

THE RECONFIGURATION OF GLOBAL VALUE CHAINS: AN OPPORTUNITY FOR LATIN AMERICA AND THE CARIBBEAN

Global and Regional Context

Today, more than 50% of global trade happens within global value chains (GVC). Participating in GVCs brings both economic and social benefits. *Productivity is enhanced*: a 10% increase in a country's level of involvement in a GVC can lead to a 1.6% increase in average labor productivity and an 11% to 14% increase in per capita GDP. *More and better jobs are created*: companies that are part of GVCs demand more skilled personnel, hire more women, and pay higher salaries than firms that only export or are not involved in trade. However, LAC is lagging behind other regions in its participation in GVCs. The number of firms in the region that are part of GVCs is low compared to other regions, and they mainly tend to be involved in the early stages of GVCs.

The current context represents an opportunity for LAC to improve its participation in GVCs. The reconfiguration of GVCs is accelerating in response to various factors, including the trade conflict between the USA and China, the COVID-19 pandemic, and the recent war in Ukraine. All of this has brought to the forefront the discussion of diversifying supply chains, since if strategic input providers in key industries are concentrated, the risk of chain disruption is high and could lead to serious economic damage. To ensure greater resilience to future disruptions, as well as reduce their environmental impact and cut costs by shortening transit distances, global companies are taking steps to align closer supply options, which has been called nearshoring. IDB estimates show that the potential gain for LAC from nearshoring opportunities in the short and medium term could represent an increase of up to US\$78 billion in exports. There are significant opportunities for the region in the automotive, textile, pharmaceutical, and other industrial value chains that could lead to an upgrading of skills and technologies.

What the IDB is Doing

The IDB is supporting the implementation of what we call the 3i strategy: (i) Investment: implementing structural reforms and financing demand-driven training programs to attract FDI and open up new markets for the region; (ii) Infrastructure: improving LAC's trade, connectivity, transportation, and logistics infrastructure is key to ensuring that companies investing in the region can be more competitive; and (iii) Integration: improving integration within the region and modernizing its approach, so as to build a broader, more competitive, frictionless market.

In 2021, the IDB approved US\$2.3 billion in public sector loans to strengthen regional supply chains, almost double the average amount of the years before the pandemic. In the same year, its private sector arm, IDB Invest, approved US\$1.2 billion to companies in the region to help them capitalize on this opportunity.

Our Tools

The IDB Group offers its 26 borrowing member countries a toolkit that articulates financial and non-financial instruments such as private and public sector loans, guarantees, reimbursable and non-reimbursable technical assistance for national promotion strategies and vertical sector studies that identify nearshoring potential by country and provide policy recommendations; trade and supply chain financing; blended financing; partial credit enhancements or risk-sharing guarantees; CapEx financing; capital investments and investment grants; and dedicated national nearshoring promotion events, among others.

Some Examples of our Work

The IDB is supporting the diversification and internationalization of the Colombian economy through a US\$24 million loan program that aims to boost exports of knowledge-based services (KBS), and to increase Foreign Direct Investment (FDI) flows through the implementation and use of new tools to streamline procedures (such as a Single Window for FDI) and consolidate Colombia as a nearshoring investment destination.

In terms of technical assistance, the IDB is developing country strategies for all 26 borrowing member countries that identify sector and product-level opportunities, bottlenecks, as well as specific policy recommendations and actions to address them, and connecting international companies and investors with businesses across the Americas.

THE FIGHT AGAINST CLIMATE CHANGE: HOW CAN TRADE POLICIES IN LATIN AMERICA AND THE CARIBBEAN HELP?

Global and Regional Context

The world has spent an astonishing 7% of the GDP (US\$6 trillion) in fossil fuels subsidies in 2020, a figure that is expected to reach 7.4% in 2025. At the IDB, we have managed to get a reliable estimate of the carbon footprint of Latin America and the Caribbean's (LAC) trade. Domestic emissions for external consumption, including international transportation, account for 20% of the region's greenhouse gas (GHG) emissions, a lower metric than that of the world's trade-related emissions, although greatly varying between countries. Our research also suggests that in roughly half of 20 LAC countries studied, tariffs are negatively correlated with the goods' emission intensity, essentially favoring trade of "dirty" goods over "cleaner" ones.

Globally, there has been a series of private initiatives - such as voluntary sustainability standards that help overcome information barriers and put pressure on local firms to reduce their carbon footprint, but their compliance costs are very high-, and public initiatives, such as enforceable environmental chapters in preferential trade agreements and tariffs on trade of "dirty goods". Carbon border tariffs have yet to be implemented but have already been the subject of several legislation proposals in the United States and have been formally proposed by the European Union (EU) to be phased in as early as 2023.

What the IDB is Doing

The IDB is supporting its borrowing member countries inform the policy debate in questions such as how changes in LAC's trade have been affecting its GHG emissions and the policy changes to reduce LAC's trade carbon footprint while minimizing potential misallocations that can hurt trade and welfare. The IDB is also providing support to implement export promotion programs for sustainable products, including green production and other sustainability certifications; foster green employment in trade/investment-intensive sectors; implement green logistics programs; and apply new technologies for the identification, attraction, and monitoring of sustainable investments, among others.

Last year, the IDB financed a record US\$4.5 billion related to climate change (30% of its total annual approvals). Additionally, at the COP-26 conference in Glasgow, the IDB announced its commitment to align all its operations with the Paris Agreement starting in 2023, and to provide US\$24 billion in climate and green financing from 2022 to 2025.

Our Tools

The IDB Group offers its 26 borrowing member countries a set of tools that include: (i) climate financing to reduce environmental impacts and develop green financial products and services; (ii) technical assistance and cutting-edge knowledge to promote low carbon and resilient policies and regulations and build the capacity necessary for effective use of current and future international mechanisms for climate actions; and (iii) institutional capacity building on pathways to finance low carbon emissions.

The IDB also leverages resources from global instruments such as the Green Climate Fund (GCF), to support LAC countries raise and realize their Nationally Determined Contributions (NDC) ambitions towards low-emissions and climate-resilient pathways. In 2021, the GCF Board approved the Amazon Bioeconomy Fund, an IDB initiative to leverage investments in support to climate change adaptation and mitigation in the Amazon basin.

Some Examples of our Work

In early 2021, the IDB Group launched the Amazon Initiative and mobilized over US\$300 million -including GCF funds- to foster socially and environmentally sustainable economic development models in the Amazon region, that will benefit its diverse communities. Here, the IDB is helping communities and producers in the Amazon increase and diversify exports and attract investments to promote socio-economic development and environmental sustainability with tools such as market insights, local capacity building, verification/certification, product traceability, matchmaking, carbon footprint reduction, and environmentally conscious processes with markets.

The IDB is also providing technical assistance and capacity building to LAC Investment Promotion Agencies (IPAs) to facilitate sustainable investments, including the implementation of cutting-edge knowledge products and digital tools. In Costa Rica, the IDB is supporting PROCOMER's Crecimiento Verde Program that promotes productive transformation processes to improve agricultural SMEs' environmental sustainability and, as a result, their export profile and internationalization.

THE DIGITAL ECONOMY AND ITS CONNECTION TO TRADE

Global and Regional Context

Digital transformation contributes to companies' and businesses' ability to access new consumers, even in other markets, by cutting entry, information, and communication costs, and increasing and diversifying export goods and enabling service exports, such as telemedicine or remote learning. Digital technology also helps speed up and reduce costs of cross-border trade operations and facilitate trade and investment flows through digitalizing customs and foreign investment support platforms.

The introduction of digital platforms could increase global Gross Domestic Product (GDP) thanks to higher productivity, more employment, and a higher labor market participation rate. An estimated 10% broadband penetration increase correlates with a 3% GDP *per capita* growth and a 2% rise in productivity.

LAC's level of adaptation to digital transformation is not only lagging behind that of developed countries but it is also very heterogenous. Digital trade in particular is lagging, as LAC accounts for only 2% of total spending in the retail segment (B2C), well below its 6% share of global trade in goods and its 7% share of gross product.

What the IDB is Doing

The IDB is supporting its borrowing member countries in three key dimensions: (i) reducing costs to the digital economy by promoting modernization, harmonization and convergence of regulatory frameworks; (ii) reducing transportation and logistics costs by improving the digital infrastructure as well as the digitalization of customs and border procedures; and (iii) cutting information costs through improved institutions for trade and investment promotion that adapt to the digital economy.

In 2021, the IDB approved more than US\$1 billion in loans to promote digitalization, prioritizing the expansion of digital infrastructure for internet access in both fixed and mobile broadband networks.

Our Tools

The IDB Group offers its 26 borrowing member countries financial instruments such as private and public sector loans; guarantees; reimbursable and non-reimbursable technical assistance; capital investments and investment grants. The IDB Group also offers non-financial instruments such as applied research; regional and global partnerships with relevant international and local organizations; and fee-based advisory and knowledge services.

Some Examples of our Work

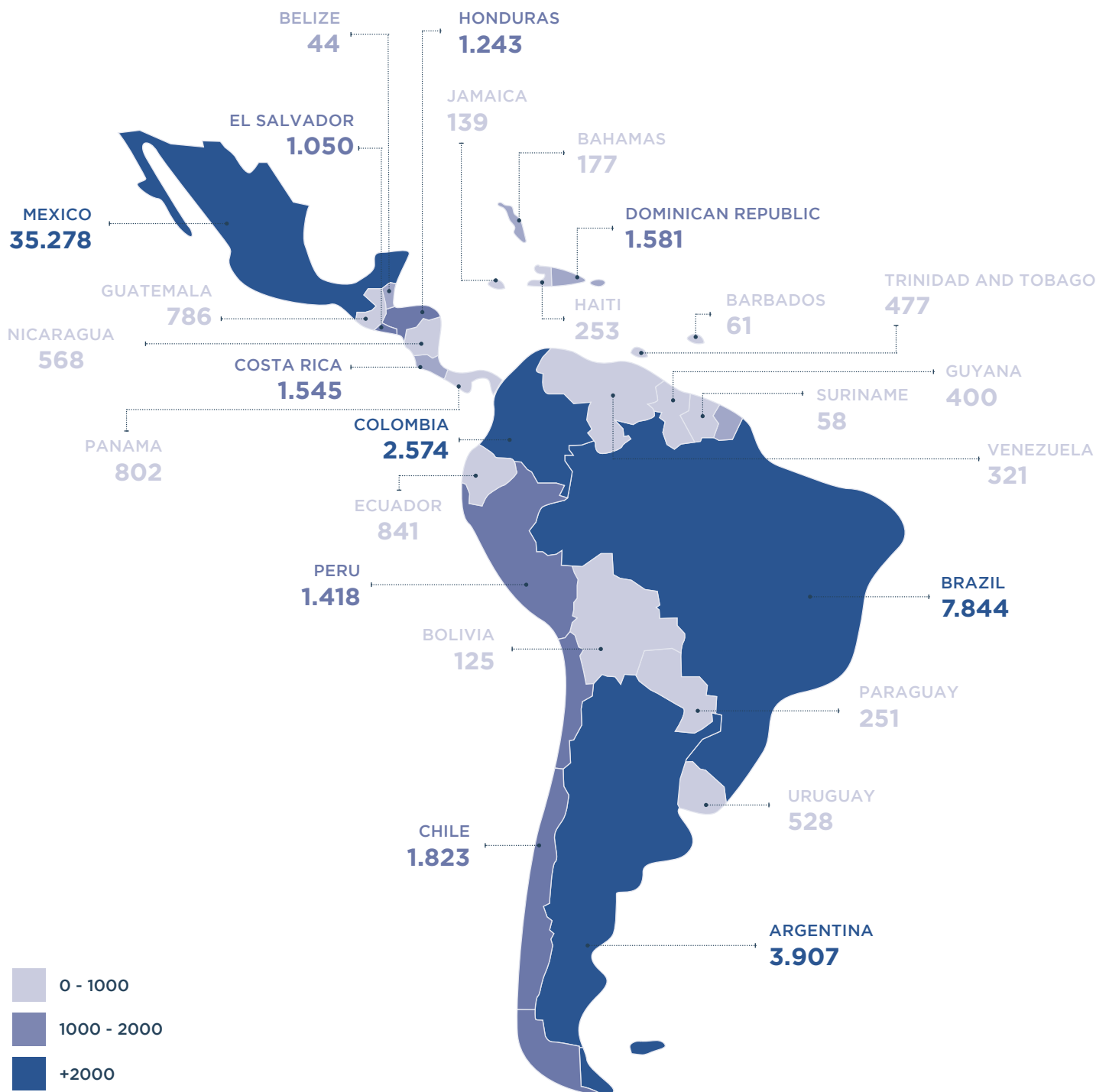
The IDB is assisting in the transformation of LAC countries' digital trade and investment through the implementation of coordinated border management frameworks, customs system modernization, investment lead generation programs and trade and electronic single windows for investment.

In Ecuador, Colombia, Costa Rica, and Suriname, the IDB is designing and implementing an Electronic Single Window for Investor Services, which facilitates FDI by reducing the time, cost, and the number of steps involved in investment processes. The IDB also supports Pacific Alliance and Central America SW interoperability initiatives. In the Caribbean, the IDB is supporting the adoption of Port Community Systems and national and regional maritime SW. These systems manage, optimize, and automate port logistics. Peru, Guatemala, Colombia, Uruguay, Ecuador, and Argentina are all promoting similar initiatives. In Brazil, the IDB partnered with BNDES to offer credit lines for SME's digital transformation to insert themselves in the digital economy. Likewise, the IDB is supporting FINTECH initiatives to enable inclusion in the financial markets. Finally, the IDB is also supporting central banks and other payment provider institutions to develop digital currencies and payment systems to substantially reduce the financial costs of cross border trade.

TOTAL NEARSHORING

OPPORTUNITIES BY COUNTRY (GOODS)

(US\$ MILLIONS)

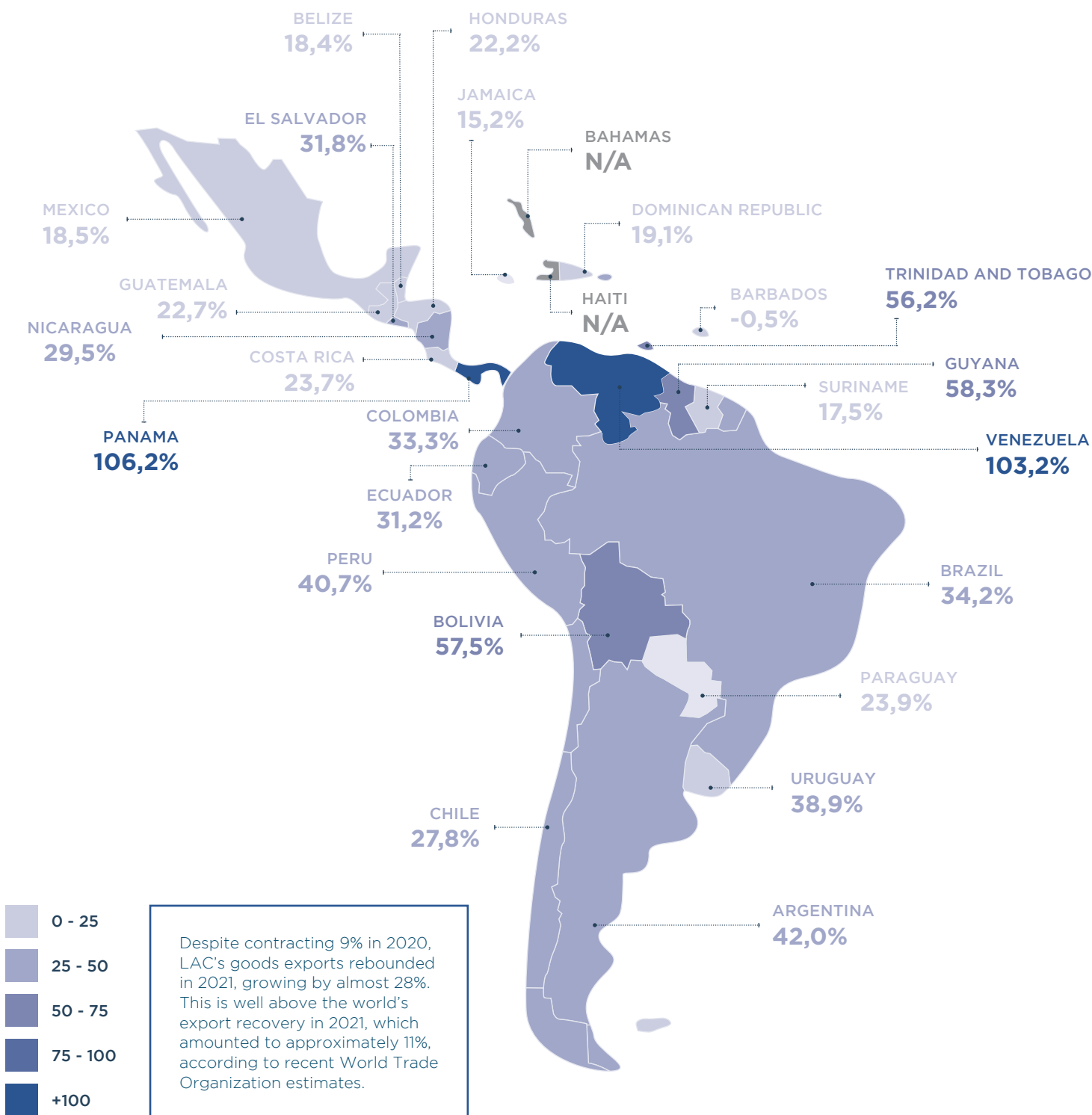


Notes: Data are from 2019. Quick wins are measured as 15% of imports to the U.S. from its top-10 non-Western Hemisphere origins of the top-50 products exported to the U.S. by each LAC country. Medium-term opportunities are measured as 15% of imports to the U.S. from its top-10 non-Western Hemisphere origins of the top-50 products exported to Europe by each LAC country. Intra-LAC opportunities are measured as 15% of imports to LAC from its top-10 non-Western Hemisphere origins of the top-50 products exported by each LAC country. In each case, the opportunities we allocate across countries are proportional to current exports. To account for potential capacity constraints, for quick wins and intra-LAC quick wins, we capped the potential gain at 100% of current exports for each product, and for medium-term opportunities, we capped the potential gain at 200% of current exports. Growth in exports is measured as (total)/ exports of LAC country to the U.S. and Europe.

GOODS EXPORTS

VARIATION BY COUNTRY

(%, 2021 VS. 2020)



FDI INFLOWS

VARIATION BY COUNTRY

(%, AVERAGE 2018-2020)

