

# Shaping the Future

of the Asia and the Pacific–Latin America  
and the Caribbean Relationship

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ADB Institute



# Shaping the Future

**of the Asia and the Pacific–Latin America  
and the Caribbean Relationship**

Asian Development Bank

Inter-American Development Bank

Asian Development Bank Institute

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# Abbreviations

ADB	Asian Development Bank
ADB I	Asian Development Bank Institute
AFTA	ASEAN Free Trade Area
APEC	Asia–Pacific Economic Cooperation
ARCO	Latin America Pacific Basin Initiative
ASCM	Agreement on Subsidies and Countervailing Measures
ASEAN	Association of Southeast Asian Nations
BIT	Bilateral Investment Treaty
BRICS	Brazil, Russia, India, PRC
CAR	Caribbean
CCT	Conditional Cash Transfer
CGL	Continuous Galvanized Line
CIF	Cost, Insurance, Freight
CMI	Chiang Mai Initiative
ECLAC	Economic Commission for Latin America and the Caribbean
EPA	Economic Partnership Agreement
FDI	Foreign Direct Investment
FEALAC	Forum for East Asia–Latin America Cooperation
FTA	Free Trade Agreement
FTAAP	Free Trade Area of the Asia–Pacific
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GPA	Government Procurement Agreement
HHI	Herfindahl–Hirschman Index
IBSA	India, Brazil, South Africa Forum

IDB	Inter-American Development Bank
IMF	International Monetary Fund
JETRO	Japan External Trade Organization
LAC	Latin America and the Caribbean
M&A	Merger and Acquisition
MEA	Ministry of External Affairs (India)
MERCOSUR	Mercado Común del Sur (Common Market of the South)
MoU	Memorandum of Understanding
NBPs	Non-Binding Principles
NTBs	Non-Tariffs Barriers
ODA	Overseas Development Assistance
OECD	Organisation for Economic Cooperation and Development
OFCs	Offshore Financial Centers
PTA	Preferential Trade Agreement
SMEs	Small- and Medium-Sized Enterprises
TPP	Trans-Pacific Strategic Economic Partnership
TRIMS	Trade-Related Investment Measures
TRIPS	Trade-Related Aspects of Intellectual Property Rights
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
UNECOSOC	UN Economic and Social Council
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
USITC	United States International Trade Commission
WDI	World Development Indicators
WTO	World Trade Organization

### Asia and the Pacific Economies

AFG	Afghanistan
AUS	Australia
AZE	Azerbaijan
BAN	Bangladesh
BHU	Bhutan

BRU	Brunei Darussalam
CAM	Cambodia
PRC	China, People's Republic of
COO	Cook Islands
FIJ	Fiji Islands
GEO	Georgia
HKG	Hong Kong, China
IND	India
INO	Indonesia
JPN	Japan
KAZ	Kazakhstan
KIR	Kiribati
KOR	Korea, Republic of
KGZ	Kyrgyz Republic
LAO	Lao People's Democratic Republic
MAL	Malaysia
MLD	Maldives
RMI	Marshall Islands, Republic of the
FSM	Micronesia, Federated States of
MON	Mongolia
MYA	Myanmar
NAU	Nauru
NEP	Nepal
NZL	New Zealand
PAK	Pakistan
PAL	Palau
PNG	Papua New Guinea
PHI	Philippines
SAM	Samoa
SIN	Singapore
SOL	Solomon Islands
SRI	Sri Lanka
TAJ	Tajikistan
TAP	Taipei, China
THA	Thailand
TIM	Timor-Leste

TON	Tonga
TKM	Turkmenistan
TUV	Tuvalu
UZB	Uzbekistan
VAN	Vanuatu
VIE	Viet Nam

## LAC Countries

ARG	Argentina
BHS	Bahamas
BRB	Barbados
BLZ	Belize
BOL	Bolivia
BRA	Brazil
CHL	Chile
COL	Colombia
CRI	Costa Rica
DOM	Dominican Republic
ECU	Ecuador
SLV	El Salvador
GTM	Guatemala
GUY	Guyana
HTI	Haiti
HND	Honduras
JAM	Jamaica
MEX	Mexico
NIC	Nicaragua
PAN	Panama
PRY	Paraguay
PER	Peru
SUR	Suriname
TTO	Trinidad and Tobago
URY	Uruguay
VEN	Venezuela

## Prologue

Trade, investment, and financial relationships between developing regions are deepening. There is no better example than the relationship between Asia and the Pacific on one hand, and Latin America and the Caribbean on the other. To capitalize on the vast potential for interregional cooperation, we have undertaken a special joint study examining how to bolster the relationship between Asia and Latin America, and enhance the catalytic role of our respective regional development banks. *Shaping the Future of the Asia and the Pacific–Latin America and the Caribbean Relationship* analyzes the economic ties between our two rapidly growing regions, how to remove existing trade and investment barriers, and how to support greater South–South cooperation.

The path toward stronger and sustained partnership is not easy. Critically, we must cast a wide net. Asia is not just the People’s Republic of China, India, and Japan; nor is Latin America just Brazil, Mexico, and Argentina. We need to ensure that an ever-increasing number of governments in both our regions can participate in expanding the sectors in which we cooperate. We must work toward improved trade logistics and physical infrastructure to improve the links among goods and services markets. Barriers to trade and investment must be dismantled on both sides of the interregional equation to enhance links between resources and higher value-added production. The Asian Development Bank (ADB) and the Inter-American Development Bank (IDB) are committed to supporting our respective regions in meeting these challenges.

Asia and Latin America are among the world’s fastest growing regions. They demonstrated strong resilience and rapid recovery following the global economic crisis, and have many useful lessons to share. For instance, Asia can gain from Latin America’s experience of pension systems, cash transfer

programs, urban infrastructure development, and agricultural modernization. Similarly, Latin America can benefit from Asia's experience in manufacturing production and supply chains, human capital formation, public-private sector partnerships, and regional financial cooperation initiatives, such as the Chiang Mai Initiative. Both regions have large domestic markets. And despite strong economic development, both still have large populations living in poverty. Both regions also have unique strengths—whether in natural resources, industry, or services. Building on these complementarities will continue to underpin our interregional relationship. We are committed to building more mature and diverse trade patterns, as well as more sustained investment and cooperation partnerships.

We would like to thank Masahiro Kawai, Dean of the ADB Institute, and Antoni Estevadeordal, Manager of IDB's Integration and Trade Sector, for spearheading the preparation of this joint report; and we would like to thank all contributors to this study. This signals increased collaboration and knowledge-sharing between our two multilateral financial institutions.



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The report is a major collaborative research effort between the ADB, the ADB Institute (ADBI), and the IDB under the general supervision of **Masahiro Kawai**, Dean of the ADBI, and **Antoni Esteveordal**, Manager of the IDB’s Trade and Integration Sector (INT). The IDB was responsible for the preparation of Chapters 1 and 4 under the coordination of **Mauricio Mesquita Moreira**, Research Coordinator of the IDB’s Trade and Integration Sector. ADB/ADBI was responsible for the preparation of Chapters 2 and 3 under the coordination of **Gloria Pasadilla**, ADBI Research Fellow.

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## Overview

American computer pioneer Alan Kay said, “The best way to predict the future is to invent it.” Kay’s aphorism is relevant to many fields, including international trade and the future of the relationship between Asia and the Pacific and Latin America and the Caribbean (LAC). Although the relationship itself does not need to be invented, governments face the challenge of finding ways to ensure that it generates strong growth benefits not just for the coming years, but for decades into the future, and for all participants.

Economic relations between Asia and the Pacific and LAC have come a long way. Trade with Asia was the main reason why the *conquistadores* sailed west in the late 15<sup>th</sup> century, only to discover America. Despite this early connection, a commercial relationship only started to gain importance after World War II with the emergence of Japan as a major investor in LAC, buyer of the region’s natural resources, and supplier of industrial goods. The relationship received another boost with the emergence of the second wave of resource-scarce “tigers”—Republic of Korea, Taipei, China, Hong Kong, China, and Singapore—in the 1970s and 1980s, which boosted trade between the two regions to new heights. Yet the major turning point would have to wait until the turn of the 21<sup>st</sup> century. The rise of Asia and the Pacific’s most populous economies—the People’s Republic of China (PRC) and India—with their manufacturing prowess and insatiable hunger for natural resources, coupled with LAC’s reemergence, has made Asia and the Pacific LAC’s second largest trading partner in a matter of a decade, while significantly increasing LAC’s strategic and economic importance to Asia and the Pacific.

It can be argued that these seismic changes were mainly the product of market forces driven by the immense resource complementarity between the two economies, with little input from governments. However, if the sizeable gains achieved to date are to be expanded, widely distributed,

and consolidated, governments must play a more decisive role. Their participation is particularly critical for strengthening and balancing the three key pillars of any successful integration initiative: trade, investment, and cooperation.

This report, a major collaborative effort between the ADB, the ADB Institute, and the IDB, seeks to support this policy agenda. In its four chapters, the report identifies the main challenges and opportunities presented by each of these pillars while drawing attention to the benefits of balancing their development. The first two chapters review historical antecedents, emerging trade architecture, and future trade scenarios between the two regions. The following two chapters examine opportunities in investments and cooperation.

## **Strengthening and balancing the pillars**

The three key pillars of integration are closely intertwined. Driven by comparative advantages, the trade pillar usually takes the lead, in the process generating the necessary scale and information for the second pillar, foreign direct investments. A critical mass of trade and investments, in turn, increases incentives for governments to cooperate in a wide range of political, social, and technical issues, which constitute the third pillar. This is not necessarily a linear process, though, and each pillar reinforces the others. More investments and cooperation, for example, create opportunities for trade, and vice versa. Interactions among these pillars help to create a more stable environment, when one compensates for shortcomings in another. In this way, these interactions produce benefits that go beyond economics and extend to include the political economy. The history of Asia and the Pacific–LAC economic relations in this last half a century roughly follows this pattern, with trade moving first and investment and cooperation catching up later. However, the trade surge taking place in the last decade has created what seems to be an unprecedented imbalance among the three pillars, bringing new challenges.

### **Chapter 1: Dealing with a trade surge**

Chapter 1 seeks to put the recent surge in trade into perspective by looking at past trends and projecting into the future. It shows that since the low

levels in 2000, trade between Asia and the Pacific and LAC has grown at an annual average rate of 20.5%, reaching an estimated US\$442 billion in 2011.<sup>1</sup> Along the way, Asia and the Pacific's share of LAC trade rose to an unprecedented 21%, right behind the 34% of the US, the region's main trading partner. Meanwhile, LAC's share of Asia and the Pacific's trade more than doubled to 4.4%. However, most of this increased activity has been concentrated in only a few economies. On Asia and the Pacific's side, the PRC, Japan, Republic of Korea, and India account for nearly 90% of Asia and the Pacific's total trade with LAC, of which half is carried out by the PRC. As for LAC, Brazil, Mexico, Chile, and Argentina account for close to 80% of the region's total trade with Asia and the Pacific.

The surge has clearly been dominated by a commodity-for-manufacturing pattern, deepening what has been a hallmark of the Asia and the Pacific-LAC relationship since its early days despite profound structural changes taking place in the two regions. This pattern of trade has translated into a high concentration of LAC's exports in a small number of basic commodities: iron ore, copper, soy, oil, sugar, paper pulp, and poultry; these goods correspond to 70% of all exports. For its part, Asia and the Pacific exports a wide range of manufactured goods, including ships, cars, electronics, equipment, and parts and components. In addition to the geographical and product concentration, and to a great extent as a consequence of them, the surge has also been marked by some trade imbalances, particularly in relationships involving Mexico and Central America, which do not export commodities. Leaving these imbalances unchecked may lead to undesirable political economy consequences.

Whereas most of these characteristics and challenges merely reflect the way comparative advantages are distributed within and across the two regions, as well as differences in country size, geography, industrial organization of firms, and historical circumstances, governments still have ample opportunities for taking action. In this context, Asia and the Pacific's experience of proactive policies to promote competitiveness of its manufacturing sector through trade and investment liberalization, investments in human capital and modern infrastructure, prudent macroeconomic management, among others, shows that appropriate public policies can play a critical role in fostering structural change. It is particularly important to dispute the

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<sup>1</sup> IDB estimate based on LAC reported data.

notion that the present situation is an inexorable byproduct of the commodities-for-manufacturing trade pattern. The gravity of Asia and the Pacific's current and projected resource constraints, as well as its strong and enduring comparative advantages in manufacturing, strongly suggest that this type of exchange will continue to dominate and drive the relationship for the foreseeable future. But this will most likely be in a scenario where commodities, and the industries on which they are based, will be carrying a rapidly increasing technological content based on advances in areas such as biotechnology, energy, and mining. All this will be against a background where these commodities will continue to enjoy rising demand and relative prices resulting from growing worldwide scarcity. This is a very distinct scenario compared to the one that prevailed in the second half of the 20<sup>th</sup> century, which fueled LAC's historical concerns and resulted in often misguided notions about the growth potential of resource-intensive activities.

However, to enjoy the benefits of this scenario, at least two sets of actions must be taken by both regions. First, LAC must make significant investments in upgrading the quality of its supply side, including human capital, trade-related infrastructure, and industrial technology. This is a challenge that both developed and emerging economies in Asia and the Pacific have generally met more effectively, and LAC could learn from their experience. Second, governments on both sides of the relationship must address the high trade costs that still beset interregional trade and undercut opportunities for diversification and technological upgrade.

High costs primarily result from two main factors. First, traditional trade barriers, such as tariff and non-tariff barriers, remain unduly high. A second major challenge is high transport costs resulting from poor infrastructure and limited and inefficient transport services, which is particularly important for trade between distant partners and even more so for distant partners that trade low-value-to-weight natural resources. The resulting trade costs translate into higher food and raw material prices for consumers and firms in Asia and the Pacific and lower returns for LAC's agricultural and mining producers.

## **Chapter 2: Developing an architecture for lower trade costs**

There are two pieces of good news about this otherwise worrisome diagnostic of trade costs. First, there is "policy space" to expand and diversify

trade, making it possible to address some of the challenges that have accompanied the trade surge. And second, governments and the private sector are using this policy space for the benefit of both regions. Such actions are discussed in detail in Chapter 2, which shows that between 2004 and 2011 an average of two free trade agreements (FTAs) between economies of Asia and the Pacific and LAC took effect every year, resulting in a total of 18 FTAs as of January 2012. This figure is expected to rise even further as four new agreements have already been signed and are waiting implementation, an additional eight are under negotiation, and 11 more have been proposed. If they all go into effect, a total of 30 FTAs between the two regions will be in force in 2020. Economies with the highest level of participation in FTAs are Chile (6), Peru (4), Panama (2), Taipei,China (4), Singapore (3), the PRC (3), India (2), Japan (2), and Republic of Korea (2).

The FTAs represented by these impressive figures vary significantly in their provisions regarding speed and coverage of tariff liberalization, number of services sectors covered, and coverage and depth of new issues, such as intellectual property rights and the so-called Singapore issues (government procurement, trade facilitation, investment, and competition). An analysis using these provisions as a measure of the agreements' depth shows that most Asia and the Pacific–LAC FTAs fall in the middle of the scale, with gradual or rapid tariff liberalization, some or high coverage of services, and a low coverage of new issues. The few “deep” or “gold standard” agreements are the Republic of Korea–Peru FTA (2011), the Trans-Pacific Strategic Economic Partnership Agreement (2006), and the Australia–Chile FTA (2009).

These last three FTAs liberalize trade in almost all goods and within a reasonable and defined time frame of 10 years or less. The liberalization of trade in services is comprehensive in all three FTAs and they all provide for the automatic inclusion of newly liberalized service sectors. The three FTAs also include meaningful provisions on new issues to promote greater economic integration among all parties, thereby securing the highest possible economic welfare gains from increased trade.

Looking ahead at how to ensure that this fledgling architecture will reduce trade costs, a number of priorities are clear:

- **Increase the depth and scope of existing FTAs.** The inclusion of WTO-plus provisions is particularly desirable, since competition policy and investment provisions are integral ingredients in strengthening

the investment pillar and the development of production networks. Inclusion of provisions on trade facilitation, harmonization of customs procedures, standards, and logistics would help to lower transaction costs. Moreover, properly addressing government procurement deepens market access, and cooperation provisions would strengthen the third integration pillar, which is discussed in more detail below.

- **Expand the geographical coverage of these agreements and eventually aim at a broad interregional FTA.** Despite their growing numbers, the FTAs either do not cover or are very shallow when it comes to some of the key Asia and the Pacific–LAC trade relationships, particularly those involving the largest economies in both regions. An interregional FTA would be an important means to address this issue, consolidate the plethora of bilateral and plurilateral agreements (and, therefore, address the risk of “noodle bowl” transaction costs arising from the proliferation of rules of origin), and better align their global and regional rules. A recent proposal for an interregional FTA through a Free Trade Area of the Asia–Pacific (FTAAP) has been under serious discussion in APEC. The formation of FTAAP, however, is expected to take many years, given the complexity of the negotiations among its 21 potential member economies. Current negotiations for an enlarged Trans-Pacific Strategic Economic Partnership (TPP), involving fewer members, are likely to be a useful stepping stone towards a broader and more ambitious integration scheme.
- **Ensure firm-level use of FTA preferences.** A growing body of evidence shows that LAC began using FTAs as a trade policy instrument relatively early, but it is only recently that firms have begun to utilize the agreements. Now that Asia and the Pacific is a new player in the FTA game, firm-level use is set to rise from present levels. The use of FTAs by firms can be encouraged by raising awareness of FTA provisions, including margins of preference at the product level and administrative procedures for rules of origin. Where possible, best practices should be adopted in these areas. Business associations and governments should increase transparency of information on how to use FTAs, particularly for small and medium firms (SMEs).

For all their value and worthy ambitions, FTAs should not be seen as the only instrument available to governments for bringing down trade costs.

When deep and broad FTAs face an unfavorable political environment, which delays negotiations for years, if not decades, governments are well advised to explore faster and more focused, sector-specific negotiations, particularly in areas where FTAs are not essential and/or their contributions cannot go beyond a certain threshold.

For instance, FTAs that include transport services among their provisions can make a substantial contribution to increasing competition, and therefore to bringing down costs. However, lower transport costs can also be achieved with stand-alone initiatives, such as open sky agreements or coordinated fiscal incentives, to increase the supply of direct shipping services between the two regions. The same reasoning holds for agreements on sanitary and phytosanitary conditions and customs procedures. In other areas, such as transport infrastructure, where congested and inefficient ports or airports raise both the freight and time costs of transportation, there is nothing an FTA can do.

In this effort to lower trade costs, all available instruments should be on the table. In this way, a better political and economic balance can be made between the costs and benefits of these instruments.

### **Chapter 3: Boosting investment**

The challenges and opportunities created by the trade surge can be better met by a more robust flow of interregional investments, which is the subject of Chapter 3. Foreign direct investments (FDI) can be a powerful instrument to diversify and upgrade a commercial relationship by allowing firms to jump trade barriers (including those imposed by distance and culture) and by offering host economies capital and knowledge that can eventually be used to upgrade and diversify their exports. They also offer new jobs and help mitigate social costs arising from the unavoidable job dislocations that result from trade and integration between two economies. But above all, such interregional investments are generally good business opportunities that can result in substantial profits.

As specifically regards the Asia and the Pacific–LAC relationship, investment opportunities generally derive from the same fundamentals that have been fueling trade, that is, both regions' immense complementarity of resources and their large and dynamic domestic markets. Instead of just importing commodities, companies in Asia and the Pacific can invest directly

in the region and in this way help to expand, secure, and add value to their supply. They can also provide manufacturing expertise and, in the process, jump trade barriers to regional and US markets, save on transport costs, and adapt their products to local consumers by making them more competitive.

As for LAC, the region's companies can go beyond exporting commodities to capitalize on its agriculture advantage by offering their expertise in product development, branding, and channel management. In so doing, they would engage the fastest-growing region in the world while adding value to their exports and expanding profit margins. They can also use FDI to take advantage of Asia and the Pacific's lower labor costs, which would improve their access to that region's manufacturing market and increase their understanding of the region's consumers.

Chapter 3 provides a detailed examination of recent interregional FDI flows. While firms have been responding to these incentives, the response has fallen short of the opportunities, particularly on LAC's side. More to the point, the gap between trade and investment has grown significantly wider during the recent trade surge. Whereas in previous trade growth cycles from the 1960s to the 1990s led by Japan and Republic of Korea, trade was followed more closely by FDI. We have yet to see this kind of robust FDI response in the current cycle led by the PRC.

That does not mean that Asia and the Pacific's investments in LAC have stagnated. Precise official figures are hard to come by because a substantial share of Asia and the Pacific's reported investment into LAC is directed to offshore financial centers (OFCs), whose final destination cannot be ascertained. If these OFC investments are set aside, the picture that emerges is still one of fast growth. But Asian investments as a share of total inward investment in LAC seem to lag relative to Asia and the Pacific's prominence in LAC's trade. In the case of the PRC, this country's investments (net of OFC transactions) made up less than 1% of LAC FDI inflows in 2010, although its share of LAC trade stood at 11%. Underinvestment on the part of LAC is clearly greater. Net of OFC, the region's investments in the main Asia and the Pacific markets (the PRC, Japan, and Republic of Korea) account for less than half a percentage point of total inflows. Meanwhile, LAC's average share of these economies' trade is currently close to 5.3%. Even Brazil, which is the largest LAC investor in Asia and the Pacific, has a big gap between its trade and investment in that region. For example, Brazil's share of Republic of Korea's trade was close to 1.5% in 2010 (or US\$12.5 billion), but

its investments in the Korean market stood at 0.4% of total FDI inflows (or US\$4.1 million).

Official investment figures come with an inevitable lag, which complicates understanding the unfolding dynamics of Asia and the Pacific–LAC economic relations. The story revealed by other sources, such as news accounts of announced investments, provides more reason to be optimistic about a stronger investment pillar in the near future, at least on the Asia and the Pacific side. One such survey carried out by the *Financial Times* found that the number of Asia and the Pacific greenfield investment projects in LAC grew at an annual average of 8% from 2003 to 2010, with estimated capital expenditures growing by 18%. These expenditures rose from US\$12.6 billion in 2003 to a peak of US\$19 billion in 2008, before falling to close to US\$16 billion after the global financial crisis. These figures are even more impressive when mergers and acquisitions are taken into account. In 2010 alone, they amounted to at least US\$20 billion.

In terms of greenfield investment alone, the main Asian investors are Japan (39%), the PRC and India (14% each), and Republic of Korea (11%), which together make up more than three-fourths of the investments in LAC. This breakdown reinforces the argument that the PRC has yet to assume a position among Asia and the Pacific investors in LAC commensurate with the size of its trade flows. In 2010, for instance, the PRC accounted for nearly 50% of Asia and the Pacific's trade with LAC, whereas Japan, which continues to lead in investments, had just 18% of trade.

Despite its rapid growth, Asia and the Pacific investment remains concentrated in LAC's largest markets—Brazil and Mexico—which accounted for 53% of projects over the period. The sectoral composition of these investments is better news, particularly for those concerned with the diversification of Asia and the Pacific–LAC trade. Manufacturing assumes a much more prominent role than that observed in trade flows, with both the number of projects and their capital expenditure rising rapidly since 2003 and reaching nearly US\$9 billion in 2011. Japan and Republic of Korea are the top manufacturing investors, while the bulk of PRC's investments are concentrated in the mining sector.

On LAC's side, data on investments announced in the media are also more optimistic, but do not fundamentally change the picture of underinvestment in Asian markets. The total number of projects grew at an annual average of 23% in 2003–2010. Estimated capital investment peaked at

more than US\$8 billion in 2008, but dropped sharply to an annual average of below US\$1 billion after the global financial crisis. These investments are mainly directed at Asia and the Pacific's largest economies—the PRC and India have 31% and 15%, respectively, of the number of projects—and are concentrated in the services sector, despite a number of high-profile investments in energy and metals. Manufacturing investments are still few and far between. LAC investments in Association of Southeast Asian Nations (ASEAN) markets are trivial.

Firms in both regions bear the sole responsibility for deciding where to invest based on rates of return and investment opportunities. Nevertheless, several public policy instruments can boost interregional investment. These instruments can be particularly helpful in diffusing and reducing the cost of accessing market information and in creating a favorable business environment with low restrictions and stable and transparent rules. Investment and export promotion agencies can be very instrumental in achieving the first objective, whereas for the second, options range from partner-specific to more general measures. In the first category are the FTAs with investment chapters and the bilateral investment treaties (BITs). In the second category, measures include the option of unilaterally liberalizing the investment regime, improving regulations on business approvals, permits and registrations, and strengthening the country's market institutions. Evidence suggests that the regions are using all options available and are making significant progress.

All Asia and the Pacific–LAC agreements discussed in Chapter 2, with the exception of three, feature dedicated chapters on foreign investment. Those that do not contain such dedicated chapters instead have investment chapters covering FDI in services; these fall under the category of “commercial presence” in the services chapter. Likewise, the number of BITs between Asia and the Pacific and LAC partners have doubled since the 1990s, totaling close to 40 agreements. Both regions have also made substantial progress in liberalizing their respective FDI regimes since the 1990s, in addition to trade liberalization. Yet, there is no room to be complacent. Bilateral FTAs between Asia and the Pacific and LAC economies and BITs remain limited in their geographical coverage, and lack some of the most important interregional relationships. Significant policy space exists to further liberalize FDI regimes in both regions, as suggested by the OECD FDI restrictiveness index, which places some Asia and the Pacific and LAC economies among the most restrictive FDI regimes in the world.

## Chapter 4: Exploring cooperation opportunities

An important but often overlooked facet of interregional relations is cooperation, the third pillar of the Asia and the Pacific–LAC relationship and the subject of Chapter 4. This is also an area where governments are the main protagonists. Unlike trade and investment, cooperation requires that public agencies pursue public policy objectives in what we can think of as “non-market” cooperation. This is admittedly a broad and diverse category that encompasses a wide array of policy areas, diverse institutional vehicles, and many actors at the national and regional levels. For this reason, analysis of interregional cooperation is not an exact science. Little hard data exists that would allow us to quantify and assess cooperation in an area such as education or innovation. Instead, Chapter 4 maps out the current modes of cooperation between the two regions, identifies trends where possible, and highlights challenges and opportunities.

Non-market cooperation between the two regions appears to be on the rise. Even over the past five years, bilateral development aid has increased notably. There has been a flurry of agreements and memorandums of understanding on topics such as education, scientific research, and energy. New Asia and the Pacific–LAC multilateral forums have appeared on the scene. In addition, we have seen efforts by LAC and Asia and the Pacific governments to take joint action in international bodies such as the UN, WTO, and G-20. At the same time, for most governments on both sides of the Pacific, Asia and the Pacific–LAC cooperation is a relatively recent phenomenon and less extensive than their engagement with other regions.

Prospects are excellent for accelerating Asia and the Pacific–LAC cooperation in the coming years. The PRC, Brazil, India, and Republic of Korea are becoming increasingly important sources of development aid, and the comparable stages of development of many LAC and Asia and the Pacific economies present opportunities for sharing knowledge and experiences that are particularly relevant and transferable among each other. Such complementarity gives these economies a potential comparative advantage in aid provision vis-à-vis traditional donors. Similarly, successful development experiences also lead to complementarities between the two regions. Asia and the Pacific’s world-class education systems, high level of science and technology sophistication, and successful export promotion policies could offer important lessons for LAC countries. LAC’s experiences in poverty

reduction policies, agriculture, mining, and urbanization could be relevant to Asia and the Pacific economies.

The growing number of Asia and the Pacific–LAC formal trade and investment agreements, as well as other diplomatic relations, whether they take the form of bilateral arrangements or participation in multilateral forums, present opportunities to expand cooperation into non-market areas. Many of the trans-Pacific FTAs signed in recent years include language on cooperation in areas such as education, science and technology, agriculture, and environmental issues, to name only a few. For example, in the Japan–Mexico Economic Partnership Agreement, words have translated into actions, with the signatory countries carrying out over a dozen joint activities since the agreement came into force in 2005.

At the multilateral level, interregional trade negotiations are moving towards deeper cooperation in areas that involve domestic policy, such as procurement and customs procedures. At the same time, new interregional forums are being created to enhance cooperation. Both trends point to increased opportunities for non-market cooperation. Finally, as LAC and Asia and the Pacific leaders make more and more trans-Pacific visits, we can only expect a further proliferation of agreements, memoranda of understanding (MoUs), accords, and protocols for non-market cooperation.

On the international stage, LAC and Asia and the Pacific have a unique opportunity to advance concrete initiatives on key global issues such as international financial regulation, climate change, and the governance of multilateral institutions. More coordination and dialogue will ensure that LAC and Asia and the Pacific economies can effectively influence the evolving global governance apparatus in areas where common interests exist.

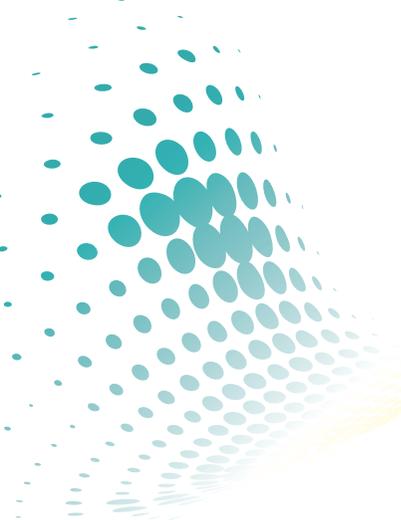
How can LAC and Asia and the Pacific make the most of these opportunities for cooperation? A few observations can be drawn based on the Asia and the Pacific–LAC cooperative initiatives undertaken to date. First, given the wide range of actors involved (foreign ministries, international cooperation agencies, national development banks, export-import banks, and ministries in areas such as education, science and technology, and energy), strategic planning and coordination across institutions is key to the success of cooperation initiatives. Secondly, cooperation efforts have been most effective when they enjoy strong legal and institutional underpinnings, such as legal standing, concrete objectives, and sufficient funding. For these purposes, MoUs are notably weak vehicles, whereas trade agreements, which

increasingly include non-market cooperation in their scope, may provide a firmer platform.

Finally, it is important to pick and choose areas of cooperation carefully. Initiatives have the biggest impact where there is both supply and demand, that is, where there is relevant expertise or knowledge to share and true priorities to address. In addition, cooperation initiatives should not run up against national or private sector interests. Examples of high-potential areas include infrastructure, climate change, poverty reduction, natural disaster mitigation, and financial regulation. The Asian Development Bank and the Inter-American Development Bank, the regions' major development partners, have a role to play in promoting Asia and the Pacific–LAC economic cooperation. Potential avenues include conducting further research on Asia and the Pacific–LAC economic ties, organizing joint conferences and policy dialogues, exchanging operational best practices, financing results-oriented cross-regional technical assistance and capacity-building activities, and contributing to trade-related interregional infrastructure (e.g., seaports and trade facilitation).

The challenges to effective cooperation are also considerable, running the gamut from the implementation issues mentioned above to more fundamental questions about the nature of interactions between states. International relations theorists have often been skeptical of cooperation, arguing that states act in response to factors that may or may not promote cooperation. This reality can be observed in Asia and the Pacific–LAC relations, such as examples where successful cooperation exists side-by-side with conflicts over trade practices. Trade between the two regions, while greatly beneficial for both sides, has also led to imbalances and worries in LAC countries over lack of diversification and the technological sophistication of its exports. Although this report suggests that some of these concerns are overstated, they are still likely to hang over the political economy of the Asia and the Pacific–LAC relationship in the future. For this reason, it is all the more important for LAC and Asia and the Pacific to choose carefully among cooperation initiatives, focusing on areas where the right incentives exist and where institutional backing and coordination are sufficient. Successful non-market cooperation can be particularly effective in alleviating the growing pains and inevitable imbalances of a relationship whose importance has surged in the last decade and which is likely to keep surging in the decades to come.





# 1 Asia and the Pacific–LAC Trade: What Does the Future Hold?

Asia and the Pacific and Latin America and the Caribbean (LAC) have a trade relationship that can be traced as far back as the late 15<sup>th</sup> and early 16<sup>th</sup> centuries, when Iberian *conquistadores* searching for a new route to India's spices discovered America along the way.<sup>1</sup> Much has changed in both regions since then. But while the relationship has strengthened, it nevertheless has remained relatively marginal, constrained by “frictions” such as distance, cultural differences, and all-out protectionism. That is to say, until recently. In the last decade, Asia and the Pacific has become LAC's second largest trading partner, right behind the US and substantially ahead of the European Union, something unprecedented in the history of the relationship. LAC has also regained importance among Asia and the Pacific's trading partners after a period of declining relevance in the 1980s and 1990s.

This booming trade is explained by a combination of extraordinary events and basic fundamentals. The major event on the Asian side is the emergence of the region's most populous economies—the PRC and India—which joined Japan, Republic of Korea, and the smaller fast-growing Asia and the Pacific economies in exporting very competitive goods and services and in demanding an ever-growing amount of natural resources. As for LAC, after decades of isolation,

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<sup>1</sup> For the purpose of this chapter, unless otherwise stated, LAC refers to the following countries: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Peru, Paraguay, El Salvador, Uruguay, Venezuela, Aruba, Anguilla, Antigua and Barbuda, Bahamas, Belize, Bermuda, Barbados, Cuba, Dominica, Grenada, Guyana, Haiti, Jamaica, St. Kitts & Nevis, St. Lucia, Suriname, Trinidad and Tobago, and Saint Vincent and the Grenadines. Asia and the Pacific refers to: Bangladesh; Cambodia; People's Republic of China (PRC); Hong Kong, China; India; Indonesia; Japan; Republic of Korea; Lao People's Democratic Republic; Malaysia; Pakistan; Philippines; Singapore; Taipei, China; Thailand; and Viet Nam.

fiscal irresponsibility, and stagnation, the region has finally changed course and found its way back to the world markets and sustainable growth. Binding these events together is the enormous resource complementarity between the two regions. Asia and the Pacific needs natural resources to grow, and Latin America can grow faster by selling those resources to Asia and the Pacific.

There is virtually no question that this growing trade has brought substantial benefits for both regions, which became all the more evident during the recent financial crisis when the relationship offered a safe haven from declining markets in the US and Europe. Yet, it is also true that this trade of commodities for manufacturing goods brings some discomfort to LAC for reasons that can be boiled down to two major concerns: that little technological sophistication is required for producing commodities, resulting in marginal knowledge spillovers for the rest of the economy; and that this type of trade can lead to specialization in a small number of price-volatile goods that are likely to face a long-term decline in their relative prices.

These concerns are well grounded in LAC's early history and therefore should be taken seriously. But the risks are overstated in the present context. The conditions in the 19<sup>th</sup> century and early 20<sup>th</sup> century that informed those concerns have changed radically in at least three ways: LAC's economies today are much more diversified and sophisticated; the technological content of activities such as agriculture and mining has increased exponentially; and—for both demand and supply reasons—natural resources are growing increasingly scarce, suggesting an upward rather than a declining trend in their price.

But even if the world had not changed, one cannot ignore the fact that the extraordinary dynamism of the relationship between the two regions is due to their very complementary comparative advantages. This complementarity is bound to exert a strong pull in resources for decades to come, no matter what policy levers the governments decide to pull. Or to frame this argument in another way: is it realistic to believe that the pattern of trade is going to shift radically and that LAC will be a major exporter of manufacturing goods to Asia and the Pacific in 20 or 30 years? Is this a likely scenario given that Asia and the Pacific's growing needs for natural resources is only bound to increase amid worldwide supply constraints, while it will likely sustain or even strengthen its manufacturing prowess with the entry of other populous newcomers such as India?

This chapter examines these key questions for the future of the relationship. It argues that even though there is room to diversify trade between the

two regions, particularly because the prevailing trade barriers are still unduly high, it is unlikely that this would change the relationship at its core. The current strong forces of comparative advantage are likely to grow even stronger in the foreseeable future, which suggests that governments should work to make the best of this trade, particularly with respect to natural resources. The stakes are high. As a number of other countries have demonstrated, selling natural resources is not a death sentence to diversification, technological sophistication, or growth. But to avoid these negative outcomes, Latin America must build its human capital and improve market access to Asia and the Pacific along the value chain. On the Asian side, there is an interest in expanding its access to those resources to ensure that the region continues to grow and feed its population, while lessening the risks of populist backlashes in its LAC partners, fueled by frustrated aspirations for more technologically sophisticated exports.

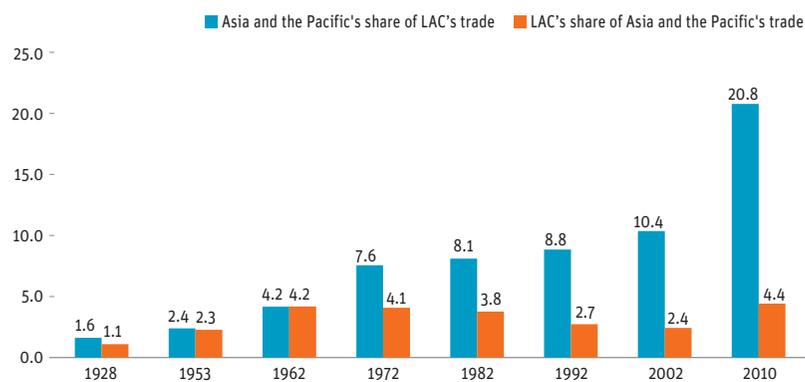
This chapter begins with an overview of the earlier and recent trends of Asia and the Pacific–LAC trade: who sells what to whom and how this has evolved since the early days of the relationship. It then discusses how this relationship is likely to look in the decades ahead, building on an analysis of its main drivers. The next section uses this likely scenario to discuss and quantify the benefits of a policy agenda tailored to address the challenges and opportunities that lie ahead. The final section summarizes the main conclusions.

## The surge

It is always useful to trace the origins of a trade relationship to better understand its present status. Figure 1 clearly shows that trade between the two regions only really began after World War II. It was fueled by two main events: Japan’s export-led growth, which kick-started Asia and the Pacific’s demand for Latin America’s minerals; and LAC’s inward oriented industrialization, which boosted demand for Japanese capital and intermediate goods. The relationship gained another boost with the emergence in the 1970s and 1980s of the second wave of resource-scarce “tigers”—Republic of Korea; Taipei, China; Hong Kong, China; and Singapore. While making Asia and the Pacific’s share of LAC’s trade grow even faster, their aggressive integration into the world markets reduced the relative importance of LAC in that continent’s trade.

The major turning point would come in the early 2000s with the emergence of the PRC and, to a lesser extent, of India. The insatiable demand of these economies for raw materials, coupled with the consolidation of trade

**Figure 1 • Asia and the Pacific's and LAC's Shares of Each Other's Trade 1928–2010 (%)**



Source: Own calculation using UN COMTRADE data, except for 1928 and 1953, which are from UN (1962) preliminary estimates.

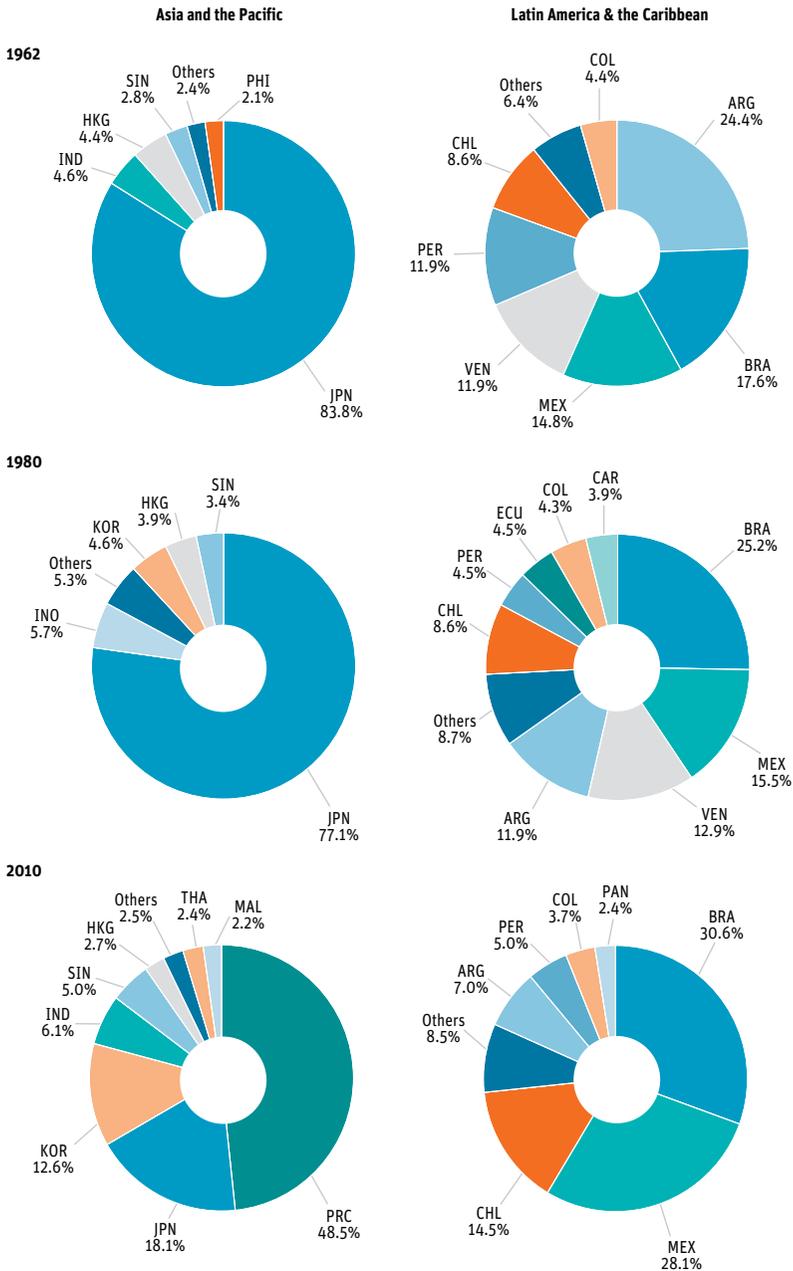
Note: See footnote 1 for the definition of the regional groupings.

liberalization in LAC, resulted in an increase in Asia and the Pacific's share of LAC's trade to an unprecedented 21% in 2010 and a reverse of LAC's declining trend in trade with Asia and the Pacific. As a result, Asia and the Pacific became LAC's second largest trading partner, right behind the US (34%) and well ahead of the European Union (13%), which historically had been the region's main trading partners. In terms of volume, Asia and the Pacific–LAC trade has grown by a factor of six since 2000, reaching US\$350 billion in 2010 and an estimated US\$442 billion in 2011.<sup>2</sup>

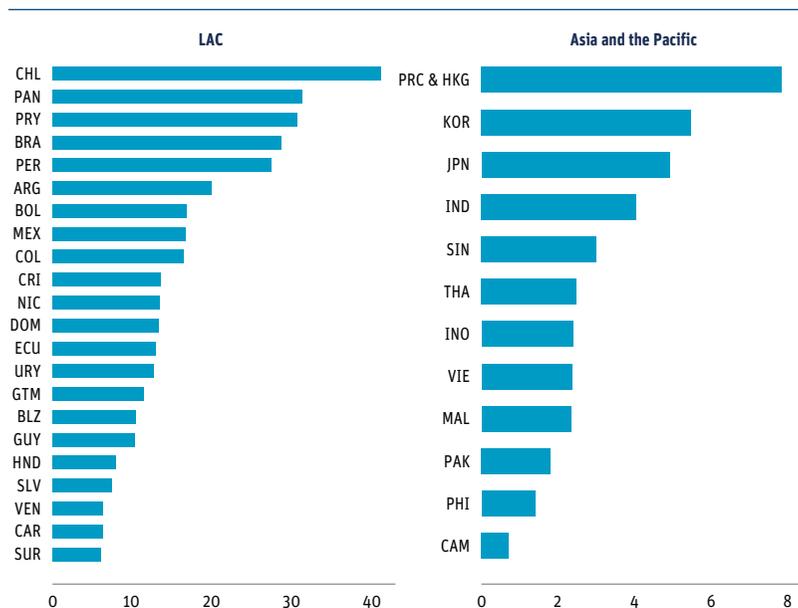
**The main actors.** Figure 2 gives another perspective on how this relationship has evolved, by illustrating the changing role of the economies involved since the early 1960s. As expected, LAC's side has been dominated by the major producers of raw materials on the one hand, and by the big consumers of Asia and the Pacific's manufacturing goods on the other. The first group saw some important shifts, with Brazil and Chile roughly doubling their shares, whereas Venezuela, Argentina, and Peru experienced a drop in their relative importance. In the second group, Mexico nearly doubled its share, almost exclusively as the result of growing imports from Asia and the Pacific.

<sup>2</sup> UN COMTRADE as reported by LAC. The figure for 2011 is an IDB/INT estimate.

**Figure 2 • The Share of LAC and Asia and the Pacific Main Trading Partners in Interregional Trade**



Source: IDB/INT with UN COMTRADE data.

**Figure 3 • Exposure to Asia and the Pacific—LAC Trade, by Region, 2010***Share of total trade (%)*

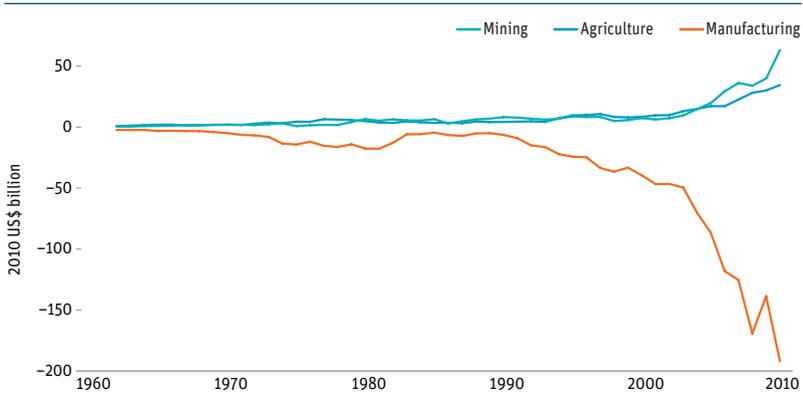
Source: IDB/INT with UN COMTRADE data.

Note: Shares for Honduras, Uruguay, and Viet Nam are for 2009. CAR, Caribbean, includes: BHS, ABW, ATG, BRB, DMA, JAM, TTO, and VCT.

For Asia and the Pacific, the big story is the shift from a dominant Japan, which accounted for nearly 80% of Asia and the Pacific–LAC trade up to the 1990s, to a dominant PRC, which came from a negligible presence to account for 50% of the trade in 2010. Alongside this major shift is the rise of Republic of Korea and India. The former, barely noticeable in the 1960s, accounted for 12.6% of total trade in 2010. The latter, which was a very distant second to Japan in the early 1960s, lost relevance until the 2000s, after opening up its economy and accelerating growth.

From these years of fast trade growth and shifting country roles emerges a picture of greater heterogeneity in terms of engagement, mirroring differences in natural resource endowments, trade policies, and rates of growth. Figure 3 lays bare those differences in both sides of the trade relationship. In LAC, the Southern Cone countries account for the highest degree of engagement with Asia and the Pacific as the region's main suppliers of exports to the PRC. The exception is Panama, whose position reflects its peculiar role as the

**Figure 4 • Net Asia and the Pacific–LAC Trade**  
By product category, 1962–2010



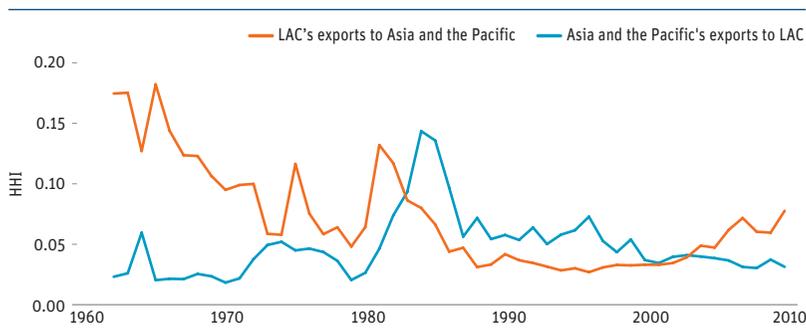
Source: UN COMTRADE.

flag of convenience in the shipping industry, leading the country to absorb a disproportionate amount of Asian ship imports. The PRC is clearly the “hot spot” in the Asia and the Pacific region’s involvement with LAC, followed by Republic of Korea, Japan, and India. The relationship has yet to take off in the ASEAN area and in economies such as Pakistan.

**The product composition.** Despite major shifts among the main traders of the Asia and the Pacific–LAC relationship over the past half century, the product composition has barely changed. In fact, the commodities-for-manufacturing goods pattern already observed in the early 1960s has only intensified—particularly since the early 2000s—despite radical structural changes experienced by both economies during the period. That much is clear in Figure 4, which presents the net Asia and the Pacific–LAC trade by product category. The exponential growth of bilateral trade is explained by a growing Asian surplus in manufacturing and by an increasing LAC surplus in agriculture and mining.

The stability of trade patterns is also evident in the recent history of the top ten exports from both regions, as shown in Table 1. Despite some important new entries from LAC over the 1962–2010 period, natural resource-intensive exports continue to dominate. Likewise, while Asia and the Pacific’s list shows some important changes at the product level, reflecting the increasing technological sophistication of its exports, manufacturing remains the dominant category.

**Figure 5 • Trends in the Concentration of Interregional Exports 1962–2010**



Source: IDB/INT with UN COMTRADE data.

Note: The Herfindahl-Hirschman Index (HHI) measures the degree of concentration of the region's exports based on products defined at 5 digits of SITC Rev. 1. It varies from 0 (least concentrated) to 1 (most concentrated).

Despite the persistence of established trade patterns, LAC diversified its exports to Asia and the Pacific. Apart from brief spikes driven by oil shocks, the level of concentration converged to the lower and stable Asian levels at least until the early 2000s when, under the influence of the PRC's emergence, the two paths began to diverge (Figure 5). This same trend is also visible at the top of the product distribution (Table 1), which shows LAC making substantial diversification gains (lower share of the top 10 exports) over the period, although without fully converging to Asia and the Pacific's levels. LAC's trend reversal in the early 2000s is also visible at the top level (not shown in the table), with its share of the top 10 exports increasing from 50% in 2000 to nearly 70% in 2010.

**The trade balance.** Another important characteristic of the relationship has been the existence of significant trade imbalances that have favored one region or another according to shifts in the growth cycle, commodity prices, and trade policy responses (Figure 6). Since the early 1990s, the pendulum has definitely swung in Asia and the Pacific's favor, but exactly how far depends on who is reporting the data. Data reported by LAC show an imbalance of up to 30% of the total trade in 2010, or the equivalent of a US\$96 billion deficit. Data reported by Asia and the Pacific, however, indicate a LAC deficit of 10% of total trade in 2010, or the equivalent of US\$37.5 billion.

Part of these differences can be attributed to the fact that LAC's exports to Asia and the Pacific are much "heavier" (high weight-to-value natural

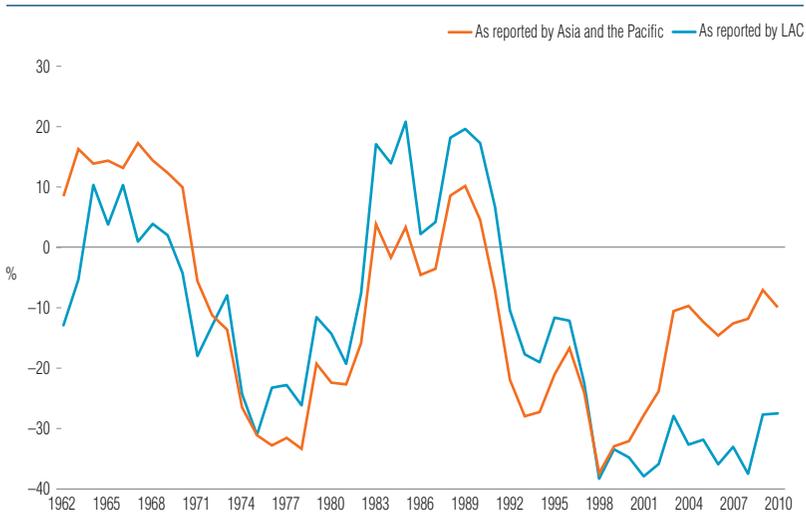
**Table 1 • Top 10 Exports in the Trade Relationship, 1962 and 2010\***

LAC to Asia and the Pacific			
1962	share (%)	2010	share (%)
Bran, pollard, sharps & other by-products	1.6	Poultry, live	1.6
Coffee, green or roasted	2.2	Sulphate wood pulp, bleached, not dissolving	1.9
Other cotton fabrics, woven, bleached	2.2	Raw sugar, beet & cane	2.3
Wheat and meslin, unmilled	3.5	Soya bean oil	2.4
Distillate fuels	4.4	Oil seed cake & meal & other veg. oil residues	2.5
Sheeps and lambs wool, greasy or fluffy	4.4	Crude petroleum	7.6
Ores and concentrates of copper	4.9	Soya beans	9.8
Maize (corn), unmilled	6.2	Refined copper including remelted	11.3
Iron ore & concentrates ex roasted	15.6	Ores and concentrates of copper	13.4
Raw cotton, other than linters	36.9	Iron ore & concentrates ex roasted	16.6
<b>Top 10</b>	<b>81.9</b>	<b>Top 10</b>	<b>69.4</b>
Asia and the Pacific to LAC			
Ships and boats, other than warships	2.3	Rubber tires & tubes for vehicles and aircraft	1.5
Plates under 3mm uncoated not h.c.	2.9	Electric power machinery	1.5
Heavy plates etc., iron, steel not h.c.	3.0	Thermionic valves and tubes, transistors, etc.	1.6
Rail & tram passenger cars not mech.	4.0	Statistical machines cards or tapes	3.0
Radio broadcast receivers	4.2	Other parts for motor vehicles	3.3
Mechanically propelled railway and tramway cars	4.8	Optical appliances & instruments, n.e.s.	3.6
Bags and sacks of textile materials	4.9	Other telecommunications equipment	4.1
Natural rubber and similar natural gums	5.1	Special transactions	4.1
Jute fabrics, woven	5.6	Passenger motor cars, other than buses	5.8
Other cotton fabrics, woven, bleached, dyed, etc.	6.1	Ships and boats, other than warships	13.3
<b>Top 10</b>	<b>42.8</b>	<b>Top 10</b>	<b>41.8</b>

Source: IDB/INT with UN COMTRADE data.

\* SITC Rev. 1.

**Figure 6 • Asia and the Pacific–LAC Regional Trade Balance as a Percentage of Total Trade 1962–2010 (%)**

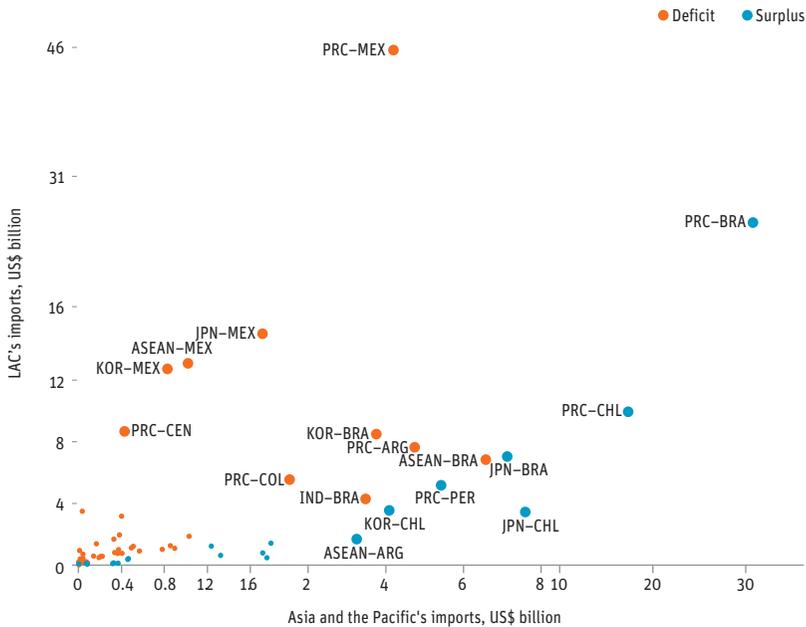


Source: IDB/INT with UN COMTRADE data.

resources) than Asia and the Pacific's exports to LAC, which require a much larger freight component when measured on a CIF (cost, insurance, freight) basis. However, this does not explain why this substantial gap has only appeared in the last 10 years, despite the stability of the trade pattern. Nor is it clear why the gap exists even in bilateral relationships such as the PRC and Mexico, where no high volumes of raw materials are involved.

As with other aspects of the Asia and the Pacific–LAC relationship, one must keep in mind the heterogeneity of situations that lie behind the aggregate figures. This is made clear by Figure 7, which shows the major Asia and the Pacific–LAC bilateral relationships as measured by the volume of the bilateral trade. It is clear that the most significant imbalances take place in Asia and the Pacific's relationships with Mexico and Central America, where there is no clear complementarity between comparative advantages. That is not the case with the relationships between Asia and the Pacific and South America, where abundant natural resources ensure either surpluses or only modest deficits in its trade with Asia and the Pacific.

Whereas there is no economic requirement that trade between regions be balanced, sizeable imbalances can create trade tensions and poison the

**Figure 7 • Asia and the Pacific–LAC Top Trade Relationships by Trade Volume, 2010**

Source: IDB/INT with UN COMTRADE data.

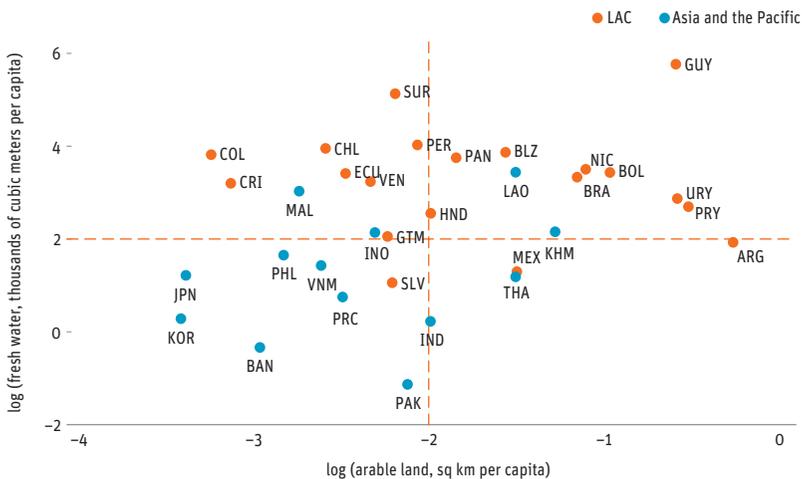
Note: CEN, Central America, stands for BLZ, CRI, DOM, GTM, HND, NIC, PAN, SLV.

political economy of the relationship. As such, governments must pay attention to such imbalances. The existence of important discrepancies in the cross-regional trade statistics adds even more urgency to this issue due to the risks of disconnects between governments and between public opinions about the challenges to the relationship.

## The future

Is the current pattern and dynamism of Asia and the Pacific–LAC trade merely temporary? Is it the result of yet another short commodity cycle? What can we expect from this relationship 20 to 30 years down the road? These are questions often asked on both sides of the Pacific, and particularly in LAC, given the region's concerns over its disproportionate role in commodity trade.

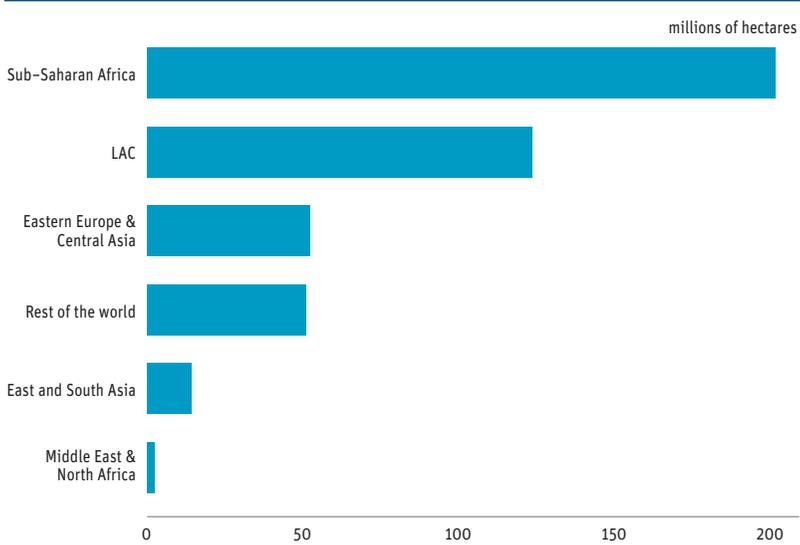
Although economists do not have a good track record when it comes to predictions, in this case the so-called fundamentals seem to speak unusually

**Figure 8 • Asia and the Pacific and LAC Selected Natural Resources Per Capita, 2009**

Source: IDB/INT with WDI data.

loudly. The first point concerns the history of the relationship. As discussed in the previous section, the pattern of trade between the two regions has been remarkably stable in the last half century despite the radical structural and policy changes that have taken place in both economies. Resource complementarity has proven to be a powerful and lasting bond. Will this change in the foreseeable future? The fundamentals suggest that it will not. In fact, it is likely that this bond will be strengthened rather than weakened, driven by ever greater resource complementarity.

**Natural resource stocks.** It does not take a complex analysis to see why. Asia and the Pacific economies, with few exceptions, have very limited land, water, and mineral resources, a constraint that will become increasingly important given the rapid growth of that region's most populous economies, which may be even further intensified by likely impacts of climate change. By contrast, LAC's resources are clearly sufficient both to satisfy its needs and to export. This point is vividly illustrated in Figure 8, which shows per capita stocks in both regions of land and water, the key resources for agriculture. Whereas Asia and the Pacific's largest and most dynamic economies are in the most restrictive quadrant (little water and little land), most of LAC is either in the "perfect" quadrant (abundant water and land) or suffers from just one of the restrictions (land).

**Figure 9 • Potential Availability of Uncultivated Land**

Source: Fischer and Shah (2010).

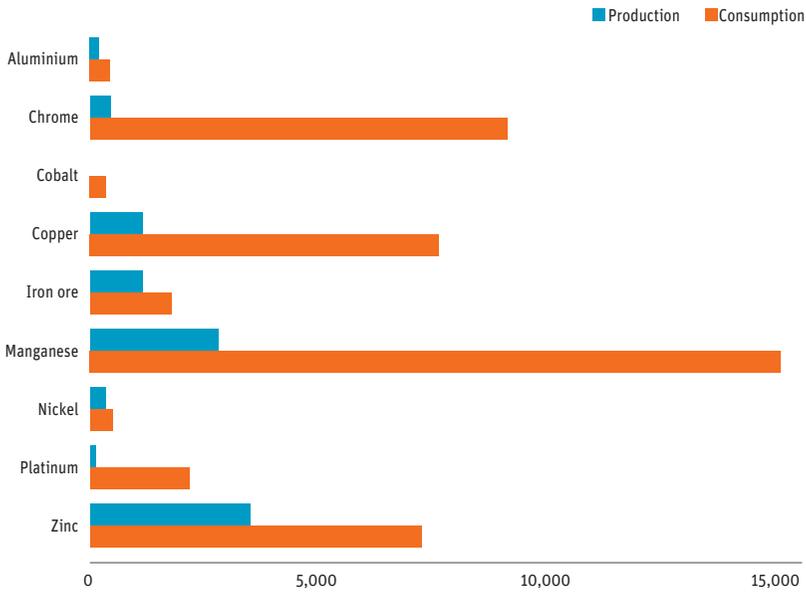
Note: Uncultivated land are areas with high agro-ecological potential with a population density of less than 25 persons/km<sup>2</sup>.

Moreover, this figure tends to underestimate the contrast between the two regions because it does not take into account the land available for expansion. That information, which is presented in Figure 9, shows a huge gap between LAC and East and South Asia, where the continent's most rapid growth is taking place. This information takes on an even greater significance because the so-called yield gap (i.e., the difference in productivity between the most productive lands) in most of East and South Asia is small, which leaves no alternative for expanding production except through use of more land.<sup>3</sup>

Asia and the Pacific's agricultural constraints are likely to be tightened even further by the environmental degradation resulting from economic growth and development. For instance, the PRC lost 20% of its cropland to urbanization in 1975–2009 and is facing a growing desertification of its soil.<sup>4</sup> At the same time, demand for food has been increasing fast in response to higher incomes and urbanization, particularly for high-protein and high-calorie food, which boosts demand for livestock and feed grains. This

<sup>3</sup> See World Bank (2011).

<sup>4</sup> See Morgan Stanley (2011).

**Figure 10 • PRC's Production and Consumption of Selected Minerals (tons), 2010**

Source: Huang (2011).

Note: Aluminium and iron ore in million tons and the rest in thousand tons.

process puts even more pressure on the supply of land and generates ever-growing spillovers to land-abundant regions, such as LAC.

These Chinese agricultural dynamics are far from unique in the rest of Asia and the Pacific. They could just as well describe the challenges being faced by India, with the exception that the PRC is more advanced in this process and India faces even more severe water constraints, as indicated by Figure 8.

Although there is less information on the extent of Asia and the Pacific's mineral reserves, the production-consumption gap of key minerals has been growing in economies such as the PRC, as shown in Figure 10. The same sort of scenario seems to be "revealed" by Asia and the Pacific's growing mineral imports, which are increasing at a faster pace than that of the rest of the world. Moreover, major importers are not only the PRC, but India, Malaysia, Indonesia, and Thailand as well. In 2000–2010, world mineral imports, excluding Asia, grew at a 14% annual average, whereas in India, Malaysia, Indonesia, and Thailand growth was respectively 23%, 22%, 23%, and 22% (UN COMTRADE).

**Demand for raw materials.** It is also true that per capita consumption of raw materials, even in resource-scarce economies, eventually ceases to grow, driven by the so-called income and technology effects. Higher incomes lead to a greater share of services in total expenditures and less of food and raw materials. At the same time, new technologies tend to (i) increase the productivity of the commodity sector of the importing countries; (ii) raise these countries' efficiency in the use of natural resources; and (iii) promote their substitution for cheaper alternatives.

There is little dispute about the importance of these effects, which are well documented empirically. Nurkse (1959), for instance, describes their impact at the turn of the 19<sup>th</sup> century, which eventually drove a slump in commodity prices and provided some of the theoretical underpinnings of LAC's import-substitution industrialization. Rather than question their relevance, the key issue here is how long it will take for these effects to prevail in emerging Asia and the Pacific economies.

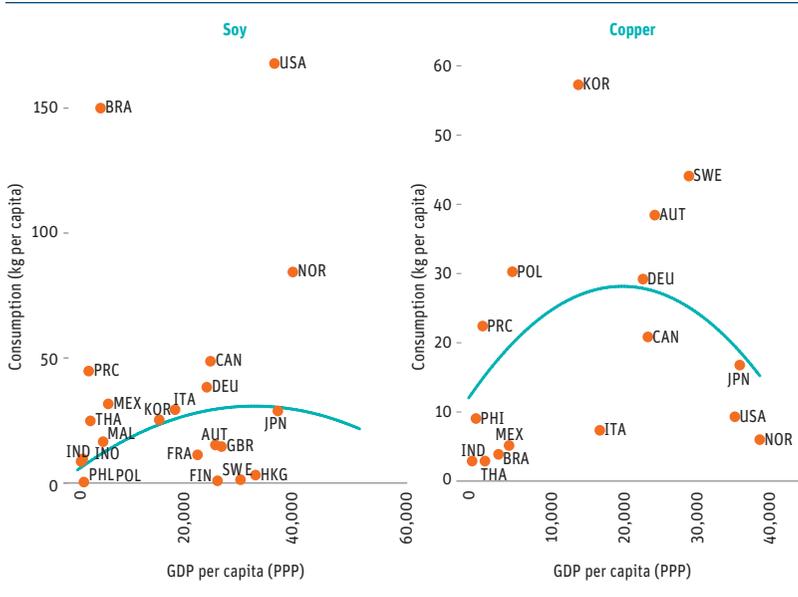
What makes this question particularly difficult to answer empirically is the scant historical precedent for the fast growth of economies as populous and as resource scarce as those that are currently leading Asia and the Pacific's growth. If anything, these characteristics seem to suggest that, short of any technological revolution, these economies will take longer to reach their "turning point" in terms of demand for commodities. But even if a standard cross-country analysis is used that does not take into account these idiosyncrasies, the results do not suggest that the current dynamism of the Asia and the Pacific–LAC relationship will fizzle out any time soon.

As an illustration, Figure 11 tries to identify a relationship between per capita consumption and income of two of the top commodities exported by LAC to Asia and the Pacific: copper and soy. As the graphs suggest, economies including the PRC and India are virtually decades away from their turning point. In the case of copper, for instance, it would take the PRC 35 years to reach this point, assuming an average per capita annual growth of 7%—slightly below the 9% average in the last 20 years.<sup>5</sup> India would take 51 years under the same assumptions. And even when the turning point is achieved, there will still be a significant and unprecedented level of demand

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<sup>5</sup> Most analysts, informed by the growth trajectories of other economies, expect the PRC to experience lower rates of growth in coming decades as diminishing returns set in. See, e.g., World Bank (2012) and Eichengreen, Park, and Shin (2011).

**Figure 11 • Copper and Soy Consumption Per Capita**



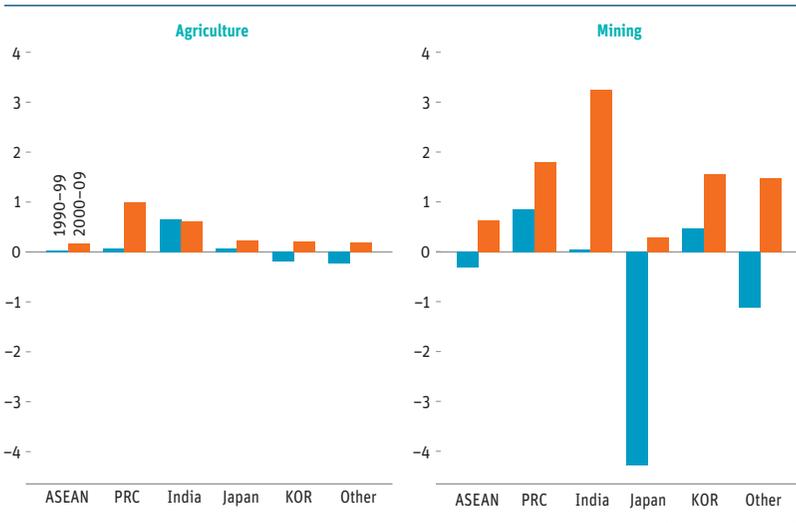
Source: IDB/INT with UN COMTRADE data, UN Industrial Commodity Statistics Database 1950–2009 and U.S. Geological Survey, 2009 data.

for LAC’s commodities, given the sheer size of these economies, which even today are already among the largest in the world.

Until the turning point arrives, the big emerging economies in Asia and the Pacific are absorbing ever-growing amounts of LAC commodities, well beyond what would be assumed by the mere growth of their GDPs. This is evident in estimates of the income elasticity of Asia and the Pacific’s imports from LAC, presented in Figure 12. These elasticities are estimated for the periods 1990–1999 and 2000–2009, which were chosen on the basis of what looks like a clear “structural break” in the Asia and the Pacific–LAC relationship (see Technical Appendix A for details).

Immediately evident is a significant increase in the elasticities of mining imports across the Asia and the Pacific economies between the two periods, led by the PRC and India. Japan also shows a major shift, but to much lower levels; an interpretation of that economy’s estimates is complicated by the near stagnation of its economy during the two periods. In the case of agriculture, the picture is less clear, with only the PRC and Republic of Korea showing production increases, and even these at levels significantly lower

**Figure 12 • Asia and the Pacific’s Income Elasticity with Respect to LAC’s Commodity Exports 1990–99/2000–09**



Source: IDB/INT.

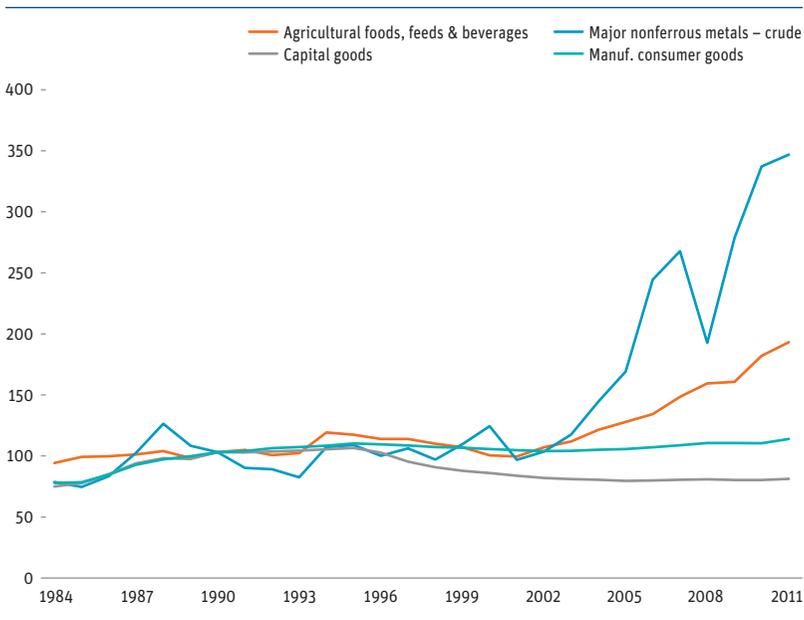
Note: See Technical Appendix A for details. ASEAN includes Thailand, Malaysia, Singapore, and Indonesia.

than in mining. The high trade barriers that still constrain agriculture trade, and which are discussed later in more detail, seem to explain these figures. Overall, the estimates confirm the expectation that the future dynamism of the Asia and the Pacific–LAC relationship will hinge on the emerging Asian giants, which not only have more binding resource constraints, but are likely to be decades away from their commodity turning points.<sup>6</sup>

**Commodity prices.** LAC’s lingering concerns over a long-term decline in the relative price of commodities seem to be at odds with the scenario of a strong, long-term demand by Asia and the Pacific’s emerging economies for raw materials, and with prospects for worldwide exhaustion of the most

<sup>6</sup> The findings of Cesa-Bianchi, Pesaran, Rebucci, and Xu (forthcoming) confirm the growing importance of economies such as the PRC for the region’s growth prospects. They show that the long-run impact of a PRC GDP shock on the typical Latin American economy has increased three times since the mid-1990s. They also show that the larger impacts of a PRC GDP shock owe as much to indirect effects, associated with stronger trade linkages between the PRC and Latin America’s largest trade partners, as to direct effects stemming from tighter trade linkages between the PRC and Latin America.

**Figure 13 • US Import Price Indices for Selected Manufacturing, Agricultural, and Mining Products: 1984–2011. 1990 = 100**



Source: IDB/INT with Bureau of Labor Statistics BEA end use import indices.

accessible and productive lands and mines.<sup>7</sup> The Prebisch-Singer hypothesis about these declining prices is still the subject of heated controversy, but this controversy is clearly about the past.<sup>8</sup> Since the early 2000s, the world economy has been experiencing one of the longer—if not the longest—upswing of commodity prices in world history, while the prices of manufacturing goods have been essentially flat or declining. This trend is illustrated by Figure 13, which uses data from the US market, arguably the most open and competitive market in the world. The pressure on manufacturing prices would be even more evident if the import price series were adjusted for the increasing quality and sophistication of those products.

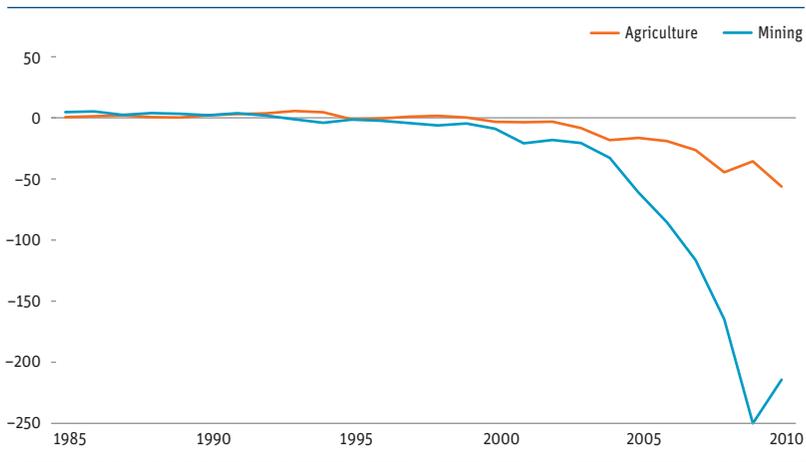
There has been considerable debate over the cause for this current upswing, including the role of short-term factors such as financial speculation.<sup>9</sup>

<sup>7</sup> For a recent evaluation of the global supply of agricultural and mining products, see, for instance, USDA (2011), World Bank (2011), and Goldman Sachs (2010).

<sup>8</sup> See, for instance, Ocampo and Parra-Lancourt (2010), Balagtas and Holt (2009), and Frankel (2010).

<sup>9</sup> See, e.g., Frankel and Rose (2010) or Irwin, Sanders, and Merrin (2009).

**Figure 14 • PRC's Net Exports of Agricultural and Mineral Goods 1985–2010 (US\$ billion)**



Source: IDB/INT with UN COMTRADE data.

Yet it seems hard to ignore the structural factors behind it. The beginning of the upswing coincides with the PRC's emergence as a massive net importer of agricultural and mineral goods (Figure 14), which does not seem to be a short-term phenomenon. Moreover, India has yet to become a net importer of food and a significant importer of minerals, a prospect it can hardly avoid in the future, given current growth rates. Likewise, the pressure on manufacturing prices cannot be dissociated from the PRC's growing presence in the international markets, where it has more than doubled its share of US manufacturing imports since the early 2000s (USITC). As in the case of commodity imports, it is very likely that India will follow suit as a major exporter of manufacturing goods, setting the stage for a long-term downward pressure on the prices of these goods.<sup>10</sup> It seems the perfect scenario for shedding long-held assumptions about which category of products is likely to face a long-run decline in relative prices.

## Trade costs

Against this background of booming interregional trade and promising prospects, what can governments do to expand and consolidate the gains? As

<sup>10</sup> See, for instance, Panagariya (2008) and Mesquita Moreira (2010).

with any trade relationship, the first place to look is trade costs. This includes not only the traditional tariff and non-tariff barriers, but also logistics costs, which assume particular importance when trade is conducted between distant partners and involves bulky and heavy goods. This is precisely the case of the Asia and the Pacific–LAC relationship, where there seems to be ample room for action on this front. Both traditional and non-traditional barriers are still unduly high, particularly within sectors and between partners with the greatest potential for trade.

**Traditional barriers.** The high cost of tariff barriers is strongly supported by the available evidence. For instance, Table 2 presents the average tariffs imposed on imports from both sides of the relationship. Each region's exports to the world as a whole are used as weights to control for the effect of protection on current bilateral trade flows. It is immediately evident that agriculture, one of the most dynamic and promising sectors of the relationship, is the most heavily protected, particularly in South Asia. Manufacturing also faces important barriers, especially on LAC's side, but tariffs are not as high as those that exporters face on agriculture.

One particularly perverse distortion of the structure of protection on both sides of the relationship is so-called tariff escalation (i.e., tariffs are directly proportional to the amount of processing). The WTO Trade Policy Reviews of the main traders in the relationship shows that agriculture again is the sector most affected by this practice. Even though both sides make use of this instrument, LAC will likely pay the higher price in terms of lost opportunities to increase the sophistication of its exports, given its comparative advantages.<sup>11</sup>

The costs of tariff distortions are compounded by non-tariffs barriers (NTBs). These latter are notoriously difficult to measure, but no less important. Here too, the governments in the two regions attempt to protect their less competitive sectors, resulting in high costs to consumers as well as hurting productivity and growth. In Asia and the Pacific, as expected, NTBs are concentrated in agriculture, where economies make frequent use of quotas, tariff quotas, and often opaque and unpredictable sanitary and phytosanitary measures. Republic of Korea, for instance, offers a typical example of the type

<sup>11</sup> See, for instance, WTO/Trade Policy Reviews for the PRC (2010), Republic of Korea (2008), Brazil (2009), and Argentina (2007).

Table 2 • Average Import Tariffs on Interregional Trade, Selected Economies, 2009 (%)

Sector	ASEAN				East Asia				South Asia			
	Caribbean	C. America	S. America	Caribbean	C. America	S. America	Caribbean	C. America	S. America	Caribbean	C. America	S. America
Mining	0.3	2.0	1.2	0.5	2.2	1.0	7.7	4.4	3.7			
Agriculture	17.4	12.7	6.8	16.0	9.7	8.8	37.6	55.1	21.4			
Manufactures	5.1	8.3	7.1	4.8	6.0	4.9	11.1	16.6	12.8			
LAC's tariffs on Asia and the Pacific imports												
Sector	Caribbean				Central America				South America			
	ASEAN	East Asia	South Asia	ASEAN	East Asia	South Asia	ASEAN	East Asia	South Asia	ASEAN	East Asia	South Asia
Mining	7.5	4.7	6.4	4.1	5.2	4.0	5.8	5.6	4.3			
Agriculture	15.9	13.4	16.5	10.5	12.6	14.4	11.0	11.2	14.2			
Manufactures	10.2	11.3	16.8	5.9	7.4	9.8	8.0	10.8	15.2			

Source: IDB/INT with UNCTAD TRAINS data.

Note: Average tariffs are first calculated at the country level, weighted by the partners' exports to the world. The subregional figures are simple country averages.

of instruments used. It has tariff rate quotas affecting a wide range of LAC agriculture exports, such as coffee, cereals, sugar, fruits, and meat, with “in-quota” tariffs ranging from 0 to 46% and “off-quota” rates as high as 750%.<sup>12</sup>

In manufacturing, Asia and the Pacific’s NTBs do not seem to be as prevalent as in agriculture, but there is evidence of difficulties, particularly in accessing the Chinese market. Concerns arise from issues such as inconsistencies in the customs classification of products into tariff categories; improper use of reference pricing for custom valuation; very restrictive government procurement rules for foreign suppliers; and the informal use of trade-related investment measures to raise the domestic content of investments.<sup>13</sup>

In LAC, it is not surprising that manufacturing is the focus of NTBs, which have been increasingly used by countries such as Brazil, Argentina, and to a lesser extent Mexico, to the detriment of Asian exporters, particularly those from the PRC, and of LAC consumers. The complaints of Asian exporters range from expensive and unwarranted technical barriers, to reference pricing, non-automatic import licenses, and “voluntary” export restraints.<sup>14</sup>

**Transport costs.** As a result of crumbling infrastructure and the weight of the goods being exported, transport costs for LAC are often as high as or higher than traditional trade barriers such as tariff and non-tariff barriers.<sup>15</sup> Transport costs are particularly relevant for the region’s trade with Asia and the Pacific because of the distance involved and the composition of the region’s exports, which include “heavy” products such as high weight-to-value natural resources, whose freight costs are a significant part of the final CIF price.

Unfortunately, transport cost data are not available for both sides of the Asia and the Pacific–LAC relationship. For some LAC countries, however, there is reliable information on the transport costs of their imports from some of Asia and the Pacific’s most important economies. As can be seen in Figure 15, ad valorem freight rates for imports from the PRC, India, and Republic of Korea (measured as freight expenditures divided by the value of imports) are in most cases close to or even higher than tariff rates. Note

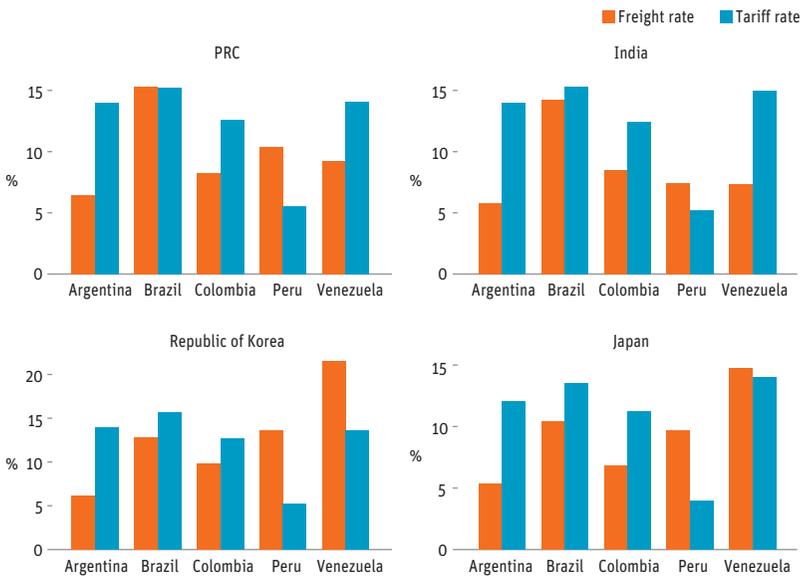
.....  
<sup>12</sup> WTO/Trade Policy Review. Republic of Korea (2008).

<sup>13</sup> See USTR 2010 National Trade Estimate Report on Foreign Barriers. China. [http://www.ustr.gov/sites/default/files/uploads/reports/2010/NTE/2010\\_NTE\\_China\\_final.pdf](http://www.ustr.gov/sites/default/files/uploads/reports/2010/NTE/2010_NTE_China_final.pdf).

<sup>14</sup> See MOFCOM (2009). See also WTO (2009), Foreign Market Access 2009 for Brazil, Mexico and Argentina. See also WTO/TPR Brazil 2009.

<sup>15</sup> Mesquita Moreira, Volpe, and Blyde (2008).

**Figure 15 • Tariffs and Ad Valorem Freight Rates on LAC's Imports from Asia and the Pacific Selected economies**



Source: IDB/INT with data from ALADI and UN COMTRADE.

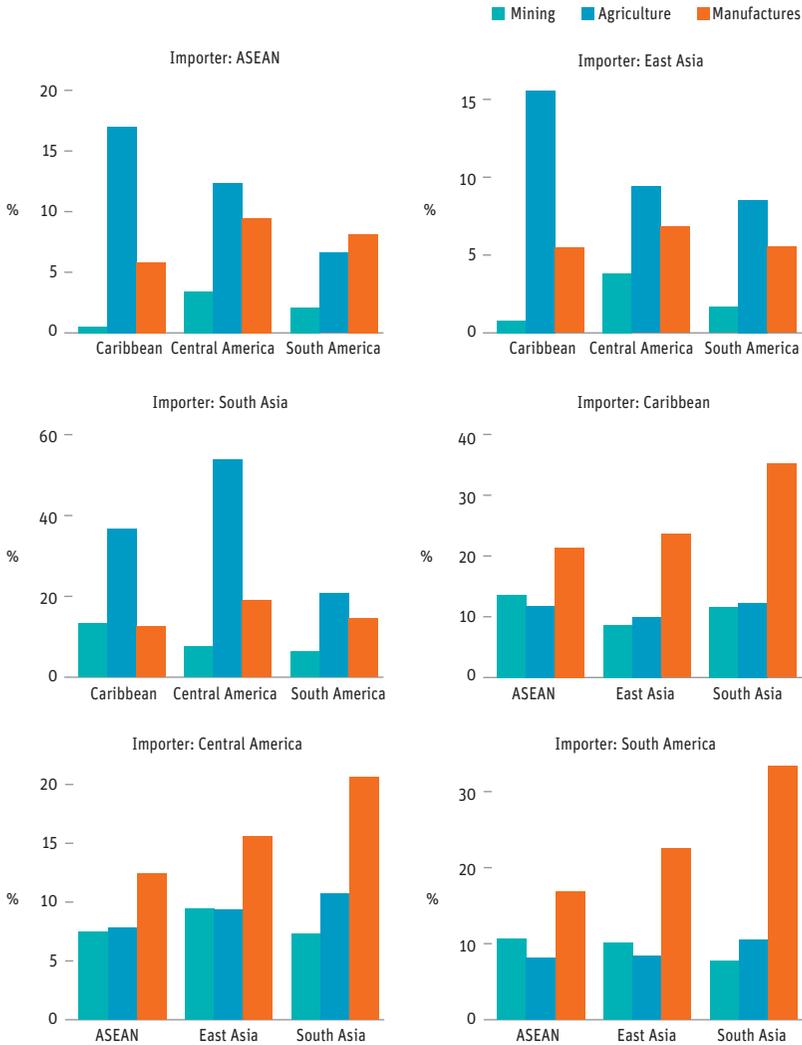
Note: Averages are weighted by the Asian economy's exports to the world in 2010. Tariff data: 2010. Freight data: 2009.

that freight expenditures do not include the time costs of transportation (depreciation and inventory costs), which in most cases are at least as high as freight rates. In the case of LAC trade with India, for instance, the lack of direct shipping service is likely to translate into significantly higher time costs than would be explained by distance. Shipping a good directly from a port such as Santos, Brazil, to Mumbai, India, would take an estimated 27 days and 15 hours (<http://www.distances.com/>). Shipping via Singapore takes 36 days and 18 hours, increasing shipping times by approximately nine days. Using a tariff equivalent of time cost estimated to export, the time necessary to complete the whole itinerary would be equivalent to a 17% import tariff.<sup>16</sup>

**The gains.** The significance of the expected gains from addressing these trade costs is illustrated in Figure 16, which presents the results of a simulation

<sup>16</sup> Mesquita Moreira, Volpe, and Blyde (2008).

**Figure 16 • Interregional Exports: Gains from a 30% Cut in Tariffs**



Source: IDB/INT. Author's own estimates. See Technical Appendix B for details.

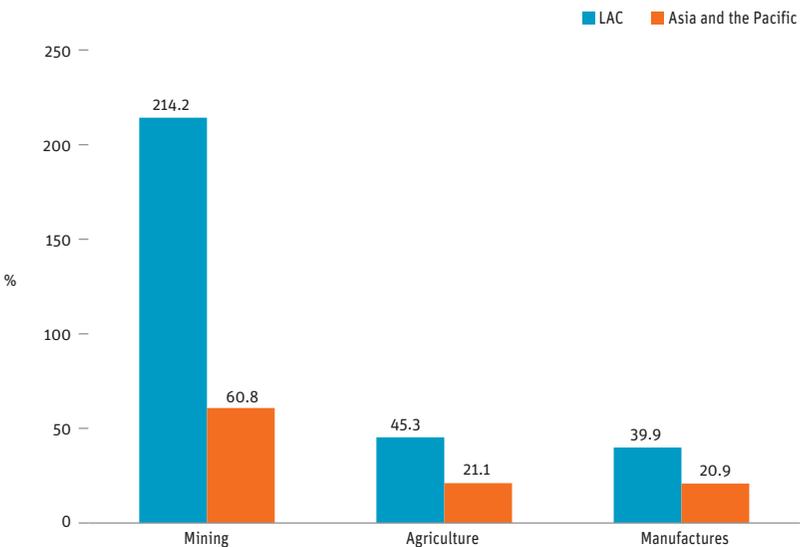
based on estimates of a modified gravity model. In this “workhorse” of trade economists, bilateral trade is modeled as a function of size, the distance between countries, trade costs, and permanent importer and exporter characteristics (see Technical Appendix B). The model is run on 1990–2009 trade data for 137 countries. The figure shows the impact on interregional

exports of a modest 30% cut in the import tariffs of select Asia and the Pacific and LAC economies. As expected, the most significant gains on the LAC side would be in agriculture in South Asian markets. On Asia and the Pacific's side, also as expected, manufacturing would account for the most significant gains, particularly in the most protected markets of South America.

It is worth noting that this exercise clearly underestimates the potential gains from addressing trade costs between the two regions since it does not include three factors: the elimination of NTBs, which clearly favors agriculture exports; a reduction in transport costs, where the gains can be substantial (as indicated in Figure 16); and general equilibrium effects, i.e., the positive and indirect effects of liberalization on factors such as productivity. Despite these limitations, the exercise serves to remind policymakers in both regions of the potential gains awaiting a more aggressive trade policy stance.

Figure 17, in turn, illustrates the potential trade gains of improvements in the transport infrastructure on both sides of the relationship (see Technical Appendix C). Also relying on a gravity model, it shows the impact on interregional exports when the quality of LAC's and Asia and the Pacific's ports, as measured by the World Development Indicators quality of port index, is upgraded to the

**Figure 17 • Interregional Export Gains of Improvements in Port Infrastructure**



Source: IDB/INT.

Note: See text and Technical Appendix C for details.

level of Denmark, which sits at the top of the quality distribution (around the 95th percentile). This upgrade involves a 70% quality improvement for the average LAC port, whereas the same figure for Asia and the Pacific is 40%.

As expected, gains are concentrated on the “heavy” natural-resource-intensive goods, with the best results going to the region with greater limitations in its port infrastructure and with a composition of exports that is dominated by these goods. Asia and the Pacific’s gains are more modest, but can hardly be described as negligible. As with tariffs, it is worth mentioning that this simple exercise is most likely a lower bound of the potential gains as it does not take into account the all-important improvements in transport services.

### The agenda ahead

During the last half century, the Asia and the Pacific–LAC relationship has moved from being nearly irrelevant to becoming one of the top priorities in the trade agendas of the two regions’ governments. Trade grew rapidly until the 1990s, and then skyrocketed in the last decade, driven by the emergence of Asia and the Pacific’s one-billion-plus–people economies, and a nearly perfect fit in comparative advantages. It would not be an exaggeration to say that this process has been mainly driven by market forces, with little direct input from governments. Yet, the time has come for governments to play a more active role.

This interregional trade has clearly brought substantial benefits for all the parties involved. It has enabled Asia and the Pacific to overcome its natural resource constraints and at the same time has opened up new growth opportunities for LAC. However, concerted policy action is now needed to expand and consolidate these gains. Trade has become greatly concentrated on a few economies and, on the LAC exports side, on a few goods, despite the great potential for diversification. In addition, this geographic and product concentration has been accompanied by some important trade imbalances that, if left unchecked, could poison the political economy of the relationship.

To a great extent the geographic and product concentration of trade is merely the result of how comparative advantages are distributed across the two regions. But it does not have to be an inevitable byproduct of the commodities-for-manufacturing trade, which has defined the relationship since its early days. A cursory analysis of Asia and the Pacific’s future resource

constraints and comparative advantages in manufacturing leaves no doubt that this exchange will continue to dominate and drive the relationship for decades to come. This will most likely take place in a context of rising commodity prices and increasing technological sophistication and diversification of those products. By building up its human capital, LAC could be perfectly positioned to take advantage of these opportunities. Asia and the Pacific, in turn, has all the incentives to expand and diversify the products it buys from LAC. They are key for alleviating that region's growing resource constraints, boosting the competitiveness of its firms and, above all, improving the welfare of its people.

For this scenario to become a reality, governments must address the high trade costs that constrain interregional trade, particularly in those sectors with higher growth and diversification potential. Agriculture clearly stands out in this regard. Tariffs and NTBs, for instance, are unjustifiably high for most trade relationships. There are reasons to be optimistic that governments will take action. As discussed in Chapter 2, a number of important initiatives have already been carried out to address these issues—for example, the free trade agreements (FTAs) signed by LAC countries, such as Peru and Chile, with the largest Asia and the Pacific economies. There have also been broader transregional initiatives, such as APEC and the Trans-Pacific Partnership, which are in different stages of development and have different objectives and membership, but which can also bring down these barriers.

While this is a good beginning, these initiatives so far cover only a handful of the potential partners in the relationship. Given the diverse situations of economies in both regions, there can hardly be a one-size-fits-all solution. When FTAs face political economy difficulties, governments should undertake more focused, sector-specific negotiations. Moreover, FTAs do not address the whole trade costs agenda. The challenge of bringing transport costs down, for instance, calls for additional actions, particularly for cooperation on regulatory and technical issues. These include transport service agreements that would boost supply and increase competition in transport services, and improvements in the quality of transport infrastructure. Opportunities for taking these actions are discussed in more detail in Chapter 4, but it is also clear that interregional foreign direct investments (FDI) (see Chapter 3) can also play a key role in achieving these objectives.

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**Technical Appendix A:**  
**Figure 12 – Income Elasticities of Import Demand**

To estimate the income elasticity of LAC’s exports to Asia and the Pacific, an unbalanced panel data set was used, covering the value of imports (at the six-digit level of the harmonized system code) traded by 137 countries for the period 1990–2009, available in UN COMTRADE. Bilateral imports are aggregated into three categories—mining, agriculture, and manufacturing—following a WTO classification. The income elasticity of exports is estimated with the following extended gravity equation:

$$\begin{aligned} \ln M_{ijt} = & \alpha + \beta_1 \ln dist_{ij} + \beta_2 \ln Y_{it} + \beta_3 \ln Y_{jt} + \beta_4 \ln L_{it} + \beta_5 \ln L_{jt} + \beta_6 \ln N_{it} + \\ & \beta_7 \ln N_{jt} + \beta_8 COL + \beta_9 COMCOL + \beta_{10} COL45 + \beta_{11} BORD + \\ & \beta_{12} LANG + \beta_{13} RTA + \beta_{14} FORMER + \beta_{15} CHN + \beta_{16} IND + \beta_{17} JPN + \\ & \beta_{18} SKOR + \beta_{19} ASEAN + \beta_{20} OASIAN + \beta_{21} LAC + \beta_{22} CHN * \ln Y_{it} + \quad (1) \\ & \beta_{23} IND * \ln Y_{it} + \beta_{24} JPN * \ln Y_{it} + \beta_{25} SKOR * \ln Y_{it} + \beta_{26} ASEAN * \ln Y_{it} + \\ & \beta_{27} OASIAN * \ln Y_{it} + \beta_{28} CHN * \ln Y_{it} * LAC + \beta_{29} IND * \ln Y_{it} * LAC + \\ & \beta_{30} JPN * \ln Y_{it} * LAC + \beta_{31} SKOR * \ln Y_{it} * LAC + \beta_{32} ASEAN * \ln Y_{it} * LAC + \\ & \beta_{33} OASIAN * \ln Y_{it} * LAC + \lambda_1 D_i + \lambda_2 D_j + \lambda_3 D_t + \varepsilon_{ijt}. \end{aligned}$$

Where

- i = 1, ..., I denotes the reporting (importing) country.
- j = 1, ..., J denotes the partner (exporting) country.
- t = 1990, ..., 2009 denotes the sample period.
- $M_{ijt}$  denotes the bilateral import flow.
- $dist_{ij}$  denotes the bilateral distance between the importing and the exporting country.
- $Y_{it}$  and  $Y_{jt}$  correspond to the GDP of the importing and exporting countries.
- $L_{it}$  and  $L_{jt}$  correspond to the land area of the importing and the exporting countries.
- $N_{it}$  and  $N_{jt}$  correspond to the the market size in the importing and the exporting countries.

COL	is a dummy variable taking the value of 1 when the countries involved share a colonial relationship, 0 otherwise.
COMCOL	is a dummy variable taking the value of 1 if the countries involved were colonized by the same country, 0 otherwise.
COL45	is a dummy variable taking the value of 1 if the countries were a colony after 1945.
BORD	is a dummy variable taking the value of 1 if the countries involved share the same border, 0 otherwise.
LANG	is a dummy variable taking the value of 1 if the countries involved speak the same language, 0 otherwise.
RTA	is a dummy variable taking the value of 1 if both countries are members in the same trade agreement.
FORMER	is a dummy variable taking the value of 1 if the countries were previously part of the same country.
CHN	is a dummy variable taking the value of 1 if the reporting country is the PRC, 0 otherwise.
IND	is a dummy variable taking the value of 1 if the reporting country is India, 0 otherwise.
JPN	is a dummy variable taking the value of 1 if the reporting country is Japan, 0 otherwise.
SKOR	is a dummy variable taking the value of 1 if the reporting country is Republic of Korea, 0 otherwise.
ASEAN	is a dummy variable taking the value of 1 if the reporting country is Thailand, Malaysia, Singapore, or Indonesia, 0 otherwise.
OASIAN	is a dummy variable taking the value of 1 if the reporting country is an Asian country not classified as CHN, IND, JPN, SKOR, or ASEAN, 0 otherwise.
LAC	is a dummy variable taking the value of 1 if the reporting country $j$ is located in Latin America, 0 otherwise.
$D_i, D_j$ and $D_t$	are importer, exporter, and year fixed effects.
$\epsilon_{ijt}$	is an i.i.d. error term which we assumed to be normally distributed.

Data on GDP, land area, and country size was obtained from the WDI (2011). Data on common language, colonial ties, bilateral distance, and RTA was obtained from the CEPII gravity dataset.<sup>17</sup>

As in Helpman, Melitz, and Rubinstein (2007), equation (1) is estimated using a two-stage estimation approach. This enables us to correct for the large number of zeros in the world trade matrix (export selection), and to control for the unobserved fraction of exporting firms (extensive margin).

In the first stage a probit is estimated, and the religion proximity between the importing and the exporting countries is the instrument to be used in the exclusion equation. This variable serves as a proxy for the bilateral trade barriers affecting entry into exporting that are not related to the determinants of variable trade costs. Then, the probability of export is predicted and used to calculate variables Eta and Delta. These two variables are included as additional controls in the second stage. Eta is the Heckman correction parameter used to control for export selection. Delta controls for the unobserved firm heterogeneity, that is, the effect of trade frictions and country characteristics on the proportion of exporters, the extensive margin of trade. In all specifications, country-specific (for both importing and exporting countries) and year fixed effects are included to control for unobserved country-specific factors affecting trade. The income elasticities of LAC's exports to Asia and the Pacific for mining, agriculture, and the total import volume of trade are reported for the periods 1990–1999 and 2000–2009.

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<sup>17</sup> For details, see Head, Mayer, and Ries (2008).

Table A.1

Endogenous Variable:	Mining			Agriculture			All Goods		
	(1)	(2)	(3)	(4)	(5)	(6)			
Total Import Value (ln)	-2.105 (0.106)***	-2.537 (0.127)***	-1.026 (0.0649)***	-1.402 (0.0737)***	-1.094 (0.0578)***	-1.595 (0.0712)***			
GDP Reporter Cty. (ln)	0.0830 (0.0172)***	0.289 (0.0890)***	0.0658 (0.0162)***	0.206 (0.0667)***	0.0429 (0.0156)***	0.409 (0.0601)***			
GDP Partner Cty. (ln)	-0.0567 (0.0183)***	0.166 (0.116)	-0.00765 (0.0200)	0.0490 (0.105)	-0.0475 (0.0212)**	0.263 (0.0779)***			
Population Reporting Cty. (ln)	2.392 (0.516)***	1.027 (0.334)***	0.858 (0.359)**	1.136 (0.190)***	0.295 (0.336)	0.881 (0.169)***			
Population Partner Cty. (ln)	-2.232 (0.516)***	-0.209 (0.457)	-0.848 (0.523)	-0.414 (0.640)	-1.831 (0.475)***	-0.0424 (0.563)			
Land Reporting Cty. (ln)	0.156 (2.195)	-5.549 (3.922)	-0.528 (1.779)	-7.519 (2.272)***	0.825 (1.430)	-4.185 (2.302)*			
Land Partner Cty. (ln)	-2.516 (4.662)	-1.022 (8.494)	-2.487 (1.316)*	-0.429 (3.601)	-2.865 (1.065)***	-4.518 (5.947)			
Reporter Cty. WTO Member	0.119 (0.0576)**	0.444 (0.105)***	0.0729 (0.0509)	0.247 (0.0764)***	0.121 (0.0490)**	0.252 (0.0740)***			
Partner Cty. WTO Member	0.111 (0.111)	0.0326 (0.205)	-0.0178 (0.0532)	0.271 (0.178)	0.0829 (0.111)	0.318 (0.164)*			
Common RTA	0.131 (0.100)	0.487 (0.0993)***	0.132 (0.0736)*	0.430 (0.0833)***	0.00391 (0.0740)	0.435 (0.0721)***			
Common Border	-0.581 (0.176)***	0.0421 (0.197)	0.468 (0.155)***	0.514 (0.187)***	0.179 (0.125)	0.372 (0.205)*			

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**Table A.1** (continued)

Endogenous Variable:	Mining			Agriculture			All Goods		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Total Import Value (ln)									
Common Language	0.153 (0.103)	0.335 (0.110)***	0.476 (0.0773)***	0.587 (0.0864)***	0.413 (0.0770)***	0.579 (0.0825)***			
Common Colony Ever	0.946 (0.159)***	1.268 (0.172)***	0.527 (0.147)***	0.858 (0.154)***	0.568 (0.155)***	0.462 (0.188)**			
Common Colonizer	0.759 (0.187)***	1.134 (0.153)***	0.486 (0.139)***	0.755 (0.146)***	0.421 (0.130)***	0.778 (0.120)***			
Colonial post-1945	0.480 (0.211)**	0.602 (0.221)***	0.706 (0.190)***	0.579 (0.175)***	0.701 (0.196)***	0.946 (0.243)***			
Same Former Cty.	0.630 (0.343)*	0.678 (0.343)**	0.0661 (0.280)**	0.594 (0.238)**	0.469 (0.267)*	0.817 (0.253)***			
Int: GDP Reporter Cty. (ln) x PRC	0.778 (0.163)***	1.475 (0.224)***	0.214 (0.140)	0.791 (0.167)***	0.187 (0.133)	1.522 (0.170)***			
Int: GDP Reporter Cty. (ln) x India	0.219 (0.176)	2.958 (0.235)***	0.628 (0.151)***	0.435 (0.128)***	0.235 (0.137)*	2.529 (0.214)***			
Int: GDP Reporter Cty. (ln) x Japan	-4.340 (1.187)***	1.262 (1.846)	0.941 (0.812)	-0.104 (1.057)	-1.761 (0.854)**	1.087 (1.126)			
Int: GDP Reporter Cty. (ln) x Republic of Korea	0.390 (0.191)**	1.265 (0.446)***	-0.265 (0.126)**	-0.000 (0.363)	0.0300 (0.176)	0.974 (0.327)***			
Int: GDP Reporter Cty. (ln) x ASEAN 4	-0.362 (0.145)**	0.345 (0.198)*	0.147 (0.100)	-0.127 (0.124)	0.0309 (0.0958)	-0.244 (0.129)*			
Int: GDP Reporter Cty. (ln) x Other Asia and the Pacific	-1.164 (0.213)***	1.183 (0.252)***	-0.269 (0.117)**	0.0480 (0.171)	-0.177 (0.127)	0.158 (0.160)			

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Table A.1 (continued)

Endogenous Variable:	Mining		Agriculture		All Goods	
	(1)	(2)	(3)	(4)	(5)	(6)
Total Import Value (ln)						
Int: GDP Reporter Cty. (ln) x PRC x LAC	-0.0262 (0.0172)	0.0274 (0.0138)**	-0.00881 (0.0172)	-0.0225 (0.0150)	-0.0292 (0.0135)**	-0.00972 (0.0133)
Int: GDP Reporter Cty. (ln) x India x LAC	-0.0415 (0.0157)**	-0.000174 (0.0118)	-0.0419 (0.00945)**	-0.0229 (0.0123)*	-0.0351 (0.00971)**	-0.0208 (0.0104)**
Int: GDP Reporter Cty. (ln) x Japan x LAC	-0.0289 (0.0156)*	-0.0109 (0.0157)	-0.00529 (0.00832)	0.0197 (0.00972)**	0.00360 (0.00788)	0.0120 (0.00804)
Int: GDP Reporter Cty. (ln) x Republic of Korea x LAC	-0.0125 (0.0150)	0.0214 (0.0139)	-0.0114 (0.00824)	-0.00140 (0.00997)	0.000471 (0.0104)	0.00414 (0.0113)
Int: GDP Reporter Cty. (ln) x ASEAN 4 x LAC	-0.0329 (0.0164)**	-0.00507 (0.0125)	-0.0371 (0.0100)**	-0.0318 (0.00865)**	-0.0304 (0.00844)**	-0.0156 (0.00720)**
Int: GDP Reporter Cty. (ln) x Other Asia and the Pacific x LAC	-0.0346 (0.0115)**	-0.000790 (0.0125)	-0.0281 (0.00665)**	-0.0191 (0.00690)**	-0.0297 (0.00690)**	-0.00558 (0.00602)
Int: GDP Reporter Cty. (ln) x LAC	-0.00604 (0.0196)	-0.0683 (0.0229)**	0.0246 (0.0206)	-0.0612 (0.0217)**	-0.0243 (0.0188)	-0.0908 (0.0162)**
Delta	-0.0267 (0.00356)**	-0.0283 (0.00379)**	0.00169 (0.00143)	-0.0143 (0.00230)**	0.00120 (0.00109)	-0.0184 (0.00204)**
Eta	2.173 (0.195)**	1.925 (0.260)**	0.764 (0.122)**	0.415 (0.217)*	0.333 (0.101)**	0.484 (0.227)**
Sample	1990–1999	2000–2009	1990–1999	2000–2009	1990–1999	2000–2009
Observations	26,346	62,867	40,518	93,602	49,659	113,161
R-squared	0.538	0.513	0.556	0.555	0.597	0.606

Sample: 1990–2009. Additional controls include dummies for PRC, India, Japan, Republic of Korea, ASEAN 4, and other Asia and the Pacific economies. All results include importing, exporting, and year fixed effects. Robust standard errors in parentheses. \* p<0.1, \*\* p<0.05, and \*\*\* p<0.01.

Note: Because of space constraints, the first stage is not shown but is available upon request.

**Technical Appendix B:**  
**Figure 16 – Import Tariffs**

To assess the impact of a reduction in import tariffs on trade, a gravity equation is estimated, controlling for the bilateral import tariffs  $tar_{ijt}$  and the infrastructure level of both the importing  $inf_{it}$  and the exporting economy  $inf_{jt}$ . The specification used is:

$$\ln M_{ijt} = \alpha + \beta_1 \ln dist_{ij} + \beta_2 \ln Y_{it} + \beta_3 \ln Y_{jt} + \beta_4 \ln tar_{ijt} + \beta_5 \ln inf_{it} + \beta_6 \ln inf_{jt} + \beta_7 reg_i + \beta_8 rej_i + \beta_9 reg_i * \ln tar_{kijt} + \beta_{10} reg_j * \ln tar_{kijt} + \beta_{11} reg_i * reg_j * \ln tar_{kijt} + \lambda_1 D_i + \lambda_2 D_j + \lambda_3 D_t + \epsilon_{ijt} \tag{2}$$

Data on import tariffs  $tar_{ijt}$  was obtained from the UNCTAD-TRAINS dataset, while an economy’s infrastructure level was proxied using the Limao and Venables (2001) infrastructure index.  $reg_i$  and  $reg_j$  are dummy variables that, depending on the case, take the value of one when the exporting economy is located in either Asia and the Pacific or in the LAC region, otherwise zero. For example, when determining the impact on Asian exports of a reduction in import tariffs in LAC,  $reg_i$  is set equal to unity when the importing economy is located in LAC, otherwise zero. Then  $reg_j$  is set equal to unity when the exporting economy is located in Asia and the Pacific. When analyzing the impact of a reduction in import tariffs of Asia and the Pacific economies on LAC exports,  $reg_i$  takes the value of one when the importing economy is in Asia and the Pacific, while  $reg_j$  will be a dummy variable taking the value of one when the exporting economy is located in LAC. All specifications include as additional controls importer, exporter, and year fixed effects.

Table B.1

Endogenous Variable: Total Import Value (ln)	LAC Exports			Asia and the Pacific Exports		
	Mining	Agriculture	Manufactures	Mining	Agriculture	Manufactures
Bilateral Distance (ln)	-1.976 (0.0701)***	-1.431 (0.0537)***	-1.656 (0.0611)***	-1.958 (0.0692)***	-1.431 (0.0546)***	-1.658 (0.0594)***
Infrastructure Reporting Cty. (ln)	2.214 (0.429)***	0.935 (0.201)***	0.331 (0.171)*	2.285 (0.434)***	0.872 (0.204)***	0.297 (0.173)*
Infrastructure Partner Cty. (ln)	0.0382 (0.773)	0.673 (0.526)	0.814 (0.508)	0.0408 (0.771)	0.664 (0.521)	0.821 (0.507)
GDP Reporter Cty. (ln)	0.0478 (0.0214)**	0.0407 (0.0189)**	0.0759 (0.0172)***	0.0465 (0.0213)**	0.0463 (0.0195)**	0.0727 (0.0177)***
GDP Partner Cty. (ln)	-0.0573 (0.0320)*	-0.0697 (0.0284)**	-0.0966 (0.0366)***	-0.0576 (0.0318)*	-0.0685 (0.0283)**	-0.0966 (0.0369)***
Import Tariff (ln)	-5.770 (0.758)***	-3.249 (0.358)***	-3.805 (0.453)***	-6.161 (0.547)***	-3.809 (0.313)***	-3.296 (0.374)***
Int: Import Tariff x Asia and the Pacific	-0.614 (0.903)	0.189 (0.526)	0.0434 (0.615)			
Int: Import Tariff x LAC	-2.223 (2.012)	-0.873 (0.697)	-0.874 (0.687)			
Int: Import Tariff x Asia and the Pacific x LAC	1.673 (2.151)	-1.075 (0.727)	1.469 (1.064)			

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**Table B.1** (continued)

Endogenous Variable:	LAC Exports			Asia and the Pacific Exports		
	Mining	Agriculture	Manufactures	Mining	Agriculture	Manufactures
Total Import Value (ln)						
Int: Import Tariff x LAC				-2.517 (1.335)*	1.333 (0.656)**	-1.106 (0.762)
Int: Import Tariff x Asia and the Pacific				2.621 (1.299)**	0.714 (0.934)	-3.701 (0.880)***
Int: Import Tariff x LAC x Asia and the Pacific				-2.733 (3.225)	-0.969 (1.465)	-3.706 (0.901)***
Implied Effect				-6.057	-2.476	-6.997
Observations	59,181	88,524	99,334	59,181	88,524	99,334
R-squared (adjusted)	0.582	0.665	0.797	0.583	0.665	0.797

Sample: 1990–2009. Additional controls include regional dummies for LAC and Asia and the Pacific, and a set of importing, exporting, and year fixed effects. In columns 1–3 the regional dummy corresponds to LAC, while columns 3–6 include the regional dummy for Asia and the Pacific economies. Robust standard errors in parentheses. \* p<0.1, \*\* p<0.05 and \*\*\* p<0.01.

## Technical Appendix C: Figure 17 – Infrastructure

To assess the impact of an improvement in a country port infrastructure on the volume of trade across the two regions, the following specification is used:

$$\ln M_{ij} = \alpha + \beta_1 \ln dist_{ij} + \beta_2 \ln inf_i * \ln inf_j + \beta_3 \ln tar_{ij} + \lambda_1 D_i + \lambda_2 D_j + \varepsilon_{ij}. \quad (3)$$

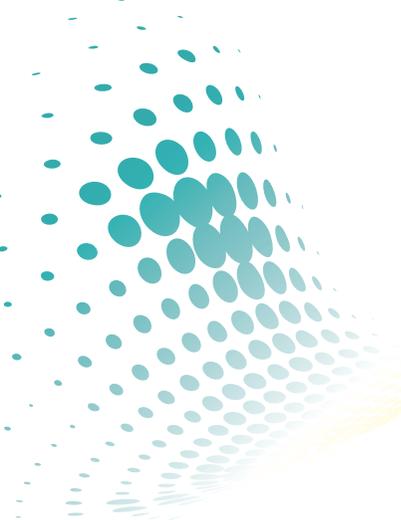
where  $inf_i$  and  $inf_j$  are the port infrastructure of the importing and the exporting country, proxied by the quality of a country's ports as measured by the World Bank WDI quality of ports index for 2009. The estimate of  $\beta_2$  obtained when estimating equation (3) for mining, agriculture, and manufactures is used to: a) simulate the impact on LAC exports to Asia and the Pacific when LAC improves its infrastructure level by 70% and b) simulate the impact on Asia and the Pacific exports to LAC when Asia and the Pacific improves its infrastructure by 40%. The asymmetrical improvement in infrastructure is based on the assumption that LAC and Asia and the Pacific improve their infrastructure up to the 95th percentile of the index distribution, which is where Denmark's ports are positioned.

**Table C.1**

Endogenous Variable:			
Total Import Value (ln)	Mining	Agriculture	Manufactures
Bilateral Distance (ln)	-2.202 (0.0875)***	-1.569 (0.0640)***	-1.701 (0.0747)***
Import Tariff (ln)	-11.90 (1.396)***	-4.298 (0.556)***	-5.192 (0.748)***
Infr. Reporting Cty. x Infr. Partner Cty.	1.235 (0.495)**	0.443 (0.497)	0.404 (0.304)
Observations	5,566	7,877	8,998
R-squared (adjusted)	0.592	0.677	0.823

Sample: 2009. Additional controls include country fixed effects of the reporting and the partner country. Robust standard errors in parentheses. \*  $p < 0.1$ , \*\*  $p < 0.05$ , and \*\*\*  $p < 0.01$ .





## 2 Asia and the Pacific–LAC FTAs: An Assessment

Following the 2008–09 global financial crisis and a sluggish recovery in the major industrial economies, the Asia and the Pacific and Latin America and the Caribbean (LAC)<sup>1</sup> regions have rebounded rapidly and are projected to enjoy steady growth for the next several years. Economic integration among both regions' developing economies has emerged as an important new driver of this growth. Since the first Asia and the Pacific–LAC free trade agreements (FTAs) in 2004, an average of two such agreements have gone into effect every year between economies of the two regions, bringing the total number to 18 as of the end of February 2012.

There have been very few studies, however, on the coverage and economic implications of such agreements. This chapter analyses the coverage of Asia and the Pacific–LAC FTAs in goods, services, and the so-called Singapore issues—investment, government procurement, trade facilitation, and competition policy—in addition to provisions on intellectual property rights (IPRs). Our detailed review of all 18 Asia and the Pacific–LAC FTAs has found that most go beyond trade in goods and services, and promote deeper integration through commitments on the Singapore issues as well as provisions on IPRs. This chapter will highlight the best such FTAs and identify key policy priorities for maximizing gains from greater interregional integration in the future.

### **Growth of Asia and the Pacific–LAC FTAs**

The 1990s witnessed the establishment of several regional economic cooperation institutions involving LAC countries, such as MERCOSUR, the North

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<sup>1</sup> Defined as the members of the Organization of America States (OAS), except the United States and Canada.

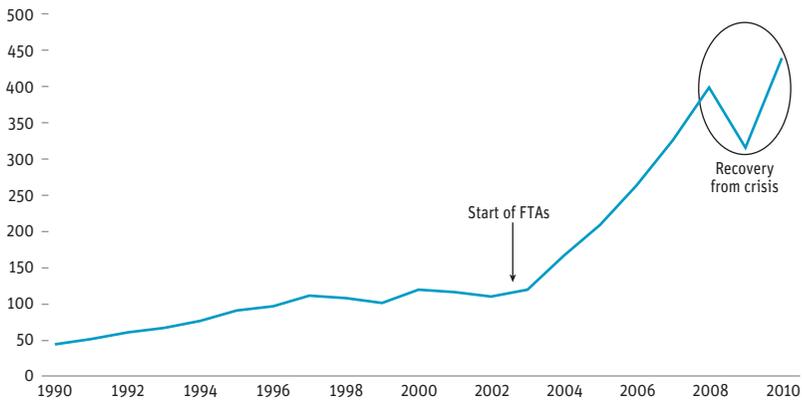
American Free Trade Agreement (NAFTA), and various developments in intra- and interregional bilateral trade relations (IDB, 2002; Estevadeordal and Suominen, 2009; Foxley, 2010). In contrast, Asia and the Pacific is a late-comer to formal regional integration. For several decades, FTAs were virtually non-existent in the region. Instead, Asia and the Pacific economies expanded trade through market-led integration without any formal arrangements, except for regional schemes such as Asia–Pacific Economic Cooperation (APEC) and the ASEAN Free Trade Area (AFTA). International trade policies at the national level were anchored in outward-oriented development strategies, high domestic savings rates, the creation of strong infrastructure, and investment in human capital. A long period of market-driven expansion of trade and foreign direct investment (FDI) emerged, during which Asia and the Pacific increasingly became a global production center with deep and diverse technological capabilities—what Baldwin (2006) aptly called “factory Asia.” Shortly after the turn of the 21st century, following this period of outward orientation and export success, the Asia and the Pacific governments sharply changed their international trade policies toward FTAs (ADB, 2008; Chia, 2010; Kawai and Wignaraja, 2011a). Today, Asia and the Pacific is at the forefront of global FTA activity (WTO, 2011).

The development of interregional trade between Asia and the Pacific and LAC is characterized by two distinct periods of growth (Figure 1). In the 1990s and the early years of the 21st century, trade between the two regions grew at an average rate of 8.5%. The turning point in interregional trade between Asia and the Pacific and LAC occurred in 2004 when annual growth accelerated to 40%. Not coincidentally, this was the same year in which the first two Asia and the Pacific–LAC FTAs came into effect (Republic of Korea–Chile; Taipei,China–Panama).

In 2009, in the midst of the global economic crisis, total trade between Asia and the Pacific and LAC fell 21%, from US\$398 billion in 2008 to US\$315 billion the following year. In 2010, however, both regions rebounded strongly from the crisis, posting a 39% annual increase in trade to reach an all-time high of US\$439 billion.

While Asia and the Pacific–LAC FTAs emerged relatively recently, expansion of FTA activity has steadily increased. Between 2004 and 2011, an average of two agreements took effect every year, resulting in a total of 18 FTAs as of January 2012 (Annex 1). The number of Asia and the Pacific–LAC FTAs is certain to rise even higher as four new trade agreements have already

**Figure 1 • Trade Flows between LAC and Asia and the Pacific, 1990–2010**  
(US\$ billion)



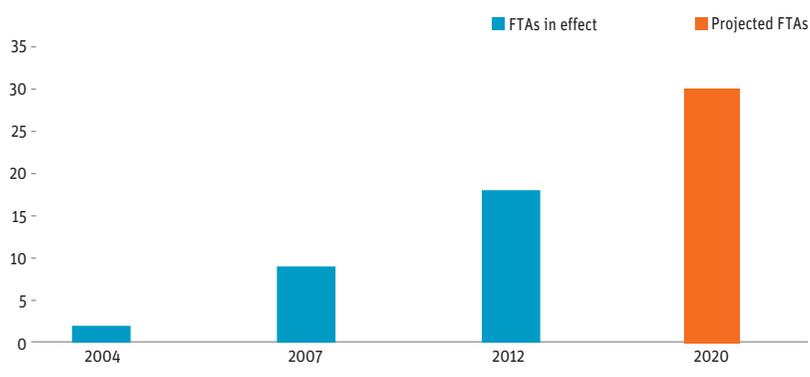
Source: International Monetary Fund's (IMF) Direction of Trade Statistics (DOTS) (accessed January 2012).

been signed and are awaiting implementation, an additional eight are under negotiation, and 11 more are being proposed.<sup>2</sup> Assuming that the four FTAs pending implementation and the eight FTAs under negotiation will be concluded by the end of the decade, a total of 30 FTAs will be in force in 2020 (Figure 2).

The leaders in Asia and the Pacific–LAC FTA activity have been Chile (6 FTAs), Peru (4), and Panama (2) on the LAC side; and Taipei,China (4); Singapore (3); PRC (3); India (2); Japan (2); and Republic of Korea (2) in Asia and the Pacific. With few exceptions, the biggest traders in Asia and the Pacific and LAC are the same that have participated in Asia and the Pacific–LAC FTAs. Tables 1a and 1b show that about 88% of LAC trade with Asia and the Pacific is conducted by the 13 countries that participate in one or more FTAs with Asia and the Pacific economies, and about 91% of Asia and the Pacific trade with LAC involves Asia and the Pacific's 10 FTA players.

Similarly, the number of FTAs alone does not indicate the importance of FTAs to economic activity or trade at the national level. It is difficult to measure how much a country's trade is covered by FTA provisions because of exceptions

<sup>2</sup> An FTA is considered to be "under negotiation" when the parties have had the first round of talks. A "proposed FTA" is when parties are considering a free trade agreement, establishing joint study groups or joint task forces, and conducting feasibility studies to determine the desirability of entering into an FTA.

**Figure 2 • Growth of Asia and the Pacific–LAC FTAs, 2004–2020**

Source: Authors' compilation.

**Table 1a • Shares of LAC Countries' Trade with Asia and the Pacific, and Number of FTAs, 1990–2010**

	%	No. of FTAs
Chile	11.8	6
Peru	4.3	4
Panama	0.2	2
Mexico	30.3	1
Brazil	26.8	1
Argentina	10.2	1
Paraguay	1.2	1
Costa Rica	1.0	1
Uruguay	1.0	1
Guatemala	0.6	1
El Salvador	0.3	1
Nicaragua	0.3	1
Honduras	0.2	1
<b>Countries with FTAs</b>	<b>88.2</b>	
<b>Countries without an FTA</b>	<b>11.8</b>	

Source: ADB Office of Regional Economic Integration, with IMF Direction of Trade Statistics Data (accessed January 2012). FTA = free trade agreement

and exclusions contained in many agreements. Furthermore, official statistics on utilization rates of FTA preferences in Asia and the Pacific are hard to come by, and published data on the direction of the services trade do not exist.

**Table 1b • Shares of Asia and the Pacific Economies' Trade with LAC, and Number of FTAs, 1990–2010**

	%	No. of FTAs
Taipei, China	3.3	4
Singapore	4.8	4
PRC	31.6	3
Japan	27.9	2
Republic of Korea	14.8	2
India	3.8	2
Thailand	2.4	1
Australia	2.0	1
New Zealand	0.7	1
Brunei Darussalam	0.0	1
<b>Economies with FTAs</b>	<b>91.3</b>	
<b>Economies without an FTA</b>	<b>8.7</b>	

Source: ADB Office of Regional Economic Integration, with IMF Direction of Trade Statistics Data (accessed January 2012). FTA = free trade agreement, PRC = People's Republic of China

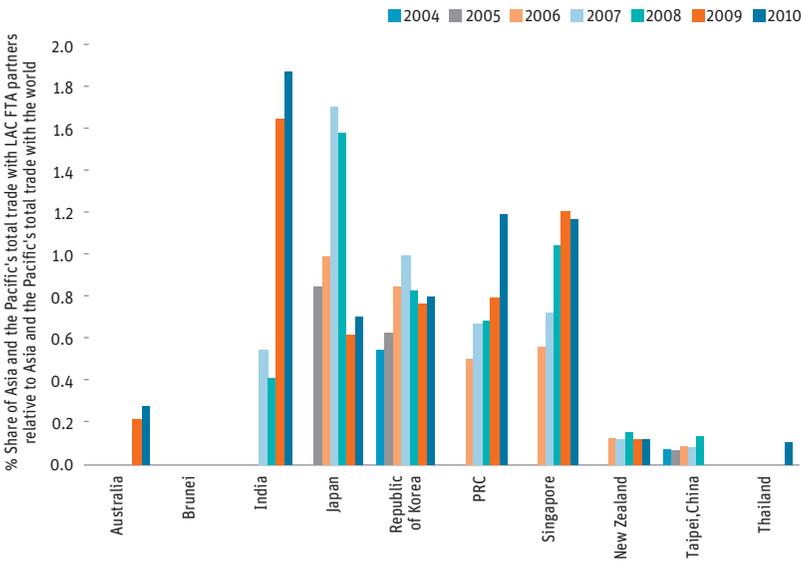
Nevertheless, by making the bold assumption that all trade in goods between two economies is covered by an FTA (if one exists), estimates can be obtained.

Figures 3a and 3b show the share of an economy's trade with its FTA partners relative to that economy's trade with the world. For every Asia and the Pacific country reviewed, the trade share with its Latin American FTA partners relative to the world did not exceed 2% in 2010. However, the trade share of Latin American countries with Asia and the Pacific FTA partners relative to the world reached as high as 35% in 2010 (e.g., Chile). Indeed, Asia and the Pacific is a major market for Latin American countries, and as mentioned earlier, at least 30 Latin America–Asia and the Pacific FTAs are expected to be in force by 2020. As a result, the trade coverage of Latin America–Asia and the Pacific FTAs is also expected to rise significantly.

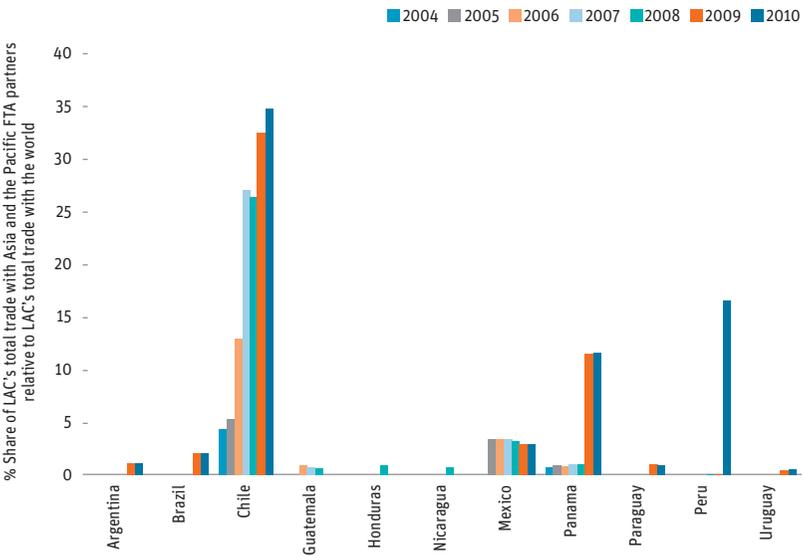
The following discussion provides four key explanations as to why Asia and the Pacific–LAC FTAs have proliferated in recent years and why they will continue to do so in the years ahead (see ADB and IDB, 2009; Kawai and Wignaraja, 2009; and Krasniqi *et al.*, 2011).

**Market-driven integration through trade.** In the 1960s and 1970s, several economies in East and South East Asia adopted outward-oriented, market-

**Figure 3a • Asia and the Pacific’s FTA Trade Coverage with LAC Countries, 2004–2010**



**Figure 3b • LAC’s FTA Trade Coverage with Asia and the Pacific Economies, 2004–2010**



Source: Estimates based on IMF DOTS (accessed August 2011) and ADB ARIC FTA database (accessed January 2012).  
 Notes: Only covers FTAs in effect for that year. The Trans-Pacific Strategic Economic Partnership (TPP) includes Brunei Darussalam, Chile, New Zealand, and Singapore. However, data on trade between Brunei Darussalam and Chile for 2004–2010 is listed as zero in the IMF’s Direction of Trade Statistics.

friendly development strategies that lowered trade and investment barriers and increased inward investment and exports. In the 1980s, LAC countries typically abandoned inward-oriented import substitution strategies associated with lackluster economic performance, in favor of market-oriented reforms. Policy reforms included trade and capital liberalization and privatization. The high tariff rates of LAC countries fell sharply to around 10%–14% in the span of a decade. Capital market liberalization led to greater inward FDI flows to LAC than in the past. In both Asia and the Pacific and LAC, market-driven economic integration requires further liberalization of trade and FDI, and the harmonization of policies, rules, and standards governing trade and FDI. These changes resulted from the increasing realization by policymakers in the two regions that FTAs, if given wider scope, can support expanding trade and FDI activities through the further elimination of cross-border impediments and other such harmonization efforts. Thus, FTAs can be part of a policy framework for deepening production networks and supply chains formed by global multinational corporations and emerging Asian firms.

**European and North American economic regionalism.** The shift in US trade policy from multilateralism and bilateralism to regionalism in the 1990s contributed to the spread of regionalism in LAC. Mexico's membership in NAFTA led some countries, such as Chile, to express interest in joining, while the MERCOSUR sub-regional customs union served as a building block for deeper South American integration that resulted in trade agreements, first with Chile and Bolivia, and subsequently with the remaining Andean countries. Furthermore, Asia and the Pacific governments were motivated to adopt FTAs by the European Union's (EU) expansion into Central and Eastern Europe, the creation of a monetary union in the euro zone, and incipient moves toward an FTAA. Governments feared that the two giant trading blocs of Europe and North America might dominate rules-setting in the global trading system, thereby marginalizing Asia and the Pacific. Increasingly, policymakers have realized the need for stepping up the pace of integration to improve international competitiveness by exploiting economies of scale and strengthening their bargaining power through a collective voice on global trade issues. FTAs can help cushion the periodic difficulties of multilateral trade liberalization, such as slow progress in the WTO's Doha Round and a perceived loss of steam in the APEC process.

**Increase in de facto interregional trade and investment.** Increasing cooperation in trade and investment between LAC and Asia and the Pacific has also facilitated the proliferation of Asia and the Pacific–LAC FTAs. Specifically, the PRC’s growing role in LAC trade and investment has contributed to the increase in interregional FTAs, particularly in the aftermath of the global economic crisis. The PRC’s “engagement in the region may be a reflection of the country’s interest in securing access to natural resources to fuel its economic growth, but the LAC market is also a destination for exports of Chinese manufactures” (ECLAC, 2008b). Meanwhile, Brazil is the LAC country with the highest levels of investment in Asia and the Pacific, primarily in the energy sector.

**Slow progress in the WTO Doha Round.** The failure of the WTO to provide a platform for a multilateral approach to further trade liberalization has encouraged governments to consider FTAs as an alternative. The WTO’s Doha Development Round, begun in November 2001, was initially hailed for its promise in promoting trade-led growth in poor countries. Since then, the talks have largely focused on liberalization in agricultural and non-agricultural goods market access. In essence, developed economies were being asked to accelerate the pace and scope of reductions in agricultural tariffs and subsidies, and developing economies were being asked to reduce tariffs for industrial goods and liberalize trade in services. As the prospects for agreeing on these issues and successfully concluding the round diminished over the years, pro-business LAC and Asia and the Pacific governments turned their attention to bilateral and plurilateral FTAs for the continued trade in goods and services as well as the adoption of the Singapore issues, which are currently beyond the scope of the WTO.

### **Scope and depth of Asia and the Pacific–LAC FTAs: An overview**

Assessing the scope and depth of Asia and the Pacific–LAC FTAs is a difficult exercise for at least two reasons. First, such an analysis requires detailed and often painstaking examination of the legal texts of agreements. Second, there is no internationally accepted methodology for assessing the scope and quality of FTA texts. An interdisciplinary analysis that blends international law with international economics seems to offer fruitful insights and a way forward. Drawing on methods used in the ADB and the IDB (2009) and Wignaraja and Lazaro (2010), the following presents some simple legal and economic criteria for assessing the scope and depth of Asia and the Pacific–LAC FTAs.

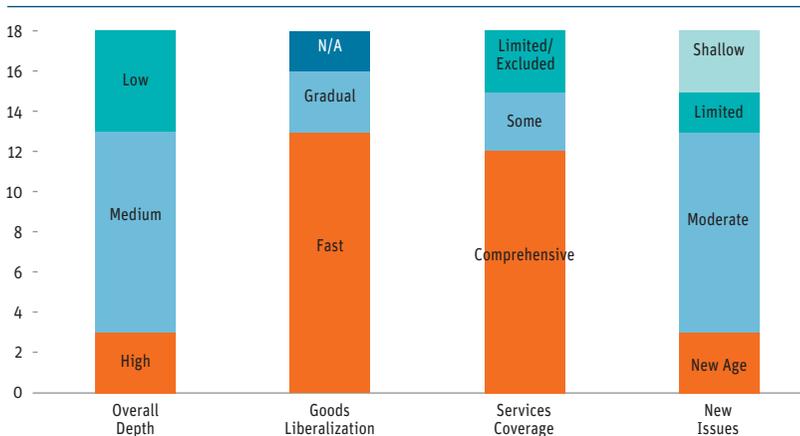
This section evaluates each of the 18 FTAs in three key areas:

- Speed and coverage of tariff liberalization, based on the criteria for FTAs in the General Agreement on Trade and Tariffs (GATT).
- Number of service sectors covered, based on criteria in the General Agreement on Trade and Services (GATS).
- Coverage and depth of new issues such as IPRs and the Singapore issues.

An evaluation of the scope of coverage for these three topics provides an overall picture of the quality of the 18 Asia and the Pacific–LAC FTAs. An overview of the results is given below, followed by a detailed analysis.

Our analysis allows us to identify the Asia and the Pacific–LAC FTAs that best promote deeper economic integration through a high level of tariff liberalization in goods, comprehensive liberalization in service sectors, and substantive provisions that address new issues. The overall depth of each Asia and the Pacific–LAC FTA is classified as being high, medium, or low. Deep FTAs are those that have relatively fast tariff liberalization schedules, coverage of some or all services, and deep integration provisions for new issues. Medium-depth FTAs are those that have relatively fast or gradual tariff liberalization schedules, coverage for some or all services, and moderately

**Figure 4 • Distribution of Approaches to Tariff Liberalization, Services Coverage, and New Issues**



Source: ADB Office of Regional Economic Integration, with IMF Direction of Trade Statistics Data (accessed January 2012).

deep integration provisions. Low-depth FTAs are those that have gradual tariff liberalization schedules, some or limited services coverage, and limited or shallow integration provisions. Figure 4 illustrates the main findings.

A distinguishing feature of the 18 FTAs between Asia and the Pacific and LAC economies is that in almost every case the FTA's scope goes beyond the traditional coverage of trade in goods. Most of these agreements also incorporate comprehensive provisions on services and cover additional elements, including intellectual property rights and the Singapore issues (investment, government procurement, trade facilitation, and competition).

Three Asia and the Pacific–LAC FTAs are deemed to be of high depth and represent the gold standard of FTAs. These are the Republic of Korea–Peru FTA (2011), the Trans-Pacific Strategic Economic Partnership Agreement (TPP) (2006), and the Australia–Chile FTA (2009). These three FTAs, which are discussed below, liberalize trade in almost all goods with few exceptions and within a reasonable and defined time frame of 10 years or less. The liberalization of trade in services is comprehensive in all three FTAs and they all provide for the automatic inclusion of newly liberalized service sectors. The three FTAs also include meaningful provisions on new issues that promote greater economic integration among all parties, thereby ensuring the highest possible economic welfare gains from increased trade.

The Republic of Korea–Peru FTA (2011) aims to eliminate tariffs over a 10-year period on all products, with the exception of 107 agricultural and marine products deemed sensitive, among them, rice, beef, onions, and garlic. The agreement also stipulates that after a five-year period all Korean exports of automobiles with engine displacement of less than 3,000 cubic centimeters will be tariff-free. In addition, the tax on Peruvian coffee will be abolished upon entry into force. Peru's import tariffs on electronic products will be eliminated over 10 years, and tariffs on color television sets from Republic of Korea will be cancelled when the agreement goes into effect. Both economies are expected to gain from liberalization of the trade in goods, specifically with respect to Korean exports of automobiles, electronics, and appliances, and Peruvian exports of copper, zinc, lead, and iron. The FTA also includes the liberalization of key service sectors. Furthermore, since one of the goals of the FTA is to strengthen investment initiatives between the two economies, it addresses deeper integration issues that provide for strong investment protection measures as well as greater market access.

The Trans-Pacific Strategic Economic Partnership (TPP, 2006) comprises four original members: Brunei Darussalam, Chile, New Zealand, and Singapore. Five more countries—Australia, Malaysia, Peru, the US, and Viet Nam—are currently negotiating to join. In TPP’s market liberalization component, duties were eliminated on the majority of tariff lines upon the agreement’s entry into force. In the case of Singapore, 100% of tariff lines were liberalized immediately. Chile undertook to liberalize 89.3% of imports upon entry into force, with an additional 9.7% of tariffs eliminated in three years. Overall, TPP liberalized 98.9% of all trade upon entry into force in 2009, and will reach 100% by 2015. TPP’s chapter on trade in services is ambitious, comprehensive, and binds parties to their existing levels of liberalization as well as to the application of any future liberalization in most sectors. The TPP investment chapter, which is currently under negotiation, includes strong commitments and meaningful obligations in other new areas, such as government procurement, trade facilitation, competition, and IPRs. For instance, the government procurement chapter imposes significant measures that maximize competition among member parties and reduce the cost of doing business for both government and industry.

The Australia–Chile FTA (2009) grants tariff elimination on all goods traded by 2015; these include sugar, which is deemed a sensitive good. Upon entry into force, tariffs on about 92% of tariff lines representing about 97% of total trade will be eliminated. Although not all key service sectors are covered in the agreement, the FTA provides export opportunities in many services areas, including mining and energy technology, engineering and consulting services, information technology, tourism, agriculture, and the food and wine industry. The investment chapter has strong legal protection and transparency provisions to provide certainty and security for cross-border investments. The government procurement chapter ensures non-discriminatory treatment and transparent and fair procedures for entities in both countries.

The majority of the remaining Asia and the Pacific–LAC FTAs also provide for relatively fast liberalization, although with varying levels of commitment. Liberalization of services in Asia and the Pacific–LAC FTAs continues to be a challenge; most continue to protect some key service sectors, such as professional, transport, and financial services. The prevailing approach of the majority of Asia and the Pacific–LAC FTAs remains moderate, and these chapters need stronger commitments, obligations, and substantive provisions to attain higher quality.

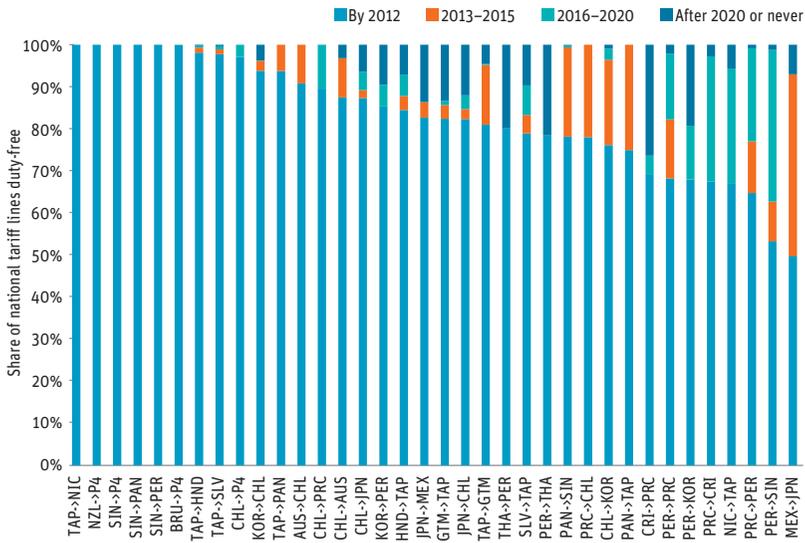
## Goods and services liberalization

The WTO criteria for an FTA liberalization of the goods trade is “where duties are eliminated with respect to substantially all the trade between the constituent territories... and... the plan or schedule for its formation is within a reasonable length of time” (GATT Article XXIV). The meaning of “substantially all trade” remains contentious. An FTA that eliminates 85% of either or both members’ total tariff lines is often regarded as covering substantially all trade. Following paragraph 5(c) of Article XXIV, the WTO interprets a “reasonable period of time” as a period that does not exceed 10 years, except in extraordinary cases.<sup>3</sup> Thus, an FTA that eliminates 85% of tariff lines within 10 years is classified as a relatively fast approach to tariff liberalization, while others are considered gradual.

Of the 16 Asia and the Pacific–LAC FTAs in effect for which data on tariff liberalization are available, all but two have a relatively fast approach to tariff liberalization that has typically resulted in increased market access in goods and improved bilateral trade flows. The Republic of Korea–Chile FTA is a case in point. Here, Republic of Korea undertook to eliminate tariffs on 93.6% of its tariff lines, impacting 99% of its imports from Chile within 10 years (WTO, 2005 and 2008). Republic of Korea’s tariff elimination schedule saw the immediate liberalization of virtually all industrial products, which contributed to a 220% increase in imports from Chile. Similarly, upon entry into force of the Japan–Mexico FTA in 2005, 3,367 (or 37%) of Japan’s tariff lines immediately became duty-free for imports from Mexico (WTO, 2009). The remaining tariffs are being progressively eliminated, and by 2015 trade in nearly all products between the two economies will be free of duties. In 2007, exports from Japan to Mexico increased 10.5%, while Japan’s imports from Mexico increased 11.8%.

Figure 5 presents time frames for the liberalization of tariffs in the FTAs between Asia and the Pacific and LAC where schedules were available. The bars show the cumulative share of duty-free tariff lines by 2012, 2015, and 2020 for each preferential tariff concession. These are then presented with the concessions, with the highest shares of duty-free tariff lines in 2012

<sup>3</sup> GATT. Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade (GATT) 1994. Article XXIV:5.

**Figure 5 • Time frames for Tariff Liberalization in Asia and the Pacific–LAC FTAs**

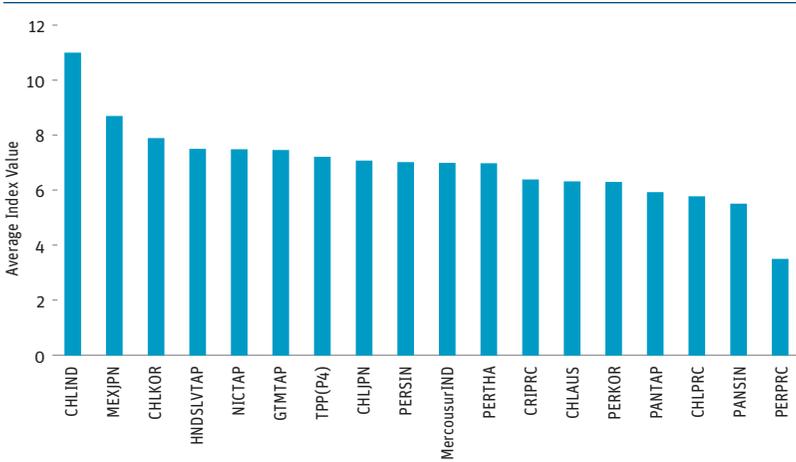
Source: IDB/INT.

furthest to the left.<sup>4</sup> Nearly half of the concessions shown will have at least 85% of tariff lines duty-free in 2012, with a substantial amount of additional progress scheduled for the next three years. Also apparent from the figure is the deep liberalization in goods that has already taken place among the four current TPP members. While this reflects comparative advantages and trade complementarities among the current signatories, it nevertheless sets forth an ambitious standard for the other economies considering acceding to this agreement and highlights the potential of the TPP as a framework for deepening trade relations throughout the Pacific Rim.

Although most Asia and the Pacific–LAC FTAs liberalize tariffs relatively quickly, they also contain temporary or permanent exclusions lists. For example, agricultural products remain highly sensitive and are often found on these lists, as is the case with the PRC–Chile FTA (2006), which excludes almost all agriculture products. In the Republic of Korea–Chile FTA (2004), Chile excluded washing machines and refrigerators on its tariff liberalization

<sup>4</sup> The labels on the horizontal axis show the ISO-3166 code for the economy providing the concession, with an arrow pointing towards the economy receiving the preference.

**Figure 6 • Relative *ex ante* Restrictiveness**



Source: IDB/INT, following the methodology of Harris (2007).  
 Note: See Annex 1 for country pairs in the FTA in the x-axis label.

schedule for Korean exports. Likewise, Republic of Korea refused to grant any form of tariff concession on Chilean exports of rice, apples, and pears. Meanwhile, the PRC–Peru FTA (2010) specifically excludes used goods, including reconstructed, repaired, remanufactured, or refurbished goods. While traded goods in many LAC and Asia and the Pacific economies remain sensitive for a variety of economic or cultural reasons, in general, tariff line exclusions should be minimized to promote trade and harmonization.

Whereas “substantially all trade” and “reasonable period of time” are the concepts most often seen as open to interpretation, properly defining “products originating in such territories” is also an important challenge. The Rules of Origin (RoO) established in the agreements serve to qualify preferential market access in goods in this regard. One approach to measuring and comparing RoOs across agreements is through an index of restrictiveness that gauges the degree to which rules permit the use of inputs produced by third parties in the production of traded final goods. Figure 6 shows the relative restrictiveness of several of these agreements.

The RoO in this sample of preferential trade agreements (PTAs) do not follow patterns observed in broader samples, such as Estevadeordal, Harris, and Suominen (2009), where greater restrictiveness is associated with larger combined economies. Here, the Chinese agreements all fall on the less restrictive end of the distribution, despite the PRC’s large size. In general,

levels of restrictiveness seem more related to the trade policy strategies of the economies involved, and less to the specific structure of international trade between the member economies. For example, the Indian agreements with Chile and MERCOSUR apply fixed rules across all products. While this approach has the benefit of simplicity and transparency, it has the drawback of not responding to the availabilities of particular inputs within the member economies. Nonetheless, given the relatively low volumes of trade expected and the limited number of products subject to preferences, such rules are unlikely to impose a significant burden.

Additionally, Korean agreements with LAC countries appear at both ends of the distribution. Relatively strict rules have been negotiated with Chile, and less strict rules have been established with Peru. The data do not reveal whether this change is due to different negotiating approaches with the two countries, or is simply an evolution in the Korean approach to RoO between the time of their first agreement (Chile) and more recent agreements, such as with Peru. Clearly, however, differences in the RoO between the two agreements could complicate any efforts for Korean producers to serve both markets if they are using non-originating materials. Furthermore, the fact that these are two separate agreements greatly reduces the potential for production sharing between Chile and Peru, as there is no provision for cumulation. If governments wish to promote longer, international supply chains, these disincentives will have to be addressed. Similar situations arise in the Indian agreements with Chile and MERCOSUR (though limited product coverage is a more significant limitation), and in the Japanese agreements with Mexico and Chile.

**Services liberalization.** GATS Article V imposes three requirements on WTO members that must be satisfied when concluding an FTA: substantial sectoral coverage, elimination of substantially all discrimination in national treatment, and prohibition on increasing barriers against nonmembers as a result of a new FTA. Strict conformity to GATS requires compliance with all three conditions. In practice, however, it is difficult to assess conformity of an FTA with GATS Article V. A practical way forward is to focus on the first condition and to interpret substantial sectoral coverage to mean that a comprehensive FTA should cover at least five key sectors. Employing the GATS classification list of 12 service sectors, we follow a simple three-tier classification in determining the quality of an FTA based on service sector liberalization:

- **Comprehensive coverage of services:** FTA covers the five key sectors of GATS (business and professional, communications, financial, transport, and labor mobility and entry of business persons).
- **Excluded or limited coverage of services:** FTA either excludes the services trade, or provides only general provisions, or covers only one of the key sectors listed above.
- **Some coverage of services:** FTA is not otherwise classified as comprehensive or excluded, and would typically cover between two and four key sectors and some minor sectors.

A service sector is deemed covered if at least one party includes GATS or GATS-plus commitments, while not considering the number of sub-sectors, volume of trade affected, or the four modes of supply. This classification system is employed in analyzing the extent of services coverage for each of the 18 Asia and the Pacific–LAC FTAs under review. Results are presented in Figure 5.

The 12 Asia and the Pacific–LAC FTAs classified as comprehensive are Republic of Korea–Chile FTA (2004); Taipei,China–Panama FTA (2004); Japan–Mexico EPA (2005); Singapore–Panama FTA (2006); Taipei,China–Guatemala FTA (2006); Trans-Pacific Strategic EPA (2006); Japan–Chile EPA (2007); Taipei,China–El Salvador–Honduras FTA (2008); Taipei,China–Nicaragua FTA (2008); Australia–Chile FTA (2009); Singapore–Peru FTA (2009); and Republic of Korea–Peru FTA (2011). Taipei,China, Japan, and Singapore are the Asian leaders in terms of degree of service coverage in Asia and the Pacific–LAC FTAs. The same can be said of Chile and Peru on the Latin American side. There are three agreements with some coverage on services: PRC–Chile FTA (2006); PRC–Peru FTA (2010); and PRC–Costa Rica FTA (2011).<sup>5</sup> Thus, all 18 FTAs under review, except India–MERCOSUR PTA (2009), India–Chile PTA (2007), and Thailand–Peru FTA (2011), cover services. The key service sector covered in the majority of the FTAs between Latin America and Asia and the Pacific is labor mobility and entry of business

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<sup>5</sup> Republic of Korea–Chile FTA (2004), Japan–Mexico EPA (2005), PRC–Chile FTA (2006), Taipei,China–Guatemala FTA (2006), TPP (2006), Japan–Chile EPA (2007), Taipei,China–El Salvador–Honduras FTA (2008), Australia–Chile FTA (2009), PRC–Peru FTA (2010), PRC–Costa Rica FTA (2011).

persons. Overall, Asia and the Pacific–LAC FTAs provide substantial coverage in services.

### Deep integration (new issues)

Various terms have been coined to define provisions dealing with issues that often lie beyond the scope of the WTO, including “WTO plus,” “deep integration,” and “new issues.” In discussing deep integration, this chapter uses the term “new issues” to describe IPRs and the four Singapore issues. Kawai and Wignaraja (2009 and 2011a), among others, emphasize the importance of including new issues in FTAs because they foster deeper economic integration among countries. Competition policy, government procurement, and investment provisions are key factors in facilitating FDI inflows and the development of production networks. Moreover, provisions on trade facilitation and logistics development help reduce trade-related transaction costs. Lastly, as technology and knowledge are integral parts of goods and services that are traded across borders (e.g., medicine, electronics, films, books, and computer software), IPR protection can promote international trade and greater economic integration.

New issues are discussed below in greater detail than tariffs and services for two reasons: first, because the commitments present a more mixed and complex picture; and second, because obligations on new issues are key to deepening integration. For each of the new issues, this chapter develops simple legal and economic criteria to assess the extent and depth of the coverage and determine whether the agreement-related provisions are above standard, standard, or non-existent (no provisions). Then, a cumulative evaluation of the level of deep integration is provided for the FTA with regard to whether deep integration is deemed new age, moderate, limited, or shallow.

**Investment.** Growth in cross-border investment flows now exceeds growth of international trade in goods, and world GDP and FDI have been key drivers of economic development around the world. The rise in FDI has spurred export manufacturing and the formation of regional production networks in East Asia, which have played an important role in connecting the region to global supply chains. Asia and the Pacific economies—specifically the PRC, Japan, and Republic of Korea—already have substantial investments in LAC and are pursuing additional investment opportunities in the region.

While international investment flows are an important aspect of the global economy, there is no overarching multilateral agreement on investment.<sup>6</sup> Without a unified body of rules, investment provisions in FTAs are important for promoting an open and competitive investment climate that facilitates investment flows and fosters greater economic integration between the parties. In this chapter, investment chapters in FTAs are classified according to the level of liberalization (market access) and regulation (protection) they provide. Provisions on liberalization include most-favored nation (MFN) status and national treatment at both pre-establishment and post-establishment, and prohibition of performance requirements. Regulatory and legal protection provisions may include a dispute settlement mechanism, fair and equitable treatment, free transfers on investment-related transactions and capital movements, expropriation and compensation for losses, and restrictions on nationality requirements for senior management and boards of directors. Thus, the following parameters were established to evaluate the quality of investment chapters in Asia and the Pacific–LAC FTAs, based on their coverage of key investment principles and the substantive provisions of an investment chapter:

- **Above standard:** An FTA investment chapter that includes all liberalization and regulation provisions mentioned above.
- **Standard:** An FTA investment chapter that embodies the core principles of investment liberalization and protection by including two key provisions: post-establishment national treatment and MFN treatment, and regulations on expropriation and compensation for losses.

Thirteen of the 18 Asia and the Pacific–LAC FTAs under review have an investment chapter.<sup>7</sup> Nine of these can be regarded as above standard<sup>8</sup>

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<sup>6</sup> The existing multilateral agreements—the WTO Trade-Related Investment Measures (TRIMS) Agreement, Mode 3 (commercial presence) of the GATS Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), Government Procurement Agreement (GPA), and Agreement on Subsidies and Countervailing Measures (ASCM)—address certain aspects of investment rules in a disaggregated manner.

<sup>7</sup> Taipei,China–Panama FTA (2004), Japan–Mexico EPA (2005), Singapore–Panama FTA (2006), Taipei, China–Guatemala FTA (2006), Taipei,China–El Salvador–Honduras FTA (2008), Taipei,China–Nicaragua FTA (2008), Australia–Chile FTA (2009), Singapore–Peru FTA (2009), Republic Korea–Peru FTA (2011), Republic of Korea–Chile FTA (2004),

while four meet only the standard provisions.<sup>9</sup> The analysis of the investment chapters also shows that four of the five FTAs that lack an investment chapter involved developing economies in both LAC and Asia and the Pacific.<sup>10</sup>

**Competition.** Competition policy is a broad set of measures and instruments governments use to prevent distortions of competition and anti-competitive behavior, and achieve a more efficient allocation of resources in liberalized markets. A well-functioning market free of anti-competitive practices enables businesses to take full advantage of liberalization, increase trade, and spur growth. Anti-competitive behavior typically includes anti-competitive horizontal arrangements between competitors, misuse of dominant market power (e.g., predatory pricing), anti-competitive vertical arrangements between businesses, and anti-competitive mergers and acquisitions. The following criteria were used to evaluate the competition chapters of Asia and the Pacific–LAC FTAs:

- **Above standard:** In addition to standard competition provisions, specific obligations to adopt or maintain competition laws, possibly including a definition of anti-competitive behavior.
- **Standard:** General obligations to take measures against anti-competitive behavior, plus commitments to promote competition among businesses and cooperation in enforcement activities.

Two of the 18 Asia and the Pacific–LAC FTAs are considered above standard—the Trans-Pacific Strategic EPA (2006) and the Singapore–Peru FTA (2009)—in that they require members to adopt or maintain a competition

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Japan–Chile EPA (2007), PRC–Peru FTA (2010), and PRC–Costa Rica FTA (2011). The PRC–Costa Rica FTA adopts an existing bilateral investment treaty between the two of them, which, although inclusive of key provisions, precludes more liberalization and regulation provisions than any other Latin America–Asia FTA investment chapter.

<sup>8</sup> Taipei,China–Panama FTA (2004), Japan–Mexico EPA (2005), Singapore–Panama FTA (2006), Taipei,China–Guatemala FTA (2006), Taipei,China–El Salvador–Honduras FTA (2008), Taipei,China–Nicaragua FTA (2008), Australia–Chile FTA (2009), Singapore–Peru FTA (2009), and Republic of Korea–Peru FTA (2011).

<sup>9</sup> Republic of Korea–Chile FTA (2004), Japan–Chile EPA (2007), PRC–Peru FTA (2010), and PRC–Costa Rica FTA (2011).

<sup>10</sup> PRC–Chile FTA (2006), India–Chile PTA (2007), India–MERCOSUR PTA (2009), Thailand–Peru FTA (2011). The remaining FTA without an investment chapter is TPP (2006).

law. In addition, they contain comprehensive administrative obligations relating to cooperation and coordination. Ten FTAs contain general obligations of varying degrees relating to competition and are thus considered standard.<sup>11</sup> These typically prohibit anti-competitive business practices in general, ensure that there are avenues for complaints over unfair practices, and obligate the relevant authorities to commit to cooperation with one another to facilitate enforcement and share best practices. The FTAs between Chile and Singapore and Chile and Republic of Korea adopt an approach that focuses on cooperation between the competition authorities of the concerned parties. The chapters on competition in these two agreements include definitions and objectives as well as provisions for notification, coordination of enforcement, consultations in the event that important interests of one party are adversely affected in the territory of the other party, the exchange of information and protection of confidentiality, technical assistance, public and private monopolies and exclusive rights, and dispute settlement. Six of the 18 FTAs under review have no competition-related provisions.<sup>12</sup>

**Government procurement.** Government procurement policies are relevant to international trade when foreign suppliers participate in domestic government procurement markets. WTO and APEC regulate procurement through a set of rules and principles for establishing efficient procurement systems. The WTO Agreement on Government Procurement (GPA) is a plurilateral agreement between 15 WTO members based on principles of national treatment and transparency.<sup>13</sup> APEC has established a set of voluntary, non-binding principles to advance liberalization of government procurement markets and increase transparency and effective competition. An efficient procurement system founded on the principles of non-discrimination and transparency can ensure the optimal use of public funds.

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<sup>11</sup> Republic of Korea–Chile FTA (2004), Taipei,China–Panama FTA (2004), Japan–Mexico EPA (2005), Singapore–Panama FTA (2006), Japan–Chile EPA (2007), Taipei,China–Nicaragua FTA (2008), Australia–Chile FTA (2009), PRC–Peru FTA (2010), Republic of Korea–Peru FTA (2011), and PRC–Costa Rica FTA (2011).

<sup>12</sup> Taipei,China–El Salvador–Honduras FTA (2008), India–MERCOSUR PTA (2007), PRC–Chile FTA (2006), Taipei,China–Guatemala FTA (2005), India–Chile PTA (2007), and Thailand–Peru FTA (2011).

<sup>13</sup> Parties to the GPA are mostly developed economies. The 27 EU countries are considered to be a single signatory. No Latin American country is a signatory to the GPA. In Asia and the Pacific, only Japan, Republic of Korea, Singapore, and Taipei,China are signatories.

Building on GPA rules and APEC principles, government procurement chapters in FTAs should include obligations and provisions ensuring reasonable scope of commitments, non-discriminatory treatment, and transparent procurement procedures and due process. The scope of commitments in government procurement chapters determines to what extent substantive rules and obligations are applied. Non-discriminatory treatment ensures that suppliers from all FTA parties are treated equally in the spirit of open and effective competition. A key provision of non-discriminatory treatment is “national treatment,” which ensures that each party to the agreement accords the goods and services of suppliers from other parties treatment that is “no less favorable than that accorded to domestic goods and services.”<sup>14</sup> Finally, in accordance with APEC,<sup>15</sup> standards on government procurement require a transparent procurement system characterized by the proper documentation of rules and the availability of relevant information to all interested parties in a timely manner through an open and commonly used platform.

Based on the above discussion, two criteria were developed to assess the quality of government procurement chapters in Asia and the Pacific–LAC FTAs, based on the inclusion of provisions embodying the core principles of non-discrimination and transparency:

- **Above standard:** The government procurement chapter embodies the core principles of non-discrimination and transparency by including a reasonably wide scope of commitments and covering all key affirmative obligations on non-discrimination (e.g., national treatment, qualification of suppliers, tendering procedure, and prohibition of offsets) and transparency. The chapter also covers substantial obligations going beyond the GPA (GPA-plus), such as electronic and e-government procurement, ensuring integrity, SME development, cooperation and training, and establishment of a single market.
- **Standard:** The government procurement chapter includes a provision regarding the scope of commitments and all key affirmative obligations on non-discrimination and transparency. It may or may not include

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<sup>14</sup> See WTO’s Agreement on Government Procurement, Article 3.

<sup>15</sup> At their meeting in Santiago, Chile, in November 2004, APEC leaders endorsed the Transparency Standards on Government Procurement, which are based on the transparency provisions of the APEC Non-Binding Principles on Government Procurement, and adopted the standards as part of the Leaders’ Transparency Statement.

a basic GPA-plus provision, such as e-government procurement and clauses to establish cooperative measures.

Out of the 18 Asia and the Pacific–LAC FTAs, eight have chapters on government procurement.<sup>16</sup> Among these, five had above standard government procurement chapters.<sup>17</sup> The Asia and the Pacific economies in these five FTAs are all GPA signatories, while none of the LAC countries are. Despite the non-accession to the GPA of these LAC countries, their FTAs conform to the core principles of non-discrimination and transparency and include obligations beyond those set by the GPA. Three Asia and the Pacific–LAC FTAs have a standard government procurement chapter.<sup>18</sup> The government procurement chapters of Japan’s FTAs with Mexico and Chile adopt the language of the GPA in most key provisions because Japan is a GPA signatory.

**Trade facilitation.** The WTO defines trade facilitation as “the simplification and harmonization of international trade procedures,” including “activities, practices, and formalities involved in collecting, presenting, communicating, and processing data required for the movement of goods in international trade” (WTO, 2011).<sup>19</sup> Numerous empirical studies have shown that even a miniscule decrease in trade transaction costs, such as burdensome customs procedures, can yield tremendous welfare gains (Engman, 2005; Hummels, 2001). Hence, it is crucial that customs and related procedures, which are at the heart of trade facilitation, adhere to best practices and remain consistent with GATT and WTO rules and regulations.

For the purpose of our study, we follow the five key principles in trade facilitation set forth in the study conducted by Willie and Redden (2007), which embody the proposed WTO measures and APEC NBPs in trade facilitation.

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<sup>16</sup> Republic of Korea–Chile FTA (2004), Japan–Mexico EPA (2005), Singapore–Panama FTA (2006), TPP (2006), Japan–Chile EPA (2007), Australia–Chile FTA (2009), Singapore–Peru FTA (2009), and Republic of Korea–Peru FTA (2011).

<sup>17</sup> Republic of Korea–Chile FTA (2004), Singapore–Panama FTA (2006), TPP (2006), Australia–Chile FTA (2009), Republic of Korea–Peru FTA (2011), Republic of Korea–Chile FTA (2004), Singapore–Panama FTA (2006), TPP (2006), Australia–Chile FTA (2009), and Republic of Korea–Peru FTA (2011).

<sup>18</sup> Japan–Mexico EPA (2005), Japan–Chile EPA (2007), and Singapore–Peru FTA (2009).

<sup>19</sup> This definition does not include non-tariff barriers to trade, such as sanitary and phytosanitary measures, or instruments to protect social and environmental standards.

These principles are transparency, simplification, harmonization, cooperation, and use of modern technology. A meaningful trade facilitation policy includes measures to put these principles into effect. Based on the above considerations, criteria have been developed to evaluate the extent to which Asia and the Pacific–LAC FTAs uphold the key principles of trade facilitation, as follows:

- **Above standard:** The customs procedure or trade facilitation chapter covers all five key principles and includes relevant measures for implementation.
- **Standard:** The customs procedure or trade facilitation chapter covers three or four of the five key principles and includes relevant measures for implementation.

Of the 18 Asia and the Pacific–LAC FTAs in effect, 16 have a customs procedure chapter or provisions on trade facilitation.<sup>20</sup> In most of these FTAs, trade facilitation provisions are found in the chapter for customs procedures instead of in a separate and distinct chapter for trade facilitation. Using the above criteria, eight out of 16 Asia and the Pacific–LAC FTAs with a customs procedure chapter or provisions on trade facilitation qualify as above standard.<sup>21</sup> Eight Asia and the Pacific–LAC FTAs are classified as having standard customs procedure or trade facilitation chapters.<sup>22</sup> We also observed that Asia and the Pacific–LAC FTAs embody the key principles of trade facilitation in varying degrees with respect to incorporating relevant measures. For instance, while the Republic of Korea–Chile FTA (2004) and the Taipei,China–Panama FTA (2004) contain only two measures on transparency (advance

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<sup>20</sup> Singapore–Panama FTA (2006), TPP (2006), Japan–Chile EPA (2007), Taipei,China–Nicaragua FTA (2008), Australia–Chile FTA (2009), Singapore–Peru FTA (2009), PRC–Peru FTA (2010), Republic of Korea–Peru FTA (2011), Republic of Korea–Chile FTA (2004), Taipei,China–Panama FTA (2004), Japan–Mexico EPA (2005), PRC–Chile FTA (2006), Taipei,China–Guatemala FTA (2006), Taipei,China–El Salvador–Honduras FTA (2008), PRC–Costa Rica FTA (2011), and Thailand–Peru FTA (2011).

<sup>21</sup> Singapore–Panama FTA (2006), TPP (2006), Japan–Chile EPA (2007), Taipei,China–Nicaragua FTA (2008), Australia–Chile FTA (2009), Singapore–Peru FTA (2009), PRC–Peru FTA (2010), and Republic of Korea–Peru FTA (2011).

<sup>22</sup> Republic of Korea–Chile FTA (2004), Taipei,China–Panama FTA (2004), Japan–Mexico EPA (2005), PRC–Chile FTA (2006), Taipei,China–Guatemala FTA (2006), Taipei,China–El Salvador–Honduras FTA (2008), PRC–Costa Rica FTA (2011), and Thailand–Peru FTA (2011).

rulings and review mechanism), several other FTAs<sup>23</sup> include three measures on transparency (e.g., publication of laws and regulations, advance rulings, and review mechanism). The same variations on relevant measures can be seen with the other four principles.

**Intellectual property rights.** IPRs are exclusive rights that enable their holders to exclude others from using protected technology or property. IPRs are necessary to reward creators, stimulate innovation, and promote economic development. In some instances, however, IPRs can increase prices and limit access to goods and technology. Striking the right balance between stimulating innovation and providing the public access to knowledge and goods is of critical importance.

IPRs encompass a wide range of different rights with different purposes, effects, and costs. While the primary purpose of patents, copyrights, and industrial design is to stimulate innovation and creativity in technology and the creative arts, the purpose of trademarks and geographical indications is advertising, ensuring that other companies cannot free-ride on brand-building efforts, and facilitating information to consumers about the origin and quality of products. Some countries are net users of patented machines and pharmaceuticals, and others are exporters. Some benefit from slack copyright protection for software, movies, and music, while others benefit from access to using trademarks or geographical indications. Therefore, the international regulation of intellectual property, whether through the WTO or an FTA, must be sufficiently flexible to leave governments the space needed to optimally balance IPR protection policies.

The Agreement on Trade-Related Aspects of Intellectual Property (known as the TRIPS Agreement), which entered into force in 1995, is the most comprehensive multilateral agreement concerning intellectual property.<sup>24</sup> IPR provisions in bilateral and regional FTAs that extend protection beyond that of TRIPS are referred to as TRIPS-plus. These include higher standards of protection (e.g., extending copyright protection from the 50 years mandated

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<sup>23</sup> Singapore–Panama FTA (2006), Taipei,China–Nicaragua FTA (2008), Singapore–Peru FTA (2008), Australia–Chile FTA (2009), Republic of Korea–Peru FTA (2010), PRC–Peru FTA (2010), and PRC–Costa Rica FTA (2011).

<sup>24</sup> The TRIPS Agreement was adopted on April 15, 1994, as Annex 1C of the Final Act of the Uruguay Round of Multilateral Trade Negotiations creating the World Trade Organization (WTO). Available at [http://www.wto.org/english/docs\\_e/legal\\_e/27-trips.pdf](http://www.wto.org/english/docs_e/legal_e/27-trips.pdf).

in TRIPS to 70 years), enhancing the scope of IPRs (e.g., expanding them to goods and services not covered by TRIPS, such as life forms and plant varieties), or requiring more extensive enforcement procedures (e.g., stronger criminal remedies and border measures). Whether an FTA contains one or more TRIPS-Plus provisions is a key in determining its level of IPR protection. The criteria used to evaluate the level of IPR protection in FTAs is as follows:

- **Above standard:** An FTA that contains one or more TRIPS-plus provisions.
- **Standard:** An FTA that contains IPR provisions that do not exceed those of the TRIPS Agreement.

Twelve of the 18 Asia and the Pacific–LAC FTAs contain IPR commitments.<sup>25</sup> In fact, each of these 12 FTAs contains one or more TRIPS-plus provisions. Thus, there are no FTAs with an IPR chapter classified as standard. The key TRIPS-plus provisions concern enforcement—which is a priority of Asian economies exporting goods and services that use advanced technology—and securing expanded protection of geographical indications, which is a priority of a number of LAC countries. The TRIPS Agreement requires protection of geographical indications, but does not list which ones are eligible for protection. All 12 FTAs offer the same level of protection as the TRIPS Agreement but regulate geographical indications in more depth by including an annex enumerating the specific geographical indications of each party that must be protected in the other party’s territory.

The most comprehensive FTA with respect to IPRs is the Republic of Korea–Peru FTA, which in addition to strong regulation on geographical indications and enforcement also expands copyright protection to 70 years after the death of the creator of the copyrighted work. The FTAs that do not regulate IP are the Singapore–Panama FTA (2006), the India–Chile PTA (2007), the Taipei,China–El Salvador–Honduras FTA (2008), the India–MERCOSUR PTA (2009), and the Singapore–Peru FTA (2009).

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<sup>25</sup> Republic of Korea–Chile FTA (2004), Taipei,China–Panama FTA (2004), Japan–Mexico EPA (2005), PRC–Chile FTA (2006), Taipei,China–Guatemala FTA (2006), TPP (2006), Japan–Chile EPA (2007), Taipei,China–Nicaragua FTA (2008), Australia–Chile FTA (2009), PRC–Peru FTA (2010), Republic of Korea–Peru FTA (2011), and PRC–Costa Rica FTA (2011).

**Summary.** Throughout this evaluation of new issues, the same classifications were used for each specific issue: above standard, standard, no provision. A cumulative evaluation of the level of deep integration was used to classify the FTAs as new age, moderate, limited, or shallow. The results of this classification are presented in Figure 5. The majority of FTAs (10 of the 18) were deemed moderate.

Nine FTAs have above-standard investment chapters and therefore strong commitments on both liberalization and protections. Two FTAs directly mandate governments to adopt or maintain competition law and are above standard, while other FTAs encourage governments to do so. The issue most lacking in LAC FTAs (and FTAs in general) is the deep integration issue of competition. Eight agreements have government procurement. Asia and the Pacific–LAC FTAs are all GPA signatories, while none of the LAC countries are. Although there is room for improvement, it is encouraging that government procurement is increasingly included in FTAs. Sixteen agreements have a customs procedure chapter or provisions on trade facilitation. In this area in particular, a harmonized approach among the FTAs is advisable. Finally, intellectual property is dealt with in 12 out of 18 FTAs, and all 12 agreements have one or more TRIPS-plus provisions.

## Priority action areas

The growing number of Asia and the Pacific–LAC FTAs creates an opportunity for future gains from further interregional integration. This deepening of economic ties between the two regions presents some key challenges that have to be surmounted if these gains are to be realized. This section identifies the priority action areas that will help spur FTA-led integration between LAC and Asia and the Pacific as follows: promoting FTAs that provide deep integration, forming an interregional trade agreement between LAC and Asia and the Pacific, ensuring firm-level use of FTAs, and addressing the “noodle bowl” problem.

### *Priority 1: Promoting FTAs that provide deep integration*

New age FTAs that comprehensively address WTO-plus issues are becoming more common globally (Fiorentino et al., 2009; Freund and Ornelas, 2010). Evidence presented here shows notable elements of deep integration, but also room for improvement. The inclusion of WTO-plus provisions, particularly the four Singapore issues, is desirable in all future Asia and the

Pacific–LAC FTAs. Competition policy and investment provisions are integral ingredients in facilitating FDI inflows and the development of production networks. High costs of interregional trade due to non-tariff barriers and poor transportation infrastructure are impediments to deeper economic ties between LAC and Asia and the Pacific. Inclusion of provisions on trade facilitation, harmonization of customs procedures, standards, and logistics development would help lower transaction costs in conducting trade. Properly addressing government procurement promotes transparency and deepens market access. Cooperation provisions—along the line of the APEC economic and technical cooperation (ECOTECH) agenda—would stimulate technology transfer and industrial competitiveness.<sup>26</sup>

### ***Priority 2: Forming an interregional trade agreement through TPP***

An interregional FTA is an important means for consolidating the plethora of bilateral and plurilateral agreements between the two regions and a way to better align global and regional rules of existing Asia and the Pacific–LAC FTAs. Such an FTA would confer a range of economic benefits: increase market access to goods, services, skills, and technology; increase market size to foster specialization and realization of economies of scale; facilitate the FDI activities and technology transfer of multinational corporations; and encourage simplification of tariff schedules, rules, and standards (Chia, 2010). Moreover, such a large grouping would help insure against protectionist sentiments that pose a risk to Asia and the Pacific’s trade and recovery.

Since 2007, a proposal for an interregional FTA through a Free Trade Area of the Asia–Pacific (FTAAP)<sup>27</sup> has been under serious discussion in trade fora in some Asia and the Pacific and LAC economies, including at APEC summits. The FTAAP could increase the two-way trade of partner economies in a significant manner, build regional integration, and also provide a useful way of reviving the stalled Doha Round (Bergsten, 2007; Hufbauer and Schott, 2009). The formation of FTAAP, however, is expected to take many years

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<sup>26</sup> ECOTECH is the APEC schedule of programs designed to build capacity and skills in APEC member economies to enable them to participate more fully in the regional economy and the liberalization process. See <http://www.apec.org> for more information.

<sup>27</sup> Free Trade Agreement of the Asia–Pacific (FTAAP) covering APEC members (Australia, Brunei Darussalam, Canada, Chile, PRC, Hong Kong, China, Indonesia, Japan, ROK, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Taipei, China, Thailand, United States, and Viet Nam).

and involve studies, evaluations, and negotiations among all 21 potential member economies. Given that the number of APEC member economies is so large, it would be more feasible for a smaller group to initiate the process. The recently emerging TPP is enjoying increasing momentum among a growing number of economies sympathetic to its goal of high-standard liberalization (Markheim, 2008).

The original TPP, also known as the Pacific Four agreement, is a plurilateral FTA agreed upon in 2006 between Brunei Darussalam, Chile, New Zealand, and Singapore. Led by the US, negotiations to expand membership began in March 2010 with Australia, Peru, the US, and Viet Nam. Malaysia joined the negotiations in November 2010. The parties aim to agree on a comprehensive 21<sup>st</sup>-century FTA that covers tariffs and services in addition to new issues such as investment, intellectual property, government procurement, competition policy, and labor and environmental regulations. The agreement is also expected to enforce strict regulation of state-owned enterprises and produce innovative initiatives to harmonize regulatory systems so as to free up global supply chains. A broad outline of the agreement was unveiled at the APEC summit in Hawaii in November 2011.<sup>28</sup>

The TPP is the only current initiative that includes several economies in both Asia and LAC, and therefore presents an important opportunity to serve as a Pacific trade bridge. The agreement's accession clause provides for the potential inclusion of many other nations. Japan, Mexico, and Canada have expressed strong interest in joining and are currently in accession talks. Others, such as Costa Rica, Panama, Philippines, Republic of Korea, and Indonesia, have been mentioned as possible future members. Through an increase in membership, the TPP could help expand and strengthen economic and strategic ties among select APEC members and lay the foundation for a wider FTA-AP. The TPP can thus be a driver of trade and investment integration across the Pacific. Although many current and potential TPP members already share FTAs, TPP could address a potential future "noodle bowl" problem by simplifying and streamlining customs procedures, tariff lines, and RoO (rationalizing, adopting coequals, upgrading origin administration, and harmonizing). By consolidating the numerous agreements in force, in conjunction with initiatives on regulatory harmonization, the TPP can particularly benefit SMEs.

<sup>28</sup> See the broad outlines of the agreement at the USTR website, <http://www.ustr.gov/about-us/press-office/fact-sheets/2011/november/outlines-trans-pacific-partnership-agreement>.

The TPP complements the ASEAN-centric approaches to regional integration in Asia, known as the ASEAN+3 (or +6) discussions.<sup>29</sup> The two processes are not mutually exclusive, and the ASEAN+3 or +6 approach could create synergies with the TPP approach through useful discussions that lead to liberalizing trade and avoiding protectionism.

Whichever avenue is taken, it is important to accelerate the liberalization of goods and services and of trade and investment, and reduce behind-the-border barriers, while pursuing domestic reforms. A harmonious approach would see a convergence between the two processes, which would be a win-win solution for the entire Asia and the Pacific community. In the end, any interregional agreement could take the form of a series of linked agreements with variable coverage of members and issues.

The possibility of significant benefits from interregional FTAs has been indicated by studies based on a CGE model, which has produced estimates of potential welfare gains to members, losses to non-members, and sector-level gains and losses. Depending on the CGE model and data sources used, these studies differ somewhat in their estimates of welfare gains and losses. These studies generally indicate that members would gain significantly from an interregional FTA (Gilbert, Scollay, and Bora, 2004; Francois and Wignaraja, 2008). Meanwhile, losses to non-members would be negligible. Krasniqi et al. (2011) examined the effects of trade integration between Asia and LAC using scenarios with and without Republic of Korea and Japan, and found that such trade integration could increase welfare by about 20% on average. Petri, Lummer, and Zhai (2011) find that the TPP and the FTAAP are competitive routes, but will create incentives for the US and the PRC to consolidate tracks into a region-wide agreement. They also find that both tracks can create additional trade volume of US\$742 billion by 2025. Finally, Park et al. (2010) analyze the effects of the FTAAP on APEC members and find that the FTAAP could provide welfare gains of US\$50–70 billion. CGE studies also indicate that larger agreements in terms of membership and issues covered would bring bigger welfare gains than agreements with fewer members and limited coverage of issues. Furthermore, a comprehensive trans-regional FTA covering a range of issues implies better alignment of compatibilities between global and regional rules in Asia and the Pacific–LAC FTAs. Ideally, the

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<sup>29</sup> The 10 ASEAN economies plus the PRC, Japan, and Republic of Korea (ASEAN+3) and Australia, India, and New Zealand (ASEAN+6).

three issues covered in this chapter—tariff liberalization, services liberalization, and deep integration—could form the heart of such an agreement.

### ***Priority 3: Ensuring firm-level use of FTA preferences***

Well-designed and comprehensive FTAs provide numerous benefits, including preferential tariffs, market access, and new business opportunities. Previous studies at the country and industry levels, however, suggest that Asia and the Pacific economies make only modest use of FTA preference rates, based on shares of export value enjoying preferences (Baldwin, 2006; World Bank, 2007). Some even view FTAs as discriminatory and a drain on scarce trade negotiation capacity in developing economies (Bhagwati, 2008).

Six comprehensive surveys of exporting firms conducted in 2007–08 by ADB and several partner researchers in Japan, the PRC, Republic of Korea, Singapore, Thailand, and the Philippines shed light on the use of FTA preferences (Kawai and Wignaraja, 2011b). Asian exporting firms tend to utilize FTA preferences more frequently than previously thought and may even be increasing their utilization rate. Of the 841 Asian sample firms, around 28% use FTA preferences. When plans for using FTA preferences are also factored in, 53% of all Asian firms either use or plan to use FTA preferences. Firms in the PRC and Japan are the highest users of FTA preferences, indicating the growing importance of FTAs at the firm level. Firms in Asia and the Pacific—in particular in the PRC, Republic of Korea, and Japan—have plans to increase the use of FTA preferences. While these findings are encouraging, there is room for improvement in FTA preference use at the firm level in Asia and the Pacific.

Surveys of private firms in LAC carried out by the IDB found that nearly all exporting firms make use of preferential agreements, the only exception being firms in countries that did not have FTAs with their principal trading partners (Harris and Suominen, 2009). The difference in LAC comes from a long history of preferential trading arrangements dating back to the 1960s, which was also a time of high MFN tariffs, creating a sizable incentive to master the procedures of qualifying for preferential duty rates. Asia and the Pacific, in contrast, is a relative newcomer to FTAs. Most of its agreements came only in the mid 2000s, but already Asia and the Pacific economies are applying low MFN tariffs in accordance with outward-oriented trade strategies.

Use of FTAs can be encouraged through the following: raising awareness of FTA provisions, including the phasing out of tariff schedules;

establishment of margins of preference at the product level; and establishment of administrative procedures for rules of origin. Business associations and governments could provide information on how to make FTAs more transparent, particularly for SMEs. Practical ideas include frequent seminars with SMEs, television programs directed at businesses, and dedicated websites and telephone help lines. More generally, institutional support systems for businesses, particularly for SMEs, need to be improved. Existing support systems for exporting under FTAs vary in quality and utilization. Business and industry associations must play a greater role in providing members with support services for exporting under FTAs. Upgrading SME technical standards, quality, and productivity could be useful so that smaller firms can participate more fully in regional production networks driven by large firms.

***Priority 4: Addressing the “noodle bowl” problem***

RoOs are another potentially challenging aspect of the surge in the number of Asia and the Pacific–LAC FTAs. The purpose of RoOs is to establish criteria for determining which goods will enjoy preferential tariffs in order to prevent trade deflection among FTA members. The multiplicity of bilateral trade agreements, such as the growing number of Asia and the Pacific–LAC FTAs, has generated a complicated, inconsistent set of RoOs, sparking concerns over the need for burdensome rules and administrative procedures that would increase the cost of doing business. Indeed, the firm-level surveys in LAC that show high levels of FTA utilization also indicate that firms in fact face challenges in utilizing multiple FTAs simultaneously, limiting their ability to leverage preferences to diversify their export markets. Multiple RoOs pose a severe burden on SMEs, whether exporting directly to FTA partners or when integrated into multinationals’ supply chains, which can be constrained by RoOs. In Asia and the Pacific, the RoO issue is mainly regarded as a future challenge, according to firm-level data presented in Kawai and Wignaraja (2011a and b). Originally termed a “spaghetti bowl” of trade deals (Bhagwati, 1995), this phenomenon has become widely known as the “noodle bowl” effect.<sup>30</sup>

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<sup>30</sup> Others suggest that the depiction of multiple FTAs as a complicated noodle bowl is misleading, arguing that the plethora of bilateral trade agreements may be creating an order of a different sort by building a foundation for a stronger regional trading system (Petri, 2008; Chia, 2010).

Supportive measures, such as encouraging rationalization of RoOs and upgrading their administration, can mitigate any negative effects of the “noodle bowl” problem in the future. Gains can be made by simplifying the preferential trading system through harmonizing RoOs and the procedures for calculation and certification of compliance, in addition to cumulation provisions that allow for more efficient supply chains without jeopardizing eligibility for preferences. Likewise, it would be useful to adopt international best practices in RoO administration. These may include introducing a trusted trader program that would allow successful applicants to self-certify origin, expand the use of business associations issuing certificates of origin for a fee, increase use of information technology-based systems of RoO administration, and train SMEs to enhance their capacity to use FTAs.

## Conclusion

Since Asia and the Pacific–LAC FTAs first emerged in 2004, an average of two FTAs has taken effect every year between economies of the two regions. The growing economic integration between LAC and Asia and the Pacific could have significant consequences for trade and investment flows because these regions differ with respect to openness to trade, protection and regulation, regionalization, and specialization and structure of trade. Yet each of these two diverse regions is using bilateral trade relations to achieve growth, development, and global competitiveness. Furthermore, investment has played a significant role in their economic relations as Asia and the Pacific economies actively pursued investment opportunities in LAC in recent years.

Our comprehensive analysis of the 18 Asia and the Pacific–LAC FTAs currently in effect identified a correlation between the proliferation of FTAs between the two regions and the rapid expansion of trade. In addition, our review found that most of these FTAs extend well beyond trade in goods and services to facilitate deeper integration through the Singapore issues and provisions on IPRs. Challenges remain in maximizing gains from greater integration in terms of liberalization of tariffs and services, yet a good deal of progress has been made on this front as well as on the Singapore issues and IPRs.

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**Annex 1 • Asia and the Pacific–LAC FTAs**

In Effect
1. Republic of Korea–Chile FTA(2004)
2. Taipei,China–Panama FTA (2004)
3. Japan–Mexico EPA (2005)
4. People's Republic of China–Chile FTA (2006)
5. Singapore–Panama FTA (2006)
6. Taipei,China–Guatemala FTA (2006)
7. Trans-Pacific Strategic EPA (2006)
8. Japan–Chile EPA (2007)
9. India–Chile PTA (2007)
10. Taipei,China–El Salvador–Honduras FTA (2008)
11. Taipei,China–Nicaragua FTA (2008)
12. Australia–Chile FTA (2009)
13. India–MERCOSUR PTA (2009)
14. Singapore–Peru FTA (2009)
15. People's Republic of China–Peru FTA (2010)
16. Republic of Korea–Peru FTA (2011)
17. People's Republic of China–Costa Rica FTA (2011)
18. Thailand–Peru FTA (2011)
Signed (Not in Effect)
19. Malaysia–Chile FTA (2010)
20. Singapore–Costa Rica FTA (2010)
21. Japan–Peru FTA (2011)
22. Chile–Viet Nam FTA (2011)
Under Negotiation
23. Singapore–Mexico FTA (2000)
24. Taipei,China–Paraguay FTA (2004)
25. Republic of Korea–Mexico SECA (2006)
26. Pakistan–MERCOSUR PTA (2006)
27. Taipei,China–Dominican Republic FTA (2006)
28. Republic of Korea–Colombia FTA (2009)
29. Trans-Pacific Partnership (2010)
30. Thailand–Chile FTA (2011)
Proposed
31. India–Colombia PTA (2004)
32. India–Uruguay PTA (2004)
33. India–Venezuela PTA (2004)
34. Republic of Korea–MERCOSUR PTA (2004)
35. Australia–Mexico FTA (2006)
36. Thailand–MERCOSUR FTA (2006)
37. Australia–Colombia (2009)
38. Hong Kong, China–Chile (FTA) 2009
39. Indonesia–Chile FTA (2009)
40. Republic of Korea–Central America FTA (2010)
41. Japan–Colombia FTA (2011)

Source: Authors' compilation.





# 3 Asia and the Pacific–LAC Investment: The Glue That Can Bind the Two Regions

## Introduction

Growth in foreign direct investment between LAC and Asia and the Pacific is important for sustaining their economic relationship. As with trade, there are important elements of complementarity in investments between the two regions. For one, LAC has rich untapped natural resources and abundant agricultural land, while Asia and the Pacific needs raw materials to fuel its manufacturing growth and feed its large population. For another, LAC has a large and growing domestic market that can absorb Asia and the Pacific investments as well as labor resources (especially in Central America), but relatively less capital; Asia and the Pacific have surplus savings they want to invest globally to diversify both their productive base and market and to reduce their dependence on traditional markets in developed economies.

For these reasons, as in the case of trade, investors from both LAC and Asia are increasingly reaching across the Pacific. Compared to virtually non-existent interregional investments in the 1980s, FDI flows between LAC and Asia and the Pacific have grown, particularly since 2004. Investments by Republic of Korea in Latin America, for example, have grown at an average annual rate of 103% since 2000, and totaled close to US\$5 billion over the past decade. Japan has long had an important presence in the region, and in 2008 its investments in Latin America reached an all-time high of US\$6.7 billion, a result of the high value of the yen, increased capitalization of financial institutions, and strong interests in natural resources<sup>1</sup> (JETRO, 2009).

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<sup>1</sup> JETRO (2009) reports that the acquisition of a large mining company that owns iron-ore deposits, together with capital transactions targeted at the Cayman Islands intended for the capitalization of financial institutions, pushed up Japanese investments in LAC

Similarly, investments by the People's Republic of China (PRC) grew from virtually nil in 2004 to more than US\$1 billion in 2010 (Figure 1).

The reverse capital flow from Latin America to Asia and the Pacific, however, remains low. For example, an Inter-American Development Bank (IDB) report shows Latin American investment<sup>2</sup> in Republic of Korea totaled only US\$46.8 million from 2000–2009, which is a mere 2% of LAC's outward foreign direct investment (OFDI) and 4% of Republic of Korea's inflows (IDB, 2011).

Considering growth prospects in Latin America, the rising cost of labor in East Asia, and continuing troubles in traditional developed country markets and destinations of Asian capital, trans-Pacific flows from Asia and the Pacific to Latin America will likely increase further. Current levels of Asian investments still leave considerable room for growth. For example, PRC's FDI to LAC in 2010 (excluding investment flows to offshore financial centers such as British Virgin Islands and Cayman Islands), is a mere 1% of its total OFDI. Republic of Korea's share in LAC's investment inflows also averages less than 1% annually.<sup>3</sup>

Similarly, as a result of increased familiarity with the Asian markets and the shift of economic gravity from Europe and North America to the East, the many emerging '*multilatinas*' (Latin American multinationals) will likely target a larger share of their investment portfolio at Asia and the Pacific. The survival instinct that enabled Latin America's companies to grow amid adverse circumstances (Casanova, 2009) would lead them to engage Asia and the Pacific more and more through both trade and investment.

Considering the important role that FDI will play in the two regions' economic relations, this chapter discusses the existing patterns and characteristics of interregional investments. This analysis uses unofficial data based on announced FDI projects<sup>4</sup> and mergers and acquisitions (section 2), and examines the growth of manufacturing investments, which have the potential to spur the development of local suppliers' networks as well as insert LAC countries in the Asian global value chain. They are also important for determining whether the traditional natural resources–manufacturing complementarity

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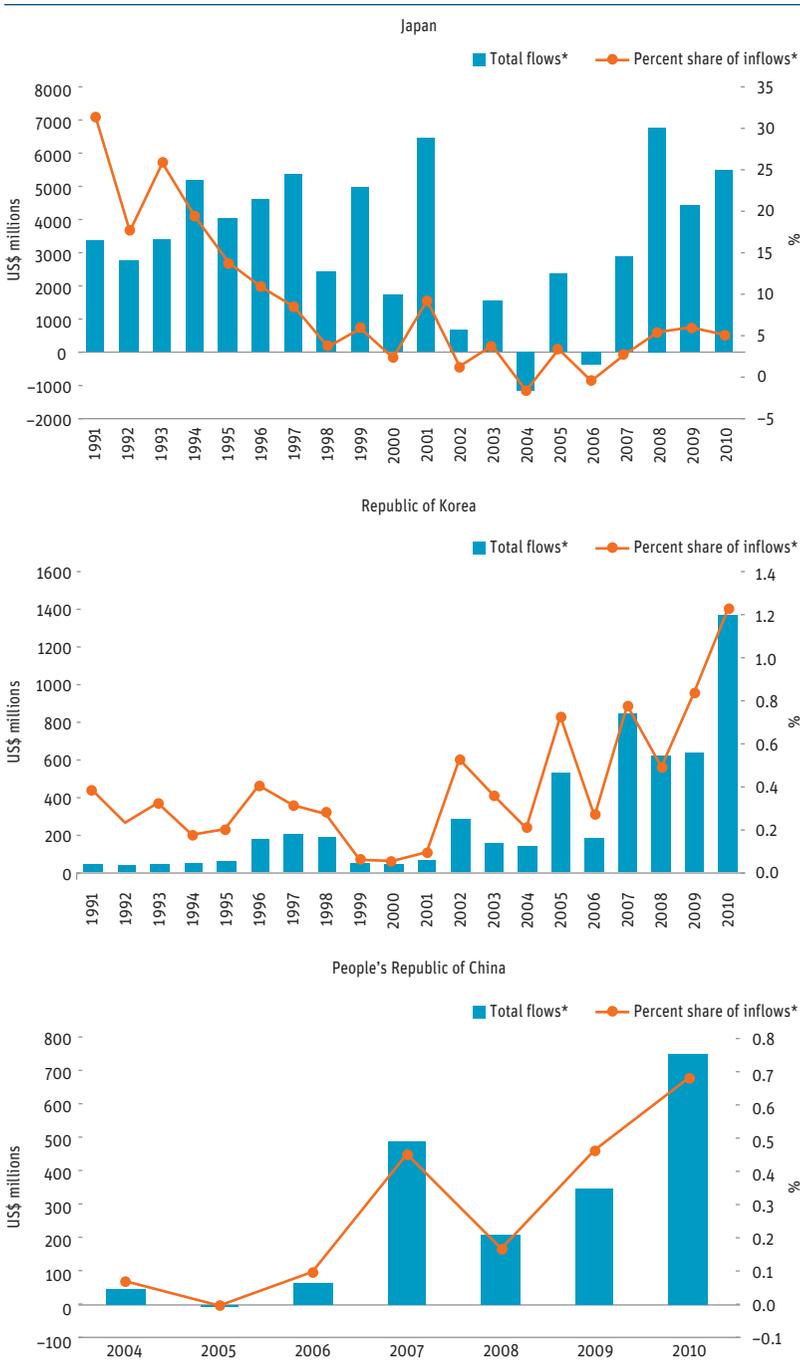
in 2008. Including its investments in tax havens, Japanese investment in LAC reached a historic high of \$29 billion.

<sup>2</sup> IDB (2011) reports investments from Uruguay, Chile, Brazil, Belize, and Venezuela.

<sup>3</sup> Except in 2010, when its share reached 1.23% of LAC inflows.

<sup>4</sup> Compiled by the *Financial Times* and made available in [www.fdimarkets.com](http://www.fdimarkets.com).

**Figure 1 • East Asian Investments to Latin America**



Source: OECD, UNCTAD, JETRO, Republic of Korea Exim Bank, PRC Ministry of Commerce.

\* Net of OFCs.

between LAC and Asia and the Pacific is slowly being supplemented by investments that can stimulate greater intra-industry trade. The final section discusses regulatory policies related to bilateral investment treaties and implementation of regulations that help improve the investment climate.

### Interregional investments: patterns and characteristics

This section analyses data of greenfield investments and mergers and acquisitions, to understand existing directions and patterns. This analysis complements other studies that have sought to give a picture of geographical and industry trends in bilateral investments between LAC and individual Asia and the Pacific economies (see, for example, IDB 2010a, 2010b, and 2011) by providing regional aggregates of investments.

**Evidence from greenfield investments.**<sup>5</sup> Asia and the Pacific<sup>6</sup> investments to LAC from 2003 to August 2011 total 924 investment projects made by 425 companies, while LAC's investment to Asia and the Pacific totals 234 projects. The metal sector, the top recipient of Asia and the Pacific investments in LAC, represents more than 12% of investment projects, while financial services, LAC's top investment sector in Asia and the Pacific, constitute 24% of total projects.

Figure 2 shows the growing number of projects and capital investment flows from Asia and the Pacific into LAC. The number of projects grew at an annual average rate of 8% from 2003 to 2010, and estimated capital expenditures increased by 18%. Asia and the Pacific investment rose from US\$12.6 billion in 2003 to a peak of US\$19 billion in 2008 before the global financial crisis slowed investments. Top Asia and the Pacific investors to LAC are established multinationals such as Toyota and Honda in vehicle manufacturing, and LG and Samsung in electronics. Since 2005, new Chinese multinationals, such as Huawei Technologies, are ranking among the top Asia and the Pacific investors in the Latin American market.

<sup>5</sup> This section draws heavily on announced FDI data compiled by the *Financial Times* and available at [www.fdimarkets.com](http://www.fdimarkets.com).

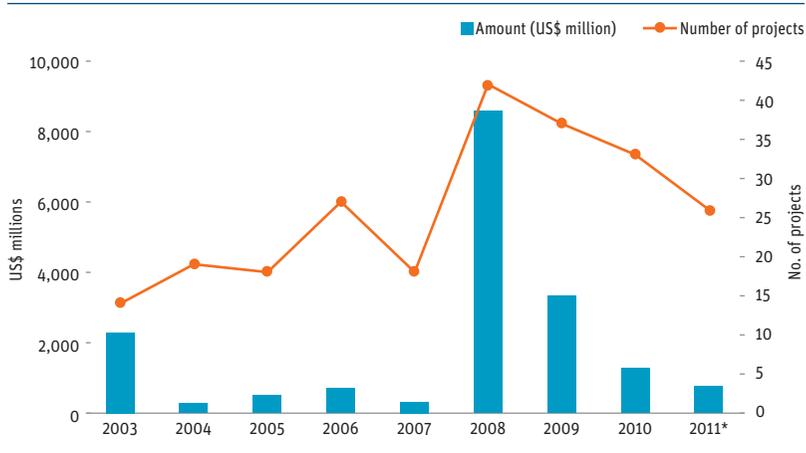
<sup>6</sup> Fdimarkets.com includes 38 economies in the Asia and the Pacific category, including some economies in Central Asia and Oceania. However, most of the investment outflows in the database come from East Asia as well as Australia.

**Figure 2 • Investment Projects from Asia and the Pacific to LAC**



Source: Author's calculations based on data from fdimarkets.com. Capital expenditures combine both announced FDI amounts and *Financial Times* estimates. 2011 data is only up to August.

**Figure 3 • Investment Projects from LAC to Asia and the Pacific**



Source: Author's calculations based on data from fdimarkets.com. Capital expenditures combine both announced FDI amounts and *Financial Times* estimates. 2011 data is only up to August.

LAC investment to Asia and the Pacific is lower, but has been increasing since 2003 (Figure 3). The total number of projects grew at an annual average of 23%, from 14 projects in 2003 to 33 in 2010. Estimated capital investment peaked at more than US\$8 billion in 2008, but fell during the

**Table 1 • Regional Distribution of Investment Projects (%)**

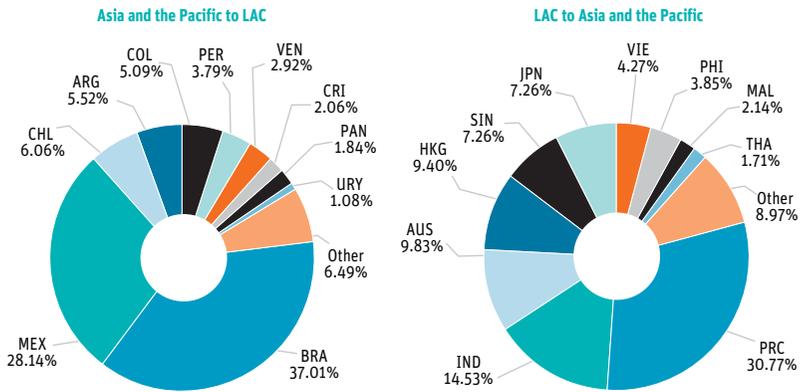
From/To	Number of global outward investment projects	Percentage share to total outward investment projects		Number of global inward investment projects	Percentage share to total inward investment projects	
		Asia and the Pacific	LAC		Asia and the Pacific	LAC
<b>Asia and the Pacific</b>	21,601	54.17	4.42	37,548	31.16	10.92
<b>LAC</b>	2,055	11.73	49.93	8,748	0.64	11.73

Source: Author’s calculation based on data from fdimarkets.com (January 2003–November 2011).

global financial crisis and has not yet recovered. The spike in capital investments in 2008 was largely driven by large investments in metals, coal, oil, and gas, as well as in energy resources. According to the *Financial Times’* fdimarkets database, for example, Brazil’s steel company Gerdau announced the expansion of its steel unit in Tadipatri, India, in 2008 with total investment worth US\$302 million. Likewise, Petrobras, Brazil’s oil company, is re-vamping an oil refinery in Okinawa, Japan, to process Brazilian crude oil for a total investment of US\$976 million. Similar large LAC projects in the coal, oil, and natural gas sectors, as well as renewable energy, are being carried out in Thailand and Viet Nam.

How significant are these interregional investments relative to total investment flows? Table 1 shows the percentage share of projects in both Asia and the Pacific and LAC relative to total outward and inward FDI projects. Asia and the Pacific investment projects in LAC constitute 4% of its global outward investments, but represent a significant share (10.9%) of investments in LAC. LAC’s investments in Asia and the Pacific, on the other hand, remain minuscule, at 0.6% of total inward investments in that region, which is not surprising given the fact that the region, and particularly the PRC, has been a magnet for global FDI inflows. In contrast, Asia and the Pacific’s share of LAC’s total outward investment projects stands at a robust 11.7%.

Table 1 also shows that despite the widely touted increase in globalization, much of the transnational investment projects remain “regional”: 54% of total outward investments of Asia and the Pacific companies remain within the region, while the corresponding figure for LAC is 49.9%. Nevertheless, despite this regional nature of both Asia and the Pacific and LAC investments, these do not dominate total investment inflows in the region. For example, in

**Figure 4 • Country Destination of Investment Projects**

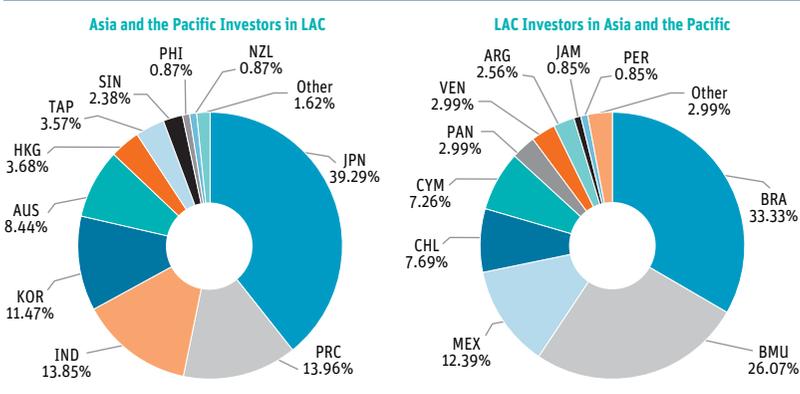
Source: Author's calculations based on fdimarkets.com database (January 2003–August 2011).

Latin America, Western Europe and North America together represent more than two-thirds of total investments (compared to LAC's intraregional investment of 11.7% of total inward investment projects in the region). Likewise, in Asia and the Pacific, more than 60% of total projects come from these two dominant regions,<sup>7</sup> while Asia and the Pacific's own intraregional investment constitutes another third (31%) of total investment projects.

**Country destination and major investors.** Which economies actually receive and undertake greenfield investments? The geographical destination of investments shows a strong concentration in both LAC and Asia and the Pacific. In LAC, Brazil and Mexico receive most of Asian investments, while in Asia and the Pacific, the PRC and India are the dominant destinations for LAC investments. Figure 4 shows that Brazil and Mexico together receive more than 50% of the 924 Asia and the Pacific investments, each taking up 38% and 28% respectively. Chile, Argentina, and Colombia each receive 6% of the total projects, while the remaining projects are spread out in small numbers across the region. On the other hand, out of 234 LAC investments in Asia and the Pacific,

<sup>7</sup> It is also significant to note that North America and Western Europe do not show the same "regional" nature of their investments. North America's intraregional investments comprise only 31% of its total outward investments, while the corresponding figure for Western Europe is 28%.

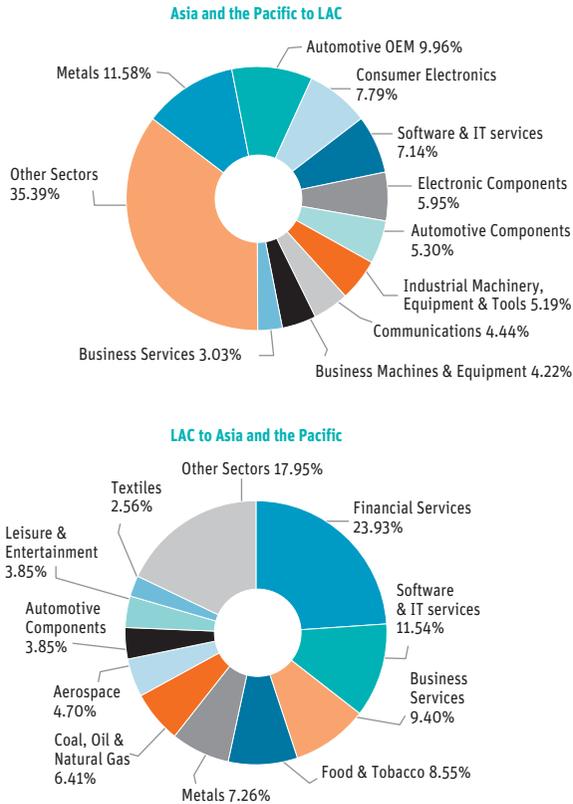
**Figure 5 • Interregional Investors**



Source: Author's calculations based on fdimarkets.com database (January 2003–August 2011).

31% are in the PRC, 15% are in India, 10% are in Australia, and 9% are in Hong Kong, China. Singapore and Japan each has 7% of total LAC projects in Asia and the Pacific. One policy implication that can be gleaned from this concentration in investments is the need to expand awareness of various economies in both Asia and the Pacific and LAC so that investors do not equate all of Asia and the Pacific with the PRC and India, or all of LAC with Brazil and Mexico.

Figure 5 shows which economies are active interregional investors. It shows that Japan (39%), the PRC and India (14% each), and Republic of Korea (11%) together have more than three-fourths of investment projects in LAC, while Brazil, Mexico, and Chile together have 53% of LAC's total investments in Asia and the Pacific. Significantly, Bermuda and Cayman Islands, both offshore financial centers (OFCs), also own more than one-third of investment projects in Asia and the Pacific. The significant investment from OFCs distorts actual interregional investment flows because there is no way of knowing whether these investments are coming from Asia and the Pacific. For example, it is well known that a huge percentage of PRC FDI inflows are actually “round-tripping” Chinese investments coursed via OFCs in order to take advantage of special FDI tax incentives. The PRC's investments in OFCs (especially the Cayman Islands and British Virgin Islands) constituted 13% of its total outward FDI stock in 2010, while 1% went to the rest of LAC (non-OFCs). It is conceivable that a sizeable portion of this returns to the PRC as inward FDI from LAC.

**Figure 6 • Investment by Sector**

Source: Author's calculations based on fdimarkets.com database (January 2003–August 2011).

**Investment by sector.** What types of companies invest in each region? LAC investors in Asia and the Pacific are mostly in the services sector. Financial sector companies have almost a quarter of projects in Asia and the Pacific; software and IT services come second with 11%, and business services with 9%. Asian companies investing in LAC are evenly distributed across various sectors, the most important being metal with 12% of projects, auto OEM (original equipment manufacturing) 10%, consumer electronics 8%, and software and IT services 7%. While there is some evidence of Latin American manufacturing investments in Asia and the Pacific, these investments seem to be exceptions at this time rather than the norm. Box 1 gives some examples of Latin American ventures into the Asian market.

### Box 1 • Market-seeking Investments from Latin America to Asia and the Pacific<sup>a</sup>

#### Marfrig Alimentos S.A., Brazil

In April 2011, Brazil's Marfrig, Latin America's second-largest beef producer, announced that the company would form two new joint ventures in PRC through its subsidiary Keystone Foods. The total investment, which is estimated to be worth US\$309 million, is meant to strategically position the company to meet the rising demand for food in the PRC market, with vertically integrated operations ranging from processing to client distribution.

The first of the new joint ventures is COFCO<sup>b</sup>—Keystone Foods Supply Chain (China) Investment Company. The joint venture will combine COFCO's local market knowledge with Marfrig's and Keystone Foods' experience in food distribution and international client development. Marfrig became a leading supplier to MacDonald's Corporation, Campbell's, Subway, ConAgra, Yum Brands, and Chipotle when it acquired Keystone Foods in 2010. The COFCO-Keystone joint venture aims to explore business opportunities in food logistics and distribution services in the PRC. It involves the development of six distribution centers, transportation fleets, and IT support platforms in strategic cities, including Beijing and Shenzhen.

The second joint venture is Keystone-Chinwhiz Poultry. The latter is a private company located in Weifang, Shandong province, with core activities in feed production and chicken production/slaughter. The joint venture is a vertical integration in food supply chain strategy, where Chinwhiz will initially supply 50% of the raw material needs of Keystone's processing units in the PRC.

#### Industrias Metalurgicas Pescarmona SAIC (IMPSA), Argentina

In April 2010, IMPSA, an Argentine power generation company, announced that it would invest US\$3 billion to develop a 1,000 MW wind farm in Viet Nam. The development would be jointly undertaken with Petro Viet Nam Power and would also involve the construction of a wind turbine plant to manufacture wind turbine generators.

Apart from venturing into wind energy production, the company also has plans to invest in Viet Nam's hydropower sector. Through its investment in Viet Nam, the company hopes to be well positioned to profit from the growth of the renewable energy sector, and clearly sees its future in Asia and the Pacific.

<sup>a</sup> Collected from various news sources and company websites.

<sup>b</sup> COFCO stands for China National Cereals, Oils and Foodstuffs Corporation. The company is the PRC's largest food producer and a leading international trader of grain, oil, and food.

**Manufacturing investments.** While natural resources remain a strong attraction for investments in Latin America, some concerns are raised about overdependence on natural resource-based sectors. Diversification appears to be a clear Latin American objective to overcome vulnerability to the boom-bust cycle that comes with dependence on the primary materials trade and investment. Some experts have also espoused a strategy for Latin America and Asia and the Pacific that goes beyond an economic relation based on endowment complementarity or inter-industry trade, focusing on more intra-industry trade (Kawai and Zhai, 2009). One way to make this happen is by increasing cross-regional manufacturing investments, since intra-industry trade generally occurs in manufacturing.

A look at Asian manufacturing investments in selected sectors which are likely to be efficiency-seeking (as well as market-seeking) investments<sup>8</sup> also indirectly indicates the existence of a growing production network in LAC. The reason is that these manufacturing investments will likely require parts and components that are either secured from local suppliers, if available, or imported from their own network of suppliers in Asia and the Pacific. Anecdotal evidence points to large multinational companies such as Samsung persuading its Korean suppliers to invest in LAC together with them. In doing so, it is able to satisfy the high local content requirement from host economies as more parts and components get to be manufactured locally, even as some critical component manufacturing, particularly those requiring “smart” technology, remain in the home economies. By manufacturing some components in LAC and others in Asia and the Pacific, Asia and the Pacific investments facilitate the insertion of LAC into the global value chain.

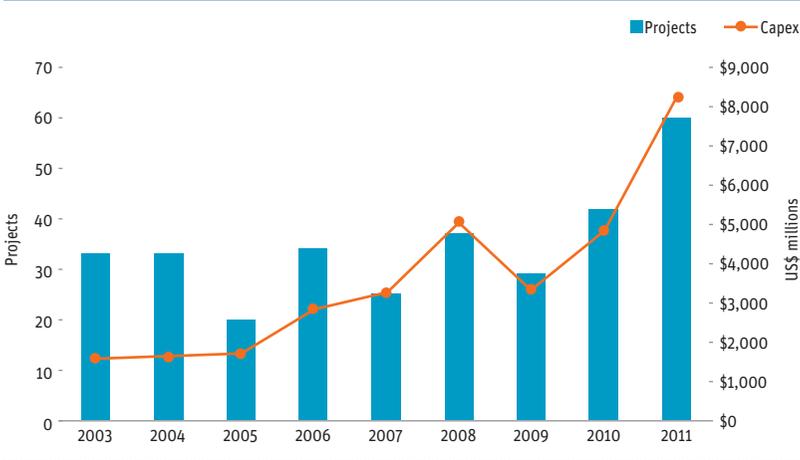
Figure 7 shows that capital expenditures in these selected sectors, particularly for manufacturing purposes, steadily rose during the global financial crisis in 2008. Then, after dropping in 2009, they rose again to nearly US\$9 billion in 2011. The number of projects generally follows the same pattern of increase.

The “usual suspects” are the biggest sources of manufacturing investments. Japan-financed projects dominate across various sectors, but especially in automotive OEM and components, consumer electronics and

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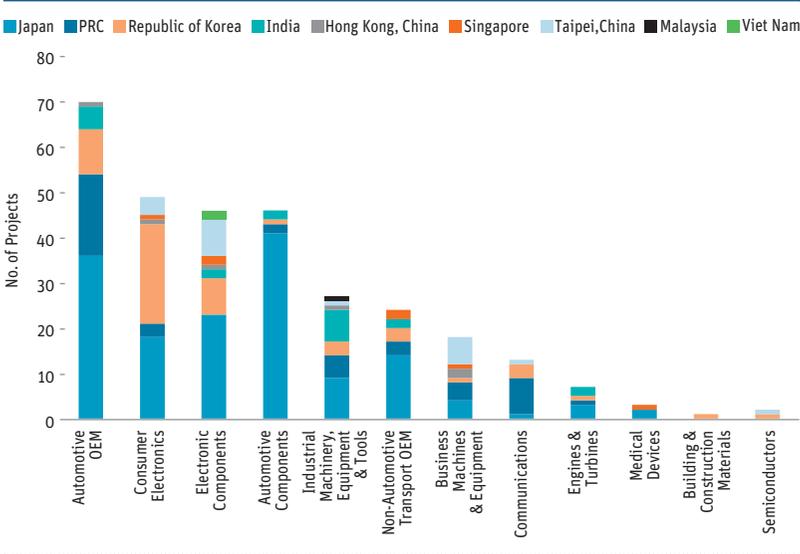
<sup>8</sup> These include automotive OEM; consumer electronics; electronic components; automotive components; industrial machinery, equipment, and tools; non-automotive transport OEM; business machines and equipment; communications; engines and turbines; building construction and materials; medical devices; and semiconductors.

**Figure 7 • Asia and the Pacific Investments in Manufacturing**



Source: Author's calculations based on fdimarkets.com database (January 2003–December 2011).

**Figure 8 • Asia and the Pacific Investors in Selected Manufacturing Sectors**



Source: Author's calculations based on fdimarkets.com database (January 2003–December 2011).

components, non-automotive transport OEM, and engines and turbines (Figure 8). Republic of Korea has a relatively stronger presence in consumer electronics and automotive sectors, while Taipei, China is strong in consumer

**Box 2 • Value-chain Insertion through Asia and the Pacific FDI****Backward integration strategy: Companhia Coreano-Brasileira de Pelotização (KOBRASCO)**

KOBRASCO is a joint venture between Republic of Korea's POSCO and its Brazilian counterpart Vale. POSCO is one of Asia and the Pacific's most profitable steel makers and the third largest in the world. Vale is Brazil's largest mining company and the world's leading producer of iron ore pellets, the main raw material used in steel production. Since 1998, KOBRASCO has operated an iron ore pellet plant with a 4 million T/Y production capacity.

In the case of POSCO, efficiency and the need to secure a supply of raw materials were main motivations for the joint venture. The Korean group needed a high-quality and low-cost pellet manufacturing facility to boost its own steel and iron production. In the case of Vale, the joint venture represented an opportunity to increase its presence in Asia and the Pacific markets while locking in an important and stable customer for its products.

**Forward integration strategy: POSCO Continuous Galvanized Line, Altamira, Mexico**

In 2009 POSCO opened a new Continuous Galvanized Line (CGL) facility in Altamira, Mexico. POSCO Mexico manufactures and sells a line of steel products mainly directed to the automobile industry, including cold rolled steel products for car body panels, hot-dip galvanized steel goods for use in construction and fabrication of automobile parts, and galvanized steel sheets, especially for production of auto parts.

POSCO Mexico was created to strengthen ties with its customers, namely various automobile manufacturing companies in Mexico and in the US. Its part in the steel production chain is the final production of steelworks. The production of semi-processed steel products (the earlier stages of the steel value chain) remains in Republic of Korea.

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<sup>a</sup> Abridged discussions based on case studies from Kwak (2011b).

electronics and business machines. The PRC has noticeable manufacturing investments in automotive OEM, communications, and business machines. The majority of manufacturing investments likewise go to the biggest domestic markets, Mexico and Brazil.

Box 2 also discusses a corporate investment strategy of strengthening both backward and forward linkages. KOBRASCO, a joint venture of POSCO

(Republic of Korea) with Vale (Brazil), is POSCO's strategy for strengthening a backward linkage. Through the joint venture, POSCO is able to procure raw materials (iron ores) from Vale, which are made into iron pellets by KO-BRASCO. The iron pellets, a critical raw material for steel manufacturing, are then exported to Republic of Korea for further processing. POSCO Mexico, on the other hand, is a forward integration strategy where the final stages in the steel manufacturing value chain are carried out in Mexico all the way to marketing to major customers, which are the automobile manufacturers based in Mexico.

### Evidence from mergers and acquisitions data

Similar to greenfield investments, interregional mergers and acquisition (M&A) deals between companies in Asia and the Pacific and LAC, while on the increase, remain insignificant relative to the total value of global M&As. Table 2 shows that only six out 152 mega-deals<sup>9</sup> involve companies from Asia and the Pacific and LAC on opposite sides of the transaction. The value of these mega-deals is US\$20 billion, or 5% of M&A value worldwide in 2010. All of these transactions involve a LAC company being acquired by an Asia and the Pacific-based company. The acquired companies are in sectors such as crude oil, petroleum and natural gas, minerals, power distributions, and electricity supply. Compared to the number of deals in 2005 (shown in parentheses), the number of mega M&A transactions in 2010 seems to indicate a growing confidence among companies in the two regions to participate in cross-border M&A activities.

Compared to interregional M&As, the number of intraregional deals, i.e., where both acquirer and acquired are located in the same region, are higher. There were 14 transactions within Asia and the Pacific and six within LAC. These transactions respectively constitute 7.6% and 2.9% of total global value of M&A. The sectors of acquired companies are also more diverse, including services and manufacturing as well as natural resource sectors.

Significantly, in a good number of mega-deal M&As, the acquirer is either from LAC or Asia and the Pacific but the acquired companies are located in neither of these two regions. All of these transactions except three are

<sup>9</sup> Based on UNCTAD's cross-border M&A data in 2010 with deal values exceeding US\$1 billion dollars.

**Table 2 • Cross-border M&A Deals Worth over US\$1 Billion Completed in 2010**

Geographic partners	Number of companies (number in 2005)	Total transactions (US\$ billion)	Percentage of total amount	Sectors of acquired companies
<b>Interregional AP and LAC</b>	6 (0)	20.2	5.04	Crude petroleum and gas; minerals; power distribution; electricity
<b>Intraregional Asia and the Pacific</b>	14 (5)	30.5	7.61	Auto parts; crude petroleum and gas; mining; hospitals; real estate services Communications; transportation services; banks; steel; agriculture (sugar)
<b>Intraregional LAC</b>	6 (2)	11.7	2.92	Soybean oil mills; crude petroleum and gas; insurance; retail stores Chemicals (fertilizers)
<b>AP or LAC as acquirer</b>	23 (9)	69.4	17.32	Communications; electric services; minerals (gold, iron); manufacturing; cable and pay TV services; computer integrated system design; crude petroleum and gas; pharmaceuticals; security system services; electric services; auto and motor vehicles; cosmetics; cement; meat packing plants; life insurance
<b>Total</b>	49	131.8	32.88	

Source: Author's based on Appendix Tables in UNCTAD (2011).

acquisitions made in developed economy markets and include some of the highest valued M&A deals. For example, 13 out of the 23 deals in this category are acquisitions of a US-owned firm by companies from Asia and the Pacific or LAC economies.

The picture painted here reflects the overall pattern of outward FDI from these two regions. That is, while their OFDI has increased since 2000, its direction has been largely to developed economies. The reasons include the need for new transnational corporations in emerging economies to immediately acquire a regional and global footprint as a gateway for quick

success in global competition. The new transnational corporations focus on well-known brands with worldwide marketing networks, as well as those with strategic assets such as distribution networks, intellectual property, or engineering technology. These, not coincidentally, are usually attributes of companies based in developed economies.

### Summing up: locational advantage and investments

Table 3 summarizes the pattern of Asia and the Pacific investments in LAC by showing the sectors with the greatest number of projects as well as the highest amount of capital expenditures in different countries. The table indicates the

**Table 3 • Top Sector Recipients of Asia and the Pacific FDI in LAC**

Destination country	Top recipients of greenfield projects	Top sector recipients of capital <sup>a</sup>
Brazil	Metals; industrial machinery and equipment; automotive OEM; software and IT services	Metals; automotive OEM; food and tobacco
Mexico	Consumer electronics; automotive OEM; electronic components; metals	Coal, oil, and natural gas; automotive OEM; consumer electronics
Chile	Metals; software and IT; business machines and equipment	Metal
Argentina	Auto OEM; metals; food and tobacco; non-automotive transport and equipment; electronic components	Food and tobacco; automotive OEM
Colombia	Automotive OEM; software and IT; communications	Coal, oil, and natural gas
Peru	Metals; coal, oil, and natural gas; communications; business machines and equipment	Metals
Venezuela	Automotive OEM; metals; communications; coal, oil, and natural gas	Chemicals; coal, oil, and natural gas
Costa Rica	Rubber; consumer electronics; business services	Coal, oil, and natural gas
Nicaragua	Textiles and apparel	Textiles and apparel
Ecuador	Coal, oil, and natural gas	Coal, oil, and natural gas; warehousing and storage
Guatemala	Textiles; business services	Business services

Source: Author's calculations based on data from [fdimarkets.com](http://fdimarkets.com).

<sup>a</sup> Based on announced capital expenses only; excludes estimates from *Financial Times*. Since many projects do not reveal their actual financial investments, the top sectors based on capital expenditures data should be treated with some caution.

clear preferences of Asia and the Pacific investors, based on the locational advantages of each country. Brazil's top sectors are metals, industrial machinery, automotive OEM, and software and IT services. Its investments from Asia and the Pacific are diversified in such a way that sectors other than these top four actually have a greater number of Asian projects than the top sectors in other countries. These investments clearly show Brazil's advantage in resources and in its large domestic market that make it attractive to resource- and market-seeking investments.

Mexico's top sectors are consumer electronics, automotive OEM, and electronic components. Again, these investments reflect Mexico's status as the export platform for US-destined products. Many of Mexico's investments are efficiency-seeking, leveraging its relatively cheap labor and low tariff access to the US market. Chile's top attraction is the metal sector as well as some services sectors. Costa Rica boasts cheap and skilled labor, and thus attracts offshored business services. The low cost of labor in Nicaragua and Guatemala, in addition to these countries' proximity to the US market, helps them to attract investments in clothing and textile manufactures.

In all, locational advantages help attract specific types of investments. South America and its Andean sub-regions attract mining and petroleum investments. Central America, with its low-cost labor, proximity, and preferential access to the US market, attracts investments in apparel, and more recently, offshored business services. Brazil and Mexico, with their relatively large domestic markets, attract market-seeking investments such as automotive and consumer electronics.

The pattern of Asia and the Pacific investments in LAC indicates motivations for investment. For example, the PRC has very clear objectives about access to natural resources, thus its huge investments in the metal sector. Republic of Korea and Japan are leveraging their competitive advantage in the automotive and consumer electronics sectors and would like to tap into domestic and regional markets. India's particular strength is services, hence its top investments are software and IT (see Table 4).

On the other hand, LAC's investments in Asia and the Pacific are clearly market-seeking. Most are being made in the fast-growing consumer market, the PRC, and into final consumer-oriented areas such as the food sector and financial services (Table 5). Brazil, Mexico, and Chile are the top three LAC investors in Asia and the Pacific. Interestingly, the other top LAC investors in Asia and the Pacific include Bermuda and Cayman Islands, and these invest

**Table 4 • Top Sectors of Interest to Asia and the Pacific Investors**

Source country	Top sectors of interest to Asia and the Pacific investors (by number of projects)	Top sectors of interest to Asia and the Pacific investors (by capital expenses) <sup>a</sup>
Japan	Automotive OEM; automotive components; consumer electronics; electronic components	Metals, automotive OEM
PRC	Metals; automotive OEM; communications; industrial machines and equipment	Metals; coal, oil, and natural gas; food and tobacco
Republic of Korea	Consumer electronics; automotive OEM; electronic components; metals	Metals; consumer electronics
India	Software and IT services; business services; pharmaceuticals	Coal, oil, and natural gas; metals; automotive OEM
Hong Kong, China	Transportation; warehousing and storage	Transportation; warehousing and storage

Source: Author's based on data from [fdimarkets.com](http://fdimarkets.com).

<sup>a</sup> Based on announced capital expenses only. Since many projects do not reveal their actual financial investments, the top sectors based on capital expenditures data should be treated with some caution.

**Table 5 • Top Sector Recipients of LAC FDI in Asia and the Pacific**

Destination	Top sector recipients (based on number of projects)
PRC	Food and tobacco; financial services; software and IT services
India	Business services; leisure and entertainment; software and IT
Hong Kong, China	Financial services; business services
Japan	Financial services

**Table 6 • Top Sectors of Interest to LAC**

Source	Top sectors of interest to LAC investors (based on number of projects)
Brazil	Financial services; metals; food and tobacco; automotive components
Mexico	Leisure and entertainment; food and tobacco; automotive components
Chile	Financial services; transportation
OFCs in LAC	
Cayman Islands	Financial services; business services; coal, oil, and natural gas
Bermuda	Business services; financial services; software and IT

heavily in financial services and service sectors (software, other business services) (see Table 6), but as discussed previously, some of these investments can themselves originate from Asia and the Pacific, especially the

PRC, round-tripping through OFCs as a way to take advantage of the PRC's FDI tax incentives.

## Policies to support interregional investments

This chapter and the previous one on trade have noted the strong complementarity of Asia and the Pacific and LAC economic structures as a foundation for enhanced future cooperation in trade and investment. However, Asia and the Pacific–LAC relations can also be built not only on inter-industry trade, but also on more dynamic intra-industry trade. Increased interregional investment in manufacturing and infrastructure can help accelerate this process, and policies that encourage deep economic integration, specifically liberalization of FDI regimes and improved regulatory policies, can help spur bi-regional investment flows.

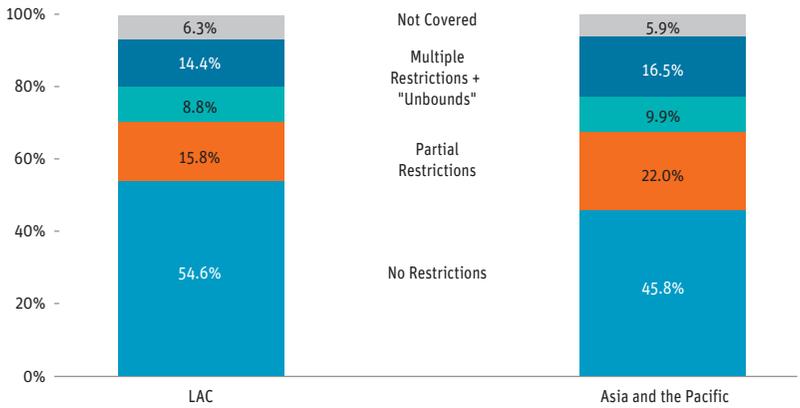
**Liberalization of FDI regimes.** Most liberalization of FDI regimes takes place unilaterally, usually as part of an overall development strategy. Some investment liberalization, however, can also come about through international investment agreements that are usually included in newer FTAs (see chapter 2). In the case of Asia and the Pacific and Latin American FTAs,<sup>10</sup> all the agreements except three feature a dedicated chapter on foreign investment, generally following a NAFTA approach. In other words, they cover both FDI and portfolio investment, follow a negative list of commitments for liberalization,<sup>11</sup> and contain protection measures, including investor–state dispute settlement. Those that do not have an investment chapter (namely PRC–Costa Rica, PRC–Peru, and Trans-Pacific (P4)) still cover FDI in services under “commercial presence” or mode 3 in the services chapter (Molinuevo and Pasadilla, forthcoming).<sup>12</sup>

<sup>10</sup> It is worth noting that Brazil has not signed FTAs with any Asia and the Pacific economy.

<sup>11</sup> That is, all sectors are open for FDI except those in the list of commitments with stipulated restrictions.

<sup>12</sup> In services agreements, for example, parties to the FTA agreement using the GATS approach list sectors in which they would like to make liberalization commitments by modes of service supply. Commitments they make under mode 3 (so-called commercial presence) supply of service are akin to investment liberalization of the service sector, provided that the restrictions they put in their schedule of commitments—if they include restrictions—are sufficiently liberal.

**Figure 9 • Mode 3 (Commercial Presence) Commitments in Asia and the Pacific–LAC FTAs**



Source: Molinuevo and Pasadilla, background paper.

An analysis of mode 3 commitments in Asia and the Pacific–Latin America FTAs shows that a significant percentage of sector commitments are fairly liberal, i.e., they have no commercial presence restrictions. Figure 9 shows that this proportion in Latin American countries’ commitments in fact exceeds those with partial or full restrictions. In contrast, Asian commitments in various Asia and the Pacific–LAC FTAs appear relatively less liberal, judging by the lower percentage of sectors with fully liberalized mode 3 (commercial presence) commitments compared to LAC’s. Because international commitments provide some confidence to investors that governments will not backtrack on investment policies that they used to attract investments, governments in both LAC and Asia and the Pacific need to consider committing more sectors for liberalization in their FTAs in order to attract investments from both regions.

It should be kept in mind, however, that opening sectors for FDI alone is not sufficient to attract actual FDI inflows. Investment liberalization must be accompanied by flanking policies related to administrative quality, infrastructure support, and other regulatory policies that are discussed below.

**Regulatory policies, investor protection, and BITs**

The fragmentation of production that has characterized most of global trade has brought to the fore other sources of competitiveness that have not previously

been considered in traditional international trade theories (Ando *et al.*, 2006). In particular, the cost of service links between production blocks has become an important determinant in the locational decisions of many multinational enterprises. If the service-link costs are high, either because of poor infrastructure or governance, benefits from locational advantage can come to naught. Many greenfield investments, for example, report that their choice of Singapore was influenced by its excellent logistics and infrastructure facilities.<sup>13</sup> On the other hand, LAC and some parts of Asia and the Pacific fail to attract more investments because of insufficient infrastructure, including poor port service and facilities, as well as complicated regulatory processes, such as customs.<sup>14</sup>

At the same time, significant improvements in some regulatory procedures that affect investments have taken place in both Asia and the Pacific and LAC. For example, Figure 10 shows that the number of procedures that foreign and domestic investors must carry out to set up a business, and the time they take, significantly declined between 2005 and 2011 for many LAC countries. In Chile, Uruguay, and Mexico, it takes fewer than 10 days to set up shop, roughly the same time it takes in the US and Republic of Korea, compared to the more than one month required in 2005.

**Bilateral investment treaties.** Finally, no discussion of investment is complete without talking about investor protection. In this regard, bilateral investment treaties (BITs)<sup>15</sup> are important because they help improve the regulatory framework by “guaranteeing certain investor rights and providing a stable and transparent mechanism and enforcement procedures that mitigate the impacts of political and economic instability” (Sachs and Sauvant, 2009). For many investors, BITs constitute a credible commitment by the host country that assuages investors’ concerns over pre-investment promises that can be broken once the investments have entered the host country (Guzman, 2009). Developing economies can particularly gain from BITs because they help to substitute for institutional quality.

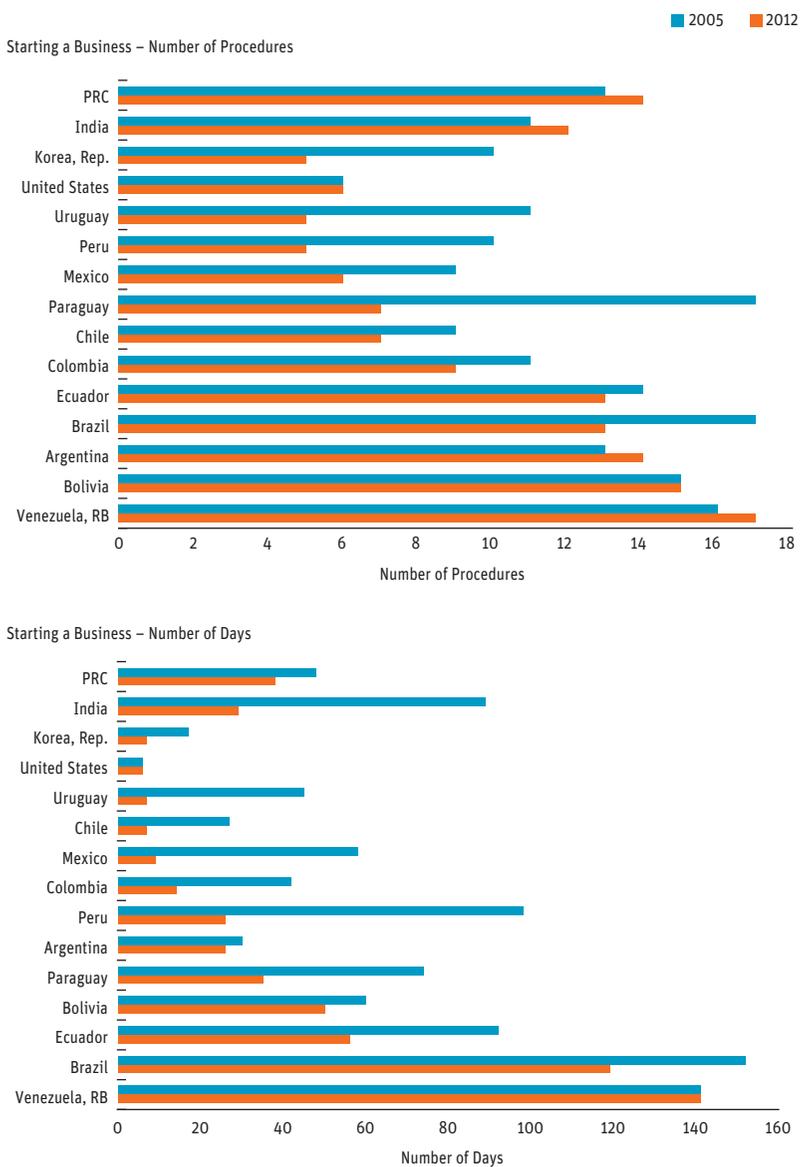
The potential importance of BITs for FDI inflows perhaps explains the global growth in the number of signed investment treaties. Governments

<sup>13</sup> From the *Financial Times* database [fdimarkets.com](http://fdimarkets.com).

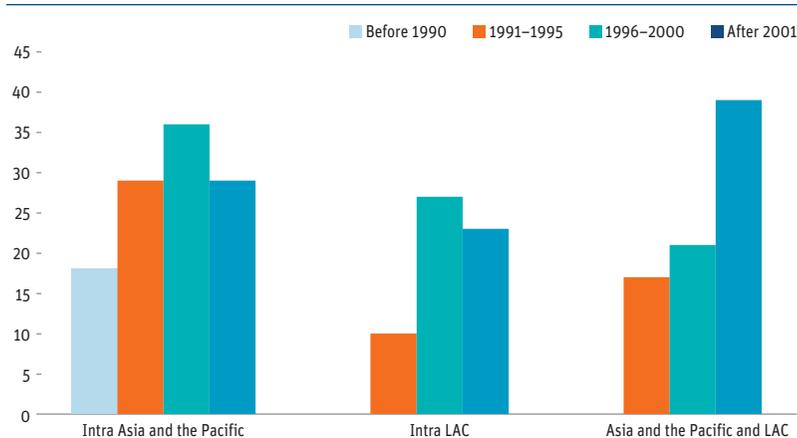
<sup>14</sup> Kwak (2011a) reports these findings based on a survey of Korean investors in LAC. For more detailed discussion of investors’ sentiments about the challenges and difficulties of investing in LAC, which likewise applies to Asia and the Pacific, see also KIEP (2009).

<sup>15</sup> And Double Taxation Treaties (DTTs).

**Figure 10 • Regulatory Quality**



Source: World Bank's Doing Business database.

**Figure 11 • Rising Bilateral Investment Treaties in Asia and the Pacific and LAC**

Source: Author's calculations based on UNCTAD data.

often feel that they need to sign these treaties to stay competitive in attracting foreign investments. Asia and the Pacific and Latin American governments appear to be no exception. Figure 11 shows the rapid rise of BITs<sup>16</sup> signed by governments in both regions among each other since the 1980s. Many of the treaties are intraregional, that is, partner economies are from the same region, either Asia and the Pacific or LAC. Interestingly, the number of BITs involving an Asian and a Latin American partner rapidly grew beginning in 2001, perhaps reflecting the rise in interregional FDI, which was discussed above.

Several empirical works have described a positive relationship between number of BITs entered into and FDI flows.<sup>17</sup> In sectors such as natural resources, FDI is particularly sensitive to the presence of BITs because these are more politicized and prone to government interference. This perhaps explains why Chile and Peru, both resource-rich economies, are among the

<sup>16</sup> Number of signed and enforced BITs.

<sup>17</sup> See, for example, the various chapters in Sauvant and Sachs (2009). Some caveats should be applied to the findings in these chapters because of possible omitted variable bias in the econometric estimation and failure to account for endogeneity. That is, not only do BITs affect FDI flows, but also vice versa. With more investments flowing from one home country to another, there is greater pressure on the home country government to sign an investment treaty with the host country.

Latin American countries with significant numbers of BITs.<sup>18</sup> Chile has signed an investment treaty with six Asia and the Pacific economies, not to mention its numerous FTAs that include investment chapters.

Similarly, empirical findings show the importance of investment treaties in the investment decisions of medium-sized firms. This is the case because, unlike small firms that will likely find arbitration costs prohibitive should there be a dispute with the host state, and unlike big multinationals, which have sufficient clout and bargaining power with host governments and hence have relatively less need for BITs, many medium-sized firms will likely find going through arbitration both affordable and worth the cost. This finding is potentially significant for the strategy of companies like Samsung, which invites Korean suppliers that are likely medium-sized to locate locally in order to build the production network in the host economy and thus increase local content. Such a strategy will work if the medium-sized suppliers have sufficient confidence that their investment will be protected in LAC. Thus, it can be concluded that the existence of a BIT may be one factor that can help spur the growth of a regionally based production network.

BITs may also be more important for some types of FDIs than for others. The effect of BITs on locational decisions may be relatively weaker for market-seeking investors, who give greater weight to economic determinants such as market size or presence of natural assets.<sup>19</sup> BITs are more likely to influence the decisions of efficiency-seeking investors, for whom several investment locations may be otherwise equally attractive. Thus, since many efficiency-seeking investments are in value chain production, Latin American countries should note this result if they want to ensure the growth of local manufacturing production networks.

### Continuing tasks

The deepening economic relationship between Asia and the Pacific and Latin America has taken place not only through increasing trade volume, but also through growth in interregional direct investments. Its total value is

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<sup>18</sup> Perhaps due to pressures from investors' home governments.

<sup>19</sup> UNCTAD finds that on balance, BITs did not play a primary role in increasing FDI. Rather, they constitute one of several factors, among which market size appears a stronger determinant for FDI than the conclusion of a BIT.

currently small relative to total flows into as well as out of each region. But the overall trend is up. Interregional flows are concentrated in Brazil and Mexico in LAC, and in the PRC and India in Asia and the Pacific. Metals is the top sector that attracts Asia and the Pacific investments in LAC, but manufacturing investments that have the potential of stimulating local suppliers' networks are also growing. LAC's investment in Asia and the Pacific, mostly in services, remains modest in its total value. However, a number of global *multilatinas* are making inroads in the burgeoning Chinese consumer market through joint ventures with local Chinese companies.

Attracting more interregional investments and increasing geographical diversity in LAC beyond Brazil and Mexico requires greater investment promotion. The same goes for LAC investors looking toward Asia and the Pacific economies. Asia and the Pacific is not only the PRC and India; there are also the small but dynamic ASEAN<sup>20</sup> economies that can benefit from LAC investments as well as provide a gateway to the continent's more developed economies.

For both LAC and Asia and the Pacific, increasing investment will require improved regulatory quality, good infrastructure, existence of a clear framework for investment protection, and an open investment regime. Achieving progress in these areas will require work aplenty for governments in both regions.

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<sup>20</sup> Association of Southeast Asian Nations.

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## 4 Asia and the Pacific–LAC Cooperation: Forging Linkages Beyond Trade and Investment

Trade and investment help to forge mutually beneficial relationships between countries and regions. As we have seen so far, these links between Latin America and the Caribbean (LAC) and Asia and the Pacific have expanded greatly over the past decade. The deepening economic relationships, driven primarily by market forces, have brought governments in the two regions closer together, resulting in opportunities for broader cooperation in science and technology, education, poverty reduction, and many other areas. We can think of these linkages as “non-market cooperation,” because they involve primarily public agencies pursuing public policy objectives.

Indeed, non-market cooperation between the two regions appears to be growing, as evidenced by increased bilateral development aid, diplomatic agreements that go beyond traditional economic relations, academic exchanges and technical cooperation, as well as the emergence and deepening of interregional forums such as APEC, FEALAC, IBSA, and BRICS.<sup>1</sup> There have also been efforts at cooperation between LAC and Asia and the Pacific economies in international forums such as the UN, WTO, and G-20. Despite these developments, such trans-Pacific linkages are in many cases a quite recent phenomenon, and Asia and the Pacific–LAC relations remain less developed than each region’s engagement with other geographical regions. This late start, along with the economic dynamism and growing political clout of Asia

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<sup>1</sup> APEC is the Asia–Pacific Economic Cooperation; FEALAC is the Forum for East Asia–Latin America Cooperation; IBSA is the India, Brazil, South Africa Forum; BRICS refers to Brazil, Russia, India, PRC, and South Africa. Each of these initiatives is discussed in more detail later in the chapter.

and the Pacific<sup>2</sup> and LAC, suggest that opportunities for interregional cooperation should be increasingly numerous and beneficial.

This chapter will present the main rationale for Asia and the Pacific–LAC cooperation, mapping existing linkages between the two regions, and presenting a preliminary assessment of their effectiveness. It will conclude with policy recommendations for enhancing interregional cooperation. One of our key findings is the need for increased attention to these interregional linkages, including systematically studying their effectiveness. Cooperation in non-market areas often comes as an afterthought to trade and investment agreements, resulting in inefficiencies and duplications that hamper their effectiveness and deprive countries of potential benefits.

### **Why Asia and the Pacific–LAC cooperation? Some theoretical and practical reasons**

International relations theory offers several reasons why states may or may not choose to cooperate. Realists would argue that states join alliances in order to maximize their power vis-à-vis those that would threaten their interests. Liberal theorists reject this zero-sum interpretation and argue that cooperation brings mutual benefits that cannot be gained if states go it alone. A third viewpoint, known as constructivism, stresses the importance of ideas such as solidarity among developing economies as driving forces behind cooperation among states. We should keep these different perspectives on international cooperation in mind as we assess the state of Asia and the Pacific–LAC relations. They remind us that governments might pursue mutually beneficial cooperation at certain times and on certain issues, but in other cases act on the basis of perceived self-interest.

The motivation to cooperate often emerges from a conception of enlightened self-interest: by helping a neighbor, a country stands to gain in the long run through enhanced security or prosperity. Some form of this reasoning applies to the relationship between Asia and the Pacific and LAC today: by contributing to socioeconomic development and scientific and educational achievement across regions, economies potentially gain larger markets

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<sup>2</sup> Here, as earlier, we are referring primarily to the ASEAN economies plus People's Republic of China, India, Japan, and Republic of Korea.

for their products, more efficient suppliers for domestic industries, and key partners in the international arena.

There are reasons to believe that the two regions are particularly well suited for cooperation. Just as similar income levels tend to encourage trade, developing economies often have knowledge and experiences that are more directly relevant and transferable to other developing economies, because they face similar infrastructure constraints, market sizes, demographic profiles, and other factors that shape the policy environment (Kumar, 2008). This is a major impetus behind so-called “South–South cooperation,” which has gained increasing momentum in recent years. Given their respective profiles, LAC and Asia and the Pacific economies should have much to offer each other.

Cooperation is also stimulated by complementarities between developing economies with different areas of policy expertise. Many Asia and the Pacific economies have grown rapidly over the last couple of decades, driven by particular success in industrialization, export promotion, and building world-class education systems. LAC countries attempting to follow a similar path can glean valuable lessons from the Asia and the Pacific experience. For their part, several LAC countries have made great strides in poverty reduction over the past decade through conditional cash transfer policies; this experience could generate useful lessons for developing Asia and the Pacific economies with similar socioeconomic challenges.

The resilience both regions showed during the recent global economic downturn (combined with fiscal constraints in industrialized economies) provides another compelling reason for Asia and the Pacific–LAC cooperation. Cooperation, whether it takes the form of development aid, joint research initiatives, or participation in multilateral forums, requires resources. While resources for these activities will be increasingly scarce in the developed economies, the PRC, India, and Brazil are emerging as important providers of various forms of international cooperation.

Along with their growing economic stature, developing economies in Asia and the Pacific and LAC are increasingly producing new knowledge in areas such as science and technology. Thirty years ago, developing economies produced only about 5% of all scientific journal publications, with India and Argentina the only LAC or Asia and the Pacific economies among the top 25 (Gaillard, 2010). By 2006, developing economies were producing 20% of such publications; the PRC nearly doubled its share of the world total and Brazil increased its portion by 35% from 2001 to 2006 alone. Given these trends,

educational exchange and science and technology cooperation between LAC and Asia and the Pacific should be increasingly fruitful for both regions.

Finally, LAC and Asia and the Pacific economies have traditionally shared common views on international issues such as UN Security Council reform and the governance of multilateral institutions. New interregional blocs such as the BRICS grouping (Brazil, Russia, India, PRC, South Africa) and the IBSA Forum (India, Brazil, South Africa) attempt to translate these shared interests into effective action and provide a basis on which to deepen cooperation in international bodies.

As trade and investment linkages continue to grow, it will be important for the two regions to forge and deepen cooperation on a broader set of issues. There are likely to be challenges ahead in the economic relationship between LAC and Asia and the Pacific, including concerns about the sustainability of current trade patterns. Deeper cooperation, including on non-market issues, can help maintain good relations between the regions even as disputes arise on economic issues.

Despite potential gains from cooperation in non-market areas, there are often considerable practical barriers to realizing them. As mentioned earlier, cooperation implies costs—direct costs, especially in the case of aid; transaction costs; and opportunity costs for resource-constrained public institutions that are the main actors in international cooperation. In addition, theory cautions us that states respond to various factors and circumstances that may or may not foster cooperation.

One important countervailing force is the need to safeguard national competitiveness. If, for example, a domestic industry enjoys a comparative advantage in international markets, cooperation in the form of technology transfer would appear contrary to national interests, or at least the interests of the domestic industry involved. In other situations, as we will see in the PRC–Brazil case study, science and technology cooperation can lead to innovations that create new commercial opportunities for both sides. Creating the right incentives requires better understanding of the most effective areas, forums, and mechanisms for cooperation. An analysis of the existing modes of cooperation between Asia and the Pacific and LAC will be a step in this direction.

### **Bilateral cooperation: many angles, but a fuzzy picture**

Bilateral cooperation between Asia and the Pacific and LAC economies takes a variety of forms. One is development assistance, which includes financing

for economic and social projects, technical cooperation, debt relief, and humanitarian aid, carried out through grants or concessional loans. Other forms are agreements, treaties, memorandums of understanding, and other diplomatic linkages; and technical, educational, or scientific exchanges. In all of these areas, interregional cooperation appears to be on the rise, although measuring cooperation is challenging due to the shortage of clear metrics and lack of systematic analysis.

**Development cooperation.** Development cooperation between economies in Asia and the Pacific and LAC is an increasingly important component of bilateral relationships. It is also the area that offers the most quantifiable evidence of interregional cooperation. The trend here is clear: interregional development assistance has increased considerably in recent years and is overwhelmingly unidirectional, with Asia and the Pacific the source and LAC the recipient.<sup>3</sup>

The PRC has been the most dynamic player in this area, more than tripling its annual foreign assistance since 2001. In 2009, that economy provided US\$1.9 billion in overseas development assistance (ODA), around 13% of it going to LAC. This is a sizable portion given the PRC's traditional focus on Africa, which still accounts for around 45% of its aid (OECD, 2011a). According to the 2011 White Paper on People's Republic of China's Foreign Aid, the first such document published by the Chinese government, much of that economy's assistance to LAC has been directed at agriculture, infrastructure projects, and public works. Climate change mitigation and renewable energy projects will likely be increasing priorities for the PRC in LAC in the coming years. In addition, these figures do not include loans to LAC from China's Export-Import Bank, which often provides concessional lending on terms comparable to traditional development lenders. An analysis of

<sup>3</sup> There is no universally accepted standard for what qualifies as development assistance, and most analysis of South-South cooperation fails to distinguish between ODA and private or commercial financing. The OECD's Development Assistance Community (DAC) is a forum where OECD members and several other donors report ODA according to standardized criteria, but most LAC and Asia and the Pacific donors do not report to the DAC. The figures cited here come from the OECD's report on non-DAC assistance, based on the reports of individual countries' international cooperation agency or foreign ministries. Given the variation among these countries in defining and reporting ODA, these estimates likely underestimate the total amount of aid in several cases.

Chinese lending by Gallagher *et al.* (2012) suggests that China's Ex-Im Bank has provided around US\$1 billion to the region on concessional terms since 2009.

Despite the growth of Chinese aid, Japan remains the largest Asia and the Pacific source of bilateral development assistance to LAC. Japan's aid to the region, which amounted to over US\$750 million in 2010, is highly concentrated geographically, with 29% going to Brazil and 23% to Peru (OECD, 2011a; JICA, 2011). While LAC's share of Japanese aid is small at just over 5%, the region is gaining strategic importance for Japan. Development assistance will likely play a role in a broader strategy to boost the investment of Japanese firms in the region, especially in the areas of infrastructure and energy resources. Another feature of Japan's engagement with LAC has been participation in so-called triangular development cooperation. This mechanism, in which Japan and LAC partners jointly carry out development projects in third countries in the region, offers a promising way to leverage the expertise and resources of Asia and the Pacific donors and the regional knowledge and existing relationships of other LAC countries.

In addition to the big two, Republic of Korea provides about 10% of its bilateral overseas development assistance to the LAC region, which amounted to US\$64 million in 2010 (OECD, 2011a). Other donor economies, however, have not prioritized Asia and the Pacific–LAC development cooperation. India has a long-standing foreign aid program, including a well-regarded technical training institute for foreign officials, in which 159 countries have participated, including several from LAC (MEA, 2011). But LAC has been only a marginal destination for Indian bilateral aid thus far.

Brazil has focused its growing aid programs within LAC and has not been a significant source of bilateral development assistance for Asia and the Pacific economies, with the exception of Portuguese-speaking East Timor.<sup>4</sup> Other LAC countries maintain bilateral international cooperation programs, but their focus is almost exclusively intraregional. The Argentine Fund for Horizontal Cooperation, for example, carries out economic and social development projects, but only 0.1% of its support through 2005 went to East Asia. Venezuela has been a major source of international cooperation,

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<sup>4</sup> However, Brazil has worked with Japan as a donor in the region through the Japan–Brazil Partnership Program, an example of triangular cooperation.

providing over US\$1 billion during 2006 in the form of oil aid, but its efforts have likewise focused on the LAC region (UNECOSOC, 2008).

Despite the intraregional focus of most LAC and Asia and the Pacific donors, development cooperation between the two regions is significant and offers considerable growth potential. For one, fast-growing economies such as Brazil, PRC, India, and Republic of Korea are likely to join Japan as major actors in development assistance. Secondly, the concept of South–South development cooperation is gaining traction among both recipients and providers as well as in multilateral organizations, driven by the belief that developing economies often have better insights into their peers’ development needs and that such linkages are mutually beneficial.<sup>5</sup> In addition, ODA can facilitate other forms of cooperation, such as joint research initiatives, creating opportunities for ongoing relationships and spill-over into other areas (see Box 1). Finally, given the great intraregional disparities in both LAC and Asia and the Pacific, many economies have a significant need for development assistance to meet their development objectives. As a result, there is both demand and supply for interregional development cooperation.

Steps should be taken at the national, regional, and multilateral levels to enhance the effectiveness of development cooperation between Asia and the Pacific and LAC economies. The idea that developing economies enjoy comparative advantages in the provision of development assistance is a major rationale for South–South cooperation. Governments should therefore identify areas of comparative advantage and focus efforts where there is corresponding demand. Likewise, recipient governments can facilitate efficient South–South development cooperation by defining strategic aid priorities, assessing the comparative advantages of aid providers, and articulating specific financing and project needs.

**Agreements, memorandums of understanding, and technical cooperation.** Diplomatic relations between Latin America and Asia and the Pacific have accelerated over the past decade, as the regions’ economies have grown increasingly intertwined. These exchanges have spawned numerous initiatives and agreements, of varying degrees of formality, on issues ranging

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<sup>5</sup> The Brazilian Foreign Ministry, for example, in describing its objectives for SSDC, rejects its characterization as “aid,” preferring “horizontal cooperation, a partnership in which both parties benefit.”

**Box 1 • Institutional Arrangements in Japan–Peru Cooperation on Natural Disaster Mitigation**

Japanese and Peruvian research institutes in 2010 launched a joint project to investigate tsunami and earthquake mitigation strategies in Peru. The project is being carried out through the Science and Technology Research Partnership for Sustainable Development (SATREPS), an innovative cooperation mechanism through which the Japanese International Cooperation Agency (JICA) and Science and Technology Agency (JST) sponsor international joint research projects on issues of global relevance. Under the SATREPS framework, JICA provides technical cooperation to developing economy research institutes, while JST supports Japanese researchers to partner on specific projects.

The “Enhancement of Earthquake and Tsunami Disaster Mitigation Technology in Peru” project envisions a series of research activities over five years, culminating in the implementation of earthquake and tsunami mitigation strategies in three locations in Peru. The project will also produce general knowledge and technical capacity that will be applicable to other Pacific Rim nations facing similar threats.

Although still in the first stages of implementation, the project has several notable strengths in its conceptualization and institutional framework. First, the cooperation entails a detailed action plan with concrete deliverables, in which sites for the implementation of disaster mitigation techniques are already identified. Secondly, the project enjoys robust institutional support from the SATREPS framework, which brings together several key Japanese ministries. This ensures that the projects chosen are aligned both with the priorities of Japanese science as well as with international cooperation and broader foreign policy goals.

Perhaps most critically, the project targets an area with special potential for cooperation between LAC and Asia and the Pacific. For one, there is strong demand given the vulnerability of both Peru and Japan (and their Pacific Rim neighbors) to earthquakes and tsunamis. It is also a field where international cooperation might be especially fruitful. Case study research on earthquakes requires a large amount of data, and collaboration between countries with similar earthquake dynamics can enhance research opportunities. Finally, natural disaster mitigation remains an area with little commercial potential, which shields cooperation efforts from concerns over competitive advantage at the national or firm level.

*Sources: Yamazaki et al. (2010); <http://www.jst.go.jp/global/english/index.html>*

Table 1 • Selected Agreements and Memorandums of Understanding between Asia and the Pacific and LAC, 2010–2011

	People's Republic of China (PRC)	India	Japan	Republic of Korea	Singapore
Argentina	<ul style="list-style-type: none"> <li>• PRC–Argentina Economic and Trade Working Group</li> <li>• PRC–Argentina Joint Committee on Agriculture</li> <li>• Renewal of Strategic Partnership</li> </ul>	<ul style="list-style-type: none"> <li>• MoU on Agriculture and Allied Sectors</li> <li>• Agreement for Cooperation on Peaceful Uses of Nuclear Energy</li> </ul>		<ul style="list-style-type: none"> <li>• MoU on Cooperation in Agriculture</li> </ul>	
Bolivia				<ul style="list-style-type: none"> <li>• Framework Arrangement on loans from Economic Development Cooperation Fund</li> <li>• MoU on Lithium Industrialization R+D<sup>a</sup></li> </ul>	
Brazil	<ul style="list-style-type: none"> <li>• Joint Action Plan, 2010–2014</li> <li>• Second PRC–Brazil Strategic Dialogue</li> <li>• MoU on the Application Policy of Data and Images produced by the PRC–Brazil Earth Resources Satellite</li> </ul>	<ul style="list-style-type: none"> <li>• India–Brazil Strategic Partnership</li> </ul>		<ul style="list-style-type: none"> <li>• Establishment of virtual laboratories in Seoul and Brasilia</li> <li>• MoU on Data Processing</li> </ul>	
Chile	<ul style="list-style-type: none"> <li>• Agreement on Trade in Services of PRC–Chile FTA</li> <li>• Action Plan for Commission on Science and Technology Cooperation signed</li> <li>• Cooperation documents on finance and quality inspection</li> <li>• Cooperation documents on S+T<sup>b</sup> and education</li> </ul>	<ul style="list-style-type: none"> <li>• Protocols for Cooperation in Agricultural Sector</li> </ul>			
Colombia	<ul style="list-style-type: none"> <li>• Economic and Technical Cooperation Agreement</li> <li>• 2011–2014 Executive Program for Education Cooperation</li> <li>• MoU to Facilitate Group Traveling of Chinese Tourists to Colombia</li> </ul>		<ul style="list-style-type: none"> <li>• Agreement on the Liberalization, Promotion and Protection of Investment</li> </ul>	<ul style="list-style-type: none"> <li>• Agreement on Double Taxation Convention on Financial Cooperation</li> </ul>	

*(continued on next page)*

**Table 1 • Selected Agreements and Memorandums of Understanding between Asia and the Pacific and LAC, 2010–2011 (continued)**

	People's Republic of China (PRC)	India	Japan	Republic of Korea	Singapore
Costa Rica	<ul style="list-style-type: none"> <li>• PRC–Costa Rica Free Trade Agreement</li> </ul>				<ul style="list-style-type: none"> <li>• Singapore–Costa Rica FTA</li> </ul>
Ecuador	<ul style="list-style-type: none"> <li>• Treaty on Economic and Technological Cooperation</li> <li>• Executive Plan of Cooperation in Science and Technology</li> <li>• Cooperation document on oil trade finance with PRC Ex-Im Bank and PetroEcuador</li> </ul>			<ul style="list-style-type: none"> <li>• Signed Arrangement for Electronic Customs Clearance System using Korean technology</li> </ul>	
Mexico	<ul style="list-style-type: none"> <li>• 2011–2015 Joint Action Program</li> <li>• Agreement on Mutual Recognition of Certificate of Studies, Diplomas and Degrees</li> <li>• Civil Aviation Transportation Agreement</li> <li>• MoU on establishing the Permanent Forum on Parliamentary Dialogue</li> </ul>	<ul style="list-style-type: none"> <li>• MoU on Cooperation on Agriculture Research and Development</li> </ul>	<ul style="list-style-type: none"> <li>• Protocol to amend agreement on strengthening Economic Partnership</li> </ul>		
Peru	<ul style="list-style-type: none"> <li>• PRC–Peru Free Trade Agreement</li> </ul>	<ul style="list-style-type: none"> <li>• Protocol of Cooperation in Science and Technology</li> </ul>	<ul style="list-style-type: none"> <li>• Economic Partnership Agreement signed</li> </ul>		
Uruguay	<ul style="list-style-type: none"> <li>• Economic and Technical Cooperation Agreement</li> </ul>		<ul style="list-style-type: none"> <li>• MoU on Cooperation between S+T ministries</li> </ul>	<ul style="list-style-type: none"> <li>• Agreement for Cooperation in Renewable Energy</li> </ul>	

Source: Asia and the Pacific's and LAC's Ministries of Foreign Affairs.

<sup>a</sup> Research and Development.

<sup>b</sup> Science and Technology.

from education to agriculture, space exploration, promotion of small- and medium-sized enterprises, tourism, and cultural exchange. Table 1 shows a selection of agreements reached since 2010 alone. While the list is not exhaustive, it indicates major trends in terms of actors and areas of interest.

Have these numerous treaties, agreements, memorandums of understanding, and protocols actually led to increased cooperation between the actors involved? It is impossible to exhaustively assess these arrangements, but we can venture some preliminary observations.

In the first place, mechanisms such as memorandums of understanding (MoUs), with their generally weak institutional underpinnings and lack of concrete objectives and funding arrangements, are often more statements of intention than credible commitments to cooperate (Moreira, 2010). One potential way to increase institutional support for cooperation is to incorporate such measures into free trade agreements. FTAs usually receive high-level political and institutional attention and include mechanisms to track progress. By folding initiatives in areas like education and science and technology into FTAs, governments might increase the chances that their good intentions produce concrete results. The Japan–Mexico Economic Partnership Agreement, which contains a chapter on cooperation included at the behest of Mexican negotiators, has led to dozens of joint projects in eight different areas including agriculture, SME promotion, and tourism (ECLAC, 2010a). Indeed, language on broader cooperation has been a feature of many FTAs reached among ASEAN economies and between ASEAN and other partners in Asia and the Pacific. Banda and Whalley (2005) suggest that these commitments to cooperate, even if vaguely defined in terms of intended outcomes, still serve to bring governments into a deeper process of consultation and dialogue.

Of the FTAs recently concluded between LAC and Asia and the Pacific, about half contain sections on cooperation, including some institutional mechanism for implementation. In addition, many Asia and the Pacific–LAC FTAs cover so-called “deep integration” issues such as competition policy, procurement, and customs procedures (see chapter 2 for a discussion of these issues). Enforcement of these provisions often benefits from countries working in tandem, for example through information sharing, coordination, and capacity building activities between relevant national agencies. Most of the FTAs signed between the two regions include cooperation on at least one deep integration issue (see Table 2).

**Table 2 • Cooperation Chapters in Asia and the Pacific–LAC FTAs**

Agreement	Chapter on Cooperation	Areas of Focus	Cooperation on “New Issues”
Republic of Korea–Chile FTA (2004)	No	N/A	Customs Procedures, Procurement, Competition
Panama–Taipei, China (2004)	No	N/A	Customs Procedures, Competition
Taipei, China–El Salvador–Honduras (2005)	Yes	SMEs, energy, agriculture, industrial development	Customs Procedures
Japan–Mexico (2005)	Yes	SMEs, science and technology, technical and vocational education and training, intellectual property, agriculture, tourism, and environment	Customs Procedures, Competition
Panama–Singapore (2006)	No	N/A	Customs Procedures, Procurement, Competition
Chile–People’s Republic of China (2006)	Yes	Economic cooperation; research, science and technology; education, labor, social security and environment; SMEs; culture; intellectual property; mining and industry	
Taipei, China–Guatemala (2006)	Yes	SMEs, agriculture, industry, tourism, energy, transport, technical barriers to trade	
Japan–Chile (2007)	No	N/A	Customs Procedures, Competition
India–Chile (2007)	No	N/A	
Taipei, China–Nicaragua (2008)			Customs Procedures
Peru–Singapore (2009)	No	N/A	Customs Procedures
People’s Republic of China–Peru (2010)	Yes	Education, SMEs, S+T, culture, tourism, fisheries, minerals, others	Customs Procedures, Competition
Peru–Thailand (2011)	No	N/A	Customs Procedures
Republic of Korea–Peru (2011)	Yes	Education, SMEs, S+T, culture, tourism, fisheries, minerals, others	Customs Procedures, Procurement, Competition
Costa Rica–People’s Republic of China (2011)	Yes	SMEs, competitiveness, S+T, agriculture, culture and sports	Customs Procedures, Competition

Source: Authors’ review of trade agreements.

A second observation has to do with the methodology for determining the effectiveness of cooperation initiatives. For example, what criteria could be used to assess an MoU in the area of science and technology? A starting point would be to see whether there were any concrete follow-up activities such as seminars, joint research initiatives, and exchanges between academic or research institutions. Even on this most basic level, results from recent Asia and the Pacific–LAC initiatives appear to be mixed. While a 2010 agreement between the PRC and Chile on science and technology cooperation led to a series of seminars with scientists from both countries in 2011, other recent agreements have resulted only in plans to carry out expert visits or create commissions, but no real action.<sup>6</sup>

Even in cases where agreements have formed the basis for active cooperation, a lack of data makes it difficult to assess their impact. One method of measuring progress in international cooperation in science and technology is to track the number of papers coauthored by researchers of different nationalities. Using this approach, Gupta and Singh (2004) found that technical and scientific papers produced jointly by Indian and LAC scientists nearly doubled during the 1990s. More systematic study of efforts at cooperation is needed to understand their potential and to help governments make the most of these initiatives.

A third observation concerns the need for sustainability to ensure the success of cooperation efforts. A joint Chinese–Brazilian venture to launch a satellite has been ongoing since 1988 and continues to produce knowledge and technical innovation, including recent commercial applications (see Box 2). The example shows how cooperation—even in sensitive areas—is possible when incentives align and financial resources are available. However, a serious investment in time was needed for the project to bear fruit. That some recent MoUs between LAC and Asia and the Pacific have yet to be acted on points to the inherent difficulty in sustaining cooperative initiatives for resource- and time-constrained public agencies.

**Education and cultural exchange.** The growing internationalization of higher education offers another space where governments can cooperate. While

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<sup>6</sup> In 2010, Peru and India signed a Protocol of Cooperation in Science and Technology that laid out plans for an exchange of scientists in the coming year; however, a proposal by the Peruvian government for the visit is still awaiting response. The PRC and Argentina formed a Joint Committee on Agriculture, also in 2010, but the Committee does not appear to have been active since then.

**Box 2 • People's Republic of China–Brazil Earth Resources Satellite (Cbers)**

In 1988, the PRC and Brazil signed a partnership between the Brazilian National Space Research Institute and the Chinese Academy of Space Technology to develop two satellites that would provide images of remote areas of Brazilian and Chinese territories. The impetus for the Protocol on Research and Production of the Earth Resources Satellite sprung partly from restrictions in developed economies on the transfer of certain technologies, due to the military applications of space technology.

At the time, the PRC and Brazil had begun to ramp up space research, with the goal of developing industrial applications. They also had a keen interest in exploring vast non-populated areas with great agricultural and environmental potential. The agreement called to pool financial and technological resources and areas of relative expertise in a total investment of over US\$300 million.

Cbers-1 was launched in 1999 and remained in orbit until 2003, two years longer than originally planned. Cbers-2, technically identical to the original, took orbit in 2003. During their lifetime, the satellites have generated daily images and collected environmental data on Brazilian and Chinese territories that has been used in agriculture, forestry, water conservation, land utilization, and resource and environmental investigation and that has informed projects on water and gas transmission in the PRC. The success of the Cbers satellites has provided the PRC and Brazil with new-found capacity to gather critical earth resource information for their territories, and to independently produce remote sensing imagery for the first time.

Building on the success of the first satellite, the PRC and Brazil signed a new protocol for space cooperation in 2002, including the creation of a third and fourth

*(continued on next page)*

the main actors are students who pursue educational opportunities abroad, universities increasingly cooperate across borders, for example by offering joint degrees with foreign institutions. For governments, international linkages in education and research offer the potential to facilitate the development of human resources and create strategic alliances and bilateral or regional relationships that can hone a competitive edge, build up key national institutions, and develop cultural and social mutual understanding across borders (De Wit *et al.*, 2005).

In education, the Asia and the Pacific–LAC connection is still in its infancy. In a comprehensive 2005 report on the internationalization of education in LAC, links with the Asia and the Pacific region barely appeared (De

generation of Cbers and other types of satellites. Brazil was in a position to contribute more technical resources and assume more operational control by the time of the signing of the 2002 protocol, thanks to its experience in the project's first stage.

The 2002 protocol also laid out a more concrete framework to guide the initiative, creating a Coordination Committee with a dispute settlement mechanism. It also expanded the agreement to include preferential treatment for firms from each country to supply parts, services, and equipment for the project. The agreement also addresses the often contentious area of commercialization, reflecting that the project had advanced to the point where the images produced and intellectual property developed had potential commercial value. However, only broad principles regarding commercialization, rather than specific rules, were put forth. The launch of Cbers-3 is scheduled for the first half of 2012, with an expanded mission that includes imaging Africa. Plans to continue the cooperation include the development of new investigation and monitoring satellites through 2020.

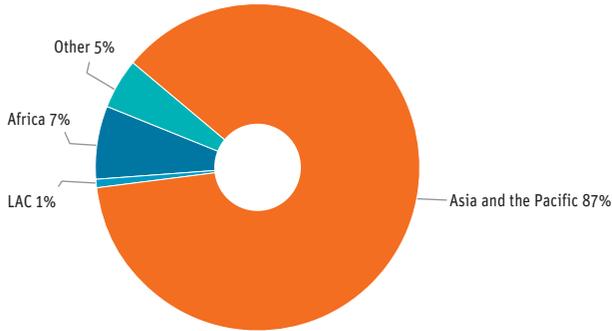
The Cbers project shows that opportunities for cooperation can provide tangible benefits for each side. The key to its success seems to have been locating a niche where commercial or competitive pressures were not at odds with the cooperation agenda (although, interestingly, the cooperation created commercial opportunities later on). Another important element was the presence of complementary areas of expertise in the face of barriers to technology and knowledge transfer by traditional space powers.

*Source:* Zhao (2005).

Wit *et al.*, 2005). Figures on the international mobility of students at the tertiary level (undergraduate and graduate) show that students from LAC and Asia and the Pacific make up a very small percentage of total international students in each other's respective universities, although Asia and the Pacific students have a larger presence in LAC universities than the other way around (see Figures 1 and 2).

This is perhaps not surprising in light of the obstacles posed by geography and language. However, efforts to overcome these obstacles might open up significant opportunities for mutually beneficial cooperation, in addition to forging closer cultural bonds. Indeed, interest in the PRC does appear to be rising among LAC students. In Argentina, growing demand for scholarships

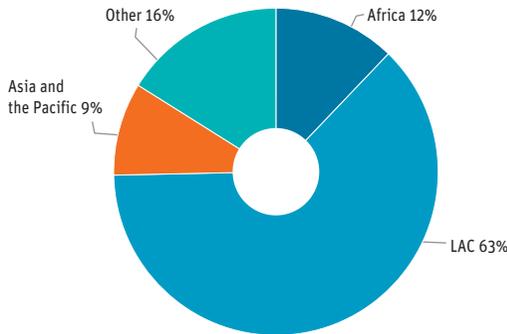
**Figure 1 • International Students in Asia and the Pacific by Region of Origin (Tertiary Level)**



Total International Students = 270,879

Source: UNESCO Institute for Statistics.

**Figure 2 • International Students in LAC Countries by Region of Origin (Tertiary Level)**



Total international students = 56,508

Source: UNESCO Institute for Statistics.

to study in the PRC has led to the signing of cooperation agreements between several Argentine and Chinese universities.

Interestingly, the LAC and Asia and the Pacific regions are at opposite ends of the spectrum when it comes to internationalization of education. A recent paper that examined institutional support for international education in LAC found a lack of strategic planning and institutional capacity to effectively incorporate the international dimension (Lopez *et al.*, 2011). Given the diversity of actors that play a role in the internationalization of education,

including education ministries, foreign ministries, science and technology ministries, international cooperation agencies, and academic and research institutions themselves, having a strategy that defines roles is likely to be key.

Asia and the Pacific, on the other hand, has been a pioneer in cross-border education. In 2009 students from the Asia and the Pacific region represented a full 52% of all students enrolled internationally, by far the largest regional share (LAC's was 6%) (OECD, 2011b). Student mobility is just one indicator of internationalization of education, however. Bashir (2007) presents data on the number of foreign affiliate campuses or joint programs operating in developing economies. The Asia and the Pacific economies included averaged 334 per country; in LAC, the figure stood at 22.<sup>7</sup> The differing degree of international integration in the education sector suggests potential lessons for LAC on the strategies and policy levers employed by Asia and the Pacific economies.

Finally, there seems to be an opportunity for greater cultural exchange between the two regions. Despite admiration of PRC's economic success, there appears to be limited knowledge in LAC about Asian culture, and vice versa. The PRC has deliberately incorporated cultural diplomacy into its foreign policy, most prominently through the opening of Confucius Institutes that teach Chinese language and culture abroad. Twenty-one institutes currently operate in 10 LAC countries. Expanding and deepening this type of exchange—especially in the area of language instruction—could facilitate educational and research linkages and lay the basis for deeper future cooperation.

### **Multilateral interregional groupings: a crowded field**

Beyond bilateral linkages, economies in Asia and the Pacific and LAC have joined a number of interregional multilateral forums with varying objectives, institutional mechanisms, and actors. Some pursue a traditional free trade agenda of reducing trade barriers and integrating markets. Others emphasize non-market forms of cooperation. Some are squarely oriented towards the Asia and the Pacific–LAC space, while forums such as the India–Brazil–South Africa (IBSA) grouping intend to engage outwardly on global issues.

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<sup>7</sup> The economies included in these figures are the PRC, Hong Kong, China, Singapore, Malaysia, Philippines, Viet Nam, Thailand, and India in Asia and the Pacific; and Argentina, Chile, Colombia, and Mexico in LAC.

In general, we might expect interregional groupings to have certain advantages and disadvantages vis-à-vis bilateral cooperation. On the positive side of the ledger, regional groupings have the potential to enable smaller, less developed economies to share in the benefits of cooperation. As we saw in the preceding section, the most successful bilateral initiatives have involved the biggest economies—the PRC, Brazil, India, Japan, and Mexico—which have the most resources to share and the greatest capacity to invest in maintaining cooperation. Regional cooperation can address the power asymmetries inherent in bilateral relations between giants such as the PRC, India, and Brazil, and the smaller nations in both regions. Interregional groupings also offer the potential to scale up cooperation efforts by bringing more resources and technical capacity to the table. On the other hand, precisely because they involve more actors, interregional cooperation initiatives can be more complex to negotiate and coordinate, and entail higher transaction costs than bilateral arrangements.

As with bilateral arrangements, interregional cooperative efforts between Asia and the Pacific and LAC have multiplied in recent years. This reflects not only the realization of their importance for governments on both sides of the Pacific, but also the growing frustration of some governments with existing groupings and with the lack of progress in international forums such as the WTO. In light of this growth, it is important to look closely at these efforts and attempt to parse out which have been effective, why, and where future efforts should focus.

**Asia–Pacific Economic Cooperation (APEC).** The Asia–Pacific Economic Cooperation (APEC) is the most prominent interregional bloc. Created in 1989 to promote economic cooperation between ASEAN<sup>8</sup> states and key trading partners in Asia, APEC has since expanded into a broad forum for promoting trade deals and economic integration among its 21 members, which now include Mexico, Peru, and Chile from LAC. While APEC’s primary objective is to facilitate trade and investment liberalization, economic and technical cooperation—known in APEC circles as ECOTECH—has been a part of the forum’s work since its inception. The ECOTECH framework encompasses mechanisms

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<sup>8</sup> ASEAN consists of Brunei Darussalam, Cambodia, Indonesia, Lao People’s Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam.

for cooperation in areas such as energy, science and technology, health, agriculture, and anticorruption.

APEC has a well-developed institutional framework, with a permanent, albeit small, secretariat and working groups in the thematic areas mentioned above, as well as those that fall under the ECOTECH agenda. Each working group has targeted action plans, implementation frameworks, and medium-term priorities. Annual member contributions supported US\$22 million in financing for over 100 projects during 2009–2010 ([www.apec.org](http://www.apec.org)).

How useful are these initiatives? Many assessments of APEC's effectiveness have been carried out, including independent evaluations of its working groups. While these provide imperfect indicators,<sup>9</sup> a common theme is that APEC's efforts in economic and technical cooperation would benefit from more strategic direction, and too often reflect the agenda of more advanced economies. In addition, a look at the nature of APEC programming on ECOTECH topics suggests that most take the form of one-off seminars, training sessions, and conferences, which makes it unclear whether there are sustained efforts throughout the year.<sup>10</sup> In other areas, such as trade facilitation, APEC has had success in bringing members into closer cooperation on issues that extend beyond traditional trade policy. Examples include streamlining visa procedures for business travelers and sharing information among members' national authorities on data privacy to protect e-commerce.<sup>11</sup> These initiatives and others implemented under APEC's Second Trade Facilitation Action Plan are estimated to have reduced transaction costs by 5% between 2007 and 2010 (PSU, 2012).

Although APEC brings strengths and weakness as a forum for interregional cooperation, one fundamental weakness is its limited geographical coverage in LAC. With only Mexico, Peru, and Chile participating, the group is overwhelmingly Asia-centric. A moratorium on new members through

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<sup>9</sup> For one, many evaluations rely on surveys in which the number of respondents is small.

<sup>10</sup> Part of the reason for this is that APEC is not a capacity-building institution per se, although working groups do organize capacity-building activities related to their agendas.

<sup>11</sup> The APEC Business Travel Card (ABTC) allows card holders pre-cleared entry to participating APEC economies. The APEC Cross-Border Privacy Enforcement Arrangement (CPEA) provides a mechanism for privacy enforcement authorities to share information and provide assistance for cross-border data privacy enforcement.

2010, combined with increased political wrangling over whether to expand, have frustrated the ambitions of interested countries such as Colombia, Costa Rica, and Ecuador.

**Forum for East Asia–Latin America Cooperation.** The Forum for East Asia–Latin America Cooperation (FEALAC) is an organization made up of 34 LAC and Asian states, created in 1998. In contrast to APEC, FEALAC’s primary aim is to foster economic and political cooperation in a variety of policy areas, including education, science and technology, innovation, and poverty reduction. It does not explicitly seek to liberalize trade relations or promote economic integration between the regions. Given its broader geographical coverage, FEALAC has the potential to be the basis for more inclusive regional cooperation. In addition, its primary focus on non-market cooperation issues could give it a comparative advantage in this area. In APEC, by contrast, ECOTECH has been seen by observers as overshadowed by the trade and investment agenda (Krongkaew, 2003).

On the other hand, FEALAC has weaker institutional underpinnings than APEC, with no permanent secretariat and ministerial-level meetings held only every three to four years (in APEC, heads of state meet annually). A possible advantage of this institutional structure could be less bureaucracy and greater flexibility, for example in shifting more of FEALAC’s work online. Despite these potential benefits, there is evidence that the forum has suffered from a lack of commitment and attention from some members. Key initiatives, such as support for small- and medium-sized enterprises (SME), identified as a priority area since 2002, show few tangible results to date.<sup>12</sup> An online secretariat—an essential tool for a grouping of 34 geographically dispersed economies—was only set up in 2011. During the group’s Senior Officials Meeting in 2010, the delegates took steps to address these concerns, adopting a strategy to increase awareness and generate stronger commitment among members (FEALAC, 2010). The strategy has given birth to a FEALAC Vision Group, charged with raising the forum’s profile. It is still unclear whether FEALAC will emerge as a robust forum for interregional cooperation.

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<sup>12</sup> In the area of SME promotion, several workshops and studies have been carried out, but more robust, consistent mechanisms, such as a proposal to create a bi-regional network of SME support centers, have yet to be realized.

### *A pair of new groupings*

As older interregional blocs struggle to define their roles, a pair of new multilateral groupings have emerged that reflect the growing international clout of the two regions' largest economies. The India–Brazil–South Africa (IBSA) Forum and the Brazil–Russia–India–PRC–South Africa (BRICS) grouping each provide new opportunities for cooperation between LAC and Asia and the Pacific economies. First, the forums have allowed for direct dialogue and exchange of knowledge among the economies involved. Secondly, in the case of IBSA, technical and economic cooperation programs in areas such as agriculture, infrastructure, and institutional strengthening are carried out in less-developed economies through the IBSA Fund, making the bloc an increasingly important venue for South–South cooperation. Finally, to the extent that many Latin American and Asia and the Pacific economies have shared interests vis-à-vis international bodies such as the UN, WTO, and G-20, both IBSA and BRICS can lend a powerful voice to those views. This final point will be taken up in more detail in the next section.

IBSA seems to have established itself as an effective vehicle for cooperation between LAC and Asia and the Pacific (and Africa). The grouping has developed a solid institutional underpinning, with a clear framework for proposing and monitoring cooperation initiatives, and thematic working groups in 16 areas, including education, social development, culture, and defense. Over a dozen memorandums of understanding and agreements have been signed between the three governments, and civil society, academic, and business summits regularly take place on the sidelines of IBSA meetings. In addition, the participants contribute an annual US\$1 million each to the IBSA Fund, which finances development projects in Africa, LAC, and Asia and the Pacific. The BRICS members held their first official meeting in 2009 (before South Africa joined the following year), and their leaders have met annually since then. During the 2012 summit, BRICS leaders announced plans to formalize the grouping and create permanent BRICS institutions, including a jointly-run development bank. Other initiatives to deepen cooperation among the BRICS members include an agreement to extend domestic currency loans to fellow members.

**Trans-Pacific Partnership.** At the same time, new options for interregional integration continue to appear. The Trans-Pacific Partnership (TPP), which builds on an existing FTA among Chile, Singapore, Brunei Darussalam, and

New Zealand, now includes Peru, Malaysia, and Viet Nam, in addition to the USA and Australia. All of them are currently negotiating towards a state-of-the-art trade agreement that would go further than any existing agreement by covering issues such as state-owned enterprises and government procurement. In late 2011, Mexico, Japan, and Canada all expressed interest in joining the TPP, which would boost the bloc's economic and political heft considerably.

At this stage, it is hard to assess the TPP's potential as a facilitator of non-market cooperation. On one hand, its stated intention of delving into behind-the-border issues that touch on domestic policy could present ample opportunities for technical cooperation and knowledge exchange. However, the comprehensiveness of the proposed agreement has already raised concerns among domestic constituencies in some member countries.

**Latin America's emerging "Pacific bloc."** Countries along Latin America's Pacific Rim, recognizing the strategic opportunity that geography has endowed them with, are taking steps to increase their own integration and cooperation with an eye towards deepening ties with Asia and the Pacific. The Latin American Pacific Basin Initiative (ARCO) was launched in 2006 by 11 LAC countries,<sup>13</sup> and has hosted a series of ministerial meetings with delegations from Japan, Republic of Korea, the PRC, and other Asia and the Pacific economies. Similarly, in 2011, the presidents of Mexico, Colombia, Chile, and Peru announced the Pacific Accord, which proposes an alliance to further integrate their economies with the aim of improving competitiveness in Asia and the Pacific markets. The three South American partners, Colombia, Chile, and Peru, went a step further by integrating their stock markets through the Integrated Market of Latin America, which allows investors in any one country to trade companies listed in the other two. It is clear that countries on LAC's Pacific coast have their sights set squarely on Asia and the Pacific. What is less clear is whether these emerging groupings will become major actors in interregional relations.

A final and related point is the potential for synergies between regional integration processes on either side of the Pacific and interregional cooperation. Through forums such as ASEAN and APEC, Asia and the Pacific economies are pursuing an ambitious integration agenda that goes beyond market integration to include efforts to simplify customs procedures,

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<sup>13</sup> Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, and Peru.

enhance investment protections, improve intellectual property protection, and ease border crossings. Stronger institutional underpinnings for intra-regional integration in LAC, which lags behind Asia and the Pacific in this regard, should facilitate cooperation between the two regions by providing a LAC counterpoint to Asia and the Pacific regional institutions and creating opportunities to scale up cooperative initiatives at the national level.

### **Asia and the Pacific—LAC cooperation on the global stage**

In the current international context, LAC and Asia and the Pacific are well-positioned—perhaps more so than ever before—to advance concrete initiatives on key global issues such as international financial regulation, climate change, and the governance of multilateral institutions. The rise of the G-20—with seven additional members from LAC and Asia and the Pacific<sup>14</sup>—to effectively replace the G-7/8 confirms the importance of these new voices in the global decision-making apparatus. Given the sheer economic, demographic, and strategic weight of the new Asia and the Pacific and LAC powers, their support will be necessary for any new international agreement to hold water.

What are the two regions' shared interests? Certainly a major area of common ground lies in reforming the governance structure of the main international organizations. LAC and Asia and the Pacific have consistently pressed to have voting shares at the IMF to better reflect global economic realities, winning a 5% shift in voting shares to emerging market economies since 2008. Brazil and India have also led a charge to reform the UN Security Council, an objective articulated at the outset of the IBSA Forum in 2003. Each country has supported the other's bid for a permanent seat, although here they have met resistance from the PRC, among others. Evidently, cooperation has its limits. To the extent that bigger economies like the PRC, India, and Brazil attain the status and prerogatives of "global powers," they may view differently attempts to further reform global governance, South–South solidarity notwithstanding.

Creating a more robust global financial regulatory framework is certainly in the best interests of the two regions, given their increasing integration with global financial markets. On this front, LAC and Asia and the Pacific both have a stake in improving the capacity of the IMF to monitor systemically important

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<sup>14</sup> Argentina, Brazil, PRC, India, Indonesia, Republic of Korea, and Mexico, which join Japan, a member of the original G-7.

economies such as the US and the EU and to assess currency misalignments and macroeconomic imbalances. Another important shared interest lies in strengthening global financial safety nets, an area where enhanced coordination is critical. Of course, the currency issue is another persistent point of contention between the PRC and many of its LAC and Asia and the Pacific counter-parts.

Multilateral trade negotiations are another area where cooperation and conflict have coexisted between the two regions. At times, governments from the two regions have joined forces, for example in successfully opposing the US and EU proposal for the 2003 Doha Round of negotiations. The WTO has also been a venue for airing LAC countries' concerns over the PRC's economic power. The region brought the greatest number of antidumping proceedings against the PRC since the latter's WTO accession in 2001 (Dominguez, 2006). In general, over half of LAC countries' antidumping complaints between 2006 and 2011 have been directed against Asia and the Pacific economies (the reverse is not true). The WTO activities point to the potential for asymmetries in the economic relationship between LAC and Asia and the Pacific to lead to political tensions.

## Conclusions and recommendations

What can we learn from this broad picture of Asia and the Pacific–LAC cooperation? First, a caveat is in order. Given the wide range of activities, institutional arrangements, and areas of interest considered in this chapter, in addition to the lack of information in many instances, we cannot draw systematic conclusions. Rather, it is our intention to make some general observations that should inform policy decisions with respect to future interregional cooperation.

**More formal study of non-market cooperation is needed.** Lack of information presents a consistent obstacle to assessing the effectiveness of non-market cooperation between the regions. While governments participate in a bewildering range of treaties, bilateral agreements, and multilateral forums—not to mention linkages forged directly at the institutional level—there has been little systematic study of the outcomes of such arrangements. In the absence of hard evidence, analysts often fall back on common perceptions that cooperation consists of more rhetoric than action and is hampered

by excessive bureaucracy and confusing, duplicative institutional arrangements. While there is some truth behind these critiques, the examples of successful, mutually beneficial cooperation show what is possible under the right circumstances. The existence of these successes calls for more attention to these issues in order to better understand the potential benefits and how they can be obtained most effectively.

### **Coordination and strategic planning among various institutions are key.**

A main takeaway from this discussion is that international cooperation initiatives involve a wide range of actors, who might be unaccustomed to working together. At the national level, actors include foreign ministries, international cooperation agencies, national development banks or export–import banks, and ministries in such areas as education, science and technology, and energy. Add to this mix the presence of counterparts in the foreign governments and, potentially, multilateral institutions, and it becomes clear that good coordination across institutions is key to successful cooperation initiatives.

At the national level, governments must have a strategic plan for cooperation that encompasses the various forums in which they participate and helps define the role of national institutions. A more systematic approach at the national level would allow governments to be more pragmatic and results-oriented about their goals, and also potentially help measure progress by establishing concrete objectives.

### **Trade agreements can be a stepping stone to broader cooperation.**

We have discussed several examples where traditional trade agreements have provided the basis for concrete cooperation in policy areas a step or two removed from trade, such as visa procedures and data privacy, as well as education and human resource development, agriculture, and science and technology. This has occurred through both bilateral arrangements such as the Economic Partnership Agreement between Japan and Mexico, as well as in regional forums like APEC. Linking cooperation initiatives to existing or emerging trade agreements makes sense for several reasons. First, there are clear synergies between trade agreements and cooperation. This is especially true of the range of policies considered under the aegis of “aid for trade,” where traditional development cooperation and trade integration intersect. More cooperation in areas such as removing infrastructure bottlenecks that constrain trade could be regarded as low-hanging fruit in terms of cooperation

opportunities. Another entry point for broader cooperation on behind-the-border policy issues is trade facilitation, which encompasses a range of logistical issues such as customs procedures, e-commerce adaptation, and “single-window” policies. The success of APEC’s trade facilitation agenda could provide a framework of standards and best practices to extend to other LAC countries.

Secondly, trade agreements provide a built-in institutional framework consisting of a legal status, often approved by legislatures, monitoring committees, and dispute settlement mechanisms. This framework is often missing from agreements and MoUs on non-market cooperation. Finally, trade and investment agreements attract high-level political attention and are usually seen as core interests; agreements on science and technology or education generally are not. Connecting the latter with the former can help raise the profile of cooperation initiatives and ensure that they are actually implemented.

**Leverage regional multilateral institutions.** Asia and the Pacific and LAC currently cooperate through participation in multilateral regional institutions such as the Asian Development Bank (ADB) and Inter-American Development Bank (IDB).<sup>15</sup> The two banks cooperate under a formal partnership, and the ADB and IDB presidents have signed agreements to support sustainable, low-carbon transport, and to share access to trade finance programs that link more than 100 financial institutions to support trade between the two regions. The Latin America/Caribbean and Asia/Pacific Economics and Business Association (LAEBA), another ADB–IDB joint initiative, provides opportunities for comparative research on the business economics of the regions and enables researchers to discuss current research and cooperate with policymakers and the private sector.

The institutions are well positioned to facilitate exchanges and knowledge sharing between policymakers, academics, and businesses from the two regions on a wider set of issues. In addition, as a forum for high-level dialogue between the two regions, the multilateral development banks should be an increasingly valuable source of ideas for interregional cooperation, including efforts to define shared interests and coordinate and provide guidance on key global issues such as financial stability and climate change.

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<sup>15</sup> Three Asia and the Pacific economies, the PRC, Japan, and Republic of Korea, are also non-borrowing members of the IDB.

**Focus on areas of strategic complementarity.** A key motivation for cooperation between developing economies is the presence of complementarities, that is, areas in which one economy has expertise, a comparative advantage, or resources that align with another's demand. In terms of comparative advantages in the provision of aid and technical assistance, India has carried out capacity-building programs for foreign government officials since 1964 through the Indian Technical and Economic Cooperation. The programs, which involve scholarships for foreign officials to come to India, have been utilized by 159 countries. LAC participation has been small, however, with the region receiving only 0.14% of the total Indian technical cooperation budget for 2010–2011. Japan has been a leader in the provision of aid for trade, an area where there is strong demand from LAC given its infrastructure needs. The LAC region only received 9% of all aid for trade in 2010. ECLAC (2010a) provides an extensive overview of Japan's aid for trade strategy and urges LAC countries to be proactive in exploiting this opportunity.

At the same time, governments wishing to exploit complementarities for cooperation must take care not to encroach on the prerogatives of national and firm-level competitiveness. Any calls for sharing technology or know-how in areas of competitive advantage in the market place will run up against private sector interests and likely sink efforts at cooperation. The public policy realm generally provides better incentives for cooperation.

That said, situations do arise where the national competitive interests of one state and the development priorities of another align to create opportunities for cooperation, either through development aid or technical assistance, in areas that are often the purview of market mechanisms such as foreign direct investment (FDI). The discussion of infrastructure below provides an example. In order to create the best possible incentives for cooperation, it is important to think about not only complementarities but also strategic complementarities, in other words, areas where both comparative advantages in terms of providing cooperation and strategic interests align, or at the very least are not at cross-purposes.

### **Where are the best opportunities for Asia and the Pacific–LAC cooperation?**

Infrastructure represents a key area of potential synergies between market dynamics and development priorities. It is also an area where public and private investment often coexist, meaning that opportunities for cross-border support run the gamut from FDI to public-private partnerships to technical assistance

and traditional development aid. Still, a good deal of bilateral support for infrastructure falls under the rubric of cooperation as we have defined it here.

This is certainly the case for Asia and the Pacific–LAC relations. Given the predominant pattern of trade that has been propelling commerce between the two regions, in which resource-rich LAC provides primary materials for Asia and the Pacific’s industrial titans, Asia and the Pacific has a clear strategic interest in improving the efficiency of LAC’s infrastructure for transporting and exporting its raw materials—all the more so, considering that transport costs associated with infrastructure constraints represent a major barrier to trade for LAC, significantly higher than the cost of tariff barriers (Moreira *et al.*, 2008). For LAC, infrastructure represents a clear area of need: the region ranks well behind other regions in metrics like road density and percentage of paved roads. The region’s investment in infrastructure, both public and private, has fallen from around 6% of GDP during the early 1990s to 2% in 2006. Experiences of developing economies internationally suggest investment of around 5% of GDP as a target for developing economies (ECLAC, 2010b).

Asia and the Pacific and LAC have begun to pursue cooperation in infrastructure, marshaling a combination of private investment and traditional development aid mechanisms. Japan, for example, has embarked on a strategy of loan assistance to develop infrastructure surrounding important natural resources. This integrated effort among the Foreign Ministry, the Japan International Cooperation Agency (JICA), and other government agencies as well as the Japanese private sector is creating opportunities for investment that could also provide LAC countries with much-needed support for infrastructure development (ECLAC, 2010a). Given its strategy of combining investment and development cooperation, its comparative advantage in the provision of aid for trade, and its focus on areas like natural resource and food security, Japan offers clear opportunities for mutually beneficial cooperation with LAC. In order to make the most of this opportunity, LAC governments need to seek out projects and define their technical and financing priorities.

Experiences with poverty reduction policies should provide ample opportunity for cooperation in the form of knowledge sharing and technical assistance between the two regions. Both regions face significant socioeconomic challenges, with large numbers of poor despite strong overall growth in many cases. Despite this general picture, a number of LAC countries have had considerable success in reducing poverty rates over the past decade through the use of conditional cash transfer (CCT) programs. CCTs help to

reduce poverty by transferring money to poor people on the condition that they carry out certain actions, such as keeping their children in school, receiving vaccinations, or having regular medical check-ups. A large literature on CCTs indicates that while they have considerable upside potential in reducing poverty, they present a special set of challenges, especially in targeting beneficiaries, monitoring conditionality, and administering decentralized cash transfers (Fiszbein and Schady, 2009).

Over a dozen LAC countries have implemented CCTs in the past decade. The programs have generally been well implemented and have had significant effects not only in reducing poverty levels but also in raising consumption and increasing the use of health and education services. More recently, several Asia and the Pacific governments have experimented with CCT programs. India has used CCTs at the state level, and is now moving towards the CCT model in its social protection programs at the national level. Given the Indian government's traditional focus on delivering physical goods and services rather than cash transfers, implementing CCTs on a large scale implies new challenges, such as monitoring transfers and conditionality. Technical assistance and international learning could be beneficial in meeting this challenge (UNDP India, 2009). While there is no one-size-fits-all CCT program, the experiences of LAC countries, especially given their diversity, should contain lessons that Asia and the Pacific governments can apply in their own CCT initiatives.

Disaster response is another policy area where there should be strong incentives for cooperation between LAC and Asia and the Pacific. Providing aid in the immediate aftermath of a catastrophic event is a critical form of cooperation, but one where many international organizations stand ready to provide support. Equally important is the opportunity to collaborate, share knowledge, and carry out joint research in disaster preparedness, planning for disaster response, and techniques for mitigation.

Disaster response represents a classic public good: the market incentive to provide relief or to help mitigate natural disasters is essentially nil, so there is little worry that cooperation would impinge on private sector interests. In addition, many LAC and Asia and the Pacific economies share ecological and topographical characteristics that make them vulnerable to the same forces of nature, such as earthquakes, tsunamis, and flooding. These similarities create opportunities for joint research that can be of enormous value on both sides of the Pacific. Finally, given the data constraints that researchers of natural disasters often face (there are only so many events from

which to collect first-hand evidence), cooperation can greatly enhance the prospects of scientific investigation (see Box 1).

Confronting the various challenges surrounding climate change represents another area where international cooperation is essential and where potential for mutually beneficial interregional initiatives exists. Beyond negotiations on an international agreement, climate change mitigation is increasingly embedded in a wide range of issues affecting the two regions, including economic competitiveness, trade negotiations, and urban development.

Governments in the two regions could cooperate on research into the environmental, economic, and social effects of climate change, as well as the impact of different mitigation strategies, through joint research and information sharing. In addition, under the rubric of climate change mitigation there is a wealth of emerging policy areas where knowledge sharing should be mutually beneficial without running up against private sector interests. These include developing carbon markets, supporting energy efficiency of consumer products, greening public transport, and implementing programs that compensate developing economies for emissions reductions, commonly known as REDD.<sup>16</sup> More specifically, the success of LAC cities such as Curitiba (Brazil), Belo Horizonte, Medellin, Bogota, and others in implementing sustainable public transport and waste management systems could provide valuable lessons, especially as Asia and the Pacific faces rapid urbanization in the coming decades.<sup>17</sup>

Cooperation between Asia and the Pacific and LAC could also help ensure a greater voice for governments in the regions in international climate change discussions. As the UN process proceeds towards a new framework to replace Kyoto, key questions remain, such as the level of developing economy contributions to emission reductions, the strength of legal commitments the new treaty will carry, and the enforcement mechanisms, if any. Here again, however, economies such as Brazil, the PRC, and India have found themselves at odds.<sup>18</sup>

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<sup>16</sup> Reducing Emissions from Deforestation and Forest Degradation (REDD) policies are carried out by the UN, the World Bank, and the Norwegian government. Over a dozen LAC and Asia and the Pacific economies are currently participating in REDD programs, either as beneficiaries or as observers.

<sup>17</sup> The urban population of Asia and the Pacific is expected to double between 2000 and 2030; it currently stands at around 48% of the total population, whereas in LAC a full 79% of the population lives in urban areas (Asian Development Bank and World Bank).

<sup>18</sup> India was the biggest holdout against mandatory targets for developing economies, which were a key element in the agreement that emerged from the 2011 Durban

Financial regulation is a particularly important challenge that needs to be addressed through cooperation across borders and in multilateral forums, especially in light of the disruptions in global financial markets in recent years. The reality of interconnected markets and financial institutions with international exposure means that central banks and national regulatory bodies need to share information and increasingly coordinate policy.

Although LAC and Asia and the Pacific economies have been shielded from the worst effects of the global financial crisis, there are still pressing reasons for mutual cooperation. First, many emerging market LAC and Asia and the Pacific economies face similar policy challenges associated with capital inflows and exchange rate volatility. There could be potential policy lessons from the experiences of governments in the two regions in this area. Secondly, as investment and trade flows between Asia and the Pacific and LAC expand, the fates of the regions' economies are becoming increasingly intertwined, most likely in ways that are not entirely clear at the present time. Cooperation can help ensure a stable environment for such inter-regional integration through measures such as the implementation of payment agreements and reciprocal credit and a system of payment in local currencies. Bilateral exchange swaps, which allow economies to carry out commercial activities directly in their partners' currency, offer another policy tool with the potential to expand cooperation. The PRC and Argentina already have such an arrangement.

On bank supervision, information sharing and communication between national regulatory authorities is needed to effectively oversee increasingly integrated financial markets on both sides of the Pacific. A first step in this direction has been taken with the first joint conference of East Asian and LAC central bankers in 2011, a forum that should be strengthened in coming years. Asia and the Pacific economies have already taken important steps to deepen regional cooperation, through formal policy dialogues among finance ministers and central bankers of the ASEAN+3 economies.<sup>19</sup> These same economies have also coordinated a regional financial safety net called the Chiang Mai Initiative, since 2000, that provides short-term liquidity to

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conference. Brazil, on the other hand, supports legally binding emissions targets for Kyoto's successor, something India and the PRC are sure to resist.

<sup>19</sup> The "+3" are the PRC, Japan, and Republic of Korea; see note 8 for a list of ASEAN economies.

stave off potential currency crises. In LAC, efforts at regional cooperation in financial regulation are less developed, and the Asian experience could provide a valuable source of knowledge.<sup>20</sup>

Finally, the emergence of the G-20 as a major forum for discussion of global financial regulation provides Asia and the Pacific and LAC governments with an opportunity to shape new standards on key issues, including capital requirements, regulation of global systemically important financial institutions, and international accounting standards. Both regions also have a major stake in discussions on reforming the IMF to improve its capacity to monitor systemically important economies and make its governance structure more representative. In this regard, better intraregional dialogue and coordination becomes an important prerequisite to ensure that the biggest LAC and Asia and the Pacific voices in the global dialogue represent the two regions' interests on issues where there is a convergence of views.

Of course, it is unrealistic to imagine any policy area where regional interests will always be aligned, or where individual governments will replace national self-interest with the ideal of South–South cooperation. As we have seen, opportunities to cooperate coexist with many points of disagreement in the panorama of Asia and the Pacific–LAC relations. Nunes de Oliveira, Onuki, and Oliveira (2006), for example, found that agreement between India and Brazil, reflected in votes at the UN and WTO, actually declined sharply between 1994 and 2004. Interestingly, it was precisely during this period that India and Brazil launched the IBSA Forum with South Africa, which is widely seen as a highly successful and effective model of multilateral cooperation. This suggests that LAC and Asia and the Pacific governments can embark on mutually beneficial cooperation in certain areas, even while disputes exist elsewhere. Doing so will require that governments take care to develop cooperative initiatives in areas where the right incentives exist and where institutional backing and coordination are sufficient.

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<sup>20</sup> For a broader discussion of Asia and the Pacific–LAC financial cooperation, see Estevadeordal and Kawai (2012), ADB–IDB Background Paper (forthcoming).

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## Shaping the Future of the Asia and the Pacific–Latin America and the Caribbean Relationship

Economic relations between Asia and the Pacific and Latin America and the Caribbean (LAC) have clearly reached a turning point at the turn of the 21st century. In a mere decade, the manufacturing prowess and insatiable hunger for natural resources of Asia and the Pacific’s two most populous economies—the People’s Republic of China and India—coupled with LAC’s reemergence, have made Asia and the Pacific LAC’s second-largest trading partner. At the same time, this dynamic trade relationship has significantly increased LAC’s strategic and economic importance to Asia and the Pacific.

It can be argued that these seismic changes were mainly the product of market forces driven by the immense resource complementarity between the two economies, with little input from governments. However, if the sizeable gains achieved to date are to be expanded, widely distributed, and consolidated, governments must play a more decisive role. Their participation is particularly critical in strengthening and balancing the three key pillars of any successful integration initiative: trade, investment, and cooperation.

This report, a major collaborative effort by the Asian Development Bank (ADB), the Asian Development Bank Institute (ADBI), and the Inter-American Development Bank (IDB), seeks to support this policy agenda. In its four chapters, the report identifies the main challenges and opportunities in each of these pillars while drawing attention to the benefits of balancing their development.

