Study on Enhancement of Integration of Regional Value Chains in Asia and Latin America and the Caribbean (CTI 08/2015T) - Final Report (Extract)

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Executive Summary

Globalization has accelerated international trade and investment flows, increased global competitiveness and facilitated industrialization of many economies. Although globalization has lifted many out of poverty through a concentration on competitive advantages and trade and investment liberalizations, numerous economies still face challenges excelling in an increasingly competitive marketplace. Low productivity levels, dearth in infrastructure, restrictive trade and investment regimes, poor institutional development, and numerous other factors impact economies’ and companies’ ability to effectively participate in the international marketplace.

Global value chains (GVCs), which interlink economies and businesses across the World, now govern economic trade and investment flows and present opportunities to integrate into an increasingly connected marketplace. GVC theory purports that economies can open their markets to international players, linking domestic businesses into the global markets. Over time, companies capable of engaging GVCs will improve production and provision of services to maintain competitiveness while also developing opportunities for improved cooperation with small and medium sized enterprises, local service providers, and the wider international business community.

The tenants and practices espoused by GVCs have had a profound impact on Asian economies over the past few decades. Asia has been driving global economic growth while the region continues to incorporate an increasing number of developing economies while emerging economies work to improve overall competitiveness. It is now clear that cooperation between the public sector, domestic firms, international investors and multinational companies can accelerate economic growth and create a means to evolve domestic, regional and global industry. As such, most Asian economies look to GVC theory, which supports the upgradation of most economic factors, to develop road maps for future growth. By incrementally making improvements domestically and actively looking to engage the global community, Asian economies and companies are both attracting investments and looking for opportunities abroad. Now the region as a whole is incredibly competitive in a number of products and services and expanding to more distant territories.

Latin America, on the other hand, has not incorporated into GVCs in a similar fashion to Asia. A heavy focus on commodity extraction and a lack of downstream investments has left the region wanting for economic diversity and complexity. Many Latin economies produce relatively similar goods and services where there has been a lack of specialization to substantially trade intra-regionally and further abroad outside of natural resource industries. Some Latin economies such as Chile and Mexico are becoming increasingly integrated into RVCs and GVCs, but the lack of a true driving force for regional connectivity constrains greater value chain integration. That being said, numerous Latin public sector entities are becoming increasingly open to trade and investment while initiatives such as Pacific Alliance can open opportunities while linking the region to Asian growth.

Although Asia and Latin America are far in distance, there is substantial opportunity for respective regions’ companies to grow across the Pacific. Latin America, with its abundance of natural resources and dearth in downstream investment offers great potential for Asian companies that have excelled and evolved in a variety of industries. Asian growth markets, on the other hand, could be attractive to Latin companies looking to expand their market reach, learn new market practices, cooperate with emerging business leaders, and access new technologies. Moreover, entering into Asian markets will push Latin companies to upgrade and evolve in order to compete and provide diversified products to Asians.
Opportunities between Asia and Latin America certainly exist, but bridging the distance can be challenging. Aside for the expanse and expense of shipping products across the Pacific, differences in languages, cultures, time zones, and business practices often complicates sustainable connectivity. Thus, companies and economies must be proactive to not only improve their own domestic economies, but also their overall attractiveness to the international business community. Domestically, economies should consistently look to improve human capital and infrastructure, become increasingly open to trade and investment flows, maintain strong intellectual property rights, assure equitable contract enforcement, support research and development to competitive industries, and govern transparently. Moreover, trade promotion and investment attraction initiatives, engaging international forums such as APEC, creating online databases to promote products abroad and provide the necessary information on how to do business domestically can improve connectivity.

Global economic volatility and changes in political directives will always complicate international affairs and the efficiency of doing business across borders. Although macro level issues may complicate trade and investment flows, there is indeed incredible potential to better link Asia and Latin America based on respective region’s competitive advantages and company expertise. Each economy must take stock of what it does best and what is demanded by global business partners. By looking to upgrade in the areas impacting GVC connectivity, Asia and Latin America can grow together commercially through trade and investment even though the distance is great.

The research for this report encompasses a broad and substantial literature review, interviews with over 100 stakeholders from six Asian and Latin APEC economies, and data analysis from global indices, economic databases, and trade and investment flows. While GVC theory is broad and encompasses most aspects of economic development, the report below looks to provide a general understanding of the tenants of GVCs, how Asia and Latin America have integrated into GVCs over the past couple decades, the level of connectivity between the two regions already, and what can be done to improve their linkages. Furthermore, we use three case studies from the salmon, soybean and automotive industries to highlight GVCs in action and characterize the connectivity between the two regions.

Although not specific to any particular economy or industry, the report provides a baseline understanding of regional progress and hindrances to GVC development and recommendations on what could be done to improve. Recommendations include high level improvements to human capital, infrastructure, and institutional development while more specific recommendations delve into trade connectivity and promotion. Overall, an integrated and coordinated approach between domestic public and private sector agencies together with international counterparts is necessary to effectively engage GVCs. The more cooperation and engagement, the better the probability to enhance GVC integration.

**Recommendations**

*High level recommendations to facilitate GVC connectivity*

The analysis above provides the background and theory as to why a number of factors are important and recommended for GVC integration. Below is a brief description of why and how improvements to each of the recommendations are necessary to better connect Asia to Latin America.

A. **Infrastructure improvements**: Improved infrastructure supports both domestic economies and international connectivity. Low quality infrastructure raises the cost of transporting goods and services and reduces overall domestic competitiveness in comparison to economies with more efficient systems. Deep water ports with short dwell times, airport connectivity, efficient road transport systems, railroad connections to industrial and trade centers, and high speed internet
connections support both business and societal efficiency. High quality infrastructures is even more important when trying to do business between Asia and Latin America. The sheer distance across the Pacific or overland already incurs expensive logistics costs and challenges connecting with counterparts in differing time zones. Time constraints and additional and unforeseen costs will discourage increasing and sustainable trade and investment. As such, each economy, both in Asia and Latin America, should look to improve the supply of all types of infrastructure to efficiently engage GVCs.

B. **Trade cost reductions and trade facilitation:** Trade cost reductions can fuel product competitiveness and support trade in intermediate goods and services. High transportation costs, delays at customs, conflicts in international trade policy and regulation, and other trade barriers discourage GVC integration as companies experience inflated costs and hindrances when trading with international partners. As such, Asian and Latin America economies looking to better integrate into GVCs should pursue open trade regimes that allow for the efficient and manageable flow of goods, especially those commodities and intermediate goods that are utilized for adding value and support comparative advantage industries. Free trade and preferential trade agreements are one mechanism economies can pursue to improve connectivity with trade partners. While bilateral trade agreements can support trade between two economies, multi-lateral and/or macro trade agreements, such as those set out by the WTO and those proposed in agreements such as Pacific Alliance, and RCEP create better harmony and facilities for inclusive trade. Aside for trade agreements, efficient and transparent customs controls, multimodal transport agreements, and cross-border freight agreements can support intra- and inter-regional trade. While there are a number of intra-regional facilities such as the ASEAN Economic Community and MERCOSUR already operating, improvements can be made and expanded to facilitate trade. The greater the harmonization, understanding, transparency, and connectivity between economies and regions, the more likely they are to increase trade and investment.

C. **Transparent and consistent rules and regulations:** Transparent rules and regulations inform businesses on what they need to be aware of and comply with when operating in an economy. This is incredibly important for FDI as foreign investors are not necessarily fully informed on the business regulatory environment, legal systems, and cultural sensitivities of diverse economies. With a sound and consistent business regulatory environment, companies, both domestic and foreign, can develop their business plan to match local specifications. If rules and regulations are frequently changing, these adjustments can frustrate businesses, create operational inefficiencies, and lower overall confidence in doing business in a respective economy.

D. **Continuous upgrading of education opportunities:** Human capital and the ability to upgrade, innovate, and effectively reach an increasing amount of customers drives overall competitiveness. Aside for enhancing business performance and creation/utilization of advanced technologies, a better educated society provides numerous collective benefits. As such, investments into both base level and higher education institutions can lay the foundation for future competitiveness. Educational initiatives, especially those geared towards developing a work-ready population, support business growth and a company’s ability to engage GVCs. Evidence supports that economies with superior educational attainment have higher per capita GDPs, standards of living, and GVC integration. This is evidenced in both Asian and Latin American economies where there are also numerous programs aimed at developing talent for a specific industry has led to successful growth.

E. **Access to finance:** Access to finance, whether it be through trade finance, project financing, SME finance, etc. is incredibly important to support local business development, upgrading, and
international connectivity. As such, public sectors should cooperate with both public and private banking institutions to supply the capital necessary to grow industry while also putting the systems in place to regulate, enforce, and control excess borrowing. Priorities should be mapped out with easier access or preferable financing terms made available for focus sectors. Moreover, banks need to be connected to international markets to facilitate trade and investment flows. Today, there are an abundance of financial products and capabilities. Some economies utilize finance more than others where it can be argued that some economies have relied on it too heavily. It is a challenging balance to provide growth capital while managing the flow of funds.

F. **Openness to FDI:** Protectionism, heavy preference for domestic companies, and active deterrence of foreign investors inhibits an economy’s ability to engage GVCs. FDI is a key driver of GVC integration where companies can open operations in different economies to utilize their expertise to grow and contribute to the investment economy. Of course it is necessary for an economy to protect strategic assets and regulate activities in sensitive industries such as nuclear and weaponry, but foreign engagement pushes the overall competitiveness of industry and encourages upgrading, innovation, and motivation to obtain greater market share. Aside for being open to FDI, economies should actively pursue FDI into priority industries that demand additional capital and/or expertise. FDI also enhances direct linkages to other economies. As foreign companies and workers enter new markets, they get to know the investment economy, positive and negative qualities, and an appreciation for local culture. This provides an additional opportunity for local companies to link with the FDI business and potentially instigate exports or obtain higher quality/competitive pricing of products through the new connection.

**Specific recommendations to facilitate GVC connectivity**

While still broad based, the recommendations below are more focused initiatives that can be implemented either at specific public sector organizations to make incremental improvements or through public-private engagements aimed at enhancing competitiveness and connectivity. These recommendations are based on the interviews and literature review conducted for this study combined with practical experience supporting trade and investment across Asia with experience in Latin America.

A. **Integrated online trade facilitation website:** Economies looking to promote SME product lines abroad and facilitate trade and investment with international partners can develop an online trade repository and database. Easily accessible high quality websites are quick and efficient ways to reach and connect with others around the world. This online database can serve numerous functions. First, an economy can take a survey the variety of products produced locally, categorize them, and then list them online in an Amazon.com type format. Next, the website can include a list of local distributors with quality rankings to support the importation and distribution of products. Thirdly, the website can work as an information database for companies that want to export as well as a regulatory database listing rules, regulations, requirements, etc. for both foreign traders and investors. By developing a functional and well organized trade and information portal, economies can support international commerce more efficiently.

B. **Active trade promotion and investment attraction activities:** Due to the incredible economic growth and increasing levels of OFDI from Asia region, Latin America should prioritize new business development initiatives to better cooperate across the Pacific while Asian economies can seek new opportunities in the Americas. public sector led initiatives to support or subsidize
market expansion or the attraction of investments can stimulate improved participation by domestic companies, especially SMEs, as well as enhancing the overall understanding of conducting cross-border business and developing meaningful business relationships. Information packets, online connectivity platforms, trade promotion missions and road shows, investment attraction initiatives, partner matching, supplier and distributor databases, etc. can all be utilized to introduce high potential companies to opportunities abroad. These initiatives should be focused on industries and companies that have apparent comparative advantages or are in priority industries. Without active public sector support, many local companies will not be aware of international prospects or how to connect while domestic investments may be overshadowed by another economy or company that more heavily promoted itself. In a globalized world, it is incumbent on both public and private sector entities to cooperate to enhance overall competitiveness and an enhanced role in GVCs. While international deals may not be immediately forthcoming, objectives should be focused on the mid-term where trade promotion and investment attraction initiatives will create the momentum for increased connectivity.

C. Institutional upgrading: Every economy’s agency has its role to play in running an economy. Accountability, rule of law, political stability, control of corruption, public sector effectiveness, and regulatory quality all have an impact on a population’s business culture as well as capabilities to effectively engage GVCs. Economies’ initiatives such as increased enforcement against corrupt practices, campaign finance reform, online licensing procedures, etc. can all be mandated by the center which will then impact most public sector agencies. Specific or district agencies can also take it upon themselves to improve their institution to not only standout locally, but they can also work to enhance capacities to better incorporate into GVCs. The Doing Business indicators also offer insights on where domestic and local level agencies can make improvements to become more internationally competitive. Although agencies can independently work for improvement, an integrated strategy to upgrade all institutions will be most effective. With quality institutions often comes more transparency and consistency while the population and business can be confident that the public sector will maintain its standpoint and provide a fair trial in times of dispute.

D. Engage international forums such as APEC, OECD, WTO, etc.: GVCs are all about connectivity and building productive relationships across borders. Economies looking to better integrate into GVCs can utilize a number of international forums to connect with high level counterparts from across the globe. Most international forums such as APEC hold conferences and summits on a variety of pressing economic, political, and international affairs issues that bring leaders from respective fields from a variety of economies together to share their experiences and best practices, enhance networks, and build consensus. Moreover, most international forums have a cohort of researchers and policy analysts with a deep understanding of both historical and current economic phenomena as well as the connections to informed stakeholders in economies’ public sectors. By actively engaging such international forums, public sector representatives can learn from their peers and build the relationships necessary to better integrate in GVCs.

E. Gear SME activities to cooperate with larger firms and/or MNCs: SMEs are the foundation of most economies where these smaller companies usually employ a majority of the population. While SMEs are abundant, they are typically less productive and inexperienced working internationally. To better incorporate SMEs in domestic, regional, or GVCs, business development programs can work to link SME suppliers with larger domestic firms that are already integrated into GVCs or through cooperation with MNCs. An economy could take an inventory of the various types of companies, from small to large, with respective product lines. Companies may list their specialization and development needs and then an agency or the businesses themselves could
look to partner with others to grow their business reach. This will be most effective when supplier SMEs can partner with the larger, exporting companies that have higher levels of productivity, capital, and experience. The larger company can convey the specifications and standards necessary to meet customer standards, provide training as necessary, and educate on required technologies. Over time, the SME will build its expertise supplying to the larger company and may be able to find clients outside of the primary partner company. On the other hand, the large company can utilize the SME to specialize in a specific process to drive efficiency improvements and outsource labor processes. This type of partnership program links SMEs to GVCs by utilizing the larger exporting company as a conduit.

F. Assessment of domestic competitive advantages with investments and R&D based on this assessment: Competitiveness is the driver of GVCs and lagging competitiveness may exclude a company from engaging wider value chains. Each economy and respective populations have unique characteristics that contribute to economic growth and development. China is abundant in people while Chile has a long coast line with a range of climates. Peru is abundant in mineral resources while Thailand has fertile agriculture. These economies have many other competencies that when tallied, derive an economy’s comparative advantage. As such, economies should focus on what they do best and what they are abundant in and develop upstream and downstream industries based on their comparative advantage. Each economy should deeply consider and analyse domestic capabilities, noting where they are strong, where they stand in a globalized world, and what they can do better to connect into GVCs and compete. It is much more efficient for an economy to excel in an industry they are familiar with or have experience in rather than trying to develop a new industry without the necessary background. Economies can then create a road map and use policies to support industrial development within priority sectors. By utilizing training programs, domestic or foreign investments, potential subsidies, trade promotion strategies, etc., new industries can be nurtured to grow over time. Although creating a competitive industry takes time and effort, it is an investment in an economy’s future and these productive industries are what link an economy to GVCs.

G. Development of integrated strategies: Participation in GVCs is not the result of individual efforts from companies or public sectors. Engagement happens as a result of combining existing competitive advantages at all levels and cooperating to enhance these advantages through joint efforts. Integrated strategies refers to the participation of public sector at all levels from central to local, the private sector including both local companies and foreign investors, as well as academics or other organizations involved in the planning of goals, policy design, human capital programs, allocation of resources, and execution of relevant actions. Policies and actions must have clearly defined goals that help achieve expectations and measured by performance metrics. These strategies must identify and empower specific stakeholders with aligned actions and give responsibility for assigned duties. More often than not, in both Asia and South America, there is a lack of communication and coordination while opposing interests divide overarching domestic and regional goals. In order to better coordinate mutually beneficial interests, an independent public-private agency with a mandate to coordinate initiatives related to GVC enhancement and ensure all the players are involved in the alignment of goals, creating an action plan, assigning responsibilities, and enforcing progress could contribute to improved GVC integration.