has exploded, LAC economies have missed significant opportunities to diversify into products of higher value added where they have a comparative advantage such as processed food. This opportunity seems all the more compelling given the fast-growing demand in Asia and the likelihood that this trend will accelerate as the middle class expands and consumption preferences evolve accordingly. While this report focuses mainly on merchandise trade, additional gains may also stem from business development in the services sector.

Against this backdrop, trade costs between the two regions are among the highest in the world. Costs are driven not only by distance, but also by restrictive trade policies and poor logistics connectivity. Tariffs faced by LAC exporters in Asia average 9.8%, whereas in LAC the corresponding rate is 7.3%. However, average bilateral tariffs can be higher due to tariff peaks in sensitive sectors. Likewise, a host of non-tariff barriers still restricts trade and prevents diversification into high-margin market segments. Most importantly, in LAC, under-investment in trade-related infrastructure coupled with inefficiencies along the logistics chains puts exporters at disadvantage with competitors in Asian markets. The aggregate logistics performance index of LAC is 82% of that of Asia, and the gap is particularly wide in the infrastructure and customs efficiency components.

Reducing trade costs would unlock a considerable trade potential. As a result of the reduction of bilateral tariffs and a drop in transport and other logistics costs, LAC exports to Asia may grow by 27.6% in the medium term, while Asian exports to the region may do so by 40.6%. In LAC, a trade surge of this magnitude would translate into a 1.6% expansion of private consumption. A region that is emerging from a severe recession can hardly afford to forego such a boost to income. A more granular analysis of untapped trade complementarities and competition for market shares further illustrates, from a private sector perspective, the specific opportunities that may arise in growing trade between LAC and Asia.

Policymakers have levers at their disposal to reignite the LAC-Asia trade relationship. The policy mix should aim to reduce trade costs through different channels, such as increasing the coverage and utilization of free trade agreements, enhancing the use of trade facilitation measures, undertaking proactive and targeted trade promotion activities, as well as boosting investment in infrastructure and promoting reforms in the logistics sector. An integrated approach with concurrent actions, supported as needed by multilateral, regional, and bilateral cooperation initiatives, would maximize results in the medium and long run. Moreover, setting an ambitious goal at the policy level and focusing the strategy on targeted outcomes in the short term may provide built-in incentives to the private sector.

Expanding the web of trade agreements would help to lift tariffs and reduce the stock of non-tariff barriers. A new set of trade rules would provide a stringent rule-based normative framework for trade growth. At the bilateral level, further trade cooperation would need to focus both on existing and potential agreements. Bilateral action may also be complemented with policy initiatives at the plurilateral inter-regional level. Strengthening ties among LAC and Asian officials may serve to build confidence and set in motion the exploratory work for further engagement.

Advancing a trade facilitation agenda would not only result in a significant reduction in the cost of doing business across

borders at a fast pace, it could also harness new technologies for maximum impact. Actions ranging from the expansion of mutual recognition agreements for Authorized Economic Operators, to the interoperability of Trade Single Windows, and to the promotion of bilateral cooperation to facilitate compliance with trade rules, are low-hanging fruits to set the LAC-Asia trade relation on a new course.

While trade officials may play a leading role in modernizing the regulatory infrastructure, trade promotion activities may help private sector representatives of both regions to lock-in business deals. Through capacity building and information sharing, trade promotion institutions can help overcome market failures, provide effective support at different stages of the supply chain, and ultimately facilitate contacts among businesses and consumers belonging to distant cultures.

However, as shown by the estimates of the LAC-Asia trade potential, overcoming poor trade infrastructure and uncompetitive logistics may generate the largest gains and is thus emerging as an utmost priority. In order to bring the LAC-Asia trade relation to a whole new level, LAC countries need to set a vision, both individually and collectively, and implement an investment plan in hard and soft infrastructure whose magnitude is as challenging as its quality and sustainability.

Fortunately, there are ample opportunities to reduce trade costs, unlock the trade potential, and magnify development benefits from the trade relationship, especially when it comes to adding value and diversifying exports, a goal that has remained elusive for most LAC countries.

Solidifying the trade relationship between Asia and LAC is especially important in the current juncture of the global trading system. With a comprehensive and strategic approach LAC governments could enhance the connectivity with Asia and make the most of the trade relation between the two regions.

Introduction

At the turn of the millennium, Latin America and the Caribbean (LAC) and Asia were two regions turning their backs to each other. Asia was recovering from a deep financial crisis, China had not yet joined the multilateral trading system, and LAC was seen as a very distant partner in economic, geographic and cultural terms. LAC, for its part, was also in the midst of a series of economic crises, external commercial strategies focused mainly on the United States and Europe, and Asia ranked at the bottom of the list of trade partners.

Fast forward two decades and LAC-Asia trade relations have grown and deepened to unprecedented levels. Asia's share of the region's total trade in goods tripled, reaching 26% in 2018 up from 9% in 2000, owing to the Chinese integration into the global trading system and to rapid growth in most of the Asian economies, which largely drove the commodity super cycle. For countries such as Brazil, Chile or Peru the Asian export share doubles the regional average. Trade in commodities such as copper, iron ore, or soybeans, has literally exploded and the importance of Asian markets has dwarfed that of any other destination across the globe. Meanwhile, Asia emerged as the main supplier of imported goods for the region, as its share of LAC imports grew from 12% to 31%, particularly in electronics, cars, and a wide range of industrial intermediate goods.

This export surge to Asia set off an economic boom in LAC, helped the region bring down poverty and inequality, and weather the 2008–2009 global financial crisis. Meanwhile, competition from low-cost manufacturing goods puts considerable pressure on LAC manufacturers, reviving concerns over the region's competitiveness. However, in the last five years bi-regional trade plateaued and followed the ebb and flow of the commodity super cycle. The challenge for policymakers on both sides is therefore to make the most of the connectivity between the two regions, in order to expand and diversify the commercial relationship, maximize opportunities, and minimize the frictions that inevitably arise with rapid change.

With fast growth and high complementarity on the backdrop, the scale and speed of this growing trade relation prompted a new generation of trade deals between LAC and Asian countries. More than twenty-six preferential agreements, including a bi-regional arrangement still involving only a limited number of partners, are already in force among countries of the two regions. Twenty more have been proposed, are under negotiation, or awaiting ratification. These agreements are meant to enhance market access, set an open and transparent regulatory framework, and boost business confidence. Further market opening would deepen connectivity and allow trade flows to expand and diversify, both into new markets and sectors.

However, trade impediments between the two regions are not only driven by trade policies, but also by high logistics costs. Indeed, reducing the cost of the network of infrastructure and services that supports the physical movement of goods across borders and commerce within borders is emerging as a key priority, as trade policy barriers between the two regions have started to fall.

This report presents an overview of how the LAC-Asia trade relationship has evolved over time and how policymakers and the private sector can make the most of the manifold opportunities on the horizon.

The first section starts by examining the trade dynamics that stemmed from the fundamental complementarities between LAC's natural resource wealth and Asian manufacturing prowess in the past two decades. It points out the increasing importance of Asia and LAC to each other and signals the need for LAC to diversify and add value to its exports.

In order to do so, through domestic investment, reforms and cooperation with counterparts in Asia and elsewhere, the region needs to lower trade costs, which continue to present a major barrier to an increasing and more diversified trade. Options for reducing trade costs—which include both traditional trade policy measures, such as tariffs and technical barriers, as well as logistics costs—are discussed in the second section of the report.

The ensuing section provides an overview of the trade-expanding effects of the agreements in force among LAC and Asian economies and quantifies the trade gains to be expected from a further reduction of tariffs, non-tariff barriers, transport and logistics costs between the two regions.

As suggested by the evidence presented in the report, there are clear opportunities to be reaped from deeper connectivity among Asian and LAC economies. In order to bring these opportunities to fruition, government officials and private sector representatives may engage in a series of initiatives outlined in the last section. Their gradual implementation may contribute to reignite commerce across Pacific routes and to make bi-regional trade work for improving lives, both in LAC and Asia.



Outlook

Trade relations between Latin America and the Caribbean (LAC) and Asia are strong, and the partnership is of high strategic value. On one hand, LAC exports to Asia key products widely used as inputs in industrial production, as copper and iron ore, and key agricultural products, as soybeans. On the other hand, LAC imports large quantities of industrial manufactured goods. As Asia continues to grow at rates that exceed the global average, the demand for LAC products keeps expanding, which represents a major opportunity to further deepen trade links. This chapter describes the evolution of trade between the two regions and signals the opportunities to expand and diversify commercial ties.

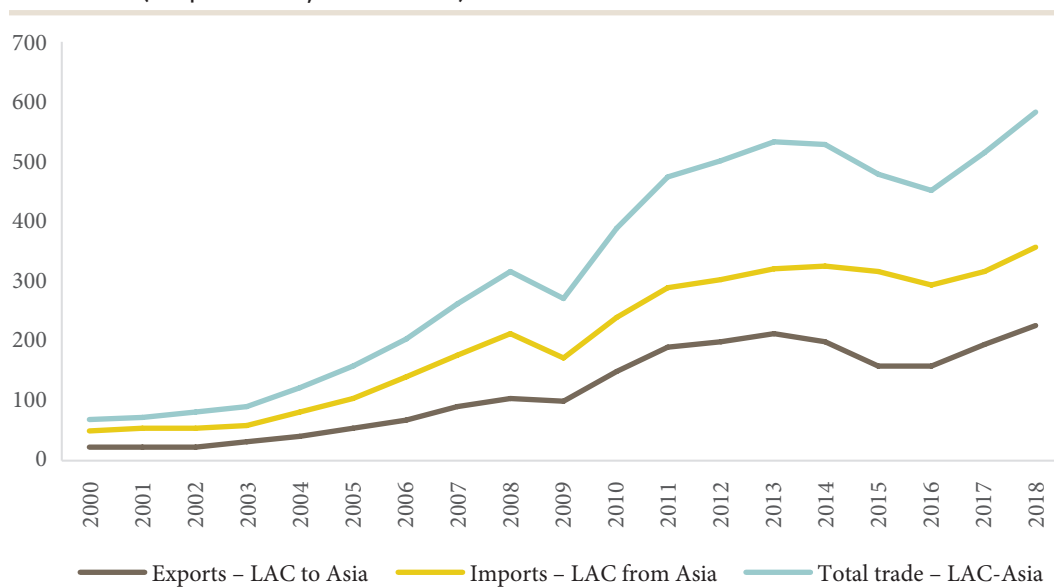
The trade relationship between LAC and Asia has been strengthening since the early 2000s.¹ Trade flows started to take off in 2003 and experienced a staggering average annual growth of 23.1% until 2011, despite a temporary fall during the financial crisis in 2009 driven by a decrease of imports from LAC (Figure 1). Between 2012 and 2016, both LAC exports and imports retracted under the pressure of economic woes in the region and the end of the commodity super cycle, but started to recover in 2017 and total trade with Asia reached a record US\$581 billion in 2018. However, since the turn of the century exports to Asia have trailed imports and the gap between the two has been growing.

Most of the growth in both exports and imports comes from the expansion of trade with China, but other Asian countries are emerging as crucial strategic partners. The growth of exports to all subregions of Asia has been higher than that to the remaining regions of the world. Between 2000 and 2018 LAC exports increased at an annual average rate of 20.4% to China, 19.1% to India, 13.7% to ASEAN countries, 11.8% to Korea, and 5.9% to Japan, which is still higher than the growth of export flows to the rest of the world (5.3%).²

1 The Integration and Trade Sector of the IDB has been tracking the growing relation between the two regions in a series of publications available at <https://publications.iadb.org/>. In particular, refer to these publications for an in-depth assessment of trade in intermediate inputs and value-added, trade in services, e-commerce, or the study of the sophistication of LAC exports, that are not dealt in detail here.

2 The Association of Southeast Asian Nations (ASEAN) includes Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. Papua New Guinea, which is currently an observer, is not included in the statistics.

FIGURE 1: EVOLUTION OF LAC-ASIA TRADE IN GOODS
(US\$ billions, 2000–2018)



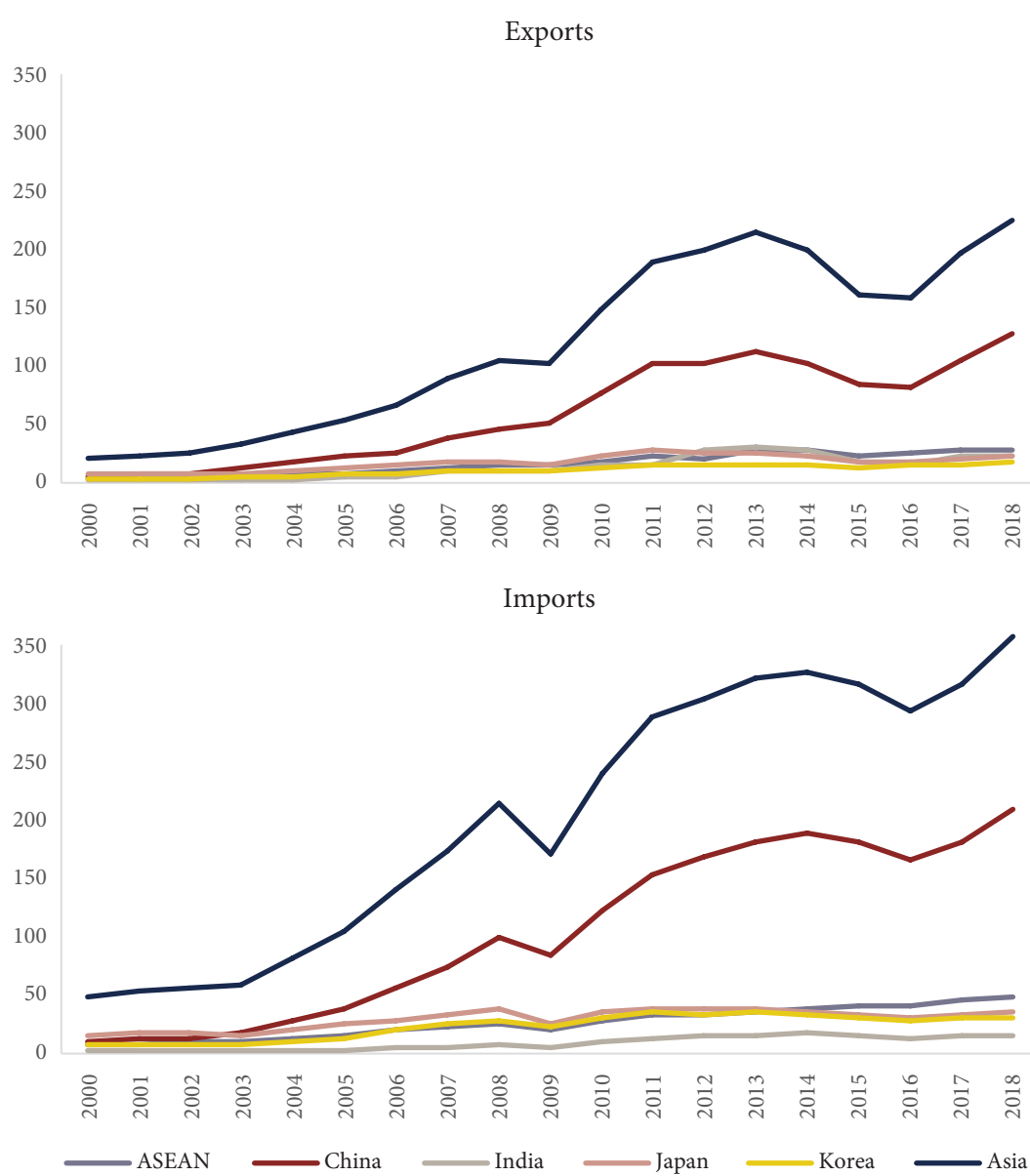
Source: IDB Integration and Trade Sector with data from IMF Direction of Trade Statistics (DOTS).

Note: Total trade is computed as the addition of exports and imports. Values might be underestimated as LAC exports from free trade zones are not included in some countries. Data for 2018 are estimated.

In the early 2000s Japan was the largest export destination for LAC (over 40% of exports to Asia), almost doubling the value of sales absorbed by China (Figure 2). ASEAN and Korea followed, while India ranked at the bottom. However, since 2000 China has been gaining ground, and in 2002 overpassed Japan as the main Asian recipient of LAC exports. Likewise, in 2013 ASEAN took over Japan as the second most important exports destination for LAC. In 2018, exports to China accounted for 57% of shipments to Asia and represented US\$128 billion, which is over four times the sales to ASEAN, and close to six times those to Japan and Korea. Although exports to India represent a small share for LAC, they have steadily increased from 5% in 2000 to 10% in 2018.

The evolution of imports of LAC from the Asian subregions follows that of exports. Japan was the largest supplier of LAC imports of goods until 2003, when it was displaced by China, and was even surpassed by

FIGURE 2: EVOLUTION OF LAC-ASIA TRADE IN GOODS BY SUBREGION
(US\$ billions, 2000–2018)



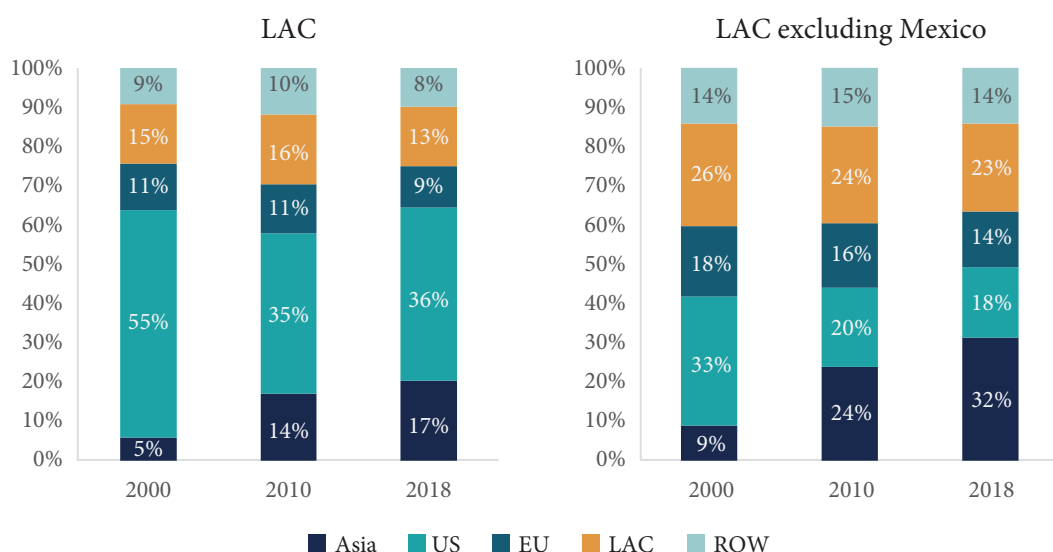
Source: IDB Integration and Trade Sector with data from IMF DOTS.

Note: Data for 2018 are estimated.

ASEAN in 2013. The share of imports from Korea has been declining, that of ASEAN has remained stable, while India's participation has slightly increased in the period of study. As a result, in 2018 purchases from China represented 59% of imports from Asia, while ASEAN, Japan, and Korea, accounted for 14%, 10%, and 4%, respectively.

LAC exports to Asian economies are not only expanding at a relentless pace in absolute terms, their relative importance as a destination market is also growing. The share of total LAC exports absorbed by Asia steadily increased between 2000 and 2018, expanding from 5.3% to 17.1% (Figure 3). Consequently, the region escalated from the last position in terms of value of shipments to the second place, although still far behind the United States (US), which absorbed 36.1% of LAC sales in 2018. However, excluding Mexico, which is deeply integrated with the US and is a major LAC exporter, the share of exports to Asia doubles, highlighting the importance of the region for the rest of LAC, and particularly for South America. In 2018 it represented 31.6% of

FIGURE 3: SHARE OF LAC EXPORTS BY DESTINATION
(Percentage, 2000, 2010, 2018)



Source: IDB Integration and Trade Sector with data from IMF DOTS.

Note: ROW stands for Rest of the World. Data for 2018 are estimated.

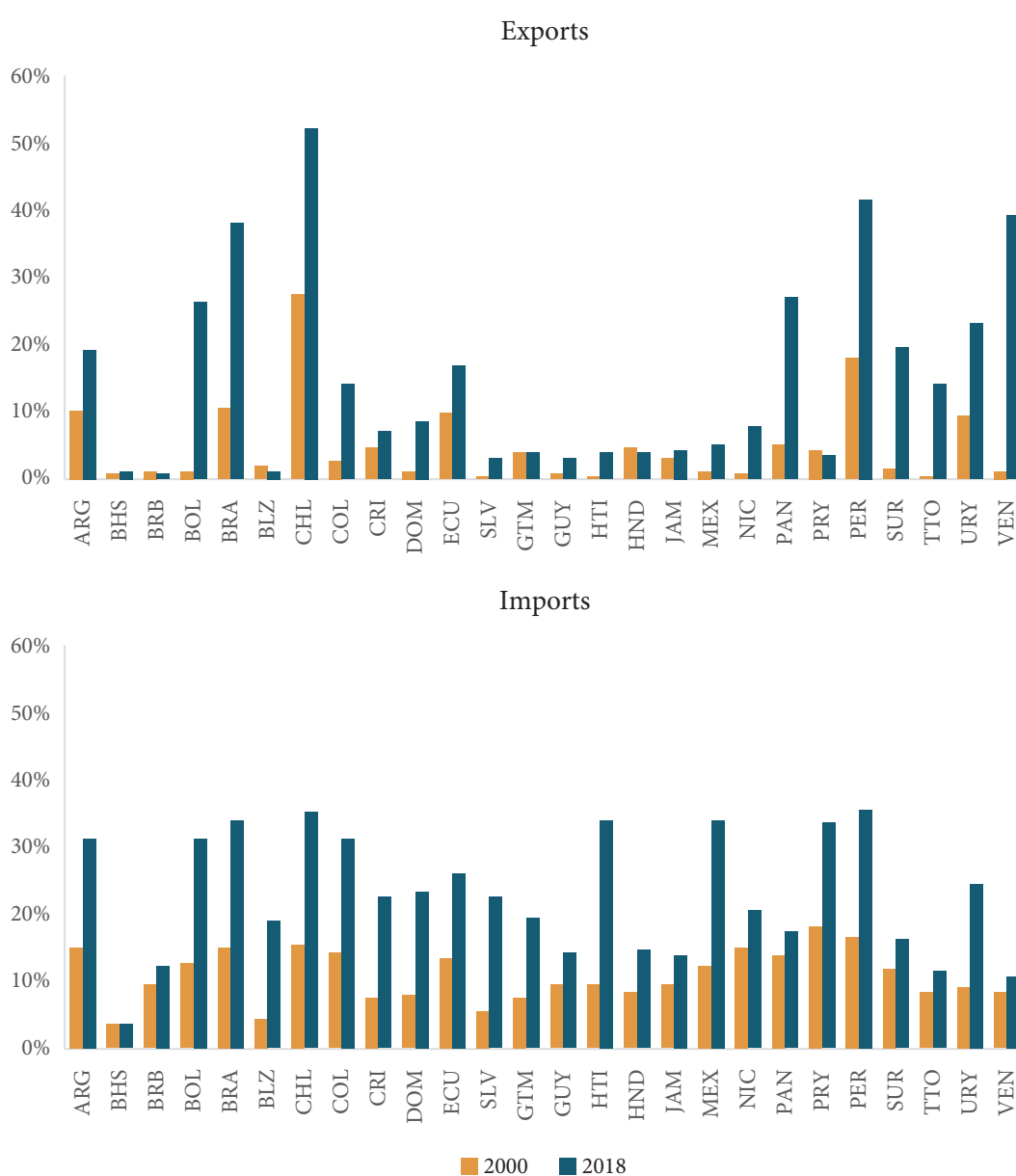
total sales and was the most important destination of exports, closely followed by exports to LAC itself (22.6%).

Within LAC countries there is heterogeneity in the trade relation with Asia. However, in most countries the commercial ties are of increasing importance. Chile is the economy with the largest share of exports going to Asia, reaching 52% in 2018 from 28% in 2000, mainly driven by exports of copper ore and copper cathodes (Figure 4). Peru, Venezuela, and Brazil send more than 35% of their products to Asia. While Peru also mainly exports copper, Venezuela ships almost exclusively oil, and Brazil's sales are concentrated in soybeans and iron ore. In contrast, the corresponding figures for Central America vary from 3% in El Salvador to 8% in Nicaragua, while those in the Caribbean range from 20% in Suriname to 1% in Barbados. Mexico stands at the lower end of the distribution with 5%.

On the other hand, the share of LAC imports from Asia is even larger than that of exports and, in most countries, it has increased over time. Among the largest economies of the region such as Brazil, Mexico, Argentina, Colombia, Peru or Chile, the shares are above 30%. At the other end of the distribution some Caribbean countries like Trinidad and Tobago and Bahamas are the ones with the lowest import share, of around 11% and 4%, respectively.

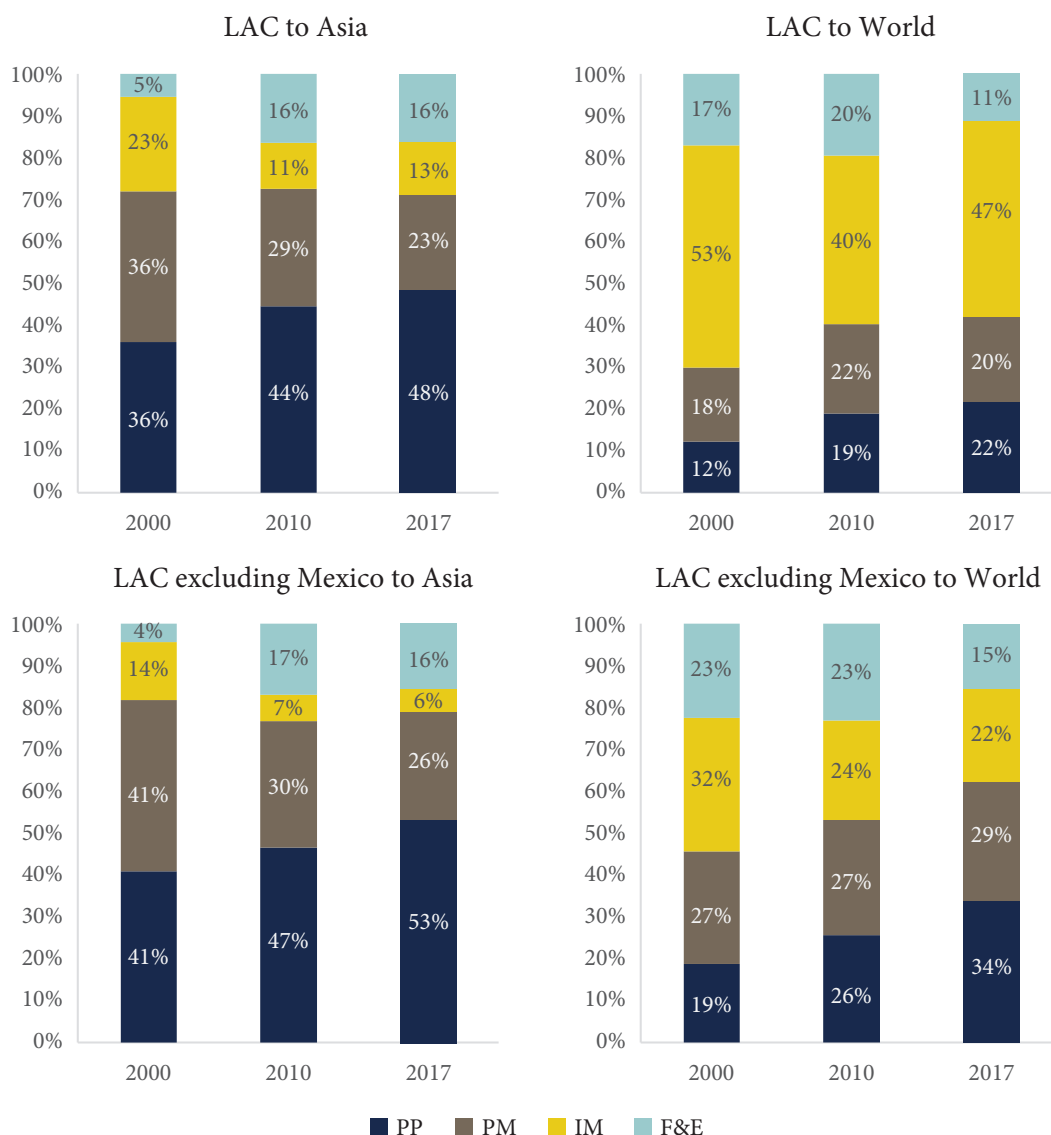
The composition of LAC exports to Asia in terms of product category differs from that to the world and is more concentrated in unprocessed goods. Shipments to Asia are mainly composed of primary products and primary manufactures (48% and 23% of total exports in 2017, respectively), followed by fuels and energy and industrial manufactures (16% and 13%, respectively) (Figure 5). This overarching inter-sectoral specialization pattern, due in part to the commodity prices super cycle, is accentuated when Mexico is excluded. However, what is striking to note is that throughout the last decade, while the share of primary products has grown by 12 percentage points, that of primary manufactures has followed a negative trend. The share of the latter in exports to Asia, excluding Mexico, decreased from 41% to 26%, while it was growing with respect to the world as a whole. This suggests that LAC economies have missed significant opportunities to diversify into products of

FIGURE 4: SHARE OF TOTAL TRADE WITH ASIA BY LAC COUNTRY
(Percentage, 2000, 2018)



Source: IDB Integration and Trade Sector with data from IMF DOTS.

FIGURE 5: SHARE OF LAC EXPORTS TO ASIA AND WORLD BY PRODUCT CATEGORY
(Percentage, 2000, 2010, 2017)



Source: IDB Integration and Trade Sector with data from the Database for the Analysis of International Trade (BACI) of the Center for Prospective Studies and International Information (CEPII).

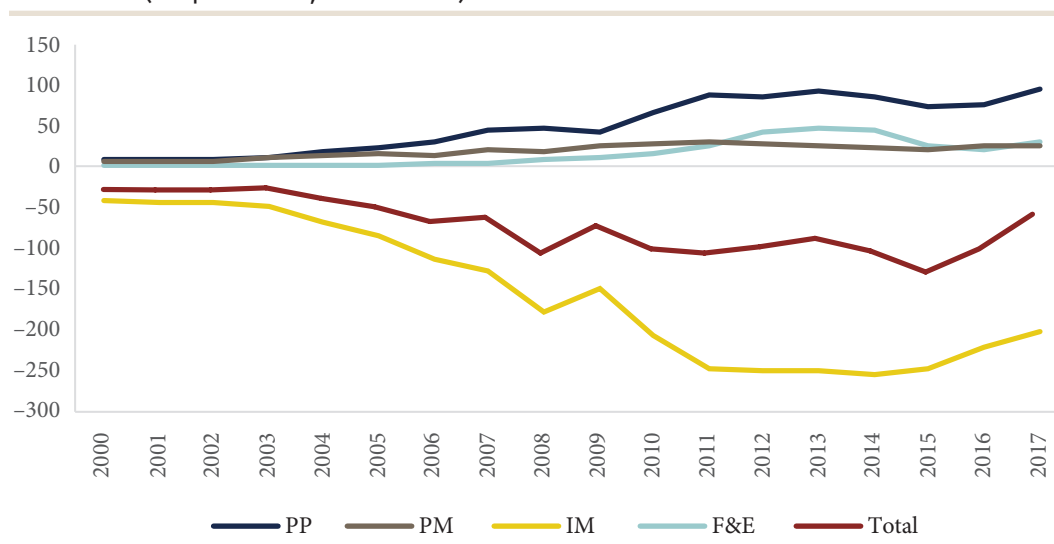
Note: Export products are divided into four broad categories: primary products (PP) including essentially commodities, primary manufactures (PM) including manufactures based on natural resources, industrial manufactures (IM), and fuels and energy (F&E). Comprehensive data to compute exports by product category are available only until 2017.

higher value-added where they have a comparative advantage and for which there is growing demand in Asia, such as food products, animal fodder or copper cathodes.

As a result of these trends, the trade deficit of LAC with Asia over the last decade has been deepening due to an increasingly negative trade balance in industrial manufactures that has not been offset by surpluses in the other three product groups, especially in primary manufactures, whose growth remained the most subdued (Figure 6). In 2016 and 2017 there was a small improvement driven by industrial manufactures and primary products. However, the correction was mainly due to the impact of the economic recession that hit LAC and drove the suppression of imports of manufactures from Asia, while the expansion of primary products had a smaller impact. As the region gradually returns to a growth path, it is likely that the trade deficit will widen again.

In terms of products, the basket of goods that LAC exports to Asia is highly concentrated, with the five major items adding to over half the

FIGURE 6: TRADE BALANCE OF LAC WITH ASIA BY PRODUCT CATEGORY
(US\$ billions, 2000–2017)



Source: IDB Integration and Trade Sector with data from BACI (CEPII).

Note: Comprehensive data to compute the trade balance at a disaggregated level are available only until 2017. Product categories defined in note in Figure 5.

value of total sales in 2017, the most recent year with available data (Table 1). Crude oil is the most exported product, amounting to 14.2% of total shipments, and it is mainly traded by Venezuela, Brazil, and Mexico (40%, 31%, and 18% of total exports to Asia, respectively). As mentioned before, primary products stand out. Exports of copper ore represent 13.0% of the total and are shipped by Chile and Peru (51% and 38%, respectively). Soybean exports are third in value (12.1% of exports) and Brazil is the far largest seller, followed by Argentina (88% and 10%, respectively). Primary manufactures are particularly interesting since they tend to be of higher value added. Copper cathodes, soybean oil-cake, and wood pulp are examples of the main primary manufactures traded by LAC, but they represented only 4.7%, 2.5% and 1.8% of total exports in 2017. No industrial manufactures appear in the top-ten list.

On the other hand, the basket of imported goods from Asia is more diverse, with the ten main products accounting for a fifth of the total

TABLE 1: TOP LAC EXPORTS TO ASIA
(Percentage, 2017)

Product	Product Category	Share	Accumulated Share
Petroleum oils and oils obtained from bituminous minerals, crude	F&E	14.2%	14.2%
Copper ores and concentrates	PP	13.0%	27.2%
Soybeans	PP	12.1%	39.3%
Non-agglomerated iron ores and concentrates	PP	7.3%	46.6%
Copper cathodes and sections of cathodes	PM	4.7%	51.3%
Oil-cake and other solid residues resulting from the extraction of soybean oil	PM	2.5%	53.9%
Wood pulp; chemical wood pulp, soda or sulphate, (other than dissolving grades), semi-bleached or bleached, of non-coniferous wood	PM	1.8%	55.7%
Soybean oil, crude	PM	1.8%	57.4%
Cane sugar	PM	1.7%	59.1%
Bovine meat, boneless and frozen	PP	1.5%	60.7%

Source: IDB Integration and Trade Sector with data from BACI (CEPII).

Note: Products defined at the 6-digit disaggregation level of the Harmonized System (HS) 1996. Product categories defined in note in Figure 5.

value of purchases (Table 2). All of these, except for one, belong to the industrial manufactures' category. Transmission apparatus is the most important item, accounting for 5.2% of total imports from Asia, with China being the largest seller with 84% of total shipments and followed by Vietnam with 8%. Vehicles accounted for 4.2% of the total, with Japan, Korea, and India representing 36%, 23%, and 20% of the total, respectively. Lastly, storage units for systems for data processing are in third place and are sold mainly by China (44%), Thailand (31%), and the Philippines (11%).

All these data suggest that there is a missed opportunity in terms of trade expansion and diversification, which can be clearly illustrated considering the market share of LAC in Asia and elsewhere across

TABLE 2: TOP LAC IMPORTS FROM ASIA
(Percentage, 2017)

Product	Product Category	Share	Accumulated Share
Transmission apparatus incorporating reception apparatus	IM	5.2%	5.2%
Motor vehicles for the transport of persons, other than public transport (i)	IM	4.2%	9.5%
Storage units for systems for data processing	IM	2.1%	11.6%
Telephonic or telegraphic apparatus	IM	1.8%	13.4%
Portable digital automatic data-processing machines weighing not more than 10kg consisting of at least a central processing unit a keyboard and a display	IM	1.7%	15.1%
Parts of electrical apparatus for line telephony or line telegraphy	IM	1.5%	16.6%
Petroleum oils and oils obtained from bituminous minerals, not crude	F&E	1.1%	17.7%
Optical devices, appliances and instruments	IM	1.1%	18.8%
Metal oxide semiconductors (MOS technology)	IM	1.0%	19.8%
Tankers	IM	0.9%	20.8%

Source: IDB Integration and Trade Sector with data from BACI (CEPII).

Note: Products defined at the 6-digit disaggregation level of the HS 1996. Product categories defined in note in Figure 5.

(i) Includes two separate items: motor vehicles for the transport of persons of cylinder capacity exceeding 1000cc but not exceeding 1500cc, and exceeding 1500cc but not exceeding 3000cc.

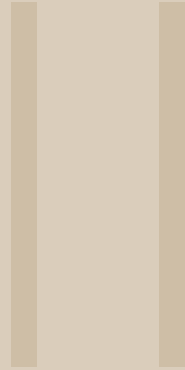
product categories. Between 2010 and 2015, LAC's share of the Asian market of primary products increased by 7 basis points and was the second largest market share gain that the region accrued in global markets, after the strong positioning of Mexico in the US market of industrial manufactures. In primary products, LAC's performance was on par with that of world-class competitors such as Australia, New Zealand, and Canada. In contrast, in the same period, LAC lost market share in the Asian market of primary manufactures. It is striking to note that the market share was lost mainly against Asian competitors, which import unprocessed raw materials from natural resource-rich economies such as those in LAC, and were more efficient in transforming them into exports of higher value-added to their regional neighbors.³

This opportunity seems all the more compelling given the fast-growing demand for food imports in Asia and the likelihood that this trend will accelerate as the middle class expands and consumption preferences evolve accordingly. Asian middle class is projected to increase to 3.5 billion people and account for 57% of global middle-class spending by 2030, up from 36% in 2015, leading to further growth in demand for higher value added food such as beef, poultry, fish, fresh fruit, and packaged snacks.⁴

In sum, trade relations between LAC and Asia are growing stronger and there are opportunities to further develop them. Even though most countries of the region already trade with Asia, the level of interaction widely varies. There are not only new trade channels to be opened, but also significant trade gains to be reaped by diversifying the existing trade patterns. In order to tap the existing trade potential between the two regions, it is key to reduce the trade costs that exporters incur as they ship goods on trans-Pacific trade routes, as discussed in the next section.

3 See Giordano, P. *et al.* (2017), *Beyond the Recovery: Competing for Market Share in the Digital Era*, Inter-American Development Bank.

4 See Kharas, H. (2017), *The Unprecedented Expansion of the Global Middle Class: An Update*, Brookings Institution.



Trade Costs

Trade relations between LAC and Asia face barriers that need to be reduced in order to deepen economic ties and unlock trade gains. Trade costs are driven by tariffs, non-tariff barriers (NTBs), and inefficiencies along transport and logistics routes. Policymakers have levers at their disposal to reduce all components of LAC-Asia trade costs. For example, trade liberalization would help lower tariffs and lift NTBs, investing in infrastructure would bring down transportation costs, while trade facilitation may slash logistics costs.

Trade costs encompass all expenses associated with transferring a product from the production plant or the farm gate to the final consumer. They include costs related to transportation, tariffs, NTBs, obtaining information, meeting legal and regulatory requirements, or enforcing contracts, among others. Some are directly measurable while others are not, and primary data on bilateral LAC-Asia trade costs are not available. This chapter thus relies on estimates of trade costs, complemented with additional indicators that allow to gauge the relative incidence of tariffs, non-tariff, transport, and other logistics costs.

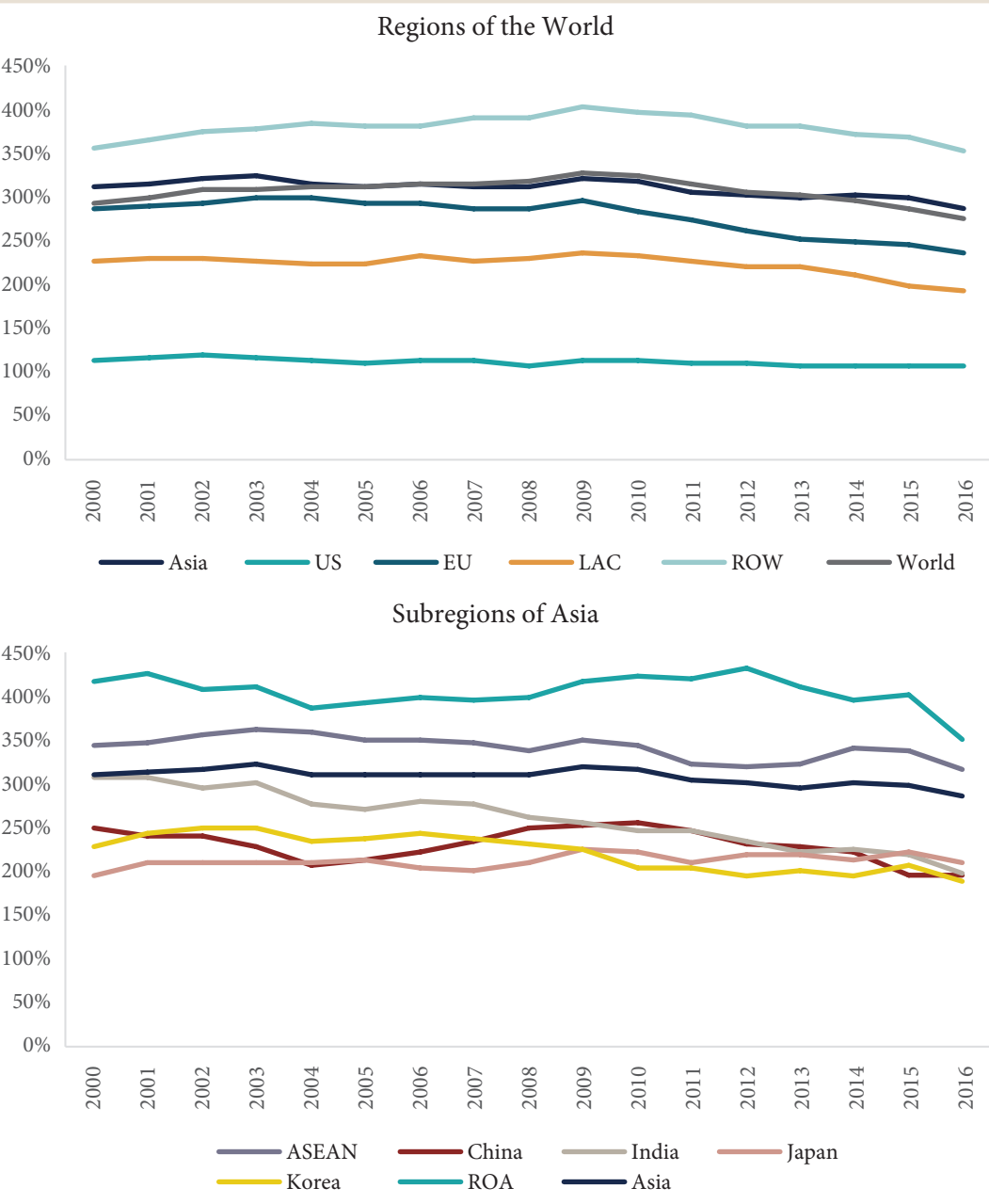
Total Trade Costs

Shipping products between LAC and Asia is expensive and, despite booming trade, there has not been a significant drop in costs (Figure 7, upper panel).⁵ The *ad valorem* total average trade cost between the two regions was 287% in 2016, compared to 311% in 2000. In comparison, trade costs between LAC and the European Union (EU) and LAC itself are lower and on a steeper downward trend, while the cost of trading with the US is much smaller, as expected by the close commercial ties and physical proximity of Mexico.

The cost of shipping goods from LAC to Asian subregions is heterogeneous, reflecting for example differences in the weight-to-value ratios of the export supply or the incidence of different transport modes (land, sea or air). In 2016, the lowest were those paid to reach

5 Bilateral total trade costs expressed in *ad valorem* terms refer to the trade cost with respect to the value of the traded good. Region to region total trade costs reflect the average costs among country pairs. Estimations were performed by the United Nations Economic and Social Commission for Asia and the Pacific (UN ESCAP) and the World Bank based on a gravity model. For details see Arvis, J. *et al.* (2013), Trade Costs in the Developing World: 1995–2010, The World Bank.

FIGURE 7: TOTAL TRADE COST BETWEEN LAC AND SELECTED REGIONS
(Percentage, 2000–2016)



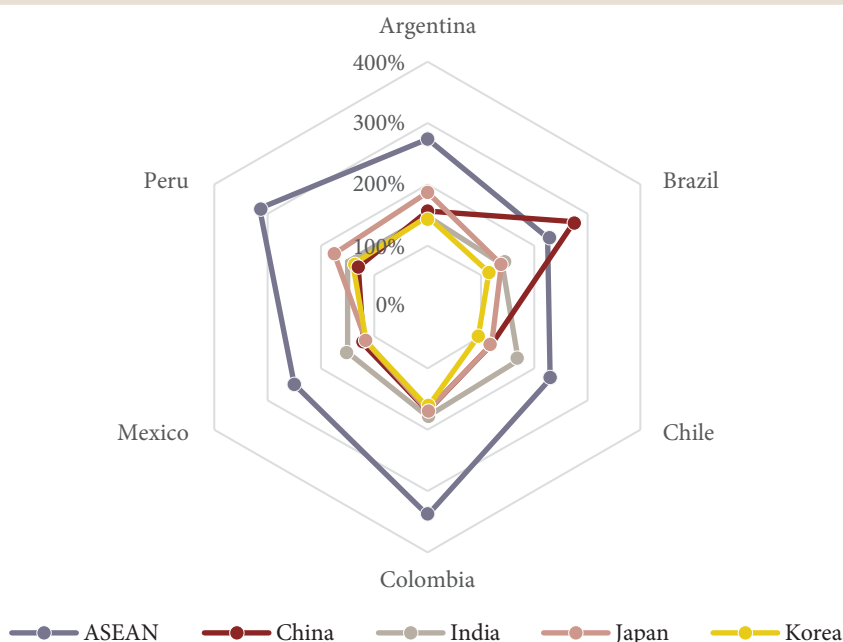
Source: IDB Integration and Trade Sector with data from UN ESCAP-World Bank Trade Cost Database.
Note: Total trade cost is *ad valorem*. ROW stands for Rest of the World and ROA for Rest of Asia. LAC includes all countries except for Haiti.

Korea, China, India, and Japan (between 189% and 213%) (Figure 7, lower panel). On the other hand, trading with ASEAN is quite costly, with *ad valorem* total trade costs of 318% in 2016. This is in part the consequence of differences in country-level bilateral costs, which points to the potential of reducing country-specific barriers to boost trade (Figure 8). For example, total trade costs of LAC countries to ASEAN range from 341% for Colombia to 226% for Brazil, while those to China vary from 277% for Brazil to 119% for Chile.

Trade Policy Barriers

Total trade costs can be reduced through different policies, including trade liberalization and infrastructure investment coupled with reforms that curb transport and logistics costs. Interestingly, tariff costs between LAC and Asia represent just a small proportion of total trade

FIGURE 8: BILATERAL TOTAL TRADE COST BETWEEN SELECTED COUNTRIES IN LAC AND ASIA
(Percentage, 2016)



Source: IDB Integration and Trade Sector with data from UN ESCAP-World Bank Trade Cost Database.

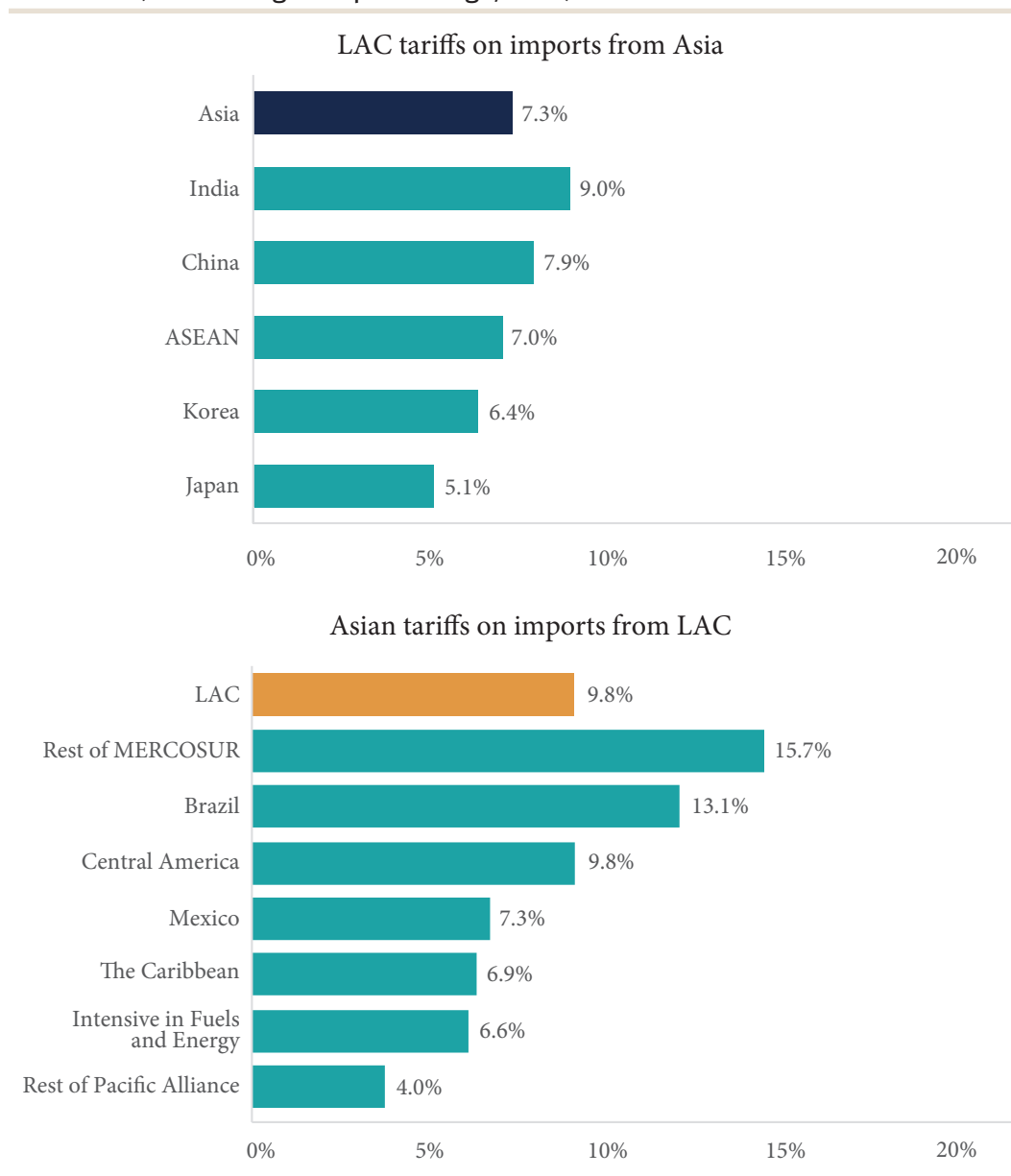
costs. Trade-weighted tariffs reflect the restrictiveness on the partner's export supply. Duties faced by LAC exporters in Asia average 9.8%, whereas in LAC the corresponding average bi-regional rate is lower (7.3%). However, while average tariffs provide a general overview of market access barriers between the two regions, there is considerable variation at the bilateral level (Figure 9).⁶ In several bilateral relations reducing tariffs through preferential trade liberalization can indeed provide a considerable boost to bilateral trade.

Among Asian exporters, India (9.0%) and China (7.9%) are those facing the most restrictive tariffs in LAC. The highest average tariff barriers across LAC are those imposed by Argentina and Brazil, not shown in the figure. In contrast, the countries belonging to the Rest of the Pacific Alliance impose the lowest tariffs. However, there are some bilateral outliers. For example, Indian exporters face tariffs higher than those applied to other Asian countries. Likewise, even though with regard to Mexico there is a liberalization potential for Asian countries, Japan already enjoys relatively low barriers due to the early implementation of a free trade agreement.

For LAC exporters, tariffs can range from an average of 13.1% or 15.7% imposed on Brazil and the Rest of MERCOSUR, respectively, to 4.0% in the case of the countries of the Rest of the Pacific Alliance. But asymmetries in market access conditions at the bilateral level are even starker than in LAC. For example, at the sectoral level, relatively high Korean average tariffs reflect the concentration of tariff peaks in sensitive agricultural products. Meanwhile, at the geographic level, in China and to a lesser extent in all other zones, Brazil can face duties three times higher than those imposed on the countries of the Rest of the Pacific Alliance. All these examples are thus suggestive of the potential trade gains to be reaped through bilateral and plurilateral preferential trade negotiations.

⁶ For presentation purposes, indicators are reported separately for Brazil and Mexico, and the remaining economies in the region are grouped as follows: Central America (Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, and Panama); Rest of MERCOSUR (Argentina, Paraguay, and Uruguay); Rest of the Pacific Alliance (Colombia, Chile, and Peru); Intensive in Fuels and Energy (Bolivia, Ecuador, and Venezuela); and the Caribbean (Bahamas, Barbados, Belize, Guyana, Haiti, Jamaica, Suriname, and Trinidad and Tobago).

FIGURE 9: BILATERAL TARIFF COST BETWEEN LAC AND ASIA
(Trade-weighted percentage, 2016)



Source: IDB Integration and Trade Sector with data from CESifo Group and World Bank.

Note: Tariffs are reported as trade-weighted averages across products and countries. Bilateral tariffs at the 6-digit level are aggregated in three steps taking into account: i) for each imposing country, the export structure of the partner to the world; ii) for each group of exporters, the share of GDP adjusted by distance to each member; and iii) for each group of importers, the share of imports from the world over the total of the group of imposing countries.

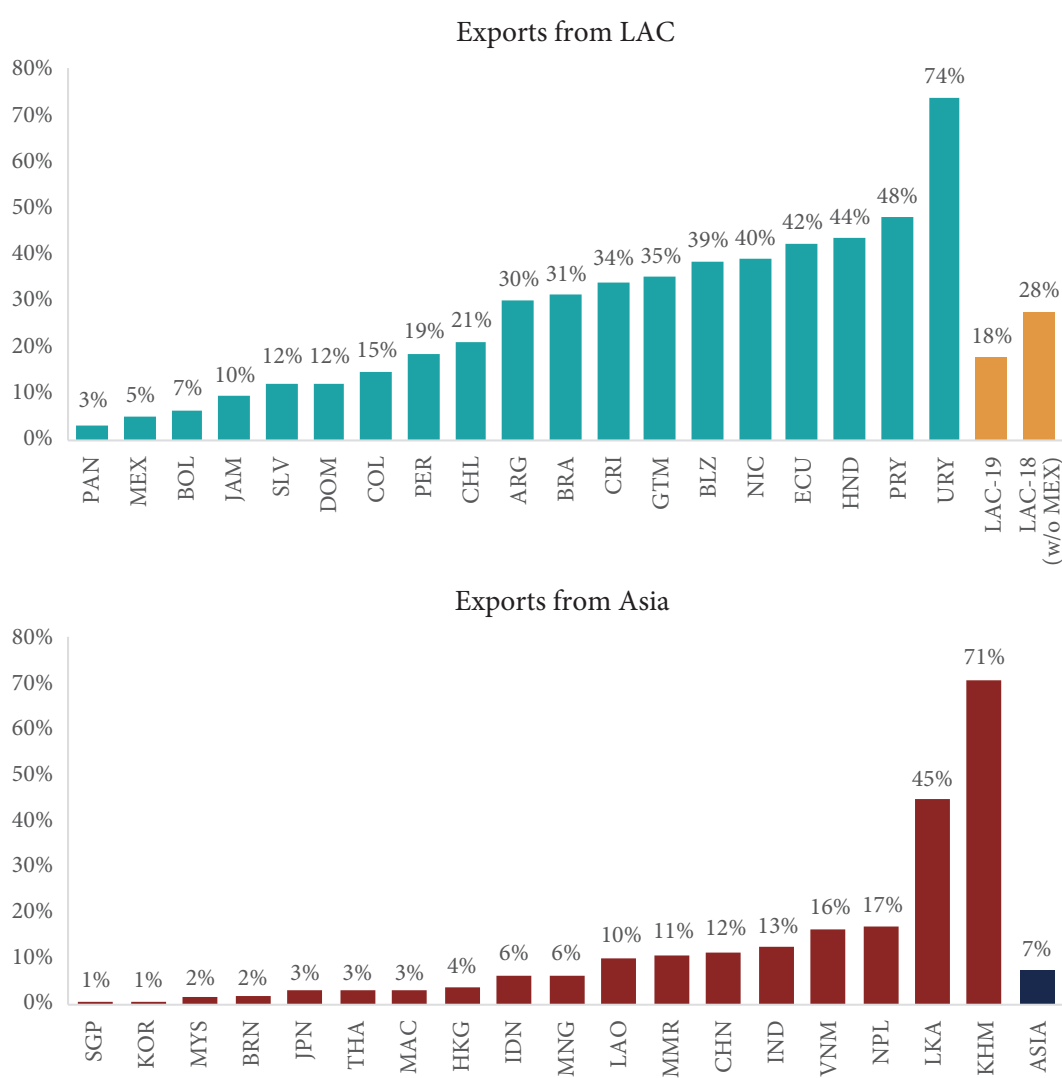
However, tariffs are hardly the only costs induced by restrictive trade policies. NTBs can be quite hefty and cumbersome, despite the fact that they sometimes attend legitimate safety concerns. NTBs include technical measures (sanitary and phytosanitary measures, technical barriers to trade, and pre-shipment inspections and other formalities), and non-technical measures (contingent trade-protective measures, quotas and quantity controls, price controls, finance measures, measures affecting competition, intellectual property, and rules of origin, among others). In LAC-Asia bilateral trade, exporters face a set of specific NTBs which apply exclusively to each other and may inhibit or slow down trade as they prevent competition on a level playing field. Cooperation on these NTBs can therefore help bilateral trade expansion.⁷

The share of LAC total exports to the world that are affected by NTBs imposed by Asia exclusively to LAC countries was on average 18% between 2014 and 2016, but it varied widely among countries (Figure 10). Excluding Mexico from the sample, as its basket is barely affected by these measures and its weight in LAC exports is large, the average increases to 28%. For example, Asian NTBs highly impact Uruguay since, on average between 2014 and 2016, 74% of its total export basket was affected by at least one such measure. Soybeans and bovine meat, which represent one third of Uruguay's total exports, were subject to 9 and 24 measures, respectively.

For Chile, Brazil, and Argentina, Asian countries are among the top trading partners, absorbing 48%, 33%, and 26% of total exports in 2016. They are heavily impacted by NTBs, with 21%, 30% and 31% of their total shipments to the world affected by Asian NTBs. In contrast, Panama, Mexico, or Bolivia are subject to a much smaller impact (3%, 5%, and 7% of total exports). On the other hand, the incidence of LAC NTBs in Asia is much lower. Nevertheless, countries such as Cambodia and Sri Lanka stand out as 71% and 45% of their total exports, respectively, are affected by at least one specific NTB applied by LAC.

⁷ For a comprehensive list see UNCTAD (2012), International Classification of Non-Tariff Measures, UNCTAD. This section focuses only on NTBs that are applied exclusively on LAC-Asia bilateral trade.

FIGURE 10: SHARE OF TOTAL EXPORTS AFFECTED BY NTBS
(Percentage, average 2014–2016)

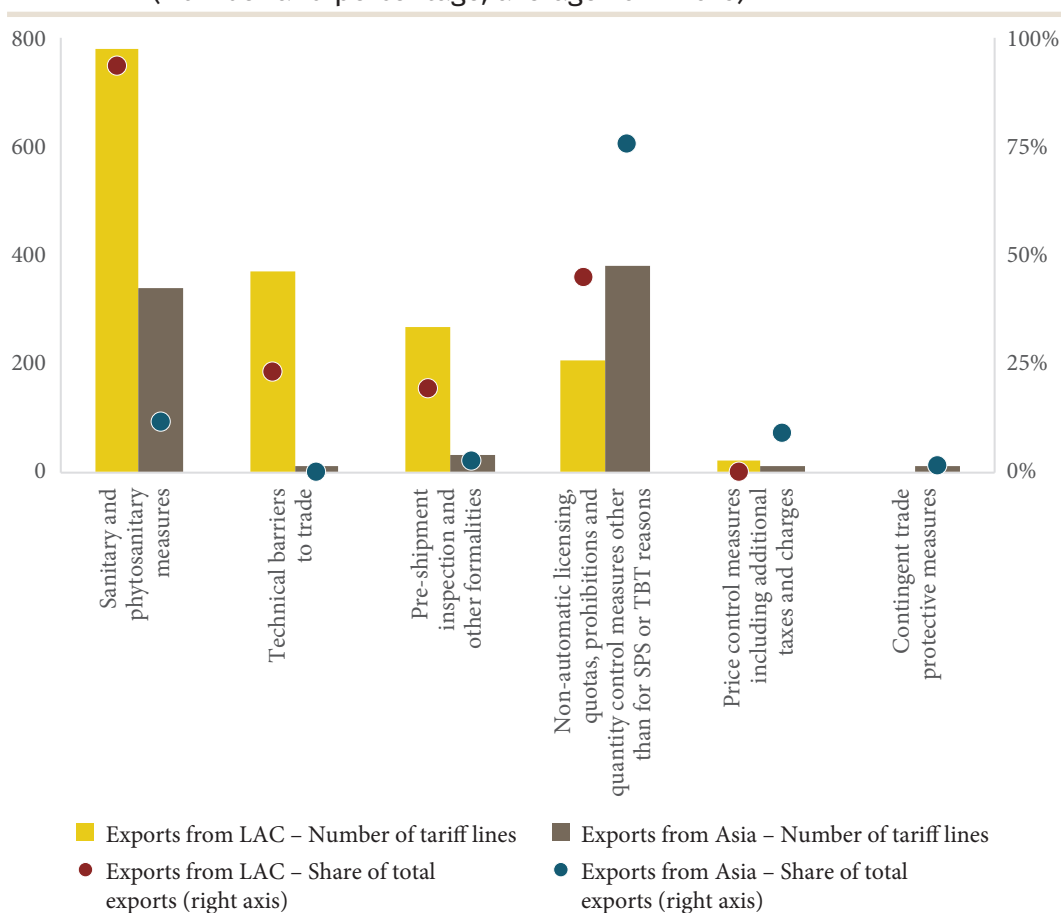


Source: IDB Integration and Trade Sector with data from TRAINS.

Note: Data represent the share of world exports affected by NTBs imposed by Asian countries exclusively to LAC (upper panel), and vice versa (lower panel). LAC-19 includes Argentina, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Peru, Paraguay, and Uruguay. LAC-18 excludes Mexico. Asian countries that appear in the database as imposing specific measures to LAC include Brunei, China, Hong Kong SAR, Indonesia, Japan, Sri Lanka, Malaysia, Philippines, Thailand, and Vietnam. LAC countries that appear in the database as imposing specific measures to Asia include Argentina, Bahamas, Bolivia, Brazil, Chile, Colombia, Ecuador, Jamaica, Mexico, Panama, Peru, Uruguay, and Venezuela.

Sanitary and phytosanitary measures (SPS) are the most pervasive type of NTB applied by Asia specifically to LAC. 775 tariff lines, representing 94% of total exports affected by NTBs, were the target of at least one SPS in 2014–2016 (Figure 11).⁸ Conformity assessments,

FIGURE 11: NUMBER OF TARIFF LINES AND SHARE OF EXPORTS AFFECTED BY NTB TYPE
(Number and percentage, average 2014–2016)



Source: IDB Integration and Trade Sector with data from TRAINS.

Note: Data corresponds to selected countries in both regions as defined in Figure 10. Percentages refer to total exports affected by at least one NTB.

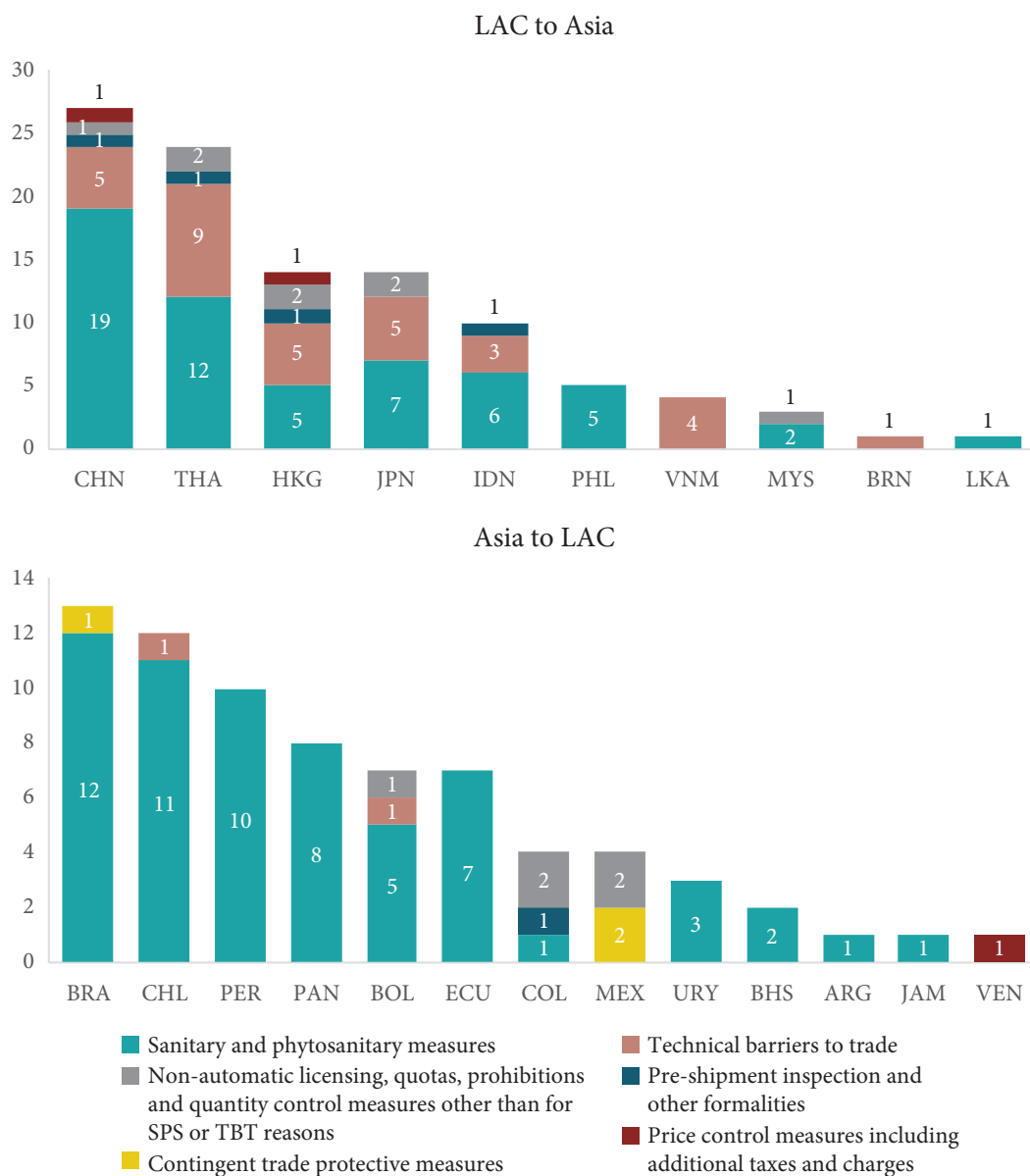
⁸ Tariff lines correspond to the HS classification (2012) at six digits.

hygienic requirements and tolerance limits for residues target major export items, such as oil seeds and oleaginous fruits, fruits, and meat and offal. Technical barriers to trade (TBT) such as labeling, marking and packaging requirements, and prohibitions or restrictions of imports set out in TBT agreements affected 371 tariff lines and 24% of exports impacted by at least one NTB, with fruits, fish, and vegetables standing out at the top of the list. Pre-shipment inspections and other restrictive customs formalities also impacted 20% of the exports and 273 tariff lines. On the other hand, non-technical barriers, such as non-automatic licensing, quotas, prohibitions and quantity control measures impacted 44% of exports affected by NTBs and 209 tariff lines, particularly in meat and offal, sugar, and cereals.

In contrast, quantity controls are the most relevant measures imposed by LAC to Asia, covering 75% of exports affected by at least one NTB and 377 tariff lines. SPS measures, although second in relevance and present in 341 tariff lines, had a much lower impact (12%). The asymmetry in the impact of SPS requirements obviously derives from the pattern of specialization of the two regions, with LAC exporting mostly primary products, affected by SPSs, and Asia manufactured products subject to other measures.

The number and types of NTB measures faced by LAC in Asian countries differ widely (Figure 12). China imposes on average 27 NTB measures exclusively to LAC, out of which 19 correspond to SPSs and 5 to TBTs. In Thailand, where LAC exporters face 24 types of specific measures, SPSs rank first, but TBTs are also impactful, with 12 and 9 measures, respectively. In contrast, there are countries that impose very few barriers to trade specifically to LAC, as Sri Lanka with only one SPS, Malaysia with 2 SPSs and one measure related to quantity controls, or Vietnam with four TBTs. Although these figures need to be qualified, as for these countries trade with LAC may not be large and as a result fewer barriers are imposed, they allow to identify the areas in which regulatory cooperation can be fruitful. Indeed, except for Philippines and Sri Lanka, all Asian countries considered apply measures to all 19 LAC countries analyzed. On the other hand, LAC countries impose a smaller range of NTBs. While SPSs are very

FIGURE 12: NUMBER OF TYPES OF SPECIFIC BILATERAL NTB MEASURES IMPOSED BY LAC AND ASIA
(Number, average 2014–2016)



Source: IDB Integration and Trade Sector with data from TRAINS.

relevant, TBT measures are infrequent. Brazil is the country that imposes the highest number of NTBs exclusively to Asia, with 12 SPSs and one contingent trade protection measure. Mexico, Colombia, and Bolivia are the economies requiring quantity controls, while Venezuela is the only one applying price control measures.

Transport and Logistics Costs

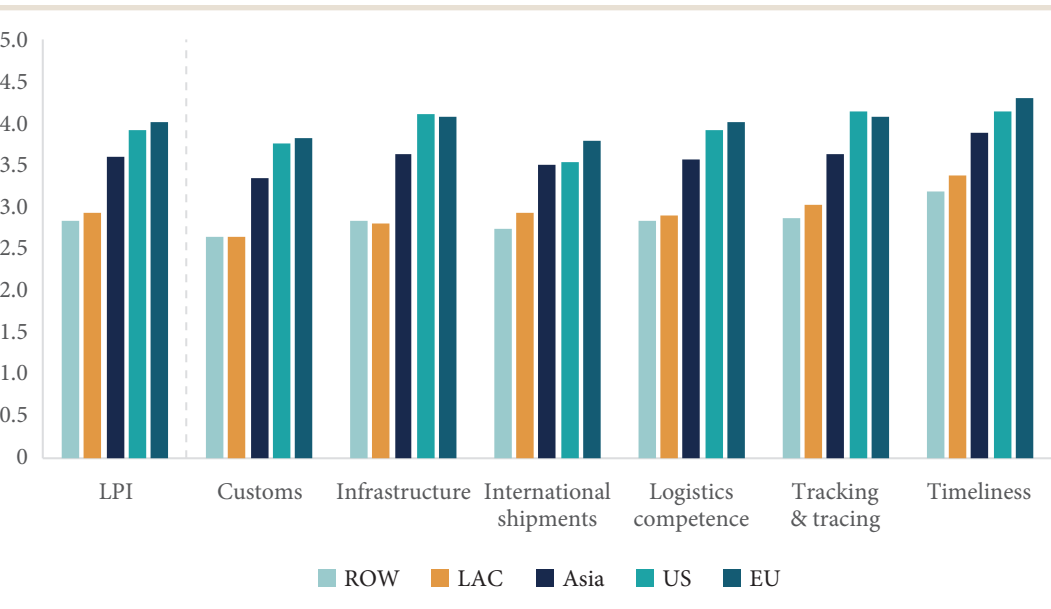
As pointed out earlier, besides tariffs and NTBs, transport and logistics costs are a major driver of total trade costs. To gauge how different regions fare in terms of trade logistics, the Logistics Performance Index (LPI) combines six indicators, grouped into inputs and outputs of the supply chain. The first category includes three areas related to policy regulations, which are the efficiency of customs, the quality of infrastructure related to trade and transport, and the quality of logistics services. The second focuses on service delivery performance and consists of the ease of access to competitively priced international shipments, the ability to track and trace shipments, and the frequency with which shipments reach consignees within the expected delivery time.⁹

LAC trade logistics performance is lower than that of the main regions of the world, and it is behind Asia, the US, and the EU in all six components of the index (Figure 13). The EU and US are on top of the distribution and close to each other, while Asia ranks third. The aggregate LPI for 2012–2018 for LAC is 82% of that of Asia, and the gap is particularly wide in the infrastructure component, with LAC's index being 77% of Asia's. Investment in the maintenance and upgrade of the network of roads, ports, and airports would therefore reduce trade costs and boost trade. Moreover, as trade with Asia expands, there would be growing demand to further develop the infrastructure network, and tailor it to the specific needs of these new trade routes.

Another area for improvement is the efficiency of customs, as LAC's index is 79% of Asia's and 69% and 70% comparing to the EU and US, respectively. Bureaucracy can be cumbersome, and containers

⁹ For more details see Arvis J., *et al.* (2018), *Connecting to Compete: Trade Logistics in the Global Economy*, The World Bank.

FIGURE 13: TRADE LOGISTICS PERFORMANCE INDEX
(Aggregated index, average 2012–2018)



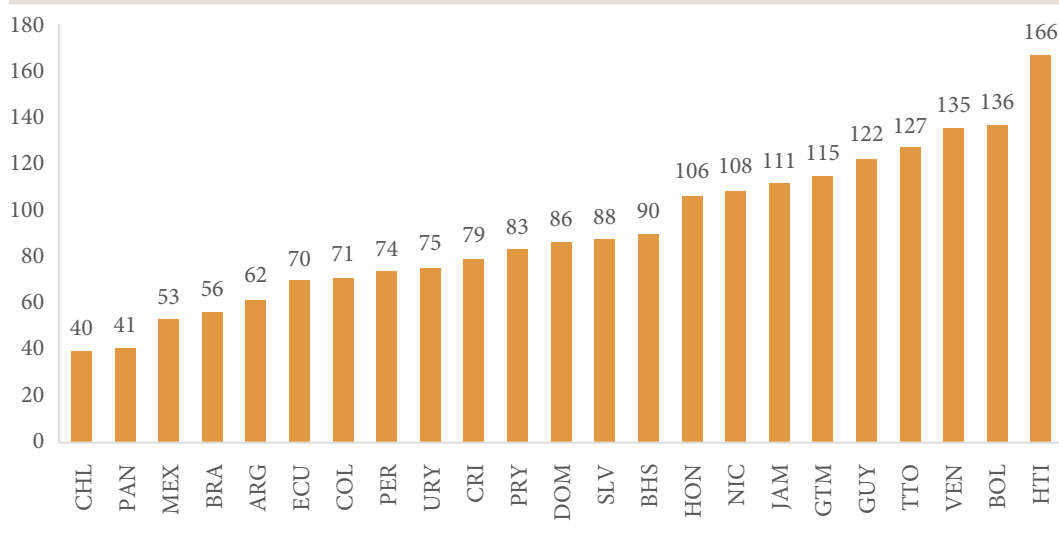
Source: IDB Integration and Trade Sector with data from the World Bank.
Note: Regions are constructed as weighted averages by total trade. Years include 2012, 2014, 2016, and 2018, and the aggregation is provided by the data source, giving higher weights to more recent years. LAC does not include Belize, Barbados, and Suriname, due to data availability.

can be grounded for several days at customs, incurring in additional storage costs and delays. Trade facilitation, as the implementation of trade single window systems, may help to accelerate customs formalities. For example, in Costa Rica, time of clearance at customs went from more than 5 days to just hours or even minutes with the implementation of the trade single window in the mid-2000s.¹⁰ On the other hand, the narrowest gap between LAC and the other regions is found in access to international shipments and timeliness.

Among LAC countries, Chile and Panama stand out in terms of logistics performance, reaching the 40th and 41th rank out of 167 countries (Figure 14). Mexico also performs relatively well, at the top third of

10 For more details see Volpe, C. (2016), Out of the Border Labyrinth: An Assessment of Trade Facilitation Initiatives in Latin America and the Caribbean, Inter-American Development Bank.

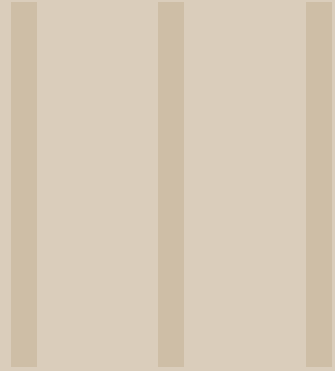
FIGURE 14: TRADE LOGISTICS PERFORMANCE RANK OF LAC COUNTRIES
(Rank, aggregated for 2012–2018)



Source: IDB Integration and Trade Sector with data from the World Bank.

the world distribution. Countries like Brazil, Argentina, Ecuador, Colombia or Peru stand above the median. In contrast, Haiti is at the bottom of the list. Countries intensive in exports of fuel and energy, like Venezuela and Bolivia, also perform poorly, in positions 135 and 136, respectively. This heterogeneity shows that although different countries in LAC have reached varying degrees of trade logistics performance, there is scope for improvement across the region.

In sum, LAC and Asian countries face high costs when trading with each other. Although distance between the two regions is an undeniable natural barrier, trade costs could be substantially lowered through the reduction of tariffs and non-tariff barriers, investment in infrastructure and other initiatives aimed at improving trade logistics. Closer cooperation, coupled with policy reforms and investment in trade connectivity on each side of the Pacific Ocean, can have a positive impact in deepening trade ties, which in turn could boost economic growth, as discussed in the next chapter.



Export Potential

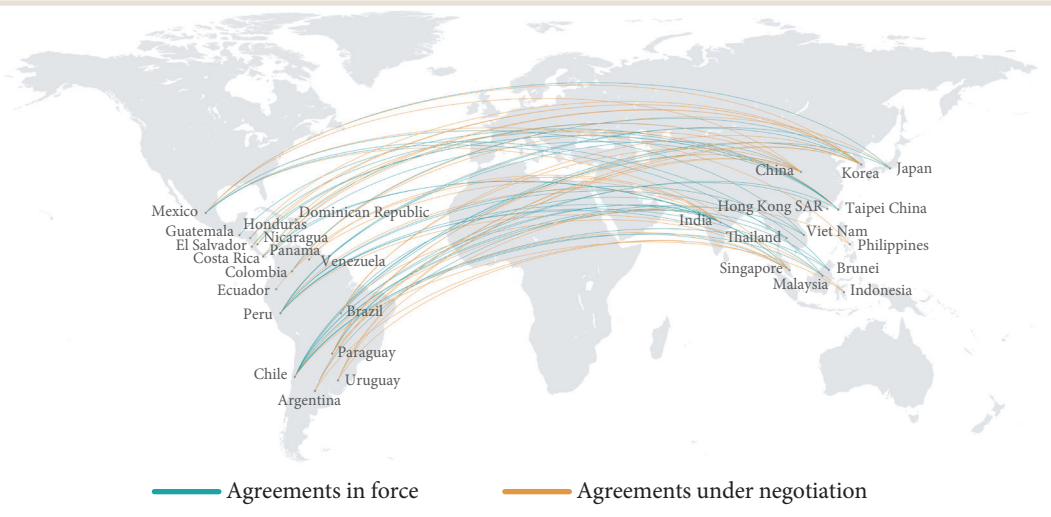
Reducing the existing trade costs among Latin American and the Caribbean and Asian countries could bring the LAC-Asia commercial relationship to a whole new level. However, in order to make trade work for development, expanding bilateral flows is as important as diversifying them into higher value-added market segments. As different policy instruments may have diverging effects at the country and sectoral level, it is of the utmost importance to combine them in a smart mix to achieve a balanced outcome. This section presents some illustrative evidence on the trade opportunities generated so far through preferential agreements, complements it with an estimation of the trade potential of a mix of policy instruments, and concludes with an indication of specific market opportunities that may be pursued to diversify the current export pattern of LAC.

Trade Expansion through Preferential Agreements

In the last decade and a half, the instrument of choice for deepening economic relations between LAC and Asia has been the negotiation of Free Trade Agreements (FTAs). The network of trade deals between countries of the two regions is dense and growing. Twenty-six agreements are already in force and another twenty are in the making, under negotiation, awaiting ratification or simply proposed and under consultations (Map 1). In LAC, Chile and Peru have been the most prolific negotiators with nine and five agreements in force, respectively. At the other end of the spectrum, MERCOSUR founding members (Argentina, Brazil, Paraguay, and Uruguay) only have one agreement of limited scope in force with India. However, even these latecomers are now considering or negotiating agreements with Asian powerhouses such as China, Korea or Singapore.

Preferential trade agreements offer an opportunity to expand market access by reducing tariffs and other regulatory barriers to trade. A comprehensive assessment of the performance of LAC-Asia FTAs is difficult given the variation in the maturity of the agreements, even more so as some FTAs are still at the early stages of their implementation phase. Nevertheless, some examples illustrate the

MAP 1: FREE TRADE AGREEMENTS BETWEEN LAC AND ASIA
(2018)



Source: IDB Integration and Trade Sector with data from official national sources.

benefits accrued by LAC countries in terms of export expansion and trade diversification, but also point to the challenges that come with market openness.

In 2006 the entry into force of the FTA between Chile and China started a process of rapid trade liberalization. In ten years, 97% of tariff lines were duty-free, and nowadays Chile enjoys the lowest preferential tariff rate of any of China’s FTA partners. Refined copper still represents an overwhelming share of Chilean exports to China and the FTA allowed a small, yet non-negligible, margin of preference compared to competitors of the caliber of Australia. Furthermore, the FTA prompted a major boost to trade diversification into high-margin products.

Chilean exports of wine to China grew on average 46% per year between 2005 and 2014. Chilean grapes, cherries, and cranberries sales grew even faster, at 73% over the same period. These products benefitted from the most significant liberalization in the FTA, with the median tariff falling from 19.2% to 0.9%. These gains have also

been replicated in agreements of Chile with other Asian countries. For example, exports of blueberries to Korea, which enter duty-free with a margin of preference of 45% against non-FTA partners, allowed Chile to become the market leader with a market share of 84%. Likewise, Chile can compete in the Indian market for kiwis thanks to a 50% preference negotiated in 2007 and extended in 2017.

Peru has also been very active in the negotiation of FTAs with Asian partners. Even though non-traditional exports still represent a low share of bilateral exports to Asian countries, there has been a drive towards diversification. Peruvian firms have begun to export 548 new products to China, almost entirely in non-traditional sectors such as metal-mechanic, textiles, and chemicals. As a result, in 2017 Peru consolidated its position as second exporter of grapes to China, after Chile. Likewise, Korea is now the third destination of Peruvian cuttlefish and absorbs growing shares of fruits and food preparations.

Most of the agreements between LAC and Asia are still in the implementation phase and have therefore not deployed their full liberalization potential. But even a recent deal like the Colombia-Korea FTA signed in 2016 offers a perspective on how quickly trade gains can set in. In 2016 and 2017, non-traditional exports of Colombia to Korea were extremely dynamic, growing at a rate of 45% while total exports were hovering around 18%. Coffee and cut flowers were two of the products that contributed the most to bilateral trade growth. Exports of coffee will be duty-free in the third year of implementation, while the average tariff of 25% on flowers will be slashed in three to five years, depending on the variety.

These examples are illustrative of the many market opportunities offered by FTAs, but governments are well-advised to not take them for granted. Following up implementation with complementary policies is of paramount importance. For example, between the entry into force of the FTAs and 2017, Peruvian exports grew by 26% to Singapore, 11% to China, but only 3% to Korea, and fell to Japan and Thailand by 13% and 4%, respectively. While the asymmetry in export performance may be due to a wide range of causes, it signals the need to implement trade facilitation, export promotion

initiatives, and trade cost-reducing investments in infrastructure to effectively capitalize the trade expanding opportunities of such agreements. On the other hand, as reciprocal market opening also unleashes growing competitive pressure on domestic producers, policymakers need to adequately prepare their economies to absorb the shock of deeper integration with Asian powerhouses, particularly in the manufacturing sectors.

Estimating the Export Potential

While the prolific negotiation of FTAs has allowed LAC exporters to establish a stronger presence in Asian markets in less than two decades, there is still potential for expansion and diversification. A computable general equilibrium model allows to consider changes in several markets simultaneously and to assess the economy-wide impact of different drivers of trade cost reductions.¹¹ The simulation is far from perfect as the model does not capture all sources of trade gains, such as those arising from the removal of NTBs, of barriers to trade in services or from greater competition, innovation and productivity. As such, it should be considered as a lower bound to potential trade gains and is more illustrative of the variations of gains across different categories of trade costs than of their absolute value.

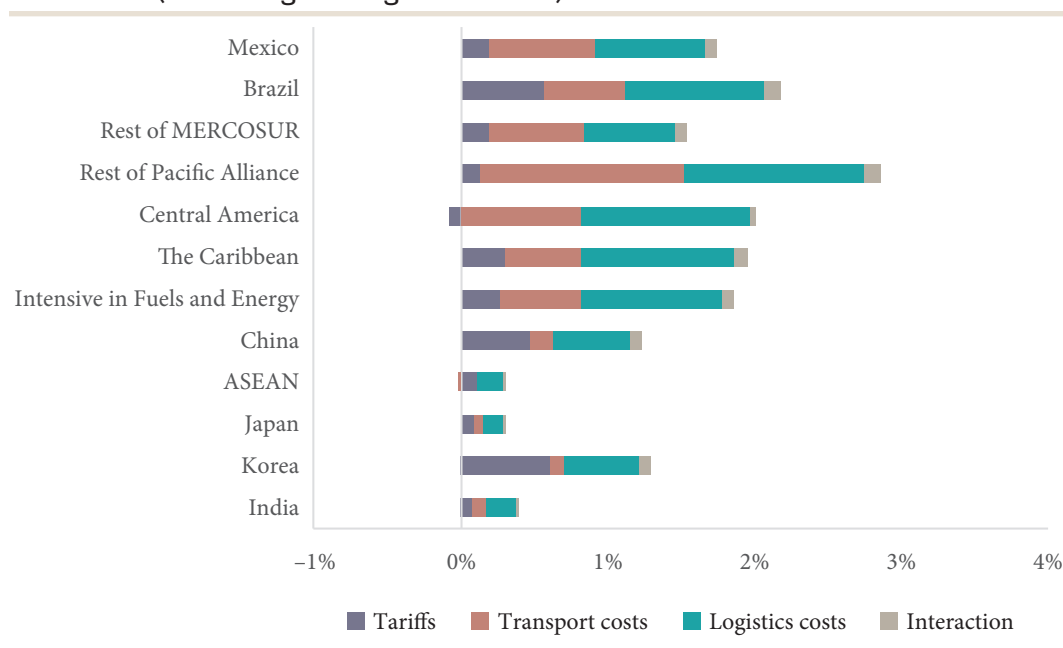
The simulation details how exports of goods would change with the reduction of existing tariffs among LAC and Asian countries and a drop in transport and other logistics costs. The stylized scenario assumes that bilateral trade may be boosted by three alternative drivers of trade cost reduction: i) the preferential tariff liberalization assumes the complete elimination of lower bilateral tariffs and non-linear reductions of tariff peaks in the most sensitive products; ii) the reduction of transport costs assumes a drop in the bilateral cost of shipping goods across the ocean; and iii) the contraction of logistics costs assumes a reduction of trade frictions due to inefficiencies in trade logistics and other regulatory red tape.¹²

¹¹ Technical details and references are available upon request.

¹² Technically, the reduction of trade costs is modeled with a static computable general equilibrium model that considers three simultaneous shocks. Trade liberalization assumes a complete phase-out of all tariffs below 50%, a 50% reduction of tariffs

The overall reduction of trade costs between LAC and Asia would bring about gains for both regions. Private consumption, a measure of welfare, would increase by 1.6% and 0.7% in LAC and Asia, respectively (Figure 15). Particularly LAC, that is emerging from a recession, can hardly afford to forego such a boost to income. However, the benefits are not evenly distributed within each region. In LAC, countries such as Brazil, Uruguay, and Paraguay stand to gain the most.¹³ Whereas in Asia, the greatest benefits may accrue to Korea, China, and Singapore. The drivers of trade cost reduction also have diverging impacts across

FIGURE 15: IMPACT ON WELFARE
(Percentage change from base)



Source: IDB Integration and Trade Sector own computable general equilibrium model estimates.

Note: Change in national welfare is measured as the variation in private consumption.

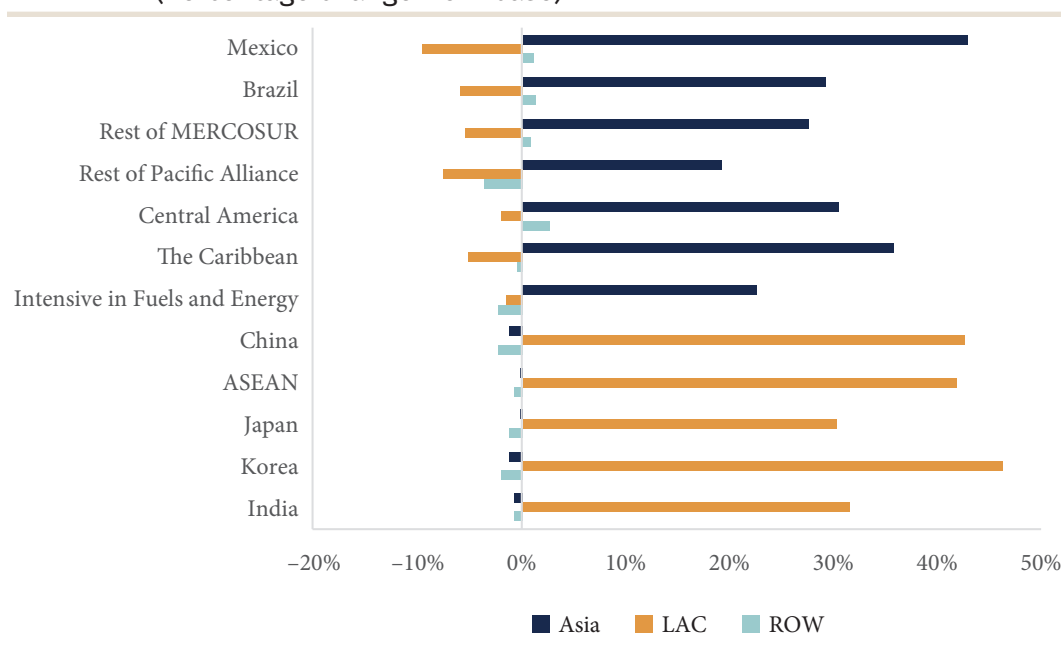
between 50% and 100%, and a 25% reduction of tariffs higher than 100%. The reduction of transport costs is modeled as a 15% reduction in the transport margin, reflecting a contraction in the cost of transport services required to ship a unit of a given good from the exporting to the importing country. The reduction of logistics costs is modeled as a 33% drop of the iceberg-type costs incurred by traders. Iceberg costs are modeled as a non-revenue generating wedge. For instance, if trade costs are equal to 15% in a given bilateral trade route, that means that if 100 units leave the origin, only 85 units will reach the destination. As these costs are set at 15% of the value of trade in the baseline, the simulations assume a reduction of 5 percentage points.

13 For presentation purposes, simulation results are presented following the country grouping described in footnote 6.

countries. Lowering logistics costs has a dominant impact in most of the countries or groups. Tariff liberalization has a relatively larger effect in Brazil and the Asian economies, except India. Whereas in the Rest of the Pacific Alliance, which includes Colombia, Peru and Chile, the reduction of transport costs leads to the largest gains, as these countries are specialized in mining exports that have on average a high transportation cost per dollar exported.

Besides the overall general equilibrium effects on welfare, the most direct and significant impact of the reduction of trade costs would be reflected in a strong expansion of commercial flows. LAC total exports may be boosted by 4%, while Asian exports may grow 0.6%, reflecting the asymmetric weight of each region in each other's trade structure. At the regional bilateral level, LAC exports to Asia may grow by 27.6%, while Asian exports to the region may do so by 40.6%, with considerable dispersion among LAC countries (Figure 16). The

FIGURE 16: IMPACT ON BILATERAL EXPORTS
(Percentage change from base)



Source: IDB Integration and Trade Sector own computable general equilibrium model estimates.

main driver of the difference in magnitude is the tariff reduction component of the scenario, which has a stronger impact on Asian exports than on LAC's, due to the initial pattern of tariff protection. In other words, while trade liberalization may bring gains to both regions, investment in infrastructure and trade facilitation reforms to reduce logistics costs is a necessary complementary policy for LAC.

As expected, a massive expansion of this scale would also bring about an adjustment of trade flows of LAC with other partners, as factors of production are redirected to produce exports bound to Asia. However, in LAC, it is interesting to note that while exports to intra-regional partners may decrease as they face stiffer competition from Asia, notably in non-food manufactured products, sales to the rest of the world, mostly the US and EU, would grow as the benefits of the reduction of transport and logistics costs would also boost competitiveness in these markets.

Such a shift in trade flows would also drive adjustment of production patterns at the sectoral level (Table 3). Agri-food sectors emerge as the main winners across LAC. Brazil may expand output in agriculture and food by 4.5% and 4.6%, respectively. But gains may be seen across the whole region. Particularly in the Rest of MERCOSUR, where the same simulation points to an expansion of 3.2% and 2.8%, respectively, and in the Caribbean, where food products would grow a significant 4.6%. In other subregions gains in these sectors are expected to be more muted. Output expansion may also occur in mining, particularly in the Rest of the Pacific Alliance (4.3%) and Brazil (3.8%). Lastly, it is worth noting that Central America may grow in manufacturing sectors such as vehicle parts (8.3%), machinery (4.0%), textiles (1.7%) and apparel (1.4%), while in Mexico growth in manufacturing sectors would be limited to vehicles (1.6%) and machinery (1.3%). Likewise, although the focus of the analysis is placed on merchandise trade, it is worth noting that services sectors would grow, albeit slowly, in almost all country groups.

On the other hand, textiles and apparel are the two sectors that may experience the greatest competitive pressure in LAC. For instance, the decline in output in textiles, that would affect virtually all subregions,

TABLE 3: IMPACT ON SECTORAL OUTPUT
(Percentage change from base)

	Mexico	Brazil	Rest of Mercosur	Rest of Pacific Alliance	Central America	The Caribbean	Intensive in Fuels and Energy	China	ASEAN	Japan	Korea	India	Rest of the World
Agriculture	1.03	4.50	3.16	1.35	0.81	1.73	1.15	-0.05	-0.20	-0.44	-0.62	0.05	-0.12
Mining	-0.01	3.82	1.82	4.31	0.20	0.59	1.15	-1.26	-0.65	-2.55	-2.90	-0.94	-0.28
Food	1.80	4.64	2.77	2.60	0.79	4.57	1.30	0.24	-0.26	-0.30	0.58	-0.13	-0.10
Textiles	-10.63	-10.93	-16.11	-6.99	1.65	-2.85	-7.85	1.72	1.89	0.35	1.83	1.13	0.06
Apparel	-2.97	-1.41	-3.44	-0.14	1.40	0.52	-1.84	1.40	1.66	0.22	0.65	1.83	0.12
Petrochemicals	-1.32	-0.29	-1.56	-2.22	-0.05	0.10	2.26	0.23	0.49	0.32	0.76	1.16	0.07
Vehicles	1.59	-3.42	-8.88	-8.89	8.29	-5.30	-6.87	0.02	1.03	0.87	6.11	0.78	-0.31
Machinery	1.28	-6.04	-11.55	-6.56	4.01	-3.65	-9.90	0.06	0.81	0.13	-0.78	0.16	0.19
Oth. Manufactures	-2.90	-0.96	-2.69	-3.36	-1.55	-1.41	-3.53	0.31	0.64	0.05	0.10	-0.22	0.18
Trade	0.55	1.16	0.64	0.88	0.08	0.96	0.26	0.30	0.11	0.12	0.52	0.14	-0.03
Transport	0.72	1.55	0.97	-0.69	-0.17	2.54	0.83	-0.10	-0.64	-0.29	-3.79	0.16	0.08
Services	0.39	0.82	0.58	0.73	0.17	0.51	0.44	0.21	-0.02	0.07	0.07	0.03	-0.01
Total	0.33	0.87	0.40	0.40	0.35	0.44	0.38	0.15	0.06	0.07	0.14	0.08	-0.01

Source: IDB Integration and Trade Sector own computable general equilibrium model estimates.

may range from -16.1% in the Rest of MERCOSUR to -2.9% in the Caribbean. Pressure on the apparel sector will be felt mostly in the Rest of MERCOSUR (-3.4%) and Mexico (-3.0%). Likewise, except for Mexico and Central America, as mentioned above, strong adjustment would be needed in industrial manufacturing sectors such as machinery (from -11.6% in the Rest of MERCOSUR to -3.7% in the Caribbean) and vehicles (from -8.9% in the Rest of MERCOSUR to -3.4% in Brazil). These results point to the necessity to flank trade liberalization with complementary policies that facilitate the transition to freer trade, an issue too often neglected in LAC in the past.

Considering that trade costs, particularly tariffs, and the share of LAC in total trade is much lower in Asia, productive adjustment would be more limited on the other side of the Pacific. While all countries or subregions may witness output growth, China and Korea emerge as the countries with the largest impact. In the former, expansion of output in textile (1.7%) and apparel (1.4%) dwarfs the effects in any other sector, while mining activity (-1.3%) would decline. In the latter, the sectoral effects are more significant. The vehicle (6.1%) and textile (1.8%) sectors may lead the expansion, while adjustment pressure would be felt in industries as diverse as mining (-2.9%), machinery (-0.8%), and transport (-3.8%). It is also worth noting that Japan, ASEAN, and India may experience a small impulse to their manufacturing sectors, and some competitive pressure in mining, agricultural, and food sectors.

Business Opportunities

These economy-wide simulations are valuable as they offer a bird's-eye view on the export potential for LAC in Asia, the relative magnitude of the effects of the reduction in different types of trade costs, and the identification of the most impacted sectors. As such, they can inform policymakers on the effects of the different components of a policy agenda to bolster LAC-Asia trade relations. However, they do not consider the short-term structural restrictions on the supply side, and their aggregation prevents the identification of specific market opportunities, which may be relevant from a private sector perspective. An assessment of the trade complementarity among

countries on the two sides of the Pacific Ocean and of the changes in market shares allows a more granular view of market niches where LAC countries have the most immediate opportunities for expansion and diversification.

Trade complementarity measures the degree to which the sectoral export pattern of one country matches the sectoral import pattern of a trading partner.¹⁴ Consequently, a high degree of complementarity indicates more favorable prospects for a trade arrangement or other trade promotion initiatives aiming at reducing trade costs. As opposed to the simulations reported above, this analysis allows identifying trade opportunities when current bilateral trade flows do not yet exist or are underdeveloped.

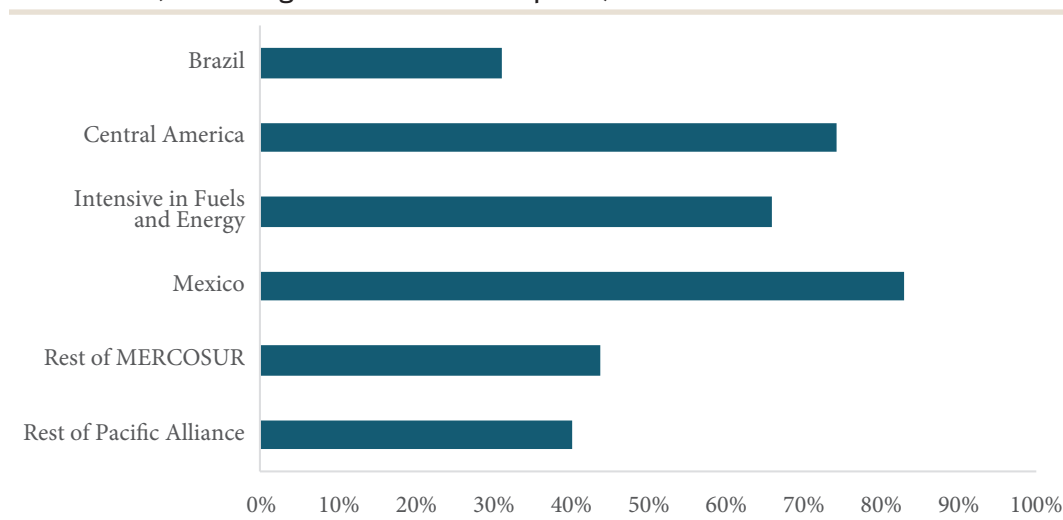
For simplicity, trade opportunities for LAC in Asia can be proxied with the share of LAC exports to the world for which there is trade complementarity with Asia. For instance, in the case of Brazil, the unexploited trade opportunities in Asia are equivalent to 31% of its total exports (Figure 17). At the other extreme, Mexico has an export bundle highly complementary with the import structure of at least one Asian country, but trade routes are for the most part not active. A few examples at the bilateral sectoral level illustrate concrete trade opportunities from a business perspective.¹⁵

While reporting detailed results would exceed the scope of the analysis, it is interesting to highlight that for most LAC countries or groups the top three trade opportunities concentrate in ASEAN. Indeed, these countries are in high-demand of products in which LAC partners hold a comparative advantage, such as vegetable animal feed from Argentina and Brazil to Cambodia, nuts from Bolivia to Vietnam, or sulfuric acid from Peru to Laos. However, in all Asian destinations, while the top three trade opportunities

14 The complementarity index, calculated at the sectoral level (four digits of the Harmonized System for the period 2015–2017), can take a value between 0 and infinity, with zero indicating no overlap between the export pattern of a country and the import structure of a trade partner, and a value larger than one indicating the presence of sectoral complementarity between country pairs.

15 Note that data for all countries in the Caribbean were not available to compute the indicators. However, as an example, in the case of Jamaica the indicator is 91%, due to a very high complementarity in aluminum. This result underscores the need to run this analysis at the most disaggregated level to identify potential actionable trade promotion initiatives.

FIGURE 17: TRADE COMPLEMENTARITY OF LAC WITH ASIA
(Percentage share of total exports)



Source: IDB Integration and Trade Sector with data from UN COMTRADE.

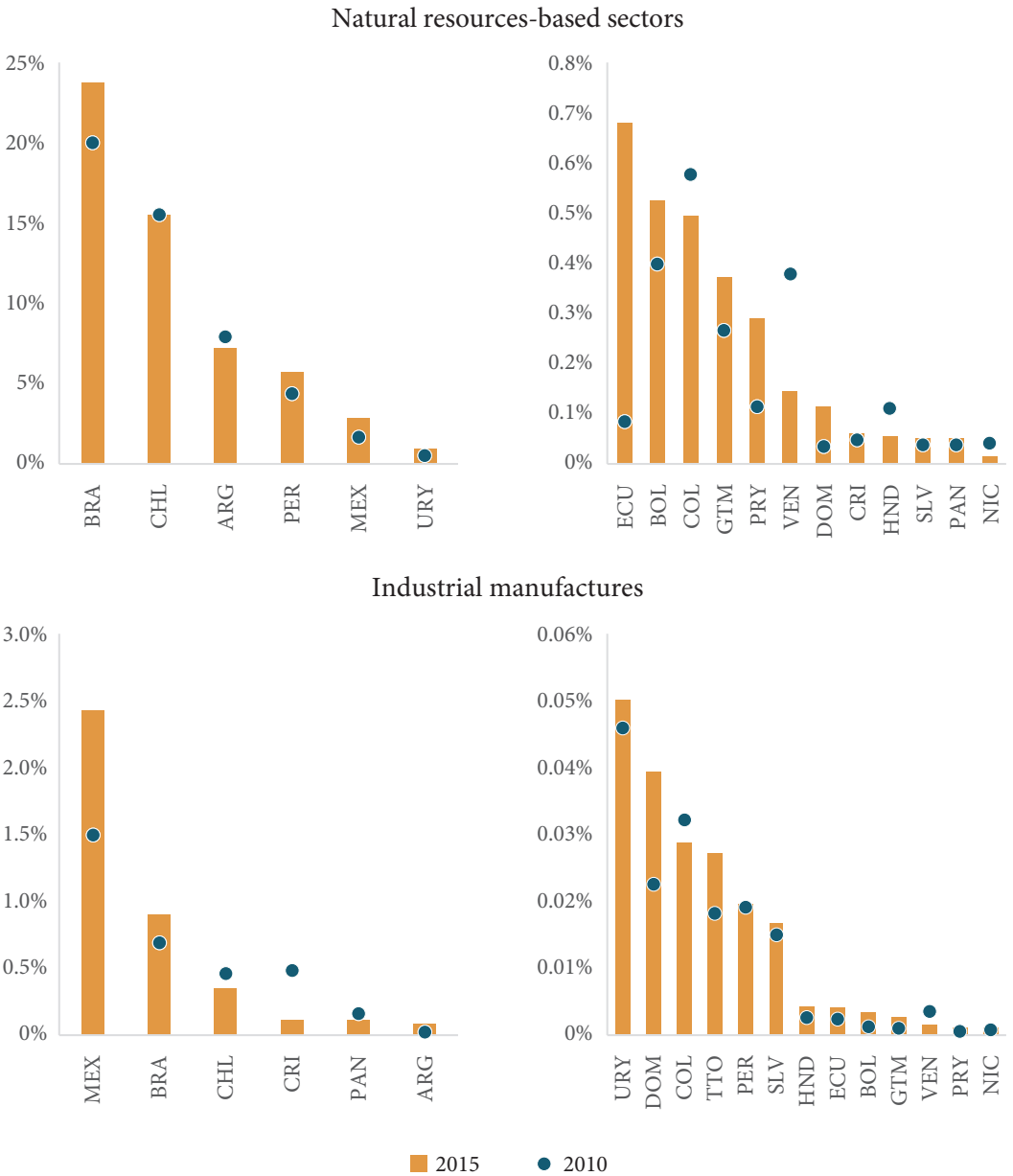
Note: The figures report for each country/group the trade opportunities in Asia as a share of total exports. Trade opportunities arise when two conditions are met: i) there is trade complementarity between country pairs in LAC and Asia; and ii) the value of current exports from LAC to Asian countries is less than 1% of total exports at the product level, allowing to focus on new markets. These conditions imply that there is potential for an increase in exports. Data for the Caribbean are not available.

often concentrate in primary agriculture and mining products, among the top ten it is frequent to find textiles, chemicals and even industrial manufacturing products that may contribute to diversifying existing trade patterns.

Identifying new market niches is certainly an avenue for trade expansion and diversification, but LAC firms also need to preserve their current market shares from competition and expand them in higher-value added segments. Market shares of LAC countries in Asia and their variation across time are analyzed separating the industrial manufacturing sectors from those based on natural resources (Figure 18).¹⁶ While, as expected, the most significant shares are those

¹⁶ As in this case the purpose of the analysis is to highlight products with an established presence and understand the interaction with main competitors in each product market, country-level indicators only consider a core export basket obtained through the exclusion of products, defined at 6 digits of the Harmonized System, representing less than 1% of total exports in 2015.

FIGURE 18: MARKET SHARES OF LAC IN ASIA
(Percentage share of total imports, 2010–2015)



Source: IDB Integration and Trade Sector with data from BACI (CEPII).
Note: Figures report exports to Asia as a share of their total imports for each LAC country. Country-level indicators only consider a core export basket, as defined in footnote 16.

held by larger LAC economies in natural resources-based sectors, there's more than meets the eye, as shown by the following examples.

Comparing the evolution between 2010 and 2015 signals a great variation in performance across LAC countries. Among the dominant players in natural resources, take for example the case of Brazil or Peru that increased their shares by 19% and 30%, respectively, in products such as corn, soybeans, and minerals, whereas Argentina reduced its share in the same market segments by 10%.

In industrial manufactures, while Chile, Costa Rica or Panama lost market shares, Mexico increased its share by 63% in high-end products such as auto parts and phones, disputing markets to advanced economies as Japan or the US. Likewise, a smaller player in these markets as Argentina managed to double its share due to the performance of leather and auto parts exporters that outcompeted rivals in the EU and Japan.

Lower shares held by smaller economies should not be overlooked as they still represent important contributions to their overall trade performance. Just to mention the most successful cases, for example, it is interesting to highlight the case of Ecuador, that was able to multiply its share in natural resources-based sectors by a factor of six, through higher exports of seafood, competing with countries such as Australia. In the same vein, Paraguay was able to move up in the value chain through greater exports of soybean oil and cake.

Behind these figures there are stories of businesses that made fortunes or missed valuable internationalization opportunities. These examples are therefore illustrative of the untapped trade potential among the economies of LAC and Asia. But they also suggest that in order to unlock such potential there is a need to deploy a wide array of instruments. Furthermore, they show that removing trade costs alone might not reveal all market opportunities and that active export promotion activities are key to bringing businesses of two distant regions such as LAC and Asia closer. Policy options to do just that are reviewed in the next chapter.

IV

Policy Options

The expansion and diversification of trade between LAC and Asian countries may benefit from several specific initiatives. All of them aim to reduce trade costs through different channels, such as increasing the coverage and utilization of free trade agreements, enhancing the use of trade facilitation measures, undertaking proactive and targeted trade promotion activities, as well as boosting investment in infrastructure and promoting reforms in the logistics sector. Joint LAC-Asian undertakings supported as needed by multilateral, regional, and bilateral cooperation initiatives, would contribute to deepening the trade ties between the two regions, help LAC countries to raise their share in Asian markets, and diversify into sectors of higher value-added. An integrated approach with concurrent actions in all these areas will maximize results in the long run. Furthermore, setting an ambitious goal at the policy level and focusing the strategy on targeted outcomes in the short term may provide built-in incentives to the private sector.

Market Access

As shown by the impact of the FTAs implemented in the last two decades and by the simulation of future scenarios, preferential market access may bring multiple tangible benefits to the signatories, including price advantages, expansion of trade volume, diversification in exports of goods and services, and greater awareness of market opportunities in destination markets. Tariff reductions, including preferential arrangements such as tariff rate quotas (TRQ) as needed, and the elimination of non-tariff barriers would make Asian markets more contestable for LAC exporters. Moreover, concluding FTAs with Asian partners would also help LAC economies to attract investment in rules-based frameworks, including in the manufacturing sectors, which can lead to LAC countries moving up the value chain. In this regard, LAC and Asian countries should consider expanding, upgrading, and deepening their network of FTAs. However, for LAC, negotiating with culturally distant partners such as the Asian will require a retooling of their negotiation infrastructure.

At the bilateral level, trade cooperation would need to focus both on existing and potential agreements. Speeding up the ratification of already signed agreements, accelerating ongoing negotiations to bring them to conclusion, and jumpstarting talks to upgrade and modernize existing agreements according to needs would ensure that LAC and Asian firms interact in an open and predictable regulatory environment and set the standard for future trade deals. Likewise, resuming stalled negotiations and expanding negotiations among partners that are not currently benefitting from preferential market access would not only magnify the potential effects of trade liberalization, but also curb the inefficient trade diversion effects that inevitably arise in a web of bilateral FTAs. Beyond market access in goods, a wider and deeper web of FTAs would also be critical to expand opportunities in service sectors.

Bilateral talks need to proceed at the pace allowed by the political readiness of the potential signatories. For example, considering the relative maturity of the technical preparatory work already undertaken, negotiations with Asian countries which already hold or are interested in associate membership status in the Pacific Alliance are good candidates for early harvests. Meanwhile, MERCOSUR members may need more time as they define their Asian priorities in the context of a new drive towards outward-oriented trade policies. In any case, it is critical that LAC countries focus right from the outset not only on the negotiation, but also on the administration of newly concluded FTAs, and on the implementation of complementary agendas needed to reap the benefits of the agreements and support sectors and segments of the population adversely affected by FTAs. Steering bilateral and multilateral cooperation towards the specific needs of freer LAC-Asian trade thus emerges as a priority.

Bilateral action may also be complemented with policy initiatives at the plurilateral inter-regional level. Subject to political and technical feasibility, the initiation of the expansion of membership to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) may be set as a goal. Existing members of the CPTPP may play a leadership role in starting negotiations with

Korea, Indonesia, Taipei China, and Thailand on the Asian side, and Colombia on the LAC side, thereby creating the foundations for an expanded FTA area across the Pacific. Strengthening ties among LAC and Asian officials, eventually leading to the expansion of the membership of Asia-Pacific Economic Cooperation (APEC), may undergird this initiative. An annual or biennial Trade Ministers' meeting of LAC and Asian countries, for example on the sidelines of the APEC summit, starting with members and gradually including non-members, may serve to build confidence among senior officials and set in motion the exploratory work at the technical level.

Trade Facilitation

Several Asian and LAC countries have been actively contributing to the implementation of the WTO Trade Facilitation Agreement (TFA) in the field of customs clearance. Enhancing cooperation in this area, as well as including additional LAC and Asian countries, can help in the implementation of the TFA commitments made at the multilateral level and further contribute to expediting customs clearance.¹⁷

Advancing in the trade facilitation agenda would not only bring about a significant reduction in the cost of doing business across borders at a faster pace than the negotiation of FTAs, it could also harness new instruments for maximum impact. The introduction of new digital technologies is indeed radically changing global trade and trade facilitation processes. For example, blockchain and other decentralized technologies are being applied throughout the supply chain and, through improvements in efficiency, transparency, and security, are further reducing regulatory compliance and transaction costs. Activities related to accelerating and upgrading trade facilitation cooperation between the two regions could thus focus on at least three priority areas.

17 For an early in-depth assessment of the implementation of trade facilitation commitments in LAC see Giordano, P. and Ramos, A. (2014), *Facing Headwinds: Policies to Support a Trade Recovery in the Post-Crisis Era*, Inter-American Development Bank.

Mutual Recognition Arrangements for Authorized Economic Operators

Bilateral and multilateral/plurilateral Mutual Recognition Agreements (MRAs) for Authorized Economic Operators (AEO) are emerging as an instrument of choice to facilitate trade from a non-tariff customs perspective. Currently, 16 LAC countries have AEO programs in place. Several of these have bilateral AEO MRA among them,¹⁸ and four countries have MRAs signed with Asian countries.¹⁹ Expanding this web of MRAs, at least among Asian and LAC countries that have FTAs in place, would notably reduce red tape in customs and generate trade gains for exporters and consumers alike.

However, the successful conclusion of an AEO MRA needs as prerequisite a high degree of convergence in the normative framework and confidence among customs authorities. Therefore, an inevitable starting point, particularly among distant partners such as those in LAC and Asia, is a well-functioning policy dialogue on customs cooperation among appropriate authorities of both sides. Such a dialogue would engage Asian countries' customs officials and their counterparts from LAC FTA partners on a regular basis, and provide opportunities, for example, to compare each other's mutual recognition standards and to review them for bilateral or multilateral MRAs.

The process would be well-served by a gradual approach. Countries that already have in place an AEO program or are considering adopting one could be the priority candidates. Likewise, countries already linked by an FTA or that are in the midst of trade negotiations may have already achieved sufficient trust among customs authorities to undertake MRA talks. If necessary, multilateral and bilateral

18 The AEO is a certification created by customs agencies to share security responsibilities with the private sector, while at the same time rewarding them with trade facilitation benefits, such as simplified customs procedures. MRAs allow AEO certified companies to receive faster customs clearance in other countries. In LAC, a multilateral MRA is in force among the countries of the Pacific Alliance (Chile, Colombia, Mexico, and Peru) since July 2017; negotiations are being finalized for MRAs among certain Central American countries (Costa Rica, El Salvador, Guatemala, and Panama, with Honduras as observer), and among the Andean Community countries (Bolivia, Colombia, Ecuador, and Peru); negotiations are being initiated among the MERCOSUR countries (Argentina, Brazil, Paraguay, Uruguay, as well as Bolivia).

19 Mexico and Korea; Mexico and Hong Kong SAR; Dominican Republic and Korea; Uruguay and Korea; Peru and Korea; negotiations are underway for an agreement between Mexico and China.

cooperation agencies may provide support, so that trade officials secure appropriate technical assistance for an in-depth analysis of AEO programs and related MRAs.

Digital innovation may also provide new solutions to cut delays in implementation. For example, blockchain technology offers a number of advantages for the management of the AEO certification process and may facilitate the conclusion of MRAs. The application of blockchain technology to customs processes makes it possible to record and share transactions in a secured and protected environment allowed by the existence of an immutable audit trail.²⁰ This technology and the associated processes could also be applied in MRAs between LAC and Asian countries.

Interoperability of Trade Single Windows

Trade between Asian and LAC economies can be further facilitated when a country has in place an electronic single window system for the simplification and optimization of trade documentation requirements, and furthermore, when national single windows are connected through an interoperability platform. Such interface allows greater efficiency and security of foreign trade, optimizes and reduces the time and cost associated with transactions related to the export, import, and transit of goods according to international standards and good practices.²¹

LAC countries require appropriate technical assistance for the establishment of electronic single windows, as well as the eventual interoperability of single windows among the countries of the two regions. At the multilateral level, the IDB and the World Economic Forum are cooperating to create a policy toolkit that would

²⁰ The IDB, together with Microsoft, developed a blockchain solution to enable automated and secure information sharing on AEOs among the customs administrations of Mexico, Peru, and Costa Rica to ensure the efficient implementation of MRAs. Chile has also joined the initiative.

²¹ For example, the interoperability of the single windows for foreign trade of the four countries of the Pacific Alliance entered into force in July 2018, with the support of the IDB. At the regional level, LAC countries have established the Inter-American Network of International Trade Single Windows (Red VUCE) to foster the exchange of good practices and transfer of knowledge for the establishment and use of single windows as a trade facilitation and control tool, and to prepare for future interoperability.

allow governments to identify and effectively apply blockchain technology to improve national trade single windows, and to build a neutral and trusted environment for bilateral, regional, and global interoperability of national single windows, enabling end-to-end digitization of international trade. Likewise, increasing resources are being directed towards the implementation of such systems at the bilateral level, as in the case of the development cooperation of Korea with LAC countries such as Ecuador or Peru.

Compliance with Trade Rules

As mentioned earlier, both industrial and agricultural products are subject to restrictive trade regulations imposed by their trade partners. For many LAC countries, satisfying these requirements in Asian markets poses significant challenges. They can therefore enhance their expertise in these areas through knowledge-sharing technical assistance programs. The value of this area of cooperation would increase as LAC countries diversify their export supply away from commodities into resource-based manufactures, that are highly sensitive to these sets of trade rules.

The establishment of a communication channel between Asian countries' customs, inspection, and standard agencies and their counterparts in LAC would be crucial to ensure that trade rules serve their legitimate purposes, and do not result in disguised protection instruments. Through a structured periodic dialogue, relevant agencies can exchange their experience with developing and applying trade regulations and national SPS and TBT measures, and open an effective channel to handle inquiries on the implementation of specific measures. Cooperation on these matters would also expedite the conclusion of SPS agreements that are lengthy to negotiate and cause major hurdles to exporters.

A technical assistance program may further help transfer Asian countries' experiences with preferential rules of origin in FTAs and support LAC small and medium-sized enterprises compliance with the rules. It could also analyze options to allow for cumulative rules of origin between Asian and LAC countries that have FTAs. In food products,

agencies could jointly assess the feasibility of an electronic exchange of phytosanitary certificates, which can lead to an interoperable platform between Asian countries and their FTA partners in LAC.

Moreover, authorities from both sides could cooperate on risk analysis, management of plant and animal diseases and pests, as well as food safety, and exchange experiment techniques and methods for laboratory uses. Exploratory targeted initiatives, focused for example on products that hold great trade potential, would allow to test and refine the cooperation modalities among Asian and LAC countries. They would also open new trade channels and serve as a catalyst for the involvement of exporters in other market segments.

Trade Promotion

LAC countries looking to expand and diversify exports to Asia should also step up outreach and marketing efforts as many consumers in Asian countries are unaware of their products and brands, and competitors are aggressively positioning themselves in the growing Asian markets. Likewise, a better knowledge of the specific preferences of Asian consumers would allow LAC producers and traders to align their export supply to local demand and take advantage of untapped market opportunities.

Individual companies, particularly small and medium-sized enterprises often lack sufficient resources to properly analyze opportunities in overseas markets and conduct marketing activities. The success of ConnectAmericas, the first online network for businesses in the Americas, in promoting LAC trade and investment with Asia is a testament of the value of trade promotion activities. Trade-supporting institutions can help small and medium-sized enterprises become exporters through various capacity-building programs and information sharing. These institutions can correct market failures and provide effective support at different stages of the supply chain. However, in order to effectively assist exporters in non-traditional markets, LAC trade supporting institutions would also need to build the institutional capacity needed to operate in Asia. Likewise, investment in trade promotion needs to be coupled with

the development of new export capacities, so that exporters can not only increase market shares with the existing export supply, but also diversify into goods and services sectors with higher value-added.

Support to market research, including on a contingent cost-recovery basis, may compensate the existence of information asymmetries that prevent entry in markets where LAC firms hold competitive advantages. The subsequent analysis of competitors' strategies, the identification of niche products and markets, and the support to the formulation of a marketing strategy may be offered at a fee. On that basis, trade promotion agencies can support cost-effective field missions and participation of firms in trade shows. One example is LAC Flavors, one of the most important food and beverages business forums in LAC, which in the last ten years has sparked growing interest in Asian buyers and importers. When the presence of specific obstacles to market penetration is identified, such agencies can offer capacity building to comply with technical and market standards and sanitary and phytosanitary measures, or garner resources for the establishment of laboratories to issue appropriate certificates.

While these are just a few examples in the wide spectrum of potential activities that LAC trade promotion initiatives can undertake at the national level to expand presence in Asian markets, there is also value in the coordination under the aegis of multilateral institutions. For example, the IDB experience shows that Trade and Investment Forums held periodically among LAC countries and China, Japan, and Korea, respectively, are highly valued by market participants as they produce tangible results in terms of business deals. A periodical LAC-Asia Trade and Investment Forum, with a broader inter-regional focus, perhaps held in conjunction with a high-level meeting of trade officials, may provide an opportunity to multiply and diversify business contacts across Asia, particularly in countries that are still marginal in the internationalization strategy of LAC businesses.

Trade-Related Infrastructure

As shown in the estimates of the trade potential of LAC countries in Asian markets, the region stands to reap significant gains from

greater market access, trade facilitation, and promotion of exports in Asia, but the returns from the reduction of trade costs determined by poor trade infrastructure and uncompetitive logistics systems are even larger. Over the past decades, trade policy in LAC has mainly focused on traditional trade costs, associated with the removal of tariffs and non-tariff barriers, whereas trade-related transportation costs have systematically been neglected. They are now becoming one of the main obstacles to trade.

A combination of factors gives transportation and logistics costs an unprecedented strategic importance in LAC trade with Asia. The very success of the trade reforms—which have drastically altered the relative importance of policy versus non-policy barriers—and the rapid transformations of the trade flows—above all the reduction of the value-to-weight ratio due to the surge of trade in commodities—made trade more sensitive to transport costs. Going forward, as LAC countries diversify trade flows into new segments such as processed food, time sensitiveness of trade logistics will become increasingly relevant and new infrastructure needs will arise.

Several empirical studies undertaken over the last years are clearly pointing to the positive effect of lowering trade-related transport costs. As an example, an IDB study focusing on the Pacific Alliance countries estimates that a 1% *ad valorem* reduction in domestic and international transport costs leads to a statistically significant increase in exports of 1.3% in Mexico, 2.6% in Colombia, 4.2% in Peru, and 4.5% in Chile. Lowering transport costs can also impact export diversification. A 1% reduction would increase the number of products exported by 0.5% in Colombia, 0.8% in Peru, 1.6% in Mexico, and 3.1% in Chile.²² Similarly, a 1% reduction of internal transportation costs in Colombia would result in a 7.9% estimated increase in agricultural goods exports, a 7.8% increase in manufactured products exports, and a 5.9% increase in mining

22 Molina, D. *et al.* (2016), *Infraestructura y desempeño de las exportaciones en la Alianza del Pacífico*, Inter-American Development Bank.

exports.²³ In order to capture trade gains of this magnitude countries in LAC face a number of challenges.

Recent assessments of the investment needs in LAC put the infrastructure investment gap at 5% of the GDP per year.²⁴ While the availability of financial resources to fund investment projects is a concern for LAC policymakers, particularly in the current juncture of slow growth and pressure for fiscal consolidation, international experience suggests that in order to harness infrastructure for trade development a number of qualitative issues are as important as the availability of financial resources.

First and foremost, as shown by the experience of Asian countries that were successful in engineering fast export growth, adopting a comprehensive vision is of the utmost importance.²⁵ The vision extends from the desired position in global value chains, supported by steadfast national will, to the selection of key infrastructure projects that serve as anchors, and the implementation of a wide array of ancillary investments in areas such as innovation, entrepreneurial development and generation of new capacities. But different positionings in global value chains carries asymmetric necessities in terms of infrastructure requirements.

The simple positioning as an exporter of raw materials with low additional processing requires a narrow focus on transport. Having in place the infrastructure to harvest, store, and dispatch products lies at the core of the strategy. Rural roads, internal transportation networks well connected with export nodes, and basic Information and Communication Technologies (ICT) to coordinate bulk logistics are the centerpieces of the strategy.

However, if the objective is to advance in the capture of value in the chain, for example with processed food of an intermediate

23 Mesquita Moreira, M. *et al.* (2013), Too Far to Export: Domestic Transport Costs and Regional Export Disparities in Latin America and the Caribbean, Inter-American Development Bank.

24 Serebrisky, T. *et al.* (2018), Lifting the Veil on Infrastructure Investment Data in Latin America and the Caribbean, Inter-American Development Bank.

25 See for example the background documents prepared for this project by Hyunghwan Joo (Korea), a team of the Chinese Academy of Social Sciences led by Su Qingyi (China), Roberto Horta and Ignacio Bartesaghi (Uruguay), and Ricardo Monge and Luis Rivera (Costa Rica).

value, the strategy needs to become more complex. This vision incorporates infrastructure as an important element, in its hard and soft components, particularly regarding trade facilitation, customs and sanitary controls, and the use of more complex ICT. The administration of more sophisticated logistics chains needs to focus on the timing of the delivery, fine-tuning of the inventories, and management of cold chains, in addition to maritime connectivity. Next to transport, other infrastructure elements become crucial, such as ICT to follow-up goods through the chain, reliable low-cost supply of electricity for cold chains, and water management to satisfy emerging demands of environment-conscious consumers.

At the end of the spectrum, capturing value through own branding and coverage of the global market requires an even wider set of interventions. Turning a product into a national brand involves intense associative capacity in the private sector and decisive government support as shown, for example, by the case of the fresh flowers sector in Colombia. The infrastructure requirements outlined above need to be complemented by high-speed internal land, maritime and air logistics, the capacity to manage logistics chains in third markets, operations centers at the destination points, permanent logistics innovation to face competition, and strong support of ICT and marketing technologies.

In order to bring the LAC-Asia trade relation to a whole new level, LAC countries thus need to set a vision, both individually and collectively, and implement investment plans in hard and soft infrastructure whose magnitude is as challenging as its quality. Sound methodologies to select the best projects, rigorous cost benefit analysis, and stringent social and environmental safeguards are crucial in order to ensure that infrastructure development contributes to long-term trade expansion and growth in a sustainable manner. Public-private partnerships could be a way to reconcile the need for state coordination and intervention when lack of resources and management limitations are binding constraints. Finally, intra-regional coordination needs to be actively supported when projects involve two or more countries, and feature project externalities and risks of coordination failure.

Conclusions

In less than two decades, economic ties between LAC and Asia have deepened to unprecedented levels with trade being the anchor of the relationship. Despite the slowdown in trade growth in the 2010s, the region remains a strategic source of natural resources for Asia, while Asian firms continue to provide a wide range of high-quality and increasingly sophisticated manufacturing products to LAC consumers and companies. However, governments and firms cannot take the trade relationship for granted.

Trade costs between the two regions are indeed among the highest in the world and reducing them can unlock a considerable trade potential. The large distance between the two regions is an inevitable barrier, but trade costs are also driven by restrictive trade policies and poor logistics connectivity. While tariffs have been falling between some countries in the two regions, a wide array of non-tariff barriers specifically aimed at each other still restricts trade flows and prevents diversification into high-margin market segments. Moreover, in LAC, under-investment in trade-related infrastructure, coupled with all sorts of inefficiencies along the logistics chains put LAC exporters at disadvantage with competitors in Asian markets.

Expanding the web of trade agreements would help to lift residual tariffs and reduce the cumbersome stock of non-tariff barriers. A new set of trade rules governing market access would allow LAC exporters to diversify sales in new markets that are bound to grow due to the emergence of a vibrant middle class in Asia. They would also provide a stringent rules-based normative framework for trade growth.

Advancing a trade facilitation agenda would not only result in a significant reduction in the cost of doing business across borders at a fast pace, it could also harness new technologies for maximum impact. Actions ranging from the expansion of mutual recognition agreements for Authorized Economic Operators, to the interoperability of Trade Single Windows, and to the promotion of bilateral cooperation to facilitate compliance with trade rules, are

low hanging fruits to set the LAC-Asia trade relation on a new course.

While trade officials may play a leading role in modernizing the regulatory infrastructure, trade promotion activities may help private sector representatives of both regions to lock-in business deals. Through capacity-building and information sharing, trade promotion institutions can help overcome market failures, provide effective support at different stages of the supply chain, and ultimately facilitate contacts among businesses and consumers from distant regions and cultures.

However, as shown by the estimates of the LAC-Asia trade potential, overcoming poor trade infrastructure and uncompetitive logistics generates the largest potential gains and is thus emerging as an utmost priority. In order to bring the LAC-Asia trade relation to a whole new level, LAC countries need to set a vision, both individually and collectively, and implement an investment plan in hard and soft infrastructure whose magnitude is as challenging as its quality and sustainability.

Fortunately, there are ample opportunities to reduce trade costs, unlock the trade potential, and magnify development benefits from the trade relationship, especially when it comes to adding value and diversifying exports, a goal that has remained elusive for most LAC countries. Solidifying the trade relationship between Asia and LAC is especially important as LAC is emerging from a recession, in a context of a critical juncture for the global trading system. With a comprehensive and strategic approach LAC governments could enhance the connectivity with Asia and make the most of the trade relation between the two regions.

