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STRENGTHENING REGIONAL VALUE CHAINS IN LATIN AMERICA AND THE CARIBBEAN

IDB GROUP CONCEPT NOTE

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INDEX

ACRONYMS & ABBREVIATIONS

ABD	Americas Business Dialogue
AEO	Authorized Economic Operator
BTA	Build the Americas
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GHG	Greenhouse Gases
GVC	Global Value Chains
ICT	Information and Communication Technologies
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IPA	Investment Promotion Agency
KBS	Knowledge-Based Services
LAC	Latin America and the Caribbean
MERCOSUR	Southern Common Market
MSMEs	Micro, Small, and Medium-Sized Enterprises
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
PA	Pacific Alliance
PPP	Public-Private Partnership
PTA	Preferential Trade Agreements
RPD	Regional Policy Dialogues
RVC	Regional Value Chains
SIEPAC	Central American Electrical Interconnection System
SMEs	Small and Medium-Sized Enterprises
SPV	Special Purpose Vehicle
SWFT	Single Window for Foreign Trade
WTO	World Trade Organization

EXECUTIVE SUMMARY

i. **The Importance of global value chains**. Global value chains – understood as the process whereby a cluster of companies based in different countries work together, from product design to distribution, under the coordination of a leading company – currently account for approximately 50% of global trade, 42% more than in the early 1990s. Partaking in a global value chain offers benefits that go beyond trade growth, such as higher productivity, trade and production diversification, greater transfer of knowledge and technology at the local level, and more and better jobs that foster gender equality.

ii. **Latin America and the Caribbean's participation in global value chains.** Latin America and the Caribbean is lagging in terms of global value chain insertion, both in its participation share and in the stages in which it participates. This low engagement can be explained by several reasons, among which are mainly: (i) the persistence of restrictive trade policies, including insufficient mechanisms for cumulation of origin and low degree of standards harmonization; (ii) high transportation costs, lag in logistics performance, and limited implementation of trade facilitation measures; (iii) high information costs; (iv) inadequate digital connectivity infrastructure; and (v) limited access to financing for companies seeking to participate in global value chains.

iii. **Global value chains reconfiguration.** The global value chains' reconfiguration process, which began after the 2008/09 crisis, has gained further momentum with the advent of the COVID-19 pandemic. To ensure the safety of their supply chains, large multinationals are seeking to secure supplies from nearby locations, a phenomenon better known as *nearshoring*. This regionalization of global value chains represents a significant opportunity for countries in Latin America and the Caribbean to position themselves as attractive destinations for these investments, consolidating their regional integration process and fostering the growth and development of new regional value chains.

iv. **A unique opportunity for Latin America and the Caribbean.** To make the best of the emerging opportunity that the reconfiguration of global value chains poses, countries in Latin America and the Caribbean must redouble their efforts to reduce trade costs, build capacity, and generate a favorable business environment, taking steps forward in the region's overdue integration agenda. This should include improving infrastructure for trade, connectivity, and competitiveness, following principles of sustainability and resilience to climate change, and reinforcing the power to attract foreign direct investment. At the same time, Latin America and the Caribbean should orient its public policies towards the generation of trade and investment promotion instruments to incentivize companies to relocate to the region and facilitate local businesses' access to funding, and best international practices – especially in the case of micro, small, and medium-sized enterprises –, so they can become efficient suppliers to investing companies, thus maximizing local impact and job creation from the reconfiguration of global value chains, with a gender focus.

v. **Additionally, to generate a friendly business environment to attract investments that can strengthen regional value chains, the region needs to advance towards the implementation of structural reforms in other areas with a crosscutting impact on companies.** First, countries need to adopt robust institutional and regulatory frameworks to boost their international insertion. A key aspect of the competitiveness improvement agenda is the presence of training and innovation policies and institutions, enhancing the private sector's capacity building and its connection to academic and scientific institutions. The agenda for the strengthening of regional value chains should also include an adequate crosscutting approach to gender and diversity that allows women-owned or led micro, small, and medium enterprises, existing or new, to benefit from this opportunity, fostering better financial conditions for businesswomen and their access to markets, and encouraging their participation in the job market.

vi. **The IDB Group can play a key role in leading the agenda to strengthen regional value chains in Latin America and the Caribbean** for a better integration into the global market, by providing and leveraging financial resources, offering technical assistance, and coordinating regional initiatives as an honest broker.

vii. **Priority areas to strengthen regional value chains in Latin America and the Caribbean**. To support the region's efforts to seize the opportunity stemming from the reconfiguration of global value chains, the IDB Group must focus its interventions in 3 key areas: (i) investment promotion and financing to foster investments and employment throughout the region; (ii) financing infrastructure and logistics services improvement projects to reduce trade and connectivity costs; and (iii) support regional integration towards convergence and harmonization of trade agreements and regulations to improve Latin America and the Caribbean's business environment.

viii. **The IDB Group's Toolkit to support the strengthening of regional value chains in Latin America and the Caribbean.** To support the countries of Latin America and the Caribbean in strengthening their regional value chains and foster their international integration, the IDB Group makes available to its borrowing member countries and companies in LAC a set of tools that include financial and non-financial instruments. These instruments should be gradually adjusted to the demands of each country, taking into consideration their specific needs to tackle priority areas to strengthen regional value chains. These tools include financial instruments such as: (i) sovereign and non-sovereign loans, guarantees, and reimbursable technical cooperation operations; (ii) capital investments; and (iii) investment grants and non-reimbursable technical cooperation. In addition, the IDB Group may complement its support to regional countries with non-financial instruments such as (i) applied research; (ii) regional and global partnerships with relevant international and local organizations; and (iii) fee based IDB advisory and knowledge services (fee for services) and advisory services for companies provided by IDB Invest.

ix. By offering borrowing member countries this set of tools, the IDB Group will be able to contribute to the following development results: (i) increased foreign direct investment flows towards LAC; (ii) increased mobilization of resources to fund operations of global value chains regionalization in Latin America and the Caribbean; (iii) increased local (direct and indirect) employment generated through regionalization of global value chains operations in Latin America and the Caribbean; (iv) reduction in physical and digital connectivity costs in the region; (v) shortened import and export processing times for both goods and services; (vi) improved business environment to attract foreign direct investment; and (vii) enhanced convergence and harmonization of trade agreements and regulations.

I. THE GROWING IMPORTANCE OF GLOBAL VALUE CHAINS

1.1 In the 1990s world trade entered a transformation period led by major global companies that gradually fragmented their productive processes, transferring some stages of their supply chains to different countries where they could be produced more efficiently, giving place to what we know today as Global Value Chains (GVCs). A GVC is a process whereby a cluster of companies from different countries work together — from product design to distribution — under the coordination of a leading company with the purpose of minimizing the system's total costs (Blyde, 2014). The leading company may own the firms that produce the inputs or choose to work with independent suppliers. Different stakeholders tend to work in coordination to ensure inputs are produced following adequate specifications and distributed timely in the right amounts to the right places. Nowadays, GVC trade is estimated to account for about 50% of total trade, 42% more than in the early 1990s (World Bank, 2020).

1.2 The factors that come into play when deciding where to establish a GVC link include, among others, geographic location, connectivity infrastructure, supplies and human capital availability, institutions, and the public policies of the recipient country. For example, the World Bank's World Development Report 2020 reports that Vietnam managed to become the world's second largest smartphone exporter in 10 years, producing 40% of Samsung phones, thanks to its accession to the World Trade Organization (WTO), a trade agreement with the United States, a favorable business environment, and competitive labor costs. These were the factors that made Vietnam an attractive target for GVC investment in this segment. The country's location was also a contributing factor, as was the ease of access to technological supplies produced in other Asian countries. Another successful case of a nation that managed to position itself in the most sophisticated GVC segments is the Czech Republic, thanks to its membership and geographic location within the European Union, and its availability of skilled labor at competitive costs. The country's admission to the European Union granted it preferential access with low costs, and fostered improvements in its institutional quality, making it a very attractive location for Foreign Direct Investment (FDI) (World Bank, 2020).

1.3 GVCs' increasingly important role makes trade and foreign investment more and more intertwined, enhancing the role played by large multinational corporations that organize labor divisions within these chains. In fact, in many industries, the participation in GVCs (and the ever-growing complexity of the tasks they perform) seems to be a condition not only for surviving in export markets, but also for progressing in terms of productivity, technology or quality, thanks to the sharing of knowledge and information that ordinarily takes place between GVC links (García et al., 2021). This suggests that there is a two-way causation between FDI flows and GVC participation. While some reports show that a country's level of GVC involvement is a determining factor for FDI emergence (Martínez-Galán & Fontoura, 2019), others point out that FDI may help increase this involvement in host countries (Adarov & Stehrer, 2019; Kersan-Škabić, 2019; Buelens & Tirpák, 2017).

1.4 In addition to the traditional development benefits brought about by trade and investment, being part of a GVC helps boost productivity, diversify trade and production, increase the transfer of knowledge and technology at the local level, and create more and better jobs, fostering gender equality (World Bank, 2020).

1.5 **GVCs hold the potential to raise a country's productivity**, not only because they offer nations a chance to specialize in sectors where they have comparative advantages, like in the case of the trade of final goods, but also because they provide them with the opportunity to specialize in the production stages of an item where they have an edge, thus generating additional commercial profits[1]. The transfer of technology and knowledge from leading global companies to other chain links is another factor associated with more efficiency and productivity. For example, the interaction with global companies within a GVC may confer suppliers benefits in terms of improving their productive processes, achieving higher quality, and shortening response times (Humphrey & Schmitz, 2000). Enterprises in emerging countries may benefit from accessing product, process, and organizational innovations more easily (United Nations, 2015). Evidence shows success stories of knowledge dissemination and learning within GVCs in different sectors such as agroindustry (Cafaggi et al., 2012), apparel (Gereffi, 1999), motorcycles (Fujita, 2011), and computers (Kawakami, 2011). In some cases, the knowledge that first-link suppliers obtain from leading companies is further transferred to other firms down the chain (Poon, 2004). The contribution of all these channels may be substantive. Recent studies suggest, for example, that a 10% increase in a country's GVC participation[2] may lead to a 1.6% gain in average work productivity, and an 11% to 14% rise in GDP per capita (Constantinescu et al., 2019). At the same time, reports that identify companies partaking in GVCs as firms that import and export, find that these are 76% more productive than those that do not practice international trade, and that they are also more productive than firms engaging only in export or import operations[3].

1.6 **GVCs generate more and better jobs**: although production tends to be more capital intensive, an increase in exports leads to job creation. Furthermore, GVC participation tends to boost demand for skilled labor and eventually improve workforce capacity building. For example, Shepherd & Stone (2012) have found that in a sample of developing countries, companies that partake in GVC demand more skilled labor and pay higher wages than businesses that only export or are not involved in international trade at all. There is evidence that higher salaries paid by GVC firms are linked to higher productivity (Lu et al., 2019). Lastly, the World Bank's World Development Report shows that companies that participate in GVC tend to employ more women and contribute to improve social results. Based on World Bank Enterprise Surveys data, Rocha & Winkler (2019) have found evidence supporting that companies that take part in GVCs hire more women than those that are not part of these value chains. In the case of Mexico, districts with higher levels of employees in manufacturing companies participating in GVCs saw, in the 1993-2013 period, a higher reduction in poverty rates as well as better access to health, education, and transportation among the more disadvantaged sectors (World Bank, 2020).

1.7 Lastly, access to GVCs can lead, under the right circumstances, to an upgrading in the type of activities conducted at the local level, with a stronger role played by those where added value is generated (Antràs, 2020). Therefore, participating in GVCs may contribute to emerging countries' growth acceleration, as has been the case, for example, in several countries in East Asia in recent decades.

II. LATIN AMERICA AND THE CARIBBEAN IN GLOBAL VALUE CHAINS

2.1 Latin America and the Caribbean (LAC) must make an effort to further regional integration which in turn will allow the region to insert itself more efficiently on a global scale.

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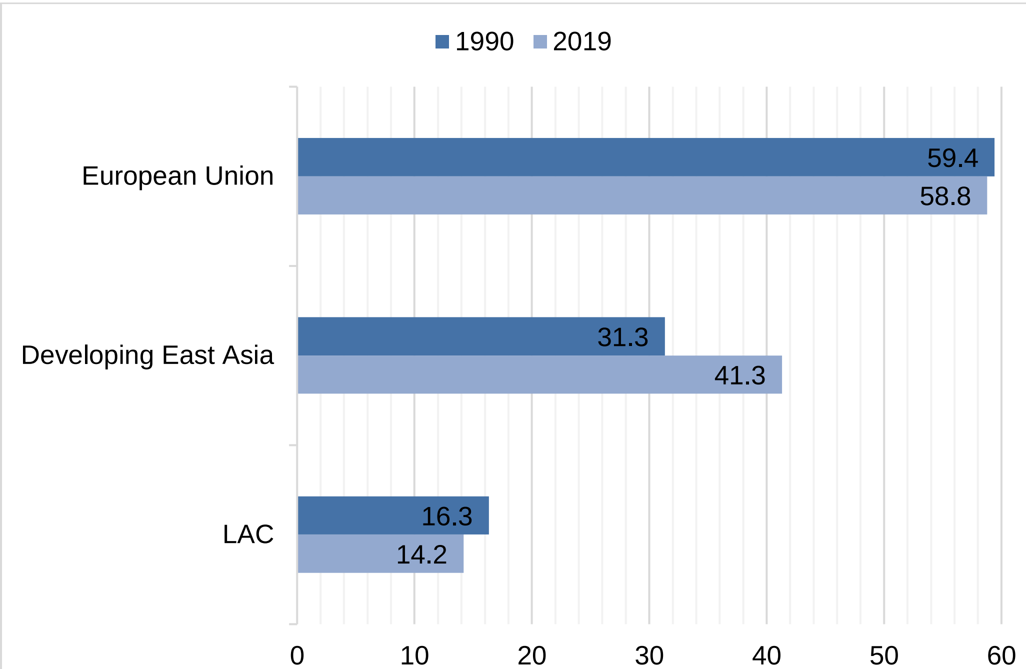
[1] This phenomenon is known as productive hyperspecialization (Antràs, 2020).
[2] Measured as the share of foreign added value to a country's exports.
[3] For a detailed assessment, see World Bank (2020) & Choi, J. et al. (2019).

Intraregional trade is lagging behind other regions in the world that have successfully undergone integration processes, such as the European Union, which has always been a benchmark for our region in terms of integration. In fact, intraregional trade in LAC has not only failed to grow but has shrunk in recent years and remains below 15%, while in the countries of the European Union it reaches 58.8%, and in the countries of developing East Asia it exceeds 41%. (See Figure 1).

Figure 1. Intraregional trade (% of intraregional trade / total)



Source: IDB with data from the Directorate-General for Statistics of the International Monetary Fund

2.2 The region is lagging in terms of GVC insertion, both in terms of percentage of participation and in the stages in which it participates. The number of LAC enterprises engaged in GVC is lower than in other regions, and these are mainly involved in early stages –especially in South America–, in which the productive structure shows a strong participation of commodities, which makes integration in GVCs difficult and leads to mainly exporting raw materials or derivatives that down the road get processed and re-exported from third countries. In Mexico and some countries in Central America, there are more companies that participate by incorporating imported intermediate goods that are later processed and exported. However, this kind of participation is only present in manufacturing stages and does not extend to other value chain segments where higher added value can be generated (Timmer, 2019; Blyde, 2014).

2.3 There are different methods to measure a country's participation in GVCs. Based on multiregional input-output matrices data, one way to measure GVC participation is by looking into a country's upstream linkages in the value chain. What is specifically gauged is the percentage of foreign added value integrated into a country's exports. Table 1 displays the simple averages of this measure in three different time periods for the countries of each of the specified regions. Overall, the figure has not changed much over time in LAC, while it has grown slightly in Asia and in the countries of the European Union. In the 2017-2019 period, the average country in LAC showed exports with 18.1% foreign added value, compared with 33.1% in the average country in Asia, and 43.3% in the average European Union country. (Blyde & Trachtenberg, 2020). (See Table 1).

Table 1. Foreign added value integrated in exports
(as percentage of exports)

	1990-1992 Average	2000-2002 Average	2017-2019 Average
LAC	19.2%	18.2%	18.1%
ASIA	31.5%	32.8%	33.1%
EU	34.4%	37.7%	43.3%

Source: IDB based on data from UNCTAD-EORA

2.4 This exercise can be carried out at a regional level to evaluate regional value chain composition, analyzing the percentage of foreign added value from within the same region integrated in a country's exports (See Table 2). From this perspective, the difference between LAC and other regions is even greater. In the period 2017-2019, for example, LAC exports contained 4.4% of added value originated within the region. At the same time, Asian exports presented 20.4% of added value from within Asia, and European Union countries' exports had 22.7% added value proceeding from countries within the European Union.

Table 2. Foreign added value originating from within the same region integrated in exports
(as percentage of exports)

	1990-1992 Average	2000-2002 Average	2017-2019 Average
LAC	3.4%	3.8%	4.4%
ASIA	17.0%	17.6%	20.4%
EU	22.8%	23.8%	22.7%

Source: IDB based on data from UNCTAD-EORA

2.5 LAC's low participation rate in GVCs responds to several reasons, namely: (i) the persistence of restrictive trade policies, including insufficient mechanisms for cumulation of origin and low degree of standards harmonization; (ii) high transportation costs, lag in logistics performance, and limited implementation of trade facilitation measures; (iii) high information costs; (iv) inadequate digital connectivity infrastructure; and (v) limited access to financing for companies interested in participating in GVCs.

2.6 **Restrictive trade policies, including insufficient mechanisms for cumulation of origin and low degree of standards harmonization.** Blyde & Trachtenberg (2020) suggest that LAC's low participation in GVCs is partially due to restrictive trade policies throughout the region, including a very fragmented network of Preferential Trade Agreements (PTAs). The lack of preference and regulation coordination between trade agreements may interfere with the development of further intraregional trade and the generation of more sophisticated supply chains. For example, rules of origin – the criterion that determines how much content may be imported from non-member countries for use in the production of goods for export to benefit from preferential treatment under a PTA – differ from one agreement to another (Mesquita Moreira, 2018). These divergences between agreements mean that a product made in most members of a PTA may not comply with the rules of origin of another PTA, even if they have members in common, placing the exporting country at a disadvantage in the latter PTA's markets. This lack of coverage and coordination between agreements in LAC is keeping intra- and extra-regional supply chains fragmented, hindering the formation of larger Regional Value Chains (RVCs).

2.7 **High transportation costs.** The region continues to face significantly higher transportation costs than its partners in Asia, Europe, and North America. An IDB report found that the transportation costs exporters face can reach between 6% and 12% of the total value of goods (Mesquita Moreira et al., 2013). The elevated cost of national transportation can be explained in part by the limited availability and low quality of physical transportation infrastructure, and scarce intermodality. International transportation costs, from national borders to the final destination, are equally high, and similarly respond to infrastructure deficiencies. Consequently, about 40% of the difference between international freight services in different countries in LAC and member countries of the Organisation for Economic Co-operation and Development (OECD) can be explained by infrastructure quality disparities. These costs are even higher in small and vulnerable economies[4], such as those in the Caribbean, where they can reach up to twice the global average (Mesquita Moreira et al., 2008).

2.8 **Lag in logistics performance.** LAC presents a significant lag in terms of its logistics performance. According to the World Bank's Logistics Performance Index, in 2018 the region posted an average score of barely 2.66 out of 5 on general logistics performance, ranking below Europe (3.40), East Asia and Asia-Pacific (3.13), and Middle East and Northern Africa (2.78). Logistics costs in LAC are between 16% and 26% of regional Gross Domestic Product (GDP), vis-à-vis 9% in OECD countries. Meanwhile, these costs represent a large share of the value of regional exports. In Central America, for example, these reach up to 40% of the final cost of exported goods. Lastly, inter- and multi-modality are limited; the region should expand its road access to port terminals by 15% by 2030 to cover the demand resulting from expected international trade growth. It is worth mentioning that a convenient transportation and logistics infrastructure is relevant for trade in final goods but is particularly meaningful when it comes to trading intermediate goods linked to GVCs. Leading GVC companies need to reduce risks associated with uncertainty and delivery hindrance of any component to avoid final good production downtime. Therefore, these companies seek suppliers in countries that have fitting transportation and logistics infrastructure (Blyde & Molina, 2014).

2.9 **Limited implementation of trade facilitation measures.** The foreign trade costs arising from lack of adoption of trade facilitation measures are one of the barriers hindering the

4 See Transportation Sector Framework Document (GN-2740-12).

development of intra- and extra-regional trade in LAC. The region still has in place burdensome administrative procedures that significantly increase average import and export times, which are longer than in Asia, Europe, and North America (Volpe Martincus, 2016). This includes not only a high frequency of physical inspections of shipments, but also a relatively low degree of progress in implementing several initiatives that countries in the region have explicitly pledged to apply under the WTO Trade Facilitation Agreement. LAC is particularly behind in compliance in key areas that reduce the timing and costs of trade, such as risk management, Single Windows for Foreign Trade (SWFTs), Authorized Economic Operators (AEO) programs, and the modernization and cooperation of customs and other relevant agencies. More specifically, the region's current SWFTs usually do not cover all border agencies and are limited to processing public administrative paperwork. In other words, they do not include other logistics operators, as the so-called port or airport community systems – which have not yet been widely implemented in the region – do[5].

2.10 **High information costs.** Information costs continue to represent a significant obstacle for companies seeking to operate in foreign countries. Seeking to reduce information costs both for companies looking to insert themselves in international markets and those interested in localizing themselves in their territories, most LAC countries have created export promotion agencies and Investment Promotion Agencies (IPAs). However, their institutional capacity tends to be limited, they have not yet adopted best international practices, and lack the appropriate articulation for an integrated systematic support to firms throughout the entire internationalization process. At the same time, not every agency has units specialized in post-investment services and care, and when they do, they are not sufficiently developed or sophisticated (Volpe Martincus & Sztajerowska, 2019). All this undermines the location advantage that LAC countries can exhibit to help them join new GVC links.

2.11 **Poor digital connectivity infrastructure.** LAC presents a wide digital infrastructure gap and low levels of production digitalization, which affect business productivity. One of the decisive factors for regional infrastructure is investment: OECD countries invest nearly twice as much per capita in telecommunications than LAC nations. 4G coverage in LAC was 83.30% in 2018, considerably lower than in OECD countries (95.63%). In 2017, the penetration of fiber-optic internet connections in the region was 3.15%, affecting the average broadband download speed, set at 4.09 megabytes per second, and 2.94 megabytes per second for mobile broadband, while in OECD countries these figures were three to four times higher (CAF, 2017).

2.12 **Limited access to financing.** Financing for the private sector is particularly low in LAC, representing 56.5% of GDP in 2019, compared with a global 133.8%, and 145.8% for OECD countries. The situation of the 28 million micro, small and medium-sized enterprises (MSMEs) is even more complicated; according to International Finance Corporation (IFC) estimates, they obtain US$185 billion in funding, while the financing gap – in other words, the unserved portion of the financing demand from MSMEs – was US$1.2 trillion in 2017 (IFC, 2017). MSMEs represent 99% of companies in LAC, are responsible for 25% of the GDP, and employ 61% of the workforce (Dini & Stumpo, 2019). Some of the main hindrances MSMEs face vis-à-vis larger companies are: (i) shorter commercial cycles with higher short-term liquidity needs; (ii) lack of risk management instruments associated to project cycles; (iii) less collateral available and executed, due to a scarcity of existing capital;

5 The Integration and Trade Sector Framework Document (GN-2715-11) includes an ample discussion on this topic.

(iv) high operational costs for financial institutions to engage in small-scale lending; and (v) lower profitability than other business segments[6].

2.13 In addition to these widespread restrictions, there is a set of challenges whose intensity varies from country to country. These challenges include insufficient skilled human resources and limited productive and technological capacity of local enterprises, as well as weak public institutions and institutional frameworks that undermine LAC countries' ability to attract FDI and join more sophisticated GVCs.

III. AN OPPORTUNITY TO INCREASE THE PARTICIPATION OF LATIN AMERICA AND THE CARIBBEAN IN GLOBAL VALUE CHAINS

3.1 **The current situation provides LAC with a unique opportunity to strengthen its RVCs, thus furthering its involvement in GVCs.** As previously stated, the world is undergoing a GVC reconfiguration process that began after the 2008/09 crisis and that shows an incipient acceleration with the advent of the COVID-19 pandemic. Seeking to make their supply chains more reliable, large multinationals aspire to secure inputs from closer-to-home locations. In fact, the current geopolitical situation and the growing perceived risk linked to the COVID-19 pandemic have put GVC diversification in the spotlight. If strategic input suppliers in key industries are concentrated geographically, the risk of supply chain disruptions is higher and could lead to significant economic losses. To offer greater resilience to future disruptions, reduce environmental impacts, and cut costs by shortening transport distances, global companies are taking steps to line up a number of input suppliers from nearer locations.

3.2 According to a study carried out by UBS Evidence Lab in June 2020, over 75% of US companies with factories overseas have decided or are considering moving part of their production to other countries[7]. In addition, a McKinsey study conducted in August 2020 shows that in a survey carried out in May 2020 to global company leaders, 93% of the firms reported to be making plans to grow supply chain resilience, generating redundancy at supplier level and reconfiguring, and regionalizing their supply chains to get closer to their target markets[8]. Another recent study conducted by Gartner shows that, in a survey of 260 companies, 49% reported to be shifting their procurement chains to alternative suppliers or locations, and 22% plan on moving to locations closer to the target country over the next few years[9].

3.3 **What is GVC regionalization or nearshoring towards LAC?** GVC regionalization towards LAC is the decision to locate part of a company's supply chain (either of a product or service) to a LAC country. This can be accomplished: (i) through FDI, opening (or expanding) subsidiaries in LAC, or (ii) by sourcing some of the necessary inputs from non-affiliated

6 See Support to SMEs and Financial Access/Supervision Sector Framework Document (GN-2768-7).

7 Available at: https://www.ubs.com/global/en/investment-bank/in-focus/covid-19/2020/supply-chains-are-shifting.html

8 Available at: https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Operations/Our%20Insights/Risk%20resilience%20and%20rebalancing%20in%20global%20value%20chains/Risk-resilience-and-rebalancing-in-global-value-chains-full-report-vH.pdf

9 Available at: https://www.gartner.com/document/3993345?ref=solrAll&refval=278020787

suppliers in LAC that can take over one or more stages in the supply chain. In other words, it is a process that can encompass investments and developing new suppliers[10].

3.4 Regionalizing value chains through nearshoring operations does not imply that the resulting end products will be consumed exclusively within the region itself. These products may be exported elsewhere in the world[11]. It is worth noting that the choice to regionalize a value chain through nearshoring operations is a market decision where companies, as part of their optimization processes, have assumed the supply chain disruption risk and are willing to pay a risk premium in exchange for higher supply chain resilience.

3.5 **The benefits of GVC reconfiguration for recipient countries.** The direct benefits of GVC reconfiguration for recipient countries are the generation of greater local investment (either domestic or FDI) and strengthening RVCs, which in turn leads to job creation and higher exports for the recipient country. The advantages are not limited to enterprises relocating their productive processes and exporting directly to a leading company; these companies also require inputs, services, and materials from other companies (upstream suppliers) whose businesses and operations may also grow. Upstream suppliers may be local firms or can also be located in nearby countries. Therefore, the impact of GVC reconfiguration operation on production and employment may extend to upstream suppliers within the same country or elsewhere in the region, fostering the creation of RVCs. In this sense, reinforcing regional integration is essential to facilitating these connections. Particularly, considering that the current GVC reconfiguration also includes reshoring operations, where companies relocate operations in their own countries. These operations can also potentially strengthen RVCs, given that they require supplies that can be obtained from other countries in the region (upstream suppliers).

3.6 Value chain regionalization allows companies of different sizes to join GVCs, which brings the aforementioned benefits, highlighting in addition to the impact on employment, benefits associated to technology, knowledge, and skills transfer to the recipient country. This is especially the case when these operations occur through FDI (Volpe Martincus & Sztajerowska, 2019). An additional benefit is the ability to respond more easily and swiftly to shifts in market preferences because suppliers are closer to end users (e.g., *fast-fashion* or customization requirements)[12].

3.7 **Trading Knowledge-Based Services (KBSs), another opportunity for strengthening RVCs in the region.** Another feature of the new global economic scenario is the growing importance of services, notably, KBSs. KBSs are easy to export through Information and Communication Technologies (ICTs) and help boost innovation and productivity for the entire economy. The worldwide KBS market has grown exponentially in recent years. Between 2005 and 2018, the cumulative growth of global KBS exports reached 145%, vis-à-vis 90% for other services and goods. It is worth noting that computing services was the only sector whose global exports grew during the second quarter of 2020, which can be explained by the trend towards teleworking and digitalization accelerated by the COVID-19 pandemic. Since these trends are unlikely to be reversed –in fact, they will probably continue

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10 See Annex I – Examples of GVC Reconfiguration, which describes some of the ways in which the regionalization of GVCs could benefit LAC.

11 Additionally, a RVC may be led by companies originally based outside the region. Such is the case of Bombardier in Mexico, a GVC led by a Canadian company that articulates a supply RVC for the industry.

12 The term *fast-fashion* points to an approach to garment design, creation, and commercialization focused on ensuring that fashion trends will be available to consumers quickly and affordably. See Merriam-Webster's dictionary, available at: https://www.merriam-webster.com/dictionary/fast%20fashion

to gain momentum –, countries in LAC countries could capture new export opportunities in this segment.

3.8 **RVC strengthening also poses a chance for LAC to reduce Greenhouse Gas (GHG) emissions and enhance its climate change resilience.** The shortening of value chains may lead to positive impacts on reducing carbon emissions linked to the production of goods and services in the region. At the same time, this reduction may be very limited or even reversed if RVC strengthening is not paired with investments in efficient logistics and productive solutions, clean transportation, and renewable energy to meet the growing power demand that a spike in regional industrial activity may create (World Economic Forum, 2009), or with production pattern changes brought about by the insertion into new value chains. It is also worth noting that the ability of different countries to offer electricity with reduced emissions and efficient infrastructure is a meaningful factor taken into consideration by downstream companies in value chains at the time of deciding where to invest, given the impact it will have on the carbon footprint of the products they offer. Climate change plays an important role in attracting GVC reconfiguration investments to LAC because the climate vulnerability of the countries where upstream production and services take place may jeopardize the stability of the value chains, with its resulting economic impacts in terms of both costs and input availability (Woetzel et al., 2020). Therefore, reducing this vulnerability to climate change and investing in resilience to natural disasters are key crosscutting elements in any strategy to promote GVC regionalization in LAC.

3.9 **LAC offers major comparative advantages to embrace product and service GVC reconfiguration operations**. While GVCs become increasingly diverse, LAC could be quick to capture a part of the trade and investment from sectors and products in which the region has already proved to be competitive. While LAC is heterogeneous, there are some differentiating factors that pave the way for exploring opportunities in different regions and countries. For example, in Central America sectors such as textiles, apparel and footwear constitute a huge opportunity for countries in the Northern Triangle (El Salvador, Guatemala, and Honduras), whereas medical instruments have high potential in Costa Rica and the Dominican Republic. The Mexican automotive industry may have the strongest chance given how closely located it is to the United States market and its excellent conditions for access. In turn, this industry has the potential to impact countries in Central America that may become auto parts suppliers. In South America, there is strong potential in different sectors such as agri-foods, electrical machinery, electronic supplies, and plastics, among others, where larger countries, like Brazil, can become catalyzers for the rest of the region (IDB, 2021). LAC also has comparative advantages for joining RVCs that feed the energy transition the world is undergoing, fostered by the integration of natural resources such as lithium in Argentina, Bolivia, Chile, and Peru – a prerequisite for battery production for electric vehicles and power storage (López et al., 2019).

3.10 **LAC may also be appealing to the KBS sector**, thanks to a combination of available skilled labor at a competitive cost, similar time zones, and cultural and language affinity, considering that Spanish-speaking countries are at an advantage to export to the rest of the region and to the United States Hispanic market. For their part, Caribbean countries also have strong potential to gain a foothold in English speaking markets given their resource availability and industries that are well developed in several sectors. Additionally, the existence of special economic zones and other types of investment and export promotion schemes in several countries makes the region even more attractive. As with products, the opportunities for services vary greatly between countries. These include, among others, outsourcing services of knowledge processes (finances, process reengineering) and back office; architecture, engineering and design; development of apps, software, and information technologies; establishing shared service centers; data centers and the cloud; market and financial assessment and intelligence services; research and development; health and education services; advertising; audiovisual services; printing and publishing services; and Fintech and Agtech solutions (López et al., 2014; López et al., 2017; Rozemberg & Gayá, 2019).

3.11 **To benefit from the emerging opportunity that GVC reconfiguration poses, countries in LAC must redouble their efforts to reduce trade costs and generate a favorable business environment**, taking overdue steps forward in the region's overdue integration agenda. This should include improving infrastructure for trade, quality, connectivity, and competitiveness, following principles of sustainability and resilience to climate change, as well as strengthening FDI attraction capacities. At the same time, LAC should orient its public policies towards the generation of trade and investment promotion instruments, just like other regions in the world do, to incentivize companies to locate in the region. These instruments can mitigate a number of market flaws related to the information problems and positive externalities of these investments. It is also important to facilitate access to financing and best international practices for local enterprises, especially MSMEs[13]. This will allow them to become efficient suppliers to investing companies, maximizing the local impact and job creation from GVC reconfiguration operations.

3.12 In addition to the aforementioned measures, in order to provide an appealing business environment that attracts investments oriented to strengthen RVCs, the region also needs to advance in the field of structural reforms of other conditions that have a crosscutting impact on companies.

3.13 **First, to boost their international insertion countries need to develop robust institutional and regulatory frameworks.** Macro-fiscal stability, rule of law, transparency and integrity, the implementation of good regulatory practices, and policies promoting inclusion and environmental and social sustainability are all essential factors to support RVCs and the MSMEs that comprise them. Recent studies have shown that improving institutional quality – enhancing contract compliance and protecting intellectual property rights – is crucial to boost a country's participation in GVCs. PTAs may help advance regulatory harmonization among countries. They constitute an institutional, external anchor that provides predictability to the domestic legal and regulatory framework. Furthermore, an institutional framework that guarantees contract compliance attracts commercial flows and the insertion in value chains, while political stability increases a country's odds to participate in GVCs with higher added value (World Bank, 2020). In addition to these institutional pillars, improving the region's business environment requires regulatory reform and harmonization and mutual recognition agreements, following international standards in priority topics such as competition, quality, accountability, legal requirements to start up a business, formality, access to banking services, digital payments and financial services, and user coverage and protection instruments, among others.

3.14 **A key dimension in the agenda to improve competitiveness is the presence of formation policies.** Human capital availability is a key factor to attract FDI (Noorbakhsh et

13 In certain specific cases, it may even be necessary to advance in vertical policies that remove specific obstacles from sectors, for example, weak regulations that impede the sector's development, lack of coordination among public agencies that need to work together to be successful, or the lack of a given sectoral public good, etc. See Crespi et al. (2014), and Mesquita Moreira & Stein (2019).

al., 2001; Nunnenkamp, 2001; Campos & Kinoshita, 2003; Banga, 2003; Nonnemberg & Cardoso de Mendonça, 2004). A qualified workforce helps boost business productivity, is a key condition for an efficient use of modern technologies and to foster innovative activities within a company. Several recent studies underlined the role of human capital to access and scale GVCs (Cadestin et al., 2018 and Urata & Baek, 2020). This role is especially meaningful in certain chains such as KBS (Jensen & Pedersen, 2012, and Py & Hatem, 2009), and is also necessary to attract higher added-value stages both upstream (e.g., innovation, design, etc.) and downstream (e.g., marketing, branding, etc.). In this scenario, it becomes increasingly important to connect the learning provided by national education systems to the emerging demands of production and innovation, while strengthening capacity building and training mechanisms through short-term or specialized training schemes.

3.15 **At the same time, although FDI may favor access to new technologies and boost the innovation capacity of recipient countries, the availability of these capacities can per se attract investments** (Addison & Heshmati, 2003; Villaverde & Maza, 2015; and Palit & Nawani, 2007). These capacities also boost the chances of seizing positive spillovers from incoming FDI (García & López, 2020). Regarding GVCs, countries with more efficient innovation systems will also have higher odds of entering chains at more complex stages (Lee et al., 2018, and Lema et al., 2019), especially those involving research, development, and design. If countries in the region look to improve their participation in these chains, a key element in the agenda is to strengthen their science and technology policies, especially promoting capacity development in the private sector, and a higher connection between this sector and universities and scientific institutions.

3.16 **The agenda for taking advantage of GVC reconfiguration must also consider existing gender and inclusion gaps in the region.** Women have lower rates of financial inclusion than men. This gender gap is present in different products and services (Demirguc-Kunt et al., 2018). Businesswomen, in particular, find it harder to access financing. An estimated 30% of companies owned or led by women face such restrictions, compared with 25% of businesses owned or led by men. Women are also asked to present more guarantees or collateral. As a result, the financial gap in the segment rises to US$92 billion (IFC, 2017). These gaps are especially acute for smaller enterprises; it is estimated that half the MSMEs requesting foreign trade financing are rejected by banks, and in over 70% of the cases, they have no financing alternatives, affecting their integration into GVCs. The financial inclusion of women and businesswomen poses an urgent challenge that must be tackled to level the playing field and help them contribute to the region’s economy. In addition, there is a gender employment gap in the region, since women’s participation in the workforce in LAC (58%) continues to be well below men’s (82%), this gap being one of the largest in the world (Bustelo et al., 2019; Barafani & Barral, 2020). Furthermore, the World Bank has found that indigenous populations (10%) (World Bank, 2015) and people of African descent (25%) (Freire et al., 2018) in LAC are up to twice as likely to be unemployed. Therefore, the agenda to strengthen RVCs must include an adequate crosscutting gender and diversity approach to help improve businesswomen’s access to finance and markets through better GVC integration, and to encourage their participation in the workforce through more (direct and indirect) job opportunities resulting from GVC reconfiguration operations.

IV. PRIORITY AREAS FOR THE STRENGTHENING OF REGIONAL VALUE CHAINS IN LATIN AMERICA AND THE CARIBBEAN

4.1 The IDB Group can play a key leading role in the agenda to strengthen RVCs to boost LAC's global insertion by providing and leveraging financial resources, offering technical assistance, and coordinating regional initiatives as an honest broker.

4.2 To this end, three thematic areas in which the IDB Group should prioritize its actions to strengthen LAC's GVCs are proposed: (i) promotion and financing to foster investment and employment in the region; (ii) financing for infrastructure projects and for endeavors aimed at improving logistics services to reduce trade and connectivity costs; and (iii) regional integration support to advance towards the convergence and harmonization of agreements and trade regulations and to improve the business environment in LAC[14].

A. INVESTMENT PROMOTION AND FINANCING

4.3 IDB Group reports have consistently found that support to export promotion significantly helps increase and diversify exports at the company level, especially for small- and medium-sized enterprises (SMEs), and particularly in the case of more sophisticated goods. Above all, these investments have been cost-effective. On average, for every dollar spent on trade promotion, exports have risen by US$10 to US$45 (Volpe Martincus, 2010). Another report, focused on 12 countries in Latin America, offers evidence that investment promotion has been an efficient tool to attract multinational subsidiaries. In particular, companies supported by national IPAs are more likely to establish a presence in these countries. This kind of intervention has also been profitable. Estimates about Costa Rica indicate that the cost-benefit ratio could range between US$13.7 and US$41.7 of additional FDI for every dollar spent on investment promotion when such investments average US$5 million and US$15 million, respectively. These figures grow from US$48.6 to US$145.9 when multinationals are assisted repeatedly with multiple services (Volpe Martincus et al., 2020).

4.4 **Lessons learned.** In relation to the IDB Group lessons learned on the promotion and financing of investment in LAC, it should be noted on the one hand that, in accordance with the Integration and Trade Sector Framework Document (GN-2715-11), work with APIs must have strong and sustained high-level support and foster collaboration with other public-private organizations. Likewise, experiences suggest that APIs should have operational autonomy, a necessary budget, and publish their results. The importance of using cloud-based management tools and setting realistic goals to measure and monitor results using the institutions' own tools is also emphasized. Lastly, the importance of inter-institutional coordination and frequent training of personnel on investment issues has been identified.

4.5 At the same time, in terms of investment financing, the Support to SMEs and Financial Access/Supervision Sector Framework Document (GN-2768-7) indicates that reduced SME access to productive financing hinders their satisfactory integration into international markets, as well as global and regional value chains. In this sense, the IDB Group has been playing a key role in the region, facilitating the dialogue among interest groups in public-private sectors to identify and understand the scope of obstacles and challenges to access productive financing. This can in turn allow operations to be designed with instruments that are better adapted to local and regional realities, with greater impact for end beneficiaries. On the other hand, a major lesson learned is the importance of leveraging synergies

[14] Annex II includes examples of activities by prioritized thematic area as a guide for project structuring.

between financial and non-financial instruments to meet the challenge of SME access to funds. Apart from programs based on guarantees, and the structuring of trust funds and investment funds, technical assistance has been a significant complement and support for access to financing since it has made it possible to strengthen the capacities of companies to develop bankable projects and improve their financial and management techniques. Lastly, in terms of achieving greater financial integration among countries of the region, it is first necessary to move towards higher levels of regulatory, exchange and fiscal harmonization.

4.6 With the aim of attracting further FDI and increasing employment in LAC, the IDB Group needs to prioritize technical and financial support to its borrowing member countries to position the region as an attractive destination for GVC reconfiguration operations. Priority actions include: developing national and regional strategies to position LAC internationally as an attractive destination for FDI; designing and implementing IPA institutional strengthening strategies; developing Single Windows for Investment; and designing and developing industrial and technological parks. Meanwhile, the IDB Group should support the adaptation of productive standards and technological and managerial development to promote value chain reconfiguration and upgrading; implementing upskilling and re-skilling programs focused on internationalization and investment attraction; and supplier development programs focused on GVC regionalization operations in LAC. Lastly, the necessary policy and institutional framework reforms should be promoted to improve the business environment[15].

4.7 The IDB Group may also use its business network, *ConnectAmericas* – with over 500,000 registered businesspeople in the region– to (i) facilitate connections between anchor companies engaged in GVC regionalization operations in LAC and their local suppliers; (ii) strengthen these local suppliers' capacities with online learning tools (massive online open courses, videos, articles, self-evaluation tools, etc.); and (iii) facilitate decision-making on behalf of investors by providing practical quality information about investment destination in the region (competitive sectors, success stories, local supplier databases, administrative information about procedures, etc.) Additionally, *ConnectAmericas for Women* – a platform focusing specifically on promoting GVC access to female owned or led companies – could be made available.

4.8 The IDB Group should support public policies aimed at providing financing for productive investments made through GVC reconfiguration operations, prioritizing those that mobilize larger investments from the private sector, and that have a higher positive impact on reducing poverty and on the region's environmental and social sustainability. Capitalizing on its robust background in financial structuring, the IDB Group should support the design and implementation of private sector financing operations with sovereign guarantee (through National Public Banks) and without sovereign guarantee (through IDB Invest) for domestic companies carrying out GVC regionalization operations in LAC, and for local SMEs who supply these companies in order to promote inclusive and sustainable growth, as well as job creation that takes the gender gap into consideration. These operations may be performed in cooperation with other international organizations, donors, local and international financial intermediaries, and institutional investors.

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15 These could include reforms aimed at ensuring macroeconomic stability, a tax structure that enables growth and customs facilitation, value chain transparency and integrity, and institutional arrangements such as management models and delivery units for the implementation of trade agreements.

4.9 IDB Invest may also make capital investments focused on productive scaling, productive efficiency, technological and regulatory implementation, capacity building and human resource strengthening, and introduction of new products, to facilitate or enhance access to GVC regionalization opportunities in LAC.

4.10 Additionally, IDB Invest may provide financial product and risk mitigation and cost reduction instrument solutions, with a special focus on tackling the gap in access to trade financing for MSMEs. These products should aim at: (i) strengthening the capacity of companies in the region to partake in RVCs; (ii) enabling their participation in international markets and expanding their trade financing sources; and (iii) optimizing their cash conversion cycle and strengthening their value chain.

4.11 Lastly, IDB Lab may promote solutions that encourage the growth of startups in LAC through venture capital funds and instruments for direct capital investment. IDB Lab may specifically support investments and local and international capital risk financing for rapidly developing SMEs, offering solutions that will enhance their productivity, making these companies more competitive in the global arena. IDB Lab will also be able to finance ecosystems for talent and companies in emerging industries that seek to participate in value chains.

B. INFRASTRUCTURE

4.12 There will be a greater opportunity to attract new trade and investment in LAC if the region develops appropriate, sustainable, and resilient infrastructure. This involves better ports, roads, airports, railroads, energy capacity and sustainability, and broadband. The region already suffers from low levels of investment in infrastructure: between 2008 and 2018, countries in the region invested an average 2.8% of GDP in infrastructure (Serebrisky et al., 2020). The IDB Group's 2020 Flagship Report estimates that the annual investment needed to close existing infrastructure gaps is between 4% and 7% of GDP (Cavallo et al., 2020). At the same time, LAC's adoption of technology in supply chains lags by a decade compared with advanced countries (Calatayud & Katz, 2019). Regarding logistics services, a recent IDB report determined that climbing one point on the Logistics Performance Index boosts a country's exports by 7% (Catalayud et al., 2021). The region needs to invest in improving infrastructure, multimodal transport, existent assets management, and services to reduce the costs of trade, connectivity, and competitiveness to take better advantage of its geographical edge for GVC regionalization.

4.13 Reducing international freight costs in LAC by 10% would boost export value by at least 30% and raise the number of products exported by 25%, both within the region as well as to the United States (Mesquita Moreira et al., 2008). Improving physical infrastructure greatly reduces transport costs, therefore leading to substantial gains in company exports, which in turn boosts the employee headcount (Mesquita Moreira & Stein, 2019). In particular, the findings of one study regarding the main bridge connecting Argentina and Uruguay, indicate that reducing transportation costs by 1% is associated to a 6.5% growth in company exports. The results of another IDB report that investigated the impact of new roads in Peru suggest that total annual exports of differentiated goods have been approximately 5.6% higher thanks to these new roads, and additional exports may have risen to about 20% of the average annual public investment in road infrastructure. These exports fostered by infrastructure represented around 4% of (net) new jobs created in the country (Volpe Martincus et al., 2017; 2014). Lastly, in terms of services, to seize the KBS exports opportunity, LAC should adopt an "end-to-end" approach, offering last mile connectivity. Aside from the general infrastructure of information technologies, the region must guarantee adequate access to equipment and capacities at company level to harness the benefits of digital transformation, which faces multidimensional challenges to better adopt technologies by different nodes and stakeholders in supply chains operating in LAC, from resistance to change to the lack of specialized human capital (Calatayud & Katz, 2019).

4.14 At the same time, a key aspect for companies to locate or expand their investments in LAC, especially those highly committed to sustainability, is access to abundant, sustainable, and reliable energy at competitive prices. Reliable energy goes beyond service quality; it also must be environmentally and socially sustainability. Supporting energy infrastructure at a national level should be complemented with the endorsement of the regional agenda for energy integration in LAC, which has had a meaningful economic and trade impact (Echevarría et al., 2017)[16]. Regional energy integration offers three benefits that are crucial for RVC strengthening: (i) it makes each country's economy more competitive by reducing regional electricity costs, because energy exchange allows imports from countries where it is cheaper than local alternatives, and exporting to countries where it is more expensive than in the country of origin; (ii) it improves energy security by allowing the flow of energy between countries, which can provide an effective backup in case of shortages due to local operational problems or emergencies; and (iii) it encourages the adoption of renewable energies that reduce GHG emissions and cut energy costs.

4.15 To ensure that the potential environmental benefits from reducing distances covered (and therefore, emissions) are not lost or reverted, investment in renewable energies is required to cover the increasing demand stemming from the generation of RVCs. Furthermore, there is a huge opportunity for regional energy integration to harness the complementarity of renewable energy sources of neighboring countries. At the same time, there should be incentives to reduce transportation carbon emissions throughout LAC to support RVCs (river and maritime cargo transport, and terrestrial transport by railroad and electric and hybrid vehicles).

4.16 Meanwhile, the crisis set off by COVID-19 has exposed the need to further develop infrastructure resilience. This includes service reliability and risk management and resilience to climate change. Evidence shows that integrating disaster risk management from the project planning stage is highly profitable, reducing losses by US$4 for every dollar invested. According to the IDB Sustainable Infrastructure Framework (IDB & IDB Invest, 2018), LAC is one of the most vulnerable regions to climate change. Therefore, to increase its resilience, it is essential to consider disaster and climate change risks in project design and development[17]. This will offer companies more security and predictability when evaluating whether to develop their investments in LAC.

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16 For example, according to the report by Echevarría et al. (2017), in the case of the Central American Electrical Interconnection System (SIEPAC), from 2012 to 2015, energy exchanges between countries grew by nearly 500%. In 2017, international exchanges reached 5% of total power sales in Central America, while in 2012, they barely reached 1%. The economic benefits of SIEPAC were the equivalent of US$305 million between 2013 and 2018, or 0.165% of regional GDP. Additionally, in the long-term, integration through SIEPAC is expected to help cut energy costs by 8.4%, which can generate an estimated growth of 0.43% in regional GDP, compared to a non-integration scenario.

17 The IDB has developed a methodology to help identify and assess disaster and climate change risks, as well as resilience opportunities for all relevant projects during its identification, preparation, and implementation phases. This offers a valuable opportunity to align existing policies, procedures, and methodologies to reduce vulnerability to climate change and associated extreme events, while boosting the region's potential to attract FDI and host RVCs.

4.17 **Lessons learned.** In relation to the IDB Group lessons learned in terms of infrastructure, the Energy Sector Framework Document (GN-2830-8) highlights the growing importance of energy integration in the region, according to the diversity of loads, consumption patterns, and endowments that give rise to multiple opportunities to lower energy costs through greater efficiencies. The lessons learned in this area point to the need for institutional, regulatory, and legal adjustments to make it possible to incorporate technological advances and new business models to capitalize on the possible efficiency gains derived from the development of non-conventional renewable energies and ICT. International experience also indicates that investments are required in infrastructure to interconnect countries, in institutional parameters that ensure contracts and in regulatory frameworks. Likewise, the importance of promoting regional collective action, harmonizing national policy reforms, updating regulatory frameworks, investments between countries and taking advantage of cross-border externalities within the execution of regional energy integration projects is highlighted.

4.18 Additionally, the Transportation Sector Framework Document (GN-2740-12) indicates that one of the most relevant lessons learned is the importance of gathering further evidence on the impact that soft investments in transportation services have on logistics costs and foreign trade competitiveness, as well as on other fields such as access to health, education, employment, poverty reduction, and quality of life improvement. Regarding lessons related to the challenge of improving the region's logistics performance, experience has underlined the importance of intersectoral planning and coordination to boost different economic sectors collectively, from first-mile challenges to long distance transportation, last-mile, and foreign trade logistics challenges. For example, projects such as the Road Master Plan of Brazil and the National Logistics Plan of Panama (PNLog) stand out for having planning instruments agreed upon between different productive sectors, thus establishing investment priorities to reduce logistics bottlenecks. Lastly, it is important to consider that the implementation of transport and logistics reforms requires high-level leadership to coordinate stakeholders, such as customs and the private sector, to achieve the expected results.

4.19 Regarding the cross-cutting issue of carbon emission reduction and infrastructure resilience to natural disasters and climate hazards, the Climate Change Sector Framework Document (GN-2835-9) underscores that investment in sustainable infrastructure is essential to meet targets and commitments and foster climate-resilient and low-carbon development. Investments in sustainable infrastructure may contribute to stimulating trade integration, employment, industrial growth, and competitiveness, while reducing inequalities at a national level and between countries. A lesson learned is that to further climate resilience in sustainable infrastructure projects, national and sub-national governments must get involved; there must also be a clear participation and guidance by ministries of planning at central level to ensure proper coordination with development plans. Additionally, it is essential to connect stakeholders to each other to ensure that knowledge on the matter is applied, and to integrate climate change issues into the cycle of regional integration and sustainable infrastructure projects undertaken in different countries throughout the region.

4.20 With the aim of fostering LAC's physical and digital connectivity, the IDB Group should provide financial assistance to: (i) programs that improve physical trade infrastructure (roads, ports, airports, etc.) and border territorial planning, under environmental, social, financial, and institutional sustainability principles that follow the guidelines to develop better infrastructure ("build back better'')[18]; (ii) renewable energy and/or regional energy interconnection projects; and (iii) projects to increase regional digital interconnectivity (broadband and fiber optics communication). This funding might include financing operations with or without sovereign guarantee, as well as technical assistance to the public and private sectors for project development operations (upstream), and during projects financing, construction, and operational phases.

4.21 Private sector participation may contribute to reduce the fiscal impact caused by infrastructure development, and thus boost the necessary investment to guarantee the infrastructure and associated services that countries in the region need, especially through public-private partnerships (PPPs). At the same time, IDB Invest, platforms, and business networks such as the Americas Business Dialogue (ABD), ConnectAmericas, and Build the Americas (BTA)[19] may maximize coordination and resource mobilization with the private sector and other development agencies. Considering that coordinating large infrastructure investment projects is imperative, the IDB Group can play a leading role by applying its technical capacity, regional scope, and reputation as an honest broker.

C. INTEGRATION

4.22 The potential to consolidate RVCs that crystallize the opportunities presented by the current situation depends on LAC's ability to strengthen its regional integration. This involves both improving the trade architecture (access, convergence, and harmonization) as well as reducing non-traditional trade costs. For example, Mexico's success as an exporter to the United States underscores the importance of access to markets for regional integration. Twenty-five years of the North American Free Trade Agreement (NAFTA) have set the rules, standards, and market access that allowed Mexican companies to enter GVCs from the United States. At the same time, a recent IDB study found that the average tariff reduction of 56% that LAC saw between 1990 and 2010 accelerated annual GDP per capita growth by 0.6 percentage points on average. Aside from access, the convergence agenda – which in the first instance seeks to harmonize and unify the complex network of agreements in the region through cumulation of origin– needs to be prioritized. Already about 90% of intraregional trade is duty-free, and even before taking GVC reconfiguration into consideration, the convergence of LAC's 33 preferential trade agreements (with 47 distinct sets of rules of origin) could generate an estimated increase in intraregional trade of 11.6%, or around US$20 billion (Mesquita Moreira & Stein, 2019).

4.23 In addition to the traditional (tariff and non-tariff) trade barriers, the region needs to address non-traditional trade costs, reducing its information and border processing costs. Trade facilitation, especially the support to reliable, efficient, and safe border crossings may be as important as Free Trade Agreements (FTAs) in fostering trade. For example, in the case of Peru, border, port, and customs processing times on average represented nearly 60% of total transportation time (Mesquita Moreira & Stein, 2019). According to Mesquita Moreira & Stein (2019), LAC is seriously lagging behind North America, Europe, and Asia in implementing its commitments to the 2019 WTO Trade Facilitation Agreement, with around

[18] The IDB Group defines Sustainable Infrastructure as infrastructure projects that are planned, designed, built, operated, and dismantled in such a way that they guarantee economic, financial, social, environmental (including climate resilience), and institutional sustainability during the project's entire life cycle. See Bhattacharya et al. (2019).

[19] BTA is a mobile app that seeks to increase competition in infrastructure bidding processes financed by IDB. BTA facilitates contacts between relevant international developers and local suppliers for each tender.

40% of those commitments still unfulfilled. LAC must fully meet its pledge to the WTO Trade Facilitation Agreement, and improve border management, implement SWFTs, update control agencies – especially customs authorities –, and expand AEO programs.

4.24 Impact assessments of the IDB's trade facilitation initiatives confirm that these measures have been effective in fostering trade: exports and imports grew significantly and new enterprises, in particular SMEs, ventured into the international trade arena for the first time. It is worth noting that, just like with investment promotion and infrastructure investments, trade facilitation initiatives have been profitable: additional exports and even gains associated to income (or cost savings) have highly exceeded the implicit costs of these initiatives (Volpe Martincus, 2016).

4.25 **Lessons learned.** In relation to the IDB Group lessons learned in terms of trade facilitation and regional integration, the Integration and Trade Sector Framework Document (GN-2715-11), highlights that, in terms of reducing logistics costs, coordination, governance and change management are the determinants of success in this type of projects since a particular technology does not necessarily guarantee their success but is rather only one out of many factors. Additionally, it is emphasized that during the design and execution stage of this type of projects, it is essential to ensure continuous political support for the programs, inter-institutional coordination, and the participation of the private sector, as well as having a project coordinating unit, with dedicated staff with experience in IDB Group policies.

4.26 Regarding regional integration agreements and schemes and the reduction of regulatory costs, business agendas must be established with appropriate calendars that favor the effectiveness of meetings and help identify the most suitable technical profiles during the negotiation and instrument revision phases. It is likewise important to promote coordination among governments and with the private sector for successful agreement implementation. Regional integration schemes such as the Pacific Alliance (PA) and the Southern Common Market (MERCOSUR, for its Spanish acronym) can be suitable platforms for these discussions. For example, in the PA, the IDB Group has actively supported initiatives such as the interoperability of FTSWs, mutual recognition arrangement of AEOs, and reduction of non-tariff barriers through the negotiation of sectoral annexes, as well as a digital agenda that includes key elements of regulatory cooperation.

4.27 To foster deeper integration of LAC to strengthen RVCs, the IDB Group, as a qualified honest broker, needs to redouble its efforts to encourage countries to press forward with the pending convergence and harmonization agenda. The IDB Group has the technical expertise to support the development of proposals to subscribe agreements for the convergence of trade agreements and regulatory frameworks to develop businesses in LAC, including proposals to standardize technical, sanitary, phytosanitary, tax, labor, and environmental regulations; the development of cumulation of origin and investment protection agreement proposals, as well as double taxation proposals; the regulation of special economic areas and the development of proposals of institutional, policy, and regulatory adjustments to foster transparency and competitiveness in LAC[20]. Additionally, the IDB Group should support the region by providing financing to reduce trade costs through the implementation of national and binational Coordinated Border Management programs; the design and development of SWFTs and Port Communities and their

[20] These may include reforms to ensure macroeconomic stability, a pro-growth tax structure, customs streamlining, transparency and integrity of value chains, and institutional arrangements such as management models and delivery units for the implementation of trade agreements.

interoperability; and the implementation of AEO programs and (terrestrial, river, maritime, and aerial) border risk management programs and customs facilitation programs.

V. THE IDB GROUP'S TOOLKIT TO SUPPORT LATIN AMERICA AND THE CARIBBEAN'S AGENDA FOR STRENGTHENING REGIONAL VALUE CHAINS

5.1 To support LAC countries in strengthening their RVCs and foster their international integration by implementing the aforementioned actions, the IDB Group makes available to its borrowing member countries and companies in LAC a set of tools that include financial and non-financial instruments. These instruments should be gradually adjusted to each country's demands, according to their specific needs to tackle priority areas to strengthen RVCs. (See Table 3).

A. FINANCIAL INSTRUMENTS

5.2 Current financial instruments that the IDB Group may offer its lending member countries in the priority thematic areas include: (i) sovereign and non-sovereign loans, guarantees[21], and reimbursable technical cooperation operations with or without sovereign guarantee; (ii) capital investments; and (iii) investment grants and non-reimbursable technical cooperation.

5.3 **Loan and guarantee operations**. The following operations may be used in support of the RVC strengthening agenda:

- (i) Sovereign investment loan and guarantee operations to finance projects aimed at supporting investment promotion, infrastructure for trade, connectivity and competitiveness, and regional integration;
- (ii) Sovereign policy-based loan operations to improve the investment environment and strengthen RVCs (investment protection agreements, double taxation agreements, and regulation of incentives, transparency and competition, among others), and promotion of a higher degree of convergence and harmonization of agreements and trade regulations;
- (iii) Sovereign loan and guarantee operations aimed at the private sector through the National Public Sector Banks for companies regionalizing their GVCs in LAC and local SMEs supplying anchor companies[22]; and
- (iv) Non-sovereign investment financing operations using existing IDB Invest instruments to support companies' efforts to implement or expand GVC regionalization activities in LAC and SMEs supplying anchor companies, through financial intermediaries or the anchor companies themselves.

5.4 In addition, the IDB may also finance reimbursable technical cooperation operations in conformity with its applicable policies and procedures. IDB Invest may also provide non-sovereign reimbursable technical assistance to entities in infrastructure project preparation

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21 In the case of guarantees with sovereign guarantee, in compliance with the IDB's Policy for a Flexible Guarantee Instrument for Sovereign-Guaranteed Operations (GN-2729-2) and Operational Policies (document GN-2729-4).

22 In the case of these projects, resources could be transferred from eligible borrowers to existing Special Purpose Vehicles (SPVs) or to SPVs created for this purpose. These will provide loans and guarantees to requesting companies. These SPVs will enable the participation of external investors, such as investment funds and institutional investors, and the opportunity to securitize in thematic instruments with guarantees provided by the IDB Group. Alternatively, or complementarily to SPVs, countries will be able to choose to establish financing mechanisms using National Development Banks as financial intermediaries, as well as to rely on IDB guarantee operations to facilitate structured financing for that purpose.

processes (upstream) to help foster the development of more resilient and efficient infrastructure, thereby strengthening the region's RVC processes. This assistance may include financial and technical resources for the development of pre-investment studies and structuring of private initiatives or bidding processes, among others.

5.5 **Capital investments**. IDB Invest may provide non-sovereign financial support for financing operations to regional investment funds oriented at investing capital in mid-sized enterprises to support their growth and boost their RVC insertion. In addition, IDB Lab may finance non-sovereign capital investments in financing operations in regional venture capital funds oriented at investing capital in high-impact startups with potential to expand in the region.

5.6 **Investment grants and non-reimbursable technical cooperation.** The IDB and IDB Lab may also finance investment grants and non-reimbursable technical cooperation operations in support of the preparation and execution of loan and guarantee operations in the areas prioritized in this document, finance the design of pilot projects, Regional Policy Dialogues (RPDs)[23], as well as training programs and courses for public officials to improve their integration and RVC strengthening knowledge. Non reimbursable technical cooperation may also be used to finance sectoral analyses and export promotion and investment attraction events[24]. In addition, IDB Lab may offer non-reimbursable financing operations for investment and contingent technical cooperation operations.

B. NON-FINANCIAL INSTRUMENTS

5.7 Non-financial instruments that may be used to support the RVC strengthening agenda described in Section IV of this document include: (i) applied research: (ii) generation of regional and global partnerships with relevant international and local organizations; and (iii) fee based IDB advisory and knowledge services (fee for services) as well as advisory services for companies provided by IDB Invest.

5.8 **Applied research.** The IDB Group's research agenda should focus on providing solid empirical evidence to help policymakers take better advantage of GVC reconfiguration opportunities and strengthen operations and activities to underpin RVCs through: (i) comparative data generation, mapping, and evaluation; (ii) impact assessment and studies, and sectoral diagnostics; and (iii) knowledge dissemination and regional networking.

5.9 **Partnerships with other organizations and multilateral development banks**. To ensure the complementarity of actions included in this agenda with other similar initiatives at the national, regional, and subregional levels, the IDB Group should work in partnership and coordination with international organizations and regional development banks operating in LAC. These include the World Bank, CAF, the Caribbean Development Bank, the Central American Bank for Economic Integration, and the Financial Fund for the Development of

23 RPDs will be able to effectively inform the process of policy formulation by offering best international practices and promoting the debate among relevant stakeholders on reform strategies connected to the three thematic areas prioritized in this document. RPDs may not only foster conversations among policymakers, IDB Group staff, and international experts about key topics regarding RVC strengthening, but may also offer a platform to discuss the design, reformulation, and adoption of relevant policies. Furthermore, RPDs may focus on different topics related to RVC integration and strengthening, following the public agenda of beneficiary countries. They will also inform the IDB Group's future operational program on these issues.

24 Innovative promotional events may be conducted with the presence of industry leaders to encourage dialogue between governments from the region and the private sector, so the latter can also be included in every stage of design, execution, and evaluation of foreign trade, investment attraction, and integration projects.

the River Plate Basin – FONPLATA, among others, to maximize the impact of specific operations and optimize resource mobilization.

5.10 **Fee based IDB advisory and knowledge services (fee for services)**[25] **and IDB Invest advisory services**. The IDB may provide advisory and knowledge services in the areas mentioned in this document through its professional staff in exchange for fees to be paid by eligible clients benefiting from the provision of such services. IDB Invest may offer advisory services to companies located in borrowing member countries to help them develop their capacity to take full advantage of LAC's integration and GVC regionalization opportunities.

Table 3. Summary of the Toolkit for strengthening RVCs

<table>
<tr><th>Thematic Areas</th><th colspan="10">Investment</th><th colspan="10">Infrastructure</th><th colspan="10">Integration</th></tr>
<tr><td>Types of intervention</td><td colspan="6">Investment Promotion</td><td colspan="6">Financing to Companies</td><td colspan="6">Financing of Trade and Connectivity Infrastructure Projects</td><td colspan="6">Trade Costs Reduction Programs</td><td colspan="6">Convergence and Harmonization</td></tr>
<tr><td rowspan="2">Instruments</td><td colspan="15">Financial</td><td colspan="15">Non-Financial</td></tr>
<tr><td colspan="5">Loans and Guarantees</td><td colspan="5">Capital Investments</td><td colspan="5">Investment Grants and Technical Cooperation</td><td colspan="5">Applied Research</td><td colspan="5">Strategic Partnerships</td><td colspan="5">Advisory Services</td></tr>
</table>

VI. WHY CAN THE IDB GROUP PLAY A KEY ROLE IN THIS AGENDA?

6.1 As the main source of multilateral financing for the region's development, the IDB Group offers a series of comparative advantages to support LAC countries efforts to seize the opportunity emerging from the current GVC reconfiguration: (i) broad experience in the design and implementation of programs in the previously mentioned priority areas; (ii) specialized business platforms and networks such as ABD, ConnectAmericas[26], and BTA, which can be used to boost the opportunities opening up for LAC in the current international context of GVC reconfiguration; (iii) the mandate and capacity to finance regional infrastructure, and lead cross-border infrastructure projects that help strengthen regional value chains and mobilize resources from the private sector to support companies in developing or expanding their activities in LAC; and (iv) as an honest broker, the IDB Group can help promote a more efficient trade architecture in the region by providing support to countries and clients in coordinating and discussing complex technical issues, a pending agenda that needs to be urgently pushed forward.

6.2 From an institutional perspective, the IDB Group may benefit from its distinct regional approach and ability to provide a platform to promote a rich and inclusive policy dialogue at regional, national, and subnational levels; and to conceptualize and fund regional projects

25 In compliance with the Policy Proposal for Fee-Based Advisory and Knowledge Services at the IDB (document GN-2706-1) and its operational guidelines.

26 ConnectAmericas may offer a platform where local investors and suppliers can sign up and apply to different support programs and obtain information on opportunities in the region. This platform may also offer investors the ability to publish their procurement requirements and local firms to enlist as prospective suppliers.

to support the identification, optimization, coordination, and harmonization of policies relevant to the agenda to strengthen RVCs in LAC. Additionally, the IDB Group has the potential to act as a catalyst to attract complementary funding, including co-funding from other multilateral agencies, and mobilize resources from the public and private sectors. The Group may also deploy its own innovative financial and non-financial products and instruments, such as combined financing, guarantees, technical assistance, and other donor resources from the public or private sectors that may have an interest in this agenda. Moreover, the IDB Group may channel internal and external sources for climate funding in support of this agenda. Lastly, as an innovation hub that mobilizes funds, knowledge, and connections, IDB Lab may conduct pilots connected to this agenda that may later be scaled through other IDB Group instruments.

6.3 The proposed approach will allow different IDB Group windows to act in a coordinated manner to articulate their various tools tailored to each borrowing member country's particular needs, considering the specific opportunities and bottlenecks they face to reach their goals. This novel multisector approach focused on a common agenda has the potential to maximize the impact of each intervention. Although the IDB Group has been supporting LAC countries in most of the aforementioned areas[27], the work agenda needs to be revised and updated to reflect the current circumstances and realities the region faces. The goal should ultimately be to seize the opportunities posed by GVC reconfiguration while at the same time offering a guide to foster programmatic dialogue in line with the priorities of the Institutional Strategy and the IDB Group's vision for the economic and social development of LAC countries in coming years.

6.4 By putting at the disposal of its borrowing member countries the toolkit described in Section V for the implementation of activities prioritized in Section IV of this document, the IDB Group will be in a position to contribute to achieve the following development results: (i) increased FDI flows to LAC; (ii) increased resource mobilization to finance GVC regionalization operations in LAC; (iii) increased in local (direct and indirect) employment generated through regionalization of GVCs operations in LAC; (iv) reduction in the region's physical and digital connectivity costs; (v) shortened import and export processing times for both goods and services; (vi) improved the business environment to attract FDI; and (vii) enhanced convergence and harmonization of trade agreements and regulations (See Annex II).

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27 The Integration and Trade Sector Framework Document (GN-2715-11) contains a section dedicated to lessons learned on the implementation of activities to reduce logistic, information, regulatory, and financing costs in LAC carried out by the IDB Group's Integration and Trade Sector (See Section IV: Lessons Learned from the IDB Group's Experience in the Integration and Trade Sector, pages 24-35). Similarly, the Energy Sector Framework Document (GN-2830-8); Transport (GN-2740-12); the Support to SMEs and Financial Access and Supervision (GN-2768-7); and Climate Change (GN-2835-9) each contain their respective Lessons Learned on each topic linked to the activities prioritized in this document.

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ANNEX I – EXAMPLES OF GLOBAL VALUE CHAINS' RECONFIGURATION

MODALITY 1: FDI + EXPORTS

Example 1: Goods

Example 2: Services

New Exports

New FDI Operation

A Mexican appliance company with destination market in Europe opens a new subsidiary company in Colombia to produce plastic parts, generating new FDI in Colombia. This subsidiary in turn buys inputs from a local company in Panama, generating a new export from Panama to Colombia, thus strengthening intra-regional trade.

A United States company opens a new subsidiary in Trinidad and Tobago to monitor its accounting and finance operations, which in turn outsources its back office in Jamaica. New FDI is generated in Trinidad and Tobago as well as an increase in Jamaica's exports of professional services.

ANNEX I – EXAMPLES OF GLOBAL VALUE CHAINS RECONFIGURATION

MODALITY 2: EXPORTS

Example 1: Goods

Example 2: Services

An American sportswear company trading worldwide and that sources from different suppliers around the world allocates part of its supply of sports shoes to new suppliers in El Salvador and Honduras (Tier 1), who in turn purchase rubber supplies in Nicaragua (Tier 2).

A Brazilian services company outsources marketing services to a provider in Argentina (Tier 1), which in turn subcontracts filming services in Paraguay (Tier 2).

ANNEX II – EXAMPLES OF ACTIVITIES BY PRIORITY THEMATIC AREA

Institutional Strategy Update	Regional Challenges		Crosscutting issues	
		Social Exclusion and Inequality		Gender equality and diversity
		Low productivity and innovation levels		Climate change and environmental sustainability
		Limited economic integration		Institutional capacity and the rule of law

Thematic Intervention Area	Investment			Infrastructure		Integration	
Objectives	Increased FDI attraction into LAC and employment levels			Greater physical and digital connectivity in LAC		Greater regional integration in LAC to strengthen regional value chains	
Results	Increased FDI inflows to LAC	Increased resource mobilization to finance regionalization of GVCs operations	Increased local (direct and indirect) employment generated by regionalization of GVCs operations	Reduced regional physical and digital connectivity costs in LAC	Shortened goods and services import and export processing times in LAC	Improved business environment in LAC to attract FDI	Enhanced convergence and harmonization of trade agreements and regulations

Products*	***Investment promotion*** • Development of national and regional strategies to position LAC internationally as an attractive FDI destination • Design of IPAs institutional strengthening programs • Design and development of Single Windows for Investment • Design and development of industrial and technological parks • Productive standards adaptation programs and reconfiguration and upgrading of value chains • Upskilling and re-skilling programs focusing on internationalization and investment attraction • Suppliers' development programs • Proposals for policy reforms and institutional frameworks strengthening to improve business environment	***Financing for companies*** • Financing for the private sector (through the National Public Banks) for companies involved in regionalization of GVC operations • Financing for the private sector (through the National Public Banks) for domestic SMEs supplying anchor companies • Non-sovereign financing and/or guarantees (third-party resources and leveraging) for companies involved in regionalization of GVC operations (only IDB Invest) • Non-sovereign financing through financial institutions, special funds, or their supply chain benefitting local SMEs supplying anchor companies (only IDB Invest) • Guarantees and/or capital investments to help companies develop or expand regionalization of GVC initiatives	***Financing for trade, connectivity and competitiveness infrastructure projects with environmental, social, financial, and institutional principles*** • Programs for improving trade physical infrastructure (roads, ports, airports, etc.) and for border territorial planning, including PPPs • Financing for renewable energy and/or regional electricity interconnection projects, including PPPs • Financing for projects aimed at increasing digital interconnectivity (broadband and fiber optics), including PPPs	***Programs for reducing trade costs*** • National and binational Coordinated Border Management programs • Design and development of Single Windows for Foreign Trade and Port Communities • Programs for Authorized Economic Operators • Programs for border risk management (in land, river, maritime and aerial areas) • Programs for customs facilitation	***Convergence and Harmonization*** • Development of proposals for convergence agreements on trade agreements and on normative and regulatory frameworks to conduct business in LAC • Development of proposals for cumulation of origin • Development of proposals for investment protection and double taxation deals • Regulation of special trade zones • Development of proposals for institutional, normative, and regulatory changes to boost transparency and competition

** Products may contribute to more than one result.*