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How to Deepen Asia-Latin America Economic Relations

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Latin America is firmly on the economic radar of Asia in the post global financial crisis world economy. Trade between the two regions has grown significantly, reaching a historic high of over half a trillion dollars in 2013. Although the growth of Asia-Latin America trade slowed since 2014, linked with falling demand for commodities in the Peoples Republic of China (PRC), this figure is projected to increase to about $650 billion by 2020. Increased trade has gone hand in hand with a flurry of diplomatic activity. In July 2014, Chinese President Xi Jinping visited Argentina, Brazil, Cuba, and Venezuela. Shortly afterwards, Japanese Prime Minister Shinzo Abe visited Brazil, Chile, Columbia, and Mexico. In May 2015, Chinese Prime Minister Li Keqiang visited Brazil, Chile, Columbia and Peru. Pledges of trade, foreign direct investment (FDI), and foreign aid accompanied these high-level visits. Both Asia and Latin America have grown faster than the world economy. From 2009-2013 annual average growth was 4.6% in Asia, 2.4% in Latin America, and 1.9% globally.

This represents a dramatic turnaround. Before the 1990s there was little trade between the two regions. It takes over a day to fly between Asia and Latin America. Transport connections between these geographically distant regions were poor and trade barriers were high. Few cultural, diplomatic, or business ties existed. Latin Americans largely speak Spanish or Portuguese which Asians largely do not. Latin America, whose goods were destined to the giant North American market, once viewed Asia as a poor region, riddled with economic crises and high risks for business.

Several factors underpin recent trade growth between Asia and Latin America. First, falling trade barriers have fostered specialization according to comparative advantage, with land abundant Latin America exporting commodities in return for manufactured goods imports from skilled, labor abundant Asia. Second, strong demand in the PRC and other Asian economies for Latin American commodities and food provided an alternative to declining markets in industrial economies, particularly since the global financial crisis. Third, Latin America has a significant and expanding regional market for Asian industrial goods and FDI. Fourth, advances in information and communication technology as well as better logistics have supported inter-regional trade.

The spread of free trade agreements (FTAs) across the Pacific is the final factor to explain recent growth, and they have supported market access, rules based trade, and business confidence. The number of FTAs has grown from 2 in 2004 (South Korea-Chile and Taiwan-Peru) to nine in 2007 and further to 22 in 2013. At least 25 FTAs are expected by 2020. Taipei is Asia's most proactive Latin America trade pact negotiator, having concluded five FTAs. Singapore has signed four such deals with Latin American economies, and PRC, Japan, and the Republic of Korea each have three. Meanwhile, Chile has eight FTAs with Asian economies and Peru has five.

Ganeshan Wignaraja, Advisor in the Economic Research and Regional Cooperation Department at the Asian Development Bank, explains that "Trade between [Asia and Latin America] has grown significantly, reaching a historic high of over half a trillion dollars in 2013,... projected to increase to $650 billion by 2020. Increased trade has gone hand in hand with a flurry of diplomatic activity."

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But much needs to be done before Asia and Latin America can reach their full trade potential in the "new normal" era of slower world growth. Other important Asian players—India and Indonesia—can benefit from trade with Latin America. The two regions have to increase the number of economies participating in mega-regional FTAs like the Trans-Pacific Partnership, still under negotiation. Their economic ties need to cover more sectors, such as services. Cross-regional policy cooperation needs to be enhanced, and structural reforms need to be accelerated.

The Asia-Pacific Economic Cooperation forum is a useful institution for creating business confidence, but few Latin American economies are in APEC. From Asia, India is also glaringly absent. A newer institution, the Forum of East Asia Latin American Cooperation (FEALAC), agreed in August 2014 to set up a business body to promote cooperation in trade and investment. More countries, especially Latin American's largest economy, Brazil, have to strengthen ties with Asia. Currently, Brazil only has one FTA with Asia and concerns have been expressed about its protectionist tendencies. Another key player could be Argentina, if it can sort out its financial crisis and escape going into default.

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Meanwhile, Mexico, Peru, Chile, and Columbia have formed the Pacific Alliance and are attempting to become more market-friendly. Chile in particular has undertaken many reforms and has several FTAs with Asia.

Asian FDI can help transform Latin American economies. Asian firms can provide valuable capital and expertise to upgrade Latin American infrastructure. Technology transfer and marketing connections from Asian firms can foster Latin American firms joining global value chains and promote internationally competitive industrialization. Small and medium enterprises (SMEs) in both regions can benefit as suppliers, subcontractors, and service providers to multinationals. However, in contrast to growing trade between Asia and Latin America, FDI has remained lackluster during the past decade. Annual average greenfield investments from Asia to Latin America between 2003 to 2013 totaled $14.1 billion, while that from Latin American to Asia were only worth $1.2 billion. Firms from Asia's major economies—Japan, the PRC, and Korea—account for the bulk of Asian FDI into Latin America and such investment is destined into a broad range of economic sectors, including automotives, machinery, electronics, metals, chemicals, petroleum, and food and tobacco.

Geographical remoteness, Asian business perceptions of country risk, differences in culture and business practices, and domestic regulations in Latin America help explain the relatively low levels of Asian FDI. Cumbersome domestic regulations in Latin America have created an image problem for the region and impede Asian investment. It takes an average of 47 days to start a business in Latin America compared to 12 days in Asia. In addition, it takes an average of 90 days to get an electricity connection in Latin America compared to 54 days in Asia. Furthermore, it takes an average 215 days to deal with construction permits in Latin America compared with 109 days in Asia.

Some Pacific Alliance members fare better than other Latin American economies on these indicators of the business environment. These economies have implemented economic reforms to boost growth and have expressed an interest in attracting Asian investors. But even they are not as open as some outward-oriented, market-friendly Asian economies like Singapore, Korea, and Malaysia.

Asian FDI can follow trade with Latin America in the future. This will bring economic benefits to both regions and help diversify the sources of world growth. To realize the large potential of Asia-Latin American business, governments should make a concerted effort to open up markets, cut redundant regulations, conclude comprehensive FTAs, build trade related infrastructure (including modernization of ports and logistics), and promote inter-regional cooperation initiatives like APEC and FEALAC.

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